

# *Free to Choose in China*

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**W**hat have been the significant changes in China's economic and political institutions? I will answer this question by discussing eight topics chosen from Milton and Rose Friedman's book *Free to Choose*. The topics are economic freedom, the relation between economic and political freedom, the role of government, social welfare, education, consumer protection, macroeconomic policy, and trends in the development of economic and political freedom.

## **ECONOMIC FREEDOM IN THE LAST HALF CENTURY**

There have been significant changes in economic freedom in China in the last half century. Economic freedom began to be severely restricted when central planning was introduced in 1953. It has increased steadily since economic reform started in 1978. Today there is much economic freedom in China.

The Chinese government adopted Soviet-style central economic planning in 1953 when it initiated the First Five-Year Plan of 1953–57. For a quarter of a century that followed, freedom in production, distribution, and consumption was restricted. For industrial production, private enterprises were converted into state-owned enterprises, which had to fulfill output targets approved by central planning. Materials used in production were centrally allocated. Urban workers were assigned jobs in the state enterprises and could not move from city to city.

In agriculture, the commune system was established in 1958. Private farming was abolished. The farmers in a traditional village were organized as a team in a commune to farm collectively. Free trade of farm products was abolished. Rural markets were banned. Each team in a commune was assigned quotas of output to be delivered to a government procurement agency for distribution in urban areas. A system of rationing of consumer goods in urban areas was put in place. Each consumer was given coupons to buy specified amounts of food

grain, oil, eggs, and cloth. Retail stores were operated by the government. There was no free market for housing. Housing units were assigned to employees by their work units at very low rents. Privately owned automobiles were nonexistent.

China's door was closed to the outside world. Foreign trade was handled by the government, which determined the exports and imports of specific products to and from specific countries. The main trading partners were the Soviet bloc countries. Foreign investment from Western countries was not welcome. Chinese citizens were not allowed to travel abroad. The border with Hong Kong, which had been open without any restrictions, was closed in the early 1950s.

Recognizing the shortcomings of central economic planning from years of experience and witnessing the economic success of neighboring market economies of Hong Kong, Singapore, Taiwan, and South Korea, the Chinese government, under the leadership of Deng Xiaoping, began economic reform toward a market-oriented economy in 1978. In agriculture, private farming was revived. The commune system was abolished by 1982. This change occurred through initiatives from below when some commune leaders discovered that output quotas could be met by assigning a piece of land to each farm household to farm and collecting a quota of output from it, rather than by having all farm households in a team to farm collectively. Under this "household responsibility system" output increased significantly because the farmers could reap the fruits of their additional effort. The central government soon adopted this system as national policy. Increase in farm output allowed the gradual abandonment of the rationing of consumer goods.

Urban industrial reform took several steps that were introduced in a period of about two decades, from granting autonomy to state enterprises in production decisions to converting them to shareholding corporations traded in stock markets in the late 1990s. China's door was opened to foreign trade and investment. In 2001, China joined the World Trade Organization to open its door further by lowering tariffs and allowing more foreign competition in agriculture, manufacturing, and service industries and in domestic trade. Observers attribute the success of China's economic reform to the gradual and experimental approach taken by the leaders, who were pragmatic and adopted what worked without being subject to ideological constraints. As Deng advised, "Seek truth from facts."

Today China has a well-functioning market economy in spite of its shortcomings. Economic freedom of the citizens has been greatly enhanced. Private enterprises have flourished. Rationing has been abolished since the early 1980s, and consumer goods are abundant. Housing has been privatized. The purchase of new automobiles in 2003 is to exceed 4.2 million units. The Chinese people can travel freely both inside and outside the country, many having come to the United States to study. They can choose and change their jobs fairly freely,

although many do not move because of the benefits of entitlements under the welfare system administered by state-owned enterprises.

There are unions, but there is no union power that restricts the freedom of employers to choose workers and the freedom of nonunion workers to choose their jobs. (In this respect, China has more economic freedom than the United States, and the topic of union power is not included in the eight topics of this paper.) There appears to be no serious infringement of economic freedom in China, with the exception of the one-child policy that allows only one child for an urban family and an additional child for a rural family if the first child is a girl.

## **RELATION OF ECONOMIC FREEDOM AND POLITICAL FREEDOM**

On pages 2–3 of *Free to Choose* we read: “Economic freedom is an essential requisite for political freedom. By enabling people to cooperate with one another without coercion or central direction, it reduces the area over which political power is exercised. In addition, by dispersing power, the free market provides an offset to whatever concentration of political power may arise.” China provides many examples for these observations.

As private farming under the household responsibility system replaced collective farming under the commune system, agricultural output increased in the early 1980s and labor was free to move. In a trip along the Yangtze River to see the Three Gorges in 1982, I witnessed many farmers on the boat carrying farm products to neighboring areas for sale and farmworkers carrying carpenter tools to find work elsewhere. As economic freedom increased, the administration of the commune system ceased to function.

There remained the need to provide security, to protect public land, and to attend to the public affairs of rural villages that were formerly within the domain of the commune system. This need, together with the economic interest of and economic power acquired by the farmers, provided the primary reasons for the direct elections of village officials that have become widespread in rural China. The central government endorses such elections because the elected officials perform important functions in Chinese villages. Village elections in China are a major component of the change of China’s political institutions toward a more democratic government.

As more consumer goods became available, rationing was no longer necessary. Goods began to be distributed in rural markets and in collectively or privately owned stores in urban areas. The role of government procurement and trading is greatly reduced. Services formerly provided by employees in government-owned retail stores, hotels, train stations, theaters, and other service-providing establishments are now provided by private enterprises for profit. The quality of services has greatly improved. The sphere of government influence

has been reduced in all aspects of economic life, including production, distribution, employment, foreign trade, and foreign investment. Government bureaucrats are replaced by nongovernment employees who are more service-minded. All this, as the Friedmans say, “reduces the area over which political power is exercised.”

The widespread abuse of economic power under the previous system of government ownership of assets and government control of resource allocation has been reduced with the rise of the free market. The system of economic planning itself induced the Chinese to take full advantage of the assets under their control. Under central planning, major economic assets were owned and controlled by the government, but in reality the government had to assign people to control and use the assets on its behalf and in the name of the state. The people who had the power to manage government assets used them for their own benefit. Corruption was only one example when the bureaucrats controlling some economic assets extracted money from people who desired to use them. A driver of a government-owned car could use the car for personal benefit. If another person desired to use the car, he would have to compensate or appease the driver since no taxicabs were available.

Under this system, the Chinese people became frustrated when they had to beg to get served or to acquire the essential consumer goods. They then aired their frustrations and returned the favor to others when other people desired goods and services from them. The quality of services provided in China was poor in general. People were unkind to one another whenever one person needed something from someone who had control of the needed asset or service. Barter became widespread. A person in charge of selling low-price and scarce theater tickets could exchange the tickets for scarce consumer goods distributed in government stores.

With the appearance of the market economy, the quality of services provided by the Chinese people has gradually improved, and the people have been kinder to one another. Now money can be used to purchase goods and services. Fewer people connected with the government have monopoly power over the control of economic resources that others need.

As collective and private enterprises flourished, a group of well-to-do citizens has emerged and gained influence and economic power in the Chinese society. In the late 1990s, under the leadership of General Secretary Jiang Zemin, the Chinese Communist Party began to accept capitalists into its membership. China has a one-party system. There are other political parties, but none can control the Chinese government. They exercise their political influence mainly through a National Political Consultative Conference, which represents diverse political interests and meets regularly at the same time as the National People's Congress. The recommendations of the conference are seriously considered by the People's Congress. Political power of the people is

exercised by indirect election of members of the People's Congress and of the members of the Communist Party Central Committee (the latter by members of the party only). To the extent that membership of the Communist Party is more open, more people will have more political freedom and more opportunities to participate in government affairs.

As economic freedom has increased, so has political freedom, although it is difficult to ascertain the precise effect of the former on the latter. Political freedom is in principle guaranteed in the Chinese Constitution adopted by the People's Congress on December 4, 1982. In Chapter I, "General Principles," Article 2 states: "All power in the PRC belongs to the people. The organs through which the people exercise state power are the National People's Congress and the local people's congresses at different levels." Article 28 states: "The state maintains public order and suppresses treasonable and other counter-revolutionary activities; it penalizes actions that endanger public security and disrupt the socialist economy ...." In Chapter II, "The Fundamental Rights and Duties of Citizens," Article 35 provides all citizens with "freedom of speech, the press, of assembly, of association, of procession and demonstration," while Article 36 provides "freedom of religious belief." However, the stated freedoms can be restricted by appealing to Article 28 of the Constitution.

In reality, the Chinese people do have much more freedom than before. They can talk freely in private gatherings and even openly in professional meetings without fear of being prosecuted. For instance, a Chinese economics professor openly criticized the labor theory of value in Marxian economics in a paper presented before a conference in Beijing in 1999. There is freedom of the press to a considerable extent, as the nongovernment press has expanded rapidly in recent years and attracted a large readership. This includes daily or weekly newspapers, magazines, and books. Opinions expressed therein are open and free, subject to only a minor degree of censorship. Censorship of foreign books is almost nonexistent.

Information available to the public is somewhat restricted because the government has control over TV and radio stations as well as the Internet. However, the control is limited because the Chinese have access to shortwave radios, and it is difficult to control the use of fax machines and the flow of information through the Internet. People residing near Hong Kong can get access to TV stations in Hong Kong that are mainly private and free.

Religious freedom has increased, as illustrated by the rapid increase in attendance in Christian churches and worship in Buddhist temples. Church attendance has been influenced by the efforts of overseas Chinese Christians, especially those in Hong Kong who invest in China's economic and educational institutions and sometimes also engage in religious activities.

Government control of the press has been reduced partly because the nongovernment press has spread by the increase in demand for reading material in

an affluent society. Conversely, demand for government-printed material has declined. As the August 5, 2003, issue of *People's Daily* reports, "Party and government-run newspapers and magazines will be forced to commercialize or face closure under major reforms.... State administration statistics show that there were 2,137 newspapers in China last year, but newspapers relying on administrative orders for subscribers accounted for 40 per cent of the total." Government and party organizations were asked to close their newspapers or magazines if they did not have sufficient paying subscribers.

Under a one-party political system, which limits political freedom, there is much economic freedom in China, for political freedom is not a necessary condition for economic freedom. Economic freedom will help increase political freedom, but political freedom may not help increase, and can sometimes reduce, economic freedom, as illustrated by many examples in the United States that have been documented in *Free to Choose*. There is much political freedom in the United States, but the many infringements of economic freedom are the subject of *Free to Choose*.

## THE ROLE OF GOVERNMENT

On page 5 of *Free to Choose*, we read: "The view that government's role is to serve as an umpire to prevent individuals from coercing one another was replaced by the view that government's role is to serve as a parent charged with the duty of coercing some to aid others."

China's experience illustrates very well "the government's [proper] role as an umpire to prevent individuals from coercing one another." In China, the need for the government to provide law and order is very important because law and order is important for social stability and economic progress.

As someone accustomed to law and order in the United States since 1948, it has taken me several visits to China to appreciate its importance. Several experiences impressed me. In 1982, when I tried to send a telegram in a post office in Guangzhou, I found that people did not line up in front of the service window and there was no way for me to get to the front to submit the draft of my telegram. I had to let a Chinese friend fight his way through the crowd to send the telegram. I wished an officer had been there to guide people to line up.

As a second experience, my wife and I were provided a tour guide while visiting Confucius' Temple in Shandong province in 1985. As the guide was explaining the points of interest to us, people began to crowd in and surrounded the guide, to the point that Paula and I were too far separated from him to hear what he was saying. As a third example, I was traveling by car to visit the site of Yuan Ming Yuan in Beijing. As we approached the site, we found a roadblock set up illegally by local residents to collect tolls. Our driver had to pay the toll before he could drive through. Extraction of fees of all kinds by

local residents from travelers passing through their territories was and is quite common in China. A strong government is needed to prevent some citizens from extracting rents illegally from others.

The Chinese government has been urged to protect intellectual property rights, which are violated in China in the sale of pirated CDs of computer software, music, and movies. Many Chinese regard law and order as more important than freedom and desire a strong government to protect them from coercion by others.

The second and improper role of the government—"to serve as a parent charged with the duty of coercing some to aid others"—can be illustrated by many examples in the early years of the People's Republic of China (PRC). Private land was redistributed in the early 1950s to the farmers. Private enterprises were turned to state-owned enterprises. Agricultural output produced in the communes was taxed for distribution to the urban population. Such coercions have been reduced with the introduction of market institutions where private property is respected. At the same time, the growing importance of the first, legitimate role of the government—"as an umpire to prevent individuals from coercing one another"—signifies that the political system in China has improved.

## **SOCIAL WELFARE**

During the period of central planning, job security was guaranteed, and support for the aged who were not supported by their children was provided by the communes in rural areas and by the state-owned enterprises and other government institutions to their employees in the urban areas. Health care in the entire country was provided under an efficient three-tier system, with village doctors treating simple illnesses in village stations, physicians with three years of medical training after high school in health centers, and better trained doctors in city hospitals in turn taking care of more difficult illnesses. A community-financed Cooperative Medical System (CMS) funded and organized health care for almost the entire rural population. Health centers and hospitals associated with state-owned enterprises and other government institutions cared for employees and their family members.

With the introduction of economic reform, the commune system broke down, and state-owned enterprises were made financially independent and downsized. Private farmers had to find their own work and support themselves in old age. Urban workers could become unemployed. In rural areas, agricultural reforms in the early 1980s led to the disintegration of the cooperative organizations that formed the basis of CMS. Rural populations had to finance their own health care, while many village doctors had their own private practice. In the urban areas, state enterprises and other government organizations had difficulty financing the health care of their employees.

Since the mid-1990s, the Chinese government has attempted to set up, step by step, a nationally unified social security system for the urban population, under the central management of the labor and social security administration departments and with social insurance funds partly contributed by the central government. Labor and social security departments at all levels are responsible for the collection, management, and payment of the social insurance funds. Besides contributions from employers and employees as stated below, the central government allocated 98.2 billion yuan in 2001 for social security payments, 5.18 times the amount in 1998 as it was expanding the system to cover larger segments of the population in steps. (All statistics on the development of the social security system can be found on the web site of *People's Daily*, <http://english.peopledaily.com.cn/>, under "White Paper on Labor and Social Security in China" in the section "White Papers of Chinese Government.")

In 1997, a uniform, basic old-age insurance system for enterprise employees was established, financed by 20 percent of the enterprise wage bill and 8 percent of the employee's wage. A part of the premiums from enterprises goes to mutual assistance funds and the rest to personal accounts, while the premiums from the employees go entirely to personal accounts that belong to the employees themselves and can be inherited. Employees participating in this program increased from 86.71 million in late 1997 to 108.02 million at the end of 2001, while the number receiving pensions increased from 25.33 million to 33.81 million, with the average monthly basic pension per person increasing from 430 yuan to 556 yuan. The rural population pay their own insurance premiums and withdraw funds from personal accounts with subsidies from the government.

In 1999, an unemployment insurance system was introduced, financed by 2 percent of the wage bill paid by employers and 1 percent paid by employees. Unemployment insurance benefits are lower than the minimum wage but higher than the minimum living allowance guaranteed for all laid-off workers. The period of drawing insurance depends on the length of the period in which insurance payments have been paid, with twenty-four months as the maximum. The number of insured persons increased from 79.28 million in 1998 to 103.55 million in 2001.

On health care, important policies were announced on January 15, 1997, in the "Decision on Health Reform and Development by the Central Party Committee and State Council." The basic objective of the Decision is to ensure that every Chinese will have access to basic health protection. For the rural population, the strategy is to develop and improve CMS through education, by mobilizing more farmers to participate, and gradually expanding its coverage. For urban employees, a basic medical insurance system was established in 1998, financed by 6 percent of the wage bill of employing units and 2 percent of the personal wages. By the end of 2001, 76.29 million employees had participated in basic insurance programs. In addition, free medical services and other forms of health care systems covered over 100 million urban population.



In terms of saving for old age, rural populations in China have more freedom than urban populations to make their decisions but are subject to more risks. Urban populations have their own personal accounts, with amounts depending on their own contributions. Their old-age insurance system has features similar to the pension system in American universities, with both the employer and the employee contributing to the fund and with each employee having his personal account. Rural populations in China have more freedom to choose their work but are not guaranteed unemployment benefits, as are the urban workers.

## **EDUCATION**

In China the government has controlled the education system since the early 1950s, but in recent years the role of nongovernment-operated and financed education at all levels has become very important.

When the government decided to adopt Soviet-type economic planning in the early 1950s, the system of higher education was modeled after the Soviet Union's, along with economic planning. The government seized control of all educational institutions. Private universities were closed and converted into public educational institutions. Liberal education ceased to exist. Education served mainly the purpose of economic development. For this purpose, it was believed that a university student should concentrate on one subject, rather than receiving a general liberal education, and that each university should specialize also. Former universities, public and private, were reorganized. One university was divided into several, more specialized institutions. The school of arts and sciences, the medical school, the engineering school, and the school of agriculture of one university were separated and became colleges on their own. Each government ministry responsible for the production and distribution of one major product had under its control colleges to train people to work in a specialized area. This was like having the School of Mines under the Bureau of Mines in the United States repeated many times for different industrial ministries. The People's Bank administered a graduate school to train staff for the Bank and its branches in different provinces. The People's (Renmin) University was established to train government officials.

At lower educational levels, the government also controlled all schools. Being welfare-minded, it wanted to raise the level of education for the entire population. By 1978, the literacy rate among the population 15 years of age or over was raised to 82 percent. No private schools were allowed. To see the expansion in education, refer to Table 1 on school enrollment at different educational levels. The enrollment figures have not been adjusted for the increase in population in the corresponding school age.

After 1978, Deng Xiaoping initiated economic reform toward a market-

Table 1  
 Student Enrollment by Level of School, 1949 to 1981<sup>a</sup>  
 (10,000 Persons)

Year	Total	Institutions of Higher Learning	Secondary Schools <sup>b</sup>		Primary Schools
			Secondary Specialized Schools	Regular Secondary Schools	
1949	2,577.6	11.7	22.9	103.9	2,439.1
1950	3,062.7	13.7	25.7	130.5	2,892.4
1951	4,527.1	15.3	38.3	156.8	4,315.4
1952	5,443.6	19.1	63.6	249.0	5,110.0
1953	5,550.5	21.2	66.8	293.3	5,166.4
1954	5,571.7	25.3	60.8	358.7	5,121.8
1955	5,788.7	28.8	53.7	390.0	5,312.6
1956	6,987.8	40.3	81.2	516.5	6,346.6
1957	7,180.5	44.1	77.8	628.1	6,428.3
1958	9,906.1	66.0	147.0	852.0	8,640.3
1959	10,489.4	81.2	149.5	917.8	9,117.9
1960	10,962.6	96.2	221.6	1,026.0	9,379.1
1961	8,707.7	94.7	120.3	851.8	7,578.6
1962	7,840.4	83.0	53.5	752.8	6,923.9
1963	8,070.1	75.0	45.2	761.6	7,157.5
1964	10,382.5	68.5	53.1	854.1	9,294.5
1965	13,120.1	67.4	54.7	933.8	11,620.9
1966	11,691.9	53.4	47.0	1,249.8	10,341.7
1967	11,539.7	40.9	30.8	1,223.7	10,244.3
1968	11,467.3	25.9	12.8	1,392.3	10,036.3
1969	12,103.0	10.9	3.8	2,021.5	10,066.8
1970	13,181.1	4.8	6.4	2,641.9	10,528.0
1971	14,368.9	8.3	21.8	3,127.6	11,211.2
1972	16,185.3	19.4	34.2	3,582.5	12,549.2
1973	17,096.5	31.4	48.2	3,446.5	13,570.4
1974	18,238.1	43.0	63.4	3,650.3	14,481.4
1975	19,681.0	50.1	70.7	4,466.1	15,094.1
1976	20,967.5	56.5	69.0	5,836.5	15,005.5
1977	21,528.9	62.5	68.9	6,779.9	14,617.6
1978	21,346.8	85.6	88.9	6,548.3	14,624.0
1979	20,789.8	102.0	119.9	5,905.0	14,662.9
1980	20,419.2	114.4	124.3	5,508.1	14,627.0
1981	19,475.3	127.9	106.9	4,859.6	14,332.8

<sup>a</sup>Excludes spare-time schools.

<sup>b</sup>Excludes workers' training schools.

SOURCE: *Statistical Yearbook of China*, 1981, 451.

oriented economy. Education was an important part of this reform process. The system of higher education was gradually changed. The main direction was to abandon the Soviet-style higher education system introduced in the 1950s in favor of a more comprehensive and integrated system, as practiced in the 1940s. For education at all levels, the government has allowed “citizen-operated” schools to develop and flourish side by side with the schools administered by government at all levels.

The gradual change occurring in education reform, as in economic reform, has taken two and a half decades and is still incomplete, but in both cases we can see what has been accomplished. Higher education has become less specialized, with universities reorganized by including previously separated colleges of medicine, engineering, and agriculture and other functional disciplines. While the Ministry of Education in Beijing still controls thirty-some major universities, the remaining state universities are under the control of the governments of provinces, cities, and townships. The curricula, including economics in particular, have changed to suit the working of a market economy.

Educational institutions at all levels continued to improve not only through the efforts of the central, provincial, and local governments but also by the efforts of the nongovernment sectors. “Citizen-operated” or privately financed schools at all levels have become widespread because there is large demand for them as the Chinese people have become richer and because the schools can be profitable.

In the late 1980s, I visited a primary school near Guangzhou that was established privately. The parents had to pay 100,000 RMB, worth about \$30,000 at the time, at the beginning of the first year for a six-year primary-school education for one child. The investors of this school used the income to build a building on a piece of land leased from the town government at low rent to encourage education. The school was said to be profitable. It was very good in terms of the quality of the teachers and the orderly behavior of the students. Often such schools were established formally by, or in the name of, an association. Associations of all forms sprang up rapidly in China after economic reform started. They are accorded some legal status that a private individual may not possess. They have already invested certain fixed costs in the right to use land or a building, in the establishment of some legal status, in the personal connections of its management and staff, and in the public recognition of the organization. All such investment can be exploited to sponsor a school or another kind of business enterprise.

Nongovernment schools have grown rapidly, not only because they are economically viable but also because many overseas Chinese are willing to support them. Chinese outside Mainland China have poured in money to support all kinds of education in China. Both financial resources and knowledge on administering educational institutions were supplied to China for its benefit, as

in the case of foreign investment, except that investment in education is non-profit in most cases. The investor contributes both time and money to improve education in China.

Observers have suggested that the Chinese education system is deficient partly because the government spends too little on education. They would cite statistics on the amount of government expenditure as a percent of GDP to support this claim. In 1995, public expenditure on education was only 2.5 percent of GDP in China, as compared with 5.4 percent in the United States and 5.2 percent as the world average. These statistics have not taken into account the non-public expenditures, contributions by overseas Chinese and other friends, and the spending by the parents to pay tuition in “citizen-operated” schools and in public schools. Outside contributions to education in certain towns, counties, and villages are substantial, including, in particular, some towns and villages near Hong Kong.

The importance of privately financed education in China and some other countries has been documented in a report, *Financing Education—Investments and Returns*, published in 2002 by the United Nations Educational, Scientific and Cultural Organization (UNESCO) and the Organization for Economic Cooperation and Development (OECD), which focuses on sixteen emerging economies. Funds from a wide range of private sources, including individuals and households, contribute much more to education in these countries than in the OECD member states. In Chile, China, and Paraguay, for example, more than 40 percent of the total amount spent on education comes from such private sources. The OECD average is 12 percent. There has been a rapid development of private education services in these countries, from wholly private, independent institutions to schools that have been subcontracted by governments to nongovernmental organizations. In China and Zimbabwe, government-subsidized, community-managed schools are said by the above report to be the backbone of the education system. (Author’s Note: When I presented the 40 percent figure for private spending on education in China in the conference, Gary Becker questioned its accuracy. I then supplied some personal observations to support this figure. Even public schools in China at all levels collect tuitions that should be included in private spending, not to mention the large number of nonpublic educational institutions. Data on government and non-government funding of education are found in Table 20-35 of *China Statistical Yearbook 2003*.)

For the United States, the major concern expressed in *Free to Choose* for primary and secondary education is that the parents have to pay taxes to finance poorly operated public schools and do not have sufficient choice of schools. For college education there is too much government subsidy, while the students should pay their own expenses as a form of investment to prevent waste and misuse of educational resources. In China, if privately financed education is

widespread and accounts for over 40 percent of total expenditures on education, the concern about public schools using up funds from parents who might prefer to send their children to private schools appears to be less pressing. Furthermore, in the case of primary and secondary school education the local governments provide choice of schools to the parents. There are usually several public schools of different qualities in the same area. Students can enter a good school if they can pass the required examinations. Furthermore, to the extent that the parents have to pay tuition to public schools that are not entirely financed by tax money, this is like the voucher system advocated by Milton Friedman, which provides parents the freedom to choose schools for their children.

For college education, in recent years government policy has been to increase tuition for students and to encourage universities to be more independent financially by seeking ways to generate income, including charging tuition for courses offered to professionals. This policy is consistent with putting the financial burden on students seeking higher education. Thus, the education system in China appears to address the concerns expressed in *Free to Choose* in the following two respects: Parents have considerable choice of private and public elementary and secondary schools for their children. Students receiving higher or professional education have to pay for it. At the same time, the government plays an active role in controlling and financing education at all levels.

## CONSUMER PROTECTION

Chapter 7 of *Free to Choose*, on “Who Protects the Consumer?”, includes the following statements: “The market must...be supplemented by other arrangements in order to protect the consumer from himself and from avaricious sellers, and to protect all of us from the spillover neighborhood effects of market transactions. These criticisms of the invisible hand are valid.... The question is whether the arrangements that have been recommended or adopted to meet them...are well devised for that purpose, or whether...the cure may not be worse than the disease” (189). “Every act of [government] intervention establishes positions of power. How that power will be used and for what purposes depends far more on the people who are in the best position to get control of that power and what their purposes are than on the aims and objectives of the initial sponsors of the intervention” (193).

In the process of reforming China’s economy, the National People’s Congress has passed much new legislation governing economic transactions. Of particular importance for consumer protection are the Product Quality Law of 1993 and the Law on the Protection of the Rights and Interests of Consumers of 1994. These laws can be found on the web site <http://www.chinalaw114.com/englishlaw/category.asp?cate=31>.

The Product Quality Law of the People's Republic of China stipulates that "producers and sellers are responsible for the product quality according to the provisions of the law" (Article 3). "It is forbidden to forge or infringe upon quality marks...the place of origin...factory names" (Article 4). The product quality supervision and control departments of the State Council are responsible for the supervision and control of the quality of the products" (Article 6). To ensure product quality, "enterprises may apply voluntarily for certification of their quality control systems to the product quality supervision and control departments" or "for certification of the quality of their products" (Article 9). "The State shall institute a system of supervision and chiefly random examination to check randomly samples of major industrial products which may be hazardous to health..." (Article 10). Chapter 3 spells out the responsibilities and obligations of producers and sellers to ensure the products are safe, have quality and other characteristics as specified, and are certified for quality inspection when necessary. Chapter 4 on compensation and damage authorizes the government quality supervision and control departments to order the producers to correct any violation (Article 28). Chapter 5 on penalty provisions states that a violating producer can be ordered to stop production, to pay a fine, to have its license revoked, or to take criminal responsibilities if appropriate (Article 38).

There are now established two administrations in the State Council to carry out the provisions of the Product Quality Law. The General Administration of Quality Supervision, Inspection and Quarantine of the PRC is responsible for certifying the quality-control systems of enterprises, issuing certification of product quality, inspecting possibly hazardous products, and enforcing all aspects of the Product Quality Law. The State Food and Drug Administration of the PRC is responsible for the approval of food and drug products for sale in the market. We need to collect more evidence to determine whether these two agencies are doing more good in protecting the consumers than harm in discouraging innovations. One important function served by certification of product quality is to facilitate the promotion of exports. A few examples of low-quality or mislabeled Chinese products in the world market may hurt the sale of other Chinese products. Some buyers of these products may desire government certification to ensure product quality. Even in this case of certification of quality of exports, readers of *Free to Choose* can present arguments in favor of a market solution.

The Law of the People's Republic of China on the Protection of the Rights and Interests of Consumers may have been partly inspired by the United Nations Guidelines for Consumer Protection adopted by the General Assembly on April 9, 1985. Chapter II lists as consumer rights the right to the safety of person in the purchase or use of a commodity; to knowledge of the true facts concerning commodities purchased; to require relevant information of a business operator providing commodities on price, place of origin, specification...; to free choice in purchasing commodities or services; to freely choose a business

operator providing commodities or services; to compare, appraise, and select when freely choosing a commodity or service; to fair dealing; to fair terms of trade; and others. Chapter III specifies obligations of business operators and states, "A business operator providing a commodity or service to a consumer shall perform obligations in accordance with the Product Quality Law of the PRC and other relevant laws and regulations."

It seems that the consumer rights and the business obligations stated above are either unnecessary in the sense that the consumer obviously has such rights unless the government explicitly prohibits them or redundant in the sense that other laws already cover them.

Chapter VI on dispute resolution provides five ways for consumers to resolve disputes with business operators: (1) negotiate a settlement with the business operator; (2) request a consumer association to mediate; (3) complain to the relevant administrative department; (4) apply to an arbitral body for arbitration; or (5) institute legal proceedings in a People's Court.

For the purpose of this paper, a key issue is whether there is a large bureaucracy to enforce the consumer protection laws that may lead to an undue expansion of government power at the expense of economic innovations. To the extent that disputes are settled by other means than through an administrative department, the tendency of expansion of government power is restricted. In China, the population is accustomed to seeking help from the government, and cheating by business operators is common. Many consumers welcome intervention by the government to protect their interests from violation by other citizens. If they are free to choose, they may well choose an amount of government protection that is not very different from what is being practiced.

## **MACROECONOMIC POLICY**

On monetary policy, the Chinese government agrees with the Friedman view that the quantity of money is the main instrument to control inflation, and it has applied this policy to maintain fairly stable price levels since the beginning of the PRC. However, there were periods in which the government failed to control the increase in money supply in order to stabilize the price level.

Before the establishment of the PRC, China experienced hyperinflation under the Nationalist government. The cause of hyperinflation was a large increase in the supply of currency as the government printed money to finance the civil war with the Communists and its other expenditures. Inflation created serious discontent and contributed to the downfall of the Nationalist government. Immediately after the establishment of the PRC, a new currency, renminbi (or the People's currency), was issued in exchange for the existing currency at a reasonable rate.

By control of the supply of renminbi, inflation was stopped within a few

months. The general retail price index of China was relatively stable from 1952 to 1978, changing from 82.27 to 100.00. There was only one episode of inflation in the early 1960s, when the general retail price index increased from 93.08 in 1960 to 112.29 in 1962. We can interpret this increase by the quantity theory of money to which the Chinese government also subscribed as the quantity equation could be found in Marxian economic textbooks used in Chinese universities. Currency in circulation increased from 9.61 billion in 1961 to 12.57 billion in 1962, while the real GDP index (with 1978 = 100) reduced from 43.9 in 1960 to 30.9 in 1961. The drastic reduction of real GDP was the result of the failure of the Great Leap Forward movement introduced in 1958.

The control of the quantity of currency in circulation became less strict in the 1980s, when the government devoted more attention to the reform of economic institutions and allowed the expansion of credit to finance economic development activities. The first large monetary expansion occurred in 1984, when currency in circulation increased by 50 percent from January 1984 to January 1985, leading to an 8.8 percent inflation in 1985. Rapid monetary expansion at annual rates of over 20 percent continued in the following years until 1988, when the rate of increase was 48 percent and the corresponding inflation rate in the fall was about 30 percent annual rate. This inflation, together with government corruption, was a cause of the discontent and demonstrations in Tiananmen Square that ended in the tragic events of June 4, 1989.

After a slight and short-lived economic slowdown following the Tiananmen incident, the Chinese economy resumed its rapid growth at annual rates of over 10 percent in 1992 and 1993. The growth was stimulated by the announcement of Deng Xiaoping in Shenzhen in February 1992 to resume and even make bigger steps in reforming the domestic economy and opening China's door to foreign trade and investment. In 1992 money supply increased by 36 percent. Inflation as measured by the general retail price index reached 13 percent in 1993 and 22 percent in 1994.

It was Zhu Rongji, as the head of the People's Bank and later as vice premier and premier, who tightened the supply of money and credit and stabilized the price level. In fact, China's retail price index was reduced from a high of 121.7 in 1994 to 97.4 in 1998. Monetary policy in the period of the Asian financial crisis of 1997–99 might even have been too restrictive.

On fiscal policy, the Chinese government believes in using government expenditures to stimulate the economy during periods of slow growth. A notable example occurred in 1998 during the Asian financial crisis and a period of slower growth in China. Premier Zhu Rongji stated at a press conference on March 19, 1998, that to achieve an 8 percent growth rate in 1998, the main policy would be to increase domestic demand. He said that "to stimulate domestic demand, we will increase investment in construction of infrastructure, such as railways, highways, agricultural land and water conservancy facilities, municipal



facilities, and environmental protection facilities. We will also increase investment in high-tech industries and in the technical renovation of existing enterprises." Thus, China adopted the Keynesian way of stimulating aggregate demand by increasing government expenditure, especially in infrastructure building.

In China, increasing government spending served not only to stimulate aggregated demand in periods of slow growth but to build infrastructure and other investment projects deemed necessary by the government. Government investment is regarded as important to achieve economic growth, which is not to be left entirely to the decisions of private investors in a market economy.

### **THE TIDE IS TURNING**

I use the same title for this section as the title of the last chapter of *Free to Choose* because in both cases the subject is trends toward more freedom. In the last chapter of *Free to Choose*, the Friedmans suggest ways to increase freedom in the United States. Our discussion in this section is confined to reporting trends toward more freedom in China.

Following the seven topics discussed in this paper, consider first the general trend of economic freedom. We see that the trend is positive as market forces expand. The Chinese people are richer and can enjoy economic freedom to a larger extent. The government has acquired understanding of the working of the market economy and has encouraged entrepreneurship. More foreign competition in the domestic market and more opportunities to compete in the world market due to China's World Trade Organization membership are pushing the economy forward and will promote more economic freedom.

On political freedom, we can see progress toward a more democratic government coming from both the demand for and supply of democratic institutions. On the demand side, as the Chinese people have more economic power and become more educated, they will demand to have more freedom and more influence in governmental affairs. On the supply side, the Chinese Communist Party and government officials will become better informed of the modern political systems of the world. As they acquire confidence and ability to govern a modern society in the course of further economic progress, they will be more willing and able to adopt democratic institutions. The change toward a more democratic government has been observed in the spread of popular elections in Chinese villages, the increasingly independent behavior of members of the National People's Congress from directions of the Communist Party, and the improvement in the practice of the rule of law, partly as a result of China's need to deal with foreign corporations in international trade and investment.

A recent example that the Chinese government can improve from experience is its handling of the problem of severe acute respiratory syndrome (SARS).

On June 8, 2003, when the SARS problem had mostly subsided, *People's Daily* carried an article entitled "SARS, a valuable lesson for the Chinese government to learn." This article states that

only by actively upholding the citizens' right to know can the government be better supervised by the public and in turn win the trust and respect of those it serves.

People are made aware of government's views through the information it releases, and they exercise their rightful supervision not only through related government agencies but also through the media, which helps keep the government abreast of public opinion. Therefore, an interactive relationship among government, citizens and the media should be put in place so that the government knows the viewpoints of the people about its policies....The right afforded to the media and law to supervise should be fully guaranteed. When such a right is firmly in place, the activities of those in power come under public scrutiny, thus government and officials become publicly accountable for what they do and therefore more likely to work to higher standards.

The October 2, 2003, issue of the *New York Times* (A12) carries an article titled "China's Leader Calls for 'Democratic' Changes" and reports that President and General Secretary Hu Jintao, in an address to the governing politburo, said the Communist Party must undertake a "sweeping systemic project" to increase public participation in government and enforce the rule of law. "We must enrich the forms of democracy, make democratic procedures complete, expand citizen's orderly political participation, and ensure that the people can exercise democratic elections, democratic administration and democratic scrutiny."

This appears to be a sign of progress toward a more democratic government. Americans accustomed to a democratic government under a two-party system might find it difficult to appreciate a democratic government under a one-party system, but I believe that election of government officials and of members of the People's Congress is possible if the Communist Party is willing to put up for election the best candidates, who may be nonparty members, for the positions in question. Under a one-party system there are ways that citizens can participate in and influence political affairs. China might well turn out to be an innovator of one form of democratic government under a one-party system.

On the role of government, we observe that the Chinese government is playing its role in maintaining law and order, which is essential for the market economy to function. When the government is engaged heavily in economic activities, free choice of the people is provided in China by allowing competition among state enterprises, among state and private institutions, as in high school education, in health care delivery, in employment, and in the control of pension funds.

On social welfare, a new social security system is being put into effect that gives the people a wider choice than the previous system of entitlement to job security, retirement income, and health care, although the performance of the new system needs to be further studied. On education, we have observed the expansion of privately financed schools and the increase in tuition for students in higher education. Both are expected to continue.

On consumer protection, the People's Congress has enacted new laws on product quality and consumer rights along the lines that are set out by a 1984 resolution of the United Nations General Assembly. There is as yet no evidence of an unduly large bureaucracy for its administration that hampers innovations in consumer products.

Finally, on macroeconomic policies, the Chinese government recognizes the importance of monetary policy and has a fairly good record in controlling the supply of money to maintain a stable price level. At the same time, it practices Keynesian fiscal policy to stimulate the economy and is active in building economic infrastructure and promoting new industries. If we allow for the possibility that the government of a developing country needs to play an active role in maintaining social and economic order, in fostering the development of market institutions and in promoting the development of some new industries, the record in providing freedom to choose in China has been reasonably good and is improving.

## NOTES

The author acknowledges with thanks helpful comments from Zijun Wang on an early draft of this paper.

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