

Professor Siu-lun Wong – September 2010

Creative Destruction: the Rise of Entrepreneurial Society in China

Two years ago we had a joint conference on the question of economic dynamism between the sinosphere and the anglosphere. On the Hong Kong side we focus on the sinosphere that we know a little bit better than the anglosphere. So when I knew that I had this opportunity to tackle the question of entrepreneurial societies, I decided to focus on the case of China as a comparison to the English-speaking world, and also to see whether we can draw any conclusions or lessons between the Chinese-speaking world and the English-speaking world in terms of the development of entrepreneurial societies. So that is the intention and therefore in the next 50 minutes or so, I will try to lay out my thoughts about the dynamics of entrepreneurship in China.

As Professor Péron said in the first keynote speech, the rise of dynamic entrepreneurship in Europe and in the West took place over several centuries. But if you look at the case of China, at least in the recent, contemporary history, we can say that the private form of entrepreneurship virtually did not exist until about thirty years ago. In my paper I will go back forty years ago, to the 1970s. It is very clear that there was no private entrepreneurship in China because the communist ideology was completely opposed to it. The only form of entrepreneurship that we can talk about in China then, in the 1970s, would be the bureaucratic one that we might call a public form of entrepreneurship, but innovation, risk-taking could be undertaken as embedded within the bureaucratic hierarchies of state enterprises. Therefore, the main aim of entrepreneurship then would have been to find the cheapest way or the quickest way to realize the plans of the planned economy. So that is the context from which I would like to put up a puzzle. Why was it that the public-private imbalance could be redressed in such a short time? In other words, within less than forty years we saw a great outburst of private entrepreneurship in China. So much so that last year you might take the example of the Global Entrepreneurship Monitor Survey. That was a survey covering about 56 countries in the world, and China joined this comparative survey back in 2002. Now, in 2009, according to that survey, China ranked seventh in the world, that is among the 56 countries taking part in the entrepreneurship survey. According to the index of so-called TEA, the yearly entrepreneurial activity index, China ranked very high. The Entrepreneurship Monitor divided the whole sample into three groups--China belonged to the so-called efficiency-driven group. The exact score for China was 18.8 in contrast to the average for the efficiency-driven economies of 11.2. Therefore, China stands very high. In

comparison to France (*laughter in the background*)--I will talk about Hong Kong too--France scored 4.3. Hong Kong lagged behind France: 3.6. That was a great horror to us. But of course, if we use the distinction between necessity-driven entrepreneurship and opportunity-driven entrepreneurship, we will know that in China the big majority is still necessity-driven entrepreneurship. And in France and Hong Kong, we might say that we are more driven by opportunity entrepreneurship. But as we heard from the second presentation in the last session, probably that is changing with time too. But anyway, I think from this simple indication, it becomes clear that private entrepreneurship is flourishing in China. There is no doubt about it at all.

So how can we account for this phenomenon? How could China change itself or at least release its entrepreneurial energy and break out of the constraints of a centrally-planned economy within just thirty years? Now, the conventional view is that it owes a lot to the foresight of the architect of economic reform in China, Deng Xiaoping. We know that Deng Xiaoping succeeded Mao Zedong after Mao's death in 1976. Deng Xiaoping probably had a small international outlook, being educated in France as a young student, but he turned around the whole situation by introducing the open door and reform policy, particularly in 1978. We can trace that afterwards to say that it released that enormous entrepreneurial energy. But I would argue that we should not exaggerate the importance of Deng Xiaoping and his reformist colleagues within the Chinese bureaucracy too much. For three reasons: first of all, Deng Xiaoping himself admitted in the early 1980s that he had not foreseen the tremendous energy coming out of the rural areas of China. At that time, the so-called township and rural industries were developing at the astounding rate of 20% a year. Deng Xiaoping said he was completely taken by surprise. He said that that was not something that they had created. And his colleagues had not anticipated it. He said that such dynamism from the rural areas took him completely by surprise. So it is not something created by the reform policy as Deng himself took it.

The second reason for us to cast doubt on the effectiveness of the reform policy is that later on, in subsequent events, we saw such recurrence showing the limitations of policy again and again. So the second example that I would draw is the personal experience of the sociologist Yang Keming. Yang Keming wrote his dissertation on entrepreneurship in China in the 1990s. In the preface to his book, he told us that he was a young doctorate student in 1989 when the Tiananmen incident happened in

China. And two years after that he was appointed lecturer at Nankai University near Tianjin. Two years after the Tiananmen incident, the Communist Party still exerted tremendous ideological control. All young academics had to be sent to the countryside as in the Cultural Revolution. I will talk about it later. So Yang Keming was sent to the countryside in the outskirts of Tianjin in 1991 as a young lecturer and spent one year there. And he said that after one year, what he got was that he and his colleagues that had been in the countryside would strike up deals with the rural leaders of the village. They would spend a lot of time looking for patents that would create business opportunities for themselves as well as for the rural peasantry that they had been associated with. In other words, the ideological indoctrination campaign actually had the unintended consequence of enhancing entrepreneurship among the young academics as well as the rural leaders. Therefore, it is not a designed policy that stimulated entrepreneurship. It is exactly the reverse, a repressive policy led to an outburst of entrepreneurial energy.

The third example that I would give is that of the political scientist Kellee S. Tsai you probably know about. In a famous book about back-alley banking in China, about the rise of private entrepreneurship, she did extensive interviews with small and medium-sized entrepreneurs in different parts of China. What she discovered was that the big hurdle that private entrepreneurs were facing was the lack of bank credit. Even when the reform policy was launched and Deng Xiaoping went on the so-called southern tour in 1992. Then the ideological control elapsed. But one control was never lifted. That was the state control on bank credit. Bank credit would be given only to state or collective enterprise. No private entrepreneurs could have access to state banking. And then no state loan entities could take deposits from the population. With such strict, stringent control, Kellee Tsai still discovered that there were large numbers of private entrepreneurs emerging because they were able to create non-official credit by creating rotating credit associations, by creating pawn-shops that could sell property. It was not these traditional pawnshops where you put your clothes or your jewelry. Even houses and real estate were being pawned there in order to create business capital. So again, we had this situation: the communist state actually enacted banking laws that were against private entrepreneurs, but in spite of that, private entrepreneurs flourished with their own initiatives. Therefore, by putting all these three cases together, my argument is that we should be skeptical about the effectiveness of the reform policy. It is quite clear to

me that it is an outburst of entrepreneurial energy from below that propelled policy, not the other way round.

If we accept that argument, then we need to find an explanation. Where did this energy come from? Why would there be such a big groundswell of entrepreneurial energy that would propel the reformist leaders in China to go forward? And my argument is very simple. I attribute that to two major events in recent Chinese history. One is the Cultural Revolution; the other is the reversion of Hong Kong to Chinese rule. Let me give the reasons for the impact of the Cultural Revolution on the rise of private entrepreneurship by attributing it mainly to three factors. Now we know that the Cultural Revolution was initiated by Mao Zedong in 1966 in order to bring down the entire communist hierarchy at that time. He wanted to create a new charismatic center. He was against the bureaucratic socialism that was being built. That was his expressed aim. **But my argument is that the Cultural Revolution actually entailed an unintended consequence that ran contrary to Mao Zedong's intentions.** For three reasons. The first reason is that **the Cultural Revolution, by attacking the central bureaucracy, actually paralyzed state control over the countryside**, and in the countryside the peasants had been restrained by the collective movements. People's communes, production brigades, and so on, were imposed on the peasantry. They preferred private, family farming. But that was not possible any more under rural collectivization. But with the onset of the Cultural Revolution, the entire state apparatus, particularly in the extractive functions, by taking production from the countryside to the center, and also by taxing the peasantry, became paralyzed. And because of that, I would argue that in some parts of China, as early as in 1968 to 1969, there were reports about collectives giving back family plots to households. In other words, the whole contracting system and household farming were in the process of being transformed; and well before the reform movement that Deng initiated in 1978, the peasants' dynamism was recreated already.

The second reason would be a wider one, I would argue. Because Mao's efforts were to attack the bureaucracy, that meant that the path of upward mobility that had been set up since 1979 was completely turned upside down. In other words, the political path of becoming a cadre, of joining the communist officialdom, actually became suspect. It was no longer attractive because one would be criticized as a reactionary capitalist roader. And the universities were closed; one was not able to

pursue the conventional path any more. So the only path left, particularly for the youth, in China was to become a red guard, to be a revolutionary supporter for Chairman Mao's idealistic pursuit. But then in 1971 the so-called Lin Biao, the designated successor to Chairman Mao, allegedly defected and died in a plane crash in 1971. And that was a turning point in the Cultural Revolution. All the idealism was gone. The charismatic center that Mao created crumbled to the ground. Widespread disillusionment set in, and I would argue that it was because of that, that at least part of the young generation in China turned its attention away from communism, which had lost its attraction. Economic interest began to set in and entrepreneurial pursuits became at least one of the viable paths forward.

And the third reason that I would argue is that the Cultural Revolution had initiated a widespread internal migration in China, the so-called "up-the-mountain-and-down-the-countryside movement." A lot of the intellectual youth at that time, when the universities were closed, had no outlet. And Chairman Mao at that time directed in 1968 that the intellectual youth should go to the countryside for reeducation. The estimate later on was that up to one tenth of the urban population in China went to the countryside. It is an unprecedented movement. My theory is that—and my argument is based on this—I would argue that such a wide movement, first of all, created a linkage between the rural and the urban world that was sharply divided after 1949. Because of the movement, such a demarcation was broken down. Therefore, it became possible for some of the intellectual youth to take up the role of "hinge" leaders and to become the intermediaries between the urban and rural areas. But even more important is that, subsequently, when the Cultural Revolution ended, this created a huge unemployment problem. These youths needed to go back to the cities, and most of them did not have a job to go back to. And it is this necessity-driven entrepreneurship that became one of the spearheads of the private entrepreneurial movement in China in the early 1980s.

I know that I am running out of time, so very quickly, I will now come to the second argument that I am advancing. In other words, **the Cultural Revolution, through this creative destruction, destroying the communist officialdom, destroying the conventional mobility channels, and also destroying the demarcation between the rural and the urban, created a groundswell of entrepreneurial energy.** But we still needed to have a change in the mentality of the policy makers

in China. In other words, how can we account for Deng Xiaoping and the reformists in China being so supportive and so positive about at least a peaceful coexistence between capitalism and socialism? And I would argue that the reason this happened was that Deng Xiaoping and other leaders faced the unprecedented challenge of having to take back Hong Kong in 1997. This was forced on them. We must keep in mind that the future of Hong Kong became a problem for the Chinese leadership as early as 1979, only one year after Deng Xiaoping consolidated his power and initiated the open door policy. The British government already sent the governor of Hong Kong at that time to test the waters, to see whether there was a possibility to extend British sovereignty or British control after 1997. And Deng clearly said to Margaret Thatcher in 1982, he said, "Sovereignty is not negotiable." Because if he negotiated over that, he would become another Li Hongzhang, who signed the Shimonoseki treaty for China at that time. He could not do that. If he did that, he would lose his own power. The Chinese Communist Party would have been repelled by the population because it could not accept such humiliation. So Deng, for nationalistic reasons, had to take the position of taking back Hong Kong. But he faced three main hurdles. First of all, the economic gap between Hong Kong and China was so great in the 1980s. I will just give you a simple example, a simple figure. In 1984 the GDP per capita for Hong Kong reached 6,179 international dollars and ranked 35th in the world. China's GDP per capita in 1984 was just \$247 and ranked 136th in the world. With this huge gap, you needed to persuade the Hong Kong population to accept the reversion in 1997. The only way out was a rapid catching up by China itself that gave the motivation. The second reason is that you needed to have the leadership to conduct the negotiation, and you needed to draw on the cosmopolitan elements within the Chinese communist leadership in order to do that. And I will give you three such reasons. I will go over that. In other words, it actually elevated the cosmopolitan elements within the leadership to a high position. And lastly, the Chinese Communist Party needed a fresh course on the workings of capitalism. And that was shown in the wide range of courses that the New China News Agency in Hong Kong, the unofficial representative of the Chinese Communist Party, organized in Shenzhen throughout the 1980s—courses for deputy governors, deputy party secretaries and deputy mayors in order to understand that. In other words, the whole mentality of the communist leadership was changed to be hospitable to capitalist and entrepreneurial elements. So I will just rest my case there. In other

words, I will argue that, first of all, the Cultural Revolution created this creative destruction. But at the top of the leadership, the Hong Kong problem also added creative destruction, removing the so-called immunity system from the communist leadership to reject capitalism. Without that, the combination of the right kind of policy and the outburst of entrepreneurship from below would not have happened. Thank you very much.

