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## Entrepreneurship Propelling Economic Changes in China

The most important aspect of the Chinese economy today is its rapid changes. These changes are propelled by the Chinese entrepreneurs. This essay is an attempt to understand who the entrepreneurs are, the environment in which they work, whether the dynamic changes will continue and what policies can be proposed to improve the changes.

For years the most important topic in the study of the Chinese economy was the economic reform led by the Chinese government and the Communist Party of China. See Chow (2007) on China's economic reform. Much of China's economic reform has been completed. The government has provided an environment in which entrepreneurs can thrive and change the economy for the better. To study the economic changes is to study the behavior of this group of economic actors. I assume that they are rational economic agents motivated by the pursuit of economic gains. Their behavior can be understood in the framework of maximization subject to the constraint of the environment. Although economic thinking applies to the present study, the propositions are qualitative rather than quantitative. Economic growth can be measured by

such important variables as real GDP, but economic changes in China have qualitative aspects that I cannot and do not wish to describe completely in quantitative terms. Yet economic thinking will be used for the explanation and prediction of the changes and for suggesting policies to improve them.

Where do the most important changes take place? Who are responsible for these changes? What is the environment in which the entrepreneurs thrive? Will the changes continue? What are the policies for improving the changes in the future? These are the questions to be addressed in this paper.

## **1 Where do the Most Important Changes Take Place?**

Starting with the basic classification of the production of goods and services in terms of consumption, investment and government expenditure, people responsible for economic changes are consumers, entrepreneurs, the government and the workers who produce the goods and services. All play their part in China's dynamic changes. I consider the most important changes to be the economic innovations for which the entrepreneurs are mainly responsible. If the reader disagrees that I have selected the most important changes, the objective of this essay remains to explain and predict the role of the Chinese entrepreneurs in making important changes in the Chinese economy.

Innovations have been occurring in many parts of the Chinese economy, from private enterprises producing consumer goods and services and producer goods to educational institutions providing educational services. Economists following the development of economics education in China are familiar with the innovations being introduced in certain top schools of economics in terms of organization, ways to motivate members of the faculty and staff, and methods of teaching and research. The successful enterprises making an important impact are numerous.

## 2 Who are Responsible for the Important Changes?

Given that the important changes are innovations, the people responsible are the entrepreneurs. The talents and areas of interest of these entrepreneurs vary, but all are self-made and all started with very little wealth. This is a main characteristic of the Chinese entrepreneurs. Simply because in the early 1980s all Chinese were poor, potential entrepreneurs started on a level playing field where no one had inherited wealth. This environment is a major factor in selecting the entrepreneurs who succeed mainly on account of their abilities.

To illustrate, several years ago while traveling in Wenzhou, I observed the operations of Mr Tiger's factory which produces cigarette lighters that dominate the world market. Mr Tiger was a worker who had been laid off by a state-owned enterprise and started making one or two cigarette lighters a day. He later created and managed an enterprise which at the time of my visit was occupying over a quarter of the world market. Another example is Dr Shi Zhengrong, who holds a PhD in physics. He returned to China from Australia in the late 1990s to start a company producing solar panels and was able, in five years, to make his company Suntech the second largest producer of solar panels in the world, second only to First Solar in the United States, while he himself became the richest person in China. As a third example, BYD Auto, based in Shenzhen, Guangdong Province, was established by its president Wang Chuanfu in 2003. It has sold 448,400 electric cars and, in December 2008, began selling the world's first mass-produced, plug-in hybrid vehicle, the BYD F3DM. In December 2008, Warren Buffet spent \$230 million buying a 10% stake in the company.

These examples illustrate the variety of innovations occurring in China. In 2010, Forbes reported that China has 64 billionaires (excluding Hong Kong which has 25), including 27 new ones (implying an extremely rapid rate of increase), second only to the United States which has 403, or 40 percent of

the world total. Based on the list from [http://www.forbes.com/lists/2010/10/billionaires-2010\\_The-Worlds-Billionaires\\_CountryOfCitizen\\_3.html](http://www.forbes.com/lists/2010/10/billionaires-2010_The-Worlds-Billionaires_CountryOfCitizen_3.html), I have recorded the top six in Appendix A.

The businesses in which these six entrepreneurs are engaged include beverages, animal feed, retail, batteries and electric cars, and real estate, suggesting that one can succeed in a variety of businesses that provide consumer and producer goods. Three of the six had a college education while the remaining three did not. I was impressed by the two leading entrepreneurs in Taiwan and Hong Kong: Wang Yung-ching of Taiwan (who passed away two years ago) and Li Ka-shing of Hong Kong. Both did not have much education and started as low-paid workers but had excellent business skills and judgment. Many leading entrepreneurs in mainland China are of the same type.

### **3 What is the Environment in Which the Entrepreneurs Strive?**

The environment will be discussed in terms of the following components.

#### **3.1 The government**

The government is contributing directly to economic changes but the present discussion is concerned with its role in providing an environment in which innovations by the entrepreneurs occur.

##### **3.1.1**

The Chinese government has provided a set of market institutions to enable the entrepreneurs to thrive. These institutions have well-known shortcomings but are good enough to allow the entrepreneurs to innovate. One institution is the enhanced legal status of entrepreneurs, from allowing entrepreneurs to join the Communist Party since the late 1990s to the March 14, 2004,

constitutional amendment on private property stating that "legally obtained private property of the citizens shall not be violated."

### 3.1.2

Like other governments, the Chinese government has been building economic and social infrastructures to facilitate the entrepreneurs' work.

### 3.1.3

The Chinese government plays an important role in regulating the economic behavior of the entrepreneurs.

In establishing a new business and in operating an established business Chinese entrepreneurs need the approval of a set of bureaucrats, of the central government if the enterprise operates nationally or internationally and of the local government where the enterprise is located. Any bureaucrat along the way has an incentive to collect economic rent from the entrepreneur. Thus the entrepreneurs need to be skilled in dealing with government officials.

In the process of rent seeking, a Chinese government bureaucrat performs a useful function by selecting the able entrepreneurs whose undertakings require his approval. To maximize the present value of rents to be collected in the future, a bureaucrat will try to select the entrepreneurs who are most promising in running a profitable enterprise. Most bureaucrats themselves are intelligent. They are members of the Communist Party which has an indirect election process for selecting more talented people to serve at higher places although some are selected through personal favors and connections. Intelligent bureaucrats have an incentive to support the able entrepreneurs in order to increase future rents to be collected.

### 3.1.4

The Chinese government conducts macroeconomic policies to provide a stable economic environment for the entrepreneurs to strive in. In so doing, it is less

subject to the influence of an independent legislature as in the US. This may affect the functioning of the Chinese macroeconomy and thus affect indirectly the environment of the entrepreneurs.

China has not experienced severe economic crises during the recent world economic downturn because its institutions are not allowed to take the large risks that American financial institutions could take. The issuers of derivative securities in the US are able to create financial assets whose values fluctuate greatly while the issuers are not required to have sufficient capital to bear the risk. The financial crisis in the US demonstrates that free exchange can lead to extreme risk taking and economic chaos. The Chinese government is slow in allowing financial derivatives to be introduced. Either by the act of the Chinese government or as a part of the nature of the Chinese people, Chinese consumers do not and cannot take as much risk as American consumers. They do not use credit excessively and spend money that they have not earned. The Chinese banking system is stable because it is mainly owned by the government; depositors do not worry about the safety of their deposits. Thus the economic environment in which the entrepreneurs strive is more stable than in the US in many respects.

### **3.2 China's market institutions**

I treat the market institutions as a separate component of the environment because government policy is only one factor in the formation of China's market institutions. I single out free entry as an important aspect despite all the imperfections of China's market institutions. Free entry is demonstrated by the different kinds of entrepreneurs and the different types of innovations that have taken place. This aspect of economic freedom enables the Chinese entrepreneurs to thrive.

### **3.3 Chinese legal institutions**

It is well recognized that a Western-style legal system is not being practiced in China although the Chinese legislature has introduced many laws similar

to Western ones to facilitate the conduct of economic activities, especially by foreign investors. These laws are not strictly enforced. To be successful, Chinese entrepreneurs have to conduct business in the Chinese way, using *guanxi*, for example. They have the ability and are accustomed to doing this.

### 3.4 The Chinese culture in defining the rules of the game

Here, I use the term "culture" in a narrow sense. In a broad sense Chinese culture has affected both the behavior of the Chinese government and the Chinese legal institutions discussed above. In the narrow sense I refer to the cultural setting in which the Chinese entrepreneurs function. There are certain culturally acceptable ways of conducting business with partners and competitors and of treating employees. Social status is important for getting things done. Thus an able entrepreneur must invest in establishing a high social status. It is often observed that the US is ruled by law and China is ruled by people. One aspect of the rule by people is that those with high social status who are highly respected can get things done even without occupying a high position. Deng Xiaoping was the paramount leader of China for years without holding a very high position in the Chinese government.

The set of rules implicit from Chinese culture affect the way in which Chinese entrepreneurs establish their position in society, partly to make their economic activities more successful. In Hong Kong, for example, by contributing large sums to charity, entrepreneurs gain social status which is an important asset for getting things done.

### 3.5 Chinese workers

I do not refer to the abundance of Chinese workers that has led to low wages, an important factor in attracting foreign investment to China. (The relative wage in coastal provinces in China has increased so that some foreign investors have been moving to neighboring countries including India and Vietnam where wages are even lower.) I refer to the work ethic and skills that the

Chinese have inherited from thousands of years of market economic activities.

### **3.6 The Chinese entrepreneurs themselves**

The Chinese entrepreneurs have their own characteristics, different from the characteristics of entrepreneurs elsewhere, because they are the result of thousands of years of Chinese history and culture as well as the recent history of turmoil and economic progress. I am not knowledgeable enough to give a complete account but can only mention a few relevant points.

Entrepreneurship has been developing for thousands of years since the market economy has existed for thousands of years. The quality and skill of Chinese entrepreneurs have been inherited from such a long historical tradition. Recent economic turmoil during the Great Leap Forward movement of 1958–61 and the Cultural Revolution of 1966–76, as well as the low standard of living during the period of economic planning up to 1978, has given the recent generation of Chinese the skill to survive and the strong desire to get rich. The recent economic growth shows the younger generation that opportunities are there for them to take. The intelligent entrepreneurs understand the environment and have the instinct and skill to take advantage of it. For example, many able Chinese entrepreneurs have taken advantage of the skill and diligence of workers by motivating them and giving them a sufficiently good set of working conditions.

## **4 Will the Changes Continue?**

My answer is yes. Given the entrepreneurs' motivation to succeed and the favorable environmental conditions, we can predict a continuation of their behavior and of similar successful changes in the future. This prediction will be proven wrong only if the motivation or ability of the entrepreneurs change (which is extremely unlikely) or if the environment becomes less favorable.

Topping the list of possible changes in the environment for the worse is the possibility that the opportunity for innovation will vanish. Schumpeter (1947, p. 124) predicted that the "perfectly bureaucratized giant industrial unit ... ousts the entrepreneur and expropriates the bourgeoisie as a class which in the process stands to lose ... its function." This has not happened to the Chinese entrepreneurs who keep on innovating and creating new firms as described in this paper. In the foreseeable future, opportunities for innovation in China and in the rest of the world will still be there for one reason alone. Future increase in output will require the use of energy and environmental resources that will damage the environment unless new methods of production are found to increase the output/energy ratio or to provide new methods of utilizing alternative sources of energy to fossil fuel. The opportunity and the need for innovation for this purpose is unlimited. Economic progress damages the natural environment unless new ways of producing and consuming are found that are friendly to the environment.

Now let me turn to other obstacles. These obstacles can be logically classified as obstacles occurring in the different components of the environment in which the entrepreneurs operate, as listed in Section 3.

The most often discussed is the instability of the Chinese government. Different observers have different opinions concerning its possible instability. Pessimists may point to serious problems facing the Chinese government, including problems of rural poverty and income inequality, the shortcomings of a one-party political system, the deterioration of healthcare provision for a large number of people in the rural area, the corruption of government officials, etc. Space constraints do not allow me to discuss each of these possibly destabilizing factors. A reader having a strong opinion on the possible instability of the Chinese government will answer the question in this section differently. On the issue of rural poverty and income inequality, the reader may refer to Chow (2009a).

One can go through the list of components of the environment facing the Chinese entrepreneurs. If a reader can find an important reason for that component to become unfavorable to entrepreneurship, his projection will be different from what I have stated.

Such differences are similar to projections based on econometric models. Different economists may select different sets of variables to be included in a model and specify different ways in which the selected variables interact to give forecast. I have described the economic actors and their environment and use this description (or model, if it were quantitative) to predict the behavior of the actors in the future. Unless there are some basic changes in the way the actors function or in their environment, my prediction should be valid.

## **5 What Policies Could Improve the Changes in the Future?**

I could go through each component of the environment listed above to suggest how they can be improved. Since the list covers many aspects of the Chinese economy, only selected policy recommendations will be included.

### **5.1 Government**

Many observers agree that the Chinese government has done a good job in carrying out economic reform to provide a set of market institutions and in providing social and economic infrastructures for the entrepreneurs to thrive. One can always point to specific reform measures or infrastructure building that can be improved. Certain large government projects such as the Western Development involve waste and corruption and can be improved.

I have pointed out the positive side of having government bureaucrats selectable entrepreneurs to support in the process of collecting economic rents. The negative side is the inefficiency of having so many layers of bureaucrats who have the authority to interfere with the working of the entrepreneurs. This is well-known

by the leadership of the Chinese government but it is not easy to improve this. An able leader like Zhu Rongji was once able to streamline the Chinese government to some extent, but if such an able leader is not present today to streamline the procedures for the entrepreneurs, a recommendation by an economist is fruitless. The same remark applies to the widespread corruption in China. Corruption is recognized by the Chinese government. The Communist Party leadership has asserted repeatedly that it is their top priority to reduce or control corruption. They do not need to be reminded that this is an important task.

In the conduct of macroeconomic policies, the Chinese government seems to have done a reasonably good job. The Chinese economy is thriving while most of the world is experiencing economic stagnation. It is easy to suggest some improvements, such as allowing the value of the RMB to be subject to the determination of market forces to a larger extent. I believe that the rigidity of the exchange rate is mainly the result of political considerations in China. It is risky for a top Chinese government official to allow the exchange rate of the RMB to appreciate rapidly because a significant, vocal segment of the population would object. A more feasible policy change is to use a large quantity of China's foreign exchange reserve for China's economic development, such as the development of the western region. The increase in the supply of US dollars resulting from such an undertaking will naturally lower the exchange value of the dollar relative to the RMB. Allowing the appreciation of the RMB in such a process may be politically more acceptable.

## 5.2 Market institutions

The Chinese government has established market institutions through economic reform. The next step is to allow more freedom for market institutions to evolve by themselves, mainly through the effort of entrepreneurs. Given sufficient economic freedom, suitable market institutions have evolved naturally around the world. Some examples are the stock markets in New York and in Shanghai during the 1920s which were not set up by the government.

### 5.3 Legal institutions

China's legal system has improved a great deal, such that citizens are now allowed to sue the government, but in practice the legal system often favors the government in settling disputes. Furthermore, some lawyers are punished because they actively pursue legal action against the government. This is one aspect of the Chinese political system with a high concentration of government power in certain areas which the government is not willing to give up. Observers, including respected scholars in China, believe that giving up power and relaxing control of the population in a number areas and treating all parties in a legal dispute as equal under the law would be good for China and for the Communist Party itself, but top leaders may not agree and are not willing to take these bold steps.

### 5.4 Culture

The culture can only change slowly. The Chinese government considers it to be its responsibility to educate or rally the population to work for the good of the country. This being the case, the government can influence the people by increasing and improving civic education in schools and by promoting the Chinese culture as it has been doing to a limited extent.

### 5.5 Workers

I treat this component as part of investment in human capital. There are ways in which the government can improve the formation of human capital by improving the education system and healthcare system and by allowing smooth migration of the labor force. The system of higher education is subject to tighter control than necessary or desirable. For example, the regulation of movement of faculty members should be more decentralized. There should be no need to get approval from the Ministry of Education when a university professor wishes to travel abroad. For the healthcare system, the supply of healthcare in China has remained stagnant for years since the mid-1990s

while almost all consumer goods and services have increased at rapid rates. This is mainly because of the monopoly on healthcare supply by local governments which are interested in spending their revenue on urban development. Allowing and protecting the free entry of private healthcare can help increase the supply and improve the quality of healthcare, thus improving the quality of human capital in China. This topic is discussed in Chow (2009b).

### 5.6 The entrepreneurs themselves

The entrepreneurs have been doing an excellent job in promoting economic changes for the betterment of China. Perhaps they can be persuaded to take a more active role in promoting the collective welfare of the country, such as contributing to activities for the common good, beyond what self-interest can achieve through the invisible hand of the market. Like anyone else, entrepreneurs can improve their spirit of service by self-education and through social action. The Chinese people have demonstrated their willingness to help others during disasters like the earthquake in Sichuan Province in 2008.

## 6 Summary

This essay has described the Chinese entrepreneurs as a group and the environment in which they thrive, explained why successful innovation will continue and suggested some policies that may help entrepreneurship thrive even better in the future.

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## Appendix A: Top Six Richest Persons in China from Forbes' List

### #103 Zong Qinghou

<b>Net Worth:</b>	<b>\$7.0 bil</b>
Fortune:	Self-made
Source:	Beverages
Age:	64
Country of Citizenship:	China
Residence:	Hangzhou
Education:	NA
Marital Status:	Married, 1 child

Mainland China's richest person. He started a beverage business in a mini-grocery in a school in Hangzhou in 1986, targeting picky children and their parents. The company name sounds like an infant's laugh. He formed a joint venture with Danone in 1996; partnership unraveled amid a dispute over the right to use the Wahaha brand, leading to bitter lawsuits. Detente took place in September 2009 when Wahaha agreed to buy out Danone's interests for an undisclosed amount. This hasn't hurt sales: now China's biggest beverage maker selling bottled water, tea drinks, juice and coffee, Wahaha's 2009 revenues are estimated at \$6.3 billion.

**#154 Liu Yongxing**

<b>Net Worth:</b>	<b>\$5.0 bil</b>
Fortune:	Self-made
Source:	Feed
Age:	62
Country of Citizenship:	China
Residence:	Shanghai
Education:	NA
Marital Status:	Married, 1 child

With \$120 in savings, he and three brothers got started raising quails and chickens in 1982. Their Hope Group became one of China's largest makers of animal feed. The siblings split in 1995; Yongxing moved to Shanghai. His privately held East Hope Group is still one of China's biggest feed producers, making 100 types; the core feed business has done well amid rising demand for meat in China as household incomes rise. The company is looking to expand in southern Vietnam. He also owns aluminum smelters and is investing in the plastics industry in China. His only son Shawn, a graduate of the University of Southern California, is heir apparent; his wife is from Texas.

**#176 Zhang Jindong**

<b>Net Worth:</b>	<b>\$4.5 bil</b>
Fortune:	Self-made
Source:	Retail
Age:	47
Country of Citizenship:	China
Residence:	Nanjing
Education:	Nanjing Normal University, Bachelor of Arts/Science
Marital Status:	Married

A Chinese literature major, he worked as a manager in a state-owned company before striking out on his own in the air-conditioning wholesale market in his native Nanjing in 1990. He soon shifted to retail. Using his \$12,000 in savings, he opened his first store with 200 square meters of floor space. Now, China's second largest electronics retailer is benefiting from the double-digit growth in the nation's retail spending; shares are up by 50% in the past year. One of Forbes Asia's 2009 "Fab 50" best large businesses in Asia, Suning bought Hong Kong appliance retailer Citicall Retail Management in February. His elder brother, property developer Zhang Guiping, is also a billionaire.

**#189 Wang Chuanfu**

<b>Net Worth:</b>	<b>\$4.4 bil</b>
Fortune:	Self-made
Source:	Batteries, electric cars
Age:	44
Country of Citizenship:	China
Residence:	Shenzhen
Education:	Beijing Non-Ferrous Research Institute, Master of Science; Central South Industrial University of Technology, Bachelor of Arts/Science
Marital Status:	Married

His BYD Co. is now one of China's top automakers. He began selling electric cars in December 2008, just a few months after Warren Buffett's MidAmerican Energy bought a 10% stake in the firm, a move that helped push up stock sixfold in 10 months. He hopes to start selling models in the US in 2010. The company also makes batteries and battery chargers; its stock tumbled this fall after its 65%-owned subsidiary BYD Electronics recalled the battery chargers it supplied to Nokia due to potential electric shocks. He left his post at a government-affiliated research institute in Beijing in 1995 to co-found BYD

Co. with Lu Xiangyang, now also a billionaire. Wu was initially a rechargeable battery manufacturer. In 2003 BYD acquired a state-owned, mid-size auto-maker in Xian.

**#212 Hui Ka Yan**

<b>Net Worth:</b>	<b>\$4.0 bil</b>
Fortune:	Self-made
Source:	Real Estate
Age:	51
Country of Citizenship:	China
Residence:	Guangzhou
Education:	Wuhan U of Science & Tech, Bachelor of Arts/Science; Wuhan University, Bachelor of Arts/Science
Marital Status:	Married

A property developer, he took his Evergrande Real Estate public in Hong Kong in November, raising \$730 million; for a brief time, he was China's richest person. Shares have since fallen from their peak. Early investors in the offering included Hong Kong billionaire Joseph Lau's Chinese Estates Holding, Hong Kong billionaire Cheng Yu-tung's Chow Tai Fook and Singapore's Temasek Holdings. The company raised another \$750 million in January, selling its five-year debt at a 13% interest rate. He earned his bachelor's degree in metallurgy in 1982 from Wuhan University of Science and Technology; and has served as adjunct professor there since 2003. He shares wealth with his wife.

**#232 Wu Yajun and family**

<b>Net worth:</b>	<b>\$4.0 bil</b>
Fortune:	Self-made
Source:	Real Estate
Age:	46

Country of Citizenship:	China
Residence:	Chongqing
Education:	NA
Marital Status:	Married

The chief executive of real estate developer Longfor Properties, which she co-founded with her husband Cai Kui, who shares the fortune. The company went public on the Hong Kong stock exchange in November 2009; cornerstone investors included Ping An Insurance, Temasek Holdings and the Singapore government. She has a degree in navigation engineering. She worked at Qianwei Meter Factory from 1984 to 1988; spent the next five years working as a journalist and editor at the China Shirong News Agency. Shortly after that, she began developing real estate in her hometown of Chongqing. Now her firm has property in Beijing and other large cities.