



China's Economic Change in Entrepreneurial Perspective: Mao Zedong (Transformative Entrepreneurship) versus Deng Xiaoping (Adaptive Entrepreneurship)⁺

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Abstract

This paper interprets China's economic transformation in entrepreneurial perspective. This paper argues that there are two types of entrepreneurial leadership, namely transformative and adaptive. Transformative entrepreneurial leaders, with creative thinking and charisma, are able to exercise ideological breakthrough in the society and implement novel economic policy. With grand vision in their minds, they shape history and bring about a "creative destruction" to the traditional society. Adaptive entrepreneurial leaders are pragmatic, flexible and adaptive in economic policy making. They learn from errors and able to exert incremental change to the economic system. They enhance a better coordination of economic activities in the society and restore social and economic orders. The concept of the two types of entrepreneurial leaders will be applied to understand China's economic transformation since 1949 under the leadership of Mao Zedong and Deng Xiaoping.

Keywords: *China's economic transformation, entrepreneurial leadership, Mao Zedong, Deng Xiaoping*

JEL Classification: *D78, D81, E65, N15*





1. Introduction

Since the establishment of People's Republic of China in 1949, China had undergone a series of socialist revolution under the leadership of Mao Zedong (thereafter as Mao). After three decades of radical economic experimentation, China remained to be one of the poorest nations in the world. In the 1980s, Deng Xiaoping (thereafter as Deng) proposed and conducted economic reforms. Since then, China's economic performance had steadily improved. For the 24 years from 1988 to 2012, China experienced an average gross domestic product (GDP) growth rate of 9.8 per cent.¹ China's long and winding road to modernization, of course, triggers the interests of many development economists. In explaining China's economic performance, most neoclassical economists utilize Robert-Solow-Romer Growth model. The formal neoclassical production function view of economic growth is like a recipe where all the growth ingredients (such as capital and labour) are dumped into a pot (growth model), heated up (quantitative calculation), then, the output target can be achieved. Such approach provides no insight into the decision-making process of actors concerned (Leijonhufvud, 1986: 203; see also Langlois and Robertson, 1993: 31-41). It is not difficult to understand the reason why scholars in mainstream neoclassical economics neglect the role of policymakers in development planning. In neoclassical mathematical growth models, human agency can be omitted and hence, has no role to play. It must be iterated that the making of national economic policy is principally in the hands of policymakers. It would be odd to study policy change without making reference to the thoughts and actions of policymakers (Yu, 2011: 132-133). To understand economic transformation of a nation in an evolutionary perspective, it requires us to know major political and economic players who are in charge of the economy. Yu (1997) argues that government agency can exhibit entrepreneurial spirit too. The term "entrepreneurial state" is used to describe the Meiji government in Japan and governments of the four Asian Tigers. This paper classifies two types of entrepreneurial leadership to explain economic transformation of China since 1949. Specifically, it uses the concept of transformative





entrepreneurial leadership to explain Mao Zedong's economic management and the concept of adaptive entrepreneurial leadership to explain Deng Xiaoping's economic reforms. Uncertainty, learning, creativity and adaptation are the key elements in understanding China's economic change. There are quite a number of works comparing the leadership and economic management between Mao and Deng (for example, Chan, 1997; Teiwes, 2001, Lu and Lu, 2008). However, these studies do not link the theories of entrepreneurship with the economic management of the two leaders. So far, no study has been done on how the two types of entrepreneurial leadership influence China's economic transformation since 1949. This paper attempts to fill such a gap.

2. Two Types of Entrepreneurial Leadership in National Economic Management: Transformative versus Adaptive

The theories of entrepreneurship in economics can be applied to understand the role of political leaders in economic change. Entrepreneurial leaders in managing an economy can be classified into two types, namely transformative and adaptive. They have different impacts on economic and political changes. The former creates new ideologies, exercises path-breaking economic policies and transforms the traditional economy into a brand new society. The latter is adaptive. The adaptive entrepreneur brings the chaotic economy back into an organized society. Through learning and trial and error, adaptive entrepreneurial leaders enhance a better coordination in economic activities, thus entailing a gradual change in the economy.

2.1. Transformative Entrepreneurship in Economic Management

This paper uses Joseph Schumpeter's contributions to the theories of entrepreneurship to construct the concept of "transformative leadership". According to Schumpeter (1934/1961), entrepreneurs bring about technological breakthroughs and exert a disturbing force on an economy, which is termed as "creative destruction" (Schumpeter, 1934/1961: 81-86). Their activities include the combination of productive factors in some new way, the introduction of a new good or quality of a good, the





introduction of a new production method, the opening of a new market, the utilization of some new source of supply for a raw material or an intermediate good and the establishment of a new organization in an industry (Schumpeter, 1934/1961: 66). Just like entrepreneurship in the market, transformative leaders in national development can bring about a creative destruction to the existing economic and social systems by introducing new political and economic ideas, brand new political processes and systems, opening up new ideologies, moral thinking and establishing new political organizations.

Furthermore, in Schumpeter's perspective (1947/1966: 150), transformative leaders encompass three essential characteristics:

First, it can always be understood *ex post*; but it can practically never be understood *ex ante*; that is to say, it cannot be predicted by applying the ordinary rules of inference from the pre-existing facts. Secondly, it shapes the whole course of subsequent events and their long run outcome. It changes social and economic situations for good and creates situations from which there is no bridge to those situations that might have emerged in its absence. Thirdly, the frequency of its occurrence has something to do with the quality of the personnel available in the society, with relative quality of personnel and with individual decisions, actions and patterns of behaviors.

Schumpeter (1934/1961: 93) reminds us that path-breaking innovation is a difficult job because it lies outside the routine framework and the environment resists in many ways. Therefore, the function of transformative leaders, in Schumpeter's view, does not only consist in inventing or creating a new system or regime, but also consists in "getting [new] things done".

While transformative leadership brings about radical change to the social system, its impacts can be positive or negative. On the positive side, it can, for example, create a more just society for the world to follow. In history, they are the Founding Fathers of the United States, Abraham Lincoln and Mohandas Gandhi. However, transformative leaders, with its creative destruction power, can bring evil and vice to human race, such as Adolf Hitler, Joseph Stalin and Mao Zedong.





2.2. The Role of Adaptive Entrepreneurial Leadership in the National Economy

It is well known that Schumpeter's mode of entrepreneurship is rare in economic history. Most entrepreneurs in the market are adaptive but their contributions in economic development should not be ignored. Likewise, there are not many political leaders as influential as Hitler, Gandhi or the Founding Fathers of the United States. Most leaders in national economic development are adaptive in nature. Agreeing with Baumol's view (1968: 85), leaders with adaptive entrepreneurship deserve a place alongside with transformative leaders in the front rank of contributors to economic prosperity. Leaders with adaptive entrepreneurship put new ideas in use. They learn and exploit the political success of others. They invent neither new ideologies nor policies, but rather apply them for the advantage of their nation. In Leibenstein's view (1978: 74), leaders with adaptive entrepreneurship possess the capacities to search and discover economic opportunities for their country. They are capable of evaluating economic projects, marshaling the financial resources necessary for national development. These leaders in national development are strategic followers.

The two modes of entrepreneurial leadership, namely transformative and adaptive, can be associated with what Schumpeter (1947/1966) called "creative response" and "adaptive response" in economic history. In Schumpeter's words (1947/1966: 150):

Whenever an economy reacts to an increase in population by simply adding the new brains and hands to the working force in the existing employment, or an industry reacts to a protective duty by expansion within its existing practice, we may speak of the development as adaptive response. And whenever the economy or an industry or some firms in an industry do something else, something that is outside of the range of existing practice, we may speak of creative response.

Hence, transformative leadership is largely associated with "creative response", while adaptive leadership, with "adaptive response". In politics, America's Founding Fathers, Adolf Hitler's Nazi of Germany,





the Meiji government of Japan, Vladimir I. Lenin in Soviet Russia, Mohandas Gandhi in India and Mao Zedong in China possess the quality of transformative leadership. Franklin D. Roosevelt (USA), Martin Luther King Jr. (USA), Lee Kuan Yew (Singapore), Ho Chi Ming (Vietnam) and Deng Xiaoping (China) are in the category of adaptive leadership. Of course, the delineation between the two types of leadership is just a matter of degree. A summary of the two types of entrepreneurial leadership was given in Table 1.

Table 1 A Comparison of Two Types of Entrepreneurial Leadership

Transformative	Adaptive
Ideological breakthrough; novel/creative thinking and pioneer in radical economic policy making	Incremental innovation in ideologies and gradual change in economic policy
Self-confidence; risk-taking and bold attempt in implementing a project	Pragmatism and consensus building
Grand vision and history shaping	Learning, errors elimination and adaptation
“Creative destruction” to the traditional society leads to coordination failure in economic activities	Restoration of social and economic orders and better coordination of economic activities
Change of a system	Change within a system



We shall apply our theories of entrepreneurial leadership to explain the two periods of economic change in China since 1949, namely Mao's and Deng's economic transformation. To do so, an understanding of the personality and biographies of Mao Zedong and Deng Xiaoping will help to explain the formation of economic policies and their impacts on China's economy.

3. Mao Zedong's Personality Traits and Leadership Style

Mao (1893-1976) was born into a peasant family in Shaoshan (Hunan province, central China). After graduating from the Hunan First Normal School in 1918, he went to Peking, the national capital of China and worked in the Peking University library. It was during this time that Mao did most of his self-study and read Marxist literature. Growing up in a traditional Chinese peasantry family and mastering no foreign language, Mao was deeply embedded in Chinese culture. Paradoxically, as a rebellious leader, he also attempted to destroy Chinese traditions and Confucian values during political movements.

It is well known that Mao was a visionary, romantic revolutionary leader (Teiwes, 2001: 1). He was "a charismatic visionary, brilliant strategist and shrewd but devious political manipulator" (Vogel, 2011: 29). He possessed supreme confidence and dominance to inspire great numbers of followers. Mao was not only a risk-taker who was "willing to get the job done but also a charismatic leader who could convert the masses" with his rhetoric (Maccoby, 2000: 69-70). Through grand visions, coupled with great charisma, Mao gained devoted followers. Mao's visions can be strongly evidenced in two bold and creative economic reforms, namely, the Great Leap Forward and the Cultural Revolution.

However, there are dark sides of Mao's personality. Mao demonstrated himself the personality traits of self-inflation, self-admiration, and the expectation of admiration from others (Sheng, 2001). He strove to gain power and glory, and worked aggressively to be admired rather than loved. He resisted advisers' suggestions, took credits for successes and blamed others for their own failures and shortcomings.



Mao was a poor listener, hypersensitive to criticism and lacked empathy. He was unwilling or unable to mentor or be mentored, and intensely competitive. When he did not like the rules, he ignored, or even changed them.² In the next section, we shall explain and illustrate how Mao's personality traits influence the economic management of China under his leadership.

4. Mao Zedong's Economic Management during 1950-1957: Venturing into a Socialist Regime

By gaining widespread support from peasants, the Chinese Communist Party (CCP) under Mao's leadership successfully established its legitimacy in mainland China in 1949. The experience and knowledge of the party leaders in general and Mao in particular had significant influences on the economic management of the Mainland, and hence the growth trajectories of the economy. Given Mao's extremely high creativity with talented leadership, but lacking knowledge of the West, how did he manage China and lead the economy out of backwardness? We argue that Mao's economic management style was governed by his split personality with a hybrid of angel and devil. In old feudal China, peasants were severely exploited by landlords. Mao acted as a saviour to the poor peasantry class. On June 28, 1950, an Agrarian Reform Law was passed to redistribute land rights. Lands of landlords were brutally confiscated by the government and subsequently redistributed to the lower-class peasants. Political movements against landlords caused the humiliation and death of many landowners. The land reform was followed by the "Three-anti and Five-anti Movements", as well as the "Anti-Rightist Movement", when property owners and businesspeople were labeled as "rightists" and purged. It is estimated that at least one million people were killed during this period (Werth *et al.*, 1999). As a result, rural and farm sectors achieved a quasi-classless system that ultimately eliminated feudalism of Imperial China. Both agriculture and industry experienced growth from 1949 to 1958. By 1958, agricultural production almost doubled from 1949 (108 million tons to 185 million tons), coal production quadrupled to 123 million tons, and steel





production grew from 100,000 tons to 5.3 million tons (Liu 2004). Mao's radical leadership in the early 1950s was generally welcomed by the public!

5. The First “Fatal Conceit”³: The Great Leap Forward (1958-60)

Mao was a talented and charismatic leader. He was able to convince the masses to follow him and exploit them for his advantages. He knew little about the economic and social systems of the West in general, production and technologies of advanced nations in particular. Of course, a person who is deficient of certain knowledge can make up by learning. However, Mao refused to learn Western technologies. He was self-centred and full of self-confidence. He was what Hayek (1988) referred to as a man of “fatal conceit”. The result of an ignorant man with strong leadership brought China into the first economic disaster in the late 1950s.

Knowing very little about the West and disregarding the economic realities in China, Mao thought that “east wind of socialism” could prevail over “the west wind of capitalism” (Sheng, 2001: 123). In 1957, under Mao's revolutionary romanticism, the Chinese Communist Party launched one of the greatest economic experiments in the human history, namely the Great Leap Forward. From 1958 to 1960, the Great Leap Forward attempted to move the country towards “a spiritually mobilized populace simultaneously bringing about the full-scale modernization of China and its transition from socialism to communism within a few short decades” (Oxford Reference Online, 2009). It aimed at accomplishing the economic and technological advancement of the country at a faster pace and with greater results. The slogan of the movement was to “overtake Britain and outperform the United States”. The movement centred on brand new socio-economic and political systems, namely the people's communes, which were created in the countryside and in a few urban areas. The aim of the political movement was to increase agriculture and industrialization through central planning and communal production. It was envisaged that the government could control the sale of agricultural goods if it also controlled the production of those goods.





This would supposedly be easier if the production plan could be done in larger groups to exploit the economies of scale. Such “creative destruction” (Schumpeter, 1947/1966) rendered extremely high transaction costs and the plan was infeasible. As a result, many people starved to death. However, the propaganda machine of the Communist Party continued to give out larger numbers of the goals accomplished in order to push people to produce more output. The local leaders of the communes were lying about the production and success of the agricultural numbers which led to more grains being sent to urban areas or being exported and not enough being left for the peasants in rural areas to consume. Apart from food production, the political movement also focused on steel production. In 1958, Mao was shown a backyard steel furnace and given the belief that steel could be produced there. He then encouraged people to produce steel in the backyards. Households, with enthusiasms, donated their cooking utensils, farming tools, or iron gates to the commune furnaces to produce steel. When Mao later knew that steel was impossible to produce in backyard furnaces, he chose not to disclose the truth to the public. The economic experiment ended up in a total failure. Amongst the Great Leap Forward’s consequences were the shortage of food,⁴ shortages of raw materials for industry, overproduction of poor-quality goods, deterioration of industrial plants due to mismanagement, and exhaustion and demoralization of the peasantry and intellectuals. As a result, millions of people died of starvation. It is estimated that between fourteen and forty million people died during the Great Leap Forward before the plan was abandoned in January 1961 in the Ninth Plenum of the Eighth Central Committee (Sheng, 2001).

6. The Cultural Revolution 1966-1976: The Economic Catastrophe in Human History

Having experienced a major setback, Mao and his party could learn from the mistakes and changed economic policies to eliminate errors. Unfortunately, learning in “wrong” direction can be possible. Even worse, bad learning by a talented leader brought China into another



economic catastrophe. Due to the failure of the Great Leap Forward, hardliners in the party had no choice but to give way under pressure. Mao stepped down from his position as the chairman of the People's Republic of China. Liu Shaoqi, the second man in the party, took the control. Together with Deng Xiaoping, Chen Yun, Peng Zhen and others, Liu's group revised the Mao's extreme left policy and initiated a series of corrective measures. Such measures would be beneficial to China's economy. However, as a distinguished founder of the People's Republic of China, Mao did not admit his errors in initiating the Great Leap Forward movement. Admitting mistakes means a severe humiliation to the supreme leader. Sheng (2001: 120) rightly argues that "the bipolar co-existence of intense paranoia and grandiose fantasies exhibited in the last 10 years or so of his life testified to Mao's deteriorating narcissistic personality disorder, which, in turn, translated into China's chaotic and frenzied politics of the Cultural Revolution". Mao showed his aggressiveness in his attempt to compete with God.⁵ As a creative leader, Mao found a way out to justify his restlessness. He blamed the failures of previous movements on the incomplete socialist regime.⁶ In Mao's view, to remedy the situation, a more radical communal property system should be conducted. In 1967, he initiated another radical political movement, which had never been experimented in the human history before, namely the Cultural Revolution.

As a charismatic entrepreneurial leader, Mao was able to organize a political movement which persuaded the masses to follow his ideologies. As Lieberthal (1995: 60) argues, revolutionary or radical economic reform "is by its very nature unsettling. Its adherents must maintain a level of frenetic intensity and passion that rarely is compatible with smooth administration. Revolutionaries tend to view complex administration as an obstacle to their goals, while civil servants often want to temper the enthusiasm and lack of technical expertise that accompany the policy thrusts of revolutionaries". Mao utilized the passion of young people to rebel against the old system and senior Politburo members by forming the Red Guards. Red Guards had two roles. Firstly, it was manipulated by Mao as a power struggle with and revenge on Liu who openly humiliated him. As a result, Liu was branded



as a capitalist. Secondly, Red Guards was used by Mao as a device to destroy the old systems and create a brand new society as Mao himself believed he was the guidance of the new world. On 16 August 1966, eleven million Red Guards gathered in Tiananmen Square to hear encouragement from Mao who portrayed himself as a supreme emperor as in the old imperial China. During the heat of the Cultural Revolution, social and economic orders were completely turned upside down. Intellectuals were transported to rural areas to do manual labour in which they did not have comparative advantages. Homes of citizens were turned into communes for collective production.

Today, scholars in New Institutional Economics (e.g. see Ostrom, 2000) argue that an extreme communal property system renders prohibited transaction costs and therefore is economically unfeasible. There are different sources of inefficiency associated with extreme communal production during the Cultural Revolution. First, there was a lack of incentive to work hard because people could not reap the rewards for what they put in. It renders high monitoring costs for the communal brigades to enforce the team to work (Alchian and Allen, 1983). Without profit incentive, political movements glorifying group effort were used to push people to work. Secondly, in the nature of public ownership of productive assets, common property rights led to the abuse of resources, thus, reducing productivity. The third source of economic inefficiency is in the distribution of the products. When price is not used as a mechanism of distribution, other methods would be applied to capture rents. Cheung (1998) argues that in the Communist society, rank and seniority in the Communist party is used for allocation of goods. Hence, every commune member engages in an unproductive ways to seek higher rank in the party. This leads to rent dissipation (Cheung, 1970, 1998).

Led by Mao's ignorance and charisma, the Cultural Revolution brought millions of people in China into starvation, violence and economic disaster. Red Guards led public beatings, humiliation, and killings of those against the Communist Party. Many of those were beaten publicly and committed suicide. The last two years of the Cultural Revolution in China witnessed a period of re-education, killing,





chaos and China fell into a society without law and order (Oxford Reference Online, 2009). Similar to other Communist countries such as North Korea, Cuba and Vietnam which adopted radical socialism and closed door policy, China became an extremely poor nation in that period. Although it is inconclusive that Mao alone creates such a human disaster in Chinese history,⁷ it is not too wrong to claim that such tragedy is largely attributed to Mao's (negative) leadership.

7. Deng Xiaoping's Personality Traits and Adaptive Entrepreneurial Leadership

While Mao is regarded as the great helmsman in China, Deng is taken as a "paramount leader" and "might best be characterized as the 'political boss' of the post-Mao period into the early 1990s" (Teiwes, 2001: 2). Born into a peasant background in Guang'an (Sichuan), Deng studied and worked in France in the 1920s, where he was influenced by Marxism-Leninist ideologies. Travelling around China, France and Moscow in his youth, Deng was more open to new and foreign ideas than Mao. However, his leadership style was more imperial than presidential (Goodman, 1997). Deng joined the Communist Party of China in 1923. He followed Mao in the Long March and was one of the eight "revolutionary veterans" in the Communist Party. Following the founding of the People's Republic of China in 1949, Deng worked in Tibet and other southwestern regions to consolidate Communist control. Deng was instrumental in China's economic reconstruction following the Great Leap Forward in the early 1960s. His economic policies, however, were at odds with the political ideologies of Mao. As a result, he was purged twice during the Cultural Revolution, but regained power in 1978.

Regarding personality and leadership style, Teiwes (2001: 1-2) comments that Deng is "a pragmatist more interested in measurable results than grand visions". His "determination to get things done his way ... was linked to a willingness to consult and modify positions". Deng's pragmatism can be best illustrated by his statement, "it does not matter if a cat is black or white so long as it catches the mouse". Deng is





also described as “an organisation man who saw his duty as one of serving the Party and its leader, and implementing the ideas of others within the leadership ... In short, Deng was pragmatic, a committed revolutionary throughout his political career, attempting to ensure that the CCP achieved power and China’s modernisation” (Goodman, 1997). Orville Schell, a historian, comments in *Newsweek* that “Deng was skilled at coalition and consensus building While Deng could be opportunistic, he was remarkably constant in his beliefs and predictable in his actions, especially when it came to economics. He rarely tormented himself over difficult decisions. His self-confidence allowed Deng to take enormous gambles” (Schell, 1997).

8. Deng’s Economic Reform since 1978: Gradual Learning and Experimentation

Mao, with his creativity and charismatic leadership, brought the nation into total chaos. The coordination of economic activities completely broke down. Production paralysed, and the economy suffered from huge shortage of foods. Inheriting a ruined economy resulting from the Great Leap Forward and Cultural Revolution in the Mao era, Deng attempted to restore the nation. Seeing that the other two Chinese economies, Hong Kong and Taiwan, performed well in the post-war period, Deng and Chinese leaders in Beijing realized that the radical communal property right system did not work. They wanted to correct the “extreme left-wing” mistakes committed during the Cultural Revolution. Following the death of Mao, a major barrier in the capitalist reform was removed. A new era dawned. In 1978, the Chinese Communist Party led by Deng embarked on a Four Modernizations programme: the party charted a middle road of maintaining political and ideological controls while gradually opening up the country and regulating the influx of new ideas, foreign trade and investment. However, in 1978, Deng did not have a clear vision of how China’s modernization should proceed. As Vogel (2011: 21) puts it “Deng did not have a clear blueprint about how to bring wealth to the people and power to the country; instead, as he confessed, repeating a widely used saying – he groped for the stepping





stones as he crossed the river.” In announcing the Four Modernizations, Deng steered away from Mao’s rigid central controls and introduced incentives to stimulate economic growth. This departure indicated that Deng was a more pragmatic leader. Deng announced a new programme for economic development, calling for the (1) abolition of the collectivized agricultural system, (2) encouragement of private peasant plots to raise agricultural products to sell in the market place, (3) reduction in centralized economic planning, making local economic units responsible for the acquisition of raw materials, (4) encouragement of technology to increase productivity, and (5) use of joint ventures with foreign firms (e.g. the United States and Japan) to bring additional funds and investment to China. Given ideological constraints as well on pragmatic grounds, Deng’s government pursued a capitalist experiment under the slogan of “Chinese-style socialist market system”, which in fact expanded marketization and privatization. He dubbed it as “socialism with Chinese characteristics”. Without any model to follow, the economic reform in the Mainland had to be conducted by trial and error. Gradualism was notably incremental in nature. This gradual reform policy had one advantage. Chinese people could partially maintain their old thinking while at the same time learn new ways of doing. The two most striking experiments at that time were agricultural responsibilities system and the Shenzhen Special Economic Zone.

9. Groping for Stepping Stones to Cross the River: Agricultural Responsibilities System

The most striking economic experiment started at the agrarian sector. It attempted to experiment a market system in the farm sector with the aim of “letting farmers to get rich first”. If this method succeeded, then reform would be extended to the industrial and financial sectors. Starting from the agricultural sector, the government de facto introduced a private property rights system under the name of “agricultural responsibility system”. According to Cheung (1998), a responsibility system “involves a contract between a household or organisation and the government, under which the individual assumes responsibility in





production, pays dues to the government, and keeps the residual". This new policy served as a small impulse to peoples' minds. Farmers and rural workers began to perceive opportunities. At first, farmers did not know what to do. During that time, they were still using the same old interpretation framework to deal with new events. Many of them dared not to move ahead. This was especially true for those people who suffered intense hardship during the Cultural Revolution. With socialist thinking being still in force in most farmers' minds at the early stage of the reform, those people moving ahead and behaving as rural entrepreneurs were condemned as capitalists' devils by other farmers. However, as many rural entrepreneurs became wealthy and did not suffer from any political condemnation, old thinking started to give way. As more farmers learned, new policies were found feasible. More precisely, Chinese people slowly constructed a new framework to deal with the capitalist way of doing things. Such mentality gained ground and was reinforced by continuous rewards. With the success in the rural sector,⁸ similar reforms were then extended to the industrial sector under the name "Bao Chan Dao Hu" (a kind of contracting system⁹) and later to the financial sector.¹⁰ As a result, more and more people accepted the new way of doing things. Even conservative Communist hardliners later gave up radical Communist ideology and were willing to learn new things. They participated in the market ways of doing things and involved in private enterprises. A new social stock of knowledge has been steadily built up as these activities were extended to the whole economy.

10. Shenzhen as an Experimental Zone

In 1980, Deng's government established Shenzhen Special Economic Zone (SSEZ) as one of the testing grounds for economic reform.¹¹ Its aim was to attract foreign capital for modernization. If we use the cost and benefit analysis to evaluate the Shenzhen project, the policy of pouring huge amount of resources into the zone by the central government may not be economically justified.¹² However, if Shenzhen is referred as an experimental zone, then the design will be a sensible



way to tackle uncertainty. Confining the experiment to one small region, the state can avoid massive disasters extending to the entire nation in case the experiment fails. On the other hand, if the experiment succeeds, then the special zone can be applied to other regions. Hence, Shenzhen had been designated as a test bed of change and a guinea pig for China's reform.¹³

Shenzhen used to be a small border town with a population of less than 30,000. At the early stage of development, the general target of making Shenzhen as a special zone was "to develop Shenzhen into an industry-led modernized city, based on the integration of agricultural and industrial development" (Gu, 1998). In August, 1980, the People's Congress passed "Regulations for the Special Economy Zone of Guangdong Province" and officially designated a portion of Shenzhen as the Shenzhen Special Economy Zone (SSEZ). The central government gave the zone special policies and flexible measures, allowing it to utilize a special economic management system. They included:

- Special tax incentives for foreign investments in the Special Economic Zone.
- Greater independence on international trade activities.
- Economic characteristics were represented as "four primacies":
1) constructions primarily relied on attracting and utilizing foreign capitals; 2) primary economic forms were Sino-foreign joint ventures and partnerships as well as wholly foreign-owned enterprises; 3) products were primarily export-oriented; 4) economic activities were primarily driven by market.
- The Special Economic Zone was listed separately in the national planning (including financial planning) and had provincial authority on economic administration. The Zone's local congress and government had legislation authority.

At the early stage of the experiment, the result seemed not promising. By 1985, some critics even pointed out that Shenzhen was a failure because it had not fulfilled its original goals. They argued that rather than being a "window" to the outside world and technology, much of Shenzhen's growth was due to the creation of import production



rather than export production that geared towards gaining capital. Foreign investors were enticed more by the prospect of a huge Chinese market than a favourable tax structure, and started enterprises designed to sell goods within China. Furthermore, many factories were designed to take advantage of the abundant supply of cheap labour and were thus low-tech. Foreigners were unwilling to invest their money in expensive high-tech capital that a largely unskilled labour force might not be able to use. The central government in Beijing was concerned about huge subsidies which were given to Shenzhen, without achieving the prescribed goals. As the result of much debate, the municipal government of Shenzhen was able to respond to the challenge by creating a plan for growth emphasizing export production and high-tech endeavours. After manipulating the tax structure, purging a corruption scandal, and rededicating itself to creating a skilled workforce, exports began to increase.

After 35 years of trial and error, the experiment seemed working. According to Shenzhen Government,¹⁴ Shenzhen is now China's the fourth largest economic driver and richest city in mainland China. In 2011, its GDP growth rate was 10 per cent, with GDP and per capital GDP amounted to US\$178 billion and US\$17,096 respectively. In 2006, Shenzhen was ranked as the best city to live in the mainland China (*Shenzhen Daily*, September 22, 2006). Thus, in hindsight, we cannot claim that Shenzhen is a failure, as assessed earlier by scholars using the cost and benefit approach.

11. Foreign Direct Investment as a Learning Channel

The Deng's government envisaged that the strategic use of foreign direct investment could help China modernize by gaining access to foreign technology and capital (Shi, 2003). Since China "opened" her door in 1979, as a result of some preferential measures, foreign direct investments continued to pour into the Mainland to take the advantage of cheap labour and rentals. According to the official definition in China (Shi, 2003), foreign direct investment took several forms. They were wholly foreign-owned investment, equity joint ventures and contractual



joint ventures. Collectively, they were called *sanzi qiye* that literally meant three types of foreign direct investment enterprises. Each type of contract was stipulated in and protected by specific laws. In addition, there were compensation trade, and assembly and processing agreements. These types of foreign direct investment were more flexible and subject to negotiation between foreign and domestic parties. These informal arrangements were popular in the early stages of the Open Door Policy, especially in the Guangdong area where most Hong Kong-invested firms were located.

In 2011, direct foreign investment in Shenzhen reached US\$4.6 billion, up 7.03 per cent from the previous year. Of that figure, investment from Hong Kong reached US\$3.24 billion, up 4.53 per cent from the previous year. Investment from the United States reached US\$82 million, down 8.62 per cent from a year ago. Its export volume increased 20.2 per cent, to US\$245.53 billion, ranking first among the nation's large- and medium-sized cities for the 19th consecutive year.¹⁵

Foreign direct investment in developing economies is regarded by Marxists as exploitation. Yu (1997: 180) argues that foreign direct investment is useful to latecomer economies in catching up with industrialized economies. As multinational firms from the advanced economies take the advantage of cheaper resources in the developing economies and invest there, local firms in the latecomer economies learn their skills and imitate their products. According to their abilities to absorb foreign technology, local manufacturers modify and gradually create some new designs. From a large reservoir of knowledge, they adopt foreign technology to local circumstances and improve on it. When imperfections arise, they make changes. In short, local firms take the full advantage of being latecomers. Later, some of the latecomer firms may spend money on R&D and move away from pure copying. By trial and error, eventually some firms establish their own brands. More importantly, by selling improved designs at lower prices, local producers can even threaten the original suppliers from advanced countries.¹⁶ They can compete in world markets. Of course, the success depends on the absorptive capacity of the nation.¹⁷ This argument seems correctly explains recent China's latest development.¹⁸ According to a report in



London (Economist Intelligence Unit, August 1, 2002), China was once seen as little more than a vast sweatshop, cheap low-tech production centre. However, that perception is changing. The report remarks:

“As multinationals relocate both factories and research and development (R&D) to China, and local rivals ramp up efforts to develop home-grown products, China is set to become a world centre for high-tech manufacturing. Chinese manufacturing is being led up the industrial value chain by the most well-known foreign technology brands. Multinationals – including Microsoft, Intel and Lucent of the US – have set up over 120 R&D centres in China so far ... The rapid shift of global manufacturing capacity to China has prompted commentators to predict the emergence of a new workshop for the world. Few, however, have noticed a newer but equally pronounced migration of foreign research and development operations to the world’s most populous nation.¹⁹ The importance of this trend, evident not only in information technology but in automation, supplies a potent riposte to sceptics who have argued that China was destined to become a giant sweatshop, productive but low tech. And although much of the cutting edge work is confined to the labs of multinational firms, the people executing it are almost exclusively Chinese. Over time, ideas and skills would be expected to flow to local companies”

(cited in *Financial Times*, 18 April 2002)

12. Learning, Imitation and Catching Up with Its Neighbours

China, as an Asian latecomer, has a wide range of industrialized nations to follow. However, learning from countries with similar thinking and ethnical backgrounds can facilitate learning and therefore reduce coordination costs during the process of catching up. At the early stage of the reform period, the Deng’s government could learn most easily from those countries which encompassed “Asian value”, such as Japan and the four Asian Newly Industrialized Economies, namely Singapore, Taiwan, South Korea and Hong Kong. Understandably, learning from Taiwan at that time was rather difficult due to mutual mistrust. Learning from Japan was possible and indeed China approved many investment projects from Japan. Singapore had been an anti-Communist economy.



Learning from Hong Kong was the most efficient, quickest and cheapest way.

Hong Kong's post-war success is well documented. It has been a free port for more than 150 years. As a result of dynamic entrepreneurs (Yu, 1997) and pro-business government policies (Yu, 2002), Hong Kong has developed into a high-income area. Hong Kong's experience has been recognized by Chinese leaders across the border. Chinese public officials wanted to learn from this small city's economy. To achieve this, China borrowed those dynamic Chinese entrepreneurs from Hong Kong.

The Open Door Policy provided opportunities for Hong Kong entrepreneurs to invest and earn profits in China, on the one hand, and for local enterprises in the Mainland to learn and catch up with Hong Kong, on the other hand. Hong Kong industrialists, with the benefits of cultural and language similarities, were the first group to relocate their factories to mainland China (Yu 1997). Hong Kong had been the largest investor in China (Shi, 2003). At the early stage of the Open Door Policy, investment from Hong Kong accounted for even more than 70 per cent of the total foreign direct investment inflow. Guangdong where more than 80 per cent of foreign direct investment originated from Hong Kong became a huge processing plant for Hong Kong companies (Thoburn *et al.*, 1990; Cheung, 1997). The Pearl River Delta had one time become the "backyard workshop" for Hong Kong.

As Hong Kong firms invested in the Mainland to take the advantages of low wages and rentals there, people in the Mainland imitated and learned from Hong Kong firms. Similar culture and languages between the two economies made learning easier. With Deng's government strove to promote to build similar Hong Kong in the Mainland, those cities in China which locate near Hong Kong such as Shenzhen and Guangzhou quickly learned and imitated Hong Kong's style of entrepreneurship and management. Consequently, living standards and lifestyles in the Pearl River Delta areas have been able to catch up with Hong Kong. Deng's economic policy paved way for the subsequent leaders, e.g. Jiang Zemin and Zhu Rongji, to follow. Hence, it is not an exaggeration to conclude that the emergence of China as the



world's second largest economy in 2010 can be attributed to Deng's legacy.

13. Conclusion

This paper interprets China's economic transformation from 1950 to 1997 in entrepreneurial perspective. This paper classifies two types of entrepreneurial leadership, namely transformative and adaptive. It argues that Mao, a transformative leader, with creative thinking and charisma, was able to exercise ideological breakthrough in the society and implement novel economic policies. After the establishment of the People's Republic of China in 1949, Mao embarked on a land reform programme and two boldest economic experiments in human history, namely the Great Leap Forward and the Cultural Revolution. These unprecedented economic experiments brought about a "creative destruction" to the economy and society of China, which entailed tremendous uncertainty to the country. Nationwide coordination failures in economic activities led to economic catastrophe in China. As a result, China became one of the poorest nations in the world.

After the passing away of Mao in 1976, Deng was able to make a comeback. Deng, an adaptive and pragmatic leader, was able to learn from Mao's errors and adapt to economic change. Under Deng's leadership, China embarked on the Open Door Policy and economic reforms in 1978. Coordination of economic activities via marketization and privatization was made possible. Through learning, elimination of errors and gradual policy change, social and economic orders in China were restored. After nearly 20 years of economic reform (i.e., from 1978 to 1997, the year Deng passed away), China was able to transform itself from one of the poorest nations in the world to a relatively wealthy economy in East Asia.





Notes

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1. Calculation based on data given in IMF *World Economic Outlook Database*, April 2013.
 2. Mao is referred to as suffering from narcissistic personality disorder (e.g. Pye, 1976, 1996; Sheng, 2001; Rosenthal and Pittinsky, 2006)
 3. The term comes from F.A Hayek's book *The fatal conceit: The errors of socialism*, published in 1988. The two cases of fatal conceit committed by Mao are the Great Leap Forward and the Cultural Revolution.
 4. Admittedly, natural disasters also played a part in causing the food shortage.
 5. In his 1946 Chinese poem, Mao wrote: "attempt to compare with the sky in height".
 6. "Neoclassical Austrian" economists such as F.A. Hayek and I.M. Kirzner argue that entrepreneurial learning can eliminate errors and thus the economy is able to move towards equilibrium. Mao's case shows that, given human ignorance, learning may not eliminate errors. On the contrary, after learning, human agents may commit further errors because it is extremely difficult to define a "correct" policy beforehand. Therefore, Lachmann's (1956; 1970) radical subjectivist position seems more appealing. For a differentiation of two types of Austrian economists, namely neoclassical versus radical subjectivist, see Caldwell (1988: 530, note 17).
 7. Pye (1976: 598) argues that "a deeper cultural and societal force that make





- possible of such a unique phenomenon”.
8. Cheung (1998) concludes that “there is no question that in China, the responsibility system has met with great success in agriculture”.
 9. Many types of contracting system were practiced during the experimentation period. For a detailed discussion, see Shiu (1996).
 10. The industrial and financial sectors are structurally more complicated than the agricultural sector. Hence, it is not surprising that the current state enterprise reforms have encountered more difficulties than the farm reform. For a discussion of the differences between agricultural and industrial sectors from the transaction cost perspective, see Cheung (1998). For a review of banking reforms in China, see Shiu (2003).
 11. China’s other special economic zones are Zhuhai, Shantou, Xiamen and Hainan.
 12. For example, Chen’s study (1993: 267) integrates domestic profits in China and concludes that the impact of the central government’s subsidies is small. His report suggests that a heavy reliance on foreign investors is unlikely to maximize the welfare of citizens and that there should be a balance between domestic and foreign investment.
 13. Shenzhen Special Economic Zone was personally proposed by Deng Xiaoping and is often called “the testing bed of Deng Xiaoping’s reform and opening up”.
 14. Shenzhen Government Online, <http://english.sz.gov.cn/economy/> (retrieved on 29 August 2013).
 15. See note 14.
 16. Hong Kong is a good example of catching up. See Yu (1997).
 17. See Cohen and Levinthal (1990) for the concept of absorptive capacity.
 18. Admittedly, at the beginning, most joint ventures were rent-seeking activities pursued by the government officials either at the township or provincial level. However, the most important fact is that Chinese people have had the opportunities to learn from overseas companies.
 19. For example, Alcatel, the telecommunications company, joined forces in 2003 with a Chinese venture capital fund, New Margin ventures, to invest US\$18 million to support innovation in telecom engineering. Alcatel expects to spend around 15 per cent of its worldwide R&D budget in Shanghai. On this investment, Ron Spithill, the executive vice-president of Alcatel, remarks that “China has long been a recipient of telecom technology, very soon it will be a source of innovative technology.” (*Financial Times*, April 18, 2002).



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