

## Finance, development and the Chinese entrepreneurial state: A Schumpeter- Keynes – Minsky approach\*

*Finanças, desenvolvimento e o estado empreendedor chinês: Uma abordagem Schumpeter-Keynes-Minsky*

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RESUMO: O argumento central do trabalho é que a o sucesso da China, e de várias empresas chinesas, em ultrapassar seus competidores em termos de mudança estrutural, upgrading tecnológico, velocidade de crescimento e gerenciamento de crises se deve ao fato de ter um Estado Empreendedor como instituição-chave de sua estratégia de desenvolvimento. A discussão subsequente explora o conceito de Estado Empreendedor dentro de uma abordagem analítica amparada nas ideias de Schumpeter, Keynes, e Minsky. A conclusão é de que ambos, a abordagem e o conceito, são particularmente adequados para a compreensão da trajetória recente de desenvolvimento da China. Embora apoiado em exemplos e considerações históricas, esse é um trabalho de corte analítico, e não descritivo.

PALAVRAS-CHAVE: China; estado; sistema financeiro; Schumpeter; Keynes; Minsky.

ABSTRACT: The paper's central claim is that China's speed and ability to leapfrog its peers in the last three decades stems, largely, from the fact that it is a fully developed Entrepreneurial State (ES). The discussion seeks to dig deeper on ES as a bridging concept that fits well with the Schumpeter-Keynes-Minsky analytical framework and one that is particularly appropriated analyzing contemporary China's development trajectory. Although rooted in a historical perspective and using historical examples, the main purpose of the paper is analytical, not descriptive.

KEYWORDS: China; state; finance; Schumpeter; Keynes; Minsky.

JEL Classification: O1; O33; O38.

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## INTRODUCTION

*“What I really suggest is that the state should assume the role of Entrepreneur-in-Chief, directing the flow of productive resources to the employments in which can best serve human needs” (H. Henderson, exchange with Keynes, 1943).*

In the ongoing debate on China and globalization, a very common question is the following: “Will China be a winner or a loser in the evolving global landscape?” The response is often [...] ultimately a loser and a host of reasons is offered to back it. The one party institutional setting, the lack of democracy (Acemoglu and Robinson, 2012), the way the financial system is organized (Walter and Howie, 2012), the failure to properly liberalize the exchange rate regime and interest rates, and so on (Pettis, 2013, ch. 4). In my attempt to address the theme, I depart from a very different perspective by suggesting a radically different question: how did China manage to become a “winner” so fast, and so many fronts? (For approaches that begin to recognize some of China’s sustainable strengths, see Berggruen and Gardels, 2013; Lee, 2012).

In 1976 the country barely managed to cover the costs of sending its highest-ranking dignitary to speak at the UN (Walter and Howie, 2012, p. 12). By 2011, it had become the second largest national economy, the largest exporter, the largest manufacturer, the possessor of the world’s largest current account surplus<sup>1</sup>, and the holder of the biggest amount of foreign reserves. In fact China is said to be currently the US’s “banker” (World Bank, 2012, p. 25, Tselichtchev, 2012).

China also exhibits the fastest rate of growth of any nations over the past two decades, an extremely fast rate of technological upgrading (Keidel, 2007, 2011, Gallagher and Porzecanski, 2010, ch. 4) and one of the most successful set of policies for poverty alleviation, which allows it to take millions above the poverty line every year. In one sentence: China has become an economic superpower. It did not “catch-up” with the west. It leapfrogged<sup>2</sup>. In addition, let me recall that the country is already a nuclear power and has veto power at the UN Security Council<sup>3</sup>.

To answer the question of how did all this happen is well beyond the purpose

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<sup>1</sup> Direct investment overseas by Chinese companies has increased from just \$ 5.5 bn in 2004 to \$ 56.5 bn in 2009. About 70 per cent of the money invested in 2010 went to other parts of Asia. Latin America came in second place with 15 per cent (“The China Cycle” FT. 09.13.2010.)

<sup>2</sup> For a discussion, from an evolutionary perspective, of the pertinence of using that concept instead of “catch-up”, see Burlamaqui and Kattel (2014) and Gerschenkron (1962) for historical illustrations of leapfrogging without using the concept.

<sup>3</sup> And this whole scale structural transformation went beyond dry economic statistics: when deplaning in Beijing for the 2008 Olympic Games, McGregor recounts, the *New York Times* architecture writer, Nicolai Ouroussoff, compared arriving at the city’s new airport ‘to the epiphany that Adolf Loos, the

of this paper, but that's the "factual background" that I think is appropriate to use when discussing China's current situation and future prospects and the kind of institutional configuration that's likely to emerge from its successive waves of reform. The reason for that is the following: looking at China as a "big success case" (although obviously not lacking problems) invites searching for lessons instead of recommending emulation (especially of Anglo-American practices and institutions).

However, my main purpose in what follows is analytical, not descriptive, and the central claim is that China's speed and ability to leapfrog its peer-nations in the last three decades stems, largely, from the fact that it is, to use Mariana Mazzucato thoughtful approach (Mazzucato, 2013), a fully developed *Entrepreneurial State* (ES). The goal of the following pages is to dig deeper on ES as a *bridging concept* that fits well with the Schumpeter-Keynes-Minsky analytical framework, under construction<sup>4</sup>, and one that is particularly appropriated for China<sup>5</sup>.

From a theoretical point of view, China's achievements reaffirm key elements of works of Hilferding, Schumpeter, Keynes, Minsky and the "Developmental State" approach to economic analysis and public policy. Some of those features are well known: The centrality of credit for innovation and development (instead of "savings"), the key role of the State in steering and governing the development process (instead of "free markets"), the strategic role of investment-development banks to provide the necessary funding, and the functionality of *financial restraint* to avoid the buildup of "financial casinos" (for the last point, see Hellman, Murdock and Stiglitz, 1996; Bresser-Pereira, 2010).

China's development trajectory has them all. Briefly discussed below, they point towards a two folded conclusion: First, it suggests that *the concept* of Entrepreneurial State should synthesize three core elements: a) a "Hilferding-Schumpeter's" type of banking system; b) an extension, to the State, of Schumpeter's entrepreneur-

Viennese architect, experienced in New York more than a century ago. He had crossed the threshold into the future' (2010, pp. 529-531).

<sup>4</sup> See <<http://marianamazucato.com/projects/inet/>>

<sup>5</sup> The reviewer's comments, alluded above, raised the need for a clarification here. The comment is reproduced as follows: "to pinpoint the visible hand of the state in strategizing outcomes and to direct finance towards those outcomes as the key factor behind China's rise is not only too simplistic, but probably incomplete" [...] to which is added " [...] my own experience with China would see its rise as being due to low level industrialization (1979 onwards, via Special Economic Zones, where labor is "exploited" to its maximum value), whereupon Chinese industrial enterprises can learn technology cheaply, whereupon China becomes the "world's factory [...]". The clarification is that I don't disagree with the referee's statement. The Special Economic Zones and labor "exploitation" have certainly played an important role in China's rising as an industrial power. My point, however, is to concentrate on something scarcely researched so far: to draw on the nature of China's state capabilities from a theoretical perspective and move them to the front of the debate on how the country managed not only to "catch-up" with its competitors, but to leapfrog them. In addition, just to try linking my own assessment with the reviewer: The Special Economic Zones where certainly a very important element in that process. However, who instituted them? The State. My guess is that in a debate we would end in a convergence mode rather than in a disagreement.

ial function; and c) the presence of a robust degree of socialization of investment as stated by Keynes in the General Theory (1936, ch.24), by Schumpeter in his characterization of “socialism” (1942, part 3), and in Minsky’s “Big-Government plus Big-Bank policy prescriptions (1986, part 5) . The second conclusion is that the Chinese State encapsulates all three dimensions and therefore should be taken as the prototype of a developed Entrepreneurial State. These are admittedly bold propositions, which should invite further debate and discussion.

## CONCEPTUALIZING THE ENTREPRENEURIAL STATE

*“A context of deliberately created stability achieved by risk-spreading mechanisms [...] can facilitate industrial deepening, export expansion, and political compromises to share adjustment costs. [...] Unassisted entrepreneurs may not have either the foresight or the access to capital to follow long-term prospects. Their decisions may lock in the country into a specialization in industries with inferior prospects” (Wade, 1990).*

Wade’s model was Taiwan. Continental China followed the path, and went further. Concerning ES’s first element: from a “macrofinancial” perspective, China is *Minsky on Steroids*. To be more precise, of what Minsky characterized, echoing Hilferding, as a (reinvigorated) form of *Finance Capitalism*<sup>6</sup>; a financial system dominated by universal banks with close ties with commerce and, especially, industry, and *geared towards finance for development* (Hilferding, 1981[1910]; Minsky, 1978, 1992, 1996; Wray, 2010, for a discussion of Minsky’s analysis)<sup>7</sup>. A universal bank model combines commercial banking and investment banking functions in a financial institution that provides both short term lending and long term funding of the operations of firms. It issues liabilities, including demand deposits, to households and buys the stocks and bonds of firms. It might also provide a variety of other financial services, including mortgage lending, retail brokering, and insurance<sup>8</sup>.

If accessed through its finance-investment behavior, China’s banking system — the “Big 4” banks plus China’s Development Bank and their SIV’s ramifications

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<sup>6</sup> As opposed to a “money manager capitalism” where the value-extraction component of finance went much beyond its value-creation dimension.

<sup>7</sup> Minsky treated these as “phases of capitalism” instead of *varieties*. According to him, that phase of finance capitalism collapsed in the Great Depression. What emerged afterwards was a new stage of capitalism: managerial welfare-state capitalism (Minsky, 1992; Wray, 2010). I don’t agree with that taxonomy. It is very much US-rooted. A state-led variety of “Finance capitalism” resurfaced in Asia and was a key feature of the “Asian miracles”. China is the latest example of that pattern (on steroids).

<sup>8</sup> From the nineteenth century to WWII, Germany had in its own Big 4’s. The “4 Ds”: Deutsche, Dresdner, Darmstader and Disconto (Hilferding, 1981 [1910]; Landes, 1969, ch. 5).

— is, the newest incarnation of the Hilferding-Schumpeter’s model of Finance Capitalism. The especially “Minskyian” traces in the model are the pervasiveness of *speculative finance*, the buildup of situations of “financial fragility”, but also the presence of a “Big Bank” and of robust financial governance<sup>9</sup>. Public ownership of the main banks is a new feature in that financial design. An important point to stress here is that *animal spirits* in the Hilferding-Schumpeter’s model come largely from the investment banks. It is their money, not the entrepreneur, which is at stake. In the Developmental-State version, they shift to the Government producing a clear case of “Socialization of investment”, an issue I will address below.

The second element backing up the ES concept points to an obvious and badly needed extension of Schumpeter’s theoretical approach: to the State. The state is, more often than not, an entrepreneur and should be at the center of a theory of economic development. An institution that combines the functions of *macro-strategist* (managing interest and exchange rates, capital flows and price and financial stability); *venture capitalist in chief* (forging and funding industrial, innovation and technology policies) and *creative destruction management* (stimulating the creative part of the process in order to speed productivity enhancement and innovation diffusion and acting as a buffer to its destructive dimension) clearly “qualifies” as entrepreneurial<sup>10</sup>. In fact, the Developmental States – especially in their Asian incarnations – and the National Security State in the US – *are different forms of a “Schumpeterian- or Innovation- State”*<sup>11</sup>.

The third element for structuring the concept of ES is the presence of a robust degree of socialization of investment. As stated by Keynes in GT’s last chapter:

“The State will have to exercise a guiding influence on the propensity to consume partly through its scheme of taxation, partly by fixing the rate of interest, and partly, perhaps, in other ways. Furthermore, it seems unlikely that the influence of banking policy on the rate of interest will be sufficient by itself to determine an optimum rate of investment. I conceive, therefore, that a somewhat comprehensive socialization of investment will prove the only means of securing an approximation to full employment; though this need not exclude all manner of compromises and of devices by which public authority will co-operate with private initiative” (Keynes, 1936, pp. 377-8).

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<sup>9</sup> Which were not in Hilferding’s model.

<sup>10</sup> See Ruttan (2006), Block and Keller (2011), Mazzucato (2013) and Weiss (2014) for complementary analyses of the US case, the whole literature on the developmental state for Asia’s cases (for instance: Johnson, 1982; Wade, 1990; Vogel, 2011; Kim and Vogel, (eds.) 2011, and Musacchio and Lazzarini, 2014, for Brazil).

<sup>11</sup> See Lundvall (1992) and Nelson (1993) for attempts to fill that gap, but the emphasis is mostly on “Collective entrepreneurship” – Lundvall – and “the institutions and mechanisms supporting technical innovation [...] in various countries – Nelson. The state is there, but not front and center.

Keynes's central message for conceptualizing the Entrepreneurial State, I suggest, is that it should extend itself much beyond the "Schumpeterian dimensions" (finance, innovation and creative-destruction management). Income distribution, employment, regulation and public-private partnerships were already at the core of his *vision*. However, the relevant, and scarcely noticed, fact I would like to call the reader's attention to for the purposes of the following discussion, is the close resemblance between Keynes's idea of socialization of investment and Schumpeter's discussion of "Socialism". Schumpeter's broad – and unconventional – description of Socialism (Schumpeter, 1942, cha. 16-7) provides us with a concrete illustration of his arguments that "Socialism" *can* work and *can* beat "Capitalism" on the grounds of conflict management and economic efficiency. Take China as the materialization of the Keynes-Schumpeter concepts of socialization of investment /Socialism and perceive what a good fit it provides.

Schumpeter begins his analysis with a, well-known, rhetorical question: Can Socialism work? His answer is "of course it can" (1942, p. 167). However, Schumpeter's definition of socialism does not focus on *statisation* of the means of production nor on the eradication of private property, but rather on *their socialisation*, which involves essentially *redesigning the frontiers and modes of interaction between the private and public spheres*<sup>12</sup>. In his own words:

"By socialist society we shall designate an institutional pattern in which the control over means of production and over production itself is vested with a central authority – or, as we may say, in which, as a matter of principle, the economic affairs of society belong to the public and not to the private sphere" (1942, p. 168).

The core concept in the definition is *control* by a central authority. Translating it to China, the Communist Party's Politburo Standing Committee provides a perfect fit. The author also does not mention absence of private property that could, and should exist. About the day-to-day operations of that system, "regulated managerial freedom" should be the norm:

"There may also be a supervising and checking authority – a kind of *cour des comptes* that could conceivably even have the right to veto particular decisions. As regards the second point, some freedom of action must be left, and almost any amount of freedom might be left, to the "men on the spot," say, the managers of the individual industries or plants. For the moment, I will make the bold assumption that the rational amount of freedom is experimentally found and actually granted so that efficiency suffers neither from the unbridled ambitions of subordi-

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<sup>12</sup> This discussion elaborates on material from Burlamaqui (2000).

nates nor from the piling up on the desk of the minister of reports and unanswered questions” (Schumpeter, 1942, p. 168).

Thirdly, the innovative process could be *co-ordinated* taking into account *timing and locational considerations*. In the process of creative destruction, *creation* would be performed in a *co-ordinated* manner and *destruction* by means of *exit policies*:

“[...] the planning of progress, in particular the systematic co-ordination and the orderly distribution in time of new ventures in all lines would be incomparably more effective in the prevention of bursts ... and of depressive reactions [...] than any automatic or manipulative variations of the interest rate or the supply of credit can be [...] And the process of discarding the obsolete, that in capitalism – specially in competitive capitalism – means paralysis and losses that are in part functionless could be reduced to what discarding the obsolete actually conveys to the layman’s mind within a comprehensive plan providing in advance for the shifting to other uses of the non-obsolete complements of the obsolete plants or pieces of equipment” (Ibid., p. 200, my italics).

Fourthly, the relation between *technological change* and *employment* could be also rationalised by co-ordination policies so that it would be possible to “re-direct the men to other employments which, if planning lives up to its possibilities at all might in each case be waiting for them” (Ibid., p. 201). Finally, the *resistance to changes* could be “strongly discouraged”, and consequently the *promotion of innovations* would be operated in a quicker and more rational way.

McGregor (2010) gives a good example, which sums up the whole picture:

“Most foreigners dealing with large Chinese state companies in the early days of economic reform – he writes – felt much like the Japanese executives from the giant Mitsubishi conglomerate negotiating to build a power plant for Baoshan Steel [...] The Japanese were aggrieved when the Chinese side got the better of them during the talks and they were forced into concessions. ‘Yes, you win the negotiations,’ the Mitsubishi executives exclaimed. ‘But it was your national team fighting our company team!’ Chen Jinhua, a titan of state industry who recounted this story in his biography, said the Japanese were right. ‘We had invited many capable experts from China’s electrical power system to join our negotiating team, but Mitsubishi, as a single company, had been unable to do so,’ Chen wrote. ‘This example showed the superiority of our wide socialist co-operation’ (McGregor, 2010, pp. 1155-61, my italics).

## THE ENTREPRENEURIAL STATE IN FINANCE

*“The money market is always, as it were, the headquarters of the capitalist system, from which orders go out to individual divisions and that which is debated and decided there is always in essence the settlement of plans for further development” (Schumpeter, 1912,Ch.3).*

China’s development trajectory fully supports Schumpeter’s statement, which is clearly a forerunner of Minsky’s “Wall-Street paradigm”. However, the first fact to register when looking at the Chinese financial sector is that the state and publicly owned banks are by large and far the biggest players:

Figure 1: Relative holdings of financial assets in China, FY2010 (RMB trillion)

RMB trillion	2006	2007	2008	2009	2010	2010 US\$ trillion
PBOC	12,86	16,91	20,70	22,75	25,93	3,9
Public Banks	43,95	52,6	62,39	79,51	95,3	14,4
Securities companies*	1,6	4,98	1,19	2,03	1,97	0,3
Insurance companies*	1,97	2,9	3,34	4,06	5,05	0,8
Σ	60,38	77,39	87,62	108,35	128,25	19,4

Note: \*Includes brokerages and fund management companies.

Source: Walter and Howie, 2012, p. 806, Table 5.

The framework of China’s current financial system was set in the early 1990s. The process of establishing a legal framework for these reforms gathered momentum with the passage by the National People’s Congress (NPC) of a central bank law, a commercial bank law and a company law. China in the mid-1990s created the so-called policy banks, for agriculture, foreign trade and domestic infrastructure, as a way of relieving commercial banks of the burden of making government policy-directed loans- which continued on a large scale nevertheless (Keidel, 2007, p. 1). As for financial regulation, the Chinese system is lean and quite straightforward. The financial sector is regulated by one bank – the People’s Bank of China (PBOC, the central bank<sup>13</sup>) and three commissions: the regulatory commissions for banking, securities and insurance.

The banking sector falls under the supervision of the People’s Bank of China and the China Banking Regulatory Commission (Cousin, 2011, p. 21). The China Banking Regulatory Commission (CBRC) was established in March 2003 with the aim of increasing the independence of the central bank and, especially, making the regulatory function of financial institutions more robust. The CBRC is the supervi-

<sup>13</sup> Founded in 1948.

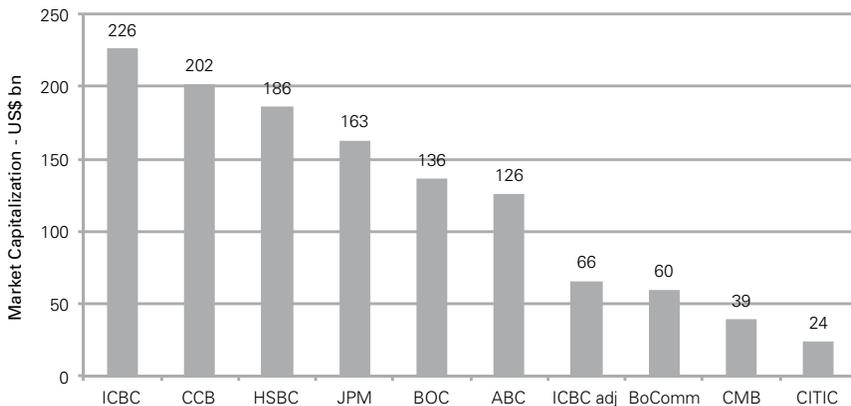
sor of financial institutions *under the leadership of the State Council*. It turned to be a key player in the guidance of the financial system through reform and recapitalization after the Asian Crisis and, even more, in preventing China’s financial system from diving into the kind of “casino capitalism” that was growing in the US and all over Europe since the eighties<sup>14</sup>. Lardy affirms this very clearly:

“Most obviously, since China’s financial regulatory agencies had steadfastly refused to permit the creation of complex derivative products in the domestic market and severely limited financial institutions’ exposure to foreign sources of these products, Chinese financial institutions had little exposure to toxic financial assets” (2011, pp. 452-4).

In fact, when in the summer of 2008, a small group of foreign “financial experts” headed to China to give financial advice, Wang Qishan, the vice-premier in charge of China’s financial sector, quickly made it clear that China had little to learn from the visitors about its financial system. His message concisely: “You have your way. We have our way. And our way is right!” (Mc Gregor, 2010, pp. 51-2). In the same vein, Chen Yuan, the celebrated chair of China’s Development Bank was thinking along these lines when he declared, in July 2009, “[We] should not bring that American stuff and use it in China. Rather, we should develop around our own needs and build our own banking system” (Yuan quoted by Walter and Howie, 2012, p. 27).

They had a point. If we look at Chinese Banks’s capitalization and non-performing loans at the height of the crisis (compared to JP Morgan, the go-to bank for the Obama administration), the data speak for itself.

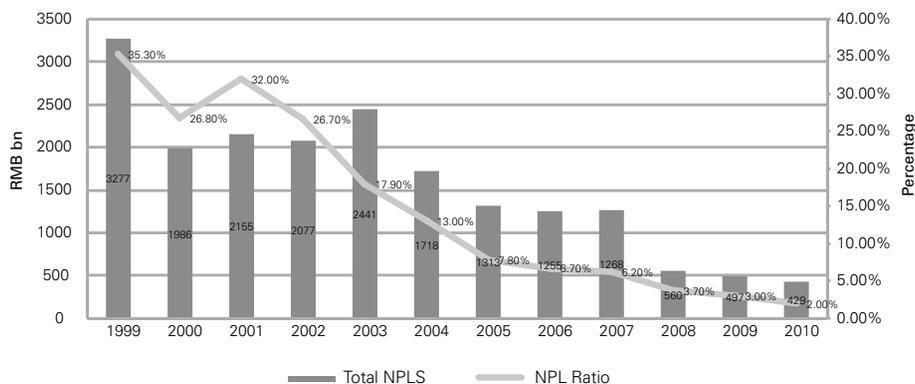
Figure 2: Chinese Bank’s Capitalization Compared with J P Morgan (JPM) in 2010



Source: Walter and Howie, 201, p. 1069

<sup>14</sup> When the savings-and-loan fiasco erupted in the US.

Figure 3: Non-Performing Loans of Top Chinese Banks: 1999-2010



Source: Walter and Howie, 2012, p. 1114

This provides a snapshot what “socialization of finance” (Schumpeter’s style) can produce by combining robust financial regulation with countercyclical measures and a strategic stimulus package (Keynes and Minsky)<sup>15</sup>.

However, the most *entrepreneurial* player in China’s finance is China’s Development Bank (CDB). Sanderson and Forsythe put it concisely: “In one decade, CDB has become the financial enabler of both China’s global expansion and domestic boom” (2013, Introduction).

With that strong statement, the authors begin their analysis of what they claim to be “the core of China’s state capitalism” [...] “A system of government-controlled banks and companies that many development countries see as an alternative to a more free market-focused system” (Ibid.). Founded in 1994, with “global operations springing from Asia to Africa and Latin-America” (more on that in the third section below), with total assets of almost 1 trillion dollars and a non-performing loan ratio of 0.4% by the end of 2010, CDB is in fact the “pilot agency” of China’s aggressive financial diversification in the last ten to fifteen years. In 2011 CDB had a loan portfolio of around US\$ 884 billion and “a business presence in 116 economies around the globe (Yuan, 2012, Chairman’s message for the 2011 CDB Annual Report, <<http://www.cdb.com.cn/english/Column.asp>>).

CDB’s hallmark financial innovation was the system of local government finance, which transformed China’s landscape in just over a decade. To understand this innovation, I have to recount the reversal of one of the core principles of the Communist Revolution: the redistribution of land from rich property owners to landless peasants. Between 1996 and 1997, as the Asian crisis started, countercyclical spending on infrastructure in China doubled, and by 2002, it had risen by nearly three times.

<sup>15</sup> For a comprehensive analysis of China’s response to the financial crisis, see Lardy (2011).

This massive urbanization was a sensible response to collapsing “global demand”, an event that would be repeated in 2008-09. However, it came with a serious downside, requiring a re-appropriation of land by the state as a condition to create “development zones” where bullet trains, sports complexes, shopping malls, apartment blocks and all kinds of urban facilities were produced/erected at a very fast pace. This re-appropriation of land was the equivalent of a vast *enclosure movement* where millions of peasants were obliged to leave their land in order to give way to urban expansion<sup>16</sup>. This growth spurt of urban construction required finance and funding in large scale, but there was still a problem to solve. In 1994, China’s premier Zu Ronjin cut local governments off from direct borrowing due to spiraling inflation. In the words of Chen Yuan<sup>17</sup>, “While our national government enjoys virtually unlimited credit, the initiators of urbanization projects, local governments, have little” (<<http://www.cdb.com.cn/english/NewsInfo.asp>>, and Sanderson and Forsythe, 2013). Here, CDB enters the scene. The bank is funded by treasury bonds, which are typically bought by China’s commercial banks, and had no difficulty in giving seed money to local governments to *start* the projects. However, more credit would have to follow in order to provide for the full funding of the projects. Collateral was the problem to solve.

Here, Yuan’s entrepreneurial vision coupled with CDB’s *innovation* solved it. Yuan knew that urbanization would vastly increase land’s prices and land was, now, in the hands of local governments, which meant the local governments were sitting into a potential “gold mine”. The innovation was the local-government financing vehicle (LGFV), a public SIV. A company set up by local governments to allow them to spend beyond the limits of their budgets (Sanderson and Forsythe, 2013). They would get *additional* money from CDB *but through* LGFVs, giving land as collateral, collateral whose value was bound to increase *because of investments made possible by the bank’s strategy*. Higher land prices would mean more local government income; hence, more room for loans – and spending.

This was a self-fulfilling strategy, a type of financial operation already devised by Soros (1987) who pointed out that the willingness of a bank to finance an investment project has a direct impact on its viability and thus, on its returns, and therefore, on its price (Kregel, 2001). It was also a Schumpeterian one where credit allowed investment to occur, raised the collateral’s value and, as the investment matured, generated the cash-flows to repay the loan. The “Wuhu Model”, as it was labeled<sup>18</sup>, worked. As Sanderson and Forsythe recount it: “[this system] managed

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<sup>16</sup> They received compensation, but well below their market value and especially to their “expected future value” once urbanization was in place. Of course if we stay within this somewhat *Marxist* way of looking at the picture, the same stroke also helped produce a sizable labor force, Marx’s “industrial reserve army”, available to sell its labor force in the new factories for a very modest price by any international standard.

<sup>17</sup> Echoing one of Modern Money Theory’s key statements.

<sup>18</sup> Because it started in the city of Wuhu.

to transform a sleepy city into a bustling metropolis that today is home to one of China's most prominent car makers, Chery Automobile, which happens to be owned by one of the first LGFVs" (2013, p. 9).

Furthermore, the model's success in Wuhu was replicated across the country, with CDB lending money to LGFVs in Shanghai (home to former president Jiang Zemin), Tianjin (home to Premier Wen Jiabao) and Suzhou. The system spread across the country, and came into its own in 2008 when it helped shield China from the worst effects of the global financial crisis. Now, every province in China has set such companies to finance infrastructure investments. (Sanderson and Forsythe, 2013, pp. 9-12).

At this point, the reader should be wondering the obvious: wasn't that precisely the type of financial behavior that produced the sub-prime crisis in the US – a leveraged lending binge backed by the assumption that real estate prices would never collapse. If so, why so much enthusiasm about it? My answer to that question is no, and for several reasons, all related to the existence and course of action of the Chinese Entrepreneurial state. First, all the players involved were public entities. The loans came from public banks to local governments and had guaranties from both the People's Bank of China and the Ministry of Finance (MOF). Secondly, under those circumstances what we have is a State-sponsored – public bank's-funded expansion, which could last for a very long time. It did. The non-performing-loan rates consistently declined for the top Chinese banks between 1999 and 2010 (recall Figure 3 above).

Thirdly, in the worst-case scenario, the banks could become filled with "bad loans". Even then, they would never face credit freeze or a "let the market do its job" in the way it happened in the Lehman Brothers – difficult to understand – decision<sup>19</sup>. The banks would be recapitalized again, and the collateral would still be there, waiting for the urban migration already gaining momentum. However, that scenario never materialized. Fourthly, and critical, there was no "destructive lending" in the process: no "NINJA" loans, no synthetic layers of leverage over leverage (naked selling or derivatives such as CDO's and CDS's) piling over the loans to enhance trader's gains, and no betting against a "client" such as Goldman Sachs-ABACUS, *Paulson* style.

Finally, and most importantly, the Party treats its banks as basic utilities that provide unlimited capital to the cherished state-owned enterprises (McGregor, 2012, p. 27). Zhou Xiaochuan, a PBOC's Director has framed the purpose of the banking system straightforwardly when discussing the need for the previous banking

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<sup>19</sup> Note that after Lehman, there were many mergers and acquisitions as well as restructurings and an ocean of cash and guarantees injected by the FED and the Treasury in the US "too big to fail" banks, insurance and corporations. After Lehman, no other big institution closed in the US, supposedly the "land of the market" (see Blinder (2013) for an excellent discussion of these issues). From that perspective China's preemptive policy action of recapitalizing the banks when they needed it and then making sure that finance and funding would be there when needed was not surprising at all: as mentioned before, Big Government *plus* Big Bank *plus* industrial policy. A Keynes-Minsky-Schumpeter approach to "policy in hard times".

reforms-cum-recapitalization: “[...] China’s financial system would be a drag on its economic growth, making it impossible for the system *to service the economy and support development*” (2009, quoted by Cousin 2011, my italics).

## THE ENTREPRENEURIAL STATE AND INDUSTRIAL & TECHNOLOGY POLICY

“[The State] gave leads. It exerted pressure. It helped in various ways in financing and promoting [...] This active leadership was, of course, something very different from mere control or regulation, and also from mere conditioning” (Schumpeter, 1939, v. 2, p. 973, my emphasis).

The quote above refers to Schumpeter’s analysis of the German recovery in the thirties<sup>20</sup>. Nevertheless, he could be commenting on China’s Entrepreneurial State. China’s 12<sup>th</sup> five-year plan for 2011 to 2015 was launched in March 2011. The plan highlights the importance of the “magic seven” industries: (1) energy saving and environmental protection, (2) next-generation information technology, (3) biotechnology, (4) high-end manufacturing, (5) new energy, (6) new materials and (7) clean-energy vehicles. The plan’s objective is to “shape” those industries in order to raise their share from 3 percent to 15 percent of the economy by 2020<sup>21</sup>. No wonder that, way before the Plan’s announcement, China’s banks were already pouring money in order to fund the long-term projects whose purpose is to turn that scenario into reality.

In fact, Chinese companies have started to win first places in global markets. Huawei has overtaken Sweden’s Ericsson to become the world’s largest telecoms-equipment-maker. The company is becoming an increasingly powerful global player, capable of going head-to-head with the best in intensely competitive markets. It follows Haier, which is already the leading white-goods-maker; now Lenovo is challenging Hewlett-Packard as the world’s biggest PC-maker. Much more will follow (cf. *The Economist*, Leader, August 2012). *The Economist*’s piece also raises a key issue from the perspective of “western competitors”: “Western governments are also suspicious of the subsidies, low-interest loans and generous export

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<sup>20</sup> Before the reader jumps to political judgments here, let me make clear that Schumpeter was *not* praising Hitler in that passage, but – surprisingly for most “Schumpeterians” – a way of state directed development. In addition, let us recall that when Hitler gained power, Germany was **already** on her way to recovery and full employment – via infrastructure spending – and that the turn to militarization did not start until 1936 (cf. Tooze, 2006). As Joan Robinson has aptly put it: “Germany had already eliminated unemployment before Keynes had time to explain it” (Robinson, *Collect Works*, v. 3).

<sup>21</sup> For a thorough analysis of the plan, see “China 2030 – Building a Modern, Harmonious, and Creative High-Income Society”. The World Bank and Development Research Center of the State Council, the People’s Republic of China, 2012.

credits lavished on favored champions”. The article has the right perception. The arsenal behind China’s industrial and technology policies is formidable and to downplay it would be a huge mistake.

Take environment. In 2010, China invested some \$ 51.1 billion into clean energy, the largest investment by any country in the world. However, in 2006, four years before that record, two Chinese companies were already on the list of top-ten solar cell producers. In 2010, six made the list, according to a BNEF report<sup>22</sup>. Among them is Yingli, founded in 1998, and one of the biggest beneficiaries of CDB loans in the solar industry, borrowing at least \$ 1.7 billion in dollar-denominated loans from CDB from 2008 through early 2012<sup>23</sup>. In 2009, Yingli opened offices in New York and San Francisco; by the year’s end, it held 27 percent of the California market. China simply took over. “*In 2011, the country supplied some 72 percent of global crystalline-silicon module production, the most popular type of solar module that converts light to energy*”. (Sanderson and Forsythe, 2013, p. 150, my emphasis.) A clear and stunning case of Leapfrogging.

In fact, 2010 saw an explosion of loans to renewable energy, mostly from CDB. The bank lent \$ 14.7 billion to clean energy and other energy-saving projects. The European Investment Bank lent € 8 billion for clean energy projects in 2010; BNDES lent \$ 3.16 billion and the US Federal Financing Bank \$ 2.12 billion. In all, since 2010, CDB – alone – has made available at least \$ 47.3 billion in credit lines to support Chinese solar and wind companies (BNEF, October 2011).

Let’s return to telecom and, in particular, to Huawei. A private firm founded in 1987 with just 21,000 Yuan, a bit more than \$ 5,000 at the time, Huawei at first struggled to win customers even in China. In 2012, as mentioned, it surpassed Ericsson to become the world’s largest telecoms-equipment-maker. Now, it is a \$ 32 billion business empire with 140,000 employees, customers in 140 countries and 65% of its revenue coming from outside China. In Europe it is involved in over half of the superfast 4G telecoms networks that have been announced, and it has become a strong competitor in mobile phones, In Africa, Huawei’s cheap but effective equipment helped make the continent’s mobile-telecoms revolution possible (*The Economist*, “Huawei: The Company that Spooked the World”, August 2012).

On December 27, 2004, in Beijing, Huawei and CDB signed a \$ 10 billion agreement for overseas markets, the first of many CDB credit lines to its customers across the developing world that would allow it to gain significant market share. It also was the beginning of CDB’s support of Chinese firms to “go global.” In April 2005, Huawei and CDB signed a risk-sharing “win-win” agreement and agreed to share information on clients and projects after the loan had been dispensed. In December 2005, Vodafone Group, then the world’s largest mobile phone company, named Huawei its first Chinese-approved supplier of network equipment. Huawei’s

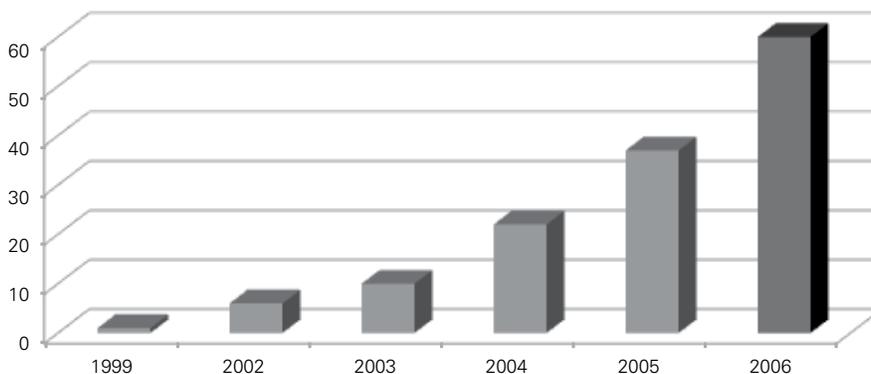
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<sup>22</sup> BNEF: Bloomberg New Energy Finance.

<sup>23</sup> When fiscal deficits were ballooning and the credit for long-term projects from private finance were frozen in most of the “North”.

road to global domination had begun<sup>24</sup> (Sanderson and Forsythe, p. 160). How did this happen? I am not aiming to provide a comprehensive answer here, but the one-liner is public funding and, ultimately, China's entrepreneurial state as the key player in forging and backing up the whole process.

Figure 4: Huawei's Overseas Sales after CDB Loan



Source: Sanderson and Forsythe, 2013, p. 162.

## CONCLUSION

There is no space for further elaboration of these points here. Nevertheless, I trust the discussion above has provided some concrete evidence to the key propositions of the paper: a) The usefulness of the Entrepreneurial State as a *bridging concept* – and the need to have it as *the* key concept of a contemporary Schumpeter-Keynes-Minsky based theory of economic change; and b) the concept's fitness to contemporary China – and to the Asian developmental states in general<sup>25</sup>. In closing, I invite the reader to evaluate China's growth path as well as its innovation pace under the Entrepreneurial State's analytical lenses. My bet is that it will throw more light than heat – although it will bring heat – to the discussion.

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<sup>24</sup> At that point, a high official of Alcatel-Lucent remembers telling his boss, the Chairman: "We won't die at the hands of Huawei; if we die, it will be at the hands of China Development Bank".

<sup>25</sup> Furthermore, I also claim its relevance to understand properly successful credit-based development-technological upgrading processes in West.

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