

China's challenge

If China is to continue its remarkable economic success of the past 30 years, it needs to tolerate and even encourage disruptive figures such as Steve Jobs. David Rowe argues that it is unclear whether the existing power structure is prepared to do so

I well remember the moment I realised the Soviet Union was destined to fail. It came upon learning that photocopiers were considered subversive devices subject to tight state control. Such controls necessarily stifle creativity and channel it in destructive directions. One of the wonders of free markets is that they provide a socially constructive outlet for the maniacal drive and obsessive focus of successful innovators.

A contrasting, seductive attraction of centrally controlled economies is that it seems a more efficient system than the messy and apparently wasteful duplication so frequently observed in free markets. Why have multiple yard maintenance or delivery services when a single, centralised service could be designed to minimise the necessary resources?

The rejoinder to this is twofold. First, 'could be designed' and 'would be designed' are very different things. The thought process that supports the subtle fallacy of centralised efficiency is a classic example of the problems that arise when thinking of human organisations in mechanical rather than biological terms. Centralised efficiency fails to materialise because lack of competition always leads to slack behaviour and a refusal to make hard decisions.

The second – and more powerful – counter-argument is that it focuses on purely static efficiency. It reasons in the context of known technology and accepted methods of accomplishing a given objective. It was Joseph Schumpeter who most powerfully illuminated the failure of this perspective. As he characterised it: "[I]n capitalist reality as distinguished from its textbook picture, it is not competition within a rigid pattern of invariant conditions,

methods of production and forms of industrial organisation which counts but the competition from the new commodity, the new technology, the new source of supply, the new type of organisation... which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives."¹

China has done a remarkable job over the past 30 years of riding the tiger of economic and political upheaval. A Chinese colleague of mine once said: "The Chinese communist party has the best personnel department in the world." This centralised, meritocratic approach to public administration has deep historical roots in China dating back to the imperial civil service examination established in the

seventh century. Impressive as the past three decades have been, however, I would argue that the hard part lies ahead.

As it emerged from the Mao era, China had huge opportunities to grow by following a pattern of investment already established in the developed industrial countries. Allocating investment in the optimal fashion was of limited importance in light of the massive opportunities to increase output by shifting labour from subsistence agriculture into more productive manufacturing activities. Manufacturing wages could be well above levels in the agricultural sector and still be highly competitive compared with those in the developed world. The perennial ingenuity and appetite for work of the Chinese people did the rest.

Looking forward, the challenges will be quite different. China's competitive wage advantage has been significantly eroded by its own success. Its future growth will be far more dependent on the type of dynamic innovation at the heart of what Schumpeter called "creative destruction". The unanswered question is whether the country's largely centralised system of bureaucratic control and state-owned enterprises will allow the forces of creative destruction to work their magic.

In May 2005, the *Wall Street Journal* published an op-ed piece by Rich Karlgaard entitled *Vladimir Ilyich Jobs*.² Karlgaard argued that Steve Jobs – the co-founder of Apple – exhibited a combination of "genius, idealism, charisma, salesmanship, obsession, paranoia and cruelty", characteristics also exhibited by other business leaders such as Howard Hughes and Henry Ford as well as history's worst tyrants such as Mao and Lenin. His point was that a free market economy allowed these potentially destructive traits to be directed into constructive and socially beneficial achievements rather than seeking influence through political power.

Figures such as Steve Jobs are inherently rebellious and disruptive. They seldom seek success through conventional channels. Open economies use these rebellious tendencies to stoke the fires of creative destruction, undermining established institutions and sustaining the innovation that drives human progress. Will China be willing to do the same, especially when powerful, state-owned enterprises are the ones being disrupted? Allowing such iconoclastic figures to pursue their unconventional path to success and economic power would require a serious adjustment to the Chinese communist party's traditional way of thinking. Necessary as this change is if China is to continue its economic success for another 30 years, it seems to me the question remains open. ■

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¹ Schumpeter J, 1975, *Capitalism, socialism and democracy* (New York: Harper, 1975) (originally published in 1942), pages 82–85

² Karlgaard R, 2005, *Vladimir Ilyich Jobs?*, *Wall Street Journal*, May 3. Also available at <http://online.wsj.com/article/0,,SB111509083186723020-email,00.html>

