

# The Allocation of Talent and Financial Development, 1897 to 1936

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The correlation between finance and economic growth is widely acknowledged in financial development literature. Yet, there is a lack of substantial empirical evidence regarding the fundamental origins of historical financial development. To address this gap, we investigate the impact of talent on financial development through an examination of a historical experiment that abruptly altered talent allocation in late Qing China.

## Historical Background

Upon its opening in 1842, China gradually developed modern finance, giving rise to numerous modern banks. Starting with the establishment of the Oriental Bank in Hong Kong by the British in 1845, the financial landscape of China underwent significant changes by 1936, with 259 Chinese banks operating in 207 cities and having 1296 branches. Different from the traditional Chinese money houses that provided small loans and other informal financial services locally, modern banks were much more professional and institutionalized in management, assembled more shareholders and capital, and operated on a greater geographic and economic scale. Accordingly, modern banking had distinct requirements for human resources.

China had in fact prepared a human capital pool for modern economic transition. China's millennium-long civil examination system had created a nationwide school system, fostering a literati class with a respect for learning. The civil examination, open to all social strata, provided a primary means of upward mobility. To ensure more chances of social mobility across regions, the Qing dynasty had assigned exam quotas to each prefecture. The number granted to each prefecture was mainly based on prefectural size and historical performance in the examinations. However, as Confucius emphasized in *The Analects*, "learning leads to officialdom," and in reality, the civil examination system directed the majority of talent towards officialdom. Consequently, before the 20th century, Chinese talent was largely absorbed into the bureaucratic system.

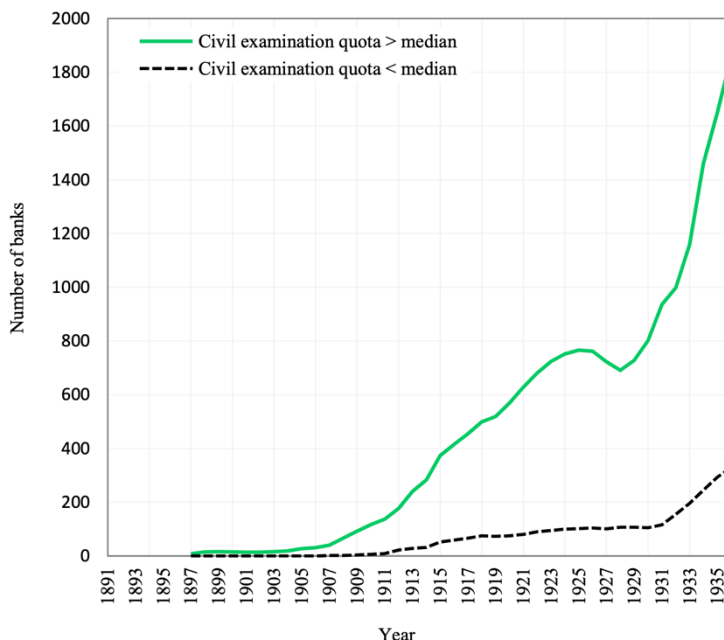


Figure 1 Growth of modern banks in China

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This talent cultivation system encountered turbulence following China's setbacks in the First Opium War in 1842 and subsequent military defeats. In 1905, the Qing government formally announced the abolition of the civil examination system, and this marked the beginning of learning from the West and the establishment of new schools. Students' goals expanded beyond government positions. The abolition not only 'pushed' students to the job market but also the modern banking sector, with its high salaries and social status, 'pulled' intellectuals. In late 19th to early 20th-century China, the rapidly industrializing nation increased the demand for funds, intensifying the need for talent.

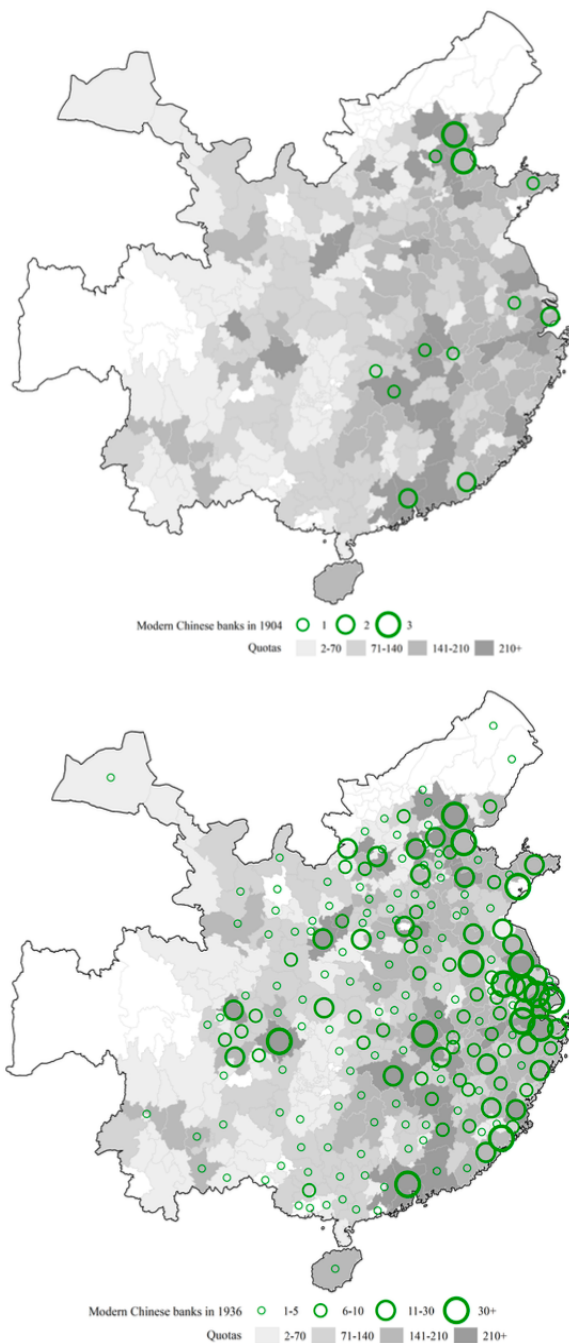


Figure 2 Distributions of civil examination quotas and modern banks. (There are 281 prefectures in the maps; these basically cover 'China proper' and exclude frontier regions that were administered outside the prefecture-county system for most or all of the Qing dynasty in 1911.)

## Key Finding

**The Data:** We gathered data on 821 modern banks from historical gazetteers and government yearbooks spanning 1897 to 1936, categorizing them annually across 281 prefectures. We measure the talent flow using the distribution of bankers between 1897 and 1936, based on the biographical records of bank board members and managers in the *Banking Yearbook* and the *Dictionary of Institutions and Peoples of Modern Banking in China*.

**First, the rise in modern banks after the abolition of the civil examination system was significantly higher in prefectures with greater civil examination quotas.** On average, doubling the number of exam quotas before 1905 resulted in a 2.36 increase in banks, translating to an almost 20 percent surge in the annual growth of the bank count after 1905.

**Second, regions with a higher count of civil examination quotas exhibited a substantial increase in the number of bankers following the abolition of the examination, indicating a shift of talent from civil service to finance.**

Doubling the quotas correlated with a 2.6 rise in bankers post the abolition. This talent reallocation trend was reinforced by students' post-examination major choices, with a significantly higher share opting for business (and finance) in regions with greater civil examination quotas.

**Third, the overall high compensation rate, prefectures with higher growth potential in finance and proximity to foreign banks are 'pull' factors directed talents to modern banking.** Notably, the impact of the examination abolition on the number of bankers in prefectures is more pronounced if these regions either had existing banks before abolition (high potential in finance) or were in closer proximity to the nearest bank.

## Policy Implication

The research findings indicate the importance of the supply of talent in modern financial development. The transition of talents from the traditional civil service system to modern banking not only did not hinder industrial growth but also spurred the adoption of advanced technologies,

contributing to overall industrial development in China. This highlights that regions with a historical surplus of talent bound by civil examinations witnessed accelerated growth and heightened productivity, particularly benefiting firms with greater external finance needs.

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