

HISTORY AND BUSINESS IN CHINA

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1. INTRODUCTION

Stock market fiasco in China – sheer incompetence.

But who are we to judge?

16 september 2008 Lehman Brothers went to the wall.

And the ensuing financial crisis is still with us.

The Chinese stock market not well developed.

More like a casino.

SHANGHAI COMPOSITE INDEX



SOURCE: WWW.TRADINGECONOMICS.COM | SHANGHAI STOCK EXCHANGE

Source: www.tradingeconomics.com

Political leadership encouraged the stock market boom.

“Look, the China Dream is coming true.”

But deeply irresponsible.

Xi Jinping himself chairs the policy-making “Deepening Reform Leadership Small Group”.

Open, fair and constructive discussion of the stock market bubble is not possible.

2. CHINA'S HISTORY AT A GLANCE

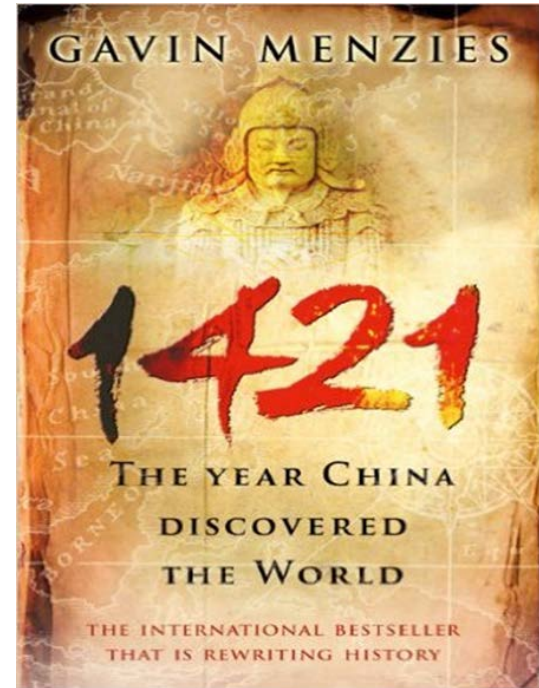
China unified in 221 BC

1421: Admiral Zheng discovered America before Columbus?

First class maritime abilities

Later, China turns inwards

The Wall is build, the ships are burnt



1793: Macartney Mission, purpose to open China for trade.
The emperor Qianlong responds in letter to King George III:

“As your Ambassador can see for himself, we possess all things. I set no value on objects strange or ingenious, and have no use for your country's manufactures.”

Mutual lack of knowledge and understanding. Still the case?

- 1839-1842: Opium war
- 1894-1895: First Chinese-Japanes war
- 1644-1912: Qing dynasty, and last emperor of China abdicates
- 1937-1945: Second Chinese-Japanese war
- 1949: Mao at the helm, the People's Republic of China (PRC) is founded
-
- 1839-1949: Hundred years of humiliation.

Chen Yun, one of the few leaders not purged under Mao:

“Had Mao died in 1956, he would have been immortal”
(before the Great Leap)

“Had he died in 1966, he would have been a great man”
(before the Cultural Revolution)

“But he died in 1976, so what can I say?”

- 1978: Deng Xiaoping in charge – Economic growth the way to renewed greatness
- 1989: Tiananmen Square incident
- 1992: Deng's southern tour – and China stays the course

- 2001: China member of WTO
- 2012: Xi Jinping becomes chairman of CCP

3. PRESENT CHALLENGES

Concept of China Dream – creating a strong and wealthy China at peace with outside powers (and, I venture, with itself).

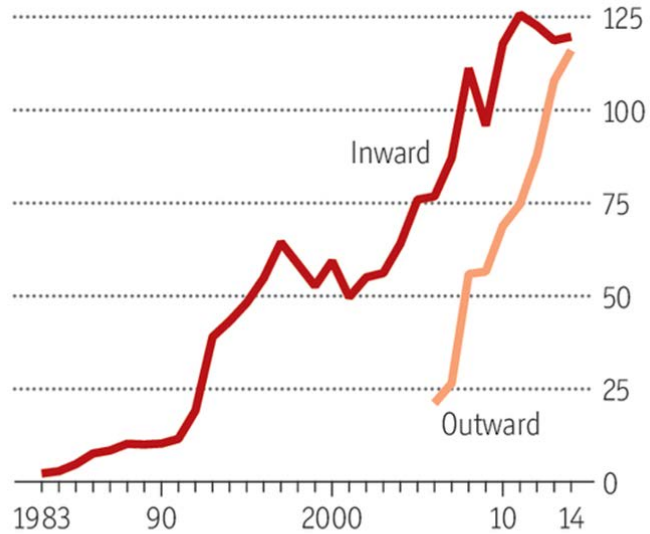
- One Belt, One Road
 - SOEs and SOBs pushed to invest overseas – infrastructure and construction
 - Outlet for vast overcapacity

- AIIB (Asian Infrastructure Investment Bank), making the US uneasy, fine with the Chinese, enjoy international cooperation with the US on the sideline (like Russia does).
- Silk Road Fund

Linking China and the Pacific with Europe, both via land and maritime routes, cf. Marshall Plan (1949-1952), trade surplus used by the US for political purposes.

Go forth

China's foreign direct investment, \$bn



Sources: MOFCOM; Rhodium Group

Economist.com

Source: www.economist.com

China's growing power creates tensions and uncertainties, e.g. the disputes over islands in the South China Sea.

Lack of real public analysis of Xi's foreign policy thinking – potential danger in disagreeing.

China's New Normal, i.e. growth rate of 5-6 %, based upon increased private consumption, of services in particular. Requires a change in income distribution. And confidence in the future.

Innovation takes centre stage

“China must rely on innovation to achieve continuous and healthy economic development”, Xi Jinping says – what does it take?

- Financial markets that allocate capital more efficiently – to the best companies, not to the best connected ones (read SOEs)
- Enforcing Rule of Law, i.e. treating all firms alike; private and public, domestic and foreign
- Encouraging competition, i.e. allowing SOEs to go bankrupt
- More open society with ideas and information floating more freely around

4. SOEs IS KEY

Arthur Kroeber (Gavekal Dragonomics): “... just walk into the street and it’s clearly a market economy. Yet in the background state intervention is pervasive.”

Need powerful connections to succeed in business.

Fierce competition in private sector.

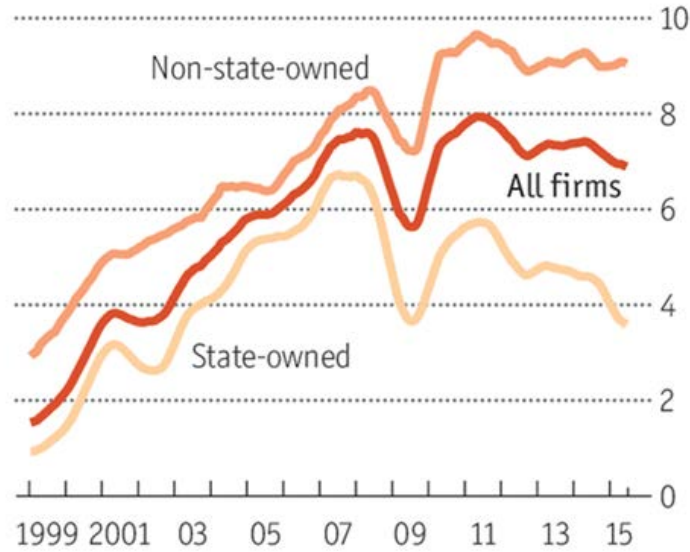
Some SOEs are more like zombie firms – but many are first class.

SOEs seldom go bankrupt and may hoard labor

- Legitimacy of present regime necessitates domestic support. Workers in SOEs provide such support.
- Incentive structure for CEOs in SOEs is such as to avoid layoffs rather than maximizing profits.

Spot the difference

Return on assets of Chinese industrial enterprises*, by ownership type, %



Sources: CEIC;
Gavekal Dragonomics

*7-month centred
moving average

Economist.com

Source: www.economist.com

SOEs quite powerful

- Ministry of Finance finds it hard to extract dividend
- SASAC – holding company for more than 100 large SOEs
- Also SOEs at local levels. i.e. at province level and further down

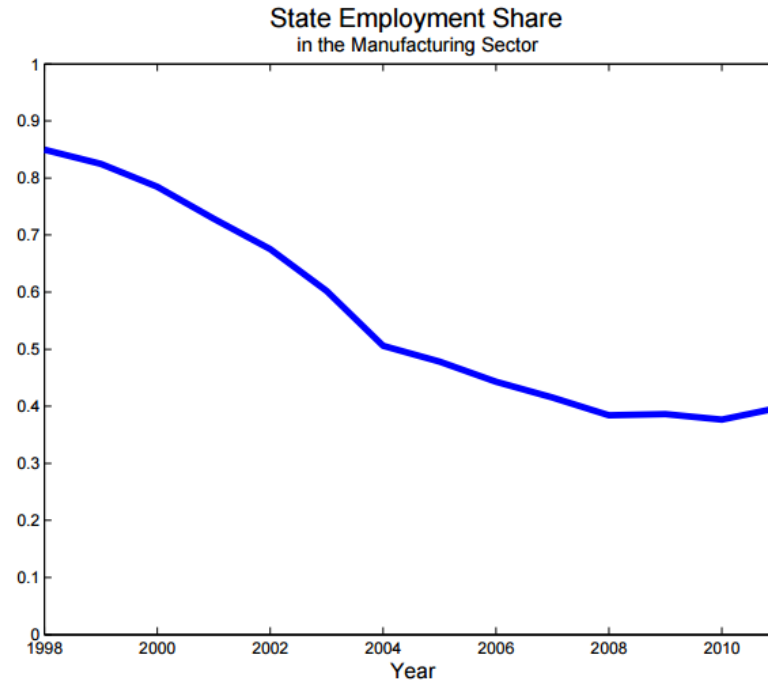
Source: www.economist.com

Close to 70 % of stock market capitalization is SOEs.
A drag on growth?

1978 – early 1990s: Reform without losers

1997 – 2003: Many losers as Zhu Rongji privatizes SOEs

Then it levels off (as Zhu leaves politics in 2002).



Source: Paper by Yikai Wang, "Will China Escape the Middle Income Trap? A Politico-economic Theory of Growth and State Capitalism".

Source: Storesletten and Zilibotti 2014

An unholy alliance between business and politics?

2001 Jiang Zemin realizes that he needs the business people for his project, China's rise.

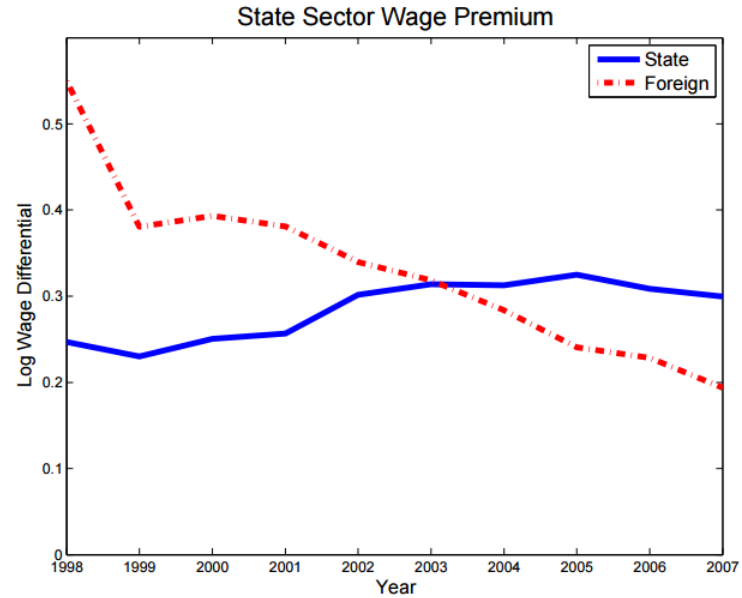
“If you need them, let them join you”, he might have said.

The Three Represents, and business people are allowed to join CCP.

Extractive political system in China

- Benefits the elite (party members, business people, and academics)
- SOE workers enjoy a wage premium – pleased with the system
- Entrepreneurs enjoy cheap labor and make good money
- Academics enjoy their work

Motivating Facts: State Wage Premium

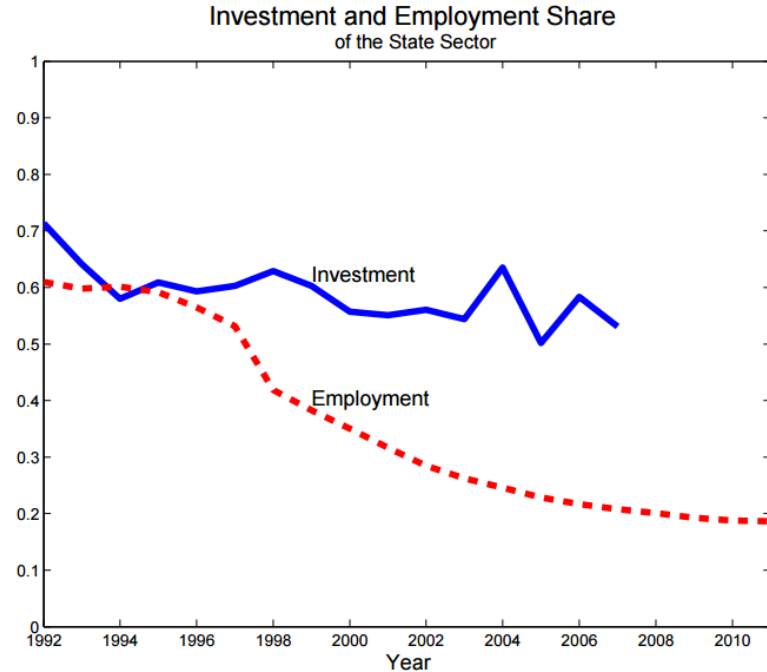


Source: Ge and Yang 2012.

Source: Paper by Yikai Wang, "Will China Escape the Middle Income Trap? A Politico-economic Theory of Growth and State Capitalism".

The State Advances as the Private Sector Retreats

Financial Repression, i.e. low or negative real return on savings, and money used to subsidize favored companies and sectors.



Source: Statistical Yearbook

Source: Paper by Yikai Wang, "Will China Escape the Middle Income Trap? A Politico-economic Theory of Growth and State Capitalism".

Two pieces of good news:

- TFP-gap between private firms and SOEs seems to be declining
- 2009, only a quarter of new loans from SOBs to private firms, whereas in 2010 – 2013, more than half

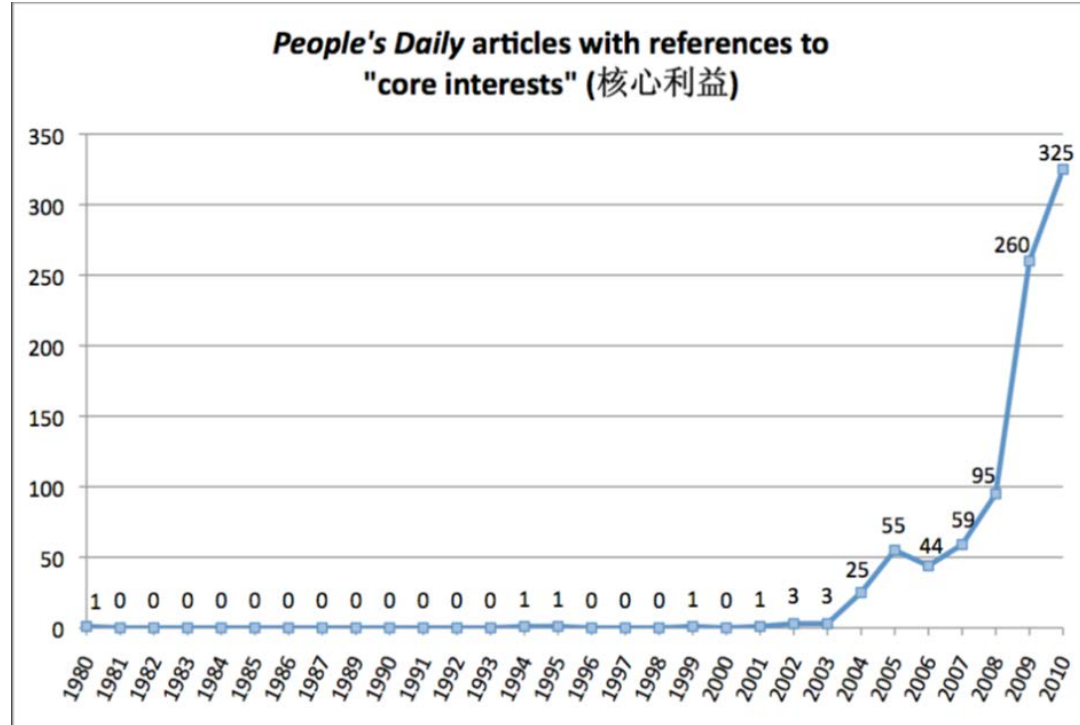
5. CHINA AT A CROSSROAD?

The Governance of China, official compilation of 79 speeches, conversations, and instructions by Xi Jinping on a wide range of topics, November 2012 – June 2014.

“... to enhance the rest of the world’s understanding of the Chinese government’s philosophy and its domestic and foreign policies.”

China must neither “seek trouble”, nor “avoid trouble”.
More provocative and assertive approach to China’s role in the world and within the Asia-Pacific region in particular.

Core interests are not for others to meddle with.



Yikai Wang: “The elite prefers to maintain a sufficiently strong state sector to guarantee political control.”

Can China live and blossom with this alliance between the political elite and business?

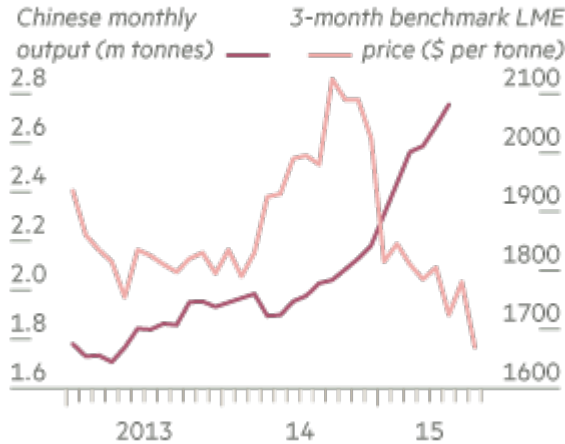
As long as growth continues, and living standards and pride both are on the increase, although income differentials remain huge, perhaps it can?

Or is China walking into The Middle Income Trap?

Appendix – China and the aluminum sector

Financial Times, Big Read. Aluminum, 11 August 2015

China drags down the aluminium market...

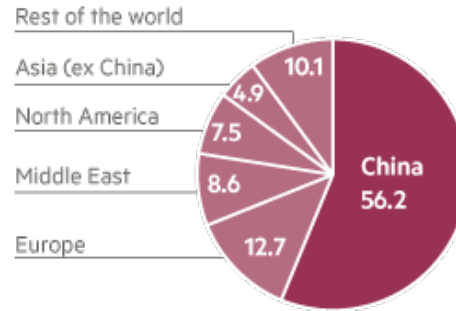


Source: Thomson Reuters Datastream

FT

...and now accounts for the majority of global supply...

June 2015 (%)



Source: The International Aluminium Institute

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...as its producers increasingly turn to exports

12-month sum (million tonnes)



Source: Haver Analytics

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