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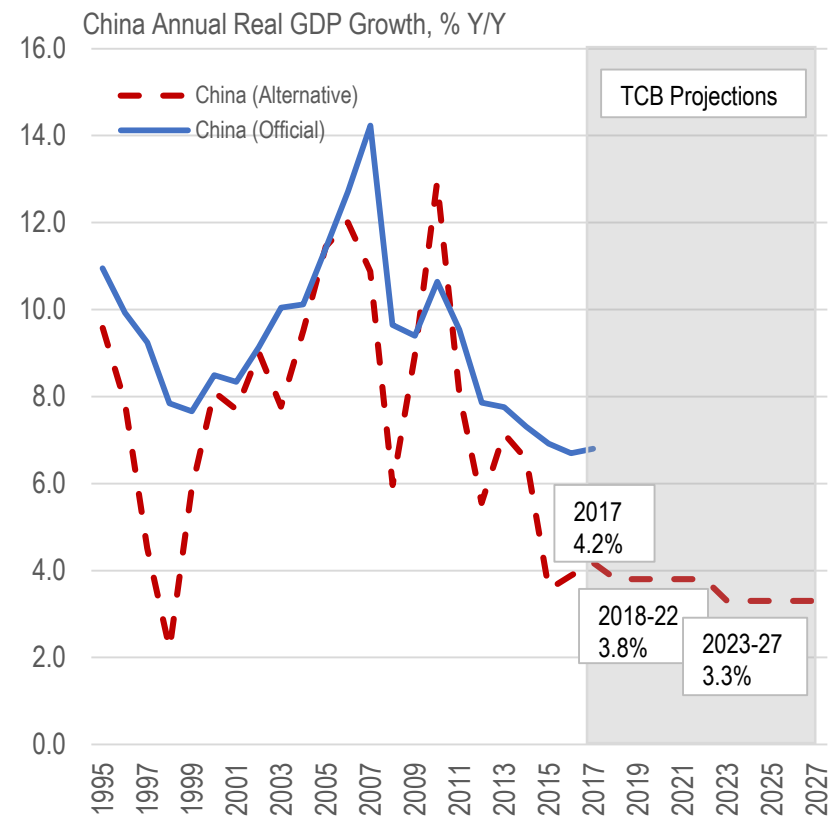
Appraising China's rise – implications for global business

January 25, 2018

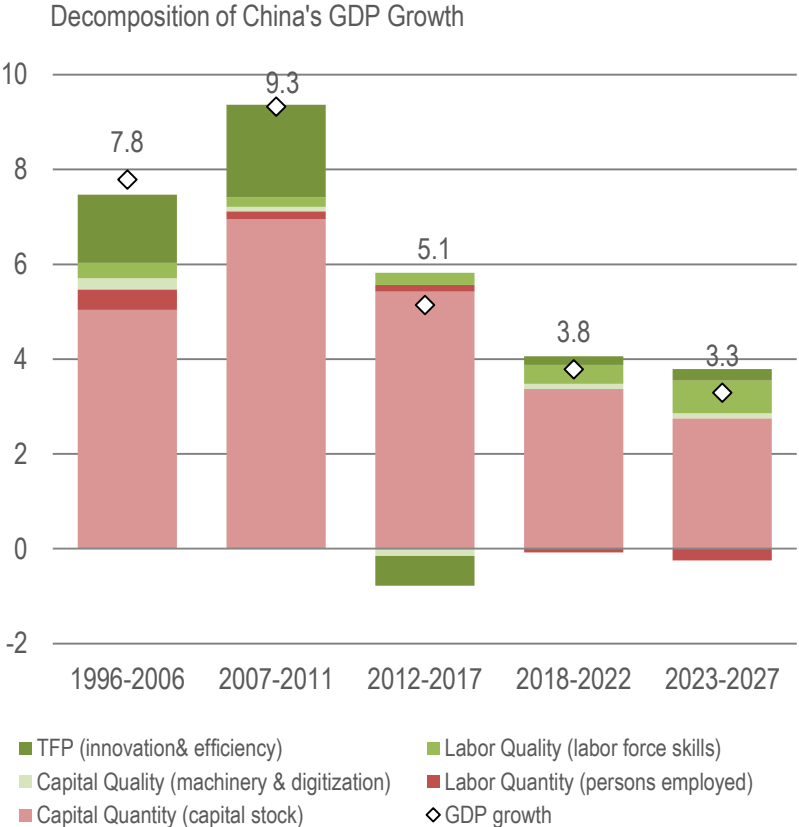
David Hoffman – david.hoffman@conference-board.org



The “long soft fall” in Chinese growth continues



Sources: NBS, The Conference Board

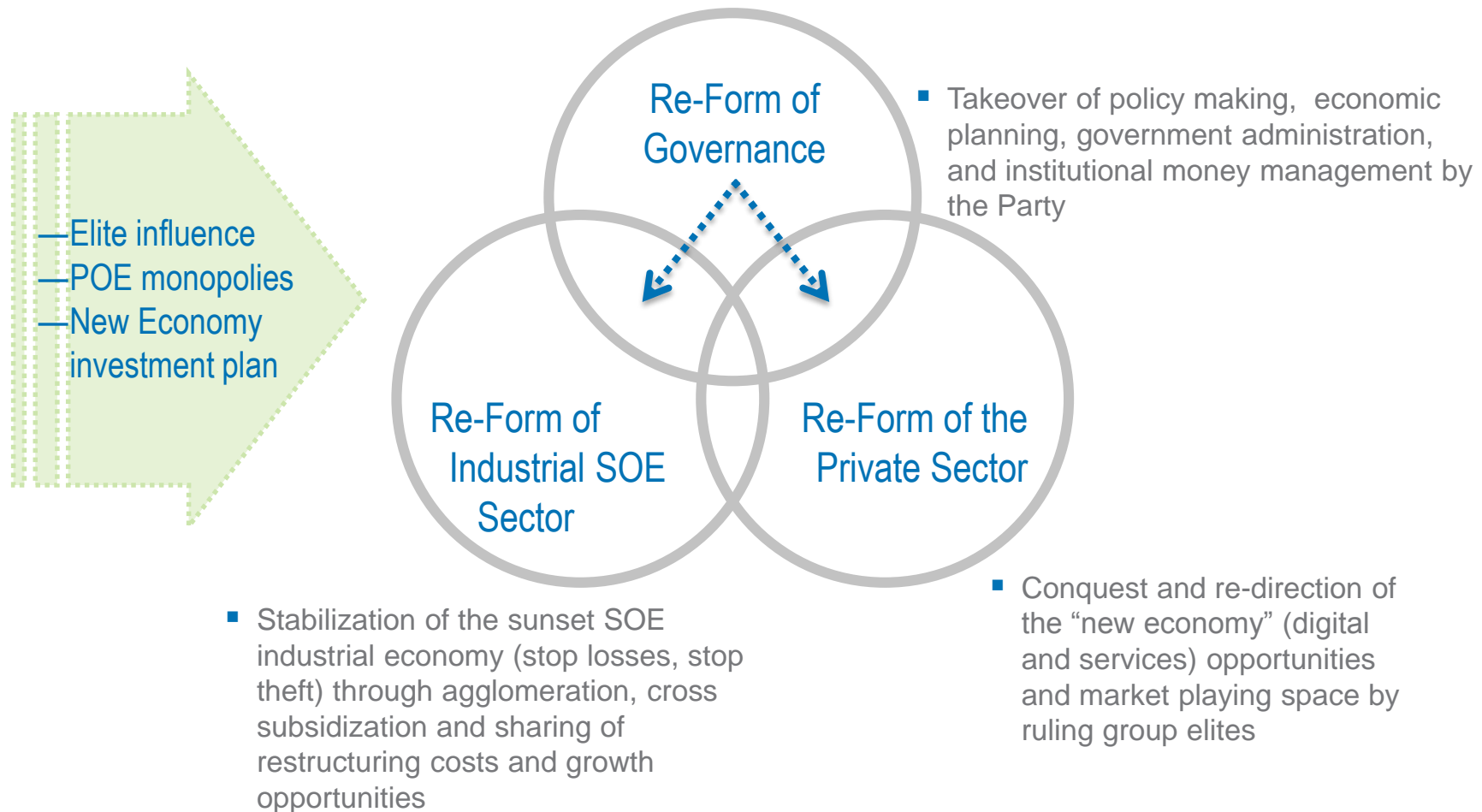


Source: The Conference Board Global Economic Outlook 2017



Instead of “reform”, we have “re-form” – an act in three parts

And all via “top-level design” and “comprehensive planning”



In essence, the 19th Party Congress affirmed trajectories that had been hardening over the last five years
Instead of “markets playing a decisive role” there’s a new political economy playbook

A Bigger, Stronger, Redder State-controlled Sector

- ✓ Ubiquitous Party oversight
- ✓ Mega-mergers to drive consolidation and regain pricing control
- ✓ New “commanding heights” – state sector entrains private sector
- ✓ Mixed-ownership re-forms to capture private sector funding channels to the benefit of the state sector

A Bird-Caged Private Sector

- ✓ Glass ceilings for foreign MNCs
- ✓ Controlled capital account
- ✓ Merging of private capital and leading private enterprises with the CCP-directed national development strategy



A Politicized and Responsive Party-State

- ✓ Party over Government
- ✓ Leninist discipline over cadres
- ✓ Centralized and top-down policy-making via Leading Small Groups
- ✓ “Politics in command” trumps economic concerns

Super-sized, super-scaled industrial planning

- ✓ Belt and Road Initiative
- ✓ Made in China 2025
- ✓ New Economy
- ✓ 13th 5-year Plan
- ✓ Strategic emerging industries
- ✓ Supply Side Structural Reform
- ✓ Xiong'an New Area and other regional development plans...



The projection of great power status is a big part of the plan

Over the last several years, China has greatly stepped up its role as a major “geo-economic” actor

Features of the Chinese system that make it a very different kind of geo-economic player –

- ✓ Long-term guiding goals – “overtake the US as leading global power” – and with clearly expressed non-convergence with Western, liberal democratic and institutional norms
- ✓ Unmatched degree of central control and bureaucratic coordination
- ✓ Unmatched degree of ideological unity (especially amongst ruling group)
- ✓ Willingness to overtly and covertly use statist tools; highly skilled at usage
- ✓ Willingness to overtly and covertly use propaganda tools; highly skilled at usage
- ✓ **Ability to recognize the criticality of timing and move quickly vis-à-vis windows of opportunity...**

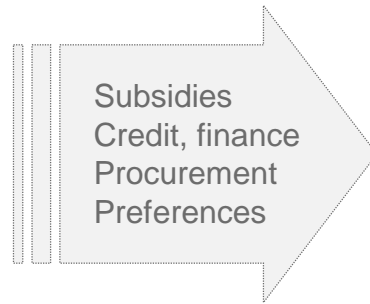
China's Geo-Economic Levers



All of these features have been greatly amplified and more precisely directed by the current leader and his ruling group



This necessarily involves the export of “Chinese characteristics”, globally



OBOR

- ✓ Politization of business; elite co-option
- ✓ Political influence
- ✓ Resource acquisition
- ✓ Chinese enterprise privilege
- ✓ Control weaknesses – product safety, environmental performance

Capital Markets

- ✓ Reporting and insider trading laxity
- ✓ Capital resource extraction
- ✓ Ownership obfuscation
- ✓ Bubble making; value destruction



Next-Gen Manufacturing

- ✓ IP devaluation
- ✓ Ecosystem control
- ✓ Super-scaling in new high-value export segments – commoditization, price stability, overcapacity....

ICT and New Economy

- ✓ Internet sovereignty
- ✓ Cybersecurity
- ✓ Cryptocurrency and Blockchain dominance
- ✓ State information control and big data intervention
- ✓ Payment system monopolies (CIPS)



The emerging outbound industrial development blueprint

Policy Constructs

- One voice; full bureaucratic alignment
- Top-level design and comprehensive planning
- Detailed policy guidelines and plans
 - e.g. Outbound Foreign Investment Catalog; Industry Association position papers

Assumed Objectives

- Stabilize, sustain and make-profitable China's industrial core
- Re-nationalization to effect controlled consolidation at home – force consolidation elsewhere
- Project Chinese influence through economic bindings for political goals

Tools (and their mechanics of use)

- Cartels; in-group non-market commercial dealing to make markets, undermine competition, achieve scale advantages, etc.
- State directed finance (incl/ investment funds, directed “PPP” investments)
- State subsidies
- Anti-competitive pricing and price manipulation via related parties
- Foreign policy – exclusive bi-laterals and FTAs
- Trade diplomacy to win projects and concessions, and indebt host countries
- POE capital attractors and project frontrunners
- Domestic regulatory engagement to support trade competitiveness
 - Shift cost structures, impose costs
 - AML/anti-trust use for industrial policy
- Domestic market manipulations:
 - Super-scaling via captive markets and government procurement
 - Pressuring of MNC actors
- Currency policy to support offshore M&A

Intended Outcomes

- Pricing power via economies of scale
- Vertically integrated and closed ecosystems and supply chains
- Cornered markets with high barriers to entry
- Captive profit pools
- Mandated privileged access to client country markets
- Mandated use of RMB
- Imposition of Chinese industrial-technical standards

****Circularities** – some positive outcomes strengthen tools and dominance

The New Economy sectors – under the rubric of Made in China 2025 – apply similar tools and mechanisms, but are more domestically oriented

Strategic Industrial Sectors

- | | |
|------------------------------|-----------------------|
| • Shipping, ports, logistics | • Power |
| • Ship building | • Commodities |
| • Steel, metals | • Chemicals |
| • Industrial machinery | • Telecoms / Internet |
| • Glass | • Payments |
| • Cement | |
| • Construction, engineering | • Manufacturing? |
| • Rail | |



Will China succeed - at the end of the day, it's all about confidence and China must make every effort to sustain it...

- ✓ Confidence in China's economic future
- ✓ Confidence in China's leadership capability to overcome all challenges

1. Debt burdens only implode if investors lose confidence in the ability to re-pay
2. Valuations excesses only implode if investors lose confidence in future appreciation



China Inc. is incredible and exceptional at building and maintaining investor confidence

1. Creating the message

- ✓ Visionary
- ✓ Vanguard
- ✓ Grandiose

2. Controlling the message

- ✓ The Party Line
- ✓ Leadership optics
- ✓ Information control
- ✓ Data support
- ✓ PR spin
- ✓ Reinforcing confirmation biases

Meanwhile, confidence eroding political dysfunction in the US and Europe only strengthen China's story....



The Contemporary Problems

- a. Limelight
- b. Grandiosity traps
- c. Data credulity
- d. Observable realities

**Increase the spending,
increase the volume, increase
the structural problems....**



BELT & ROAD
BIG DATA Zones MIC 2025
JIN-JING-JI SSSR EV (no-gas)
SPFTZ SDR AIIB RENEWABLE ENERGY
HSR HK-CONNECT Dalian-Yantai tunnel
CIPS Xiong'an Tibet-Xinjiang tunnel
T-FLIGHT Big Data Zones



Working assumption – economic gravity and US/EU push-back will eventually manifest to “trajectory-changing” levels

Economic Evolutions –

- The Planned Economy reversion will not succeed in reviving China’s economy
- Within the medium-term, confidence will wain as a function of:
 - ✓ Increasing debt build up
 - ✓ Non-progress on “reform”
 - ✓ Missed targets on grand plans
 - ✓ Observable economic malaise
 - ✓ Under-performance of Chinese unicorns
 - ✓ Observably more restrictive social sphere
- Capital outflow and currency devaluation pressures will resume
 - China can financially weather one more 2H15/1H16 defense



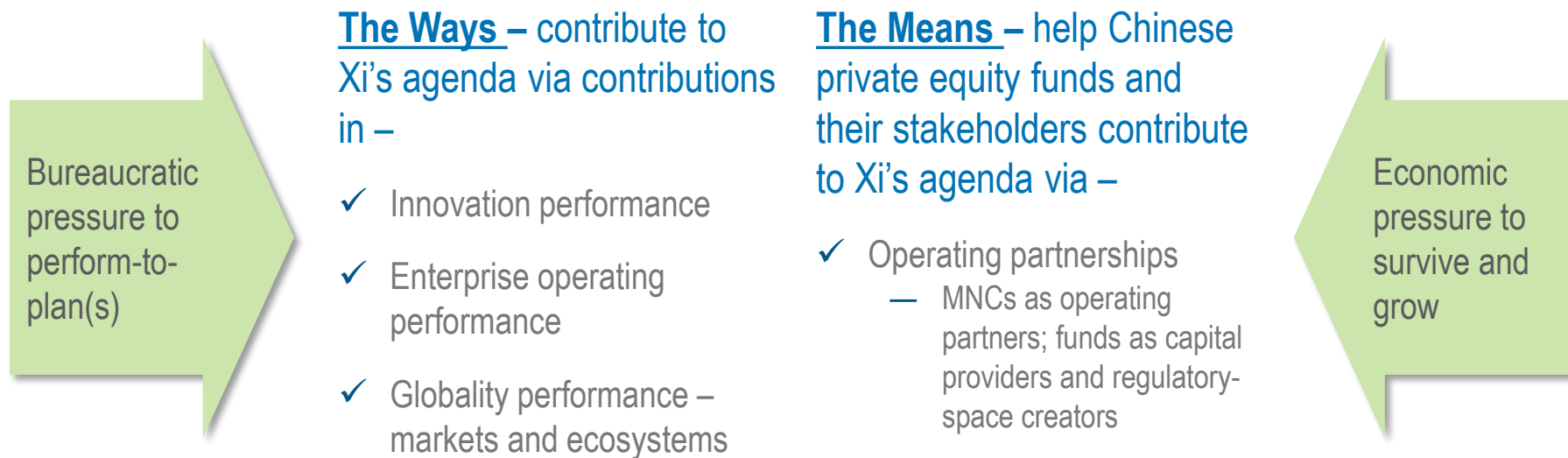
Impacts –

- The need for FDI will intensify
- The need for access to global capital markets will intensify
- Indigenous innovation won’t lead to much. China can’t divorce itself from reliance on foreign technology providers
- The need for business operating performance will intensify
- Reciprocity demands from trading partners will intensify

→ There will be a return to “reform and opening up” and to convergence



In the meantime, foreign investors must find new value propositions and partnerships...



Selected China Center member resources

For more detailed analyses of the issues, premises and theses outlined in this briefing, see:

“The Long Soft Fall in Chinese Growth – Business Realities, Risks and Opportunities” – research report ([here](#)); “Global Economic Outlook – Emerging Asia: Slowing, but still leading the way” – research report ([here](#))

“China’s Global Impact: The Business Exposures and Economic Implications of a Globalizing China” – research report ([here](#)); “Will the world change China, or will China change the world? Appraising the probabilities for external factors to shape internal dynamics” – China CEO Council workshop deck ([here](#))

“Getting through to 2022: Alignment imperatives and strategies in a digitalizing, politicizing and globalizing China – China CEO Council workshop deck ([here](#))

“New China Models – revisiting the MNC playbook for a rapidly changing China” – China CEO Council workshop deck ([here](#)); Quick Note version ([here](#))

“Another hammer in the toolkit: USTR’s Section 301 investigation buttresses accumulating US arsenal for possible economic confrontation with China” – Quick Note ([here](#)); China Center OpEd (CNBC): <https://www.cnbc.com/2017/11/07/trump-must-avoid-sparking-a-trade-war-with-china-commentary.html>

“Party Over Government - Dangjin Zhengtui 党进政退” – Quick Note ([here](#)); “Back to Basics: The CCP at 95” – Quick Note ([here](#))

“The 19th Party Congress – Where to now from here? What do 19th Party Congress precursors, meeting machinations, and proclaimed outcomes tell us about the future play-space for foreign investors in China?” – China CEO Council workshop deck ([here](#)); “The long road to the 19th Party Congress - How we got to now, and what it means for the future” – Quick Note ([here](#)); “Politics in Command: China after the 19th Party Congress” – Quick Note ([here](#)); China Center OpEd (Foreign Affairs): <https://www.foreignaffairs.com/articles/china/2017-11-14/why-xis-power-grab-will-hurt-chinas-prospects-reform?cid=int-lea&pgtype=hpg>

Non-Member Access: please contact Ethan Cramer-Flood at ethan.cramer-flood@conference-board.org





The China Center for Economics and Business

Equipping members with essential knowledge to improve business performance in China.

After some 10 years of doing joint research projects in China beginning in the 1990s, the China Center was formally established as non-profit research organization in Beijing in 2006.

The Center works to deepen understanding and improve engagement in China's socio-economic development – both for leading multinational companies operating in the China market and for leading Chinese companies now expanding into global markets.

Our explicit public purpose in China is to enhance economic, statistical, and business practice transparency in order to improve market efficiency.

In doing this – through rigorous data work, empirical research, and on-going senior-level engagement with Chinese officials and institutions – we gather unique market intelligence and generate valuable insights on China's complex and often difficult business environment to help our members develop a deep “structural understanding” of China's economy and business environment, and thereby make better business decisions.

The China Center seeks to work to improve statistical measurement, economic analysis, and business practice measurement —and through these initiatives, provide the fact-bases and metrics needed for informed debate.

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