The New China Playbook

Beyond socialism and Capitalism

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This book is about reading China in the original, coming to understand its people, economy, and government in a way that the truth is not lost in translation.

It was clear to me that sophisticated Americans possessed only Simplistic understanding of life in China.

Chinese political science textbooks were in a constant state of revision, as Marxist thought gradually morphed into “socialism with Chinese characteristics.”

This book proposes an alternative view – more nuanced, more complex and hopefully more helpful.

China continues to defy conventional wisdom- far from acting with an invisible hand to manipulate the economy behind the scenes, the state has intervened often, heavily and sometimes clumsily.

Today the private sector in China accounts for more than 60 % of national output, 70 % of the nations wealth and 80 % of Urban employment. 30 years ago it was the other way around.

Chinese economy can be called managed capitalism, mayor economy, socialism with Chinese characteristics. This model does not fit any category.

Three features make the Chinese economy:
1. mobilize collective action for the sake of the country
2.political centralization is coupled with economic decentralization and
3.it’s institutions are still nascent.

Most developing countries have neither state capacity nor good institutions. China has a strong state capacity and weak institutions, while USA has strong formal institutions and an eroding state capacity.

The combination of state guidance at the macro level and market mechanisms at the micro level, explain China’s rapid growth spurts and its technological uptake in a short period of time.

The Chinese state can scrap old rules and make new ones overnight, influence when and how firms can invest overseas, leveraging the financial system to meet a national goal.

In China, the interventionist state is rooted in paternalism, a hallmark of government in China since the Confucian times.

For the Chinese, there is little difference between state paternalism and authoritarian parenting.

Chinese always balance obligation and deference with free will.

The latest World values Survey of 2017-2020 indicates that 95 % of Chinese have significant confidence in the government, compared to 33 % in the US and 45 % as global average.

Chinas economic ambitions have extracted a high price, households were weighed down by below market wages and low returns on their savings.

China’s new playbook is based on innovation and technology, meant to be attained through self reliance and an unparalleled sense of national urgency and pride.

China’s rapid economic growth has been replaced by a burgeoning emphasis on improving the softer side of development – a cleaner environment, greater food security and a higher quality of life.

Chinese young people are big spenders, prodigious borrowers and have a knack for lifestyle consumption.

Deep down , Chinese are steeped in their own culture, bound by their own traditions and rooted in their own communities.

The power of economic growth lies in its ability to change people's lives.

China's GDP has grown 9.5 % CAGR over 40 years. In contrast America's GDP grew 4 pc per year in its best years of 1920-1970.

Good institutions need a merit based bureaucracy. China introduced a meritocratic system for bureaucrats in the third century BC.

The state in China is not supervisory and regulatory in nature, it plays a leadership role in development education and mobilization behind specific priorities.

China’s isolationism made it miss out on the industrial revolution.
By late 19 th century, the Qing dynasty found itself at the mercy of western powers.

In 1978, China was No 33 in global trade with an import plus export value of $206 billion. By 2017, China was No1 with a total value of $4.1 trillion, a 20 time increase.

In the thirty years of Chinese GDP growth, productivity accounted for half of China's growth.

Cheap credit became a drug supporting the industrial sector, and at one point served as a lifeline for the entire economy.

The recent slowdown in China is more a question of reform stalemate than it is of diminished potential.

The consumer is the first of the three primary agents in any economy, the other two being the firms and the state.

In 2012, President Xi reined in gifts for bureaucrats and government officials. Overnight, the luxury market in China dropped in segment size.

In China, the average family dedicates 25 % of their annual spending to educate one child. In America, that number is 5 %.

Families cite education cost and property costs as major impediments to raising a big family. In 2021, in response, the government closed down tutorial classes for school age children.

It is a truth that a man wanting to get married in China needs to own a house/apartment and a car.

The trade war between USA and China is one of consumption, the hyper consumption US consumer vs the underconsumption Chinese consumer. When China produces more than it can absorb domestically, it will run a trade surplus, when USA consumes more than it can produce, it runs a deficit.

Chinas corporate sector has two types of firms- SOE – State Owned Enterprises and private firms. Their perspectives are vastly different.

Symbiosis between the state and private sector can be especially useful in an economy with immature institutions and imperfect free markets.

Local governments in China can give out licenses, contracts, cheap land and direct loans from local banks.

Relationships play a key role for private enterprises.

This was the old model of state – private collusion. Call it cronyism, corruption, or the grease that lubricates the wheels of the machine of the local economy. It is take a cut from the firms in return for a helping hand.

The number of active firms doing business in China increased ninefold between 2000 and 2019. But, a more striking fact is that private owners with state connections owned about a third of the capital registered by these companies.

China’s new playbook is about balancing regulation with innovation, fairness with efficiency, transparent and clear guidelines, good communication and consistent policies.

In China foreign investment in mining, education, media, telecom and certain IT companies is restricted.

Data reveals that on average JVs perform better in China than both wholly owned subsidiaries and domestic ones.

The challenge for MNCs in China is less about policy and regulation and more about fierce domestic competition.

Domestic companies in China are going up the value chain in cosmetics and fashion which was the privy of MNCs in the past.

The requisite skills for success in China are speed, agility, awareness of local conditions, confidence balanced by humility and the ability to adapt to changing conditions.

Servility towards government is not a necessary condition for success with the new generation of Chinese entrepreneurs. They want to build better products and services and don’t want to take short cuts.

China is a ‘political economy’.
The first is the power of the state
the second is the structure of political centralization and the third is the feature of adaptability.

Chinese citizens accept the limitations on privacy with facial recognition etc. for the sense of safety provided by the highly organized and capable Chinese communist party.

In China, economic development at a local level for an official translates into political capital.

The Chinese system confers power and resources on local officials. This comes at a price – corruption.

The empowerment at local level also creates problems in collaboration, goods produced in one area need not be welcome in another area as is seen with cars.

In China the joke goes that “GDP figures produce the officials and the officials produce the GDP figures”

In China , the sum of the provincial GDPs is always 5 % higher than the actual country GDP.

China has recognized the problems of being the world's factory. Rising house prices, bad traffic, environmental degradation.

The rising middle class in China is putting pressure on the softer aspects, increasing prosperity always lets citizens feel that they have a greater stake.

The newly revised administrative procedure of 2015 expands people's rights to sue the government. Power is not taken for granted.

Social media is an anti corruption vehicle in itself. Of the 13.2 billion blog posts, 11 million were government related and 5.5 million of them involved corruption cases.

Centralized regimes are good for long term commitment, but less effective when it comes to accountability and flexibility.

Despite China's strong GDP growth, its stock market has performed poorly. Between 2000 and 2018, the China GDP quadrupled yet a $ 1 investment by a citizen would have remained that $ 1.

This is not an anomaly, it is reflective of the topsy turvy financial system.

China’s financial system is overtly dependent on banks. Bank Credit is the main source of financing.

In China, you can IPO only with profit shown in the last three years. Most Chinese tech companies list outside China.

Between 2000 and 2018, 33 % of companies were delisted in USA, Brazil was 13 % and China was 2.7 %.

Property accounts for 60 % of Chinese household assets compared to 25 % in the US.

Data around this is suspect, we need to be wary of the housing data form official Chinese sources.

Till 1997, employers gave houses to employees. In 1997, the government privatized the housing market.

In China all land is owned by the state except rural land. Land lease can be thirty years for industrial land, forty for commercial land and seventy for residential.

Home ownership is at the highest in the world, more than 90 % of the 276 million urban households own a house compared to 65 % in the US or 42 % in Switzerland.

China's extraordinary savings rate is more than enough to cover its domestic investment needs. This means that the economy does not need to rely on foreign capital. China is unlikely to be at the mercy of outside speculative money.

Because China's financial system is not mature, the state constantly intervenes , the more it intervenes the more distortions it creates and the slower it becomes to mature.

Chinese innovations tend to focus on new applications of existing technology. Chinese applications in AI are world class including self driving cars, drones, facial recognition etc.

Chinese are good at making existing technology better and cheaper. China has been creative with business models.

The first generation Chinese companies of 2000 s simply copied their western counterparts with poor results.
No economy copies its way to the top.

In addition to copying, protectionism is another touted reason for China's tech success. There is some truth to this.

996 captures the China work ethic, 9 am to 9 pm six days a week.

Data is a highly politicized commodity that raises national security and privacy concerns. When data is customer focused and specific to a particular culture the large countries like China and US have an advantage.

93 % of Chinese value security over freedom while 72 % of Americans value freedom over security.

More than 80 countries have adopted the Chinese surveillance technology systems.

Mature economies have extensive experience with old technology and hence they do not move to new technology. Look at New York airport and see Beijing airport. Beijing airport is a state of the art airport.

Of the 25 most valuable tech companies, 11 were American and 9 were Chinese. Of every 10 $ in VC money invested in AI in 2018, 5 $ went to China start ups and 4 $ to US start ups.

Enforcement of intellectual property has been weak in China. It was never considered a problem, but now the government has set in motion IP protection centers across the country.

China leads the world in number of patents, however the quality of these patents is not first rate.
China has only standardized testing to evaluate people, it does not get out of the box thinking to contribute to breakthrough innovation.

Technology is intertwined with trust, trust lies at the heart of achieving a universal tech standard. Many founders and CEOs of Chinese unicorn tech companies are millennials and they get this.

China is the largest trading partner for 120 countries in 2020, overtaking the role played by US two decades ago.

Between 1986 and 2008, we saw hyper globalization, cheaper communication, better internet access, cost of transportation, more efficient ships and air transportation all helped.

What constitutes fair trade is different for developed economies and developing economies.
Developed countries makes the rules and then play around the rules.

Chinas rise as a global trading power stems from the success of its domestic economy. It then rode the wave of hyper globalization.

In the new playbook, China will go up the value chain and compete with products made by Japan, Germany and the USA.

China needs the world and the world needs China, even though it is many times ‘cold politics but hot economics’.

Climate change, environmental degradation, terrorism, cybersecurity cannot be addressed without cooperation between US and China.

With the possible exception of India, no country will emerge to challenge China impact on the global economy.

A fully international currency must be held as a reserve by central banks, must be used to invoice trade around the world, must be the currency of denomination for bonds and bank loans.

The most important factor that is lacking in China, a critical element for any international currency to be successful is the maturity of its financial markets.

A predictable and credible central government is also needed. No one wants to hold a currency that runs the risk of the government depreciating it with its policies overnight.

Digital currencies could help dislodge the dollar from its position.

I believe we will see two major central banks in a future world, one in the US and the other in China.

Of the 5 million Chinese students that went abroad to study between 2000 and 2019, around 86 % returned to China, that’s a staggering number.

5 forces that will shape China in next few decades

1. Sense of urgency to address social problems
2. China will shed its young nation tag as its economy comes of age
3. Economic power with ability to influence global rules.
4. Work with USA peacefully and collaboratively
5. Getting used to a legal and social environment.