A CRASH COURSE ON CHINA
“Let China sleep. For when China wakes, she shall shake the world.”

Napoleon Bonaparte
China: the Emerging Economic Giant
STATISTICAL OVERVIEW
China Economic growth : 1961-2013

Source: www.globaleconomy.com/China/Economic_growth
China and US industrial production

$ billion at current prices - log scale

Source: Calculated from UN National Accounts

Source: John Ross, Key Trends in the World Economy, November 24, 2013 at http://ablog.typepad.com/key_trends_in_the_world_e/
Industrial Production Compared to June 2007

Source: Calculated from US - Federal Reserve, China Trading Economics, EU Eurostat, Japan Ministry of Economy Trade and Industry

Source: John Ross, Key Trends in the World Economy, November 24, 2013 at http://ablog.typepad.com/key_trends_in_the_world_e/
% Change in GDP
2Q 2008 - 2Q 2013

Source: Calculated from US Bureau of Economic Analysis NIPA Table 1.3.3, Trading Economics

Source: John Ross, Key Trends in the World Economy, November 24, 2013 at http://ablog.typepad.com/key_trends_in_the_world_e/
When Will China Overtake the American Economy?

Regional Distribution of Gross Domestic Product, 1970-2025

Note: Shares are based on GDP in US$ at current purchasing power parities. Europe includes all 28 members of the European Union as well as Switzerland, Norway, and Iceland. Other advanced economies are Australia, Canada, Israel, Hong Kong, South Korea, New Zealand, Singapore, and Taiwan Province of China. Southeast Europe includes Albania, Bosnia and Herzegovina, Macedonia, Serbia and Montenegro, and Turkey.


Source: Blogs-images.forbes.com
GDP Growth in China

China and US Nominal GDP (in $US trillion)

Assumptions made by Yao Yang (China Center for Economic Research, Peking U):
China GDP 8%, inflation 3.6%, RMB appreciation 3%, US GDP 3%, inflation 2%
Uneven Income distribution has become a problem

![Income Ratios: Top 10% to Bottom 10%]

Source: Embassy of Canada presentation 2012
Economic Weight of China
We divided China into 22 clusters, representing 92% of urban GDP in 2010.

McKinsey ClusterMap

China is Not One Market
The Emerging Middle Class

• Dramatic expansion in the private sector – aggressive entrepreneurship has produced 2.5 million firms, increasing by some 200,000 per year- providing bulk of employment, tax and overall national growth

• Emerging large and consuming middle class
  – Probably 125+ million now
  – 300+ million with significant discretionary spending power by 2010
Annual Auto Sales in China and the U.S.

Million Vehicles


17-01-12
Housing Costs Across China, 2015

Source: Embassy of Canada, Beijing, 2015

Source: Soufun, NBS, Demographica, Embassy calculations
Trends in Urbanization (percentage of population)

Where China is Today

- Average GDP growth of 9.7% in past 24 years
- World’s largest foreign currency reserves (around 4 trillions in 2014)
- World’s largest exporter
- Second largest economy by Nominal GDP in 2014 (121th in nominal per capita GDP and 89th and 97th on PPP basis according to IMF and CIA figures in 2013)
- Ranked 118 out of 178 in environmental performance in 2014 by Yale Environmental Performance Index.
China’s Growth Sectors

• Automobiles and Clean Energy Vehicles
• Retail and consumer goods industries
• Housing and household electronics
• Entertainment and education
• Aviation, travel and leisure
• Speed rail and logistics
• Renewable Energy and energy conservation
• Environmental, agricultural and manufacturing technologies (& products)
• High-end Equipment Manufacturing
• New materials and IT
• Life sciences products and Pharmaceuticals
THE NEW NORMAL IN CHINA

Slower growth
China: growth rate of real gross domestic product (GDP) from 2010 to 2021

The graph shows the change in real gross domestic product (GDP) in China until 2015, with IMF forecasts until 2021. In 2012, China's GDP change amounted to about 7.7 percent. That year, the GDP of China had amounted to 8.9 trillion U.S. dollars.

[Bar chart showing GDP growth from 2010 to 2021]

Source: www.statistica.com/statistics/263616
Sources of China’s Economic Growth, 4th to 12th Five Year Plan (%)

Diagram source: Kenndy and Johnson, Perfecting china Inc., the 13th Five Year Plan, Center for Strategic International Studies, May 2016, Figure 2.1, p.4
Rising Dominance Of the Service Sector

China, share of GDP from:

<table>
<thead>
<tr>
<th>Year</th>
<th>Industry</th>
<th>Services</th>
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<tbody>
<tr>
<td>2000</td>
<td></td>
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<td>2012</td>
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<td>2015</td>
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CHINA’S GEOGRAPHICAL CONSTRAINTS & VULNERABILITY
What shape firm behaviors?

Like Western firms, Chinese firms are shaped by the same factors, in their own context.
Western Complaints about Chinese Business Culture

• Longer time scales
• Objective data and Information hard to get
• Performance management system unclear
• Incentive system not based on performance
• Financial management systems designed to monitor not to exercise control and provide information
• Paternalistic organizational culture
• Not used to working on tight schedule and cost constraints
• Indirect Communications style
• Rules are unclear & too many changes
• Planning and priority setting not followed
• Non-transparent commercial and legal cultures
• Rely too much on Guanxi
Chinese Complaints of Western Business Culture

- Too rigid and inflexible
- Too straight forward (not diplomatic enough)
  - Too rule-bound
  - Ask for too many details
  - “Slow” to make decisions
  - Inefficient government
- Too impersonal (do not care to build personal relationship)
- Too impatient (short in-country visits and rush to results)
- Do not understand Chinese hierarchy and culture.

Source: compiled by E. Wong
Understanding the Stylized Chinese Firm (SOE)

**Governance**
- Authoritarian or top-down decision-making model – though power now shared within board sometimes
- Collective Management culture – consensus within middle-management
- Senior SOE managers are appointed by “Organization Department” of CPC
- Lack (or do not value) transparency and formal processes
- Personal factors play a large role in many management and investment decisions

**Incentive & Performance Systems**
- SOE managers are rewarded for attaining “national goals” during tenure
- Bureaucratic Promotions prospects are important to SOE top managers
- Subjective and collective performance assessment
- Avoidance of personal risks and accountability

**Business Cultural**
- Government-centric
- Non-trusting of outsiders – value Guanxi
- Less rigid and legalistic than the West
- Speed is a key efficiency metric
- Accept and expect institutional ambiguity

**Source of Funds**
- Commercial bank loans – nature maybe more important than the return of projects
- Private equity or internal funds
- Institutional banks – preferential interest rates
- Finance companies – rates of return, but constraints on investment types
China’s Government System
Understand Chinese government: The Role of the CPC

National People’s Congress - Parliament

Central Committee of the CPC – decision makers

Central Military Commission - Army

State Council – government cabinet

People’s Consultative Congress – vehicle for consulting with other political parties & leaders

Leadership of party all pervasive though unseen

Source: American Chamber of Commerce PRC
Who’s in charge?
The main links between organs of power

Source: The nomenklatura, Vertical meets horizontal, Who really holds the power in China? Dec 1st 2012 | BEIJING | from the print edition
Structure of Chinese Government

Central Committee of Chinese Communist Party
- Secretary general
- Politburo Standing members
- Military Commission

National People’s Congress

Standing Committee/NPC Committee
- President
- Vice president

State Council

Government Ministries
- Commissions e.g. planning & reform, ethnic, People’s Bank of China
- Key Organizations under the State Council e.g. Xinhua news agency
- Regulatory commissions i.e. insurance, banking

State Administrations i.e. state assets, tourism, quality, worker safety, IP etc.

Local People’s Congresses

People’s Consultative Conference

Supreme People’s Court, Supreme People’s Procuratorate

Working offices e.g. legislative and Taiwan affairs
Organizational Mandates & Functions

**The Central Committee of CCP**
- Meets in plenary sessions to form key policies
- Approves nominees to the NPC.

**National People’s Congress**
- Changes basic Law, approves Laws submitted by CCP Standing Committee
- Meets annually for about 2 weeks to review and approve major new policy directions, laws, the budget, and major personnel changes.

**People’s Consultative Conference**
- Includes other political parties

**NPC Standing Committee**
- Exercises Power when the NPC is not in session.
- Enacts and amends all laws not enacted by the NPC so long as it does not contravene the basic principles of original laws.

**State Council**
- The Cabinet
  - Enacts administrative regulations in accordance with the constitution and the laws
  - Present initiatives to the NPC to approve following recommendation from the CCP.

**People’s Congresses at the provincial and autonomous region levels**
- Enact local regulations that do not contravene the Constitution.

**Supreme People’s Court, Supreme People’s Procuratorate**
- Higher, intermediate, and basic people’s courts
Commissar System at Chinese Organizations

Personnel decisions are made by the organization department of the CCP
Everything is subject to the “leadership of the party” which is enshrined in China’s constitution, though the party is not legally registered in China. Party membership is seen as a mark of excellence and passport to a better job.
Other Political Parties in China

- China Revolutionary Committee of the Kuomintang
- China Democratic League
- China Democratic National Construction Association
- China Association for the Promotion of Democracy
- Chinese Peasants' and Workers' Democratic Party
- China Zhi Gong Dang
- Jiusan Society
- Taiwan Democratic Self-government League
Role of other Parties

• The eight other political parties are independent organizations and enjoy political freedom, organizational independence and are legal equality under the Constitution are not opposition parties. They perform a consultative role and are “partners” in the discussion and administration of State affairs i.e. the chairmen of the eight political parties are now vice chairmen of Standing Committee of NPC and vice presidents of the Chinese People's Political Consultative Conference.
The Rule of Law

- Lack of Western tradition of “rule of law” and religious sanctions
- The Confucius tradition i.e. hierarchical and authoritarian social structure
- The mandate from heaven and the benevolent ruler
- Legal system in development
- A unitary state with latitude for local interpretation of laws and regulations
- Laws passed by the NPC must be supported by implementation regulations for implementation
Understand Regulatory Environment

GOVERNANCE

LAW

REGULATIONS

IDEOLOGY

The Communist Party of China

Source: Adapted from American Chamber of Commerce PRC
Key reform Measures announced at the Third Plenum (policy Issues) of the 18th CPC Congress

• Relax investment restrictions and expand construction of free trade zones (FTZ) in inland and border areas.
• Accelerate globalization by easing capital inflows and outflows
• Deepen economic reform to ensure a "decisive" role for the market in allocating resources while retaining a dominant role for state ownership.
• The Communist Party of China (CPC) will strengthen its leadership role with a central leading team for "comprehensively deepening reform”.
• Further reforms of the administrative system through innovative administrative methods enhancing the credibility and effectiveness of government through a law based, service oriented government.
• Fiscal system reforms to improve budget management, match between local spending and expenditures, and transparency.
• Establish a state security committee to improve social governance and safeguard the interests of the people enhancing social stability

Highlights of the Fourth Plenum
(Party Governance) of the 18th CPC Congress

- Build a country with “Social Rule of Law with Chinese Characteristics”
- Ensure CPC leadership in such country
- Strengthen implementation of the constitution; promote administration by law and awareness of the public; build a law-abiding government and society; safeguard social justice; and sharpen CPC leadership in promoting the rule of law.
- Rule the country in line with the constitution and promote government transparency.
- Protection of human rights.
- Set up mechanism to monitor and supervise officials.
- China will recruit more lawmakers, judges and prosecutors from qualified lawyers.
- CPC will improve its internal rules and mechanisms.
- The PLA will promote rule of law and enforce strict discipline.
- China will guarantee the “One country, two systems” practice and promote national reunification in line with the law.

Source: news.xinhanet.com/english/china/2014-10/23/c_133737957_2.htm
The Chinese Economy
Is China Capitalist?

http://intelligencesquaredus.org/debates/past-debates/item/544-china-does-capitalism-better-than-america
“It does not matter if it is a black cat or if it is a white. As long as it catches mice, it is a good cat.”

Deng Xiaoping
China as a Transition Economy

- Centrally planned economy in transition depends on good governance
- Strong state is needed for the transition period – even to create a framework for a market economy
- Governance vs. human rights issues
- Institutions will evolve and be shaped by changing economic and social forces
“We are the Communist Party. We will define what Communism is.”

Socialism with Chinese Characteristics –
Market Economy as way to Socialist outcomes
Socialism with Chinese Characteristics
An Evolution

- “De-collectivization” of agriculture
- “Marketization” of State-owned assets
- Economic liberalization
- “Privatization” of many State Owned Enterprises (SOEs)
- Emergence of a vibrant private sector which is now the engine of growth companies
- Market Economy as way to Socialist outcomes
The Concept of Chinese Capitalism

- Chinese Capitalism is made up of state capitalism, private capitalism, and international capitalism.

Source: Marina Yue Zhang, China 2.0: The Transformation of an Emerging Superpower … and the New Opportunities.
The Business Environment in China
Factors shaping China’s Business Environment

• State capitalism – bureaucratic corporate culture, not always profit-maximizing, agency problems with CEOs, changing government policy and regulations, emphasis on relationship with officialdom, not all private companies are truly “private”

• A relationship society and economy – due diligence trust building processes maybe different, and Guanxi and Face are key in business relations and negotiations

• Immature legal framework – business model must include a dispute resolution model you can work with.

• Emerging economic power, new to internationalization

• Uneven development and diverse regional circumstances – there are many “Chinas,” they may communicate and operate differently

• In a hurry to get things done, short-term oriented and fiercely competitive.
# Economic Significance of the State Sector

## Comparison of the private sector and the observable state sector (RMB bil)

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<tbody>
<tr>
<td><strong>Gross industrial output value</strong></td>
<td>483</td>
<td>2,921</td>
<td>11,491</td>
</tr>
<tr>
<td><strong>Industrial value added</strong></td>
<td>120</td>
<td>745</td>
<td>2,256</td>
</tr>
<tr>
<td><strong>Total employment (urban + rural, mil.) in 2007</strong></td>
<td>18</td>
<td>46</td>
<td>76</td>
</tr>
<tr>
<td><strong>Industrial taxes</strong></td>
<td>17</td>
<td>103</td>
<td>506</td>
</tr>
</tbody>
</table>

China Business Structure:
Government relations inextricably tied to business success

15 of the 20 largest State-Owned Enterprises in China are headquartered within four kilometers of Zhong Nan Hai.
China Business Structure:
Government and State Owned Enterprises

An evolving Relationship
Structure of Chinese Government

Central Committee of Chinese Communist Party

Secretary general, Politburo Standing members, Military Commission

President, Vice president

National People’s Congress

Standing Committee/ NPC Committee

State Council

Local People’s Congresses

People’s Consultative Conference

Supreme People’s Court, Supreme People’s Procuratorate

Government Ministries

Commissions e.g. planning & reform, ethnic, People’s Bank of China

Key Organizations under the State Council e.g. Xinhua news agency,

Regulatory commissions i.e. insurance, banking

Key Organizations

State Administrations i.e. state assets, Foreign exchange, tourism, quality, IP etc.

Working offices e.g. legislative and Taiwan affairs

17-01-12
Consensus Building in Economic Policy Formation
Provincial and Central

Other Ministries i.e. Environment, Energy etc.

Economic Reform and Development Commission

State Assets supervision & admin Commission

Ministry of Commerce
Major Chinese FDI needs the approval of various Chinese authorities, including the national or provincial authorities responsible for SOEs (the State-owned Assets Supervision and Administration Commission, SASAC), the National Reform and Development Commission (NDRC) and the State Council (depending on transaction size). Access to foreign exchange is controlled by the State Administration of Foreign Exchange (SAFE). NDRC approval usually comes after a business agreement is reached but before final approval from the foreign government. NDRC is concerned mainly with the nature of the investment and the investment parties (are they consistent with national policies?), rather than the commercial conditions.

This process ensures compliance with national goals of China i.e. the five year plans and changes in government development policy.
Percentage of Overseas FDI Changes By Various Policy Making Agencies to 2010

Source: Huang Wenbin & Andrea Wikes, Analysis of China’s Overseas Investment Policies, CIFOR, 2011, p.3
State Capitalism in China
Provincial and Central

Competition among dominant Firms is between SOEs
Impetus for the “Going out” Policy & Why prominence of China’s Policy Banks And need to follow Chinese Politics.
China’s FDI Outflows

US$ billion

MOFCOM figure:
US$145.7 billion

Source: Statistical Bulletin on China’s Outward Foreign Direct Investment

China’s Outward FDI versus Global FDI Flows

China became top 10 global investor

Sources: Ministry of Commerce and State Administration of Foreign Exchange, People’s Republic of China; United Nations Conference on Trade and Development; Rhodium Group.

China as the most important emerging economy investor
China’s outward FDI footprint

Source: National Bureau of Statistics

Diagram source: EY, Riding the silk road: China sees outbound investment boom, March 2015, p.3
China in the Global Supply Chain

Target zones for Chinese FDI

Invest for:
- Resource acquisition
- Technology
- Export potential

Invest for:
- Market Access
- Export potential
- Technology
- Diversification

China’s Five Year Plan
Summary of China’s Five-Year Plans
Goals of the 12th Five Year Plan
March 2011 to 2015

- Develop China’s Western Region
- Protect the Environment and Improve Energy Efficiency
- Continue transition from an Export oriented to a consumption oriented economy
- Improve the living standard of the Chinese people
- Develop 7 priority industries and increase their share of GDP from 2 to 8% by 2015
The 13th Five-Year Plan

China's New Five Year Plan
Realising the China Dream – 2020 Goals
Growth | Innovation | Sustainability

**Infrastructure**
- 30,000km of high-speed rail covering >80% of major cities
- 60% Urbanisation ratio of permanent residents
- 30,000km of highways built or upgraded
- New airport in Beijing

**Environment**
- 5 million new energy vehicles manufactured and sold
- RMB 6-10 trillion invested in environmental initiatives
- Total farmland maintained at:
  * 1.865 billion mu = 1.24 million km²
  * > 32.56 million mu = 21.7 thousand km² of new construction land every year

**Financial services**
- Increased focus on "green" finance and financial innovation
- Further opening up of financial markets
- Further internationalisation of RMB

**Health**
- Two-child policy fully implemented
- At least 2.5 registered practitioners for every 1,000 people
- Life expectancy increased by an average of one year

**Social & economic development**
- +50 million urban jobs created
- Added value of strategic new industries to reach 15% of GDP
- GDP over RMB 92.7 trillion by 2020, annual growth rate +6.6%

GEOPOLITICAL ISSUES
CHINA’S GEOGRAPHICAL CONSTRAINTS & VULNERABILITY
Middle Eastern Politics & China’s Energy Supplies

Turkey: 4 billion cu. m of natural gas in 2010, more in 2011

Kazakhstan: 200,000 bpd of oil

Iraq: 224,000 bpd of oil in 2010

Afghanistan: Copper

U.S. CENTCOM
United States Central Command

Kuwait: 197,000 bpd of oil in 2010

Saudi Arabia: 892,000 bpd of oil in 2010

Pakistan: Waypoint for mil flights to Middle East and Africa

Oman: 316,000 bpd oil in 2010, port access at Salalah

Iran: 426,000 bpd of oil in 2010
CHINA: A COUNTRY OF GEOGRAPHICAL, ECONOMIC CULTURAL LINGUISTIC & ETHNIC DIVERSITY

Geographical misalignment
Of population and resources

Population concentration along coastal regions

Natural barriers to communications & transportation

The North South Divide

Ethnic minorities concentrated in border regions
China’s Strategic Economic Interests

- Natural Resources
- Access to new technology and markets
- Security in international trade
- Movement up the value chain
- Acquisition of Global Brands, management skills, & Marketing Expertise
- Stability in currency reserve value
FDI in Resource Firms

- China has been investing in iron ore, copper, and nickel mines in Australia, Papua New Guinea, Philippines, and Chile since 2001.
- Oil and gas joint ventures in Sudan, Iran, Pakistan, Russia, central Asia and South America have been undertaken since 1999.
- Recent Investments in Alberta’s Oil Sands
The Invisible Hand of the State

- International Relations Consideration
- Influence of National Policy and Strategic Goals
- Influence of the Growth Sectors
- “Support” from the State
- Vetting by the State
Food for Thought

• Signs of stable elite politics – history of smooth succession during reform period (upcoming change in March 2012 is important to watch).

• Relatively responsive government and policies – from growth and “opening up” policy to “Harmonious society”, to abolition of agricultural tax and private property law etc.