Two Strong Hands: China’s Vision of the Private Sector

Chang-Tai Hsieh
University of Chicago

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Markus Brunnermeier
China

- **Commanding Heights**: strategically important sectors
  - Public utilities
  - Natural resources
  - Platform economy (Alibaba, Tencent, …)

- **Middle income trap – Anti-resilience**
  - Switch from *catching up* to frontier *R&D*
  - Example of escaping:

  Beijing’s Bismarcking Ghosts”
  (with Rush Doshi and Harold James) *Washington Quarterly*

  Imperial Germany vs. UK | China vs. US
  - Berlin-Bagdad Railway | Belt-Road Initiative
  - Tech acquisition: Krupp | AI
  - Standard setting: Telefunken
China’s Strong Hand Destroys “Invisible Hand”

- Invisible Hand (Adam Smith)
  - Price signal
    - Conveyer of information about scarcity
    - Future cash flows

- Interventionistic hand
  - Price signal
    - Investors collect info about
      - Gov. intervention
      - Not cash flows

“China’s Model of Managing its Financial System” (with Michael Sockin and Wei Xiong) Review of Econ Studies
The Battle of Ideas

- “Economic Model” of a country
- Promote competition to limit concentration of power
  
  German Ordoliberalism  (Freiburger School)
  
  - Private sector:
    - Mittelstand companies vs. National Champions
      - Germany  France
    - Promote SMEs, but large firms are more productive
  
  - Public sector:
    - Germany: Federalism
    - China: Tournament among local cadres
1. China's crackdown on the tech sector and financial conglomerates will harm the economy
   a. Yes
   b. No

2. Does Xi Jinping want to return to Mao's economic vision?
   a. Yes
   b. No

3. China's economy will collapse in the medium run?
   a. Yes
   b. No
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Poll

1. What could the most successful growth model?
   a. Import substitution
   b. Export-led growth
   c. Consumption-led growth

2. What is the biggest impact on Africa’s growth?
   a. Education
   b. New forms of governance
   c. New Tech (incl. FinTech)
   d. Global trade
   e. New entrepreneurship
   f. Others

3. African demographics is more of a
   a. Opportunity
   b. Challenge
Economic Outlook for China

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May 2022
End of Free Markets and Private Enterprise?

- Crackdown on technology companies (Alibaba, Tencent, Meituan-Dianping, Didi)
- Dismantling of large conglomerates starting in 2018 (Wanda, Anbang, Hainan, Tomorrow, Evergrande)
- “Xi Jinping Aims to Rein in Chinese Capitalism, Hew to Mao’s Socialist Vision,” WSJ, September 2021
- “Is China Uninvestable?” The Economist, May 2022
Improved Conditions for Private Firms

- Rank in WB Doing Business Indicators improved substantially
  - Doing business type of indicators for each city/province

- Simplified business regulations
  - Business registration done online (less than five minutes.)

- Judicial/Legal Institutions
  - Bankruptcy law, new bankruptcy courts
  - Payment enforcement, enforced by social credit system
  - New courts to adjudicate business disputes; Adjudication time falls; business dispute decisions published online

- Better access to credit
  - Share of credit to SMEs increase
  - New Beijing and Shanghai Stock Exchanges (STAR)
Contradiction in China’s Policy Direction?

- **Dangerous time to be Jack Ma**
  - Market capitalization of publicly traded firms fallen by more than 1 trillion

- **But conditions for SMEs have never been better**
  - Number of firms increases from 55 million in 2012 to 150 million in 2021
  - Vibrant startup/VC industry
“Small” City (2 million people) in Southern China

- Actively look for quality prospects
- Initial discussion to learn about investor
- Feasibility Analysis
- Identify land and other needed services
- Approval by Vice-Mayor
- Sign agreement
Organization of Local Government

- Party Secretary
- Mayor
- 9 Vice-Mayors
- Each Vice-Mayor assigned 20 “important” projects
- Local cadres use power of local Communist Party to help their “projects”
Ping-An Insurance

- Traded in HK and Shanghai, Market Value ≈ 200 billion US$

- Major Shareholders:
  - HSBC Insurance (10%)
  - HSBC Bank (10%)
  - Shenzhen Investment Management Company (9%)
  - Yuanxinhang Investment (8%)
  - Shenzhen Xin Hao Shi/Shenzhen Jing Ao (11.5%)


- 3% Owned by Taihong Holdings
Taihong Holdings

- **Share of ownership:**
  - 28%
  - Owner: Xuanda
  - Owned by: Feng Zhixi (Wife of Wen Jiabao's brother, 33.7 million)
  - 26%
  - Owned by: Liu Donsheng
    - 48%
    - Shengchurui
    - 32%
    - Liu Donsheng
    - 20%
    - Partly owned by: Zhang Jiankun (Brother of Wen Jiabao's wife, 1 million, 27% of Shijixing)
  - 25%
  - Owned by: Tianjin Shuiheping
  - 12%
  - Owned by: Hongrui

- **Share of ownership:**
  - 90%
  - Owned by: Li Baozhen
    - 70%
    - Owned by: Duan Weihong (Friend of Wen Jiabao's wife, 21.2 million)
    - 30%
    - Owned by: Zhang Yuhong (Family friend and colleague of Wen Jiabao's brother, 9.1 million)
  - 10%
  - Owned by: Chen Hengmei (Mother-in-law of Wen Jiabao's son, Winston Wen, 13.4 million)

- **Number of Ping An shares effectively controlled:**
  - 80%
  - Owned by: Dalian Haichang
  - 20%
  - Owned by: Shuxing

Two relatives obtained stakes in Ping An through Hongrui, beginning in 2005. By 2007, Yang Zhiyun, left, the prime minister's mother, held $120 million worth of Ping An stock; and Yang Quanmei, the father-in-law of the prime minister's son, held $113 million.
Influence of wealthy individuals (such as Duan Weihong) so widespread that it was viewed as an existential threat to the Party

First strong hand: Crackdown on forces that pose a threat to party control, which includes large wealthy private firms

Part of broader campaign to restore Party control
- Anti-corruption campaign (2012 - ?)
- Party cells in private companies and NGOs
- “Golden” shares in in critical companies
- Increase authority of Party committees in SOEs, hospitals, universities
- Increased importance of loyalty in party promotion
- Local cadres spend time on “political study sessions” and Party inspection teams
Campaign to Support “Desirable” Private Firms

- Campaign to rein in successful Chinese firms hurts growth
- Second strong hand: Support SMEs that do not threaten the party
- Vision is a dynamic market economy under the control of the Communist Party
- Aggregate growth effect depends on net effect of the “two strong hands”