Markus Brunnermeier: So welcome back everybody for another webinar organized by Princeton for everyone worldwide, we're very happy to have Chang-Tai Hsieh with us, hi Chang-Tai. Chang-Tai will talk about two strong hands, China's vision of the private sector, so we're looking forward to learning a lot about China and the vision that the Chinese Government has for its economy. When I think about hands, I think about invisible hands, by Adam Smith, and I was wondering, to what extent strong hands or a strong hand destroys the invisible hand. And typically invisible hands, you can associate with the price signal its economy of information about the scarcity of a particular product or an asset and the future cash flows, or what it pays off, so one is the marginal utility, one is the payoff. And if you have too much of an interventionist hand, then the price signal might not necessarily depend on the information about the underlying fundamentals, about the cash flows and so forth, but it might be much more signaling what the government will do in the future. I've done some work with Wei Xiong and Michael Sockin where we really focus on that-- actually once investors think mostly what will the government do, what government intervention will come, they will zoom in on collecting information about that, and the best only signals about future government interventions, rather than the cash flows and that actually might distort resources down the road. Now that's essentially if you have strong hands but, more generally, if you have China's model, if you think about it as a government, you might want to throw the commanding heights, that's how Lenin put it. And Lenin said okay you don't have to control the whole economy, you just have to control the commanding heights consisting of strategically important sectors, like public utilities and natural resources and I would say platforms which are now in the new world where data is part of the commanding heights like Alibaba and financial Tencent and others. So that's essentially where Chang-Tai will go today. And one other challenge for China is essentially whether it will be caught in the middle income trap or not, so we know that different economies catch up with the advanced economies. Initially it's a very different process, because you just have to copy essentially what the advanced economies are doing, but once you add the frontier, you have to do your own R&D and they have to have a very different economic structure in this switch over from trying to catch up, from being at the frontier and pushing the frontier is very different, and you might be trapped if you don't manage to switch over as well, you don't have the resilience in a sense if you don't manage to switch over. And there's some examples where you know people escape this middle income trap and if you go back in the 19th century, you can actually compare imperial Germany. When imperial Germany in the 19th century tried to catch up with the UK and similarly the US was trying to catch up with the UK. While China is catching up with the US now and then you know being potentially caught in the middle income or not
caught, but what's striking essentially is that there's a lot of similarities between imperial Germany in the 19th century to China today, so imperial Germany actually was trying, it was a landlocked empire, so it tried to build you know, railways and there's famous Berlin backup railway and if you go to Istanbul, you see, you know, still a lot of these remaining part of the railways and the Belt and Road initiative is essentially similar concept, what China is doing now. There were also a lot of attempts to acquire new technological knowledge, and that's the same thing that China is doing now, in the way you compete in order to be able to set the standards. There was a big competition, for mobile communication and other types of communication, and how to set the standards at that time. And similarly there's some standard setting now in artificial intelligence and China's putting a lot of effort in this now. There are a lot of similarities that are strikingly similar. And, Germany and the US in the 19th century escaped the middle income trap and of course it could be that China is escaping it too, but it requires certain strategies and perhaps the two strong hands is one of the strategies.

4:30
So when I think about the two strong hands, Chang-Tai will say more about it. It comes to me through the battle of ideas, you know, what economic model does a country pursue and the different ways to do it. One way it seems very close to me to have this German Ordoliberalism perspective where you promote competition to limit concentration of power, so you really want to have no concentration of power, so you limit the concentration of power, and one way to do it is to have more competition. And you can do this in the private sector and in the public sector and this Freiburger school or the Ordoliberalist, they actually would like to have competition at the private sector, where you know, instead of having national champions, so in France, they promote national champions, it's a different economic model. In Germany, they want to have this Middelstand which is you know you have a lot of midsize economies, mid sized companies, and you promote competition among the midsize companies rather than have a few national champions being globally, you know big companies. And that was essentially very much what the German model was as German Ordoliberalism became very prominent in Germany after the Second World War, also because the allies really didn't like any concentration of power in Berlin, they wanted to avoid any concentration of power, so we have a lot of competition at the private sector, so no concentration of economic power, but also have a federal system, not to have a concentration in one capital, but you have a decentralized governance structure so there's no concentration of power unlike what the Nazis had before. It seems to me to some extent, and I think Chang-Tai today will enlighten us that, for the private sector, the Chinese are going the same route that they would like to have more mid-sized companies competing with each other rather than a few national champions. But in the public sector it's very different, so the German structure was off the second was a very federal structure, no concentration of political powers while in China, you had a tournament of local leaders and you select the best local leaders out of that and I don't know how this will play out, but there's of course there's a very strong power at the center, much more powerful than in Germany and that's you know, a different way of doing it, so I will be curious to learn how one would put this to strong hands in the context, how you know we think in Germany vs France, but there's a struggle within Europe, what economic model to follow. So Chang-Tai put forward three questions and I'm curious how we will think about them after Chang-Tai gives us his perspective. The first question was China's crackdown on the tech sector and the financial conglomerates will harm the economy, yes or no? And actually it is 80% thought it will harm the economy and 17% know so that's a strong, so the going after and financial tense and, and all this will actually harm the economy.
Markus Brunnermeier: The second question was does shipping, the President of China, what does he want to return the mouse economic vision is it, yes or no, and actually one quarter thought he wants to go back to mouse economic vision, which you know might not be so successful.

49
00:12:10.590 --> 00:12:20.010
Markus Brunnermeier: But 75 think yeah we will go a different direction that's for the second question, the third question is china's economy would collapse in the medium term on the medium Brown.

50
00:12:20.640 --> 00:12:29.130
Markus Brunnermeier: And only 10% thing china's economy would collapse 9% thing that will do fine and you know the high debt levels and all those things will not be.

51
00:12:29.670 --> 00:12:33.540
Markus Brunnermeier: warning, but it was not a worrisome because it won't collapse.

52
00:12:34.230 --> 00:12:44.670
Markus Brunnermeier: With this we pass on the microphone to Shanghai and he will tell us about is too strong hands, and so, by increasing title, and I think it's a very nice auditors.

53
00:12:45.150 --> 00:12:55.890
Markus Brunnermeier: To get deeper insights how the Chinese economy will look like or is moving to a new framework thanks again Dante we're looking forward to your presentation.

54
00:12:56.880 --> 00:12:59.040
Chang-Tai Hsieh: Thank you Marcus can everybody hear me.

55
00:12:59.580 --> 00:13:00.000
Markus Brunnermeier: Yes.

56
00:13:00.120 --> 00:13:11.760
Chang-Tai Hsieh: Okay, great so if there's one message, or one idea or one question that I want you to be thinking about it's, the question is.

57
00:13:12.750 --> 00:13:25.080
Chang-Tai Hsieh: What is the political foundation for china's support of the private sector so that's going to be my overarching question and that that's going to be what i'm going to try to answer.
Chang-Tai Hsieh: The we're going to start this is that i'm going to start by just revisiting the headlines coming out of China that we've seen in the last two or three years and the headlights have been dominated.

Chang-Tai Hsieh: By by the stories of of of the crackdowns on some of the most successful Chinese companies that that that edits and it's useful to group it into two groups of of companies.

Chang-Tai Hsieh: there's been a crackdown on some of the most innovative Chinese companies on the tech sector and here i'm just with this thing, some of them, but it's not, these are not the only one, so.

Chang-Tai Hsieh: there's been a crackdown on on on Ali Baba has been acquired done a Ted said there's been a crackdown on on the main one there's been a crackdown on dd.

Chang-Tai Hsieh: You know not too long ago, I think I was having a conversation with mark is just a few years ago about whether some of the money platforms of 10 cent or Ali are going to dominate the world, nobody is talking about that now.

Chang-Tai Hsieh: So so just think about sort of the sea change that we've seen in.

Chang-Tai Hsieh: In the last two years, the other thing I.

Chang-Tai Hsieh: want you to know that this is also come out in in the media, but perhaps it's been less prominent but it's also been as important.

Chang-Tai Hsieh: This started earlier, starting in about 2018 there's been a systematic dismantling of the largest Chinese conglomerates.

Chang-Tai Hsieh: that these are accommodation of financial companies real estate companies or just mix conglomerates.
Chang-Tai Hsieh: That do a variety of things so here i'm just listening, some of them, the one that group was perhaps what are the first one.

Chang-Tai Hsieh: The unbound group the high Niall group that does everything from airlines to banking to real estate, you know it's I guess it's it's a conglomerate the the tomorrow group and and last fall everybody was.

Chang-Tai Hsieh: was focused on on the hunger or in English every ground right so that's been the other, but I just want you to realize that this is not all that good going on that, I think that the message.

Chang-Tai Hsieh: That what you see out I think is absolutely right that there's been a crackdown on some of the largest and some of the largest some of those.

Chang-Tai Hsieh: Some of the most successful with Chinese companies which.

Chang-Tai Hsieh: You know, I think that if you would ask if we were to be doing the seminar three or four years ago, or five years ago nobody would have ever expected there everybody thought.

Chang-Tai Hsieh: that some of these companies were going to be the Chinese were the Chinese champions, or they were eventually going to be the Chinese champions.

Chang-Tai Hsieh: So what's going on, and I was saying that there's one there's a conventional wisdom that is emerging, that I see emerging and i'll just pick on to.

Chang-Tai Hsieh: headlines to illustrate what I think is the conventional wisdom water journals That said, September of 2021.
Chang-Tai Hsieh: The headline is it says Xi Jinping aims to rein in Chinese capitalism whew to mouth socialist vision that basically China is going back to mouse economic model of socialism central planning reminds on stayed on firms.

78
00:16:52.950 --> 00:17:05.820
Chang-Tai Hsieh: Just in the most recent issue of The Economist the headline was a China an investable right, so this is one sort of dominant story that's come out of China.

79
00:17:07.560 --> 00:17:33.330
Chang-Tai Hsieh: What I also want to highlight is that there's also another campaign that's been going on for 567 years that hasn't really made it into the headlines, but for anybody that pays attention to what goes on on the ground in China it's equally big equally strong and and maybe even have.

80
00:17:34.440 --> 00:17:45.300
Chang-Tai Hsieh: have important effects, so I would so here's what I just want to summarize that, at the same time that you have seen this crackdown.

81
00:17:45.870 --> 00:17:54.270
Chang-Tai Hsieh: On on the largest and most successful Chinese private firms what you also see is that there's been a rollout.

82
00:17:54.750 --> 00:18:03.870
Chang-Tai Hsieh: of a number of institutional changes that have improved conditions for private firms right, so I just want to.

83
00:18:04.410 --> 00:18:09.570
Chang-Tai Hsieh: there's a lot that there's a lot here and I will say that this has been done.

84
00:18:10.080 --> 00:18:23.670
Chang-Tai Hsieh: Maybe in a in a more quiet way, and none of this has made it into the Western media, but I think it's equally as important and what what I see quantitatively in the data is that they're equally as important.

85
00:18:24.000 --> 00:18:30.960
Chang-Tai Hsieh: there's a lot of so let me just try to summarize what I think are the most important parts of this number one is that.

86
00:18:31.500 --> 00:18:44.310
Chang-Tai Hsieh: Business regulations have been dramatically simplified, that is, in every locality in China, it is now really, really, easy to register your business that's either done online.
Chang-Tai Hsieh: or there's or every single tell every single village every single city there's there's a one stop shop where you can register your business and the other thing that has happened is that the amount of capital that you need in order to register your business has.

Chang-Tai Hsieh: has come down so starting a business has become very, very easy in China, and later on i'll show you some data that I think that this is that a very big effect in a number of startups in China.

Chang-Tai Hsieh: The second piece of the changes that i've seen is, I think that there's been a vast improvement or changes in what i'm going to call judicial legal institutions.

Chang-Tai Hsieh: In in legal it's legal institutions there how's it, but particularly but the ones that are focused on business, I don't think there's any question that these are change, and I think for the better, I.

Here, let me just highlight three things there's a new bankruptcy law and there's a new bankruptcy law, and there are new bankruptcy courts.

So this was a process bankruptcies used to be done by the local by used to be done by local Congress and it's now out of the hands of the local colleges that there's there's no legal system and there's no.

Chang-Tai Hsieh: There there there's our judicial system that deals with the bankruptcy there's even a vast improvement in payment enforcement.

Chang-Tai Hsieh: And I think that you know, a big part of it has been the creation and the spread of the social credit system so that it's now really easily or very hard to escape not making your payments so payment enforcement.
Chang-Tai Hsieh: has improved dramatically they're also now new ports outside of bankruptcy new legal there's now a new legal system whose only purpose is to adjudicate business disputes contract disputes and.

Chang-Tai Hsieh: Things like that empirically what you see in the data is that the the time that it takes to adjudicate a business dispute drops dramatically right, and if you.

Chang-Tai Hsieh: talk with people to do try to understand what's going on on the ground, what you also find out very quickly is that is that there's the creation of this new legal system.

Chang-Tai Hsieh: And there are also high powered incentives that have been put in place on the.

Chang-Tai Hsieh: On the people that are in charge of the system to be as efficient as possible, so maybe the way to think about it is that there's like a mini now was campaign to make business dispute.

Chang-Tai Hsieh: Resolution death or he or easy what you also see is all of these decisions are published online, so you can go and and there are millions of them so then so they it's really easy to get this information.

Markus Brunnermeier: Like can ask a quick.

Markus Brunnermeier: Essentially, China wide the whole Oh, is it from Providence to Providence the from so is ios or control that there's more control moving to Beijing away from the local authorities.

Chang-Tai Hsieh: This is all done at the local level.
Chang-Tai Hsieh: I mean, this is all yeah.

Markus Brunnermeier: The bankruptcy law applies to all of China, I guess.

Chang-Tai Hsieh: Yes, the bankruptcy law applies I the law, yes that's that's right but, but if you know anything about China that basically it's still in terms of the administrative authority it's still it's still a huge in the system.

Chang-Tai Hsieh: And it's and it's up to the local government to implement this.

Chang-Tai Hsieh: The third thing that I want to highlight is that I think that there's also been a big improvement of of.

Chang-Tai Hsieh: Financial institutions that empirically what you see in the data is that the sheer of credit from the state on banks.

Chang-Tai Hsieh: to small and medium sized family goes up empirically what you see in the data is that there's there's an explosion in vc funds and there's an explosion in startups that are funded by bye bye bye.

Chang-Tai Hsieh: bye bye vc funds there's a vibrant Chinese version or several Chinese versions of Silicon Valley in the Shenzhen and also there's there's a district in Beijing called song one soon which which.

Chang-Tai Hsieh: there's not been a whole lot of discussion here, but I think it's also a vibrant startup ecosystem there as as well.

Chang-Tai Hsieh: and the last thing I want what I mentioned, is that there are now two new stock exchanges there's now there's a new Beijing stock exchange and there was a.
Chang-Tai Hsieh: Earlier, there was a Shanghai stock exchange called star, which was dedicated only to a science and technology startup so what this does is that you can see how this helps us because it provides an exit option.

Chang-Tai Hsieh: For that, and one last fact, if you want to summarize all this.

Chang-Tai Hsieh: If you look at how China did in the World Bank doing business indicators this thing that was canid last year, which I think is rather.

Chang-Tai Hsieh: Unfortunate there are all kinds of problems with with things like the World Bank doing, they are being been.

Chang-Tai Hsieh: Doing Business indicators, but I do think there's a lot of useful information that I think you know the way I think about the doing business indicators it's like the US news and world report.

Chang-Tai Hsieh: Rankings of the best universities in the US, there are all sorts of problems, but I rather it be there than not being there because there's useful there is.

Chang-Tai Hsieh: There is useful information but yeah so, but what you see in terms of the World Bank doing business indicators before it was canned last year is a China over the last 10 years has improved dramatically.

Chang-Tai Hsieh: In and what you also see is that the Chinese authorities have replicated something like the World Bank doing business indicators across China us to to basically collect data on on how each locality was doing in terms of of of.

Chang-Tai Hsieh: Making business easier, we make a making the business better okay so.

Chang-Tai Hsieh: What is going on, I think.
Chang-Tai Hsieh: This is the reality in China now so.

Markus Brunnermeier: Can I just.

Markus Brunnermeier: guess what about this a credit to SMEs to small and medium.

Markus Brunnermeier: Enterprises, this is primarily coming from and financial and the new platforms, but.

Chang-Tai Hsieh: No.

Chang-Tai Hsieh: i'm saying is basically a credit that is coming from the state on back so if you add on the stuff that are coming from.

Chang-Tai Hsieh: And from ED financial and all these other financial it's not just financial but all these local financing vehicles.

Chang-Tai Hsieh: What you see is that the sheer of money that of credit that's going to do to small and medium sized private firms has really exploded dramatically.

Chang-Tai Hsieh: So the data that aside is only from the state of that what i'm saying is that you even see it among the the state on backs, so the way they would say that you know.

Chang-Tai Hsieh: we're trying.
Markus Brunnermeier: To start a public policy statement saying that our second hand always say any official announcement, or just you see it on the ground but there's no jumping never announced that.

137
00:26:14.670 --> 00:26:16.380
Chang-Tai Hsieh: Second there's never any announcement.

138
00:26:16.440 --> 00:26:20.700
Chang-Tai Hsieh: that the second head or even the first head that's my terminology.

139
00:26:21.960 --> 00:26:29.910
Chang-Tai Hsieh: that's something that I, I like it, though, so the the names that are giving is not Communist Party.

140
00:26:30.660 --> 00:26:36.690
Chang-Tai Hsieh: it's my name for for it, I tried to mimic the Communist Party that if if they were to have.

141
00:26:37.020 --> 00:26:45.780
Chang-Tai Hsieh: A marketing department or a well functioning marketing department, not the propaganda department, but they do have a wealth ocean market harbor, this is what.

142
00:26:46.590 --> 00:26:54.120
Chang-Tai Hsieh: I would say, they should interests of marketing right, so this is the Chinese version of the Marcus academy right, if you want to put.

143
00:26:55.710 --> 00:27:09.030
Chang-Tai Hsieh: Put put it that way, so you may think that, so let me just point out that what what seems to be a contradiction in china's policy direction that on the one hand.

144
00:27:09.870 --> 00:27:23.340
Chang-Tai Hsieh: It is a very dangerous time to be somebody like Java like it's it's it's, and this is well understood and in the data what you see, and this is the part that is widely.

145
00:27:25.020 --> 00:27:33.930
Chang-Tai Hsieh: discussed in the media that the market cap of the largest publicly tray or large largest publicly traded from the China has fallen life has fallen like a rock.

146
00:27:35.040 --> 00:27:42.510
Chang-Tai Hsieh: That, if you put your money into publicly traded tray nice firms God bless you because you will have lost a ton of money.

147 00:27:43.410 --> 00:27:54.780
Chang-Tai Hsieh: But at the same time that the conditions for the private small and medium sized firms, I think, most obviously, most of which are still not treated as the moderator.

148 00:27:55.650 --> 00:28:06.090
Chang-Tai Hsieh: have never been better if you look at the data and say the number, the number of firms, you see a tripling in the number of firms over the last 10 years.

149 00:28:07.710 --> 00:28:16.230
Chang-Tai Hsieh: You see, I mentioned before a vibrant startup and and and and the vibrant vc industry.

150 00:28:17.280 --> 00:28:32.640
Chang-Tai Hsieh: So the big question is what is going on, why is it dangerous to be jack ma and why is it that, at the same time that they're dead they're putting down the hammer.

151 00:28:33.000 --> 00:28:42.930
Chang-Tai Hsieh: On the most successful Chinese companies they're trying to help the other firms that could eventually turned out to be like jack ma.

152 00:28:43.830 --> 00:28:53.640
Chang-Tai Hsieh: i'm taking my time to answer that question because i'm going to take a step back and i'm going to bring you back to China from 10 years ago and I want to illustrate.

153 00:28:55.470 --> 00:29:06.210
Chang-Tai Hsieh: We, why is it that it is currently a very dangerous time to be joking about this, I think, to understand that question, you have to understand where Chinese growth comes from.

154 00:29:07.020 --> 00:29:15.960
Chang-Tai Hsieh: Okay, so forgive me for ID tour i'm going to give a five Min admitted detour then i'm going to come back and answer the question.

155 00:29:16.530 --> 00:29:28.740
Chang-Tai Hsieh: Okay, so let me start by bringing you back to China for about 10 years ago so about 10 years ago, maybe this is nine years ago nine or eight years.

156 00:29:30.090 --> 00:29:39.090
Chang-Tai Hsieh: my collaborators on this other project, we made a visit to a small Chinese city in southern China small about 2 million people.

00:29:40.350 --> 00:29:57.600
Chang-Tai Hsieh: We went there because we wanted to understand what local governments did right, so we got there and our entree into the system was through the this person that was a vice Mayor of education in this city.

00:29:58.770 --> 00:30:02.280
Chang-Tai Hsieh: Because he was a former student of one of one of the people that.

00:30:02.820 --> 00:30:13.620
Chang-Tai Hsieh: I was doing this project with so my collaborators showed up at device mayor's office so just to be clear who this person was this was a person in charge of the public schools in the city.

00:30:14.250 --> 00:30:27.480
Chang-Tai Hsieh: We got there and the vice mayor was not there, and this person Chief of Staff apologized I said that you know that he was looking forward to your visit my his most Honorable teacher.

00:30:28.560 --> 00:30:38.700
Chang-Tai Hsieh: And he's going to try really hard to to to to meet with him later that day the some important visitors had come had had come to town so then.

00:30:39.480 --> 00:30:50.250
Chang-Tai Hsieh: he's they started to chat about what divided mayor's Office does and the vice mayor's Chief of Staff proudly you know after about half an hour handed us this flow chart.

00:30:51.330 --> 00:31:04.050
Chang-Tai Hsieh: Okay, then say this is what we do.

00:31:04.380 --> 00:31:13.740
Chang-Tai Hsieh: They there's a process, they actively look for quality prospects, they have an initial discussion to learn about the investor the other take a feasibility analysis that it.
Chang-Tai Hsieh: landed other nita services there, whatever it is that they're talking about goes through the approval by the Vice mayor and they sign the.

Chang-Tai Hsieh: sign the agreement, so let me take a pause here, and let me ask if there's a way in which I can ask the audience, what do you think the vice mayor's Chief of Staff is talking about.

Markus Brunnermeier: yeah probably it's about new projects to sell a certain land where new companies can build.

Chang-Tai Hsieh: it's not about what let me see what this is this is exactly what it looks like that what the vice mayor's office was doing.

Chang-Tai Hsieh: was basically what I call what our quality prospects, these are basically businesses that that are that are setting up in the city, so what you quickly find out, and I guess we went there.

Chang-Tai Hsieh: my mind my collaborators went there, because they they knew what was going on.

Chang-Tai Hsieh: That what you see in the city, and this is something that you see in every city in China.

Chang-Tai Hsieh: Is that what at every level of the bureaucracy, the main thing that they'd be rockers he was doing is that they weren't doing what the official title or the official office was doing what they were doing is that they were basically.

Chang-Tai Hsieh: working overtime to basically get companies have set up in the city that's what quality prospects are it's basically all these companies, you know who can I.
Chang-Tai Hsieh: So, think of what they were doing as being sort of the equivalent of what half of you know what happened three years ago when.

00:32:53.730 --> 00:33:03.540
Chang-Tai Hsieh: In American studies when Amazon said that they were going to set up a second headquarter right all the cities went into overdrive and saying hey me me me me it's.

00:33:04.080 --> 00:33:13.860
Chang-Tai Hsieh: Like that's what these guys are doing right that's what these these guys, so let me just give you a broader sense of how this local government is organized.

00:33:14.190 --> 00:33:22.800
Chang-Tai Hsieh: The number one guy is the secretary of the Communist Party number two guy is the mayor, so this is, I think that's well understood so be ever do anything in China.

00:33:23.070 --> 00:33:30.810
Chang-Tai Hsieh: don't ever make the mistake to think that the mayor is the number one guy he's not is not it's the party Secretary that's the number one guy.

00:33:31.200 --> 00:33:42.270
Chang-Tai Hsieh: And then there are nine vice mayors and the guy that we knew is one of the nine by smears but what you find and then and then what we can document in this case.

00:33:42.630 --> 00:33:50.970
Chang-Tai Hsieh: Is that each of the vice mayor is assigned roughly 20 important projects and what we mean by projects.

00:33:51.420 --> 00:34:04.980
Chang-Tai Hsieh: aren't are busy they are in charge, they are the point person for specific private companies and they are responsible for bringing them into the city they're responsible for making sure that these companies have everything that they need.

00:34:05.460 --> 00:34:19.710
Chang-Tai Hsieh: In order to grow, the grow and we were we were not able to figure out the companies that the beer was in charge of or the partner, secondly, which Roger daltrey there are some that are in their heads, so the way that you want to see.

00:34:20.250 --> 00:34:25.500
Markus Brunnermeier: These startups So these are large companies just searching for new headquarters like Amazon.
Chang-Tai Hsieh: These are, in this case it's mostly large companies, the.

Chang-Tai Hsieh: yeah these are and just to be clear, for you know, for those of you who For those of you who are.

Chang-Tai Hsieh: enamored with the notion of state on firms, these are all private firms, I mean, these are all private firm so so really would like what these guys care, the most about is not the local state owned firms but it's but it's these private firms.

Chang-Tai Hsieh: That that's what they are 10 years ago that's what they are spending their time on.

Chang-Tai Hsieh: And that was their most important political priority to try to bring these companies at the town and to get these companies to grow, so the way I want to summarize sort of what the system was.

Chang-Tai Hsieh: Is that these local officials these local cadres they use the power of the local Communist Party to help their projects in this case, think about 250 companies in the city of two in the city of to.

Chang-Tai Hsieh: 2 million, and then the other piece, which I think is important is that it's not just this this local government that is doing that that that all these local governments are competing with with our are.

Chang-Tai Hsieh: are competing with each other in order, in order to do the soul, the best way that I can think of to to describe how competition takes place is that.

Chang-Tai Hsieh: it's really about the competition between businesses in the different cities it's the competition between Shanghai in all the companies that are tied to the party Secretary of aging versus Beijing Inc versus shenton incubator versus the 2000 other localities in China okay.
Markus Brunnermeier: So is it like opening the doors to make regulation easy or is it also providing funding so they're connected with state owned dangerous.

Markus Brunnermeier: That's a boring fund is this companies.

Chang-Tai Hsieh: Yeah that's a great question until about 2010 or so local governments did not have access to capital city, it was not about access to capital, one of the consequences of the 2008 financial crisis.

Chang-Tai Hsieh: Was that trying to implement a big fiscal stimulus and that opened the doors, because the way that was implemented was that they basically.

Chang-Tai Hsieh: got these local governments to create these off balance sheet financial companies and then, when the fiscal.

Chang-Tai Hsieh: Fiscal program or the fiscal stimulus was over, they basically use these financial vehicles these ufology companies to then channel money.

Chang-Tai Hsieh: And, and that that became the origin of shadow banking in in China, a couple years later that's men shadow banking started as an effort to try to get access to funds directly from from a Chinese families.

Chang-Tai Hsieh: But that was that so think of this as being sort of where things were about 10 years ago, why does this lead us up to the moment that we're in it's about the political implications of this month of this this particular.

Chang-Tai Hsieh: model of growth and the maybe the way that I want to illustrate this is to talk about a story that came out in the New York Times in 2012.
Chang-Tai Hsieh: That did two things in one of the New York Times, the pulitzer prize, and it also got the New York Times permanently blocked in China.

Chang-Tai Hsieh: Okay, but, and I think it's important because it's because I think this illustrates the story in in the times here the streets, the political.

Chang-Tai Hsieh: The political consequences of that particular model which is, which is going to lead us to the first strong hand that.

Chang-Tai Hsieh: They give back to in a minute, so the story in The Times came out it came up in October of 2012.

Chang-Tai Hsieh: was a story about this big insurance company wasn't just an insurance company called Ping on insurance think of this as a company, this was traded in Hong Kong Shanghai with a market cap of about $200 billion.

Chang-Tai Hsieh: If you look at who owns the company it's the hsbc back at three local financing vehicles so local governments that have put their money.

Chang-Tai Hsieh: What the New York Times noticed, so the title of the article of the new Yorkers was called the hidden shareholders of.

Chang-Tai Hsieh: of keeping on and what the guy from the times figured out it's a good question how he fi how that a couple of years before 2012 3% of the company shifted to becoming owned by this by this other company called high home holdings.

Chang-Tai Hsieh: Which what is tiger holding it's basically a holding show right, so what the article is about is basically what is type on holdings Okay, so this is a picture.

Chang-Tai Hsieh: From that piece in the times Okay, what is ty ty Hong Kong holdings, when what the times was able to do is that at the time.
Chang-Tai Hsieh: there's this Chinese registration data is basically the the registration records of companies.

And it was possible at that time to basically go to these to these local registration officers you follow a very basic form you pay a small fee.

Chang-Tai Hsieh: And you can see the registration documents or every Chinese company so that's what the time is there and what, and this is what he felt that he found a typhoon holdings is owned by two people.

And by three other holding shots right and then he went back and he looked got the registration documents of each one of these holding shells and the first thing that he documented.

Chang-Tai Hsieh: Is at these holding shells are look like they look like a Russian doll, that is, you know it's a holding show we look at the whole thing show in itself is owned by several other holding shells and that that holding shelf is owned by a bunch of other whole.

Chang-Tai Hsieh: bunch of other holding shells and so on, what the report of the times, he had a patient is that he basically went any trace down the entire tree.

Chang-Tai Hsieh: He traced on the entire tree eventually he figured out that tae kwon holdings was owned by basically people were relatives have one job as family.

Chang-Tai Hsieh: which was who he was the the the number two person in China at the time Okay, and by this other person called the the woman at the bottom called one color dwyane Wade Hong.

Kong called top ramen home and there's no a fascinating book written by her former husband that came out in the last year called red room that that I strongly recommend that you read, because now, I think, with that book, we now know the full story of this case okay so.
Chang-Tai Hsieh: What do I want you to take away from this, what I want you to take from this is that this kind of corporate structure started to become.

Chang-Tai Hsieh: The standard the norm for all the large Chinese private companies ended is when you started asked why it's easy to think about a reason why.

Chang-Tai Hsieh: Think back to the previous model where all these private companies they needed these local communist party officials to basically smooth the path for them.

Chang-Tai Hsieh: Okay Now you can ask a question okay Why are these local Communist Party visuals doing this for them, maybe they're doing this because they are.

Chang-Tai Hsieh: The Chinese equivalent of, say, priests of the Catholic Church they're doing us out of the goodness of their hearts and our the sense of mission.

Chang-Tai Hsieh: Maybe that's part of what's going on, but then at at a point where some of these companies, some of these projects turned out to be billion dollar companies.

Chang-Tai Hsieh: You know there's a very real temptation to say why not, you know I work so hard to get this company from $10 million to a billion why isn't it just fear that I have a small piece of that Okay, so this started to become this practice started to become widespread.

Chang-Tai Hsieh: Widespread so this brings us back then to the first strong hand Okay, so this was the world as of 2012 2013 2014.

Markus Brunnermeier: What my interpretation is people almost only got the Chinese way of having oligarchs.
Chang-Tai Hsieh: This is, I would say that's right, I would say I think what prevented from being oligarchy is just.

Chang-Tai Hsieh: Yes, and no, yes, but what what there's also this other feature of the Chinese system which is tremendous competition which basically limits there.

Chang-Tai Hsieh: So it's different from V, I think the Russian model which what what what what typically thinks about you think about.

Chang-Tai Hsieh: All the characters are very little of this, I think, is about rent most of it is really the that these are real businesses, these are real businesses, and they are, they are competitive, that they are yes it's a very competitive system.

Chang-Tai Hsieh: But the political so I want to bring you back the political implication of this particular model is that it's this.

Chang-Tai Hsieh: Is that this system was based on this on this alliance between entrepreneurs and local party congress Okay, so what started to happen in my interpretation is that.

Chang-Tai Hsieh: As these companies grew and became billion dollar companies, you know building dollars means that you start to matter right and you start to matter and the influence of the wealthy people such as this one, who was in.

Chang-Tai Hsieh: The picture become so widespread that it was viewed as an existential threat to the party in in the following sets that, basically, if you are a local party Qadri.

Chang-Tai Hsieh: What do you care more about do you care more about your hundred million dollars worth of equity.

Chang-Tai Hsieh: In these companies or do you care about maintaining your loyalty to the party and what is fabulous about the book by Miss daughter's husband and I strongly strongly recommend is that there's one chapter in the book where.
Markus Brunnermeier: You can you repeat the title because somebody would like to know that.

Chang-Tai Hsieh: Yes, let read grew let.

Chang-Tai Hsieh: His title there's a fascinating chapter in the book where they describe how they were able to basically push for the promotion of their people in the party.

Chang-Tai Hsieh: So, think about what what happens then the question is who controls, who right is it it is a party that's in charge of sort of the most important parts of the party on in terms of WHO.

Chang-Tai Hsieh: The who gets promoted up the system, or is it just the private interest of people like miss dawn and her husband, and I would say that you would you see is growing.

Chang-Tai Hsieh: evidence that that it is these entrepreneurs start to become really powerful political they started becoming very, very powerful, or at least, there was the perception that these guys really matter politically.

Markus Brunnermeier: So drunken can I.

Markus Brunnermeier: So there's this understanding that how the Chinese system works is through this tournament within the party.

Markus Brunnermeier: You know you're very successful in your Providence once you're more successful than the others, you move up the ranks and began them was successful in Beijing, you this would be undermined, to do subscribe to this tournament you.

Markus Brunnermeier: Or do you think this is not destroying the tournament viewers entry.
Chang-Tai Hsieh: I mean the tournament view is, I would say the official narrative in China that's the official narrative it's.

Obviously.

Chang-Tai Hsieh: it's really hard to know whether this is what is going on, or not I mean, so that this is not a joke, but it's all like the day when I get access to the personnel files of the communist party's organization department, I can test it apparently.

Chang-Tai Hsieh: that's not going that's going to happen, so I can safely say.

Chang-Tai Hsieh: i'm going to put forward, I think that they are i'm sure there are cases in which it's this tournament, but I would say that that is the I think a dramatic over simplification of of of.

Chang-Tai Hsieh: of how who have who gets promoted and who does not get promoted and I want to say that there's.

Chang-Tai Hsieh: There there, there are lots of other potential forces that also drive that that will also.

Chang-Tai Hsieh: drive it, so let me just come back and say what we have seen in China in the last 10 years is this broad based campaign okay.

Chang-Tai Hsieh: of which what i'm describing is only one part of it, to restore the control of the party and I will say that the way that you want it to think about it is that.

Chang-Tai Hsieh: You know I think there's this conventional wisdom that that the senior leader parties senior leaders in the party, the frequently talked about the.
Chang-Tai Hsieh: The Soviet Union and Eastern Europe and they say that the main mistake that was made, and this is a little quote is that they were not man enough to stand out and take an.

Chang-Tai Hsieh: intake and and and take and take back control so their prescription of what happened of what happened in Eastern Europe is that the Communist Party lost.

Chang-Tai Hsieh: lost their monopoly on power and they were not willing to fight in order to keep the monopoly power so.

Chang-Tai Hsieh: What what what's happened in China in the last 10 years was basically like the have a big campaign by the party to not go that route right.

Chang-Tai Hsieh: To to not go that route so i'm going to call this, this is not party that is not what the party has called it, but I would call it the first strong hand that is it's basically.

Chang-Tai Hsieh: What has happened is that there's been a crackdown on forces that pose any kind of a threat to the control of the party which includes some large wealthy private firms and and.

Chang-Tai Hsieh: and hopefully it's now clear at least my view on why is it that these guys posed sport was viewed as both in such a threat.

Chang-Tai Hsieh: To the party so it's not just a standard story in the US, that the wealthy companies have money, and they are power, but I think it's in China is a little bit different just because of this of the particular.

Chang-Tai Hsieh: alliance between the local Communist Party Congress and and successful entrepreneur, but I also want what what the audience to realize that it's not just this right that it's part of this broader.
Chang-Tai Hsieh: Cat it's part of the broader campaign to restore the control of the party that's the way you want to think about the anti corruption campaign that all almost all the anti corruption cases is about these local cadres.

00:49:58.740 --> 00:50:06.480
Chang-Tai Hsieh: Getting pills from from from from wealthy are from a wealthy entrepreneurs just going to crack down.

00:50:06.810 --> 00:50:17.760
Chang-Tai Hsieh: On celebrities you think about why our celebrities dangerous well because they're celebrities other that they're a source of independent political powers, but the crackdown.

00:50:18.180 --> 00:50:26.550
Chang-Tai Hsieh: NGOs is a crackdown on all the other potential sources of the transmission of ideology and he's that's my interpretation of the crackdown on.

00:50:26.970 --> 00:50:34.380
Chang-Tai Hsieh: On the after school Tutoring companies because there's no, you know these these Tutoring companies by not in the business of transmitting.

00:50:34.680 --> 00:50:40.800
Chang-Tai Hsieh: Communist Party ideology they're there to make sure your kid passes the methods and and that does no good.

00:50:41.400 --> 00:51:00.330
Chang-Tai Hsieh: Because you don't control what is being taught in the end, then let me just go on and say there the party cells in there's now widespread sells the Communist Party in private companies golden shares in critical infrastructure companies at the level of the party.

00:51:01.710 --> 00:51:14.190
Chang-Tai Hsieh: party committees are now much more important in in state entities, by which I mean stayed on firms hospitals university, so, if anything, it used to be that there.

00:51:14.610 --> 00:51:19.560
Chang-Tai Hsieh: always has been, this door structure in the stadium in the city in the state on and.

00:51:20.130 --> 00:51:26.700
Chang-Tai Hsieh: stayed on entities, for example, for most of the people here in this audience, you may have visited Chinese universities.
Chang-Tai Hsieh: That there's the president of the university or the dean of the school that that that you may see, but what you also know.

Chang-Tai Hsieh: Is are almost always right across the corridor there's also the office of the party Secretary of the Secretary of the Communist Party.

Chang-Tai Hsieh: And the authority of of the ladder has increased relative to the authority.

Chang-Tai Hsieh: Of the of the former there's now that increase importance of showing making sure that you are loyal to the party in terms of in terms of whether you are.

Chang-Tai Hsieh: promoted empirically what you see is that the the same guys that my co authors visited they used to work 24 seven.

Chang-Tai Hsieh: On business development that's no longer true right they now spend a great deal of their time on political study said on on Political Studies polluted study surgeons learning Xi Jinping thought, etc, and also.

Chang-Tai Hsieh: every few months there's now a different party inspection team that comes through that comes through check some things checks, I think, and it's a way to try to say it's all part of this care part of this campaign to impose party discipline OK so.

Markus Brunnermeier: The way to quantify how big efficiently losses on terms of economic brokenness.

Chang-Tai Hsieh: it's a great.

Chang-Tai Hsieh: Question right.
I wish yeah I mean I would love to do that, or I would love if somebody were to able to even something simple like.

Just a time you survey, or what local cutters are doing are spending time on are doing time and that would be lovely but part of what that I think will be very hard to do it in.

today's China because it will, it will be viewed as something that also threatens the control of the party, if you if you were to try to do that so.

So, so this is the first strong hands and and the way I want you to understand is that it's not in isolation right it's not just this one thing, but it's just.

part is just I think probably the most important component of this broader of this of this broader campaign to try to you know I guess to use marcus's term to try to make sure that Chinese all the guards do not control the political system.

Okay Now let me just say that what just be clear sort of this my view on what this is not Okay, it is not a crackdown on large companies per se.

right that is it's not about the trainees, all of a sudden becoming like Elizabeth Warren.

That I don't think that that's what it is because there's no practical if if you know there's a lot of people who are saying that oh it's about.

crackdown on monopolies trying to deal with mark trying to deal with the market power of some of these platform company there is zero crack down on some of the biggest monopolies that they just happen to be stayed on.
Chang-Tai Hsieh: write about, and let me just also highlight for the for the foreign investors is that there were zero crackdown on the large foreign firms and, in fact.

00:54:46.830 --> 00:54:57.450
Chang-Tai Hsieh: The conditions for the foreign firms, I think, have gotten even better so tesla in Shanghai has gotten deals that I think no other company.

00:54:57.960 --> 00:55:19.770
Chang-Tai Hsieh: In China has been able to get access to Taiwan semiconductor in a non in a non Jing is treated well as well, and if they ever wanted to expand in China, you will guarantee you that 1000 local governments will we will have will be knocking on their door foxconn.

00:55:20.430 --> 00:55:27.600
Markus Brunnermeier: is staying organized by the local government or in Beijing that give testimony special deal with deciding about the special.

00:55:27.990 --> 00:55:36.540
Chang-Tai Hsieh: it's I mean it's it's it's a Shanghai, to me, let me just say that, like the biggest deal that does, I mean.

00:55:37.950 --> 00:56:11.070
Chang-Tai Hsieh: You look at the kind of deals that tesla has is is incredible the like they get some of the best land in Shanghai for free, they are the only foreign car company that's that has been allowed to own the company 100% all the other companies have to operate through joint ventures.

00:55:59.130 --> 00:56:11.070
Chang-Tai Hsieh: And the reason is because it is viewed it's viewed in the same way by the Chinese as as US us investors like, if you think about why tesla is.

00:56:11.760 --> 00:56:19.320
Chang-Tai Hsieh: valuation is so high, is because it's viewed as being the company that is going to bring us to the next stage of cars.

00:56:19.680 --> 00:56:25.980
Chang-Tai Hsieh: That we are finally good to go to move away from the hubble year from the model that was introduced by Henry Ford.

00:56:26.280 --> 00:56:38.340
Chang-Tai Hsieh: And we there's going to be the new paradigm and tesla is going to be in in charge of it, so they are willing to do whatever it takes to to get their piece of of this so for a.
Chang-Tai Hsieh: If the way I think about it is I look the reason why there's no path and and large.

Chang-Tai Hsieh: A large for foreign firms is or it's easy to understand why there's no crackdown on the state on monopolies that is.

Chang-Tai Hsieh: You control so they never pose a threat to you why is there not a crackdown on a large for for for what, precisely because there, for that is because there for firms, they can.

Chang-Tai Hsieh: They they can never challenge you politically in the same way that that chalk mark can.

Chang-Tai Hsieh: Okay, so it sort of reminds me of the story, I don't know whether it's true but there's a story that i've heard about.

Chang-Tai Hsieh: Indonesia under Suharto that the only people that could make the deals with waters families where the Indonesian Chinese.

Chang-Tai Hsieh: That if you're a native Indonesian you weren't able to make a deal, and the reason was because the Chinese were in the minority and they were also hated.

Chang-Tai Hsieh: There was a hater so that even if they become billionaires because they were Chinese they could never threaten Suharto poor they can they never threaten so hard to Paul.

Chang-Tai Hsieh: So so hard to a political, so I again I want to emphasize here that it's my us that it's not about sort of it's a very different, although on the surface, it may look like.

Chang-Tai Hsieh: The same kind of thing that we're seeing in the US, you know the stories that we're hearing out of the FTC the things stories we're hearing out of Elizabeth Warren staff.
Chang-Tai Hsieh: About you know growing monopoly power, etc, etc, I don't think at all what is going on in China, despite on a spot on the surface, it looks like the same thing here, I think, fundamentally, is about the threat to to to a threat to the Lennon as part of.

Chang-Tai Hsieh: Now let me end by saying that you know the problem.

Chang-Tai Hsieh: With this political campaign with the first strong hand this was what Marcus high versus what what.

Chang-Tai Hsieh: Marcus highlighted that if you crack down and some of your most successful firms and, more broadly, if you if you crack down on the model on this alliance that has delivered you growth that obviously.

Chang-Tai Hsieh: You know you're going to grow that, if so, and then, if you heard growth, then, that if you ever grow, then, then I mean that.

Chang-Tai Hsieh: That is the other thing that eventually I think if if the Chinese economy falters, in the long run, that I think is also going to pose a very real threat to the party.

Chang-Tai Hsieh: To to the power of the party because it's built a lot of its legitimacy on this notion that it is competent at it and it is deliberate, growth and prosperity Chinese citizens, and if it doesn't do that anymore, then that then, then that is serious political trouble.

Chang-Tai Hsieh: So this is where the second strong hand comes.

Chang-Tai Hsieh: Right, the second song and and.

Chang-Tai Hsieh: And then.
Chang-Tai Hsieh: i'm not going to to repeat the list of things that have done, but let me just say what is the vision.

Chang-Tai Hsieh: That the vision is that it's basically the recognition that the first strong hand which they need in order to survive politically.

Chang-Tai Hsieh: Basically, to kill off the oligarchs also hurts growth, but if you really heard growth that is also going to kill you so you, and then the second strong hand is to try to square that circle that is.

Chang-Tai Hsieh: it's what we're going to what what what I think what they're attempting to do.

Chang-Tai Hsieh: to support the millions of small and medium sized firms to do what they haven't done for decades, but now they're beginning to they they are that they are beginning to to.

Chang-Tai Hsieh: To do this, and the key advantage of the small and medium sized firms is that as long as they remain small they don't pose a political threat.

Chang-Tai Hsieh: They are not oligarchs so it's about you don't you don't face a threat from a $30 billion company, but you do face a threat from a $30 billion company.

Markus Brunnermeier: Leave somebody owns.

Markus Brunnermeier: 20 of these firms is this a problem.

Chang-Tai Hsieh: It is possible it's possible that there's somebody that owns 20 of them, and if you have a bad Marcus I have another paper we are trying to document, this does.
Chang-Tai Hsieh: not go.

Chang-Tai Hsieh: In let me not go into that now, but let me just end by just saying, but summarizing what I think the vision is that it's about trying to do to have two things it's about having a dynamic market economy Okay, that is fully under the control of the Communist Party.

Chang-Tai Hsieh: that's the goal okay.

Chang-Tai Hsieh: And whether they're going to be able to do it, or whether these or another way to say this is that whether these two strong hands are in contradiction.

Chang-Tai Hsieh: I guess I don't know I don't know so you know, can you have growth if you if it from from a lot more billion dollar companies, but at the same time you kill off the.

Chang-Tai Hsieh: The you kill off the billion dollar companies will the billion dollar companies start investing if they know that if they ever become a billion dollar company, they will come into the firing line of the party right I don't know I don't know if that's the but here I.

Chang-Tai Hsieh: yeah so I guess that's all that's all I want to say that is this is where I think, China is now, and whether it will work or not.

Chang-Tai Hsieh: But time will tell.

Markus Brunnermeier: Let me ask a few questions also from the audience.

Markus Brunnermeier: So you have more slides or we can.
Markus Brunnermeier: So one thing is if i'm a small and medium enterprise, but i'm being successful become bigger and bigger.

Markus Brunnermeier: yeah what do I do when I become too big, I spin off companies in all States small or do we just stop growing and saying I don't want to fly under the radar.

Markus Brunnermeier: The two ways that I just don't become active anymore I just keep doing what i'm doing but I don't expand was a spin off companies do we see already so companies spinning off other sub companies, just to stay small to be one conclusion somebody might have.

Markus Brunnermeier: To specialize more and the other thing having thing i've conglomerate with covering many, many things I spin off companies and they're all small and independent them.

Chang-Tai Hsieh: that's a good question, I guess, I don't have the evidence yet to fully I yeah I would say that I don't have the evidence to fully answer that question.

Chang-Tai Hsieh: I mean one answer could could be that you just you that if you know this is going to happen, then you just don't undertake the efforts and you don't undertake the investments that are needed in order to grow.

Markus Brunnermeier: start a new company.

Chang-Tai Hsieh: The question then is what is view.

Chang-Tai Hsieh: You could start up a new company and I guess, I do have documentation that an important margin, by which entrepreneurs grow in China is is through is through the is through the extensive margin.

Chang-Tai Hsieh: Not a not so much to the.
Chang-Tai Hsieh: The question is whether having lots of companies will also put you in the firing line.

Chang-Tai Hsieh: and

Chang-Tai Hsieh: Let me just say that, and I think there's.

Markus Brunnermeier: Because you said everybody was managing 20 companies, it could be that I manage now hundred companies.

Markus Brunnermeier: hundred small companies and i'm my incentives are equally distorted not belong to the party too, but below.

Chang-Tai Hsieh: yeah yeah no you're so let me just go back to sort.

Chang-Tai Hsieh: Of the story from the times it, so the way that guy from the times did it is he basically went to the went through the paper documents, what is now possible is at fault that all these registration data it's been digitized.

Chang-Tai Hsieh: And they are now a couple of companies.

Chang-Tai Hsieh: Then now sell it there now so as, so now it is really easy to sort of be to to put together this ownership map.

Chang-Tai Hsieh: of a given person so it's really before it used to be hard you basically have to go through every single.
Chang-Tai Hsieh: registry if a person owns 200 companies it's a lot of work to figure it out now I think it's it's much easier to figure out whether a person has to to us as 200 companies and then, if you have 200 companies that are collected worth $30 billion.

Markus Brunnermeier: Also me is that this you know if you think about what's the big advantage of China and everybody tells me it's a scale.

Markus Brunnermeier: Know it's like you have 1.6 million people a billion people well if you go to another market it's a small tiny market here.

Markus Brunnermeier: yeah and that speaks essentially that there's a huge advantage for being big and if the official doctrine is not to allow you to be big you don't take advantage of the scale, so you can actually reduce the scope to become much more specialized and still scale up.

Markus Brunnermeier: Is this one, you see that you know companies, become more specialized less conglomerates, but they still want to explore this scale or or that will be attention of the two strong hands and saying, or you know, the first animal prevent exploiting the scale of dementia.

Chang-Tai Hsieh: We see lots of creation of small companies, I think that the creation of new companies is.

Chang-Tai Hsieh: Is recent enough that I don't.
Chang-Tai Hsieh: So let me just say that there are two things that we've seen in the data in the last 15 years so whatever they tell you now is based on the registration right.

Chang-Tai Hsieh: Ray just registration records that you see that the top the top owners grow and the way they grow is is by essentially by by building up more firms and the way it's typically done is they build up more firms by through joint ventures with stayed on firms so that's one pattern.

Chang-Tai Hsieh: Now, whether that has come to a halt that's kinda how I guess our data doesn't it's it's I think this this what i'm talking about is to recent.

Chang-Tai Hsieh: For it to show up yeah in in the data The other thing that you see is a lot of the single owner or one owner one firm that that has.

Chang-Tai Hsieh: That has exploded, the question that you're asking I think it's really more a question about 10 years down the line, what are these guys going to do right and.

Markus Brunnermeier: So the other thing is, and you hinted to it a little bit is that it might be that certain data is just reclassified so once you know the government doesn't like big firms anymore i'd rather have five small SMEs.

Markus Brunnermeier: And what was initially treated as one big firm is now you know to five SMEs.

Markus Brunnermeier: is still an issue that also the loan data and other things you know, given that i'm a get a favorable treatment before label myself an SME.

Markus Brunnermeier: That there's a relabeling going on, or that the stores to Daytona sense.
Markus Brunnermeier: Just to.

Chang-Tai Hsieh: get this data in the data that I have.

Chang-Tai Hsieh: It so I have.

Chang-Tai Hsieh: Access to the registration data up into 2009 until 2019 I don't see that yet in the data.

Chang-Tai Hsieh: So maybe eventually is going to happen, but I haven't seen it yet.

Markus Brunnermeier: So the next issue would like to raise is.

Markus Brunnermeier: There was always the understanding and we talked about this earlier that the Chinese firms expand become national champions, and then also make.

Markus Brunnermeier: take on an important role in the international market and other countries if you don't allow national champions, if you don't allow big companies it's probably much harder to reach a broad.

Markus Brunnermeier: Is this less important for the Chinese party that you know you have some national champions, you know being very active in in other Asian countries or in Africa.

Markus Brunnermeier: One is sacrificing that deliberately or that's it's overlooked that that's one of the costs.

Chang-Tai Hsieh: Well that's that.
Chang-Tai Hsieh: If you go back to the world in China in 2012 2013 there's this really interesting pattern that you see in the Chinese data that.

Chang-Tai Hsieh: In almost every country in the world what you see is a large firms, export and smaller firms.

Chang-Tai Hsieh: That that's a pattern, you see, almost.

Chang-Tai Hsieh: Everywhere in China in in at least in the manufacturing data, you see exactly the opposite pattern what you see is that the smaller firms are the one that export and the big firms don't.

Chang-Tai Hsieh: My interpretation of that pattern is is that is one of the consequences, what is one of the negative consequences of that particular of the model of growth that I described.

Chang-Tai Hsieh: That, if you are say a car company based in Shanghai what you do is that because you are the local champion you don't.

Chang-Tai Hsieh: You have the power to not let anybody else in to that market okay.

Chang-Tai Hsieh: But these are the largest companies like, if you look at the largest car company, these are the Shanghai based car car car now.

Chang-Tai Hsieh: The car companies that export in China, these are the companies that are the local champions of a city like the one that I described.

Chang-Tai Hsieh: I visit a 2 million person city, these are the companies that were like to sell in Shanghai, but they don't.
Chang-Tai Hsieh: They don't because they're basically blocked by the Shanghai companies so the way that they can do it, so what you see them doing is that the end this is almost their words, they say that.

01:11:37.950 --> 01:11:54.360
Chang-Tai Hsieh: When we sell in Central America, the reason that we sell in Central America is because we can compete on a level playing field in Central America, but in Shanghai or Beijing or other cities we were up against the local party bus.

01:11:55.500 --> 01:12:07.260
Chang-Tai Hsieh: So I would think to just flip your question and had that having more small and medium sized club because of this part in so that, let me just say Lord the empirical pattern.

01:12:07.620 --> 01:12:16.290
Chang-Tai Hsieh: Is that the larger Chinese companies generally by and large, do not export or the export less it's a small and medium sized firms that do.

01:12:16.710 --> 01:12:31.770
Chang-Tai Hsieh: That do having more small and medium sized firms that force by itself, my prediction is that that's going to lead to more, not less Okay, with one caveat with with one caveat, which is is.

01:12:33.750 --> 01:12:38.400
Chang-Tai Hsieh: The reaction of the West to this month, that is.

01:12:39.480 --> 01:12:48.930
Chang-Tai Hsieh: If you know that this is what you're dealing with what you are that this, you are, that that you are trading.

01:12:49.470 --> 01:12:59.580
Chang-Tai Hsieh: With the market economy and under the control of the Communist Party then does that will that make you and which a lot of discussion about this world that would.

01:12:59.880 --> 01:13:17.520
Chang-Tai Hsieh: make you try to be more cautious in terms of who you are engaged in treatment that, fundamentally, you know that even the these are small companies that they are fundamentally still under the control of the party right so it's it's it's the huawei debate with barge.

Markus Brunnermeier: But if I may summarize what you're saying, because of this local party control, you have essentially a segmented market at home in China yeah.

421
01:13:28.710 --> 01:13:40.050
Markus Brunnermeier: And you don't have to scale effect because it's so segmented so it's a big disadvantage, so what you do is rather than try to sell abroad coming internationals small company exporting a lot yeah.

422
01:13:40.140 --> 01:13:52.290
Markus Brunnermeier: Absolutely, but China for goes this entry through the segmentation this big advantage of scale effects at home, which it still allows the test last if one comes back and explore the scale, but the domestic ones cannot.

423
01:13:52.770 --> 01:13:55.590
Markus Brunnermeier: exactly is this to stock OK.

424
01:13:57.930 --> 01:14:12.840
Markus Brunnermeier: I see so that's a very interesting, but in a sense, it reminds me you're In Germany, we have to submit those down this mid sized companies, which are small very specialized but a very internationally active, they are the leaders in very small segments.

425
01:14:13.890 --> 01:14:14.820
Markus Brunnermeier: around the globe.

426
01:14:16.050 --> 01:14:20.250
Markus Brunnermeier: But they don't they don't grow too large conglomerates that was done by some families.

427
01:14:21.960 --> 01:14:25.620
Markus Brunnermeier: And there's some similarity they I guess on this.

428
01:14:28.740 --> 01:14:29.070
Markus Brunnermeier: topic.

429
01:14:29.220 --> 01:14:35.580
Chang-Tai Hsieh: I would love to know why is it that Germany develop in this way, I mean I.

430
01:14:36.870 --> 01:14:37.140
I.
Markus Brunnermeier: So historically Germany was very segmented to know it was not one concrete was many little.

Markus Brunnermeier: small States come together and there was a spirit always to have smaller cameras family and companies.

Markus Brunnermeier: What smalling I probably it's what small in China might be large Germany because number of people is not not much not.

Markus Brunnermeier: Let me just conclude a little bit so we also we did not touch on this over investment in real estate, the huge debt burden.

Markus Brunnermeier: Does this interact in this vision, somehow, and this came also from you know how you may how China was actually managing you 2008 the global financial crisis by having this huge stimulus.

Markus Brunnermeier: You touched upon it a little bit that this had so many vacations that suddenly the local leaders could also help in the financing of these new companies.

Markus Brunnermeier: and give them extra leverage and make this more powerful and for the first time in but you see the debt level into playing with us on investment in real estate is this totally orthogonal or do we have to see any.

Chang-Tai Hsieh: Part of it, I mean I think it's it's part of it, I mean, where does that come from it comes from the sing it comes from the same alliance it comes from exactly the same lions.
Chang-Tai Hsieh: But where it was i'm going to say the institutional consequence of how China decided to fund its fiscal stimulus, that is if the funny thing is that, if you look at the if you look at the.

01:16:20.490 --> 01:16:33.330
Chang-Tai Hsieh: The the accounts of the Chinese Government in 2008 2009 when they ran a huge fiscal stimulus you look at the budget deficit of the government, nothing changed.

01:16:34.860 --> 01:16:41.250
Chang-Tai Hsieh: And the reason is because the way that it was basically to create all these off balance sheet companies, and then they would borrow.

01:16:41.790 --> 01:16:51.510
Chang-Tai Hsieh: they're not officially part of the guy was officially part of the government, the really interesting that then to just go back your story is what happened after 2010.

01:16:51.930 --> 01:17:02.760
Chang-Tai Hsieh: When the fiscal stimulus was over the central government say okay guys, the fiscal stimulus program is over, that that shut down all these local these these often and she companies.

01:17:03.030 --> 01:17:13.650
Chang-Tai Hsieh: And you can imagine what these local governments, said that you know I have 10% of GDP flowing in flowing through these financial companies, no, thank you, I like.

Chang-Tai Hsieh: Having can having control over this, then what happens that then they started to fund these companies and they saw they started to fund these projects right, it is this alliance and starting into 2000 and then.

01:17:30.210 --> 01:17:42.510
Chang-Tai Hsieh: If you want to go through the full story in 2012 and what what What happened was that the central garbage can order the state on bands to stop lending to the archeology companies.

01:17:42.840 --> 01:17:53.760
Chang-Tai Hsieh: The response of the local government than was was to say okay fine we're then going to set up these shadow banking institutions to basically get money that we know we can no longer get from.

01:17:54.090 --> 01:18:03.300
Chang-Tai Hsieh: The you know no longer get from the central bank's either what they started, and I would say that what is all this will make a lovely study to that that is.

01:18:04.380 --> 01:18:19.950
Chang-Tai Hsieh: I think that what they've been doing is partly what you said to basically lend to real estate lend to all these projects that are that are have gone bust that will eventually go bust, but I also think that.

01:18:21.390 --> 01:18:30.420
Chang-Tai Hsieh: Almost all of the vc funds are also funded by these local financing the logo, so it that I I my.

01:18:31.020 --> 01:18:37.500
Chang-Tai Hsieh: My guess is that if you are to get all that data and give it a look at the price of what they've invested their money and.

01:18:37.830 --> 01:19:11.700
Chang-Tai Hsieh: I think what you what you're going to find is the Bible distribution, that is, they are going to be a bunch of projects that I think are are is stuff that you think that the financial sector should be doing and and a bunch of stuff that looks like that looks like crony lending.

01:19:12.270 --> 01:19:17.520
Markus Brunnermeier: So let me conclude with the final question.

01:19:19.530 --> 01:19:25.890
Markus Brunnermeier: Do you think what the Chinese party does is the ultimate thing for them to do, given the amount of stay in control.

01:19:26.970 --> 01:19:40.410
Markus Brunnermeier: And secondly, do you think it was a deliberate strategy to to strong hands that haven't go, we have there's two components, or do you think it just happened to an out this way, and you exposed found this rationalization.
Chang-Tai Hsieh: Let me answer the second question, first, I absolutely believe that it is very much the way I would describe it.

Chang-Tai Hsieh: I don't think at all, it was a deliberate strategy, I think it really is the second thing that you, you are.

Chang-Tai Hsieh: Describing I think what I mean I may the way I present It may sound like it was a deliberate strategy I don't mean to do that at all, it was very much like to use the Chinese term crossing the River by putting stones, it was very much, I think.

Chang-Tai Hsieh: Just trial and error and and figure out what works and figure out what what what.

Chang-Tai Hsieh: doesn't work, but I think that is true of almost like almost everything that you see coming out of China that I think.

Chang-Tai Hsieh: That that very rarely is a plan in this way is applied in this way and it's only after the fact that they you start to package, it into.

Chang-Tai Hsieh: I mean, I think you know you started out by talking about the belt and road about the role the way I think about about the road is that it was primarily a marketing campaign.

Chang-Tai Hsieh: That it was already good going with I think there's one the other consequence.

Chang-Tai Hsieh: Of the fiscal stimulus that after the fiscal stimulus ended all these companies, then took their projects and they went.
Chang-Tai Hsieh: And they basically took their projects abroad in 2015 days before the central government decided to do is to basically put a ribbon around all these projects and call it.

Chang-Tai Hsieh: campaign, and many of us then interpreted as this campaign, you by the Communist Party to control the world I would look at what what what is what the origin of it, I don't think that's the case.

Chang-Tai Hsieh: that's the case at all, so let me just answer that is that I don't think at all, it was a dilute it was a deliberate campaign, I think.

Chang-Tai Hsieh: that the first strong hand, I think, very much is a deliberative campaign because that I think was I don't think they call it that, right they they that's not what they call it.

Chang-Tai Hsieh: But that and but, but even then I don't think they decided and all the pieces, at the same time, I mean the first piece was the anti corruption campaign and all the other pieces was again.

Chang-Tai Hsieh: crossing the River right coke or across the river bye bye touch the song so in a sense, I guess, to what i'm doing is that I am yeah I am putting a label on putting a ribbon on.

Chang-Tai Hsieh: What I see them doing, but if.

Markus Brunnermeier: You do think it's the optimal strategy for the Chinese Communist Party.

Chang-Tai Hsieh: Well, what goal.

Markus Brunnermeier: Given the goal, you want to stay in control.
Markus Brunnermeier: And you don't want to bring their economic growth, I mean you have to keep, as you said, keep economic growth going, otherwise you also lose power.

01:22:27.300 --> 01:22:30.120
Chang-Tai Hsieh: My own view you want about my own view.

Yes.

01:22:33.630 --> 01:22:37.500
Chang-Tai Hsieh: I mean my own personal view, is it absolutely is the wrong church.

Markus Brunnermeier: absolutely wrong so.

Chang-Tai Hsieh: Much it's as is a wrong is wrong is around me.

01:22:44.640 --> 01:22:54.540
Chang-Tai Hsieh: I think it comes back to sort of this i'm going to call it, this new this new eroticism of the party that that that.

01:22:55.620 --> 01:23:06.120
Chang-Tai Hsieh: you either have complete control over everything or you die or you die that I think is just me that is sort of fundamental to the DNA of the party.

01:23:06.600 --> 01:23:15.390
Chang-Tai Hsieh: My belief is that it's absolutely NUTS right but it's a way that they it's a way that they think it's a way that I think and and you know I.

01:23:15.870 --> 01:23:33.360
Chang-Tai Hsieh: I respect how everybody thinks, but in my own personal view, I think that's just a crazy view of the world, I mean you know I believe in freedom, I believe in freedom, I think that there are ways in which you can do what you want to do, while still giving people their freedom.

01:23:35.880 --> 01:23:38.010
Chang-Tai Hsieh: I mean what is it it's liberal democracy right.
Markus Brunnermeier: So you don't think so, this strategy makes it harder to stay within one unified global economy to think that makes makes a bipolar world more likely as well, or because you have, on the one hand, you have more.

Chang-Tai Hsieh: It's a great question right it's a great.

Chang-Tai Hsieh: Yiannis corn, I wrote this op ED in the Financial Times, the titled something like I have created a Frankenstein and if you know something about your nose or nine he was instrumental in the first 10 years of Chinese reform.

Chang-Tai Hsieh: But she was one of the people behind sort of the design of their price liberalisation strategy.

Chang-Tai Hsieh: There was this famous week long boat ride down the Yangtze river in 1985 when all the young Chinese read all the young Chinese reformers hammered out their plan and yellows wasn't fighting on that boat right was.
Chang-Tai Hsieh: ended jada's road and basically said look, you know I thought back in 1985 that I was doing something good right, but what i've done what he said is that i've created this Frankenstein which is way by which he means it's this.

Chang-Tai Hsieh: rich country, but with a particular political structure and it's it's become a Frankenstein and I don't know the answer to to to that well, I guess, would I say that I don't know I don't know so so it's it's it's that I think is the fundamental question.

Chang-Tai Hsieh: That that faces us right that the face of we all understand about the gains from trade we all, you know so that's well understood the question is, what are you willing.

Chang-Tai Hsieh: To trade off right, what are you willing, I mean sort of the same dilemma that Europe is facing germany's facing with respect to Russia now right that they are games from trade but.

Chang-Tai Hsieh: What else, are you are you trading So the question is what, and this is beyond my pay scale we were, which is what are the implications of the world, for having if we.

Chang-Tai Hsieh: If this vision works right what will, what are the implications for the world if the most powerful country economically, the world is this lead into structure as well right and.

Markus Brunnermeier: Good so with this.

Markus Brunnermeier: Big open question.

Chang-Tai Hsieh: Adam I don't know.

Markus Brunnermeier: We will come back once you have answered or found a solution.
Markus Brunnermeier: To that this was very fascinating I think it's very nice to you know put a ribbon around it and kept the big vision and conceptualization what's going on, I think I really appreciate that and I really like it.

Markus Brunnermeier: So, thanks to you, and thanks to all the participants and next week, we will talk about how we can actually make all purchases more efficient, in particular by having a purchasing board.

Markus Brunnermeier: In contrast to OPEC, so how to design the best way to purchase energy instead of ashes on will present that next Thursday.

Markus Brunnermeier: So thanks again.

Markus Brunnermeier: All right, talk to you soon.

Markus Brunnermeier: All right, bye bye.