

China Watch

A China Business Report prepared by David Mahon,
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S P R I N G 2 0 1 0

*When the government does not interfere
the people are simple and happy.*

*When the government does interfere
the people are tense and cunning.*

Laozi, 5th century BC

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The illiberal nation

Over the last 24 months, China has experienced challenges to its economic and social stability as great as any it has faced in the last two decades.

China is becoming increasingly conservative. The Party has reasserted its power and the security services have more political influence than at any time since the early 1990s. We are experiencing a new era of nationalism and totalitarianism. This will not be short-lived.

British manager of a multinational trading company

The first challenge was internal. The Chinese government misread the rise in food prices in early 2008 as harbingers of greater inflationary forces. The real causative factors lay in the supply chains of products such as meat and

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grain, showing how, despite the extraordinary evolution of the Chinese domestic market, it is still a developing economy in which the supply and demand for many products lack balance. The government was also concerned about the steep rise in house prices that was depriving ordinary

citizens of the chance to buy apartments. The banks restricted credit and the economy began to slow, leaving China off-balance when the global financial economic crisis hit.

Throughout this period there was also the growing pressure of the Olympic Games in Beijing. As any post-Munich, post-9/11 nation would be, China was naturally anxious that the games would be used for demonstrations against its own domestic policies, or as a forum for random international terrorism. Uprisings in Lhasa and many cities in Muslim Xinjiang in 2008

by Tibetans and Uyghurs using China's Olympic year to draw attention to their grievances confirmed these fears.

Security organisations, which had faded in importance over the previous decade, were re-empowered. General surveillance was increased in major cities; open air markets were closed and minority residents of Beijing, particularly Tibetans and Uyghurs, were sent back to their provinces. Due to the stringent visa vetting processes, instead of receiving 12 million visitors to the Olympics, Beijing received only 6 million, causing many businesses to lose money and the potential for an international public relations coup to be only fulfilled partially. After the Olympics, the restrictions remained in place, making it hard for foreign business travellers who visit China regularly to get visas. The reason given for maintaining these restrictions throughout 2009 was that the celebrations for the 60th anniversary of the founding of the People's Republic of China posed another security risk.

Throughout this period ran the deadly rhythm of the global economic crisis, during which the world seemed (and still seems, to some extent) united in fear of another Great Depression. Despite its own strong economy, China faced an uncertain future with understandable anxiety.

As the Chinese export sector declined in 2009, millions of workers from the export boom towns of the coast returned to their often economically backward home provinces. The brutal attacks on Han Chinese in Xinjiang's capital, Urumqi, were initiated by disaffected young Uyghur workers who had lost their jobs in Guangdong province. They returned home, indignant at years of mistreatment and racism, to unemployment and the shock of the extent to which they had been marginalised by Han Chinese in the province where the Uyghurs had once been the majority.

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There was also an increase in demonstrations over the arbitrary application of law in some cities and counties, particularly in respect of the appropriation of land from farmers or the relocation of urban dwellers as inner cities were redeveloped. As shock followed shock throughout 2008 and 2009, the Chinese

government increased surveillance and security, appearing to regress to the anxious reactions of previous decades.

The Expo 2010 in Shanghai, to open in May 2010 and run for six months, is the latest justification for the maintenance of many of these security restrictions. A common current debate among sinologists and Chinese domestic political and economic analysts is whether this slide will continue or is a temporary reaction to extraordinary and unfortunate events.

Old solutions to new problems

Over the last two years, China has done what many governments do in time of crisis: reach for the tools that they have used in previous crises in order to deal with new ones. Chinese security officials would argue that the measures worked and that China has come through a very difficult period in a relatively stable manner. From a security standpoint this is true, and the threat of international terrorism cannot be ignored. Nevertheless, while China tightened domestic surveillance and applied denser immigration filters, there was no sense that the country had become the police state that it has so often and mistakenly been cast as being.

If anything, a bureaucracy that usually functions well became less efficient, as government servants struggled to apply stricter rules. The liberty of ordinary citizens was still compromised and the pettiness of many of the measures revealed an insecure administration with a propensity to overreact. China knows only too well that, while it is easy to give more power to security services, it is a slow and difficult process to rescind those powers. This is as true in Washington and London as it is in Beijing.

The world is still struggling with the ramifications of unnecessarily invasive powers, such as the extra banking compliance and cross-border security measures that were established after the World Trade Center attacks and the London and Madrid bombings. With perhaps more subtlety than Beijing, but no less manipulation, some Western governments have kept the language of vague external threats alive as an instrument of social control. China will still have its North Korean moments, but it cannot afford the social rigidity that results from this insidious strategy.

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A unique form of liberalism has played as important a role in the evolution of China as the single-mindedness of its political leaders (so often praised by foreign business people and envied by Western politicians), or the patience and stamina of its population. If the Chinese Communist Party had loosened the tethers that

bound the people to communism with a single gesture, the country would have collapsed. The pressure was released slowly and somewhat consciously, first for the Party's own ends in developing the economy, and then because there was no choice.

Having tasted real freedom, Chinese people wanted more than just the freedom to make more money, consume and travel; they wanted to be free from the fear that gripped China from the late 1950s to the late 1970s, and in various ways into the early 1990s. The Chinese Communist Party remains in power not simply because of its ability to deliver ever-increasing wealth (or at least the prospects of it), but also its ability to

nurture a growing sense of personal freedom and dignity. This recent loss of social flexibility can only be temporary. The medium- and long-term mandate of the party depends upon increased openness and transparency.

"Look at the generational differences in this team. Those born after 1985 seem less constrained; they travel more, expect more of life and take more risks. They are often said to be more selfish, but this is unkind, as they have their own life struggles and the traditional family obligations. The older staff have their unique qualities too, but they tend to be more conservative and often have more circuitous ways of getting things done; it manifests at times as a sort of cunning. I see this in myself. It is a hangover from the Cultural Revolution."

Chinese CEO of a foreign joint venture

China's tilted markets

There are foreigners who believe that China will not be free to realise its potential until the Communist Party has been overthrown and a new, more pluralistic system that resembles Judeo-Christian democracy is established. The fall of the Soviet Union and the sudden independence of its satellite states have shown that revolutionary change can be as

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destructive as it can be liberating. In a country as backward as most of China remains, and as vast and populous, it is reckless to hope for the collapse of any of the current key systems of government, no matter how flawed they may be. The forces that really count in the

economic and political history of any nation are the medium- to long-term trends. Any chart measuring the trends in transparency and individual liberty in China over the last 20 years would show steep rising curves. These will continue because the government has no choice and the people, for all their forbearance, will accept no less.

Foreign companies have been complaining that China's illiberal shift has already affected commercial activities in the country. There has, in fact, been no demonstrative change in China's market. The Chinese economy, while being more open than even many developed economies in the world, has always been affected by local political interests and wary of foreign dominance. It has never been a level playing field, but it may appear to be more tilted toward local interests now that the financial stakes are higher. Although still haunted by insecurity, China is now also a wealthier and more confident nation than it was even five years ago. Its need for foreign investment is less, as it now focuses more on acquiring technology and knowhow.

Many foreign managers in China have been here less than 18 months and have few firm benchmarks against which to measure current events. Some

of those foreign businesspeople who have been here longer may miss the atmosphere during the years when Chinese businesspeople were less confident and more deferential. Chinese market factors have often been used by foreign managers as excuses for failure.

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An emboldened China will make a more assertive negotiator in international transactions and will become increasingly stubborn about such issues as the currency valuation and dumping charges. It is sobering to note that, in the debate, more heated in Washington than anywhere else, the image of China as a negative arbiter of world trade and currency values is without foundation. China's share of world trade in 1990 was a mere 1.9%, rising to 4% in 2000 and still only 10% in 2009. Yet, galvanised by the knowledge that it has come through the recession stronger than before, China will engage in the world with more confidence and with higher expectations.

'China was one of the more open economies in the world during the 1990s, and it was hard for foreign companies to make money. Now that it is more competitive and to some extent more controlled, foreign firms with flawed strategies are struggling. But good firms have never done better. We must just get over it. China is stronger. All nations protect their companies as far as they can.'

Foreign investment banker in Shanghai

The pending trial of Rio Tinto staff has unnecessarily haunted foreign companies since the arrest last year of Stern Hu and his associates, who pleaded guilty to corruption charges last month in the face of incontrovertible evidence. This case has had a higher-than-usual profile due to the strategic importance of the iron ore trade between Australia and China, and the timing of it does have political significance within that sector. It has, however, been a largely straightforward criminal case and, despite some media distortion, has never been about China sending warning signs to foreign companies in general that the rules of business had changed and foreign firms would be marginalised unless they complied with Chinese strategies internationally.

When the trend toward a looser society resumes, the Chinese government will need to find the courage to become even bolder in stepping out of the way of the collective aspirations of its people. China, which is already lagging behind in technical innovation, modern education and commercial management systems, cannot afford to stifle the urge of its people to continue experimenting and seeking new ways of doing things. Only a truly flexible environment will achieve this. It may not concern most Chinese citizens that graphic artists in Beijing, Shanghai and other cities are so often criticised and harassed, or that films are still heavily censored. Even the ineffectual manner in which the Internet is censored affects very

few people and may be easily bypassed. The need for the right of petition against corrupt officials and negligent companies is perhaps more keenly felt, but, as in any society, is only pursued by the very tenacious few.

Growth for growth's sake

One great fault in the emergence of market forces and the rapid expansion of the economy is the Chinese national political obsession with growth. True growth is a subtle quality in any economy. In China this seems well understood by the central government but often neglected by provincial governments chasing short-term GDP targets and industrial development. Economic growth is to many officials the new Chinese ideology, as deeply rooted and as blindly followed as any communist principle of the past.

One of Beijing's last Ming Dynasty suburbs around the Drum and Bell towers is about to be razed to make way for a modern, Disney-like 'Beijing Cultural Time City'.

Growth for its own sake has rendered many local governments thoughtless despoilers of the environment and, through appropriation of land for industrial and urban development, abusers of the rights of China's poor, in particular its barely educated farmers. Many local governments have also become cultural vandals. One of Beijing's

last Ming Dynasty suburbs around the Drum and Bell towers is about to be razed to make way for a modern, Disney-like 'Beijing Cultural Time City'. Beijing City can be as renegade as any distant province when it comes to defying ministry dictates.

Opaque and therefore often unhealthy alliances between governments, city councils and business exist all over the world, but in China they have become the source of a great deal of waste, corruption, and public insecurity. While much of the developed world has gone too far with the extent of its requirements for resource consents and other approvals, the other extreme, exemplified by China's closed and often abrupt commercial decision-making process, is not the answer. The environment that is expected to nurture new technical and educational systems will not function if key aspects are being removed randomly according to the whims and anxieties of the government.

As in the United States after 9/11, the reactions of a state to real or perceived threat can be extreme, but they need not define the direction of the nation. Just as America's future will not be defined by its recent need to tilt at military windmills in the Middle East, China's future will not be defined by the recent anxious tightening of the screws of state security. ☹