

China's Global Disruption

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China's Global Disruption: Myths and Reality

BY

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INVESTOR IN PEOPLE

To Margaret, Edwyn and Arthur

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List of Abbreviations

| | |
|-------|---|
| AI | Artificial Intelligence |
| AIIB | Asian Infrastructure and Investment Bank |
| BIS | Bank for International Settlements |
| BoP | Balance of Payments |
| BRI | Belt and Road Initiative |
| CCP | Chinese Communist Party |
| CFETS | China Foreign Exchange Trade System |
| CIPS | Cross-border Interbank Payment System |
| CF | Countercyclical Factor |
| CPI | Consumer Price Index |
| CPTPP | Comprehensive and Progressive Agreement for Trans-Pacific Partnership |
| DCEP | Digital Currency Electronic Payment |
| EBIT | Earnings Before Interest and Tax Expenses |
| EM | Emerging Markets |
| FDI | Foreign Direct Investment |
| FX | Foreign Exchange |
| G3 | Europe, Japan and the United States |
| GDP | Gross Domestic Product |
| GFC | Global Financial Crisis |
| ICT | Information and Communication Technology |
| IMF | International Monetary Fund |
| IP | Intellectual Property |
| IPR | Intellectual Property Rights |
| IT | Information Technology |
| JPY | Japanese Yen |

| | |
|------------|---|
| LGD | Local Government Debt |
| LGFVs | Local Government Financing Vehicles |
| MNC | Multi-National Companies |
| MPA | Macro-Prudential Assessment |
| NBFIs | Non-Bank Financial Institutions |
| NEER | Nominal Effective Exchange Rate |
| NPL | Non-Performing Loans |
| OECD | Organisation for Economic Co-operation and Development |
| PBoC | People's Bank of China |
| PPI | Producer Price Index |
| PPP | Public-Private Partnership |
| P2P | Peer-to-Peer Lending |
| RCEP | Regional Comprehensive Economic Partnership |
| REER | Real Effective Exchange Rate |
| SDR | Special Drawing Right |
| SOE | State-Owned Enterprise |
| SPV | Special Purpose Vehicles |
| STEM | Science, Technology, Engineering and Mathematics |
| S.W.I.F.T. | Society for Worldwide Interbank Financial Telecommunication |
| TFP | Total Factor Productivity |
| UNCTAD | United Nations Conference on Trade and Development |
| UNPD | United Nations Population Division |
| WMP | Wealth Management Products |
| WTO | World Trade Organization |
| ZIRP | Zero Interest Rate Policy |

Preface

The ascent of China to the global stage is going to cause disruption to the *status quo*. This is not only because China's emergence has come under the global scrutiny but also because its increasing weight will create ripples in the global system whenever it moves. As an illustration, nothing is more apt than the COVID-19 crisis that hit China first in December 2019 and then developed into a global pandemic through 2020, causing severe disruption in every aspect of human life across the world. We shall discuss this particular disruption in the beginning and concluding chapters of this book.

More generally, the 'China disruption' is a natural phenomenon as the world needs to accommodate a rising power while the existing ones try to defend their positions. So, let us face it. You can run but you cannot hide from it. Understanding China properly is imperative to enable the world to manage the upcoming disruption and transit to a state with a new global power. But, China has often been misunderstood, leading to distorted business and policy decisions.

In my view, the media has played its part in creating confusion and propagating distorted views on China without substantiation. For example, in reporting on China's COVID-19, or coronavirus, outbreak in early 2020, a major international newspaper published an opinion piece by an academic calling China 'the real sick man of Asia' and accusing its government of covering up the health crisis.¹ While a healthy dose of scepticism is appreciated and there is nothing wrong with exposing any possible wrongdoings, both the author and the publisher provided no evidence at all to support the claim, at which Beijing took serious offence.

Similarly, another international newspaper reported that

...the most fateful consequence of the official silence was that it facilitated the exodus of some five million people in the weeks before the city (of Wuhan, the epicentre of the coronavirus outbreak in China) was quarantined on January 22, thus helping to transport the virus all over the country and overseas

¹China is the real sick man of Asia, by Walter Russell Mead. *The Wall Street Journal*, February 3, 2020.

to underscore their narrative of China covering up the serious state of the virus outbreak.² This kind of reporting was hardly intellectual or impartial, as it showed that the journalists were either ignorant about China or distorted the evidence to fit their narratives.

Any informed China watcher knows that most if not all of these five million people that the report alluded to were migrant workers who always went back to their home towns during the Chinese New Year (and other major Chinese festivals) for family reunion. They left early (before the city of Wuhan was locked down) because they had to get home before the New Year, not because the city government ‘facilitated the exodus’ as the journalists assumed and promulgated as a fact. China has some 280 million migrant workers, or floating population, who travel back home from the cities where they work every Chinese New Year for family reunion. That is why many observers call this Chinese New Year travel the largest migration on earth.

So the problem with misreading China and, hence, the analysis about its global disruption has a lot to do the contamination and abuse of public information, aggravated by socio-cultural differences in doing the analysis. The latter is highlighted by the fact that what is understood by the West of China is often not the same understanding by China of the West. These problems have created an expectation gap between what the world expects China to deliver and what China can actually, and want to, deliver in terms of policy and reform actions. This gap has become a key factor in creating geo-political tensions and market volatility, and in hyping the fears about China’s global disruption.

All these distortions, suspicions and confusions have led to an irony of the world’s opinion on China’s global impact. It is worried about the global disruption that China would cause when it thrives, and it is also worried about the disruption when it collapses. Most of the time, it does not even seem to have a clue about whether China would thrive or collapse, and many China watchers and experts are often wrong about their predictions on China’s development.

Underscoring the problem of misreading China is the fact that over the decades, major speculators who bet on a China collapse sending shock waves across the globe in the form of a banking crisis, or an asset market blow-up, or a debt-currency crisis have all lost big money. It seems that these ‘intelligent’ money managers have never learnt their lessons. On the other hand, optimists and alarmists think that China would take over the world with its technological advancement and economic clout in the not too distance future. This also creates fears about the emergence of a dominant China disrupting the world order.

Does the world want China swim or sink? Or is it too confused about the Middle Kingdom and does not know what to do with it? Research and media coverage on China abound, but China-bashing is a favourite and common approach to talk about China. This does not help to better understand this giant country. To put it bluntly, when a lie is told a thousand times (about China in our case here), it becomes the truth. In the public domain, guesstimates, conjectures,

²Coronavirus: The cost of China’s public health cover-up, by James Kyngé, Sun Yu and Tom Hancock. *Financial Times*, February 7, 2020.

a priori reasoning from dubious assumptions and media-generated hallucinations are reiterated so often that they are taken as facts. The demagoguery of contemporary populism, especially in America, ensures that clamour about China needs no evidence at all to fuel it! The two international media reports on China's coronavirus outbreak that I alluded to above underscore all this vividly.

To aggravate the problem of confusion and misunderstanding about China, some observers who often disguise themselves as experts would even skillfully turn some structural positive stories, such as Beijing's anti-corruption campaign and withdrawal from the distortive implicit guarantee policies, into negative horrifying stories of a systemic collapse in China.³ Some had even bet on a collapsing China based on these distorted views by short-selling Chinese assets and lost tens of millions of dollars in the end due to these bad decisions.

Past mistakes about China abound. When it joined the World Trade Organization (WTO) in 2001, for example, many observers and analysts thought that China would liberalise to become a democracy. This was because, the logic goes, Japan, Taiwan and South Korea had all moved in that direction after joining the WTO when their countries became wealthy enough to prompt their growing middle classes to demand more say in the system. Hence, China would follow the pattern.

That turned out to be wrong. China seems to be moving more towards political centralisation since President Xi Jinping took office in 2013. This has led to an emerging concern that China's economic collapse would be inevitable because it has defied for too long the widely held view that political openness was necessary for sustaining economic growth. China's exceptionalism of high growth without political openness should be ending soon, according to this logic. So, its growth rate would have to collapse to commensurate with its closed political system, creating devastating effects on the global system.

A less dramatic view is that China would get stuck in the 'middle income trap', just like many other emerging economies that do not make it to the rich income country status after decades of high growth. The worry about China's future growth has, in turn, raised a practical concern about China disrupting the world order by pursuing currency devaluation as an escape route to its potential growth disaster, thus triggering future currency wars.

China's history of surprising the world goes even earlier. Before Deng Xiaoping's economic liberalisation in 1978, most China watchers did not think that China would undertake serious economic reforms and usher in the longest period of fast economic growth in the world history. But it did. And earlier yet, it was inconceivable that a large country like China would lose the Opium War

³For example, see Chinese bank on verge of collapse after sudden bank run, by Tyler Durden. *Zero Hedge*, January 11, 2019. Retrieved from <https://www.zerohedge.com/markets/chinese-bank-verge-collapse-after-sudden-bank-run>. The Zero Hedge website was permanently banned by Twitter for violating rules against harassment and abuse in early 2020, as reported by *Bloomberg News*, 'Zero Hedge Permanently Suspended from Twitter for "Harassment"', by Siraj Dato, February 1, 2020.

(Yu, 2018) so decisively to a relative small British naval fleet and ended up having to cede Hong Kong. And it did.

Amid all the China-bashing and negativity on one hand and hype and optimism on the other hand about the Middle Kingdom, is the world going to get China wrong again? This time around, may be the Middle Kingdom is not doomed to live under the Communist Party's ruling; may be its growth is not collapsing; may be its demographic problem is not biting so soon as many observers have expected; may be its banks are not crumbling; may be its debt bomb is not going to explode; may be its technological advancement is not as threatening as commonly perceived; may be Chinese President Xi Jinping is not just grabbing power as seen by the West; may be China is not going to trigger another currency war... The list can go on.

What complicates the analysis on China and what kind of disruption it will cause to the world is the emergence of neo-conservatism, led by the United States (Elghossain, 2019), towards the rise of China in the global stage. This attitude has manifested itself in strategic competition between the two nations, creating biased views on each other by each other and by the public that interfere with rational analysis.

Ideally, the developed world in the West, led by the United States, should take steps to engage China with mutual understanding, especially on global issues and shocks like the COVID-19 pandemic and environment and climate changes. Practically, the United States would have to accept China as a country with a different political and economic model, in which the state leads the way in pursuing some economic and social objectives. China, on the other hand, should accept those Western practices that could help it progress and integrate into the world system. If both sides can accept and accommodate each other's differences, they can co-exist with peace and stability.

However, all these co-operation and co-existence will not be possible without proper understanding of China's policies, intentions, changes, risks and actions. Blindly insisting on China to accept the Western value of democracy and socio-economic systems will not work. China will not bow to any foreign demand to transform its development model by weakening state-owned enterprises substantially or withdrawing the role of the state in directing strategic economic sectors. Escalating tensions with China could push the world powers, led by the United States, into the Thucydides Trap of disastrous war (Allison, 2017).

Furthermore, most Western players tend to misread the internal and external pressures on China since President Xi took office by thinking that these pressures had weakened his governance. Arguably, this misreading has emboldened the West to force China to change and accept the Western values. But, there is a distinct difference between how political development like the Hong Kong protests (which started in June 2019 and turned into riots that are still ongoing at the time of writing) and the Taiwanese presidential election in 2020 are seen inside and outside China.

In China, these chaotic incidents did not raise feelings of admiration or envy, let alone inspiring people to challenge Beijing's authority that the West thought they would. Instead, they reaffirmed the belief of most ordinary Chinese in the

importance of stability for delivering continued social and economic progress and prosperity. This belief has actually helped Chinese President Xi Jinping and the Communist Party to leverage on the Hong Kong and Taiwan issues to rally nationalism to solidify their power as opposed to weaken the Chinese leadership and eventually lead to the demise of the Communist regime.

Even the COVID-19 health crisis was not able to shake the Chinese leadership power as the United States had hoped when US President Donald Trump capitalised on growing public distrust of China that was fanned before the outbreak by waging a major anti-China campaign in May 2020. Leveraging on the xenophobic anti-Chinese discourse in some western countries, the Chinese government turned its political campaign to combat COVID-19 into a moral crusade involving the whole country. As a result, Mr Trump's strategy of 'demonising' China (Froomkin, 2020) backfired by fanning nationalism in China, which Beijing had skillfully exploited to further gain support from both the local and overseas Chinese in an alleged united front to fight the virus. Arguably, both Washington and Beijing had used the health crisis as a tool to engage in a new Cold War, which we shall discuss in a subsequent chapter in this book.

Sino-US tensions are going to remain as part of every country's life in the future, regardless of the US presidency or party. This will be a major global disruption. The trade war that President Trump waged against China in 2018 will not go away as it is a manifestation of the secular Sino-US strategic competition on technology, linking national security of the two countries in the fight. China used to admire the United States for its dynamism, creativity, innovative capacity, cultural influence and economic breath and opportunity. It still does and still recognises the United States as a great power, but the level admiration has gone down sharply since the US subprime crisis in 2008 which exposed significant fractures in the Western capitalist/democratic system. Western, especially American, provocations in recent years have only fuelled nationalism in China – this is the inside view from China, which runs against the view from the West.

So it is imperative to gain better understanding about China in order to manage the inevitable global disruption that it will bring. This book tries to serve this prime purpose by engaging in rigorous research-driven discussions with data and evidence, but not anecdotes, narratives and opinions out of thin air, as the backbone for the debates and arguments. It takes a critical approach to explore many of the may-be scenarios mentioned above by examining the changing structure of the Chinese economy and by questioning many conventional wisdoms about China. It combines the political and economic aspects of China and the world to articulate the hidden, and often misunderstood, themes and trends in China to gain better understanding of its impact on the world system.

The book starts with examining the world's two major concerns about China's global disruption – China's launching of an official digital currency in late 2019 and the COVID-19 crisis that hit China in late 2019 to early 2020 and developed into a global outbreak with significant global ramifications. The geo-political impact of the COVID-19 crisis leading to long-term global disruption will be explored in the first chapter and discussed again in the last chapter. The other chapters will examine the structural, political and economic factors that are

unfolding in China and assess their impact on the global system. A critical and research approach is used to assess conventional wisdom and distorted views and debunk myths that underlie the confusion and fears about China's global disruption and to reveal hidden trends and implications that have been overlooked.

In the case of a thriving China that creates concerns about the rise of a bully wreaking havoc on the global system, we shall (1) discuss and question the conventional wisdom of President Xi Jinping's power-grabbing move to achieve his 'Chinese Dream', which has invited international criticism on him reversing China's governance reform and trying to export China's autocratic model to the world; (2) examine the fears about China's technological advancement taking over the world; (3) assess the concern about China's global ambitions through the renminbi internationalisation programme and the Belt and Road Initiative; and (4) examine China's role in affecting the global growth cycle.

On the concerns about the global disruption caused by a collapsing China, we shall (1) assess the Sino-US trade war and its impact on China's growth and the global system; (2) debunk the myth about China's vulnerability to financial (debt and banking) crises sending seismic shock waves to the world; (3) examine the debate on China's debt problem and the flaws in analysing China's debt risk; (4) uncover the missing analysis on China's long-term growth challenge with respect to the middle income trap and demographic problems and their relevance to the world; and (5) evaluate the risk of China using a currency war as an escape route to solve its future growth problems.

The book concludes with some final thoughts on the serious possibility of a global disruption brought upon by the Thucydides Trap and an inherent tendency of the world to self-inflict systemic disruption even without China playing any role in it. Global disruption is becoming the 'new normal' of the future, but instead of being a negative force China at times can provide examples and lessons for the global community to think about managing the disruptions due to the world's geo-political and economic evolution.

Chi Lo
July 2020