

MORGAN CREEK

CAPITAL MANAGEMENT

ALTERNATIVE THINKING ABOUT INVESTMENTS

New China Perspectives



Welcome to the latest issue of Morgan Creek's **New China Perspectives**. This issue is comprised of research from Morgan Creek's China-based investment team together with curated articles of interest. In addition to timely political and economic news covering greater China, Morgan Creek's China team seeks to provide in-depth perspectives on investing in the technology, consumer and healthcare sectors in the region. Our research leverages the "on the ground" insights of our team together with

Morgan Creek's decades-long experience in covering the region. To learn more about our team and investment offerings, please email chinateam@morgancreekcip.com.

Best Regards,

Handwritten signature of Mark W. Yusko in black ink.

Mark W. Yusko
CEO & CIO

NOTES FROM THE BUND¹

This is the second instalment of our newsletter discussing the cycle of centralization and decentralization of political authority in China. In the previous newsletter we covered how the pendulum of China's political authority gradually swung from centralization (Mao and Deng) to decentralization (Jiang and Hu) in time for China to progress from an agrarian economy to the manufacturing powerhouse it is today. In this segment, we will discuss why we believe the pendulum may need to swing back towards centralization for China to complete its industrial revolution and realize its ambitions to become an advanced economy.

Xi era [2013-Present]: Resetting the Party

Xi Jinping came to power in 2013. The years prior to his ascent saw elite members of the party and their families caught in various scandals:

- The son of a provincial level deputy police chief was involved in a drunk hit-and-run case² injuring and killing two pedestrians in 2010. He drove off the scene, shouting, "Go ahead and sue me if you dare. My father is Li Gang".
- The People's Bank of China published a report in 2011 alleging that thousands of corrupt Chinese officials stole more than \$120 billion³ and fled overseas.
- In the same year, Wenzhou officials were accused of trying to cover up a fatal high-speed train collision⁴ that killed 40 people. The then railway minister was accused of

corruption and fired before the crash.

- The New York Times ran an article⁵ in 2012 about how “princelings” (or relatives of high-level officials) use their family connections to grow wealth.
- The son of a high-ranking government official died crashing his Ferrari⁶ in 2012. He and his two female passengers were discovered unclothed in the car. His father was later investigated and discovered to have received bribes and stolen state secrets.

Public fury at the blatant corruption of elites and their relatives was at an all-time high. Weak central authority meant the top leaders in the central government were unable to rein in their subordinates. In fact, many analysts anticipated given the prevailing trend that Xi would be a [“weak leader... hampered by factional struggles”](#).

No major decisions could be made given infighting, party discipline was at an all-time low as cadres were fighting to line their own pockets, and the broader public was incensed at the unabashed actions of their elites. The future going concern of the party was at stake. Hu, Xi’s predecessor, broke with tradition and handed over all positions – including the important chairmanship of the central military commission – to Xi simultaneously giving him full authority to centralize authority once more to clean house. Xi did not disappoint. Since his ascension, he has run many anti-corruption campaigns, investigating and punishing more than 4 million cadres of which nearly 500 are senior officials.⁷

China’s success in upgrading its industry will likely depend on centralization to focus its resources

We believe China is also now at an inflection point attempting to transition its economy and upgrade its industry. As its working population continues to age and the education level of its citizenry continue to rise, wages and demand for white collar careers follow in tandem. China has little choice but to move up the industry value chain. However, this brings it into competition with the incumbents (the developed nations). Unlike in its prior phases of industrial development, where labor, capital and technology transfer were for the most part unconstrained, China is facing restrictions on the movement of more of these factors of production. To progress, China must once again rely on aggregating its resources and directing them towards strategically important industries. In the semiconductor field as an example, China has invested \$291 billion from 2021 to 2022 covering 741 semiconductor investment projects⁸, and has further launched an additional \$40 billion state-backed technology investment fund in September 2023.

In history, the pendulum swings endlessly between centralization and decentralization of political power

If one studies history, this cycle appears to repeat:

- The opening sentence of the Romance of Three Kingdoms, a historical novel about the fall of the Han dynasty and the rise of the Three Kingdoms that supplanted it goes:

“The empire, long divided, must unite. Long united, must divide.”

This sentence succinctly describes the ebb and flow of the approximately dozen imperial dynasties of China, which endured for an average of 208 years. The period in between successive dynasties are characterized by complete decentralization, civil war and anarchy, such as the Spring and Autumn period after the fall of the Zhou dynasty, or the Three Kingdoms period mentioned above, or the modern “Warlord Era” that followed the implosion of the Qing dynasty.

- This is not limited to China. Ancient Rome also transitioned from a republic to an empire after power shifted from a representative democracy to a centralized imperial authority under Augustus. Over time, it decentralized and splintered under Diocletian, and gradually devolved and imploded.
- In more recent political history, the US underwent similar cycles over its two and a half century history. One such cycle began with Roosevelt, who assumed the presidency at the depth of the Great Depression. He embarked on a centralization effort within the executive branch of the federal government to enlarge the authority of the government in regulating the life of its citizens. His “New Deal” for instance was a plan to redistribute wealth from capital towards labor. Important programs launched in that era included Social Security, the National Labor Relations Act and the Banking Act of 1935. Several presidents including Truman and Carter continued to build upon Roosevelt’s model of “Big Government” until Reagan reversed course to deregulate and decentralize.

The Future

Centralization and decentralization each have their costs and benefits. The history of global dynasties has shown that no single system has (yet) ever endured in perpetuity: the pendulum must swing ever between the two. The moment the system stops evolving and becomes ossified, man’s base nature may kick in to attempt to bend the established rules to advance his own self-interest at the expense of the broader population. Inequality can form over time, an arrangement which rewards the few at the expense of the many comes into being and becomes gradually untenable.

Is China’s current system capable of overcoming this challenge?

Long time observers all agree that at this stage of his career, President Xi is concerned with molding his legacy. His legacy is invariably tied to the continued prosperity of the Party. The Party, at a little over a century old, has survived by constantly reinventing itself to remain relevant to the people of China. The internal changes (many extremely painful) have been tremendous. In the first forty years of its inception, the range of the Party’s policies has been wider than any other political organization in the world. As long as the Party continues to have that sense of crisis and remains adaptable to change, we believe it has a good chance to persist.



Figure 2: China’s wide range of policies has shown its adaptability

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CHINA NEWS SPOTLIGHT

China's Efforts in Promoting Digital Trade Benefit World, Says Expert: The promotion

of digital trade creates new business opportunities, while China's efforts in this area have a positive impact on the world, especially developing countries, Pamela Coke-Hamilton, executive director of the International Trade Center (ITC), has said. The development of China's digital economy over the last few decades has been remarkable, with the rise of platforms such as Alibaba, Jingdong, Tencent and TikTok, Coke-Hamilton said in a recent written interview with Xinhua. [Read More.](#)

Beijing, Paris Eye Visits, Trade: Senior diplomats from China and France on Friday highlighted the need for a self-reliant approach in shaping their ties, greater trade and exchanges of visits and jointly tackling global challenges in a world full of turmoil. These messages stood out at a news conference held by Foreign Minister Wang Yi and visiting French Foreign Minister Catherine Colonna in Beijing on Friday evening. Relations between China and France enjoy a legacy of resilience and an enterprising spirit, "showing a strong strategic nature and a leading role in a world of turmoil and changes", Wang said. [Read More.](#)

China Pledges Deeper Trade Ties with Vietnam : Chinese Commerce Minister Wang Wentao pledged to deepen bilateral trade ties with Vietnam during a meeting with Vietnamese Prime Minister Pham Minh Chinh in Ho Chi Minh City on Saturday, China's commerce ministry said. Wang said China-Vietnam trade cooperation had already achieved "fruitful results" and would include strategic areas such as the digital economy, green development and cross-border e-commerce, according to a readout published late Saturday by the Chinese ministry. [Read More.](#)

Alibaba Develops Native DingTalk App for HarmonyOS, as Huawei Aims to End support for Android Apps: Alibaba Group Holding is developing a new version of its workplace collaboration app that is compatible with Huawei Technologies' HarmonyOS platform, as the US-sanctioned telecoms equipment giant seeks wider adoption of its home-grown operating system and moves to cut dependence on Google's Android. DingTalk, one of four business pillars newly tasked with spearheading Alibaba's future growth, will also collaborate with Huawei in industrial innovation, technology application and business development, according to a post published on DingTalk's WeChat account on Thursday. [Read More.](#)

ByteDance to Wind Down Nuverse in Full Retreat from Gaming: TikTok maker ByteDance plans to wind down its Nuverse gaming brand and retreat from mainstream video games, four people familiar with the matter said. ByteDance told Reuters it had decided to restructure its gaming business after a review, without giving further details. "We regularly review our businesses and make adjustments to center on long-term strategic growth areas. Following a recent review, we've made the difficult decision to restructure our gaming business," the spokesperson said. [Read More.](#)

China's Goldwind Installed a 16 MW Offshore Wind Turbine in just 24 Hours: Chinese wind turbine maker Goldwind has installed its massive 16 megawatt (MW) offshore wind turbine in a "record-breaking" 24 hours. Goldwind has already brought another of its GWH252-16MW wind turbines online; in September, that turbine set a new world record for electricity generation – in a typhoon – by an individual wind turbine in a 24-hour period. (It produced 384.1 megawatt-hours in 24 hours – enough to power nearly 170,000 homes.) [Read More.](#)

¹The Bund is a historic waterfront area in central Shanghai, where Morgan Creek's office is located. From the 1860s to the 1930s, it was the rich and powerful center of the foreign establishment in Shanghai, operating as a legally protected treaty port. The picture above is part of the historical waterfront.

² Source: Li Gang's son faces trial over fatal accident; <http://www.china.org.cn/>; Dec. 23rd, 2010

³ Source: Report reveals huge scale of corruption among Chinese government officials; <https://www.theguardian.com/>; Jun. 17th, 2011

⁴ Source: China bullet train crash 'caused by design flaws'; <https://www.bbc.com/>; Dec. 28th; 2011

⁵ Source: 'Princelings' in China Use Family Ties to Gain Riches; <https://www.nytimes.com/>; May. 17th, 2012

⁶ Source: Son of Chinese politician died after engaging in 'sex games' with two women while driving at high speed in his Ferrari; <https://www.independent.co.uk/>; Sep. 7th, 2012

⁷ Source: China's Anti-Corruption Campaign: Tigers, Flies, and Everything in Between; <https://thediplomat.com/>; May. 12th, 2022

⁸ Source: China invested US\$290.8 billion in semiconductor projects between 2021-2022; <https://www.digitimes.com/>; Tue. 27th, 2023

Important Disclosures

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Morgan Creek Capital Management | 301 W. Barbee Chapel Road, Suite 200, Chapel Hill, NC
27517

[Unsubscribe ljacob@morgancreekcap.com](mailto:ljacob@morgancreekcap.com)

[Constant Contact Data Notice](#)

Sent by myusko@morgancreekcap.com