

MORGAN CREEK

CAPITAL MANAGEMENT

ALTERNATIVE THINKING ABOUT INVESTMENTS

New Asia Perspectives



Welcome to Morgan Creek's *New Asia Perspectives*, an open forum where we share our proprietary research together with curated articles of interest. We seek to offer a variant interpretation of important political and economic events through an Asian lens by leveraging our team's "on the ground" insights and decades-long experience in covering the region. We disseminate our research through newsletters, webinars and periodic whitepapers. Feel free to forward our research to colleagues you think might be interested and please share any interesting research you come across as well. To offer comments, share research, or learn more about our team and investment offerings, please email chinateam@morgancreekcip.com.

Best Regards,

A handwritten signature in black ink that reads "Mark W. Yusko". The signature is written in a cursive, flowing style.

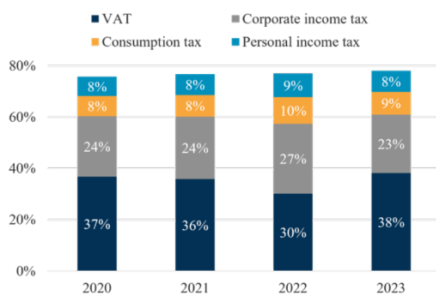
Mark W. Yusko
CEO & CIO

NOTES FROM THE BUND¹

Concerns about China's local government debt and property bubble have drawn significant attention in recent years. These two issues are actually closely interrelated, largely due to their ties to the country's tax system. The recently proposed consumption tax reforms are significant, as they aim to ease these pressures. In this series, we'll explore China's tax system evolution and how the reform could address these challenges.

China's tax structure is widely recognized for its tax-sharing system. This fiscal arrangement allocates tax revenues between the central and local governments based on the type of tax and an agreed-upon formula. The four major types of taxes—value-added tax (VAT), corporate income tax, personal income tax, and consumption tax—constitute nearly 80% of the country's total tax revenue.

Top 4 types of taxes in China (% of total)



Distribution between the Central and Local Gov.

Tax Types	Subtypes	Central Gov.	Local Gov.
VAT	Collected by customs	100%	
	Not collected by customs	50%	50%
Corporate income tax	SOEs, Financial institutions, Railway Dept., etc.	100%	
	Others	60%	40%
Consumption tax		100%	
Personal income tax		60%	40%

Figure 1: Major types of tax and distribution²

This tax-sharing system was introduced as part of a major reform of China's public finance system in 1994. Prior to this reform, a different system was in place: the central government determined a fixed amount of tax revenue for local governments to remit, allowing local governments to retain any excess tax collections. As China's economy expanded, the total tax revenue of local governments grew, while their remittance obligations remained unchanged. This created a situation where local governments retained an increasingly larger share of the revenues. Additionally, to further limit the amount of revenue shared with the central government, local governments often shifted income to off-budget accounts. By 1992, off-budget income had surpassed on-budget income by 1.1 times.³ This ultimately resulted in local governments becoming increasingly wealthy, while the central government faced growing financial difficulties. The 1994 tax-sharing reform intended to rectify this imbalance by classifying taxes into three categories: national taxes, local taxes, and shared taxes. Most taxes were designated as national taxes, with only a few, such as the land appreciation tax, allocated to local governments. This reform restored central government control over the fiscal system and led to two well-known phenomena:

- **The establishment of a national transfer payment system:** With tax revenues centralized under the central government's control, resources from developed eastern regions could be redistributed to support underdeveloped western regions, promoting balanced national development.

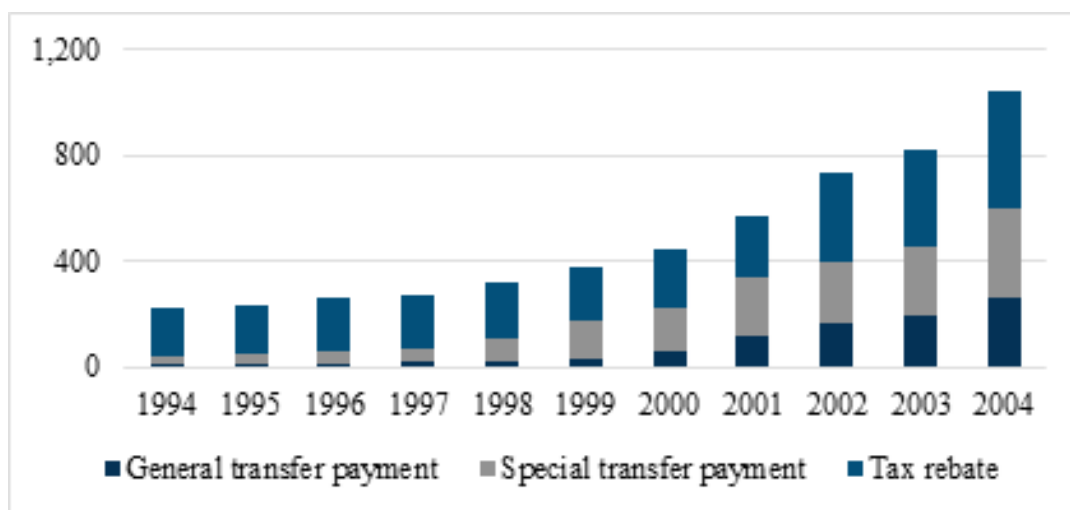


Figure 2: Three types of transfer payments since reform⁴

- **The rise of land-based finance:** With traditional business and income taxes now controlled by the central government, local governments turned to land-related

revenues as an alternative source of funding. This included the land appreciation tax and business taxes in the construction sector, leading to a growing reliance on land-backed financing.

After the implementation of the tax-sharing system, central government revenue increased significantly. In 1994, central fiscal revenue reached 291 billion yuan, growing by 104% year over year (“YoY”).⁵ This shift greatly strengthened the central government's ability to manage macroeconomic policies. On the local government side, the adoption of land financing allowed for increased investment in infrastructure, aimed at attracting high-quality companies to boost regional revenues. This system played a critical role in China's industrialization process. However, as China began regulating its overheated real estate market, negative consequences also emerged. Local governments had become overly reliant on land-related revenues, which, by 2020, accounted for approximately 56% of their total local governments' fiscal income.⁶ In 2022, revenue from land transfer fees saw a sharp decline, with income from the sale of state-owned land use rights dropping by 23% compared to the previous year, placing significant pressure on local finances. Additionally, real estate-related taxes also decreased, with deed tax and land appreciation tax falling by 11% and 8% YoY, respectively, further exacerbating local fiscal imbalances.⁷

However, we believe that the proposal from the Third Plenum to reform the collection of the consumption tax may offer a potential mechanism to compensate for fiscal revenue shortfalls, thereby easing some of the financial pressure on local governments. We will elaborate on this in the next article.

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ASIA NEWS SPOTLIGHT

SE Asia's Potential for Mid-market PE Holds Promise Despite Macro Risks: As Southeast Asia gains prominence in the global private equity landscape, the region's mid-market segment, especially, shows bright prospects, according to seasoned investors. “In Southeast Asia, we are beginning to see a lot of positive trends. The demographic dividend is taking shape. You have seen a lot of the young population entering the workforce, and that it is growing, and we are also seeing a lot of shifts in consumerism. [Read More.](#)”

China: Three New European Countries soon to Benefit from Visa-free Travel: China announced today that citizens of Greece and Slovenia will soon be exempt from visa requirements for stays of 15 days. This announcement comes a few days after a similar declaration concerning Norwegian nationals. Currently attending the United Nations General Assembly in New York, Wang Yi, China's Minister of Foreign Affairs, met today with his Slovenian counterpart, Tanja Fajon, and his Greek counterpart, Georgios Gerapetritis. [Read More.](#)

Chinese Stocks Post Best Week since 2008 after Stimulus Blitz: Chinese equities have surged to their best week since 2008 after Beijing launched an economic stimulus package including a \$114bn war chest to boost the stock market. The CSI 300 index of Shanghai- and Shenzhen-listed companies is up 15.7 per cent for the week in its best performance since November 2008, when China announced a similar stimulus package in response to the global financial crisis. The rally, which has also helped buoy European markets and industrial metals, comes as China's leadership rushes to support the country's capital markets, stabilize

a property sector crisis and boost domestic consumption in order to meet its economic growth target of 5 per cent for the year. [Read More.](#)

China Accelerates Big Data, AI Application in Ocean Industry, Anticipating Revolutionary Changes: China is making significant strides in utilizing big data and artificial intelligence (AI) in the ocean industry, particularly in marine spatial planning. These technologies are significantly enhancing accuracy and efficiency and are expected to revolutionize deep-sea exploration and the broader marine industry, the Global Times learned at an event held in Beijing on Thursday. Marine Spatial Planning Cooperation Workshop of Maritime Silk Road Partner Countries kicked off in Beijing on Thursday, hosted by China Oceanic Development Foundation (CODF). [Read More.](#)

Thailand Revolutionises Elderly Healthcare Services with Home AI Assistants: Thailand's latest AI-powered Dinsaw robot, the "Home AI Assistance", is expected to play a crucial role in providing healthcare to the elderly at home, as reported by online newspaper The Nation. Introduced recently by CT Asia Robotics, the robot aims to address challenges posed by an ageing society, which has led to an increase in bedridden seniors and a shortage of caretakers. Chalermpon Punnotok, the company's founder and CEO, explained that this robotic assistant can help ease stress and loneliness among the elderly, while facilitating their medical treatment. [Read More.](#)

Smart, Green Technologies Attract Attention at China-ASEAN Expo: Guided by remote control, a mechanical loader can upload tonnes of materials or even transport them to production lines -- all without a driver behind the wheel. This intelligent loader, developed and manufactured by China's Guangxi LiuGong Machinery Co., Ltd., is gaining popularity among mining and construction companies of the Association of Southeast Asian Nations (ASEAN) countries. "Catering to demands for high-end, diversified, and personalized products in the construction machinery market, LiuGong has focused on the electrification, digitization, interconnectivity and intelligence of machinery, with double-digit annual growth in R&D investment," said Li Dongchun, a senior manager of the company. [Read More.](#)

HSBC AM Launches Asia Energy Transition Fund: HSBC Asset Management (AM) has set a target of USD 750m for its inaugural Asian energy transition infrastructure fund, according to two sources familiar. The Red Hexagon Energy Transition Asia Fund is seeking an anchor limited partner (LP) and will offer co-investment opportunities, the sources said. The manager will kick off roadshows in October to this end, after launching the vehicle in May. HSBC AM launched the energy transition infrastructure strategy with the former team behind Green Transition Partners, a Hong Kong-based manager acquired by HSBC last January. HSBC made its first investment from the newly formed strategy in Tekoma Energy, a Tokyo-headquartered solar developer, in August 2023. [Read More.](#)

Japan's Chip-Making Equipment Exports to China Surge by 61.6% Y-o-Y in August: Japan's exports of semiconductor equipment to China in August rose by 61.6% year-on-year to \$1.29 billion, according to Japan's Ministry of Finance. The country last month exported 6,742 tons of equipment to China, an increase of 41% from the previous month, the report stated. Machinery and equipment account for 23.2% of Japan's total exports to China, with semiconductor equipment making up 11.9% of that. Dutch company ASML saw its chip equipment exports to China grow 21% in the second quarter, reaching 2.3 billion euros (\$2.57 billion). ASML's advanced lithography equipment, including extreme ultraviolet (EUV) machines, remains essential in the production of semiconductors that are 7nm or smaller. [Read More.](#)

In Asia, Alternative Proteins are the New Clean Energy: In August, bioengineers, chemists, plant biologists and food scientists based in China and Singapore came together in

a closed hybrid conference with one ambitious goal: to unlock the massive economic and food-security promise of plant-based and cultivated meat. As biochemist Huang Dejian at the National University of Singapore highlighted at the start, Asian scientists are poised to play a crucial part. Just as researchers in the region were instrumental in putting the world on a path to affordable clean energy, they can do so again — for sustainable foods. [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.

²Source: Ministry of Finance of the People’s Republic of China

³Source: Keywords of the “Four Histories” | Why was the tax-sharing reform implemented in 1994?, <https://www.thepaper.cn/>, Oct 13, 2020

⁴Source: Wind Database

⁵Source: Wind Database

⁶Source: Wind Database

⁷Source: Report on the Fiscal Development Index of China's Regions in 2022, Institute of Finance and Taxation of Renmin University of China, 2022

Important Disclosures

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