



Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise

By Carl Walter, Fraser Howie



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The truth behind the rise of China and whether or not it will be able to maintain it

How did China transform itself so quickly? In *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise, Revised Edition* Carl Walter and Fraser Howie go deep inside the Chinese financial machine to illuminate the social and political consequences of the unique business model that propelled China to economic powerhouse status, and question whether this rapid ascension really lives up to its reputation.

All eyes are on China, but will it really surpass the U.S. as the world's premier global economy? Walter and Howie aren't so certain, and in this revised and updated edition of *Red Capitalism* they examine whether or not the 21st century really will belong to China.

- The specter of a powerful China is haunting the U.S. and other countries suffering from economic decline and this book explores China's next move
- Packed with new statistics and stories based on recent developments, this new edition updates the outlook on China's future with the most cutting-edge information available
- Find out how China financed its current position of strength and whether it will be able to maintain its astonishing momentum

Indispensable reading for anyone looking to understand the limits that China's past development decisions have imposed on its brilliant future, *Red Capitalism* is an essential resource for anyone considering China's business strategies in today's extremely challenging global economy.

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Editorial Review

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Q & A with the authors of *Red Capitalism*, Revised edition

Red Capitalism was recently named one of *The Economist's* books of the year. Have you been surprised by the success of the book?

Yes. We knew the story of bank reform and the larger picture it painted about how China is run was an important story but we were very surprised by how well received it was. We were able to give a narrative to the reform program in China which people could understand just as China was starting to suffer from and appreciate the impact of its huge stimulus program which it launched in response to the collapse of the global economy in 2008.

Since publication what are the most notable changes you have seen in the China market?

The most notable change is the attitude and sentiment of foreign investors and commentators. A few years ago the sentiment towards China was very positive. The large stimulus plan was seen as huge positive for China and those urging caution were lone voices. Now the sentiment has shifted significantly. The weakness of the banking system is much better understood as is the huge amount of debt that has been built up over the past few years in the pursuit of high growth rates. This change of sentiment is clearly shown by the stock prices with all the Chinese bank stocks falling significantly in 2011.

What was wrong with the stimulus program? Didn't it produce economic growth?

In late 2008 as the global economy collapsed Chinese companies had to lay off workers, and lots of them. It was reported that 20 million workers were laid off in the export sector as demand for Chinese exports collapsed. In response to that the Chinese leaders turned on the credit taps via the banks and flooded the economy with money. Local governments were encouraged to get people working and a vast amount of that money went into infrastructure projects: roads, office blocks, sports stadiums and such like. The local government couldn't borrow directly from the banks so they set up Local Government Financing Vehicles, LGFVs, to borrow on their behalf. These LGFVs entities have borrowed at least 11 trillion RMB and many of the projects they built are not economically viable i.e. they won't produce any revenue. The net result is that growth initially came through the construction but now that the loans are coming due there is no revenue to pay the debts off! The stimulus wasn't wrong; it just was that much of the funds went into projects which could never pay back the loans needed to build them.

But even if China has wasted some of the stimulus isn't China a rich country now? Surely they can use part of their 3 trillion US\$ of foreign reserves to pay down these debts?

China is still in many ways a poor country and can't afford to waste much of its hard earned wealth on bailing out its banks or building worthless infrastructure or vanity projects. Money that is spent on wasted projects is money that can't build schools or hospitals. The bank bailout of a decade ago has still not been fully accounted for and yet a new bad debt crisis is brewing. The foreign reserves give a false appearance of wealth. They are very important for a large trading economy which China is to facilitate trade but they cannot be used or brought back to China without stoking inflation pressures.

What must China do to avoid bad debt problems in the future?

The first step has to be to better price money. Basically savers in China get very low interest rates and the large State owned enterprise get cheap credit which is then used on unproductive projects. The hard working China saver is paying for the mismanagement of the State owned enterprises. But changing this system is very tough. It would mean the government can no longer set interest rates, it would ideally mean that capital controls are also substantially loosened and that State owned enterprises are no longer guaranteed access to cheap funding. Changing any of these things would be a bold step for the government and given the cautious nature of political decisions in China this will take a very long time to do. Until then China's economy will boom and bust but with Chinese characteristics!

2012 will see a change in the leadership of China, will new leaders help re-start reform?

Nothing can be ruled out but many of the problems within China cannot be solved with a simple change of faces. Many of the problems are structural and there are now so many powerful and politically connected players whose primary goal is to maintain the status quo that even the strongest of reformers will struggle to bring real change. Even if reformers gain the upper hand the global environment will be very tough for the next few years which will encourage a very cautious approach from China.

From the Inside Flap

In the space of just a few short decades, China has transformed itself from a nation scarcely able to cover the cost of sending its highest-ranking dignitary to speak at the UN to one with financial reserves numbering trillions of dollars. In *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise*, Revised Edition, Carl Walter and Fraser Howie, experts in Chinese finance, tell the story of China's incredible ascension, how it got to where it is now, and what the future holds.

Exploring how China's financial institutions—from banks to corporations—and most importantly, the national Communist Party, shape the country's economic choices, development, and reform and what this means within China and for the rest of the world, the book examines whether or not the twenty-first century really will belong to China, calling into question the sustainability of the current system. Going deep inside the Chinese financial machine to illuminate the social and political consequences of the unique business model that has transformed the country into an economic powerhouse, Walter and Howie investigate whether the incredible gains of the last thirty-plus years really live up to their reputation.

While China has seemingly adopted a Western style of economic and commercial growth—complete with stock-listed corporations and a growing class of accountants, lawyers, and investment bankers—the reality is that China remains a Communist country, one in which the state can—and frequently does—step in to save struggling industries. In contrast to the common view of China as an unstoppable freight train of growth, *Red Capitalism* shows how the country's decades of development have been marked not by steady ascension but rather an ongoing series of booms and busts that many corporations would not have been able to weather without large-scale government intervention.

With new and expanded coverage of China's "Big 4" banks; why assigning credit ratings is still a problem; the rapid growth of Chinese national debt; and more, this fully revised edition of *Red Capitalism* is indispensable reading for anyone looking to understand the limits that China's past development decisions have imposed on its promising future.

From the Back Cover

Praise for Red Capitalism

"The most important financial book of the year." —James Grant Editor, Grant's Interest Rate Observer

"Red Capitalism peels back the façade of China's economy and reveals how the dominant role of the state has led to enormous financial leverage and endemic malinvestment. China's major role in the global economy makes Red Capitalism required reading for any financial industry fiduciary." —Mark L. Hart III Chairman, Corriente Advisors, L.L.C.

"China is bent on superpower rivalry; reserve currency status for the renminbi is a glint in the party's eye. Red Capitalism puts a powerful case that its economy and financial system are not fully equipped to support such aspirations." —Financial Times

"This book allows us to further deepen our analysis and prepare for the tumultuous events which impend." —Socialism Today

"Walter and Howie possess a rare depth of experience in the analysis of the Chinese financial sector. Their hard-hitting conclusions, based on a wealth of empirical research, will stimulate debate about the future of the Chinese financial system at a critical point in its evolution." —Peter Nolan Sinyi Professor of Chinese Management, Cambridge Judge Business School, University of Cambridge

"Concise and erudite, Red Capitalism is a fantastic deep dive into China's structurally flawed financial system." —China Economic Review

"A penetrating analysis that demonstrates how hard it is to follow the old adage 'follow the money,' and how rewarding it is to understand what will really drive China into the future." —Christian Murck President, American Chamber of Commerce in China

"Walter and Howie put the Chinese financial system under the microscope to examine how an absence of leadership, institutional squabbling, and complacency have seen appetites for reform splutter out, replaced by stagnation and dysfunction. There is a fascinating, entertaining, and necessary corrective to the hyperbole surrounding China's seemingly miraculous rise." —David Wilder Beijing Bureau Chief, Market News International

"Red Capitalism is an important addition to the reading list of any China-watcher." —The Hindu

"Red Capitalism is a superb guide to China's financial labyrinth. It's a must-read for anyone who wants to understand the sources of Chinese economic power, and the threat posed by the nation's vast hidden debts." —Arthur Kroeber Editor, China Economic Quarterly

NAMED A BEST BOOK OF THE YEAR BY THE ECONOMIST

Users Review

From reader reviews:

Shirley Frazier:

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James Vazquez:

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David Miller:

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