

**Demetri Kofinas:** 00:00:00 Today's episode of Hidden Forces is made possible by listeners like you. For more information about this week's episode or for easy access to related programming, visit our website at HiddenForces.io and subscribe to our free email list. If you listen to the show on your Apple podcast app, remember you can give us a review. Each review helps more people find the show and join our amazing community. And with that, please enjoy this week's episode.

**Demetri Kofinas:** 00:00:32 For those of us living in western countries, it's difficult to appreciate the scope of China's development, and that's because of the way in which the country allocates capital and generates credit. Bank liabilities in China have grown at an astonishing rate over the last 25 years. From 2009 to 2011 alone, assets in China's banking system expanded by 77%: \$7.6 trillion dollars over just a three-year period.

**Demetri Kofinas:** 00:01:07 The impact of China's loan growth can be seen in the skyrocketing prices of Chinese real estate, the overcapacity of its factories, and the pollution of its environment. Cognizant of these excesses, Chinese officials have been trying to reform the country by reigning in investment and stemming corruption, but even the best efforts of Chinese authorities cannot fix the country's broken demographics.

**Demetri Kofinas:** 00:01:35 China's population is aging faster than anywhere else in the world. In 2015, the country had seven and a half working-age adults to support every senior citizen. In 15 years, that ratio will drop to four to one, and by 2050, there will be only two adults to support every man and woman in retirement. It is the fear of Chinese officials that the country will grow old before it grows rich, falling victim to the so called middle income trap, mired in debt and saddled with decades of malinvestment. Air pollution, idle factories, and broken promises.

**Demetri Kofinas:** 00:02:18 This week on Hidden Forces, Dinny McMahon, Shadow Banks, Ghost Cities, and the End of the Chinese Miracle.

**Demetri Kofinas:** 00:02:45 Dinny McMahon, welcome to Hidden Forces.

**Dinny McMahon:** 00:02:46 Great to be here, Demetri.

**Demetri Kofinas:** 00:02:48 So you're coming straight form the Outback? Where are you coming from? I told you when I saw you downstairs - I had to come get you, because we were trying to find the location - and I was expecting someone in a suit and tie. I've seen you dressed to the nines, presenting at the Wilson Center, or wherever. Hair

slicked back, in a suit, and here you come, and you look like you're out of a Crocodile Dundee movie.

- Dinny McMahon:** 00:03:09 I wouldn't quite say that's the natural order of things, but it's been a while since I've seen anything of the Australian Outback. I've been in the US for the last few years. I live in Chicago these days. I have the good fortune of marrying an American woman.
- Demetri Kofinas:** 00:03:21 Really?
- Dinny McMahon:** 00:03:22 After living in China for 11 years, we made our way to this part of the world.
- Demetri Kofinas:** 00:03:25 Did you meet her in China, your wife?
- Dinny McMahon:** 00:03:27 We did. We did. There was an American at an American university campus in Nanjing, we met each other and-
- Demetri Kofinas:** 00:03:33 Oh, really?
- Dinny McMahon:** 00:03:33 Yeah. The rest is history, as they say.
- Demetri Kofinas:** 00:03:36 This is the third episode we've done on China, and all three of them have started with how they met their spouse. With Anne, we were introduced by Anne Stevenson-Yang, who was episode 16 I think. She told me in that interview that she met her husband when she went to China. She was interested originally because she was into the ideas of Mao Zedong, and she was kind of a revolutionary. She's like, "Finally someone understand the peasants."
- Demetri Kofinas:** 00:04:00 She went in 1985, she was working at Business Week, and then she applied to a local newspaper there or whatever, and they accepted her. Then she was touring the country before 1989, and that's where she met her husband. Elizabeth Economy, she just mentioned that she ended up meeting her husband and then went off to the institute wilderness, like of academia or whatever. With you, your wife, when did you guys get married?
- Dinny McMahon:** 00:04:22 About five years ago now.
- Demetri Kofinas:** 00:04:23 Okay. You weren't prepared to talk about your personal relationship.
- Dinny McMahon:** 00:04:27 It's actually funny. I reckon I stayed in China as long as I did because of her, because I think you actually find when you meet somebody from another country and you meet in a third

country, it becomes a lot easier to stay there than having that conversation about, "Are we going to move to the US or Australia?"

- Demetri Kofinas:** 00:04:42 Yeah.
- Dinny McMahon:** 00:04:43 In the end, we had that conversation and she won out.
- Demetri Kofinas:** 00:04:45 It's also an interesting experience meeting someone from your home country when you live abroad. It's a different type of relationship, and also adjusting to coming back to your home country. Well, it's actually different with you because you're Australian, but if you were both to come back to the United States, let's say and you were both American, that it's an interesting experience for some couples. Sometimes it can be a good thing. Sometimes it's not, but the good thing with you guys is that you're, one is American, one is Australian.
- Demetri Kofinas:** 00:05:08 Let's talk about the subject that you're here to speak about today, which is China. Big word. As I said, we did two other episodes on China. I've learned so much from those two episodes, and I feel like I'm more prepared today to talk about this than ever before. With Anne, as I mentioned, I was on the Chinese banking system, and the financial system. With Elizabeth Economy, it was focused more on the political system. What I came to understand through that process was that distinction is not as clear in China as it is in the United States.
- Demetri Kofinas:** 00:05:41 You've written a book called China's Great Wall of Debt. It's actually about much more than just debt. It covers a wide range of issues that bleed into and outside of the political system. Maybe we can start with why you decided to write this book at this point in your life. It was published March 2018 I believe. What prompted you to write this book, and how long had you been working on it?
- Dinny McMahon:** 00:06:03 Well, I spent 10 years as a financial journalist in China, and the last six of those were specifically covering China's financial system. Over that course of that entire period, being a foreign journalist in China can be an incredibly frustrating experience in terms of getting straight answers from the authorities, even just working out how the system works given that it is so radically different from how Western markets operate just in terms of questions of access. I certainly found over time that no matter how much time I spent reporting on China issues, there were these kind of big gaps in my understanding of how the bigger picture all came together. I certainly found my last few years at the Wall Street Journal.

**Dinny McMahon:** 00:06:43 I was working on a haul of big picture stories, which on the face of it, kind of felt unrelated. I was writing about zombie companies, and shadow banking issues. I was working about local government debt problems, and over time I realized that these were all interconnected, but what I really needed was the time to work out how the system worked as a whole. I think as much as anything, it was after spending such a long time in China, writing a book was almost a cathartic experience, because it was a way to step back and try and work out and really understand everything that I'd been looking at for years.

**Demetri Kofinas:** 00:07:13 How many years were you working on it?

**Dinny McMahon:** 00:07:15 The stories that are in the book, all the anecdotes, because that's how I structured the book, I've been collecting for about six years. Now, the point. I hadn't realized initially that they were going to make a book.

**Demetri Kofinas:** 00:07:26 That's another thing I wanted to ask you, which is how does someone even write something like this? I would find it overwhelming to piece together all these different stories, but you weren't keeping those stories to write a book. They were just coming as part of your reporting?

**Dinny McMahon:** 00:07:37 Yeah, absolutely, and once I got an inkling that actually this fits into a bigger picture, and I started revisiting some of these stories. I mean, so often I was writing about ghost cities, for example, and so I went out and visited a ghost city a couple of times. When I realized that I was going to do more with this then I kept going back, so I did a few more trips after that to work out what had happened. That's how the dynamic changed over my last couple of years as a journo.

**Demetri Kofinas:** 00:08:00 What's that like, going to a ghost city?

**Dinny McMahon:** 00:08:04 It is fascinating, because to give a brief description what it is, right? I mean, most people probably do understand at this point in time, but it turns the idea of a ghost town on its head, right? US West is dotted in ghost towns, which are places that sprung up in response to a specific demand, so invariably there was a gold rush, or a silver rush. People piled in, the town sprung up overnight, the people left just as quickly when the resources paved it out, but a ghost city is firstly on a scale of magnitude inordinately bigger.

**Demetri Kofinas:** 00:08:34 How big are we talking here? What are the biggest ones? What are we talking about?

**Dinny McMahon:** 00:08:39 Well, some of these, the blueprints for the cities were that one day they'd house a million people. Now, in terms of having sufficient housing, they're getting to a point where you've actually built a ghost city to those proportions. I'm not sure any cities actually got that big, but the one that I was writing about in Liaoning province in China's Northeast could have comfortably housed a hundred thousand people.

**Dinny McMahon:** 00:09:00 You turn up to these places, and it's not that they don't have anybody living there, because the Chinese government, local officials, have ways of effectively creating at least a sort of a nuclear population, right? They'll close down the surrounding schools and force everybody to go to new schools in the cities. They'll close down the existing hospitals and get everyone to use this one. Government buildings, it's like the local Ministry of Education will all of a sudden find itself being relocated to the ghost city, so you kind of have this kernel of a population. But then, the city is built to a scale for far more people than will ever end up living there.

**Demetri Kofinas:** 00:09:35 It's like you said. It's doing ghost towns on its head. You built the city, and then you do things like blow up a school in one town and force the kids to go 50 miles to the other one. That was actually one of the stories that Anne gave us during her interview.

**Dinny McMahon:** 00:09:49 It's amazing, because doing that in particular has so many moving parts to it, right? On one level, it's a way to get people living in the ghost city, right? The other thing is, if you're closing down a school in a regional large town, or a regional city, invariably that is probably sitting on some pretty valuable property, right? The moment that you close down that old school, you can then sell it off, local government gets more revenue. Meanwhile, everyone moves into this new city where the land is a lot cheaper. It works for the local government on a whole lot of different levels.

**Demetri Kofinas:** 00:10:21 I want to get into that, the perverse incentives that exist in China, because I think that's such a big part of the mystery of how the system works. I don't think we're going to solve any major mysteries here, because I think my experience of China is, the more I look into it, the more confused I get. There is some level of understanding that comes out of engaging with the subject. You mentioned numbers, or the control, the challenge of being a reporter in China. One of my subtitles here for the interview is Lies, Damn Lies, and Statistics.

**Demetri Kofinas:** 00:10:52 I think in America, in the West I guess more broadly, we have an expectation that numbers are massaged. We have an expectation that statistics are used to bolster a position. You cherry-pick statistics, but there's some sense of sanctity. There's some sense in which the numbers didn't arise purely out of an arbitrary process, or purely to support some specific alternative number or objective. As I understand it, numbers in China operate in a very different way. In some sense, the number is target that signals to the rest of the system what to do.

**Demetri Kofinas:** 00:11:34 Explain to me why it's so challenging to report, and how someone from the West, or you're not from the West I guess. You're from Australia.

**Dinny McMahon:** 00:11:42 Well, we [crosstalk 00:11:43]-

**Demetri Kofinas:** 00:11:45 How do you do your job, and what have you learned about how the Chinese relate to numbers?

**Dinny McMahon:** 00:11:50 Okay. Certainly working for the Wall Street Journal. Pretty much every story you write revolves around data, so the data problem in China has a lot of different aspects to it. On one level, there is this sense that ... Well, there's some truth to it, that some Chinese data just is outright incorrect. I mean, for all intents and purposes, it's probably gander. I know Anne made this point that often it's a target, but often it's propaganda. I mean, you take something like the GDP figures. No one really believes that the GDP figures is what Beijing says in any given quarter. They're just too smooth. There is no possible way that the numbers are so [crosstalk 00:12:23]-

**Demetri Kofinas:** 00:12:22 So you've already made up some portfolio, 15% every year.

**Dinny McMahon:** 00:12:26 That is a perfect way to describe it, alright? The numbers just don't change as much as they must be changing for a country with 1.4 billion people, so there's that. In some ways, it's propaganda, and I think often foreigners look at that and they just feel like the Chinese are ... It's almost a personal slight, but the Chinese are lying to us. When they put out these numbers, it's us that they're lying to. When, for the most part, so much of the problems with Chinese data, it's a real problem and a frustration to the people living within the system.

**Dinny McMahon:** 00:12:54 Now, sometimes you have things like GDP, which kind of has a propaganda purpose. Sometimes the problem is local officials. They have a target that they have to meet, or they have to show that they're being particularly successful at achieving a certain

level of growth, generating a certain amount of employment, so they often just outright lie about the numbers. Then they pass that up the chain of command, and then level above them lies to their superiors, and on and on all the way out up to the top.

- Dinny McMahon:** 00:13:21 Sometimes the big problem, particularly as a journalist, is that you find a figure, and then it's published by the Central Bank, and then the next month, or the next quarter, or the next year, that figure just doesn't exist anymore, so you don't have comparable data from one period to the next. Another huge frustration is that they changed the definition, same issue. You can't compare it from period to period, and that sort of opacity is a tool of governance. As an outside, even inside the system, if you can't tell exactly what's going on with the system and the economy, then that gives the authorities a certain degree of power and control to be able to control the narrative of what they want you to believe is going on.
- Dinny McMahon:** 00:14:01 So yeah, as a journalist, this can be incredibly frustrating. After a while, you work out that you can find new and interesting data sources that aren't being massaged because no one's really looking at them. No one thinks they're important, so you can dig out interesting stories from stuff that just isn't really getting much attention.
- Demetri Kofinas:** 00:14:19 Would an example of that be, before the Chinese government got wise to it, but would an example be of electricity in China? At some point as I understand it, electricity was being used as a way to figure out what actually economic activity looked like. And then of course people started leaving the lights on, as I understand it.
- Dinny McMahon:** 00:14:37 Yeah. Well, this was what is referred to as the Li Keqiang index, Li Keqiang being China's current premier. In one of the WikiLeaks leaks years ago there was a conversation leaked from the US Embassy between the US Ambassador and Li Keqiang. Li Keqiang came out and said that GDP data is manmade and that he doesn't look at it for any indication of the Chinese economy. What he looks at is freight, electricity, and I forget what the third one was.
- Dinny McMahon:** 00:15:04 Whilst that could have worked quite well as a proxy for real growth at the time, once more and more people started looking at that, then the people who were in a position to control that information woke up to that and started massaging the numbers by leaving the lights on.

- Demetri Kofinas:** 00:15:18 Whoa, a very perverse incentive. Just to reiterate something you said to bolster a previous point, there's a quote in your book where you cite someone who, when asked whether you asked him or whether it was something that you were pulling from some other anecdote about, "Why not be more transparent about some particular dataset?"
- Demetri Kofinas:** 00:15:35 And his point was, "Why would we do that? Doing that would actually hurt us because of the fallout that would come from being honest about some particular situation or whatever. And you emphasize that I think to make the point that it sounds like in China, their relationship to facts, or to truth, is that there's such a desire to control. Whether it's the narrative, whether it's the economy, that they don't see the benefits of liberalization as much as we do. Which I think also speaks this larger challenge of getting there, right? That sort of reform. And again, even that word as I understand it, in China, it can mean so many different things.
- Demetri Kofinas:** 00:16:14 I would love for you try and explain to me and to our audience, we've gone through this with Anne, we've gone through it with Elizabeth, and I want to go through it with you, how the Chinese system as you would describe it, is organize? How does the state apparatus fit into the economy, fit into the government from the center, from Beijing, from the provincials, to the local governments? How does all of that operate? Can you try and paint some picture for us?
- Dinny McMahon:** 00:16:39 One of the reason that is quite difficult is that in some ways it's a moving target, alright? So when I wrote the book, this is how I would have described it, and so I think outsiders sort of typically see China as being, often they see it as either being communist, or they see it as being capitalist. Certainly if they see it as communist, they see the Chinese Communist Party is being all-powerful. What the president or the chairman says has an inordinate amount of power.
- Dinny McMahon:** 00:17:04 It is effectively a Kremlin imposing its will on the rest of the economy, and that's not how China has ever worked. Lower levels of authority, whether that be the executive of a state-owned enterprise, or provincial governor, a city mayor, or even a person in charge of a township. They have an incredible amount of autonomy to do what they believe is right for the local community. Certainly that's within reason because they're all part of this Communist Party structure, and they report to the level immediately above them.

**Dinny McMahon:** 00:17:35 However, at the same time, they have a lot of ability to either push back against what Beijing is telling them to do, or most often, and this is what we've seen over time and time again over the last decade is that they get creative in the ways that they get around the rules.

**Demetri Kofinas:** 00:17:52 From above, there's policy. From below, there are countermeasures.

**Dinny McMahon:** 00:17:55 Yeah.

**Demetri Kofinas:** 00:17:55 How do you say it in Mandarin?

**Dinny McMahon:** 00:17:57 Shàngshù zhèngcè hé yǐxià duìcè.

**Dinny McMahon:** 00:17:59 It's funny. Foreign journalists love this other expression, which is, "The mountains are high, and the government's far away." Which is this idea that the further you get away from Beijing, the less authority Beijing has, but that particular expression, Shàngshù zhèngcè hé yǐxià duìcè, that was the expression in our bureau. Because we just saw it time and time again that there'd be something that would come out. In particular, Beijing would be trying to crack down on shadow banking, and all of a sudden the world would go, "Oh, wow. The data's changing."

**Dinny McMahon:** 00:18:25 All of a sudden, trust loans are being reigned in. Beijing is finally taking this debt accumulation hand in hand, and then after a while you realize, "No. What actually happened is that the financial system just got creative and conspired with local governments just to come up with new ways to lend that no one's been looking at." That, I think, has been the dominant economic trend for the last decade, but that's starting to change a little bit now.

**Demetri Kofinas:** 00:18:47 I don't know where you were going exactly before I made you speak Mandarin, which I would love to do it again one more time with another quote. But you were talking about the local government and this kind of weird relationship between the Beijing and some of these provincial areas, or I don't know how they all break down. The thing that I find remarkable, and I'd love for you to shed some light on it, is how this works where they're required or expected to spend, and yet the way that they collect is not straightforward tax revenue, right?

**Demetri Kofinas:** 00:19:22 For example, you give the example of the value out of tax. That local governments, as I understand it, are incentivized to prop up zombie companies, because zombie companies, even if

they're not profitable, as long as they're generating revenue, you're able to tax those. Because they're creating stuff, and that tax taxes the component parts that are coming out of the factory basically. They're incentivized to do that because they're getting 25% of that tax, whereas they have to wait to negotiate to get the money from Beijing, which is basically like this suction action where the center sucks up capital and then redistributes it out. Talk to me about that perverse sort of relationship, how that works. And then again, to reemphasize the point, it seems that's the challenge of how do you take a system that works so differently and try to turn it into what we have, which is supposedly what the Chinese economy's supposed to transition into.

**Dinny McMahon:** 00:20:15 Okay. Well, I'd say probably the biggest problem with the local governments is the incentive structure, right? The thing that local officials get judged on, whether they're being successful or not, is a degree to which they have been able to stimulate economic growth. But perhaps the most important metric of that is the degree to which they've been able to increase tax revenue.

**Dinny McMahon:** 00:20:35 There's a few ways they go about it. In terms of their relationship with companies, that's where this zombie problem that you were talking to comes to, right? Because a zombie company is still generating VAT, which is effective a sales tax. It is still generating tax that goes directly to the local governments as long as it's making sales. It could be using a fraction of its capacity. It might be owning operating at 60% of its capacity. It might be hemorrhaging money, but the cost of keeping that company alive falls to the financial system, whereas the benefits of keeping that alive is a taxation that feeds into the local coffers.

**Dinny McMahon:** 00:21:10 And that's really important to the local officials, because they get judges on their ability to generate taxation. If they shut down that firm, all of a sudden they're receiving less tax, and they have to pay out more money out of their own pockets to pay off pensions, and maybe land remediation, and all sorts of other issues. So it's an interest to keep these companies alive.

**Dinny McMahon:** 00:21:30 And then this feeds through with the infrastructure construction as well. The local governments aren't ... Up until recently the governments have been tweaking the way that local governments fund infrastructure construction, but traditionally they haven't been able to pay for it out of taxes, or out of revenue. So the way they've paid for infrastructure is through land sales.

**Dinny McMahon:** 00:21:52 So you had this situation where the local officials have been hugely incentivized to appropriate land from farmers in the surrounding Hinterlands. Taking it from them at cutthroat prices and selling them to property developers, which then gives the local authorities the resources they need to build the infrastructure, which is then necessary to stimulate the economic growth, which they need to prove that they've been a good official.

**Dinny McMahon:** 00:22:17 So these sort of perverted political incentive schemes ... If you're sitting in Beijing, certainly back at a time kind of looked inspired. It was a standardizing way that you judge officials throughout the entire country on the same metric. The way that's fed through into the way the economy has worked has had really destructive impact.

**Demetri Kofinas:** 00:22:38 You mentioned the government's role in claiming land from farmers. No one actually owns land in China, right? It's given on these, what, 80 year leases?

**Dinny McMahon:** 00:22:48 It depends on the land. Residential land, I think it's seven year lease, commercial land is 50, and agricultural land is 30 year leases.

**Demetri Kofinas:** 00:22:56 Okay. There's a quote from your book that I've pulled out here about this, because this has come up over and over again in my research in China. You write, "Land lies at the heart of China's investment boom, and it's why the country's economic boom is so fragile."

**Demetri Kofinas:** 00:23:09 Let's talk a little bit about the role of real estate in China, the role that these perverse incentives have played in creating booms in real estate. How can a Westerner think about the real estate market in China? What's driving it, and on what scale is the bubble in Chinese real estate? How localized is it? How nationwide is it? How important is the real estate story in China?

**Dinny McMahon:** 00:23:35 I think the best way to think of real estate in China is that it's not one market. It's probably not even fair to say that it's too, but thinking that it's two markets is probably the best way for us to go at it here. On one level, you have a whole lot of housing that's being built in China's smaller cities, and a lot of that has been built really for speculative purposes.

**Dinny McMahon:** 00:23:56 Because nominally the reason that you've had a huge expansion in housing in a lot of small places in China was this vision that

we've had hundreds of millions of people moving from the countryside to the cities. That somehow that was going to affect all Chinese cities equally, whereas in actual fact, that's not what happened. So you've got a lot of cities that never actually experienced that inflow of migration, but they built housing in anticipation that it would happen, and people bought that housing because it became an investment.

- Dinny McMahon:** 00:24:25 Bricks-and-mortar has traditionally been the single most investment avenue for Chinese people, and so you've had a huge amount of money that's gone into it.
- Demetri Kofinas:** 00:24:32 Why is that?
- Dinny McMahon:** 00:24:33 Well, traditionally the reason has been because China's financial markets just haven't been deep enough. The stock market only got going in the '90s. There weren't enough stocks, and then at the end of the day it was really a casino. If people wanted a relatively secure and accessible financial asset that they could invest in, it ended up being property.
- Dinny McMahon:** 00:24:52 Of course, part and parcel of this as well is China's capital controls, which meant that Chinese people couldn't take their money and invest overseas. Bonds originally was a fairly thin market. The stock market was a thin market. All that was really left was property. Now, that's changed over recent year, particularly starting probably in 2009 with this flourishing of the shadow banking market. You've had a massive expansion of the bond market. The stock markets got significantly bigger. You had this proliferation of fixed income products called wealth management products.
- Dinny McMahon:** 00:25:21 At the same time, property still does occupy a very special place in the investment decisions of Chinese people so there is still this incentive to, first buy a home, and if you have the resources, to buy an investment property.
- Demetri Kofinas:** 00:25:36 What do people mean when they talk about the shadow banking system in China? I've heard you talk about it a number of times. I'm not really clear on what it is.
- Dinny McMahon:** 00:25:43 Right. The shadow banking system in China is a collection of non-bank financial institutions. The way to think of China's financial system is kind of a bit like the Island of Misfit Toys. From a distance, everything kind of looks familiar, but once you get up close you realize that things are not quite the way they seem.

**Demetri Kofinas:** 00:26:03 That's a reference from the 19, what is it, 72, Rudolph the-

**Dinny McMahon:** 00:26:07 Rudolph the Red-Nosed. Christmas classic, Rudolph the Red-Nosed Reindeer.

**Demetri Kofinas:** 00:26:10 Christmas classic with the abominable snowman. I mean 1968.

**Dinny McMahon:** 00:26:13 That's right.

**Demetri Kofinas:** 00:26:14 '66, something like that.

**Dinny McMahon:** 00:26:15 Something like that.

**Dinny McMahon:** 00:26:16 You have trust companies, for example. Trust companies aren't like trusts in the United States. What they became in China was effectively almost they're like special service vehicles. They're away to save money from the public, or increasingly from the banks, and then make loans to companies, or to local governments or whatever. What the shadow banking system, was almost a parallel financial system to the banks that was a way of raising credit to lend to property develops to pretty much give private tech to anyone who needed credit.

**Dinny McMahon:** 00:26:47 The thing is, as with the Western version, I said it was a parallel system, but in actual fact, there's all these links between the formal banking system and the shadow banking system. The reason that this shadow system exists is because it does the things that the formal banks aren't allowed to do, or supposed to do because of regulatory efforts to make them safer. Because the banks can't do a whole lot of risky stuff, they cooperate with the shadow banking system to be able to do it instead.

**Dinny McMahon:** 00:27:14 That was really what fed this huge explosion of debt in the Chinese economy, because Beijing could regulate and recognize the risks. They saw that property developers and local governments, industries suffering overcapacity, they were expanding too much and they really needed to get less credit. So they told the banks, "Lend less."

**Dinny McMahon:** 00:27:33 The way the banks responded was by cooperating with the shadow banks to be able to keep the flow of credit moving into these sectors of the economy. Now, this dynamic's changed a little bit since the beginning of last year. Finally, Xi Jinping, because he's managed to consolidate so much power in his own hands because of the crackdown on corruption. He's now being in the position to change the dynamic a little bit, such that the

shadow banking system has been massively reigned in since the middle of last year.

- Dinny McMahon:** 00:28:02 Now, having said all that, things seem to be changing now again, because Beijing is getting seriously worried about the trade war, growth is slowing, and they're trying to stimulate the economy again. When they start stimulating, they start to relax a little bit on shadow banking, so conceivably, the progress that we've seen made since the beginning of last year looks as though it might be going into reverse again.
- Demetri Kofinas:** 00:28:27 Because every time they make the reforms that they need to, it's going to come with some pain, and the pain hurts, and no one likes pain.
- Dinny McMahon:** 00:28:33 Absolutely. There's this political threshold of how much growth is acceptable, and actually working out where that threshold ... It's a moving target. For years when I first started as a journalist, that target was eight. There was this political slogan that we needed to maintain with the eight percent annual growth, so growth was 12 percent, 10 percent, 11 percent, but it always had to be above eight. Then in recent years, it'd stick below that. There's been this realization that China doesn't need to create the volume of jobs that it needed back then when eight percent was seen as so important.
- Dinny McMahon:** 00:29:04 So now it's a question of, what is the key number? One idea is that okay, well, Xi Jinping wants the size of the economy to double between I think 2010, 2020. To be able to hit the 2020 target, China needs to grow at least I think 5.5 percent for the next few years. So it's like, "Is that the new level? Or is there another political consideration going on? Or is it really about the stress that people are feeling at a local level?"
- Dinny McMahon:** 00:29:32 If growth gets below, say, 6.5 percent, do you really start seeing ordinary people fill the stress of that slowing growth in certain parts of the country? So the authorities in Beijing see something that the rest of us don't, so like okay, we've got to stimulate at this point because it's just not politically sustainable to let growth slow any further.
- Demetri Kofinas:** 00:29:50 Does that sound as asinine to you as it sounds to me?
- Dinny McMahon:** 00:29:55 Maybe I've just spent too long reporting on China, because if it's-

**Demetri Kofinas:** 00:29:59 If it were that easy, Easter Island would have been the most successful civilization in the history of humanity. If growth were as easy as, "Well, we want to hit this target. Let's go." I guess that's another way of asking, what kind of malinvestment are we looking at for the Chinese economy? Obviously you don't know, but give me a fuzzy sense. What are we talking about here?

**Demetri Kofinas:** 00:30:21 Obviously these ghost cities are malinvestment. There are a lot of it there, but how much could be lurking under the surface that because of the way that they direct investment in China. And also the, as you've made the point, another thing here, maybe you can say this in Chinese, numbers make officials so officials make up numbers. This relationship to information and opacity, and the bending of the rules. What are we looking at here? It's the scariest thing of this entire story for me.

**Dinny McMahon:** 00:30:52 If we're talking about malinvestment. It's the stuff that you can see, and there's the question of how we quantify it. The malinvestment turns up most obviously with industries that are suffering overcapacity. So you have this situation where I think the government itself, at least a few years ago, had a list of almost two dozen industries in which there was overcapacity, which is everything from steel ...

**Dinny McMahon:** 00:31:12 Steel's a great example. I think in 2003 China was still a net importer of steel. A couple of years ago at least, China was exporting more steel to the rest of the world, than was being produced that is, by Canada, the United States, and Mexico combined. China is currently capable of producing more steel than it could ever conceivably hope to use.

**Demetri Kofinas:** 00:31:32 Well, you said in the book that they have the single biggest, what is it, forge? What's it called?

**Dinny McMahon:** 00:31:37 That wasn't actually producing steel. That's another industry that's suffering overcapacity, but this was like a company that makes the machines that factories need. This was a company that makes steel mills, it makes power producing plants, and it's suffering massive overcapacity, because all those sorts of industries are suffering overcapacity.

**Demetri Kofinas:** 00:31:54 But they've built things that they can't even use, because they don't have the demand yet for it, going back to the point about building apartment buildings where people haven't moved in. And there was that other story you had about the ballpoint pens, that they couldn't make ballpoint pens because they

didn't have that fine level of engineering, even though they make like 80 percent of the world's pens.

- Dinny McMahon:** 00:32:11 Absolutely. I mean, that's a slightly different issue. We can get into that a little bit because that speaks volumes about the trade conflict at the moment. In terms of malinvestment, first issue is the overcapacity we were talking about. Second one is local governments building infrastructure and public works. That's a big thing to think it's not just infrastructure, it's public works, a governmental, ornamental lake, stuff like that, that they can't pay for or it's just massively underutilized and will never have the economic payoff that justifies the investment. Then of course there's the empty housing.
- Dinny McMahon:** 00:32:40 Then becomes a question of how you quantify this. And the issue is, in any other country, the way you'd look at it is like, what is the nonperforming loan ratio in China, but the official data in China doesn't mean anything. I mean, I think it's currently, at the bank something like 1.8 percent of all loans are officially recognized as being nonperforming. That's slightly worse than United States but slightly better than Germany, so that gives you an idea. I mean, that number has no meaning whatsoever.
- Dinny McMahon:** 00:33:06 And quite interestingly, the beginning of this year, the Chinese Banking Regulator actually published an essay in which it outlined the various ways that the banks were lying about their bad loans. Then a question of okay, so if the number isn't real, what is the real figure? And this is an open question. I've seen estimates anywhere from four percent to 20 percent, and even when you come up with a number like that, well, that might be the figure today, but that ratio will go up as the Chinese economy continues to slow.
- Dinny McMahon:** 00:33:36 You've got to remember, this is an economy which borrowed money in the expectation that the economy would grow at significantly higher rates. The more the economy slows, the more bad loans there will be, and that is I think something that's clearly keeping Beijing away at the moment, but as the trade war fights. Because they're already facing smaller growth, and the tariffs and the trade war, you would expect, would put even more pressure on that growth.
- Demetri Kofinas:** 00:33:58 So pushing on a string. Let's talk about the trade war. Let's talk about the economic war. One of the things that I've been noticing in the signaling, whether I'm listening to Donald Trump, whether I'm listening to Mike Pence, who recently spoke against China. What's interesting is I think the Trump administration is

beginning ... They're very politically astute, and Steve Bannon was actually out speaking as well about rerouting the global supply chain for a while. Economic war with China is a central aspect of the platform, because it really resonates with a population that, I think, rightly sees a level of unfairness with respect to how the United States and the Chinese relationship has evolved, at least if you're part of the Rust Belt.

**Demetri Kofinas:** 00:34:37 What's going on with the trade war? What impact have the tariffs had, and how are the Chinese seeing this? What can you tell us about this?

**Dinny McMahon:** 00:34:44 Yeah, right. I think up until only recently the trade war hasn't really had much of an impact. I think that started to change in the most recent trade data, because up until now, because people have been seeing the tariffs coming down the turnpike. They've been front-loading their exports.

**Dinny McMahon:** 00:34:59 Chinese exports, generally speaking being pretty robust over the last few months. I think they've changed a little bit in September. I think the real big impact over the next however months, however years, it'll depend on whether, you know. And most recently, the Trump administration put a 10 percent tariff on \$200 billion dollars' worth of Chinese exports to the US. They retain the right to increase that to 25 percent on the first of January, and Trump's also said that if China retaliates in a meaningful way, then the US could put another 200 and more tariffs on another \$250 billion dollars' worth of goods.

**Dinny McMahon:** 00:35:31 Now, generally speaking, China isn't as dependent on exports as it once was. I think only four percent of GDP is Chinese exports to the US, which is down about half the level of 2008. The thing is, this starts to change the dynamic behind, or the incentive behind, foreign companies building factories in China, even Chinese factories operating their factories in China. One of the factors that's generally overlooked is that China isn't a cheap place to manufacture anymore, and this is something that's been changing fairly aggressively in the last few years, and there's a lot of reasons for it. The cost of land, for example.

**Dinny McMahon:** 00:36:07 I know one Chinese entrepreneur, and I write about him in the book, who was expanding his textile mill. He was based in Shandong Province, kind of the heartland for private industrial companies in China, and he moved to South Carolina because the cost of the land was just so much cheaper. Energy prices are going up again because of fracking in shale in the United States. If push comes to shove, the US is in a position to have lower energy costs than China.

**Dinny McMahon:** 00:36:31 Once again, this was one of the factors that drove out this textile producer a few years back. Environmental compliance. Once upon a time, that's why foreign companies moved to China in the first place, because China didn't worry about the impact of manufacturing on the environment. That is radically changed in the last few years, because China's not just dealing with air pollution, but huge boarder supply and pollution issues, and soil issues.

**Demetri Kofinas:** 00:36:54 Soil, right. 20 percent of the land is non-arable that would otherwise be arable.

**Dinny McMahon:** 00:36:57 Absolutely. It's a huge problem. Then you've got, the big issue is wages, so traditionally there's always been this vision that China had almost this endless supply of workers moving from the countryside to take factory jobs. What we assumed was endless turned out to have an end. I mean, that supply of migrants looking for industrial and manufacturing jobs in the cities has slowed to a trickle.

**Dinny McMahon:** 00:37:21 Now, at the same time, the fallout of the one-child policy is finally starting to be felt, which is China has a shrinking working-age population. You put all that together, and China is becoming more and more expensive place to actually make stuff. You put a 10 percent tariff on that, you put a 25 percent tariff, and you're really accelerating this process. Which meant that China really needs to change the composition of its industry in a hurry so that it's producing more highly value-added stuff that isn't going to leave China because it's just too expensive to manufacture.

**Demetri Kofinas:** 00:37:54 What a challenge. Let's stick on this a little bit with the one-child policy. The median age in China is roughly equivalent to the United States, about 38, right? But that doesn't really capture the picture, right? Because you've got this abnormal vacuum, demographic vacuum that's born out of the one-child policy, right?

**Dinny McMahon:** 00:38:12 That's right.

**Demetri Kofinas:** 00:38:13 How does that manifest? How and when do we see that?

**Dinny McMahon:** 00:38:15 It's already started.

**Demetri Kofinas:** 00:38:17 When was the policy put in place, too? Tell us.

**Dinny McMahon:** 00:38:19 I'm going to say 1979. Originally, that had real economic dividends for China, right? If you only have one child per family then that frees up both parents, really, to work, because you can give that one child to the grandparents to raise. There's less state resources going towards taking care of children. The dividend was, there was only one child so you had more adults, effectively, working in the workforce.

**Dinny McMahon:** 00:38:46 Now that's been completely turned on its head, and I think it was in 2012 that the size of the working-age population started to shrink. That's going to have two major fallouts between ... I forget what year the working-age population shrinks to its minimum size. I know by 2030, the impact of this are really going to have a significant impact on the economy.

**Demetri Kofinas:** 00:39:10 So about 100 million fewer people or something like that?

**Dinny McMahon:** 00:39:13 That's right. Yeah. I forget over what period. It might be about 15 years. But it's, on one hand, the number of people in the workforce is shrinking. On the other hand, you have more people who are retired, so the drain on the healthcare, and on pensions is significantly greater. At the same time, more people have to be taken out of the workforce in order to take care of the aging population, so it really does present a pretty significant challenge to the structure of the economy in the not so distant future.

**Demetri Kofinas:** 00:39:42 I was thinking of something, though, when I was reading that, which is that also to the point of the trade wars and stuff like this, automation is increasingly was threatening jobs, manufacturing jobs. It isn't low-wage labor, correct? In other words, that the Chinese are going to have to face threats from automation irrespective of whether they can be competitive as a lowering their labor cost, right?

**Dinny McMahon:** 00:40:05 You would think so. I mean, so far everything I've read and I've heard about automation in China isn't so much about people losing out their jobs to it, but yeah. You would imagine that would happen. You would be in a position where if you're going to retain furniture factories, or toy factories, or textiles factories, there are two options. It can either stay in China and those jobs can be taken over by machines, or they could move to Cambodia.

**Demetri Kofinas:** 00:40:30 Because my thought was really, if China didn't have the debt problems it has, what would the structural demographic issues really mean, right? And I think they would, in some sense, be an opportunity as well, particularly given the levels of population

of the country, the levels of pollution, and if we get increasing automation, the fact that there could be fewer people could actually be a benefit. But you've got unfunded, they consider it unfunded liabilities in China, but this would probably be a good opportunity to talk about the debt. Because the demographics are one thing, but when you combine them with the debt, the picture becomes all of a sudden very different.

- Dinny McMahon:** 00:41:09 Yeah. The debt picture is quite interesting. The IMF, the Bank for International Settlements, a number of central bankers around the world. Even Chinese officials in recent years have been warning that if the debt continues to increase, and particularly if it increased in both the pace and the way that it was accumulating, particularly through those shadow banking mechanisms I was talking about. If things continued in that direction, then it was really potentially destabilizing to the Chinese economy.
- Dinny McMahon:** 00:41:37 The IMF points out that almost every other economy that has accumulated this much debt this quickly has experienced some sort of financial crisis. The Bank for International Settlements has a whole lot of measures by which it assesses whether a country is facing a financial crisis, and they're all flashing red for China is the way the BIS says it, so yeah. The debt levels, hugely elevated levels, so the question then is what do they do about it.
- Dinny McMahon:** 00:42:04 Starting last year, Xi Jinping managed to launch what he calls a deleveraging campaign. Now, that's something of a misnomer, because the absolute level of debt hasn't decreased, and in fact, the size of the debt relative to the size of the economy continues to increase, because that's the way the economy grows. China's economy is dependent on investment-led, debt-fueled growth, and that requires at the moment for debt to expand faster than the pace of growth.
- Dinny McMahon:** 00:42:32 Rather than calling it a deleveraging campaign, the best way to think of it is as a de-risking campaign. They've been reigning in shadow banking, they've been pushing the banks to write off their bad loans more aggressively. The whole idea is trying to make the system less risky so that it can continue effectively lending more money in the short-term so it can support growth.
- Demetri Kofinas:** 00:42:52 Is that also another way of saying more accountable?
- Dinny McMahon:** 00:42:54 No. No, I don't think it's more accountable.

**Demetri Kofinas:** 00:42:58 For example, with the banks, it's not saying you need to be more accountable for your bad loans. It's not because they still know that the government will save them. The government will bail them out.

**Dinny McMahon:** 00:43:05 Yeah. Well, if you're looking at the bad loans, sure, they're writing off more bad loans, but the nonperforming loan level that they're disclosing still bears no resemblance to reality. They're writing off more and more bad loans, but the level of the NPL ratio just doesn't change. By some estimates at the pace that they're writing up these bad loans, it could take a decade at least to sort of deal with this nonperforming loan ratio.

**Dinny McMahon:** 00:43:30 Now, that doesn't suggest a level of accountability. This feels like more a negotiation or a compact or a compact between the government and the banks that we are going to slowly deal with this problem, and the government will help keep everything stable until they've worked through these issues. I don't think that's a question of accountability, whether it be accountability to the public, or shareholders, or whatever.

**Demetri Kofinas:** 00:43:51 Let's talk about Chairman Xi, because the thing I learned from reading your book that I did not know, with Elizabeth we discussed at length the consolidation of power in China and how some say he's even amassed more power than Chairman Mao. What I didn't realize, and you make the point in the book, is that that consolidation of power is actually impartial of the reform process, that the way in which there are all these different counteracting or countervailing incentives in China working against each other, and working against reform and against the stated goals of the body politic. That the consolidation of power by Chairman Xi is part of the way that they're going to actually be able to reform the country, right?

**Demetri Kofinas:** 00:44:39 How is that process going? First of all, the consolidation of power, is that still ongoing? And how is he going to do that? And how is that whole process coming along?

**Dinny McMahon:** 00:44:49 Yeah. When Xi Jinping launched his anti-corruption campaign, everyone's spent a long time trying to work out what he was trying to achieve, and I think in hindsight, he had a lot of goals. There wasn't just one thing he was trying to achieve. On one level, he was really dealing with corruption, and he continues to do it. When he came to power, there was perhaps no other issue that was a source of frustration among ordinary Chinese people. Then the degree and the excess of official corruption in China. So that was one thing he was dealing with.

**Dinny McMahon:** 00:45:19 Then there was dealing with political rivals, and then one of the other real benefits of this is he's managed to smack heads, so to speak, to a sufficient degree that lower levels officials aren't willing to do an in-run around what Beijing asks of them anymore. If something is asked of them by Beijing, if there's a rule or regulation, some sort of dictate, they now do what they're told. Xi has managed to consolidate a huge amount of power in his hands, so that means that something like the deleveraging, de-risking campaign is significantly more successful than similar efforts in the past, because people are doing what they're told.

**Dinny McMahon:** 00:45:56 On one level, yeah, that's been important for the reform process. However, the other side of this equation is that everybody is so terrified of doing the wrong thing that that is having an impact on the ability to reform the economy as well. So there is this almost inertia in the bureaucracy, because officials worried of showing any initiative just in case it's the wrong thing or they get signaled out, or for whatever reason. Or that when there is something that is asked of them, if they're asked to jump so high, they'll jump twice as high to prove their loyalty.

**Dinny McMahon:** 00:46:33 We've seen a couple instances like that. Last year when the authorities were implementing, or introducing gas heating to China's Northeast, the rollout ended up being far too aggressive far too quickly, such that there wasn't enough gas to go around through this frigid winter. So a whole lot of people were left without heating because these officials were trying to show their loyalty to Xi Jinping to such an extent that they overdid it.

**Dinny McMahon:** 00:47:00 This is the problem. On one hand, to be able to impose top-down reform. Xi has had to break down the system and consolidate a lot of power in his hands. The problem with that is that you then end up with inertia and sycophantic officials, and no one willing to show the initiative in dealing with economic problems. Which, back in the '80s and the '90s was one of the great strengths of the Chinese system and allowed local areas to really experiment and drive ahead with economic reform.

**Demetri Kofinas:** 00:47:30 Well, there was a huge cultural flourishing during the 1980s, right? That led up to Tiananmen Square.

**Dinny McMahon:** 00:47:36 Yeah. I think so often we look at the fact that China is run by one party, and we see the entire period of the last 50, 60 years as being in one hue at one time. The social change and the political to and fro that's gone on in China since 1979 is great as anything experienced in the United States, so yeah. The China of

the 1980s, even the China of when I moved there as a journalist in 2004, 2005, was significantly more open than it is today.

- Demetri Kofinas:** 00:48:05 What is the biggest fear of the Chinese leadership, if you could identify it?
- Dinny McMahon:** 00:48:11 I'd be guessing, given I don't have a particularly close relationship with them.
- Demetri Kofinas:** 00:48:15 Well, what do you think? The reason I ask, it is because one of the things that I've heard, I think you've mentioned it as well, is the middle income trap that Chinese officials are terrified that they're not going to be able to achieve the escape velocity and they're going to get stuck in that area between a developing and a developed economy.
- Dinny McMahon:** 00:48:33 Yeah.
- Demetri Kofinas:** 00:48:34 I think demographics are a big part of that. Their demographics are not great for a country that's still developing, that's at about eight thousand. What is it? The average income-
- Dinny McMahon:** 00:48:46 Average income, yeah.
- Demetri Kofinas:** 00:48:47 ... for an adult. Can you explain to us what that is, and why they're so afraid of it?
- Dinny McMahon:** 00:48:52 Yeah. This is a vision of the 40 years of fast-paced growth. All of a sudden, rather than naturally segueing from being a developing country and becoming an OECD nation, a rich nation, as the trajectory would suggest. Instead they hit a wall as almost every other developing country has, and they end up mired in this permanent state of being a developing economy.
- Dinny McMahon:** 00:49:16 This idea was first drummed up by the World Bank. A few years ago, a batch of economists did a survey of I think it was 101 countries that could be fairly interpreted or defined as being middle income in 1960. So middle income, they weren't rich nations, they weren't poor nations, they were developing economies. They found that by 2008 only 13 of those 101 had actually transitioned into being rich nations, and almost so many of the others had seemed to be on track. Whether it be in Mexico, or Argentina, they were curious where they were growing aggressively. In Malaysia, Thailand, the Asian tigers during the late 1990s, and then a crisis or some sort of other economic event, and they never made the transition, and that's what China worries about.

**Dinny McMahon:** 00:50:04 I think, on the economic side of things, that's what keeps them up at night, and there are so many factors that could feed into aggravating that, and one of them as you said is the population issue. There's been this long held concern that China will become old before it becomes rich, and the more the working-age population shrinks, the harder it is to become rich. Because all of a sudden you've got less people working, and you have to start redirecting resources towards an aging population.

**Dinny McMahon:** 00:50:33 I think what one of the underlying tensions of the trade conflict at the moment is that Beijing came up with a solution for dealing with its middle income trap, and this was this recognition that it can't continue growing the economy as it is, which is driven by debt. So they need a new model of economic growth, and that new model was to force march the economy up the value added chain, out of, away from investing in infrastructure and housing, away from low-end textile manufacturing, and into industries that required a greater degree of technology.

**Dinny McMahon:** 00:51:07 Because when they look around and they see developed economies, that's what they look like. They're high-end manufacturing industries. So that was a vision. That is how they will change the Chinese economy, but the way that they've decided to do that is by targeting a whole lot of high-end industries such as semiconductors, electric vehicles, robotics, and by achieving a degree of dominance. Or building up those industries using things like subsidies, and non-tariff barriers, and quotas, and state funds to buy foreign technology.

**Demetri Kofinas:** 00:51:39 I've never heard you use that phrase before, "They're afraid of becoming old before they become rich." I really like that, and it makes me think about the unfair metric by which all developing economies ... Maybe unfair is the wrong word. Unrealistic metric by which all developing economies are judging success at this point, because they've seen what the United States has done and what the Brits have done, sort of the Anglo world. They industrialize, but the world was very different when they went through their process, and now the Chinese with a much larger population, and a very different world where they're dealing with problems of pollution. We're all dealing with problems of rising sea level.

**Demetri Kofinas:** 00:52:16 I don't know what impact, by the way, that would have on China. There's lots of coastal real estate, a lot of these coastal cities. The fact that this is the standard that they're holding themselves to, and not only they're holding themselves to, but they have given their populations this metric by which to hold

them accountable, right? Because since Tiananmen Square, that was the compromise, what you're describing, right? The compromise was, "Okay, listen. Let's chill a little bit on all this political freedom. That's all great and everything, but let's focus on, we're going to give you growth. We'll give you economic growth. You give us political power." Right?

- Demetri Kofinas:** 00:52:45 And that breakdown is what could cause social unrest in the country, and that's ultimately what they fear, right? It's not the middle income trap, it's not demographics, it's not debt. It's social unrest.
- Dinny McMahon:** 00:52:56 Absolutely. It is the hold of the party over the nation, so it's anything that potentially undermines that is really the threat.
- Demetri Kofinas:** 00:53:03 I think that's underlying what this book is really about, right? At the end of the day, that's what this is ultimately about, because that's the question. Can the Chinese political class navigate this abyss and get to the other side with the country still intact? The political system, whether it's changed or not, intact without having had a revolution of sorts or some major level of unrest.
- Dinny McMahon:** 00:53:25 Yeah. I guess so, actually. I hadn't quite thought of it in exactly those terms, but yeah. I think that's [crosstalk 00:53:29]-
- Demetri Kofinas:** 00:53:29 And what do you think the verdict is, Dinny, since you haven't thought about it before I'm going to put you on the spot right now. Obviously, when I ask that, and I ask it fairly. I don't ask you to tell me for sure. Give me the best answer you can. What do you think? What do you think when you look over that horizon?
- Dinny McMahon:** 00:53:45 I think actually even seeing where that horizon is at the moment is becoming more and more difficult to identify. I think we're entering into a period of really extreme uncertainty when it comes to the Chinese economy, and by extension sort of the political dynamic. The reason is, I think we're only entering the very early stages of this US-China trade conflict. The fallout, and the direction, and the knock-on effects of what that's going to have, not just for China and the US, but for the greater global economy as well. That's going to take years to play out.
- Dinny McMahon:** 00:54:16 Now, at the same time, I think in China we're already seeing a hardening of the political environment. I mean, the tone or the general environment of that you sort of experience in places like Beijing and the rest of the country. There's a lot less personal freedom. There's a lot more surveillance than there

was even five or six years ago, so I think the dynamics, both politically and economically, are just changing so much and so quickly at the moment. And it's really quite difficult to actually be able to know what China's going to look like in five years' time at this point.

- Demetri Kofinas:** 00:54:48 That's the second time you brought up the trade war, the economic war with the United States. Do you think it's underappreciated in the press here? They've been talking about it but I sort of glaze over when I listen to it, because I don't really have any way to quantify or understand it. Do you think it's a bigger deal than most of us realize?
- Dinny McMahon:** 00:55:06 I'm starting to think it's a huge deal. You listen to the speech that Vice President Pence gave yesterday. He really took the idea of the trade conflict and put it in a much bigger context. I mean, this isn't just about steel jobs and trade balancing anymore. He brought everything from human rights in Taiwan, and the technology issue, and lumped it all together and started to redefine US relationship with China.
- Dinny McMahon:** 00:55:33 There was a story yesterday that Bloomberg ran. I'm not sure whether you saw it. About how-
- Demetri Kofinas:** 00:55:36 Absolutely. I posted it on Facebook and it got more play than anything else, the computer chip, the manufacturing chip.
- Dinny McMahon:** 00:55:42 I think this is potentially a game changer. This all of a sudden puts supply chain issues in stock security terms, so if originally the idea of the trade, kind of a fringe view of the ultimate goal was to bifurcate global supply chains to split the US supply chain off from China. I think increasingly that could actually be the direction that we're heading in, and if so, that has huge ramifications both for the cost of manufacturers in the United States, the economic opportunity for the rest of the emerging world, the potential for growth and investment in China. I think really has a potential to start reallocating resources globally.
- Demetri Kofinas:** 00:56:24 The quote that I was looking for when I was mentioning Pence's speech, because we were referring to the same one, or maybe it wasn't a speech. I think it was actually a quote he gave to the Hoover Institute, and it had to do with election meddling. He said that what the Chinese are doing to the United States right now, "Pales in comparison to what China is doing." What the Russians are doing, sorry. "Pales in comparison to what China is doing." And I was bringing that up from one point of view.

**Demetri Kofinas:** 00:56:48 First of all, I know from my research in Cyber War that the Chinese are actually far more droit, at least from my readings, than the Russians are. But I thought in terms of a political strategy I could see it all coming together. As I've been watching and listening to this administration and their signaling, I think they're far more politically astute than American journalists understand. And I think that the incorporation of Cyber War election meddling, and basically acknowledging that there's election meddling happening in the United States, but then transferring that to the Chinese and pointing it in that direction.

**Demetri Kofinas:** 00:57:26 I think it's all part of a general strategy to put the focus on China, and I think just that alone, that more increasingly belligerent rhetoric with the Chinese, and also the seemingly ... Again, I'm not at the administration. Maybe there's logic to this. There very well could be. I don't mean to suggest there isn't, but this seemingly schizophrenic relationship with our allies, with the government's allies, and it's supposed enemies. You could see it nowhere better than in South Korea and North Korea, and China, right?

**Demetri Kofinas:** 00:57:58 It's a confusing time, and I think all that uncertainty has failed to materialize inequities. It's failed to materialize in the US stock market. The reality is, at least in the West, we've had a pretty good time the last 10 years. A lot of things have been going well for us, and there are a lot of black swans on the horizon, whether it's a market downturn. Whether it's a hurricane flying up the East Coast, another more catastrophic storm that's adding increasing levels of turbulence in our climate, et cetera. Yeah.

**Demetri Kofinas:** 00:58:31 I think I'll let you get the last note in here, Dinny. I know you're on a tight timeline. You gotta get to the airport.

**Dinny McMahon:** 00:58:37 No. To be honest, Demetri, I don't have much more to add than that. I think we're very much entering uncharted territory at the moment, and I think the way ... Not even just the trade relationship, but I think the way that China and the US relate to each other, and engage with each other, where it be in education in students, whether it be cross-border investment in technology, or anything else. Or whether it just be the trade relationship, or even how the two countries see each other from just a security standpoint.

**Dinny McMahon:** 00:59:05 It feels like all of those things are in flux at the moment, and how that plays out is going to have an impact not just on the Chinese economy, but certainly it will have an impact in the US side of things as well.

**Demetri Kofinas:** 00:59:16 I want to encourage listeners to get Dinny's book. I've loved having Anne and Elizabeth on the show, and love them. This is the best book I've read on China. I love the anecdotes. I was actually going to ask you if you brought me a lavender bear. I guess you haven't.

**Dinny McMahon:** 00:59:32 If you have one minute. Seriously, when I went to this lavender farm selling teddy bears-

**Demetri Kofinas:** 00:59:37 That's in the book, by the way, this story. It'll make sense.

**Dinny McMahon:** 00:59:40 I should have bought as many as I could, because everybody I spoke to all, all wanted a bear.

**Demetri Kofinas:** 00:59:45 They all wanted a lavender bear.

**Dinny McMahon:** 00:59:46 Absolutely.

**Demetri Kofinas:** 00:59:47 It's another incredible story of the power of the Chinese consumer, whether it's with Hollywood, whether it's aged by Joe. So I do encourage listeners, if you're interested in a really textured story full of anecdotes, but also numbers and facts from someone who's obviously spent a lot of time in China and thought about these things. I do encourage Dinny's book, and Dinny, again, I want to thank you for coming on the program.

**Dinny McMahon:** 01:00:08 No. It's been great to be here, Demetri. Thank you.

**Demetri Kofinas:** 01:00:09 Thanks.

**Demetri Kofinas:** 01:00:11 And that was my episode with Dinny McMahon. I want to thank Dinny for being on my program. Today's episode of Hidden Forces was recorded at Edge Studio in New York City. For more information about today's episode, or if you want easy access to related programming, visit our website at [HiddenForces.io](http://HiddenForces.io) and subscribe to our free email list.

**Demetri Kofinas:** 01:00:35 If you're a regular listener to the show, take a moment to review us on Apple Podcasts. Each review helps more people find the show and join our amazing community. Today's episode was produced by me and edited by Stylianos Nicolaou. For more episodes, you can check out our website at [HiddenForces.io](http://HiddenForces.io). Join the conversation at Facebook, Twitter, and Instagram at [HiddenForcesPod](https://www.instagram.com/HiddenForcesPod), or send me an email.

**Demetri Kofinas:** 01:01:08 As always, thanks for listening. We'll see you next week.

