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Milken Roundtable Discussion: Perceptions of China in the Global Economy

Breakout session Sponsored by Fred Alger Management, Inc.

Sponsor:



Prospering in
a Changing World

April 26-28, 2004
Beverly Hilton Hotel
Los Angeles

Speaker's Biography:

Thomas Farb

Managing Director, New America Partners

Thomas Farb is Managing Director of New America Partners. New America Partners is a private equity firm with a strategy of achieving above average returns by investing in companies which gain a competitive advantage by combining U.S. company capabilities (principally sales, marketing and products) with low-cost production in China. From 1998 to 2003, Farb was General Partner and chief financial officer of Summit Partners, a Boston-based private equity firm with \$5 billion of committed capital under management. Prior to that, Farb was chief financial officer and executive vice president of Indevus Pharmaceuticals, chief financial officer and vice president of Strategic Planning for the medical device company Cytoc Corporation, and chief financial officer and senior vice president of Aircraft Funding Corporation. Farb served on the Board of Directors of Redwood Trust, Fair Isaac Corporation, Symon Communications, Saf-T-Med Corporation (acquired by Becton Dickinson) and HNC Software. Farb is also a trustee of several non-profit organizations.

Speakers:

Dan Chung, President, Chief Investment Officer, Director of Research, and Portfolio Manager, Fred Alger Management, Inc.

Thomas Farb, Managing Director, New America Partners

Rob Koepp, Research Fellow, Milken Institute

Nan Nan Xu, President, Rock-Asia Capital Group



Moderator: Harold Goldstein, Managing Director, Xinhua Finance

Blogger's Note: (Pronounced Shin-wah). Xinhua is a data provider in China. Sounds like a Hoovers or Reuters.

Summary: In this informal roundtable discussion, moderator Harold Goldstein will lead an interactive Q&A session on common impressions of China. Do we need to deepen our understanding of China? Can we believe the data that is available on China? Does the country practice free trade? Are human rights issues in China being overplayed or underplayed? Are perceptions of investment risk in China reliable?

Blogger's Notes: Nan Nan is a consultant. Rob recently did a study on how to create the next high-tech park (i.e. Silicon Valley) in China. Dan Chung's firm is managing 12 billion in assets and they manage a China US Growth fund.

Harold (right): Is China moving into a bubble framework? Is the story of the past running into roadblocks and choppy waters? The China story can only be understood in historic terms. Taking a highly stratified, centralized and regimented system into a basically free market system in basically 20 years is simply staggering.

Harold presented the following slide which shows the number of years to double per capita GDP. It took the UK from 1780 to 1838. It took the US from 1839-86. It took China less than ten years to do it twice since 1978.

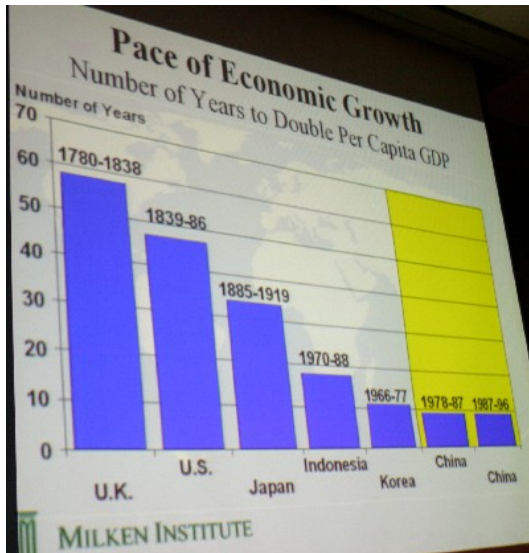


Copper 97 to present 11 to 20% of the world's total.

Second largest importer of oil with 7% of the globe's consumption.

Harold says China has pricing power in shipping and commodities.

Since 1979 when Deng Shao Ping decided communism didn't work. Harold recanted a quote from Deng "It doesn't matter if a cat is black or white as long as it catches mice," as evidence of China's pragmatism.



Harold discussed Thom Frieman's column about Intel's essay contest. 50,000 students from the US, and six million from China.

Harold called competing with China terrifying and said we need to come to grips with it.

Harold put together six important stories to discuss in the roundtable:

1. Macroeconomics
2. Global trade
3. Currency
4. Outsourcing
5. Cultural story
6. Investment Story

Rob: concerns about overheating are justified. Is this a sort of major hindrance to major growth. China may have a rough landing, it may see a precipitous drop in GDP over the next 24 months, but the more important story is that fundamental changes are taking place. China is producing about 200,000 graduates in science and engineering each year that is more than the US, Germany and Japan combined. I would argue the nature of the reforms means that the China GDP growth story will continue even if there are bumps in the road.

Harold (moderator): Asks about local governments with large political power that can counter national policy. Have you seen local government enact policies that run counter to the national policy.

Rob: China is opening up media sources. If you look at regions like Guangdong in the south and Shanghai they are putting out more and more signs of what we would consider a free press. I think media is one way you can see that.

Thomas: Localities are working with the central government. There are a number of industries where the government says there will not be any more lending, but I talk to friends of mine at banks in provinces and they tell me number one that they don't have the systems to track loans. Second, the localities have a very different view of those industries. If there is an automotive parts company the

locality gets to keep 25% of the taxes that are collected. There is a second tier of banks that makes loans. This is a problem China has had for a number of years how to run a central government in a very large area.

Social unrest because of unemployment is a haunting thought of people in China. There are two areas I worry about a lot. One is the central government, which has learned a lot from Tiananmen Square, but I worry more about local officials who might make some bad decisions.

The second worry I have about China, and it relates to the black and white cat saying, in many ways the US's capitalism is more socialist then China's. They actually have more entrepreneurs. They don't have the social programs -- the safety nets. The safety net used to be the family, now with people moving to the city the family can't do that. Also, there is no unemployment.

Dan talked about the north being the best place to live in during communism and now the worst. He wonders how they will handle this north and south tension. Also how China will deal with labor and environmental regulation as they join various world trade organizations.

One crazy anecdote from an investor in the audience about an ATM company started by a couple of young Chinese nationals. The government came along and took over the company and now the entrepreneurs have to work for the government.

Nan Nan on the panel explained that you have to do a lot of due diligence, however her idea of due diligence sounds more like investigating the mafia!

