

market notes: Invisible Hand (Cuffs) of Entrepreneurial Drive

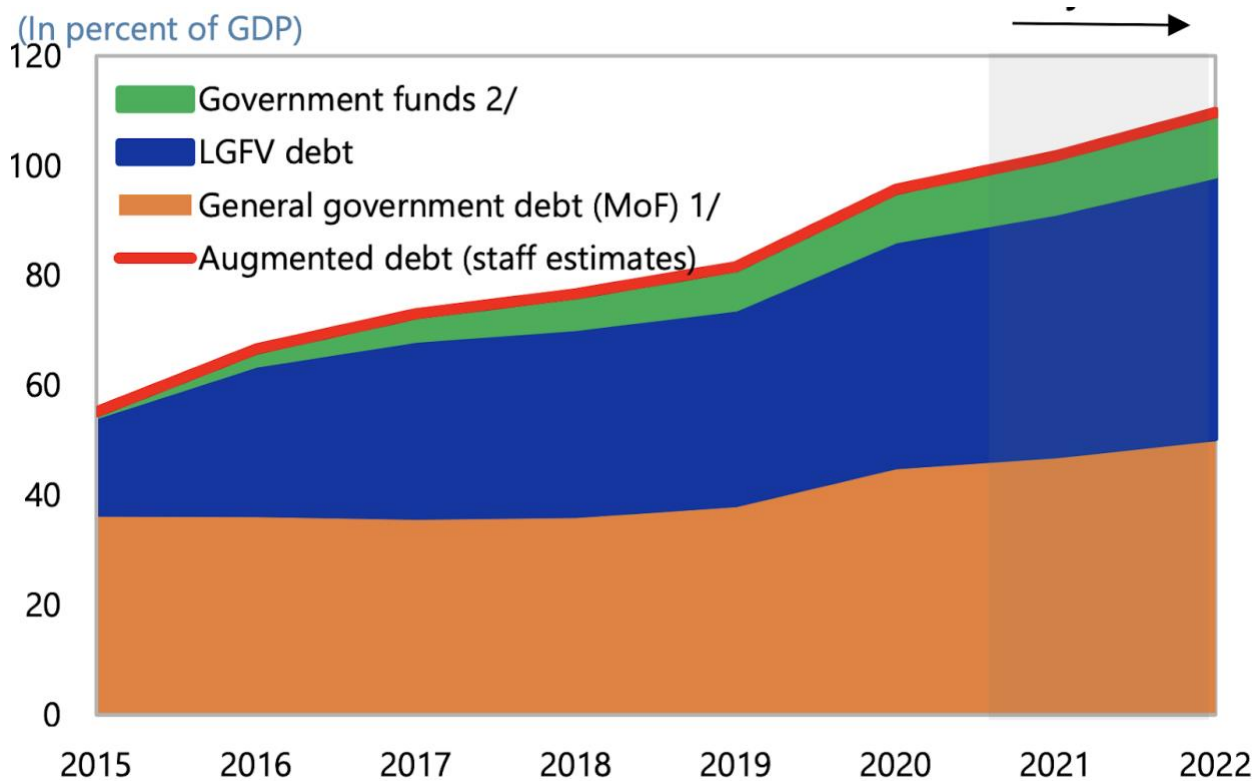
“I wouldn’t do it.” Advice to budding entrepreneurs from a wildly successful one. Having the best tech – like crypto payment rails – and entrepreneurial drive isn’t enough. You need macro support. That’s China’s delicate balance – and the rest of us, too.

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11/10/23 - Marcel Kasumovich, Deputy CIO, Coinbase Asset Management

1. Bāoróng. It's the Chinese phrase for tolerance and patience. Every great entrepreneur enters the arena with expectations of great rewards for executing great change. You wouldn't do it otherwise. And then they are humbled and humiliated. But they also don't quit. It's not the seven habits of success. It's the ability to endure, to turn lemons into lemonade. And make no mistake, it's a sacrifice beyond what could have been imagined from less humble beginnings.
2. When thinking of entrepreneurial drive, it is tempting to dismiss China. It would also be a mistake. Crypto is a great example. China policy worked to eradicate crypto. In September 2021, People's Bank of China (PBOC), China's central bank, [banned](#) the use of cryptocurrency on the grounds it posed a vulnerability to the financial system. Yet, China ranks 11th on the [2023](#) Global Crypto Adoption Index, ahead of all developed countries except the United States.
3. And despite all their differences, China is aligned with the United States on its regulatory obstinance toward digital adoption. In both countries, the rise in regulatory frictions gave time for traditional finance to catch up to the technological progress of crypto rails, China with its central bank digital currency, and the United States with its FedNow. And in both countries, adoption is limited, with less than [20% of people](#) employing the CBDC in China and FedNow [flopping](#).
4. Why? Foxes don't tend to the sheep. The proliferation of crypto payment rails outside of regulatory purview risks displacing traditional banks. New real-time settlement systems in China and the United States operate through commercial banks. And banks, watching these trends pass by initially, do little to encourage adoption. For instance, to use a CBDC in China, you withdraw from a bank and use it like a bank card. It's hardly a compelling user experience.
5. Financial instability is not caused by new technologies. It is the byproduct of past policy missteps. Take an abbreviated history. China was directly responsible for 25% of global growth from 2002-2022. Emerging markets under China's great influence, accounted for 54% of global growth; the US was 22% over the same period. All economic roads ran through China's rapid integration into the global economy, and developed countries welcomed the support.
6. Then it stopped.
7. China isn't blindly beholden to growth. Naturally, the hope and expectation is of rapidly rising living standards. China distorted domestic savings to support investment, avoiding foreign boom-bust capital flows that plagued past emerging markets. Fixed investment accounted for more than 40% of GDP in the past two decades with abnormally high domestic saving rates of 46% of GDP compared to 18% for the United States. Those funds went into property.

8. A recipe for financial stability? Hardly. All politics are local, and so are the weakest links of the financial system. Excess investment is tied to the property sector, with local governments borrowing to finance real estate and infrastructure activity. Local government bonds rose from almost nothing in 2013 to be **larger** than central government debt by 2017. Local government loans were repackaged into wealth management products for investors starved for yield.
9. China aimed to stomp out local bond risk from its central command. It is in keeping with a long history of balancing between reforms that encourage entrepreneurial energy and centralized goals of stability. Reforms in 1995 aimed at grasping the large and letting go of the small, called “zhuada fangxiao.” State owned enterprises fell from 262,000 in 1997 to 116,000 in 2007. When instability risks arise, entities like China’s Central Financial Work Conference “fix” it.
10. Fiscal is the “fixing” – another bond between China and the US. China’s restructuring of public companies from 1997 to 2007, public investment from 2008 to 2014, restraining local government financing from 2015 to 2019, and the COVID response were absorbed through debt and growth. But that’s when inflation didn’t matter. Now, throwing money at the problem risks social instability given global capacity constraints exposed with the COVID pandemic.
11. The entrepreneur lives and dies by good market conditions and good luck. Macro policies that inadvertently thwart markets by subsidizing past mistakes are the invisible hand restraining entrepreneurial drive. Consider the simplest of statistics – China’s GDP is up 12-times from 2002 to 2022 while total equity market capitalization is 65% of GDP, roughly one-third of the US. Value diverted from investors warps incentives for market-based capital.
12. It is the socialization of finance spurred by the collectivism of loss. It is also why decentralization is so valued. Great advancements in payments, like Panda Remit, are operating in more than 30 countries, allowing money to move freely out of China. But. Like the FedNow service, regulators can turn it off in the name of financial stability. And that’s only because of initial conditions of past policies gone wrong. Decentralization is dormant, not dead.

Figure 1: China’s Creeping Debt – Their Currency, Our Problem



Source: International Monetary Fund (China 2021 Article IV).

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