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Transcript

CHINA IN THE WORLD PODCAST

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Guest: **Shi Han**

Episode 12: “Reverse Haggling” in China
January 21, 2014

Haenle: You're listening to the Carnegie–Tsinghua China in the World Podcast, a series of conversations with Chinese and international experts on China's foreign policy, international role, and China's relations with the world. Brought to you from the Carnegie–Tsinghua Center, located in Beijing, China, I'm Paul Haenle, the Director of the Carnegie–Tsinghua Center, and I'll be your host.

Today we're joined by Shi Han, a resident scholar at the Carnegie–Tsinghua Center whose research focuses on international business issues arising from interactions between American and Chinese businesses, as well as competition and cooperation between state and non-state economic entities. In addition to overseeing the Global Business and Economics program at the Carnegie–Tsinghua Center, Shi Han is the Managing Partner of China Line LLC, a Chicago-based management consulting firm that specializes in cross-border alliances and acquisitions. Shi Han, thank you very much for joining us today.

Shi Han, your most recent article on the Carnegie–Tsinghua website focuses on a practice called “reverse haggling” and its negative effects on the Chinese economy. Could you begin simply by explaining to our listeners what reverse haggling is?

Shi: It's a business practice that didn't have a name. A typical buyer comes out to buy anything—you would either shop for a lower priced item or haggle a bit to try to negotiate the price down. And what I'm talking about here is a practice where buyers don't haggle the price down; instead, they haggle the price up. So, we call it reverse haggling. It happens in China, primarily in the less competitive industries.

Haenle: Why is reverse haggling done, and why is it harmful to China's economy?

Shi: It's related to this criminal activity by some of these purchasing managers, who take bribery or take kickbacks, and since the kickback volume would go up with the purchase volume, they would be interested in maximizing their payoff. The way they choose to do that is not to keep the purchasing price at the competitive level, but they would ask the sellers to quote a higher price so that their kickbacks will go up as well.

Haenle: Very interesting. How does this affect not only China's economy, but what are the implications also for international markets and for foreign economies?

Shi: The negative effect for China's economy is higher prices for about everything, since a lot of this kickback-taking and reverse haggling takes place in industries upstream in the economy—petroleum, natural gas, chemicals. Higher purchasing prices at these companies eventually translate to higher costs for manufacturers downstream. As for international business, it has the appearance as if international companies selling into China would have something to gain because they would be able to sell more expensive items to state companies. But it also raises the risk of doing business in China because this is not lawful activity even within China. Also, when the cost of doing business—running a manufacturing business—is higher, it would eventually raise the cost of Chinese manufacturers who export to the rest of the world, weakening their competitiveness.

Haenle: Thank you. You know, Shi Han, until I read your article, I had never heard of the phrase “reverse haggling.” Is this something relatively new? Is it something that foreign companies are

aware of or is it something that they're unaware of and don't know how to deal with it? And, is the government in China aware of it and taking steps to deal with it?

Shi: Well, the term is something that I came up with about the phenomenon that's been around for a long time, and known for both domestic authority as well as the international companies. And the previous rounds of economic reform failed to eliminate this problem, and issues just stayed on for a long time. But it seems there are many signs that the current leadership in China is addressing this issue more aggressively.

Haenle: Let's turn to the leadership. Last November, as you know the Chinese leadership convened the Third Plenum of the 18th Party Congress. The Third Plenum of a new congress in China has historically been associated with economic reforms when it coincides with the start of a new 10-year presidential term. This year at the Third Party Plenum, Xi Jinping released a document and that set the economic reform agenda for the next 10 years. The document encompassed wide-ranging reform proposals, the core of which was that the market should be the decisive actor in the Chinese economy, which had been welcomed by the foreign business community. Shi Han, in your opinion, what were the most meaningful reforms to come out of the Third Plenum and what were the most disappointing aspects of the Third Plenum?

Shi: Obviously, the announcement about the market forces as the decisive actor is a rather big step forward. But I think what surprised me a bit was to see new regulations about realigning the legal organizations within the country; the local judges and the judicial system on the local level, will no longer be sponsored by the local government, rather, they will report to the central government instead. It seems to me it's a rather big step forward.

In terms of disappointment, it's true on the business side we didn't see any announcement about, let's say, major changes in the management of state companies. But also, we didn't see any groundbreaking changes in the political reform, like several decades ago when the Party was consciously trying to separate its Party affairs from the day-to-day running of the administration, the bureaucracy. Now these new political reform measures are not really seen in this document.

Haenle: Within the Third Plenum document, and also coming out of the December Economic Work Conference, where the leaders announced their six priority areas for reform in 2014, was there anything coming out of these two meetings that can address the issue of reverse haggling?

Shi: In one word, perhaps not much, because discussion and policy initiatives about introducing competition and bringing in private businesses as well as foreign investors to the formerly monopolized state sectors, and the issue of graft and bribery were on the agenda. This reverse haggling issue has very much its collusive characteristics because it seems that every player in the game has something to gain and there is often no one who will be hurt in a very obvious manner so that he would step out and reveal this scandal or anything like that. We don't even get that much reporting of the kind of reverse haggling activities going on, not to mention somebody who wants to turn them in. If that continues to be the case, on top of the lack of monitoring and control in very large state companies, the reverse haggling problem will not go away that easily.

Haenle: Let me ask you more generally, coming out of Third Plenum and the December Economic Work Conference, looking at the dual priorities of the Chinese leadership to achieve

growth targets for next year as high as 7.5 percent and also rebalance the economy, tighten credit, and address local borrowing and debt, are these at odds with each other, and can they both be achieved?

Shi: Yes, I think it can be achieved because my understanding is that the current leadership is putting in a lot of effort in liberalizing the economy by simplifying the approval procedure for businesses, getting rid of a lot of its more restrictive requirements for setting up a business so that business opportunities will be explored and a new market will be created. That will not really require that much expansion of credit or even physical spending. Having said that, I don't want to accept the hidden assumption as if the higher the growth rate, the better, because we've seen the damage the growth has done to the environment and the kind of growth that's driven in part by this reverse haggling-like activities, where you have a lot of transactions going on but not really bringing many benefits to customers and especially the consumers, and probably want to see a healthier growth which has fewer of these shady elements instead of just a higher number for GDP.

Haenle: Some of the reform proposals as we've discussed this year—many have concluded that they're quite promising—but the real test will be whether or not the new leadership can actually implement these proposals. Do you think, in your estimation, has Xi Jinping and his colleagues, do they have the political muscle to push reforms past entrenched resistance by state-owned enterprises, local government officials, and other interest groups whose comfortable positions would be threatened by change?

Shi: I don't think the ruling party ever lacks the political muscle. I'd like to point out also that the localities, the state companies, are not always necessarily always resistant to reform measures. If that's the case, then that will take the burden of the top leadership off quite a bit, and they may have a chance to push it through.

On referring to the fact that some profit-driven business executives at top state companies are thinking about diversifying their business and even selling off some of their subsidiaries, this is for the purpose of increasing the business of the company. And, for local governments, there is bargaining going on. If, let's say, the revenue source is no longer the real estate or land sales then what else is really available to them? They are talking about a property tax and other sources of revenue. So, I think it's subject to negotiation and I see some hope that a conclusion can be reached between them.

Haenle: Well, Shi Han, I want to thank you very much for your time today. That's it for this edition of the Carnegie–Tsinghua China in the World podcast. If you'd like to learn more about Shi Han's research at the Carnegie–Tsinghua Center, you can find his publication on reverse haggling and other work on the Carnegie–Tsinghua Center website at www.carnegietsinghua.org. I encourage you to explore our site and see the work of all our scholars at the Carnegie–Tsinghua Center. Thanks for listening, and be sure to tune in next week.