



## **Louis-Vincent Gave: Understanding China's Structural Growth Drivers**

**Erik:** Joining me now is [Gavekal](#), co-founder Louis Vincent Gave. Louis, this is an interview that I've wanted to do with you for years now. We usually talk about the macro events of the day and so forth, but I wanna zoom out for this interview and go to the big picture topic of China and its role in the global economy, both historically and looking forward.

Now, Louis, something you and I share in common is we both have permanent resident status in Hong Kong. When I first moved there in 2009, I figured it was gonna take me a year before I would fully understand Hong Kong and Chinese culture. My actual experience was after two years, I was maybe ready to start asking intelligent questions. It's much bigger than I ever imagined. So I wanna start from the very beginning. Let's imagine that I don't know you, but I spot you at the airport and I say you're Louis Gave. Hey, how about if we share a taxi into the city? 'cause I'd love to ask you about what it is that investors get wrong about China.

What I need to know if I'm coming here to understand this. And the first thing you tell me is nobody takes a cab to the airport. We're gonna get take Airport Express. Let me show you That's right. How to get a little bit more in touch with modern society here. 'cause we don't do that taxi cab crap in Hong Kong.

So we're sitting on Airport Express and I say, Louis, I don't know shit. Tell me what the, what it is that Westerners get wrong about understanding China, Chinese culture, and particularly Chinese economics from an investor perspective.

**Louis:** First of all, thanks again for having me, Eric. I always love catching up.

To your point on the cabs versus taking the subway. I think, I can't remember who said this, and it's a good quote because I like it, that the

mark of a rich country, of a rich developed country isn't that poor people have cars, but that rich people ride the subway.

**Erik:** I couldn't agree more

**Louis:** And to your point, today, where do you feel more comfortable indeed riding the subway? Is it Hong Kong, is it Singapore? Is it Shanghai, or is it New York, London or Paris? Not that there's anything wrong with the New York, London or Paris subways, but they're definitely not as pleasant an experience as you get, in Hong Kong.

So first things first. What, any visitor, first time visitor to a Shanghai, a Beijing, a Hong Kong. Can't avoid seeing is how superior the public infrastructure has become. Whether you look at your public transport, whether you look at your shopping malls, take any kind of public infrastructure, the parks, the, it's it is mind blowingly superior. So you have to ponder, I think if you're intellectually honest you have to take a step back and say, okay, how can they do this? And we can't, given how far ahead we were, 30 or 40 years ago, how, how did we mess this up in the west?

How did we get to the point where China's life expectancy is now higher than the United States when 30 years ago it was 20 years below? I think these are questions that, we should all be looking in the mirror and say, okay how did this happen? And

**Erik:** Hang on a second, Louis. I just wanna point something out because a lot of our Western listeners may not realize that in the United States, when you think about it, what is public transportation?

It's designed for the poor people. Everybody's expected to have a car if you can possibly afford one. And if you can't afford one, we gotta do something to take care of the poor people. So let's give 'em public transit. It's a completely different equation. In Asia, public transit is designed to solve everybody's problem, and only about 2% of Hong Kong residents actually own a motor vehicle.

And it's a status thing. It's not about practical need, it's, you want to be a rich guy, you gotta have a fancy sports car. But it's not about practical use. I don't think that really exists in the West.

**Louis:** I think that's a very fair point and that, to be perfectly blunt. That has a lot to do with China's geographic makeup.

If you look at China today, it's roughly the same land mass as the United States. It has four times the population of the United States, but contrary to the United States, the population isn't really that spread out, 94% of the Chinese population lives on less than half of China's territory. Most of China is uninhabitable, the Tibetan plateau, the Gobi Desert, the Taklamakan desert. It's very hard places to live. So the way you have to conceive of China is imagine the United States. Imagine four times the population and everybody living along the East Coast.

So with that, you get, of course, big urban planning challenges. If all these people were to have cars, the whole place would be one big traffic jam. You could say to a sense, necessity is the mother of all inventions and all that. China has no choice but to have great public transports.

It, it doesn't have the option that the US had of everybody has a car, everybody lives in a 5,000 square foot house in the suburbs. Everybody can have a 1500 square foot garage where you can add, have cars and, kayaks and bikes and whatever else. So the geographical makeup of the place means that the consumption patterns de facto end up being very different.

The other of course, obvious takeaway from this very different geographical makeup is that in China, you're simply not going to see what you often see in the United States or in Europe. IE families with 6, 7, 8, 9 kids. These simply don't exist in China. They don't exist because, the lack of space being what it is.

And that is by the way, a lot of people talk about China's terrible demographics, and maybe we'll talk about that a little bit later. But this is something that you find all across East Asia. It's the same story in Japan. It's the same story in Korea, same story in Taiwan, Singapore, Hong Kong.

The population density is such that you end up with a very different demographic profile, which de facto has a big impact on economic activity. If only because my favorite, my very favorite quote ever is a quote from Jean Bodin, a French humanist philosopher from the 16th century who would say the only wealth is man, today we have to

acknowledge that all across East Asia, all the countries I named we are producing fewer and fewer men and women, therefore.

If you're gonna keep getting growth in that part of the world, the productivity of these people has to continue improving constantly. This means massive investments in education. This means massive investments in machinery. This means massive investment in robotics, all of which is happening in front of our very eyes.

Everyone talks about the dramatic transformation that you've seen in China in the past few decades. If you look at the past four decades, China's lifted 700 million or so people out of abject poverty, and frankly, into a middle class type lifestyle. It's undeniably unprecedented in the history of humanity.

My guess is it will never be repeated. It is an amazing story which, frankly deserves. All of our attention deserves books, how did it happen? How could they do it, et cetera. But the other enormous transformation that people talk less about in China is how China in the space of one generation has gone from graduating 350,000 universities students a year to to graduating 12, 13 million university students a year.

It's a transformation in China's human capital that is simply absolutely daunting. So it's, part of my excitement and my enthusiasm for China is how quickly the places transforms itself, how quickly it moves up the value chain. How quickly, China goes from being, again, a complete backwater to now all of a sudden being the biggest car exporter in the world, or the biggest nuclear energy power in the world or being the biggest producer of high-speed trains in the world, all pretty complicated businesses. And this China has done all this in a generation. It's an, it's a massively exciting story. And again, I think one that that, the more you dig in, the less bored you become.

**Erik:** Let's dig in a little bit more, because that obviously begs a really important question, which is how the heck did they pull this off? Now, I would imagine if there was, somebody from the CCP here, they would say this proves that unbridled US capitalism is not really the greatest thing ever is Americans like to believe.

And maybe government central planning is a better idea than people gave 'em credit for. Now, that's not necessarily my view, but I think we've

gotta at least acknowledge that's probably their view. Do they have a point?

**Louis:** To be honest, no. First I would say I wish that had unbridled US capitalism. I'm not sure that we do, but I guess that, that, that would veer us into a whole other debate.

So I'll just leave that here. And I would say that when you look at China's growth of the past decades I think first we have to acknowledge. It that it comes in different waves. But the first and most important point to acknowledge is that economic growth happens very often when you move from being very stupid to just plain stupid and to just maybe not so stupid.

And as you make that move, then all of a sudden growth appears hardly because of course the default mode of every entrepreneur, the default mode of every businessman is to fight and try his best to to produce more with less. So what do I mean by all this? When you look at China, I think it's important to acknowledge where the starting point was 45 years ago.

When Mao dies, you had a guy who was, for all intents and purposes, a massive control freak. He wanted to control everything down to the point where, he would di the party would dictate where you would work. The party would even dictate what you would wear, to down to the clothes on your back.

And so Den Xiaoping comes to power and Den Xiaoping realizes here we are, we have 20% of the world population, and we don't even have 5% of global GDP on the world stage. China is a pygmy. Nobody takes us seriously. And so from there, Deng Xiaoping says, you know what? I'm going to try something.

I'm gonna try liberalizing labor. I'm gonna tell the Chinese the overseas Chinese in Hong Kong and Singapore, in Indonesia and wherever else you guys can come back in. And exploit my workers. You can set up factories here, whether it be a toy factory, a plastic flower factory, you name it. And you can exploit my workers and keep some of the profits and workers can come from anywhere and join your factory.

And that was the creation of the special economic zones like Shenzhen, Wenzhou and others. And in so during, as soon as China started to

liberate labor, the place took off. And then since then, each time China has struggled. China, the leadership, the CCP, has basically embraced another liberalization. So in the late seventies, early eighties, again, you liberalize labor and the first guys who make big money in China are the guys who go and set up factories there.

Then you hit a wall. In the late nineties with the Asian crisis and with the need to reform the SOEs before China is allowed into the WTO. And so China liberalize land and all of a sudden you see private property developers come in and the place absolutely booms. And then the next wave of big money in China is made, around land development and property development.

So having liberalized labor, having liberalized land starting in the mid 2000's, they also liberalize commodities. And you start to see private sector, coal mines and private sector copper mines. And you start to liberalize basically, the underground, in China. And you start to see commodity traders set up in China.

And then of course having liberalized land, having liberalized commodities, having liberalized labor, you come to the final frontier. Which is the liberalization of capital. Now here, things get very tricky because I'm sure you've seen Scarface. The idea that first you get the money, then you get the power and then you get the women.

When it comes to liberalizing capital, the Chinese Communist Party is well aware that if you massively liberalize capital, you in essence give up the very core of your power, IE the control of money. And so I think what you've seen is, some people would say it's three steps forward, two steps back.

Some people would say it's two steps forward, three steps back. But really since the attempt to create a bond market to internationalize the Renminbi, and everything else since, 2011, since that, attempt to liberalize the world of capitalist started in 2011. It's been a constant struggle at the very top of the Chinese Communist party to know how far they would go in the liberalization of capital.

And I think part of the struggle has been amplified that much more since China's, of course, is always looking over its shoulder at the United States, and they look at what's happened in the United States with the liberalization of capital and they see Lehman Brothers and they see,

busted banks and the need to keep interest rates at zero and everything else.

And therefore it scares them. And so I think the story of the past 10 years is really this sort of tug of war on the liberalization of capital and perhaps helps explain why. Chinese growth that used to be eight, nine, 10% a year is now down to four or five. But the bottom line, and I'm sorry, this is such a long-winded answer but the story of Chinese growth is first and foremost a story of deregulation of labor, deregulation of land.

It's a story of growing economic freedom. It's not a story of growing of, a government that was really stupid from 1950 to 1978 and then all of a sudden got smart.

**Erik:** Louis, something I've noticed is that we, westerners are so conditioned to really believe in democracy. And please don't anyone get me wrong, I definitely believe in democracy.

But look, if you're competing with someone, you've gotta understand the strengths and weaknesses of your opponent. And one of the things that is different about China is that their government is not constrained by an election cycle. And frankly, they're laughing at us. They watch us, which you get one president, and all of a sudden the national priority is build a border wall.

Four years later, different president, the top priority is tear down the border wall. We may go back to the first president who's puts the next priority on building the border wall again, four years later, who knows what happens. They just look at this as incredible inefficiency. And I think even some of the Chinese people scratch their heads and say, supposedly I think they would like democracy better to have more of a say in their government.

But getting to this. Crazy election cycle centric decision making process where nobody ever thinks strategically beyond an eight year presidential cycle is probably not the best way to run a country long term. Tell us a little bit about how China makes its longer term plans. Who does the decision making?

Is it the Communist party? Is it somebody else? How does it work? And how does that translate to some of the strengths that we've seen in their ability to compete with the West?

**Louis:** Before I answer that question, because it's a super important question, let me just say that the strength of democracy isn't in picking leaders and it's not in picking the right policies.

The strength of democracy is in getting rid of the bad ones. It's when you get bad leaders when you get bad policies, you can get rid of them with minimal bloodshed and no destruction of properties. That really is democracy's massive comparative advantage. And so having said this, in China, how does policy get made?

It's, that again, I think has changed a lot over the past 30 years. My answer 10 years ago would be very different than the answer today. 10 years ago you had or 12, 13 years ago, you had a politburo, nine and then seven all males, all engineers all basically sharing a vision of an economy.

A very Marxist vision of an economy that's like a big machine. And that if only you got better information, you could at the right time, push on the right button or pull on the right lever and hereby adjust things. I think that was the view 13, 14 years ago. Obviously in the past decade we've had massive consolidation of power around Xi Jinping.

And with that consolidation of power, you could say that the policy risk as been enhanced the policy risk has been enhanced because instead of having management by committee, which was what, which we had again 12, 13 years ago, instead of having management by committee, which sort of, you would hope probably takes out more extreme measures of now what you have is management one guy holds all the keys to power.

And this has created I think a very different modus operandi within the Chinese halls of power where. The first thing a CEO of a state owned company or a head of a regulator or a minister or something or other, or a party chief in a province, the first thing they think about when they come into the office now is I don't want to upset the top guy.

So I, I can't afford to to upset Xi Jinping. And so if Xi Jinping, tells me this is the path we're going down, I'm definitely not questioning it and I'm doing everything I can to be seen, to be going down this path. So I highlight this because now the policy risk is greater.

Having said this, how does policy work in China? And I think this is where perhaps there's a misconception in the western world, and let's take electric cars as an example. What happens in China is the government decides 10 years ago, electric cars are the future. We need to go down the path of electric cars.

And so they make a big speech. Xi Jinping makes a speech saying, you know what guys? Electric cars are the future. And that's pretty much all he does from there, from that speech, what happens is that every automaker, every provincial government, every major city now decides, oh, I need to produce electric cars.

And so every local bank will now be funding electric cars in their own districts. And before you know it, you have 40, 50, 60 companies all around China producing electric cars. Every local government, every major city will want to have its own electric car champion. And these electric car champions, again, will be funded through the domestic savings captured by the local banking system.

At this point you enter what I would call the Hunger Games phase of Chinese capitalism. You've got 40, 50, 60 guys that are, more or less with an open checkbook. And that competes with each other like crazy. Then from the 40, you go down to 20, eventually down to 10, eventually down to five.

And the end result is that you end up with an ecosystem where all of a sudden you can buy electric cars for less than \$10,000. And where most people in China can now afford an electric car, this is thus very different from what we would have in France or in the US where we say, okay, electric cars are the future.

I'm gonna give subsidies to Tesla, to produce electric cars. So in the US which you end up with is the government subsidizes Tesla. And Tesla ends up with a market cap of \$800 billion producing \$50,000 cars. And you end up with very few electric cars on the road.

Meanwhile, in China, you end up with a BYD, who's obviously the leader now in the space but BYD, because it's had to fight the Hunger Games comes out of it, pretty lean pretty beat up with a market cap that's a 10th of Teslas at \$80 billion. But it's producing sub \$10,000 cars.

And again, everybody in China now drives electric cars. And so I think the perception we have in, of, in the western world that we have of in China is, oh, the government chooses its champions subsidizes them and that's unfair, et cetera. But it's actually very different. It's a very hunger game, again, model of capitalism where, everybody is competing crushing each other's margins until , you get this, the survivor.

And in the end, that's obviously a terrible outcome for shareholders because, a lot of these companies get wiped out along the way, et cetera. It's a terrible outcome for shareholders. But if the goal was to get a bunch of electric cars on the road then you've actually achieved that goal.

Meanwhile in the us, which you've achieved. Through the government subsidies is that Tesla gets to be part of the MAG 7. And that you don't have that many electric cars on the road, but you have the most profitable and biggest electric car company in the world. And I think in the US that is seen as winning because in the US the tendency is to view things through the lens of the stock market.

It's oh, if our stocks are doing better, then we're winning. But then when you compare, say Shanghai to San Francisco or Beijing to New York if she came off the plane and didn't care about stock market performance, you would think Shanghai was winning, not San Francisco.

**Erik:** Louis in the investment community that we live in, Jim Rogers did a really good job decades ago of predicting this miracle of growth in China that we're talking about today.

And, he was very outspoken at the time in advocating investment in Chinese equity markets. China might have gotten much richer, but holders of Chinese equities sure haven't. So what's going on here? Why have Chinese equities been such a dud for the market? When Jim's predictions definitely came true.

Miracle of Chinese growth, education of the Chinese people that you talked about, it's all demonstrably true, but I don't think anybody got rich in this Chinese stock market along the way.

**Louis:** Part of that is the hunger game model of developments that, that I highlighted. Which actually brings me to, to an important point is that the correlation between GDP growth and stock market returns.

In most emerging markets is is extremely weak. I know, and we assume, we, we see the growth, it's exciting and we think, oh, I'm gonna participate in that growth through the equity markets. But in emerging markets that's not a one for one relationship. It's not a one-for-one relationship.

What whatsoever? And, you could just look at the past and it's not just by the way in in emerging markets. If you look at the past decade, US GDP growth has actually looks like it's gone down structurally from 3% down to 2%. But over that period, US equity returns have been fabulous.

That correlation between GDP and GDP growth, economic growth, and and shareholder returns isn't always there. So that's a, I think a first important point. But if you'll allow me to get theoretical for just one second. I don't know if you've ever heard of a guy called Harry Brown.

He was the he ran for libertarian candidates to be US president back in the eighties. And he had a great idea. He highlighted that, what he called the permanent portfolio, where you would do a quarter in local equities, a quarter in local cash, a quarter in gold, and a quarter in bonds.

The idea being that whatever economic environment you're hit with, there'll be one quarter that thrives and one quarter that doesn't do as well, but you rebalance every quarter or once a year. And over time, what Harry Brown called the permanent portfolio. Delivers very satisfactory returns. So if, and if you look at pretty much any country you care to pick, Switzerland, France, uk, us, China, you get returns of between three and 5% a year with and the best parts, with never more than a 10% drawdown and very low volatility.

Now, why am I highlighting this? If you think of the permanent portfolio in the United States over the past 10 years, equity have basically almost gone three x. And over the past decade, gold has basically risen 50%. But at the same token, in real terms, if you were in cash, you've lost 20% in real terms.

And if you were in US treasuries, you've roughly lost the same over the past decade in the us your permanent portfolio. Has lost 20% on the bond side. So your permanent portfolio in the US over the past decade has returned 3%. On average you made money on gold, you made money on equities, you lost on cash and you lost on bonds.

Now look at what happened in China. You do the same exercise in China, and this is where it gets fascinating is over the past decade on your permanent portfolio in China, you also made money on gold just like you would've had everywhere else. You actually did make money over the past decade on Chinese stocks.

You actually did make money on Chinese bonds and you actually did make money on Chinese cash. So much so that your permanent portfolio is actually grew in China. While you made 3% on your PERT portfolio in the us, you made 5% on the PERT portfolio in China. Now, why do I illustrate this? I think that when it comes to policy, there's basically three markets.

You got your currency market, you've got your bond market, and you've got your equity market. In the US, policy makers will sacrifice bonds and currencies every day of the week for equities, and they'll do that because 70% of Americans own equities. So whenever the stock market is down 20%, or pick your number, it might be 25.

But we all know there's a fed put. We all know that if stocks fall enough, the Fed will step in and sacrifice the long-term returns of bonds and the long-term returns of the US dollar to save the equities. And we know that because they've done it time and time again. Now I'm gonna adjust. The old quotes, I'm sure the Churchill's quotes of they sacrificed honor to get peace, and they ended up with neither or Ben Franklin's quotes of, if you sacrifice liberty for security, you end up with neither.

Let me suggest this. If you sacrifice your currency for growth, eventually you get neither. Now, I would argue that for the past 15 years in the US we have been sacrificing currency and obviously bond markets to get growth in equities. And we have, equity markets are up three X and in China, they did not.

In China, they don't care that much to policymakers, they don't care that much about equities. The thing that matters the most is first currency, then bonds, then, equities are the variable of adjustment that that end up bearing the brunt of the economic cycle, which frankly is how it should be.

I want a policymaker who holds firm on the currency, holds firm on the bond markets, and then let's, the equity markets adjust where they may. Now, the reality is that in China, in, in the past decade, we've been

paying for the excesses of the previous decade. There were, we all know about the Chinese real estate bubble, the excess infrastructure spending, Etc.

Now, Western policymakers would've paid for these excesses through a debasement of the currency and through a debasement of the bond markets in China. The equity holders were made to pay for these excesses, which is I think the right order of things. And the reason in China, you can have the equity holders pay for things, is that only roughly 10% of the population own equities, a hundred percent on REB and indirectly through banks, almost a hundred percent of people own bonds.

So why should a hundred percent of people pay for 10% who own equities? No. It makes much more sense to have the 10% bear the brunt of the adjustment, and that's what we've had in China for the past decade.

**Erik:** Louis, as you described earlier in this interview, China has clearly done an unprecedented job of catching up with the West, and they've done it in such a short time.

It's amazing. But in order to grow from here, growth requires innovation, and innovation is different from catching up. Something I've noticed about Chinese culture and really Asian culture in general from having lived there for a few years, is I think they're just way better than we are in the West at optimizing systems, making them efficient, particularly designing them to handle lots and lots of people very efficiently in a time-sensitive way. They're just way better at that, in my opinion, than anything I've seen in the West. But innovation requires throwing out the rules and just forgetting about the way we're used to doing things and doing it in a completely different way. Something I've noticed about Asian culture is throwing out the rules is definitely not allowed.

You're not allowed to ignore the rules that exist in society for everybody's safety, the way you can get away with in the West. And I think it may be less natural for that culture to really throw the rules away and think about doing something in a completely new and different way. So can China deliver on innovation to the extent necessary to not just catch up with or keep up with the West, but to really move ahead and compete in the sense of leadership?

**Louis:** So that's a very tough question. I'll be honest. And I think my own thinking on this is, has evolved the past few years. If you had asked me the, this two or three years ago, I would've said probably not. I would've said two or three years ago that, the Silicon Valley great comparative advantage is that everybody there in Silicon Valley believes that, you ask for forgiveness, not permission, which in essence is one of the comparative advantages of the West.

I've written a number of pieces over the years highlighting how you have really two feelings that bind societies together. You can have societies based on guilt, which is what we have in, I would say, Judeo-Christian societies. Make a mistake. You say, I'm sorry people forgive you and you move on.

This is why a lot of entrepreneurs have had several bankruptcies, but they're able to pick themselves off the floor, Etc. And then you have societies based on shame. And societies based on shame tend to be much more socially cohesive. They tend to have a lot less crime.

And, most of the Asian societies are based on shame. The idea that I don't want anything that brings shame onto myself and to my family, onto my group onto my school. And to you, to the point you just highlighted, this sort of cultural difference between societies based on guilt and society based on shame, you would think would be a massive break to technological progress, to risk taking, to entrepreneurship and whatever else.

Frankly, that's what I would've argued two, three years ago. Having said that, one of the things I have to acknowledge is that, if you look at the past two, three years, and I think most people are missing this right now because nobody's traveling to China anymore, obviously no one went during the COVID years.

And once COVID ended, Russia invaded Ukraine, and China subsided with Russia. And so the whole world decided, oh China's uninvestable, I'm not gonna waste my time going there anymore. And in any event, returns on equities, there have been dismal, even if returns on bonds have been terrific and returns on the renminbi have been very solid I'm not gonna waste my time going there anymore.

So most people haven't traveled in China for the past few years, and as they haven't traveled there, I think they're really missing out on how

quickly. China is jumping ahead in industry after industry, whether it be FinTech, whether it be e-commerce, whether it be obviously electric cars, whether it be power delivery whether it be transports, high speed rail the transformation. I didn't go to China for almost three years because of the COVID restrictions, and when I went back I was blown away by just how much it had changed in three years. The idea that China can't deliver innovation, let me put it to you this way. BYD released a car a couple months ago that it's a hybrid car.

It costs 14,000 US dollars. It's a sedan. It's basically looks like a Tesla model three but it's a hybrid car. And the car goes 2000 kilometers on one tank of gas. It is by now the most gas efficient, fuel efficient gas car in the world by a factor of over 50%. And again, at a price of 14,000 US dollars, this is all of a sudden a revolutionary car.

It's a car, like there are no others in the world. I look at, the Xiaomi phones that are, by all measures far superior to anything Samsung or, Apple is producing.

**Erik:** Hang on Louis, I wanna push back a little bit on that because the things you're saying are things I would've predicted the fact that China could look at something that somebody else invented, like Tesla and say, we can do a much, much better job of designing and building electric cars than Tesla did.

And we're going to do it and we're gonna do it cheaper and better and everything, no surprise whatsoever. To me. You take something else like smartphones and you say, we could develop better ones cheaper. They're really smart, they have incredible engineering capabilities, but that's taking something like the electric car or the smartphone that somebody else invented in doing a much better job, re-engineering it in a better way.

Where's the example where? It's China who said, wait a minute, we should not be using gas cars. We should be using electric cars. Or we should say, forget about flip phones. Let's invent smartphones instead. Where did China invent the paradigm changing thing that led the rest of the world to recognize the old way of doing things didn't make sense.

**Louis:** That's a fair, that's a fair criticism. And you could say there's still enough low hanging fruit, optimizing other stuff.

**Erik:** I think there's more money to be made in optimizing other people's ideas. I, it's not meant as a criticism. I, it's

**Louis:** No. It's, no, I get it. And for now for China, maybe, that's good enough that generates enough growth.

If you can produce better cars at a cheaper price point, you don't need to invent the flying car, even though, they do have the prototypes for the flying cars. I'm sure you've seen the videos on the XPeng, the one that's producing Shenzhen. The XPeng flying car, which, looks pretty cool or frankly, the BYD car that goes in the water the amphibious car.

Continue to add things at the margin without completely upending everything. But, if we look back, what are the great inventions of the past 20 years, you could say one of them is of course the smartphone that's changed the world.

You could argue potentially it's the electric car. Although, how much has the electric car really changed the world? I'm not convinced it has changed at all that much. It's, it takes us from A to B at the same speed perhaps with a little less pollution, but that's not even a given.

Given the all the mining that you need to do cobalt and lithium and whatever else. Yes, China didn't invent a smartphone. China is, you and I have talked in the past of China's molten salt reactors. So China's working on those, and you could say that's just an, again, an adaptation of what's being done before.

**Erik:** They're doing a better job of it, by the way, and they've really got their act together. But it is another example of a technology invented in the United States that the United States failed badly to commercialize the way it should have. China is running with it with great success. But I think this goes back to what you said before about permission versus forgiveness, because one thing I'm absolutely certain of is that Chinese engineers, a and technologists are not one iota less smart than Westerners.

I think they may be smarter, but the thing is, the consequences of just doing something without getting permission first in that culture are rather different than they are in Silicon Valley. And I think that's probably what holds 'em back. It's not the talent of the engineers and scientists, it's the fact that.

Having daring to just do what you believe in, even though you don't have permission. It's not the policy it's not consistent with the strategy. Xi Jinping has laid down and all of the people below him are following. You've got a better idea, so you're just gonna go off on your own and do it. There's a lot of consequence to that in China that doesn't exist in Silicon Valley.

**Louis:** Yeah, no I agree with that. And again, going back to what China's comparative advantages are, which I think we are seeing in real time, is of course the critical size of the market and the ability to rapidly adapt and improve on products so that you end up today with China being the global leader in FinTech being the global leader in yeah, we've mentioned electric cars, but it's, very quickly you can adapt existing technologies, and that's where China's comparative advantage lies.

Perhaps much more so to your point than in coming up with new inventions. But, coming up with new inventions, again, you look at the past 25 years, frankly, apart from the smartphone, a again, a terrific invention, world changing what, what has really been world changing in the past 25 years. Really big and world changing inventions are pretty few and far between.

**Erik:** Louis, I couldn't possibly agree more with that point, but let's move out to the bigger picture now and talk about clearly the overall trend here is China has made incredible progress in the last several decades. So decades.

Does that mean that they're now a threat to the rest of the world because this growth could overrun other economies and if not the rest of the world, is it a threat to its near neighbors, Taiwan, Philippines, Vietnam, India, so forth.

**Louis:** This is a question I often get and. I think the first thing we have talked to acknowledge is it hasn't been thus far.

China, unlike other big, powerful countries, hasn't gone around and invaded other places, hasn't gone around and shipped lots of weapons signed military alliances that, set up military bases in lots of places. So you know the answer, the obvious answer would be, not this far.

Of course, , who knows what the future holds. Because, the big shift in China over the past decade is that, China has started to look abroad. I

think, in the years, if you go back to Mao then Den Xiaoping, then then Jiang Zemin and Hu Jintao, when these guys became President, China was such a mess.

It was so far behind economically to the rest of the world that. These Chinese leaders, frankly, had very little time for the abroad. It was all eyes on what was going on domestically, all hands on deck and whatever happened abroad, it wasn't really China's problem. Then of course, as China develops, this changes hardly of course, because the more China grows, the more China needs commodities from the rest of the world, unlike the United States, which happens to be energy self-sufficient, which happens to be food self-sufficient which happens to be pretty much self-sufficient in any major commodity you care to think of.

China basically needs to import almost every commodity. It potentially needs except for rare earths. But everything else, China needs to import. So as China grows, it has no choice. But to all of a sudden build relationships with foreign countries who can provide these commodities.

Now, as we all know, part of the challenge in the world is that a lot of the commodities are produced in places where the politics can be dicey. Whether you look at the Middle East, whether you look at Africa, whether you look at some parts of Southeast Asia now, if you go back to Xi Jinping's arrival and to power his very first speech he starts talking about the One Belt One Road.

He starts talking about the Silk Road Fund. He basically starts talking about how China is going to help countries, whether your Kazakhstan or your Kenya's or your Indonesia's, he's gonna help these countries build infrastructure. He is gonna help fund it. A in a move that frankly smacks of imperialism.

Now, when I say imperialism, I don't mean that China's gonna go out and invade Kazakhstan or invade, Indonesia, but that the history of every empire is first and foremost a road building exercise. You build the roads and you build the roads to bring in commodities cheaper and to push out finished goods, higher value, added, finished goods to the outer realms of the empire.

That's why in Europe, we say all roads lead to Rome. That's why the Persians say Darius was a traitor. The history of every empire is how do I get commodities in cheap and push out the higher value added goods

to the outer realms of the empire? And of course, this has been Xi Jinping's strategy for the past decade.

One built one road, silk Road fund, Etc. It's all about. Building the roads to bring in the commodities and push out the finished goods, which they are doing today. Selling the cars, selling the tractor, selling the telecom switches all across emerging markets. Now, when you go to a country and you say, Hey, I'm gonna build a road for you, or I'm gonna build a dam for you, or I'm gonna build a canal for you, or an airport, that country is usually very happy.

You know why not Everybody loves getting infrastructure. The challenge then becomes you're gonna start moving goods along that road or along that canal, and the challenge becomes, if the goods moving along that road or that canal, start getting pillaged by brigands because the local country can't keep the peace.

Then before you know it, you have to send. Troops along that road to make sure that the goods can circulate. This is again, the history of every empire. It's the history of the United States. That's how the United States today ends up with 800 military bases. And I haven't misquoted this 800 US military bases around the world, because when you're an empire, that's that's what you do.

And so that's, to be honest, is the real challenge for China today. I think they're still in the road building phase of the empire, which is all happy days. Good. Everybody likes you. The problem becomes if and when the trade along those routes, no, no longer become secure, how do you secure it?

Do you send troops? When you do, you start building local resentments. You start building, people get upset. People start attacking your troops. That's option one. Option two is you pay off the brigands. You say, Hey, tell you what. Stop attacking my caravan. And I'll cut you in on some of the profits of this trade.

And to be honest, I think this is the path that China will go because it's, it tends to be less costly in the first place. And now in the western world, we don't have that option. 'cause, we can't pay brigands. But China doesn't have the same ethical or institutional constraints that, that we do.

Or, the third option is you say, okay, the strategy didn't work and I'm gonna fall back now.

**Erik:** Louis, I agree emphatically with the essence of what you just said about China and its need to import commodities from the rest of the world. But I wanna push back on that in a very strong way, in a very specific way, which is all of that was true in the age of oil, which we're still living in.

I'm going to make the argument that in the coming age of nuclear China is at least 15 years ahead of the west already on both conventional and advanced nuclear technologies. They have enough thorium under their own soil to power the entire planet for the next thousand years.

They're doing everything necessary right now to build a thorium nuclear fuel supply chain, as well as to develop thorium molten salt reactor technology, which they're going to use to power a new fleet of container ships and for a whole bunch of other things. They've been a little bit shy to say exactly which other things, but I can very easily imagine China developing an energy dominance and therefore an economic dominance over the rest of the world.

And a lot of people don't seem to understand me when I've said this before. I'm not criticizing China or putting them down. They're doing. Everything exactly right. I'm envious of their policies and their achievements. I wish we could get our act together in the west and keep up at least enough to compete.

But what's going on is the West doesn't get it. We are stuck in nonsensical nuclear energy policy that's based on irrational emotions left over from the 1970s that never made sense then. And I'm very concerned that everything you just said is all about to change. And although, yeah, there's a lot of commodities that don't have anything to do with oil and energy.

Most of your argument I think was an energy argument and it's not gonna happen overnight. But in the next 20 years, I think you're going to see a energy dominance in China that's entirely fueled by locally sourced thorium, and they're not gonna need one drop of oil from the Middle East.

**Louis:** My long-term health belief that economic activity is energy transformed. When you look at the commodities world. There's energy and there's everything else. And everything else really doesn't matter all that much. Almost everything else can be replaced.

If you live in a world, the world that you describe is a world in which China essentially has almost zero cost of energy, you can replace a lot of commodities through the application of more energy. The world you describe Eric, and it's not a world I disagree with, by the way to be very clear.

But the world that you describe is actually a world in which, China's threat to the rest of the world goes down dramatically because, China's, one of China's big sense of insecurity today perhaps its single biggest sense of insecurity, is its energy dependence vis-a-vis the rest of the world.

And historically when you're dependent on energy that's, and you want to be a geopolitical superpower. Those are two conflicting hopes. You can't be a geopolitical superpower and be energy dependent as Japan found out in the 1930s. And so a world in which China does gain energy independence, I think is def facto a much, much more peaceful world.

One in which we don't have to worry about China being a threat to its neighbors, one in which we don't have to worry about China being a threat to the rest of the world. It's also, to be honest, the world you describe is a world that is extremely exciting, right? Again, if you start off with the premise that economic activity is energy transformed, if we manage to dramatically reduce the cost of energy for, a fifth of the global population, and perhaps more because China will export that technology then that that's tremendously bullish for everybody.

Now to your point on, the western world is asleep at the wheel and doesn't have to worry about pushing forward on nuclear. I think the explanation for that is simple enough, right? When you have \$2 natural gas price in the US you essentially have almost free energy.

So the shale revolution, which to me has been one of the biggest macro development of the past decade, the shale revolution was a huge boom to the United States and has allowed the United States to cruise comfortably and not worry too much about what was coming up in the

rear. Because if you have a much cheaper cost of any of energy from everybody else, then you're winning.

And the US sure as hell has been winning for the past decade. But yeah, you could have a genuine paradigm shift.

**Erik:** Smart winners understand why they're winning and they make sure they have a plan to continue winning. And my criticism is, I think we couldn't be screwing this thing up worse. We're so complacent with our energy policy.

**Louis:** I think on this, smart winners understand why they're winning. I think Americans are mixing up the symptoms with the causes and that they see the massive outperformance of the Nasdaq. They see the massive outperformance of the MAG 7. And the conclusion most Americans take is, oh, our stock market is doing better than everybody else's.

Our tech stocks are doing better. Therefore, the US boom must be because we're crushing it in tech. I look at it completely differently. I think you had a huge boom in energy, which collapsed cost of energy in the US led to much weaker inflation than you otherwise would have led to a stronger dollar than you otherwise would have.

This allowed the FED to keep interest rates lower for much longer, created excess liquidity that ended up going into technology and allowed Apple to re-rate from, 10 times earnings to 35 times earnings and allow Microsoft to re-rate from 20 times earnings to 38 times earnings. But it wasn't, it, this is a symptom of the energy boom rather than the cause of the US outperformance.

And yes, to your point if you think the US continues to have a massive comparative advantage on energy relative to everybody else, then you stick with US stocks. If, like you and I, you tend to believe that this comparative advantage of the United States of energy is actually on borrowed time. And that at some point in the next five years, the skills will fall from the world, the rest of the world's eyes, then you will have a massive rotation into Chinese assets.

**Erik:** Louis, on that note, we should probably wrap this up in the interest of time. I can't thank you enough again for a terrific interview. Before I let you go, please tell our listeners a little bit more about what you do at

Gavekal, the books that you've written and where they can follow your work.

**Louis:** Yeah so again, thanks again for having me. Always love catching up. I've really enjoyed this conversation. We do three things at Gavekal. We publish research for institutional investors out of our Hong Kong and Beijing offices. The website is [Gavekal.com](http://Gavekal.com), G-A-V-E-K-A-L. We have a private wealth arm both out of Mauritius and out of Bellevue, Washington, depending on whether you're a US investor or non-US investor.

And then we have an asset management arm, mostly doing Asian equities, Asian fixed income. And you can find all that again on our [website](#).

**Erik:** Patrick Ceresna, and I will be back as Macro Voices continues right here at [macrovoices.com](http://macrovoices.com).