

MAY 2010

McKinsey Quarterly

China's state capitalism and multinationals: An interview with the president of Eurasia Group

Ian Bremmer discusses the changing rules of competition in China, where the state is the principal actor and arbiter in the economy.



As China gains dominance on the world stage, more and more multinational corporations will need to rethink their assumptions about competing under its state-capitalism model—one in which the government is the principal economic driver. So says Ian Bremmer, president of the political-risk consulting firm Eurasia Group and author of the upcoming book *The End of the Free Market: Who Wins the War Between States and Corporations?* In this video interview, Bremmer discusses the fundamental distinctions between state capitalism and free-market economies, as well as the strategic implications this has for Western companies and governments alike. McKinsey Publishing's Rik Kirkland conducted the interview in New York.

We're in an environment, over the course of the last 20, 30 years, where we've declared a lot of obituaries: We've declared that communism is dead and that the West has won. We've declared that the state is dead and that multinational corporations have won. And we've declared that authoritarianism is dead and that instead democracy has won. Now, we got one of those three correct: communism's gone. And it's really not coming back. You look at Cuba, you look at North Korea—I'm not getting all that inspired by the return of global communism. But multinational corporations? The state's gone? No way.

And democracy? Authoritarianism's gone? Not from where I sit. And the fact that authoritarianism and the state are back, and back with a vengeance—particularly following the economic crisis and the folks that got hurt as a consequence of the economic crisis—that has congealed into the rise of state capitalism.

In the last year, the country that has come the fastest out of this global economic crisis has been the one that does not accept the notion that a regulated free-market economy is the way to run things. Rather, it is the rise of state capitalism. State capitalism is a system where the state is the principal actor and arbiter in the economy. And so, as a consequence, the state is driving investment and it's setting the rules.

So if you are a Western multinational, and your model is saying, "I'm going to be making lots and lots of money in state-capitalist countries," you better have reasons to believe that, over the medium and long term, you will still be able to do business there. In other words, are there local competitors right now? Are they of scale? Will there be [competitors] in three or five years? What is it that you offer that is not only indispensable today but is going to be indispensable tomorrow that [the state] cannot compete with, rip off, or decide it doesn't need because there are local, state-owned or state-connected companies that will take you out? And I will tell you that Western multinational CEOs have not yet gotten this joke. This is of critical importance.

You have to recognize that your comparative advantage today is not necessarily going to be your competitive advantage tomorrow. You furthermore have to recognize that what you think is your comparative advantage may not be appreciated by a state player as a

comparative advantage that matters. Google in China: yes, they have difficulties with the fact that there's censorship. But that's not why Google isn't in China. Google's not doing well in China because Baidu was supported by the Chinese government to be the premier search engine for China. And ultimately, Google had to make that decision.

I think we have reached a peak on openness. I think that the Chinese model hasn't changed all that much. They've been state capitalists, embracing lots of what the West had to offer. They've been sending lots of exports out there. But the point is that they needed money. And so it really didn't matter what kind of a system China had, because they were so relatively underdeveloped that anything the West was prepared to go and invest in, they said yes.

China no longer needs foreign capital. What China needs is technology, advanced technology, increasingly, quite advanced technology. But Western corporations, increasingly, aren't willing to provide that level of technology, especially given how bad [intellectual-property] protection and regulation is in China. And especially given what's been happening on cyber security over the course of the last several years, which is getting much more public and much more well understood.

So as a consequence, you have an environment where everyone used to go into China because the Chinese needed the investment. Now they don't need the cash. What they need, Western corporations are increasingly loathe to provide. The model has become vastly harder. Now, the reason for the model becoming harder is different. It's still this fundamental incompatibility. It's just that the extraordinary scale and the competitiveness of China has made it front of mind. And that's the point. When you have 10 percent Chinese growth and 10 percent US unemployment, you're unable to avoid these things. You have to look at them right in the face.

China's not going away in a year. It is not going to crack from social instability. It is not going to crumble from environmental degradation in the next couple of years. The Chinese state-capitalist model is robust not because of the model but because 1.3 billion people at sub-\$3,000 per capita income, building out and urbanizing, still have extraordinary productivity gains that they can wring out of the system.

So you can do massively inefficient things at the national level and still look like you're winning for a long time. In fact, it may well be the most appropriate model for China to get through politically over the course of the next five, ten years. And that's what's so hard about this, that the Chinese, ultimately, may well be doing the right thing given this level of development. But you're now in a world system where the most important growing economy is not a mature, developed state with commitment to rule of law and strong institutions and robustness and the rest—it is an emerging market. An emerging market where the political insecurities are the ultimate driver. Hence, state capitalism.

Related thinking

“State capitalism and the crisis”

“Beyond economics: Factoring politics into investment strategies”

“A new world disorder”

“Preparing for the next Asia”

The one thing that a very serious, very rapid rise of a state-capitalist model will do is it will force Western governments, eventually, out of this gridlock, out of this lethargy. And if that can be harnessed for constructive purposes, then that’s going to ultimately be a very positive story. The fear is, of course, that it isn’t and that you end up looking inward. You end up focusing on closing up borders, less immigration, less free trade, more subsidies, more protectionism. And that, ultimately, is not the way to ensure that the free-market system prevails. ○

Copyright © 2010 McKinsey & Company. All rights reserved.