Dragoman Digest

China attracts record US$131 in venture capital funding

Despite this impressive figure, there are growing concerns that regulation may hamper innovation

Venture capital investment in China has reached a record high of over US$131 billion in 2021 – almost 50 percent higher than last year's figure. This unprecedented number defied public expectations, as there was widespread concern that increased regulations would hinder investment. Measures introduced as part of President **Xi**'s common prosperity campaign include anti-trust fines, forced restructurings and various regulatory efforts to break up monopolies.

Though venture capital investment in the digital platforms targeted by regulators has declined, priority industries like semiconductors, biotechnology and robotics have benefited from increased capital flows. Investment in biotechnology, for example, reached over US$14 billion, up tenfold since 2016. This marks a clear success for government efforts to shape and divert capital flows.

Nonetheless, this approach is not without potential risks. China's most successful tech companies including Alibaba, Didi and Tencent have benefited greatly from China's relatively laissez-faire regulatory approach which allowed markets – rather than the state – to allocate capital. Where the state has allocated capital, results have been far less successful. Despite having spent over US$100 billion in pursuing semiconductor self-sufficiency, China's gains in this area have been piecemeal. Whilst the sheer size of investment means that some tech breakthroughs will be likely, there is no guarantee of overall success.

Japan echoes trans-Atlantic self-sufficiency drive

Economic self-sufficiency back in vogue

By March 2024, Japan is aiming to implement a US$4.38 billion subsidy program assisting domestic companies to develop critical and emerging technologies including large capacity batteries and chips. This recent announcement came after Japan's new Prime Minister **Fumio Kishida,** in one of his first steps in the top job, created a specialised economic security ministry. Japan's new subsidy program was specifically sparked by concerns that it was too reliant on foreign nations (including **China**) for medical supplies and semiconductor production. TSMC – which announced its plans to build a US$7 billion chip plant in Japan last November, will become of the first recipients of the program, receiving US$3.5 billion in subsidies.

Japan's subsidy program broadly mirrors those introduced or under formulation in the **US** and **EU**. In October 2021, the EU announced its US$50 billion European Chips Act, introduced to boost the production of local manufacturers. Under the program, the EU will aim to increase its global share of semiconductor production from 10 percent to 20 percent by 2030. Further concrete details are expected to emerge in the next six months. The US is aiming to support its chip sector following worsening global chip shortages and a sharp reduction in the US' share of global chip manufacturing. It aims to mobilise funding through its own US$52 billion Chips for America Act. Progress on passing the Act – which is part of the broader Innovation and Competition Act – has stalled, though agreement now appears to be imminent.

The suite of countries pursuing self-sufficiency policies – China can also be added to this list – has prompted concerns over the integrity of the World Trade Organisation's domestic subsidy rules. There is also an added risk that the duplication of manufacturing capabilities will lead to less efficient global supply chains and less spending on innovation.

Record number of small business closures paints a worrying picture of China's current economic health

With three times the number of small businesses closing than opening, China's private sector is clearly in strife

Despite tax and fee cuts from the **Chinese** government valued at over US$156.9 billion, small businesses have been closing at historic rates – with predictions indicating that the trend will continue this year. Each month in 2021 an average of 397,435 micro and small businesses closed, surpassing the monthly average in 2020. As of 2018 China had approximately 2.4 million small firms, and over 15.6 million micro businesses, accounting for over 98 percent of total companies. With small private businesses encompassing 60 percent of China's GDP and 80 percent of the nation's non-government employment, the health of small businesses helps shed light on China's current economic situation, amid warnings from its ex-finance minister that current economic indicators are failing to accurately reflect true conditions. The closure of small businesses has had flow on effects to other sectors. Notably, recent graduates are increasingly reluctant to apply for private sector jobs, with a substantial increase in applications to the public service and SOEs.

Given such volatility, civil service and SOE jobs – previously referred to as the "iron rice bowl" because of their guarantee of life-time job security – are seen as more secure. The private sector slowdown comes amidst worsening demographics, and a slowing property sector. It remains to be seen at this stage how effective the central bank's urging for lenders to give larger and cheaper loans to small and medium enterprises will be in soothing the evident economic pain.