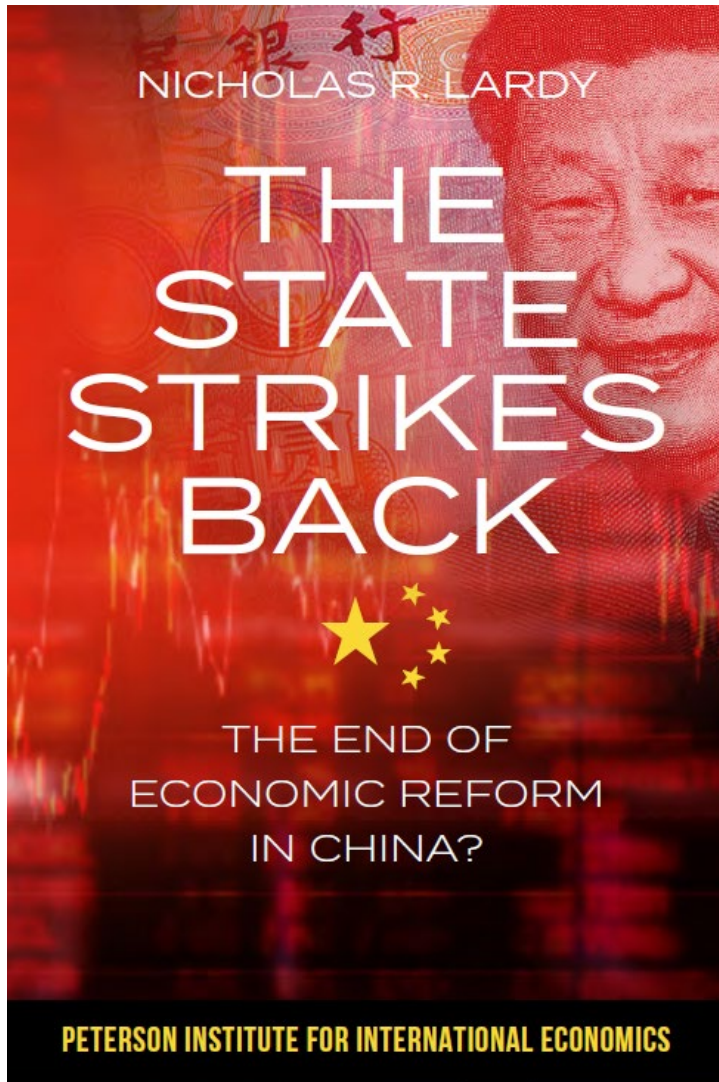




The State Strikes Back: The End of Economic Reform in China?

**Nicholas Lardy
Anthony Solomon Senior Fellow
Peterson Institute for International Economics**

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- State-owned enterprises are dragging down China's growth
- China's potential growth over the next decade is >8%



Conventional Wisdom

Larry Summers, 2014: “China is long overdue for a correction that would bring its growth rate in line with the median global historic rate of 2 percent per capita.”

Minzner, 2018: “the rapid growth of exports and investment that powered China’s growth is now tapped out. We should expect permanently lower growth.”



China's Approach

The Policy:

November 2013 Third Plenum, 18th Party Congress: “The market must become the decisive force in the allocation of resources.”

The Reality:

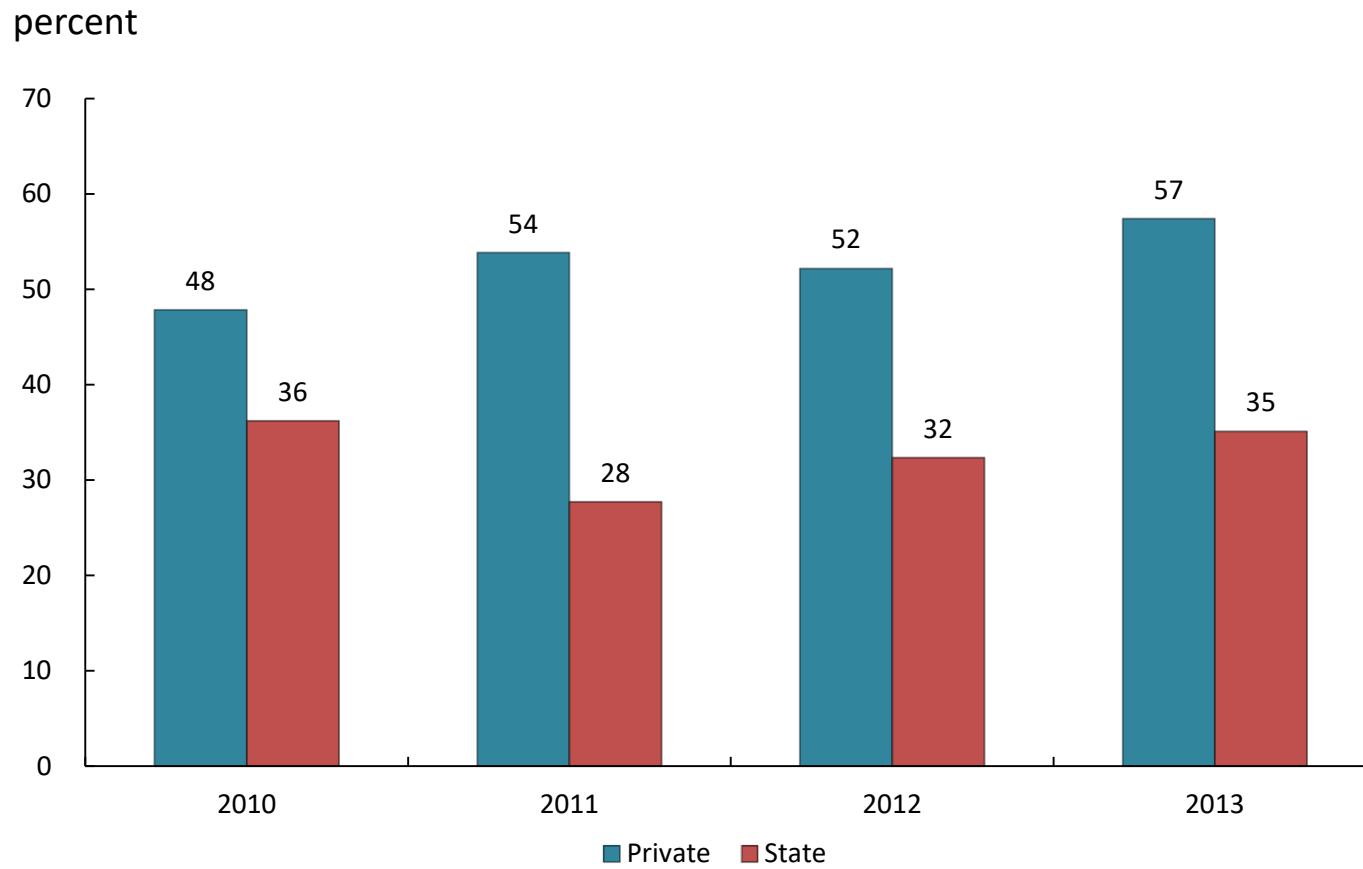
Xi Jinping has pushed state industrial policy and an expanded role for state enterprises. The share of bank lending going to SOEs has more than doubled and private firms have been squeezed out.



The Rise of the Market Economy

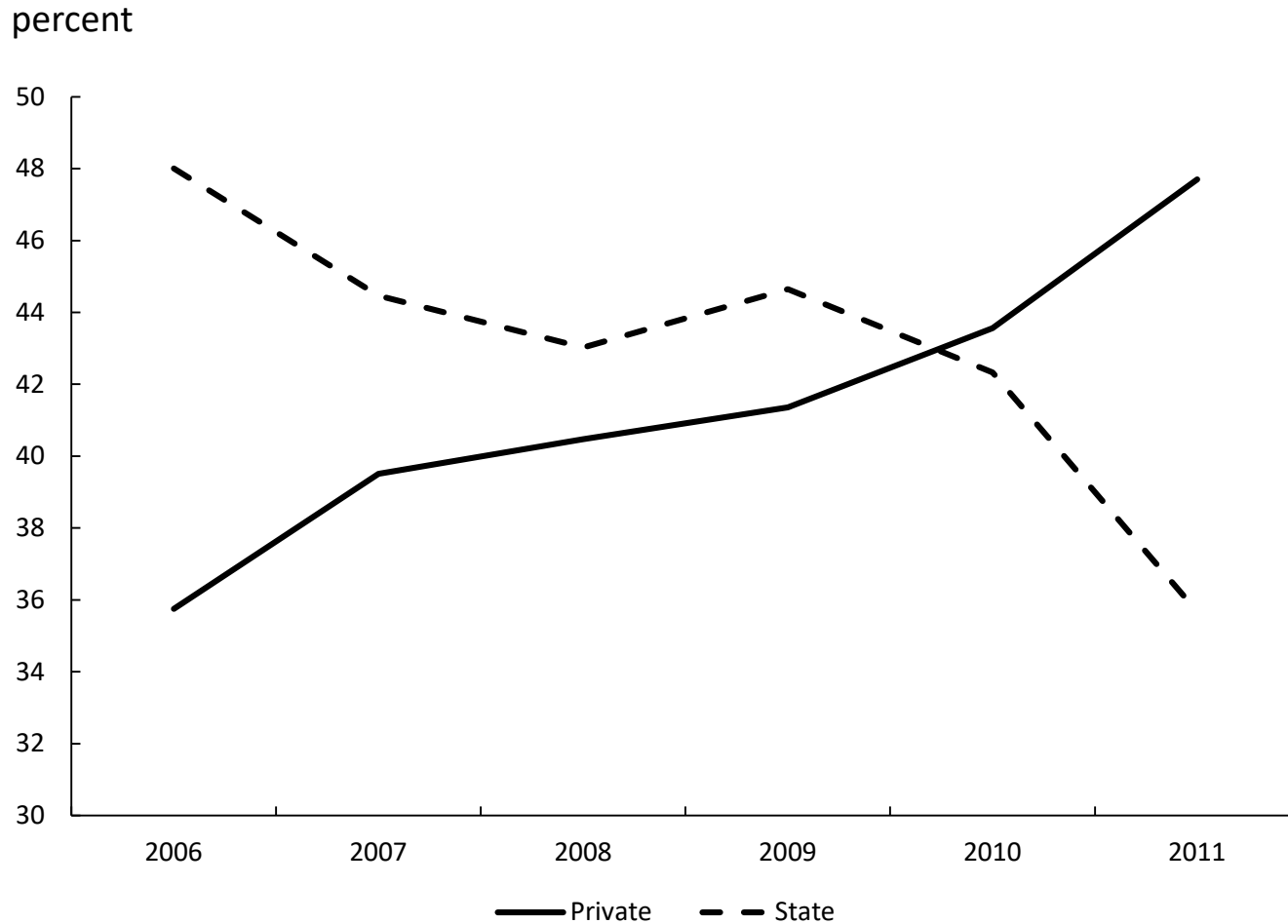
- Price reform
- Legal status for private firms
- Substantial flow of credit to private firms
- Rising share of investment by private firms
- Displacement of state firms in industry and exports

Flow of Loans to Nonfinancial Enterprises by Ownership, 2010-13



Source: China Banking Society.

State and Private Investment, 2006-11

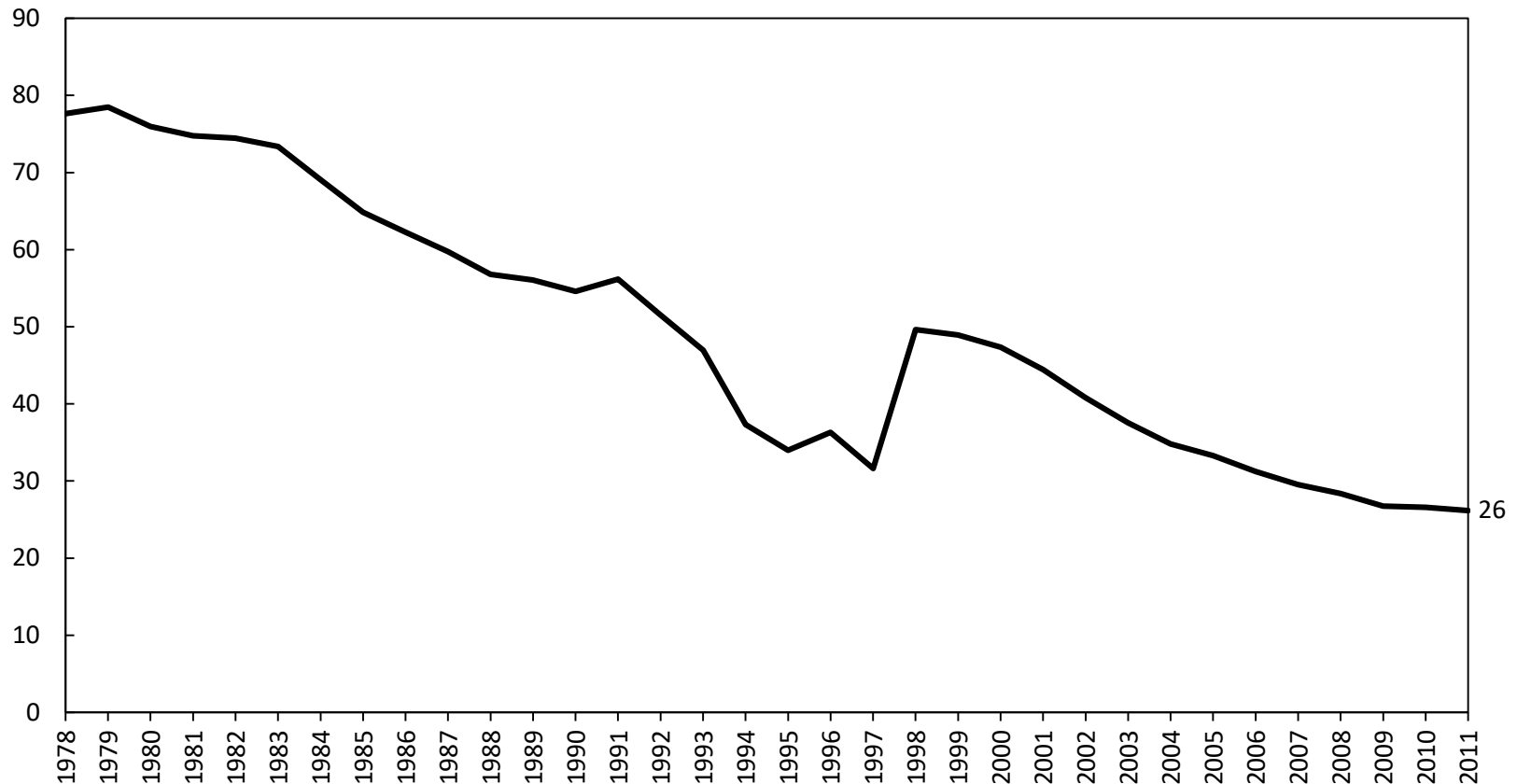


Source: National Bureau of Statistics of China.

Gross Industrial Output of State Firms, 1978-2011



Percent of total gross industrial output



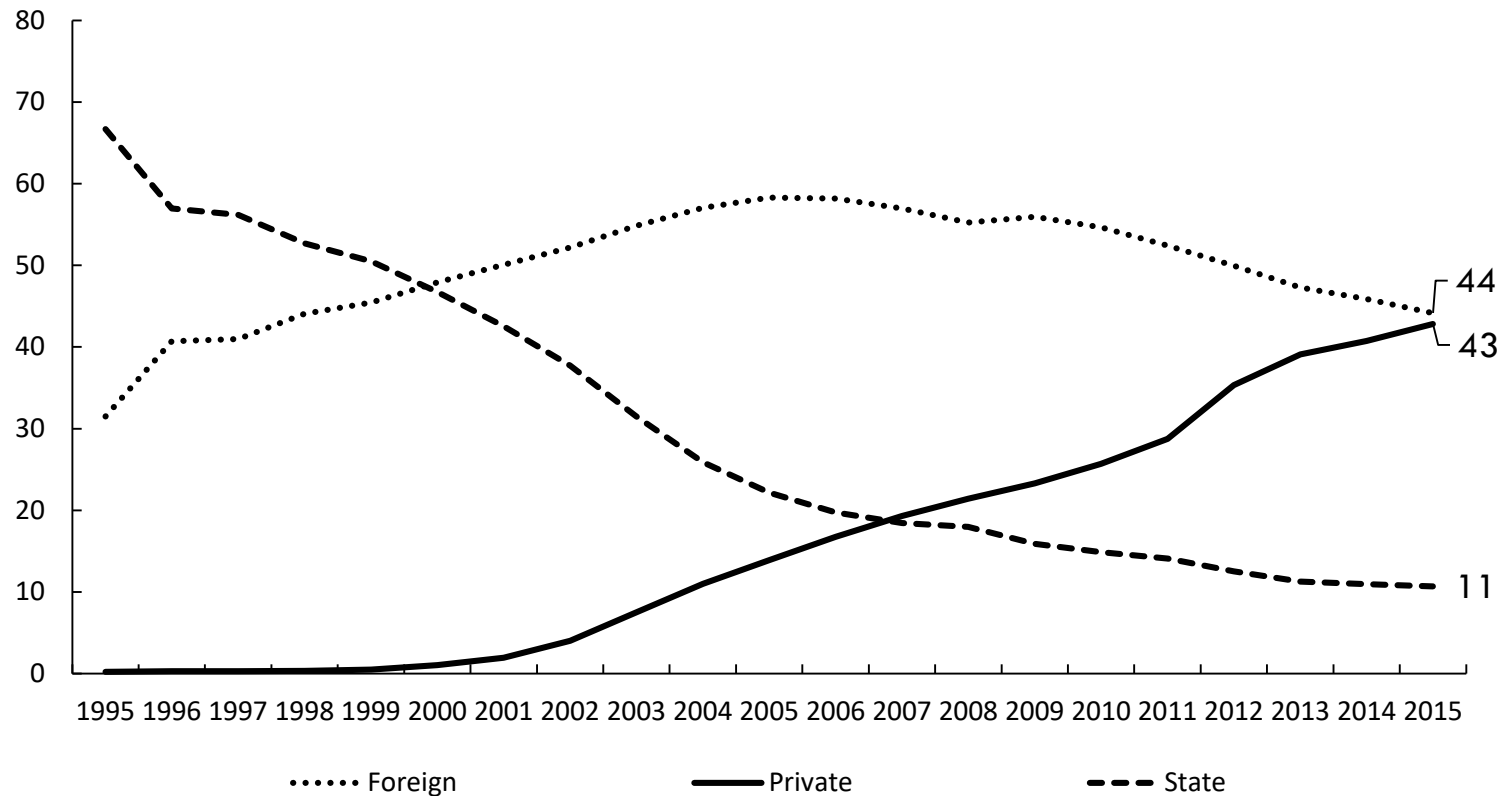
Note: Data include only above-scale firms, with sales greater than RMB5 million (1998-2011) and firms with sales greater than RMB20 million (beginning in 2011). This data series appears to have been discontinued.

Sources: National Bureau of Statistics of China (2012b, 518); National Bureau of Statistics www.stats.gov.cn (accessed February 28, 2014).

Sources of Chinese Exports by Ownership Status, 1995-2015



Percent of total exports



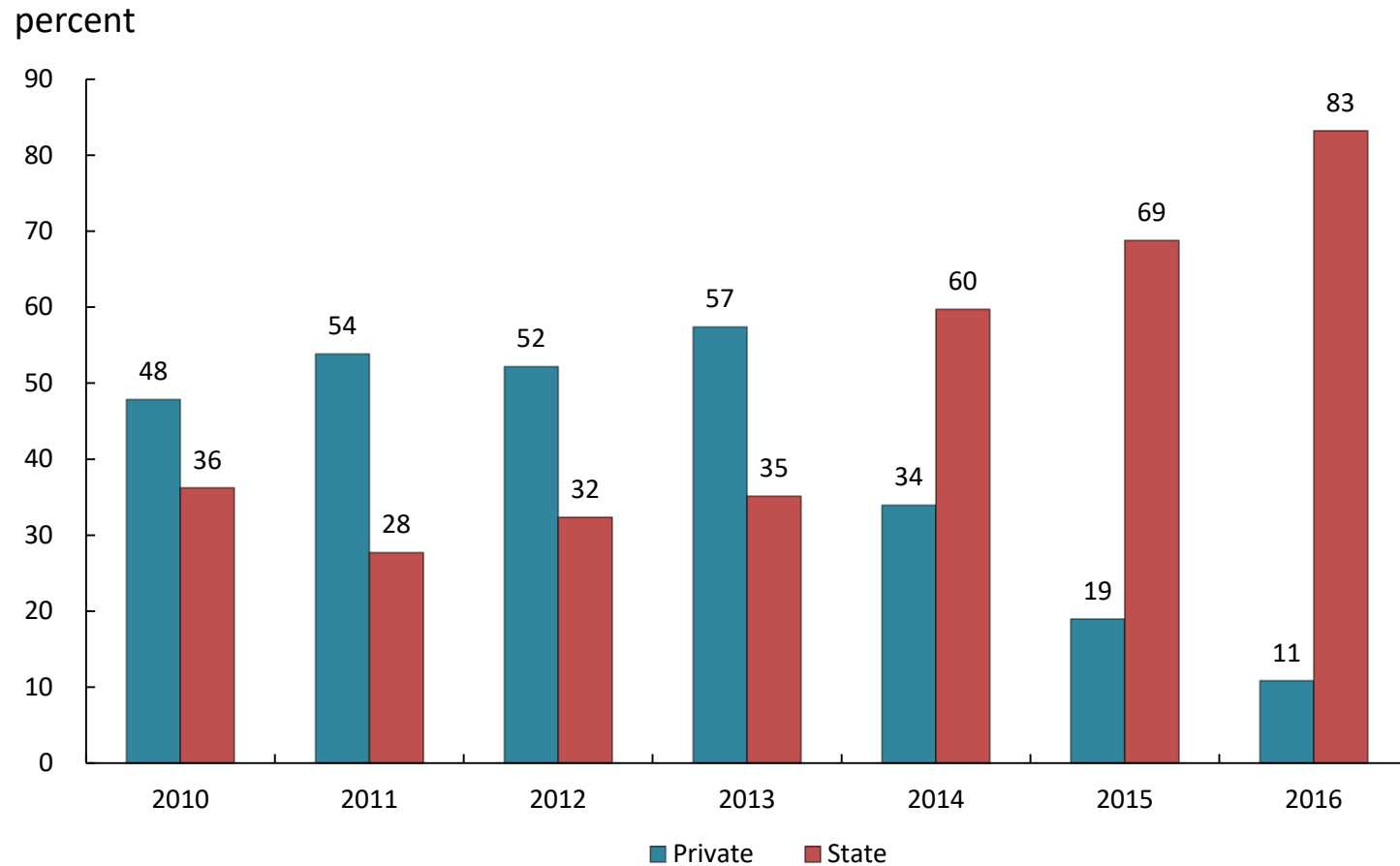
Sources: General Customs Administration; ISI Emerging Markets, CEIC Database.



Rollback of Market Reform since 2013

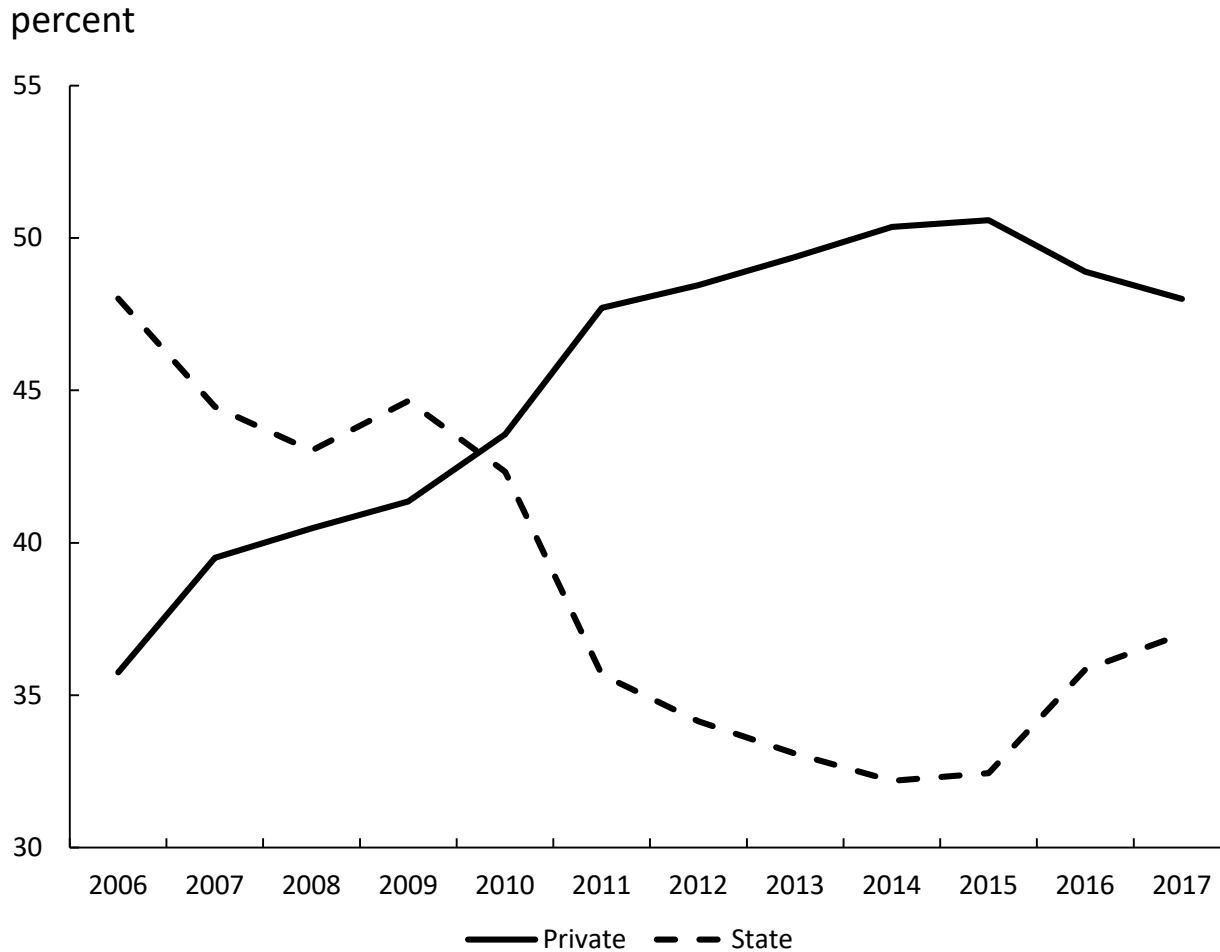
- Bank credit to private firms drastically curtailed
- Share of investment by private firms plateaus and then falls
- Growth of state industrial firms overtakes that of private industrial firms
- Anti-competitive mergers resume in 2015

Flow of Loans to Nonfinancial Enterprises by Ownership, 2010-16



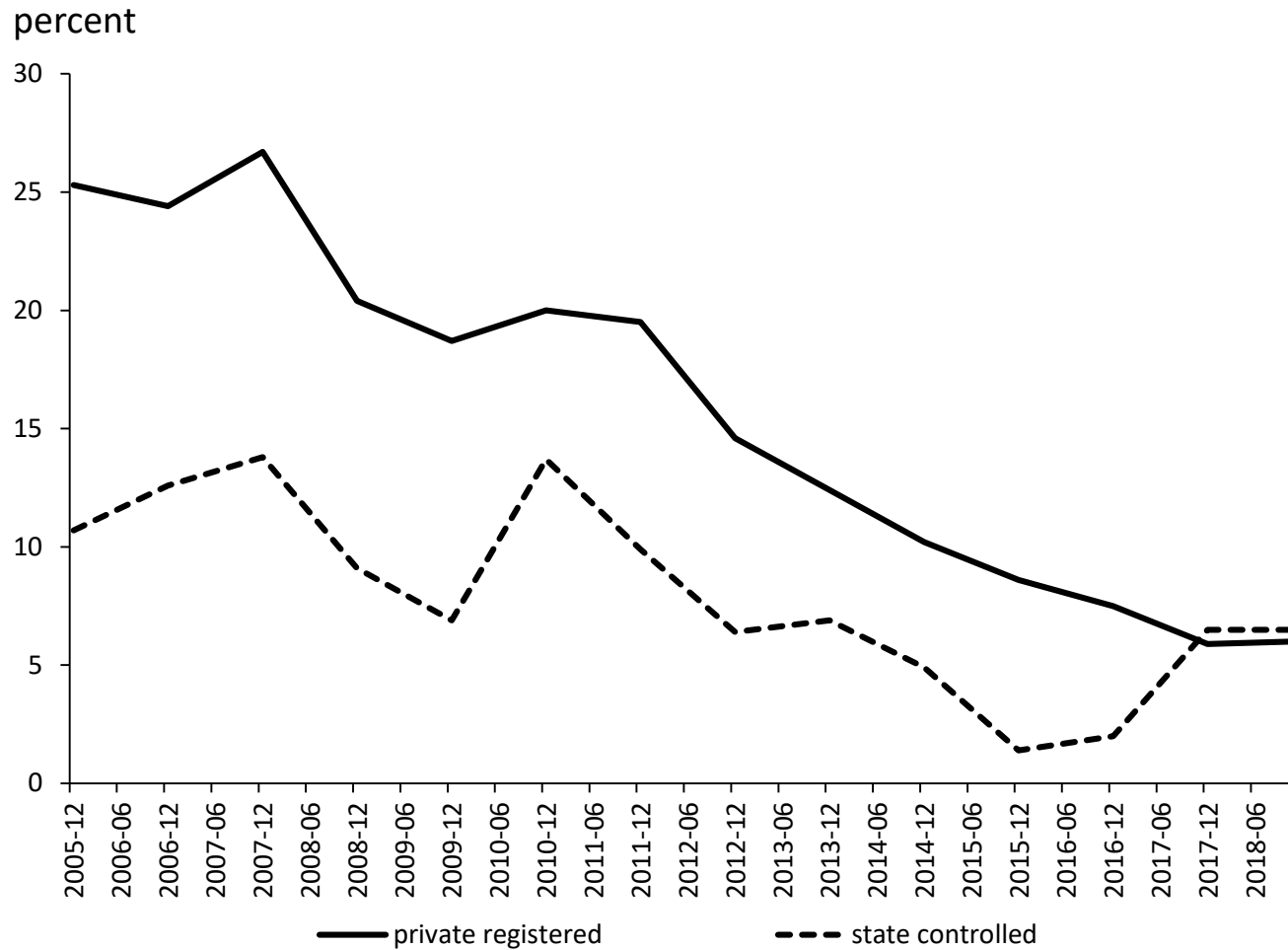
Source: China Banking Society.

State and Private Investment, 2006-17



Source: National Bureau of Statistics of China.

Growth of Industrial Output by Ownership



Source: National Bureau of Statistics via Wind (Accessed on January 16, 2019).

SASAC-orchestrated Mergers, 2015-17



Company Name	Company Name	Date of Merger
Shenhua Group	China Guodian Corporation	August 2017
China National Machinery Industry Corporation (Sonimach)	China High-Tech Group	June 2017
China Grain Reserves Corporation (Sinograin)	China National Cotton Reserves Corporation	November 2016
China National Building Materials Group Corporation	China National Materials Corporation (Sinoma)	August 2016
China National Cereals, Oils and Foodstuffs Corporation (COFCO)	Chinatex Corporation	July 2016
China National Travel Service (HK) Group Corporation	China International Trade Services Group Corporation	July 2016
China Merchants Group	Sinotrans & CSC Holding Company	December 2015
China Ocean Shipping Group	China Shipping Group	December 2015
China Metallurgical Group	China Minmetals Corporation	December 2015
China Nam Kwong Group	Zhuhai Zhenrong Corporation	December 2015
CNR Corporation	CSR Corporation	August 2015
China Power Investment Corporation	State Nuclear Power Technology Corporation	June 2015

Source: State-owned Assets Supervision and Administration Commission of the State Council, www.sasac.gov.cn (accessed on 5 September 2017).

Return on Assets of Central SASAC Enterprises, 2005-17



Year	Profits (billions of renminbi)	Assets (billions of renminbi)	Return on assets (percent)	Liabilities/assets ratio (percent)
2005	641	10,630	6.0	56.1
2006	765	12,192	6.3	55.8
2007	997	14,927	6.7	55.7
2008	696	17,629	3.9	58.4
2009	815	21,058	3.9	60.1
2010	1,143	24,427	4.7	60.8
2011	1,266	28,036	4.5	62.1
2012	1,300	31,357	4.1	62.7
2013	1,300	35,017	3.7	63.4
2014	1,400	38,669	3.6	63.0
2015	1,167	47,581	2.5	66.7
2016	1,233	50,500	2.4	66.7
2017	1,423	54,500	2.6	66.3

Source: State-Owned Assets Supervision and Administration Commission.



Return on Assets of State and Private Industrial Enterprises, 1996-2016





Estimating the Drag on China's Growth

The deteriorating productivity of SOEs and the squeezing out of private investment is reducing China's growth by an estimated 1.6 to 2.0 percentage points annually.



Capturing Convergence Potential

- China's per capita GDP, measured in comparable prices, is only one-quarter of the US level, suggesting that there is substantial potential for further convergence of per capita GDP toward the US level.
- Capturing this convergence will require a roll back of Xi Jinping's rollback on reform.



Thank you!