Chinese need to stop propping up inefficient state enterprises

Left to right: Jing Ulrich, managing director and vice-chairman of Asia Pacific, JP Morgan Chase; He Fan, chief economist, Caixin Insights Group; and Christine Wong, director of the Centre for Contemporary Chinese Studies, University of Melbourne speaking at the Canberra Australian Leadership Forum. Sean Davey

by Tony Walker

China needs to escape a vicious circle in which household savings are used to prop up inefficient money-hungry state-owned enterprises if it is to reshape development strategy to sustain growth into the future.

Jing Ulrich, managing director and vice-chairman, Asia Pacific of JP Morgan Chase, told a leadership forum in Canberra that state-owned enterprise reform should be an absolute priority to reduce a national debt burden and improve efficiencies.
"China is a nation of savers. Enterprises are spenders. This needs to change, and would require painful structural reform," she said.

Ms Ulrich said China needed to develop a social safety net to give its people confidence to utilise their savings to propel consumer-led growth, rather than putting money in the bank.

This was a critical requirement in China’s transition from a demand-driven economic model. Chinese consumers save 40 per cent of household income, which is then recycled into inefficient state enterprises by state-owned banks.

This had contributed enormously to economic distortions, including chronic state-owned enterprises overcapacity.

All the speakers on a Can China Reform panel at the Crawford Australian Leadership Forum – part sponsored by The Australian Financial Review – expressed concern about the level of Chinese debt that now stands at between 250 per cent to 280 per cent of GDP.

SOE liabilities – to state-owned banks – accounted for more than half of this indebtedness.

Professor Christine Wong, director of the Centre for Contemporary Chinese Studies at the University of Melbourne, described financial interactions between the central government and SOE's as an "incredible mess", and the issue of local government debt as a "black hole".

He Fan, chief economist and head of Caixin Research, told the forum the "sheer size" of China’s debt was less of a problem than structural economic challenges.

China, with its massive foreign exchange reserves, retained room for manoeuvre in its efforts to rationalise state-owned industries, but a liquidity crisis could not be ruled out among smaller banks and non-bank financial institutions.

These were main lenders to local government.

Mr He said that in order to bring about stricter controls over bank lending at the provincial level what might be needed would be some burning off to avoid a bigger conflagration.

The Caixin chief economist proposed a Roosevelt-type "New Deal" to bring about reforms of enterprises and the banking system along with a stimulus
policy to create greater demand.

He called for more attention to be paid to "pro-growth structural reform".

The speakers took a relatively sanguine view of China’s latest economic circumstances.

Ms Ulrich said that since the March quarter the Chinese economy had stabilised. The property market had recovered somewhat, and the services sector was growing at a much more rapid pace, contributing something like two-thirds to growth.

She said the big question for China in its reform process would be whether it was able to "stomach short-term pain for potential long-term gain".

China’s unsteady progress towards greater liberalisation of its political system under the leadership of President Xi Jinping was addressed by several of the speakers with Mr He saying that "even a strong man can carry out market-oriented reforms".

Mr He described China's situation as "very complicated", but he observed there was no way the country would "go back to a traditional model".

He likened China's to a teenager seeking to be an adult in the latest phase.

"The US and its allies should work out how to accommodate China," he said.

Ms Ulrich expected that China’s political system would maintain a status quo, but there were still many ways for Australia and China to work together.

Mr He concluded: "anything can happen in China".
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