



European Chamber
中国欧盟商会

Overcapacity in China



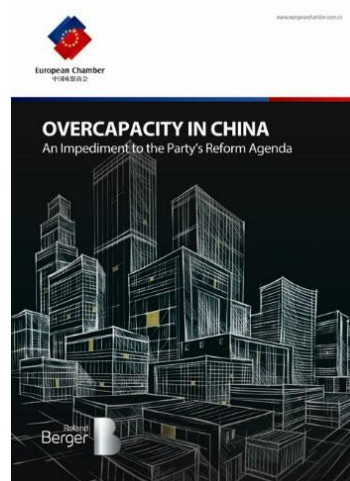
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An Impediment to the Party's Reform Agenda

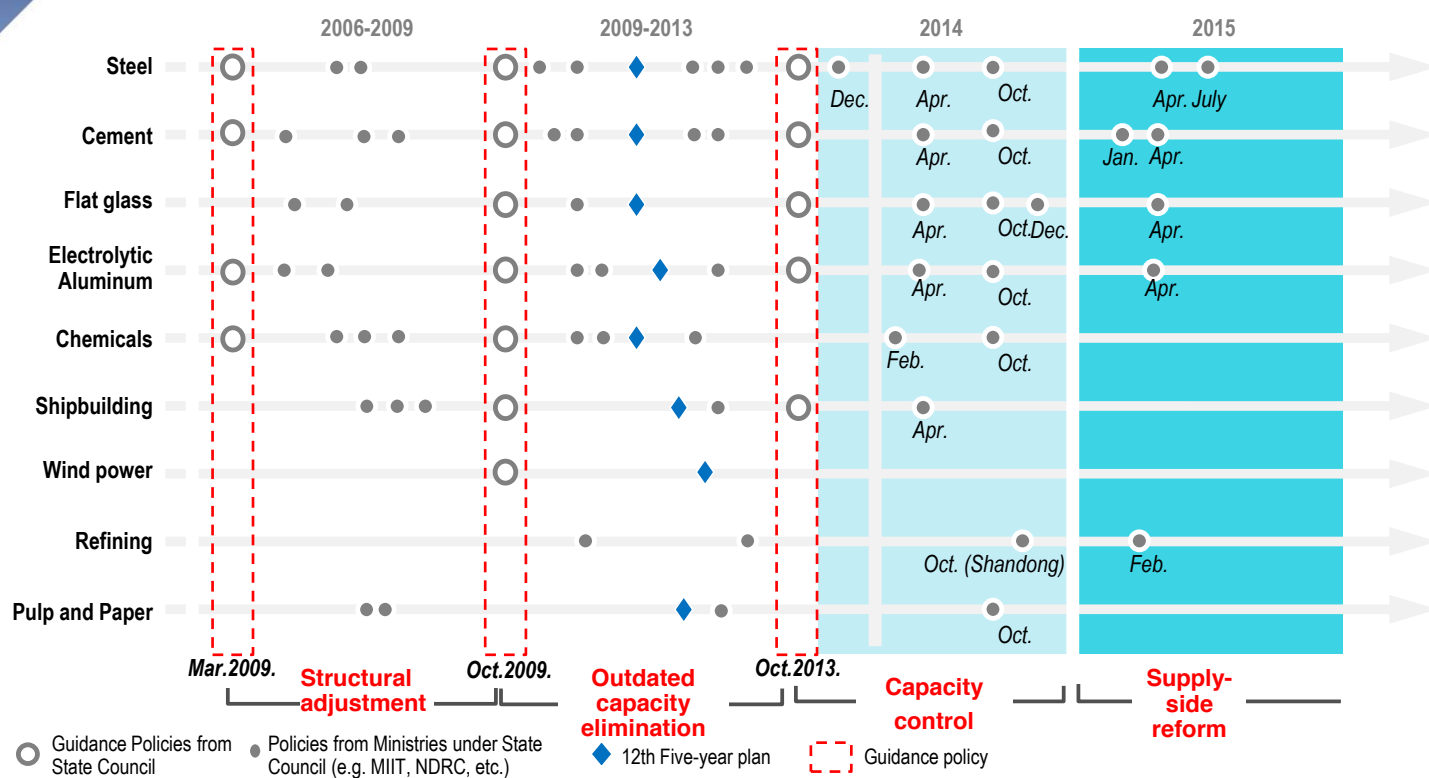
22nd February, 2016

The Chamber's New Major Report

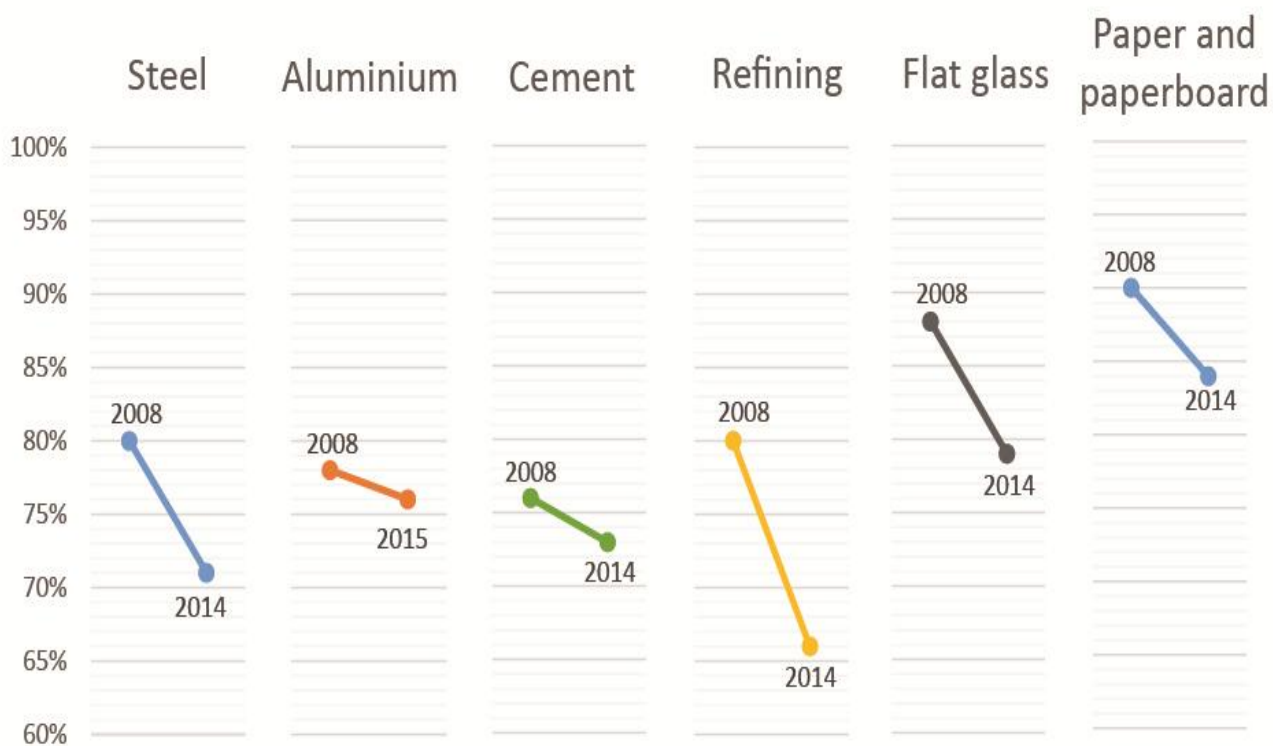
- Research conducted in **autumn and winter 2015**
- Examines **causes, effects** and provides **policy recommendations**
- Input from leading European companies operating in China and European Chamber research
- **Builds on the European Chamber's original 2009 report** with completely updated analysis



Central Government Action to Curb Overcapacity (2006-2015)



Utilisation Rates in Six Industries



Crude Steel and Refining

	Crude Steel		Refining	
	2008	2014	2008	2014
Capacity	644m tonnes	1.14bn tonnes	391m tonnes	686m tonnes
Production	512m tonnes	813m tonnes	31m tonnes	456m tonnes
Utilisation rate	80%	71%	80%	66%
Overcapacity	132m tonnes	327m tonnes	77m tonnes	230m tonnes

Main Causes of Overcapacity

1. Local protectionism and the fragmentation of industries that is driven by regionalism.
2. Weak enforcement of regulations.
3. Low input prices due to government policies.
4. A fiscal system that encourages local governments to attract excessive investment.

Main Causes of Overcapacity

5. Widespread availability of inexpensive technology.
6. Environmental, health and safety (EHS) standards and laws that are not fully implemented.
7. A philosophy of market share vs. profitability.



Restructuring vs. Rebalancing

- Due to the scale of problems faced, China's economy needs restructuring, not rebalancing.
- Stimulating the economy through investments in industries characterised by overcapacity is misaligned with the goal of ensuring quality and sustainable growth.

—Levin Zhu

Former head of China International Capital Corporation

Singapore

16th October, 2015

Domestic Impact

- Misallocation of land, capital and labour that could be put towards more productive use.
- Environmental degradation from pollution-intensive industries.
- Low profits lead to a lack of sufficient funds for R&D projects.
- Difficult to service interest payments and loans.



Global Impact: Trade Tensions

- Export of goods in industries characterised by overcapacity frequently leads to trade disputes.
- Potentially produces unemployment in export markets: increases pressure on their governments to take steps to defend jobs.
- Protectionism could destroy the benefits of globalisation by disrupting the global production chains that it depends on.
- Complicates the ability of Chinese companies to invest and operate abroad.



Myth Busting: OBOR and the AIIB

- Scale of expected AIIB funding is too small to alleviate overcapacity in China.
- Significant limitations on the ability of industries like cement and plate glass to export products.
- Many markets along OBOR are too small – some are likely unwilling to absorb overcapacity.



Examples of Direct Recommendations

1. Cut capital expenditure (break iron triangle of local politics, SOEs, and banks).
2. Reform the fiscal system to give local regions more funding possibilities.
3. Enforce environmental laws.
4. Improve IP protection in order to safeguard innovations.
5. Reduce energy price subsidies to industry and continue resource price reform.
6. Publish more reliable and transparent industry data in a timely manner so companies can make informed decisions.



Examples of Indirect Recommendations

1. Redistribute SOE dividend payments to Chinese households indirectly through government spending on social security, healthcare and education.
2. Continue to increase government spending on pension and healthcare systems in order to provide the social 'safety net'.
3. Enhance the business environment for SMEs.



Thank You



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