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FOR LEADERS OF THE NEXT GENERATION

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Time to End 2100 Years of Debate about the Role of the State in China's Economy

*On the 70th anniversary of the founding of the People's Republic of China, the political leadership should renew its pledge of economic liberalisation and firmly continue down the path to modern prosperity, writes **Joerg WUTTKE**, President of the European Union Chamber of Commerce in China, Chief Representative of BASF China, and Member of the stars International Board, based in Beijing. A few days ago, Wuttke also shared his perspective at the 12th stars Switzerland symposium 2019 in the session on "Competition without Catastrophe: Can the US and China get along?" together with John ALLEN, President of The Brookings Institution, and WANG Yong, Professor at Peking University.*

On October 1st, China will be celebrating the 70th anniversary of the founding of the People's Republic.

But another anniversary of great significance will pass this year, largely unobserved: 2100 years ago, in 81 BC, the "Discourses on Salt and Iron" were held to determine the economic course of the Western Han Dynasty.

Reading the accounts of the debate convened by the imperial court at the time instils one with a strange sense of reverse *déjà vu*. Two factions argued with each other over the role of the state in the economy, with the central debate coming down to one faction calling for the court to abandon its state-run monopoly on the production and sale of salt and iron goods while the other called for the status quo of state control to endure.

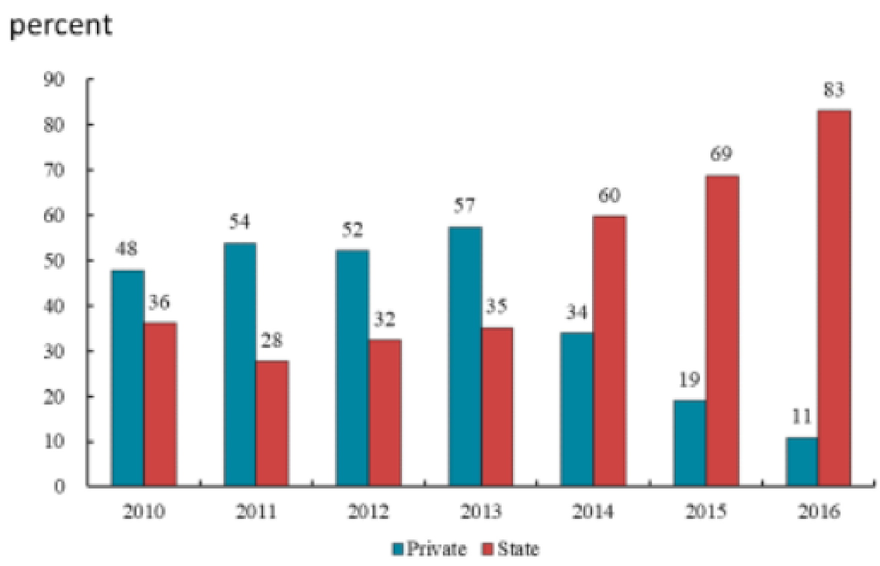
How little things have changed in the intervening twenty-one centuries.

“Industrial Hegemony” by state-owned enterprises

The salt monopoly in China only saw the start of proper liberalisation two years ago, while the Chinese steel industry remains utterly dominated by the state-owned sector. Meanwhile, dozens of centrally owned state enterprises (SOEs) act as “industrial hegemons” in both the Chinese and international markets while thousands of competition-leeching locally owned SOEs hoard market share and pile on debt at the expense of the finance-starved private sector.

Unfortunately, the role of these SOEs has only grown in recent years as the system follows the calls for state-owned companies to become “better, stronger, bigger”. As noted by Dr. Nicholas Lardy, the resurgence of SOEs is made clear by the fact that the share of bank loans to non-financial corporations that were state-owned surged from 35 per cent in 2013 to 83 per cent in 2016, while the share going to private firms plummeted from 57 per cent to a paltry 11 per cent in the same timeframe.

Figure 3. Misallocation of Loans to Nonfinancial Enterprises After 2013



Source: China Banking Society.

An outsider looking in might assume that the central conclusions made 2100 years ago by the Western Han Imperial Court had been passed all the way down without question to Zhongnanhai today. Fortunately, the debate is alive and well, albeit mostly behind closed doors. However, every once in a while, the internal policy discourse makes its way into the public.

The difference between Southern and Northeastern China

“Competitive neutrality”, the idea that the government should provide equal treatment to all enterprises, regardless of state or private ownership, suddenly boomed as a public topic of discussion in leadership circles after former and current People's Bank of China Governors Zhou Xiaochuan and Yi Gang spoke in public about the principle.

Since then, the new and powerful State Administration for Market Regulation and the State Council have both promoted the concept, as did Premier Li Keqiang in his 2019 Work Report.

Some leaders clearly understand the need to implement competitive neutrality to allow market forces to do their job while preventing the distortions that monopolistic and privileged SOEs exert on the economy. A simple look at the booming and dynamic economy of Southern China, which has leaned heavily towards market liberalisation, in comparison with the industrial rustbelt in Northeastern China, which retained much of the structure of the state-planned model, tells us clearly which economic system produces better results.

These trends are not lost on China's reformers, nor are they ignored by the millions of aspiring entrepreneurs and migrant workers that have steadily voted with their feet as they relocate to the south.

Continue down the path to modern prosperity

Competitive neutrality and a return to proper SOE reform can reinvigorate the Chinese private sector – and with it, development. More importantly, embracing such measures would go a long way towards digging out the remaining foundations of China's state-run economic model to make room for the roots of a true market economy.

Considering what kind of miracles Chinese entrepreneurs and foreign investors have been able to produce under a partially open and semi-market economy, one can only imagine what sort of advancements might be possible in a fully liberalised one.

China's economic reform agenda has sputtered to a halt in recent years, and the leadership must now decide: It can go in reverse against the last four decades of progress through reform and reassert the 2100-year-old feudal notion that a state-directed economy is the right path. Or it can step on the gas pedal and continue down the path to modern prosperity by completing its economic liberalisation, thus ending 21 centuries of debate.

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