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Whither China's Private Sector?

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BOOSTING PRIVATE SECTOR'S BUSINESS CONFIDENCE A TOP PRIORITY

Business confidence in China's economy has been flailing for months as evidenced by the continuous decline in composite Purchasing Managers' Index for output since March 2023. In particular, China's private sector has shown especially weak and passiveness in economic activities. Not only has the annual growth in fixed asset investment by private firms started to decelerate as early as February 2021, it has turned negative since the beginning of 2023. Private sector fared worse than state-controlled enterprises as well as foreign invested enterprises and firms with funding from Hong Kong, Macao and Taiwan.

Due in part to falling business confidence, quarter-on-quarter growth from April to June 2023 was much lower than expected, at 0.8%, a huge drop from the previous 2.2%, according to China's National Bureau of Statistics (NBSC). Economic weakness is also reflected in record high youth unemployment of 21.3%, signs of deflation pressure and considerable contraction in exports. There is also little sign of recovery given long-standing problems, such as high local government debt and weak real estate sector.

As an important component of China's economy, the private sector and its strength are critical to the country's economic prosperity. According to the Fourth National Economic Census conducted by NBSC, as at end-2018, 84.1% of China's legal entities (in a total of about 18.57 million) were registered as "private enterprises" and contributing to about 57.2% of employment (in a total of 298.3 million).[1] Restoring confidence and re-energising business activities of the private sector are thus key to revitalising China's economy, a top policy concern of the Chinese leadership.

[1] There is a closely related definition, private-controlled legal entities. Those under this slightly broader-defined group made up 93.6% of the total in numbers and 72.8% in employment in the same Economic Census.

On 19 July 2023, two days after the release of China's disappointing economic figures, the Central Committee of the Communist Party of China (CPC) and the State Council jointly released the "Opinions on Promoting the Development and Growth of the Private Economy",[2] (the Opinions hereafter). This was followed closely by a series of government documents rolling out supporting policy measures that are considerably stronger than those of the past, including measures to further lift restrictions over the real estate sector and boost domestic consumption. On 28 July 2023, eight central government departments, led by the National Development and Reform Commission (NDRC), jointly issued the "Notice on Implementing Several Recent Measures to Promote the Development of the Private Economy".[3] It further specified the division of labour among 15 central government departments to implement the Opinions. The speedy release of such focused and coordinated policy documents suggests that concerns over poor economic performance have likely reached the highest authority and private sector development is receiving much greater policy attention.

ENCOURAGING CHANGES

The solemnity of the Opinions also shows that policymakers are adopting a more serious approach. First, this is the first document jointly issued by the CPC Central committee and China's central government specifically for the development of the private sector in China. Only two documents were released by the State Council specifically for the private sector in 2005[4] and 2010.[5]

Second, for the first time, the private sector has been urged in a party document to be "bigger, better and strong", an approach that has been directed at only the state sector in the last 10 years.

Third, compared to most other party documents, the Opinions skipped the usual verbose of the background, great picture, policy targets and so on. The document spelt out 31 measures in six directions, including improving the business environment and law system, strengthening government service and providing industry service support, as well as introduced more friendly business and social policies for entrepreneurs and the private sector.

The Opinions also witnessed several reversals of stance such as those for the platform economy. It now emphasises more of the industry's contribution to employment, consumption expansion and international competition and encourages its development instead of cracking down on the "disorderly expansion of capital" of the digital market a couple of years before.

WORD FREQUENCY ANALYSIS

However, the document also reiterated some old terms and statements that are of concern to the private sector, such as "anti-monopoly and anti-corruption" and "promote the healthy

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2 https://www.gov.cn/zhengce/202307/content_6893055.htm, accessed 31 July 2023.

3 https://www.ndrc.gov.cn/xxgk/zcfb/tz/202308/t20230801_1359007.html, accessed 31 July 2023.

4 The 2005 document is "Several Opinions on Encouraging, Supporting and Guiding the Development of Individual and Private Sectors and Other Non-public Economy", available at https://www.gov.cn/zwgk/2005-08/12/content_21691.htm, accessed 7 August 2023.

5 The 2010 document is "Several Opinions on Encouraging and Guiding the Healthy Development of Private Investment", available at https://www.gov.cn/zhengce/content/2010-05/13/content_3569.htm, accessed 7 August 2023.

development of talents in the private sector". Indeed, the former had been used in the crackdown of selected private businesses.

Comparing the frequencies of some key words in the current document with Opinions of the 2005 and 2010 State Council documents (Table 1) for private sector development, it reveals changes that are not conducive to private sector development.

First, in the latest Opinions, the word "party" appears considerably more frequently, while "market" and "government" have shown sharp drop in the wordcount. This is a cause of grave concern for the private sector as it is taken as the significant strengthening of party's direct involvement in the private sector affairs. Not only is the role of the market downplayed, the governance responsibilities of the government also seem to be overtaken by the party apparatus.

Second, while the wordcount for "law" and "regulation" was lower than in the 2005 document, it doubled those in the 2010 document. In the early 2000s, as China was still making intensive efforts at improving its law system and fulfilling WTO requirements, it is understandable if more emphasis was placed on law and regulation in the 2005. However, the tightening of regulation implied by the latest document could hardly be taken as a market-friendly signal.

Third, there was less mention of financing and financial support in the newly released document than in the previous two documents, indicating that fewer market-oriented policy tools would be available, leading to doubts about the fairness and effectiveness of the policy implementation.

Fourth, the mention of risks was evidently more prominent in this latest document than before. This is consistent with other government documents since the 18th National Congress. However, the huge amount of cost incurred for risk control in the last few years has led many to reconsider the nature and extent of "risk" that would be inherent in their business endeavours.

TABLE 1 FREQUENCIES OF SELECTED WORDS IN THREE GOVERNMENT DOCUMENTS ON PRIVATE SECTOR DEVELOPMENT

Key Words/Document Issuing Year	2005	2010	2023
Market (市场)	26	28	18
Party (党)	2	1	11
Government (政府)	25	20	8
Guide (引导)	12	28	23
Support (支持)	32	31	31
Law (法) and Rule (规)	126	33	63
Finance (金融/融资)	21	19	7
Public finance (财政)	1	4	1
Risk (风险)	2	4	7
Property right (产权/财产)	7	9	12

Note: The 2005 document is titled "Several Opinions on Encouraging, Supporting and Guiding the Development of Individual and Private Sectors and Other Non-public Economy", issued by the State Council on19 February 2005 (available at https://www.gov.cn/zwgk/2005-08/12/content_21691.htm, accessed 14 August 2023). It has 7,035 words in total. The 2010 one is titled "Several Opinions on Encouraging and Guiding the Healthy Development of Private Investment", issued by the State Council on 13 May 2010, (available at https://www.gov.cn/zhengce/content/2010-05/13/content_3569.htm, accessed 14 August 2023). It has 5,866 words in total. The latest is titled "Opinions on Promoting the Development and Growth of the Private Economy", issued jointly by the Central Committee of the Communist Party of China and the State Council on 19 July 2023 (available at https://www.gov.cn/zhengce/202307/content_6893055.htm, accessed 19 August 2023). It has 6,761 words in total.

MARKET RESPONSES AND CHALLENGES

The rapid expansion of a vibrant private sector contributed significantly to the success of China's post-1978 reform and economic development. Today, to help revive the Chinese economy, it is essential to address the 'confidence crisis' of the private sector and to support private businesses with adequate incentives and financing assistance. Numerous challenges and contradictions remain.

The first is the conflict between national security consideration and perceived excessive development of private capital. The economic role and contribution of the private sector have been acknowledged and gradually accepted following Deng Xiaoping's "black cat white cat" analogy. By including private property in the constitution, the rights of the private sector have also been recognised. However, the profit accumulation enjoyed by private business owners may be seen as inconsistent with the government's "common prosperity" goal. The potential monopolist power and influence of wealth associated with the expansion of private capital have also raised concerns for the Chinese government.[6]

The second is the misalignment of governments' objectives across regions and at different levels. As local governments' access to resources differs considerably, their relationships with private sector at their localities vary. Some local governments heavily rely on private enterprises for tax revenues while the private sector may not be as important to the central government or to some state-dominated regions.

The third is the conflict between the government's long-term development strategy and private enterprises' short-run operation. A policy agenda with a good long-term target might be ill-suited for small firms, which are often private firms. For example, regulations on environment protection will raise the production and operation cost for most manufacturing businesses, which can be crucial for the survival of some private enterprises at this juncture.

The fourth is the business difficulties that may arise from some government policies for private firms. One example is the central government's deleveraging campaign, while desirable, has made it more difficult for the private sector to access cheap financing. During difficult times, China's private sector needs huge low-cost funding, which is available to private sector only in a loose financing environment. According to data released by the People's Bank of China (PBOC) on 11 August 2023, the year-on-year growth of aggregate financing stock was 8.9% in July 2023, lower than the 9% of the previous month. This deceleration is due mainly to significant fall in mid- and long-term bank loans by households and enterprises.[7]

On the other hand, year-on-year growth of bill financing and loan from non-bank financial institution were a respective 15% and 47%, both significantly higher than the previous month of -203% and -18%. These short-term financing are more expensive than bank loans and used more by private businesses than SOEs or foreign invested companies. At the same time, the private lending composite rate increased from 13.76% to 14.92% even though interest rates of bank loans have been decreasing in 2023, indicating a lack of access to bank loans by the private sector. The increase in lending costs for private sector is very likely an important reason for the fall in borrowing.

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[6] For more details, please refer to https://www.gov.cn/xinwen/2020-12/27/content_5573663.htm, accessed 29 August 2023.

[7] https://www.reuters.com/business/finance/china-july-new-bank-loans-tumble-credit-growth-weakens-further-2023-08-11/, accessed 15 August 2023.

The situation has been compounded by the central government's efforts to deleverage that started in 2018.[8] Until most recently, the PBOC was still abiding by a "prudent monetary policy".[9] While this is reasonable, given the high debt level of China's local governments, their financial affiliates and the real estate sector,[10] it also implies that the lack of financing for the private sector may not go away soon.

These contradictions and the resulting weaknesses in the private sector have placed downward pressure on the economy. To regain economic momentum, these conflicts would need to be eradicated before any policies can effectively stimulate the development of China's private sector.

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Best regards,
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National University of Singapore

8 https://www.bloomberg.com/opinion/articles/2022-11-28/china-s-debt-pile-deleveraging-campaign-four-years-on, accessed 11 August 2023.

9 https://www.reuters.com/world/china/china-will-keep-yuan-basically-stable-step-up-macro-policy-adjustments-pboc-2023-06-30/, accessed 11 August 2023.

10 https://www.nytimes.com/2023/07/08/business/china-debt-explained.html, accessed 11 August, 2023.