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China's economic reforms will give a boost to the private sector

Words backed by action will make the private sector more competitive with state-owned enterprises

Topic | Invest China

China's efforts to create a more balanced economy built on sustainable growth are leading to changes that include allowing private investment in new sectors, experimenting with new policies in free-trade zones, easing investment through trade agreements and cutting red tape.

"China has always been protective of what it labels as strategic centres [energy, telecommunications, utilities and finance] in the past", says Albert Park, director of the Hong Kong University for Science and Technology, for emerging market studies.

Areas that encompassed "natural monopolies [such as electricity distribution] and sensitive industries [such as broadcasting]" were left to be dominated by state-owned enterprises (SOEs), says Daniel Rosen, co-founder of Rhodium Group, a New York-based research partnership and a 20-year China economic analyst.

Such protection served "to cultivate domestic firms as market leaders", notes Julian Evans-Pritchard, China economist at Capital Economics. At the same time, protected companies often "saw inferior productivity growth relative to international competitors as a result", Rosen says.

As China shifts towards a more consumer-oriented economy, increased competition leads to changes that affect private domestic and foreign companies as deeply as they impact consumers. "The impetus is greater efficiency, productivity and sustainability, and better management of national fiscal obligations," Rosen adds.

Some sectors call out for great foreign investment. Because "the majority of hi-tech medical equipment is imported, in order to operate sustainably, greater access to this sector by private capital is needed, if not required", notes Maria Kotova, a senior associate in the international business advisory department at Dezan Shira and Associates, a specialist foreign direct investment practice.

Reform has come in other ways, as well. "[Premier] Li Keqiang and others are pushing administrative reforms, making it easier to register and to do things without too much red tape," Park notes. "People feel significant changes are occurring."

Other changes cited by Rosen include the “implementation of a consumer-welfare oriented competition policy system, the elimination of direct and indirect subsidies to firms in competitive industries ... and the reduction of barriers to market entry and market exit”.

Not every company and industry will take advantage of these changes equally. “It’s tough these days for Hong Kong firms built on a labour-intensive model, they may just go away or move on to other countries,” Park observes.

Even so, “foreign firms which already have a presence in China and an understanding of the regulatory environment are most likely to register in the zone and take advantage of the changes”, according to Evans-Pritchard. Foreign financial firms operating in the zone and providing services to other companies outside the zone also look set to prosper. Companies that provide data processing, online gaming, shipping and logistics as well as educational services appear to be early beneficiaries, Kotova notes.

Bilateral free-trade agreements (FTAs) such as the one with Australia to permit new investment in the services sector also help, she adds. While FTA’s will continue to have impact, especially a potential deal with the United States, “the gains from bilateral FTA's are likely to be much more limited than across-the-board liberalisation at the domestic level”, Evans-Pritchard says.

Analysts expect the most successful elements of these experiments will become national. “That’s the China model, to experiment in areas and if it works, expand it,” Park notes. “To some extent, the administrative reforms going on everywhere are an extension of what is happening in Shanghai, though not to the same degree.”

Broader changes have already been announced.

Rosen suggests that words backed by action will make the private sector more competitive with state-owned enterprises. “Non-state firms have been at a disadvantage for so long that SOEs need to be visibly pulled back from market dominance, not just told they are on a level playing field with private firms.”

Park suggests that changes in fields that open up to private domestic and foreign firms come quickly when new entrants emerge. If China “wants to open up those sectors, people will come, they know what to do if they are allowed in”.

Evans-Pritchard emphasises the positive impact of private companies for consumers and businesses. He suggests that competition “would either force state firms to improve efficiency in order to maintain market share or result in an increasing share of assets being directed to the private sector”. Either way, the economy wins.

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