

CHINA PRIORITISING QUALITY OVER QUANTITY IN DRIVE TO GENERATE SUSTAINABLE ECONOMIC GROWTH

I embraced an opportunity early this year to visit Beijing for a conference, whose participants included representatives of leading national regulatory bodies and think tanks, corporate executives, and industry experts and academics. It was clear that while China is set for lower economic growth this year, this decrease represents a welcome central government focus on creating a cleaner, more efficient economy.

China's Drive for Quality over Quantity

The consensus among many government officials and private sector economists at the conference was that China will experience a somewhat lower growth rate in 2018. This reflects the Chinese government's desire to meaningfully improve the national quality of life by carefully applying the growth brakes.

Key deceleration factors could include somewhat higher interest rates, and cutting new infrastructure investments that may not be necessary at this juncture. There will likely be a shift away from spending in coal and steel toward investments in the environmental arena, which I believe is a good tack to take.

Of course, one of the challenges in driving forward is that China needs to transform the relationships between central and local governments to further eliminate structural corruption and translate national goals into effective action.

For example, the central government has traditionally presented local governments with growth targets but without providing ideas or wherewithal to get things done. Strapped for funds and having limited tax bases, too many local governments have turned to the shadow banking system, exposing them to conflicts of interest and potential corruption. Another area of corruption would typically be in real estate development, where local governments have played key roles in planning.

So, it seems that the Chinese government will do more than just set targets, getting more involved in the process of setting and implementing policies at the local level as part of a focus on better economic progress.

Financial Reform

The government looks to drive financial reforms in two key respects. One is to tackle the nonperforming loans of small local banks, which essentially means dealing with assets that are not proving sufficiently profitable. The other is to address shadow banking. So far, asset reforms have progressed quite

well in the coal, steel, and some other sectors beset by overcapacity. Reforms with small banks and shadow banking should prove fruitful if the government influences local policy processes.

Addressing the Environment

In a panel discussion on the environment, panelists noted that a factor in environmental improvements has been central government successes in reducing overcapacity in coal and steel, which has pushed up prices for these commodities, forcing businesses to consume them more efficiently. The central government message to companies is that the quality of the environment does matter, and profligate pollution is no longer tolerated.

The prime environmental issues in China are air, water, and soil pollution. Japanese companies can offer some assistance with filtering technologies for ameliorating air and water pollution, stemming from Japan having to overcome its own environmental damage in the 1960s and 1970s. Materials companies in Japan, for example, can offer a range of environmental solutions, while plant engineering construction firms have a lot of experience in minimizing the ecological impacts of factories and other big-ticket facilities.

Then there are large Japanese companies with production experts on the ground in China, devoting considerable energies to guiding production partners through implementing and maintaining processes that are efficient and environmentally friendly.

One challenge for Japanese providers of technology to date has been that their offerings have often been over-engineered and over-priced from Chinese perspectives. To cite an example of a steel plant a decade ago, the Japanese could offer a technology that would cut nitrogen oxide emissions by 99%. But the plant chose one that delivered a 95% reduction, at a lower price. However, times are changing. With China's central government becoming much tougher on pollution these days, local companies will likely need the high-end environmental solutions that Japanese players are well placed to provide.

It seems evident just by looking around that the environment is changing for the better in China. For example, representatives at the conference said that the number of "blue sky" days in Beijing had increased around 60% over the previous year. That was also my experience, as the Beijing atmosphere during my visit this year was far clearer than a year earlier on a previous visit. It is worth noting a report by

chinanews.com late last year quoted a Ministry of Environmental Protection report that stated that the average density of fine particulate matter (commonly called PM 2.5) had dropped around 23% on October and November in Beijing, Tianjin, and 26 other large cities around China.

I well remember Japan's bitter experience with pollution in my youth, which is not all that long ago. So, positive signs in China give me confidence that its environment can become much better in the years ahead.

In fact, the central government's role in that improvement may result in far faster improvements than Japan itself experienced. In Japan, manufacturers spearheaded the drive for a cleaner environment. The national government was, in many senses, an observer. One weakness of Japanese companies in the improvement effort was that they all took different approaches to resolving environmental issues. That resulted in some disparate technological standards that are great individually but could be challenging to market and probably need some packaging. I suspect that a top-down approach would have been far more efficient in Japan and that China will probably progress well in keeping with central government standards.

I mentioned earlier that Japanese environmental solutions providers can certainly offer some great technologies to Chinese companies going forward, through production engineering, filter technologies, and other capabilities in capital goods-related areas. As Chinese companies become increasingly clean and seek to translate environmentally-friendly credentials into business opportunities around the world, it is not beyond the realms of possibility for Japanese players to collaborate in production processes. But it also remains to be seen whether Japanese companies will put in the effort they need to generate business.

Electric Vehicles

One field in which I think Japanese, American, and German players have more immediate business opportunities is the electric vehicle market in China.

I visited several domestic automobile manufactures during my trip. I found that none were as interested as expected in electric vehicles despite strong government interest in progress. That is because these companies believe that it will take time to move forward, with hybrid vehicles being more practical technically at this juncture. There are, after all, limits to government power. It could assist a shift to electric vehicles by, for example, installing a charging infrastructure, but that is about it for now. So, foreign electric vehicle makers do enjoy a technological edge, and I would be interested to see how they can capitalise on that position while the priorities of Chinese automakers remain elsewhere.

Economic Disparity

Another takeaway from my trip was the economic disparity that I noticed between Beijing and the countryside. It is clear that it will take China a significant amount of time to eliminate that gap. But therein opportunities should emerge, as indeed they may through China's Belt and Road Initiative, a

development strategy that extends infrastructure-driven efforts within China to encompass economic development in countries throughout Eurasia and parts of the Middle East. The initiative should deliver broad-based economic and political benefits for China and its partners in the decades to come.

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