China Boosts State Firms As Entrepreneurs Struggle

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ZHANJIANG, China (AP) — Reformers say China needs more entrepreneurs like Liu Peijian. His chain of six furniture stores employs 60 people. But Beijing's response to the deepest economic slump since the 2008 crisis is to pump money into state industry, leaving businesspeople like Liu who create jobs to fend for themselves.

Across town from Liu's office is a project that exemplifies China's mini-stimulus: A 69.6 billion yuan ($11 billion steel) mill being built by a government company and financed by state-owned banks that lend little to the private sector. It will employ 5,000 people — or one job for each $2.2 million of investment.

"We get no government help," said Liu, as his office air conditioner struggled against the muggy heat of this southern city. "But we're a small company, and small companies shouldn't bother the government."

Spending like that of Baosteel Group, owner of the Zhanjiang mill, is expected to help push up economic growth later this year. But the emphasis on state industry that creates few jobs will come at a longer-term cost, setting back efforts to reduce reliance on investment and generate self-sustaining growth powered by consumer spending.

The strategy will further entrench subsidy-guzzling government companies that dominate industries from oil to telecoms. That might hamper reforms the World Bank and others say are needed to keep the economy growing by curbing state industry and nurturing free-market competition and more dynamic private companies.

"When the economy gets into trouble, all those good intentions get thrown out the window, and we revert to Plan A, which is always to encourage more investment and ensure that funds keep flowing to state-owned companies," said Mark Williams, chief Asia economist for Capital Economics.

Beijing has cut interest rates twice since the start of June and reduced fuel prices as it tries to buoy growth that declined to 8.1 percent in the first quarter. It has promised more spending on low-cost housing, airports and other public works. That will pour money into state-owned construction companies and suppliers of steel and cement.

Baosteel's Zhanjiang mill is one of a series of industrial projects the government approved in May as stimulus measures after previously blocking them to prevent overinvestment in unneeded facilities. State-owned Wuhan Iron & Steel Group also received approval for a new mill state media say will cost more than 60 billion yuan

($9.5 billion).

Both are to be financed by state banks, which still channel at least 80 percent of lending to state companies despite China's three decades of market-oriented reforms and the growth of private business that has driven its economic boom.

Leaders including Premier Wen Jiabao have promised to help the private sector with more bank lending and other measures, but entrepreneurs say they have yet to see changes.

"I have never been able to get a bank loan," said Deng Mingxin, owner of a company in Changshu, a city northwest of Shanghai, that makes components for zippers. He said state companies appear to get credit easily while bank employees expect bribes to approve loans for private borrowers.

Deng's workforce has shrunk by two-thirds to 10 people over the past six months as employees left after wage hikes of up to 30 percent failed to keep pace with rising living costs. He said he is considering moving to lower-cost Vietnam.

"I am disappointed at the situation in China," he said. "This is unfair."

Today's state companies and their relationship to the private sector have changed drastically from the era of central planning.

Beijing cut back state industry in the late 1990s, wiping out tens of millions of jobs. Then a new generation of leaders began in 2005 to build up elite companies such as oil giant PetroChina Ltd., phone carrier China Mobile Ltd. and Bank of China Ltd. to control industries deemed strategic.

State companies benefit from monopolies, low-cost bank loans, free land and other favors. Instead of competing with private companies, state firms extract money from them by controlling access to oil, electric power, phone service and other essential resources.

Communist leaders say China needs big companies that can compete globally. But the system also serves a political goal by providing a source of jobs and money to reward the party's supporters and keep it in power in a rapidly changing society.

Beijing's 4 trillion yuan ($586 billion) stimulus in response to the 2008 crisis added to the growth of state industry. Government-owned construction and other enterprises received the bulk of that while thousands of small manufacturers and other private companies went bankrupt.

State industry growth also has been driven by official directives that say companies in steel, energy and other industries deemed strategic must have at least 50 percent government ownership. In some cases, private entities were forced into being acquired by state companies.

Estimates of the portion of the economy controlled by non-private companies range from 30 percent to as much as 50 percent if entities such as worker cooperatives are included.

State industry's vast wealth — and high pay for executives who are political appointees, not risk-taking entrepreneurs — is fueling public resentment.

The top tier of 119 state companies directly controlled by the Cabinet received subsidies worth an estimated 7.5 trillion yuan ($1.2 trillion) in 2001-09 in the form of low-cost land, bank loans and other resources, according to the Unirule Institute of Economic Research, an independent group in Beijing.

"People are gradually becoming aware that state-owned enterprises are inefficient and unfair institutions that occupy the people's resources to serve their own circle," said Unirule director Sheng Hong.

"The high levels of government and the ruling party increasingly recognize this," Sheng said. "On the other hand, state-owned enterprises are a huge interest group. They have a lot of political influence and money."

Zhanjiang, in Guangdong province, the heart of China's export-driven manufacturing industries, reflects the conflict between the Communist Party's need for a robust private sector and its determination to build up state-owned companies.

The backbone of the local economy is private factories that employ thousands of people making furniture and traditional Chinese medicines or processing seafood.

Liu, who named his company Yi Pian Hong after a 1960s postage stamp that shows communist radicals holding aloft Mao Zedong's Little Red Book, expects this year's sales to be comparable to 2011. That is better than some competitors, but below the 20 to 40 percent annual growth his 5-year-old company is used to. The company pays for its financing needs out of revenues or credit from suppliers.

"Certainly, it's hard to get a bank loan," Liu said.

At another furniture company, a manager said sales might be down 10 percent due to government curbs on housing sales that were imposed to cool surging prices. He asked not to be identified by name because he was not authorized to speak for his company.

The local branch of China's central bank said a survey of small businesses in Zhanjiang found 90 percent reported cash shortages or trouble credit.

Despite the prominence of private industry in Guangdong, only 12 percent of its bank lending goes to entrepreneurs, according to a speech by the province's deputy party secretary, Zhu Mingguo, reported by a party newspaper.

"The bigger state-owned companies can stay afloat because they have access to finance, and that means that they have a huge competitive advantage," said Williams. " So whether it just involves them taking market share or outright taking over the smaller firms, the result is, they come out the other end in a much stronger position."