The People's Republic of China is exporting industrial capacity and financial risk

As the People's Republic of China — the PRC — develops its "Go Global" suite of policies, it has expanded international capacity cooperation as a way to adjust to the "new normal" of low industrial growth.

It's a novel approach to overcapacity — where an industry is capable of building or producing more than it can sell — which was caused in the PRC by the 2008–2009 spending stimulus that flooded traditional industries. Steel, cement, aluminum, paper, glass, and everything from pork production to robots are in 2017 overwhelmed by cyclical overcapacity.

Extending the lifespan for reform in the PRC's industrial economy by moving production offshore from industrial-policy-protected provinces into the global system is an innovative solution to the country's industrial slowdown.

But the financial ramifications of continuing to avoid standard accounting and competition principles mean the bitter pill is yet to be swallowed. The PRC is not booking surplus production against foregone revenue and profit, and plant and machinery are idle.

It is not a guarantee for the PRC's industrial investment architecture.

The underlying financial structure of the PRC's export of excess industrial capacity to strategic partners in Africa, Eurasia, and South America is essentially untried. As the PRC struggles to audit its own local government debt, there could be serious financial risk in the export of industrial capacity.

International capacity cooperation projects are supported through dedicated funds such as the Silk Road Fund, the China–ASEAN Investment Cooperation Fund, the China–Latin American Fund, the China–Africa Industrial Cooperation Fund, and others. These funds range from two billion dollars to 40 billion dollars in capital stock. As infrastructure investment funds, they leverage the PRC's enormous foreign exchange reserves to offshore state-driven investment.

The People's Bank of China, the State Administration of Foreign Exchange, and the China Investment Corporation distribute funds through the policy banks—the China Development Bank, Export Import Bank of China and Agricultural Development Bank of China—and the big-four commercial banks.

These direct state investment to industrial plants offshore.

Projects exist or are planned for continental Africa, South America, Eurasia, Europe, and members of the Association of Southeast Asian Nations, and are often promoted under the "Belt and Road" strategy being pushed by Beijing as a means of soft diplomacy.

State-owned enterprises, such as the China Railway Group and China Railway Rolling Stock Corporation, are active in developing industrial economies; the China Nuclear General Group and Hualong International Nuclear Power are in developed economies.

The first major capacity cooperation plan was issued to lower levels of government in May 2015 through the State Council's Guiding Opinions on the Promotion of International Capacity Cooperation and Equipment Manufacturing, aiming to build on the PRC's existing capabilities.

The document outlined 12 key sectors for cooperation: steel, nonferrous metals, construction materials, railways, electricity, chemicals, textiles, automotive, information and communications technology, engineering machinery, and aerospace and marine engineering.

Within 15 months, official Ministry of Commerce statistics were showing nonfinancial overseas direct investment stood at 130 billion dollars for the first three quarters of 2016, with outward investment in the equipment manufacturing sector recording a 350 percent year-on-year increase.

Provincial governments are the principal state actors in the international capacity cooperation policy. The National Development and Reform Commission is coordinating capacity cooperation and has signed agreements with Hebei, Hubei, Shandong, Jiangxi, Anhui, Gansu, Yunnan, Jiangsu, Henan, Sichuan, Liaoning, and Guangxi to develop cooperation mechanisms.

For example, Jiangsu is paired directly with the China Development Bank and matched with Indonesia, Cambodia, Ethiopia, and the Russian Federation for offshore industrial clusters in engineering machinery, rail transportation, new energy, shipbuilding, and marine engineering.

Gansu is using the China–Africa Development Fund and to pair with Iran, Zimbabwe, Ghana, Indonesia, and Thailand on production chains in mineral resources, textiles, nonferrous metals, traditional energy, and photovoltaic energy.

The strategy lets the PRC export capital goods and import consumer goods without having to open its markets to foreign competition. Middle- and low-income developing countries benefit from capital investment and technology transfer.

It is not a solution to the PRC's economic problems, but it does buy some breathing space while the central authorities deal with local government debt and sort out problems with its own chronic overcapacity.

This was based on a blog post by Tristan Kenderdine, research director at Future Risk, and a PhD candidate in political science and international relations at the Australian National University, Crawford School of Public Policy.

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