POLICY BRIEF

Assessing the Impacts of Excess Capacity

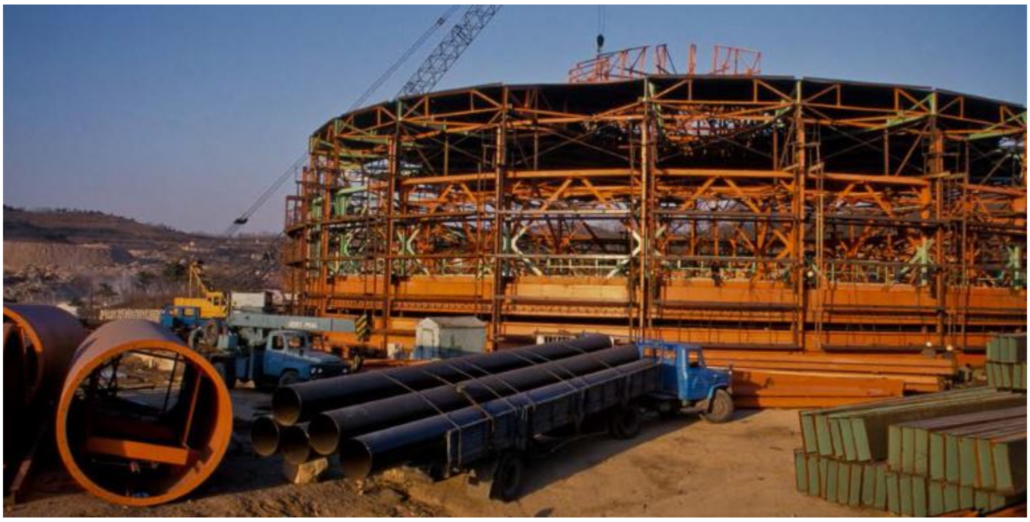


Photo credit: Raul Del Rosario/ADB.

An analysis of excess capacity in the People's Republic of China looks at the factors that contributed to overinvestment in manufacturing.

Introduction

Since the 1990s, manufacturing in the People's Republic of China (PRC) encountered several rounds of excess production capacity. To address this issue, the government has taken a series of measures over time in the areas of administrative management, industrial development policies, environmental regulations, and monetary policies.

During 2007-2013, managing excess capacity was flagged as one of the key government tasks at each of the annual central economic work conferences. At the conference in December 2013, the government clarified that capacity utilization in the steel, cement, aluminum, plate glass, and shipbuilding industries were all below 75%, and decided to bring capacity utilization back to normal.

Four options for this were proposed:

1. boosting domestic demand to absorb excess capacity
2. boosting external demand through a "go global" strategy
3. using mergers and acquisitions to reduce excess capacity through consolidation

4. strengthening and better enforcing environmental and energy efficiency standards to eliminate some capacity.

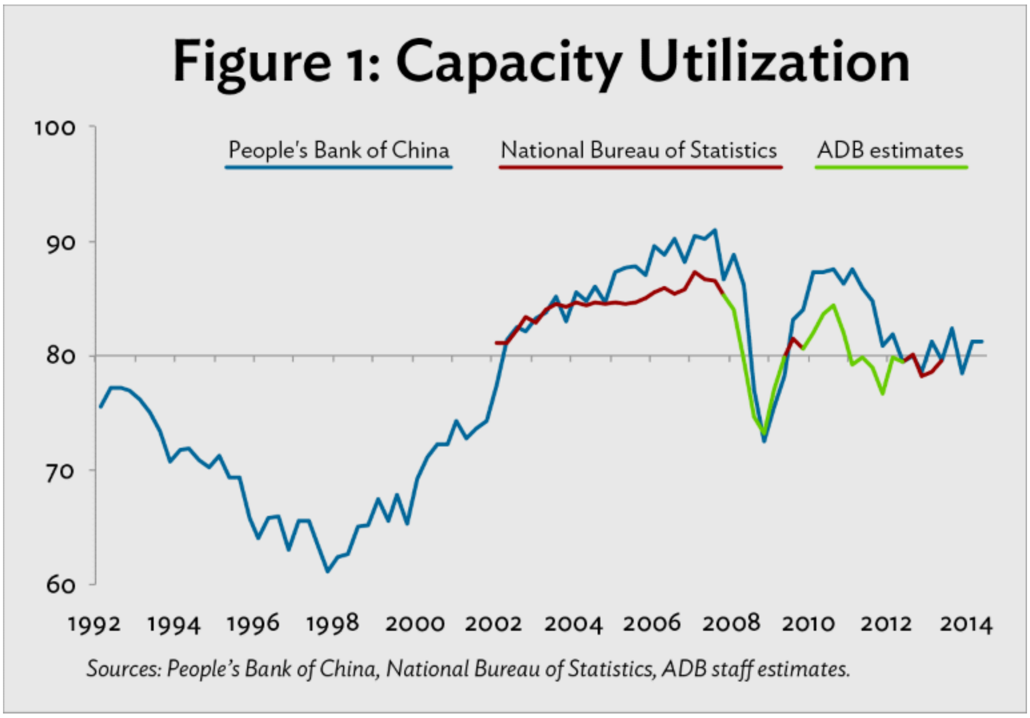
Although there is no consensus on the definition of excess capacity and how to measure it, historical data for the US (1967-2013), 17 Eurozone countries (1991-2013), Japan (1978-2013), Korea (1988-1998), Brazil (2005-2012) and Taipei,China (1981-2007) suggests that the normal capacity utilization rate is between 79% and 83%. A level of capacity utilization above 90% then implies capacity shortage while below 75% implies significant excess capacity.

This policy brief is based on a consultant's report, entitled Knowledge Work on Excess Capacity in the People's Republic of China, published by the Asian Development Bank.

lysis

Capacity utilization estimates by various organizations

Quarterly data from the People's Bank of China (PBOC) and the National Bureau of Statistics (NBS) shows that the PRC's manufacturing sector suffered from low capacity utilization (below 79%) during the second quarter (Q2) of 1992 and the first quarter (Q1) of 2002, and between Q4 2008 and Q4 2009, with average capacity utilization rate at 69.6% and 75.8%, respectively (Figure 1). Capacity utilization between Q1 2013 and Q1 2014 (Figure 1) stood at 80% on average for manufacturing in total, close to the minimum of the range that can be seen as normal.



As there are gaps in NBS reporting about capacity utilization and the PBOC publishes its data with a time lag, we estimate capacity utilization with the growth rates of industrial value-added (VA) and the producer price index (PPI) as independent variables; this approach is based on experience in the US and 17 Eurozone countries. Industrial value-added growth, PPI, and capacity utilization are obviously closely correlated (Figure 2 and Figure 3).