

# Exploring "China's Partial Overcapacity" and Domestic Demand Insufficiency from an Accounting Perspective

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## Abstract

**This paper analyzes the reasons for weak consumer demand and insufficient investment demand, pointing out that slow growth of income level, lack of consumer confidence, and poor investment environment are the main factors leading to insufficient domestic demand, and discusses the identification and treatment of overcapacity from the perspective of accounting information, emphasizing the role of accounting standards in the recognition of losses, impairment of assets, and profit allocation. At the same time, this paper analyzes the impact of accounting policies on domestic demand, including tax policies, changes in accounting standards and transparency of financial reporting, etc., and in response to these issues, it proposes strategies such as adjusting relevant macro policies, taking countermeasures at the enterprise level, improving the relevant accounting system arrangements, and strengthening the supervision and risk prevention mechanism, etc., and concludes that industrial structural adjustment and policy support are the key to solving the problems of overcapacity and insufficient domestic demand. It is also believed that industrial structure adjustment and policy support are the key to solve the problems of overcapacity and domestic demand shortage.**

## Keywords

**Accounting perspective, domestic demand deficit, overcapacity.**

## 1. Introduction

In the course of China's economic development, whether overcapacity and insufficient domestic demand has become a long-standing problem. This problem affects the healthy development of the economy and restricts the rational allocation of resources and the enhancement of market competitiveness. In particular, under the accounting perspective, is there overcapacity in China? What form of overcapacity? These issues are directly related to the survival and development of enterprises and the economic order and stability of the whole society. This study aims to analyze the status quo, causes and influencing factors of the problems of overcapacity and insufficient domestic demand in China from the accounting perspective, and to provide theoretical basis and decision-making support for the formulation and implementation of relevant policies, with the core objective of analyzing the inner connection and law of the problems of capacity-related and insufficient domestic demand in China from the accounting perspective.

## 2. Analysis of "China's Overcapacity Theory" and Domestic Demand Insufficiency from Accounting Perspective

### 2.1. Analysis of whether China has excess capacity

Measures of overcapacity usually include capacity utilization, the affluence of production capacity, and the relationship between market demand and supply, etc. When capacity utilization is below normal, it indicates that a firm has overcapacity, when a firm's production capacity is much higher than its market demand, the risk of overcapacity increases, and overcapacity occurs when the growth of market demand slows down while supply continues to increase <sup>[1]</sup>.

#### 2.1.1. Depreciation of fixed assets and capacity utilization rate

According to international accounting standards, the depreciable life of manufacturing equipment is usually 8-10 years, while the average useful life of equipment in Chinese industrial enterprises is close to 8 years, and the aging of equipment in some industries is prominent (e.g. steel and cement). If companies do not update their equipment in a timely manner, the actual capacity of book assets may be lower than expected, leading to a decline in capacity utilization. For example, China's industrial capacity utilization rate will be 76.2% in 2023, lower than the historical pivot level (about 78%-80%), and the capacity utilization rate of some industries, such as computers, communications and electronics, and chemicals, is even lower than 70%. This indicates that there is structural overcapacity in some industries.

#### 2.1.2. Mismatch between inventory turnover and market demand

Inventory turnover in industries with excess capacity (e.g., steel, photovoltaics) is chronically low, reflecting serious inventory backlogs<sup>[2]</sup>. For example, in 2012, China's steel industry had a 21% overcapacity and PV cells had a 95% overcapacity, significantly increasing the risk of inventory impairment in corporate financial statements. In addition, the low ratio of exports to production capacity (e.g., exports of new energy vehicles accounted for less than 10 percent of production) further exacerbates the pressure on domestic inventories.

#### 2.1.3. Government subsidies and inflated asset values

Local governments have promoted enterprise investment through tax incentives and land subsidies, resulting in a disconnect between the book value of some enterprises' assets and their actual profitability. For example, the photovoltaic industry blindly expanded production under the stimulus of policies, and eventually formed excess capacity due to the fall in global demand, which inflated the fixed assets and construction-in-progress accounts in the balance sheets of enterprises.

#### 2.1.4. Comparison of international accounting standards

The capacity utilization rates of the United States and the European Union are 72% and 75% respectively, which are close to that of China (76%), but the overcapacity in some Chinese industries (e.g., iron and steel, cement) has long-term and structural characteristics. For example, China's iron and steel production capacity exceeds demand by 120 million tons, and electrolytic aluminum has a surplus of 35%, while such industries in Europe and the United States have completed capacity clearing through market-based adjustments.

From an accounting perspective, the problem of overcapacity in some industries in China is structural in nature, manifesting itself in low utilization of fixed assets, insufficient inventory turnover and inflated assets. To solve this problem, it is necessary to combine the optimization of accounting standards, the enhancement of financial disclosure and the guidance of market-oriented policies. At the same time, it is necessary to distinguish between "absolute overcapacity" and "phased overcapacity". For example, although there is short-term capacity expansion in the new energy industry, it is in line with the needs of the global green

transformation in the long term, and it is necessary to digest the capacity through technological innovation and international cooperation.

## **2.2. Analysis of China's domestic demand deficit**

The lack of domestic demand is an important feature of the current global economic situation, which is mainly reflected in the weakness of consumer demand and investment demand. Examined from an accounting perspective, the overcapacity faced by China is closely linked to the problem of insufficient domestic demand, and the lack of consumption growth reflects the limited nature of the increase in residents' incomes, which restricts the expansion of domestic demand; at the same time, the instability of the investment environment, which is subject to the double impact of economic structural adjustment and overcapacity, has further inhibited the willingness of enterprises to invest. Industrial restructuring has also fallen into a stage of difficulties, with heavy pressure on the transformation of traditional industries, while the development of emerging industries is not yet mature enough to support economic growth. This series of problems was reflected in the financial data in the form of slowing revenue growth, declining asset turnover and possible asset impairment risk.

## **3. Accounting Perspectives on Overcapacity and Domestic Demand Deficiency from Multiple Perspectives**

### **3.1. Accounting information and overcapacity identification**

From the perspective of inventory information, accounting provides enterprise management with comprehensive feedback on the current status of inventory, trends in changes, and potential risks by accurately recording the quantity, amount, and changes in inventory of goods or raw materials. This helps management to understand the inventory status in a timely manner, rationally control inventory levels, and avoid inventory backlogs and waste.

In terms of sales information, accounting analyzes in-depth the market demand and supply relationship by counting sales revenue, sales volume and other data, providing management with a comprehensive view of the current status of sales, development trends and potential opportunities. Through the above system, the management can keep abreast of the market dynamics and grasp the changes in consumer demand, so as to formulate more accurate market strategies and marketing tactics.

Finally, considering the cost information perspective, through comprehensive accounting of production costs, including raw materials, labor, manufacturing costs, etc., the accountant will provide the management with a detailed analysis of the cost composition, change trends, and optimization space, which will facilitate them to understand the cost structure of the enterprise, discover the weaknesses of the cost control, and take corresponding measures for improvement. Enterprises can optimize the production process, improve production efficiency, reduce raw material costs, etc., to reduce production costs and improve the profitability of the enterprise under the premise of ensuring product quality and performance.

### **3.2. Accounting standards and excess capacity treatment**

In the context of overcapacity, accounting standards are particularly important for the treatment of enterprises' financial situation. In the following, the loss recognition standard, the asset impairment standard and the profit distribution standard will be elaborated to reveal how accounting standards affect the financial treatment of overcapacity by enterprises.

#### **3.2.1. Loss recognition guidelines**

When an enterprise suffers losses due to overcapacity, it should recognize the losses in accordance with the law to ensure the authenticity of the financial information. According to China's new accounting standards, asset items such as inventories, financial assets and

investment properties need to be valued using the fair value or effective interest rate method to reflect the true value of the assets. When the value of these assets declines, enterprises should make corresponding asset impairment provisions to hedge risks and adjust profits.

### **3.2.2. Guidelines on impairment of assets**

Overcapacity will lead to a decline in the value of assets, and enterprises should make provisions for asset impairment to reflect the true value of assets. China's new accounting standards impose strict regulations on the provision and reversal of asset impairment to control the profit fluctuation of enterprises. For example, the new standard has made significant changes to the accounting method for long-term equity investments, adopting the cost method of accounting for subsidiaries, so that the book profit or loss of subsidiaries, which could have been recognized as "investment income", can no longer be recognized. The updated changes in the standard are conducive to reflecting the long-term operation of enterprises and improving the accuracy and transparency of financial information.

### **3.2.3. Profit-sharing guidelines**

When dealing with changes in profits due to overcapacity, enterprises should comply with the profit distribution policy to ensure that shareholders' rights and interests are protected. The new accounting standards have changed the valuation of asset items such as inventories, financial assets and investment properties, making it possible for the profits of enterprises to fluctuate greatly in the short term. In order to safeguard the interests of shareholders, enterprises should formulate a reasonable profit distribution plan and strengthen the supervision and management of the profit distribution process.

## **3.3. Analysis of the impact of accounting policies on domestic demand**

As an important means for the government to regulate the economy, accounting policy has a significant impact on expanding domestic demand and promoting economic growth. The three key aspects of tax policy, changes in accounting standards and transparency in financial reporting will be analyzed in detail below.

### **3.3.1. Tax policy**

Tax policy occupies an important position in accounting policy, and it has a significant role in reducing the burden of consumers and stimulating the growth of domestic demand. Government departments can adopt policy instruments such as tax incentives and tax exemptions to guide enterprises to increase investment in research and development, improve product quality and competitiveness, so as to promote industrial upgrading and structural adjustment, and they can utilize tax instruments to regulate the distribution of income, raise the income level of residents, and further stimulate the demand for consumption.

### **3.3.2. Changes in accounting standards**

Changes in accounting standards may have far-reaching impacts on business operations, which in turn may affect consumer confidence and expectations. For example, changes in certain accounting standards may lead to fluctuations in corporate profits or recapitalization, thus affecting the profitability and growth prospects of enterprises. How to cope with such changes? This requires that enterprises need to pay close attention to the dynamics of accounting standards and make timely adjustments to their business strategies in order to maintain a sound development posture. Enterprises should also strengthen internal control and risk management, improve the accuracy and transparency of financial reporting, and enhance consumer trust.

### **3.3.3. Transparency in financial reporting**

Transparent financial reporting can provide accurate and comprehensive financial information, which is one of the keys to increasing consumers' trust in enterprises, and is conducive to

consumers' better understanding of the economic situation, profitability and development prospects of enterprises. Enterprises can establish a sound internal control system to ensure the accuracy and completeness of financial reporting, and should also strengthen external auditing and supervision to improve the credibility of financial reporting.

## **4. Coping strategies and recommendations from an accounting perspective**

### **4.1. Direction of macroeconomic policy adjustment and optimization**

#### **4.1.1. Deepening supply-side reforms**

The Central Economic Work Conference emphasized that deepening the supply-side structural reform and implementing the details in the four aspects of "consolidation, enhancement, upgrading and smooth flow" are important tasks in 2025. Specifically, it is necessary to continue to promote the work of "three go, one down, one supplement", optimize the supply structure, improve supply efficiency, reduce ineffective supply and expand effective supply. This will help improve product quality and competitiveness and promote sustainable economic development. Macroeconomic control should be strengthened to stabilize market expectations, guide capital flows and promote stable economic growth by adjusting monetary, fiscal and industrial policies, etc. The above measures will help reduce the comprehensive financing costs of the real economy and stimulate market demand and vitality<sup>[3]</sup>.

#### **4.1.2. Strategies to expand domestic demand and promote stable economic growth**

The Central Economic Work Conference proposed that expanding domestic demand on all fronts would be the key to economic work in 2025. The first key element in determining demand is income, and the government is realizing the goal of increasing residents' disposable income and improving their consumption capacity by boosting residents' income, increasing the income of middle- and low-income groups, raising the basic pensions of urban and rural residents, and raising the financial subsidy standards for urban and rural residents' health insurance<sup>[4]</sup>. And in terms of improving the consumption environment, the two main means of strengthening infrastructure construction and improving the convenience and comfort of consumption will help to reduce the cost of consumption and promote the release of residents' consumption potential.

#### **4.1.3. Strengthening reform and opening-up**

The Central Economic Work Conference emphasized the need to unswervingly promote reform and opening-up, strengthen international economic and trade cooperation, and promote high-quality economic development. Only by steadily expanding systematic opening-up and continuously building the Invest in China brand will it be conducive to enhancing China's competitiveness and influence in the global economic system and promoting mutually beneficial and win-win international economic and trade cooperation.

## **4.2. Enterprise-level responses**

In the current complex and changing market environment, enterprises need to take a series of targeted measures to respond to market competition, technological change and changes in customer demand. This paper will be from the technical innovation, product structure and layout, cost control and capital management of the three aspects, the detailed description of the enterprise level response measures.

### **4.2.1. Strengthen technological innovation and research and development**

Enterprises should actively introduce advanced technology, establish cooperative relationships with industry leaders, and jointly carry out technology research and development, through the introduction and digestion and absorption of international advanced technology, enterprises

can enhance their own technical level and realize leapfrog development, while enterprises should increase R & D investment, establish independent R & D team, independent technological innovation, and the formation of core technologies with independent intellectual property rights. Technology is the first driving force for development, and training innovative talents is an important guarantee for technological innovation, enterprises must pay attention to the introduction of talents, training and incentives, with a view to providing sufficient R & D funds and a good working environment for the innovation team to stimulate the vitality of innovation.

#### **4.2.2. Optimize product structure and layout**

Market demand is in a dynamic environment of constant change and renewal, which requires enterprises to pay close attention to market dynamics and timely adjustment of product structure. According to the market demand and trends, eliminate backward products, upgrade new products, improve product value-added and market share. At the same time, we should pay attention to optimize the industrial layout, establish a reasonable industrial chain and supply chain system, reduce production costs and improve production efficiency. In this way, enterprises can better meet market demand and enhance competitiveness.

#### **4.2.3. Strengthening cost control and fund management**

Cost control and capital management is an important means for enterprises to improve profitability and reduce business risks. Enterprises should establish a sound cost control system to reduce production costs by improving production efficiency, reducing raw material and energy consumption, etc. should also strengthen capital management, establish a scientific capital allocation and risk control mechanism, and ensure the safe and effective utilization of funds. Enterprises will improve profitability, reduce business risks and realize sustainable development in the process of effectively controlling costs, improving cost utilization and strengthening the ability of resource allocation.

### **4.3. Improvement of relevant accounting arrangements**

Driven by the wave of digital transformation, the standardization of enterprise accounting and information disclosure, the effectiveness of cost control, and the rigor of accounting supervision are facing unprecedented challenges. How to deal with these challenges? There are a series of measures that enterprises need to design and apply to ensure the standardization and accuracy of accounting and information disclosure, improve the efficiency of cost control, and strengthen accounting supervision<sup>[5]</sup>.

Standardizing accounting and information disclosure is a key part of enterprises' efforts to improve the quality of financial information, and enterprises should strengthen the standardization of accounting to ensure that accounting records are true, complete and accurate. This includes regular preparation, review and audit of financial statements to ensure the authenticity and reliability of financial information. Enterprises should also strengthen the transparency of information disclosure and disclose timely and accurate information on financial position, operating results and cash flows to meet the needs of investors and stakeholders. Standardizing accounting and information disclosure will improve the effectiveness of accounting information users in utilizing the information, enhance the degree of trust of accounting information users, improve the enterprise's own credibility, and increase investors' confidence in the enterprise.

Enhancing cost-effectiveness and competitiveness is one of the keys to expanding market share and profitability, and enterprises should establish a sound cost control system to monitor and manage costs throughout the process. The establishment of a sound cost accounting system, standard cost system and cost quota system, enterprises can realize the fine management and effective control of costs, enterprises should also strengthen the cost analysis, timely detection

of cost deviation and take measures to correct, in order to improve cost-effectiveness and competitiveness.

Strengthening accounting supervision and law enforcement is a powerful guarantee for enterprises to ensure the authenticity and integrity of accounting information, enterprises should establish a sound accounting supervision mechanism to strengthen the supervision and management of accounting work. For the discovery of financial fraud, fraud and other behaviors, enterprises should be seriously held accountable in accordance with the law, and never condone tolerance, harboring, to ensure the authenticity and integrity of accounting information, pay attention to strengthen self-supervision, the establishment of a sound internal control system, and to improve the ability to prevent risks<sup>[6]</sup>.

## 5. Concluding remarks

In the process of China's economic development, the problems of whether overcapacity and insufficient domestic demand are becoming more and more prominent, which has become an important factor affecting the smooth operation of the economy. In order to analyze this problem in depth, this study comprehensively discusses the relationship, impact and solution of overcapacity and lack of domestic demand from the accounting perspective and in the context of the actual situation. It is found that the problems of overcapacity and insufficient domestic demand coexist and are interrelated, which together have a far-reaching impact on economic development.

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