

THE CPC 18TH CENTRAL COMMITTEE'S THIRD PLENARY SESSION

## ALL-ROUND REFORM

MAIN POINTS ON REFORM AND OPENING UP FROM THE COMMUNIQUE RELEASED ON NOV 12, 2013

Much has come from the third plenum regarding the management of State-owned assets, particularly State-owned enterprises. The reforms are not going to wipe SOEs out of existence, however.

The communique said China's basic economic system is one that depends on public ownership as its main body but allows for the prosperity of various ownerships. Both public and nonpublic ownerships are important components, it said.

Regarding public ownership, represented mainly by SOEs, it said China will continue to strengthen their vigor, their power of self-control, and their influence. For nonpublic sector ownership, such as the millions of privately held small enterprises, the communique said China will provide ample room for their vitality and creativity.

In the meantime, it said, due protection will be provided to cover property rights, to develop a mixed economy (a mix of public and private ownership), to push for a modern enterprise system in SOEs, and to support the healthy development of nonpublic enterprises.

The third plenum did not mention the word monopoly once. However, one of the most frequently mentioned words was "market". It featured 22 times.

"Building a unified but open, orderly and competitive market system will guarantee the market plays a decisive role in the allocation of resources" in society, it said.

On this basis, autonomous management and fair competition can be made possible as well as consumers' free choice and the free flow of goods and services. A major effort is to be made toward this goal, and to knock down the internal barriers holding back progress in efficiency and fairness.

The leadership also called for the further liberation of people's minds and society's productivity by removing defects in all aspects of the system.

The process will be quickened in economic structural reform, to build a more efficient, equitable and more sustainable economy, the communique said.

China must accelerate construction of a new agricultural management system and give farmers more proprietary rights, to realize the equal exchange of production factors, achieve a fair allocation of public resources between urban and rural areas, and promote healthy urbanization, the communique said.

Granting farmers overdue property rights of collective land is a breakthrough, said Pan Jiahua, a researcher on urbanization with the Chinese Academy of Social Sciences, who explained that a land-transfer market becomes conceivable once farmers' proprietary rights are confirmed. This milestone will bring concrete benefits to farmers, lay a foundation for modern agriculture, and pressure local governments to end their reliance on land transfers for large profits, he said.

Li Tie, a researcher on city development with the National Development and Reform Commission, said: "Only by removing institutional restrictions hindering the free flow of economic factors can the potential of healthy urbanization really be released."

China's financial market system will be improved, according to the communique.

Guo Jiaquang, a professor at the Central University of Finance and Economics, said the market, rather than the government, is likely to play a more important role in deciding China's exchange and interest rates. As an effective measure to control the macroeconomy, the exchange and interest rates have long been tightly regulated, he said.

China started to allow banks to decide their own lending rates in July, although deposit rates are still fixed by the central bank. The limit on the deposit interest rate should be lifted step by step to benefit the public, Guo said. A deposit insurance system should be established as soon as possible to prevent banks from malicious competition, he added.

Support will be given to ensure the healthy development of the nonpublic economy, the communique said.

Mei Xingbao, an external supervisor for the Bank of China, said a multi-layered capital market is likely to be cultivated with more private capital.

Competition will be introduced to improve the efficiency of State-owned banks, which have already accumulated large amounts of wealth through financing government-funded projects, he said.

He said it is expected to become easier for small and medium-sized enterprises to get loans from banking agencies after competition is introduced.

State-owned banks tend to resist reform because they have got used to earning money easily through government-funded projects, Mei added.

A scientific fiscal and taxation system is an institutional guarantee to optimize resource allocation, protect the integrity of the market, safeguard social fairness and maintain China's long-term peace and stability, the communique said.

"Although there are few details, this part should contain simplification of tax items and a new tax base for local governments," according to Rui Meng, a professor of finance and accounting at the China Europe International Business School. "Local governments should no longer rely on increment (land transfers) and should shift toward inventory (property tax)."

Minister of Finance Lou Jiwei has previously promised to expand trials of a property tax, while reform of the consumption tax is also in sight. The resource tax on coal and metals, which had been levied by volume, will be calculated on a price basis, he said.

"These three aspects should be part of the tax reform," Rui added.

The communique said: "we must attach importance to legislation, explicitly clarify the duties of governments at various levels..."

Rui Meng, a professor of finance and accounting at the China Europe International Business School, said he believes the central government will withdraw some expenditure duties.

"Previous statements only stressed local government 'initiatives', but this reform is aimed at the long-discussed disparity between local government revenue and spending responsibilities," he said.

"This is a call for curbing reckless borrowing," he continued. "Too often, local governments have invested heavily in redundant projects with very low returns. They should leave most investments — infrastructure, for example — to the market, thus reducing low efficiency and rent-seeking in these activities."

Curbing reckless borrowing also requires a transparent budget system, he said.

While last year's 18th CPC National Congress called for building an "ecological civilization", this year's third plenum discussed how to make it happen.

To build a beautiful China, the country must improve the system of land development, conservation of resources and environmental protection, the communique said.

A bottom line for ecological protection should be established, it said. China must improve the system of property rights for natural resources and better regulate the use of those resources. The country should also establish a system of compensation for the use of natural resources and the subsequent impact on the ecosystem.

"It is no longer a concept, but a workable plan with the same weight as economic and market development, and will involve participation across all dimensions — political, social, and cultural," said Zhang Xiaode, a professor at the Chinese Academy of Governance who specializes in economic and ecological civilization.

The communique points out that to better adjust to the new realities of economic globalization, the country must accelerate the pace of opening-up, both internally and in terms of the outside world. The country will lower the thresholds for investment, accelerate the construction of free trade zones, and boost opening-up in inland and coastal areas.

Huang Hai, vice-president of the China Association of Trade in Services, said relaxing the investment barriers and accelerating the construction of free trade zones are fundamental changes.

"Take foreign investors, for example, previously they were only allowed to invest in the fields and projects stipulated in the Catalogue of Foreign Investment Industries. However, under the new regulations in the Shanghai Free Trade Zone, they can invest in a wider range of fields," said Huang.

Businesses have more rights and receive an improved service in the new free trade zone. If the pilot in Shanghai is successful, it may be expanded nationwide, he added.

The communique said China will strive to make social welfare fairer and more sustainable. Reform of social affairs is vital to guarantee all citizens enjoy the fruits of China's development, it said.

Guan Xinping, director of the department of social work and social policy at Nankai University, said China has almost met the goal of universal social welfare coverage for its urban and rural populations, but a great disparity still exists among different professions and regions.

"The system is fragmented, as different people enjoy different levels of welfare," he said. "It's vital for the government to tackle the disparity and enable people to enjoy equal welfare." He added that China's social welfare system should also be more sustainable, to cope with the potential risks from an aging population and inflation in the long run.

According to the communique, China's urban-rural structure is the main obstacle restricting the integrated development of cities and the countryside.

"We must develop a new type of integrated, mutually beneficial relationships between industry and agriculture, city and countryside, under which industry should promote agricultural development, and the city should promote progress in the countryside, to let farmers have equal chance to take part in modernization and share the fruits of modernity," it said.

Chen Xiwen, a researcher into agricultural development with the CPC Central Committee's Leading Group of Countryside Work, told media it is "absolutely necessary and practical" to integrate the city and countryside, and industry and agriculture, to improve farmers' livelihoods and fill the gaps in the dual structure.

"After being nurtured by farmers, industry and development in the cities should serve agriculture and the countryside in return," he said.

The communique says that to construct a socialist cultural power and strengthen China's soft power, the country will further deepen cultural restructuring. China will improve the cultural management system, establish a modern cultural market system, build a modern public cultural service system, and further open the cultural market.

In terms of cultural development, the government has already made some changes.

"As the economy grows, the market will become the major provider of cultural consumer goods and channels for the public. Comparatively, public services will switch to the fundamental role. As a result, we need to build and perfect the cultural market system," said Tuo Zuhai, deputy director of the Cultural Market Division at the Ministry of Culture.

## Reform: Market has a 'decisive' role in allocation of resources

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It is the first time in a decade that the Party has set out a reform plan covering all sectors.

The road map is expected to boost China's development and benefit the world after 204 Central Committee members gathered in Beijing for the four-day closed-door meeting to discuss and endorse a decision on "comprehensively deepening reform".

By 2020, China is to achieve "decisive results" in reforms in important fields, with economic changes a central part of the overhaul.

Reform and opening-up, the communique said, are the most distinguished characteristics of modern China and the crucial choice to settle the fate of the country.

Among other initiatives singled out for reform, the Party said it will deepen fiscal and tax reform, establish a unified land market in cities and the countryside, set up a sustainable social security system, and give farmers more property rights — all seen as necessary for putting the world's second-largest economy on a more sustainable footing.

To achieve all this, China pledged to better coordinate the top-level design of the reform by "wading across the stream by feeling the way", a term used to describe pushing ahead reforms with no experience to learn from.

The communique released after the 1993 Third Plenum recognized the "basic role" of the market, but Zhang said it was a compromise being reached at a time when the consensus for a market economy was insufficient.

"Now it is time to break away from excessive government control and allow the market to take the lead. The market should be entrusted with the role it deserves in a market economy," he said.

Rui Meng, a professor of finance and accounting at the China Europe International Business School, said a bigger role for the economy is accompanied by the right positioning of government, which should improve the ability to provide public services to fill the gap that the market cannot cover.

Shada Islam, policy director of the Brussels-based think tank Friends of Europe, said China is very much on the path of furthering market-led economic reform.

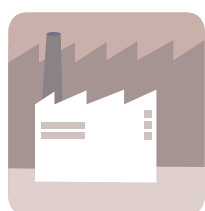
"There were some concerns before the plenum that some of the expectations were very high and that China's new leadership is not able to deliver on many of the expectations," Islam said.

However, since reading the document after the meeting, Islam said the first indication is that many of the expectations are going to be met at least as policy guidelines. "It's very important that China continues the path of opening-up and market-led economic reform to realize its own equitable and equal society."

She said the focus on building an equal society is vital for the "Chinese Dream" to become reality. "It's also very important for future stability in China," she said.

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Zheng Yangpeng contributed to this story.



## VARIOUS FIRMS TO PROSPER

There are approximately 144,000 SOEs, employing 37 million people. They enjoy much more autonomy than in the era of the planned economy, but their supervision has proved inadequate on occasion. Current problems include the distribution of internal income and job-related executive expenditure. Experts say further market-oriented reform of SOEs will require the separation of asset administration from day-to-day management.

Text in **black**: Key points in the third-plenum communique.

Text in **blue**: Background information provided by China Daily.



## MARKET'S ROLE 'DECISIVE'

A legacy of the old planned economy is that a number of industries are still dominated by large State-owned enterprises. Up to now, meaningful participation by non-State sector companies has been impossible.

The main monopolies are:

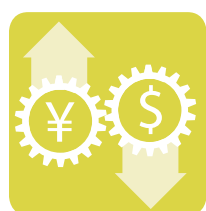
- Railway development and operations
- Petroleum and natural gas production, refining and trade
- The electricity grid and supply
- Telecommunications network service, and banking and other major financial services.

Hazards arising from the monopolies spill over into the areas of public interest, including corruption among high-level executives.



## LAND REFORM OF A NEW KIND

While the law allows the transfer and lease of land rights, an effective market mechanism covering a variety of aspects is still required, including the processing of land rights transfers and protecting farmers' interests. The methods of land acquisition used by local governments and developers vary from place to place and from case to case and tend to provoke complaints and resistance from farmers. The ultimate victim of the lack of a working land rights market is farm modernization. Small, uneconomic plots are no longer adequate to meet the rising demand from cities for basic food supplies, nor do they generate good incomes for farmers.



## EXCHANGE &amp; INTEREST RATES

The task consists of two components: Reform of the renminbi exchange regime and reform of interest rates. The mechanism for detailing on the exchange rate is becoming more market oriented. The currency's exchange rate with the US dollar has risen from 8.5 to 6.2 over the last decade, amid growing exports. Along with this is the renminbi's use as a global currency in trade and investment, which has necessarily led to liberalization of convertibility for the capital account. Since the mid-1990s, piecemeal progress has been seen in the liberalization of interest rates.



## COMPETITIVE BANKING

The second part of the financial reform is aimed at introducing more competition into financial services. The restructuring of the four largest State-owned banks since 2003 has helped them grow into some of the largest banks in the world in terms of assets. Some smaller joint-stock banks and credit services have also come into being. But for a country with myriad small enterprises, services are far from enough. Shadow banking is rampant where official banking either doesn't exist or is unable to provide the services required. Institutional barriers have remained high, preventing private investors from obtaining financial services, let alone operate their own banks.



## REFORM IN TAXATION

This is a crucial part of the fiscal reform. Old, counter-productive taxes will make way for new, more productive taxes, such as the property tax, which has been piloted in some cities but has failed to have the desired effect to cool down property prices. The resource tax is only being collected at extremely low rates. An integrated regime and standard for consumption tax is lacking. The new environmental tax is often levied in the form of various administrative fees, which is not the best method. These taxes are believed capable of not only providing a sustainable revenue stream for local governments, but also of generating incentives for cutting waste and curbing pollution.



## CENTRAL-LOCAL FISCAL DUTIES

Nearly all local governments have to rely heavily on land rights auctions to supplement their revenue, hence the skyrocketing price of real estate in many cities. The governments are hungry for new revenue sources, while their means of raising money (such as bond issuance) and ways of managing its use are yet to be effectively regulated. There is no transparent and fully accountable system for local government debt, which is raised separately and lacks a uniform national regime, and is often disguised in many forms, giving rise to various strains of corruption. This is an aspect where the role of law is fundamentally important. China will have to rely on laws and their enforcement to manage the central-local divide of fiscal revenues and duties. However, all changes to the law will be decided by the central authorities.



## BE GREEN AND INNOVATIVE

The Environmental Protection Law and the 77 environmental protection courts nationwide are beginning to function to provide a legal framework. Pollution and environmental damage offences are under the increasing effective check of the justice system, but conservation and emissions reduction mainly rest with the government's efforts to adjust the industrial and energy structures, rather than market leverage of taxes and fees. China's energy consumption per unit of gross domestic product fell 5.5 percent in 2012 compared with 2011. However, the decline is 7.3 percentage points lower than the central government's target. To further cut emissions and reduce energy use the nation needs to introduce more technological breakthroughs.



## CONTINUOUS OPENING-UP

Since the new cabinet assumed office in March, great efforts have been made to trim the government's power to grant administrative approval powers. Following that came the decision that capital registration will no longer be a requirement for opening a new business. These moves have made conducting business easier for both Chinese and foreign companies. Some newly developed areas in central and western China have started to receive more investment from overseas, especially in high-end manufacturing. In the meantime, service industries have been required to open up even further, most noticeably in the newly designated Shanghai pilot free trade zone, which is to serve as a testing ground for the new programs for the opening-up of the country's financial and service industries.



## ALL CITIZENS FOR SECURITY

China started its basic social security network in 2012, but has yet to achieve equality among all citizens. For instance, the country's 300 million or so migrant workers are entitled to social insurance in the cities where they work but still face obstacles in receiving the benefit if they leave their current jobs to work in other cities. Retirement insurance is also of prime importance, as some 500 million people — 35 percent of the population — will be aged 60 or older by 2050. Maintaining the value of the huge pension insurance fund, which affects the livelihoods of hundreds of millions, is another challenge for the government.



## CITIES AND COMMUNITIES

China's official urbanization rate hit 52.57 percent in 2012, yet recent research conducted by Tsinghua University indicates that only 27 percent of the population has urban hukou, or household registration, and fully enjoys the public services available to all urban residents. The hukou system, which is more than 50 years old, has created a divided society and divided cities. Pilot programs are ongoing. In June, the State Council proposed abandoning hukou controls in small towns and cities, and gradually easing hukou restrictions in middle-level cities.



## CULTURAL DEVELOPMENT

China's cultural industries are developing rapidly, but many problems still exist. Inadequate market research has resulted in cultural products unable to meet people's demands in both quality and quantity. Inadequate protection of intellectual property rights is impeding the development of cultural peripheral products and China's cultural products and services are still not competitive in the international arena. The development of the cultural industries in different regions of the country is unbalanced, with coastal provinces being more advanced than the inland areas. Moreover, a lack of proper financial support is also hindering development.