China

Status quo at China's National People's Congress session

By Invitation

Insightperspectives regularly invites experts to write about "special" issues of importance to the financial market. In this context, **Joergen Delman**, professor, PhD, China Studies, Department of Cross-Cultural and Regional Studies, University of Copenhagen, has been invited to make his assessment of the just closed annual sessions of the National People's Congress (NPC).

Joergen Delman works on China's political economy, politics, civil society, climate policies and environmental issues. He is a frequent public speaker and media commentator on these topics and has lived in China for ten years, working as a consultant for international development organisations, as well as Danish and international businesses. He has worked extensively with and within Chinese government organisations at central and local level. **Joergen Delman** is Co-coordinator of ThinkChina.dk.

Shifting the focus of the economy

China's political leadership ended its annual session of the National People's Congress (NPC), the world's largest parliamentary body, on 15 March. As usual, the event was tightly scripted and choreographed. The Deputies approved the Government's work reports and plans, including the 13^{th} five-year plan, which starts this year. The NPC session is the final step in a long process, and China's parliamentarians have only had little influence on the plan, at least as parliamentarians. The draft was approved by the Central Committee of the Communist Party already in October 2015, which means that the future aiming points and the main targets were already set by then. Even more, a huge number of associated plans have to be elaborated at central and local levels, and the entire planning process seems to be increasingly out-of-synch with the work of the NPC.

Xi's course towards the "New Normal"

The 13th five-year plan is Xi Jinping's first as Communist Party leader and it sets the framework for his so-called "New Normal". One of the major challenges is the economic slow-down, from double digit growth a few years ago to an annual growth target of not less than 6.5 % during the period 2016-2020. Whereas China's economy will continue to grow handsomely, the economic slow-down entails a need to restructure the economy towards being more balanced, green, consumption driven, innovative and service oriented, while curbing overcapacity in investment heavy production, transport and real estate development infrastructure.

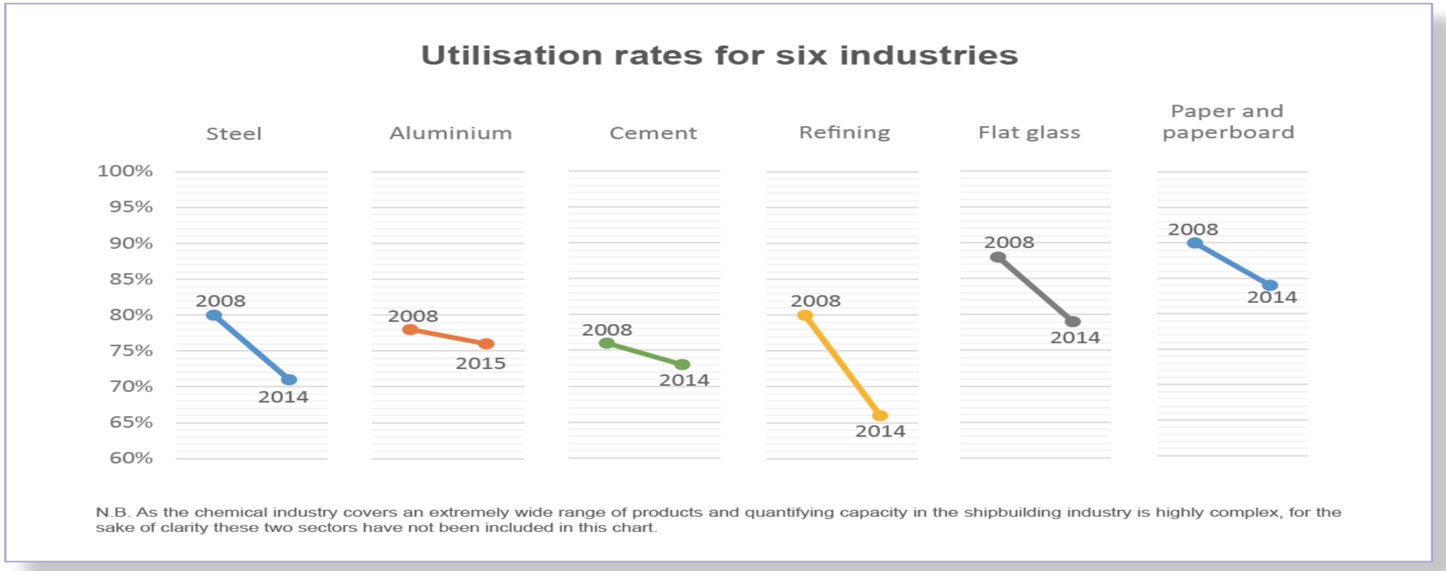
According to Premier Li Keqiang's report, this is already happening. The service sector accounted for 50.5% of GDP in 2015, more than half for the first time, and the contribution of consumption towards economic growth reached 66.4%. But the overcapacity in key sectors remains a serious challenge as documented recently in a report by the European Chamber of Commerce in China (see graph on the previous page).

National People's Congress

The about 3.000 members of the NPC represent China's elite, with 72% being members of the Communist Party. Most members are government or party officials (often the same) whereas some represent the productive sectors. However, they are all top leaders or models of some kind. 23.4 % of the members are women. Only a very small proportion qualify as front line workers (farmers, workers, teachers etc.). The group of members from the business sector has grown over time and is now about 30-35%, many are from the state owned sector.

The Chamber report notes that overcapacity is caused by well-known, recurrent factors, i.e. local protectionism and the fragmentation of industries driven by regionalism; weak enforcement of regulations, including environmental and health policies and standards; low input prices due to government policies; a fiscal system that encourages local governments to attract excessive investments; widespread availability of inexpensive technology; and finally a philosophy of market share and not profitability. The huge 2008-2009 financial stimulus package exacerbated the problem by channeling funds to questionable projects, either directly or through subsidies. The SOE (state-owned enterprises) manufacturing sector grew by 18.8 % annually until 2014. The stimulus policies boosted the economy in the short term but they distorted markets further and made China's reforms more complex.

While these issues are recognized by the Chinese leadership, it has been unable to tackle them at the roots, since the central government's initiatives, especially prohibitions and restrictions, affect key sectors in many localities around the country, not least in terms of public finance and jobs. However, Prime Minister Li did note that significant cuts had been made in outdated production capacity already, and that the work must continue, especially with regard to non-productive or non-profitable "zombie enterprises". Millions of workers have been laid off, yet unemployment will remain stable at 4.5 % in the cities.



Source: European Chamber of Commerce (2016.2.22) Overcapacity in China: An Impediment to the Party's Reform Agenda.

The government sets aside money for re-training of laid-off workers and expects that a stimulus package for start-ups and innovation will help create new jobs in other sectors.

SOE reforms

The SOE reforms presented in 2015 are still on the table. Li Keqiang emphasized the need to continue with structural adjustments of the large SOEs. Reforms last year already saw the reorganization of a number of large SOEs, and the reforms will continue to diversify rights to equity ownership, including selling off shares to employees. There will be new openings for non-state businesses in monopoly sectors such as oil, natural gas, electrical power, communications, transport and municipal administration.

The government will institute trials with delegation of more powers to the executive boards of the SOEs, there will be more competitive recruitment of executives, and salaries are expected to become more competitive. At the same time, there should be more control with their use of state capital. Local governments will be granted more power over their own SOE reforms and the social obligations of SOEs will be lifted off their shoulders gradually to make them more competitive. However, with Xi's leadership insisting on maintaining Party control with appointment of Chairmen of Boards and CEOs in SOEs the independence of SOEs and their market orientation will remain doubtful. Even more, last year Xi insisted on cutting the remuneration of SOE leaders.

SOEs versus private companies

The excessive focus on development of SOEs in recent years has come at a cost to the private sector. However, the proceedings of the NPC indicate that the private sector should not continue to suffer. Li Keqiang argued that the government would "energize" private companies by allowing them to compete with SOEs (as noted above) and by offering equal treatment in the market place and in relation to access to finance.

President Xi Jinping held a meeting with private entrepreneur members of the NPC during the session in Beijing. He reassured them that traditional criticisms of them as purely profit hungry capitalists were politically unacceptable and that future reform would focus on removing the barriers to private companies in the marketplace, not least to allow competition with SOEs. He also encouraged political and administrative leaders around the country to assist the private sector in solving their problems.

Contradictory signals to the business world?

However, Xi Jinping and Li Keqiang's promises do not necessarily allow business people a real voice. As an example, Ren Zhiqiang's blog with more than 37 million followers was closed by the cyber police ahead of the NPC session for openly critizing Xi Jinping's most recent demand for "absolute loyalty" to the Party by Party members and for arguing for a more democratic political system. Ren is a prominent business member of the Communist Party and the Chinese People's Political Consultative Conference, but he was criticized by the leading theoretical journal of the Party, "Red Flag", for being "anti-Party".

This is a danger signal, just one step ahead of political or legal persecution. However, the anti-corruption body of the central communist leadership under Wang Qishan, published an article subsequently saying that: "[We should be] not afraid of wrong comments, but afraid of no comments at all"… "Whether diverse opinions and suggestions were allowed could always determine the rise or fall of a dynasty." This statement seems to contradict Xi's demand for absolute loyalty and may reflect some level of disagreement within the leadership. Another famous top-notch businessman, Jack Ma, founder of Ali Baba, blasted the central leadership last year in December for not having dealt properly with China's environmental challenges. Ma's statement is still viewable on websites in China. Whether Ma is more influential than Ren is hard to say, but contradictory statements like these provoke doubts about the real unity of China's top leadership.

NDRC vs Ministry of Finance

China's two super ministries, the Ministry of Finance and National Development and Reform Commission (NDRC) presented their own work reports and plans at the Session. The two reports were aligned with the government's overall work report and plan for 2016. But it is clear that as the five-year plans are becoming less important for directly guiding the economy and as the NDRC also seems to be gradually stripped of some of its vital functions, the Ministry of Finance becomes more important as it is sitting on the national coffers. As expected, the Ministry's budget report was reasonably optimistic about prospects for 2016. National and local budgets will increase, but old problems persist. There is an increasing budget deficit and it is difficult to maintain a balanced budget due to inflexibility in the budget structure. The debt pressure on local governments is increasing, and it is noted that the revenue of local government managed funds will decrease due to a 13.2

% decrease in revenues from the sale of state-owned land use rights. Local governments are clearly under increasing financial pressure, and the demands for funds transfers from the central government will increase. Therefore, it is far from certain that all the projects in the five-year plan and the associated local plans will materialize.

Xi Jinping vs. Li Keqiang

As usual, Xi Jinping was at the centre of media reporting during the NPC session. He has been here, there and everywhere. Prime Minister Li Keqiang was less visible and he seems to have permanently accepted a more withdrawn role. This being said, neither the leaders nor the NPC broke any news. The devil may be in the details as some of the analysis above indicates, but otherwise the session was a *status quo* meeting that demonstrated the firm grip of Xi's leadership on economic development, restructuring and reforms as well as on the overall political landscape. Whether that is sufficient to steer China through towards a "New Normal" remains to be seen.

Denmark – March 16, 2016