

# China's Annual Political Gathering

A review of the Second Plenary Session of the 12<sup>th</sup> National People's Congress and the government's reform agenda

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# Introduction

On Thursday 13<sup>th</sup> March, China concluded the second session of the 12<sup>th</sup> National People's Congress ("NPC") a day after the Chinese People's Political Consultative Congress ("CPPCC") wrapped up its parallel session. The lianghui, as the two meetings are commonly known, are one of the most important annual events on the Chinese political calendar. This year's lianghui marked the first year in office of Li Keqiang as Premier and provided important detail in how the government will implement the directives announced during November last year.

The sessions presented few surprises and reinforced a commitment to deepen economic liberalisation and enhance the role of market forces with many of the details reaffirming the key principals detailed during the 3<sup>rd</sup> Plenary Session of the Central Committee of 18<sup>th</sup> Communist Party of China ("CCCPC") last November. Reform – including increasing the role of market forces – was front and centre over the last two weeks. In Premier Li Keqiang's first Government Work Report to the nation he mentioned "reform" a record 77 times in his nearly two hour report – compared to just 55 times in last year's Government Work Report delivered by the former premier, Wen Jiabao.

The leadership team has recognised that the growth model that has driven the country over the last 35 years is not sustainable and is causing significant challenges. Li Keqiang outlined reforms that will increase the role of market forces and adjust the role of government. Multiple sectors were called out by Li and others at the meetings for specific reforms – from finance to healthcare – while also calling on national resolve to tackle environmental challenges. Li noted that *"environmental pollution has become a major problem, which is nature's red-light warning against the model of inefficient and blind development"* and stated to delegates that *"we must have the mettle to fight on and break mental shackles to deepen reforms on all fronts"*.

As Premier Li noted, reform and opening-up are closely interconnected. Combined they will bring a range of positive opportunities for investors. The commitment to allow market forces to play an increasingly decisive role in China is positive for business as it will introduce greater predictability. Yet, even with reform and opening-up as central pillars rough corporate success in China will not guarantee continued success through this current administration. Some of the considerations that we discuss later in this report include:

- The battle against officials' misconduct has expanded firmly into the corporate environment. **It is imperative that companies operating in China ensure their corporate compliance systems are robust** and are matched to the scale of their expanding China business.
- **The expectations on companies operating in China have evolved** and they are being held to a higher standard than they were in the past. Companies must ensure that they are operating in China consistently with their global values and are genuinely responsible local citizens.
- **Some sectors will remain challenging**, regardless of the positive reform agenda. For companies operating in those sectors it will require concerted issue engagement and resolve.
- **The authorities are working to change the economic growth model** and companies that operate in areas that were previously prioritised must consider how they can adjust to meet the new long-term focus.
- **A number of government bodies are looking to make their mark with decisive judgements**, such as those involved in anti-trust.

Brunswick's Public Affairs team in China have compiled an overview of the key takeaways from this year's lianghui, the implications for business and what it may mean for China's future policy direction. Analysis of previous political meetings is available at [www.brunswickgroup.com/publications/reports](http://www.brunswickgroup.com/publications/reports).

# Key Themes from the Lianghui

## *The Reform Agenda*

Li Keqiang focused heavily on the importance of reform at the lianghui and stated unequivocally that reform is the top priority for the government. He noted that while reform has brought great benefit to the country, China's reform had entered a critical "deep water zone". Statements released by the Party last November also noted the country must be prepared to pass through an area of deep water – a period that will challenge the tested method of crossing areas of water by feeling the stones.

Many of the announcements made over the last two weeks are part of a commitment to reduce bureaucratic red tape and gradually shift the country away from a planned economy to one based more genuinely on market forces. Some of the key principals driving the reform agenda include:

- **Economic, Not Political:** Economic reform remains paramount to transform China's economic growth away from exports and fixed investment. The Party established the *Central Party Leading Group on Comprehensively Deepening Reform* to design the reform plans and to coordinate and supervise the implementation. The Leading Group held its second meeting just a couple of days before this year's lianghui during which it approved many of the reform programmes. A reform programme under the Party's instructions will certainly not lead to political reform.
- **Strengthening the Centre:** The current reform programme highlights decentralisation and deregulation. However, the process itself will be managed and supervised by the



central authorities. Officials must follow and implement central policies and will be punished for selective implementation.

- **Role of the Market:** A greater emphasis has been placed on allowing the market to play a "decisive" role in the allocation of resources and pricing. The core solution to economic reform lies in defining a proper relationship between the government and the market. Many of the reforms mentioned in this report are fundamentally changing the role of the state in the economy – including adjusting the focus of the backbone of the state planning mechanism – the National Development and Reform Commission.
- **Changing Role of Government:** The role of government in the economy must adapt to match the developmental position of the country. The authorities will continue to reduce bureaucratic red tape and improve coordination between the centre and the provinces with the

support of fiscal and taxation reform. At the same time, the public should have the ability to scrutinise the use of power and "to cage power of the authorities".

- **Role of Public Sector:** Equal importance is placed on the development of the public and non-public sectors. However, even with discussion around reform of the SOE ownership model, the basic economic system continues to depend on public ownership as a cornerstone of its long-term success.
- **Balancing Power and Supervision:** Many of the policies and directives ultimately balance the authorities desire to decentralise power regarding day-to-day operations and management of the country while maintaining a centralised supervisory power.

*We look at specific areas slated for reform later in this report.*



## Opening-Up: The Next Phase

*“Opening-up and reform have been launched as integral parts of the same initiative, as they are mutually reinforcing,”* stated Li Keqiang. To adjust to the new realities of economic globalisation, China must accelerate the pace of opening-up, both internally and in terms of the outside world. The country will lower the thresholds for investment, reduce bureaucratic investment approval barriers, accelerate the construction of free trade zones, and boost opening-up in both inland and coastal areas.

Over the last 35 years China has leveraged capital to drive economic development while guiding the introduction of western concepts, management skills, best practises and technologies. If the previous phases of opening-up provided an answer to the necessity of opening-up, the current reform programme must provide an answer to how to govern the country in an open market economy while addressing fundamental societal challenges.

Investment continues to be an important component of economic development. As part of the reform agenda the authorities will abolish or simplify preliminary review and approval procedures, give businesses full power over their investment decisions, and make it easier to make investments and start businesses. A system that lists all items over which government review and approval are required will be developed and released to the public – only items on the list will be subject to government review and approval. Investment that raises the cumulative quality and return on investment will be favoured – as

opposed to the scale of investment.

Li Keqiang also stated that China *“will foster a new open-economy system and advance a new round of opening-up to embrace the international market”*. The Go Global priority will focus on increasing *“China’s competitiveness through expanding its overseas business presence”* including reforming management of outbound investment approvals so that investment is mainly reported for record keeping and approvals are delegated to lower

Century Maritime Silk Road including the building of the Bangladesh-China-India-Myanmar Economic Corridor and the China-Pakistan Economic Corridor. These initiatives will build economic insurance that balances the perceived risks in western economies that could undermine China’s own economy, while also creating a new set of strategic partnerships to balance traditional US and European power bases in the region.



levels of government.

Li also reaffirmed that the country will actively participate in critical bilateral and multilateral forums and continue negotiations on investment agreements with the United States and Europe and also accelerate free trade area negotiations with the Republic of Korea, Australia and the Gulf Cooperation Council.

At the same time, Premier Li also called on the country to intensify the planning and building of a new Silk Road Economic Belt and a 21<sup>st</sup>

## Corruption and Governance

The fight against corruption remains firmly on the agenda. In his meeting with the press on 13<sup>th</sup> March, Li noted that corruption is the *“natural enemy”* of government and that it was imperative that they take a zero tolerance approach. A total of 31,555 officials were convicted of work-related crimes in China last year, 23% of whom were given prison terms in excess of five years.

Li Keqiang stressed that the key to

corruption restraint is to control the power and spending of officials while also expanding government transparency. The public must have the ability to scrutinise the government and the government must reform to “let power operate under the full glare of the sun”. He called on government at all levels to release their budgets and final accounts to the public and that all public spending on official overseas visits, official vehicles and official hospitality must be made public.

During his meeting with the press at the close of the lianghui, Li stated unequivocally that corrupt behaviour will not be tolerated and infractions will be prosecuted without mercy and to the full extent of the law – no matter the individual or how senior their position. The country must work to ensure that corruption will have nowhere to hide.

In addition, the government will implement a corporate blacklist system to document companies that violate market principles and infringe the rights and interests of consumers. Those that have violated the system will be punished to the full extent of the law.

More reforms are expected to China’s judicial system to overcome problems over transparency and corrupt judges, including curtailing the power of the CPC Political and Legal Committee to interfere in legal cases. The government made it clear that more effort will be exerted in accepting supervision from the public, including soliciting public opinion and paying more heed to media reports.



### Societal Challenges

Among the statements made during the lianghui, an underlying preoccupation has been with major issues facing China – feeding its people, addressing societal divides, keeping the lights on, tackling pollution, and building a society that is safe, fair and meets people’s most basic of needs.

In reflection on the importance of responding to citizens’ issues, Li stated at the start of the lianghui that “in carrying out reform, we need to focus on areas where the public call for reform is strongest” and where “there is extensive public consensus”.

# The Reform Agenda in Detail



## Government Reform

A basic principal embedded in the reform programme is to differentiate and redefine the roles of government, market and societal entities so that the government will be able to focus on ensuring fairness, justice, rule of law and providing services, the market can be used to efficiently allocate resources and determine pricing, and social entities can support dispute resolution and provide stability.

**The reform agenda places great emphasis on allowing the market to play a decisive role in the allocation of resources.** The core solution to economic reform lies in defining a proper relationship between the government and the market.

A critical structural reform is the announcement that the National

Development and Reform Commission (“NDRC”) will reduce its power as part of the government’s campaign to give the market a greater role. The NDRC’s review and approval power will be cut and its macroeconomic and overall policy coordination authority will be strengthened.

This is a significant change to a long-standing state planning mechanism. Weakening the power of the NDRC should not be underestimated due to its well established role as a super-ministry and strong interest group support.

Ultimately, as Premier Li noted in his meeting with the press, *“We need to ensure that market energies can do anything that is not prohibited by the law, and government departments must not do anything unless it is mandated by the law.”*

**Streamline approval procedures and ensure the economy is responsive to market forces.**

China will continue to streamline government administration by further reducing and simplifying administrative approvals and delegating more power to lower-levels of government. Since coming into office last year, the administration has eliminated or delegated 416 review and approval items and has announced its desire to remove another 200 items from State Council review this year by pushing them to lower levels of government. Li has vowed to eventually eliminate one-third of the 1,700 administrative review and approval items held by ministries under the State Council.

Instead of administrative pre-approvals, China will establish a mechanism to enhance coordination between local



governments to strengthen oversight on delegated matters relating to on-going business operations, and put in place a social credibility tracking system to better protect market rules and competition.

## Financial Reform

Important reforms in the banking and financial sector were announced including liberalisation of interest rates and the launch of privately owned banks.

**China to allow the creation of five new banks owned entirely by private companies.** On 11<sup>th</sup> March at the lianghui, the China Banking Regulatory Commission (“CBRC”) announced that 10 privately-owned companies had won approval to launch privately owned banks as part of a new pilot programme. Five privately owned banks will be established with each bank funded by at least two of the privately owned companies.

Those approved by the CBRC include: two of China’s leading internet giants, Tencent and Alibaba; Wanxiang, an auto parts producer; and Fosun, an industrial conglomerate.

The new banks will be able to adopt one of four models that include a small deposit, small loan model that puts a limit on the size of each client’s deposit and a cap on the amount they can borrow. An alternative model is a big deposit, small loan model that has a minimum deposit requirement to open an account and sets a cap on the size of the loan. Others will focus on corporate clients.

The CBRC has stated that the companies creating the new banks must

be controlled by Chinese nationals and have the majority of their assets inside China. The new banks cannot be incorporated in a tax haven.

In addition, Li Keqiang stated that the authorities will “*guide private capital to invest in or hold shares in financial institutions and intermediary financing services*”, while also promising to promote the development of internet banking.

**China to liberalise bank deposit rates within two years.** Premier Li stated in his Work Report that China “*will continue to liberalise interest rates by granting financial institutions more power to set their interest rates*”. Then on 11<sup>th</sup> March, the head of the People’s Bank of China, Zhou Xiaochuan, stated that the country will likely liberalise bank deposit rates within one or two years. Currently, one-year deposits rates at commercial banks are capped and are being undercut by the shadow banking sector and new money market funds offered by new entrants like Alibaba.

In addition to curbing the shadow banking sector, liberalising interest rates will allow market forces to better reflect demand and supply for credit and also give the PBOC an important monetary policy tool.

**Continued move toward renminbi convertibility.** Premier Li pledged that while the renminbi exchange rate would be kept basically stable, they would expand its floating range and move toward convertibility under the capital account.

**Enhancing risk management.** A deposit insurance system will be established and the authorities will improve the risk disposal mechanism of financial institutions. The authorities

will also develop agricultural insurance and research the establishment of catastrophe insurance solutions.

When asked about financial risk stemming from the shadow banking sector, Premier Li noted that “*we are tightening regulation and have set a timetable for implementing the regulative measures under the Basel III accord*” and that to the question of whether China’s capital adequacy ratios were too high for banks that while “*we are a developing country, this is what we have to do – we cannot let today’s stepping stone become tomorrow’s stumbling block*”. Li noted that monitoring must be tightened and problems dealt with in a timely fashion to make sure regional and systemic financial risks do not occur.

**Local governments to have greater influence over their financing.** China will build a standard financing mechanism for local governments to issue bonds in a bid to ease their debt pressure. Historically local governments have been restricted in their ability to raise capital on their own (a pilot programme to allow greater liberalisation is in operation in six provinces and municipalities). Going forward, local authorities are expected to be allowed to issue bonds as a way to develop a regulated local borrowing mechanism. To guard against and defuse debt risks, China will also implement a new comprehensive government financial reporting system.

**Promoting internet finance and financial inclusion.** The Work Report highlighted the importance of developing internet banking and expanding financial inclusion so as to benefit a wider group of people through the on-going financial reforms. This is the first time that internet finance

has been written into the government work report, which reflects demand for more innovative financial products. Despite risks from unchecked financial innovation, the government is focused on how to improve relevant regulations and benefit more people and small or micro businesses.

### *SOE Reform*

**Accelerating the development of mixed-ownership entities and enhancing corporate governance.** In November last year the Party placed equal importance on the development of public and non-public sectors. While there is little question that the dominance of the public sector will remain, the reform plan discussed state owned enterprise (“SOE”) privatisation via the promotion of mixed ownership structures.

In the recently concluded lianghui, the authorities committed to improving the distribution and structure of the SOE sector and accelerating the development of mixed ownership economic entities.

**Increased opportunities for non-state capital.** The government will formulate measures to allow non-state capital to participate in projects that have traditionally been restricted to SOEs. Sectors named explicitly include banking, oil, electricity, railway, telecom, resources development and public utilities.

Further implementation measures will be introduced to permit non-public enterprise participation in franchising. There are also further reforms in railway investment and the financing system.

### *Fiscal and Tax System Reform*

**Expanding tax reform.** The authorities will replace business tax with value added tax in additional sectors this year – including into the railway, postal, and telecom services sectors. In addition, they will abolish

As part of the pilot programme, the central government aimed to eliminate double taxation and reduce the overall tax burden on businesses by increasing VAT revenue. The pilot programme, applied to transportation and six modern services sectors, first commenced in Shanghai and later



more fees and replace them with taxes, reform the excise tax and resource tax, and move ahead with legislation on a property tax and environmental protection tax.

Over the last two years, the government embarked on one of the most ambitious tax reform programmes in recent history. The Ministry of Finance and the State Administration of Taxation jointly initiated the “Pilot Programme to Convert Business Tax into Value-Added Tax” on 1<sup>st</sup> January, 2012, targeting to replace corporate income tax (or business tax) with VAT and to restructure the current tax rates.

extended to another 11 regions, including Beijing, Tianjin and Shenzhen. In August last year the VAT pilot programme was extended nationwide and the scope expanded to more service sectors. The reform is to be completed by the end of 2015.

While aiming to reduce the overall tax burden on business, not all companies in the pilot sectors have benefitted given the fact that some companies were subject to a business tax at a lower rate than the VAT rate.



# Economic Growth and Domestic Consumption

Officials will continue to prioritise quality economic growth and quality investment as they work to transform the economic growth model away from exports and fixed investment. China sent its strongest signal yet that its days of chasing breakneck economic growth were over, promising to wage a “war” on pollution and reduce the pace of investment to a decade-low as it pursues more sustainable expansion.

**Pursuing a consistent fiscal and monetary strategy.** Li Keqiang stated that the country will continue to implement a proactive fiscal policy

Finance, stated that “7.3% or 7.2% would count” while a spokesman for the State Council stated that growth just below the target would be acceptable. The 7.5% target is not surprising – but officials’ comments around flexibility have not been heard before.

In 2011 when the 12<sup>th</sup> Five-Year Plan (2011-2015) was released the former premier, Wen Jiabao, set the goal to reduce economic growth to “around 7%” over the course of the Five-Year Plan period. At that time the leadership team, of which Xi Jinping and Li Keqiang were part of, indicated

consumption is considered a critical driver of China’s changing long-term growth engine. Li Keqiang stated during the lianghui the authorities’ commitment to shift to a more sustainable growth model based on domestic consumption and service industries instead of investment and trade.

As part of the government’s strategy to increasing citizen’s ability to consume they will focus on increasing incomes, improving consumption policies, fostering new areas of consumption and increasing consumption services. Li Keqiang stated in his Work Report that the authorities will encourage non-government investors to enter and operate in new service areas – including those in the elderly care, health, tourism, and cultural sectors. In addition, to boost citizen’s ability to travel – the government will implement a paid holiday system.

As a new engine to boost domestic demand, specific emphasis was placed on developing **information consumption**. This calls for speeding up the deployment of 4G (*China Mobile launched its services officially in January this year with more than 200,000 base stations – more than all the base stations deployed across Europe*), building 100M fiber optic networks and expanding broadband into rural villages, and delivering converged telecom, radio, TV, and internet services over a single broadband connection.

**China is preparing to usher in a new phase in its opening-up to the outside world.** Opening-up and reform are integral parts of the same fundamental initiative and are mutually



and a prudent monetary policy, while working to improve the macro control policy framework, ensuring stable growth and employment, and keeping a cap on inflation.

**Officials indicated greater flexibility around economic targets.** While the authorities continued to target “around 7.5%” GDP growth for this year, multiple officials mentioned that this was only a target. Lou Jiwei, Minister of

that China will no longer worship GDP as the cornerstone of its development. Instead economic growth must not come at the expense of resource depletion or pollution. The current leadership team is continuing to adjust the growth model and development priorities.

**Domestic consumption as a future pillar of sustainable economic growth and the role of technology.** Boosting domestic

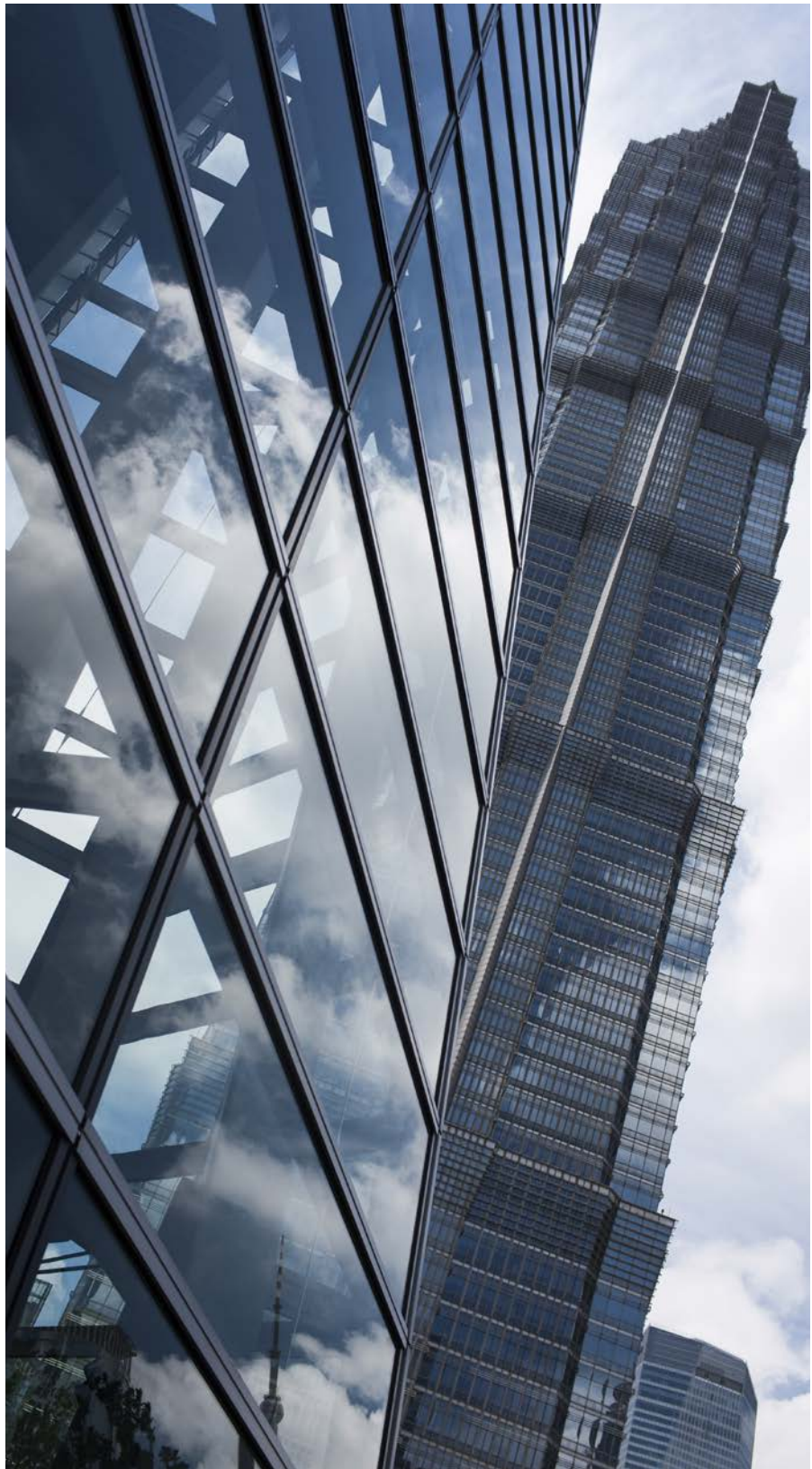
reinforcing – so stated Premier Li in his Work Report.

The premier noted the importance of foreign investment and committed to opening-up more service sectors to foreign capital and levelling the playing field for domestic and foreign companies to operate on fair terms. He also stated that he would work to ensure that China remains a “*top choice for foreign investment*”.

The Shanghai Free Trade Zone was called out as an important initiative that should be launched in additional locations. New trials are already in the works. In the near-term shorter “negative lists” identifying restrictions on foreign investment in the zones are expected to be released. In addition, Premier Li pledged to open China’s inland and border areas wider to the outside world.

**Upgrading China’s position in global trade while developing successful Go Global strategies and Chinese brands.** As part of officials’ desire to transform the economic growth model, they have prioritised a transformation in the position of China’s factories in the global value chain. They aim to transform and upgrade the processing trade sector and raise the position of Chinese manufacturing in the global division of labour.

In addition, Li Keqiang noted the importance of creating Chinese brands and developing international marketing capabilities that can take Chinese culture and intellectual property to new markets.





# Enhancing Wellbeing and Social Harmony

Societal challenges are evident across the country from urbanisation through to environmental degradation and pollution. A significant portion of political focus is centred on addressing these challenges and bettering citizens' livelihoods.

Premier Li stated that *"we need to meet people's basic living needs, to provide the last resort for people to fall back on in case of special difficulty, and to promote social fairness. Those topics related to citizens' livelihood presents priority on the government's work agenda"*.

## A New Path for Urbanisation

Emphasis was put on improving urban-rural relations and ensuring that people living outside cities have equal participation in the modernisation of the country. Li Keqiang called on the need to *"embark on a new path of urbanisation"* that should put people first; integrate industrialisation, technology, and agricultural modernisation; improve urban planning; and protect the environment.

China is in the midst of a phenomenal migration as its citizens make the transition to urban areas. As an immediate next step, the government is going to focus on three tasks that are centred on "100 million people". This includes: granting urban residency to around 100 million rural people who have moved to cities; rebuilding rundown city areas and villages inside cities where around 100 million people live; and guiding the urbanisation of around 100 million rural residents in cities in the central and western regions.



## Hukou Reform

The household registration system – or hukou – remains hugely controversial and has significant impact on the free flow of labour in China – especially migrant labour.

Premier Li stated that the household registration system will be reformed including granting urban residency to rural migrants and their families who are willing and able to stay in cities and towns where they have had jobs or done business for a long-time.

In addition, Premier Li stated that *"more children of migrant workers living with their parents in cities will be entitled to go to school there – including secondary school and college"* thereby addressing a significant challenge and frustration among migrant workers and their families.

## Healthcare

Over the last year significant attention has been centred on the healthcare sector and a myriad of challenges ranging from the funding of healthcare facilities to how to ensure the safety of doctors.

Reforms announced during the lianghui have included consolidating the national basic medical insurance system and improving the mechanism for the government, employer and employee to share the costs of basic medical insurance.

At the same time Li Keqiang stated that the way hospitals were funded would be changed – including abolishing *"the practice of compensating low medical service charges with high drug prices"*, adjusting the price of medical care and drugs, and creating a mechanism for running hospitals with non-government capital.

Vice Premier Zhang Gaoli reiterated the importance of speeding up public hospital reforms and improving the operational mechanism of grass-root level health institutions.

In addition, emphasis was placed on strengthening the training of doctors.

Ultimately, Premier Li stated that it was imperative to *"press ahead with medical reform and work out a Chinese solution to this global problem"*.





## Family Planning

At the end of last year it was announced that China would further loosen its long-standing one-child policy. So far eight provinces have implemented policies allowing couples to have a second child if either of them is single child.

Since the policy was launched debate has shifted to predicting the launch of a comprehensive two child policy (i.e. any family regardless if either parent is from a single child family). Li Bin, the head of the National Health and Family Planning Commission stated emphatically that there is no timetable in place. China is expected to welcome an additional one million new children each year with this recent family planning revision.

## Environment

*“Environmental pollution has become a major problem, which is nature’s red-light warning against the model of inefficient and blind development,”* stated Li Keqiang.

The environment is a challenge that impacts everyone, regardless of background, wealth, or political position. Environmental pollution has become a major problem with smog affecting ever larger parts of the country. Today many living in China start their day not by looking at the weather forecast, but checking the air pollution index.

**Li Keqiang promised to take strong measures to strengthen pollution prevention** – including implementing a plan to reduce PM<sub>10</sub> and PM<sub>2.5</sub> emissions by improving the industrial structure, raising energy efficiency, reducing vehicle exhaust emissions, and preventing and monitoring wind borne dust. In parallel, 50,000 small coal fired furnaces will be shut, desulphurisation and denitrification in coal-burning power plants will be expanded, and six million old high-emissions vehicles will be removed from the road. In parallel to the removal of the old vehicles, the government will promote the development of new-energy vehicles.

Premier Li stated during his press conference that, *“to declare a war on smog doesn’t mean we are declaring a war on nature. Rather, we are going to declare a war on our own inefficient and unsustainable model of growth and way of life”*.

**In addition, the way energy is produced and consumed will be targeted.** Energy intensity will be cut by more than 3.9% while the proportion of electricity generated by non-fossil fuel will be increased. Greater emphasis will also be placed on developing unconventional energy sources including natural gas, coal seam gas, and shale gas.

The Environmental Protection Law and the Air Pollution Prevention and Control Law will be revised this year to ensure that all pollutants can be closely monitored – and that polluters will be held accountable for the damage they cause.

## Education

Education received a high priority at the lianghui with a commitment to further develop resources and make access more equitable.

In addition to ensuring central and western regions and rural areas have access to compulsory education, the government intends to continue to invest in boosting education quality – both in terms of facilities and teachers.

Preschool education will be developed, institutions of higher learning will be given more decision making power, the development of private schools will be encouraged, and the establishment of employment-oriented modern vocational education facilities will be accelerated.

# Priorities for 2014

Li Keqiang outlined nine core priorities for the government this year.

## 1. Deepening reform

Reform is front and centre in the government agenda with many measures designed to allow the market to play a “*decisive*” role in the allocation of resources and pricing while reducing bureaucratic red tape.

Great emphasis has been placed on increasing transparency, reforming the fiscal and tax system, liberalising the financial sector, and adjusting the way SOEs operate and are structured.

## 2. Expanding opening-up

Reform and opening-up are considered by officials to be mutually reinforcing and together with the reform agenda a new phase of opening to the outside world will be pursued ranging from free trade zones to China’s inland and border regions.

Foreign capital will have access to more service sectors and the authorities will work to create a fair competitive environment for both domestic and foreign companies. In parallel, China will seek to increase the competitiveness of its own companies and support them in their Go Global strategies.

At the same time, China will continue to engage in bilateral and multilateral platforms, it will continue to negotiate investment agreements and free trade agreements, and will develop the new Silk Road trade routes connecting China to the Middle East and all in between.

## 3. Boosting domestic demand

Domestic consumption is an important

driving force of economic growth and considered a pillar in the new economic growth model. Significant focus will be given this year to building a framework that supports greater domestic consumption – from initiatives that raise incomes and expand the service sector to the introduction of paid annual leave.

Supporting the growth of modern connectivity is seen as a way to boost new forms of consumption – in particular information consumption. 4G deployment, convergence, e-commerce, and other technologies

property rights to rural residents and prudently carry out rural land reform trials, as well as reforms of state-owned farms, grazing land and forestry farms. In addition, programmes will be put in place to help support children, women and elderly citizens left behind as a result of migrant labour working in cities.

## 5. Promoting people-centred urbanisation

Urbanisation is bringing with it a raft of challenges as enormous numbers of rural residents move to urban centres. The government is working



that enhance consumption will receive special support.

## 4. Advancing agricultural reform and rural development

China is going to see more strengthened policies to protect agriculture as the sector and its modernisation is vital for ensuring China’s stability and food security. The government will increase investment in major water conservancy projects and continue to grant more

to put citizens’ interests at the centre of this phase of urbanisation as it tackles these challenges head-on and ensures both rural and urban residents jointly enjoy the benefits of modernisation. Priorities include reforming the household registration system, extending basic public services to cover rural migrant residents in the cities, and increasing support for urbanisation in the central and western regions.





## 6. Upgrading the economic structure via innovation

As a core force for upgrading China's economic structure, the government will encourage businesses to play a more active role in technological innovation. In addition, China will establish innovation and entrepreneurship platforms for emerging industries, strengthen the protection of intellectual property, and link researchers' compensation to the market value of their research. In addition, China will continue to remove out dated and high polluting technologies, while strengthening environmental protection laws and punishing those caught polluting.

## 7. Accelerating the development of social programmes

China will strengthen the development of social programmes to promote social justice and balanced development across regions, including increasing government spending and resource allocation to education and deepening reforms in the cultural sector. Reform of the healthcare sector is seen as critical – including reconsidering how hospitals are funded, reforming the system for basic medical insurance schemes, and implementing changes recently made to the one-child family planning policy.

## 8. Improving people's wellbeing

The government will continue to increase spending on government-subsidised housing and integrate the operation of public and low-cost rental housing, narrow the income gap via reforming the income distribution system, and establishing a unified pension system for rural and urban residents as part of a wider effort to reform its pension schemes. In addition, the government will focus on ensuring employment opportunities to meet demand from new graduates.

## 9. Building a sound environment

Pollution surrounds all those living in China and its constant presence is nature's red warning against the country's economic model. It is not sustainable and it has the full attention of the central leadership. The plans start with an overarching goal to reduce  $PM_{10}$  and  $PM_{2.5}$  emissions and calls for the removal of highly polluting energy sources, promotion of electricity generated by non-fossil fuel, and development of unconventional energy sources. In parallel, China will continue to carry out projects for clean water, land restoration, and ecological conservation.



# Implications for Business



In this section we have highlighted some of the overarching implications that are likely to affect businesses operating in China in the coming years.

## *The Positive*

The significant and far reaching reform agenda presents a range of opportunities and positive forces for investors operating in China.

**The government is focused on reform** and is gradually shifting the country away from a planned economy to one based more genuinely on market forces.

**The commitment to allow market forces to play an increasingly decisive role in China is positive for business** as it will introduce greater predictability – especially when taken with the parallel track that will see the role of government in business decrease.

**Investment approvals are set to get simpler and faster** with the elimination or delegation of review

and approvals held by ministries under the State Council. Reforms will provide local governments more discretionary power to approve local investment projects that should make local engagement easier and quicker.

**The role of the state owned sector is changing** and the government is pushing for the acceleration of mixed-ownership entities that may pave the way for further SOE reform.

**New sectors have been earmarked for private investment and are expected to be less restrictive to foreign investment** – including new energy solutions, services, parts of the financial sector, elderly care, and education.

**Additional free trade zones are to be launched in the coming years bringing competition to attract investors.** The competition between zones may pave the way for more opening-up and faster development of the overall free trade zone model.

## *The Considerations*

We remain largely optimistic about the policies and directives being laid out by Premier Li and the leadership team. However, that does not mean things will be smooth sailing for investors in China. Far from it, there are critical areas that investors must consider and adapt to because the expectations on investors are changing. The approaches that brought corporate success in China will not guarantee continued success through this current administration.

President Xi and Premier Li are fighting endemic corruption and Premier Li was unequivocal that there would be zero tolerance for corruption – regardless of the individual or their seniority.

In parallel to the battle against corrupt officials and Party members, corporate governance has been pushed into the headlines following multiple allegations of corporate corruption or wrongdoing.

**It is imperative that companies operating in China ensure their corporate compliance systems are robust** and are matched to the scale of their expanding China business. As companies expand across the breadth of China, they must revisit their systems as it's rarely a one-size fits all model, nor as simple as copying global practices and policies without thoughtful localisation.

**The expectations on companies operating in China have evolved** and they are being held to a higher standard than they were in the past. Beyond corporate compliance, this also requires companies to be responsible in every aspect of their operations and conduct – not just socially responsible.

**The focus on quality foreign investment will continue** and it is thus critical companies articulate their local value proposition clearly and build advocates. Officials have stressed that it is critical to optimise the structure of investment and improve its performance and return.

**Costs are increasing rapidly** – from raw materials, energy, and distribution to labour costs. Inflation continues to push wages higher each year, while pollution is making it harder to attract global talent. A range of artificially low prices for utilities – such as water, electricity and oil – will eventually be corrected as the leadership uses pricing to achieve critical changes in behaviour.

**Some sectors will remain challenging**, regardless of the positive reform agenda. For companies operating in those sectors it will require concerted issue engagement and resolve. Sectors that have seen important reform – such as the banking sector – remain largely off limits to foreign investors and others like telecom and the internet continue to restrict genuine foreign investment.

**Domestic objectives trump foreign investors' interests** and as a result the leadership team will remain strong advocates of domestic industry interests and this may still lead them to support policies that weaken overarching reform goals. It remains important to consider what keeps officials and critical audiences awake at night and identify ways that a company can leverage its expertise to bring solutions.



**A number of government bodies are looking to make their mark with decisive judgements**, such as those involved in anti-trust.

**China will take a firmer position on the world stage.** While it is positive to have China more engaged, it will also present times of distinct challenges to all at the table – such as navigating regional sensitivities. Related disputes may cause bilateral tensions that impact the business environment.

**China's economy continues to grow, but at a slower rate** and a slower target than in earlier years. The lower target is intentional as it is imperative to change the growth model. Officials have voiced optimism that they will meet targeted growth, but there is clear risk and uncertainty.

**The authorities are working to change the economic growth model** and companies that operate in areas that were previously prioritised must consider how they can adjust to meet the new long-term focus. The role of infrastructure investment will not change overnight, but priorities and incentives for other sectors will increase.

**The rise of new interest groups in China means that the authorities are forced to balance the interests of a broader range of stakeholders** including SOEs, private investors, and foreign investors – as well as societal interest groups. Amid greater reform and opening-up, the competitive environment will become more complex for all participants.

# Political Backgrounder

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## *The Lianghui*

The “lianghui” (两会), or two meetings, as the annual gathering of the National People’s Congress (全国人民代表大会) and the Chinese People’s Political Consultative Conference (中国人民政治协商会议) is commonly referred, is typically held during the first two weeks in March.

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## *National People’s Congress*



The National People’s Congress (“NPC”) is the highest legislative body in China and has sole responsibility for enacting legislation in the country. The NPC, which meets once a year in March, enacts and amends basic laws relating to criminal offences, civil affairs, state organs and other relevant matters. When the NPC is not in session each March, the Standing Committee of the NPC is tasked with enacting and amending laws except basic laws that must be enacted by the NPC.

The NPC is also responsible for electing and appointing members to central state organs – including the Standing Committee of the NPC, the President of the People’s Republic of China (now Xi Jinping) and the Premier of the State Council (now Li Keqiang). Based on nominations by the Premier, the NPC is also responsible for appointing China’s Vice Premiers, State Councillors, Ministers (in charge of ministries or commissions), the Governor of the People’s Bank of China, and the Auditor-General and the Secretary-General of the State Council. It also elects the Chairman of the PRC Central Military Commission and appoints all other members of the PRC Central Military Commission. It also elects the President of the Supreme People’s Court and the Procurator-General of the Supreme People’s Procuratorate.

The 12<sup>th</sup> NPC was formed in March 2013 and will serve a five year term.

### **Second Session of 12th NPC**

**Date:** 5<sup>th</sup> March to 13<sup>th</sup> March, 2014

**Participants:** 2,932 deputies (elected in March 2013)

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## *Chinese People’s Political Consultative Conference*



The Chinese People’s Political Consultative Conference (“CPPCC”) is a political advisory body that consists of representatives from a range of political organisation, academia, business leaders, celebrities, and other experts. The National Committee of the Chinese People’s Political Consultative Conference (中国人民政治协商会议全国委员会) typically meets on an annual basis at the same time as the NPC.

### **Second Session of 12th CPPCC**

**Date:** 3<sup>rd</sup> March to 12<sup>th</sup> March, 2014

**Participants:** 2,172 members (elected in March 2013)



# Brunswick Group

*Brunswick is the global leader in financial and corporate communications, providing senior counsel to Chinese and multinational clients around the globe on critical issues that affect reputation, valuation and business success.*

## **Brunswick Public Affairs**

Brunswick works with its clients to monitor and respond to the business environment, build understanding among key groups, address public policy issues, mitigate negative changes to the operating environment and ensure business continuity. We advise our clients on the most effective messages they can use to communicate their case, whom they should target and how they should engage. We work closely with in-house government affairs teams to broaden public support for our clients' positions and build a better understanding of their businesses amongst relevant policy-making audiences.

Our approach combines government relations, media relations, issue management and corporate citizenship strategies to influence public policy, build a strong reputation and find common ground with stakeholders.

*The Brunswick team is available to provide additional guidance on issues in this report.*

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