

The CPC Third Plenum Announces a New Roadmap for Reform in China - An Overview

On 12 November 2013, the Third Plenum of the 18th Central Committee of the Communist Party of China (CPC) (Third Plenum) concluded after a four-day closed-door meeting among China's top party leaders. The Third Plenum marks the first anniversary of China's new leadership taking office and sets the important roadmap for the country's future development. The Communiqué of the Third Plenum, which was the first document to be released after the meeting closed, sets out the general directions of China's reform, which aims to remove stagnancy in economic growth and address rising social concerns. Subsequently on 15 November 2013, two other important documents namely the Decision of the CPC on the Major Issues relating to the Overall Deepening of Reform (Decision) and an Explanatory Statement issued by the General Secretary of CPC and China's President Xi Jinping (Explanatory Note) were released to fill in more details. All these documents (collectively the Documents) now form the roadmap of China's future policies with a view to reviving and fostering economic growth through vigorous reforms in various areas.

This client briefing aims to provide an overview of the key objectives set out in the Documents and future reforms to expect.

While the roadmap released in the Third Plenum covers a wide spectrum of new policies, the major focus falls on reforming the existing economic and social functions of the government, as well as determining CPC's mission in the next decade. The reform redefines the relationship between the central and local level governments, the government and the market, and the government and the general public. Remarkably, the first and foremost objective of all reforms is to "let the market take the decisive role in allocating resources". This represents a significant departure from the "minor" role which the market has been allowed to play since the central leadership decided to build China into a "socialist-market economy" in 1992. The

proposed move may well put China onto a trajectory of transformation into something more akin to the nature of a market economy. To achieve this momentous task, the central CPC leadership is expected to confront key structural issues in the following respects:

REFORMS TO THE ECONOMY

Restructuring the Economic System

- One major objective under the Decision is to perfect China's economic system through the encouragement of diversified ownership comprising State, collective and other non-State investments, while reiterating that State ownership remains the pillar of China's socialist-market economy.
- Regarding public ownership which is represented mainly by State-owned enterprises (SOEs), the government will improve the management of State assets and introduce a modern corporate system to operate SOEs. The ratio of profits derived from State capital that is required to be contributed to public financing will be raised to 30% by 2020.
- For the non-public sector such as the millions of privately-held small and medium-sized enterprises, the government affirms that they have equal rights and business opportunities as the public sector. This is the first time where China expresses that the private sector will be treated on the same footing as SOEs. In addition, more policies will be issued to enable non-public enterprises to access those economic sectors in which they are presently restricted.
- In the meantime, property rights will be duly protected and stronger momentum will be applied to develop China into an economy driven by a combination of public and private ownership.

Strengthening Market Mechanisms

President Xi Jinping mentioned in the Decision that "the focus of the restructuring of the economic system is to allow the market to play a 'decisive role' in the allocation of resources". To this end, China will develop a modern market system whereby businesses would be allowed to operate independently and compete fairly, while consumers should be free to choose and spend, and that merchandise could be traded freely and equally. The initiatives below may greatly promote foreign investment and private business:

- The central government will set up a fair, open and transparent market for all participants. The so-called "negative list" model (currently adopted in the China (Shanghai) Pilot Free Trade Zone) would be expanded nationwide. Pre-establishment national treatment will extend to onshore investments in sectors not listed in the "negative list", so as to enable all market participants (including foreign investors) to enjoy equal investment opportunities in sectors outside the "negative list".
- A streamlined enterprise registration system will be established. As such, the government will further reduce administrative matters that entail qualification verification, allow business licenses to be issued

prior to the regulatory certificates (先照后证) so that business can commence promptly, and change the registration of "paid-in" capital into registration of "committed" capital.

- The financial sector will be further opened up. Specifically,
 - qualified private capital will be permitted to set up small and medium-sized financial institutions;
 - a multi-layer capital market will be set up through the establishment of the stock public offering registration regime and the formation of multiple channels for equity financing;
 - catastrophe bonds will be rolled out; and
 - more diversified financial products will be introduced.
- China is also considering to liberalize the exchange rate of Renminbi (RMB) and the interest rate. In particular,
 - the exchange rate of the RMB against the US dollar has risen from the RMB 8.5 to RMB 6.2 in the last decade. The increasing function of the RMB as a global currency in trade and investment may necessarily lead to its liberalisation and free convertibility under the capital account; and
 - since mid-1990s, little progress has taken place in the liberalisation of interest rates. Currently, bank deposit rates are still subject to ceilings set by the People's Bank of China, to secure bank profits at the expense of consumers. A liberalized interest rate could prompt banks to compete by offering better terms to attract consumers. This step forward will be vital in creating a market-driven economy.
- Financial institutions will establish a deposit insurance system and a proper market exit mechanism. As these measures enhance the business competitiveness of banks, greater protection would also be afforded to depositors in case of default.

Reducing Governmental Intervention

The Decision notes the need to remove bureaucratic red tape and reduce administrative intervention by the government. This will create greater efficiency and offer a more relaxed business environment for both domestic and foreign investors.

Reforming Fiscal and Tax Policies

The Decision suggests a number of changes to the fiscal and tax regime, including but not limited to expanding the reform of the value added-tax and consumption tax regimes. This is aimed at providing a stable income base to the relatively under-developed provinces such as Western China, which have long been considered of high priority in the formulation of any future policies. The government will also roll out special regulations to reform China's property tax system.

Reforming Rural System

The development of China's populous rural sector has always been high on the agenda of the central leadership. As part of the bolder moves of the Third Plenum, the Decision pledges to reform the long-established "two-tier" system of land ownership which has restricted farmers from trading in land use rights. The Decision calls for a major change so that "farmers could participate equally and enjoy the fruits of modernisation".

Building a New Open Economy

Another potentially significant move under the Decision is China's determination to formulate a "new open economy". This aims to facilitate the two-way cross-border flow of financial and other resources and to further enhance international cooperation. Specifically,

- China will relax entry barriers on foreign investors and maintain a stable, transparent and efficient foreign investment regime. Going forward, the government will
 - gradually open up the financial, educational, cultural and medical sectors to foreign investment and relax existing investment restrictions on nursing, architectural design, accounting and auditing, commerce logistics and e-commerce business;
 - deepen and broaden the reform within the China (Shanghai) Pilot Free Trade Zone which is reflective of the general direction of China's future policies and which provides a testing ground for the government to try out experimental measures. An increasing number of similar free trade zones will be established on a national scale;
 - allow domestic enterprises and individuals to carry on overseas investment and other activities such as greenfield investment, M&A, securities investment and joint investment; and
 - work closely with foreign governments on bilateral or multilateral treaties to reform the administrative regime for overseas investment and to better protect investors' interests.
 - The government will accelerate the construction of free trade zones (FTZ) in other parts of China. The wider FTZ network will be the pilot in experimenting reforms in various major areas such as market access, customs administration, inspection and quarantine, environmental protection, investment protection, government procurement and e-commerce.

POLITICAL SYSTEM: STATUS QUO

The fundamental mechanics of the existing political regime will remain unchanged. The Decision declares that socialism is the cornerstone of China and the central leadership is adamant to preserve CPC's immaculate power and interests. It would not be surprising that the progress of political reform, if any, would be slow,

The Decision stresses respect for the Constitution as being of the highest legal authority, the improvement of the enforcement of administrative laws, the safeguarding of judicial rights and

independence, and legal protection for human rights. Particularly, the Decision recommends the establishment of a general legal advisory regime and a platform whereby the public may scrutinise the legislative process and the use of authority to avoid abuse.

PRIVATE INVESTMENTS IN CULTURAL INDUSTRIES

A potentially significant development revealed in the Decision is that the threshold for private investment in the publication and film production sectors would be lowered.

REFORM OF SOCIAL WELFARE

The maintenance of social stability in China is of paramount importance. To achieve this, China will strive to ensure social welfare is provided on a fair and sustainable basis. As stated in the Decision, "the reform of social affairs is vital in guaranteeing that all citizens enjoy the fruits of China's development". Sectors in which social welfare reforms have been proposed include education, employment, income adjustment, social security systems and medical.

ENVIRONMENTAL PROTECTION

This is part of China's ultimate goal to build "a beautiful China". The government will improve the system of property rights on natural resources and better regulate their usage. A compensation scheme will be put in place to address the misuse of natural resources that has adversely impacted on the ecosystem.

NATIONAL DEFENCE AND MILITARY AFFAIRS

In light of ongoing territorial disputes with neighbouring countries, the need to protect and preserve China's territorial jurisdiction has driven the CPC to approve the establishment of the State Security Council. While specific details on the functions of the State Security Council are yet to be released, the Explanatory Note describes them as being the formulation of national security strategies, the promotion of national security regulations, and the devising of national security plans. It is anticipated that the State Security Council would consolidate the powers of the Central Military Commission (which controls the armed forces), a foreign affairs leading group and a national security leading group, and operate in a way similar to that of the U.S. National Security Council.

CPC'S LEADERSHIP

Last but not least, the Decision calls for the strengthening and improvement of the CPC's leadership in coordinating efforts to ensure the success of the reform. A central Leading Group on Deepening Comprehensive Reform" will be established as spearhead to design reforms on a "top-down" basis, to play a key coordinating role among authorities, to promote integrated reforms and to supervise the implementation of reform plans.

TIMELINE

The Third Plenum has set 2020 as the deadline for achieving "decisive results" of the key objectives under the Decision. This timeline is consistent with the time frame set out at the Sixth Plenum Session of the 16th Central Committee of the CPC in 2006, which declared that the goal to achieve "a harmonious socialist society" would have to be achieved by the conclusion of the 13th Five-Year Plan (2016-2020).

CONCLUSION

The Decision is a high-level document that covers an extensive spectrum of reform plans. It points out the directions for the future development of China by establishing firm and fundamental ideological concepts. It is upon this framework where relevant government authorities are required to amend existing regulations or issue new ones to effect concrete liberalisations.

Remarkably, following the release of the Decision, the Governor of the People's Bank of China, Zhou Xiaochuan, has expressed that China will place stronger emphasis on the role of market exchange rates, and that the central bank will "basically end normal intervention in the currency market". Zhou further indicated that participation in the Qualified Domestic Institutional Investor program and Qualified Foreign Institutional Investor programs will be relaxed and restrictions will eventually be abolished to promote inbound and outbound investments in the capital market.

In conclusion, the Document evidences that China is clearly aware of the rising importance of connecting with and opening up to the global market. While facing multiple challenges on the economic front, the new Chinese leadership has demonstrated its determination to transform China into a more liberal and investor-friendly market. Hopefully, future regulations will be effective in implementing the reforms under the Decision so that China and the investors, domestic and foreign alike, will truly achieve growth and benefit from new development opportunities.

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