

New Roadmap for Achieving the China Dream

Business and economic implications of the Third Plenary Session of the CPC's 18th Central Committee

A year after taking office, China's new leadership led by President Xi Jinping has unveiled the much-awaited reform roadmap, which is to guide the nation's development over the next decade.

The 20,000-word roadmap – the *Decision by the CPC Central Committee on Several Major Issues Concerning the Comprehensive Deepening of Reform* – was adopted at the Third Plenary Session of the 18th Central Committee of the Communist Party of China (CPC) held in Beijing from 9-12 November 2013. Traditionally, grand reform plans are announced during the third meeting as new

leaders are seen to have had time to consolidate their position. The most famous Third Plenary Session of the 11th CPC Central Committee in 1978 marked the end of class struggle and the start of a strategy of reform and opening up.

The new comprehensive roadmap, which met most of the public's expectations for the plenum, is likely to bring about a new round of economic reform and will have significant implications for Chinese enterprises and foreign companies operating in and doing business with China.

Key highlights of the roadmap include:

- The market is granted a “decisive role” in the allocation of resources, a change from its previous “fundamental role”
- The focus of the new round of reform is economic restructuring, and the key issue is to define a proper relationship between the government and market
- The private sector is granted the right to set up banks and participate in the restructuring of state-owned enterprises (SOEs)
- The “inviolability” of property rights of the private sector is emphasised
- The government is to retreat from approving corporate investment decisions on projects
- The market will be given a greater role in price determination
- A judicial court will be established to protect intellectual property rights
- The “one-child” policy will be relaxed
- Foreign companies will enjoy national treatment on market access, provided that investments are not in areas covered by the ‘Negative List’
- Barriers to entry for foreign investment in finance, education, culture, healthcare, elderly care, construction design, audit and accounting, logistics, e-commerce and manufacturing will be lowered

The plenum decided to establish a high-level “leading group for comprehensive deepening of reform” to manage the design, planning, coordination, implementation and supervision of the reform measures. A new National Security Committee will also be set up.

The CPC plenary sessions aim to set the tone and provide principle guidelines for the country’s overall development. Detailed implementation plans will be worked out by the respective government agencies at a later stage.

Based on information from the roadmap and communique from the plenum, we expect the Chinese market will face profound changes in a wide range of sectors.

Lowering market barriers

- **Equal treatment for foreign enterprises, with barriers to sectors lowered or removed**
- **Business registration process will be simplified**
- **Prices will be decided by the market, not by the government**

The plenum has vowed to build a “unified, fair and open market system” where domestic and foreign companies will enjoy “equal rights, equal opportunities and equal rules”. Enterprises, unless under special circumstances, are free to make their own investment decisions without the need to seek government approval. Companies will be allowed to engage in any business not included in a “Negative List” of sectors. Business registration procedures will be simplified and the government will no longer seek to verify the amount of capital registered. More free trade areas like the China (Shanghai) Free Trade Zone are expected to be set up.

Barriers to sectors are also to be reduced or removed. For instance, in the healthcare industry, private investors will be allowed to set up new clinics, especially not-for-profit medical institutions, and to participate in the restructuring of public hospitals. Private investors are also granted permission to engage in online and print publishing, restructuring of art troupes, as well as to take a majority stake in the production of state films and TV dramas.

Companies and individuals in China are given freedom to invest overseas at their own risk. They are allowed to engage in foreign construction contracting and labour service cooperation projects as well as green-field investments, securities investments and mergers and acquisitions.

Pricing of products will be determined by market demand and supply factors and the government will no longer intervene. Prices of water, petroleum, natural gas, electricity, transport and telecoms will be subject to market reform and competitive pricing mechanism.

Meanwhile, the plenum pledges to deepen reform of the judicial system to ensure that judicial and procuratorial bodies independently and impartially exercise their respective powers pursuant to law. A judicial court on intellectual property rights will be set up.

These measures will increase the ease of doing business in China, with companies exercising greater autonomy in managing their businesses.

Reform of government functions

- **Role of government is redefined**
- **Government intervention in daily corporate operation will be reduced**
- **Higher performance ratings will be awarded to environment- and energy-related work**

In conjunction with allowing the market to play a “decisive” role in resource allocation, the plenum pledges to transform government functions to create a “service-oriented” government that is “ruled by law”. The role of government has been defined to formulate and implement development strategies, plans, policies and standards, supervise market activities, provide public services and safeguard against market failures.

According to the latest roadmap, the government will “to its greatest extent” reduce intervention in daily operation of enterprises and abolish all approvals in areas where market mechanisms will suffice. The size of government departments and number of leaders will be reduced. Tighter budget controls will be imposed on government expenditures to reduce extravagancy on items such as cars, meals, overseas tours and government buildings construction.

The GDP growth-focused performance evaluation system will be amended to provide higher ratings to work related to environmental protection, energy conservation, production safety and technology innovation. Government agencies are also required to engage services from the private sector through a tendering process.

These measures, while improving the government’s transparency and efficiency, will help reduce corporate operation costs and create more business opportunities.

SOEs versus the private sector

- **The state ownership will remain “dominant” in the economy**
- **The private sector is an “important component” of the economy**
- **“Mixed ownerships” between public / private enterprises are encouraged**
- **Private investment is encouraged in the restructuring of SOEs**

The plenum maintains that China’s basic economic system is based on “the dominant public ownership” developing along with diverse economic ownerships. It reiterates the influence of the public sector. It also vows to develop the private-sector economy, which is recognised as an “important component of the socialist market economy”.

The roadmap also states that China will “safeguard the economic rights and legal interests” of all economic ownership, while providing fair and equal treatment to all entities.

According to the roadmap, different forms of ownership that cross-hold shares to create greater “mixed ownerships” are encouraged. It calls for SOEs to transform themselves into “national capital investment companies (NCICs)”, whose main tasks are to focus on economic sectors crucial to national security, and to provide public services, develop strategic industries, protect the ecological environment and support technological advancement.

It states that projects run by the NCICs should allow private enterprises to own shares in them. The monopoly sectors run by the NCICs also need to undertake reform measures to separate government functions from enterprise, and work to bring in competition. According to the roadmap, “all forms of administrative monopolies should be abolished”.

The NCICs are also required to set up a system in which professional managers are engaged to promote entrepreneurship. SOEs are encouraged to recruit more management staff directly from the market.

These changes will benefit the private sector by allowing privately-owned enterprises access to areas previously off limits to them. Many new business opportunities, such as corporate restructuring, mergers and acquisitions and project investments, are likely to arise.

Financial reform

- **Greater market access for domestic and foreign financial institutions**
- **Interest rates liberalisation is expected to accelerate**
- **Opening-up of the capital market will be promoted**

In addition to its support for establishing private banks, the plenum also unveiled financial liberalisation measures that grant greater market access to domestic and foreign financial institutions. The government will promote the reform of financial institutions and the registration platform for initial public offerings, improve the multi-tier capital market system, promote equity financing, develop the bond market and raise the ratio of direct financing. It will also improve the insurance compensation platform and establish a calamity insurance system. A bank deposit insurance system will be introduced.

The plenum calls for accelerating the liberalisation of interest rates and promoting the further opening up of the capital market on market entry and exit. While no timeline has been set, measures to bring about renminbi (RMB) convertibility under the capital account is expected to gather pace.

Fiscal and taxation reform

- **Redistribution of power and authority between central and local governments**
- **Budgetary transparency and efficiency to be a focus**
- **High energy-consuming products will be taxed; a wider roll-out of VAT is expected**
- **Property tax may be introduced**

As the world’s second largest economy, China’s GDP rose from RMB364 billion in 1978 to RMB52 trillion in 2012, and the government’s fiscal revenue jumped over 100 times to RMB11.7 trillion last year. Still, there remain many problems such as an unbalanced fiscal distribution between central and local governments, low transparency and overspending on construction projects.

To combat these issues, the plenum will improve legislation and form a clearer divide between power and authority among different levels of government. It will also focus on budgetary transparency and increasing efficiency. In response to calls for lower taxes, pledges were made to bring about changes to improve the local taxation system, gradually increasing the ratio of direct taxes and promoting value-added tax (VAT) reform. Meanwhile, tax incentives provided by local governments will be reined in and subject to rules based on a unified national tax regulation.

Going forward, the consumption tax will be adjusted to apply to high energy-consuming and heavy-polluting products as well as some luxury goods. Further reform to the resources tax will also accelerate. The government will accelerate the legislation of a property tax and individual income tax-rates will be adjusted.

Urbanisation and rural development

- **A new type of urban-rural relationship is expected**
- **More property rights will be granted to farmers**
- **The hukou system will be reformed**
- **The “one-child” policy will be relaxed**

As the roadmap indicates, the existing “dual urban-rural economic structure” hinders the integration of urban and rural development. To better coordinate the country’s urbanisation drive, the plenum advocates a new type of industry-agriculture relationship whereby farmers are able to equally participate in China’s further economic development and growth.

For the first time, the plenum pledges to “give farmers more property rights”. Farmers will be entitled to own property rights over their land and housing, and will be able to mortgage and trade their land rights.

In establishing “a unified urban and rural construction land market”, rural land will be given the same rights and price levels as state land, providing farmers with the chance to benefit from the appreciation of their land value. This may have a significant impact on China’s inflated housing market.

The controversial residence permit (*hukou*) system will undergo a reform. Residents will be given access to freely migrate to towns and smaller cities, while *hukou* restrictions in medium-sized cities will be gradually lifted. However, the number of *hukou* in bigger cities, however, will remain under strict regulation.

The rigid “one-child” policy is to be relaxed. Couples are allowed to have two children if either parent is an only child. This is likely to expand the population by around one to two million each year, and to some extent help alleviate China’s rapid ageing problem.

While this is a big step forward for farmers seeking to leave their rural dwellings, most migrant workers prefer to move to bigger cities where there are more job opportunities and better access to education and healthcare services. It remains to be seen how effective this policy will be.

Environmental protection

- **Property rights ownership over natural resources will be introduced**
- **Prices of natural resources will be reformed**
- **Emissions trading markets will be promoted**

The plenum pledges to build “ecological civilisation” and protect the environment “through system mechanism.” It calls for establishing clear property rights ownership over natural resources such as river, forest, mountain and land and enforcing their proper usage. Strict enforcement will be granted to protect the designated ecological reservation areas.

It emphasises the principle of paid use of resources and the polluter-pays principle. Prices will be reformed to reflect true values of natural resources according to demand and supply forces, the extent of their scarcity and restoration costs of ecological damage.

The plenum pledges to further develop the environmental protection market by promoting the exchange of carbon emission rights, energy conservation volume, waste discharge rights and water rights over a trading system. It calls for the introduction of a “capping” system over the total amount of waste discharge and for independent environmental supervision and enforcement.

In the coming years, the government is expected to take tough actions to reduce production in energy-intensive industries such as steel, cement, electrolytic aluminium and chemicals.

Extractive industries such as mining, and oil and gas, will need to factor in ecological restoration and compensation costs when drafting their business plans.

Conclusion

China’s leadership has clearly shown a firm commitment to continuous reform and opening up. The targets and approaches identified are a result of numerous fact-finding missions by the senior leaders and through close consultation and compromise with all relevant stakeholders.

The scale of the new round of reform will be enormous, as the party aims to adopt a holistic approach to cover the economic system, political system, cultural system, social system, environmental system as well as the development of the party system. But the Chinese leadership has expressed its confidence in dealing with the challenges and institutional barriers it may face and delivering the outcomes as planned in the roadmap.

In the coming months, we expect that more detailed implementation plans will be discussed and released, with many legal changes to be approved by the National People’s Congress in March 2014.

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