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Third Plenum – disappointingly vague or refreshingly bold?

- **A communique vague on detail – but a big bang was always unlikely**
- **Reform is still on; pace to accelerate**
- **But output growth rates will still slow in the future**

Following the much-hyped 3rd Plenum of the 18th Party Congress (9th 12th November), the preliminary communique has been carefully dissected with as many interpretations as there are commentators. Depending on your perspective the document could be read as disappointingly vague or as refreshingly bold. In truth, we can gauge the continued reform work; and – more importantly – until 2020 when we can see the results of the reforms. That being said, there are some points that deserve to be highlighted – some of which have been broadly speaking ignored. In addition, more details were released today, giving further insight into the discussions.

Much has been made of the fact that there will be a Chinese National Security Council. In truth, it would probably be better to ask why there wasn't one in the past. A more important point seems to be the announcement of a Leading Small Group on Comprehensively Deepening Reform. This implies that the authorities are aware of the difficulties likely to face reform, notably from entrenched interests; and that they are determined to press on regardless. We do not yet know the composition of this Leading Small Group. However, if, as seems likely, it will be headed by one of the six Vice Premiers or potentially even by Premier Li Keqiang himself, it will be a powerful signal of the leadership's commitment. (Interestingly, there was once a similar group tasked with co-ordinating reform; but it was disbanded in 2001.)

There are more reform details in the so-called 383 Plan, published in late October by the Development Research Centre of the State Council (ie, government). '383' refers to a reform trinity (market; government; and corporations), eight key sectors (administrative reform; basic industry; land reform; finance sector; fiscal and tax reform; SOEs; innovative and green development; and opening up the economy) and three breakthroughs (lowering market entrance to invite investors and increase competition; setting up a basic social security package for all citizens; and allowing collective lands to be traded on the market). But, while interesting, bold and more detailed, this is still an outline, not a plan.

Further details of the 3rd Plenum discussions were released on Friday 15th November. This release highlighted reforms to the much-criticised *hukou* (domicile registration) system and social security reform. It also said that China will ease its family planning policies (the so-called one-child rule, admittedly already much eroded) and abolish its labour camps. Land reform was discussed more explicitly with an increase in property rights for rural citizens, likely through the ability of migrants to sell or lease their farms to help support their new urban lifestyles.

One of the vested interests likely to oppose reform is, as ever, the management of the state-owned enterprises (SOEs). While the communique emphasises the dominant role of public ownership and state owned enterprises, the language clearly points to injecting further competition in the economy with markets playing a 'decisive role' in allocating resources. This may not always be easy; there are some

Stein Brothers (UK) Ltd.
Telephone: +44 (0)7768 094 340
Email: gabriel.stein@steinbrothers.co.uk

sectors where the SOEs form oligopolies (eg, telecommunications and utilities) and where they are likely to block new entrants. But the status of the SOEs may no longer be what it once was. The communique talks about the need to "vigorously develop a mixed ownership economy". This is apparently code for allowing private capital to take larger stakes in SOEs. At the moment, they are able to take a 50% stake; but it seems that the idea is that this limit will be raised. It may not apply to all sectors, certainly not strategic ones like arms; but it is likely to apply to newer and more dynamic sectors.
Another point that bears mentioning is the 2020 deadline ("The Plenum demanded that decisive results are achieved in important areas and crucial segments by the year 2020"), again showing a determination to move ahead. That being said, reform will remain piecemeal. Significantly, the communique very deliberately copied a phrase from the 1978 3rd Plenum, namely "crossing the river by feeling the stones", intended to reassure opponents that there will be no precipitous rush into misguided reforms.

The most difficult reforms remain the issues of capital account and interest rate liberalisation. These were obliquely referred to in the communique – but not openly so, leaving some commentators with the impression that they were not discussed at all. Again, however, the repeated use of terms like 'reform' and 'the decisive role of the market' shows that these plans remain on track. It is just that anyone who expected immediate results in the shape of a big bang, are likely to be disappointed. As expected the free trade zones, particularly the new Shanghai FTZ, is likely to play an important role in experiments with interest rates and capital account liberalisation. Xinhua, the official news agency, wrote that China will relax restrictions on investment and step up the development of free trade zones and increase opening-up of inland, coastal and border areas. The intention to accelerate capital account liberalisation was another point highlighted in the 15th November release.

The overall impression from the 3rd Plenum is that economic reform remains on track and that its pace will accelerate. The slower Chinese output growth in the wake of the Great Recession has shown that the export-led growth model – dependent as it is on demand elsewhere – has reached the end of its usefulness. Hence, reform is not only desirable, but necessary in order to change the growth pattern. Even so, reform will not enable China to maintain past growth rates. In the future, Chinese growth will have to come more from higher productivity growth and from a greater share of household consumption. At the same time, there is clearly a move to massage down expectations of future growth. There are rumours that the official growth target will be lowered to 7% in the near future; but where previously official growth targets were conservative estimates expected to be exceeded, they are now becoming more realistic targets that should be achieved, if possibly with some effort. Significantly, Finance Minister Lou Jiwei last summer talked about 6½% as acceptable (although this was quickly redacted to 7½% on the Xinhua website). It may well turn out to be less than that – but it will be more balanced and more sustainable.

Gabriel Stein 2013-11-15
gabriel.stein@steinbrothers.co.uk

Stein Brothers (UK) Ltd.
Telephone: +44 (0)7768 094 340
Email: gabriel.stein@steinbrothers.co.uk