

Reflections



Overview

The annual sessions of the National People's Congress (NPC) and the Chinese People's Political Consultative Conference (CPPCC) began in China's Great Hall of the People on March 3, 2012 and concluded on March 14. Referred to as the *lianghui* (Two Meetings), the event is a gathering of China's two national legislative bodies. The CPPCC debates policy and offers advice, while the NPC passes major legislation, and approves the national budget and government work plan for the coming year.

The NPC is technically the highest organ of state power in China, but major decisions are largely guided by the Communist Party. That said, the Two Meetings offer an important opportunity to gauge the political temperature in Beijing and nationally, and determine important policy trends.

Six Business Takeaways

"Domestically, it has become more urgent but also more difficult to solve institutional and structural problems and alleviate the problem of unbalanced, uncoordinated, and unsustainable development"

—Wen Jiabao



Slower growth makes reform more difficult. GDP growth target for 2012 was pegged at 7.5%, its lowest level since 2004. Though only an indicative target, slower growth gives China's leaders less latitude to implement political and economic reforms. Business executives will face greater pressure to be more risk averse, slowing restructuring of operations and causing a loss of some flexibility.

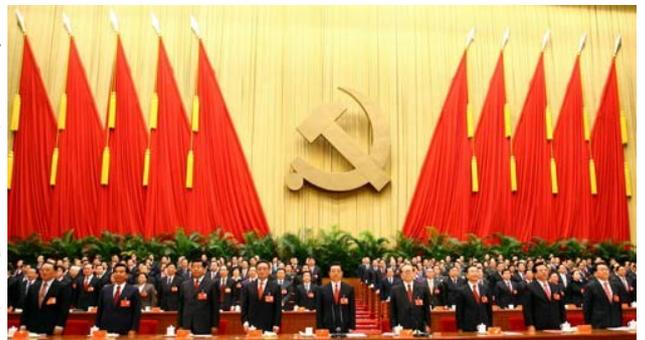
Cultural development increases nationalism. Following last fall's Central Committee meeting, the NPC continued promotion of Chinese culture old and new as an anchor for morality and source of social cohesion. From Mao's era, Lei Feng has made a comeback. This trend could quickly evolve to increase nationalism, supporting the emergence of "national champion" companies. Acquisitions and regulatory approvals for MNCs may become harder. Celebration of Chinese distinctiveness will prompt MNCs to reassess corporate positioning and product branding as well as speed the process of localization.

Economic rebalancing changes the business landscape. Increasing domestic demand and consumption in China's economic mix will have repercussions for specific sectors and geographies. The transitions will offer opportunities for services and consumer goods industries. There will be increasing restrictions on companies with energy and resource-intensive operations to change their business models or relocate from the Pearl and Yangtze river deltas and Bohai region to central and western China.

Rule of Law takes another step. The Criminal Procedure Law was the one significant piece of legislation passed by the NPC. Though not considered as central to doing business, this law represents an additional small step along the long road towards greater rule by law. It includes a clause "respecting and safeguarding human rights", and legalizes arbitrary detention.

Role of state sector is unsettled. The debate over economic reform is unresolved within the NPC. The anniversary of Deng Xiaoping's 1992 southern tour and convenient timing of the World Bank / DRC report were seized upon by the proponents of market reform. Also contributing was the push for more funding of SMEs. Yet, SOEs maintained strong support within the NPC and continue to consolidate and gain market share in many sectors. The outcomes of this debate are particularly important to MNCs as they determine their latitudes for maneuver within China's market structures. No resolution is expected in the short to medium term, but the debate should be monitored closely and will figure in the maneuvers around the upcoming Party congress.

Fifth generation leaders have limited latitude for political reform. As the first leaders to lack the personal imprimatur of Deng Xiaoping, the 5th generation leadership will have to establish their authority by consensus-building among the various special interests within the Party. The upshot is that the preconditions for significant reform are absent. The NPC reinforced the view that the new leadership will be initially tentative.



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Policy Focus

Slow and steady—MACROECONOMIC POLICY:

Premier Wen announced that China will continue to implement a proactive fiscal policy and a prudent monetary policy, with the following targets:

- **GDP growth at 7.5%**
- **CPI at 4%**
- **Government deficit at 1.5% of GDP**

The GDP target is the lowest since 2004, and reflects the growing challenges to China's continued growth (namely weakening demand at home and abroad), as well as a desire to concentrate on the "quality" of growth. In the past, actual growth has always overshot the target, and most experts expect growth to be 8-9% in 2012.

Price stability remains a top priority for policymakers. Easing inflation expectations in recent months (CPI of 3.2% in February) will not translate into monetary loosening, but will instead allow more room to carry out price reforms in the energy sector.

China's projected budget deficit is lower than many expected (and hoped for), but does not mark any decrease in spending. In fact, total government spending is projected to increase by 14.6%.

Not so fast—INCREASE DOMESTIC DEMAND:

In order to rebalance the economy and reduce China's exposure to external shocks, a main goal of policymakers is to move away from the current export-led, investment-driven growth model to one driven by domestic demand. Key policies to effect these changes are:

- Raise individual income as percentage of national income
- Raise minimum wage
- Expand consumer credit
- Focus fiscal policy away from investment
- Implement paid vacations to encourage consumer spending on travel, fitness, and tourism
- Increase dividends paid by state-owned firms and raise bank deposit rates to direct funds away from investment
- Encourage online shopping and support consumption of environmentally-friendly goods
- Reform the income distribution system by raising the proportion of individual income as a percentage of national income

While all of these are sound policies that push China in the desired direction, rebalancing will not happen in the near term. The government itself reports that growth in consumer demand will fall in the coming year, and growth in fixed-asset investment will continue to outpace growth in retail sales.



Building a social safety net—SOCIAL POLICY:

Building a social safety net serves a twofold purpose: it alleviates social pressures arising from China's large and growing income inequality, and it frees up money for consumption by alleviating the need of households to save for basic services. 2012 policies and targets include:

Expanding access to healthcare

- Raise subsidies for medical insurance for non-working urban residents
- Institute a rural cooperative medical care payment of 240 yuan per person per year
- Further improve the social security system and the services for people with disabilities

Increasing employment

- Encourage growth in industries that supply a large number of jobs
- Implement policy to promote entrepreneurship
- Improve training and professional skills for those outside the workforce
- Increase spending on science and technology, education, culture, health, and sports programs by RMB 2.82 trillion to ensure a well-rounded workforce

Improving access to housing

- Complete five million and begin construction on seven million low-income housing units
- Strictly enforce policies discouraging speculative or investment-driven housing
- Relax eligibility for urban household registration and reduce difficulties faced by migrant workers in securing services, i.e. employment, social security, housing and children's education

The Hu and Wen administration has long made "social harmony" a cornerstone of its policy focus, but discontent among the poor and rural citizens has increased in recent years. These policies look to address this discontent, but implementation will be dependent upon the willingness of local leaders to absorb the significant costs associated with such programs.

Policy Focus

Moving up the value chain—HIGHER QUALITY GROWTH:

Chinese leaders want to make the Chinese economy both more productive and more environmentally sustainable. Key policies include:

Invest in strategic emerging industries

Reform energy prices to better reflect the market

- Make the price of electricity better reflect the price of coal
- Reform prices of refined oil products and proceed with price reform of natural gas
- Implement progressive pricing mechanisms for nuclear power, hydropower, and power generated from other renewable energy sources

Make growth more environmentally sustainable

- Develop major energy conservation and environmental protection projects
- Impose strict control of water resources and reform prices of agricultural-use water
- Expand trials of carbon emissions trading and cap-and-trade schemes for pollution
- Restrict loans to industries that are energy-intensive, have high emissions or possess excess production capacity

Reform state-owned enterprises (SOEs)

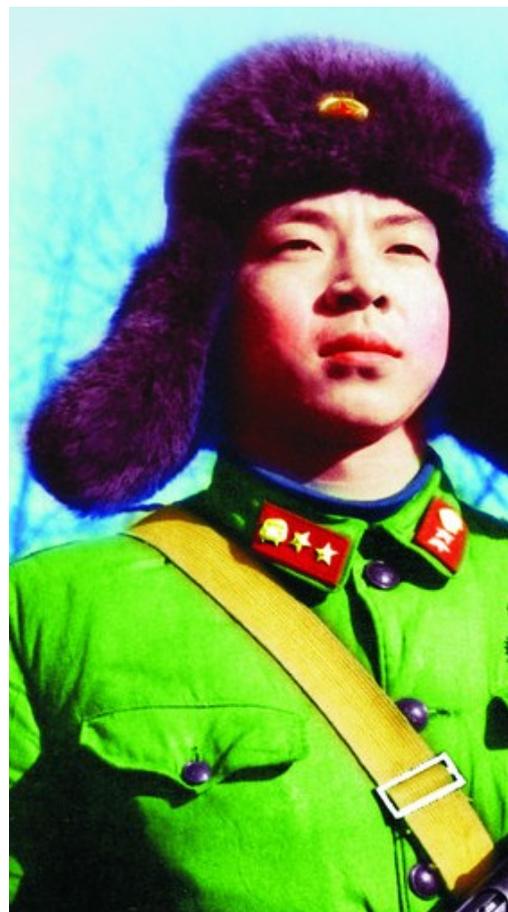
- Create 'national champion' organizations that can compete internationally
- Upgrade and revitalize traditional industries
- Break up monopolies and relax restrictions on market access to encourage investment

Support small, micro and individually owned businesses with preferential tax policies

Reform the financial system

- Establish a deposit insurance system, and reform policy-based financial institutions
- Improve initial public offerings and better protect investors' rights and interests
- Explore deepening the bond market to reduce dependence on bank lending
- Move towards capital account convertibility
- Actively develop the bond market and accelerate development of the insurance industry

Chinese leaders have talked about the environment for years, but have repeatedly failed to reach their targets for emissions and energy efficiency. It is doubtful that reality will catch up to rhetoric in the short term, especially with growth of environmental spending trailing overall growth in government expenditures. Continued consolidation of SOEs will make them more profitable but will crowd out the private sector and hinder overall productivity gains.



To promote core socialist values, Mao era role model Lei Feng has made a comeback in 2012

Head winds—INTERNATIONAL TRADE

Trade makes up a large part of the Chinese economy, but the government expects total trade to grow by only 10% in 2012, down from 22.5% in 2011. In February China experienced its largest monthly trade deficit in over a decade, and expects an overall trade deficit in 2012. With global demand slowing and protectionism brewing in Washington and Brussels, it is unlikely that Beijing will do much to continue appreciation of the renminbi. The slowdown in trade will give further impetus to improving domestic demand.

Key policies include:

- Implement the "go global" strategy with particular focus on mergers and acquisitions
- Relax restrictions on individuals investing overseas
- Implement the export tax rebate policy, increase financing and credit insurance and help enterprises with difficulties from falling orders, rising costs, and increasing trade friction

The passage during the NPC of the U.S. legislation reinstating countervailing duties (CVD) and a WTO case on rare earth exports puts greater pressure on China to look for trade retaliation.

North Head has a history of providing public affairs services to companies with trade cases in Washington D.C., Brussels and Canberra, involving China and other Asian countries.

Closing Time

Bo Xilai exits stage left.

On March 15, the Ides of March, Bo Xilai was officially removed as Party Secretary of Chongqing. Bo was replaced by Vice-Premier, Zhang Dejiang, who will retain his duties as Vice-Premier.



Bo was recently known for his flamboyant promotion of the 'Chongqing model' that included 'red' songs, anti-triad campaigns, and greater equality. Many were uneasy with his self promotion and ill-disguised quest for elevation to the Politburo Standing Committee. Bo's dismissal should be viewed as part of the preparatory 'clearing the decks' and maneuvering prior to the Party congress.

Number Matters

The following is a collection of numbers collected from following the "Two Meetings".

- NPC Delegates: **2,978**
- CCPC Delegates: **2,262**
- Hong Kong, Macao & Taiwan Delegates: **35**
- Number of Times Government Work Report Applauded: **26**
- Number of CPPCC Proposals: **6,609**
- Participating Media: (Domestic & Foreign) **242**
- Journalists: **>3,000**
- % Foreign Journalists: **30**
- Security Force: **>70,000**
- Assigned Hotels: **17**
- Conference Autos: **449**

Trends in Central Government Expenditures

Largest Increases

Housing	23.1 %
Social Security and Employment	21.9 %
Culture, Sports and Media	18.7 %
Medical and Health Care	16.4 %
Education	16.4 %

Smallest Increases

Resource Exploration, Electricity and Information	6.1 %
Public Security	7.7 %
Transportation	8.1 %
Energy Conservation and Environmental Protection	9.0 %
Stockpiling Grain, Edible Oils and Other Materials	9.4 %

Proposals abound!

Among the 6,609 proposals summited, a few stood out as questionable, whacky and / or insightful. Below is our pick of proposals:

- Nominate the Spirit of Lei Feng to the UNESCO World Heritage Center as the cultural and intangible being
- Issue 500 and 1000 yuan currency bills to meet the needs of economic and social development
- Reduce the legal marriage age to 18 for both sexes, from the current 20 for women and 22 for men
- Legalize prostitution in China
- Legalize live extraction of bear bile
- Establish a transfer platform, through which the poor from minorities can sell the reproductive rights of a second child to the rich
- Compel husbands to pay their wives for domestic labor to publically promote its value and compensate for lack of appreciation
- Start a countrywide program to send criminals to the desert to plant trees to halt desertification in northern China

About Us

North Head is a strategic communications and public affairs consultancy with a clear China focus. It specializes in partnering with multinational companies operating in this dynamic but challenging market, and supporting Chinese companies extending their reach globally. To receive future issues of *China Reflections*, please send an email to info@northheadcomms.com