

# **The 3rd Plenum of the 18th CPC Central Committee: Setting sights on a new China**

**The Fung Business Intelligence Center  
November, 2013**



# Contents

- **An overview of the 3<sup>rd</sup> Plenum and the reform initiatives**
- **Eight “big deals” in the reform blueprint**
- **Our assessment of the reform initiatives**
- **Implications for business**



## An overview of the 3rd Plenum and the reform initiatives

1. The 3<sup>rd</sup> Plenum, which concluded on 12 Nov 2013, introduced reform measures that are widely commented as “the most sweeping changes to the economy and social fabric in China in nearly three decades”.
2. The reform blueprint adopted by the 3<sup>rd</sup> Plenum— the “Decision on Major Issues Concerning Comprehensively Deepening Reforms” (the Decision)—laid out 60 reform initiatives covering six key areas, including: economic, political, cultural, social, eco-conscious civilization, and party building.



3. Most domestic and international investors view the reform package very positively and are impressed by its comprehensiveness and aggressiveness in terms of scope and depth. The initiatives reflect that the new leadership clearly understands the problems that China is currently facing and what medium- and long-term structural reforms are needed to address these problems.
4. In particular, we think that the reform blueprint is solid and specific in terms of the reform goals and implementation measures. If successfully implemented, the reforms would guide China's second half of the journey towards a true market-based economy, and significantly lift China's growth potential in the coming years and decades.



# Eight “big deals” in the reform blueprint

## 1. *Market vs. Government*

### – Deregulation

- Market to be given the “decisive” role in allocating resources (previously “basic”)
- Reduce government approval for economic activities and adopt a negative-list approach to market access management

### – Re-regulation

- Strengthen and improve the five basic functions of the government, including: macroeconomic management, market regulation, public service delivery, social governance, and environmental protection



## **2. *SOE reform***

- Emphasize the co-existence of public and non-public ownership
- Encourage indirect government control over SOEs
- Allow more SOEs to develop into mixed-ownership enterprises
- Increase gradually the SOE dividend payout ratio to 30%, up from the current 0-15%

## **3. *Legal system reform***

- Base government functions on the rule of law
- Judicial system to become more independent from local governments
- Abolish the labor camp system

## **4. *Rural land reform***

- Grant farmers the legal titles of land use rights
- Allow farmers to more freely transfer (sell and buy) their land use rights



## **5. *Financial reform***

- Encourage private investors to establish small- and medium-sized financial institutions
- Accelerate interest rate deregulation
- Accelerate the reform towards capital account convertibility

## **6. *Fiscal reforms***

- Central government to take on more fiscal expenditures
- Establish a debt-management system and a risk-alert system for central and local governments
- Accelerate the property tax legislation process, and introduce property tax in more cities



## **7. *Demographic and urbanization policy reform***

- Allow urban couples to have two kids if one of the spouse is an only child (currently both parents need to be only child)
- Hukou (household registration) system of small- and medium-sized cities will be relaxed, while that of mega cities will be tightly controlled

## **8. *New institutional set ups and specific deadline for implementation***

- A new Central Reform Leading Group will be established to centralize powers in economic domain
- A new State Security Committee will be established to centralize powers in non-economic domains
- Decisive results are to be obtained in key areas in 2020



## Our assessment of the reform initiatives

1. The Decision essentially calls for the government to retreat from its role in allocating basic resources—notably capital, energy, and land. As a counterpart to this retreat from direct market intervention, the Decision spells out the positive roles of government that must be strengthened, which include: macro management, market regulation, public service delivery, management of social stability, and environmental protection. In short, the vision seems to be to move China towards a “pro-market system with a capable government”.
2. On the whole, we hold a positive view on the implementation of the reform initiatives, in spite of the fact that more follow-up details in certain areas need to be provided. We think that the reform package may be more successfully implemented than previous initiatives over the past ten years, as the Decision encompasses a clear and profound roadmap and a largely concrete enforcement mechanism.



3. In particular, the newly established *Reform Leading Group* and the *State Security Committee* would centralize reform enforcement, counterbalance the power of local governments, and help overcome resistance. The specific reform goals and deadline (2020) also showed the strong political will of the leadership to carry out the reform in a timely manner.
  
4. While we expect that the financial and fiscal reforms and some social reforms including reforming the Hukou system, easing the one-child policy, and ending the labor camp may be implemented immediately, more wrenching changes such as land reform, reining the power of SOEs and a more universal social welfare system may take years to show results.
  
5. That said, we think the follow-up details to be worked out will be the result of negotiation with affected vested interest groups. Challenge will also come from slower economic growth in the near term as a consequence of structural reform and its impact on employment and stability. Nevertheless, we believe the pressure might be gradually absorbed by the growth in service industries and the private sector, which would be boosted by the reform measures.



## Implications for Business

1. The deregulation measures and the reforms of SOEs would permit private companies to enter most industries other than those related to national security, such as banks, infrastructures, public services, new energies, telecom, medical services etc. This would significantly boost the growth of the private sector, and lift China's growth potential in the coming decade.
2. Widened market access for foreign investors to a number of service industries, better-defined boundaries between government and market, and proper rule of law would mean more investment opportunities and a more open, efficient and transparent business environment for foreign investors. Eventually, China would move towards a pre-establishment national treatment system, which is part of the TPP requirement.



3. A rough estimate shows that around half of the urban families at child-bearing age can benefit from the easing of the one-child policy, and about 10 million babies could be born as a result of the reform. This could be an immediate boost for baby/child related consumption such as infant formula, baby care products, clothing, education etc., and may help raise China's long-term growth potential by easing the decline in the working age population.
  
4. The Hukou system reform will substantially increase the mobility of farmers and help speed up the pace of urbanization. Since the reform will put the expansion of mega cities in control, while the small- and medium-sized cities will be the main carrier of urbanization, we expect that China's large amount of small- and medium-sized cities will grow rapidly in terms of both population and consumption.



5. The property tax initiatives will become a key part of the long-term property stabilization mechanism. This tax will provide a more stable source of local revenue, and help reduce the reliance of local governments on land sales and reduce the incentive of local governments to push up land prices. In the longer term, it would help reduce the chance of property bubbles.
  
6. The structural reforms may to a certain degree compromise the speed of growth in the near term, and a slower GDP growth rate of around 7% in China in the coming years is anticipated. However, reforms will improve the sustainability and stability of China's long-term economic development.
  
7. Businesses should keep a close eye on the development of the Shanghai FTZ, since some of the deregulation reforms are now under experiment in the Shanghai FTZ. The Decision also declares that "a number of qualified areas will be built into FTZs".



# The End

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