博然思维

BRUNSWICK

CHINA ANALYSIS

FOURTH PLENARY SESSION, 11TH NATIONAL PEOPLE'S CONGRESS

A review of key issues from the 2011 lianghui

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1. INTRODUCTION

On 14th March China concluded the Fourth Session of the 11th National People's Congress ("NPC"), while the National Committee of the Chinese People's Political Consultative Congress ("CPPCC") concluded one day earlier. These annual meetings, held during the first two weeks of March each year, mark one of the most important events in the Chinese political calendar.

The "lianghui", as the two sessions are commonly referred, brought together 2,981 members of the NPC, China's legislature and the highest body of state power, and 2,252 members of the CPPCC, the nation's key political advisory body, into two separate parallel sessions.

Of particular importance, the NPC approved the national economic and social development plan for 2011 and also the 12th Five-Year Plan (2011-2015) which provides key economic and developmental targets for the next five year period. The full version of the final 12th Five-Year Plan is expected to be officially released by Xinhua News Agency within one-week of the close of this NPC session.

Brunswick's team in China have put together an overview of issues addressed in this year's lianghui, including the national economic and social development plans for 2011, key issues raised during the sessions, what they mean to those in China, and the implications to business.

> *"The lowering of the (GDP) target (to 7%) not only demonstrates the government's determination but also indicates a major move to transform the country's economic growth pattern."*
>
> *"We should make full use of this opportunity to adjust the economic growth pattern and address the unbalanced, uncoordinated, and unsustainable factors that have existed in China's economy for a long time."*
>
> *"The more the economy develops, the more attention we need to pay to strengthen social development and ensuring and improving people's wellbeing."*
>
> Premier Wen Jiabao

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2. Key Observations from the NPC

2.1. Leading Issues

Economic Targets

During the NPC officials emphasised China will no longer worship GDP as the cornerstone of its development. Instead Premier Wen stated that economic growth must not come at the expense of resource depletion or pollution. He also stated that it was critical to look at the composition of GDP growth – and in particular the percentage of R&D and education in GDP and energy per unit of GDP.

Key Economic Targets for 2011	
Gross Domestic Product	Around 8% growth
Energy Consumption	3.5% reduction (per unit of GDP)
R&D	1.85% (as a percentage of GDP)
Education	4% (as a percentage of GDP)
Consumer Price Index	Around 4%
Deficit	RMB 900 billion
Money Supply (m^2)	16% increase

Quality, sustainable, and diverse economic growth has been emphasised.

Similar to the government's longer-term position on foreign investment – quality of investment, not quantity of investment – the emphasis on economic growth has taken a similar switch to an emphasis on quality, sustainability, and diversity.

The government has targeted growth of "*around 8%*" in 2011 and "*around 7%*" during the 12th Five-Year Plan.

Economic Reform

Economic reform remains a cornerstone of development and there is broad commitment to "*accelerating economic restructuring*" and "*transforming the pattern of economic development*". Premier Wen has focused on the importance of "*economic restructuring*" since 2004, when he delivered his first work report, except for 2007 and 2008 when the concept was not mentioned. In recent years "*economic restructuring*" has also been closely tied in his opening address to "*opening up*" and the promotion of "*innovation*".

Increased validation of economic reform with Chinese characteristics.

In addition, in the premier's work report this year he opined that while the world economy will continue to recover slowly, the foundation for recovery is still not solid. Economic growth in developed economies is considered weak, unemployment rates are and will remain high, and some countries are still under the threat of sovereign debt crises. The instability in developed economies brings increased concern that the economic model promoted by developed nations is not as strong as previously thought and has given greater support to following economic reform with Chinese characteristics.

New Sources of Economic Growth

R&D spending as a percentage of GDP will reach 2.2% in the next five-years – making it higher than the OECD average.

In addition to specifying new key industry sectors for growth in the coming Five-Year Plan (page 9) officials are targeting to further develop more value-added products and services in order to shift China away from a reliance on investment, low-wage manufacturing, and exports. In addition, there is a clear emphasis on expanding domestic consumption and expanding imports of high-end products – each of which should help rebalance the China's trade balance with foreign nations.

Political Reform

Wu Bangguo, chairman of the NPC, stated in his work report to the NPC that "*we have made a solemn declaration that we will not employ a system of multiple parties holding office in rotation*". Wu also ruled out "*separate executive, legislative, and judicial powers*". The declaration received particular attention

following recent unrest in the Middle East and Africa; however, it is important to note that this is not a new statement by Wu who in his 2009 work report stated basically the same: "*we must draw on the achievements of all cultures, including their political achievements, but we will never simply copy the system of Western countries or introduce a system of multiple parties holding office in rotation, a system with the separation of the three powers or a bicameral system*".

Political reform remains on the agenda; however conflicting opinions exist regarding the nature, role, and timing of reform.

Yet, beyond the past two week's gathering of the NPC it is evident that there are differing opinions among senior officials over the role and timing of political reform. In the past year many have noted that Premier Wen has referenced political reform in speeches and taken significant steps to address sensitive topics, such as his editorial in The People's Daily in April last year titled "*Returning to Xingyi, Remembering Hu Yaobang*[1]". The development of the annual Report on the Work of the Government is a long process with significant drafting, redrafting, discussion, and compromise; in this year's report Wen only managed to promise to "*actively yet prudently advance political restructuring*". Premier Wen has periodically mentioned "*political restructuring*" in his annual Report on the Work of the Government: in 2009 he promised to "*carry out political restructuring in an active yet prudent manner*", in 2005 he committed to "*energetically yet prudently promote political restructuring*", and in 2004 that "*concrete and prudent efforts will be made to promote political restructuring*". During his meeting with the media on 14th March, Premier Wen noted that "*it is by no means easy to push forward political restructuring in a country with a population of 1.3 billion*", but that it should be "*pushed forward in an orderly way*" and "*with stable and harmonious social conditions*". Behind the scene politick regarding political reform continues.

SOCIAL ISSUES AND CITIZENS' WELLBEING

Citizens' wellbeing is becoming increasingly important and prioritised in public statements.

The wellbeing of citizens was given higher priority in the work report and in subsequent discussions than in previous years. The premier stressed that in addition to "*accelerating the transformation of the pattern of economic development*" it was critical to "*ensure and improve the people's livelihood*". Many observers have noted that "wellbeing" defined a large portion of this year's NPC gathering.

In addition, widespread public concern regarding inflation, the cost of housing, and medical insurance and pensions were prominent. In discussing rising housing prices, the premier noted that local governments would be held "*strictly accountable*" for reining in runaway housing prices and that the central government will enhance inspections of local government efforts.

NON-STATE SECTOR

China is currently formulating rules to further enhance the development of the non-state sector, noted Premier Wen during his meeting with the media on 14th March. In May last year the State Council issued new rules, dubbed the "*New 36 Guidelines*" to encourage the non-state sector's involvement in infrastructure, public housing, public services, and financial services. The "new" guidelines complement the previous 36 Guidelines that were issued in 2005. A key emphasis of the guidelines is that China commits to treating all enterprises – regardless of ownership – equally (including market access).

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[1] Hu Yaobang (胡耀邦) served as the General Secretary of the Central Committee of the Communist Party of China from 1981 to 1987, the highest ranking official in the Communist Party. Hu's death in April 1989 led to large gatherings in Tiananmen Square to pay respect to the former leader and ultimately triggered protests that resulted in the June 4th incident. Hu has been rarely mentioned since that time in official government or Party media, or by state leaders.

2.2. Key Concerns and Challenges

Premier Wen dedicated significant attention to outlining challenges.

In Premier Wen's work report he spent longer than in previous years detailing challenges facing China and key public concerns that have yet to be adequately addressed. While difficulties and challenges facing the country have been explicitly discussed in the last two work reports, the amount of attention given to the challenges is noteworthy.

The premier noted that development is not yet well balanced, coordinated, or sustainable. This has led to a number of critical concerns including:

- Resource and environmental constraints hinder economic growth;
- Investment and consumption imbalances;
- Large income disparity;
- Insufficient scientific and technological innovation capabilities;
- Irrational industrial structure;
- Continued weakness in the agricultural sector;
- Uneven development between urban and rural areas and regions;
- Coexistence of pressure to expand employment and structural shortages of qualified personnel in some industries;
- Defects in systems and mechanisms that hinder scientific development.

In addition, the premier acknowledged three key goals from the 11th Five-Year Plan (2006-2010) that had not been achieved. Inadequate growth in the service sector was highlighted; the sector did not yet represent an adequate amount of GDP nor did it employ enough people. In addition, spending on R&D as a percentage of GDP remained too low.

Political acknowledgement of citizens' concerns that remain unaddressed and a driver of this year's developmental plans.

The premier stated that "*we need to put people first, make ensuring and improving their wellbeing the starting point and goal of all our work, unwavering work for prosperity for all and ensure that everyone shares in the fruits of development*" and that "*we must make improving the people's lives a pivot linking reform, development, and stability*". Some of the key public concerns that remain unaddressed included:

- Lack of high-quality educational and medical resources and their uneven distribution;
- Increasing upward pressure on prices, and exorbitant housing price increases in some cities;
- Increasing social problems resulting from illegal land expropriations and housing demolitions;
- Significant problems facing food safety;
- Rampant corruption in some areas.

2.3. 12th Five-Year Plan Objectives

The 12th Five-Year Plan, submitted on 5th March to the NPC for review, was approved on 14th March with 2,778 delegates voting in favour, 59 against, and 38 abstentions. The final full Chinese and English versions of the plan are expected to be released simultaneously in the days following the close of the NPC.

Key objectives in the Plan stated during the NPC are detailed below. At the outset the Plan notes that its goal is to ensure "*a better life*" and that reform should "*ensure and improve the people's wellbeing*" and "*promote long-term, steady, and rapid economic development and social harmony and stability*".

GDP growth lowered to 7% over the 12th Five-Year Plan period.

To become a "moderately prosperous society" officials seek to diversify the economy and grow the service sector.

- **Economic**: As mentioned by Premier Wen during his web chat with netizens on 27th February, the government has set a target of 7% growth in the economy over the next five years (from 7.5% during the 11th Five-Year Plan). Based on 2010 prices, the country's GDP in 2015 should exceed RMB 55 trillion.
- **Services**: The service sector will be further promoted with the goal of raising its value added contribution to GDP by 4%.
- **Urbanisation**: Urbanisation is expected to increase from 47.5% to 51.5%.
- **R&D**: Investment in R&D will increase to 2.2% of GDP.
- **Healthcare**: Further reform of the pharmaceutical and healthcare system will be enacted with a focus on improving the basic medical and health care systems and expanding availability. In addition, basic pension and medical insurance systems will be expanded to cover all urban and rural residents and the proportion of expenses for medical treatment paid out of the medical insurance fund will be increased to over 70%.

Stringent environmental goals are prominently detailed in the 12th Five-Year Plan.

- **Environment**: The proportion of non-fossil fuels in primary energy consumption should reach 11.4%; energy consumption and CO_2 emissions per unit of GDP should be reduced by 16% and 17% respectively; and the release of major pollutants should be reduced by 8% to 10%.
- **Employment**: Over the next five years an extra 45 million urban jobs will be created, an increase approximately the size of the population of Spain.
- **Income**: Per capita disposable income of urban residents and the per capita net income of rural residents will rise by an annual average of over 7% in real terms.
- **Corruption**: The government voiced continued commitment to making "*institutional changes to end the excessive concentration of power and lack of checks on power, and resolutely prevent and punish corruption*".

3. 2011 Targets and Longer-Term Priorities

This year marks the first in the 12th Five-Year Plan. While the finalised Plan was confirmed on 14th March, it will not be published in its entirety until approximately a week following the conclusion of the NPC. In the interim we have outlined the key plans for the coming year. The first year in each Five-Year Plan is considered a key foundation setting period and thus many of the goals below are expected to be consistent with the intent of the 12th Five-Year Plan.

Top 10 Overarching Themes for 2011			
1.	Keep overall price levels basically stable	6.	Strengthen social development and ensure and improve the wellbeing of the people
2.	Further expand domestic demand, especially consumer demand	7.	Vigorously enhance cultural development
3.	Consolidate and strengthen the position of agriculture as the foundation of the economy	8.	Deepen reforms in key areas
4.	Accelerate strategic economic restructuring	9.	Further improve opening to the outside world
5.	Vigorously reinvigorate the country through science and education	10.	Strengthen efforts to promote clean government and combat corruption

Source: Premier Wen Jiabao's Report on the Work of the Government, 2011

3.1. National Economic and Social Issues

Economic Growth

As in prior years GDP has been targeted to grow "*around 8%*" in 2011 from 10.3% actual growth last year. CPI is to be around 4%.

Annual GDP Targets and Real Performance		
	Target	Official
2011	Around 8%	
2010	Around 8%	10.3%
2009	Around 8%	9.2%
2008	Around 8%	9.6%
2007	Around 8%	14.2%
2006	Around 8%	12.7%
2005	Around 8%	11.3%

Source: Report on the Work of the Government and National Bureau of Statistics

Annual growth targets will be reduced to 7% for the 12th Five-Year Plan – a drastic departure from the standard "around 8%".

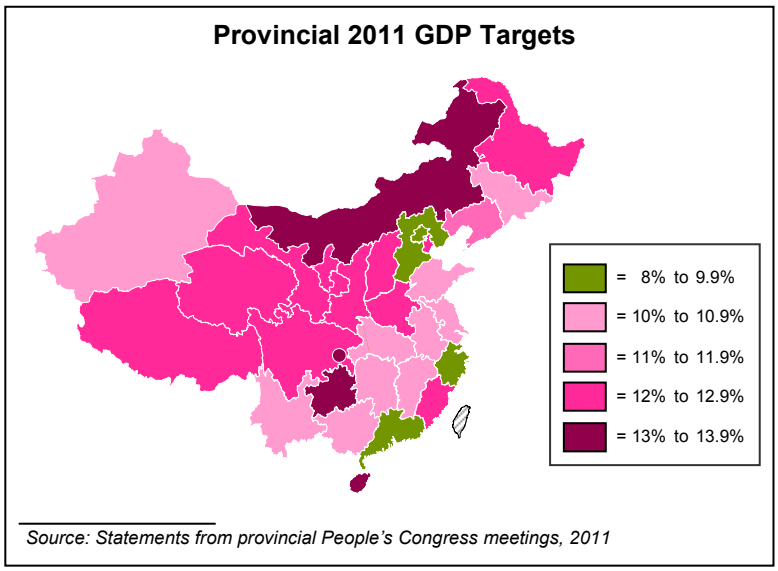
More significantly, Premier Wen announced an average annual growth target of 7% for the 12th Five-Year Plan period, a departure from the magical 8% growth-floor that has been assumed necessary to create enough jobs for the market. Premier Wen stressed that it will not be easy to achieve a high-quality and efficient annual growth rate of 7%, but that it demonstrates the government's determination to "*transform the country's economic growth pattern*". He noted China faced a dilemma that on one hand "*fast growth would bring more jobs but lead to high inflationary pressure*" while on the other "*a slower speed means less new jobs and risks economic recession*".

Emphasis on the quality of growth, sustainability, and citizens' wellbeing.

While China has typically exceeded the annual and Five-Year Plan targets, the fact the target dropped below 7% for the coming Five-Year Plan is a strong signal of the central government's new priorities. In addition to cooling the economy, greater emphasis has been placed on the quality of growth, sustainability, and citizens' wellbeing.

Prior to the NPC, each province and municipality held its own congress in which they disclosed their 2011 GDP targets. The disparity between central government targets and provincial targets is clear with most aiming for growth above 10%.

Provincial GDP targets remain significantly higher than central targets.



Fiscal and Monetary Policy

Originally announced in December, China will continue its "*proactive fiscal policy*" and "*prudent monetary policy*". For the coming year authorities project a deficit of RMB 900 billion, which includes a central government deficit of RMB 700 billion; the deficit is RMB 150 billion less than budgeted last year and will represent around 2% of GDP. Broad money supply (m^2) is targeted to increase by 16%.

The Renminbi will see major progress on the road to full convertibility in the next five years.

CURRENCY

Premier Wen noted that the government is continuing its efforts to make the Renminbi convertible under the capital account. Meanwhile, Hu Xiaolian, deputy governor of the People's Bank of China, commented that while the currency will see major progress on the road to full convertibility in the next five years, no timetable has been set. Meanwhile, Zhou Xiaochuan, governor of The People's Bank of China, indicated that the Renminbi would not play a prominent role in curbing inflation; data released on 11th March indicated China's consumer price index rose 4.9%, year-on-year, in February.

In his meeting with the media Premier Wen noted that while China will "*further expand the elasticity of the Renminbi exchange rate band*" based on changes in market demand, the country "*must take into account that this kind of appreciation will be gradual, because this concerns the capacity of businesses to absorb it and also concerns employment; we must maintain the stability of society as a whole*".

Domestic consumption will increase in 2011 with retail sales to increase 16%.

Consumer Demand

Government spending will be used to increase domestic consumption. In addition, particular emphasis was placed on promoting consumption in the areas of culture, travel, and old-age care, as well as developing new services that promote new forms of consumption such as e-commerce.

Retail sales of consumer goods are projected to increase 16% this year. In the domestic travel sector, 2.31 billion tourist trips will be taken, up 7.4% over the previous year.

Migrant workers living in cities will be eligible to receive an urban hukou.

MIGRANT LABOUR AND THE URBAN HUKOU

Significant emphasis continues to be placed on addressing migrant labour issues. Of particular note this year, officials committed to granting migrant workers urban resident permits if they have stable jobs and have lived in cities or towns for a number of years. The hukou is a system of residency permits that was originally designed to control the movement of people between urban and rural areas; individuals were broadly categorised as either "rural" or "urban" workers.

In addition, programmes will be launched to address remuneration, schooling for migrant children, public health, renting homes, and social security. Previous years have focused on ensuring employment for migrants, managing forced expropriation of homes, and redundancy protection. Rolling on from previous years, officials voiced the importance of equal access to compulsory education for the children of migrant workers in cities.

Employment

In 2011 China will create more than nine million new urban jobs, or just less than the size of Sweden's population of 9.4 million, while over the next five-years it will create 45 million new urban jobs, which is roughly the total population of Canada and Portugal combined. To support this job creation process the central government will invest RMB 42.4 billion to assist and promote employment. Meanwhile, urban unemployment will be no higher than 4.6%.

Income disparity remains a key concern.

New income tax rules to be launched soon.

INCOME

Income disparity remains a key concern. In 2011 the government aims to increase urban and rural per capita disposable net income by at least 8% in real terms, while also increasing the minimum wage.

Individual income tax thresholds will be adjusted to reduce the tax burden on low-and-middle income people while also regulating "excessively high" income, standardising the management of executive pay, and tackling bonuses

in SOEs and financial institutions.

Premier Wen noted "*we will reverse the trend of a widening income gap as soon as possible and ensure that the people share more in the fruits of reform and development*".

TRADE

To address continuing trade balance tension China intends to increase the import of advanced technical equipment, key parts and components, and energy and raw materials. In addition, imports from countries with which China has a large trade surplus will be increased to correct trade imbalances and handle trade friction. On the export side, China aims to increase the proportion of services and outsourcing, and actively expand the export of Chinese branded goods.

INDUSTRY CONSOLIDATION

Trans-regional industry consolidation promoted.

Excess capacity is to be eliminated by encouraging key industries to pursue trans-regional acquisitions, reorganisations, and "*raising the level of industrial concentration*" in China.

REGIONAL DISPARITIES

New investment rules to be released to encourage investment in central and western China.

Regional disparities remain a key concern and are driving aggressive investment incentives in the central and western regions. The National Development and Reform Commission is expected to release a new list of industries in the western region that will be encouraged and revise the *List of Industries with Local Strengths in the Central and Western Regions for Foreign Investment*.

HONG KONG AND MACAO

The premier also noted continued support for Hong Kong and Macao. Particular emphasis was placed on helping Hong Kong enhance its position as an international finance, trade, and shipping centre, while Macao support focused on helping it diversify its economy and develop into a world centre of tourism and leisure. Additional emphasis was placed on enhancing intra-regional cooperation between Guangdong, Hong Kong, and Macao.

12th Five-Year Plan chapter dedicated to supporting Hong Kong and Macao.

When the premier met with media on 14th March he stressed that he felt "*Hong Kong's advantaged position as an international financial centre has not changed*". He noted that the central government would support Hong Kong developing itself into an offshore Renminbi centre and that already Renminbi deposits in Hong Kong exceeded RMB 300 billion. The premier also noted that many of the pilot programmes the mainland had taken in the reform of its financial sector had been first conducted in Hong Kong.

Finally, in order to address concerns that the mainland was breaching the "*One Country, Two Systems*" philosophy by imposing the Five-Year Plan model on Hong Kong and Macao, the premier stressed that the inclusion of a chapter on Hong Kong and Macao is to support development and that it will not be imposed on the special administrative regions.

3.2. PRIORITISED SECTORS

NEW STRATEGIC SECTORS

Prior announcements indicated that the value-added output of the new strategic industries has been targeted to account for 8% of the country's GDP by 2015 and 20% by 2020. Industries include: energy conservation; environmental protection; new energy; biotechnology; high-end equipment manufacturing; new materials; and new energy vehicles.

The Ministry of Industry and Information Technology is expected to submit plans for four of the new strategic industries to the State Council after the Lianghui with plans released publicly in the second half of the year. The industries will include: new energy vehicles; high-end equipment manufacturing; new materials; and information technology industries.

Food security and food safety will drive agricultural investment.

AGRICULTURE

Agriculture, rural areas, and farmers were given top priority for the coming year with particular emphasis on safeguarding food security. This year the central government has allocated RMB 988.5 billion from the central budget for agriculture, rural areas, and farming, an increase of RMB 130.5 billion from last year. In addition, there is emphasis on developing non-agricultural industries in rural areas, improving farmers' vocational skills, supporting local entrepreneurialism, and encouraging non-agricultural employment in rural areas.

RMB 458.9 billion to be invested in agriculture, forestry, and water conservancy in 2011 – an 18.3% year-on-year increase.

Repeated food scares have undermined confidence in domestic food and are driving central plans to restructure the food industry, strengthen food safety monitoring capabilities, and improve the government's ability to ensure food safety.

ENERGY

New energy strongly featured in 2011 and 12th Five-Year plan.

The development of new energy remains a priority with officials aiming to drive the clean use of traditional energy sources, the construction of smart power grids, and the development of clean energy technology. Meanwhile, officials will focus on conserving energy in the industrial sector, construction, transportation, and public institutions, and popularising energy-conserving technology and equipment, and improve energy efficiency.

Key Energy Targets for 2011

	2010	2011
Raw Coal	3.24 billion tons	4.9% increase
Crude Oil	203 million tons	Unchanged
Natural Gas	96.8 billion cubic meters	10.1% increase
Electricity Generation	4.2 trillion kilowatt-hours	8.0% increase
Hydro Power		6.1% increase
Nuclear Power		13.3% increase
Wind Power (on grid)		45.0% increase

Source: National Development and Reform Commission

RMB 159.2 billion is earmarked for investment in energy conservation and environmental protection in 2011 – a 10.3% year-on-year increase.

In concrete terms, the government has set a target to reduce energy consumption per unit of GDP by 3.5% compared to last year. In energy intensive industries the government intends to implement new limits on energy consumption per unit of production, and create energy efficiency standards for energy consuming products.

Key Environmental Targets for 2011

	2011	Last 5-Years
Energy Consumption (per unit of GDP)	3.5% decrease	19.06% decrease
Carbon Dioxide Emissions	3.5% decrease	
Sulphur Dioxide Emissions	1.5% decrease	14.29% decrease
Chemical Oxygen Demand	1.5% decrease	12.45% decrease
Water Consumption *	7.0% decrease	36.70% decrease
Land Afforested (hectares)	6 million increase	

** Water consumption is per RMB 10,000 of value added industry*

Source: National Development and Reform Commission

Pilot cap-and-trade programmes will be launched in 2011.

In addition, pilot cap-and-trade programmes will be launched this year to control overall energy consumption.

Officials aim to strengthen the development of large oil and gas production bases, and improve the structure of the refinery industry. In addition, coal-mining firms will be merged or reorganised to eradicate both unsafe practices and address environmental issues.

In renewable energy officials aim to promote the use of new energy sources

and in 2011 increase installed power-generating capacity of on-grid wind power facilities by 45%.

TRANSPORT

RMB 286.7 billion is earmarked for investment in transportation and transport in 2011 – a 10.3% year-on-year increase.

The build-out of the nation's transportation network remains a high-priority and important transportation routes will be further enhanced this year with priority given to the construction of passenger railway lines, trunk railway lines in the western region, national expressways, national and provincial trunk highways, the main navigation channel on the Yangtze River, high-grade inland waterways, ports and regional airports in the central and western regions, and main airports in the western region.

Key Infrastructure Expansion Targets for 2011

Industry	New in 2011	At Year End
Railway Lines	8,000 km	99,000 km
High Speed Railway	*4,700 km*	*13,000 km*
Highways	120,000 km	4.1 million km
Expressways	*9,000 km*	*83,000 km*
Inland Waterways	400 km	10,400 km
Civilian Airports	6	181

Source: National Development & Reform Commission

Railway targets remain unchanged.

In February the minister of railways, Liu Zhijun, was removed from his post and put under investigation on charges of corruption. Liu's detention, as well as subsequent detentions of other railway officials, called into question previous targets and plans for the sector. The announced targets from the National Development and Reform Commission indicate the railway build-out will continue in accordance with earlier targets.

CONSTRUCTION / BUILDING

Green building and retrofitting older buildings with energy saving features promoted.

China will improve energy conservation in existing buildings, promote energy conservation in new buildings, and accelerate energy-saving renovations to existing buildings. A low-carbon city pilot project is expected to launch this year that will see multiple such cities developed. In addition, a new initiative to expand flu-gas denitration in coal-fired power plants is to launch to control particle pollution. Meanwhile, a special campaign to get 10,000 enterprises to save energy and lower their carbon emissions will be launched together with a new green building campaign.

MEDICAL AND HEALTHCARE

RMB 172.8 billion is earmarked for investment in medical and healthcare in 2011 – a 16.3% year-on-year increase.

In 2011 the government intends to expand the national system for basic drugs at the primary level and put in place a system to guarantee supplies of basic drugs, strengthen drug oversight, ensure drug safety, and reduce drug prices. At the same time initiatives will continue to reform public hospitals, enhance hospital management systems, and the mechanism for setting prices for medical services.

For foreign investors, the government stated it will encourage non-governmental investors to establish medical institutions and expand market access for nongovernmental and foreign investors looking to establish medical institutions.

EDUCATION

Spending on education to reach 4% of GDP.

RMB 296.4 billion is earmarked for investment in education in 2011 – a 16.3% year-on-year increase.

Government spending on education will reach 4% of GDP with greater priority placed on fostering students' ability to think independently, solve practical problems, and be innovative. In 2011, gross enrolment in secondary education is expected to reach 84% and plans call for enrolling 6.75 million undergraduate students and 560,000 graduate students. The preschool education market is also being targeted.

FINANCIAL

Financial market reform will encourage financial innovation, push forward market based reform of interest rates, and expand the use of the Renminbi in

cross-border trade. In addition, the government is continuing its efforts to make the Renminbi convertible under capital accounts. Additional areas this year include accelerating the development of the bond and futures markets, and increasing the proportion of direct financing. Meanwhile, to support rural communities officials are promoting the development of "*new types of rural financial institutions*".

Greater network convergence strongly promoted along with the Internet of Things.

TECHNOLOGY

Greater convergence of the telecom network, radio and television broadcasting network, and Internet continues to be a priority, together with the development of a "*next-generation IT industry*", the roll-out of a high-performance broadband information network, and promotion of the Internet of Things, an initiative closely associated with Premier Wen.

RMB 194.4 billion is earmarked for investment in science and technology in 2011 – a 12.5% year-on-year increase.

In addition, a number of technology programmes were identified as key areas for innovation and development including those on the National Broadband Internet Agenda, cloud computing, the Internet of Things, integrated circuits, flat-panel displays, space infrastructure, regional aircraft and industrialisation of general aviation aircraft, as well as major application and demonstration projects on the health of the people and on using information technology to benefit the people.

Large scale 4G to be commercially launched in three-to-five years.

On the sidelines of the Congress Miao Wei, minister of industry and information technology, commented that "*it will still take three to five years*" until China begins large-scale commercial use of 4G; TD-LTE network trials are currently underway in six cities.

3.3. DIRECT INVESTMENT

FOREIGN DIRECT INVESTMENT

Quality foreign investment prioritised.

The premier reemphasised the government's position that high-quality foreign investment should be prioritised with particular emphasis on foreign investment in advanced technology and research and development. In addition, foreign investment is encouraged in high-end manufacturing, high-tech industries, modern services, energy conservation, and environmental protection, as well as broader investment in the central and western regions.

Updated list of industries for foreign investment to be released.

China in the near-future will revise the *List of Industries for Foreign Investment* and the *List of Industries with Local Strengths in the Central and Western Regions for Foreign Investment*.

OVERSEAS DIRECT INVESTMENT // GO GLOBAL

China's "*Go Global*" plan is to be accelerated. To support the initiatives, the government will improve relevant supporting policies, simplify examination and approval procedures, and provide assistance for qualified enterprises and individuals to invest overseas.

4. RECENT ACCOMPLISHMENTS

At the start of each NPC the premier reports on the work of the government during the previous year, the accomplishments, and some of the challenges. This recently concluded session also included a review of the key accomplishments from the just concluded 11th Five-Year Plan (2006-2010).

We will not detail all accomplishments outlined by the premier and other officials during this year's lianghui; instead, we have touched-on some of the

leading accomplishments highlighted by the premier and other officials.

GDP grew 11.2% during 11th Five-Year Plan.

CHINA'S ECONOMY

The premier noted that China had effectively warded off the impact of the global financial crisis and maintained steady and rapid economic growth. Meanwhile, over the last five years GDP grew at an average annual rate of 11.2% to reach RMB 39.8 trillion with primary, secondary, and tertiary industries growing 4.3%, 12.2%, and 9.5%, respectively, last year. Expanding domestic consumption has been a long-term goal and officials noted retail sales of consumer goods totalled RMB 15.7 trillion, a year-on-year increase of 18.3% and 3.3% higher than targeted. The premier also noted that the trade surplus decreased over the last two consecutive years, and the year-on-year decrease was 6.4% in 2010.

Retail sales totalled RMB 15.7 billion in 2010.

INVESTMENT

Fixed asset investment across the country was RMB 27.81 trillion, up 23.8%. Non-governmental investment accounted for 51.1% of total fixed asset investment in urban areas.

Urban disposable income reached RMB 19,109 in 2010.

INCOME

Over the last five years per capita disposable income of urban residents rose an annual average of 9.7% and the per capita income of rural residents by 8.9% in real terms. Last year, per capita disposable income and rural per capita income reached RMB 19,109 and RMB 5,919, respectively; this represented year-on-year growth of RMB 1,934 and RMB 766, respectively – the first time since 1998 rural income grew faster than urban income.

EMPLOYMENT

Over the last five-years China created 57.71 million urban jobs, greater than the population of Canada and Australia combined, and 45 million agricultural workers found urban employment, approximately the population of the Ukraine. In 2010, 11.7 million urban residents entered the workforce for the first time and the urban unemployment rate was 4.1%.

INFRASTRUCTURE

To drive growth, facilitate travel, and enhance trade China expanded the railway system by 16,000 km over the last five years and the road system by 639,000 km, including 33,000 km of expressways. It also built, improved, or expanded 33 airports. In 2010, 4,986 km of railway were put into operation, raising the total to 91,000 km; 120,000 km of highways were opened to traffic, raising the total to 3.98 million km; and nine new civilian airports were put into service, raising the total to 175.

Meanwhile last year, to support data networks, China expanded its optical cable network by 1.66 million km, raising the total to 9.95 million km; and 49.24 million broadband Internet access ports were opened, raising the total to 188 million.

Central government spending on environmental protection totalled RMB 33 billion in 2010, a 140% year-on-year increase.

ENVIRONMENT AND ENERGY USAGE

In his opening remarks, the premier drew attention to the fact that China had formulated policies, measures, and national objectives for controlling green house gas emissions by 2020. In 2010 investment funds from the central government budget for energy conservation and environmental protection totalled RMB 33.3 billion, a 140% year-on-year increase – and the government provided RMB 51.8 billion in special funding for conserving energy and reducing emissions. The premier also noted that last year China had actively implemented the National Climate Change Programme.

In the 11th Five-Year Plan energy consumption per unit of GDP fell 19.1%.

New power generating units with a capacity of 445 million kW were brought online, including hydropower plants with 96.01 million kW capacity and nuclear power plants with 3.84 million kW capacity. At a more local scale the country has actively promoted energy efficient products and, for example, installed over 160 million energy saving light bulbs.

FINANCIAL REFORM

Over the last five years the country has steadily resolved issue related to the floating non-tradable shares of listed companies; successfully launched the ChiNext stock market; introduced stock index futures and security margin trading; and deepened reform of the insurance sector. In addition, the premier noted that China had made significant progress in the reform of the mechanism for setting the Renminbi exchange rate and expanded trials for settling cross border trade accounts in Renminbi.

SOE REFORM

Enhanced corporate governance in the state sector implemented.

The central authorities have continued to push reform among state owned enterprises (SOEs). Some of these reforms have included converting SOEs into stockholding companies. Last year a corporate system or stockholding system was implemented in over 70% of the central SOEs, at the same time a pilot project for standardising boards of directors was extended to 32 central SOEs.

EDUCATION

During the 11th Five-Year Plan the government invested RMB 4.45 trillion in education and expanded its investment at an average annual rate of 22.4%. In addition, the government made urban and rural compulsory education free so all children of school age can receive education at no cost; compulsory education is for those six-to-fifteen years of age.

MEDICAL

Over the last five years a special fund was established under the state budget to renovate or build 23,000 town and township hospitals, 1,500 county hospitals, 500 county traditional Chinese medicine hospitals, and 1,000 county maternity and childcare hospitals, as well as to build 2,400 community health service centres.

The service industry represents 43% of GDP and contributes 34.8% to employment.

SERVICE INDUSTRY

As part of the leadership's attempt to diversify the economic growth drivers, the service industry now contributes 34.8% of the country's employment while the value-add of the sector accounted for 43% of GDP.

GO GLOBAL

At the end of 2010 Chinese outbound investment totalled USD 220 billion.

At the end of last year outbound Chinese investment reached USD 220 billion and the total volume of contracts to build foreign projects and provide overseas labour services reached USD 335.2 billion. Non-financial outward direct investment for 2010 totalled USD 59 billion.

5. IMPLICATION FOR BUSINESS

In this section we have highlighted some of the overarching implications that are likely to affect businesses operating in China in the coming years.

Significant central spending: While much of the stimulus money has been spent, there remains commitment from government to increase spending to accelerate economic restructuring, which means companies in certain sectors will continue to benefit – such as those in environmental sectors, educa-

tion, high-tech, and healthcare.

Quality of foreign investment: Greater emphasis has been placed on encouraging high-quality, sustainable, and diverse growth over short-term economic gains. Previous focus on quantity of investment is long-gone, foreign firms need to consider quality and alignment with developmental objectives. Investment is being prioritised in high-tech industries, R&D, and new strategic sectors. New policies to encourage foreign investment are expected soon.

Diversifying Growth: As China tries to shift away from being the factory floor of the world and transform its economic growth pattern the mix of investment incentives will shift from a previous focus on lower value-add sectors such as manufacturing to higher value-add sectors such as services. However, China remains large and diverse and new guidelines will incentivise lower-value add industry to central and western provinces – in addition, inland provinces have targeted significantly higher annual growth than eastern seaboard provinces.

Increasing domestic consumption: At the heart of the Five-Year Plan is an effort to expand domestic consumption by raising salaries and providing a stronger social safety net in order to increase the purchasing power of Chinese consumers. While companies can expect to benefit from consumers purchasing more goods – both locally produced and imported – there is expected to be further pressure on operating costs.

Rising operating costs: Operating costs are expected to rise substantially over the next five years as minimum wages are increased to boost domestic consumption and offset inflation pressure, pricing reforms are implemented on raw materials, and environmental policies and enforcement are increased.

Going green: Companies need to review their environmental practices in China and ensure that they are adopting best practices in line with China's continued focus on rectifying environmental damage, lowering environmental pollution, and reducing energy consumption per unit of GDP.

More competition, particularly in strategic sectors: The 12th Five-Year Plan reiterates support for "*national champions*" that can compete globally. Having identified strategic sectors where it aims to drive growth, it is likely Beijing will encourage leading domestic players in these sectors to compete internationally. Foreign companies will face intensifying competition – both in the Chinese market and beyond – from fast-growing and heavily-subsidised Chinese counterparts. In terms of local procurement, foreign companies in strategic sectors may benefit from tax breaks, subsidies, and other preferential policies, particularly if they are willing to locate R&D facilities in China.

Opportunities and risks in innovation: The 12th Five-Year Plan provides a significant boost in R&D spending over the next five years to promote domestic innovation. While initial concerns surrounding "*indigenous innovation*" have been increasingly addressed, foreign firms will need to ensure biases in treatment do not appear. Sectors where China does not have local know-how are expected to see continued incentives and policies to encourage foreign firms to share technology.

State-owned players continue to dominate: Premier Wen called for the private sector to play a more important role in China's economy going forward; however, the Plan is short on concrete details about how the private sector will be encouraged and the state sector continues to receive significant resources to modernise. Capital spending is likely to remain a key growth driver in the coming years providing SOEs capital resources to continue domestic expansion while also pursuing a "*Go Global*" strategy.

6. Political Backgrounder

The Lianghui

The "lianghui" (两会), or two meetings, as the annual gathering of the National People's Congress (全国人民代表大会) and the Chinese People's Political Consultative Conference (中国人民政治协商会议) is commonly referred, is typically held during the first two weeks in March.

National People's Congress

The National People's Congress ("NPC") is the highest legislative body in China and has sole responsibility for enacting legislation in the country. The NPC, which meets once a year in March, enacts and amends basic laws relating to criminal offences, civil affairs, state organs, and other relevant matters. When the NPC is not in session each March, the Standing Committee of the NPC is tasked with enacting and amending laws except basic laws that must be enacted by the NPC.

The NPC is also responsible for electing and appointing members to central state organs – including the Standing Committee of the NPC, the President of the People's Republic of China (currently Hu Jintao), and the Premier of the State Council (currently Wen Jiabao). Based on nominations by the Premier, the NPC is also responsible for appointing China's Vice Premiers, State Councillors, Ministers (in charge of ministries or commissions), the Governor of the People's Bank of China, and the Auditor-General and the Secretary-General of the State Council. It also elects the Chairman of the Central Military Commission and appoints all other members of the Central Military Commission. It also elects the President of the Supreme People's Court and the Procurator-General of the Supreme People's Procuratorate.

The 11th NPC was formed in March 2008 and will serve a five-year term. The 12th National People's Congress is expected to be formed in March 2013.

Third Plenary Session of 11th NPC
Date: 5th March to 14th March, 2011
Participants: 2,981 deputies (elected in March 2008)

Chinese People's Political Consultative Conference

The Chinese People's Political Consultative Conference ("CPPCC") is a political advisory body that consists of representatives from a range of political organisation, academia, business leaders, celebrities, and other experts. The National Committee of the Chinese People's Political Consultative Conference (中国人民政治协商会议全国委员会) typically meets on an annual basis at the same time as the NPC.

Third Plenary Session of 11th CPPCC
Date: 3rd March to 13th March, 2011
Participants: 2,252 members (elected in March 2008)

BRUNSWICK GROUP

Brunswick is the global leader in financial and corporate communications, providing senior counsel to Chinese and multinational clients around the globe on critical issues that affect reputation, valuation, and business success.

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Our approach combines government relations, media relations, issue management, and corporate citizenship strategies to influence public policy, build a strong reputation and find common ground with stakeholders.

The Brunswick team is available to provide additional guidance on issues addressed in this report.

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