

# China

## The State of China's Union: 2006

### Summary

China's largest annual political ritual, the simultaneous meetings of the National People's Congress (NPC) legislature and the advisory body Chinese People's Political Consultative Congress (CPPCC), just concluded after tying up top Party and government officials for almost two weeks. For foreign observers, key pieces of the yearly conclave are the Premier's "Government Work Report" and publication of the NPC legislative agenda. This year's meeting also saw NPC ratification of China's Eleventh Five-Year Plan. Both that Plan, approved by the Communist Party Central Committee in October 2005, and Premier Wen Jiabao's Government Work Report, showed the current administration holding to its policy course of promoting "sustainable economic development" while creating "a harmonious society." These are code words for keeping GDP growth near its current high rate while trying to relieve the severe social dislocations that growth and the breakdown of collective institutions has caused over the past two decades. One important event happened off stage: an official announcement that Executive Vice Premier and number six man in the Party Politburo, Huang Ju, a follower of former President Jiang Zemin, had been hospitalized. In fact, Mr. Huang is dying of pancreatic cancer; and his death should allow further consolidation of political power by Party General Secretary and State President Hu Jintao, who has been governing with a Politburo majority loyal to Jiang.

### Government Work Report: Steady as It Goes

A Chinese Premier's annual "Government Work Report" resembles an American President's "State of the Union Address," complete with its own, Chinese-style political theater. Typically lengthy, Premier Wen Jiabao's March 5 address to the NPC ran 75 minutes and was punctuated on cue by applause from the 3,500 delegates and spectators in the Great Hall of the People. (As one mark of how China is changing, Internet users posting comments to the official New China News Agency website satirically suggested the Premier spare his throat and talk less.)

Premier Wen began his Report with a litany of statistics summing up the economy's 2005 performance: GDP up 9.9% to make China a \$2.28 trillion economy, FOREX reserves at \$818.9 billion, \$60.3 billion in utilized FDI and \$1.42 billion in foreign trade. Urbanites' incomes reached \$1300 per capita and farmers' \$400—both showing solid increases on 2004 but also pointing to the widening gap between city and countryside.

Moving from Wen's statistical summary into dense bureaucratic prose, the Report reflected the current Chinese administration's continuing emphases on alleviating rural poverty, restoring social equities to create a "harmonious society," and ensuring sustainably high economic growth rates. These goals flow from what the Party and government have taken to calling "the concept of scientific development." For a Party and government leadership populated almost entirely by engineers, "scientific" has a nice ring; and the adjective bespeaks the disciplined, gradualist, consensus-building style of governing that Hu and Wen have adopted. Behind the "scientific" label, however, stands the leadership's effort to re-assert central government control and balance on an economy that had been growing a bit too spontaneously for those who maintain central planning ideology.

Hence, as he listed the government's 2005 achievements, Wen Jiabao spoke first of the "macro-economic adjustments and controls" that had cooled the real estate market, dampened fixed-capital investment and lifted the government's fiscal revenues. Macro controls aside, Wen cited the government's elimination of the agricultural tax on farmers and increase of farm subsidies as necessary boosts to rural income. Turning to China's foreign economic relations, Wen noted continuing implementation of WTO commitments, adjustments to the RMB exchange rate, tariff cuts and other measures to facilitate foreign trade. But the bulk of achievements listed concerned "quality of life" issues: environmental protection, healthcare, social security and pensions, and building up the judicial system.

As he identified continuing challenges, Wen placed rural poverty and food security at the top of his list. Excessive fixed-capital investment and over-capacity came next, followed by more social issues—the relatively high costs of healthcare and education, mine and factory safety, and further protection of the environment.

To resolve these issues and fulfill his government’s mandate, Wen enumerated eight policy priorities:

- Maintaining “balanced and relatively fast” economic growth, with 7.5% to 8% targeted;
- Improving the quality of rural life—“new Socialist villages” is the slogan;
- Improving industrial and energy efficiency while enhancing environmental protection;
- Narrowing differences among China’s disparate regions;
- Increased spending on scientific research and manpower;
- Continuing the “reform and opening” begun by Deng Xiaoping in 1978 by spreading growth more equitably across Chinese society;
- Taking better care of “the masses”’ needs in housing, schooling, healthcare and other social goods; and
- Strengthening democratic governance while maintaining social stability.

When sketched on the Eleventh Five-Year Plan, Wen’s statements provide a good guide to government spending and deployment of its other resources. They also echo the Hu/Wen administration’s signature tune: creating in China a “harmonious society” in which all citizens can share the country’s prosperity. That’s the bright side. The underlying truth, though, is that the top leadership has been jarred by the level of social unrest in the countryside—87,000 violent “mass incidents” reported for 2005—plus grumbling discontent among migrant workers and other unenfranchised members of the urban work force. Resolving these increasingly common, increasingly severe social problems will test the leadership’s mettle, for social conflict in today’s China often pits “the people” against the Party, particularly in rural areas where Party cadre remain among the least competent and most venal in the apparatus. The political question raised is whether Hu and Wen will risk discontent within the Party to settle social strife.

As for the central government’s role in the industrial and export-oriented economy, administrative measures and exhortations will go only so far in trimming back uneconomic investment and excess capacity. More careful scrutiny of state bank lending should also help. But Beijing’s writ, whether from the state planners or the central bank, does not extend as far as it used to; and powerful provincial Party figures will likely continue to make bad investments financed by sweetheart loans from local branches of state banks. The greed of corrupt officials drives these decisions, as does a kind of lemming instinct and the personnel evaluation system for Party officials, which emphasizes new investment and job creation. At least another generation will be needed before these ills begin to disappear from the Chinese political economy. No wonder, then, that Wen Jiabao’s list of 2005 achievements read very much like his list of 2006 challenges.

## Taiwan

Of special interest were Wen’s comments on Taiwan. Two weeks before the NPC convened and almost certainly timed to its opening, Taiwan’s President Chen Shuibian disbanded the island’s moribund “National Unification Council” and discarded a set of “Principles for National Reunification.” Both the organization and the document dated from 1990, a time when Beijing and Taipei were in serious dialogue about reconciling their political differences. Not bound by legislative or legal constraint, Chen made these two moves with a rhetorical flourish sure to draw a reaction from Beijing; and within hours of Chen’s pronouncements both President Hu and Premier Wen had condemned them in stern language.

This was political theater on both sides of the Taiwan Strait. The ever opportunistic Chen, lacking both a legislative majority and an obvious successor, is trying to bolster his Democratic People’s Party ahead of Legislative Yuan and Presidential elections in 2007 and 2008, respectively. For their part, no top leader in Beijing can afford to leave unchallenged a provocative statement from Taiwan’s most senior elected official.

In fact, however, relations across the Taiwan Strait have not been as close as they are now since 1949, when the Kuomintang (KMT) fled the mainland. Beijing’s moderate policies have succeeded: leaders of the KMT and other non-governing parties in Taiwan have been received at the highest levels in Beijing, trade and investment are flourishing as product supply chains integrate across the Strait, and well over a million Taiwan passport holders—5% of the island’s population—live permanently on the mainland. In

his Government Work Report, Premier Wen reflected this new reality: while bluntly warning Chen Shuibian against “separatist” action, Wen stated clearly and explicitly the central government’s commitments to protect the property and legitimate interests of Taiwan residents on the mainland.

### 11-5, The Eleventh Five-Year Plan

The basic content of the Plan, and much of its language, had been approved by the Communist Party Central Committee last October; scholars and government experts spent another four months revising the Plan into the draft ratified by the NPC this past week.

“11-5,” as the new plan is dubbed in Chinese shorthand, does not emphasize the quantitative targets that characterized earlier plans drafted under Soviet tutelage. Rather, the current plan, intended to guide government work through 2010, provides a broad blueprint for economic and social policies. In practical terms, the plan also indicates government budget priorities: if something gets mentioned in the plan, it gets money; otherwise, it does not.

Claiming to reflect the “concept of scientific development” and echoing Wen Jiabao’s Government Work Report, four key themes inform the Plan:

- Building “new socialist villages,” that is, weaning rural areas off low-value agriculture and allowing urbanization to continue apace.
- “Independent innovation,” or developing China’s own R&D capabilities to compete globally. Conservatives will read this goal as encouraging the adoption of indigenous national standards and regulations to limit foreign market penetration.
- Promoting “mutually beneficial and complementary policies of opening toward the outside world”—another goal with possibly protectionist and xenophobic content, although it also aims at a rough balance in foreign trade and a gradually appreciating RMB.
- Putting priority on governmental reform and honest government actions, which Party leaders are unlikely to undertake.

Behind the political rhetoric, the Plan in essence mandates increased government spending to alleviate rural poverty. Already, the Hu/Wen administration has taken steps to relieve the tax burden on peasants and to channel farmers toward higher value-added agriculture. Rural health and education will get more resources, and there may be greater respect

shown for farmers’ land use rights, albeit without granting them marketable title. Rural unrest and the continued migration of surplus rural labor into China’s cities have been consuming concerns of the top leadership for some years now, even as violence has flashed in rural areas. This is the first five-year plan in which Hepatitis B is listed as a major public health hazard, although the Plan offers no treatment program other than infant vaccination. Combating Hepatitis B by vaccination alone means that the disease—carriers exceed 120 million already—will take generations to eradicate.

Science and technology R&D monies will increase under “11-5,” but so will choices of pillar industries and national champion companies. Wider use of national standards and protectionist regulations should also be anticipated, to give domestic Chinese firms some breathing room from foreign competitors who should, in most industries, now be able to operate with the freedom promised by China’s WTO commitments. As for urban healthcare, welfare and pension systems—concerns of China’s growing middle class—the Plan offers little more than muddling through, as there is no political consensus yet on how to mix public and private payments for these social goods. Hence, China’s savings rate will likely remain high as families who can afford it put aside cash for healthcare and retirement funds the state cannot provide.

### Legislative Calendar: Foreigners Beware

The NPC legislative docket as approved by the NPC indicates that the Anti-Monopoly Law and laws equalizing tax treatment of foreign and domestic enterprises are advancing faster through the legislative process than had previously been anticipated. In summary, the Anti-Monopoly Law, as currently drafted, would presume market dominant status based on a firm’s share of the Chinese domestic market rather than by its conduct in price setting or other abuses of market position. Repeated interventions of the ABA, European and American government agencies and trade associations and other interested parties have thus far failed to influence the Chinese drafters to align their proposed law with contemporary international best practices. Chinese media play on the draft Anti-Monopoly Law has made clear its xenophobic thrust, while China’s local and de facto state monopolies—telecoms, electric power, etc.—have been ignored by the drafters. Indeed, the chapter intended to combat administrative monopolies, which appeared in earlier drafts, has been deleted from the latest text.

The unified enterprise income tax law would equalize tax rates, which currently favor foreign manufacturers and were designed to encourage foreign direct investment. This effort,

intended to level the playing field between domestically and foreign-invested enterprises, would do nothing to tighten enforcement even though domestically-invested enterprises are widely believed to underpay their taxes.

To judge from their new positions on the NPC legislative calendar, the Anti-Monopoly Law could be enacted by late this year and the unified enterprise income tax law in the first half of 2007—two or three years sooner than had been widely anticipated. Enforcement of both laws will, however, remain problematic. The Ministry of Commerce still has only a handful of people to review concentration transactions, few of them proficient in competition regulation. While the unified enterprise income tax law might well get a strong push from the Ministry of Finance, local officials across the country will continue to compete for foreign direct investment and attempt to contrive tax and other preferences that will attract those funds. Indeed, the NPC saw statements by officials from various special zones promising preferences to investors, presumably with the support of the Ministry of Commerce.

Conversely, the draft Property Law, which would guarantee protection of private property, has been dropped from the legislative agenda. While this draft had aroused some ideological opposition from staunch conservatives who saw it as betraying Communist ideals of public ownership of resources and the means of production, possibly stronger opposition came from Party officials who have personally benefited from sales of real estate and other state assets. Postponing enactment of a property law is a particularly regrettable step in a fast-changing Chinese economy where 60% to 70% of GDP now flows from the non-public sector.

## Politburo Politics: Tea Leaves Turning

Conspicuously absent from the NPC ceremonial opening was Huang Ju, Executive Vice Premier in his government role and sixth-ranking member of the Communist Party Politburo Standing Committee. In China today, as in yesteryear, the Party still calls the shots. The nine-man Politburo Standing Committee is China's de facto top leadership, and in its current composition has been dominated by men loyal to former Party General Secretary and State President Jiang Zemin, leaving the incumbent Hu Jintao to head what in Western parliamentary language might be called a “minority government.” Huang Ju, former Shanghai Party Secretary and currently Executive Vice Premier in charge of finance and IT, has long been a stalwart ally of Jiang Zemin.

According to informed sources, Huang Ju is now terminally ill with pancreatic cancer and fast deteriorating. Huang's departure from the Politburo would give Hu Jintao the chance to place one of his own loyalists on the Standing Committee, thus balancing the Committee in his favor, or, to similar effect, simply leaving the Standing Committee smaller by one member. While speculation about Huang Ju's successor preoccupies Beijing, State Council decisions in his government portfolio, particularly in financial services, appear to have slowed. This may affect the planned listings of state banks as well as approvals for foreign acquisitions in the financial services sector. But neither Premier Wen nor President Hu can allow such a vacuum to last long.

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