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CHINA ANALYSIS

EIGHTEENTH CONGRESS: EXPECTATIONS ON HOLD

ABOUT

The Chinese have long been obsessed with strategic culture, power balances and geopolitical shifts. Academic institutions, think tanks, journals and web-based debate are growing in number and quality and give China's foreign policy breadth and depth.

China Analysis, which is published in both French and English, introduces European audiences to these debates inside China's expert and think-tank world and helps the European policy community understand how China's leadership thinks about domestic and foreign policy issues. While freedom of expression and information remain restricted in China's media, these published sources and debates provide an important way of understanding emerging trends within China.

Each issue of China Analysis focuses on a specific theme and draws mainly on Chinese mainland sources. However, it also monitors content in Chinese-language publications from Hong Kong and Taiwan, which occasionally include news and analysis that is not published in the mainland and reflects the diversity of Chinese thinking.

The French version of China Analysis can be accessed online at www.centreasia.eu.

Introduction
by François Godement

Did personalities or issues dominate the 18th Party Congress, which ended on 14 November with a new leadership for China? Delayed by as much as a month, but still just within the prescribed five-year term limits, the Congress was preceded by a summer of anxious waiting and rumours. How would the case of fallen Politburo member Bo Xilai be settled? Was a deal being brokered inside the party leadership, or would jockeying for key positions continue until the last moment? Was the volatile atmosphere surrounding the maritime incidents with Japan a backdrop to the power game at the top?

These burning issues were widely spoken of in social media, but they were not directly discussed in China's press and journals. However, this issue of *China Analysis* uncovers significant expectations about matters that are likely to dominate the new leadership's five-year mandate. Hu Shuli, the liberal journalist and economist, and Deng Yuwen, a contrarian Central Party School intellectual, evidence the anxiety of China's political reformers on the eve of the congress. They parse every word of outgoing president Hu Jintao in his July speech at the Party School – his real swan song in front of expected successor Xi Jinping, who formally heads the school. Hu Shuli focuses on hopes for a legal reform and on a new stage of development for the market economy. Deng instead makes a scathing indictment of political stagnation and its consequences – a theme that

is much stronger than the thin hope he places on the fact that Hu Jintao endorsed democracy without qualifiers or reservations.

Our three other sources outline key reforms needed in state-owned enterprises (SOEs), the energy sector, and social welfare. China's SOEs are at the nexus of the party-state and the economy, even though they are neither its leading exporters nor its most profitable sector. China's energy sector has absorbed huge resources, but it still relies on coal and imported oil, with alternative energy sources such as solar and wind heavily dependent on energy. Finally, the social sector and the creation of a welfare state, although advanced by the outgoing leadership, remains conditional on resources being made available. But the rebalancing of China's growth towards the domestic economy requires a safety net that can cut down the need for savings.

So, a reform agenda was promoted among China's public intellectuals on the eve of the 18th Party Congress. Has it been vindicated? There is every indication that the congress has instead focused on the short-term but vital issue of political power. President Hu's outgoing speech at the congress did not meet the expectations of Hu Shuli and Deng Yuwen, although he did mention political reform and the need to fight corruption. The new Standing Committee of seven members is older than its predecessor five years ago – five of its members will not outlast a single term. Two of the most reformist members of the Politburo have not been promoted, and only Li Keqiang has a reformist pedigree. Retired party elders, including former president Jiang Zemin, whose physical presence dominated the congress, have reportedly cast votes again. And four of the new leaders have important and sometimes multiple family ties to the PRC's first leaders. The leadership of the Military Affairs Commission – power of last resort in China's Leninist system – was officially decided before the congress even met. In fact, it will be the first presidential title of Xi Jinping, who will also head the state after March 2013.

Can China 1.5, as evidenced by the conclusion of the 18th Party Congress, produce a China 3.0, as China's public intellectuals wish, from their different points of view? If a strong leader dominating a smaller leadership team decides that it should, it is still possible. But he and his colleagues will have to fight their own nature, as a group that is more than ever descended from the party-state's legacy, and closely associated with its state economy.

1. Insiders call for political reform

by François Godement

Sources:

Hu Shuli, "Looking at the 18th Congress from the perspective of the July 23 speech", *Caixinwang*, 28 July 2012.[1]

Deng Yuwen, "The political legacy of Hu and Wen", *Caijing*, 2 September 2012.[2]

In the long and tense summer that has preceded the 18th Party Congress, many public intellectuals have said little or have addressed single issues, avoiding making judgements on the party line. Nationalists and neo-Maoists have piggybacked on the anti-Japan sentiment caused by the Senkaku-Diaoyutai dispute. Liberal economists have debated the real extent of rebalancing that is happening in China's economy. And everybody has been fascinated with the rumours of personal struggle inside the party's top echelon, which has led to a delayed Party Congress. But since late April 2012, when the government clamped down again on any high profile advocacy of political liberalisation, few people have spoken out. Ai Weiwei, who has guest-edited a whole special issue of the British *New Statesman*, remains an exception.[3] His status is a source of puzzlement: has he so far enjoyed immunity because of his celebrity, or is it because of divergent views inside the leadership? By mid-September, when the *New Statesman* issue appeared, Xi Jinping had just re-emerged from a two-week absence and had let it be known that he could endorse the politically liberal views of economist Hu Deping, Hu Yaobang's son and a noted supporter of democratisation.

This exception aside, however, the summer has mostly been one of anxiety. High-level debate happened behind closed doors, and public attention was focused on the potential implications of the Bo Xilai case. Would the party close ranks and limit the political consequences, or would Bo Xilai's purge allow political and legal reforms to be resumed?

Against this background, Hu Shuli and Deng Yuwen take on the question of reform. Hu is generally known for her frankness and willingness to speak out against vested interests and corruption. Her July 28 op-ed for *Caixin* dealt with the very sensitive topic of political reform. Far less well known than Hu outside the party, Deng Yuwen is the deputy editor of *Xuexi Shibao*, the Central Party School's theoretical journal, and is a frequent advocate of democratisation. He achieved instant notoriety through Weibo, China's Twitter, when it rapidly spread his opinion that China had gone through ten years of political stagnation, but also that Chinese society was not ready for democracy. As we shall see, his actual analysis is far more nuanced on both counts.

Both Hu and Deng begin their analysis with President Hu Jintao's July 23 speech to the Central Party School. They try to find evidence in Hu's speech of support for their own views, while also noting the ambiguities in what the leader said. As Hu writes, "the general secretary indicates in which direction the wind is blowing before the Party Congress." Furthermore, the head of the Central Party School is often the incoming party leader, in this case, Xi Jinping. Both Hu and Deng stress that the speech expresses the legacy that the outgoing leader wants to pass on to his successor. Their reading of the speech rests on a few tell-tale signs. Hu Shuli notes that Hu Jintao has emphasised the need to "unswervingly carry out" reform, including "safeguarding electoral democracy, expression, and supervision", and has warned against delaying political reform. She points out a little-noticed change in formulation in the speech from Hu's report to the 17th Party Congress. Where Hu had earlier written of the need to implement a "system of socialist law" (社会主义法制, *shehuizhuyi fazhi*), he now speaks of a "system of national law" (国家法制, *guojia fazhi*). The encouraging shift in language reflects the debate that has been going on in the party over the past year on the status of law with regard to the party itself.

Hu Shuli hopes that Hu Jintao's legacy of a "scientific outlook on development" will prove to be the "theoretical breakthrough" that the party needs, beyond simply changing the people at its head. To expand on what this might mean for systemic economic reform, she goes back to a previous era, that of the 14th Party Congress in October 1992 and its 3rd Plenum in November 1993. At that time, issues such as overall macro-economic control and allowing the market to play a defining role in the exploitation of natural resources were discussed and implemented in a 50-article chart for economic reform. She says that China's rapid growth was a "dividend of reform" (改革红利, *gaige hongli*). But her perplexity shows when she also says that personality issues are less important than policy issues: clearly, the former have overtaken the latter.

Deng Yuwen wrote two articles for the party's theoretical journal that were published in full by *Caijing*, the economic journal which used to be a vehicle for Hu Shuli, but has become less daring since her departure. The second article was soon removed from circulation. *Caijing* comments that a summary excerpt of Deng's views on Weibo led to a misunderstanding: he is believed to oppose direct democratic elections because he wrote that Chinese society is not ready for it, at least in the excerpt carried by Weibo. *Caijing* does not say this, but Deng's article has been widely seen as an attack by the Party School, led by Xi Jinping, on

[1] Hu Shuli is editor-in-chief of *Caixin*.

[2] Deng Yuwen is deputy editor of *Xuexi Shibao*.

[3] Issue dated 17 October 2012. According to the *New Statesman*, Ai agreed to guest edit this issue back in April 2012, when there was a sudden surge of liberal expression in the Chinese media after Politburo member Bo Xilai's downfall.

the "ten years of stagnation" during the Hu-Wen rule.

What did Deng really write? He starts out by praising China's success in the past decade. It has achieved impressive economic growth, risen as a global power, effected "the beginning" of a move towards transparent government, opened up internationally, and developed a social policy. But Deng lists ten major issues that remain unsolved. Economic growth remains unbalanced and increasing income inequality has prevented the expansion of the middle class. Residency permits still discriminate against peasants and migrants and the one-child policy is leading to demographic ageing. The country still takes a quantitative rather than qualitative approach to education and science. Environmental degradation continues, and, in spite of moves towards alternative energy sources, the country has not achieved energy security. Deng sees a moral breakdown of society, a reactive and passive diplomacy, and lagging political reform and democratisation. Some of the critiques are scathing. The loss of revolutionary ethics and the failure to build values consistent with a market economy have resulted in "the struggle for life of a bestial society" (生存竞争的动物层次, *shengcun jingzheng de dongwu cengci*). The party's neglect of political reform is "ostrich-like behaviour" (驼鸟态度, *tuoniao taidu*) that undermines its legitimacy. The party should "give power back to the people" (还权于民, *huanquan yumin*), and, perhaps, sooner rather than later. Deng ends by saying that the growing contradictions in Chinese society have led to a strong expectation of political change among the people – and "they may not be patient enough to wait five years for it" (公众未必有五年的耐心来等待, *gongzhong weibi you wunian de naixing lai dengdai*).

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This is, of course, extraordinary language to come from the Central Party School, whose idea of democracy is often inspired by Singapore-style political systems. However, Deng does add some reservations to his own ideas. For instance, he emphasises that the party is right in its conception of democracy based on the rule of law. He says that this vision of democracy contrasts with the idea of democracy as an open-ended concept, which is a path to political anarchism. He lists a number of developments that must happen before political democracy is implemented in China. These include changing the political culture, narrowing the income gap, educating people about democracy, and ensuring the absence of any separatist threat, which could be encouraged by a democratic process. But Deng refuses to qualify or restrict the kind of democracy that he envisions, referring to it simply as "liberal democracy" (自由民主, *ziyou minzhu*). Without saying so, Deng implies that "socialist democracy" is meaningless. And he mentions that in his July 23 speech, Hu Jintao glossed over the content of democracy to address practical issues of implementation.

This is the central point of Deng's article, and represents its common thread with Hu Shuli's line of reasoning, as she contends that Hu Jintao has moved forward by extolling political democracy without the usual "socialist" qualifier. Deng Yuwen wishes that Hu Jintao had been more specific. The two commentators look forward to the 3rd Plenum after the 18th Congress – the meeting at which actual policies tend to be determined – to find out whether their liberal aspirations have any basis in reality.

2. Building a Chinese welfare state

by Thomas Vendryes

Sources:

"Getting rid of workers' health insurance for employees to implement national health insurance", Editorial, *Xin Shiji*, No. 39, 8 October 2012.[4]

Fu Yanyan, "A different kind of public hospital", *Xin Shiji*, No. 33, 20 August 2012.[5]

Gu Xin and Yu Hui, "Establishing a national ministry of social security", *Caijing*, 29 July 2012.[6]

Gu Xin and Yu Hui, "Towards universal health insurance", *Caijing*, 1 July 2012.

Fang Laiying interviewed by Ren Bo, "A discussion with the director of the Beijing Municipal Health Bureau: how to set the tone for the reform of Beijing's health system", *Xin Shiji*, No. 24, 18 June 2012.[7][8]

"Broadening healthcare reform will face conflicts of interest", Editorial, *Diyi Jingji Ribao*, 29 June 2012.

In China's pre-1978 planned economy, "work units" (单位, *danwei*) provided Chinese people with some of the safeguards supplied elsewhere by social insurance, ensuring a measure of care for the sick and the elderly. However, as Gu Xin and Yu Hui say, gradual economic and social liberalisation has led to the disappearance of this system, which was anyway neither particularly generous nor especially equitable. Today, all that is left of the system is the health insurance that is provided to employees of the few urban work units still in existence. Social insurance has never really been a political priority in China. Nonetheless, some safety nets and insurance institutions have been set up over the past few years. These organisations aim to address the effects of, for example, poverty, the new phenomenon of unemployment, and the ageing of the population, and to ensure people receive a "minimum subsistence allowance" (最低生活保障，*zuidi shenghuo baozhang*).

In healthcare, local governments and public funds have in part taken over the role of the work units. In cities, health insurance is provided for urban residents (城镇居民医保，*chengzhen jumin yibao*), and in the countryside, a "new rural cooperative" health system (新农合，*xinnonghe*) has been set up. But as an editorial in *Xin Shiji* on 8 October 2012 pointed out, these social insurance institutions are fragmented. This makes effective management problematic. And it leads to significant disparities and inequalities in terms of scope and of reach, both from a geographical and statutory perspective. The result is that some people receive better social cover than others, at a lower individual cost.

Why build a welfare state?

The writers believe that China's social insurance system must be unified and homogenised. The effort must be centrally driven by a new national Ministry of Social Security (国家社会保障部，*guojia shehui baozhang bu*), which should unite the different administrations and services that perform functions relevant to social protection. The goal should be the creation of a real "welfare state" (福利国家，*fuli guojia*), bringing together all government-provided social insurance and security, most important among which is health insurance.

Gu and Yu say that some people think China is not yet developed enough for this kind of project, or that social insurance only "looks after the lazy" (养懒汉，*yang lanhan*). But they believe that China could benefit greatly from a welfare state in its current phase of development. They point out that social insurance schemes in Western countries were often set up before their time, such as, for example, Britain's Poor Laws, or in difficult periods, such as the United States' New Deal.[9] And they say that most "upper middle income countries" (中高收入国家，*zhonggao shouru guojia*), the UN and World Bank bracket in which China itself is placed, have set up social insurance schemes, as recommended by the "new Washington consensus" (后华盛顿共识，*hou huashengdun gongshi*).

Xin Shiji's editorial says that in political terms, a welfare state would support the transformation of the role of the state. From being a planner and actor in the economy, the state could become a regulator and insurance provider. Social insurance would help limit China's growing inequalities, which are worsened by differing access to public and social services. And the welfare state could play a stabilising role in the economy. Because social security nets reduce the need to save for emergencies, a welfare state could help resolve one of the major imbalances in China's development: extremely high levels of personal saving and low domestic consumption. Gu and Yu say that the welfare state would form the "basic social infrastructure" (社会性基础设施，*shehuixing jichu sheshi*) that has been the key to sustainable development in today's rich countries.

Gu and Yu say that setting up this new system should not be too difficult. It would have public support, since it would be a response to clear demands from contemporary Chinese society. And some of the elements involved already exist. But they also say that the process of creating a welfare

[4] The paper says that the unnamed editorialist is a professor at the School of Public Administration, University of Beijing.

[5] Fu Yanyan is a journalist for *Caixin*.

[6] Gu Xin is professor at the School of Public Administration, University of Beijing and Yu Hui is a researcher in the Department of Research into Industrial Economics at the Chinese Academy of Social Sciences.

[7] Fang Laiying is the director of the Beijing Municipal Health Bureau.

[8] Ren Bo is *Caixin*'s editor-in-chief for public policy issues.

[9] The "Poor Laws" were instituted in Britain at the end of the 16th century and lasted until 1834. Their purpose was both to control and support the poorest parts of the population and one major feature was the provision of weekly assistance to the poor.

state must be appropriate to China's current level of development. There is no consensus on the exact shape that the social insurance system should take and on the proper mechanisms for implementation.

Reforming the national health system

Of the elements of this welfare state, the one that is closest to being achieved is health insurance. *Diyi Jingji Ribao* says a series of reforms and experiments have been carried out in the health insurance system since 2009, some of which have had a degree of popular success. But the problems of the health insurance system are many and serious.

Xin Shiji and Gu and Yu say that the health insurance system is based on three pillars, each covering just one section of the population. Two – urban residents' health insurance and the rural cooperative health scheme – are financed by local authorities. The third – urban workers' health insurance (城镇职工医保，*chengzhen zhigong yibao*) – is funded by the work units, in a framework inherited from the collectivist era. The system is fragmented, which makes it inequitable and hard to manage. Not all Chinese citizens belong to the same system, and cover varies significantly in cost and coverage depending on place of residence or work unit. And, as Ren Bo and Fang Laiying say, "doctor visits and medical treatment are difficult and expensive" (看病贵看病难，*kanbing gui kanbing nan*).

China could benefit greatly from a welfare state in its current phase of development.

Xin Shiji says urban workers' health insurance, which is largely financed by levies on business, must be eliminated. For that to happen, the two remaining pillars, urban residents' health insurance and the rural cooperative scheme, would need to be developed. Both systems are financed by local authorities and provide, at least locally, a comparable service for all citizens. Abolishing urban workers' health insurance would remove one of the worst elements of inequality in access to public and social services. And it would ease financial pressure on Chinese companies. Health insurance would then be entirely financed with either local or national public money, along the lines of the UK's National Health Service (NHS).

Xin Shiji, *Diyi Jingji Ribao*, and Gu and Yu say that these various local systems should be brought together in a unified national system. This would be partly paid for by state or local authorities, who would give more than 350 yuan a year per individual, and possibly around 500-600 yuan. A small contribution of about 200 yuan a year would be made by individuals, which would be adjustable according to income. The new system would obviously represent a new burden on public finances. It would cost about 460 to 500 billion yuan a year – about 5 percent of current government spending. While this would be a considerable outlay, it should be manageable, given the health of China's central government finances.

Medical, hospital, and pharmaceutical reforms

Fu Yanyan, Fang Laiying, and Ren Bo say that introducing a national, universal health insurance scheme on the model of the NHS would necessitate reforming the medical, hospital, and pharmaceutical systems. One of the main characteristics of the Chinese medical system, besides the poor management of the hospital sector, is the low pay that doctors and medical professionals receive. This means that healthcare professionals duplicate examinations and try to earn money by prescribing and selling drugs, which are over-prescribed and over-priced. All the writers speak out against this "use of drugs to finance medicine" (以药养医，*yi yao yang yi*).

Fu describes one experiment that seeks to rectify these problems. In Shenzhen, city authorities and the University of Hong Kong have partnered to set up an experimental hospital. Doctors are paid significantly more than they would receive in the usual healthcare system. Patients pay a fixed amount of 130 yuan, which covers all examinations and drugs for the first week of treatment. These innovations considerably limit the scope for using drugs as the main source of income for medical professionals. Fang and Ren talk about a similar, more general reform launched in Beijing in the spring of 2012. This reform is aimed at instituting stricter controls on the costs of medicines and medical examinations.

These two experiments demonstrate the difficulties involved in carrying out a thorough reform of the medical system. In Shenzhen, traditional public hospitals are concerned about the emergence of a rival that offers cheaper treatments and pays its doctors well. In Beijing, Fang says, implementing a local medical insurance scheme means that a support system for patients must be created, which would include reimbursing them for out-of-pocket expenses. But for logistical reasons, the reform cannot in the short term include, for example, the many pharmacies that are not located in hospitals. So, pharmacies can retain a monopoly on drug provision and can generate high profits from drug sales.

These problems serve as a reminder that creating universal national health insurance and building an effective system of care will be a gradual process, and further experiments are needed. As Deng Xiaoping famously said, "the river is crossed by feeling for stones" (摸着石头过河，*mozhe shitou guo he*). But these articles show that the stakes and the benefits of introducing a welfare state into China are well understood. China is at a stage of development at which the overwhelming majority of "developed" countries began to establish a real national social insurance scheme, including and especially a healthcare scheme. Gu and Yu hope that the 18th Congress of the Chinese

Communist Party (十八大，*shiba da*) will give a decisive push to the Chinese welfare state, which could make a significant contribution to addressing the major economic, social, and political imbalances in today's China.

3. Reforming China's state-owned enterprises

by Agatha Kratz

Sources:

Lin Yongsheng, "Again determining the efficiency of state-owned enterprises", *Xin Shiji*, 13 August 2012.[10]

Zhang Wenkui interviewed by Wang Xiaobing, "The next growth opportunity is the reform of state-owned enterprises", *Xin Shiji*, 20 July 2012.[11]

Sheng Hong interviewed by Chen Cai, "Public ownership has lost its halo of virtue", *Licaiyi Zhoubao*, 27 November 2011.[12]

Sheng Hong interviewed by Wang Daojun, "Private enterprises have the right to access all markets", *Dongfang Zaobao*, 15 May 2012.

Ahead of the 18th Congress of the CCP, the Chinese press is busily speculating on the reforms that the new leadership will undertake. Several commentators think changes should be made to state-owned enterprises (SOEs): companies whose shares are mostly or entirely held by state or local government. Lin Yongsheng, Zhang Wenkui, and Sheng Hong all advocate comprehensive and far-reaching reform in the system of state-owned enterprises.[13]

SOEs' contribution to the Chinese economy

Sheng Hong says that in 2011, the aggregate gross income of Chinese SOEs was 30,300 billion yuan.[14] Thus these companies represent a sizeable share of the Chinese economy. Lin Yongsheng says that the importance of these companies to the economy has gradually decreased since the reforms of the 1970s. However, they still account

[10] Lin Yongsheng is deputy director of the Centre for Market Economy Research at Beijing Normal University.

[11] Zhang Wenkui is deputy director of the Enterprise Research Unit at the Development Research Centre of the State Council (国务院发展研究中心). He was in charge of implementing the reform programme laid down by the State Assets Supervision and Administration Commission (SASAC). He also contributed to the World Bank's "China 2030" report, published this year, and has taken part in the reform and restructuring of many public companies, particularly in the civil aviation sector. This interview was conducted in June 2012, before the publication of July's economic figures.

[12] Sheng Hong is director of the Unirule (Tianze) Institute of Economics, Beijing, and professor at the Centre for Economic Research at Shandong University.

[13] Sheng Hong is a highly controversial figure in the SOE debate. Some people say that the *Dongfang Zaobao* interview with Sheng on 15 May 2012 was the reason for the dismissal of *Dongfang Zaobao*'s vice editor-in-chief. See Scott Greene, "Is Winter Coming for the Chinese News Media?", *China Digital Times*, 20 September 2012, available at http://chinadigitaltimes.net/2012/09/is-winter-coming-for-the-chinese-news-media/.

[14] By comparison, China's GDP was 47,000 billion yuan in 2011, according to the IMF's *World Economic Outlook, October 2012* (Washington DC: IMF, 2012).

for 30 percent of all Chinese companies.[15] They are more important in some sectors than in others. In consumer goods, for instance, SOEs account for "only" 50 percent of invested capital. In other, "strategic" sectors, such as defence industries, telecommunications, or energy, they represent nearly 90 percent of total invested capital.

Sheng Hong says that not all SOEs are the same. Some are genuine industrial monsters, but others operate on a relatively limited scale. These differences are reflected in their varying profitability. Some are completely financially viable, while others are in financial difficulties. Sheng Hong is famous for his insights on SOE profitability. In 2011, his research centre, the Unirule (Tianze) Institute of Economics, published a damning report that highlighted the SOEs' economic inefficiency. The report established that, from 2001 to 2009, Chinese SOEs recorded an average annual return of 8.16 percent. But when the enormous state subsidies that they received were taken out of the picture, their average annual return fell spectacularly, to –6.29 percent. The companies are not economically viable, and yet they receive massive government assistance through multiple grants and subsidies.

In spite of these poor figures, many people favour maintaining SOEs, for a range of reasons. Zhang says that supporters cite the sustained growth of SOEs in the past and the substantial contribution they have made to the country's development. But Zhang rejects this argument: the SOEs may have produced large volumes of goods and services, but have failed to deliver high return on investment. Lin says that some people want to preserve the state's capacity for action in key industries that are linked to "national well-being". (国计民生, *guoji minsheng*). They say that the SOEs have a strong "sense of social responsibility" (社会责任感, *shehui zerengan*), and so their monopolies should be retained in strategic areas such as energy and defence industries. Lin disagrees. He says that although natural monopolies and strategic SOEs exist all over the world, these sectors in developed economies are at least partially liberalised and open to competition.

Sheng does not think that SOEs are fundamental to guaranteeing "economic security" (经济安全, *jingji anquan*). He points out that the United States' main economic resource is oil, but its oil companies are mostly privately owned. He says that "patriotism" (爱国, *aiguo*) is not about holding shares. Sheng criticises Wu Jinglian, an economist who says that listing some SOEs on the stock market has turned them into ordinary, responsible companies. Sheng says that this is "only piecemeal reform, of little consequence" ("只是小打小闹、小改小革", *zheshi xiaoda xiaonao, xiaogai xiaoge*). It has not solved the major problems that the SOEs have created. They cause distortion in the allocation of economic resources. They are given advantages at the expense of private companies. And they generate politicisation, conflicts of interest, and rent-seeking behaviour.[16]

Problems created by SOEs

Sheng Hong says it is easy for SOEs to access many more significant sources of financing than other companies, which allows them to implement major investment projects. Because they have a more flexible status than private companies, they do not need to worry much about financial losses, since, as Sheng ironically puts it, they act "for the public good" (民生, *minsheng*). And where private companies must provide returns to shareholders, the Chinese state as principal shareholder of the SOE does not claim dividends. So, all SOE profits are automatically reinvested in the business, which creates cash reserves and builds capacity to self-finance future projects. This distorts economic signals, because private companies, whose shareholders do claim their share of company profits, cannot compete on investment capacity. This imbalance is exacerbated, Sheng says, by the fact that SOEs have privileged access to credit in the Chinese financial system, which is also state-run.

Along with this special status, the SOEs' size and monopolistic position causes serious distortions in China's economic sphere, especially in "resource allocation" (资源配置扭曲, *ziyuan peizhi niuqu*). Reforms are needed to limit these distortions and to improve the efficiency of the Chinese economy. Zhang explains that although they are "beautiful" (漂亮, *piaoliang*), SOEs distort prices. Increased competition would enable prices to be adjusted to their market level. Lin agrees with Sheng and Zhang that the SOEs represent a form of market failure. As well as generating losses, they distort the perceptions of economic agents, who cannot rely on market signals to make decisions about production or investment. These monopolies also block private companies' access to markets, even though private firms are more competitive and have more potential to generate profit. SOEs use their size and their political support to set up barriers and hold onto their advantage in the market.

Lin recommends that the SOEs be reformed as quickly as possible, starting with poorly performing companies that are only surviving because of the financial and political support of the Chinese state. These companies must not be allowed to keep underperforming on the pretext of ensuring "economic security". Allowing them to carry on would in fact put the country's economy at risk, by wasting resources that could be better invested elsewhere.

To demonstrate the politicisation of Chinese companies, Sheng Hong cites a report by the Unirule (Tianze) Institute of Economics. The study looked at 183 senior employees

[15] Report on the Development of the Market Economy in China", Centre for Market Economy Research, Beijing Normal University, 2010.

[16] Rent-seeking behaviour happens when an economic agent seeks to obtain an economic rent, either for himself or for those close to him, by manipulating the social or political environment in which he operates, rather than by creating new wealth.

at the level of deputy minister and above in 19 ministries and commissions. It found that 56 of them had already had experience in managing a state-owned enterprise. Zhang says that this politicisation means that SOEs are not subject to the principles of competition and the market economy.

The politicised system creates potential conflicts of interest. Politicians are rotated between SOEs and ministries. They are judged on the performance of their companies, so they use their connections to ensure that their companies get special treatment from public bodies. These conflicts of interest mean the state ends up formulating policies that are expensive for the Chinese people, simply to benefit particular SOEs. Zhang says that politicisation also creates opportunities for "rent-seeking" (寻租, *xunzu*). The government must act more strictly in judging and punishing this behaviour.

Sheng Hong talks about the opportunities for corruption that the SOE system creates. The Chinese Ministry of Railways, for example, has in the past taken on huge projects that had enormous funding but little economic value. Sheng says the industry has not hesitated to "use the leftover money to make so-called investments in the services sector" (他们拿着剩余的钱，用来做所谓的第三产业投资， *tamen nazhi shengyu de qian, yonglai zuo suowei de disan chanye touzi*). Given the lack of transparency, it is difficult to know the real internal rate of return for each of the projects, or to hold the SOEs accountable. Sheng says that the SOEs' corrupt behaviour tarnishes the government's reputation and compromises its legitimacy and authority. The government, which he thinks is largely in favour of reform, must therefore begin to restructure the SOEs.

Reform: obstacles and opportunities

Sheng says the SOEs and their managers have become powerful interest groups. Their financial and political clout gives them significant influence over public policy and inside government circles. Sheng says that, historically, the Chinese government has found it easier to reform less profitable and less sought-after fields, where opposition is weak. But in the sectors in which the SOEs operate, the stakes are very high and the markets and potential profits (or rents) are enormous. And the opponents of reform are made up of very powerful and well-organised interest groups. Sheng says that reforming the SOE system amounts to saying that the companies have been poorly managed so far. This opens the door to challenging and questioning the government's legitimacy.

Many people are concerned that liberalisation could cause imbalances. Lin says that SOEs provide a large amount of China's tax revenue. They have become so embedded in the economy that uprooting them could have serious repercussions for tax revenues, employment, and production, at least in the short term. Even so, Sheng says that China's current circumstances represent an opportunity for reform. Leadership is about to change, growth is slowing, and economic indicators have been disappointing. Just as the reforms to SOEs in the early 2000s were motivated by the bankruptcies of the late 1990s, so the next wave of reforms could be driven by the economic downturn of 2012.

Zhang suggests that SOE reform could give China its most important new growth opportunity. The last two waves of reform were the reform of state-owned enterprises in the early 2000s and China's entry into the WTO in 2001. These reforms offered growth "dividends" (红利, *hongli*) to China. Zhang says that, if it is to keep on growing, China "must find a new reform dividend" (我们需要创造新的改革红利, *women xuyao chuangzao xinde gaige hongli*). This new spur to growth could well lie in the reform of SOEs. Zhang says that after 30 years of continuous growth, China is at a very delicate moment in its economic history. It can no longer rely on political or cyclical levers of growth; it must readjust its economic model if it wants to avoid a hard landing. Reforming the SOE system could provide China with its "next opportunity for growth" (下一个增长机会，*xiayige zengzhang jihui*).

> The companies are not economically viable, and yet they receive massive government assistance through multiple grants and subsidies.

Choosing the right reforms

What needs to be done is to reorganise, merge, close, reduce, and even sell some of the activities and branches of these companies. Sheng says that SOEs must be judged on their performance using objective criteria, and only those SOEs that are making a profit without subsidies should be left on the market. Once this first wave of reforms has been achieved, and once the privileges of the SOEs have been abolished, China can progress towards eventually eliminating all of the SOEs.

Zhang thinks the Chinese economy should have less than 15 percent public participation by 2030, as against 30 percent today. If possible, public capital should be under 10 percent. Reducing the market share of the SOEs is not just a possibility – it is a necessity. Otherwise, economic distortions will not be corrected and China's growth might decline even more sharply.

Sheng Hong ends by saying that if the SOEs really are the people's businesses, and if they are to be maintained even in the face of repeated calls for reform, then at least their governance must be reformed. The people through their taxes pay for setting up and capitalising the SOEs, as well as for their many subsidies. The SOEs are the people's property. So, the people should be able to "govern" these companies. For this reason, power and legitimacy to manage the

SOEs should be taken from the executive and given to the congress. The higher levels of power should be reformed at a "constitutional level" (宪政层面, *xianzheng cengmian*), and the management of the SOEs must revert to the people. Sheng's idea here, it should be noted, is definitely intended to be applied beyond the sphere of public companies.

All the writers think SOEs should be reformed as quickly as possible. Some are more forceful than others both in criticising and in recommending action. But they all agree that the subject should be thoroughly debated, and that the process of reform should get under way after the 18th Congress.

4. Energy reform: moving from administration to regulation

by Marie-Hélène Schwoob

Sources:

Yang Fuqiang, "The energy system is in urgent need of new reforms", *Caixin-Zhongguo Gaige*, 1 September 2012.[17]

Yang Mingzhou, "Yang Mingzhou: five key points to ensure our country's energy security", *Zhongguo Gaige Wang*, 17 July 2012.[18]

Towards "sustainable development" of energy

China's model of rapid economic development has had plenty of successes since the start of this century. But rapid growth has caused the country's energy needs to increase, and China's energy security is now at significant risk. Yang Fuqiang says that by 2009, China had become the world's leading consumer of energy. By 2011, it accounted for more than 20 percent of global primary energy consumption.

China has faced challenges related to growing energy consumption before. Yang Fuqiang says that at various points between 1950 and 1980, the country experienced serious energy shortages. Post-Maoist reforms enabled a dramatic increase in production, but they did not permanently solve China's energy problems. So, in the early 2000s, growth in the country's power needs meant that China again found itself with insufficient energy. Since then, China has invested significant amounts in energy. Yang Fuqiang says that between 2001 and 2010, China invested 14,500 billion yuan in the energy sector, which enabled capacity to be doubled. The energy market has been reformed, and along with trying to improve supply, the country is also seeking to slow down growth in domestic demand. To do this, China is promoting energy efficiency, which is now a mainstay of the country's energy strategy.

Both Yang Fuqiang and Yang Mingzhou point out that China has other energy challenges besides security of supply. Climate change, environmental degradation, and resource depletion are also factors in the energy equation, which the authors formulate as the "question of sustainable development of energy" (能源可持续发展的问题, *nengyuan kechixufazhan de wenti*).[19] In recent years, the central

[17] Yang Fuqiang is a senior advisor on environment, energy, and climate change at the NRDC (Natural Resource Defense Council), which is a US-based NGO specialized in environmental protection.

[18] Professor Yang Mingzhou is a senior engineer specialising in energy at the State Electricity Regulatory Commission.

[19] Yang Fuqiang notes that although the growth rate of China's carbon emissions remains unchanged, the country will by 2020 be responsible for between 25 percent and 28 percent of global emissions. This would

government has been trying to alter policy to meet these new challenges, and these issues were taken into account in drafting the 12th Five-Year Plan (which covers the period 2011-2015). The government set targets of a 16 percent reduction in energy intensity and a 17 percent reduction in carbon intensity (consumption/emission per unit of GDP). And it laid down various goals for integrating carbon-free energy into the energy mix. But the writers say that serious problems remain.

Yang Fuqiang says that the reforms carried out in the past 30 years cannot ensure environmental protection. He thinks the goals of the 12th Five-Year Plan will be difficult to achieve. In 2011, there was only a 2.01 percent improvement in energy savings – not particularly hopeful in light of the goal of a 17 percent reduction within five years. Even if the energy intensity and carbon intensity reductions in the 12th Five-Year Plan were reached by 2015, Yang Fuqiang says that energy consumption would still have increased by 26.2 percent over 2010 levels, and CO_2 emissions would have grown by 17.7 percent.

Market and institutional reforms

The writers agree that China must urgently develop a new energy resource structure that is "clean and low in carbon" (能源结构的低碳化清洁化, *nengyuan jiegou de ditanhua qingjiehua*). They make several proposals for ways to bring this change about. Yang Mingzhou says the slowdown in the economy should reduce pressure on energy consumption. The government should take advantage of this temporary downturn to adjust the country's energy mix and reach the goals of 11.4 percent of non-fossil energies by 2015 and 15 percent by 2020.[20] Both writers suggest that the Chinese economic model should itself be reevaluated. Yang Fuqiang thinks the energy and carbon intensity reduction efforts could be good starting points for the transformation of China's economic model. Yang Mingzhou thinks the Chinese government should coordinate its economic and energy development. It needs to set a "reasonable" pace of development and work to promote appropriate modifications to the Chinese economic model.

Yang Mingzhou recommends restarting the market reforms that got under way a few years ago. Breaking up the monopolies of the major state-owned enterprises, separating transport and distribution of electricity, and liberalising (electricity) markets should enable the creation of transparent price-setting mechanisms. This would help to ensure resources are allocated efficiently and would improve the country's energy system. He points to market reforms carried out in Europe and the United States, which have provided for "green" and carbon emission quotas trading. He says that this system has already proven its effectiveness by changing the energy structures of some countries.

For these reforms to take place, several institutional problems need to be resolved. The National Energy Bureau is the administrative authority in charge of the national energy programme. But Yang Fuqiang says that the bureau's functions, including setting prices, overlap with those of other administrative entities under the authority of the National Development and Reform Commission (NDRC). He points to a lack of coordination, duplication of effort, and an absence of clarity in allocating responsibilities. He says that institutional reform would not only help institute an energy security strategy, but would also cut administrative costs.

Yang Mingzhou thinks the main obstacle facing the regulatory system is the fact that regulators carry out political tasks as well as their monitoring duties. This diminishes both the availability and the integrity of the people in charge of regulation. To fix this, the writer says China must radically reform its institutional system.

Yang Fuqiang says the energy bureau does not have the authority to limit the power of the state-owned oil and electricity companies or to control the erratic behaviour of local actors. Yang Mingzhou says construction and investment in the energy sector is chaotic. In some parts of the country, investors and producers are expanding too quickly, and in other regions, energy sector actors are just not interested in developing capacity. He thinks local practices are still project-driven and opportunistic and do not follow central government policies. This makes coordination difficult, particularly in implementing the central government's policies on environmental protection.

The shape of a new institutional energy system

Yang Mingzhou says some people are recommending the creation of an energy department, just as they did before the creation of the National Administration of Energy in 2008. He says the key question is not when the institution will be established, but instead, what form it will take. One possible option would be to create an independent commission for regulating energy alongside an energy ministry. Yang Mingzhou says successes abroad prove that having a body responsible for coordination and supervision ensures sustainable development of energy, improvements

put it in a difficult situation in international negotiations on climate change. China's energy mix is particularly to blame in emitting pollutants and causing atmospheric pollution. In 2011, according to Yang Fuqiang, 70 percent of energy came from coal, and less than 8 percent from renewable energies.

[20] Yang Mingzhou makes a number of recommendations on specific ways to adjust the energy mix. In hydropower, he thinks standards should be unified and construction coordinated to improve ecological protection. To deal with population resettlement, mechanisms for public participation and compensation should be set up and land laws reformulated. In renewable energies, the government should create policy to support technological innovation rather than large-scale manufacturing. Infrastructure should be developed for the transformation, transport, and stockpiling of natural gas, and shale and coal seam gas should be developed. In nuclear energy, security and control standards should be tightened and China should advance into the future as one of the leading countries in the world for innovation.

in service delivery, regulation of the economy, and optimal allocation of resources. In order to avoid conflicts of interest, the experts on the regulatory commission should not be chosen from government agencies, nor should they exercise any political function or have any political power. Their only concern should be driving the modernisation of the institutional framework, with the long-term goal of providing sustainable development of energy and ensuring energy security consistent with market-driven logic. Institutional reform should streamline the overlapping functions that have existed for decades between different departments. And it should solve the problems of shared responsibilities and recurring institutional squabbles.

Yang Fuqiang also recommends the creation of independent bodies for regulation and monitoring. Along with the regulators, a national department of energy (国家能源部, *guojia nengyuan bu*) should be constituted under the authority of the State Council, to take responsibility for energy supply, carbon emission reduction, and the management of state enterprises. He thinks the independent regulatory bodies should eventually be able to self-audit. Until then, Yang Fuqiang says the existing regulatory bodies should be freed from oversight. As it stands, the State Electricity Regulatory Commission is under the authority of the NDRC and the National Nuclear Safety Administration comes under the remit of the Ministry of Environmental Protection. Instead, Yang Fuqiang says, they should be directly supervised by the State Council.

Successes abroad prove that having a body responsible for coordination and supervision ensures sustainable development of energy, improvements in service delivery, regulation of the economy, and optimal allocation of resources.

Yang Fuqiang suggests that another commission, distinct from the one in charge of regulating electricity, should regulate the gas and carbon markets. He also thinks the legal framework for energy needs to be reformulated. The lack of a solid legal framework has led in the past to a proliferation of administrative decrees and, whether by promoting law breaking or by passivity, has encouraged people to bypass the law.[21] So, China should enact an "Energy Law" (能源法, *nengyuanfa*) that would guide activities in the sector until 2020. The writer says that every province and large city should set up a department in charge of dealing with climate change issues.

There are few articles in the Chinese press that lay out such unambiguous positions on the reform of the energy system as these. But it seems clear that the major issue in the energy debate at the 18th Party Congress will be institutional reform. The current system is beset by incomplete market reforms, state enterprise monopolies, lack of transparency in price setting, and lack of clarity in allocating administrative functions and responsibilities. These arguments seem to point to a necessity for comprehensive reform and the creation of regulating institutions that are more powerful than existing administrative channels and their vested interests.

Translation: Peter Brown
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[21] For instance, it has turned a blind eye to the establishment of polluting companies that contribute to an increase in GDP.

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This issue of China analysis was produced with the support of Stiftung Mercator.

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