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The 12th Five-Year Plan

Introduction on the 12th Five-Year Plan and its implementation

The 12th Five-Year Plan was first debated in October 2010 at the plenary session of the Central Committee of the Communist Party of China (CPC) and released shortly after this session. As expected, the National People's Congress (NPC) has approved the 12th Five-Year Plan on 14 March at its closing meeting. The Plan will cover the years 2011 to 2015.

The five-year plans of the Chinese government aim to set out the general guidelines for the country's economic and social development in the coming years. In particular, they deal with the planning of key national construction projects, the distribution of productive forces and the different economic sectors' contributions to the national economy. They set the direction of future development and set targets for economic and social achievements.

The 12th Five-Year Plan is a rather abstract document. While stating many ambitious goals, it contains barely any indications on which practical measures will be put in place to implement such objectives, or on how the achievements considered will be financed. Therefore, one is left to guess on what exactly the effects of the Plan on business life in China will be. On the other hand, it is certainly true that many important pieces of legislation will follow the guidelines of the Plan in the next years. The Plan will be the road map of legislation in the PRC until 2015: that is why lawyers and businessmen should be informed about its contents. Certain industries will be favoured, construction projects will be decided and social measures will be taken. Thus, the 12th Five-Year Plan will have a strong impact on the life of people and the business of companies in China.

The five-year plans of the 31 Chinese provinces, municipalities, and autonomous regions will follow the national Five-Year Plan closely, as they are subject to the approval of the central authorities in Beijing. However, the implementation of the 12th Five-Year Plan will greatly depend on Beijing's ability to make the various provinces and municipalities follow its policies. Officials on the municipal and provincial level as well as businessmen sometimes resist orders by the central government. On the political level, it shall be noted that the country's leadership will change during the effect of the new Plan. The Plan is therefore a way for the current leadership to ensure that tomorrow's leaders will follow the policy set today.

The following is an overview of the policies and goals stated in the 12th Five-Year Plan.

The background to the 12th Five-Year Plan: the main challenges facing today's China, as seen by the Communist Party

In accompanying documents to the 12th Five-Year Plan, the CPC has stated its views on the current economic climate and on the challenges awaiting China in the next decade.

According to economic experts, China is presently in a critical stage of its development. China's GDP was approximately USD 4'380 per capita in 2010¹. The stated purpose of the government is to reach a GDP of USD 12'000 per capita by 2020. Now it is true that China went through tremendous development in the last 30 years, but one could say that it started almost from nothing. Studies have shown that the figure of USD 4'000 per capita is relatively easy for developing countries to achieve. In contrast, it is very difficult to go from USD 4'000 to around USD 10'000 per capita. Many developing countries have failed taking this step and have been stuck at around USD 4'000 for a long time. The CPC seems to understand that China must avoid at all costs stalling out at about USD 4'000 per capita. Its stated objective is to entirely restructure the Chinese economy in order to overcome the danger of stagnation and to build a "moderately prosperous society" by 2020.

In this context, the CPC has presented a list of what it considers the biggest challenges facing China today.

The first challenge on the list is the burden of resource constraints. As its economy is very reliant on heavy industry, China needs considerable amounts of energy and raw materials.

The second challenge is the economic imbalance. The high investments in the light and especially in the heavy industry stand in stark contrast with the very low domestic consumption. Currently, only about 27% to 35% of the Chinese economy is driven by national consumption, compared to about 70% for the United States. This figure has been decreasing in the last ten years and astonishingly, it is the lowest figure ever recorded in any country. This means that a considerable part of the economy is driven not by domestic consumption, but by the export of consumer products, the heavy industry and state-sponsored infrastructure projects.

The income disparity constitutes another imbalance within the country. There is an income regional disparity, on the one hand: the rich coast contrasts with the poor West, Center and North-East. There is a huge social disparity, on the other hand: In average, a Chinese manager (highest management) earns about 100 times more than a line worker of his own company. Wealth must be spread more evenly between the people. The public must be allowed to enjoy the fruits of reform and development, says the CPC.

¹ This GDP figure is based on the IMF's World Economic Outlook Database. China's GDP per capita based on PPP (purchasing-power-parity) was approximately USD 7'500 in 2010.

Further, the CPC criticizes China's weakness in its capacity for domestic innovation. Although many products are assembled in China, very few of these are actually designed or invented here. Almost all high-tech parts come from abroad. The stated objective of the plan is to spend 2.2% of the GDP on research & development by 2015 and to reach an average 3.3 patents for every 10'000 people by 2015. Ideally, China would like to turn its coastal regions (the "world's factory") into hubs of R&D, high-end manufacturing and service sector.

The predominance of the heavy industry relates with the weakness of the service industry, which makes up only 30% of the Chinese economy. This figure is not only low but abnormal. Again, a large heavy industry is expensive because it eats up so much energy and raw materials. Efforts will be made to strengthen the services industry.

The CPC also sees the agriculture as being in great need of reform. The Chinese agriculture, albeit one of the most productive in the world, uses great amounts of fertilizer and occupies a huge number of people. The average Chinese farm is far too small to be productive. The average Chinese farmer earns about RMB 5800 per year. Further, as the farmers do not own their land, they lack incentives to invest in infrastructure such as irrigation. As a result, the farmers are in systemic deficit and very dependent on assistance by the government. The basic problem is that the country side is too crowded. Considering what has been said above, the repartition of workers in the country must be changed radically: the weight must be shifted from the agriculture area (inefficient, overcrowded) and from the heavy industry (too costly in resources) to the services industry. The solutions (see below): Hundreds of millions of people must be moved from the agriculture to the service industry.

Finally, the CPC finds that current urban and rural developments are not coordinated, as urbanization takes place mostly on the coast, leaving the West, Center and North-east behind. Even within the coast, there are high disparities in the rates of urbanization.

The solutions put forward by the CPC

There are certainly big challenges awaiting China in the next decade, and looking at the statements made in the 12th Five-Year Plan, the CPC does not intend to take half-hearted measures to tackle these issues. In short, the Chinese government intends to rely greatly on "scientific development" to solve the problems. This means, on the one hand, that continuous economic development shall provide the means to solve all of China's challenges; on the other hand, it means that such development must rely on science rather than on ideology. For China, this is an important distinction: unlike in the early days of communist China, ideological constraints shall not be given absolute priority when making economic and social choices. This reflects today's political consensus within the elite.

The second big statement of the CPC is that it intends to entirely modify the structure of China's economy. Currently, the Chinese economy is led by exports, the heavy industry and to a large scale relies on foreign technology and old energy. The government wants the economy to achieve a much better balance, i.e. one in which domestic consumption and the services industry play a leading role, and one that relies on domestic innovation and on low carbon energy.

Here are the 10 measures stated by the government to reform the Chinese economy in the next five years. The measures are not listed randomly, but in order of their importance in the eyes of the government.

The 10 measures

1. Unleash domestic consumption

...while maintaining a stable economy. This is the central measure in the effort to reduce the reliance on exports, but how will this be done?

The reason why domestic consumption is so low is simply because most Chinese people have no money to spend. The new wealth of the economic boom has been very unevenly spread and Chinese wages are still very low for global standards. For years, income increases have lagged behind economic growth. Only higher incomes and a better social system can really encourage domestic consumption. Consequently, the CPC wants to create jobs for people coming off the farms, increase the wages and establish pension schemes and health insurance coverage (see measure 7 below). A further possible measure would be to increase the income limit, above which people pay taxes. In general, the country must prosper in a more even manner and spread wealth in the public. These measures are not only a question of improving the economy, but also a political imperative for the government. Low wages and lack of employment may cause great dissatisfaction in the public and responding to these concerns will keep the country stable.

The stated goal is to increase the minimum wage standard by no less than 13 percent on average each year and to triple the wages in ten years. Some municipalities already increased the minimum wages significantly in recent times, and Beijing will encourage regional and municipal authorities to follow. But in general, the government will have a hard time enforcing wage increases. Who will pay for the added labour costs? Chinese companies will try by all means to oppose higher minimum wages, which would reduce their margins. It is a good guess that foreign and in general private-owned companies will bear much higher labour costs.

2. Modernize the agriculture

A farmer must work on at least 40 hectares in order to be productive, but the average Chinese farm of today has about 0.65 hectares. In order to solve this problem, the government wants to move 200 million people from the agricultural to the services and industry sectors. These are unskilled people, which may be extremely difficult to integrate in these sectors. The CPC gives no precise indications on how it intends to reach this objective, but one effective means to develop the country side is to create opportunities in the rural areas themselves instead of restricting them to big cities, for example by opening universities or starting scientific projects. Moreover, the government wants to create 45 million new jobs in urban areas by 2015.

3. Develop services trade, energy logistics and marine resources

In particular, the government wants to improve transport from the coast to the Center, the West and the North-East. This means large infrastructure projects in these areas, which in turn may help taking farmers off the land.

4. Integration between rural areas and cities

The largest cities (Shanghai, Beijing and Guangzhou) are already overpopulated and are not willing to take in further immigrants. Therefore, the plan is to move the millions of farmers (mentioned above) to 2nd and 3rd tier cities. Furthermore, new cities will be built in the rural areas – the fact that the Chinese countryside is so densely populated makes this possible. In other words, the government wants to create jobs and prevent urban migration by creating urban environments from scratch and build infrastructure in the outside rural areas. The high-speed railway and highway projects may be put in relation with the realization of such measures.

5. Promote energy saving

Rather or even instead of creating new (and clean) energy sources, China wants to focus on energy saving. At the moment, the country is enormously wasteful of its energy and becoming more energy-efficient will be much less costly than creating more energy. The stated goal is to cut the energy consumption per unit of GDP by 16 percent. This may be done, for instance, by enhancing or introducing harsh punishing administrative measures to force high energy-consuming companies or entire industries to reduce their consumption.

Water consumption and carbone dioxide emission by the industry shall also be reduced. Part of these objectives was planned to be reached by increasing nuclear energy production: the government had originally planned to add a capacity of 40 gigawatt to the existing 13 gigawatt stemming from atomic energy. In the light of the events in Japan, these plans have been put on hold shortly after the release of the Five-Year Plan.

6. Education and training of the workforce

Education and training is essential in the effort to boost the services sector and the local research and development. The educated workforce shall enhance domestic innovation and thus allow the development of the high-tech industry meant to replace the current assembling/manufacturing industry.

7. Establish a comprehensive public social welfare system

This measure may be viewed as a means to encourage domestic consumption (measure 1). Today, a Chinese worker earning an average salary can count on having about USD 470 at his disposal when he reaches retirement and social security belongs to the main worries of the Chinese public. In the absence of pension funds and a health insurance cover, it is only logical that Chinese people are afraid to do anything but save their earnings. Only when they have a guaranteed pension plan will the Chinese people stop saving and start spending. In consequence, bold objectives have been set: everyone shall enjoy a medical cover by the end of 2011 (!) and beneficiate of pension schemes by 2015.

8. Encourage cultural production for “soft power”

The idea is to spread Chinese culture around the world in order to enhance the understanding of China abroad. Again, the CPC does not say how it intends to do this.

9. Reform the economy

By this, the CPC means reform of the currency policy and of the control of energy prices.

10. Opening up the country, but “differently”

As already explained above, a balance between export and import must be attained. But the CPC also wants to encourage Chinese firms to invest abroad. This is a very interesting fact for Western companies, but the CPC remains silent as to how it intends to encourage such investments. Incentives are certainly needed, as mainly privately-owned Chinese companies are still rather timid when it comes to invest in companies abroad.

One more stated goal is to make China participate more actively in international economic governance. Currently, China is still reluctant to play its growingly important role in international bodies, but it will have to learn to play by the international rules.

Closing remarks

The 12th Five-Year Plan envisions a radical change to the structure of China's economy, rather than a mere reform. As outlined, the main features of this restructuration are the shifts from an export-led to a domestic-based economy and from the reliance on the producing industry to a better balance with the services industry, all the while moving an important part of the workforce from the agricultural to the services sector and reducing disparities between regions and people. The fundament allowing these changes shall be a steady economic growth and an increase in domestic consumption. Of course, a big uncertainty remains as to Beijing's ability to implement these measures, the first challenge being to make the rest of the country do what the central government orders. The next uncertainty concerns the financing of the Plan.

These measures must be put in the context of an overheated economy with a potential property bubble, in which inflation, scarcity in housing and a growing gap between rich and poor may ignite dissatisfaction in the public. Some of the measures are necessary to respond to these concerns and prevent any social unrest. The government also considers the current economy to be imbalanced and uncoordinated and wants a slower and more sustainable economic development. Shortly after the approval of the new Five-Year Plan by the NPC, the government has announced its intention to keep the economic growth at an average rate of 7 percent in the coming years.

Finally, what does the 12th Five-Year Plan mean for foreign companies? Foreign investment will be encouraged in modern agriculture and in the high-tech and environment protection industries. Furthermore, investment by Chinese companies abroad will certainly increase, albeit slowly. On the other hand, foreign companies established in China may have to face higher labour costs as they will be requested to pay for the new governmental measures. However, it shall be noted that there is a general trend towards higher wages all over China and that the new regulations are only one factor amongst others. In particular, the wages are drawn upwards by the higher costs of living.

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