

China Flash

Follow-up “blueprint” from Third Plenum lifts promise of reform

The final document of the “Third Plenum” was released late last Friday, some three days after the initial Communiqué. The latter laid the groundwork for reforms, but was also notable for its lack of detail, little mention of the financial sector, and its support of the role of the State in the economy ([China Flash](#)). In contrast, the follow-up blueprint is encouraging for its scope and list of reforms that had been missing from the Communiqué. On balance, the blueprint meets our expectations for reforms needed to inject a greater role of market forces in resource allocation, improve center/local government fiscal relations, and liberalize the financial sector, among others (Table, in download version). The document has also gained praise from observers for relaxing the one-child policy and abolishing labor education camps. However, in all areas it lacks detailed policy steps and timetables, and as such it remains to be seen whether the reforms will be implemented as envisaged, and in time to achieve a rebalancing of the economy to sustain medium-term growth (see [China/Asia Outlook](#) for details).

The blueprint establishes a high-level government team (rumored to be headed by Premier Li Keqiang) to design and facilitate implementation of reforms, and conveys an important role to free trade zones to promote reforms. Key reforms listed in the blueprint are summarized below and in the attached Table (see download version).

- **Economic and financial reforms:** key items include fiscal reforms to balance expenditure and revenues between the central and local governments, financial sector reforms to accelerate the liberalization of interest rates and facilitate private investment, opening the capital account and increasing exchange rate flexibility. Also included are steps to facilitate urbanization through reforms to the Hukou system and rural land rights. Importantly, the blueprint emphasizes SOE governance including through private shareholding and a higher dividend payout requirement. Deregulation and market pricing of utilities and natural resources also receives attention. Finally, without providing specifics, the document stresses a higher degree of access by domestic and foreign investors, especially in the service sector (broadly in “finance, education, culture, and healthcare”).
- **Public administration reforms:** these are emphasized in order to reduce the degree of intervention in the market and to enhance the government’s efficiency and framework of macroeconomic management. Reforms in this area also include a streamlining of public administration by cutting red tape and reducing the number of administrative tiers.
- **Social sector reforms:** these include the expansion of social security coverage to the rural population, along with improvements to medical insurance, pensions, and the hospital system. Also included is the gradual relaxation of the existing “one-child” policy.
- **Legal & judicial reforms:** enhancing the independence of the court system, strengthening anti-corruption institutions, and protecting human rights.

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Table

Reform measures from the Third Plenum

Key Reform Areas	Evaluation	Elements
Economic & Financial		
Fiscal	In line with expectations. Important for enhancing effectiveness of government administration and addressing local government debt problem.	<ul style="list-style-type: none"> • Balance expenditures and revenues between central and local governments • Expand VAT and property tax • Income tax changes to improve distribution
Financial sector	Missing from Communiqué, but included in blueprint. Reforms are in line with expectations and ongoing initiatives. Implementation may meet resistance from state-owned banks and vested groups.	<ul style="list-style-type: none"> • Interest rate liberalization (remove cap on deposit rate) • Allowing private investment in the banking sector
Capital account & exchange rate	Missing from Communiqué, but included in blueprint. Sequencing and gradualism will be needed to ensure financial stability. We do not expect full liberalization before 2020.	<ul style="list-style-type: none"> • Capital account liberalization (gradual) • Enhance exchange rate flexibility
Urbanization	In line with expectations. Hukou reforms to be restricted to mid- and small-size cities. Awaiting details.	<ul style="list-style-type: none"> • Hukou system reform • Improve urban planning
SOE governance	Missing from Communiqué, but included in blueprint. Envisaged reforms do not go as far as hoped.	<ul style="list-style-type: none"> • SOE restructuring to reduce role in the economy and increase competition from private sector • Establish state holding companies to manage SOEs • Raise dividend transfers to central government (to 30% by 2020 from current average of 10%)
Land reform	Limited in scope	<ul style="list-style-type: none"> • Land (ownership) rights for farmers
Market pricing	In line with expectations.	<ul style="list-style-type: none"> • Deregulation of controlled prices of water, gas, and electricity.
Investment access	Encouraging list of reforms, but implementation remains to be seen.	<ul style="list-style-type: none"> • Expand access of private investors in the service sector; shift to negative list approach • More equal treatment of domestic and foreign investors • Expand and accelerate free trade zones • Participate in regional free trade and investment agreements
Public Administration		
Streamlining and reducing intervention	In line with expectations.	<ul style="list-style-type: none"> • Reduce number of administrative tiers • Cut red tape
Social Sector		
Social Security	Not mentioned in communiqué, but included in blueprint. In line with expectations.	<ul style="list-style-type: none"> • Expand social security for rural population • Gradually raise retirement age and reduce payroll tax, improve pension system
Medical services	Not mentioned in Communiqué, but included in blueprint. As expected.	<ul style="list-style-type: none"> • Enhance medical insurance, hospital system reform
Population policy	Not mentioned in Communiqué, but included in blueprint. As expected.	<ul style="list-style-type: none"> • Further relax one-child policy
Legal & Judicial		
Rule of law	Encouraging set of reforms, but may be difficult to implement.	<ul style="list-style-type: none"> • Restructure the court system to enhance independence • Overhaul anti-corruption institutions • Human rights (abolish “education through labor”)

Source: BBVA Research



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