

february 2021

open to autarky: China's coming 5-year plan

To be unveiled in March, plans for the next five years will power the PRC's ambition to become the leading world economy by mid-century. Supply chain security now outranks economic growth, elevating science, technology and innovation high up the agenda. Carbon neutrality wins a faster trajectory, while urban middle-classes are urged to spend more. Foreign trade, investment and knowhow are welcomed, if only to reduce future reliance on foreign tech and imports. Marshalling these agendas to converge by 2035 demands boosting total factor productivity and a quasi-level playing field. But at more of a premium is allowing the right mix of talent into the tent under Party's expanding control of both political and economic levers.



finishing touches to PRC emblem in flowers,
National Day, Shinan district, Qingdao
credit: Serj Malomuzh, Shutterstock

No clear GDP target will be included in the 14th 5-year plan (2021–25). Following the previous target of doubling the 2010 economy by 2020, much lobbying has called for more of the same over the next 15 years. That may be attainable at current growth rates, affirmed Xi Jinping 4 Nov 2020, but mid-to-long-term goals need instead to prioritise better economic structure and efficiency: quality must trump speed.

This signals tougher reforms. Entering his third term with no successor in sight, Xi will seek to build his legacy: a 'basically modernised' socialist economy by 2035, 15 years ahead of Deng Xiaoping's schedule. Beyond GDP, this expands development goals to include security, social and environmental issues, with formal reference to classic socialist redistribution a subcurrent.

The economy is to support this by becoming less export oriented, even as red carpets roll out for foreign investment and expertise. Xi's dual circulation paradigm envisions an ultra-large domestic market (the primary cycle). This would enable China to be less subservient, hence more strategic, in interactions with global markets (the secondary cycle).

5-year plans dictate the pace of rolling out this long-term vision, mobilising a large, multifaceted state apparatus and vast resources towards detailed targets. Virtually all the hard targets of the 13th 5-year plan (2016–20) have been met.

ultra-large domestic market

Many of the tougher reforms revolve around making production factors market-based and increasing total factor productivity; this will cover

- **land:** unifying urban-rural land markets
- **labour:** reforming the *hukou* (household registration) system, raising education levels and raising retirement ages
- **capital:** registration-based IPOs and opening up financial markets
- **tech markets:** improving patent quality, ownership and trade
- **data:** closing legal grey areas and developing it as a public good
- **price-setting:** reducing interference, primarily by local officials

At face value, this ambitious agenda suggests the state will gradually cede control to the market. In reality, it will compensate (and then some) by tightening its grip over a smaller group of leading firms through Party cells and admin checks. Industry policy actively promotes creating 'national teams', captained by SOEs (state-owned enterprises). In line with the long-term centralisation of power under Xi, local officials have less discretion to bend rules (accrue debt; ignore environmental regulations) in pursuit of GDP growth. There is less patience with non-productive, non-innovative investments. Beijing has already allowed bond defaults in some large, state-funded projects and SOEs (namely semiconductors and autos).

Rules-based governance (PRC-style 'rule by law') is a further facet of this macro-approach. Anti-monopoly regulations, for instance, are used against large firms whose loyalty is in doubt, such as Alibaba-affiliate Ant Group. Despite apparent similarity to Western models, this adds challenges for international business in China.

getting middle classes to open their purses

Given domestic consumption is to make up for exports, 'demand-side' measures (sequel to 2015's 'supply-side') are to be expected in the 5-year plan, following their December 2020 Politburo debut. Rather than redistribution via tax reform or minimum wages, this suggests efforts to convince habitually frugal Chinese households they can do with smaller financial buffers. Improving social insurance and benefits (healthcare, education and pensions), not to mention real estate markets, would help, but will be hard to pull off. Even suggestions of reform tend to spark social discontent and indeed urban protests.

Take retirement ages. Plans for gradually raising them will finally emerge in the coming five years. Current age limits (between 50 and 60 depending on gender and occupation) were set in 1978. With birth rates falling to a critical level in 2019, if nothing is done, retirees will equal the workforce in number by 2050. Already under severe pressure, pension funds have run into the red by over C¥100 bn (AU\$200 million) annually since 2013. The funding gap is expected to top C¥1 tn (AU\$200 bn) in the next decade. On the other hand, unemployment is a major concern, worsened by COVID-19. Infant and elderly care, typically provided by



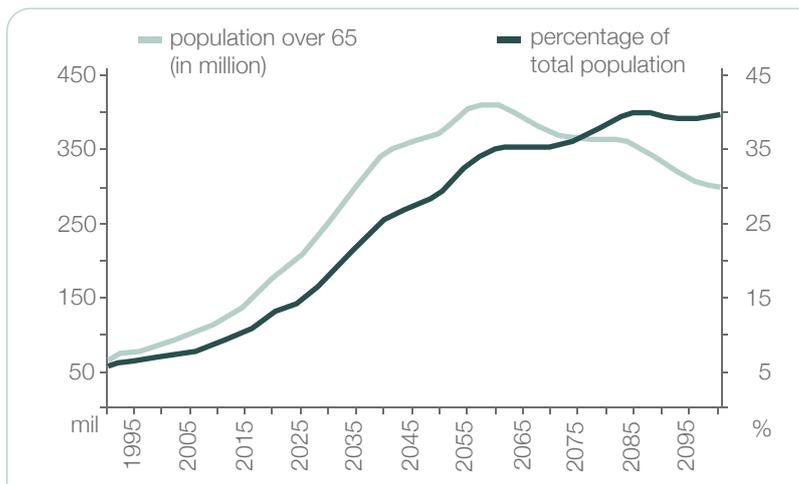
Lou Jiwei 楼继伟
former finance minister

Changing the structure of local government debt is key, argued Lou in December 2020, acknowledging that it has been rising due to COVID-19. 'Project-based' special purpose bond issuance should be wound down, and more general purpose bonds issued. This promotes consumption and increases standards of living, claims Lou, minister between 2013 and 2016. Investment in healthcare, education, pensions, nurseries and other welfare facilities improves the level of basic public service and promotes consumption.

chart 1: China's ageing population

ageing is expected to accelerate, thanks to a rapidly declining birth rate; per capita GDP is far from that seen in many developed countries facing a similarly ageing population, leaving a huge burden for aged care in China

source: NBS, Evergrande Research



retirees, threatens to become too costly to provide if they are kept in work. Incentives for commercial care are likely, yet any uncertainty will undermine efforts to coax households to be less frugal.

revitalising the countryside

The vast countryside offers another pathway to boost local consumption, albeit with challenges of its own. Promoting rural sales of (low-speed) new energy vehicles is already the standout public campaign to boost consumption. Productive factors are meant to flow freely between urban and rural regions. Homestead plots will remain collectively owned, but a rural-urban integrated market for construction land is planned for 2022. Extended tenure and firewalling of other types of rural land make farmland more fungible, opening the door to large-scale farming by ag firms and coops.

Bringing the investment needed, these 'new ag operators' are meant to modernise and upgrade agricultural production and better integrate it with industry. For the same reason, Beijing will yet again invest in infrastructure, including broadband and 4/5G coverage, in a bid to raise consumption. While pinning hopes on large and modern ag firms, Beijing vows to protect smallholders, still 98 percent of operators: rural revitalisation must prevent backsliding from the formal eradication of absolute poverty, declared at the end of 2020.

green growth

By pledging carbon neutrality by 2060, Xi has delivered Chinese firms an economic opportunity of global scale. Expected to peak in the 2020–30 period, carbon emissions are to rapidly decline 2030–45, leaving tougher last steps (entailing carbon storage) for 2045–60. A carbon emissions market is to be 'basically set up' by 2025: it will have an impact only after the apportioning of emission rights is adjusted, sometime after 2025.

A volume cap on coal consumption would have more effect. The massive fossil fuel SOEs will most likely be able to stave this off, despite the imperative to peak emissions. That said, the 5-year plan will set ambitions in power generation, grid upgrades, power pricing and emissions reduction. These will become hard targets in subsequent



Tang Renjian 唐仁健
Minister of Ag and Rural Affairs

A seasoned political operative, Tang returned to his ag roots when appointed the sector's top bureaucrat in December 2020. A long-term advocate for farmers, he stresses stability in his reading of the No. 1 Document, released 21 Feb 2021. Concerted support for industrial development, community relocation and social security is needed in underdeveloped regions, he says, pointing out that central policy will urge broader support for infrastructure projects and public services. This is the beginning of a 5-year transition, he highlights, from fighting poverty to revitalising the countryside.



Cui Dongshu 崔东树
China Passenger Car Association
secretary general

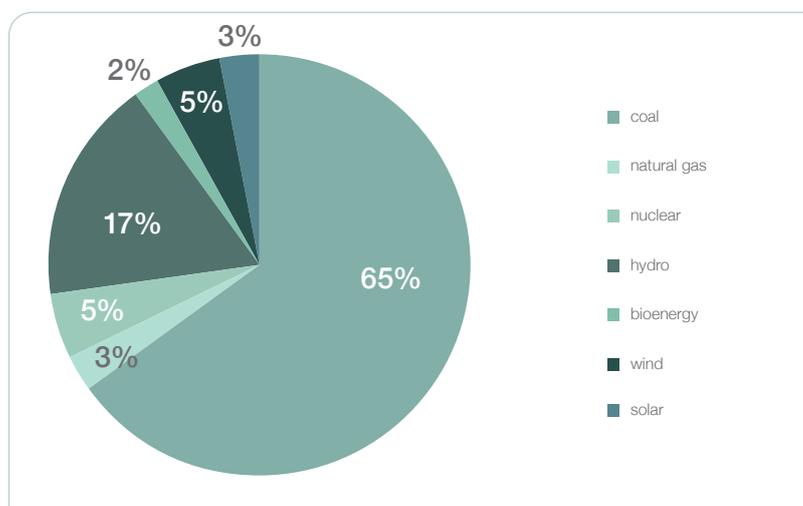
A strategy is needed to meet the C¥35/kg (AU\$7/kg) target price for hydrogen fuel by 2024, warns Cui, which will be included in the hydrogen industry 5-year plan, currently in draft. Rather than propping up sales with subsidies or credits, a 21 Sep 2020 measure confirms Beijing will reward urban clusters for building hydrogen ecosystems, empowering local government rather than industry.

chart 2: China's power generation by source, 2019

source: IEA World Energy Outlook 2020

5-year plans for energy, coal, renewables, etc. Few such goals of the last 5-year period were missed.

In power generation, targets are likely to increase the shares of nuclear (5 percent in 2019), wind (5 percent) and solar (3 percent). The first of these did not meet its target for the last plan; the other two greatly exceeded their quotas for capacity growth. Hydropower (supplying 17 percent of power in 2019) will be integrated with renewables, cutting in to stabilise peak supply. Gas-powered plants (supplying 3 percent in 2019) will respond to peak demand as well. All of this is to eat into the share of coal, which commentators argue should be reduced from some 60 percent today to 55 or even 50 percent by 2025. Hydrogen will be explored as a future technology to store and transport renewable energy.



global impact

Many of the tougher reforms outlined above will make the PRC a more predictable and better-regulated market (not least for international firms). At the same time, improving market efficiency reflects a desire to reduce international exposure, grounded in a dread of being 'decoupled' from foreign tech and other essentials.

Running through the dual circulation paradigm, a dilemma confronts trade partners. On the one hand, Beijing is opening more sectors to FDI, expanding pilot free trade zones and making concessions in multilateral trade agreements (including data trade in RCEP). On the other, these efforts ever more transparently serve ambitions to become self-reliant, expressed in the current ideological mantra of 'baseline thinking'.

Implied in this is a combination of capabilities: doing without imports (unless cheaper, e.g. integrated circuits, bearings or corn), while controlling international supply chains. Beijing is already a 'power trader', mobilising trade tactics in support of national ends.

high quality development



Pan Jianwei 潘建伟
University of Science and Technology of China executive vice president

Breaking foreign tech strangleholds entails working with the world, argues quantum specialist Pan. Knowledge should be made universal via a 'controlled open source' paradigm. 'Control' comes from asymmetric advantages in key links in the supply chain, preempting any potential chokepoints. 'Open source' deals on this basis will, says Pan, lead to cutting-edge breakthroughs. Requirements for investment-hungry scitech firms to make profits should be relaxed, he advises, giving capital markets more say in deciding a firm's growth potential. His firm QuantumCTek listed on the STAR market in July 2020.

The 14th 5-year plan will give science, technology and innovation near-absolute priority. Beyond raising productivity, boosting consumption, revitalising the countryside and cleaning up the environment, becoming a scitech powerhouse is an issue of national security. The quest for self-reliance dictates breaking 'foreign tech strangleholds': the technological edge that the US and its allies can deploy against the PRC. Catch-up (in integrated circuits, seed development and anti-cancer drugs) is Beijing's credo, alongside building chokepoints it can itself deploy in areas like quantum computing and artificial intelligence.

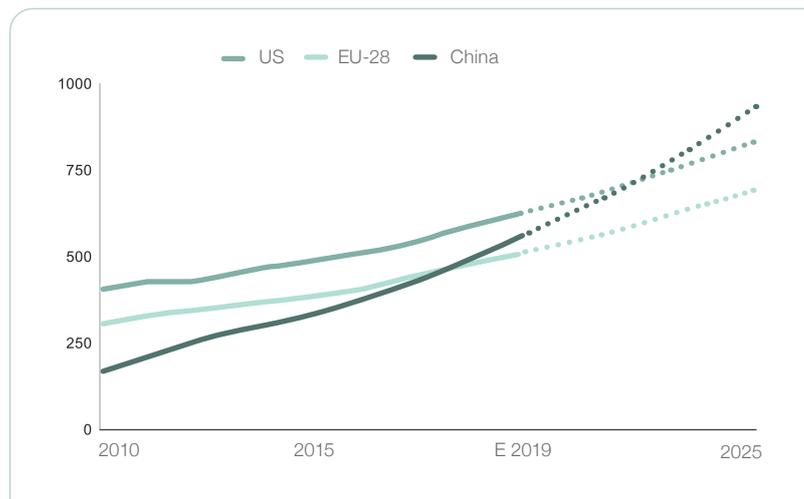
Beijing has become more mindful of the high price of heavy-handed market interference; industry policy will amplify private sector trends by increasing tax rebates and encouraging stock market investments. IP protection will improve. Investors are directed towards the 'strategic emerging industries', a buzzword making a comeback in late 2020, and likely to feature in the 5-year plan.

Beijing will single out areas of such strategic importance to justify leveraging, in Xi's words, 'the unique ability of the socialist system to concentrate resources'. National labs, megaprojects and special programs will be launched, and research funding agencies, universities and public research institutes will be expected to align their priorities accordingly.

chart 3: gross domestic R&D expenditure (US\$ bn) PPP

R&D investment grew by double digits in the past five years and reached C¥2.4 tn (~A\$470 bn) in 2020; Beijing will overtake Washington in absolute terms by 2022 to become the world's leading funder of research

source: OECD and China's National Statistics Bureau



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