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Chinese Media Digest
中国传媒摘

The Chinese Media Digest, launched in November 2014, provides critical analysis of news articles, blogs, and official speeches published in Chinese-language news media.

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REFORM AGENDA

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REFORM AGENDA

State-Owned Enterprise Reform Expected in Early 2015

China's plan for reforming its state-owned enterprises (SOEs) could be issued as soon as early 2015, a change that has been in the works since last November's Third Plenary Session. According to an "authoritative source," a consensus on the proposed reform plan was reached after several rounds of discussion between the recently established SOE Research Group and the State-owned Assets Supervision and Administration Commission, the Ministry of Finance, the National Development and Reform Commission, and the Ministry of Human Resources and Social Security.

The authoritative source divulged to *Economic Information* that one area of consensus centered on classification of state-owned assets as "public welfare" or "commercial enterprise." Chen Qingtai, deputy director of the economic committee of the Chinese People's Political Consultative Conference, specified SOEs classified under "public welfare" can be further divided into those possessing "political function" and those possessing "profitable function." Politically functional SOEs serves as a tool for the government to achieve particular targets, whereas profitably functional SOEs must earn financial returns, to be used to serve the people and the public. According to Chen, this classification is indicative of a shift from government use of SOEs as a tool to control the economy, develop strategic industries, allocate resources, and promote economic growth, to the government loosening its grip on SOEs by allowing more competition.

As for mixed ownership, SOE reform will expand efforts to open up to private capital. In competitive sectors, state-invested organizations can decide to pull in strategic investors based on their own needs, or on the basis of profit maximization. Additionally, the pilot program that allows employees of "backbone" SOEs in the technology, service, and administration sectors to hold company shares will be expanded, and will be prioritized above other strategic investors.

The article points out that, while SOE reform has not yet been realized on the national level, more than 20 localities have already published plans for SOE reform. For example, in Beijing, more than 80 percent of state capital has been focused on providing public services, strengthening infrastructure investment, developing forward-looking strategic industries, protecting the environment, and safeguarding public welfare. In Guangdong, the goal is to form around 15 large-scale industry associations with profits or assets more than RMB 100 billion. In Shanghai, those companies that are not explicitly identified as wholly owned by the state will undergo equity diversification over the next three to five years. In Tianjin, by the end of 2017 there will be at least one listed company among key corporations, and the operational state asset securitization ratio will reach 40 percent.

- 竞争性国企不要求绝对控股 (Competitive State Enterprises Do Not Require Absolute Ownership)
  Economic Information, December 17, 2014
  http://www.jjckb.cn/2014-12/17/content_531416.htm

China’s Economy Adjusts to the “New Normal”

Last week, China’s top leaders concluded the Central Economic Work Conference, a meeting focused on mapping out implementation of reforms set forth in last year’s Third Plenum. The key theme of the conference was developing China’s economy under the “new normal.” In an op-ed in Party newspaper *People’s Daily,* Pan Shengzhou, deputy director of the Policy Research Office of the CPC Central Committee, explained under the “new normal,” China’s economic growth is slowing from “high-speed” to “mid-high-speed,” embodying the government’s intention to focus on the quality of economic expansion rather than the quantity. As a result, China’s economy will evolve to become more advanced and structurally sound.

2015 will be a crucial year for comprehensively deepening reform, said Pan. The Central Economic Work Conference set forth several economic and social tasks that it sees as instrumental in achieving meaningful reform:

- *Strive to maintain stable economic growth*. To preserve the balance between stabilizing growth and adjusting the economy’s composition, macro-level policy must be upheld simultaneously with promoting balance of the “three carriages” of China’s economic growth: consumption, investment, and exports.

- *Actively cultivate new growth targets*. To do so, the market must first play a decisive role in allocation of resources. Second, prioritization of scientific research and achievements is needed to promote industrial innovation. Third, government policy should be broadened to promote fair market competition, innovation, and efficiency.

- *Accelerate the shift in agricultural development*. Agricultural development should shift from focusing on expansive operations that seek to increase output at the expense of resources and consumption, to a development plan that gives equal weight to quantity and quality of output, emphasizes increased competitiveness, emphasizes innovation in agricultural technologies, and emphasizes sustainable, intense development.

- *Optimize room to grow the economy.* Local regions should continue to promote economic development in accordance with the “One Belt, One Road” strategy (linking Silk Road countries to support infrastructure investment), the Beijing-Tianjin-Hebei integration strategy, and the Yangtze River Economic Belt strategy.

➢ 在新常态下促进经济平稳健康发展 (Promoting the Stable, Healthy Development of the Economy under the “New Normal”)
People’s Daily, December 18, 2014
http://politics.people.com.cn/n/2014/1218/c1001-26228933.html

China's Repeated Fuel Tax Hikes Criticized as Excessive

The recent decline in global energy prices may be playing into the hands of the Chinese government, which is using the opportunity to increase fuel-based taxes. Effective December 1, the Ministry of Finance (MOF), in conjunction with the State Administration of Taxation, switched from a volume-based to a price-based consumption tax on coal, the country's dominant energy source.[1] MOF has also raised consumption tax rates on oil and gas repeatedly over the past three months, most recently on December 12.[2] (Most tax adjustments in China's authoritarian system do not require legislative approval.) These measures bring much-needed fiscal revenue to the Chinese government in the face of an economic slowdown, and add to a series of reforms aimed at discouraging wasteful resource use. Higher taxes are easier for consumers to swallow when the underlying energy prices are low.[3]

A different view is put forward in an opinion piece in *Xinhua Daily Telegraph*, a Beijing-based paper sponsored by the official Xinhua news agency. The article's author, journalist Shu Shengxiang, argues the oil consumption tax loses credibility as a tax if it is repeatedly increased in lockstep with the decline in global oil price. For one, a tax should be just that – an item that is only modified periodically, in order to provide some measure of certainty to households and businesses trying to manage their budgets. Shu writes, "If you constantly adjust the tax rate, up to twice every two weeks, is the tax still 'fixed' in any way?"

Shu asserts there is no grand economic strategy behind the tax hikes. Rather, the Chinese government is trying to offset losses in fiscal revenue and protect China's state-owned oil companies. He states:

> *If you repeatedly conflate changes in oil prices with adjustments in the oil consumption tax rate, you're sending a message to the public that the government does not want to see the price of oil fall and will use tax increases as a means of stabilizing the oil price. In other words, the oil consumption tax stops being a real tax and starts becoming an 'oil price adjustment fee' […]*

Based on the latest oil consumption tax increase (from RMB 1.12 to RMB 1.4 per liter), Shu reckons the effective tax rate is now 40 percent, higher than the rate for equivalent taxes in the United States and Japan. He voices concern that the fiscal proceeds from this onerous tax could be reallocated as subsidies to China's oil companies, rather than benefitting the general public that bears the brunt of the tax burden.

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[1] Paul Pennay, "China's New Coal Tax Takes Effect," *The Daily Telegraph*, December 2, 2014. *http://www.dailytelegraph.com.au/business/breaking-news/chinas-new-coal-tax-takes-effect/story-fnn9c0gv-1227142123432?nk=545dbeee252a998c14fb36af335524de*.

[2] Kenneth Rapoza, "China Raises Taxes on Oil & Gas," *Forbes*, October 13, 2014; Xinhua, "China to Raise Fuel Consumption Tax, Cut Retail Prices," December 12, 2014; Xinhua, "China to Raise Oil Product Consumption Tax," November 28, 2014.

[3] For more information, see Iacob Koch-Weser, *China Fiscal Policy Revamp Faces Hurdles*. USCC Economic Issue Brief 6 (Washington, DC: U.S.-China Economic and Security Review Commission, September 30, 2014). *http://origin.www.uscc.gov/sites/default/files/Research/Issue%20brief_China%20Fiscal%20Policy%20Revamp%20Faces%20Hurdles.pdf*.

- 别把燃油税弄成“油价调节费” (Don't Turn the Fuel Tax into an “Oil Price Adjustment Fee”)
  Xinhua Daily Telegraph, December 15, 2014
  http://www.cet.com.cn/plpd/jjgc/1403513.shtml

Finance Experts Grapple with Risky Internet Lending

At the China Internet Financial Innovation and Development Forum held last month in Shenzhen, finance experts gathered to discuss China's booming internet finance industry. E-commerce giants like Alibaba and other internet companies are branching into the financial sector to provide payment and settlement services, lending, and sales of investment products.[4] Because small- and medium-sized enterprises (SMEs) often do not qualify for financial products offered by China's giant state-owned banks, internet financing, particularly peer-to-peer (P2P) lending, is becoming a preferred channel for borrowing money. Yi Huanhuan, secretary-general of a leading internet finance club in China called IFC1000, explained how SMEs are driving China's internet finance boom:

> *China is in a situation where most [formal] financing is going to the real estate sector and other high-volume staple industries. As a result, most SMEs don't have access to appropriate financing. In the third quarter of 2014, the number of Chinese SMEs increased by about 60 percent, with an absolute increase of about 9.2 million companies.*

According to Yi, the future of internet finance is targeted at these SMEs. China's more than 1,500 P2P lending platforms financed upwards of $110 billion this year, up from only $10 billion in 2012.[5] Despite the high number of platforms operating in this space, Yi argues “the current number of financing platforms is still far from covering the needs” of China's millions of SMEs.

As a new, up-and-coming industry, internet lending faces the “three no” problem: no oversight, no standards, and no threshold for participation. As a result, risk abounds. After a number of P2P platforms started showing signs of financial distress in November 2013, news of internet lending businesses shutting down due to bankruptcy or fraudulent behavior has continued to surface. This November alone, the number of failed lending platforms reached 39, an all-time monthly high. Statistics showed that, as of November 30, the number of “problem platforms” in operation in China reached 288 in total (not including those in Hong Kong), with 50.7 percent of those platforms based in Guangdong, Zhejiang, Jiangsu, and Shanghai.

Industry experts have taken various positions on how to oversee risky internet financing. Yi Huanhuan estimates that in the next few years, most funds will continue to move from high quota lending markets like real estate and bonds to the stock market, exposing it to the risks of internet finance. Zhang Chenghui, head of the Research Institute of Finance at the PRC State Council-run Development Research Center, believes the “P2P industry needs to be sufficiently vigilant, and hold firm to the bottom line” of providing financial services to support the real economy, rather than allowing borrowed funds to be used in stock market speculation.

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[4] Takeshi Jingu, “Internet Finance Growing Rapidly in China,” Nomura Research Institute, March 10, 2014. *http://www.nri.com/~/media/PDF/global/opinion/lakyara/2014/lkr2014189.pdf*.
[5] Wu Qiuyu, “More Safety Needed in Internet Finance,” *People's Daily*, December 8, 2014. *http://finance.people.com.cn/n/2014/1208/c1004-26164295.html.* Staff translation.

Transparency is essential for successful oversight, according to Liu Shengjun, vice president of the China Europe International Business School Lujiazui Institute of International Finance. Liu points out that P2P platforms have trouble discerning good borrowers from bad primarily because China's credit rating system is lagging behind. Li Aijun, deputy director of the China University of Political Science and Law Financial Law Research Center argues "traditional financial standards don't apply here, as internet lending platforms don't have a capital adequacy ratio of 8 percent" as required of formal financial institutions by Chinese regulators. In this sense, establishing a system to provide verified, accurate, and complete borrower information is one of the best ways to reduce risk in the internet finance industry.

- 11 月网贷问题平台数量创新高 (Troubled Internet Lending Platforms Hit a New High in November)
  Economic Information, December 8, 2014
  http://www.jjckb.cn/2014-12/08/content_530181.htm

Fall of the Russian Ruble Hurts Chinese Automakers

Precipitated by a crisis in Russia's economy, the Russian ruble plummeted over the past week, compounding the currency's rapid depreciation in 2014. Russia's central bank has scrambled to impose steep interest rate hikes, while Russia's cabinet has convened emergency meetings to find ways to contain the damage.[6] *Caijing*, one of China's top finance magazines, asserts the ruble's fall has also placed certain Chinese companies "under the gun."

Caijing identifies the biggest loser as Geely, a publicly traded company and one of China's largest independent automakers. Geely sells a large portion of its low-cost vehicles in foreign emerging markets like Russia. The falling ruble hurts Geely in several ways: reducing the value of Geely's ruble-based sales revenue; limiting the ability of Russian consumers to purchase imported cars denominated in renminbi and dollars; and diminishing investor confidence in Geely's Hong Kong-traded stock, which fell by 22 percent following news of the ruble's decline. *Caijing* reports Geely has already adopted countermeasures, such as raising its retail prices in Russia in the short term and shifting more auto production there in the long term, in order to avoid the currency misalignments that now plague traded goods.

The *Caijing* article also details the volume of cars different Chinese carmakers are selling in Russia. Little-known Lifan Auto Group actually tops the list, with 17,909 units sold through the first ten months of 2014. Geely comes in second, with 14,519 cars sold over the same period. Chery and Great Wall rank third and fourth, with 13,801 and 12,965 units sold, respectively. All of these top carmakers saw steep year-on-year declines in their Russia sales from 2013 to 2014, indicating the severity of Russia's economic downturn.

Outside the auto sector, *Caijing* identifies few companies with significant exposure to Russia's economy. Gree Electric, a producer of electrical appliances, generates some sales there, but *Caijing* maintains these are small compared with the company's China sales. Harbin Hatou Investment Co. Ltd., based in Northeast China, recently established a subsidiary in Russia, which engages primarily in logging and timber processing. Huasi Agricultural Development Co Ltd., a company publicly traded in Shenzhen, sells fur coats and other fur-based textiles to Russia.

- 卢布暴跌 哪些中国企业可能“躺枪”？ (The Ruble Plummets: Which Chinese Companies Might Be "Under the Gun"?)
  Caijing, December 17, 2014
  http://economy.caijing.com.cn/20141217/3777492.shtml

[6] Michael Birnbaum, "Russia Imposes Steep Interest Rate Hike as Ruble Plummets," *Washington Post*, December 16, 2014. *http://www.washingtonpost.com/world/to-halt-crisis-russia-central-bank-hikes-interest-rates-as-ruble-falls/2014/12/16/9ebb1610-4c9e-45bd-9297-475b0d3878cc_story.html*.