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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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Hurdles Abound in Unifying China's Pension Systems

On January 14, 2015, China's State Council published a plan to merge its dual-track pension systems, under which government employees contribute nothing while corporate employees contribute 8 percent of their salaries.[1] According to official estimates, China's public employee population is the largest in the world, and is expected to reach 1.43 billion by 2020.[2] Due to the legacy costs of paying for government and other state worker pensions since the pension system was introduced in 1991, China's pension fund was more than $13 trillion in debt in 2012, according to a study published by the Chinese Academy of Social Sciences in June 2014.[3]

According to Liu Yan, a well-known Chinese economics and finance commentator, China should move forward with its plan to close the gap between public and private sector retirement schemes, but three key issues stand in the way. First, the historical guarantee that government employees retain their "iron rice bowl"—or guaranteed job security and wages for public sector workers—is crumbling. Ms. Liu argues China must overcome the traditional mindset that gives special privileges to government employees.

The second challenge facing pension system unification, says Ms. Liu, lies in coordinating the interests of individuals at different levels of seniority. The recently published unification plan emphasizes building a new system targeted at public sector employees whose seniority lies between most senior and most junior, and integrates reform of the salary and occupational annuity system. But concrete implementation of the detailed rules and regulations for combining systems is a distant prospect. While senior workers may retain the old benefits and new workers can receive the new benefits, mid-career workers find themselves in an awkward situation. China's State Council estimated 37 million current state employees will not have pensions fully paid for by the government, but will have to contribute the same amount as corporate employees under the reform plan.[4] On top of that, talks of raising the retirement age and other reform proposals further complicate pension system unification.

Ms. Liu argues a third challenge for pension reform lies in the technical complexities of building an entirely new and comprehensive pension system. Restructuring the pension system will involve, among other things, developing an administrative mechanism, a channel for collecting contributions, and methods for calculating and distributing funds. In addition, China will need to institute a compulsory occupational annuity system, come up with a plan for calculating pension replacement rate[*] levels, and establish a system for integrating individual accounts with a society-wide pension plan. Another pressing challenge is to coordinate pension plans for corporate employees across all sectors of the economy.

- “并轨”面临全方位制度重构 ("Unification" Faces Comprehensive Systemic Restructuring)
  Economic Information, February 4, 2015
  http://www.jjckb.cn/2015-02/04/content_537168.htm

[*] Replacement rate refers to the percentage of a worker's preretirement income that is paid out by a pension program upon retirement.

Fairness Key to Funding China's Pension Scheme

In early February, the heads of China's National Social Security Bureau, an agency under the Ministry of Human Resources and Social Security (HRSS), convened their annual meeting. According to economics journalist Ouyang Mijian, HRSS Vice Minister Hu Shaoyi expressed concern at the meeting that expenditures for five types of social security† have outstripped revenues for three years running, contributing to an increasing shortfall in public social security funds. Of the five types, China's pension fund is the biggest drag. Mr. Ouyang claims fiscal subsidies to the pension fund in 2013 amounted to no less than $49 billion. In many provinces, local governments are plugging this gap through their fiscal budget, in some cases exhausting surpluses accrued in previous years.

Mr. Ouyang lists a few policy options for narrowing the pension funding gap. One is to increase coverage, so more people pay into the system. Another is to increase contribution rates. Both of these approaches, however, would face major resistance. Contribution rates are already too high in some cases and, if anything, need to be lowered. That point has also been driven home by China's Vice Premier Ma Kai.

Mr. Ouyang suggests a better solution: improving the distribution of pension funding and spending. Currently, some companies rigorously deduct pension contributions from employee salaries, while others do not. This has the knock-on effect of allowing some workers to take home larger paychecks than others. Adding to this problem is a lack of redistribution at the national level, so that some areas of the country have pension fund surpluses while others run large deficits. This mismatch exacerbates existing inequality, as cash-strapped governments in poorer areas try to meet growing spending requirements.

The author notes that China's worker-retiree ratio is currently 9:1 in cities and 3:1 nationwide. If pension contributions were fully collected, funding would be more than enough to meet expenditures. In view of this, the current funding shortfalls are the result of policy failure, not demographic decline.

- 公平化可缓解养老基金收支平衡压力 (Fairness Is Key to Relieving Pressure on Security Funding Gap)
  21st Century Business Herald, February 9, 2015
  http://pinglun.21cbh.com/2015/2-9/5NMDAwMzZfMTM2OTU5NQ.html

CHINA'S STRATEGIC DEVELOPMENT

China's Northwest Sees Steel Opportunities on the "One Belt, One Road"

On February 1, 2015, China's leaders convened in Beijing to establish key targets for advancing the construction of the New Silk Road Economic Belt and the 21st Century Maritime Silk Road, the two complementary tracks that together comprise the country's "One Belt, One Road" (OBOR) development strategy. One week later, China's national railway operator announced plans to

† China's five basic social security schemes are basic pension, basic medical insurance, unemployment insurance, work-related injury insurance, and maternity insurance.

invest more than $125 billion in railway construction in 2015, build 8,000 kilometers of rail line, and prioritize railway construction in China's western regions as a means of jump-starting the OBOR strategy.[5]

According to an article in *China Steel News*, the OBOR strategy could serve as a boon for northwestern China's steel industry, a sector currently struggling with overcapacity and declining demand. In 2014, Xinjiang's eight large-scale steel plants registered capacity utilization rates of only 40 to 60 percent. In February, October, November, and December, the plants saw "very obvious" reductions in production. Moreover, earnings for the autonomous region's largest steel company, Baosteel Xinjiang Bayi Iron and Steel (Xinjiang Bayi), dropped 11.4 percent from 2013 to 2014, with the company incurring nearly $325 million in losses.[‡]

The article avers the OBOR strategy could counteract these trends by: (1) boosting overall consumption of steel products, (2) stimulating steel exports, (3) providing policy support for steel companies "going out" and investing abroad, and (4) promoting the construction of regional logistics networks and subsequent upgrading of local industry.[§]

Among the 64 countries located along the OBOR, 70 percent are net importers of structural steel and thus comprise a key target market for China's steel exports. Furthermore, of the 118 economic trade cooperation zones China has established in 50 countries, 77 are located in OBOR countries and 35 are in the six countries that border Xinjiang. As such, the OBOR strategy holds tremendous implications for Xinjiang—the "bridgehead connecting China and Central Asia"—and for its steel industry. The article estimates that if Xinjiang's six neighboring countries each invested $80 billion in fixed assets, these investments together would generate demand for approximately 1.8 million tons of structural steel.

Within this climate, Xinjiang Bayi could "ride the spring winds of the New Silk Road, sell products to Central Asian countries, and stimulate the Xinjiang steel industry." The company's success could eventually help Xinjiang overcome its steel capacity surplus. The article cautions, however, that Xinjiang Bayi must avoid direct competition with Jiuquan Iron and Steel, the northwestern steel giant headquartered in Gansu.[**] That means focusing on mid- and high-end markets, such as household appliances, cars, solar energy products, and petrochemicals.

- 西北望 — "一带一路" 上的钢铁机遇 (Northwest Hope – Steel Opportunities on the 'One Belt, One Road')
  China Steel News, February 9, 2015
  http://www.csteelnews.com/xwzx/djbd/201502/t20150209_273465.html

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‡ According to Bloomberg Business, Xinjiang Bayi blamed the profit decline on "excess production capacities, weak demands, fierce competitions and slumping sales prices." "Xinjiang Bayi Iron & Steel Announces Earnings Results for the Year 2014," Bloomberg Business, January 30, 2015.
http://www.bloomberg.com/research/stocks/snapshot/snapshot.asp?ticker=600581:CH

§ Meanwhile, to ease short-term regional supply-demand imbalances, all five northwestern provinces have called for increased investment in infrastructure and fixed asset projects. For 2015, Shaanxi, Xinjiang, Gansu, Ningxia, and Qinghai each budgeted 2.2 trillion RMB, 1.23 trillion RMB, 930 billion RMB, 370 billion RMB, and 330 billion RMB, respectively.

** In an effort to prevent excessive competition and market inefficiencies, China's "going out" strategy favors dominant national champions over smaller companies. The article reports that this year, Jiuquan Iron and Steel—along with Gansu's Baiyin Nonferrous and Jinchuan Group—plans to build production bases in Kazakhstan.

Rethinking China's "Going Out" Strategy in the High-Speed Rail Industry

In the last five or so years, China's "going out" strategy has shifted from commodity-based flows to infrastructure investment projects in countries with competitive bidding processes. High-speed rail (HSR) construction abroad has been the focus of recent investment projects. As of January 2015, China was negotiating HSR contracts with 28 countries.[††]

In the rush to promote its star industry, however, China has encountered speed bumps, causing some experts to caution against the blind pursuit of new contracts. For example, China Railway Construction Corp won Mexico's first HSR contract, only to be dropped in October when Mexico's foreign minister shelved the project indefinitely due to government revenue shortfalls.[6] In late January, the Greek government decided not to sell a majority stake in the port of Piraeus to a consortium that included China's Cosco Group, thereby delaying plans for a China-Europe land-sea express line to be built by Chinese companies.[7]

Mei Xinyu, a researcher at the Chinese Academy of International Trade and Economic Cooperation affiliated with the Ministry of Commerce, suggests ways to improve China's overseas projects in the HSR sector:

- *Do not blindly assume responsibility for overseas projects*. In the process of "going out," China's mass transit industry creates new opportunities to raise profits, but also encounters new risks. For example, a Chinese company might move from exporting equipment to landing a construction project, issuing financing, and supervising project operations. Rather than maximize profits, Chinese companies should consider the most appropriate way to "go out."

- *Do not blindly pursue exports of high-grade, precision, and advanced industrial products*. While 300 kilometer per hour high-speed rail lines are a source of national pride in China, the feasibility and necessity of overseas HSR projects must be carefully assessed. If there is not enough through-traffic to ensure financial feasibility, for example, the project will incur losses and become a burden to the host country.

- *Take note of the host country's ability to repay*. Emerging market economies that depend on primary commodity industries are in a difficult state, as commodity markets are quite bearish at present. When faced with a country such as Mexico that struggles to repay its loans to Chinese creditors, China must decide whether to abide by the initial financing plan or wait for a recovery in the local economy to issue additional financing.

- *Take note of the host country's foreign investment policies to foster the best possible environment for Chinese exports*. The central government's new "One Belt, One Road" policy emphasizes the importance of coordinating policies across regions and projects that Chinese companies engage in overseas.

➢ 高铁出海宜稳健行驶 (High-Speed Rail Abroad Should Proceed Steadily)
Economic Information, February 4, 2015
http://www.jjckb.cn/opinion/2015-02/04/content_537174.htm

[††] Iacob Koch-Weser and Garland Ditz, *Chinese Media Digest No. 4*, January 30, 2015, p. 5. *http://origin.www.uscc.gov/sites/default/files/Research/Chinese%20Media%20Digest_No4_0.pdf*.

Lowering the Reserve Requirement for Chinese Banks: A Smart Move?

On February 4, the People's Bank of China (PBOC), China's central bank, lowered the reserve requirement ratio (RRR)—the amount of reserves commercial banks are required to hold. The *Wall Street Journal* estimates this will free up more than $100 billion in capital for Chinese banks to lend, at a time when China's economy is registering historically low growth rates.[‡‡] According to an opinion piece in *China Economic Daily*, the PBOC's RRR reduction has been criticized in China either as a reckless stimulus policy or as a means to prop up financial markets. The article's author, Cai Dao, counters that the PBOC is in fact taking prudent measures to support vulnerable groups in the Chinese economy. In conjunction with lowering the RRR, he argues, the PBOC is ensuring that the resultant increase in bank lending will flow primarily to small- and medium-sized enterprises and rural areas.

Mr. Cai further argues that lowering the RRR is the best way for the PBOC to respond to current trends. In the past, rapid growth, asset bubbles, and large speculative currency inflows made the RRR an important tool to prevent excessive lending and stem inflation. Now, these upside risks are waning, so there is room to lower the RRR. Concurrently, the PBOC's other short-term measures for stimulating the economy have been less successful. These include short-term liquidity operations (SLOs), the Standing Lending Facility (SLF), and the Medium-Term Lending Facility (MLF),[§§] which collectively pumped some $200 billion into Chinese banks last year. The problem is that these short-term operations have induced banks to engage in short-term borrowing and long-term lending, a risky combination.

Writing in the *21st Century Business Herald*, Sun Xingjie, a public policy professor at Jilin University and a prominent commentator,[***] places the PBOC's latest move in international perspective. He notes that the Bank of Japan and the European Central Bank are also instituting looser credit policies, while the U.S. Federal Reserve (Fed) is delaying interest rate hikes. Last year, Dr. Sun argues, the principal concern for central banks was just the opposite—the inflationary risks of quantitative easing, an asset-buying program introduced by the Fed in 2008. Since the Fed terminated the program in October, concern has shifted to deflation.

Dr. Sun sees Japan as the epitome of a deflationary economy, dating back to its fall into recession in the late 1980s. Prime Minister Shinzo Abe has attempted to counteract this trend through an expansionary monetary and fiscal program. However, the steep fall in oil prices, coupled with

‡‡ Lingling Wei, "China Cuts Reserve Requirement Ratio," *Wall Street Journal*, February 4, 2015. *http://www.wsj.com/articles/china-cuts-reserve-requirement-ratio-1423047341*.

§§ Bloomberg explains these monetary tools as follows: (1) SLOs were adopted by the PBOC in January 2013. They mainly involve the use of repurchase agreements and reverse repos with maturities of fewer than seven days, as an extra tool to manage the country's cash supply; (2) the SLF was introduced in early 2013 to provide 1-month to 3-month liquidity support to banks. It required banks to provide high-rated debt and credit assets as collateral. The PBOC used SLFs in the first half of 2014 but not in the second half; (3) the MLF month was created in September 2014 in the form of 3-month lending into Chinese banks. Bloomberg, "PBOC Falls Back on Trusty Rates Lever as New Tool Kit Not Enough," November 21, 2014. *http://www.bloomberg.com/news/articles/2014-11-21/pboc-falls-back-on-trusty-rates-lever-as-new-tool-kit-not-enough*.

*** Sun Xingjie has also published extensively for the *Financial Times* Chinese-language website. See *http://www.ftchinese.com/search/%E5%AD%99%E5%85%B4%E6%9D%B0/relative_byline*.

weak growth, has put Japan back on a deflationary path. Dr. Sun is concerned that several major economies could be dragged into the “vortex” of this “Japan sickness.”

Dr. Sun concludes that central bankers alone cannot stem deflation. If key growth drivers, such as a productive workforce and technological innovation, are not in place, allowing more credit to cycle through the economy will simply foment asset bubbles and keep uncompetitive companies in business. Governments should thus do more to support the real economy through such measures as reforming taxes and increasing budgetary spending, for example.

- 单靠货币政策难抗通缩风险 21 世纪经济报道 (Monetary Policy Alone Is Not Enough to Combat Deflationary Risks)
  21st Century Business Herald, February 9, 2015
  http://pinglun.21cbh.com/2015/2-9/5NMDAwMzZfMTM2OTU5Nw.html

- 才道：央行降准，是谁的奶酪？ (The Central Bank Lowers the Reserve Requirement Ratio: Who Benefits?)
  China Economic Daily, February 12, 2015
  http://www.chinadaily.com.cn/hqcj/zgjj/2015-02-12/content_13224647.html

[1] Gabriel Wildau, “China Pension Reform Targets Civil Servant Privileges,” *Financial Times*, January 15, 2015. *http://www.ft.com/intl/cms/s/0/3141eb64-9c97-11e4-a730-00144feabdc0.html#axzz3RNnqxUAo*.
[2] *China Daily Asia*, “40m Govt Employees Face Pension Reform,” January 14, 2015. *http://www.chinadailyasia.com/nation/2015-01/14/content_15214012.html*.
[3] Ren Bo, “China Turning Gray over Pension Reform Stress,” Caixin (China), January 12, 2015. *http://english.caixin.com/2015-01-12/100773318.html*.
[4] *China Daily Asia*, “40m Govt Employees Face Pension Reform,” January 14, 2015. *http://www.chinadailyasia.com/nation/2015-01/14/content_15214012.html*.
[5] Chen Qingsong, “Railway Leads Infrastructure Investment of 800 Billion RMB, A Feast for All to Share,” *China Enterprise News*, February 9, 2015. *http://finance.sina.com.cn/roll/20150209/213621512084.shtml*.
[6] Tom Mitchell and James Crabtree, “Political Risks Stalk China SOEs Abroad,” *Financial Times*, February 11, 2015. *http://www.ft.com/intl/cms/s/0/0988edfc-af43-11e4-b371-00144feab7de.html#axzz3RYawmT2q*.
[7] Angeliki Koutantou, “Greek Government Says to Halt Piraeus Port Sale,” Reuters, January 27, 2015. *http://www.reuters.com/article/2015/01/27/greece-election-privatisation-idUSA8N0UD00Z20150127*.