

Summary and Analysis of the 12th Five Year Plan



What is in the 12th Five Year Plan

- The 12th Five Year Plan (FYP), covering the period from 2011 to 2015, is aiming for average annual GDP growth of 7% (actual growth rate during 11th FYP was 11.2%) and is seeking what it terms “inclusive growth” – diminishing GDP adoration, rebalancing the economy to spread benefits more equally, alleviating social inequality and protecting the environment. The government wants to create 45 million jobs in urban areas, keep registered urban unemployment below 5% and boost domestic consumption.
- Investment in environmental protection is expected to increase to around RMB 3 trillion over the five-year period. Much of this will go to pollution control, with an aim to cut the release of major pollutants by 8% to 10%, and to reduce chemical-oxygen demand, sulphur dioxide, ammonia nitrogen and nitrogen oxide by 1.5% per year until 2015.
- As part of its strategy to meet carbon-intensity and energy-intensity targets, China is aiming for “more efficient” nuclear-power development. It also plans to boost hydropower construction in the southwest and increase the length of its high-speed railway to 45,000 kilometers.
- China’s forest coverage rate is targeted to rise to 21.66 percent and forest stock to increase by 600 million cubic meters. Meanwhile, annual grain-production capacity is to be no less than 540 million tonnes and farmland reserves no less than 1.8 billion mu (around 1.2 million square kilometers).
- Beijing will prioritize – with the aid of tax breaks and beneficial procurement policies – the development of seven “Strategic Emerging Industries” (SEIs): biotechnology; new energy; high-end equipment manufacturing; energy conservation and environmental protection; clean-energy vehicles; new materials; and next-generation information technologies. It is thought these industries could contribute 8% of GDP by 2015, up from approximately 5% now.
- Two-thirds of the central budget is to be invested in “improving people’s livelihood” (minsheng 民生) in 2011. Over the FYP period, the government is aiming for a population no greater than 1.39 billion and wants to increase average life span by one year. Some 36 million apartments for low-income families will be built or renovated. Pension schemes are to cover all rural residents and 357 million urban residents.

B-M’s reading of the 12th FYP

- **FDI (MNC) still needed** Some bankers and economists have predicted that during the process of transforming the development model from export- and investment-oriented to domestic consumption-driven, the Chinese government might force a hard landing of GDP growth by controlling the speed and spread of FDI and other investments. We consider this scenario very unlikely, at least in short run (1-2 years). GDP is still one of the most important items on the evaluation scorecard of government officials. Also, elite groups, from central government rulers to local party bosses and SOE managers, derive their legitimacy and self interests (wealth) from economic growth and expansion, so they have incentives to maintain the status quo. Overall, we believe the current development model, although described by Premier Wen as unhealthy, unbalanced and unsustainable, will last for quite a while.



For sure, the Chinese government knows that foreign countries, Western and developing ones alike, are growing more and more intolerant toward this mercantilist economic model. This is the reason why the 12th FYP emphasizes increasing importation: the Chinese government believes more imports may allay pressure and even help to accumulate goodwill. This is a good opportunity for MNCs, as demonstrated by Boeing several weeks ago that it inked a contract worth tens of billion dollars with Chinese state-owned airlines.

- **More Selective for FDI** While transformations will happen gradually, changes are bound to be made. It is dangerous to assume that since local party bosses have incentives to keep the status quo, the central government would not be selective about FDI and MNCs. With central government fully understanding the current incentive distortions, the State Council and the NDRC will push as hard as possible to promote growth in the seven SEIs and support people's livelihood projects. The best way for MNCs to avoid being dragged into the infighting is to look for ways to align businesses and investment with both sides' interests and to communicate benefits that suit both sides' motivations. For example, although criticized by some policy makers as over-investing, IBM has had no problem getting permission from the NDRC to invest huge amounts of money in cloud infrastructure in some cities that are not cloud computing pilot cities, by emphasizing the livelihood side of benefits like E-Government and traffic control.
- **MNCs Easy Targets** Under the current economic model, Chinese households are subsidizing exporters and SOEs, resulting in wealth being channeled from households to exporters and SOEs, and therefore suppressing domestic consumption. The 12th FYP aspires to stimulate domestic consumption. This objective, however, can be achieved only when the incentive structure is reformed in a way that transfers wealth from SOEs and exporters back to households. Under China's current political structure it is very difficult, if not impossible, for vested interest groups, especially SOEs and local government officials, to give up benefits. The obvious easy target is foreign-owned enterprises and privately owned, export-oriented manufacturers. For example, Wal-Mart and Carrefour were recently blamed for impeding government initiatives to reduce food prices. This is very unusual since the retail industry has been one of the most open and friendly sectors for FDI and MNCs. Also, governments in Guangzhou, Shanghai and Beijing are already experimenting with mandatory union collective wage bargaining, aiming for 80% coverage within three years.
- **SOE More Dominant** Compounding the risk of becoming easy targets, MNCs will also see increased competition from SOEs. In the 12th FYP and the NPC press conferences, the proposition that SOEs will be the main drivers to stimulate innovation and R&D was mentioned frequently and regarded as self-evident. Chinese government officials—especially after the 2008 financial crisis—have seen their faith in the Beijing consensus steadied, the idea that state-directed capitalism and tight political control are the elixir of growth. The competition is not just inside China; with the “going abroad” strategy becoming one of the most important industry policies during the 12th FYP period, MNCs will find more and more SOEs going to their home countries and fighting for international market share.

During the 12th FYP period, slow, epic changes are set to be pushed by the central government, with vested interest groups (e.g., SOEs and local government) being dragged, screaming and kicking, against them. As a result, the central government will be more selective about FDI and MNCs, and those interest groups will try to turn to MNCs as easy targets to shoulder the costs of reform. MNCs should, on one hand, carefully monitor the regulatory and policy situation. On the other hand, they should align their business strategies and objectives accordingly. Government relations have never been more critical.

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