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The Essential Guide to China's
Economic Policy and New Leadership

by Wei Lin & Oliver Barron

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People's Bank of China

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Reading Between the Lines

**The Essential Guide to China's
Economic Policy and New Leadership**

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**TO
OUR MOTHERS**

Preface

The English language literature on China is seemingly endless, the vast majority of which tries to explain aspects of China's history, culture and economy to the Western world. This is a commendable task, for the history is expansive and the culture very different from that known in the West, whether in the United States of America or Europe.

Lately, many of these books have focused on China's meteoric rise to the world stage, its incredible potential, the innumerable risks overcome and the many more that lie waiting. No matter what point in history authors begin their account of China's growth (most commonly either in 1978, the beginning of the reform and opening up, or 2001, when China joined the WTO), however, the focus almost always turns to what China should or needs to do in the future

to succeed in becoming a global superpower.

The problem with this approach is that the recommended course proposed for China is formed on the basis of experience in other countries which, while similar in certain ways, is also very different. Generally speaking, authors usually make comparisons to either the growth model of the West or that of Japan and the Asian Tigers of South Korea, Taiwan, Hong Kong and Singapore. People look to the US economy because China is in the process of adopting some more market-oriented reforms, and the US has long been the paradigm of the free market. Meanwhile, comparisons to the Asian Tigers give comfort, as it is thought that cultural similarities make the path more predictable. When following either approach, however, the end solution is China transitioning towards a free market economy. We believe this conclusion is premature.

The Chinese, possibly more than the people of any other country, are students of history. China's history is longer than any other modern civilization and almost everyone in China, whether the common man or top officials, views history as an indispensable part of where they are and where they will go.

Three events in history stick out as to why China will not follow the same path of other nations. The first two contradict a path built on the Asian Tigers model, while the third raises questions about the US model. First, there are the large currency reforms undertaken by Japan in the mid-1980s under pressure of foreign governments, which contributed to one of the largest economic bubbles in history. Second, there is the Asian Financial Crisis in 1997 and the

effect it had on the majority of the region. Third, and most important, is the global financial crisis that began in 2007, which made many people rethink the correctness of the financial model in the US on which the structure of global markets has been based.

Beyond these three, there are countless other events in the history of China and the world that have shaped the opinions of top policymakers in ways that are far removed from the Western way of thinking.

So, instead of focusing on what China should do, in this book we will attempt to explain what the most likely path of reform will be. Each step of the way, we will explain the unique historical conditions that have led China's economy to where it is now, and how historical and cultural factors affect the decisions that are likely to be made in the future. We will try to shed some light on the Chinese economy and explain why and how some quintessentially Chinese practices are used to solve problems, highlighting both the positive and negative effects of China's distinctive economic model.

Most books on China tend to fall into one of three categories. The first category is those books that try to explain how to do business in China. For the most part, they are stories of how entrepreneurs and businessmen got swindled out of their money and undercut by domestic competitors. They generally present China in a negative light. Second are those books that are less about personal experience, but yet still focus on the negatives, outlining what they see as the inevitable failure of China's system. Third, and lastly, are those books that focus on the positives and defend why China will continue its un-

precedented economic success.

In contrast to all of these books, we attempt to be as neutral as possible on China's economic prospects. While we recognize that the task facing China's new leaders is immense, we choose not to simply focus on the negatives, nor will we highlight only the positives. We attempt to elucidate areas where China has potential, as well as draw attention to problems that the leaders face, outlining how they may attempt to address them.

By no stretch of the imagination is this an easy task, but we believe our respective backgrounds make us uniquely qualified to do so. We, the authors – one Chinese and one American – have lived and worked both in China and in the West. Our experience and ongoing collaboration, with countless hours of thoughtful dialogue between us, puts us in the uncommon position of being able to analyze and succinctly explain what could be expected.

Without the input from the Chinese psyche, many books on China miss subtle forces that have profound impact. Meanwhile, the addition of Western thought to such Chinese thinking may elucidate certain inferred forces or actions that would otherwise remain unexplained to the outside world.

The book is split into two parts. The first part is a review of China's economy and the reforms that can be expected, as mentioned above. The book is framed in the context of the 12th Five-Year Plan, which lasts from 2011 to 2015. China began to use five-year plans in 1953 as a way for the central government to guide economic development. Although many things have changed over the last 60 years, policymaking remains rooted in central planning.

The second part is designed for reference purposes. It will offer fresh insight into China's newly elected leadership, from the Top Seven in the Politburo Standing Committee down to the new heads of each major ministry. It will include outlines of major functions of the different regulatory agencies and the most important people in each body, as well as other key terminology that must be known to understand China.

The second part, in many ways, should be more useful than the first in terms of understanding China. While there are many reforms on the agenda of top policymakers, the decisions on which reforms will be prioritized over others and how quickly they will be implemented are related to the disposition of the people in charge and the relative distribution of power between individuals or government agencies. While China has many potential reforms to undertake, they will not be addressed in order of economic priority, as one might expect.

The reforms will be undertaken based on the ability of the new leadership to negotiate with special interest groups. While this is true in many countries, accentuated, for example, by the partisanship within the United States Congress, the negotiations in China are of a different nature given the historical power structure concentrated among just few individuals. Therefore, understanding the power dynamics and the predilection of the newly elected leadership is of utmost importance.

This book, therefore, has two uses. First, it can be used as a tool to give a background and history of economic policy and a review of what reforms are

likely to be enacted in the medium term. The second is to act as a reference manual for all things related to China's economy. Whether it is the structure of the government, the tasks of each agency or the particular leanings or influences of each person, the information can all be found in this book and can give a basic understanding of how policy is enacted and carried through.

Abbreviations

ABC	Agricultural Bank of China
ABMTN	Asset-backed Medium-term Notes
BOC	Bank of China
CAR	Capital Adequacy Ratio
CBM	Coal-bed Methane
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
CDB	China Development Bank
CEWC	Central Economic Working Conference
CIC	China Investment Corporation
CIRC	China Insurance Regulatory Commission
CMB	China Merchants Bank
CMSB	China Minsheng Bank
CNOOC	China National Offshore Oil Corporation

CNPC	China National Petroleum Corporation
CPC	Communist Party of China
CPI	Consumer Price Index
CPPCC	Chinese People's Political Consultative Conference
CSRC	China Securities Regulatory Commission
FAI	Fixed Asset Investment
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GITIC	Guangdong International Trust and Investment Corporation
GW	Gigawatt
ICBC	Industrial and Commercial Bank of China
IPO	Initial Public Offering
IPP	Independent Power Producer
LDR	Loan-to-deposit Ratio
LGFP	Local Government Financing Platform
LNG	Liquefied Natural Gas
M&A	Mergers and Acquisitions
MIIT	Ministry of Industry and Information Technology
MLR	Ministry of Land and Resources
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOHRSS	Ministry of Human Resources and Social Security
MOR	Ministry of Railways
NAFMII	National Association of Financial Market Institutional Investors
NAO	National Audit Office
NBS	National Bureau of Statistics
NDRC	National Development and Reform Commission
NEA	National Energy Administration

NPC	National People's Congress
NPL	Non-performing Loan
PBC	People's Bank of China
PSC	Production Sharing Contract
RRR	Reserve Requirement Ratio
SAFE	State Administration of Foreign Exchange
SAIC	State Administration for Industry and Commerce
SASAC	State-owned Assets Supervision and Administration Commission
SAT	State Administration of Taxation
SERC	State Electricity Regulatory Commission
SHIBOR	Shanghai Interbank Offered Rate
Sinopec	China Petroleum & Chemical Corporation
SME	Small and Medium Sized Enterprise
SNWDP	South-to-North Water Diversion Project
SOE	State-owned Enterprise
TCE	Tons of Coal Equivalent
UHV	Ultra-high Voltage
VAT	Value Added Tax

Contents

Preface	i
Abbreviations	vii

PART I

Chapter 1 Big Picture	2
Chapter 2 Monetary Policy	29
Chapter 3 Local Government Financing Platforms	65
Chapter 4 Property Market	84
Chapter 5 Energy	108
Chapter 6 Investment and Key Projects	126
Chapter 7 The Outlook for Major Reforms	145

PART II

Chapter 8 China's New Leadership and Government	184
Chapter 9 National Development and Reform Commission	212
Chapter 10 Ministry of Finance	222

Chapter 11	People's Bank of China	235
Chapter 12	Ministry of Commerce	250
Chapter 13	Ministry of Industry and Information Technology	262
Chapter 14	State-owned Assets Supervision and Administration Commission	270
Chapter 15	China Banking Regulatory Commission	284
Chapter 16	China Securities Regulatory Commission	291
Chapter 17	China Insurance Regulatory Commission	300

LIST OF TABLES

Table 2.1:	Mandates of Major Central Banks	32
Table 3.1:	NAO 2010 Estimates of LGFP Borrowing by Guarantee and Platform Level	75
Table 3.2:	LGFP Debt Maturity Schedule	81
Table 5.1:	Natural Gas Supply and Demand 2015	114
Table 5.2:	Natural Gas Supply and Percentage 2015	114
Table 5.3:	Energy Consumption by Type (2010 vs. 2015)	121

Table 6.1: Breakdown of Transportation Network Mileage	144
Table 7.1: Current Available Currency Swap Agreements	167
Table 8.1: Inter-Ministerial Joint Efforts	189
Table 8.2: Ranks of Government Officials	194
Table 8.3: Three Key Steps of Top Officials	205
Table 8.4: Portfolios of Top Officials	207
Table 8.5: List of Ministries, Commissions, Organizations and Institutions Under the State Council	208
Table 16.1: Bond Market Regulation	294
Table 16.2: Bond Product Regulation	294

LIST OF CHARTS

Chart 1.1: Power Structure	4
Chart 1.2: GDP Growth Rates, Target vs. Actual	13
Chart 1.3: Share of GDP by Expenditure	16
Chart 2.1: M2 and M2 Relative to GDP	45
Chart 2.2: RMB/USD Exchange Rate vs. China CPI Inflation	50

Chart 2.3: Wealth Management Product Issuance by Maturity	56
Chart 2.4: Lending Rates, Benchmark vs. Shadow Banking	60
Chart 3.1: Local Government Land Transfer Fees and Growth	67
Chart 3.2: LGFP Loans and Share of Total Lending	70
Chart 3.3: Loan Pricing Relative to Benchmark Lending Rates	72
Chart 4.1: Nominal Indexed Price for Property, Stocks and Deposits	87
Chart 7.1: RMB Deposits in Hong Kong	166
Chart 10.1: CIC Governance	226
Chart 11.1: Regulation of the Banks	243