

## READING

## **Between the Lines**

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



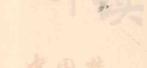
Wei Lin & Oliver Barron

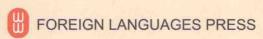


SASAC

People's Bank of China

Chinese Dream





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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 12<sup>th</sup> 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**

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

**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 Industrial and Commercial Bank of China ICBC IPO Initial Public Offering IPP Independent Power Producer LDR Loan-to-deposit Ratio Local Government Financing Platform LGFP LNG Liquefied Natural Gas M&A Mergers and Acquisitions MIIT Ministry of Industry and Information Technology MLR Ministry of Land and Resources Ministry of Finance MOF MOFCOM Ministry of Commerce MOHRSS Ministry of Human Resources and Social Security Ministry of Railways MOR NAFMII National Association of Financial Market Institutional Investors National Audit Office NAO National Bureau of Statistics **NBS** National Development and Reform Commission **NDRC** NEA National Energy Administration **NPC** National People's Congress NPL Non-performing Loan People's Bank of China PBC **PSC Production Sharing Contract** Reserve Requirement Ratio RRR State Administration of Foreign Exchange SAFE SAIC State Administration for Industry and Commerce SASAC State-owned Assets Supervision and Administration Commission State Administration of Taxation SAT SERC State Electricity Regulatory Commission Shanghai Interbank Offered Rate SHIBOR China Petroleum & Chemical Corporation Sinopec Small and Medium Sized Enterprise SME South-to-North Water Diversion Project SNWDP SOE State-owned Enterprise Tons of Coal Equivalent TCE Ultra-high Voltage UHV Value Added Tax VAT

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