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Guest post: China set for most far-reaching economic reforms in a generation

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By William Rhodes

It is likely that the “The Third Plenum of the 18th Chinese Communist Party Congress,” which takes place in mid-November, will set the government’s economic policy course for the next five to 10 years. The path ahead will see domestic consumption and substantial financial innovation and liberalisation replacing the emphasis on exporting, and heavy public sector investment, as the prime drivers of growth.

The road that President Xi Jinping and Premier Li Keqiang are embarked upon may involve the most far-reaching economic reforms since former leader Deng Xiaoping made his famous 1992 Shenzhen speech.

In 1992, Deng underscored the need to follow through on the “modernisation” course that he initiated in the 1980s and he emphasised the need for the economy to strengthen investment and become far more export-oriented. These policies, pursued by Deng’s successors, spurred extraordinary overall economic growth including the emergence from poverty into the mainstream of hundreds of millions of Chinese.

Now, however, I believe that Xi and Li accept that the era of double-digit annual GDP growth has ended. They are building Communist Party support – and this is why the forthcoming plenary session is important – for rapid action on an economic agenda that they hope can deliver sustained annual growth of between 7 and 7.5 per cent.

I have made over 70 trips to China over the last two decades and after many recent conversations with people in and out of the government I am convinced of the determination of the leadership to press resolutely ahead with reforms. The core of a number of the planned economic policy changes were determined by the previous regime, but implementation was repeatedly delayed.

The recently announced establishment of a free trade zone in Shanghai will serve as a laboratory to test measures designed to further open China’s economy and specifically the financial sector. It will also be used to move to full RMB currency convertibility within five to 10 years, which is faster than is widely expected.

We have already seen the freeing up of interest rates on the lending side, now similar moves on the deposit side will follow. This will be helped by the introduction of bank deposit insurance, which Premier Li Keqiang recently discussed at a World Economic Forum conference in Dalian. This move aims to contribute to overcoming a pervasive sense of financial insecurity among the Chinese, which promotes high levels of savings and constrains consumer spending. Further crucial reforms that can spur the call to spend more and save less will involve the strengthening of the social safety net.

I do not believe that Xi and Li underestimate the scale of the challenges that they confront. These include risks in the financial sector. Recent years have seen massive lending to many municipal and provincial governments, as well as state owned enterprises, while the balance sheets of commercial banks and the shadow banking sector have been growing rapidly. The volume of non-performing loans needs to be watched carefully as China has to ensure that it does not revisit the kind of situation seen over a decade ago when the banks needed to be recapitalised and asset management companies had to be created to take over problem bank loans.

Adding to the economic challenges are the relatively depressed levels of foreign demand for Chinese goods as a

result, in particular, of the negligible growth in the eurozone and the moderate US economic recovery. This is, of course, a further stimulus for moves within China to become less reliant on exports for securing growth.

As Xi and Li map the route to far-reaching changes in economic policies, so like Deng a generation ago they must confront political challenges. Vested interests in all the institutions of governance in China are well entrenched and shaking up the system will not be easy. The government is acutely aware of substantial public concerns over a range of complex issues, such as widespread corruption and mounting environmental problems. On this latter issue, for example, Xi stressed after being sworn-in as president in March that he would launch a comprehensive effort to protect the environment, ranging from food security and water preservation to curbing air-polluting industries and raising clean air levels in cities.

The forthcoming Communist Party plenary will assuredly approve the extensive reform programs that Xi and Li have determined and these will be at the core of their tenures as China's leaders. Given the implementing challenges there is scope for skepticism. I submit it would be a mistake to underestimate both the zeal and the skill of China's new leaders in the area of economic and financial reform.

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