THE WALL STREET JOURNAL.
WSJ.com

ASIA NEWS | February 28, 2012

Blueprint of China Reforms Leaves Role of Party Vague

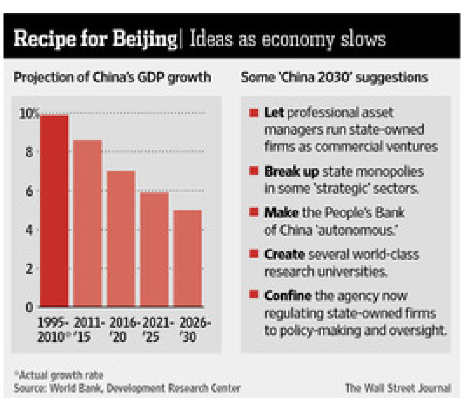
By BOB DAVIS

BEIJING—A report by the World Bank and a prominent Chinese think tank recommends sweeping changes in the Chinese economy, including reducing the power of state-owned enterprises and breaking up monopolies, but doesn't examine the role of the institution that will have the biggest say in such changes: the Chinese Communist Party.

The Wall Street Journal reported last week that the report would urge revamping China's model of state-led capitalism, but it wasn't clear how the report would recommend proceeding. The "China 2030" report argues that the government should take on the easiest political challenges first as a way to build momentum and score what the report calls "quick wins." Those changes include raising bank deposit rates, so consumers can earn more on their money, and increasing dividends paid by state-owned firms, as a way to boost government revenue for social spending.

But more fundamental changes in the way state-owned companies are governed are left to the end of the reform process, presumably because they face the toughest political opposition, even though the report, which warned of a scenario of rapidly slowing Chinese growth, labels such changes "key to China's efforts to consolidate the foundations of a market economy."

Eswar Prasad, a Brookings Institution China scholar who was in Beijing for a conference to discuss "China 2030," said that because the report was a joint venture between the World Bank and the Development Research Center, which reports to China's State Council, the government's top executive agency, it was constrained politically. "The recommendations are limited to market-oriented reforms within a framework that remains dominated by state control," he said.



World Bank President Robert Zoellick said that senior party and government officials appear to support change. "You've had this one-party system drive a very effective growth process for 30 years," he said in an interview. "Now the questions is 'Can [the economic system] be changed?' "

"China 2030" said that the Chinese economy was bound to slow down between 2011 and 2030 to an average growth rate of 6.6%, compared with an average of 10% in the previous 30 years. By 2025, the report forecast, growth would decline to an annual average of 5%, as the Chinese work force ages, productivity slows and infrastructure and other investments produce lower returns.

But the report warned that China risked a far sharper reverse if it didn't fundamentally remake its economy to rely much less on exports and investment. "There is no saying whether this slowdown will be smooth or not," the report warned. "Any sudden slowdown could unmask inefficiencies and contingent liabilities in banks [and other enterprises]...and could precipitate a fiscal and financial crisis."

Moreover, the report argued, responding to such a downturn with huge stimulus spending—as China did in response to the global financial crisis of 2008 and 2009—could be ineffective. "Inflation and instability could result, possibly undermining investor confidence and ultimately leading to slower growth and even stagnation."

Many other countries that like China had reached so-called middle-income status—which the World Bank defines as annual per capita income of between $1,006 and $12,275—have failed to advance further up the income scale. Of 101 middle-income countries in 1960, only 13 had become high-income by 2008, according to the report.

To avoid such a slump, China should sharply scale back the role of the state in the economy, the report argues. That includes revamping huge state-owned companies, which dominate the country's energy, transportation and natural-resource sectors and also frequently own real-estate and other businesses. They should be run by professional asset managers charged with selling off extraneous businesses and operating them as commercial ventures, the report urged.

The agency that now regulates the state-owned firms, called the State-Owned Assets Supervision and Administration Commission, should "confine itself to policy-making and oversight," the report recommended, not management.

The goal, the report said, was to boost competition, which is "the key to improving the efficiency and innovation capability of Chinese enterprises." In that vein, the report also recommended "breaking up state monopolies or oligopolies in key industries," including petroleum, chemicals, electricity distribution and telecommunications, and letting private firms compete in some sectors the state deems "strategic."

Additionally, the report urged that the central bank, the People's Bank of China, be made "autonomous," and that universities also be given greater independence. It also urged that China create several "world-class research universities."

Those recommendations could require big changes by the Communist Party—a subject the report doesn't address. For instance, the party's personnel department now hires and fires managers of state-owned firms, giving it vast power over the direction of the companies. The Politburo Standing Committee, the party's most powerful organization, sets broad monetary policy, which is then implemented by the PBOC.

Mr. Zoellick said he didn't believe the party would be a roadblock. "If you ask whether the party can have a meritocracy that produces good leaders, my answer is they haven't done so bad so far," he said.

But Mr. Prasad, the Brookings scholar, said some of the report's recommendations may be less bold than they appear because of the state's desire to continue to keep control. The report's call for central-bank autonomy, for instance, simply meant "greater operational independence rather than true independence from the government in making major monetary-policy decisions," Mr. Prasad said.

Mr. Zoellick said he thought China's incoming leaders would move on some of the report's recommendations. "What I expect you'll see with the next generation of leaders is an experimentation with these ideas," Mr. Zoellick said, adding that leaders would likely launch pilot projects. "I don't see a big bang reform, but I see a process of trying to evolve" the economy.

China's leadership transition begins later this year when Vice President Xi Jinping is expected to become the new head of the Communist Party, succeeding Hu Jintao. Mr. Xi has been briefed several times on the recommendations, said individuals involved with the report, while Vice Premier Li Keqiang, who is likely to become premier—China's No. 2 position—endorsed the preparation of the report after Mr. Zoellick proposed it in late 2010.

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A version of this article appeared Feb. 28, 2012, on page A13 in some U.S. editions of The Wall Street Journal, with the headline: Blueprint of China Reforms Leaves Role of Party Vague.