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China's Economy

The 2021 NPC and the Chinese Policy Outlook

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- Executive Summary -

China's Economy

The 2021 NPC and the Chinese Policy Outlook

The 2021 National People's Congress set the 14th Five-Year Plan (2021–2025) and economic policy for 2021. The NPC set no growth target for the five-year period, with the authorities continuing to focus on promoting high-quality growth through productivity gains while expanding domestic demand and boosting scientific and technological capacities. The growth target for 2021 was set at 'over 6% y-o-y.' While moving to reduce the fiscal deficit, the government will continue to spend and cut taxes in order to support the economy. The authorities will avoid any sharp tightening as they move to normalize policy away from the easing phase. Key tasks for 2021 will include strengthening innovation, expanding domestic demand, and revitalizing the rural sector/improving living standards (both connected to boosting incomes). The NPC also amended Hong Kong's electoral system, apparently with the aim of eradicating the pro-democratic faction.

The 2021 NPC and the Chinese Policy Outlook

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1. Introduction

The fourth session of the 13th National People's Congress (hereinafter 'the NPC') was held over March 5–11, 2021. It set medium-term goals for the 14th Five-Year Plan (2021–2025) and longer-term targets for up until 2035. It also adopted the Report on the Work of the Government (which mainly outlined government policy for 2021) and the budget proposal, for example.

This year's NPC also outlined the results of China's efforts to tackle the COVID-19 outbreak. Last year's NPC was pushed back by around two and a half months to the end of May, though this year's was held at the start of March as is custom. China had seen new COVID-19 outbreaks at the start of 2021, particularly in Hebei Province and other northeastern regions, but these were brought under control relatively quickly thanks to measures such as large-scale PCR testing, regional lockdowns and restrictions on travel (back home or on vacation) over the Spring Festival holidays, so the NPC was able to take place at the same time as regular years. Furthermore, a domestic vaccine development and production system has enabled China to roll out vaccines relatively swiftly,¹ so the authorities were able to hold a big meeting with participants from all over China.

At +2.3% y-o-y, China was the only major economy to post positive growth in 2020. This was down to the swiftness of its COVID-19 response together with infrastructure investment and expanded exports of medical products, telecommunications and electronic equipment on the back of special pandemic-related demand. It is not all good news, though. China's debt has ballooned on the aggressive fiscal policies and monetary easing introduced to tackle COVID-19. Micro, small and mid-sized companies are also struggling and the employment situation is grim, while Beijing also faces a long-term stand-off with Washington over hi-tech. Given these problems, attention was focused on what policies the Chinese government would announce at the NPC.

This report will review the 14th Five-Year Plan and China's economic policies for 2021 based on the text adopted by the NPC and the content of press conferences, etc. The report will also examine the newly-announced reforms to Hong Kong's electoral system.

2. The 14th Five-Year Plan and major economic targets

The NPC adopted 14th Five-Year Plan (2021–2025) objectives and longer-term targets for up until 2035 in the 'Outline of the 14th Five-Year Plan (2021–2025) for National Economic and Social Development and the Long-Range Objectives Through the Year 2035' (hereinafter, 'the Outline'). The Outline sets out the major economic targets of the 14th Five-Year Plan (Fig. 1) and long-range objectives through to 2035. It also introduces key measures to achieve these goals. Outlined below are some of the more noteworthy aspects of these economic

¹ Yu Qingming, NPC deputy and chairman of China National Pharmaceutical Group Corporation (Sinopharm), told the media that 5,000 NPC deputies and political advisors had received Sinopharm's COVID-19 vaccine. ('“5000 多代表委员接种新冠疫苗”有示范效应,' 中国新闻网, dated March 5, 2021).

targets and key policies.

(1) Economic objectives: China has not set a clear target for real GDP growth as it seeks to achieve high-quality growth through productivity improvements

The NPC's long-term objectives through to 2035 were essentially a reiteration of the contents of the Outline of the 14th Five-Year Plan (hereinafter, 'the Five-Year Plan Outline'), as adopted at the Fifth Plenum of the 19th Central Committee of the Communist Party of China (hereinafter, 'the Fifth Plenum').² These include raising per-capita GDP to the level of a moderately developed economy, for example, and making major breakthroughs when it comes to core technologies.

The most noteworthy of all the major economic targets is the target for real GDP growth. Following on from the Five-Year Plan Outline, this remains a qualitative goal, with the NPC stating it should be 'maintained within a reasonable range [and] set annually according to the circumstances.' On this point, the National Development and Reform Commission (NDRC) said it would no longer be judging economic performance on real GDP growth alone given that the Chinese economy had already entered the phase of high-quality growth. The NDRC also said an active, independent and composed response would be needed to tackle the ongoing uncertainties and risks to the domestic and external environment that China would face over the next Five-Years, adding that development should be pursued in a more flexible manner, with room left to deal with uncertainties. It also said the authorities would respond in a flexible, agile manner in accordance with the pace of the Chinese economic recovery and any improvements in the highly-uncertain external environment.

The NPC's Report on the Work of the Government also said the authorities would strive to promote high-quality development and improve efficiency while maintaining sustainable and sound economic development, with the Outline following in the footsteps of the Fifth Plenum and so on by reiterating the objective of achieving high-quality growth through productivity improvements. It also set out major targets such as ensuring labor productivity growth tops GDP growth and that the surveyed urban unemployment rate remains within 5.5%.

² For details about the Five-Year Plan Outline, see 'Outline of China's Five-Year Plan and Long-Term Goals —Enhancement of Innovation for Sustainable Growth through 2035' (Mizuho Insight; November 13, 2020) by Yoshino Tamai and Naoaki Sato.

Figure 1: Numerical targets of the 14th Five-Year Plan

| Target | As of 2020 | 2025 target | Target type |
|---|-------------------|---|-------------|
| Economic development | | | |
| Real GDP growth | 2.3% | Maintain within a reasonable range. Set annually according to the circumstances. | Indicative |
| Labor productivity (GDP per worker) growth | 2.5% | Faster than real GDP growth | Indicative |
| Urbanization rate | 60.6% (2019) | 65% | Indicative |
| Innovation-led development | | | |
| R&D expenditure growth | — | Average annual growth of over 7%, with the total R&D spending/GDP figure topping the total result for the 13th Five-Year Plan | Indicative |
| No. of high-added-value invention patents per 10,000 people | 6.3 | 12 | Indicative |
| GDP share of the added value of digital economy core industries | 7.8% | 10% | Indicative |
| Livelihoods and welfare | | | |
| Per capita disposable income growth | 2.1% | Same level as real GDP growth | Indicative |
| Urban surveyed unemployment rate | 5.2% | Less than 5.5% | Indicative |
| Average years spent in education among the working-age population | 10.8 years | 11.3 years | Binding |
| No. of doctors per 1,000 people | 2.9 | 3.2 | Indicative |
| Basic pension insurance participation rate | 91% | 95% | Indicative |
| No. of childcare facilities for children under 3 per 1,000 people | 1.8 | 4.5 | Indicative |
| Average life expectancy | 77.3 years (2019) | + 1 year | Indicative |
| Resources and the environment | | | |
| Energy consumption per unit of GDP | — | -13.5% | Binding |
| CO ₂ emissions per unit of GDP | — | -18% | Binding |
| Percentage of days with good urban air quality | 87% | 87.5% | Binding |
| Percentage of water quality at Class III (potable) or above | 83.4% | 85% | Binding |
| Proportion of primary energy accounted for by non-fossil-fuel sources | 12% | 15% | Binding |
| Forest coverage rate | 23.2% (2019) | 24.1% | Binding |
| Safety and security | | | |
| Total food production capacity | — | Over 650 million tons | Binding |
| Total energy production capacity | — | Over 4.6 billion tons of standard coal equivalent | Binding |

Note: 'Indicative' refers to targets that the government is striving to achieve through environmental upgrading and systemic reforms, etc. 'Binding' refers to targets that the government is obliged to hit.

Source: Prepared by MHRT based on Xinhua News Agency's '中华人民共和国国民经济和社会发展第十四个五年规划和 2035 年远景目标纲要'

(2) Promoting innovation: China plans to boost its science and technology capacities with a focus on basic research

As mentioned above, the key policies of the 14th Five-Year Plan follows on from the Outline of the 14th Five-Year Plan in the way it prioritizes 'promoting innovation' with scientific and technological independence and self-reliance as the strategic support of national development. The Outline also set a target of boosting R&D spending by over 7% on average each year while ensuring that R&D spending/GDP tops the total result for the 13th Five-Year plan. R&D spending has seen double-digit y-o-y growth since 2016 (Fig. 2), so the figure of 'average annual growth of over 7%' looks eminently achievable. Furthermore, the figure for R&D spending as a proportion of GDP stood at 2.4% in 2020, with the authorities now aiming to top this figure over the next five years.³ Considering how the '2.5%' target for the 13th Five-Year Plan (2016–2020) was not met, it seems the authorities wanted to set a more realistic target this time around. Premier Li Keqiang has stated that R&D spending as a proportion of GDP remains low. The figures back him up, with China lagging behind South Korea (4.5% in 2018), Japan (3.3% in 2018), Germany (3.1% in 2018) and the US (2.8% in 2018).⁴ This is why China is seeking to steadily catch up with the developed nations through an innovation-driven development model that prioritizes quality and efficiency while keeping a lid on any disorderly expansion.⁵

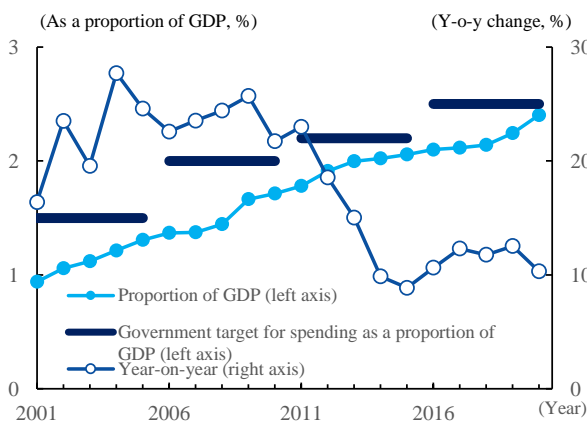
³ State Council Information Office, '深入贯彻新发展理念 确保“十四五”开好局起好步发布会' (March 8, 2021)

⁴ The figures for R&D spending/GDP in South Korea, Japan, Germany and the US are based on OECD data.

⁵ During a press conference, the Ministry of Industry and Information Technology said the development of new industries should not involve blind and repetitive construction, for example, and it called for moves to prevent an en-masse rush to commence activities. Ministry of Industry and Information Technology, '工业和信息化部部长肖亚庆在“部长通道”回应制造业、中小企业、工业互联网、数字经济等相关热点问题' (March

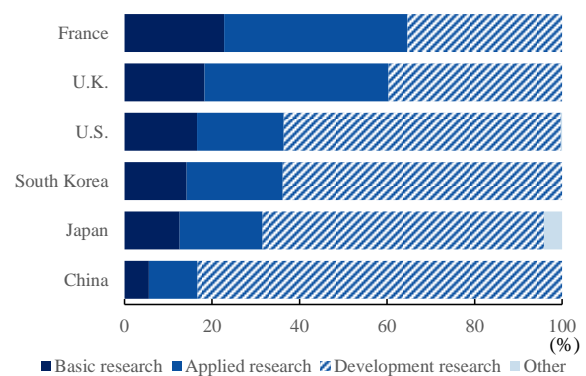
Basic research has been given a particularly important role when it comes to the promotion of innovation. The Outline sets a goal of making basic research account for ‘over 8%’ of total R&D spending. Given how this figure stood at 6.2% in 2020, the new target has been set at a comparatively high level, thus indicating the importance allocated to basic research. Last year, Premier Li Keqiang spoke of China’s weaknesses when it came to basic research and early-stage innovation.⁶ In a press conference after the NPC, meanwhile, the Premier also pointed to the low level of R&D spending in China compared to the developed nations (Fig. 3) and he said China needed to strengthen its core of basic research and applied basic research in order to boost its capacity to innovate in the area of science and technology.⁷ The Outline calls for the ‘strengthening of assiduous basic research’ and it sets out a ‘Ten-year Plan for Basic Research.’ It also calls for public spending on basic research and it outlines policies aimed at developing the human resources for basic research. Given that China and the US will remain at loggerheads for a while when it comes to science and technology, China intends to boost innovation centered around basic research in order to develop its own independent scientific and technological capacities and ensure it does not have to rely on foreign firms and capital.

Figure 2: R&D spending as a proportion of GDP (year-on-year)



Note: Government targets indicate the targets outlined in five-year plans.
 Source: Prepared by MHRT based on materials from China’s National Bureau of Statistics (NBS) and CEIC Data

Figure 3: Major-country spending on R&D



Note: The figure uses 2017 data for France and 2018 data for the other countries.
 Source: Prepared by MHRT based on OECD data

(3) Strengthening manufacturing: The government is aiming to enhance manufacturing on the back of concerns about ‘premature deindustrialization’

The 14th Five-Year Plan places more emphasis on manufacturing, with the word ‘manufacturing’ featuring 31 times as opposed to just 14 times in the 13th Five-Year Plan.⁸ Of particular note is the phrase about ‘maintaining the basic stability of manufacturing (as a proportion of GDP).’ After hitting 32.5% in 2006, the share of manufacturing as a proportion of GDP steadily fell until it reached 26.2% in 2020.⁹ On this point, a government think tank noted that while Japan, South Korea, Germany and other developed nations had kept this figure above 20% even after hitting per-capita GDP of between \$30,000–40,000, the figure had fallen below 30% in China

8, 2021)

⁶ 中国政府网, ‘李克强主持召开国家科技领导小组会议’ (December 7, 2020)

⁷ ‘李克强总理出席记者会并回答中外记者提问’ 新华网 (March 11, 2021)

⁸ In contrast, mentions of the ‘service industry’ moved more-or-less flatly (from 25 to 27 mentions), with a target for the share of services as a proportion of GDP also scrapped.

⁹ See Note 3.

after per-capita GDP topped \$10,000, with the proportion falling too fast. The think tank added that premature deindustrialization was one of the risks facing the Chinese economy over the next five years.¹⁰ In the wake of these concerns, the Outline said the authorities would profoundly implement a strategy to make China a strong manufacturing nation. Other policies mentioned in the Outline include strengthening core industrial strengths (core parts, materials and software, etc.) while boosting supply-chain innovation, added value and safety. The Outline mentioned several strategic emerging sectors, including next-generation communication technologies, biotech, new energy, new materials, high-end equipment, new-energy vehicles, environmental conservation, aviation and space, and marine facilities, with the authorities aiming to build a new industrial system to drive development by upgrading manufacturing and boosting international competitiveness in these areas.

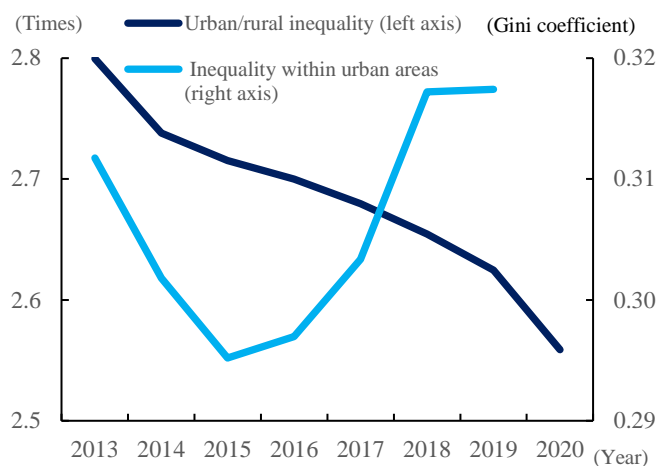
(4) Shifting to an economy driven by domestic demand: Tackling inequality holds the key to expanding consumption

The Outline also reiterates the government's policy of 'dual circulation.' This policy was mentioned at a meeting of the Chinese Communist Party's Politburo in July last year, with the Politburo calling for China to move swiftly to a new development framework that relies mainly on a 'great internal circulation' while promoting both 'internal and international circulation.'¹¹ More specifically, the Outline talks about accelerating the formation of a complete system of domestic demand in order to promote the consumption of information and digital products, expand the consumption of services, and grow China's middle class. However, one issue will be how to rectify inequalities. The 13th Five-Year plan saw the implementation of several measures to reduce the number of people in poverty to zero. These measures steadily reduced inequalities between urban and rural areas, but inequalities within urban areas is growing (Fig. 4). As a means to address this issue, the Outline talks about strengthening income redistribution functions using taxation and social security systems. It also introduces a policy to make it easier for rural migrant workers and others with non-urban residency permits to obtain urban residency permits. Problems relating to housing and education have been the main factors driving up inequality between those with and those without urban residency permits. This policy aims to tackle these problems. This will not be easy, though. It will increase the fiscal burden, for example, and the authorities will need to ensure this policy chimes with other goals such as reforming the social security system and promoting balanced regional development. The government's success or failure in tackling the issue of inequality within urban areas will have a big impact on moves to shift to an economy based around domestic demand, so the situation will require monitoring.

Figure 4: Urban/rural inequality and inequality within urban areas

¹⁰ Chinese Academy of Social Science, '国新办举行解读十九届五中全会精神吹风会 黄群慧等专家解析重点问题' (November 18, 2020)

¹¹ For details about 'dual circulation,' see 'China's Economy Continues to Recover at a Gentle Pace: The Focus Shifts to Expanding Domestic Demand and Boosting Innovation Capacity' (Mizuho Insight; October 1, 2020) by Yoshino Tamai.



Note: 1. Urban/rural inequality = Urban disposable income ÷ rural disposable income
 2. The 'inequality within urban areas' figures are estimates based on five income layers.
 Source: Prepared by MHRT based on NBS data

3. Economic policy measures in 2021: Prudently seeking an exit from crisis mode

This section will review the NPC's major numerical targets and other economic policies based on the contents of the Report on the Work of the Government and so on. The policies essentially follow in the footsteps of the policies outlined by the Central Economic Working Conference at the end of December last year.¹² Many of these targets and policies hark back to 2019, before the pandemic. This suggests the authorities are aiming to exit from crisis mode based on an awareness of the firmness the Chinese economy's fundamentals. However, there remain a number of uncertainties related to infections, for example, so the government will probably manage policy in a cautious manner with no sharp breaks with the fiscal expansion and monetary easing implemented in 2020.

(1) The growth rate target for 2021 was set at 'over 6% y-o-y'

As the first fiscal year of the 14th Five-Year Plan (2021–2025), 2021 has been positioned as an 'especially important year,' with the authorities setting a real GDP growth target of 'over 6% y-o-y' for the year. There was speculation before the NPC meeting that the authorities would refrain from setting a growth target, just as they had done in 2020, but with the domestic economy on the road to recovery, for example, it seems the authorities have set this target as the minimum threshold for maintaining stable growth.

Some observers have suggested the 'over 6% y-o-y' target is somewhat conservative. This is because they expect the economy to grow relatively strongly compared to the low growth seen in 2020 due to COVID-19. However, when the government has set growth targets more in line with market expectations (8–9% y-o-y), this has led to concerns about excessive investment by regional governments, so it seems the government is aiming instead to achieve stable, high-quality growth based on the target set in 2019 (6–6.5% y-o-y), before the pandemic struck. However, if the target had been set at '6%,' there is a danger this low level would have sent a message about monetary tightening. This appendage of 'over' to the 6% figure was probably an attempt to nip this concern in the bud. Furthermore, in a press conference on the final day of the NPC, Premier Li Keqiang suggested real growth could surpass this 'over 6%' figure. He also spoke of the importance of ensuring the target remains consistent

¹² For details about Central Economic Working Conference, see 'Chinese Economic Policy in 2021: China will begin to tackle structural problems while prudently searching for an exit strategy' (Mizuho Insight; December 25, 2021) by Yoshino Tamai and Naoaki Sato.

with the targets for 2022 and 2023, with market expectations likely to be thrown into confusion if the targets shifted too sharply from year to year. As such, it seems the ‘over 6%’ figure also reflects a desire to keep growth targets consistent and market expectations stable.

Other major targets are outlined in Figure 5. Employment-related targets were set at 2019 levels, with the new urban jobs target fixed at ‘more than 11 million’ and the surveyed urban unemployment rate at ‘around 5.5%.’ The authorities are aiming to return the jobs situation to pre-pandemic levels. In his press conference, Premier Li Keqiang also positioned employment as a priority policy issue, with the authorities striving to stabilize the jobs situation (a key concern for the Chinese people). Furthermore, the target for reducing energy consumption (per unit of GDP) was absent in 2020 owing to the impact of COVID-19, but it has now been set again at ‘around -3.0%.’ This was the only unmissed target among the 38 targets set in the Report on the Work of the Government in 2019. By setting the same target as in 2019, the authorities have indicated that energy-saving initiatives are indispensable to the achievement of high-quality, efficient economic growth.

Figure 5: Major numerical targets for 2021

| Heading | 2021 | | 2020 | | 2019 |
|--|--------------------------------|----------------|--|-----------------------------|---|
| | Numerical target | Y-o-y change | Numerical target | Result | Numerical target |
| Real GDP growth | Over +6.0% | (Same as 2019) | Not indicated | +2.3% | +6.0–6.5% |
| Consumer price index (CPI) | Around +3.0% | (↓) | Around +3.5% | +2.5% | Around +3.0 % |
| New urban jobs | More than 11 million | (↑) | More than 9 million | 11.86 million | More than 11 million |
| Urban surveyed unemployment rate | Around 5.5% | (↓) | Around 6% | 5.2% | Around 5.5% |
| Fiscal deficit (to GDP) | Around 3.2% | (↓) | Over 3.6% (over RMB 3.76 trillion) | 3.7% (RMB 3.76 trillion) | 2.8% (RMB 2.76 trillion) |
| Local government special bonds | RMB 3.65 trillion | (↓) | RMB 3.75 trillion | RMB 3.75 trillion | RMB 2.15 trillion |
| Central government budget for infrastructure | RMB 610 billion | (↑) | RMB 600 billion | RMB 600 billion | RMB 577.6 billion |
| No. of people living in poverty in rural areas | — | — | Zero | Zero achieved | Over 11 million people |
| Energy consumption (per unit of GDP) | Around -3.0% | (Same as 2019) | Not indicated | -0.1% | Around -3.0% |
| Food production capacity (volume) | Over 650 million tons | — | Not indicated | 670 million tons | Not indicated |
| Money supply (M2) | In accordance with nominal GDP | (↓) | Growth clearly higher than the previous year | 10.1% (2019: +8.7%) | Growth that matches nominal GDP growth and the previous year's figure |
| Total social financing | | | | 13.3% (2019: +10.7%) | |

Source: Prepared by MHRT based on data from Xinhua News Agency and the NBS

(2) Though the government is seeking to shift fiscal policy away from the crisis phase, it will continue to take a proactive stance

The economic policies talked about raising the quality and efficiency of the government’s proactive fiscal policy and making it more sustainable. The authorities are prepared to tolerate a certain level of fiscal mobilization as China emerges from the crisis period, with spending and tax cuts set to support the economy from here on too. This stance is apparent in the fiscal deficit (to GDP) target. At 3.2%, the target in 2021 is down compared to 2020 (3.7%), when the deficit grew sharply on moves to tackle COVID-19, but it remains at a slightly high level, up +0.4 percentage points compared to 2019’s result of 2.8% (Fig. 6).

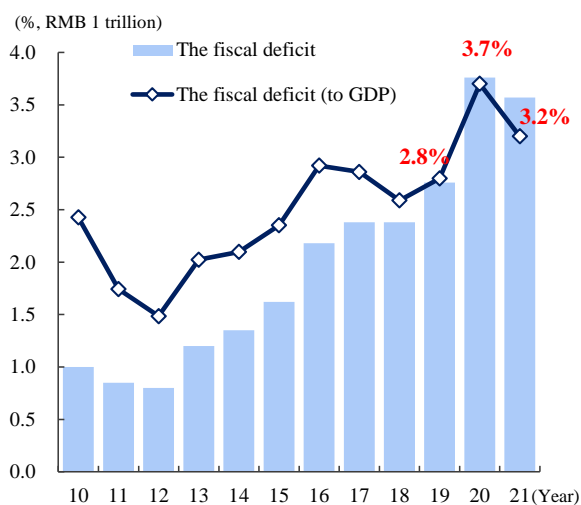
A detailed examination of fiscal policy suggests the authorities are still prioritizing infrastructure investment and support for small and micro businesses. Local government special bonds are used to pay for infrastructure investment, with the money paid back through earnings from the infrastructure, for example. The figure for issuances of these bonds was set at RMB 3.65 trillion for 2021, essentially unchanged on 2020’s figure of RMB

3.75 trillion. Though this level was kept fixed in order to keep a lid on local government debt, it remains high compared to the figures from 2019 and earlier.¹³ This reflects the government's belief that increased investment is as essential as consumption when it comes to expanding internal demand, a key plank of the 14th Five-Year Plan. With the government focusing on quality and efficiency, though, it will provide priority support to existing construction projects as it seeks to expand the usage of funds in a 'rational' manner. Given the excessive nature of investments in the past, it seems the authorities are sending out a message about the inadvisability of expanding investment without any considerations of profitability.

The government will also extend the duration of some tax cuts for small and micro businesses while also expanding the number of eligible firms. Specifically, the basic exemption threshold for value added tax will be lifted for small taxpayers, with preferential treatment also expanded when it comes to the business income tax paid by small/micro businesses and the self employed. It seems the government will maintain and strengthen targeted policy support for those sectors that were hit hard in the pockets by COVID-19.

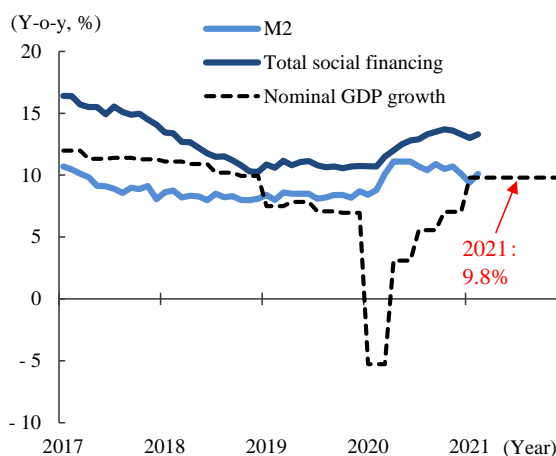
The central government will also transfer more funds to local governments in order to boost the efficiency of fiscal spending. Given its room to move on the fiscal front, the central government had transferred fiscal resources to regions before now, but this general transfer of funds from the center to the regions will hit +7.8% y-o-y in 2021, up slightly on 2020's figure of +7.5% y-o-y.¹⁴

Figure 6: The fiscal deficit



Note: The figure for 2021 is an estimate.
 Source: Prepared by MHRT based on materials from the Chinese Ministry of Finance and CEIC Data

Figure 7: The money supply (M2) and total social financing



Note: The nominal GDP growth figure for 2021 is an estimated based on the budget proposal.
 Source: Prepared by MHRT based on materials from the People's Bank of China and CEIC Data

(3) Monetary policy is shifting from easing to a more neutral stance

As indicated at the Central Economic Working Conference at the end of 2020, the authorities have stressed the importance of keeping 'prudent monetary policy flexible and targeted and at a reasonable and appropriate level.' A comparison with the 2020 Report on the Work of the Government reveals the addition of the words 'targeted' and 'reasonable,' with the authorities set to continue transitioning in stages to a neutral stance (away from the

¹³ Local government special bond issuances stood at RMB 0.8 trillion in 2017, RMB 1.35 trillion in 2018, and RMB 2.15 trillion in 2019 (Chinese Ministry of Finance).
¹⁴ Based on data from Xinhua News Agency. At the time of budget proposal.

phase of monetary easing). This direction is also reflected in the money supply targets. The authorities have said the growth in money supply (M2) and total social financing (the total business and individual financing amount) should accord with nominal GDP growth in 2021. This represents a shift away from 2020's target of 'growth clearly higher than the previous year' and back closer to the wording used in 2019, before the pandemic. An estimate of the government's expected nominal GDP growth rate for 2021 based on the budget deficit amount and the deficit-to-GDP data contained in the budget proposal yields a figure of around +10% y-o-y. This level probably falls in line with the government's money supply targets. At around 10%, money supply and total social financing growth would approach 2019 figures (Fig. 7), a statistic that chimes with the aforementioned 'regression to 2019.'

Scientific and technological innovation, green technologies, small/micro businesses and other sectors have been designated priority sectors when it comes to loans from financial institutions. Cash flow support will be provided to small and micro businesses by extending the grace period for principal and interest repayments and boosting the amount of lending by large-scale commercial banks to small/micro business by over 30% y-o-y. Financial support for scientific and technological innovation is a newly-added item. As discussed later, the government is supporting innovation fiscally and financially by expanding the system of tax benefits aimed at R&D.

China's debt has swollen to an unprecedented level (270.1% of GDP as of the end of 2020¹⁵) as a result of measures to deal with the pandemic. The phrasing about 'maintaining basic stability' suggests the authorities will avoid any sharp deleveraging in a manner that could depress the economy. The Chinese government had pursued deleveraging from 2016 as part of moves to cut excess debt. It gradually switched track thereafter as the economy slowed, with the 2019 Report on the Work of the Government going on to talk about the 'keeping the macro leverage ratio basically stable.' The Chinese government's stance towards debt in 2021 resembles its stance in 2019, before the pandemic, with the government strongly focused on striking a balance between avoiding any sharp deleveraging while preventing financial risk from an expansion of debt in the medium- to long-term. The 2020 Report on the Work of the Government did not mention deleveraging, with deleveraging shelved for a time as the government turned its attention to tackling COVID-19, so policy management will probably focus more on the debt burden this year compared to the last.

There are also concerns about the financial risk of a real-estate bubble, with the government reiterating its stance that 'housing should be used for living, not for speculation.' The authorities have already taken steps by capping the proportion of bank RMB loans that can be extended to the real-estate sector or for personal mortgages (effective from January 2021), but the real-estate sector remains overheated and the authorities are prepared to take further measures as needed.

(4) Key tasks for 2021

As shown in Figure 8, the authorities have divided the key tasks for 2021 into eight areas. Fundamentally, this follows on from the key policies for 2021 outlined by the Central Economic Working Conference at the end of 2020. As explained below, though, the NPC did introduce some new details and it did reiterate some aspects.

The pursuit of scientific and technological innovation is positioned as a task of utmost importance in the 14th Five-Year Plan. The Central Economic Working Conference had discussed boosting fiscal support for this goal,

¹⁵ The macro leverage rate as indicated by China's National Institution for Finance and Development. It shows the debt of the non-bank, government and household sectors as a proportion of GDP.

but the NPC set out some new concrete policies, namely ‘increasing central government expenditures on basic research by 10.6% y-o-y’ and ‘expanding preferential tax treatments to encourage enterprises to increase R&D spending.’¹⁶ The NPC also talked about planning and implementing the ‘Sci-Tech Innovation 2030 Agenda,’ a major long-term science and technology project announced in 2016 in the ‘13th Five-Year Plan’s National Science and Technology Innovation Program.’ The NPC reiterated that innovation would be accelerated in areas like AI, quantum communication/calculations, brain science, air and space travel, and deep-sea technologies as part of this agenda. This year’s Report on the Work of the Government newly added a phrase about realizing major breakthroughs in key technologies ‘just as a blacksmith in the past would spend years forging the perfect sword.’ This reveals the intention to promote the development of China’s own technology over the medium- to long-term in the face of prolonged frictions with the US, with the government set to pursue initiatives in this area from 2021.

As with innovation, the expansion of domestic demand is also a key plank of the 14th Five-Year Plan. The NPC outlined several policies in this area, such as (1) increasing personal incomes through multiple channels, (2) improving networks for the flow of goods and services, (3) encouraging increases spending on home appliances, automobiles, and other big-ticket items,¹⁷ (4) promoting the consumption of services (healthcare, culture, tourism, and sports, etc.), (5) encouraging the development of new products and services, (6) promoting the integrated development of online and offline consumption, and (7) encouraging platform companies to reduce their service fees. Though these policies are more specific than those set out by the Central Economic Working Conference, they do not seem that novel when it comes to making expanded consumption the driver of future growth. As for investment, the NPC reiterated the commitment to the goals outlined by the Central Economic Working Conference, such as launching a number of major transportation, energy, and water conservancy infrastructure projects, investing in urbanization through the renovation of old urban residential communities, and developing information networks and other new types of infrastructure.

When it comes to shifting to an economy based around domestic demand, (1) ‘increasing personal incomes’ will have a vital role to play. As to how the government will go about increasing incomes, the NPC did not mention any details with regards to moves to ‘stabilize and expand consumption’ (Fig. 8, 4-(1)), but it did separately mention improving the employment-first policy, implementing the rural revitalization strategy, and improving living standards (Fig. 8, 1-(4), 5 and 8), so it seems the authorities will try to increase incomes by resolving structural household problems and boosting consumption.

Firstly, the NPC indicated it would continue to pursue last year’s employment-first policy. This will include: offering fiscal and financial support to firms that do not cut jobs; cutting premiums on unemployment insurance and workers’ compensation; continuing to expand vocational training; continuing to subsidize contributions to social insurance made by workers in flexible employment (temporary or seasonal workers, etc.); and abolishing residency permit requirements when people try to access social insurance. According to the contents of Premier Li Keqiang’s press conference on the last day of the NPC, delivery drivers and other flexible workers form the lynchpins of new industries such as net shopping or delivery services, with this category already encompassing over 200 million people. Flexible workers have played an even more important role during the pandemic, with the government expanding support for this sector as it tries to boost incomes and improve the employment situation.

¹⁶ The tax deduction on corporate research and development costs will be raised from 75% at present to 100% for manufacturers. If they have not been included as intangible assets in current profits and losses, these costs can be deducted at 100% (it has been 75% up until now) when calculating taxable income.

¹⁷ The Ministry of Commerce and 11 other departments jointly released a series of related policies at the start of 2021. These include the recommencement of a campaign to encourage automobile usage in rural areas, and subsidies to encourage consumers to buy low-carbon vehicles and green/smart appliances to replace their existing products. For details, see ‘Report on Measures to Promote High-cost Consumption/Consumption in Key Areas and Rouse Latent Consumer Spending Potential in Rural Areas’ (Mizuho China Policy Brief; February 17, 2021) by Lui Jiamin.

The focus on living standards in the 14th Five-Year Plan is reflected in the NPC's policy measures for 2021, with the key task of 'improving living standards' featuring more sub-headings than any other key task. When it comes to specific policies in this area, the NPC mentioned: (1) developing a more equitable education system through the provision of better schooling for children of rural migrant workers in cities, etc.; (2) improving the healthcare system and cutting healthcare costs; (3) stabilizing house prices, cutting taxes and fees on rental housing, and addressing housing difficulties; (4) increasing the basic pension for retirees and the subsidies and living allowances for entitled groups while expanding coverage of unemployment insurance.

As for rural revitalization, the NPC established a five-year transition period for rural areas lifted out of poverty, with jobs promotion schemes, skills training and other assistance remaining in place during this time. China defines people as living in poverty if they earn less than RMB 2,300 a year (this was in 2010, with the equivalent figure around RMB 4,000¹⁸), while counties with per-capita incomes of less than RMB 2,300 defined as 'counties in poverty.' According to a government announcement, though there were 5.51 million people living in poverty and 52 'counties in poverty' as of March 2020, these figures had been reduced to zero by the end of 2020. Even after achieving the goal of eradicating poverty, the government will continue providing aid to ensure people don't slip back into poverty. It is also aiming to boost rural incomes and reduce the income divide between urban and rural areas.

Other noteworthy points include (1) stricter regulation for platform companies, (2) opening up, and (3) the environment.

As for point (1), the Central Economic Working Conference outlined measures to 'step up efforts against business monopolies and guard against unregulated expansion of capital' while ensuring that 'financial innovations are made under prudent regulation.' These goals were also covered under the key task of 'advancing reforms in key areas' (Fig. 8, 2). Both these targets encompass platform companies and they are consistent with moves to crack down on Alibaba at the end of 2020 on the grounds of monopolistic behavior,¹⁹ for example.

With regards to (2) 'opening up,' the NPC reiterated the Central Economic Working Conference's statement that China would consider joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). It also outlined plans to deepen economic cooperation structures by swiftly enacting/implementing the Asian Regional Comprehensive Economic Partnership (RCEP), concluding negotiations on an investment agreement with the EU, and accelerating FTA negotiations with Japan and South Korea, for example. Though the 2020 Report on the Work of the Government had mentioned a 'phase one trade agreement' with the US, there was no mention of this in the 2021 Report. However, there was new wording stating that China would 'promote the growth of mutually beneficial China-US business relations on the basis of equality and mutual respect.' With the US reviewing its China policy in the wake of President Biden's election, it seems Beijing was sending a message about the ongoing importance of its economic relations with the US.

As for (3) 'the environment,' the NPC followed the Central Economic Working Conference by adopting the goal of achieving peak carbon dioxide emissions by 2030. It also outlined measures to tackle atmospheric, river, sea and soil pollution while stepping up ecological conservation endeavors.

¹⁸ State Council Information Office, '脱贫标准“一二三”不受疫情影响而改变 今年将开展脱贫攻坚普查' (March 12, 2020)

¹⁹ On November 10, 2020, the State Administration for Market Regulation (SAMR) announced it was soliciting public comments on the draft of its 'New Guidelines on Preventing Monopolistic Behavior by Platform Companies.' On February 2, 2021, the State Council's Anti-Monopoly Committee released the 'Anti-Monopoly Guidelines on the Platform Economy.' This sets out actions that would be classified as monopolistic behavior, such as demanding that a client does not use competing platforms or unfairly cutting prices in order to expand market share. The authorities have also cracked down on financial services provided by platform companies. They have strengthened the regulations governing internet micro-lending while banning major internet financial companies from taking deposits on behalf of banks in accordance with instructions from the authorities.

Figure 8: Key tasks for 2021

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|--|
| 1. Ensuring the continuity, consistency, and sustainability of macro policies to keep major economic indicators within an appropriate range |
| (1) A proactive fiscal policy (2) Implement and improve tax reduction policies (3) A prudent monetary policy (4) Improve the employment-first policy to enhance its performance |
| 2. Advancing reforms in key areas and further energizing market entities |
| (1) Transform the functions of government (2) Reduce enterprises' production and operating costs through reform (3) Promote the common development of enterprises under diverse forms of ownership (4) Deepen reforms of the fiscal, taxation, and financial systems |
| 3. Promoting high-quality development of the real economy through innovation and fostering new growth drivers |
| (1) Raise our capacity for pursuing scientific and technological innovation (2) Leverage market forces to encourage enterprises to engage in innovation (3) Ensure the stable operation of industrial and supply chains and improve them |
| 4. Expanding domestic demand as a strategic move and fully tapping the potential of the domestic market |
| (1) Stabilize and expand consumption (2) Expand effective investment |
| 5. Implementing the rural revitalization strategy across the board and promoting steady development of agriculture and growth in rural incomes |
| (1) Align efforts to consolidate and expand the achievements in poverty alleviation with efforts to promote rural revitalization (2) Enhance our ability to ensure the supply of food and major agricultural products (3) Take solid steps in advancing rural reform and development |
| 6. Pursuing high-standard opening up and promoting stable and improved performance in foreign trade and investment |
| (1) Promote steady growth of imports and exports (2) Use foreign investment more effectively (3) Promote high-quality Belt and Road cooperation (4) Deepen multilateral, bilateral, and regional economic cooperation |
| 7. Enhancing pollution prevention and control and ecological conservation and promoting continuous environmental improvement |
| (1) Continue to intensify efforts to improve the environment (2) Take solid steps toward the goals of achieving peak carbon dioxide emissions and carbon neutrality |
| 8. Improving living standards and steadily advancing social development |
| (1) Develop more equitable and higher-quality education (2) Improve the healthcare system (3) Strive to meet people's housing needs (4) Do more to meet people's basic living needs (5) Better meet the intellectual and cultural needs of our people (6) Strengthen social governance and develop new ways to conduct it |

Source: Prepared by MHRT based on Xinhua News Agency's '政府工作报告' (March 12, 2021)

4. The decision to review Hong Kong's electoral system

In addition to the aforementioned economic policies, the NPC adopted the 'Decision of the NPC on Improving the Electoral System of the Hong Kong Special Administrative Region.' This revises Hong Kong's system of elections for its Chief Executive and Legislative Council (parliament).

The Chinese authorities said the review was because 'the anti-China riots and turbulence that occurred in Hong Kong, including the anti-extradition bill movement in 2019, reveals that the existing electoral system in the Hong Kong SAR has clear loopholes and deficiencies.'²⁰ It seems the authorities were particularly perturbed by

²⁰ '关于《全国人民代表大会关于完善香港特别行政区选举制度的决定（草案）》的说明' 新华网 (March 5, 2021)

primaries held independently by the pro-democrats (over July 11–12, 2020) to elect candidates for the upcoming Legislative Council election in September 2020. The pro-democrats leading the primaries had said that if the democratic faction won a majority of seats in the Legislative Council and then voted down the draft budget bill, it would be able to force through the resignation of the Chief Executive. It seems the Chinese authorities viewed this movement as an attempt by the pro-democrats to seize control of Hong Kong.²¹ With Legislative Council elections looming in September 2021 (postponed from September 2020 due to COVID-19) and a Chief Executive election in March 2022, the Chinese authorities decided that now was the time to step in to ensure ‘patriots administer Hong Kong.’

The details of the review are outlined in Figure 9. There were basically four major revisions: (1) membership of the Election Committee (the body that elects the Chief Executive) will be expanded to include more pro-Beijing members, (2) some seats in the Legislative Council (parliament) will be indirectly elected by the Election Committee, (3) Legislative Council candidates will need nominations from the Election Committee, and (4) a review committee will be newly established to review the qualifications of candidates for elections. The expanded role of the Election Committee will enable Beijing to make its presence felt more in elections for the Chief Executive and Legislative Council. As for (4), the qualifications of candidates will need to conform with the ‘Law on Safeguarding National Security in the Hong Kong SAR,’ a move that seems aimed at removing all pro-democrats at the candidacy stage.

From here on, after deciding on the details regarding the composition of the Election Committee and Legislative Council, the Standing Committee of the NPC will amend the Annexes to the Basic Law (the legislation that determines the procedures for Chief Executive and Legislative Council elections), with the Hong Kong government then amending relevant local laws accordingly. Hong Kong’s current Chief Executive Carrie Lam has indicated she wants to fast track these procedures, with some reports saying the new system will be in place by May 2021.²²

The aforementioned revisions to the electoral system are broadly in line with expectations and reports. At this moment in time, they have not led to any demonstrations or market disturbances in Hong Kong. Going forward, this could prove a source of friction between China and the new Biden administration in the US given the latter’s focus on human rights and democracy. When the US and China held their first top-level talks under the new Biden administration (March 18–19, US time), it seems the two sides did indeed clash, with the US outlining its concerns about human rights and democracy, including in Hong Kong, for example, and Beijing accusing the US of meddling in China’s domestic affairs. A lot will depend on the actual details of the reforms and how they are actually put into practice, but there are probably many companies thinking about relocating or many individuals thinking about leaving over the medium-to long-term on these concerns about intensified US/China frictions and the decline of democracy in Hong Kong, so the situation will still require monitoring from here on.

Figure 9: Revisions to Hong Kong’s electoral system

| | Chief Executive election | Legislative Council (parliamentary) election |
|----------------|---|--|
| Current system | <ul style="list-style-type: none"> The Chief Executive is elected by an Election Committee with 1,200 members | <ul style="list-style-type: none"> There are 70 seats on the Legislative Council |

²¹ In fact, on January 6, 2021, it was announced that 53 pro-democrats involved in the primaries had been arrested under the ‘Law on Safeguarding National Security in the Hong Kong SAR’ for attempting to seize control of the legislature.

²² ‘Lam vows to fast-track laws for polls revamp,’ *South China Morning Post*, March 17, 2021.

| | | |
|----------------|--|---|
| | <ul style="list-style-type: none"> ● The Election Committee comprises 300 electors from each of the following 4 sectors: <ol style="list-style-type: none"> (1) Industry, commerce and finance (2) The professions (3) Labor, social services, religious and other sectors (4) Legislative Council members, representatives of district organizations, Hong Kong deputies to the NPC, and Hong Kong members of the National Committee of the Chinese People's Political Consultative Conference ● Candidates can stand for selection after obtaining at least 150 nominations from members of the Election Committee ● Candidates are elected by a majority of Election Committee votes | <ul style="list-style-type: none"> ● The breakdown is as follows: <ol style="list-style-type: none"> (1) Elected by functional constituencies (35 seats) (2) Directly elected (35 seats) |
| After revision | <ul style="list-style-type: none"> ● The Election Committee has been expanded to 1,500 members ● The Election Committee comprises electors from each of the following 5 sectors (though the details have not been announced, reports say each sector will send 300 electors) <ol style="list-style-type: none"> (1) Industry, commerce and finance (2) The professions (3) Labor, social services, religious and other sectors (4) Legislative Council members and representatives of district organizations (5) Hong Kong deputies to the NPC, Hong Kong members of the National Committee of the Chinese People's Political Consultative Conference, representatives of Hong Kong members of related national organizations ● Candidates can stand for selection after obtaining at least 188 nominations from members of the Election Committee and at least 15 nominations from each of the five sectors ● Candidates are elected by a majority of Election Committee votes | <ul style="list-style-type: none"> ● There are 90 seats on the Legislative Council ● The breakdown is as follows (the details have not been released, but reports say (3) will have the most seats): <ol style="list-style-type: none"> (1) Elected by functional constituencies (2) Directly elected (3) Indirectly elected by the Election Committee ● Legislative Council candidates will need nominations from the Election Committee |
| | <ul style="list-style-type: none"> ● A review committee will be established to review and confirm the qualifications of candidates for the Chief Executive, Legislative Council and Election Committee. The qualifications of candidates should conform with the 'Law on Safeguarding National Security in the Hong Kong SAR' | |

Source: Prepared by MHRT based on Xinhua News Agency's '全国人民代表大会关于完善香港特别行政区选举制度的决定' (March 11, 2021)

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