

# **OECD High-level Parliamentary Seminar China's Current Economic Policy Challenges**

**6 October 2005**

**OECD Headquarters**

## **Programme**

**Chair:** *John West, Head of Public Affairs Division, Public Affairs and Communications, OECD*

**9.30: Welcome coffee**

**10.00: Welcome remarks** – *Donald J. Johnston, Secretary-General, OECD*

**10.05: Overview of China's Current Economic Policy Challenges** – *Richard Herd, Senior Economist, Economics Department, OECD*

China's economic growth has averaged 9½ per cent over the past two decades and the economy has become substantially integrated with the world economy. Much of these gains have come about through profound shifts in government policies. Reforms have allowed market prices and private investors to play a significant role in production and trade. But although economic dynamism has helped reduce the number of Chinese living in absolute poverty, income levels are still low and inequality is on the rise, not only between the cities and rural regions – average incomes in the countryside are only one third of those in the cities – but also within the more prosperous coastal provinces.

The scope of private ownership has become substantial, producing well over half of GDP and an overwhelming share of exports. Private companies generate most new jobs and are improving the productivity and profitability of the whole economy. The government has restructured the state-owned business sector, resulting in a massive loss of jobs. Still, a large part of the state sector remains to be restructured. The performance of the business sector could be strengthened more through a further modernisation of the business framework and better enforcement of laws in the economic sphere, especially those for intellectual property rights. A more flexible exchange rate would support a stable macroeconomic environment. While fiscal policy has been run in a stabilising fashion, the outcome of monetary policy has been considerable volatility of inflation.

**10.25: Discussion**

**11.00: Intellectual Property Rights in China** – *Wolfgang Hübner, Head of Structural Policy Division, Christina Sampogna, Administrator, Biotechnology Division and Gang Zhang, Administrator, Science and Technology Division, Directorate for Science, Technology and Industry, OECD*

Top leaders in the Chinese Government have become aware of the importance for China to build a sound intellectual property rights (IPR) system. They realise that protecting intellectual rights is crucial as a condition for foreign investment and technology transfer as well as for promoting Chinese innovation, which will determine China's future competitiveness in the global knowledge economy. China has quickly developed a set of IPR laws and standards over the past two decades, but despite efforts taken to improve IPR enforcement, infringement of IPR in China has been growing in recent years. The main challenge for the coming years is to improve upon the governance of the legislative, administrative and enforcement systems in order to make the existing laws more effective in stimulating innovation and protecting IPR.

The elaboration of the IPR system takes place in the broader context of building an institutional framework for market forces. The institutional environment that should support the IPR system is not yet fully in place. For instance, China has yet to introduce an anti-monopoly law to curb abuse of IPR. Recent amendments to China's Constitution on the protection of private property will consolidate the legal basis for intellectual property, and efforts to improve the rule of law will benefit the protection of intellectual rights.

**11.20: Discussion**

**12.00: Reforming the Financial System** - *John Thompson, Counsellor, Directorate for Financial and Enterprise Affairs, OECD*

With the economic reform begun in the late 1970s, Chinese banks have been moving away from their passive role under central planning. But, owing to unclear ownership structures and a history of support of regional and industrial policy, most Chinese banks have a governance regime that is not well adapted to the active role in resource allocation of banks in a market economy. This is particularly true for the four large state-owned commercial banks (SOCBs) which account for the predominant share of bank assets. Lacking profit-oriented owners to monitor bank management, the SOCBs have historically functioned as extensions of the government, with senior executives named by the party and approved by the State Council.

In contrast to the SOCBs, the second largest category of banks, the 11 Joint Stock Banks (JSBs), have stronger earnings and better balance sheets. The JSBs, are partly owned by the government and partly by other interests, and do not have the historical legacy as instruments of supporting government policy. Their management has a stronger commitment to profitability. The most recent phase of bank reform in China began in 2003 and aims at improving competition between the SOCBs and other kinds of domestic banks; increasing transparency and exposure of all Chinese banks to scrutiny by the market and expanding foreign presence partly linked to Chinese WTO membership and partly linked to a desire to benefit from foreign competition.

**12.20: Discussion**

**12.45: Break before lunch**

**13.00: Working lunch:**

**Role of OECD in Managing Globalisation, including co-operation with emerging economies**

*Chris Brooks, Director, Public Affairs and Communications, OECD, Jean-Marie Metzger, Director, Trade Directorate, OECD and Frédéric Langer, Counsellor, Centre for Co-operation with Non-Members, OECD*

**15.00: Improving Governance in China** - *Nick Manning, Head of Public Sector Management and Performance Division and Leila Choukroune, Consultant, Directorate for Public Governance and Territorial Development, OECD*

China is now undergoing a crucial transformation in its system of governance, adapting institutions and the functioning of the state to an increasingly market-oriented economy. China's rapid change is not only visible in the flourishing private sector enterprises and the radical renewal of its urban landscapes. It can also be seen in the transformation of its institutions. Over the past 25 years Chinese authorities have taken measures to adapt the role of government and public administration to an increasingly market-driven economy. The administrative, productive and social service functions previously folded into a structure of closely linked organisations have been dispatched to different public and private organisations. State-owned enterprises have been separated from the public administration and new regulatory bodies have been set up. Chinese authorities have laid bases for modern tax, budget and civil service systems. China has also taken steps toward a system based on the rule of law, and has embarked on an ambitious regulatory reform programme. Progress in governance was achieved in a relatively short period of time and has contributed in a crucial manner to sustain China's high growth rate.

This transformation is also being spurred by key strains that have emerged related to fiscal and financial imbalances, rising inequalities and environmental deterioration. Heightened social tensions, partly due to increasing inequality within society and massive migration to the cities, are also linked to corruption, insufficient public services and rising unemployment and could undermine prospects for sustainable growth. Good Governance is crucial to address the challenges China faces and ensure sustainable development".

**15.20: Discussion**

**16.00: Labour, Social and Agricultural Issues in China** – *Anders Reutersward, Principal Administrator, Directorate for Employment, Labour and Social Affairs, OECD and Andrzej Kwiecinski, Senior Analyst, Directorate for Food, Agriculture and Fisheries, OECD*

China's economic reforms have established a new relationship between enterprises, workers and the state, placing the public administration at arm's-length from most decisions in the economy. The Enterprise Law and the labour Law, both dating from 1994, assign employers a new role, which is separate from government and permits enterprises to concentrate on their business activities. Many administrative and social responsibilities have therefore been removed from what was called work units (danwei), while the state is facing the need to develop a variety of institutions that previously did not exist or had different functions. This process is well underway, but much remains to be done. The problems encountered are still partly related to China's peculiar heritage, but the principal goals and policy constraints are comparable to those found in many developing market economies.

Some governance issues of relevance mainly in China's urban areas are comparable to those in developed OECD member countries, making it pertinent to draw on their unemployment insurance and 'active' measures to promote job search, and, in social insurances, questions about fund management and how these are linked with other policy decisions.

A more fundamental problem is that all formal labour market institutions in China – as in other developing countries – have limited application outside the most developed part of the economy, which consists mainly of urban formal enterprises. Implementing labour law and social insurance is generally difficult in the less-productive rural and informal segments of the labour market. But real incomes are rising in most parts of the economy, and the present scale of rural-urban migration and economic interdependence makes it urgent to reduce institutional inequity as far as possible. The government now seeks to promote integration between urban and rural labour markets, a process that is well under way although still at an early stage.

Although the importance of agriculture in the Chinese economy has fallen, it is still a key sector, accounting for 15% of GDP and providing above 40% of employment. About 60% of China's population continues to live in rural areas. Since the reform process started in 1978, agriculture has been transformed from a tightly controlled, centralised system of commune-based farming into a household-based system increasingly driven by markets rather than plans and targets fixed by the government. In response to this change, agricultural production surged and incomes increased, thus helping to alleviate a large part of rural poverty. Currently, China's agriculture supplies food for 1.3 billion Chinese citizens and contributed to the annual net exports of agro-food products at about USD 3 billion between 2000 and 2002.

China's leaders now de-emphasize formal economic planning and allocation by command and are increasingly open to allocation by markets. Yet the agriculture sector remains a sensitive area and subject to central guidance, especially for food staples. China's official policy of encouraging a "socialist market economy" implies that production of and trade in commodities considered of strategic importance will continue to be managed, with state-linked enterprises still playing an important role. This dual approach to basic regulatory mechanisms of the economy contributes to the creation of a complex organisation framework. A "spider web" of institutions has been evolving, sometimes with unintended consequences, but strides have been made to reduce redundancies and improve accountability and professionalism in decision processes.

**16.20: Discussion**

**17.00: Closing remarks**