

2009 NPC & CPPCC Annual Sessions

Analysis & Insights

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HILL & KNOWLTON China

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Table of Contents

1. Introduction.....	1
2. Agenda Highlights	1
2.1 Economic Issues	1
2.1.1 Economic Revitalization.....	1
2.1.2 Inward Investment & Foreign Trade.....	3
2.1.3 Food Safety.....	3
2.1.4 Sustainability and the Environment.....	4
2.1.5 Chinese Companies ‘Going Global’.....	4
2.2 Social Issues.....	4
2.2.1 Unemployment.....	4
2.2.2 Healthcare Reform.....	5
2.2.3 Social Security.....	5
2.2.4 Affordable Housing	5
2.3 Government and Politics.....	5
2.4 Cultural Development and Education.....	6
3. Conclusion.....	7

1. INTRODUCTION

Amidst the deteriorating global economic environment and increasing expectations regarding China's response, the 2009 annual sessions of China's National People's Congress (NPC) and the Chinese People's Political Consultative Conference (CPPCC) were held from March 3rd to March 13th. Unlike in recent years, the agenda for this year's proceedings did not include approvals of major legislation or the announcement of major government structural and personnel changes. This year, economic revitalization was the core topic. More specifically, China's government is facing the very ambitious task of achieving 8% GDP growth in 2009. The government recognizes, however, that even during economically difficult times, growth should not be achieved at the cost of China's social fabric. In looking to achieve this balance, a number of additional areas received significant attention, most notably including those that are social, political and cultural related.

These proceedings give China observers an increasingly transparent window on the debates within China's leadership, and provide tremendous insight into China's future direction. This document is intended to provide a brief overview and analysis of the major developments in and around the NPC and CPPCC proceedings.

2. AGENDA HIGHLIGHTS

2.1 Economic Issues

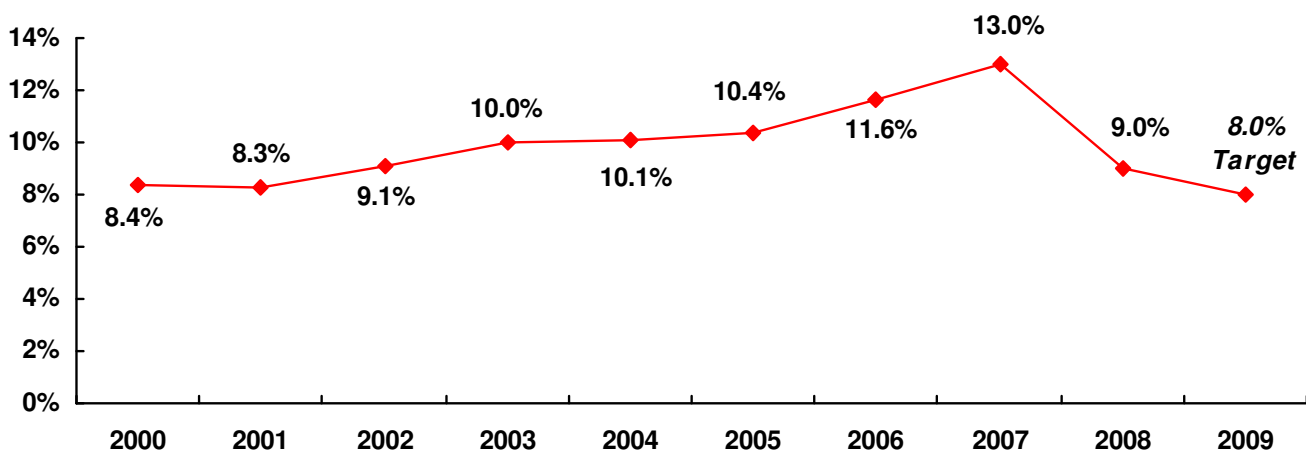
The government's focus on China's economy and major industry issues dominated the NPC and CPPCC proceedings. In addition to stimulus of the Chinese economy, key areas touched upon in the group discussions, press conferences and interviews included inward investment and foreign trade, food safety, sustainability and the environment and China's 'going global' efforts. A brief overview of each of these areas follows below.

2.1.1 Economic Revitalization

Facing the global economic crisis and the impact it is having on the Chinese economy, a quick revitalization of China's economy represents the paramount priority for China's leadership. As reflected in Premier Wen Jiabao's Government Work Report, delivered at the opening of the NPC on March 5th, the government is looking to maintain steady and fast growth through 2009, despite deteriorating external conditions.

Premier Wen officially set China's 2009 GDP growth target at 8%. The government's 2009 budget will include a historically high deficit of USD 140 billion (RMB 950 billion), accounting for an estimated 2.8% of GDP. This should be easily manageable given the central government's estimated USD 920 billion (RMB 6.27 trillion) debt in 2009, or about 20% of GDP. Though many external observers note that these targets, and particularly the 8% GDP growth target, are very ambitious against the backdrop of a reeling global economy, these aggressive targets confirm China's proactive fiscal policy and approach to the current crisis.

Figure 1: China's GDP Growth Rate 2000-2009



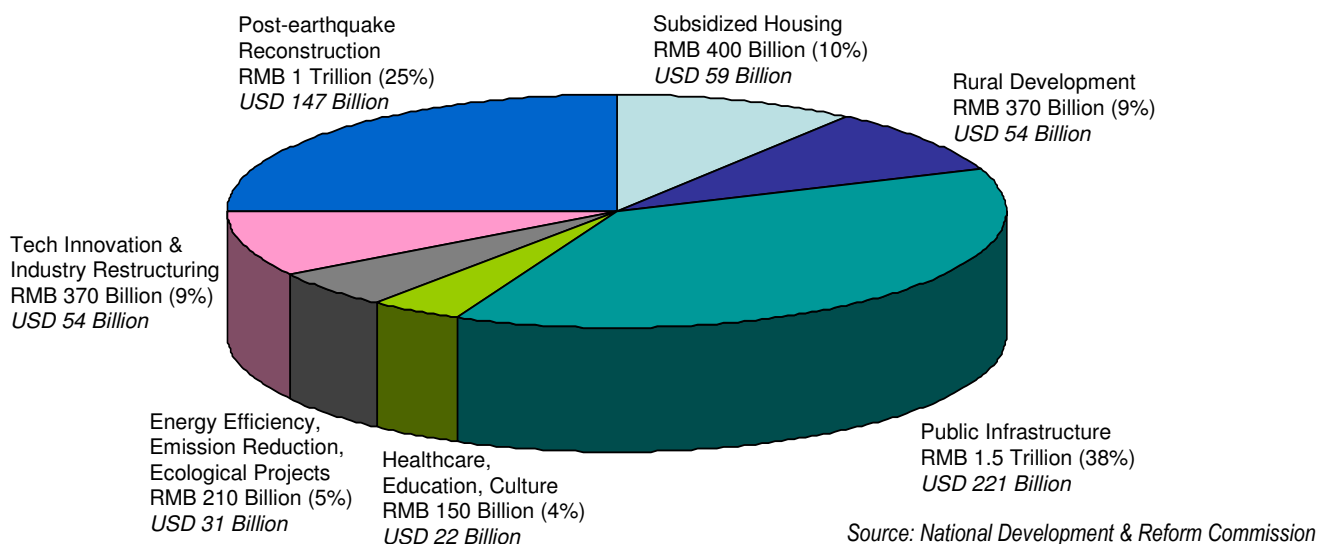
Source: National Bureau of Statistics of China

Prior to this year's NPC and CPPCC sessions, the government issued a number of measures to boost industry's and the public's confidence in the Chinese economy, namely a USD 588 billion (RMB 4 trillion) stimulus package and subsequent revitalization plans for 10 key industries.

This stimulus package, which remains at the center of attention for MNCs across industries, was rushed out in November 2008, with only general direction on how it would provide a boost to the economy by the end of 2010. The government indicated that approximately USD 174 billion (RMB 1.18 trillion) would be offered directly by the central government and that the remainder represented investment from local governments and non-government sources (e.g. state owned enterprises, private firms and MNCs). Contrary to what many expected prior to Premier Wen's presentation of the Government Work Report on March 5th, the Premier did not provide significant detail on implementation of the stimulus package and did not announce additional stimulus measures, to the disappointment of many industry players.

Likely in response to growing questions about implementation of the stimulus package, the National Development and Reform Commission (NDRC) released a revised general breakdown of areas for its allocation (see Figure 2). It is worth noting the differences between this latest allocation breakdown versus the earlier version released by the NDRC in November. Investment allocated to public infrastructure (-16.7%) and energy efficiency, emission reduction and ecological projects (-40%) sectors were decreased, while investment to subsidized housing (+42.9%), technological innovation & industry restructuring (+131.2%) and healthcare, education & culture (+275%) sectors were significantly increased.

Figure 2: Breakdown of Stimulus Package, Disclosed in March 2009



The NDRC has noted that this budget allocation will be further adjusted as the economic situation evolves. This flexibility was also voiced by Premier Wen, who stated in his press conference at the closing of the NPC that the government is prepared to issue additional stimulus policies whenever needed. There is speculation that the government is looking to see what impact the USD 588 billion stimulus will have over the course of the first half of 2009 before considering the possible injection of additional investment.

In January and February of 2009, the government issued revitalization plans for ten key industries, including automobile, iron & steel, equipment manufacturing, textiles, shipbuilding, electronics & IT, light industries, petrochemicals, non-ferrous metals, and logistics. Despite a recent and serious slump in housing sales, real estate is not officially listed on the list of ten industries for focused revitalization. The ten industry revitalization plans are looking to optimize industries, reduce excess capacity and improve competitiveness in high value sectors, efforts that will help China address both its short and long term economic goals. These plans will also be supplemented by detailed implementation guidelines over the coming months.

The focus on infrastructure has sparked significant debate regarding the long-term need to increase domestic demand as a major driver for China's economy and the immediate need for job creation. While infrastructure certainly plays a role in building long-term domestic demand and domestic industries, a strengthened welfare system will also be critical to stimulating consumer spending over the long-term. This argument undoubtedly contributed to the NDRC's revised allocation of the stimulus package, with more investment now headed to healthcare, education, culture and industry restructuring and relatively less to public infrastructure.

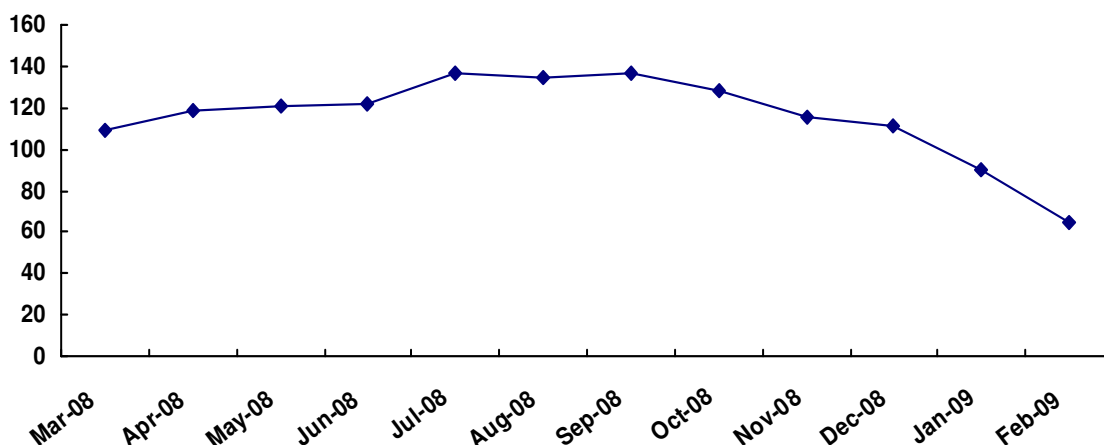
2.1.2 Inward Investment & Foreign Trade

In February 2009, utilized foreign investment showed a 15.8% decline from January and a 22.6% decline from the same period of the previous year. Though an obvious concern, the decrease in foreign investment has not received as much attention from the government as other areas such as exports. Fewer efforts have thus focused on boosting investment, with only a few sideline policies implemented in the run up to and during the annual NPC and CPPCC sessions, including the lowering of property taxes for foreign invested enterprises (FIEs) in December 2008, the simplification of approval of foreign investment projects in March and a few policies granting preferential treatment to investors from Hong Kong and Macau in certain industries.

A precipitous decline in exports, however, is a serious concern (see Figure 3). February 2009's USD 65 billion in exports represents a 52% drop from September 2008's USD 136 billion in exports. This drop is significantly worse than most observers predicted, many of whom had hoped to see a slight rebound in February exports after the January Chinese New Year. Large amounts of these exports are in labor intensive industries, including apparel and manufacturing, presenting significant employment challenges to China's economy.

In order to boost exports, China's Minister of Commerce, Chen Deming, pledged that all export taxes will gradually be eliminated. Minister Chen also noted that China opposes trade protectionism and that China will firmly support the revival of the WTO's Doha development round. He clearly noted that appropriate protective measures that are developed within the WTO's framework do not represent trade protectionism. Some speculate these remarks were both a criticism of the "Buy American" provisions included in the U.S. stimulus package and a defense of China's alleged trade protectionism and government procurement processes.

Figure 3: China Exports March '08 – February '09 (USD Billion)



Source: General Administration of Customs of China

2.1.3 Food Safety

A renewed focus on food safety was sparked by a number of recent food safety-related issues such as last year's melamine-tainted milk incident. With the recent issuance of the Food Safety Law in the run up to the NPC and CPPCC sessions, the government is prepared to take a much stricter approach to regulating China's food industry.

The Food Safety Law replaces the weak and insufficient Food Hygiene Law. In addition to establishing the State Council-level National Food Safety Commission, the new law streamlines national food standards, introduces food recall measures, establishes a cross-ministry food safety information system and risk monitoring and assessment mechanism, prioritizes civil compensation for food safety victims, significantly increases punishment for noncompliance with food safety-related law and regulations, increases oversight on functional food and food advertisements, and increases quality inspections of food imports and exports. The law is to take effect on June 1st, 2009.

As the law covers a wide range of areas, involving a number of different government organizations, there still remain many ambiguities that should be further addressed in future regulations, implementation guidelines, and legal explanations by the government. Coordination between various government organizations will likely be a significant challenge, even after the establishment of the State Council-level National Food Safety Commission.

2.1.4 Sustainability and the Environment

Sustainability, as a key policy initiative set out in China's 11th five year plan (2006-2010), did not receive as much attention during this year's proceedings as last year. However, many of last year's major priority areas, namely energy efficiency and emission reductions, will continue to be a focus this year. In line with the Law on Circular Economy Promotion, which came into effect on January 1, 2009, the government is embarking on a nationwide campaign to promote resource recycling, resource conservation, energy efficiency and waste reduction.

This year, clean energy was a fresh priority, including nuclear energy, wind power, solar energy and hydro power. Zhang Guobao, director of the National Energy Administration (NEA), said in an interview that the central government would invest more to further boost the development of the clean energy industry, confirming Premier Wen's remarks in his Government Work Report. One example of this focus is a new policy guideline that supports the development of China's new energy automobile industry. It supports new energy automobile trial projects by providing financial subsidies for the procurement of new energy automobiles and the development of relevant infrastructure and battery technology.

As a macro issue, climate change was conspicuously absent from this year's proceedings. Most environment-related discussion specifically addressed energy efficiency issues and support for the development of new energy industries. As China focuses above all else on driving economic growth, it will be interesting to watch China's evolving position on climate change, and its dialogue with the United States on this subject.

2.1.5 Chinese Companies Going Global

"Chinese Companies Going Global" represents an initiative that has been encouraged by the Chinese government for more than a decade. The past few years have witnessed gradual, but significant, shifts in the concept of "Going Global". One major shift is the government's current support for large firms that demonstrate strong international management capabilities. Furthermore, smaller firms are actively being discouraged from expanding overseas. The significant number of setbacks experienced by Chinese firms in their overseas expansion efforts has helped impress this pragmatic approach on the government. The other shift relates to the Chinese government's efforts to make strategic investments overseas via large state-owned enterprises (SOEs) in key industries, particularly in the resources sector. Premier Wen alluded to this in his report, albeit in a low profile manner. Minister of Commerce Chen Deming also stressed China's need to successfully conduct acquisitions overseas during a media interview on the sidelines of the NPC.

This latter shift, including government backed SOEs acquiring assets overseas and expanding in global markets, is meeting significant international resistance, including challenges by foreign regulatory bodies, media and overseas competitors. Indeed, many argue that China is taking advantage of the current global economic downturn to acquire assets cheaply and across diversified markets and industries. Others argue that China represents a much needed source of cash in a tightening global economy. Regardless, even though Chinese companies' global ambitions certainly represent competition to some, this move presents MNCs with important opportunities for collaboration. MNCs may want to consider exploring which Chinese companies present the best partnership opportunities to their own business development strategies at this relatively early stage.

2.2 Social Issues

Inadequate access to healthcare, insufficient social security, unemployment and lack of affordable housing are issues that have attracted increasing attention from both the public and the government. Preventing social unrest has always been a top priority for the Chinese government and therefore properly addressing these increasingly complex social issues continues to be a major focus.

2.2.1 Unemployment

Of all social issues, unemployment is the most sensitive for the Chinese government and one that is now being greatly magnified by the financial crisis. The official "registered urban unemployment rate", which does not include China's large migrant worker population, reached 4.2% by the end of last year, and the government is aiming to keep this figure below 4.6% in 2009. Current estimates place the migrant worker population at 130 million, of which 20 million have recently been unemployed. These statistics are particularly alarming for the government, as a large majority of these migrant workers are losing urban jobs and do not want to return to their rural farming-based hometowns.

The government is thus urging all companies to refrain from cutting jobs and strictly adhere to the Labor Contract Law, which, relative to earlier policies, increases the rights of employees in a number of areas. SMEs have also increasingly become the center of attention for two major reasons. They are not only the source of a large portion of China's Labor Contract Law-related violations, but they represent the best opportunity for job creation. Premier Wen stated that SMEs should be strongly supported by the government, indicating a possible shift for a sector that has traditionally received relatively little direct government support.

Also, interestingly, the government is strongly encouraging entrepreneurship among university graduates as traditional industry and major companies face employment challenges in the current environment. Government statistics estimate that six million fresh graduates will enter the workforce this year, with over one million still jobless after graduating last year. This expanding group of young and educated job-seekers represents a real government concern.

2.2.2 Healthcare Reform

China's healthcare system is widely regarded as seriously ailing and represents a major source of complaints from the general public. Since China's initiation of major healthcare reform in 1997, persistent problems that continue to receive major attention from the public include inaccessibility to proper medical treatment, inadequate coverage, high costs of treatment and medications, underdeveloped hospital management systems, an unbalanced allocation of rural and urban medical resources and overall insufficient public expenditure.

The new and widely anticipated Healthcare Reform Plan aims to reinitiate reform of the healthcare industry. It underwent a protracted drafting process and sparked heated debate between various relevant parties, including hospitals, industry players and those representing the general public. Having received support from the State Council in January, it is undergoing final revisions and is expected to be officially released in the near future. The plan commits approximately USD 125 billion (RMB 850 billion) in total investment to healthcare over the next three years. It will likely separate the distribution of most drugs from hospital operations, make public hospitals non-profit oriented and increase the number of local level clinics, particularly in rural areas.

Industry observers note that the draft places significant focus on the public's increasing demand for medical drugs. Supply and demand issues are a key point of concern for industry players and manufacturers in particular. Given the complexity of these issues, the final drafting of this plan is still underway.

2.2.3 Social Security

Social security represents a major concern for the general public, according to various surveys conducted prior to the NPC and CPPCC sessions. China's social security system is insufficient for many employees in the private sector, migrant workers, the rural population and, needless to say, the unemployed. Key social security benefits, such as medical insurance, unemployment benefits and retirement pensions are unavailable to a significant proportion of China's population.

Still, against the backdrop of the current economic crisis, the government is deliberately not advancing significant changes to China's social security system, due to the major costs associated with doing so for China's 700+ million workers. Premier Wen did include a brief mention on the need to address social security, and the NPC announced that the drafting of a Social Security Law would be included on its 2009 legislation agenda. It is expected that the issuance of the law, which may take a long time to be finalized, will eventually help expand and improve social security coverage.

2.2.4 Affordable Housing

Housing also remains a hot topic and a source of widespread concern amongst the general public. Even with the current slump in the properties market, housing prices remain too high for most families, particularly in big cities. Despite the government's tight overall budget, the government is committing significant budget to subsidized housing, highlighting this as a clear priority.

2.3 Government and Politics

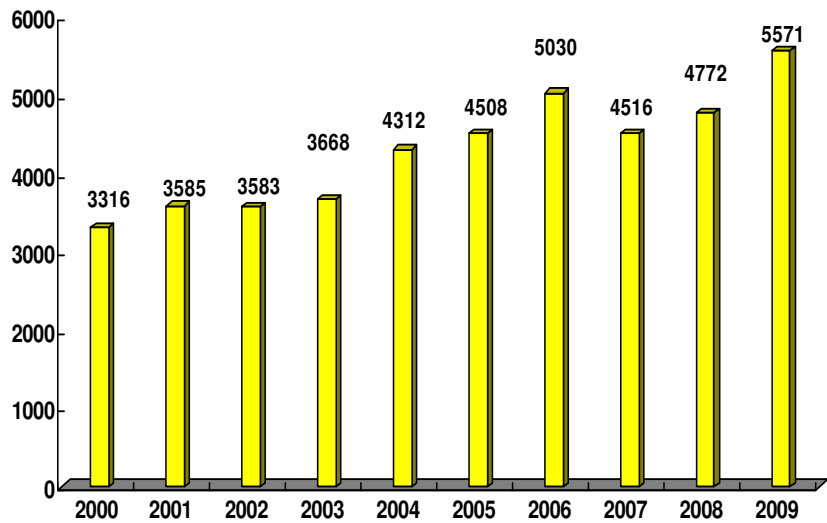
Of all the steps that the government is taking to advance government reform, China's anti-corruption initiative is the area in which the government most proactively responds to public calls. As reflected in Wen Jiabao's Government Work Report, the government will continue to make serious efforts in cracking down on corruption, a focus that is considered by many as more important than ever during China's economic recovery efforts.

The government openly promised transparency and committed itself again to strict inspection, with the establishment of 24 inspection groups composed of officials from various government ministries. In addition to these inspection groups and official NPC oversight, the government called upon the media and general public to help check persistent corruption.

In the latest revision made to the Criminal Law just before the NPC and CPPCC sessions, two remarkable provisions regarding corruption were also added. The first one stated that incumbent or former government officials will be held legally liable if their relatives or any other people with close relationships to them are involved in corruption. The other addition increases the legal punishment for government officials with unexplained sources of personal assets.

Transparency in policy making has been making gradual headway, and NPC Chairman Wu Bangguo has pledged that this will continue. The government is disclosing an increasing number of draft laws and regulations for public comment, both through the internet as well as directly with academia, trade associations, foreign chambers of commerce and even directly to key industry players. Foreign chambers of commerce have been playing an increasingly important advisory role in the making of key laws and regulations, including the Labor Contract Law and the Anti-Monopoly Law. This year, the government's legislation agenda will include a number of important laws and regulations that MNCs can directly or indirectly influence to reflect their interests.

Figure 4: Proposals Submitted to the CPPCC 2000-2009



Source: Chinese People's Political Consultative Conference

As shown in Figure 4, the number of proposals submitted this year by individual CPPCC delegates on a wide array of topics is significantly higher than those of previous years. This reflects more active participation in advising the government and is complemented by a matching increase in discussion and debate at these sessions. Although the significance of these developments should not be exaggerated, they do represent another gradual step towards greater government transparency.

Political reform is deliberately referred to as a separate issue from government reform by China's leaders. Despite acknowledging the need to improve the political system, China's government still defends its one party system. Chinese leaders claim that Chinese society is not ready for radical political reform, especially during a financial crisis. They maintain that political stability is not only essential for today's China, but also for the rest of the world.

China's second most senior official in the government hierarchy, NPC Chairman Wu Bangguo, emphasized in his NPC work report that China will not copy western democratic systems, will not adopt a three-branch system of government and will further enhance the rule of the Communist Party of China. Observers widely believe that Wu made this point in direct response to recent calls for political reform.

Thirty years into China's reform and opening up period, external observers widely note that China's political reform process lags far behind its economic reform process. It will be interesting to watch how the Communist Party of China's positioning evolves alongside a slowing economy.

2.4 Cultural Development and Education

The government aims to promote Chinese culture around the world and improve the cultural awareness and savvy of China's public. Premier Wen called for building a stronger cultural identity amongst the public, improving the cultural life of citizens, protecting cultural heritage, developing cultural industries, supporting mass sports and professional sports and improving basic education. Gaining a strong identity and cultural recognition on the global stage has also become a key cultural development theme. The Beijing 2008 Olympics represented a milestone push in support of this, and the government is trying to maintain its momentum via other platforms, including the World Expo 2010 Shanghai.

Cultural development also helps economic development. As China encourages its companies to 'go global', the need for them to understand foreign culture and customs has become an increasingly pressing issue. Local cultural issues often play a role in problems and failures in expanding into overseas markets. At the same time, the government recognizes that China needs to appear more culturally attractive to foreign investors, and not simply attract investment based on labor costs and other economic incentives. For MNCs operating in China, cultural adaptability will certainly remain important, including in internal communications and external PR activities, from stakeholder outreach activities to sponsorships and CSR efforts. MNCs are increasingly incorporating cultural events and platforms in their PR and branding strategies.

Indeed, culture-related industries are demonstrating steady growth in the current economic downturn and may be experiencing an actual boost from the poor financial environment. The government is currently looking to further increase growth in the industry, especially in the consumer-related areas of movies and arts. The government aims to industrialize culture-related industries and is encouraging innovation and entrepreneurship; this represents a significant shift from years past.

The government is also giving priority to the improvement of education at local levels, especially in underdeveloped rural areas. The stimulus package specifically aims to help improve education facilities and cultural development in rural areas. Education as a whole, and particularly free compulsory education, continues to be a government priority on the social agenda. The long-term insufficiencies in China's basic compulsory education, due in large part to a lack of government funds, have long been both a rural development problem as well as a problem for the development of a high quality workforce. Donations from charity organizations and corporate entities continue to help supplement the government's budget, although the scale of the remaining challenges is immense.

3. CONCLUSION

China is at a very interesting junction along its development path. The global financial crisis, its influence on the Chinese economy, and the corresponding actions being taken by the Chinese government are fueling major internal changes to China's business environment. The NPC and CPPCC proceedings underlined the fact that China is responding aggressively to the global financial crisis, ambitiously pursuing 8% GDP growth, while at the same time trying to bring greater transparency and efficiency in government. The gatherings also reaffirmed China's unwavering commitment to a one-party system that views stability and the alleviation of critical social issues as paramount. At the same time, and beyond the recent NPC and CPPCC sessions, China is playing an increasingly important role in global affairs, in the world economy and in major global frameworks established around issues from climate change to security.

For companies operating in China and those simply with a stake in China's response to the current economic crisis and a host of other issues being played out on the global stage, effective communications has never been as important as now. Communication and systems for in-depth monitoring are essential to understanding China's rapidly evolving industry, regulatory, social and political landscapes. Such understanding is the basic foundation for creating business development strategies that align with China's needs, priorities and initiatives and influence China's dynamic evolution.

The government's ongoing attention to social issues, for example, presents real opportunity for companies to align their corporate social responsibility (CSR) objectives with the government's social priorities. The government is strengthening CSR standards for companies in China, as evidenced by the State-owned Assets Supervision and Administration Commission's (SASAC's) CSR guidelines for SOEs and the Ministry of Commerce's (MOFCOM's) soon-to-be-finalized guidelines for FIEs. MNCs have opportunities to partner with local Chinese companies that are eager to learn CSR best practices. They also have opportunities to strengthen their 'advisor' roles with the Chinese government by contributing to the development of CSR standards. As the government's CSR-related expectations continue to rise and local Chinese companies catch up to internationally accepted CSR practices, this will increasingly represent an arena of soft competition, not only among MNCs but also with Chinese companies.

Beyond CSR, China's government is actively looking for help in addressing a broad array of issues, from job creation and the revitalization of major industries, to energy efficiency and climate change. Effective communication coupled with the development of informed and long-term government and public affairs strategies are essential not just to respond to the changing external environment and minimizing risk, but for creating real competitive advantage in the Chinese marketplace.

Hill & Knowlton China: Government & Public Affairs

The importance of an effective government & public affairs practice has never been as vital for companies operating in China as it is today as government responds to and shapes the accelerating evolution of China's socio-economic landscape.

Hill & Knowlton China's government & public affairs practice continues to set the standard for strategic and impact-driven work in China, connecting clients with the broad base of stakeholders essential to success in the market, shaping their agendas and influencing outcomes to key issues that matter most to business. As the first international public relations firm to enter China 25 years ago, Hill & Knowlton China is deeply rooted in the community and trusted by government decision makers and key non-governmental influencers. Our deep experience allows us to offer an unrivalled understanding of the local environment and decision making processes.

Leveraging this unique combination of international best practice and local experience, we strive to add value wherever most needed, from senior strategic counsel to flawless execution. Underpinning everything we do is our attention to in-depth intelligence gathering and analysis. Rigorous research in industry, regulatory, policy and government related areas enable us to develop strategies for our clients that influence critical policy and issue-specific developments, delivering competitive advantage.

Intelligence Gathering, Analysis and Strategic Counsel: Hill & Knowlton conducts in-depth industry, regulatory, policy and government research, monitoring and analysis on behalf of its clients. Thorough stakeholder and issue mapping services allow clients to develop best informed strategies that reflect local realities and unique insights. Hill & Knowlton anticipates trends and develops strategies to deliver competitive advantage and influence long-term policy, regulatory and issue-specific developments. Ongoing strategic counsel and recommendations on strategic adjustments help clients maintain this edge in the rapidly evolving external environment.

Government Relations: Through a combination of communication platforms and individual relationships, Hill & Knowlton helps clients establish institutional relationships with government decision makers and key influencers. Strong communication is critical, and Hill & Knowlton helps clients build and maintain levels of dialogue necessary for collaborative success in China's government and business environment.

Crisis Planning and Communications Training: As issues arise, and in times of crisis, Hill & Knowlton provides senior strategic counsel, developing timely and effective communication plans against key stakeholders. Proper engagement and clear communication, based on a full understanding of the latest developments, is essential to effectively managing critical issues.

Corporate Social Responsibility: Hill & Knowlton helps clients to develop and execute CSR plans that leverage their unique strengths. As local stakeholders increasingly look to companies for leadership in CSR areas, we help our clients to communicate their achievements and goals in this area to audiences across the country and around the world.

Going Global: Hill & Knowlton also leverages its global government & public affairs practice on behalf of Chinese clients, developing and refining their global business development strategies, and building their internal government & public affairs capabilities around the world.

For more information, visit www.hillandknowlton.com.cn

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