Go on, bet the farm

At a crucial gathering, China’s leader must push for bold change, particularly in the countryside

Two years after the death of Mao Zedong, it put the thirce-purged Deng Xiaoping at the helm, raised the importance of livelihoods above class struggle, loosened state controls and led to the opening of China to foreign trade and investment. In a nod to the left it still clung to the “people’s communes” in the countryside that had led to mass starvation under Mao; but with Deng in charge, they soon unravelled. The consequences affected a large chunk of humanity. Annual incomes were then $200 a head; today they are $6,000. For the rest of the world, everything the plenum accomplished is contained in the shorthand “China’s rise”.

On November 9th China’s party chief and state president, Xi Jinping, convenes another conclave in Beijing, this time the third plenum of the 18th central committee (such plenary sessions take place at least every year, whereas central committees, containing the country’s top 370-odd apparatchiks, are chosen at a five-yearly party congress, the latest in 2012). This meeting, at an army-run hotel in the capital, will be as secret as ever. As in 1978, it will be months or even years before the full import of the plenum becomes clear. But Mr Xi has been saying to foreign leaders that the coming session will be the most important for China since 1978, dropping hints of momentous change. It will certainly prove momentous if Mr Xi is radical in two areas that are crying out for reform: the state enterprises, with the financial system that underpins them; and the countryside, where farmers still lack clear rights to their land.

You say you want a revolution

Deng’s reforms—and further ones in 1993 that led to China’s joining the WTO—were powerful, but they have run their course. China no longer has boundless cheap labour. Mighty but inefficient state enterprises stifle competition and hog financial resources. A vast misallocation of capital disadvantages private business and ordinary savers.

This imperils China’s robust economic growth. That matters to a party whose legitimacy since 1978 has rested on delivering the goods. So when Mr Xi talks of a “master plan” for reform and of a “profound revolution”, he is probably serious. He and the reformist prime minister, Li Keqiang, have assembled an impressive bunch of market-oriented advisers (see page 49). Further, having crushed the forces of Bo Xilai, another (leftist) aspirant to power now languishing in jail, Mr Xi appears to have more authority than any leader since Deng.

When it comes to the state-owned enterprises (SOEs), privatisation is regrettably not on the agenda. Still, Mr Xi should make them more commercial and accountable. Best would be to hand ownership to the National Social Security Fund, set up to serve a rapidly ageing society. The fund could then appoint directors to govern the SOEs in the interests of future pensioners. He should also force greater competition by cutting SOEs’ preferential access to cheap finance. As well as cutting the SOEs’ perks, Mr Xi should take further steps to liberalise interest rates, exchange rates and capital flows. This would pave the way for China’s currency eventually to become fully convertible—vital if it is to be a mature economic power.

The second area for profound change—the countryside—is, in the long run, even more important. This is partly because just under half of China’s 1.4 billion people still live there. But the immediate problem is that lack of rural reform is connected to a crisis in local-government financing. The central government has devolved ever more spending responsibilities to local governments, especially after a huge fiscal stimulus ordered in 2008 in the wake of the global financial crisis. Yet they have meagre means of raising revenues. Hence the need for a property tax to create a stable source of revenue.

For too long, local party bosses have relied for their finances—and their personal enrichment—on requisitioning farmers’ land and selling it to developers. The beneficial effects (such as a surge of country folk seeking a better life in the cities) are threatened by the harmful ones. Migrant workers in the cities are treated as second-class citizens, working in the least-safe jobs and denied proper housing, schooling and health care. Farmers who stay on the land remain at the mercy of local party tyrants (see pages 25-27). Inadequate compensation and the lack of clear land title are farmers’ biggest gripe.

Playing to the provinces

Mr Xi should give China’s peasants the freedoms the Communists supposedly fought a revolution for. Land reforms following the 1978 plenum freed peasants from the communes but denied them other rights. They cannot sell their fields or, except to fellow villagers, their homes. They cannot mortgage land or home. In contrast, millions of registered city dwellers have become proud homeowners thanks to the sweeping privatisation of urban housing in the late 1990s.

Giving farmers full rights to their land and housing would have big positive effects. More of them would move to the city—especially if the restrictions on urban household registration were also abolished—boosting the hopes of shifting an investment-heavy economy towards consumption. Those who stay behind would enjoy the relative freedom from party interference in their daily lives that city dwellers do.

It would be a deep and popular revolution, but can Mr Xi face down the opposition? In 1978 Deng overcame the champions of the command economy by turning the provinces into champions of economic growth. Decentralisation is responsible for some of today’s local problems, including the fiscal mess. Thus Mr Xi cannot enlist the provinces for this revolution without absolving them of their debts once and for all. Even then, today’s reactionaries are powerful, and include such beneficiaries of the system as SOE bosses and the corrupt members of many of the most powerful Communist families in the land. But once the provinces are on board, Mr Xi must, if he and his plenum are not to go down in history for all the wrong reasons.
Changing the economy

The long weekend

**HONG KONG**

China's leaders will soon reveal their ambitions for economic reform

RUNNING the world's biggest country requires sacrifice. For the Communist Party's top 376 officials on its central committee, the sacrifice includes the occasional weekend. From Saturday November 9th until the following Tuesday, they will gather in Beijing for the third time since Xi Jinping became head of the party nearly a year ago. The "third plenum", as this meeting will be called, is the new leadership's chance to lay out its stall on economic reform. In the past similar gatherings have shaken the world. The third plenum in 1978, for example, sealed Deng Xiaoping's authority over the party, allowing his vision of "reform and opening up" to prevail. Another third plenum, in 1993, set the stage for a ruthless shake-out of loss-making state-owned enterprises (SOEs).

If the past provides the inspiration for ambitious reform, the present furnishes the compelling need for it. In recent years China's growth has slowed significantly to under 8%—and were it not for a timely fiscal stimulus would be slower still. Some of the slowdown is inevitable, the consequence of a diminishing technological gap with the rest of the world and a declining working-age population. But two other macroeconomic trends are causing concern. The investment spending sustaining China's growth appears to be yielding sharply lower returns. At the same time, credit is growing faster than GDP (see chart 1). It suggests that people are borrowing to buy assets, particularly land and property. The more these assets appreciate, the more people borrow.

Will Mr Xi rise to the occasion? He has done nothing to downplay expectations. As the son of an early revolutionary leader, he seems more comfortable in power than his predecessor, Hu Jintao, who ran a disapproving third plenum ten years ago. He has already imposed his style on the presidency, dispensing with some of the pomp and extravagance that used to attend the position. Perhaps, like aristocrats everywhere, he feels free to break with established practices because it was people like him who established them.

In taking a keen interest in economic reform, Mr Xi has encroached on the formal responsibilities of the prime minister, Li Keqiang, who oversees the economy. This is not unprecedented: Jiang Zemin, president from 1993 to 2003, also busied himself with economic affairs. Helen Qiao of Morgan Stanley points out. It is also potentially a good sign. Both the president and the prime minister share similar views about reform. By engaging in economic matters, Mr Xi is presumably backing his prime minister rather sideling him.

Reformers sit throughout the government. Zhou Xiaochuan, who helped clean up the banks in Mr Jiang's time, has been governor of the central bank for a decade. From there he can oversee the liberalisation of interest rates, exchange rates and capital flows. The finance ministry is now headed by Lou Jiwei, another accomplished technocrat who previously ran the China Investment Corporation, the country's sovereign-wealth fund. Under Mr Ji, he helped reclaim a bigger share of the country's fiscal revenues for the central government. Under Mr Xi he may have to revisit that fiscal settlement, giving a bigger share back to local governments. Even Wang Qishan, a tough-minded financial expert who does not have an economic brief in this government, may yet exert a powerful if indirect influence on reform. As head of anti-corruption efforts, he is an intimidating figure for any compromised SOE boss hoping to obstruct progress.

The road map Mr Xi will submit to the third plenum has been months in the making. It draws on the advice of China's ministries and the wider network of official research institutes and think-tanks. To knit it together, Mr Xi has appointed Liu He, a thoughtful, reform-minded policy adviser who was educated at Harvard's Kennedy School and whom Cheng Li of the Brookings Institution once compared to Larry Summers, the brilliant academic who be-
came Barack Obama’s economic guru. As a technocrat, Mr Liu has no power to impose his own ideas. But in picking him, Mr Xi clearly endorses some of the things he stands for.

Mr Liu used to work for the Development Research Centre (DRC), an official think-tank serving China’s cabinet. He had a hand in the “China 2030” report published last year by the DRC and the World Bank, which detailed the reforms China would need over the next two decades. In recent days China’s media has been abuzz with another DRC reform plan, known as the “383” plan, which is equally ambitious. It sets out three overarching reform principles (“effective markets require effective states and vice versa” is one), no fewer than eight reform priorities (cutting red tape, breaking up monopolies, reforming land ownership, liberalising finance, reforming the public finances, reforming state-owned enterprises, promoting innovation and opening up to foreign investment) and three broad strategies for achieving them.

The 383 plan shows that China’s government has its own in-house advocates of liberalisation. It is not only outsiders (let alone just foreigners) who champion the cause of sweeping economic reform. However, the DRC is free to espouse what is desirable without much concern for political feasibility. Mr Liu no longer enjoys that luxury. His plan may echo the 383 plan’s opening refrain that the state and the market must evolve together. But how much of the middle eight will make it into the plenum document is unclear.

The central committee can be expected to endorse the government’s efforts to cut red tape. It will promise to spend more on pensions, health care and affordable housing. It may also raise taxes on natural resources and further liberalise electricity prices. But it is unlikely to take on the fiscal and SOE reforms that are necessary to redress the gross misallocation of capital.

Fiscal reform is difficult because it requires the central and local governments to renegotiate the division of revenues and responsibilities, says Shen Jianguang of Mizuho, a Japanese bank. Local-government outlays, especially at the county level, run far ahead of local revenues (see chart 2). This spending is also often wasteful. Local governments scramble to promote industrial activity rather than public amenities, poaching trade and investment from their neighbours by duplicating whatever worked next door.

Both problems would be eased by an annual tax on the market value of properties. It would provide a stable source of revenues for local governments, helping to bridge the gap between their receipts and outlays. It would also encourage local governments to invest in public goods, such as clean air or better drainage, that raise the value of properties, thereby increasing the tax base. Despite its theoretical appeal, such a tax does, however, pose some practical difficulties, including the need for up-to-date registers of ownership and credible calculations of a property’s value. Overcoming those obstacles will serve as one test of Mr Xi’s reform credentials.

State enterprises are another source of wasteful investment. After the 1993 plenum, thousands of loss-making SOEs were sold, scrapped or merged, resulting in about 40m people losing their jobs. But in recent years, the retreat of the SOEs has ground to a halt (see chart 3).

Not even the DRC envisages outright privatisation of the SOEs. Its 383 plan looks instead to Singapore’s Temasek, a state-owned holding company, as a potential model. The state could be a patient, long-term investor in enterprises, seeking to maximise the value of its holdings. Xiao Geng of the Fung Global Institute in Hong Kong advocates that the government’s stake in the SOEs should be held by the National Social Security Fund, which was set up to plug the gaps in China’s pensions.

The SOEs shuttered in the 1990s were loss-making drains on the exchequer. Many of the remaining SOEs, especially those owned by the central government, are profitable, however. That makes them far more difficult to cull: they are sacred cows because they are cash cows.

Unfortunately the SOEs’ nominal owner does not greatly benefit. The SOEs pay too little in dividends, and what they pay is collected not by the finance ministry but by the State-owned Assets Supervision and Administration Commission (SASAC), which oversees them. It then ploughs these earnings back into the SOEs under its purview. Another test for Mr Xi, therefore, is dividend policy. He will pass if SOEs are required to pay higher dividends and to pay them not to SASAC but to the central government’s coffers.

Given the obstacles they face in improving SOEs and local public finances, China’s budding reformers will press ahead where they can, in the hope that half-measures build momentum to finish the job. In some cases, this strategy may work. In allowing shadow banks to proliferate, for example, China’s liberalisers have created pressure for interest-rate deregulation. Until formal banks are allowed to raise the rates they pay on deposits, they will lose customers to lightly regulated alternatives offering higher yields.

Yet there are potential dangers to this “skewed reform”, as Louis Kuijs of the Royal Bank of Scotland puts it. Were China, for example, to liberalise interest rates and capital flows without removing any of the SOEs’ privileges, it might find that finance simply flows more freely to the same firms that already gobbles up more than their fair share. Even commercial lenders, able to price risk and set interest rates freely, would be keener to lend to big firms that dominate their markets and can count on the state should they ever get into trouble.

China’s leaders set great store by gradualism. Even the momentous 1978 plenum changed the country by increments in the following months and years. But gradualism is not the same as inertia. It has been many years since the last big changes. If China’s leaders wait another five or ten years to renew the momentum of reform, the consequences will take more than a long weekend to fix.
A world to turn upside down

MORTAGING a village home is a sensitive issue in China. A nervous local official has warned residents of Gumian, a small farming community set amid hills and paddies in Guangdong province, that they risk leaking state secrets if they talk to a foreign reporter about the new borrowing scheme that lets them make use of the value of their houses. They talk anyway; they are excited by what is going on.

Urban land in China is owned by the state, and in the 1990s the state allowed a flourishing property market to develop in the cities. That went on to become a colossal engine of economic growth. But rural land, though no longer farmed collectively, as it was in Mao’s disastrous “people’s communes”, has stayed under collective ownership overseen by local party bosses. Farmers are not allowed to buy or sell the land they work or the homes they live in. That hobbles the rural economy, and the opportunities of the farmers who have migrated to the cities but live as second-class citizens there.

Hence the importance of experiments like those in Gumian. Cautious and piecemeal, they have been going on for years. Some are ripe for scaling up. Handled correctly, such an expansion could become a centrepiece of Xi Jinping’s rule.

On October 7th Mr Xi said the government was drawing up a “master plan” for not just more reform, but a “profound revolution”. Such talk is part of the preparations for a plenum of the Communist Party’s Central Committee which will begin on November 9th. It is the third such meeting since Mr Xi came to power; because the first two plenums of a party chief’s term are given over largely to housekeeping matters, including party and government appointments, third plenums are the ones to watch.

And Mr Xi is marking this one out as particularly important. In private conversations with Western leaders he has been comparing the event to the third plenum that, in 1978, saw Deng Xiaoping’s emergence as China’s new strongman after the death of Mao two years earlier, and set the stage for the demise of the people’s communes. Indeed “profound revolution” is a deliberate echo of a phrase of Deng’s.

Air cover for ground manoeuvres

Mr Xi wants to be seen as a new strongman of similar calibre, one unafraid to take on big targets—as with his sweeping campaign against corruption—and willing to tear down the huge remaining barriers to China’s reincarnation as a market economy. How much of this is braggadocio remains to be seen. But there is some evidence that the semi-paralysed market for rural land—one of the biggest of those remaining barriers—is becoming a priority.

In August a state-controlled newspaper said that experiments in the trading of rural construction land were about to be launched around the country. The report, which was later played down by the party, caused quite a stir. Caixin, a Beijing magazine, said the excitement was a sign that the “pent-up force [of land reform] was waiting to explode”.

Although it will surely be discussed, land reform will not be the focus of the plenum: officials have indicated that, unusually, the party meeting is going to cover the whole spectrum of reform-related issues, rather than dwell on a single area. But the details of what is discussed are not the key to understanding the plenum. What matters is unpicking the carefully crafted and coded pronouncements that ensue, designed—as Stephen Green of Standard Chartered, a British bank, puts it—to provide “air cover” for policies that will be unveiled later. After all, the 1978 plenum said that it was endorsing Mao’s communes; but the nods and winks of the leaders gathered there encouraged reforms to spread across the country anyway.

The policies for which this plenum will provide cover are going to reflect the party’s belief that China needs to change the way it is developing. The growth model driven by investment which yielded so much in past decades offers diminishing returns; it needs to be replaced by one fuelled in large part by productivity improvements and consumer spending. This analysis will be used to support a series of economic measures, from liberalising in-
holders of urban hukou. They are thus a huge potential source of spending. But for this potential to be realised, they need a way to sell up in the countryside.

Though now much criticised by Chinese economic reformers, Hu Jintao, Mr Xi’s predecessor, paved the way for some level of rural land reform. A plenum in 2008, also the third in a cycle, upheld the Maoist notion of collective ownership of rural land—but at the same time called for the “gradual” establishment of a “unified urban and rural market” for construction land, which includes land used for rural housing and factories. And the plenum declared that individual farmers’ rights to farmland, hitherto restrained by investment-inhibiting 30-year leases, could be extended indefinitely. Lawmakers have been arguing ever since over revisions to the all-important Land Administration Law that would put reforms into place. But bickering in the capital has not put a stop to tinkering in the provinces.

The past five years have seen widespread experiments with rural land rights, such as the dabbling with mortgage loans in Guimian. Caution has been the watchword, even in Guangdong, a province that has been used for economic experimentation since Deng’s day. (Xi Zhongxun, Mr Xi’s father, was a senior official there in the crucial years after 1978.) The mortgages in Guimian, for example, are only available to pay for the construction of houses in the same village: no heading off to the city with a sackload of cash. Liu Hongzhi, who oversees the scheme, quotes a famous phrase often attributed to Deng, though in fact coined by a colleague: “We are crossing the river by feeling the stones.”

Dozens of Guimian’s households have taken advantage of the loans to help them build five- or six-storey houses (pictures). The need for the buildings, and their scale, are due to the bullet-train track recently laid down straight through the village. Compensation from the railway for the land taken and housing demolished in the process paid for much of the building; the hope that a new station will make renting out rooms a nice little earner accounts for the size of the houses.

At a communal feast which accompanied the completion of one of the houses, villagers undeterred by the state-secrets obsessed official explained that they had borrowed less than a tenth of their houses’ cost. But borrowing the extra bit made a lot of sense if it got them extra rooms, as the terms—a fixed interest rate of 6%, with repayment due in five years—were deemed easy. Mr Liu thinks it highly unlikely that anyone will default: “It’s impossible not to be able to return the money,” he says. This is probably just as well. What would be done if someone actually did default is still not entirely clear.

Chongqing, a south-western region of some 30m people, began a similar scheme allowing farmers to mortgage their homes in 2010 when run by Bo Xilai, the party chief recently sentenced to life in prison for corruption and abuse of power. Since then the southern provinces of Guizhou and Yunnan have also launched similar experiments. Cui Zhiyuan of Tsinghua University, a former adviser to the Chongqing government, says the mortgage loans are small and farmers “extremely cautious” borrowers.
ers. The ideological resolve of party officials has yet to be tested by foreclosures.

Remarkably, in a country that embraces so many other aspects of capitalism, ideology still matters in the countryside. The notion of collective ownership of rural land is enshrined in the constitution and officials are loth even to hint that it might be changed. Some of them see it as a badge of the "socialism with Chinese characteristics" that the party says it upholds.

Local governments worry that clearer property rights for farmers would make it far more difficult to appropriate land for building infrastructure, factories and urban housing. Selling requisitioned land to developers is a critical source of local-government revenue, and land serves as collateral for local governments' borrowing (another big headache for Mr Xi: their debt has been spiralling). Ideology aside, these governments resist any notion of changing a system that has done them so well.

For all such concerns, though, the reforms launched by Mr Hu have persisted and spread. Chongqing and Chengdu, the capital of the neighbouring province of Sichuan, have been trailblazers. Soon after Mr Hu's third plenum in 2008 they launched land-trading schemes that aimed to unlock the value of rural land and speed up urbanisation. These let developers bid for land certificates, or di pian, created by the conversion of rural construction-land into farmland. They could then use the di pian to build on an equivalent area of rural land in a place approved for urban development. The result, in theory, would be no net loss of farmland, and an opportunity for farmers in areas developers do not care for to cash in on the insatiable demand for urban land. Of the di pian selling price, 85% goes to the farmers themselves: an unusual recognition, as Mr Cui points out, that farmers should share the development value of their land. Chinese media say the city of Guangzhou, in Guangdong, is planning to launch di pian trading, too.

In August the Chinese press reported that Guangdong had circulated draft regulations that would allow villagers in the province to buy houses from residents of other villages in the same township, and take over the rights to the land underneath. If the rules are adopted, China would have taken at least a baby step towards creating a market for rural housing. In the coastal province of Zhejiang, the city of Wenzhou (another hotbed of economic reform) has gone further. In October it set up a “Rural Property Rights Service Centre”, a clearing house that in theory allows urban residents to buy houses from villagers within the same county. In practice, say Chinese media, potential buyers still worry that, without a revised Land Administration Law, such rule bending is too risky.

In other places, though, plenty of people are taking risks. Near suburbs, many farmers build houses on their land that they sell to city dwellers who hope the law will never be enforced. By some estimates one in five homes used by Beijing urbanites is technically on village land, and in Shenzhen in Guangdong the proportion may be nearly half. It is a vast legal mess, although many farmers in peri-urban areas have benefited. And it does nothing for those leaving villages far from the cities, where half-ruined, derelict houses are becoming an increasingly common sight.

This earth divided
Mr Xi has yet to show signs of tackling the land law directly. But soon after taking over as party chief he took an important step towards easing further experiments and reform. A policy document on rural issues adopted in December 2012 and made public a month later said that by the end of 2017 farmers should be given certificates showing exactly where their fields lie, and that similar certificates for their housing land should be handed out “as soon as possible”. It is going to be a laborious task, with much squabbling and much recourse to satellite-aided surveying. But without demarcations, a well-ordered land market cannot take shape. And local media now frequently report the handing over of housing deeds to happy farmers who have never held such things before. Some of Guanxi’s villagers, flush with railway cash, say that they wanted the deeds that came with the mortgages far more than they needed the money itself.

That desire reflects one of the key attractions of land reform—and one of the reasons that Mr Xi may find it difficult. Providing farmers with deeds and rights to dispose of them, will weaken the often tyrannical grip on their lives that control over land gives to grassroots party organisations. Those living in the countryside will begin to enjoy the relative freedom from party interference in their daily lives that city dwellers began to experience in the late 1990s, when the housing controlled by tens of thousands of Soviets was handed over to their occupants. “Farmers cannot be said to enjoy human rights unless they enjoy property rights,” says Sun Dawu, the founder of a large agribusiness in the northern province of Hebei.

Political change is not something Mr Xi would necessarily wish to hasten, or to be seen hastening. In the build-up to the plenum he has been covering his reformist economic tracks by paying startlingly anachronistic homage to Mao and mounting an unusually harsh crackdown on dissent and wayward online discourse. Officials have been made to watch a documentary about the collapse of the Soviet Union as a warning against Gorbachev-like fantasies. If he thinks an urgent need for the economic benefits of land outweighs the concerns about the empowerment of peasants at the expense of apparatchiks, he may still be cautious about being quite that explicit. But he does not necessarily need to be any clearer, as long as the message is understood.

Around the time that the 1978 plenum was talking of its support for people’s communes, a group of impoverished farmers in Anhui province secretly decided to divide up their village farmland into privately managed plots. Eventually, in 1981, the party gave its explicit blessing to the “household responsibility system”, as it called this once sacrilegious approach to farming. By then nearly half of villages were practising it. The following year work officially began on dismantling the communes. Far-reaching reform had ensued from the plenum, but from the bottom up. The same could happen again.