China’s 12th Five-Year Plan
by Fan Gang & HE Liping

What is the Five-Year Plan?
The Five Year Plan is a strategic blueprint issued by the Chinese government providing a closely followed framework of economic policies and priorities.

Why is the Five-Year Plan Important?
The implementation of previous Five Year Plans have proven to be watershed events which have significantly altered the direction of China’s economy. The 12th Five Year Plan provides every indication that the effects will be just as dramatic.

What is the 12th Five Year Plan?
The Chinese Government’s 12th Five Year Plan was implemented to focus on transforming China from an export driven economy to one built upon consumer driven growth. In order to bring this change about the Five Year Plan has identified key industries to target for development and support.

About the Author:
Dr. Fan Gang

Dr. Fan Gang is one of China’s most influential economists and a respected adviser to the country’s leadership on economic reform and strategic development. He is an expert in the macroeconomics of long-term development, international trade and currency, foreign relations and China’s regional integration within Asia. He speaks on China’s financial risk and financial systems reform, foreign exchange regimes and revaluation, and on China’s economic reform and globalization.

Based in Beijing, Dr. Fan Gang is director of the National Economic Research Institute (NERI), Chairman of the China Reform Foundation and President of the China Development Institute. He also serves as China local partner for GlobalSource Partners, an exclusive team of emerging market consultants that includes some of the brightest minds in the emerging market world.

Dr. Fan Gang previously served as a member of the Monetary Policy Committee of the People’s Bank of China. He is currently a member of the Advisory Committee of the Ministry of Labor and Social Security of China, and serves as International Advisor to the Center for International Development at Harvard University.

Dr. Fan Gang has been a Fellow of the World Economic Forum since 1995, a Fellow of the Chinese Economist Society (USA) since 1993 and is a consultant to the World Bank, UNDP, ESCAP and to the OECD. He was awarded the title “Global Leader for Tomorrow” by the World Economic Forum in Davos (1995) and has been ranked among the “World’s Top 100 Public Intellectuals” by Foreign Policy and Prospect magazines (2008).

Dr. FAN Gang earned his Ph.D. in economics at the Graduate School of the Chinese Academy of Social Sciences, and has received honorary doctoral degrees from University of l’Auvergne, France, in 2004, and Royal Road University of Canada in 2011.
History of the Five Year Plans

The People’s Republic of China, shortly after its establishment in 1949, decided to adopt a Soviet-styled, socialistic, centrally planned system. A five-year plan was then thought to be the best catalyst for and calibration of centralized decision-making and national resource mobilization for a medium-term period. In 1952, a special central government body was established in charge of the formulation and implementation of a five-year plan. The agency was called the PRC State Planning Commission, directly under the State Council. The head of the SPC was usually a vice premier or an equivalent. At the end of 1952 the first Five-Year Plan, for 1953-1957, was endorsed and rigorously implemented during the period.

The first FYP was almost entirely industry-focused, and in particular, largely oriented toward the establishment of the defense industry. More than 100 major heavy industry complexes and factories were constructed throughout the country, many of which received Russian aid and technical assistance.

The first FYP became the milestone of the young People’s Republic’s industrial development, and the government often praised it for its role in laying the foundation of modern Chinese industrialization.

As China under Mao gradually distanced itself from its alliance with Russia and began to seek its own development in a more alternative, independent, way, subsequent FYPs differed from their predecessor in content and methodology. The second five-year plan was loosely formulated for 1958-1962, but 1958 and 1959 were the years of the so-called “Great Leap Forward”, which was Chairman Mao’s inspiration and served effectively as a disturbance to the original second FYP.

The failures of the “Great Leap Forward” and the natural disasters of the early 1960s prompted the Chinese government to retreat from its ambitions and to conduct a major economic adjustment in 1963-1965. After that, China resumed its FYPs and subsequently introduced three more: the third FYP, for 1966-1970; the fourth FYP, for 1971-1975; and the fifth FYP, for 1976-1980. But all these FYPs were also greatly disturbed or even interrupted by the “Great Cultural Revolution” (1966-1976), another major political campaign initiated by Chairman Mao.

From the early 1980s, the Chinese government tried to treat the FYP more seriously than before, and intended to extend its content to issues such as social development. However, these efforts were complicated by Deng Xiaoping’s reform initiatives, which included granting more autonomy and freedom to enterprises and regional governments. This was most apparent in the four consecutive FYP periods: the sixth FYP, for 1981-1985; the seventh, for 1986-1990; the eighth, for 1991-1995; and the ninth, for 1996-2000.

Since the mid-1990s, the Chinese government has decided to move toward a “socialist market economy” through which indicative plans are to replace the older, compulsory ones. Economic relations between the central and regional governments have also been reshaped, with the former regaining both power and leverage.

The three most recent FYPs have been formulated in this manner. The tenth FYP, for 2001-2005, first called for “industrial restructuring” or “making an adjustment in economic structures”, and the general spirit has been reiterated in the eleventh FYP, for 2006-2010, and twelfth FYP, for 2011-2015.

Also notable is that beginning with the eleventh FYP, its Chinese name has changed from “ji-hua” (plan) to “gui-hua” (program or projection) in order to highlight its indicative nature.

Both the eleventh and twelfth FYPs are the result of comprehensive internal consultation among virtually all government bodies, at the national and provincial levels. The content has broadened vastly, and the development objectives have been expanded on all fronts.
The Implementation of the Five-Year Plan

The formation of an FYP is a year-long process, consisting of multiple rounds of intensive and extensive discussions and consultation. The process includes virtually all government bodies at the national and provincial levels, and all industries, along with input from intellectuals of various backgrounds. The content of the recent FYPs has expanded vastly, and the objectives for the development they focus on have been raised on all fronts. However, while there are still a few "administrative targets" that must be met during the five-year period through rigorous policy means, such as "energy intensity" or "pollution reduction", most quantitative targets are that of forecast or expectations for reference. In some sense, today’s FYP in China is similar to Japan’s plans in the 1970s and 1980s: it is more a consensus building process and national target-setting plan for future development than an executively imposed work load allocation. Therefore, the requirement of the government is focused more on providing the means and policies that will enable the economy and society to achieve those targets.

It is important to understand the current nature of the Plan, how it is formulated and implemented, as well as the differences between the Plan and the final results.

As a country with a strong tradition of industrial policy-setting, the Chinese government holds a number of policy instruments in pursuing the goals of the FYP. These include fiscal resource allocation, taxation, price regulation and control, market entry control, credit support, subsidies and government procurement, among others. In implementing the targets of the 12th FYP, several ministry-level bodies are playing decisive roles.

State Development and Reform Commission

The SDRC is sometimes called the National Development and Reform Commission (NDRC). It is the successor to the State Planning Commission and is a result of a ministerial reshuffle in 2003. The body has overwhelming power to approval large-scale investment projects and has authority over price regulation in major areas.

Ministry of Industry and Information Technology

Previously China had many industrial ministries in various sectors. They were eventually merged into one, the MIIT, in 2008. This body is responsible for industry entry, industrial standards, new technology promotion, and regulation of corporate M&A in industry, among other functions.

Ministry of Commerce

The MOC is responsible for all policy affairs in domestic commerce and foreign trade, as well as China’s domestic and external direct investment. It has a role in encouraging imports of advanced foreign equipment and technology.

Ministry of Science and Technology

The ministry is mandated to promote technological progress and innovation in China. It performs a major role in formulating policy measures in science and technology, and runs various R&D funds and investment funds in the area.

State-owned Asset Supervision and Administration Commission

The SASAC was created in 2003 and currently supervises and administers more than 100 of the largest Chinese state-owned non-financial corporations. The agency has been keen to promote the rapid growth and restructuring of these SOEs.

In addition to the above-mentioned ministries, many other ministries and government departments are working in accordance with the requirements of China’s industrial policy as well as the 12th FYP. Moreover, many provincial and municipal governments have been eager to promote industrial development in areas that have been highlighted
in the 12th FYP book. They often provide concessions to business developers and investors in their jurisdictions.

China’s new leadership is determined to pursue further reform, and aims to restructure and rebalance the Chinese economy. In order to boost domestic consumption, new policy initiatives are meant to reduce the social barriers hindering people from moving into cities and towns from rural areas, to get them better access to social and public services, and to increase their social insurance coverage. Moreover, the government would like to take policy measures to help raise the pace of personal income growth – the so-called “income double target” for the next 10 years, and to cut surcharges on government services in various areas. A few steps were taken to cut taxes for the lowest income groups in recent years. Furthermore, local governments have been increasing the minimum wage standard. However, as the government no longer has the right to set primary income, it seems there’s not much it can do about increasing household income/consumption, except to support economic growth and job creation. However, as household consumption only accounts for about 37% of GDP (government consumption accounts for 14% of GDP, and national saving 49%, most of which goes into domestic investment), the potential of the domestic market for consumer goods and services is obviously huge.

Goals of the 12th Five-Year Plan

In March 2011, the People’s National Congress approved the compendium of the 12th Five-Year Plan for 2011-2015 presented by the State Council. The compendium highlights major objectives for China’s economic and social development in seven areas and puts forward various exact targets. Some are soft targets, mainly for policy reference and therefore, not legally constraining, while others are hard targets that will require policy intervention if and when actual performance is deemed outside the target.

Economic Growth and Macroeconomic Stability

China’s gross domestic product is to grow 7% per annum in real terms during 2011-2015, while total employment in cities and towns is expected to increase steadily, and CPI inflation is maintained at a reasonably low level. The government should also aim at reducing China’s external imbalances.

Economic Restructuring

China should see its household consumption ratio (consumer spending as a proportion to GDP) rise during the five-year period. Major breakthroughs should be made in strategic new industries. The share of the service sector in China’s GDP should rise 4 percentage points, to 47% in 2015, and that of people living in cities and towns as a proportion of the total population should also rise 4 percentage points, to 51.5% in 2015.

Development in Science and Education

The nine-year compulsory education scheme should continue to be monitored closely and rise in quality. Spending on research and development as a proportion of GDP should reach 2.2%. The number of patent registrations should increase 1.6% per annum over the five-year period.

Resource Saving and Environmental Protection

A number of hard targets are proposed in this area. The total 121.2 million hectares of land for cultivation should by no means be reduced. Water usage per unit of industrial value added should fall 30%. The coefficient of effective water usage in agricultural irrigation should rise to 0.53. Non-fossil energy in total primary energy consumption should reach 11.4%. Energy consumption per unit of GDP should fall 16%. CO2 emission per unit of GDP should fall 17%. Pollutants of all major types should be reduced considerably. The forestry coverage ratio should be raised to 21.66%, with the volume of trees higher by 600 million cubic meters.
Improvement of Living Standards

China should continue to control its population growth, with the total population not exceeding 1.39 billion during the five years. Mixed life expectancy should rise by one year, to 74.5 nationally. Disposable income per capita in urban households and net income per capita in rural households should grow at least 7% per annum. The new social pension fund system should cover all rural areas nationally. The number of people in urban areas participating in basic pension fund systems should reach 357 million. Thirty-six (36) million units of social housing will be built in cities and towns. The number of people in poverty should decline considerably.

Social Development

Basic public services should be made more accessible to all people, and peoples’ rights and interests should be protected and safeguarded concretely. Cultural establishments and pursuits should be promoted with more vigor, and the importance of cultural industries in China’s GDP should rise considerably.

Maintaining Direction in Reform and Economic Openness

China must continue to pursue further reforms in major areas such as public finance and taxation, financial services, factor prices, and monopolistic sectors. The government should produce changes in its systems in order to raise credibility and efficiency. China should continue to increase its external openness.

In addition, the 12th FYP suggests that the service sector as a proportion of China’s GDP will rise from 42% in 2010 to 47% in 2015, and that the percentage of the population living in cities and towns will rise from 47.5% to 51.5%.

In the first half of 2013, services reached 45.3% of GDP, indicating that the pace of the growth has been well in line with the 12th FYP.

The urbanization ratio in 2010 was just about 50%. The target is to increase this ratio by about 1% per year, which would require that additional new jobs be created in cities and towns.

The 12th FYP’s “Focus Industries”

The 12th FYP is extremely comprehensive and ambitious, calling for further development and modernization in all sectors of the Chinese economy. From agriculture to manufacturing, from mining to transportation systems, from education to medical care, and from banking to insurance, the 12th FYP lays out every detail of the targets for upgrades and advancement during the next five years.

In particular, China has achieved tremendous progress in its industrial development in the recent past and is the world’s largest producer of many major industrial products. The 12th FYP continues to emphasize industrial development in China, seeking to maintain and strengthen China’s international competitiveness in industry through the future.

The following nine industries are identified as “Key Industries” in the 12th FYP book. As they are already well developed, policy-makers’ emphasis is to provide for restructuring and further technological enhancement.

THE NINE KEY MANUFACTURING INDUSTRIES

1.) Equipment making

China should enhance its ability to produce sophisticated and automated equipment sets, further raising its ability to initiate improvements and innovation.

2.) Shipbuilding

The industry should improve capacity and follow international standards, transforming its shipbuilding technology as well as its ability to produce highly value-added accessories.

3.) Automobiles

The priority is to enhance China’s independent capacity to manufacture automobiles, realizing domestic production of all key parts and parcels, and producing vehicles that are more energy efficient, greener, and safer.
4.) Metal making and Building Materials
China should stop seeking capacity expansion and instead pursue quality enhancement. More investment in R&D should be undertaken in order to enhance efficiency and reduce emissions.

5.) Petrochemicals
Leading corporations in the sector should invest in and build a handful of large-scale integrated petrochemical complexes, raising the quality of products and producing high-end new products.

6.) Textiles and Light industry
The country needs to upgrade its equipment in textiles and light industry, especially in food safety, raising its standards and technical capacity. Toxic elements have been frequently found in domestic dairy farm products in recent years, and the industry is suffering from a bad reputation.

7.) Packaging and Paper-making Industry
Equipment, materials and techniques in the industry should all be upgraded and developed. China should aim to produce high-value packaged products.

8.) Electronic information
R&D capacity should be increased, with stronger domestic development of basic technology.

9.) Construction
Firms in the industry should continue to replace obsolete techniques with new ones, and endeavor to make the industry greener.

SEVEN STRATEGIC NEW INDUSTRIES
In addition to the above “Key Industries”, the 12th FYP underscored seven “Strategic New Industries” and called for utilization of national resources to capture the frontiers in these industries.

1.) Energy saving and environmental protection
China should establish a handful of model projects in this area and begin to make this an economically feasible industry.

2.) New Generation of Information Technology
Chinese firms should catch up with the world frontiers in technology and applications and build up their own capacity and networks for all major new generation IT breakthroughs.

3.) Biology
The country should build its own industrial clusters in biological engineering, develop platforms for research and early application, and support laboratories for new biotechnology.

4.) High-end equipment making
Leading Chinese corporations should continue their pursuit of technological progress in aircraft and aerospace, rapidly upgrading technological capacity to produce high quality equipment for machinery making, high-speed rails and urban transportation systems.

5.) New energy
More efforts should be made to increase China’s capacity to produce equipment for nuclear energy, solar power and wind power, among other energy sources.

6.) New materials
Chinese producers should catch up with the vanguard in R&D, production and utilization of sophisticated, high-quality and non-substitutable industrial materials.

7.) New-energy powered automobiles
The government will continue to encourage the production and use of hybrid powered and pure battery powered vehicles.
In short, China’s seven “Strategic New Industries” should rise to 8% of GDP by 2015, eight times the level in 2010.
Information Technology

The Chinese government has been strongly promoting what is called “self-initiated innovation,” encouraging firms to invent and upgrade new technologies based on their own research and development. Investment in cutting-edge equipment will enjoy various means of preferential taxation and financial treatment.

Consumer discretionary

This is a fast-growing sector in general. In particular, the automobile industry has been growing at a strong pace over the past decade. Many firms in the sector are endeavoring to increase brand recognition and market share. Competition is extremely tense.

Consumer Staples

Food safety and quality are the main problem in the sector today, and regulators of the industry have been under pressure to make improvements. Demand is accelerating for better, more reliable products, which would in turn, raise the reputation of the industry.

Health Care

This industry is believed to be technologically backward and inadequate in providing service. The government is trying to pursue reform in regulation and liberalization of the sector. The pace of demand for health care has been high, and is expected to remain so in the future.

Utilities

Along with urbanization and the growing population in cities, the demand for utilities has been growing rapidly in China. Capacity is deemed inadequate and inefficiently run in many cities. In response, many Chinese cities are pursuing capacity expansion during the 12th FYP period, including of subway systems, water supply systems, and road networks, and many other infrastructure works.

Industrial Materials

Growth of demand for industrial materials is likely to decelerate from its high level of the past decade but should still remain relatively strong during the 12th FYP.

KFYP Sector Breakdown

as of 9/30/2013

A Word of Caution

Some industries that were highlighted in the 12th FYP, such as solar panel equipment making, have already reached over-heated growth rates and suffer from overcapacity problems. Government incentives have sometimes become a source of unbalanced development in certain areas, as too many people have tried to enter those markets.

Nonetheless, there are many new areas in which a good deal of opportunities are emerging for rapid development during the 12th FYP period. They were mentioned but were not literally focused upon in the FYP and include the health care industry, the eco-environment industry and modern agriculture, among others.
New Leaders’ Commitment to The 12th Five Year Plan

The 12th FYP is, in effect, a result of the consensus between retired leaders and the new leaders, who worked together during the transition period of 2010-2011. The blueprint has been carefully balanced on the themes of growth, stability and reform. The new leaders appear to be shifting moderately toward reform and stability, and they are also openly committed to the key targets set forth in the 12th FYP, including growth levels and carbon emission reduction. They seem to realize that the engine of China’s continuing growth will largely be domestic demand.

In particular, Premier Li Keqiang has recently spoken of the “bottom lines” for China’s economic growth, which is understood to be the growth target set forth in the 12th FYP: 7% for GDP growth and 3.5% for CPI inflation (among other targets). This means that if the current slowdown were to continue, with GDP growing near or below target, the Chinese government would react by adopting some major policy stimulus measures in the future.

Carefully consider the Funds’ investment objectives, risk factors, charges and expenses before investing. This and additional information can be found in the Funds’ prospectus, which may be obtained by clicking here. Read the prospectus carefully before investing.

Investing involves risk, including possible loss of principal. There can be no assurance that the Funds will achieve its stated objectives. The Funds focus their investments primarily with Chinese issuers and issuers with economic ties to China. The Funds are subject to political, social or economic instability within China which may cause decline in value. Fluctuations in currency of foreign countries may have an adverse affect to domestic currency values. Emerging markets involve heightened risk related to the same factors as well as increase volatility and lower trading volume. Current and future holdings are subject to risk.

Narrowly focused investments typically exhibit higher volatility. Internet companies are subject to rapid changes in technology, worldwide competition, rapid obsolescence of products and services, loss of patent protections, evolving industry standards and frequent new product productions. Such changes may have an adverse impact on performance.

The KraneShares ETFs are distributed by SEI Investments Distribution Company, which is not affiliated with Krane Funds Advisors, LLC, the Investment Adviser for the Fund.