

2020 Two Sessions: Uncertainty on the Road to Recovery



Crossing the River by Feeling the Stones

Stability, employment, and resilience were the dominant themes at the annual gathering of the National People's Congress (NPC) and the Chinese People's Political Consultative Congress (CPPCC) – collectively known as the Two Sessions. Buffeted by the unprecedented impact of the COVID-19 pandemic and escalating tensions with the United States, this year's meetings were among the most consequential of the last 40 years.

In response to COVID-19, China's leadership is focused on domestic growth and stability, even as it prepares to take measures to guarantee long-term political security. Economic targets were scrapped. Instead, job creation and public welfare took priority – with 2020 targets including a surveyed unemployment rate target of around 6% (and registered urban unemployment rate of around 5.5%) through the creation of more than nine million new urban jobs.

The government is also foregoing the type of massive debt-creating stimulus it unleashed following the 2008 Global Financial Crisis to get there, mobilizing 'proactive and impactful' fiscal tools, flexible monetary policy, and targeted investment, alongside fee and tax cuts. Budget deficits will increase from 2.8 to more than 3.6% of gross domestic product (GDP), producing an additional RMB 1 trillion (USD 140bn) in spending. This will be supplemented by the issuance of RMB 3.75 trillion (USD 525bn) in special-purpose local government bonds, a year-on-year increase of RMB 1.6 trillion (USD 224bn), and another RMB 1 trillion in 'COVID-19 control bonds'.

For the current recovery, China's leadership has prioritized boosting domestic consumption by driving cash to localities, where the harshest impacts of the economic impact are now being felt. The country's economy shrank 6.8% in the first quarter. The impact of the decline has been seen in rising unemployment and

combined with being in lock-down a reduction in consumer spending. 'Meeting domestic demand' is the 'starting point and foothold for development', President Xi Jinping told delegates at the meetings.

Beyond guaranteeing jobs and basic livelihoods, Xi is betting that China will emerge from the pandemic stronger and more resilient by accelerating investment in scientific and technological innovation, and promoting the digital economy, intelligent manufacturing, healthcare, and new materials. Such policies, alongside a strengthening domestic economy and commitments to further opening-up, may prove enough to attract more overseas investment. A shortened Negative List of sectors prohibited from foreign investment, alongside financial services reforms, should also help.

The importance of a domestic, demand-driven recovery is underscored by weakening foreign trade and an increasingly complicated international environment.

To add to the challenges, the passage of a national security resolution for Hong Kong on the last day of the NPC has further exacerbated geopolitical tensions. The US responded almost immediately, stating that it intended to revoke the 1992 US-Hong Kong Policy Act which recognizes Hong Kong as distinct from the Chinese mainland. If this is revoked it will present significant challenge for businesses operating in Hong Kong.

The national security legislation is being drafted and details are limited. Ultimately this resolution may be the most significant geopolitical outcome of this year's Two Sessions and the strongest indication that China will not compromise on national sovereignty even in the face of anticipated reaction.





Key Takeaways

- **Stability and resilience:** China has opened its 'post-pandemic' economy internally, while keeping its borders with the rest of the world largely closed as part of its continuing COVID-19 response. Xi told delegates that while the nation pursued 'development in a more uncertain and unstable world', the country's potential and resilience remain unchanged. That includes a broad domestic economy boasting a workforce of 775 million and more than 15 million private businesses.
- **Scrapping economic growth targets:** China dropped the GDP growth target due to the prevailing uncertainty the COVID-19 pandemic. Setting GDP targets have been criticized in the past for encouraging growth-at-all-costs development, wasteful spending, and environmental degradation. While a specific GDP growth target has not been set, the authorities have stressed economic development remains important. Now removed, GDP targeting may be gone for good.
- **Jobs, jobs, jobs:** Employment is this year's top priority. As part of its 'employment-first policy', the government has committed to creating nine million new urban jobs, while maintaining a surveyed urban unemployment rate of around 6%, and a registered urban unemployment rate of around 5.5%. Securing jobs for 8.74 million college students graduating this year is a priority.
- **Six Fronts and Six Areas:** The government's slogan capturing this year's national challenge. The six fronts are ensuring stability in employment, the financial sector, foreign trade, foreign investment, domestic investment, and (market) expectations. The six areas refer to protecting job security, basic living needs, operations of market entities, food and energy security, stable industrial and supply chains, and normal functioning of primary-level governments.
- **Domestic-driven recovery:** Consumption is a key driver for this year's economic growth, Premier Li Keqiang said, as China seeks to bolster its economy against an inevitable global recession, and increase its 'self-reliance'. This builds on a long-term trend of boosting domestic consumption, a theme underscored at the Two Sessions with commitments to build out the e-commerce infrastructure, which connect rural areas to the cities.
- **Central leadership strengthened, with Xi at the Core:** Although the central leadership faced early criticism for its handling of the outbreak, the ability to mobilize national resources and contain spread of the virus strengthened their position over time and allowed the country's battle against COVID-19 to be elevated as a national cause. 'We, all the sons and daughters of the Chinese nation, have stood together in the most trying of times and built a Great Wall of solidarity against the epidemic', Premier Li said in the Government Work Report.
- **Debt is tomorrow's problem:** Since 2017, China's financial regulators have aggressively addressed the rising use of leverage, shadow banking and debt, with the government naming debt-driven financial risk as one of China's three 'Critical Battles' (the others are against extreme poverty and pollution). Amid its response to COVID-19, central bankers and officials are adopting a more tolerant view of debt as part of the COVID-19 'six fronts' and 'six areas' strategy. Officially, the deficit-to-GDP ratio this year will reach more than 3.6%, up from 2.8% last year.
- **Stimulus in many forms:** Unlike 2008, China is not rolling out a massive stimulus package – at least not yet. Instead, the government is committed to a mixture of flexible monetary policy and proactive fiscal measures, alongside investment incentives and tax and fee cuts. The government said it will issue RMB 3.75 trillion (USD 525bn) in special-purpose local government bonds in 2020, which are chiefly used to fund infrastructure projects, representing an increase of RMB 1.6 trillion (USD 224bn) over 2019.
- **New infrastructure and new urbanization:** The priority for these bonds will be to finance 'new infrastructure' projects, including next-generation information networks and expanded 5G applications, the industrial internet, and cloud computing. Spending will also be used to transform the urban infrastructure of smaller cities and towns, as China seeks to attract more farmers to enter the ranks of urban workers, business owners, and consumers.
- **Local governments to drive recovery:** At least RMB 2 trillion (USD 280bn) of the stimulus will pass directly to prefecture and county governments for spending on post COVID-19 recovery. One big challenge will be whether the central authorities can drive fiscal discipline. The government is calling on officials at all levels to tighten their belts. 'We will scrutinize all expenditure items and see that every cent is used where it is needed most and where market entities and the people will feel the greatest benefit from it', the Ministry of Finance vowed.

- **More medical and healthcare spending:** In the aftermath of the pandemic, the government is also focused on improving basic medical services and the public health system, including disease detection, response, management, and treatment capabilities. Expect more funds to develop drugs, vaccines, and testing reagents to prevent a resurgence of COVID-19, along with lower barriers for those wishing to set up manufacturing in China.
- **Firmer lines on foreign policy:** We expect China to continue to pursue a more muscular approach in international arenas, asserting its interests and pushing back strongly against what it sees as infringements on its national sovereignty. 'Today's China is not what it used to be a hundred years ago, nor is the world anything like the one a century ago', Wang Yi, the foreign minister, told reporters.
- **Window for foreign investment to open wider:** Expect a shorter Negative List this year, while the government has committed to further relaxing restrictions on the country's financial services and capital markets. More changes in manufacturing and agricultural sectors may be on the way. 'Faced with changes in the external environment, we must stay committed to opening our door wider to the world ... and make opening up a catalyst for reform and development', Li said. China's COVID-19 recovery efforts lead most of the world, which could make a difference.
- **Removing the hidden barriers to market access:** The government also pledged to improve the business environment and create a more level playing field for foreign enterprises and private Chinese firms to compete against the country's dominant state sector. 'We will urge local governments to keep track of hidden barriers to market access and give priority to dismantling these barriers for private enterprises, especially micro, small, and medium-sized ones', the National Development and Reform Commission (NDRC) said. Mixed-ownership reform will also 'prudently' move forward at central-government-controlled state-owned enterprises, which booked RMB 30.8 trillion (USD 4.3tn) in operating income last year.
- **Hong Kong national security resolution increases business uncertainty:** The decision to move forward with national security legislation for Hong Kong has escalated geopolitical uncertainty, leading to fresh unrest in Hong Kong and a strong response from the US, the UK and other nations. Expect China to push back against announced US actions, led by a decision to revoke the 1992 US-Hong Kong Policy Act which recognizes Hong Kong as distinct from the Chinese mainland, and the UK following statements that it may grant citizenship to Hong Kong residents holding or eligible for British National Overseas passports. Rising geopolitical tensions will present new challenges for companies.
- **Long-term goals still matter:** Longstanding goals of eliminating rural poverty and protecting the environment were reaffirmed by the government at this year's meetings, in spite of the havoc brought about by the pandemic. While economic growth will trump in the near-term as part of the COVID-19 recovery plan, expect environmental regulation and enforcement to continue over the long-term. Sustainability programs promoted by business will continue to resonate with the government and with citizens.

The shadow of COVID-19 has been firmly on this year's Two Sessions. Leaders at the gathering presented a path to recovery, yet uncertainties remain – whether from COVID-19 or geopolitical. Companies must review their playbooks as those currently in place are not guaranteed to work in this environment.



The Domestic Landscape

The new COVID-19 reality

China is opening up internally, while its international borders remain for the most part closed as part of the continuing response to the pandemic. With traffic returning to roads, students to schools, shoppers to malls, and diners to restaurants, life appears to be reverting to normal. Yet things are not as they once were. Although China has largely contained COVID-19, new local outbreaks continue to appear. 'The pandemic is not over', Li warned in the first passages of the Government Work Report.

As the economy opens internally, the leadership remains on high alert against a second wave of infections.

Strict limits on visitor numbers to businesses, parks and tourist sites are in place, face masks remain commonplace, and often still required, in public, and temperature and identity checks, and registration, are still necessary for moving between neighborhoods, and into venues.

During the five-day May holiday, internal travel restrictions were loosened following the outbreak. 115 million tourist trips were taken, yet approximately 60% were by car to local areas, highlighting that recovery starts locally.

The government remains on high alert for a second wave – testing, for example, all 11 million residents of Wuhan in a ten-day campaign at the end of May, and re-introducing lockdowns in some cities in response to new local outbreaks. The whole country is protected by a travel firewall, with only Chinese citizens and, more recently, critical personnel from select countries, allowed to enter. Mandatory quarantine for those crossing the national border remains in place. The travel firewall is expected to remain firmly in place for the foreseeable future.

A delayed, shortened Two Sessions reflected the new COVID-19 reality

The Two Sessions themselves reflected this new reality. Delayed from their usual March date, they operated over a shortened timespan of eight days, and with social distancing in place at press conferences, many of which took place virtually. The Government Work Report itself was significantly shortened, almost by half, in the most unusual Two Sessions in recent memory.

Economy showing signs of recovery

After shrinking 6.8% year-on-year in the first quarter, the first drop in 28 years, China's economy is showing signs of recovery. This is evident in the numbers and the confidence we see first-hand on the street across China.

Industrial activity is up. According to the most recent government statistics, industrial production rose 3.9% year-on-year in April, after contracting 1.1% in March and 25.9% in February. Exports rose 3.5% year-on-year in April, against expectations, although imports shrank 14.2%, reflecting a drop in domestic demand.

Boosting domestic consumption is proving more difficult than production. Retail sales contracted 7.5% year-on-year in April, though better than the 15.8% drop in March. As we walk the malls in China, it is clear that confidence is returning on the street with shops week on week visibly busier and people walking out with shopping bags.

Investment also contracted in April, by 2.2% year-on-year, though at a slower rate than the 10.9% fall in March. Industrial profits also fell 4.3% year-on-year in April, improving on a 34.9% plunge in March.

April figures show an economy on the path to recovery.

Confidence in the path

Although international reaction to China's response to COVID-19 have been mixed, domestic satisfaction with the central government in Beijing is high, with the economy now reopened and infections largely under control. Confidence in central leadership has been buoyed by an uncertain global landscape, as other nations continue to struggle to contain infections. Critical voices, notable in the early days of the crisis, have largely disappeared.

Part of China's response utilized sophisticated track-and-trace technologies, which were rolled out and accepted with limited discussion of privacy issues. Now that the virus has been largely brought under control, questions about the longer-term use of these technologies and the data are being raised. At the Two Sessions, prominent tech leaders called for personal data protections to be strengthened. These calls may be partially addressed in the medium term with passage through the NPC of the Civil Code, promising new limitations on the use of personal data by the state and businesses.

Local officials have borne the brunt for lapses in their areas; the position of the central leadership has been strengthened during COVID-19

Local officials have been held to account for mishandling the response in their jurisdictions: the Party boss of Hubei province, for example, was removed in February, along with the Party boss of Wuhan city, the epicenter of the COVID-19 outbreak in China. The central leadership's position, however, has been strengthened, in part by elevating the response to COVID-19 as a national cause.

In February Li Keqiang was made head of a task force established to oversee the national response to COVID-19. State media has emphasized China's assistance to other countries struggling to contain the virus, underscoring China's role as a responsible global stakeholder. Xi Jinping's position appears unchallenged, if not further bolstered.



Maintaining Social and Economic Stability

Confidence in GDP growth target dropped

China dropped its GDP growth target for 2020, the fourth time it has done so since 2000 – and the first since 2002. In the Government Work Report, Li noted this was due to the ‘great uncertainty’ regarding the COVID-19 pandemic and the global economic environment.

Dropping the GDP growth target will allow local government to focus on boosting jobs and supporting business, while promoting higher-quality investment.

Growth still matters. As stated in the NDRC’s 2020 plan, ‘not qualifying the economic growth target does not mean that we will not pursue economic growth’.

Not bound by a specific growth rate, however, the state will be better able to concentrate on what it sees as the critical problem of maintaining social and economic stability, boosting jobs and supporting business, while continuing to steer the economy towards the long-term goal of ‘high-quality’ growth. ‘If we rigidly set one [a GDP target], then the focus will be on strong stimulus and to hit the growth rate, which is not in line with the purpose of our economic and social development’, Xi said during a Two Sessions side panel.



> 3.6%
deficit-to-GDP ratio
0.8% increase from 2019

Many economists have long argued against setting a target as it pushes local governments to channel investment into unproductive areas, boosting production regardless of demand, and leading to the mass misallocation of capital (think ‘ghost cities’ and ‘bridges to nowhere’) and environmental degradation.

Six fronts and six areas

Instead, the state is promulgating the new mantra of ‘maintaining security in the six areas to ensure stability on the six fronts’ as its focus for social and economic security. The six fronts are: ensuring stability in employment, finance, foreign trade and investment, domestic investment, and overall market expectations. These were first declared in 2018. The six priority areas are: maintaining job security, people’s livelihoods, businesses, food and energy security, and stable industrial and supply chains. They entered official discourse in April. The emphasis on these priority areas before and during the Two Sessions indicates they are currently the overriding concern of government, and the focus of targeted stimulus measures.

The ‘six fronts’ and the ‘six areas’ are now the top priorities of government.

Employment first

Stabilizing employment and ensuring living standards is paramount. The official unemployment rate hit historic highs in February, reaching 6.2% before falling to 5.9% in March then rising again to 6% in April.

Mindful of unemployment causing social instability, the government is doubling down on an 'employment-first' policy

The government is focused on maintaining and creating jobs (setting a target, for example of creating more than nine million new urban jobs in 2020) and supporting the businesses that provide them. It has emphasized a role for startups in boosting employment, indicating support for migrant workers, college graduates, and demobilized military personnel to return to hometowns and villages to start their own businesses.



9M new urban jobs
down from 11 million in 2019

The government is particularly concerned with creating meaningful employment opportunities for the 8.74 million university students scheduled to graduate this year, while continuing its policy of drawing people away from large cities and towards small and medium-sized ones through a series of subsidies and penalties, a policy it refers to as 'new-style urbanization'.

Higher debt tolerated

Since the end of 2017, China's financial regulators have aggressively addressed the rising use of leverage, shadow banking and debt, with the government naming debt-driven financial risk as one of China's three 'Critical Battles' (the others are against extreme poverty and pollution). The government is adjusting its tolerance for debt in response to COVID-19 and the Two Sessions indicate a willingness to accept higher levels of debt to realize its

strategy for the 'six fronts' and 'six areas' in the near term. Once the economy recovers, expect the authorities to return to this Critical Battle.

The government has signaled a greater tolerance for debt to support social and economic stability

In the Government Work Report, Li announced the government would raise the fiscal deficit by RMB 1 trillion (USD 140bn) to 3.75 trillion (USD 525bn) – allowing a deficit-to-GDP ratio of more than 3.6% from 2.8% last year – and issue an additional RMB 1 trillion in 'COVID-19 control bonds'. 'Extraordinary measures for an unusual time', Li said. This additional RMB 2 trillion (USD 280bn) will go directly to local governments, to be used primarily to stabilize employment, meet basic living needs, and protect struggling businesses. 'This includes giving support to cut taxes and fees, reduce rents and interest on loans, and increase consumption and investment', Li said.



RMB 1 Trillion
in special COVID-19
recovery bonds

The government also signaled bank lending would increase, flagging required reserve ratio reductions, interest rate cuts, and re-lending to enable M2 money supply and aggregate financing to grow at notably higher levels than 2019. Increasing debt was 'feasible, safe and necessary', the Secretary General of the NDRC said at a briefing.

An additional RMB 2 trillion will go to local government for spending on the 'six areas'.



Relief for businesses

Li also laid out a range of further tax and fee cuts for businesses of about RMB 500 billion (USD 70bn), while extending measures due to expire in June to the end of the year. These include exempting micro, small and medium businesses from basic pension, unemployment and work injury compensation insurance contributions and removing VAT on services in sectors including hospitality, hotels, tourism and entertainment, and culture and sports. The policy also allows micro and small businesses and self-employed individuals to postpone payment of corporate incomes taxes until the end of 2021. The government calculates that these measures will lead to additional savings of RMB 2.5 trillion (USD 350bn) for businesses in 2020. Separately, large commercial banks have also been directed to increase lending to micro and small businesses by more than 40%.

The government will further cut taxes and fees, with a focus on micro, small and medium businesses.



**RMB 500 Bn
tax and fee cuts**

Big spending on new infrastructure and new urbanization

The government has also targeted issuing RMB 3.75 trillion (USD 525bn) in special-purpose local government bonds this year, which are chiefly used to fund infrastructure projects, representing an increase of RMB 1.6 trillion (USD 224bn) over 2019. Priority will be given to so-called 'new infrastructure' and 'new urbanization' (public facilities and services in county seats), along with major projects, such as high-speed and intercity rail (budgeting an additional RMB 100 billion (USD 14bn) in railway development capital).



**RMB 3.75 trillion
in local government
special bonds**

1.6 trillion increase from 2019

With a focus on new infrastructure, new urbanization, and major projects

'New infrastructure', including for 5G, the Internet of Things, the Internet of Vehicles, the industrial internet, artificial intelligence, and big data, will be a focus of new government spending

The Chinese Communist Party's Central Committee first raised the idea of 'new infrastructure' at the Central Economic Work Conference in December 2018, and it has since become a key focus of government, with the goal of building the digital infrastructure that will support the upgrade of industry and new modes of consumption. It includes areas such as 5G, the Internet of Things, the Internet of Vehicles, the industrial internet, smart cities, artificial intelligence, and big data.

We also see a boost in the roll-out of smart transport and energy infrastructure, with the government specifically referencing the building of charging facilities for new-energy vehicles. During the Two Sessions, Miao Wei, Minister of the Ministry of Industry and Information Technology, said China is currently adding about 10,000 new 5G wireless base stations a week to its network after China's mobile operators expedited 5G base station tenders for nearly 500,000 units since Chinese New Year. Significantly, 'innovation infrastructure' is also included as a form of 'new infrastructure', which the NDRC in April defined as infrastructure that supports scientific research and technological development.

Xi has called on China's tech giants to contribute to the rollout of the digital infrastructure. During the Two Sessions, Tencent announced it would invest RMB 500 billion (USD 70bn) in 'new infrastructure' in the next five years. We expect other tech giants to follow with similar announcements.





Foreign Investment and Business Environment

China passed the new Foreign Investment Law at the Two Sessions in 2019, promising a more level playing field for foreign companies, and an expansion of the areas in which investment is welcome; the Law became effective at the start of 2020. Opening has continued, with financial services seeing the most notable relaxation of investment restrictions: ownership caps in securities, fund management, futures, and life insurance ventures were abolished a year early, while rules regarding foreign participation in the insurance and asset management industries were loosened. The 'Negative List' of sectors in which foreign participation is forbidden was further reduced by 20 items in June 2019, with restrictions loosened or removed in areas across mining, manufacturing, transportation, and entertainment.

Foreign investment, one of the 'six fronts', continues to be a central focus. In the days before the Two Sessions began, the state issued a major policy document on restructuring the economic management system, pledging, among other things, wider and easier access for foreign investors to more sectors, and further reductions to tariffs and nontariff barriers to increase imports.

China has signaled further opening of the service, financial, manufacturing, and agricultural sectors.

The Two Sessions maintained this theme. 'Faced with changes in the external environment, we must stay committed to opening our door wider to the world ... and make opening up a catalyst for reform and development', Li stated in the Government Work Report, noting a significantly shortened Negative List would be issued this year.

China's key macroeconomic planning agency, the NDRC, indicated further opening of the service, financial, manufacturing, and agricultural sectors were on the horizon. The government also promised equal access to COVID-19 support relief funds for foreign companies in China.

The government made further commitments to improve the business environment and create a fairer playing field for both foreign enterprises and private Chinese firms in competition with the dominant state sector. 'We will urge local governments to keep track of hidden barriers to market access and give priority to dismantling these barriers for private enterprises, especially micro, small, and medium-sized ones', the NDRC said, while pledging to end the unequal treatment of private enterprises in licensing, business operations, and public procurement.

The government wants to dismantle hidden barriers to market access, and create a more level playing field.

This is reflected in our own conversations with foreign businesses in China, which have reported, proactive engagement by government officials expressing openness to assisting them in overcoming potential regulatory hurdles. The increased focus on opening-up in this year's Two Sessions points to the importance of all economic stimulus, regardless of origin. It also presents a window for foreign businesses to engage and push for greater market access where they may have hit barriers in the past.

Focusing on the Domestic Economy

Recovery starts from within

At the Two Sessions, the government underscored that China cannot rely on its external economy to lead recovery, and that economic development must start at home. It has identified boosting domestic consumption as a key strategy for driving economic growth and mitigating the risks brought about by the global pandemic. This follows earlier recognition by the government that consumption is key to sustaining growth, which led to policies that have slowly diversified China's export-driven growth model. The government has warned about China's exposure to international supply chain disruption, and Xi has called for China to become 'self-reliant'.

Continuing to increase consumption-driven GDP is a key goal of the government

Bolstering demand, however, is far from simple. The lack of a sound social safety net for workers stands in the way. Multiple surveys suggest people are adopting a thriftier approach in the post-pandemic world. As trade tensions with the US continue to escalate, the coming year will test the strength of China's domestic market. On the supply side, Li said there would be support for exporters to redirect products to the domestic economy, to mitigate the impact of a global recession and the loss of export-oriented jobs.

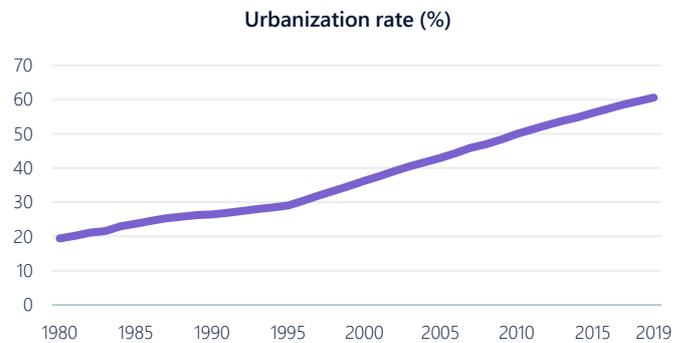


Increasing rural-urban flows

At the Two Sessions, the government recognized that e-commerce has played a vital role in both supporting people and maintaining consumption during the lockdowns, and promised support for food delivery platforms, ride-hailing apps, and other types of e-commerce businesses. Integration of offline and online retail will be a key focus. One critical area of attention is the build-out of e-commerce infrastructure, which facilitates the flow of agricultural products from the countryside to cities, and the trade of industrial goods into rural areas. Plastic packaging used in e-commerce, however, is also prompting the government to develop and introduce systems for reducing and recycling waste.

China sees connecting online-offline retail, and boosting logistics networks in rural areas, as a key method to boost consumption

The government will continue to build out rural infrastructure, while encouraging farmers to move to smaller cities and join the ranks of urban businessowners and consumers. China's urbanization rate hit 60% in 2019.



E-commerce used in cross-border trade has also become a focus. During the COVID-19 outbreak, China pledged to set up 46 new cross-border e-commerce pilot zones, in addition to the 59 existing ones, to foster new international trade at a time when exports are impacted by diminishing global demand.

Healthy China

Just as the SARS outbreak was a catalyst for China's healthcare reform seventeen years ago, COVID-19 is expected to spur investments in medical infrastructure. During the NPC, Xi stressed the need to revamp the public health network, admitting the outbreak had 'exposed weak links and inadequacies' in the system.

The COVID-19 outbreak will spur on critical reforms in China's healthcare sector.

Investments in the development of vaccines, medicines and rapid testing are expected, along with more facilities for epidemic control and laboratories. Epidemic prevention at the community level is a priority, as is ensuring the availability of emergency supplies, and public health access.

Lawmakers also released a legislative plan that reflects new public health priorities. A total of 17 laws are planned to be passed or amended in 2020-2021, including the Biosecurity Law, Wild Animals Protection Law, Frontier Health and Quarantine Law and Agricultural Products Quality Safety Law.

The pandemic is accelerating China's embrace of technology to deliver healthcare in new ways, including the use of online consultations and tele-pharmacies. Greater government support for internet-based medical services is expected.

Tech-based healthcare will be a theme of the coming year.



China, its Borders and the World

The Two Sessions focuses primarily on domestic issues, however this year's meetings convened during a period of rising geopolitical tension and growing acrimony between the US and China. In recent months, Washington DC has taken unprecedented action to place restrictions on Chinese companies operating in the US, while sanctioning other firms for alleged human rights and national security concerns. US President Donald Trump has accused Beijing of undertaking predatory trade practices and stealing intellectual property, while placing blame on Beijing for the COVID-19 pandemic.

China's leadership made clear during the Two Sessions that Beijing would firmly push back against US allegations and any attempts to interfere in what it considers China's internal affairs. 'It is most regrettable that while the coronavirus is still out there, a "political virus" is also spreading in the US and jumping at any opportunity to attack and slander China', Foreign Minister Wang Yi said at a press conference. 'Some political forces in the US are taking China-US relations hostage and pushing our two countries to the brink of a new "Cold War"'. Wang called on 'people with wisdom and foresight on both sides' to 'step forward to stop it'.

Hong Kong national security resolution

The NPC's decision at the Two Sessions to move forward with national security legislation for Hong Kong is already exacerbating bilateral relations. Details on what will be included in the legislation are not yet available.

The Basic Law, promulgated in 1990, states in Article 23 that Hong Kong shall 'enact laws on its own to prohibit any act of treason, secession, sedition, or subversion against the Central People's Government'. To date, the Hong Kong government has not passed legislation in accordance with Article 23. An attempt in 2003 led to approximately half a million people taking to the streets, which led the Hong Kong authorities to pull the proposed legislation.

The Government Work Report notably omitted reference to the Basic Laws of Hong Kong and Macau, for the first time since 2013, instead adopting more forceful language about the responsibilities of the local governments to fulfil 'their constitutional responsibilities' to establish 'legal systems and enforcement mechanisms for safeguarding national security'.

China's leadership made its position clear at the Two Sessions that Hong Kong remains an internal affair and a sovereign issue. 'We will firmly defend national interests', Wang said. 'We will show more resolve and take more effective steps to safeguard China's sovereignty, security, and development interests, and forestall and foil all external attempts to interfere in China's internal affairs.'

The NPC confirmed on the afternoon of Thursday May 28 it would move forward with the national security legislation. The US responded before China awoke on Friday that it intended to revoke the 1992 US-Hong Kong Policy Act which recognizes Hong Kong as distinct from the Chinese mainland and considers it to be a separate customs territory. The UK responded equally fast, voicing its concern and stating that it intends to extend the time that Hong Kong residents holding British National Overseas passports can stay in the UK and potentially grant citizenship to Hong Kong residents holding or eligible for BNO passports.

China's decision to move ahead with Hong Kong security legislation has amplified geopolitical risk.

Bilateral and regional tensions are certain to worsen as a result. The months and years ahead will give indication whether this action will undermine Hong Kong's role as an international financial center and an entry hub into the Chinese mainland. Regardless of the outcome, for Hong Kong-based companies and businesses operating in Hong Kong, it will be critical to fully understand how China's policies and the announced US measures may impact activities, particularly with regards to ongoing operations, supply chains, and data security.

A responsible global power

At the Two Sessions, China reaffirmed its commitment to the multilateral trade system and international governance bodies, while repeating calls for reform of US- and European-centric global institutions, particularly of the World Trade Organization. China still wants to advance economic relationships overseas, regardless of weakening global demand, and the government said it will pursue increased connectivity with neighboring countries through the China-Mongolia-Russia, China-Pakistan, and China-Indochina Peninsula economic corridors. China also noted its intention to improve the operations of its free-trade zones, realize the Regional Comprehensive Economic Partnership, and establish a China-Japan-South Korea Free Trade Area.

China sees international health cooperation as a critical arena in which it can build a reputation for being a responsible global stakeholder and provider of global public goods, in line with its ambitions to reach great power status by mid-century. In the lead-up to the Two Sessions, state media repeatedly called out China's support for other countries responding to COVID-19, whether through the supply of personal protective equipment or technical expertise. 'China stands ready to work with other countries to strengthen international cooperation on COVID-19 control', Li said.

China's extensive Belt and Road Initiative (BRI) also has become part of this new health-based diplomacy, with the foreign minister promoting health cooperation among BRI countries, 'building the "Healthy Silk Road" to contribute to the establishment of a global line of defense against epidemics'.

In Brunswick's recently released report titled 'Understanding Global Opinion of Chinese Businesses: A Growing Divide Between Developed and Emerging Markets', it is clear that emerging markets are overwhelmingly welcoming to Chinese businesses, while trust is declining in developed markets. This current environment is expected to accelerate this trend.

China will continue its support for the multilateral trade system, while also pursuing its reform.



National Rejuvenation Still the Goal

Building a moderately prosperous society

While facing challenges at home and overseas, the Two Sessions underscored the government's commitment to meet earlier announced long-term objectives. 2020 remains a crucial year. The central leadership has targeted it would eliminate extreme poverty in rural areas and double national and per capita GDP from 2010 levels – a lynchpin goal for building a so-called 'moderately prosperous society' before 2021, the 100th anniversary of the founding of the Chinese Communist Party. Achieving these milestones would bolster the state's legitimacy and the governments claims that a 'great rejuvenation of the Chinese nation' is being realized.

China has not lost sight of long-term goals, such as eliminating rural poverty

Eliminating extreme poverty

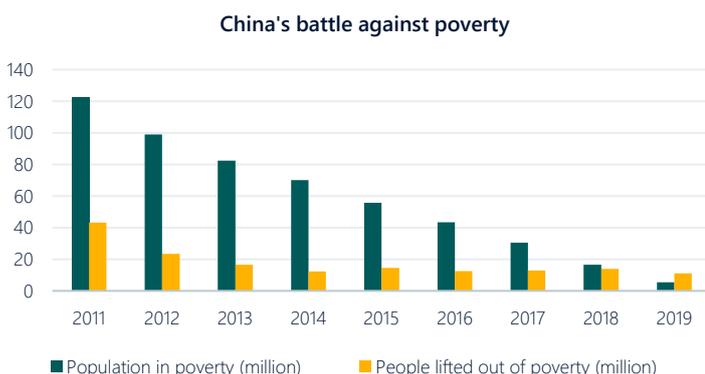
In his Government Work Report, Li emphasized that China 'will win the fight against poverty'. While 99 million residents lived below China's official poverty line at the end of 2012, that number had been reduced to 5.51 million by the end of 2019, according to government statistics.



0 rural residents living in extreme poverty

from 5.51 million at end 2019

The impact of the COVID-19 pandemic may have created setbacks, however, pushing many people back below the poverty line. The government vowed to 'provide assistance and support' for those experiencing difficulties, ensuring 'basic living needs are covered'. The government in 2020 has earmarked RMB 146 billion (USD 20bn) for local poverty alleviation programs, representing a RMB 20 billion (USD 2.8bn) increase for the fifth consecutive year, supplemented by a one-off payment of RMB 30 billion (USD 4.2bn) funded by carryover funds.



Whether a Chinese or multinational firm, having a poverty alleviation strategy remains beneficial in engaging in China.

Doubling GDP and per capita incomes over 2010 levels

Official economists have estimated GDP would need to grow 5.7% and per capita incomes 1.75% in 2020 for the government to achieve a doubling of national and per capita GDP from 2010 levels.

Given the impact of COVID-19, the government has all but admitted it will not achieve the first of these objectives this year. He Lifeng, head of the NDRC, said during the Two Sessions, however, that after years of rapid growth, a GDP growth rate in 2020 of just 1% would still see an economy 1.91 times the size of 2010.

In any case, it seems likely that China will have reached both goals before the end of next year.



CPI 3.5% ↑ YoY

up from 3 percent in 2019

Environmental protection still key

Even as the government this year focuses on COVID-19 recovery, the 'Critical Battle' against pollution continues to be one of its 'main targets', according to the Government Work Report. 'Priority will be given to the campaigns to keep our skies blue, our waters clear, and our land pollution-free', the Ministry of Finance noted in its Two Sessions report. China has allocated a total of RMB 407.3 billion (USD 57bn) in 2020 for environmental protection, up from RMB 390.6 billion (USD 55bn) in 2019.

Improving environmental governance will remain a priority though the year.

Business should expect a continued rollout of new regulation, and enforcement of existing policies, through the year. Environmental regulation and enforcement will keep tightening in the long term, as the government prioritizes building what it calls a 'modern environmental governance system'. Sustainability programs by business that consider this concern will continue to resonate clearly with the state and with citizens.



The Next Five Years

With China's 13th Five-Year Plan (2016–2020) drawing to a close, drafting has begun on the next national development blueprint for 2021–2025. While Five-Year Plan (FYP) guidelines and targets are not as rigid as they once were, the FYP still carry significant policy implications. The Party leadership is expected to convene its fifth plenum this year, typically held in October, to review the near final draft plan before it is approved at the Two Sessions in 2021.

When top officials met last November to discuss the 14th FYP, Li warned that an increasingly challenging and uncertain international environment will characterize the next five years. He also said China is at a crucial stage of transforming its model of development.

Increasing China's 'self-reliance' will be a key theme of the next economic blueprint.

Although few details on the themes of the next Five-Year Plan were released at this year's Two Sessions, Beijing will remain under enormous pressure, as the impact of the COVID-19 pandemic continues and relations with the US deteriorate. The government's decision to become economically more self-reliant is critical, and its move to unleash domestic demand, while deepening opening up and reform, will undoubtedly characterize government strategy in the years ahead.

Two Sessions Backgrounder

What are the Two Sessions?

The Two Sessions, or lianghui (两会) as the sessions are commonly known in China, are the annual gathering of the National People's Congress (全国人民代表大会全国人民代表大会) and the Chinese People's Political Consultative Conference (中国人民政治协商会议中国人民政治协商会议). Typically held during the first two weeks in March, they were delayed in 2020 due to the outbreak of COVID-19, and held from 21 to 28 May.

What is the NPC?

The National People's Congress (NPC) is China's highest legislative body and has sole responsibility for enacting legislation in the country. The NPC meets once a year in March and enacts and amends basic laws relating to the Constitution, criminal offences, civil affairs, state organs and other relevant matters. When the NPC is not in session, the Standing Committee of the NPC is tasked with enacting and amending laws, except for basic laws which must be enacted by the NPC.

The NPC is also responsible for electing and appointing members to central state organs—including the Standing Committee of the NPC, the President of the People's Republic of China (currently Xi Jinping) and the Premier of the State Council (currently Li Keqiang). Based on nominations by the Premier, the NPC is also responsible for appointing China's Vice Premiers, State Councilors and Ministers.

This year was the Third Session of the 13th NPC. The 13th NPC was formed in March 2018 and will serve a five-year term. This year's session was held from May 22 to 28.

What is the CPPCC?

The Chinese People's Political Consultative Conference (CPPCC) is a political advisory body that consists of representatives from industry, academia, business, entertainment, politics, and other areas. The National Committee of the Chinese People's Political Consultative Conference (中国人民政治协商会议全国委员会) meets on an annual basis during the same period as the NPC.

This is the Third Session of 13th CPPCC. This year's session was held from May 21 to 27.

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