Xi's System, Xi's Men:
After the March 2018 National People's Congress

Barry Naughton

The National People's Congress meeting in March launched a significant administrative reorganization and approved the appointment of a new generation of economic technocrats. The technocrats are skilled and generally support market-oriented reforms. The reorganization is generally market-friendly, but its main purpose is to create a more disciplined and accountable administration to serve as an instrument for Xi Jinping.

Last year, after the 19th Communist Party Conference in October, Xi Jinping laid out a general economic program for the next three years. This March, at the 13th session of the National People's Congress, Xi introduced significant changes in the administrative structure and fleshed out the personnel assignments that will prevail for the next few years. These changes demonstrate once again how firmly Xi is in control of economic policy and personnel. Even if Xi had not also changed the constitution to eliminate term limits for the president (himself) and vice-president, these changes would be enough to demonstrates Xi's power and ruling style.

The policy framework laid out at the end of 2017 allows space for renewed system reforms. As explained in the previous contribution to *CLM*, successful economic management in 2017 has permitted Xi to prefer "high quality" growth over "high speed" growth, and in particular to launch "three battles": reducing financial risk; eliminating poverty; and improving the environment.[1] While deepening economic conflicts with the United States have certainly complicated the policy environment, until now the Xi administration has stuck to this basic policy orientation. The significance of the NPC meeting thus centers on the administrative reorganization and on the personnel selected. I begin with personnel, which is simpler and will help in understanding the significance of administrative changes.

Four New Vice-Premiers: Two Powerful and Two Marginalized

The position of vice-premier is an important one that is rather hard for us outsiders to get a handle on. Vice-premiers have what we might call "fuzzy defined portfolios." That is, there are definitely "slots," and each vice-premier fills a position roughly the same as one of his or her predecessors. However, the exact responsibilities are never publicly announced, and the actual scope of responsibility only emerges as activities are reported in the press and form a cumulative picture. The NPC appointed four new vice-premiers, one of whom, Han Zheng, is also a member of the Politburo Standing Committee.

Han Zheng is the executive vice-premier, taking over from Zhang Gaoli. His portfolio is inclusive, but with a stress on overseeing economic agencies. In April, his chairmanship of the Central Party Hong Kong-Macau Work Coordination Group was revealed, another position taken over from Zhang Gaoli. Han Zheng was mayor of Shanghai for 10 years, and first party secretary of Shanghai for another five. He has a reputation for competence and has also navigated successfully through treacherous political currents. As mayor, he was promoted to acting party secretary in 2006–2007 after the fall of Chen Liangyu, then reverted to mayor when Xi Jinping was parachuted into Shanghai to serve (briefly) as party secretary. Han Zheng has been able to maintain good relations with a long list of rapidly changing patrons and superiors.

By far the most striking and important appointment to vice-premier is that of Liu He, who now serves as a kind of "economics czar." As readers of this publication know well, Liu He's elevation was also entirely predictable. Already the key economic adviser and confidant to Xi Jinping, Liu has exercised predominant influence over economic policy for five years now. Taking over Ma Kai's "slot" as vice-premier is not in and of itself a big change for Liu He, but it gives him a more regular and institutionalized platform within the Chinese system. Liu He's portfolio is somewhat broader than Ma Kai's was, since Liu has taken over at least two functions held by other vice-premiers in the previous administration. Liu He has assumed oversight of international commercial relations—primarily negotiations with the United States—which were carried out by Wang Yang in the previous administration. Liu He has also absorbed technology policy into his purview, whereas that oversight was exercise by Liu Yandong in the previous administration.

Liu He is in an extremely strong position, due to his formal positions and his close relation with Xi Jinping. Moreover, although Liu He has a personally understated manner, his ambitions for the economy are at least as great as his formal positions. The press release from the first meeting of the new Deepen Reform Commission had a line that seems to have come straight out of Liu He's playbook: "we will use multiple policy tools, including fiscal, monetary and structural reforms, to bring into play the [diverse] strengths of government, enterprises, and business association to create a new mechanism for participation in international macroeconomic policy coordination."[2] Ambitious indeed, and arguably he will need every tool at his disposal to manage through the disputes with the Trump administration.

Indeed, Liu He's position is somewhat exposed. Raised to unprecedented prominence, riding high in the wake of the economic successes of 2017, Liu He is also vulnerable to criticism as the Trade War with the United States intensifies. After all, Liu He's Harvard Kennedy School degree, fluent English, and ability to understand Americans are part of his credentials. Yet his ability to talk to the American side has not prevented trade talks from being repeatedly broken off, Chinese offers rejected out of hand, and gradually increasing sanctions being applied by both sides. In particular, the cutting-off of ZTE from American high-tech suppliers, a very serious matter, shows how difficult it is to come to terms with the Americans. [Please note that days after this was written, President Trump appeared to revoke the ZTE sanctions via a Sunday-morning tweet.]

It is quite a drop from these two powerful and capable vice-premiers to the other two. Sun Chunlan has taken over the health and education portfolio from Liu Yandong, but without getting oversight over the technology portfolio that Liu Yandong had exercised. Sun is to ride herd over China's global ambitions in the educational realm, but her own educational credentials are remarkably weak. Both her bachelor and graduate degrees were from correspondence programs, one from Liaoning University (economics) and the other from the Central Party School (political science).[3] People grumble that the post as secretary of Tianjin Municipality was already well beyond her ability. Perhaps it is just sexism, or perhaps it is an obsession with credentials, but the suspicion remains that she has been stuck in the "woman's slot" to show that Chinese women can also be leaders. Sun Chunlan had served since 2014 as head of the United Front Work Department of the party, which was, of course, tipped for significant expansion during this period.

Finally, Hu Chunhua's authority has also been somewhat circumscribed compared to that of his predecessor Wang Yang. Wang Yang already had to settle for a somewhat awkward job portfolio that combined international commercial negotiations and poverty alleviation. However, Wang played a generally successful role dealing with the Americans, which gave him substantial visibility. Now Hu Chunhua has taken over the portfolio, but with Liu He obviously dominating the US negotiation, Hu's authority is limited: he showed up recently at an exhibition promoting Chinese brands in Shanghai. The poverty alleviation task is not trivial, but probably not enough to satisfy an ambitious politician. Of course, in Hu's case, the limitation is not competence; quite the contrary. By general agreement, Hu's record as Guangdong party secretary, from 2012 to 2017, was excellent. But Hu is cursed to have been one of the two youngest Politburo members in 2012, thus making him one of the potential successors to Xi Jinping. At least he is in a better position than the other young potential successor, Sun Zhengcai, who was sentenced to life in prison last week.

Liu Kun, New Minister of Finance

Liu Kun, the new minister of Finance, is certainly not well known in China. Born near Chaozhou, Guangdong, in 1956, he tested into Xiamen University in 1978 and then went to work in the Guangdong provincial government for more than 30 years. He rose through the provincial Fiscal Bureau to become vice-governor in 2010, and was then named vice-minister of Finance in May 2013, moving to Beijing for the first time. He served two and a half years, filling in as Lou Jiwei's deputy.[4] Liu developed a mastery of details of the budget process, and coordinated the introduction of "Industrial Guidance Funds," which invest fiscal funds into venture capital funds in order to leverage available capital.[5] At the end of 2016, he was moved to the National People's Congress, where he served as the head of the sub-committee that oversees the budget, before being called back to the Ministry of Finance to serve as minister.

Liu Kun thus brings deep experience with local government—at least in a wealthy province like Guangdong—and demonstrated competence. This skill set should serve him well. Fiscal reform has been stalled out since 2014, and there are far too many deferred problems. Now expect Liu Kun to preside over renewed movement. In an important March speech, Liu Kun explained that the principles had been established upon which a new system of central-local fiscal relations could be built.[6] These include the principle that long-term resident population (not household registration population) will be the basis for progressive equalization of per capita social service outlays. Inter-governmental transfers will be increased. The central government will assign responsibility for setting different types of outlay standards to the center and localities, something already done with respect to a number of educational support and welfare outlays.[7] This process is to be extended to more complex and expensive items such as actual education outlays, medical, transport, and environmental outlays on a sector-by-sector basis. Local governments are to be given greater taxation authority, including the ability to influence the new personal income tax system schedule to roll out soon (which shifts to an annual tax with deductions for children's education and medical expenses).[8] These announcements may indicate that the ice is finally melting, and that inter-governmental fiscal reforms may begin to inch forward again.

New Financial Leadership

Yi Gang was named head of the People's Bank of China (PBC) by Premier Li Keqiang on March 19, 2018. Extremely well qualified, highly intelligent, and with a strong commitment to market-opening reforms, Yi had already been doing most of the day-to-day work running the PBC, and was the clear favorite of departing PBC governor Zhou Xiaochuan. Despite these impressive credentials, Yi Gang was not the front-runner for the PBC post, particularly given that he emerged from the 19th Party Congress last fall as only an alternate member of the Central Committee. Yi Gang has two "flaws" for a top position like this. First, he is a genuinely nice person, and thus may lack the sharp elbows necessary to survive in the sometimes vicious competition and freewheeling policy debates that characterize Beijing. Second, he is a true overseas-trained technocrat with a U.S. economics Ph.D. (University of Illinois) and experience as a U.S. professor (Indiana). There seems to be a glass ceiling in China that prevents fully socialized American academics from ascending to authoritative policy-making positions.[9] Thus, Yi Gang's appointment came as a surprise.

Even more surprising, though, less than a week later, it was announced that Guo Shuqing would become party secretary of the PBC, and thus Yi Gang's superior. (Zhou Xiaochuan had always been both central bank governor and party secretary). Guo Shuqing had been recalled from Shandong Province to run the China Banking Regulatory Commission (CBRC) a year ago, and his position had been enhanced when the NPC voted to fold the country's insurance regulatory agency into Guo's CBRC. Both Yi and Guo are committed market reformers, and they have previously worked together under Zhou Xiaochuan at the PBC.[10] In other respects, they are quite different. Guo definitely has sharp elbows when needed, and indeed has repeatedly ruffled feathers when he has tried to accomplish a lot quickly. Harder to pin down, Guo has that combination of casual camaraderie and subtle aggression which qualifies as communist party leadership style. Thus, the announcement and the way it was made were very surprising, while the final outcome hardly seemed surprising at all.

"Twin Peaks" with Chinese Characteristics

In terms of the financial regulatory system as well, the new arrangement makes some sense. The new financial regulatory structure rolled out since the 19th Congress has a hierarchical structure, with a new State Council Financial Stability and Development Commission (国务院金融稳定发展委员会) at the apex. This commission met once in November 2017, but has not had a publicly announced meeting since. Presumably Liu He is the chairman—since his predecessor, Ma Kai, chaired the November 2017 meeting—but this has not been officially confirmed. The creation of this commission was a straightforward response to the regulatory failures of 2015–2016. The old regulatory system had clearly failed to deal with financial activities that fell in between the cracks of traditionally defined sectors. Especially egregious had been the regulatory failure that allowed "insurance companies" like Anbang, Evergrande, Foresea and Tian'an to raise billions of dollars in bogus "universal life insurance products."[11] Internet banking, as exemplified by Alibaba's Alipay transactions network and Yu'ebao money market fund also constitute an enormous challenge. The new Financial Stability Commission was designed both to exercise comprehensive oversight over all financial activities and to provide guidance for future reform and restructuring.

The system was further integrated by the combination of banking and insurance oversight in the new China Banking and Insurance Regulatory Commission (CBIRC), giving it much greater regulatory scope. The logic is that both banking and insurance are forms of indirect finance, taking deposits or insurance policy investments, and making investments separately. The China Securities Regulatory Commission (CSRC) covers direct finance, in which investors take variable equity stakes in their investments, and which presents very different regulatory challenges. Moreover, the current head of CSRC, Liu Shiyu, seems to have things under relative control.

However, the other aspect of regulatory reform presented a challenge to this neat picture. Loosely patterned on the UK's "twin peaks" system, the new regulatory structure strengthens the PBC, the central bank. This is because the central bank takes on macro-prudential regulation, which involves looking into commercial bank balance sheets and making sure they are solvent and stable.[12] This gives the PBC broader authority, since it will now exercise both monetary policy and macro-prudential functions. The other regulators (CBIRC and CSRC) are expected to focus on "micro" regulation, making sure that procedures and practices treat customers fairly. Indeed, inspectors from CBIRC fanned out in April to visit bank branches and check their lending practices, primarily for consumer and real estate lending.[13] This division of responsibilities, in some sense, gives the old China Bank Regulatory Commission (CBRC) less to do and a lower position in the hierarchy. By appointing Guo Shuqing PBC Party Secretary, policy-makers reinforce the regulatory crackdown currently going on, and provide a strong-man system of top-down regulation that is typically Chinese. This is "twin peaks" with Chinese characteristics.

Xi's New Administrative System

The outline of an ambitious party and government reorganization was laid out at the Third Plenum on February 28, 2018.[14] A little over two weeks later, the NPC adopted a State Council reform plan that is based on the party resolution, but surprised some observers with its scope and some unanticipated content.[15] The basic thrust of the reform was to create a smaller number of stronger ministries. There have been seven rounds of government reorganization since 1982, and "super ministries" have been a popular topic of discussion since 2008. However, past implementation has been uneven—an Energy super-ministry was never created, although a Transportation super-ministry was—and the current reform is considerably more thorough than previous proposals.[16] Essentially, it strengthened several ministries by concentrating in them related functions which had been dispersed among different ministries and independent agencies. This was clearly a "rationalization" in the sense that it typically gave a single ministry more or less a monopoly over a given policy area. Some of the big "winners" in the economic area include:

Ministry of Natural Resources

This new ministry takes over from the previous Ministry of Land and Resources, but absorbs land planning functions from the National Development and Reform Commission (NDRC); urban planning from the Ministry of Construction, and land management functions from the Ministry of Agriculture, among others.

Ministry of Ecology and Environment

One of the most striking changes, this expanded Ministry of Environmental Protection absorbs the climate change portfolio from NDRC; water resources management from the Ministry of Land and Resources and Ministry of Water Conservation, and a number of other environmental functions from other agencies.

State Administration for Market Regulation

Based on the former State Administration for Industry and Commerce, this powerful new body absorbs the State Administration for Quality Control, State Administration of Food and Drug, and the price administration functions of NDRC. Crucially, it groups together in its own hands the anti-monopoly functions previously scattered among the three agencies the NDRC, Ministry of Commerce, and the State Council Anti-Monopoly Commission Office (which has caused many headaches for foreign firms).

Ministry of Science and Technology (MOST)

MOST will assume control over the National Natural Sciences Foundation (NNSF) and the Foreign Experts Bureau.

Other important redefinitions greatly strengthen the National Audit Office, the National Supervision Administration, the National Health Commission, and the new Ministry of Emergency Management. Somewhat surprisingly, the universally acknowledged "loser" from this reorganization was the NDRC, which sacrificed several of its most important powers. The rationale was to induce it to focus on genuine macroeconomic steerage and planning, and withdraw from most concrete interventions. This was surprising since the head of the NDRC, He Lifeng, has been a close follower of Xi Jinping, and his agency has obviously lost "clout."

There is much to be said for this reorganization, rationalizing responsibilities and constraining the ability of NDRC to intervene in an enormous range of economic situations. We should note that such a strategy has costs as well, which are exemplified by the decision to put the NNSF under the Ministry of Science and Technology. Currently, both the NNSF and MOST make research grants to a broad range of scientists and engineers. However, NNSF sends proposals to outside committees for peer review, while MOST's research grants are generally decided in-house and are considered to be highly politicized. If NNSF's procedures are submerged into MOST procedures, there will be a substantial loss in fairness and, ultimately, research efficiency. Of course, it is possible that MOST will ring-fence NNSF's grant procedures to protect their relative integrity, but in that case, why bother to subject NNSF to MOST in the first place? Similar situations with respect to fragmentation and diversification are evident in other organizations as well.

Two New Commissions

At the top of the new administrative structure are two commissions that formerly were "leadership small groups" (LSGs). A key feature of the first five years of Xi Jinping's rule had been his use of these two LSGs to directly steer economic policy-making. These LSGs have now been redefined as commissions. That gives them a higher bureaucratic rank and more authority to issue documents in their own name.[17] Otherwise, it is not clear what difference this reclassification will make.

The new Central Commission on Comprehensively Deepening Reform (CCCDR) has already met twice, on March 28 and May 11, 2018.[18] Its modus operandi seems to be virtually unchanged, and its basic structure is also intact (it has a number of Specialized Reform Groups under its supervision, each headed by a Politburo member, and the Economics Specialized Group headed by Liu He). Like the previous LSGs it has met for an afternoon and passed between 10 and 20 documents or resolutions each time. Periodicity seems unchanged as well. The first meeting seems to have been largely organizational, whereas much of the attention at the second meeting was devoted to the ongoing administrative reorganization, which is extending from the central level down through the localities. The CCCDR has re-articulated its mission more strongly, though: its purpose is to preside over the restructuring of every aspect of the society, government, and economy.

The new Central Commission on Finance and Economics (CCFE) has met only once (on April 2), but seems much more focused on the current policy priorities. It also had to pass new statutes and procedures, and, perhaps surprisingly, Wang Yang is a member. The substantive part of the CCFE communiqué was entirely devoted to the "three battles."[19] Financial de-risking and deleveraging was discussed, with the restatement of the objective of "stabilizing and then gradually reducing the macroeconomic leverage rate." A paragraph each was then devoted to poverty alleviation, and environmental improvement. It seems the CCFE will be the command post for the three economic battles Xi is determined to wage, and win, by 2020.

Conclusion

Two clear conclusions spring from this brief description. First, Xi Jinping has assembled a first-rate economic team in the key jobs, particularly the key financial jobs. The old warhorses—Zhou Xiaochuan at PBC and Lou Jiwei at the Ministry of Finance—have stepped down, but their successors are also extremely capable and strongly committed to market-oriented economic reform. Their jobs will generally be made easier by the organizational changes that have been effected, including in the regulatory structure of the financial system. The position of Liu He has been strengthened as well, not just by his designation as vice-premier and Politburo member, but also by the appointment of allies to key positions and having aspects of his policy approach incorporated into recent documents.

Second, while administrative and organizational changes are, on balance, market-friendly, this is not their main purpose. Their main purpose is to make the hierarchy a more disciplined and efficient transmitter of top-level commands. Each ministry is designed to have exclusive control over an issue area so that it can be an effective instrument for the top leader's aspirations. The leader's span of control is reduced, and the accountability of the bureaucracy to the leader's commands is enhanced. The machine that has emerged from the National People's Congress looks to be leaner and meaner, and more capable of carrying out the ambitious objectives of the top leadership.

Notes

[1] Barry Naughton, "Economic Policy in the Aftermath of the 19th Party Congress," *China Leadership Monitor*, no. 55 (Winter 2018).

[2] Xinhua News Agency. "Xi Jinping calls the first meeting of the Central Comprehensive Deepening of Reform Commission" (习近平主持召开中央全面深化改革委员会第一次会议), March 28, 2018, accessed at http://www.gov.cn/xinwen/2018-03/28/content_5278124.htm.

[3] Xinhua News Agency, "Sun Chunlan: Member of Political Bureau of CPC Central Committee," October 25, 2017; accessed at http://www.xinhuanet.com/english/2017-10/25/c_136705642.htm.

[4] Jiang Yunzhang 降蕴彰 and Wang Yanchun 王延春, "Liu Kun, an old finance hand, will become the new Minister of Finance; he will face the challenge of Central-Local Fiscal Relations" ("老财政" 刘昆执掌财政部：将应对央地财权划分等挑战), Caijing Mobile, March 19, 2018, accessed at https://news.caijingmobile.com/article/detail/355759. "Liu Kun 刘昆," Guangdong Province Website, http://www.gd.gov.cn/govpub/ld/201007/t20100726_126163.htm.

[5] Liu Kun 刘昆, "Bring into play the guidance function of fiscal and tax policy; facilitate venture capital to assist the development of innovation" (发挥财税政策引导作用 促进创业投

资助力创新发展), October 14, 2016, Speech at the Fourth China Venture Capital Summit; accessed at http://www.cpppc.org/zh/pppyw/4183.jhtml.

[6] Zhou Xiaoxiao 周潇枭, "New Finance Minister Liu Kun discusses fiscal reform for the first time" (新财长刘昆首秀谈财税改革), *21st Century Business Herald* (21世纪经济报道), March 27, 2018, p. 2.

[7] State Council Office, "Reform program for dividing expenditure responsibilities and outlays for basic public services between center and localities" (基本公共服务领域中央与地方共同财政事权和支出责任划分改革方案), January 27, 2018; document no. 6 (2018) State Council Office 国办发〔2018〕6号, accessed at http://www.gov.cn/zhengce/content/2018-02/08/content_5264904.htm.

[8] "New Finance Minister Liu Kun discusses fiscal reform for the first time," p. 2.

[9] Note that Liu He has studied in the U.S., most famously acquiring a master's degree in Public Administration from Harvard's Kennedy School. Guo Shuqing spent time at Oxford. Neither of these equals the intense socialization required to succeed in a competitive Ph.D. program.

[10] Zhang Qi 张奇, "Chinese-style financial regulation: Chairman of the Banking and Insurance Commission Guo Shuqing will also be party secretary and vice-governor of the PBC" (中国式金融监管：银保会主席郭树清兼任央行党委书记，副行长), *21st Century Business Herald* (21世纪经济报道), March 27, 2018, pp. 1, 9. In 2004, Guo Shuqing was one of four vice-governors, and Yi Gang one of three assistant governors under Zhou Xiaochuan.

[11] See Barry Naughton, "The Regulatory Storm: A Surprising Turn in Financial Policy," *China Leadership Monitor*, no. 53, Summer 2017.

[12] Ren Zeping 任泽平, Fang Siyuan 方思元, and Gan Yuan 甘源, "The new mission of the future 'super-central bank'" (未来"超级央行"的新使命), March 20, 2018, http://mp.weixin.qq.com/s/P96h56C4YN1fKFLWV51yIw. In the UK, the macro-prudential functions are exercised by the "Prudential Regulation Authority" which has been placed within the Bank of England, while the micro-regulatory functions are in a separate Financial Conduct Authority.

[13] Reuters, "China's financial watchdog begins inspections of banks' risky lending: sources," April 25, 2018, accessed at https://www.reuters.com/article/us-china-regulations-loans/chinas-financial-watchdog-begins-inspections-of-banks-risky-lending-sources-idUSKBN1HW187.

[14] CCP Central Committee, "Communist Party Center Resolution on Deepening the Reform of Party and State Administration" (中共中央关于深化党和国家机构改革的决定), February 28, 2018, accessed at http://www.xinhuanet.com/politics/2018-03/04/c_1122485476.htm.

[15] State Council, "State Council Administrative Reform Program" (国务院机构改革方案), March 17, 2018, accessed at http://www.gov.cn/guowuyuan/2018-03/17/content_5275116.htm; see also CCP Central Committee, Program for Deepening Reform of the Party and State Administration" (深化党和国家机构改革方案), March 21, 2018, accessed at http://www.gov.cn/zhengce/2018-03/21/content_5276191.htm-1.

[16] Liu He 刘鹤, "Deepening the reform of the party and state administrative structure is a profound change" (深化党和国家机构改革是一场深刻变革), *Seeking Truth* (求是), March 2018, accessed at http://www.qstheory.cn/zdwz/2018-03/13/c_1122527717.htm; Li Zichen 李紫宸, "2018 State Council Administrative Reform: Interviewing Wang Yukai,

Professor at the National School of Administration" (2018 国务院机构改革：专访国家行政学院教授汪玉凯), *Economic Observer* 经济观察报, March 19, 2018, p. 2.

[17] The new commissions pass new "statutes" at their first meetings; while these differ from the statutes adopted by the former leading small groups, these are not publicly available.

[18] Xinhua News Agency, "Xi Jinping calls the first meeting of the Central Comprehensive Deepening of Reform Commission" (习近平主持召开中央全面深化改革委员会第一次会议), March 28, 2018, accessed at http://www.gov.cn/xinwen/2018-03/28/content_5278124.htm; Xinhua News Agency, "Xi Jinping calls the second meeting of the Central Comprehensive Deepening of Reform Commission" (习近平主持召开中央全面深化改革委员会第二次会议), May 11, 20018, accessed at http://www.gov.cn/xinwen/2018-05/11/content_5290309.htm.

[19] Xinhua News Agency, "Xi Jinping Presides over first meeting of the Finance and Economics Commission" (习近平主持召开中央财经委员会第一次会议), April 2, 2018, accessed at http://www.gov.cn/xinwen/2018-04/02/content_5279304.htm.