China Politics
Resolution Articulates Continuity with Incremental Reforms

- The Central Committee Resolution on Further Deepening Reform Comprehensively to Advance Chinese-Style Modernization projects continuity from 2013 reform roadmap
- Premier Li Qiang's absence from the drafting group of the Third Plenum's Resolution indicates his focus on implementing party orders while Cai Qi focuses on coordination
- Fiscal reforms feature incorporating government credit in budget management, heavier central expenditure, and expansion of local taxing authority
- Hukou reform will focus on improving rural residents' access to urban social services and liberalizing their land back home
- Beijing aims to support high-quality development with more institutional building, including plans for key industries' relocation and redundancy, as well as strategic reserve
- There will be more open-up for foreign trade and investment, but not necessarily equal treatment in all contracts
- Beijing also attempts to treat industrial and financial capital differently, likely meaning stronger supervision over the later than the former
- Beijing continues to view AI governance from a content-centric lens

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At around 4:30 PM on Sunday, the Party's official news outlet, Xinhua News Agency, released the full text of The Central Committee's *Resolution on Further Deepening Reform Comprehensively to Advance Chinese-Style Modernization* ("the Resolution"). This highly anticipated reform roadmap was passed by the Third Plenum three days prior. Xinhua also released an explanation by general secretary Xi Jinping to the Central Committee on the drafting process of the Resolution.

The full text of the Resolution confirmed most of the assessments covered in our earlier preview pieces (see: Key Reforms Expected at the Third Plenum and Xi Holds Symposium to Highlight Priorities at Third Plenum).

Overall, the Resolution reflects continuity from Beijing's last reform roadmap in 2013, with strong emphases on creating new growth drivers, bridging urban-rural gaps, moving up the industry value chain, and promoting innovation. It also incorporates Beijing's top priorities in recent years, such as the resilience and security of the industry value chain and supply chain, creating a level playing field for different types of market players, tighter financial supervision, and better handling of the fast-evolving external environment.

It is important to note that the top leaders were likely concerned about market sentiment. While the communiqué of the Third Plenum released last Thursday did not mention "common prosperity" at all, the Resolution only mentioned the term once. In addition, the central bank also cut 10 bps off China's 1-year and 5-year loan prime rates (LPR) today, echoing the communiqué's call to stabilize growth.

Reform leadership reveals a simpler role of Li Qiang

The most important takeaway did not come from the Resolution but rather from Xi's explanation of it. According to Xi, a drafting group for the Resolution was formed last

November, with him as the chair and Politburo Standing Committee (PBSC) members Wang Huning, Cai Qi, and Ding Xuexiang serving as vice chairs.

The absence of Premier Li Qiang, who ranks second in the PBSC, is a major surprise. Despite being a vice chair of the Central Comprehensively Deepening Reform Commission (CCDRC)—the party commission established in 2013 to coordinate the comprehensively deepening reform initiative—Li was not included in the drafting group for the Resolution. Wang and Cai, who are vice chairs of the drafting groups, are also CCDRC vice chairs.

This omission confirms our earlier assessment that **Li holds a simpler portfolio, primarily focused on implementing party orders and decisions, rather than being the "second in command" in all matters like his predecessors**.

Instead, Central Committee Secretariat first secretary Cai Qi, who sits on the drafting group as a vice chair, has been playing a more prominent role as the central coordinator between ideology, development, and security. This shift underscores Cai's increasing influence and a redefined dynamics of the Party's top leadership (see: New Policymakers, New Dynamics).

However, it is important to note that Li remains crucial to the reform process. Many of the reforms and their outcomes will still fall under his purview, including attracting foreign investment, driving innovation, and improving the overall business environment for the private sector and multinationals. This indicates that while Li's role may be more execution-focused, it is still pivotal for the successful implementation of the Resolution's objectives. To this end, Li likely provided critical input to the drafting of the Resolution.

Yet, Li's absence from the drafting group means **he will play a lesser role in the high-level coordination of reforms**. Ensuring the reforms are well-paced, conflict-free, and do not alarm the market will fall primarily to Cai, as the central coordinator, and Wang, as the office director of the CCDRC and the Party's chief ideologist. **They will be key in maintaining the coherence and stability of the reform process.**

The macro policy orientation consistency assessment will likely be under Cai's purview. Xi emphasized the need for such consistency to avoid conflicting signals that could undermine market confidence last December during the annual Central Economic Work Conference. This assessment will cover both economic and non-economic policies, with **Cai positioned to oversee this process and act as the crucial gatekeeper against non-economic policies that could lead to negative market reactions**.

Fiscal reform means more help before shock

The most significant reform outlined in the Resolution concerns China's fiscal system. First, the Resolution calls for all revenue generated through administrative power, government credit, and state-owned resources to be placed under budget management. **The inclusion of government credit is particularly noteworthy, as it indicates that Beijing will start using government bond issuance to back China's money supply, as we previously predicted** (see: PBOC Communicates to Confound the Market).

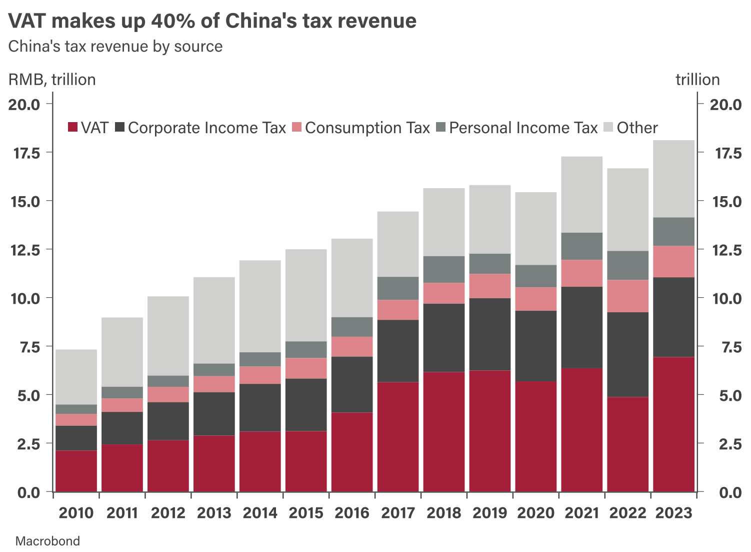
Consistently, the Resolution promises to increase the share of fiscal expenditure by central government. It explicitly pledges to reduce the scope of central obligations entrusted to local governments, which currently include basic public services such as education and healthcare, infrastructure, and environmental protection. Additionally, it calls for the establishment of a national social security service platform and better coordination of pension and healthcare insurance funds. **This shift signifies that the central government will take on a more active role in funding strategic projects and enhancing China's social welfare programs.**

Secondly, the Resolution aims to establish a tax mechanism that is conducive to high-quality development, social equity, and market unification. Specifically, it calls for reforms to the individual tax system to cover business income, capital gains, and property income, and to improve the tax collection mechanism. To enhance people's livelihoods, it also seeks to regulate the mechanisms for wealth accumulation and to improve the taxation system in the real estate sector.

The taxation of income sources beyond salaries, especially those from wealth accumulation, is inevitable in Beijing's pursuit of common prosperity. Such incomes were already made taxable by the Individual Tax Law in 2018, but enforcement has been weak. Now with the law effective for over five years, Beijing appears ready to move forward. This said, this reform may not lead to an immediate rise in individual tax burdens: **Beijing may start by allowing the deduction of capital losses to encourage more compliance with tax rules, similar to its implementation of the law in 2019.**

The wording related to real estate tax is also worth highlighting. Instead of "accelerating the legislation of real estate tax and pushing through reform" as stated in the 2013 reform roadmap, the Resolution merely states to "improve the taxation system" of the sector. **This likely means adjustments within the current system, such as reducing taxes on real estate transactions and decreasing local governments' reliance on land sales, before the actual expansion of real estate tax.**

Third, the Resolution plans to improve the central-local fiscal balance. **This section exceeds expectations with an explicit promise to expand local governments' taxing authority.** The reform of consumption tax is discussed here, with a focus on shifting the collection from production to consumption stages and sharing a portion with local governments—without mentioning any expansion of scope. Additionally, local governments may set their own tax rates for urban maintenance, construction, and education, as well as some non-tax revenue. This will provide local governments with more financial autonomy and the ability to address specific regional needs.



The Resolution also promises to share more of the value-added tax (VAT) with local governments. Currently, provincial governments share 50% of the VAT, which accounts for 40% of China's tax revenue. In January, Jiangxi province announced that it would share 60-70% of provincial revenue with lower-tier governments. If this approach is applied to the central-provincial balance, it will significantly relieve local governments' fiscal stress.

Finally, it is important to recall that one of the key goals of fiscal reform is to unify the domestic market. As Beijing enforces the standardization of market rules across the country and compels local governments to abandon protectionist measures, it will become easier for firms to relocate based on market opportunities. **Despite gaining more taxing authority, local governments may still be cautious in raising tax rates due to the higher risk of losing their tax base.** Localities that lose attractiveness to businesses and residents may still rely on transfers from the central government.

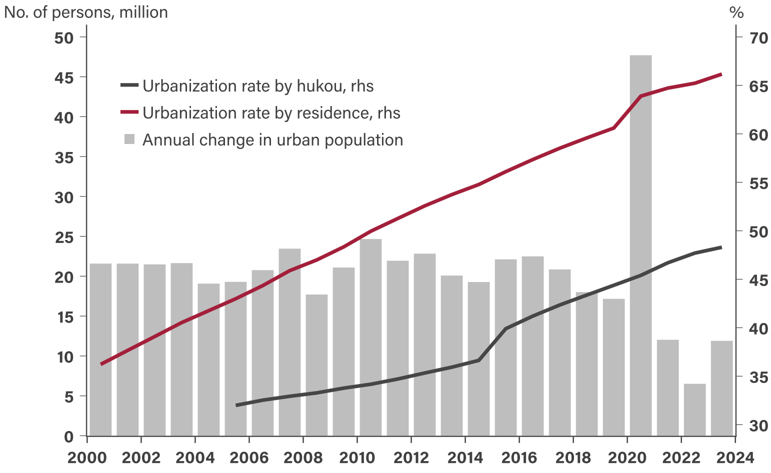
Social service and land reforms to facilitate urban-rural integration

As for urban-rural integration, the Resolution also offers more details. For cities, the goal is to establish a mechanism that encourages positive interaction between industrial upgrades, population agglomeration, and urban development. **This means cities will need to provide public services such as social security, housing, and education to people working and living there, regardless of their *hukou*.** By doing so, China's 300mn rural migrant workers may finally be able to settle in cities, bridging the urban-rural divide and fostering greater social cohesion.

Moreover, the Resolution calls for coordinated development of large and small cities in a compact layout. **This approach seeks to avoid urbanization driven solely by land conversion**, which has been prevalent in the northern and western regions over the past two decades. Instead, the Resolution aims to create a more efficient governance system for large cities and to facilitate the integrated development of city clusters. It further pledges to grant more economic and social management authority to towns with large populations and robust economies. **Coastal cities with increasing populations will likely benefit from enhanced policy support, reflecting a strategic shift in urban planning.**

More reforms are required to encourage settlement in cities

China adjusted its urban hukou in 2015 and urban population in 2020 after national censuses



Macrobond

For rural areas, the most significant development is land reform. The Resolution explicitly calls for **better utilization of rural residential properties, which occupy roughly 70% of China's rural non-agricultural land.** Historically, these properties faced strict transaction restrictions due to concerns about social stability. However, with improved access to urban social services for rural migrant workers, reform in this area may finally advance. In practice, rural residential properties could be leased and utilized through equity investment or business cooperation, leading to an increased supply of rural non-agricultural land.

The Resolution also pledges to match China's land supply to its regional development plans. It aims to prioritize land supply for strategic projects and pillar industries, ensuring that regions with advantages in these sectors can expand and thrive. **It also calls for more urban land supply in areas with growing population.** Additionally, it pledges to optimize urban industrial and commercial land supply by accelerating the development of a secondary market for land transactions and allowing more flexible conversion of land use purposes.

New institutions to support high-quality development

Regarding high-quality development, **the Resolution aims to support the new sectors with new institutions, so as to promote their sustainable growth**. It also aims to advance industrial upgrade, thus application of digital and green technologies, via higher national standards. Additionally, it calls to promote digitalization of industries and industrialization of data services, and to establish a mechanism to ensure reasonable share of investment in manufacturing as well as lower transaction costs and taxes for this sector.

The Resolution also pledges to support the service sector by improving relevant institutions, optimizing accounting, and promoting standardization in this sector. Specifically, it calls to develop industrial internet platforms so as to bypass local protectionism measures and better integrate services with industrial activities. It also promises more support for consumer services by regulating intermediary service agencies, as well as more reforms in standard setting, financing, and management to upgrade China's infrastructure services.

The most significant change in this regard, however, is the Resolution's heavy emphasis on the resilience and security of China's industry value chain and supply chain, as the geopolitical environment deteriorates and major powers around the world implement industrial policies to encourage firms to relocate manufacturing capacities back home.

Specifically, the Resolution identifies integrated circuits, industrial machine tools, medical equipment, instruments, basic software, industrial software, and advanced materials as key sectors of focus. It highlights the need for robust institutions and mechanisms to bolster development in these sectors. **This indicates that Beijing will invest more to remove impediments hindering the improvement of security and resilience in these industries.**

A more crucial call is to create a coordination mechanism for industries to be "relocated domestically in a progressive and orderly manner." This trend has been ongoing for years due to rising labor costs in economically-advanced regions, most recently highlighted by the 14th Five-Year Plan and a guideline issued by the Ministry of Industry and Information Technology. The Resolution now hopes to improve benefit sharing between transferors and recipients. **Such coordination is essential to sustain fiscal income for inland regions receiving coastal industries, especially as China transforms its tax system that will favor localities (most of which are coastal) with more residents and higher incomes.**

The Resolution also aims to create a strategic hinterland and industrial redundancy, meaning the establishment of idle capacities to buffer against global supply chain shocks or new export control measures targeting China. This initiative is complemented by another key reform to improve China's national reserves system, which includes strategic reserves of food, energy, and critical minerals.

State-owned enterprises (SOEs), particularly central SOEs, will play a key role in this effort. Since the trade war began, China has pivoted its SOE reform toward strategic assurance. For example, China Mining Group and China Rare Earth Group, two central SOEs established in 2022 and 2021, respectively, have been mandated to strengthen China's control over key resources—both to meet domestic demand and to regulate supply to other countries.

This strategic shift is why the Resolution calls for making state capital and SOEs stronger, better, and bigger, and steering them toward key industries and sectors with national security and national economy implications, as well as those in forward-looking and strategic emerging sectors.

Foreign trade and investment may still face unequal treatments

Discussions of China's further opening-up in the Resolution are somewhat disappointing. The Resolution does promise to actively connect with international high-standard economic and trade rules in areas such as property right protection, subsidies, environment standards, labor protection, government procurement, e-commerce, and finance. It explicitly pledges to defend the multilateral trading system centered around the World Trade Organization, actively participate in the reform of global economic governance, and expand the network of high-standard free-trade zones.

The Resolution also promises to expand the opening-up of China's goods, services, capital, and labor markets for foreign trade and investments. In particular, it aims to fully implement the negative list for cross-border services, which currently covers 71 items such as maritime, internet news, and payment services—meaning more liberalization of the rest. It also calls for more expansion of service open-up pilots, more support for international professional services, and more development of offshore international trade and finance.

However, it fails to meet a key ask by foreign firms, which is to treat foreign and domestic firms equally in the contract bidding process. This term was included in Beijing's latest attempt to attract foreign investment in March, thus was expected to be included in the Resolution. While the Resolution does promise equal treatment for foreign firms in terms of access to resources, licensing, standard setting, and government procurement, the omission of the bidding process could still disadvantage foreign firms in contracts with non-government entities such as SOEs.

The omission is likely related to Beijing's concern over supply chain resilience as discussed above. After all, Beijing is unlikely to treat foreign investments equally in strategic projects designed to shield China from external shocks. **The Resolution also calls for strengthening China's counter-sanction and counter-interference regimes, as well as measures against long-arm jurisdiction**, likely in response to not only restrictions imposed by the US but also those from its allies as a result of US pressure.

Industrial capital and financial capital to play different roles

In the financial sector, upcoming reforms will focus on channeling resources to strategic sectors like innovation, as well as strengthening supervision and risk prevention. Both initiatives represent stronger state intervention and are unlikely to be welcomed by the capital market.

Specifically, the Resolution calls for the formulation of a Financial Law to improve the financial regulatory system, build a safe and efficient financial infrastructure, enhance protection for financial consumers, establish a "firewall" between industrial and financial capital, and promote the high-level opening-up of the financial sector.

The "firewall" concept is particularly noteworthy. **It reflects Beijing's distinct attitudes towards industrial and financial capital, aiming to treat them differently.** This likely implies stronger supervision of financial capital compared to industrial capital, as the latter aligns better with Beijing's call for "long-term capital." When discussing policies to foster new-quality productive forces, the Resolution explicitly calls for the development of "patient capital" like angel investment, venture capital, private equity, and government funds.

The Resolution also expects foreign capital to play a role in China's financial sector. It reiterates support for qualified foreign institutions to participate in financial business pilots and pledges to make it easier for foreign capital to conduct equity investment and venture capital in China. In contrast, the Resolution adopts a more cautious stance on the outflow of China's financial capital. It promises only steady progress in RMB internationalization and calls for mechanisms to safeguard financial security amid further opening-up.

AI governance to focus on content regulation

The Resolution briefly touches on the governance of artificial intelligence (AI), following Beijing's content-centric approach. It calls to improve the mechanism for developing and managing generative AI in the same section with cyberspace governance that emphasizes heavily on news propaganda and online public opinion.

This approach is consistent with developments over the past three years, during which generative AI has seen dramatic global expansion. China has had a head start in regulating internet content and the cyberspace ecosystem under a comprehensive and sophisticated regime involving all key government and industry stakeholders. The success of this approach has led to path dependence among policymakers and regulators in AI.

Cyberspace Administration of China (CAC)'s 2023 provisional regulations on generative AI contained traces of its past directives on content-based recommendation algorithms and deep synthesis. The logic stems from the Party's 2020 guidelines on developing a law-based society, in which AI is seen as part of the broader cyberspace ecosystem.

This means China will align its AI regulatory framework to its ideological baselines. To Beijing, the unpredictability of AI-generated content carries the risk of serious social and political consequences that policymakers can more readily fathom, given the Party's history in regulating public discourse.

This has been proved by Beijing's AI regulations and top-level regulatory discussions to date, which have mainly focused on the application end of AI-powered technologies. The thrust of this discourse is to prevent AI from creating a parallel information and socioeconomic distribution beyond the Party's and state's own.