

# 1 China

CAO Houle

## I. Introduction

The People's Republic of China (China), is a unitary sovereign state in East Asia, with a population of over 1.381 billion.<sup>1</sup> Covering approximately 9.6 million square kilometers, China is the world's second largest state by land area,<sup>2</sup> and either the third largest by total area.<sup>3</sup> The state is governed by the Communist Party of China based in the capital of Beijing. Since the introduction of economic reforms in 1978, China has become one of the world's fastest-growing major economies. As of 2014, it is the world's second-largest economy by nominal GDP and largest by purchasing power parity (PPP). China is also the world's largest exporter and second-largest importer of goods.<sup>4</sup>

### I.1 Geography and climate

China's total area is generally stated as being approximately 9,600,000 km<sup>2</sup>.<sup>5</sup> The territory of China lies between latitudes 18° and 54° N, and longitudes 73° and 135° E. China's landscapes vary significantly across its vast width. In the east, along the shores of the Yellow Sea and the East China Sea, there are extensive and densely populated alluvial plains, while on the edges of the Inner Mongolian plateau in the north, broad grasslands predominate. Southern China is dominated by hills and low mountain ranges, while the central-east hosts the deltas of China's two major rivers, the Yellow River and the Yangtze River.

China borders on 14 countries, and is adjacent to 8 countries across the sea. Neighbors of China's mainland are Mongolia to the north, Russia to the northeast, Kazakhstan, Kyrgyzstan, Tajikistan to the northwest, Afghanistan, Pakistan, India, Nepal, Bhutan to the west and southwest, Myanmar, Laos and Vietnam to the south. The East and southeast is across the sea from the Philippines, Japan, South Korea, Brunei, Malaysia and Indonesia.

China exercises jurisdiction over 22 provinces, 5 autonomous regions, 4 direct-controlled municipalities (Beijing, Tianjin, Shanghai, and Chongqing), and 2 mostly self-governing special administrative regions (Hong Kong and Macau), and claims sovereignty over Taiwan. The country's major urban areas include Shanghai, Guangzhou, Beijing, Chongqing, Shenzhen, Tianjin and Hong Kong.

China's climate is mainly dominated by dry seasons and wet monsoons, which lead to pronounced temperature differences between winter and summer. In the winter, northern winds coming from high-latitude areas are cold and dry; in summer, southern winds from coastal areas at lower latitudes

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<sup>1</sup> "China Population". [www.worldometers.info](http://www.worldometers.info). 15 March 2016. Retrieved 15 March 2016.

<sup>2</sup> "Countries of the world ordered by land area". [Listofcountriesoftheworld.com](http://Listofcountriesoftheworld.com). Retrieved 27 April 2010.

<sup>3</sup> The total area ranking relative to the United States depends on the measurement of the total areas of China and the United States.

<sup>4</sup> White, Garry (10 February 2013). "China trade now bigger than US". *Daily Telegraph*. London. Retrieved 15 February 2013.

<sup>5</sup> "Geography – china.org.cn". [china.org.cn](http://china.org.cn). Retrieved 31 May 2015.

are warm and moist.<sup>6</sup> The climate in China differs from region to region because of the country's highly complex topography.

## I.2 History and culture

China is one of the world's oldest civilized nation, which dates back to more than 10,000 years. The 5,000 years period is commonly used as the date when China became unified under a large empire. China alternated between periods of political unity and disunity at intervals, and was occasionally conquered by external groups of people, some eventually being assimilated into the Chinese population. The Xia dynasty of China (from c. 2100 to c. 1600 BC) is the first dynasty to be described in ancient historical records such as Sima Qian's Records of the Grand Historian and Bamboo Annals.<sup>78</sup>

Time list of Chinese Dynasties

- Primitive age
- The Xia Dynasty (late 22th century BC- early 16th century BC)
- The Shang Dynasty (16th century BC-11th century BC)
- The Zhou Dynasty (11th century BC-771 BC)
- The Spring and Autumn Period (770 BC-476 BC) & The Warring States Period (475 BC-221 BC)
- The Qin Dynasty (221 BC-206 BC)
- The Han Dynasty (206 BC-220 AD)
- The Wei and Jin Periods & The Northern and Southern Dynasties (220 AD-581 AD)
- The Sui Dynasty (581 AD-618 AD)
- The Tang Dynasty (618 AD-907 AD)
- The Five Dynasties and Ten States Period (907 AD-979 AD)
- The Song Dynasty (960 AD-1279 AD)
- The Yuan Dynasty (1206 AD-1368 AD)
- The Ming Dynasty (1368 AD-1644 AD)
- The Qing Dynasty (1616 AD-1911 AD)
- History of Modern China(1911 AD- )

Chinese culture is regarded as very extensive and profound. The Four Great Inventions of China, namely the Compass, Gunpowder, Paper and Printing, has a significant impact on the development of Chinese civilization and a far-ranging global impact. The Great Wall, Grand Canal and other ancient projects are regarded as engineering miracle in the world. Besides, the advanced technology and thought in ancient China have contributed immensely to the progress of mankind. For example, the presentation of ratio of the circumference of a circle to the diameter, the invention of armillary sphere, the medical works of “Compendium of Materia Medica”, the art works of “the Book of Songs”, the geographic works of “Shui Jing Zhu”, the agricultural works of “Qi Min Yao Shu” and the encyclopedia of “Tian Gong Kai Wu”, etc. Most social values of China are derived from Confucianism and Taoism. As the mainstream of the Chinese traditional, Confucianism permeates Chinese life and culture, even having the impact on the world.

There are numerous heritages of the deposit of culture in China, loaded with massive history. So

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<sup>6</sup> Regional Climate Studies of China. Springer. 2008. p. 1. ISBN 9783540792420.

<sup>7</sup> "Public Summary Request Of The People's Republic Of China To The Government Of The United States Of America Under Article 9 Of The 1970 Unesco Convention". Bureau of Educational and Cultural Affairs, U.S. State Department. Archived from *the original* on 15 December 2007. Retrieved 12 January 2008.

<sup>8</sup> "The Ancient Dynasties" University of Maryland. Retrieved 12 January 2008.

far, there are 31 World Cultural and Natural Heritages in China determined by UNESCO's World Heritage Committee (WHC). In addition, China has nearly 400,000 known unmovable cultural relics above- and underground and boasts a wide variety of arts and crafts renowned for excellent workmanship. And the number of museums nationwide has reached about 2,000 if the local non-governmental museums are included. Also, there are a great many world-famous scenic spots and historical sites in China, including Great Wall, the Yellow River, the Yangtze River, and Potala Palace, etc.

### **I.3 Population and Ethnic Groups**

China officially recognizes 56 distinct ethnic groups, the largest of which are the Han Chinese, who constitute about 91.51% of the total population.<sup>9</sup> The Han Chinese – the world's largest single ethnic group<sup>10</sup> – outnumber other ethnic groups in every provincial-level division except Tibet and Xinjiang. Ethnic minorities account for about 8.49% of the population of China, according to the 2010 census. Compared with the 2000 population census, the Han population increased by 66,537,177 persons, or 5.74%, while the population of the 55 national minorities combined increased by 7,362,627 persons, or 6.92%. The 2010 census recorded a total of 593,832 foreign citizens living in China.

### **I.4 Language**

There are as many as 292 living languages in China.<sup>11</sup> The languages most commonly spoken belong to the Sinitic branch of the Sino-Tibetan language family, which contains Mandarin (spoken natively by 70% of the population),<sup>12</sup> and other Chinese varieties: Wu (including Shanghainese), Yue (including Cantonese and Taishanese), Min (including Hoochew, Hokkien and Teochew), Xiang, Gan, and Hakka. Languages of the Tibeto-Burman branch, including Tibetan, Qiang, Naxi and Yi, are spoken across the Tibetan and Yunnan–Guizhou Plateau.

Standard Mandarin, a variety of Mandarin based on the Beijing dialect, is the official national language of China and is used as a lingua franca in the country between people of different linguistic backgrounds.<sup>13</sup>

Chinese characters have been used as the written script for the Sinitic languages for thousands of years. They allow speakers of mutually unintelligible Chinese varieties to communicate with each other through writing. In 1956, the government introduced simplified characters, which have supplanted the older traditional characters in mainland China. Chinese characters are romanized using the Pinyin system. Tibetan uses an alphabet based on an Indic script. Uyghur is most commonly written in a Perseo-Arabic script. The Mongolian script used in China and the Manchu script are both derived from the Old Uyghur alphabet. Modern Zhuang uses the Latin alphabet.

### **I.5 Religion**

Over the millennia, Chinese civilization has been influenced by various religious movements. The

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<sup>9</sup> "Communiqué of the National Bureau of Statistics of People's Republic of China on Major Figures of the 2010 Population Census (No. 1)". National Bureau of Statistics of China. 28 April 2011. Archived from the original on 15 January 2013. Retrieved 14 June 2013.

<sup>10</sup> Lilly, Amanda (7 July 2009). "A Guide to China's Ethnic Groups". Washington Post.

<sup>11</sup> Languages of China – from Lewis, M. Paul (ed.), 2009. *Ethnologue: Languages of the World*, Sixteenth edition. Dallas, Tex.: SIL International.

<sup>12</sup> Kaplan, Robert B.; Richard B. Baldauf (2008). *Language Planning and Policy in Asia: Japan, Nepal, Taiwan and Chinese characters*. *Multilingual Matters*. p. 42. ISBN 9781847690951.

<sup>13</sup> *Rough Guide Phrasebook: Mandarin Chinese*. Rough Guides. 2011. p. 19. ISBN 9781405388849.

"three teachings", including Confucianism, Taoism, and Buddhism (Chinese Buddhism), historically have a significant role in shaping Chinese culture, each of them finding a role within common (or popular) Chinese religion. Freedom of religion is guaranteed by China's constitution, although religious organizations that lack official approval can be subject to state persecution.

Demographically, the most widespread religious tradition is the "Chinese religion", which comprehends Confucian and Taoist modalities, and consists in allegiance to the shen (神), a character that signifies the "energies of generation", who can be deities of the natural environment or ancestral principles of human groups, concepts of civility, culture heroes, many of whom feature in Chinese mythology and history. Among the most popular folk cults are those of Mazu (goddess of the seas), Huangdi (one of the two divine patriarchs of the Chinese race), Guandi (god of war and business), Caishen (god of prosperity and richness), Pangu and many others. China is home to many of the world's tallest religious statues, including the tallest of all, the Spring Temple Buddha in Henan.

The government of the People's Republic of China is officially atheist. Religious affairs and issues in the country are overseen by the State Administration for Religious Affairs. A 2015 poll conducted by Gallup International found that 61% of Chinese people self-identified as "convinced atheist".<sup>14</sup>

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<sup>14</sup> "Gallup International Religiosity Index" (PDF). Washington Post. WIN-Gallup International. April 2015.

## II. Overview of macroeconomic activity and fiscal position

### II.1 Economic Overview

The Chinese economy experienced astonishing growth in the last few decades that catapulted the country to become the world's second largest economy. In 1978—when China started the program of economic reforms—the country ranked ninth in nominal gross domestic product (GDP) with USD 214 billion; 35 years later it jumped up to second place with a nominal GDP of USD 9.2 trillion.

Since the introduction of the economic reforms in 1978, China has become the world's manufacturing hub, where the secondary sector (comprising industry and construction) represented the largest share of GDP. However, in recent years, China's modernization propelled the tertiary sector and, in 2013, it became the largest category of GDP with a share of 46.1%, while the secondary sector still accounted for a sizeable 45.0% of the country's total output. Meanwhile, the primary sector's weight in GDP has shrunk dramatically since the country opened to the world.

**Table 1 China Economy Data**

	2011	2012	2013	2014	2015
Population (million)	1,347	1,354	1,361	1,368	1,375
GDP per capita (USD)	5,575	6,260	7,037	7,569	7,808
GDP (USD bn)	7,511	8,476	9,576	10,352	10,736
Economic Growth (GDP, annual variation in %)	9.5	7.8	7.7	7.3	6.9
Consumption (annual variation in %)	11	9.1	7.3	7.8	-
Investment (annual variation in %)	24	20.6	19.6	15.7	10
Industrial Production (annual variation in %)	13.9	10	9.7	8.3	6.1
Retail Sales (annual variation in %)	17.1	14.3	13.1	12	10.7
Unemployment Rate	4.1	4.1	4.1	4.1	4.1
Fiscal Balance (% of GDP)	-1.1	-1.6	-1.9	-1.8	-3.5
Public Debt (% of GDP)	14.9	14.5	14.8	15	-
Money (annual variation in %)	13.6	13.8	13.6	12.2	13.3
Inflation Rate (CPI, annual variation in %)	5.4	2.6	2.6	2	1.4
Policy Interest Rate (%)	6.56	6	6	5.6	4.35
Stock Market (annual variation in %)	-21.7	3.2	-6.7	52.9	9.4
Exchange Rate (vs USD)	6.29	6.23	6.05	6.21	6.49
Exchange Rate (vs USD, aop)	6.46	6.31	6.15	6.16	6.28
Current Account (% of GDP)	1.8	2.5	1.5	2.7	3.1
Current Account Balance (USD bn)	136	215	148	277	331
Trade Balance (USD billion)	154	231	258	383	602
Exports (USD billion)	1,898	2,049	2,209	2,342	2,283
Imports (USD billion)	1,744	1,819	1,952	1,959	1,681
Exports (annual variation in %)	20.2	8	7.8	6	-2.5
Imports (annual variation in %)	25	4.3	7.3	0.4	-14.2
International Reserves (USD)	3,181	3,312	3,821	3,843	3,330
External Debt (% of GDP)	9.3	8.7	9	8.6	13.2

Source: the World Bank and IMF database

### II.2 International Environment

#### II.2.1 Trade Balance

China's accession to the WTO in December 2001 paved the way for its economic rise and significantly contributed to increasing world trade from 2002 to 2008. Another noteworthy event in the early 2000s was the introduction of euro coins and notes in 2002. Strong Chinese demand for

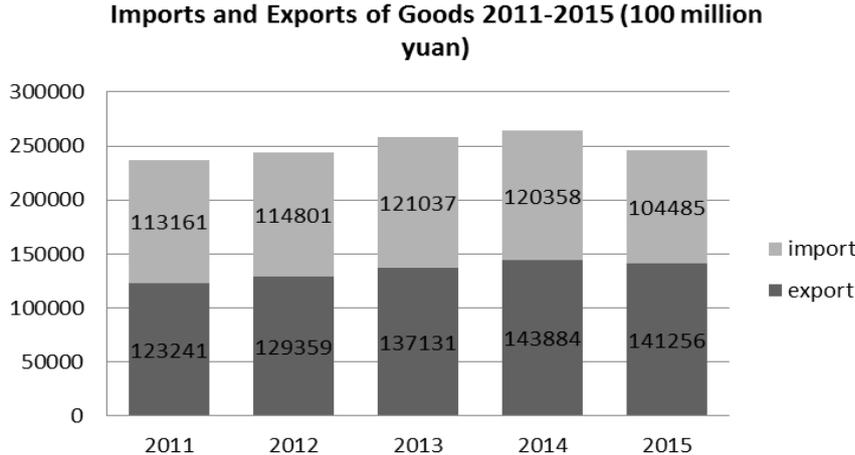
natural resources contributed to rising prices for crude oil and other primary commodities between 2002 and 2008. The 2008 financial crisis, triggered by the subprime lending crisis in the United States, led to a global recession between 2008 and 2011. The volume of world exports plunged 12 per cent in 2009 while world gross domestic product (GDP) dropped 2 per cent.<sup>15</sup>

China overtook Japan as the leading Asian exporter in 2004, three years after its accession to the WTO. China surpassed the United States in 2007 and Germany in 2009 to become the world’s leading exporter.

The total value of imports and exports of goods in 2015 reached 24,574.1 billion yuan, down by 7.0 percent over the previous year. Of this total, the value of goods exported was 14,125.5 billion yuan, down by 1.8 percent, and the value of goods imported was 10,448.5 billion yuan, down by 13.2 percent. The balance of imports and exports (exports minus imports) was 3,677.0 billion yuan, an increase of 1,324.4 billion yuan over the previous year.<sup>16</sup>

Since 1995, China has been recording consistent trade surpluses which from 2004 to 2009 has increased 10 times. In 2015 as a whole, China’s total trade dropped by 7 percent, as exports shrank 1.8 percent and imports fell sharply by 13.2 percent due to a weaker renminbi and falling commodity prices.

**Figure 1: Imports and Exports of Goods 2011-2015 (100 million yuan)**



Source: Statistical Communiqué of the People’s Republic of China on the 2015 National Economic and Social Development

Table 2 shows the general situation of international trade. Among the exports, mechanical and electronic products account for the largest part and Foreign-funded companies are main sources. That can be explained by high proportion of processing and assembling trades in electronic products’ exports. China is at the low-end of this industry’s international market.

<sup>15</sup> International Trade Statistics 2015, World bank

<sup>16</sup> Statistical Communiqué of the People’s Republic of China on the 2015 National Economic and Social Development, 2015.

**Table 2 Total Value of Import and Export of Goods and the Growth Rates in 2015**

Item	Value (100 million yuan)	Increase over 2014 (%)
Total value of import and export of goods	245741	-7
Exports	141255	-1.8
Of which: General trade	75456	2.1
Processing trade	49553	-8.8
Of which: Mechanical and electronic products	81421	1.1
High & new technology products	40737	0.4
Imports	104485	-13.2
Of which: General trade	57323	-15.9
Processing trade	27772	-13.7

Source: National Bureau of Statistics of China (2016)

Table 3 demonstrates the regional distribution of imports and exports in 2015. In 2015, the biggest trade surpluses were recorded with Hong Kong, the US, the Netherlands, India, the UK, Vietnam, Singapore and Indonesia. China recorded trade deficits with Taiwan, South Korea, Australia, Germany, Brazil and South Africa.

**Table 3: Imports and Exports by Major Countries and Regions and the Growth Rates in 2015**

Country or region	Exports (100 million yuan)	Increase over 2014 (%)	Imports (100 million yuan)	Increase over 2014 (%)
European Union	22096	-3	12985	-13.6
United States	25425	4.5	9238	-5.4
ASEAN	17221	3.1	12097	-5.4
Hong Kong, China	20589	-7.7	797	2.8
Japan	8424	-8.3	8881	-11.4
Republic of Korea	6291	2.1	10847	-7.1
Taiwan, China	2785	-2	8904	-4.6
India	3612	8.5	831	-17.2
Russia	2161	-34.5	2066	-19.1

Source: Statistical Communiqué of the People's Republic of China on the 2015 National Economic and Social Development

The total value of imports and exports of services in 2015 was 713.0 billion US dollars, up by 14.6 percent. The export value of services was 288.2 billion US dollars, up by 9.2 percent. The import value of services was 424.8 billion US dollars, up by 18.6 percent. The deficit of exports minus imports of services was 136.6 billion US dollars.

The year 2015 witnessed the establishment of 26,575 enterprises (excluding banking, securities and insurance) with foreign direct investment, up by 11.8 percent over the previous year; and the foreign capital actually utilized was 781.4 billion yuan (126.3 billion US dollars), up by 6.4 percent. Among the enterprises, 2,164 of them were invested by investors from countries along the Belt and Road, up by 18.3 percent; and the foreign capital actually utilized was 52.6 billion yuan (8.5 billion US dollars), an increase of 25.3 percent.

## II.2.2 International Investment Position

The net international investment position measures the difference between a country's external assets and liabilities. Table 4 illustrates the international investment position of China from 2011-2015.

At the end of 2015, the net international investment position reached 1.59 trillion US dollars. And the external financial assets totaled 6.21 trillion US dollars, while its external financial liabilities stood

at 4.62 trillion US dollars. The reserve assets exceeded 3.41 trillion US dollars, accounting for 55 percent of its external financial assets.

Attracting Foreign Direct Investment (FDI) to promote the domestic economy is an effective method. With the stable environment, good infrastructure, large domestic market and low labor costs, China has become one of top priority of foreign investments. At the end of 2015, FDI in China reached 2.84 trillion US dollars, accounting for 62 percent of the country's external financial liabilities. Foreign portfolio investment reached 810.5 billion US dollars and other investment hit 964.3 billion US dollars.

**Table 4: The time-series data of International Investment Position of China (100 million USD)**

Item	End-2011	End-2012	End-2013	End-2014	End-2015
Net International Investment Position	16884	18665	19960	16028	15965
Assets	47345	52132	59861	64383	62189
1 Direct investment	4248	5319	6605	8826	11293
2 Portfolio investment	2044	2406	2585	2625	2613
3 Financial derivatives (other than reserves) and employee stock options	0	0	0	0	36
4 Other investment	8495	10527	11867	13938	14185
5 Reserve assets	32558	33879	38804	38993	34061
Liabilities	30461	33467	39901	48355	46225
1 Direct investment	19069	20680	23312	25991	28423
2 Portfolio investment	2485	3361	3865	7962	8105
3 Financial derivatives (other than reserves) and employee stock options	0	0	0	0	53
4 Other investment	8907	9426	12724	14402	9643

Source: State Administration of Foreign Exchange (2015)

### II.2.3 Balance of Payment

China's external position is extremely solid. The current account has recorded a surplus in every year since 1994. The capital account followed suit and only recorded two deficits in the last 20 years. This situation of surpluses in the both the current and the capital put pressure on the national currency and prompted the Central Bank to sterilize most of the foreign currency that entered the country. The current account surplus reached its peak in 2008. Since then, however, the surplus has since narrowed as the currency strengthened and domestic demand increased.

China's capital account has bold controls, which implies that the country lacks the freedom to convert local financial assets into foreign financial assets at a market-determined exchange rate and vice versa. The new Xi-Li administration and the People's Bank of China vowed to accelerate interest rate liberalization and capital account convertibility. In this regard, Chinese authorities have started to implement some measures, such as removing a cap on foreign-currency deposit rates in Shanghai and releasing some controls on the currency.

**Table 5 China's Balance of Payments 2015 (100 million of US dollars)**

Item	2014	2015
<b>1. Current account</b>	<b>2,774</b>	<b>3,306</b>
Credit	28,047	26,930
Debit	-25,273	-23,624
<b>1.A Goods and services</b>	<b>2,627</b>	<b>3,846</b>
Credit	25,242	24,293
Debit	-22,616	-20,447
<b>1.A.a Goods</b>	<b>4,350</b>	<b>5,670</b>
Credit	22,438	21,428
Debit	-18,087	-15,758
<b>1.A.b Services</b>	<b>-1,724</b>	<b>-1,824</b>
Credit	2,805	2,865
Debit	-4,528	-4,689
<b>1.B Primary income</b>	<b>133</b>	<b>-454</b>
Credit	2,394	2,278
Debit	-2,261	-2,732
<b>1.C Secondary income</b>	<b>14</b>	<b>-87</b>
Credit	411	359
Debit	-397	-446
<b>2. Capital and financial account</b>	<b>-1,692</b>	<b>-1,424</b>
2.1 Capital account	0	3
Credit	19	5
Debit	-20	-2
2.2 Financial account	-1,691	-1,427
Assets	-5,806	-491
Liabilities	4,115	-936
<b>3. Net errors and omissions</b>	<b>-1,083</b>	<b>-1,882</b>

Notes: In the financial account, a positive value for assets represents a net decrease while a negative value represents a net increase. A positive value for liabilities represents a net increase while a negative value represents a net decrease.

Source: State Administration of Foreign Exchange (2016)

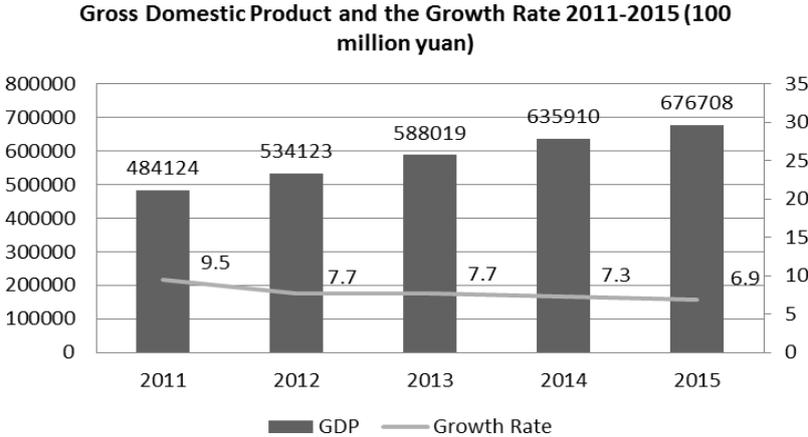
## II.3 Domestic Environment

In the past year, China has encountered many difficulties and challenges in its development. However, under the leadership of the Central Committee of the Communist Party of China (CPC) headed by General Secretary Xi Jinping, and with confidence and courage, all the people of China have worked to overcome obstacles and have pressed ahead with a pioneering spirit. As a result, progress has been achieved and stability ensured in economic and social development, the main tasks and targets for the year have been fulfilled, and major achievements have been made in reform, opening up, and socialist modernization. (Li, 2016)

### II.3.1 Economic Growth

China's economy has realized a rapid growth over the last 10 years with GDP increased more than 4 times, which surprises the world. In 2015, the gross domestic product (GDP) was 67.7 trillion yuan, up by 6.9 percent over the previous year. This growth rate is the lowest one during the recent 10 years.

**Figure 2: Gross Domestic Product and the Growth Rates, 2011-2015**



Source: National Bureau of Statistics of China

According to preliminary accounting, the gross domestic product (GDP) in 2015 was 67,670.8 billion yuan, up by 6.9 percent over the previous year. Of this total, the value added of the primary industry was 6,086.3 billion yuan, up by 3.9 percent, that of the secondary industry was 27,427.8 billion yuan, up by 6.0 percent and that of the tertiary industry was 34,156.7 billion yuan, up by 8.3 percent. The value added of the primary industry accounted for 9.0 percent of the GDP, that of the secondary industry accounted for 40.5 percent, and that of the tertiary industry accounted for 50.5 percent, the first time for the tertiary industry to taking up more than 50 percent. The per capita GDP in 2015 was 49,351 yuan, up by 6.3 percent compared with the previous year. The gross national income in 2015 was 67,302.1 billion yuan.<sup>17</sup>

**II.3.2 Fiscal Policy and monetary policy**

In responding to the mounting downward pressure on the economy, China exercised targeted and well-timed regulation on the basis of range-based regulation. China adopted proactive fiscal policy that focused on increasing intensity and efficacy by expanding the scope of structural tax reductions, reducing fees across the board, and putting dormant budgetary funds to good use. Local government bonds issued to replace outstanding debt reached 3.2 trillion yuan, lessening the interest payment burden of local governments by approximately 200 billion yuan while also reducing their debt repayment pressure. China pursued prudent monetary policy with an appropriate amount of intensity, making several cuts to interest rates and required reserve ratios, reforming management of the loan-to-deposit ratio, creating new monetary policy tools, and increasing support for the real economy. Effective investment increased, special-purpose funds were established, and development was strengthened in areas in need of attention, including water conservancy, rundown urban areas and dilapidated rural housing, and railways and highways in the central and western regions. Consumer spending was promoted in key areas, spurring rapid growth in spending on recreational travel, online shopping, and information goods and services. In 2015, China also responded proactively to a variety of risks and challenges in the financial sector, such as unusual fluctuations in the stock market and the foreign exchange market, ensuring that no systemic or regional threats arose, thus safeguarding China's economic and financial security.

<sup>17</sup> Statistical Communiqué of the People's Republic of China on the 2015 National Economic and Social Development

By the end of 2015, money supply of broad sense (M2) was 139.2 trillion yuan, reflecting an increase of 13.3 percent. Money supply of narrow sense (M1) was 40.1 trillion yuan, up 15.2 percent. Cash in circulation (M0) was 6.3 trillion yuan, up 4.9 percent.

In 2015, the increment of social financing reached 15.4 trillion yuan, decreased by 467.5 billion yuan over 2014 on a comparable basis. Savings deposit in Renminbi and foreign currencies in all items of financial institutions totaled 139.8 trillion yuan at the end of 2015, an increase of 15.3 trillion yuan. Of this total, the savings deposit in Renminbi stood at 135.7 trillion yuan, an increase of 15.0 trillion yuan. Loans in Renminbi and foreign currencies in all items of financial institutions reached 99.3 trillion yuan, an increase of 11.7 trillion yuan. Of this total, loans in Renminbi were 94.0 trillion yuan, an increase of 11.7 trillion yuan.<sup>18</sup>

**Table 6: Savings Deposit and Loans at the end of 2015**

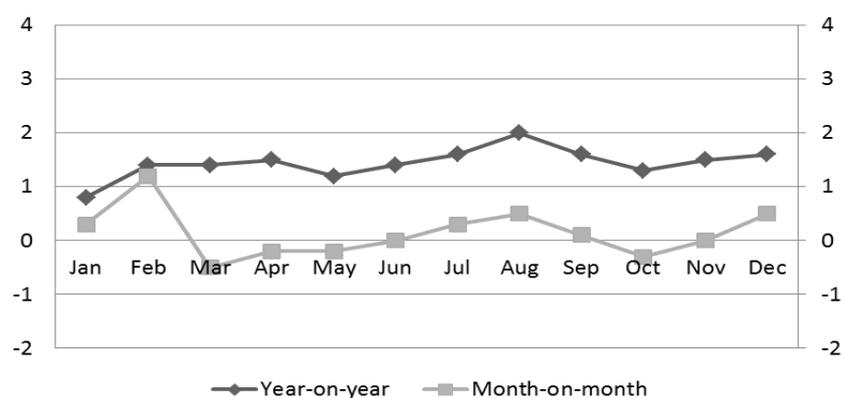
Item	Year-end figure (100 million yuan)	Increase over 2014 (%)
Savings deposit	1,397,752	12.4
By households	551,929	8.9
Deposits in RMB	546,078	8.7
By non-financial enterprises	455,209	13.7
Loans	993,460	13.4
Domestic short-term loans	366,684	7.3
Domestic medium and long-term loans	538,924	14.2

Source: Statistical Communiqué of the People's Republic of China on the 2015 National Economic and Social Development

### II.3.3 Inflation

The consumer prices in 2015 went up by 1.4 percent over the previous year. Of this total, the prices for food went up by 2.3 percent. The prices for investment in fixed assets decreased by 1.8 percent. The producer prices went down by 5.2 percent and the purchasing prices for manufactured goods down by 6.1 percent. The producer prices for farm products were up by 1.7 percent.

**Figure 3: Monthly Change in Consumer Price in 2015**



Source: Statistical Communiqué of the People's Republic of China on the 2015 National Economic and Social Development

<sup>18</sup> Statistical Communiqué of the People's Republic of China on the 2015 National Economic and Social Development

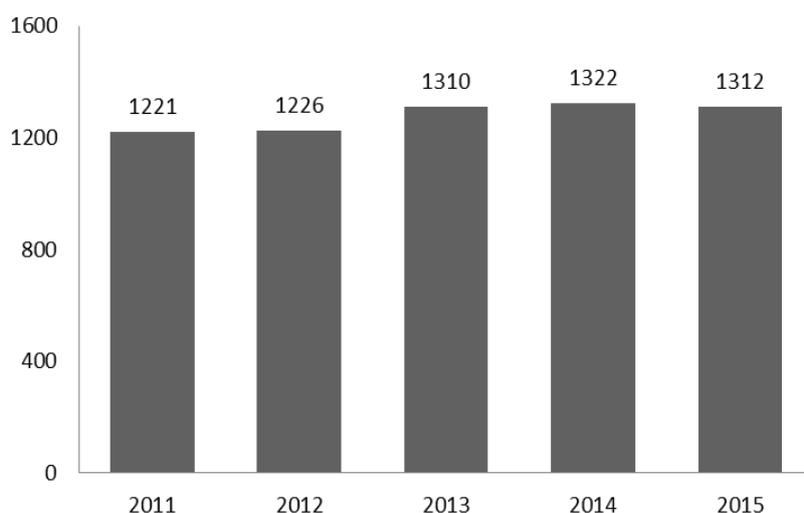
**Table 7: Changes of Consumer Prices in 2015**

Item	National Average	Urban	
		Urban	Rural
General level of consumer prices	1.4	1.5	1.3
Of which: Food	2.3	2.3	2.4
Tobacco, liquor and articles	2.1	2	2.3
Clothing	2.7	2.8	2.3
Household facilities, articles and services	1	1	0.9
Health care and personal articles	2	1.9	2.3
Transportation and telecommunication	-1.7	-1.6	-1.9
Recreation, education and culture articles	1.4	1.4	1.4
Residence	0.7	1	-0.3

Source: Statistical Communiqué of the People's Republic of China on the 2015 National Economic and Social Development

### II.3.4 Employment

At the end of 2015, the number of employed people in China was 774.51 million, and that in urban areas was 404.10 million. The newly increased employed people in urban areas numbered 13.12 million. The registered urban unemployment rate was 4.05 percent at the year end. The total number of migrant workers in 2015 was 277.47 million, up by 1.3 percent over that of 2014. Of which, the number of migrant workers who left their hometowns and worked in other places was 168.84 million, increased by 0.4 percent, and those who worked in their own localities reached 108.63 million, up by 2.7 percent.

**Figure 4: Newly Increased Employed People in Urban Areas 2011-2015 (1000 person)**

Source: Statistical Communiqué of the People's Republic of China on the 2015 National Economic and Social Development

The overall labor productivity was 76,978 yuan per person in 2015, an increase of 6.6 percent compared with that in 2014.

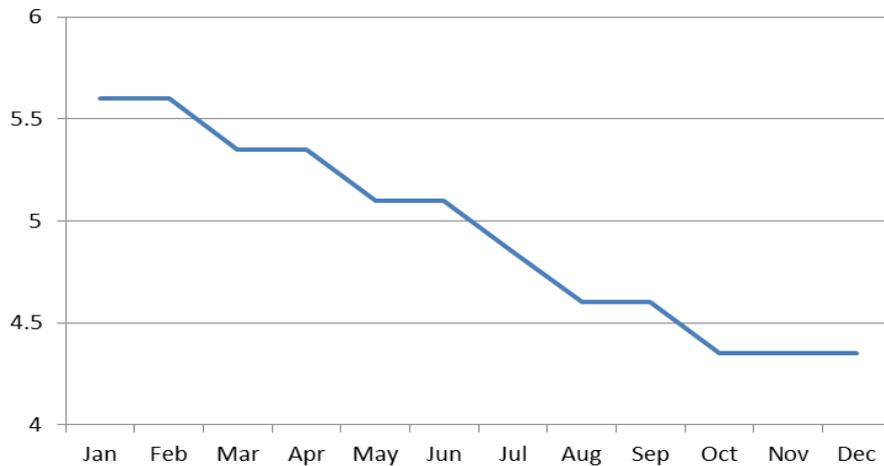
### II.3.5 general public budget revenue

The general public budget revenue reached 15,221.7 billion yuan in 2015, an increase of 832.4 billion yuan or up by 5.8 percent over the indicator of the same coverage in the previous year. Of this total, the taxes collected in the whole year reached 12,489.2 billion yuan, an increase of 571.7 billion yuan or up by 4.8 percent.

### II.3.6 Interest rates

It was predicted in the early of 2015 that liquidity would turn the tight trend toward a tight balance, interest rates would turn unilateral upward toward high level of stabilization, and the liquidity would turn the taste of the tightening trend toward a tight balance. The impact of interest rate liberalization has decrease on the growth of interest rates. The difference between the benchmark interest rate and national debt has reached a historic high point, so the space for increasing is limited. The new financial market participants will also be expanded, but the impact would be less than its "scratch" period.

**Figure 5: Interest Rate Trend in China 2015**



Source: World Bank

### II.3.7 Exchange Rate Level

During 2015 to 2016 Chinese yuan was desperation gradually. Till early D

**Figure 6: USD/CNY Exchange rates trends**



Source: Bank of China

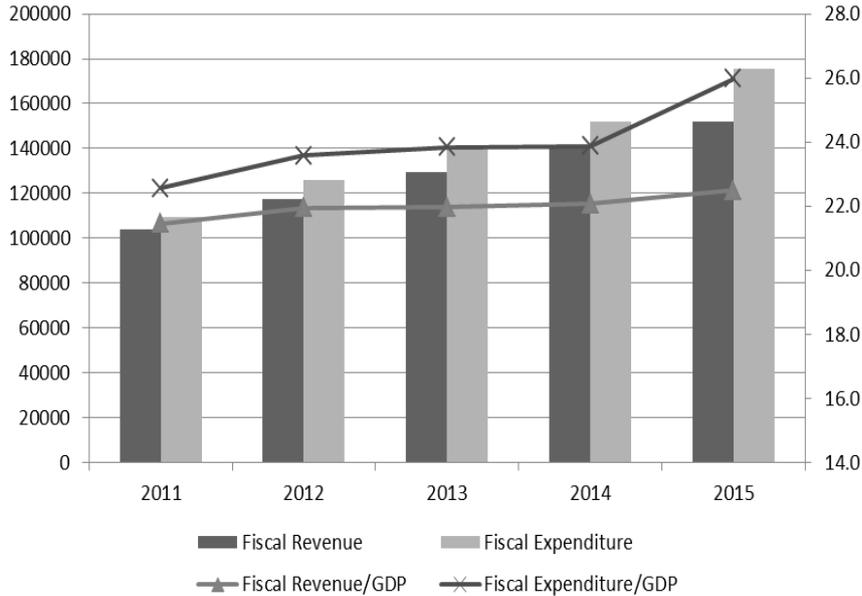
**II.4 Fiscal Position**

Since the new administration was launched, China has continued its positive fiscal policies, but has adopted a conservative stance toward massive public projects. The problems of excessive production capacity and real estate market heating up followed by a large-scale economic package after the Lehman fall explain China’s current stance. A clear picture has emerged of central government finances being relatively healthy, while local governments have serious debt problems.

Uncertain and unstable factors of the global economic recovery is still a lot, the quantitative easing policy in the US is still uncertain to be out, the increasing debt of euro zone and unemployment high rate issues are still outstanding, the effect on Japanese short-term stimulation policy declines, and among emerging market countries, Russia and India have the risk of stagflation. At the same time, the international market competition is becoming increasingly fierce, the trade and investment protectionism intensifies and the traditional competitive advantage of our country's export will also be a restriction to foreign trade growth.

The general public budget revenue reached 15,221.7 billion yuan in 2015, an increase of 832.4 billion yuan or up by 5.8 percent over the indicator of the same coverage in the previous year.<sup>19</sup> Of this total, the taxes collected (without subtracting export refunds) accounted for 92.3% of fiscal revenue.<sup>20</sup>

**Figure 7: Transition in Fiscal Balances (Unit: 100 million yuan, %)**



Source: State Administration of Taxation, MOF

<sup>19</sup> Statistical Communiqué of the People's Republic of China on the 2015 National Economic and Social Development

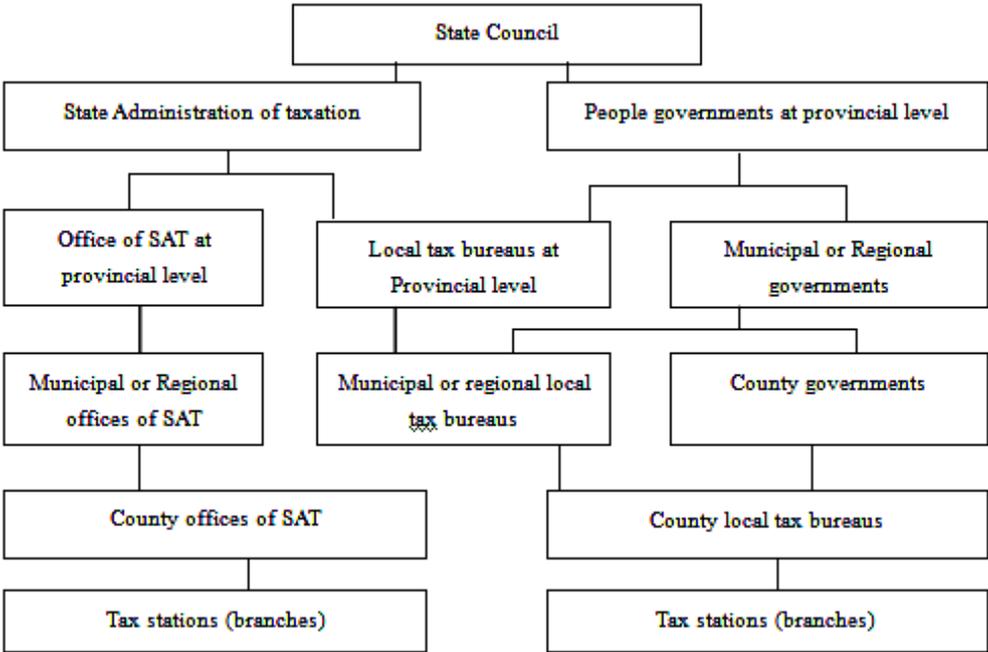
<sup>20</sup> State Administration of Taxation Annual Report 2015

### III. Tax system

#### III.1 State Administration of Taxation (SAT)

Established previously as a directorate within the Ministry of Finance in 1950, the SAT is now an independent agency of the State Council. In response to the financial reform which segregated the collection and administration of tax into state and local taxes administrations in 1994, the organization of the SAT is made up of a head office and co-existing state and local tax administrations at each provincial level and below. This organizational structure adopts a vertical management system, in terms of organization, personnel and budget, in relation to the state tax administrations at each level. There is a shared management framework with local governments over the local tax administrations at the provincial level and below.<sup>21</sup>

Figure 8: Organizational Chart of China's Tax Administration



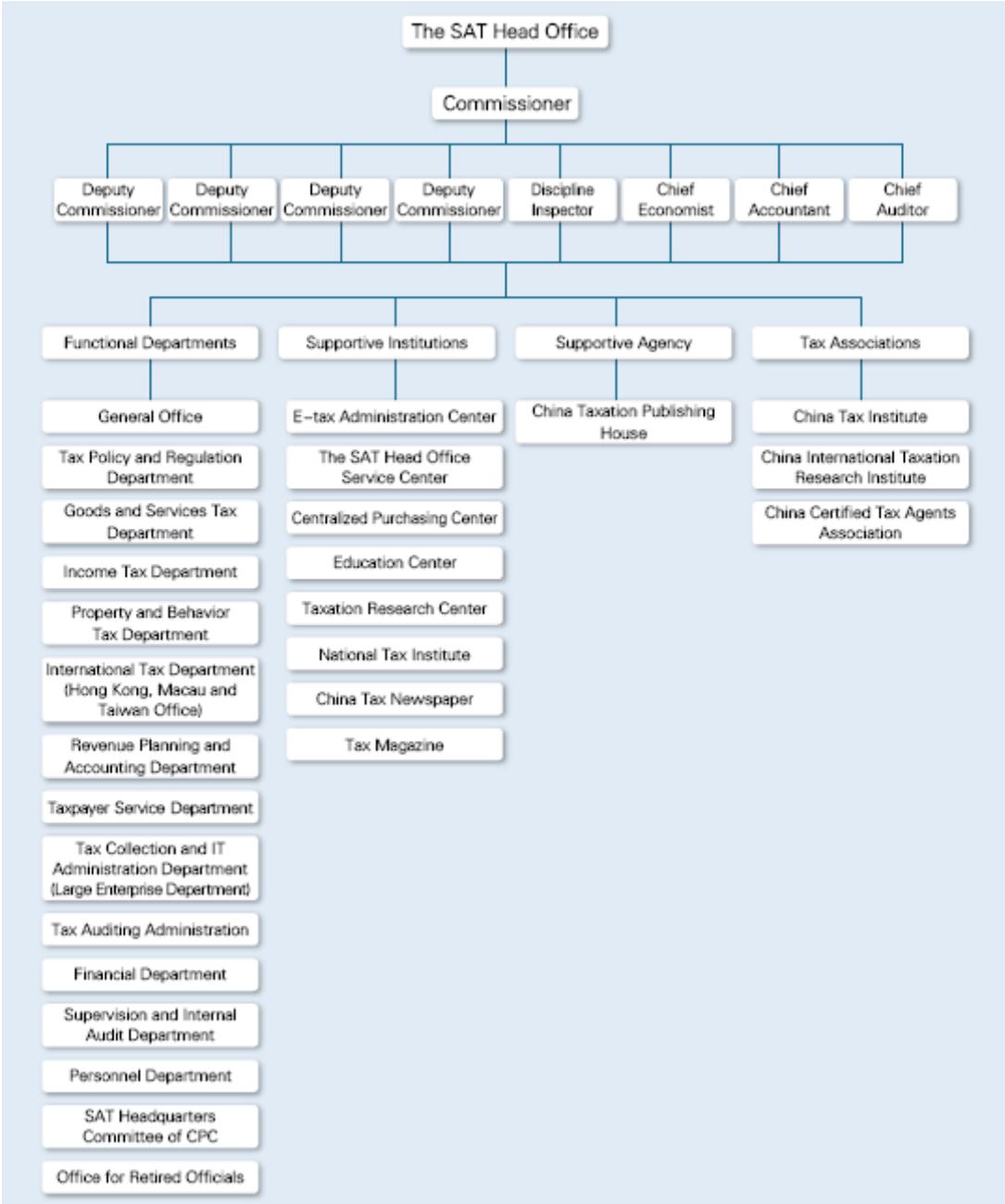
Source: State Administration of Taxation

#### III.1.1 Organizational Structure of SAT Head office

The Management Board of SAT consists of one Commissioner, four Deputy Commissioners, one Discipline Inspector, one Chief Economist, one Chief Accountant, and one Chief Auditor. SAT head office contains 15 functional departments and 8 supportive institutions (e.g. E-tax Administration Center). Also, the SAT Discipline Inspection Office is designated by the Central Commission for Discipline Inspection of the Communist Party of China (CPC).

<sup>21</sup> State Administration of Taxation Annual Report 2015

**Figure 9: Organizational Structure of the SAT Head Office**



Source: State Administration of Taxation

**III.1.2 Responsibilities of SAT Head office**

Key responsibilities of the SAT include:

- Draft tax laws, regulations and implementation rules; provide advice on draft legislation; make joint efforts with the MOF to devise and distribute implementation measures; interpret tax laws and policies during enforcement, and report afterwards to the MOF for record-filing.
- Collect and administrate state taxes, shared taxes, and legally required funds (fees) to ensure collection of the due amount of taxes.
- Participate in the design of macro-economic policies and develop state and local tax regimes, conduct research on overall tax burden and provide tax technical decisions for positive macro outcomes.

- Implement reforms on tax administration, including designing and drafting new laws and regulations, ensuring internal conformance and providing guidelines to local tax administrations.
- Safeguard taxpayer's rights, including establishing Service Delivery Standards and drafting laws to supervise performance of local tax administrations.
- Exercise taxpayer-segmented management and provide tailored services to taxpayers, particularly for large taxpayers.
- Draft tax revenue medium and long term forecasts and annual plans; carry out investigations of revenue source; analyze and forecast tax revenues; carry out measures of tax relief.
- Update IT strategies; plan for sustainable IT development covering mid-term and long-term; organize and expand Golden Tax Project.
- Expand information exchange and international cooperation; engage in international and regional tax negotiations; sign and execute tax agreements and treaties.
- Handle import/export taxation and process export refund claims.
- Administer vertical management of state tax office network. Conduct shared management, with local governments, of local tax office network, including appointment/dismissal of General Directors of provincial local tax administrations.
- Accomplish other tasks assigned by the State Council.<sup>22</sup>

## **III.2 Overview of China's Tax System**

### **III.2.1 Current Tax System**

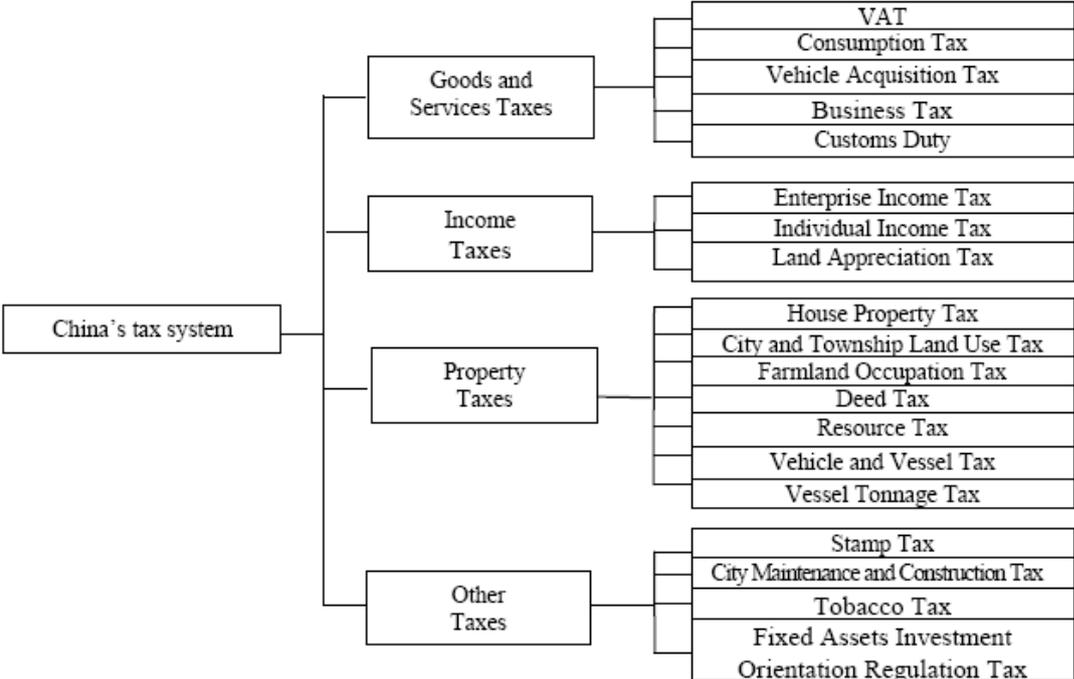
There are 18 different kinds of taxes in China, which can be divided into three categories according to their nature.

- 1) Goods and services taxes, including VAT, Excise Tax (Consumption Tax), Business Tax, Vehicle Purchase Tax and Customs Duty.
- 2) Income taxes, including Corporate Income Tax and Individual Income Tax.
- 3) Property and behavior taxes, including Land Appreciation Tax, Real Estate Tax, Urban and Township Land Use Tax, Arable Land Use Tax, Deed Tax, Resources Tax, Vehicle and Vessel Tax, Stamp Duty, Urban Maintenance and Construction Tax, Tobacco Tax, and Vessel Tonnage Tax.

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<sup>22</sup> State Administration of Taxation Annual Report 2015

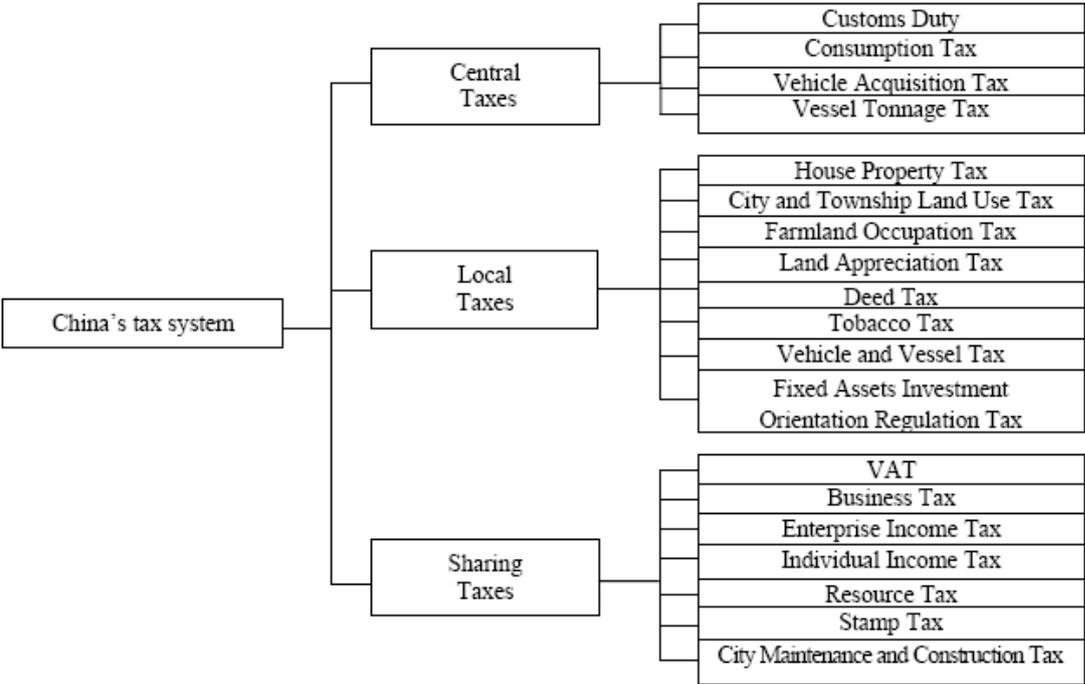
**Figure 10: China’s tax system (by category of tax)**



Source: "Tax System of the People's Republic of China" (Liu, 2012)

At the same time, according to the revenue sharing system between the Central Government and the Local Government, the tax system can be divided into 3 categories: Central Taxes, Local Taxes, and Sharing Taxes. Central Taxes refer to the tax categories whose tax revenues contribute to the Central Government’s regular revenue. Local Taxes refer to the tax categories whose tax revenues contribute to the Local Government’s regular revenue. And the Sharing Taxes refer to the tax categories whose tax revenues should be shared between the Central Government and the Local Government. With regard to VAT, the import VAT belongs to the Central Government, and the rest parts are divided 75% to the Central Government and 25% to the Local Governments. With regard to Enterprise Income Tax and Individual Income Tax, in general, the Central Government and the Local Governments share 60% to 40%. With regard to Business Tax and City Maintenance and Construction Tax, the part paid by the railway department, the headquarters of various banks and the headquarters of various insurance companies belong to the Central Government and the rest belong to the Local Governments. As for Resource Tax, the part paid by the offshore oil enterprises to the Central Government, and the rest to the Local Governments. And 97% of the Stamp Tax on securities transactions contributes to the Central Government, 3% to the Local Governments (Liu, 2012).

**Figure 11: Chinese Tax system (by level of budget)**



Source: “Tax System of the People’s Republic of China” (Liu, 2012)

**III.2.2 Tax System and Adjustments in 2015<sup>23</sup>**

**III.2.2.1 Business Tax to VAT Reform**

The Business Tax to VAT Reform is not only an important strategic measure introduced at a critical time when China is upgrading its economy, but also a most important building block of the fiscal and tax reforms. This reform has made steady progress since its introduction three years ago. The VAT pilot program, initially covering the transportation sector and certain modern services, was launched nationwide on August 1, 2013. Since January 1 2014, the pilot program was extended to cover railway transportation and mail services. Since June 1 2014, the telecommunication services sector was also included in the pilot program.

By the end of 2015, a total of 5.92 million corporate taxpayers in China had been brought under VAT in the pilot program, including 1.13 million general VAT payers and 4.79 million small-scale VAT payers. In 2015, this reform reduced tax liabilities of the new VAT taxpayers by 144.6 billion RMB, while the previous VAT taxpayers deducted input VAT on a broader scope, leading to a reduction of 122 billion RMB in tax liabilities. Consequently, the VAT reform has had far-reaching strategic significance by stimulating growth and promoting competitiveness among business sectors.

**III.2.2.2 Preferential treatment for small-scale and marginal profit businesses continued**

Since August 1 2013, small-scale VAT and Business Tax taxpayers with monthly turnover below 20,000 RMB have been temporarily exempted from their respective VAT and Business Tax liabilities. Between October 1 2014 and December 31 2015, the exemptions for VAT and Business Tax had been expanded to small-scale VAT and Business Tax taxpayers with monthly turnover ranging from 20,000

<sup>23</sup> State Administration of Taxation Annual Report 2015

to 30,000 RMB. In 2015, this policy was further extended to the end of 2017.

Before January 1 2014, qualified small-scale and marginal profit enterprises with an annual taxable income of 60,000 RMB or less were entitled to a reduction in tax base of 50% and a preferential rate of 20%. Since January 1 2014, this preferential treatment has been granted to those with an annual taxable income of 100,000 RMB or less. The benchmark was raised further to 200,000 RMB on January 1 2015, and to 300,000 RMB on October 1 2015.

In 2015, tax reduction for small-scale and marginal profit enterprises totaled 101.54 billion RMB, including 17.7 billion RMB reduction of CIT and 83.84 billion RMB reduction of VAT and Business Tax.

### **III.2.2.3 Resource Tax Reform moving along**

On May 1 2015, Resource Tax on rare earth, tungsten and molybdenum started to be collected on ad valorem basis throughout country. At the same time, the Resource Tax rate on ferrous ore was reduced to 40%.

### **III.2.2.4 Excise Tax Reform scaled up**

On January 13, 2015, the Excise Tax rate for refined oil products was further raised. On February 1, 2015, batteries and coating materials became subjected to Excise Tax. On May 1, 2015, the ad valorem tax rate on cigarette for wholesale was raised from 5% to 10 %, and an additional per unit tax levied at 0.005 RMB/cigarette.

## **III.3 Brief Introduction of Main Taxes**

### **III.3.1 Valued Added Tax (VAT)**

Nowadays, VAT is popular around the world because it is easy to collect and more neutral. VAT was introduced into China after implementing the reform and opening-up policy at the end of the 70s. There were a series of tax reforms complying with the principle of broad tax base, neutral nature and simplification. After the latest revision of "Provisional Regulations of the People's Republic of China on Value Added Tax" was implemented in 2009, the input VAT of fixed asset could be deducted. This reform can delete the double taxation of equipment purchase and lower the tax burden. Nowadays, in order to further resolve the double taxation problem and improve tax system, China has implemented VAT Pilot Project to replace Business Tax with VAT in the transportation sectors and some modern service sectors.

VAT has become the major source of fiscal revenue for the Central Government. Domestic VAT accounted for 26.3% of total tax revenue in 2012, being the largest component. VAT is levied on the added value occurred when selling goods and providing services and on the value of imported goods. The main tax legislation is the "Provisional Regulations of the People's Republic of China on Value Added Tax" and Detailed Rules for Its Implementation.

#### **a) Taxable items and tax rates**

In general, the basic tax rate of VAT is 17%. The low tax rate of 13% is just levied on limited goods. The zero tax rate is applied on export goods. Table 13 shows the taxable items and tax rate of VAT.

**Table 8: Taxable items and tax rates of VAT**

Coverage of collection	Tax rate
1) Crude Oil, mine salt and goods other than those listed above	Basic tax rate: 17%
2) Taxable services	
1) Product of agriculture, forestry and animal husbandry, aquatic products	Low tax rate 13%
2) Edible vegetable oil and food grain duplicates	
3) Tape water, heating, cooling, hot air supplying, hot water, coal gas, liquidized petroleum gas, natural gas, methane gas, coal/charcoal products for household use	
4) Books, newspapers, magazines (excluding the newspapers, magazines distributed by the post department), video and audio products, electronic publication	
5) Feeds, chemical fertilizers, agricultural chemicals, agricultural machinery and plastic covering film for farming	
6) Dressing metal mineral products, dressing non-metal mineral products, coal, industrial salt and edible salt	
Exportation of goods (except those prohibited from exportation and prohibited from importation by the state)	0%

Source: "Tax System of the People's Republic of China" (Liu, 2012)

#### b) Computation of tax payable

Taxpayers of VAT are divided into two types: normal taxpayers and small taxpayers determined by tax offices according to the sales. With regard to the normal taxpayers, they need to separately calculate the output tax and the input tax for the current period. And the difference between the output tax and the input tax is the actual amount of VAT payable. With regard to small taxpayers, the more simple method is applied, tax payable = Sales Value × 3%.

In order to balance the tax burden of import goods and domestic goods, the import goods should be levied on the import VAT and customs are responsible to withhold it. Tax payable = (Customs completion price + Customs Duty + import Consumption Tax) × Applicable VAT rate.

If the exporters export the goods that are applicable of 0% rate, they may apply to the tax authorities for the input tax refund on those goods exported. At present, the refund rates consist of 6 grades, 17%, 16%, 15%, 13%, 9%, and 5%. And as for the goods purchased from small taxpayers, the refund rate is 3% (Liu, 2012).

The VAT assessable period shall be one day, three days, five days, ten days, fifteen days, one month or three months, determined by tax offices according to taxpayers' tax payable and other criterions.

#### c) Threshold and exemptions

Threshold of VAT is special for the self-employed businessmen and other individuals. The threshold has been increased to 5000-20000 yuan sales value per months or 300-500 yuan sales value every time since 2011. So the small self-employed businessmen can enjoy more tax preference.

The exemptions are limited, including: the self-produced primary agricultural products sold by agricultural producing units and individuals, contraceptive medicines and devices, antique books purchased from the public, instruments and equipment imported for direct use in scientific research and experiment, import materials and equipment granted by foreign governments or international organizations, oversea donations to support the poverty relief and charity cause, the special articles imported for exclusive use of the disabled, sales of used goods.

There are a number of tax preferences on agricultural goods, recycling goods, energy conservation and emissions reduction services, software sector, medical and health sector, disabled employment, etc.

d) Invoiced based

China is adopting invoice based VAT. Due to the advanced IT technology, most invoices are issued by the special IT equipment. When the taxpayers would like to deduct the input tax, the VAT Invoice Matching System would trace the corresponding output tax invoice through the information of the input tax invoice. And only after the corresponding output invoice is checked and the information is matched up, the deduction is permitted in the tax return. As a result, the tax evasion and tax fraud cases on VAT have decreased significantly.

### III.3.2 Consumption Tax

The main tax legislation of Consumption Tax is the "Provisional Regulations of the People's Republic of China on Consumption Tax" and Detailed Rules for Its Implementation.

Consumption Tax is levied on some specific consumer goods in addition to VAT, called as Exercise Tax in some countries. Excise tax can not only increase revenue but also influence on the public health, environmental protection, and consumption moral. Different countries regulate different taxable items of Consumption Tax for different purposes.

a) Taxable items and tax rates

The current taxable items include 14 items. Table 14 illustrates the specific items and its tax rate.

b) Computation of tax payable

The computation methods of tax payable of Consumption Tax are composed of ad valorem and specific duties. Seen from table 13, some items apply the ad valorem, so tax payable= sales value× applicable tax rate. Some items apply specific duties and tax payable= sales quality× applicable tax per unit. However, some items apply compound methods, and tax payable= sales value× applicable tax rate+ sales quality× applicable tax per unit, such as, cigarettes and white spirits.

In order to balance the tax burden of import goods and domestic goods, some import goods should be levied on import Consumption Tax and customs are responsible to withhold it. Tax payable = (Customs completion price +Customs Duty) ÷ (1- Applicable tax rate).

The Consumption Tax assessable period shall be one day, three days, five days, ten days, fifteen days, one month or three months, determined by tax offices according to taxpayers' tax payable and other criterions.

**Table 9: Taxable Items and Tax Rates of Consumption Tax**

Taxable Item	Tax Rate
Tobacco	
Grade A cigarettes	Sales*56% + 0.003 yuan per piece
Grade B cigarettes	Sales*36% + 0.003 yuan per piece
Wholesale of cigarettes	5%
Cigars	36%
Cut tobacco	30%
Alcoholic drinks and alcohol	
White spirits	Sales value*20% + 0.5 yuan per 500g (ml)
Yellow spirits	240 yuan per tone
Beer of class A	250 yuan per tone
Beer of class B	220 yuan per tone
Other alcoholic drinks	10%
Alcohol	5%
Cosmetics	30%
Precious jewelers, pearls, jade and stones	5%, 10%
Firecrackers and fire works	15%
Finish Oil products	0.8 yuan/liter, 1 yuan/liter, 1.4 yuan/liter
Motorcycles	3%, 10% (with cylinder capacity
Automobile	1%, 3%, 5%, 9%, 12%, 25%, 40% (with cylindercapacity)
Golf and tools	10%
High-class watches	20%
Yachts	10%
One-off wood chopsticks	5%
Wood floor	5%
Coating	4%
Battery	4%

Source: "Tax System of the People's Republic of China" (Liu, 2012)

### III.3.3 Business Tax

The main tax legislation of Business Tax is the "Provisional Regulations of the People's Republic of China on Business Tax" and Detailed Rules for Its Implementation. Business Tax is levied on turnover when taxpayers provide taxable service, transfer intangible assets or sell real estate. In belief, goods should be levied on VAT, while most service should be levied on Business Tax in China.

#### a) Taxable items and tax rates

There are nine kinds of services whose providers should pay Business Tax. Different flat rates are adopted on different services.

**Table 10: Taxable items and tax rates of Business Tax**

Taxable items	Tax rates (%)
1. communications and transportation	3
2. construction	3
3. financial and insurance businesses	5
4. post and tele-communications	3
5. culture and sports	3
6. entertainment	5-20
7. services	5
8. transfer of intangible assets	5
9. sales of immovable properties	5

Source: "Tax System of the People's Republic of China" (Liu, 2012)

#### b) Computation of tax payable

The tax payable is calculated based on the turnover of services. Tax payable= Turnover × Applicable tax rate

### **III.3.4 Enterprise Income Tax**

The main tax legislation of Enterprise Income Tax is the "Law of the People's Republic of China on Enterprise Income Tax" and Detailed Regulations for Its Implementation. Enterprise Income Tax is levied on operation income and other income of enterprises in China. There are more than 30 million enterprises in China. Enterprise income Tax is a significant tax type in China, accounting for 19.5% of total tax revenue.

#### a) Taxpayers

The taxpayers of Enterprise Income Tax are divided into resident enterprises and nonresident enterprises. The resident enterprises include the enterprises established by law in the territory of China and the enterprises established by foreign laws but with the effective management situated in the territory of China. Non-resident enterprises include the enterprises established by foreign laws and with the effective management situated abroad but with establishment or place in China and the enterprises with income sourced within China but without establishment or place in China (Liu, 2012).

#### b) Objects of taxation

The objects of taxation of resident enterprises are not only their income sourced within China but also the one sourced from foreign countries. That means resident enterprises should pay the Enterprise Income Tax on their worldwide income. The incomes include operating income, transferring property income, dividends income, interest income, rent income, franchise royalties income, donation income and other income.

The objects of taxation of non-resident enterprises are divided into two types. With regard to non-resident enterprises established by foreign laws and with the effective management situated abroad but with establishment or place in China, the object of taxation is the income of establishment or place sourced within China and the income sourced abroad but actually connected to the establishment or place in China. With regard to non-resident enterprises with income sourced within China but without establishment or place in China or those that have establishment or place in China but the income is not connected with their establishment or place in China, the object is just the income sourced within China.

#### c) Tax rate

Before 2008, "Income Tax Law of the People's Republic of China for Enterprises with Foreign investment and Foreign Enterprises" was applied to levy Enterprise Income Tax on foreign enterprises, while "Provisional Regulations of the People's Republic of China on Enterprise Income Tax" was applied on domestic enterprises. Although the nominal tax rate is same, namely 33%, a great deal of tax preferences was provided to foreign enterprises. As a result, the effective tax rate of foreign enterprises is 11%, about half of the one of domestic enterprises, which is 22% (Zhou, 2006). In order to balance the development and enhance the equity, China combined the two tax laws with the

uniform “Enterprise Income Tax Law of the People's Republic of China” since 2008. The tax policy is equal to foreign and domestic enterprises.

The basis tax rate is 25%, which is levied on the income of resident enterprises and non-resident enterprises whose incomes are actually connected to their establishment or place in China.

The low tax rate is 20%, which is levied on the non-resident enterprises that have no establishment or place in China or the income is not connected to their establishment or place in China. However, the actual tax rate is 10% because of tax preferences (“Textbooks of Certified Tax Agents”, 2013).

**III.3.5 Individual Income Tax**

The main tax legislation of individual Income Tax is the "Individual Income Tax Law of the People's Republic of China” and Detailed Regulations for Its Implementation. Individual Income Tax is levied on individuals rather than families in China.

a) Taxpayers

The taxpayers of Individual Income Tax are divided into resident individuals and nonresident individuals. The resident individuals include the individuals that have domicile in China and the individuals that have no domicile in China but have resided in China for one year or more. The nonresident individuals refer to the individuals without domicile in China who never live or have lived in China less than one year.

b) Objects of taxation

With regard to the resident individuals, in general, the objects of taxation are their world-wide incomes. With regard to the nonresident individuals, the objects of taxation are only their incomes sourced within China.

China implements the classified income tax system. There are 11 taxable items of Individual Income Tax, including salary income, self-employment operating income, contract operating income, personal service income, remuneration income, franchise royalties income, transferring property income, dividends and interest income, rent income, incidental income and other income. Different items are applied by different tax rates and computation methods.

With regard to the salary income, there is the progressive tax rate system with 7 grades from 3% to 45%. Employers are responsible to withhold the income tax every month. The threshold is 3500 yuan per month.

**Table 11: Tax rate of salary incomes**

Grade	Monthly Taxable Income	Tax Rate (%)	Quick Deduction
1	Income of 1500 yuan or less	3	0
2	That part of income in excess of 1500 to 4500 yuan	10	105
3	That part of income in excess of 4500 to 9000 yuan	20	555
4	That part of income in excess of 9000 to 35000 yuan	25	1005
5	That part of income in excess of 35000 to 55000 yuan	30	2755
6	That part of income in excess of 55000 to 80000 yuan	35	5505
7	That part of income in excess of 80000 yuan	45	13505

Source: “Tax System of the People’s Republic of China” (Liu, 2012)

With regard to self-employment operating income, the annual taxable income is calculated by gross operation income minus costs, expenses, taxes and losses. There is the progressive tax rate

system with 5 grades from 5% to 35%.

**Table 12: Tax rate of self-employment operating income**

Grade	Annual Taxable Income	Tax Rate (%)	Quick Deduction
1	Income of 15000 yuan or less	5	0
2	That part of income over 15000 but not over 30000 yuan	10	750
3	That part of income over 30000 but not over 60000 yuan	20	3750
4	That part of income over 60000 but not over 100000 yuan	30	9750
5	That part of income over 100000 yuan	35	14750

Source: "Tax System of the People's Republic of China" (Liu, 2012)

With regard to contract operating income, the annual taxable income is calculated by gross operation income minus the necessary expenses. The tax payable is calculated by applying the same progressive tax rate as table 17.

Except above three kinds of individual income, other 8 taxable items are applied to the flat tax rate of 20%. With regard to personal service income, remuneration income, franchise royalties income and rent income, the taxable income is calculated by gross income minus specific deduction. With regard to transferring property income, the taxable income is calculated by transferring income minus original value, expenses and taxes. With regards to dividends and interest income, incidental income and other income, taxable income is the gross income of each payment.

In general, the Individual Income Tax is applied by withholding system. However, there are some cases that the taxpayers should self-assess and file the return. For example, taxpayers' annual income are more than 12 thousand yuan or taxpayers get salary from two or more employers or taxpayers get salary abroad or taxpayers are self-employment businessmen, etc("Textbooks of Certified Tax Agents", 2013).

### III.3.6 Vehicle Acquisition Tax

China's Vehicle Acquisition Tax is a tax levied on taxpayers when they acquire vehicles by purchase, import, denotes, self-consumption on self-products and rewards. The tax base is the taxable price of the taxable vehicles and the tax rate is single rate with 10%. The tax payable is equal to the taxable price of the taxable vehicles multiple by 10% tax rate.

The Vehicle Acquisition Tax is administered and collected by the state tax offices. The tax revenue is contributed to the Central Government to specially be used on traffic cause.

### III. 3.7 Customs Duties

The main tax legislation of Customs Duties is the "Current Regulations on Import and Export Duties of the People's Republic of China". And the objects of taxation are the goods and articles imported and exported through the customs frontier. Customs Duties are collected and administered by the customs authorities and contributed to the Central Government's revenue.

According to the Regulation, there are import duty rates and export duty rates. The import duty rates include most favored nations tariffs (MFN), conventional tariff rates, special treatment tariff rates, general tariff rates and duty quota rate (Liu, 2012). As joining WTO, the import duties of China have dropped gradually. By 2011, the average MFN tariffs of import duties are 9.6%, among which, agricultural products is 15.6% ("Trade profile of China", n. d.). In actual, the export duties are levied on about 20 kinds of goods with low tax rate.

There are more than 100 countries have conducted the trade treaties or agreements on reciprocal

duties with China. As a result, basically, China levies the preferential tariff rates on import goods (“Textbooks of Certified Tax Agents”, 2013)

### **III. 3.8 Land Appreciation Tax**

Land Appreciation Tax is levied on the appreciation from the transfer the use rights of lands and property rights of the ownership of the buildings on the land and any attached facilities.

It adopts four levels of progressive rates, including 30%, 40%, 50% and 60%. The threshold is the appreciation amount less 20% of the sum of deductible items. The transferring of self-owned ordinary residential houses is tax exempted.

### **III. 3.9 House Property Tax**

Taxpayers are owners, mortgagees, custodians and users of house properties. In one case where the tax base is the residual value after the subtraction of 10% to 30% from the original value of the property, the tax rate is 1.2%. If the house properties are rented out, the object of taxation is the rental income and the rate is 12%.

The tax is collected on annual basis and paid in installments. The revenue is contributed to the Local Government. The house property owned by individuals for non-business use can be exempted (Liu, 2012).

### **III. 3.10 City and Township Land Use Tax**

The objects of City and Township Land Use Tax are the land and the tax base is the area of occupied land. The tax rates are different with different regions.

The tax is collected on annual basis and paid in installments. The revenue is contributed to the Local Government. Government, people’s organization, and public used lands are tax exempted.

### **III. 3.11 Farm Land Occupation Tax**

Farm Land Occupation Tax is levied on the activities of occupying the farm land to build house or make other nonagricultural construction. It is levied once when occupation of farm land. And the tax revenue is collected by local tax bureau and is specially spent on establishing special agricultural development fund, to develop and improve the farm land.

### **III.3.12 Resource Tax**

Resource Tax is levied on the exploitation of mineral resources or production of salt. The target is to promote the reasonable allocation and exploitation of resource and save use of recourse.

The taxable items include 7 items, crude oil, natural gas, coal, other non-metal ores, ferrous metal ores, non-ferrous metal ores and salt.

### **III.3.13 Vehicle and Vessel Tax**

The taxpayers are the owners or operators of taxable vehicles and vessels. The tax is withheld by insurance institutions when receiving mandatory insurance fees. The revenue could support the development of local transportation facilities. The related taxation affairs are regulated by “Vehicle and Vessel Tax Law of the People's Republic of China”.

### **III.3.14 Deed Tax**

Deed Tax is one kind of the property taxes. The objects of taxation are the land use rights and

ownership of houses that are transferred. The tax base is the transaction price or assessment price by tax authority. The tax rates range from 3% to 5%. The taxpayers are the individuals or units that receive the use rights of land or ownership of houses.

### **III.3.15 Stamp Tax**

Stamp tax is imposed on the specified economic documents written or received during the economic activities and transactions. The documents include economic contract, property transfer documents, business books, and license certification, etc. The collection of Stamp Tax is completed by taxpayers themselves, including computing tax, buying revenue stamps, and sticking revenue stamps.

### **III.3.16 City Maintenance and Construction Tax**

City Maintenance and Construction Tax is an additional tax. The taxpayers are those who should pay VAT, Consumption Tax or Business Tax. The tax base is the actual total amount of VAT, Consumption Tax and Business Tax. The tax rates are 7%, 5% and 1%, imposed on taxpayers in cities, in town and counties, in other areas respectively. The purpose of collection of this tax is to support and improve the city maintenance and construction.

### **III.3.17 Vessel Tonnage Tax**

The objects of Vessel Tonnage Tax are the vessels entering into the ports of China from abroad. The tax base is the net tonnage of the vessels. It is collected by customs authorities. There are 67 countries and regions that have concluded most-favored nation convention or treaty with China to enjoy the preferential rate (Liu, 2012).

## **IV. Country specific Fiscal Issues**

### **IV.1 Near-term Growth.**

The economy is expected to grow by 6.6 percent in 2016, slowing to 6.2 percent in 2017. This assumes:

Domestic demand holds up on generally robust labor market conditions, with consumption contributing more than half of overall growth. Investment growth is expected to pick up slightly in 2016—as strong infrastructure spending and a rebound in real estate and SOE investment offset weakness in manufacturing and non-SOE investment—but to moderate in 2017 as stimulus measures wane.

External demand is expected to remain subdued, with net exports dragging growth in 2016–17. Export growth will stay tepid, while imports are likely to pick up in line with investment.

Policy support provides a positive fiscal impulse in 2016, returning to gradual consolidation in 2017. The projection assumes a slightly higher ‘augmented’ deficit relative to last year, resulting from a larger on-budget deficit as well as slightly stronger off-budget local government spending supported through policy bank lending and the new special construction fund.

Credit growth is assumed at 15 percent year-on-year in 2016, based on the authorities’ total social financing (TSF) projection and staff adjustments for local government debt/loan swaps.<sup>2</sup> In 2017, credit growth is assumed to slow to 13 percent as investment growth moderates and corporate profitability improves with the pick-up in producer price inflation and progress in reducing overcapacity.<sup>24</sup>

### **IV.2 More Pressure on the Yuan**

When cash poured out of China in the early part of this year, many thought it only a matter of time before the government ran down its foreign-exchange reserves, forcing a big depreciation.

In fact, the Chinese government pushed back by intervening at home and abroad to prop up the yuan. It also moved to tighten capital controls. The move succeeded in slowing the outflow of cash and the yuan returned to where it was in early January.

The big question is whether the stability will continue when the US Federal Reserve raises interest rates again. Janet Yellen, the Fed’s chairman, said recently that a rate rise is probable in the coming months.

If that does happen, China is now in a better place to resist the pressure. Extensive capital controls remain intact and the economy is itself stronger.

### **IV.3 Demographic Problem**

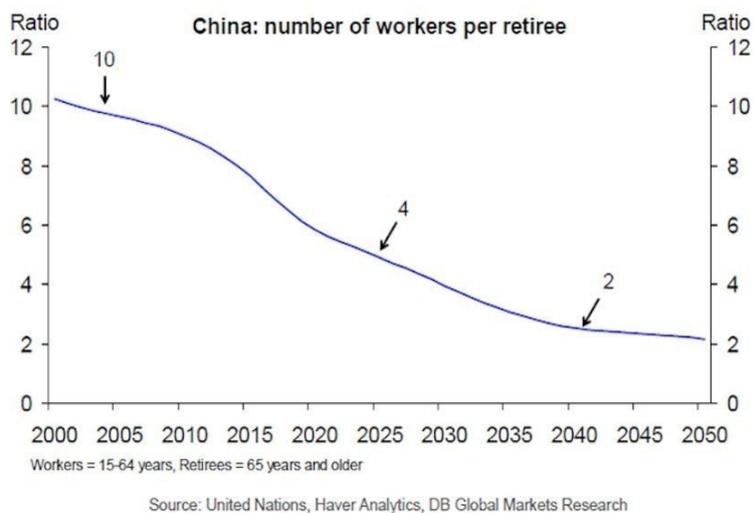
The country’s elderly population will keep growing over the next several decades, while its working-age population will keep shrinking.

Under current trends that could mean that by 2040 there could be just two workers for each person of working age in the country. As retirees increasingly outnumber working-age people, the pressure on today’s younger generation will intensify.

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<sup>24</sup> THE PEOPLE’S REPUBLIC OF CHINA 2016 ARTICLE IV CONSULTATION—PRESS RELEASE;STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE PEOPLE’S REPUBLIC OF CHINA, 2016, IMF Country Report No. 16/270

**Figure 12 China number of worker per retiree**



When the new, two-child generation becomes middle aged, its members will each have to support only one elderly person, on average, alleviating the economic pressure associated with such a high old-age dependency ratio.

But that will take a few decades. In the meantime, the post-1980s one-child generation will be supporting not only the elderly, but also a higher number of young people.

Although this will undoubtedly be tough for the one-child generation, an unintended side effect will be a surge in consumption, as its members will have little choice but to spend a lot more.

The shift to a two-child policy was badly needed – and not just because it will achieve the intended long-term goal of balancing the country’s demographic structure. While there are certainly pitfalls, including a difficult transition period, the policy could prove to be a boon to China’s efforts to put its economy on a more stable long-term growth path.

#### **IV.4 Investment Drops**

The investment drops with stabilization, the annual growth rate is about 12%. In the first half, the national fixed asset investment grew 11.4%, the growth rate decreased significantly over the previous year. At the same time, with the new normality of the structural adjustment, the structure of fixed asset investment is changing. Categorically, it is still insufficient for the investment recovery at the second half of the year.

First, the real estate investment has not been to the bottom. Determined by some regular factors such as emerging the peak of the purchase population, passed the peak of a newly started residential area, and over one set per urban household, China's real estate market has appeared a favorable turn. And the peak of real estate construction area is likely to achieve this year, during the period of "the 13th five-year-plan ", the newly started residential construction area will continue to decline. Second, the infrastructure is expected to rise slightly led by the policy. Third, the investment to manufacturing maintains a low growth. The investment to manufacturing is often determined by the three factors of infrastructure, real estate and exports, which determines that the investment in the manufacturing is difficult to take a turn for the better in a short-term. Moreover, since the second half of last year, the company's profitability has been not satisfied, which limited the ability to expand investment in manufacturing. The annual investment to manufacturing is expected to grow about 10%, which is 3.5 percentage points lower than last year.

In addition, after years of rapidly increasing, the growth rate of the service industry and other types of investment is also significantly reduced in the first half, and it was only 13.8% rising, which is significantly lower than the average growth rate of the past 5 years. It is worthy of high attention that manufacturing and export slowing down has an effect on investment in the service industry, especially in the productive service industry. Comprehensively, taking into account the future trends of the various components, and combined with the progress of investment and the distribution regularity within months, it is expected to increase around 12% of the annual investment.

## **V. Conclusion: Where We Stand and Where We Go? <sup>25</sup>**

On the basis of the CPC Central Committee Recommendations for the 13th Five-Year Plan for Economic and Social Development, the State Council has drawn up the the 13th Five-Year Plan for Economic and Social Development, centering on the goal of finishing building a moderately prosperous society in all respects and designed to address serious issues such as unbalanced, uncoordinated, and unsustainable development, stresses the need to promote innovative, coordinated, green, open, and shared development. It proposes the main targets and tasks for economic and social development over the next five years as well as development policies, initiatives, and projects. There are the six areas highlighted in the draft.

### **V.1 We should work to maintain a medium-high rate of growth and promote the development of industries toward the medium-high end.**

To finish building a moderately prosperous society in all respects and double the 2010 GDP and per capita personal income by 2020, the economy needs to grow at an average annual rate of at least 6.5% during this five-year period. To that end, we will move faster to improve or upgrade the structure of industry and launch initiatives that use advanced technologies and can drive industrial development. Our goal is that by 2020, advanced manufacturing, modern services, and strategic emerging industries as a proportion of GDP will have risen significantly and that per capita labor productivity will have risen from 87,000 yuan to over 120,000 yuan. By that time, China's aggregate economic output should have exceeded 90 trillion yuan, and the quality and efficacy of development should have significantly improved. For a developing country like China with such a large population, this will be a truly remarkable achievement.

### **V.2 We should ensure that innovation better drives and energizes development.**

Innovation is the primary driving force for development and must occupy a central place in China's development strategy, which is why we must implement a strategy of innovation-driven development. We should launch new national science and technology programs, build first-class national science centers and technological innovation hubs, help develop internationally competitive high-innovation enterprises, and establish pilot reform zones for all-round innovation. We should make consistent efforts to encourage the public to start businesses and make innovations. We should promote the extensive application of big data, cloud computing, and the Internet of Things. We need to move faster to transform China into a manufacturer of advanced and quality products and a country that is strong on intellectual property rights. We should strive to achieve major breakthroughs in basic research, applied research, and research in strategic and frontier fields by 2020. China's investment in research and development is expected to reach 2.5% of GDP, and the contribution of scientific and technological advances toward economic growth should come to reach 60%. Fulfilling these objectives will turn China into an innovative and talent-rich country.

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<sup>25</sup> LI, K. (2016). "Report on the Work of the Government at the First Session of the Twelfth National People's Congress".

### **V.3 We should make progress in new urbanization and agricultural modernization as well as in balancing development between urban and rural areas and between regions.**

Narrowing the gap between urban and rural areas and between regions is not only a key part of economic structural adjustment; it is also crucial for unleashing developmental potential. We should advance the new, people-centered urbanization. This will mean granting urban residency to around 100 million people with rural household registration living in urban areas and other permanent urban residents, completing the rebuilding of both rundown areas and "villages" in cities involving about 100 million people, and enabling around 100 million rural residents to live in local towns and cities in the central and western regions. By 2020, permanent urban residents should account for 60% of China's population, and 45% of the Chinese people should be registered as permanent urban residents.

### **V.4 We should encourage green ways of working and living and speed up efforts to conserve ecosystems and the environment.**

We need to protect the environment while pursuing development and achieve development in a well-protected environment, making sustained efforts to build a sound ecological system. We need to take serious action to prevent and control air, water, and soil pollution, set a red line that the country's total area of ecological spaces should not fall below, move forward with eco-friendly projects to protect and restore mountains, waters, forests, and farmlands, and intensify ecological conservation and restoration efforts. Over the next five years, we should aim to ensure that water consumption, energy consumption, and carbon dioxide emissions per unit of GDP are cut by 23%, 15%, and 18%, respectively, and that forest coverage reaches 23.04%. We should also make it our aim, within this timeframe, to develop and use energy and resources much more efficiently and make improvements to the quality of ecosystems and the environment. In particular, we should strive for major progress in the control and prevention of air pollution and see to it that the air quality of cities at and above the prefectural level is good or excellent for 80% of the year. We must work to build, through tireless efforts, a Beautiful China where the sky is blue, the land is green, and the water runs clear.

### **V.5 We need to deepen reform and opening up to create new institutions for development.**

Fundamentally, development relies on reform and opening up. We must deepen reform across the board, uphold and improve the basic economic system, establish a modern system of property rights, and see that a rule of law government is basically in place. It should be ensured that the market plays the decisive role in resource allocation and the government better plays its role, and work should be accelerated to create the systems, mechanisms, and growth model that will guide the new normal in economic development. We should work for significant progress in pursuing the Belt and Road Initiative and for breakthroughs in our cooperation with other countries on industrial capacity. We should promote the optimization of imports and exports, significantly increase the proportion of trade in services, and promote China's transformation from a trader of quantity to a trader of quality. We should put into force across the board the management system for pre-establishment national treatment plus a negative list, and progressively build a network of high-standard free trade areas. With these efforts, we should be able to usher in a new phase in building an open economy based on new systems.

**V.6 We need to ensure that continuous progress is made in raising living standards, and see that everyone shares in the fruits of development.**

Guided by the vision of people-centered development, we need to continue to strengthen points of weakness in meeting basic needs for the people in order to achieve common prosperity. We need to fight hard to win the war against poverty and help lift out of poverty all rural residents falling below the current poverty line, and achieve poverty alleviation in all poor counties and areas. We should put in place a national catalogue of basic public services. We should establish more equitable and sustainable social security systems. We need to ensure that all schools providing compulsory education comply with educational standards, that everyone has access to secondary education, that China has more world-class universities and first-class fields of discipline, and that the average number of years of schooling received by the working-age population increases from 10.23 to 10.8 years. We need to create 50 million plus new urban jobs. We need to improve the income distribution system, reduce the income gap, and increase the proportion of the middle-income group in the whole populace. We should improve systems of government housing support, which should include the rebuilding of 20 million housing units in rundown urban areas. We need to work for progress in building a Healthy China and achieve a one-year increase in average life expectancy. We need to respond proactively to population aging. We should build a modern system of public cultural services and put into effect cultural programs to boost civic morality and keep Chinese culture thriving. These efforts should enable people not only to enjoy a better life in material terms, but also to live a more enriching intellectual and cultural life.

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