

## **2 China**

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### **I. Introduction**

The People's Republic of China is located in the eastern part of the Asian continent and on the west coast of the Pacific Ocean. Its land area covers about 9.6 million square kilometers, which is the third largest country in the world following Russia and Canada. The eastern and the southern mainland coastline is more than 18 thousand kilometers, and the area of inland and border sea water covers about 470 million square kilometers. There are more than 7600 islands, including Taiwan which is the largest island with the area of 35798 square kilometers. Up to January 4, 2013, there are 7.057 billion people in the world. According to the sixth national census, by the end of 2013, there are 1.36 billion people living in China (excluding the Hong Kong, Macao and Taiwan), which is about 19% of the world's total population. This becomes the lowest world's proportion for population in Chinese history.

#### **I.1 Geography**

China's territory northern point reaches the north of Mohe near the middle of the HeiLongjiang River (53°30' northern latitude), and south reaches Cengmuansha to the south of Nansha Islands (4° northern latitude), across latitude more than 49 degrees; and east to the confluence of the rivers HeiLongjiang and Wu Suli (135°05' eastern longitude), west to the Pamirs (40°73' east longitude), crossing more than longitude 60 degrees. The distances cover over 5000 kilometers both from south to north and from east to west.

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 is separated into 4 municipalities, 23 provinces, 5 autonomous regions, and 2 special administrative regions. The capital of China is Beijing. On September 27, 1949, on the first plenary session of the Chinese people's Political Consultative Conference a decision got a unanimous agreement that decide on Beijing as the capital of the People's Republic of China, and from that day on Peiping changed its name to Beijing.

Beijing, referred to as Beijing, is the location of the Central Committee of the Communist Party of China and the Central People's Government of the People's Republic of China. Beijing is one of the four municipalities directly under the central government, the center of national politics, economy, science and culture. It is also one of the centers of domestic and international communication, and one of China's historical and cultural cities and ancient capitals.

#### **I.2 Ethnic Groups**

China has 56 different ethnic groups including 55 national minorities besides the Hans, which are

Zhuang, Manchu, Hui, Miao, Uyghur, Tujia, Yi, Mongolian, Tibetan, Buyei, Dong, Yao, Korean, Bai, Hani, Kazakh, Li, Dai, She, Lisu, Gelao, Dongxiang, Gaoshan, Lahu, Shui, Va, Nakhi, Qiang, Monguor, Mulao, Xibe, Kyrgyz, Daur, Jingpo, Maonan, Salar, Blang, Tajik, Achang, Pumi, Evenk, Nu, Kinh, Jino, Deang, Bonan, Russian, Yughur, Uzbek, Monpa, Oroqen, Derung, Tatar, Nanai and Lhoba. The distribution characteristics of those ethnic groups are limited settling, staggered living and intermixed with ethnic groups. Minority nationalities live in the Han nationality regions.

Generally speaking, there are two characteristics of the distribution of ethnic groups in China. One is largely intermingled with small inhabit. The minority population is mainly concentrated in the southwest, northwest and northeast provinces and autonomous regions. But in these areas Han people mixed live with them at a quite high ratio. For instance in the three autonomous regions of Inner Mongolia, Guangxi, Ningxia, the Hans population are more than that of the minority nationalities, even in Xinjiang the proportion of Han people has risen to 40%. Meanwhile, in the area of the Han nationality, ethnic minorities inhabit with Han. The other is a wide range of distribution, but mainly concentrated in the West and the border region. There are 11 provinces where exist 56 ethnic groups, accounting for 35.5% of the total national 31 provinces. Although minority nationalities are widely distributed, their population is still mainly concentrated in the West and the frontier regions. The population of minority nationalities in these 4 provinces ,Guangxi, Yunnan, Guizhou and Xinjiang, account for more than half of the population of the country. In addition, the line of China's land border is more than 20 thousand kilometers in length, most of which covers the minority areas.

### **I.3 Language**

China is a multi-ethnic, multi-language, multi-dialect, multi-lingual country. According to the academic circles, there are 80 kinds of languages and about 30 kinds of words used in China. The minority nationalities have the freedom to use and develop their own language and characters. The state promotes the nationwide use of Putonghua and standard Chinese characters.

Chinese is the most used language in China and in the world. It is one of the six official languages of the United Nations. Chinese is the common language of the Han ethnic group in China which takes up 91.51% of the total population, in addition, some ethnic minorities also are turning to use or dual-using Chinese. Modern Chinese have standard language (Mandarin) and dialect. The standard pronunciation of Mandarin is based on the pronunciation of the Beijing dialect, the word of the dialect of the northern dialect, and the grammar of the modern vernacular language. On October 31, 2000, it is determined by "the people's Republic of China national general language and writing method" that the national language is the common language of Mandarin. Chinese dialects are generally divided into seven major dialects: northern dialect, Wu dialect, Xiang dialect, Gan dialect, Hakka dialect, Cantonese dialect, min dialect. Those dialect areas distribute several sub-dialects and idioms. With the exception of the Han, China's 55 ethnic minorities accounted for about 8.49% of the total population. In addition to the Hui and Man which have been using Chinese totally, the other 53 ethnic groups all have their own languages, while some nations also use different languages used within different branches.

### **I.4 Religion**

China is a multi-religious country. The main religions believed in China are Buddhism, Taoism,

Islam, Catholicism and Christianity. Chinese citizens can freely choose and express their beliefs and religious identity. According to incomplete statistics, in China there are more than 100 million religious believers, nearly 139 thousand religious approved opening activity places, 360 thousand religious workers and more than 5500 religious groups. Religious groups are organized more than 100 religious institutions to train religious teachers as well. The religions in China have five basic characteristics --- mass, national, international, complexity and permanent.

The history of Buddhism in China is more than 2 thousand years. According to statistics, China has 33 thousand Buddhist temples with 200 thousand monks and nuns. Taoism originated in China has a history of more than 1700 years. China's existing Taoist temples are more than 9000, with more than 50 thousand Taoist priest and Taoist nun. Islam was introduced into China in the seventh Century AD. Hui and Uygur and other 10 ethnic minorities are the believers of Islam. The total minority population is about 21 million, over 35 thousand existing mosques, and more than 4.5 Imam and Akhund. The Roman Catholicism was introduced into China in the seventh Century AD, massively after the Opium War in 1840. China has about 5.5 million Catholics, about 7000 religious workers, about 6000 Catholic Church. Christianity (Protestant) was introduced to China in the early nineteenth Century AD, and massively introduced into China after the Opium War. There are over 23 million existing Christians, 37 thousand religious workers, 25 thousand churches and 30 thousand simple activity places.

## II. Overview of macroeconomic activity and fiscal position

### II.1 Macroeconomic Environment

The global economy has slowly recovered, and the tail risk faced by advanced economy has weakened which remains to be seen whether it is a long-term recovery. The risk of continuous falling has increased for the growth of the emerging market economy, there are different difficulties and bottlenecks for the development, and deepening reform has become the only driving force for emerging economies. Macroeconomic appears stability development trend, the financial reform continues deepening, the strength of financial institutions further enhances, the financial market develops steadily, financial infrastructure continues to advance, and the financial system is overall stable. China's economy has entered the growth stage with medium speed, the Chinese government is making great efforts to promote structural adjustment and economic rebalancing and transform from investment driven to consumption driven, in order to achieve sustainable development.

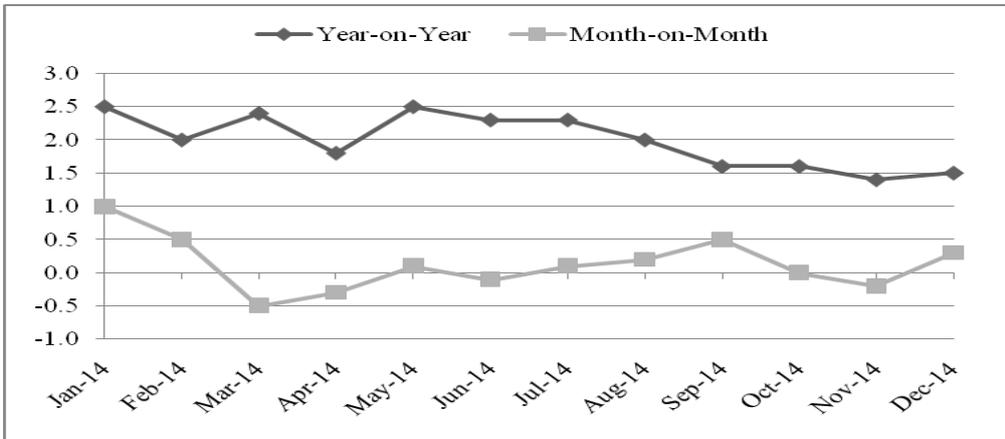
#### II.1.1 International Environment

In 2014, in developed countries and developing countries the economy will continue the differentiation, and developing countries outside Europe and Asia are lack of growth momentum. Although the overall growth rate of the world economy will be slightly improved, China's external economic environment is still complex.

##### II.1.1.1 Economic Growth Slightly Higher

Economic growth will be slightly higher than the previous year. According to exchange rate law, the World Bank in January 2014 forecasted that world economy would grow 3.2%, which is 0.8 percentage higher than the previous year. According to purchasing power parity (PPP), the International Monetary Fund (IMF) in January predicted that the world economy would grow 3.7% in 2014, which was 0.7 percentage higher than the previous year.

Figure 1: Monthly Changes in Consumer Prices in 2014



Source: National Bureau of Statistics of the People's Republic of China

The prices increased slightly in China. The consumer prices in 2014 increased by 2.0 percent compared to the previous year. The prices for food increased by 3.1 percent and the prices for

investment in fixed assets increased by 0.5 percent. On the other hand, the producer prices and the purchasing prices for manufactured goods fell down by 1.9 percent and 2.2 percent and the producer prices for farm products were down by 0.2 percent.

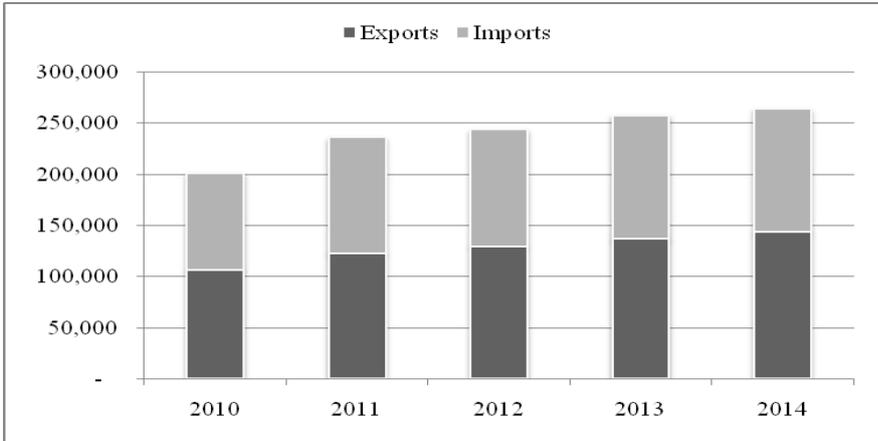
**II.1.1.2 Global Inflation**

In January the World Bank forecast in 2014 oil prices in the international market would fall 0.6%, and non-energy prices will fall 2.6%. Macroeconomic indicators of developed economy have overall improved, and countries economic growth of some emerging market has stabilized. In 2014 the recovery pace of the world economic is expected to accelerate slightly, and the foreign trade situation has been improved to a certain extent. The International Monetary Fund in October 2013 was expected in 2014 3.6% percentage of global economic growth which is 0.7 percentage higher than in 2013. The World Trade Organization in September was expected in 2014 an increasing proportion of 4.5 of global trade scale, which is 2 percentage higher than in 2013.

**II.1.1.3 Global Trade Growth**

Global trade growth will accelerate. The International Monetary Fund in January forecast that the world trade volume in 2014 would grow 4.5% which is 1.8 percentage higher than the previous year. The World Bank forecast in 2014, January that Global trade volume would grow 4.6% which is 1.5 percentage higher than the previous year.

**Figure 2: Imports and Exports, 2010-2014 (100 million yuan)**



Source: Statistical Communiqué of the People’s Republic of China on the 2014 National Economic and Social Development

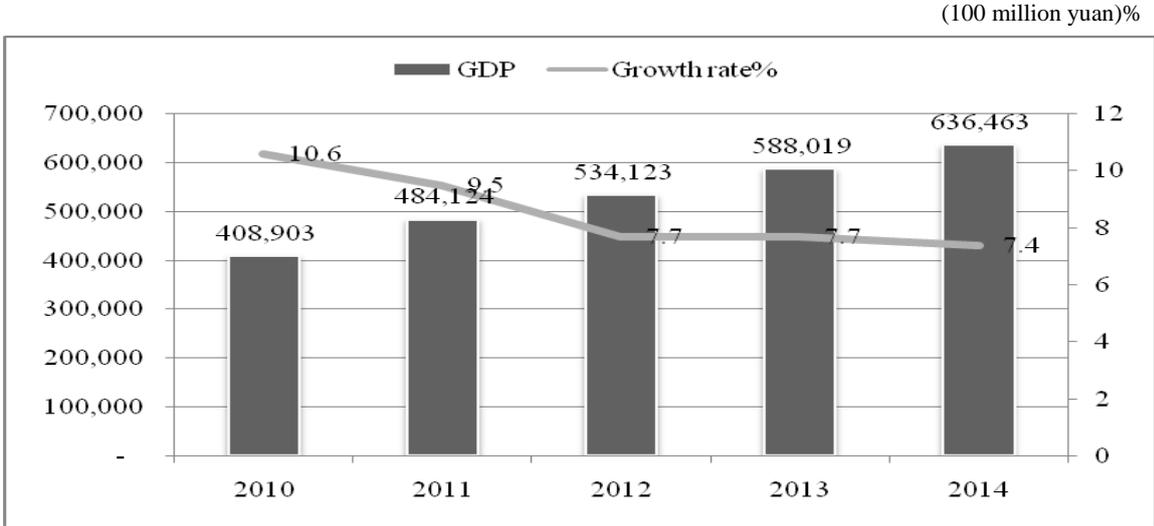
The total value of imports and exports of goods in 2014 came to 26,433.4 billion yuan, increased by 2.3 percent over the year of 2013. Among this, the exports of goods were 14,391.2 billion yuan, increased by 4.9 percent, while the imports were 12,042.3 billion yuan which was down by 0.6 percent. The balance of imports and exports (exports minus imports) was 2,348.9 billion yuan which made an increase of 739.5 billion yuan compared with 2013.

**II.2 Domestic Environment**

**II.2.1 Economic Growth and Economic Cycle**

According to the theory of the political cycle, China's economic growth rate will rise from 2013 to 2018, however, according to the investment theory, with the economy transition from investment driven to consumption, investment and import and export coordination, China's economic growth will slow down from 2013 to 2017. Therefore, we can conclude that the inflection point of China's economic growth will appear in 2012 and enter the stage of medium-speed growth.

**Figure 3: Gross Domestic Product and the Growth Rates, 2010-2014**



Source: Statistical Communiqué of the People's Republic of China on the 2014 National Economic and Social Development

According to Figure 2, the gross domestic product (GDP) of the year 2014 was 63,646.3 billion yuan, up by 7.4 percent over the previous year which was the lowest growth since 1990, but it was higher than the expected 7.3 percent. Preliminary accounting, the annual GDP was 636463 billion yuan, which was an increase of 7.4 percent compared on year calculated at comparable prices. In the quarter year-on-year GDP growth rate, there was an increase of 7.4% in the first quarter, an increase of 7.5% in the second quarter, an increase of 7.3% in the third quarter, and an increase of 7.3% in the fourth quarter. In the industries, the first industry added value of 5833.2 billion yuan with an increase of 4.1% over the previous year; the second industrial added value of 27139.2 billion yuan with an increase of 7.3%, and the third industrial added value of 30673.9 billion yuan with an increase of 8.1%. From the chain point of view, in the fourth quarter GDP growth rate was 1.5%.

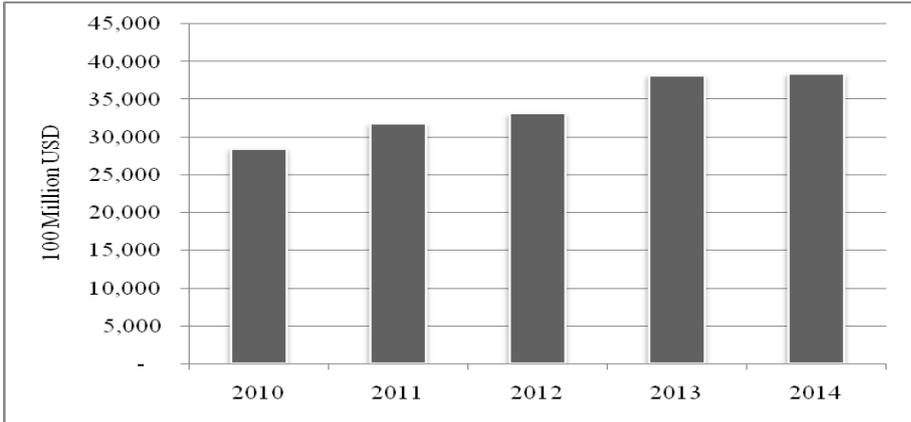
**II.2.2 Fiscal Policy**

The adjustment and optimization of structural tax cuts and spending structure will become increasingly large. The government will provide more public services. Enhance the social fairness and justice with the promotion of the equalization of basic public services. Fiscal policy is more focused on integration of short-term and medium and long term, and service comprehensively deepens the reform of the overall situation. Strengthen and improve the financial macro adjustment and control, to promote the steady growth, adjusting structure, and the way of transfer. The positive fiscal policy and comprehensive deepening of reform are closely integrated, stimulate the development of small and medium enterprises, adjust and optimize the structure of domestic demand, support industrial restructuring, and support to implement the strategy of innovation driven development.

**II.2.3 Monetary Policy**

The work conference of the central bank set the tone of monetary policy which is "enhance the forward-looking, targeted and coordinated of regulation". The central bank will comprehensively utilize monetary policy tools such as required reserve ratio, repurchase and reverse repos, central bank bills and short-term liquidity adjustment tools, to maintain reasonable liquidity conditions, stabilize the expectation of the market entity and meet the funding needs of the real economy. At the same time, the financial market reform will further deepen.

**Figure 4: Year-end China’s Foreign Exchange Reserves 2010 – 2014**



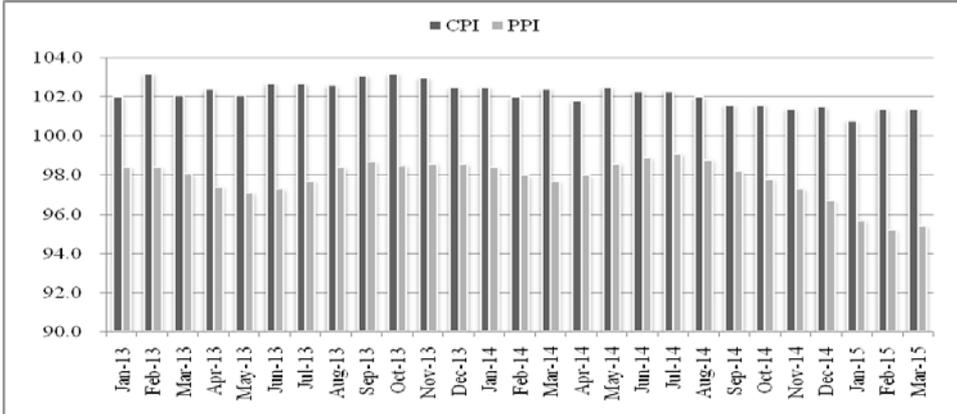
Source: National Bureau of Statistics of the People’s Republic of China

The foreign exchange reserves slightly increased. By the end of 2014, China’s foreign exchange reserves have reached 3,843.0 billion US dollars, which is an increase of 21.7 billion US dollars compared with that at the end of 2013. In addition, at the end of 2014, the exchange rate was 6.1428 RMB to 1 USD which was an appreciation by 0.8 percent over that of 2013.

**II.2.4 Inflation**

Although moderate inflation may have left space for possible monetary policy and resource pricing reform, it may be even more worrying that the producer price index continues deflating, which is closely related to corporate profits and investment in the manufacture. If the real economy is further weakened, it will cause downturn pressure on the general price level. It may exacerbate the pain of economy leverage, which has been reflected in the banking crisis in 1990s.

**Figure 5: Differences in Consumer Price Index and Producer Price Index for Industrial Products (The same month last year = 100)**



Source: National Bureau of Statistics of the People’s Republic of China

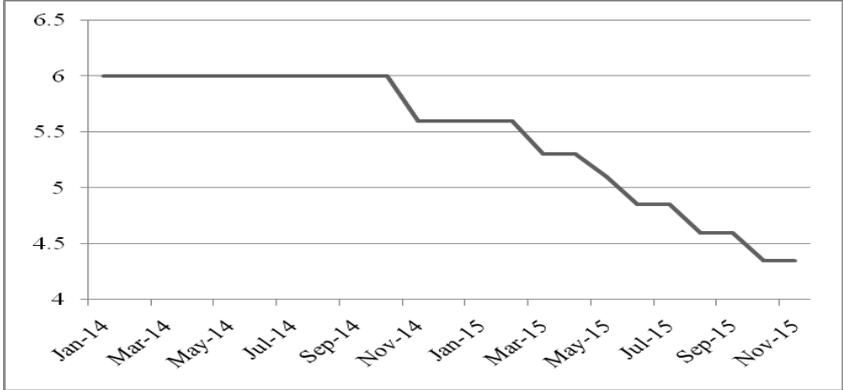
In the year of 2014, the cumulative growth rate year-on-year of China's consumer price index (CPI) fell from 2.49% in January to 2.0% in December. In January, 2015, CPI growth rate month year-on-year fell to 0.8%. The growth rate of industrial producer price index (PPI) in January 2015 fell to negative 4.30%.

The reasons for deflation were sharp falling down of international commodity prices, and rapid developing of the electronic commerce causing compression of the circulation cost. Both these two aspects were positive. While there were another two reasons which were excess capacity and insufficient demand. Therefore, appropriately relaxing the currency and increasing the structural adjustment and reform efforts are all needed.

**II.2.5 Interest Rates**

It was predicted in the early of 2014 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 6: Interest Rate Trend in China**

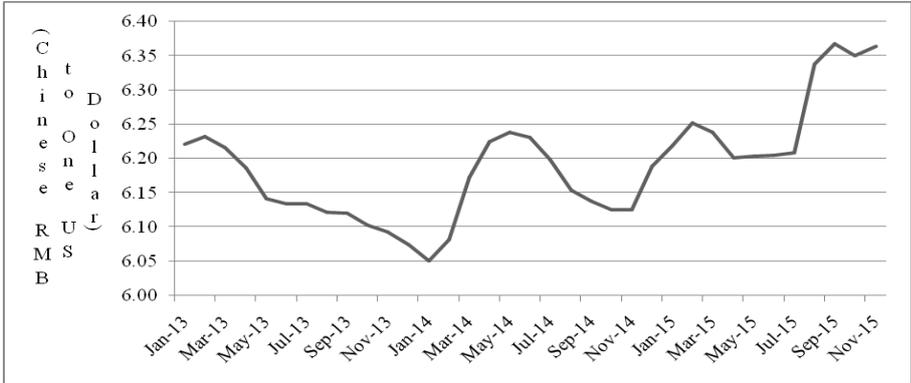


Source: World Bank

**II.2.6 Exchange Rate Level**

NPC & CPPCC (National People's Congress and Chinese People's Political Consultative Conference) has just ended, and the central bank has begun to take actual action. The central bank announced that since March 17<sup>th</sup>, 2014, the floating range of exchange rate of RMB against the U.S. dollar expands from 1% to 2% in the inter-banks spot foreign exchange market. The two-way interaction of the RMB exchange rate has a two-way effect on the trade. Specifically, on the one hand, the disappearance of unilateral appreciation of RMB is conducive to exports. The weakening of RMB helps to mobilize the enthusiasm of exports and encourage exports. On the other hand, the periodical depreciation and the flexibility of the RMB exchange rate may increase the cost and risk of imports.

**Figure 7: RMB/US Dollar Exchange rates trends**



Source. Bank of China

**II.3 Fiscal Position**

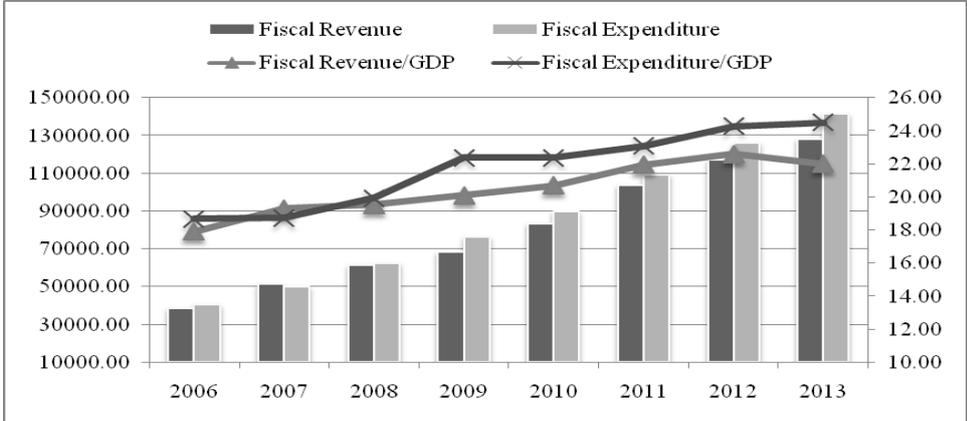
Since the new administration was launched, China has continued its positive fiscal policies, but has adopted a conservative stance toward massive public projects. The problems of excessive production capacity and real estate market heating up followed by a large-scale economic package after the Lehman 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.

China’s national fiscal revenues for fiscal year 2013 climbed 10.1 percent (1.18 trillion yuan) compared to the previous fiscal year, reaching 12.9143 trillion yuan. Of the total fiscal revenues, approximately 6 trillion (+7.1%) and 6.9 trillion yuan (12.9%) belonged to the central government and local governments, respectively. China’s fiscal expenditures, on the other hand, increased about 1.37 trillion yuan (+10.9%) compared to the previous fiscal year, reaching 13.9744 trillion yuan, of which

about 2 trillion (+9.1%) and 11.9 trillion (+11.3%) belonged to the central government and local governments, respectively.

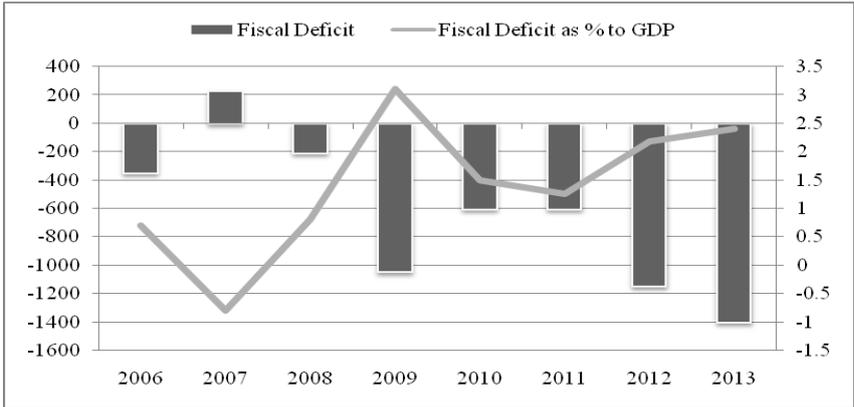
**Figure 8: Transition in Fiscal Balances (Unit: 100 million/%)**



Source: Ministry of Finance of the People’s Republic of China, National Bureau of Statistics

China’s fiscal scale has grown along with its economic growth, multiplying tenfold in the period from 2000 to 2012, and has witnessed average annual growth rates of 20 percent or more. Although the fiscal revenue-to-GDP ratio in 2000 was about 14%, occupying quite a small portion, it became about 23% in 2012, the same level as the ratios in Thailand and South Korea. Talking about the ratios between the central and local governments, fiscal revenues are evenly contributed by both parties, while 15% and 85% of the expenditures are accounted for by the central government and local governments, respectively. The ratios have remained almost at the same level for the last few years

**Figure 9: Transition in Fiscal Deficit (Unit: 100 million/%)**



Source: Ministry of Finance of the People’s Republic of China, National Bureau of Statistics

The fiscal deficit has climbed to approximately 1.6 trillion yuan in 2013, and the deficit to GDP ratio increased to 2%, from 1.6% in 2012. The issuance of bonds by local governments increased by 100 billion yuan to 350 billion yuan in 2013 compared to 250 billion yuan in 2012. The fiscal deficit in 2014 was expected to be at the same level, but some say that the amount of bond issuance by local governments would increase by an additional 50 billion to 400 billion yuan.

## **III. Tax system**

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

#### **III.1.1 SAT Division**

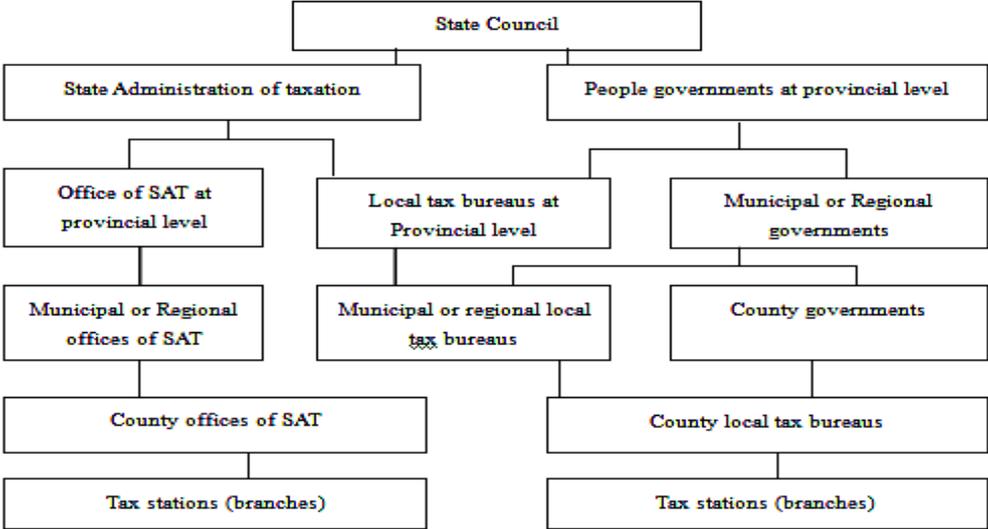
The tax authority is the department in charge of tax collection and management. In 1994 China began to implement the tax sharing fiscal administration system in order to further straighten out the relations of financial revenue within central and local, better play the functional role of state finance, strengthen the central macro-control ability, promote to establish the socialist market economic system and develop the national economy continuously, rapidly and healthily. At the same time, in order to meet the needs of tax sharing fiscal administration system, China has carried on the corresponding reforms of the tax administration. The central government set up the State Administration of Taxation which is organized directly under the State Council. The tax institutions of provincial and provincial below is divided into two systems which are the state administration of taxation and the local taxation bureau.

The state of administration of taxation has set up four levels which are the SAT, the offices of SAT at provincial (autonomous regions, municipality directly under the Central Government) level, at the prefecture (city divided into districts, autonomous prefecture, league) level, and at the county (city, banner) level. The state tax bureau system implements the leadership system of vertical management by SAT, and carries out the vertical management in terms of the approval on organization, staffing, funds and leader posts under the principle of one-level-down management. There are three levels of the departments of the local tax bureau system on the basis of administrative division, namely the local tax bureaus at provincial (autonomous regions, municipality directly under the Central Government) level, at the prefecture (city divided into districts, autonomous prefecture, league) level, and at the county (city, banner) level. The management system, organization setup, and staffing of the local tax bureaus are subject to the organic law of the local people's governments. All levels authorities have their specific responsibilities.

The state (local) tax bureaus are set up in accordance with the law, and unified the name to be the offices of SAT or local tax bureaus, tax branches, tax stations, and inspection offices of the offices of SAT or local tax bureaus. Those names and responsibilities of the tax authorities are determined by the administrative tier, administrative (economic) division or affiliation. All levels of the tax bureaus are fully functional bureaus, and set up according to the administrative division such as the province (autonomous region, municipality directly under the Central Government), the sub-provincial city, prefecture (city, league, autonomous prefecture) and district of municipality directly under the Central Government and of sub-provincial city, the county (banner), and the county-level city and the urban area of prefecture-level city, and the divisions at the prefecture level and above may also be set up according to the economic division in the district of city. Tax branches and tax stations are not fully functional bureaus (stations), but the agencies of the higher-level authorities, which may be established by administrative division or economic division. If they are the urban areas or areas with jurisdiction over five villages and towns (sub-districts) or above, it is allowed to establish tax branches there. While the organizations which have jurisdiction no more than four villages and towns (sub-districts) are called tax stations. The inspection offices of tax bureaus at all levels are the organizations directly under the tax bureaus at all levels, which are established in accordance with the law and with external functions. If it is necessary, the inspection offices may be established in the urban area of

prefecture-level cities, and according to administrative division or on a cross-district basis, as appropriate.

**Figure 10: Organizational Chart of China's Tax Administration**

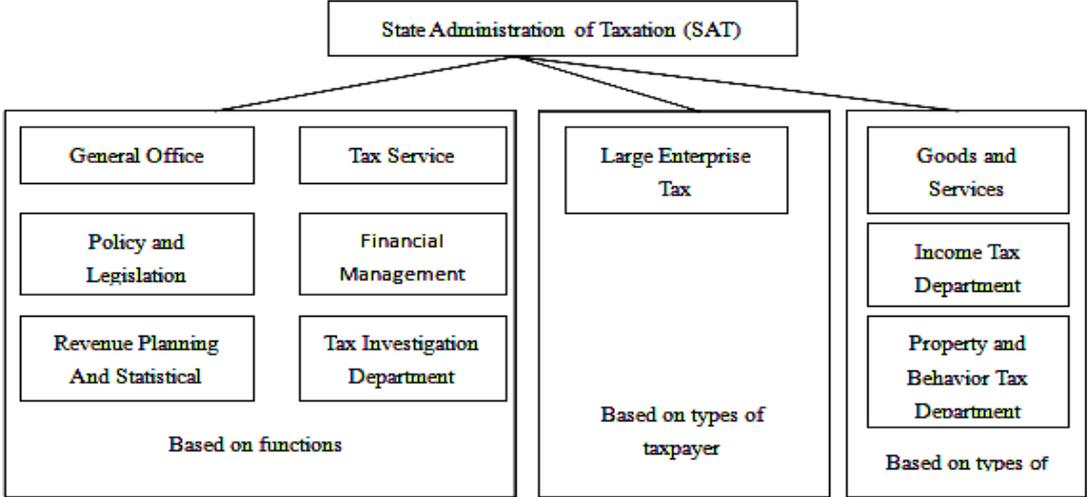


Source: State Administration of Taxation of the People’s Republic of China

**III.1.2 SAT Organization**

There are 14 different administrative departments within SAT which response different taxation administration. Those departments are organized according to functions, types of taxpayers and types of taxes.

**Figure 11: Organization of SAT**



Source: State Administration of Taxation of the People’s Republic of China

**III.2 Overview of China’s Tax System**

During over 30 years of implementing the reform and opening-up policy, with several reforms,

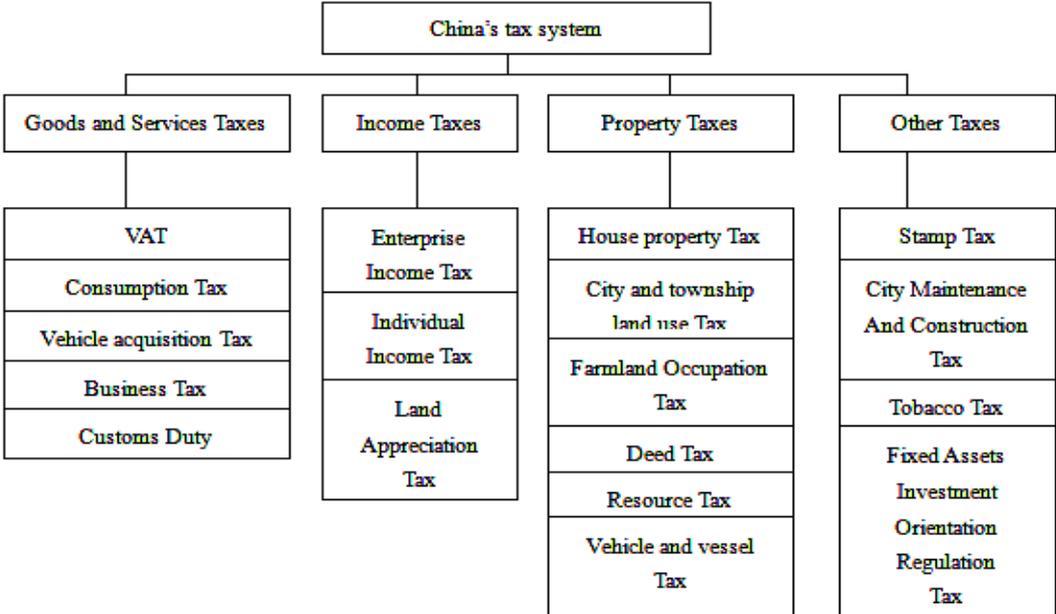
China's tax system is becoming more and more perfect. In the initial period of the reform and opening-up policy, the tax reform made it as a breakthrough that was to meet the needs of opening up and establish the foreign-related taxation system. In 1983 and 1984, a two-step reform of the state-owned enterprises was implemented successively, the "substitution of tax payment for profit delivery", which fixed the distribution relationship between the State and enterprises in the form of taxation.

In 1994, China implemented the taxation reform since the founding of new China which was considered to be the largest scale, the most extensive coverage, the most remarkable effect and the most far-reaching influence of the tax system. That reform actively set up the taxation system to fit in with the needs of the socialist market economic requirements focusing on the aim of setting up the socialist market economy. Since the year of 2003, a series of reform was implemented step by step according to the requirements of scientific outlook on development, focusing on the aim of improving the socialist market economy and building a moderately prosperous society in all respects, for instance, the reform of rural taxes and fees, improving the taxation system of goods and services, income tax and property tax system.

SAT is responsible for the domestic VAT, vehicle acquisition tax, most part of business tax, enterprise income tax and city maintenance and construction tax, enterprise income tax paid by central enterprises, the central and local enterprises, joint-stock enterprises, local banks, non-bank financial enterprises, enterprise income tax paid by part of enterprises and institutions, as well as enterprise income tax paid by offshore oil enterprises, and other taxes' management.

Local Taxation Bureau is responsible for some part of business tax, some part of the enterprise income tax of enterprises and institutions, individual income tax, resources tax, stamp tax and city maintenance and construction tax, property tax, urban land use tax, farmland occupation tax, deed tax, land value-added tax, travel tax, tobacco tax with the tax collection and management.

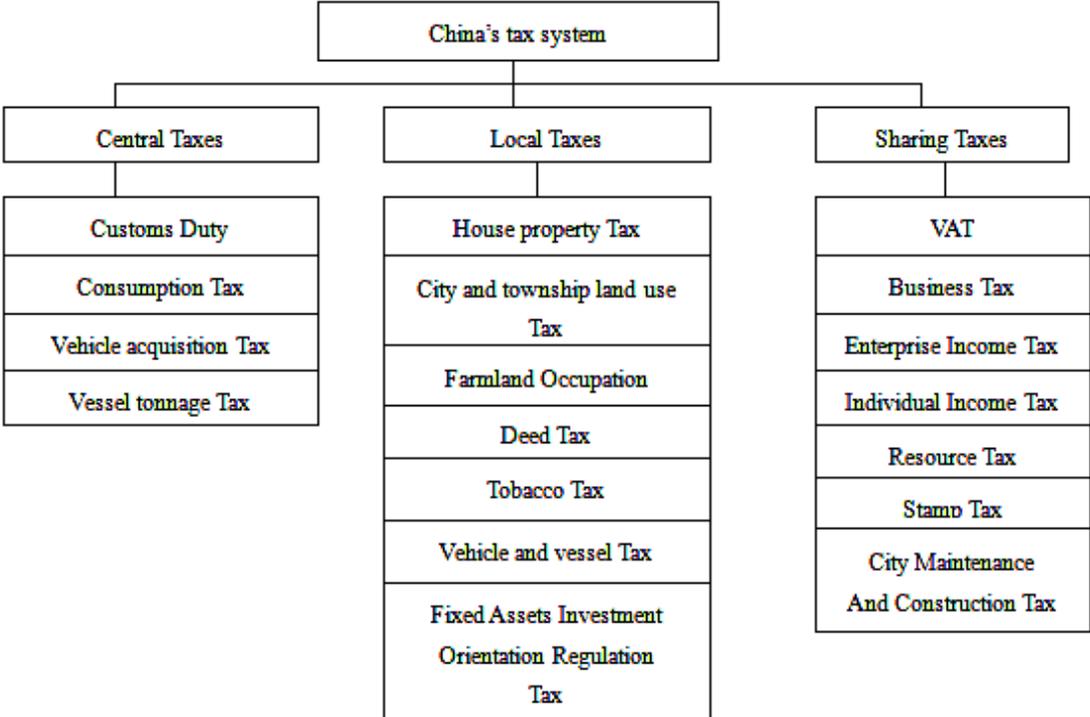
**Figure 12: Chinese Tax System (by category of taxes)**



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

With several changes, at present, there are 19 categories of taxes in China which are value added tax, consumption tax, business tax, enterprise income tax, individual income tax, resource tax, urban and township land use tax, house property tax, city maintenance and construction tax, tax on the use of arable land, land appreciation tax, vehicle purchase tax, vehicle and vessel tax, stamp tax, deed tax, tobacco leaf tax, customs duty, tonnage dues, and fixed assets investment orientation regulatory tax. Among them, 17 taxes are imposed by the taxation administration and fixed assets investment orientation regulatory tax was suspended to be collected from the year of 2000 decided by the State Council, while customs duty and tonnage dues are levied by the Customs Department as well as the import value added tax and import consumption tax.

**Figure 13: Chinese Tax System (by level of budget)**



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

**III.3 Tax Categories**

**III.3.1 Value Added Tax**

The value added tax ("VAT") is imposed on the entity and individual engaged in marketing goods, providing processing, repair or replacements services or importing goods within China. VAT has become one of the most important taxes in China, the proportion of the VAT tax revenue in China's total tax accounts for more than 60%, which makes VAT to be the largest tax. VAT is levied by the State Taxation Bureau, 75% of the tax revenue turn over to the central fiscal revenue, while the rest 25% to the local revenue. Import VAT is levied by the customs, which is all turn over to the central financial revenue.

**Table 1: Taxable Items and Tax Rates of VAT**

Coverage of collection	Tax rate
1) Crude Oil, mine salt and goods other than those listed above 2) Taxable services	Basic tax rate: 17%
1) Product of agriculture, forestry and animal husbandry, aquatic products 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 news papers, 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	Low tax rate 13%
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)

The VAT taxpayer is divided into the general taxpayer and the small-scale taxpayer according to some identified standard. As for the general taxpayer, the VAT is imposed on the increment value of its sale (or import) of goods or provision of processing, repair and/or replacements services, the basic tax rate is 17%, the lower tax rate is 13%, and the tax rate for export goods is 0; as for the small-scale taxpayer, a simplified system of computation of tax payable is applied, and the rate is 3%.

Value added tax is a turnover tax collected and based on the added value of goods (including taxable services) produced in the process of circulation. From the principle of tax, VAT is a turnover tax referred to the service additional values or the commodity added value in many links' of the commodity such as production, the circulation and the service. The price excluding tax, which is borne by consumers, there is no VAT without value added.

In practice, it is very difficult to accurately calculate the new added value of the goods or the added value in the production and circulation process. Therefore, China uses the general method of tax deduction used internationally. According to the sales of the goods or services calculating the output VAT with the provisions of the tax rate, and then deducting VAT paid for obtaining the goods or services which is the input VAT, the difference between output and input VAT is the VAT that should be paid.

### III.3.2 Consumption Tax

The consumption tax is imposed on the entity and individual engaged in producing, consigned processing, or importing taxable consumer goods within China, including the state-owned enterprises, collective enterprises, private enterprises, joint-stock enterprises, other enterprises, administrative units, institutions, military units, social organizations and other units, individual operators and other individuals. In addition, foreign investment enterprises and foreign enterprises which do production, processing, retail and import of taxable consumer goods should also be consumption tax taxpayers. The taxation scope covers 14 tax items such as tobacco, alcoholic drinks and alcohol, cosmetics, jewelry and precious stones. The consumption tax payable is assessed respectively under the rate on value method or the amount on volume method on the basis of the volume of sales or the quantity of sales in respect of the taxable consumer goods, in accordance with the tax items specified by the tax laws.

**Table 2: 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 cylinder capacity)
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)

Consumption tax is a kind of tax levied to taxable consumer goods of production, processing, retail and import by the State to reflect the consumption policy. Consumption tax is a turnover tax imposed on the units and individuals that are engaged in the production and import goods which should be taxable in the tax law in China. It is a kind of indirect tax imposed on specific consumption goods and consumption behavior.

### III.3.3 Business Tax

The business tax is imposed on the entity and individual engaged in providing taxable services, transferring intangible assets or selling immovable property within China. The taxable services cover 7 tax items, such as transportation industry, building industry, and finance and insurance industry. The business tax payable shall be calculated on the basis of the business turnover, amount of transfer or sales volume in respect of the taxable services or taxable activities at the statutory tax rate. The tax rate applicable to entertainment industry is 20%, except that the tax rate applicable to the billiards clubs and bowling halls in such industry is 5%; the tax rate applicable to all the other tax items is 3% or 5%. However, China is implementing a wide range reform program to replace the business tax with a value-added tax, which means probably after 2016 business tax will totally turn to VAT and disappear.

### III.3.4 Enterprise Income Tax

All enterprises and other income receiving organizations (excluding sole proprietorship enterprises and partnership enterprise) within China shall be the taxpayers of the enterprise income tax. The enterprises are divided into resident and non-resident enterprises. Resident enterprises shall pay the

enterprise income tax for the income obtained in and out of China. Non-resident enterprises shall pay the enterprise income tax as determined according to whether there are organizations or establishments for them in China, and whether the income has exact relationship with the organizations or establishments. In terms of the enterprise income tax, the balance derived from the total income of an enterprise in each tax year after deducting the tax-free income, tax-exempt income, other deductible items as well as the permitted carry-forward loss of previous year(s) shall be the taxable income. The tax rate is 25%.

### III.3.5 Individual Income Tax

The individual income tax is imposed on the taxable income derived by individuals (including 11 taxable items, such as the income from wages and salaries derived by the individuals, the income from production, operation derived by individual industrial and commercial households). A progressive tax rate of 7 levels which is implemented a comprehensive monthly collection from 3% to 45% is applied to the income from wages and salaries. A progressive tax rate of 5 levels from 5% to 35% is applied to the income from production and business and the income from contracted or leased operation of enterprises or undertakings derived by individual industrial and commercial households (note: which is similarly applied to the investors of sole proprietorship enterprises and partnership enterprises). A flat tax rate of 20% is applied to all the other types of income. From September 1, 2011, in terms of the income from wages and salaries, the standard monthly deduction for expenses is increased from RMB 2000 to RMB 3500.

**Table3: 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 5500 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)

**Table4: 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)

### III.3.6 Resource Tax

The resource tax is imposed on the entity and individual engaged in exploiting various taxable natural resource. The taxation scope covers 7 major categories, i.e. crude oil, natural gas, coal, other non-medal ores, ferrous ores, non-ferrous ores and salt. The resource tax is collected under the rate on value method and the amount on volume method. The resource tax rate applicable to crude oil and natural gas products is 5% to 10% of the sales volume. In terms of the resource tax, the tax amount standard for other tax items varies from RMB 0.3/ton to RMB 60/ton, depending on the kinds and

locations of the resources.

### **III.3.7 Urban and Township Land Use Tax**

The urban and township land use tax is imposed on the land in cities, county towns, administrative towns and industrial and mining districts. The tax shall be levied on the entities and individuals who use the land on the basis of the actual area of the land used at the specified tax amount. The tax amount standard is determined on the basis of big cities, medium-sized cities, small cities and county towns, administrative towns and industrial and mining districts, ranging from RMB 0.6 to 30/m<sup>2</sup>. The urban and township land use tax is calculated on a yearly basis and paid in installments.

### **III.3.8 House Property Tax**

The house property tax is imposed on the houses within the cities, county towns, administrative towns and industrial and mining districts. The tax is calculated on the basis of the residual value or the rental income of the house property. The taxpayers include the house property owners, managing entities of the houses (which are owned by the whole people), pawnees, custodians and users. The tax rate is classified into two categories: where the tax amount payable is calculated on the basis of the residual value of the house property, the applicable tax rate is 1.2%; where the tax amount payable is calculated on the basis of the rental income of the house property, the applicable tax rate is 12%, however, where individuals lease their residential houses at the market price, the applicable rate is 4%. The house property tax is collected on a yearly basis and paid in installments. As from January 1, 2009, foreign-invested enterprises, foreign enterprises and organizations, and foreign individuals (including Hong Kong, Macau and Taiwan-funded enterprises and organizations, and the compatriots of Hong Kong, Macau and Taiwan) shall pay the house property tax in accordance with the Provisional Regulations on House Property Tax of the People's Republic of China.

### **III.3.9 City Maintenance and Construction Tax**

The city maintenance and construction tax is imposed on the entities and individuals who pay value added tax, consumption tax and business tax. The tax is calculated on the basis of the value added tax, consumption tax and business tax actually paid by the taxpayer. There are 3 levels of tax rate applied on the basis of the taxpayer's location, i.e. 7% (urban area), 5% (county towns, towns) and 1% (areas other than the urban area, county towns or towns). The city maintenance and construction tax shall be paid respectively together with value added tax, consumption tax and business tax.

### **III.3.10 Tax on the Use of Arable Land**

The tax on the use of arable land is imposed on the entities and individuals who use the arable land to build houses or for other non-agricultural construction purposes, and is collected on the basis of the area of the arable land used. The tax amount standard ranges from RMB 5 to 50/m<sup>2</sup>.

### **III.3.11 Land Appreciation Tax**

The land appreciation tax is imposed on the increment value of the transfer of State-owned land use rights, above-ground structures and their attached facilities, and is collected at the specified tax rate. There are four level progressive rates, i.e. 30%, 40%, 50% and 60%.

### **III.3.12 Vehicle Purchase Tax**

The vehicle purchase tax is imposed on the entities and individuals who purchase the taxable

vehicles, such as cars, motorcycles, trams, trailers and agricultural transport vehicles. The vehicle purchase tax is calculated under the rate on value method, and the tax rate is 10%. The price for tax assessment is the total amount of the price and other charges in addition to the price paid by the taxpayer to the seller for the purpose of purchasing the taxable vehicle (excluding value added tax); the State Administration of Taxation will provide for the minimum price for tax assessment of the taxable vehicles of various types by reference to the average market transaction price of the taxable vehicles.

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

The vehicle and vessel tax is imposed on the vehicles and vessels within China, which shall be registered with the regulatory departments in accordance with the law, and shall be paid by the owners or managers of the vehicles and vessels. There are six major tax items, such as passenger vehicles and commercial vehicles. The annual tax amount standards of the tax items vary from RMB 36 - 5400/vehicle, or from RMB 3 - 60/ton in terms of dead weight (net tonnage), or from RMB 600 - 2000/m in terms of the length of yacht body.

### **III.3.14 Stamp Tax**

The stamp tax is imposed on the entities and individuals executing or accepting the taxable instruments specified in tax laws during the economic activities and exchanges. In terms of the stamp tax, the tax amount payable shall be calculated at different proportionate tax rates in respect of the contract price or on the basis of a fixed amount per instrument, in the light of the nature of the taxable instruments. There are four levels of proportionate tax rates, i.e. 1‰, 0.5‰, 0.3‰ and 0.05‰.

### **III.3.15 Deed Tax**

The deed tax is imposed on the land and houses the titles to which are transferred through such means as transfer, assignment, purchase or sale, gift or exchange, and shall be paid by the entities and individuals who are the transferees. Where the land or houses are the subjects of the transfer, assignment, purchase or sale, the tax shall be calculated on the basis of the transaction price; where the land or houses are the subjects of gifts, the tax shall be assessed by the collection authority; where the land or houses are the subjects of exchanges, the tax shall be calculated on the basis of the difference between the exchange prices. The tax rate is from 3% to 5%.

### **III.3.16 Tobacco Leaf Tax**

The tobacco leaf tax is imposed on an entity that engages in the purchase of tobacco leaves (including aired tobacco leaves and baked tobacco leaves) within China, and shall be calculated on the basis of the sum as generated from tobacco leaf purchases at the tax rate of 20%.

## **IV. Country Specific Fiscal Issues**

### **IV.1 The Reform Program to Replace the Business Tax with a Value-Added Tax**

In 2011, approved by the State Council, the Ministry of finance and the State Administration of Taxation jointly, the reform program to replace the business tax with a value-added tax started. From January 1st, 2012, Shanghai became the first pilot of replacing the business tax with a value-added in transportation industry and part of modern service sectors. Since then on, the reform of the taxation system for goods and services has begun. From August 1st, 2012 to the end of that year, the State Council will expand the pilots of replacing the business tax with a value-added to 10 provinces, while Beijing started the reform from September in 2012. By August 1st, 2013, the reform of replacing the business tax with a value-added has been put into practice to the whole nation. On December 4th, 2013, Premier Li Keqiang chaired the executive meetings of the State Council and announced the decision that from January 1st, 2014, rail transport and postal services would be included into replacing the business tax with a value-added. Thus transportation industry has already been fully integrated into the reform to replace the business tax with a value-added. From June 1st, 2014, the telecommunications industry has been included into the reform pilot.

Business tax is the main tax categories for the local taxation administration. Therefore, this reform program to replace the business tax with a value-added tax has an effect on local taxation.

#### **IV.1.1 Substantial Decline In Local Tax Revenue**

The reform directly leads to a substantial decline in the total local tax revenue. Business tax has a pivotal position in the local tax revenue. After the reform, the present business tax will be imposed by the state administration of taxation from local administration, which directly causes the decrease of local taxation revenue. From the data analysis of industry tax revenue statistics from the year 2012 to 2014, it is not difficult to find that the proportion of business tax accounted for in the local taxation revenue increases year by year, in which the business tax levied from construction industry, real estate and financial industry accounts for about 80% of total business tax. If the three major industries have implemented the reform to replace business tax with a value-added tax in 2016, it will surely lead to a substantial decline in local tax revenue. It would be difficult to achieve the target of improving the proportion of the local tax revenue accounted for local GDP and local fiscal revenue, and it means as the main tax business tax will appear to be completely quit the stage of local tax revenue.

#### **IV.1.2 Local Fiscal Revenue**

The reform will further weaken the growth potential of local fiscal revenue and reduce the proportion of local fiscal revenue in total local revenue. If the share proportion of tax revenue remains the present proportion of 75: 25, the tax revenue of the central level will increase. In contrast, the tax revenue of local level will face a sharp drop, and the proportion of local fiscal revenue in total revenue will further reduce. In the current tax system, the business tax is the first important tax categories, of which the tax revenue mostly belongs to the local government. However, after the reform program to replace the business tax with a value-added tax, the central will share 75%, and the local will share 25% that means even if the total tax revenue unchanged, the local government revenue will reduce 75% as well.

**IV.1.3 Lose Main Taxes**

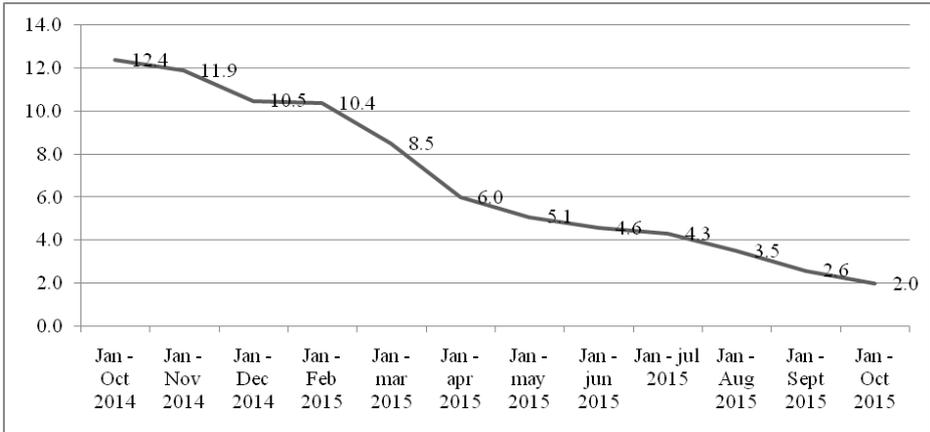
After the reform, the local tax revenue will lose main taxes, so that the function of the local taxation administration will be weakened, and the difficulty of tax collection will be increased.

Business tax, corporate income tax and individual income tax are currently not only the main tax categories of local tax revenue, but also the main force for the growth of tax revenue. With the expansion of the reform, the local tax revenue will lose the revenue from business tax all or most, in addition, due to the business tax of new enterprises will be imposed by the state administration of taxation, there will be no growth space for the local tax revenue. Meanwhile, the corporate income tax and individual income tax imposed with local tax invoice will disappear for the loss of administrative power of invoice, all mentioned above will be bound to cause that all the three main tax categories will comprehensive decrease in the local tax authorities, the local tax authorities' position in the taxpayer and the local government will be significantly weakened, and they will face with the situation of reposition. Moreover, after the reform, the original taxpayer of business tax must be handed over to the state administration of taxation, so the separated systems of the state and local tax administration makes it hard to dock their own information systems, which lead to great difficulty for a large number of basic information and historical data to transfer.

**IV.2 Economic Trends**

China has been affected on the 4 mainly negative factors which are the outflow of capital, the sluggishness of manufacturing industry, the downturn of real estate and the withdrawal of foreign investment. As a result, economy has slipped into the track of deflation, corporate liabilities will increase, salaries will go no further, the level of consumer spending will decline and buyers for houses are currently taking a wait-and-see attitude. However, it is difficult for the real estate developers to get funds return, which lead the capital chain to be tight or even maybe broken. On the other hand, the economic malaise of the real estate industry affects directly to the fiscal revenue of local government. The real estate industry and related industries, such as construction, cement, steel and furniture account for nearly a quarter of Chinese economic aggregate.

**Figure14: Growth Rate of Investment in Real Estate Development**



Source: National Bureau of Statistics of the People's Republic of China

In the first half, China's economy continues to adjust differentiation trend and some core indicators have a sign of a pick-up, positive factors increase and the effect of steady growth policy has shown.

But the overall downward trend in economic operation has not been reversed. The down force led by continued shrinking demand and depth adjustment of supply, reduction of production capacity, asset restructuring lagging behind; heavy industry and overcapacity coexists with the emerging up force led by new technologies, new formats and new model. The real economy to reduce leverage, inventory, and gradually release the risk coexists with the virtual economic leverage and financial risk accumulation.

Adjusting differentiation in economy is the reflection of structural adjustment, and is the process of converting and taking over the old and new power. At present, the power of differentiation downturn overall is still greater than the power of remodeling upturn, the expected target of annual growth of 7% still need policy more powerful and efficient. We must keep the idea of steady the macroeconomic policy, flexible the microeconomic policy and based by social policy. Take great pains to explore the potential, revitalize the stock and control risk, so as to avoid the economic stall and steadily rebuild a new balance.

Current economic operation reflects some situation. The growth of demand is continuing to drop, but the adjustment of supply is lagging behind. The serious oversupply leads price decline continuously, and the growth of corporate profits and fiscal revenue slows down. Development environment and conditions have changed, however, the method of local government to promote economic development transfers relative lagging behind. The traditional power is weakening, and new growth momentum is growing, while the breakthrough and innovation of institutional mechanisms relatively lags behind, and the growth potential and space has not been fully released. The overall performance is the marginal effect of macro policy is decreasing, and the pressure of stable growth is difficult to be relieved in short term.

### **IV.3 New Changes and New Characteristic**

Compared with the trend of continuous downward since the third quarter last year, positive factors in the economic operation recently has increased with the effects of macroeconomic policies and the reform.

#### **IV.3.1 Obvious Differentiation Trend**

The trend of differentiation is more obvious. The traditional forces from economic adjustment and differentiation continue going down, while the emerging forces is growing gradually. Look from area circumstance, the regions which highly depend on resources and heavy industry have the largest decline in this round of adjustment. This is a situation that the regions that have a substantial decline in PPI are mainly the same as the regions that has a GDP growth and the lack of financial revenue, among which, Liaoning, Shanxi and Heilongjiang are more typical. The area where the transition started earlier and industrial structure set more reasonable remains economic growth generally stable, such as Guangdong, Jiangsu and Zhejiang. Look from the industry, heavy industry adjusts too large which made the contribution more than 75% of the PPI falling down, while other industries and services are relatively stable. The traditional retail industry falls down, while the e-commerce has a rapid growth. Part of the industries appears the sign of recovery after a period of adjustment and integration, textile, chemical fiber, photovoltaic, rail transportation equipment manufacturing and other industries, for instance. Look from the enterprise, while many enterprises in the same industry are having a deficit, the enterprises are having smooth operation, and probably having an optimistic expectation of the future, which are with certain core competitiveness, accelerating the integration and

restructuring of industrial chain, participating in global competition actively and paying attention to research, development and innovation.

### **IV.3.2 Infrastructure Investment**

The motive power of steady growth in infrastructure is becoming weak. Infrastructure investment has been the important means for the Chinese government to stabilize fluctuations in the economy and play an important role in cell cycle regulation. However, investigation shows that it has been affected by decreasing of the financial income and increasing of the debt pressure and other factors, it is obvious that the power from the current local government to promote infrastructure investment funds is insufficient, and the growth of government fund income is slow down. At the same time, subject to long-term investment in the future is not optimistic and the mechanism is not smooth, the intention for private capital to participate in infrastructure construction is not as expected.

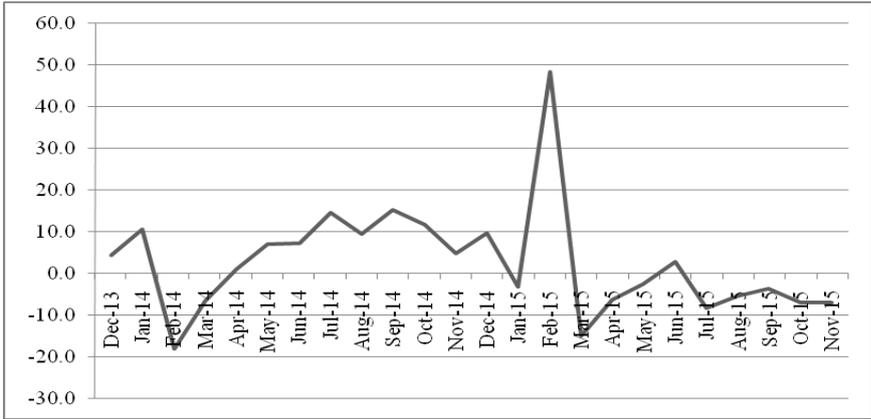
### **IV.3.3 Financial Risk**

The financial risk increases because of the capital turning from real economy to fictitious economy. Under the influence of those factors that the real estate market is changing periodically in China, the local debt is restructuring, risk control is strengthening and excess production capacity is serious, these departments' ex-ability to raise capital prices and absorb funds significantly shrink, and capital from the real economy to the capital market. Although experienced several times of intensively cutting the requirement reserve ratio (RRR) and lowering key interest rates, the money market interest rates decreased significantly, the capital for real economy is still tight and the capital price is also high. While the real economy gradually reduces leverage and risk, fictitious economy is continuously increasing leverage, especially using the method of OTC with capital, margin financing and the umbrella trust, to push up the capital market leverage. Under the background of economic downturn and monetary easing, the price of the real economy is high, the capital market fluctuates greatly, and the risk of economic operation is increasing, which increase the risk of economy, increases the conflict between the micro prudential supervision and macro prudential, and increased the contradictions between the stock and increment.

### **IV.3.4 Export Growth**

Export growth was significantly lower than expected. Before June, China's imports and exports fell down 1.9% on year-and-year basis, of which, the export growing up 2.1% and the import falling down 6.7% are both lower than the annual target. From a global perspective, over the past 30 years, world trade growth has an average of two times of the global GDP growth, however, in recent years, the growth of international trade are significantly lower than that of the global GDP growth.

**Figure 15: Total Value of Exports, Growth Rate (the same period year=100) (%)**



Source: National Bureau of Statistics of the People’s Republic of China

**IV.3.5 Economic Performance**

Economic performance has not been improved. First, the pressure on the financial income is obvious. In the first half, the national fiscal revenue grew up 6.6% (according to comparable caliber is only 4.5%), which is lower than GDP and the growth of industrial added value. In addition, there is a substantial reduction on local land transfer income and the capability of local financial supporting steady growth and promoting transformation. Second, there is not a substantial improvement in corporate earnings. The last 6 months above scale industrial enterprises’ profit was reduced by 0.7%. Although the decline has narrowed, it is largely because of the business cost reduction of financial services, a lot of profit obtained from the stock market investment, and the prime operating revenue is still reducing. Third, the force of replenishing stocks is insufficient.

In addition, the risk of deflation has not been removed, PPI grows negatively for along term and the decline is large, and GDP adjustment index is negative. It is concerned that hidden unemployment and structural unemployment has increased with the economic downturn, and the quality of statistical data is not satisfied. The current economic operation reflects that the growth of demand continues dropping, while the adjustment of supply is lagging behind. Serious oversupply leads to prices continuous downturn, and corporate profits and fiscal revenue grow slowly. Development environment and conditions have changed, but the way of the local government to promote economic development changes relatively slowly behind. Traditional power weakened and new growth momentum is growing, in contrast, breakthrough and innovation for institutional mechanisms is relatively lagging, and the growth potential and space has not been fully released. The overall performance is that the marginal effect of macro policy is decreasing and the pressure of stable growth is difficult to be relieved in short term.

**IV.4 The Goal of 7%**

Further efforts are needed to achieve the expected. In the stable background of employment, income and the community, as long as we hold the bottom line of systematic hazard, it is acceptable that the growth rate of GDP is slightly lower than 7%.

**IV.4.1 International Economic Differentiation**

The international economic differentiation becomes narrow and exports may not be as expected. This year, the international economic continues the differentiation trend, but the relative difference gradually reduced. The growth of the United States and Britain with a better recovery is slightly less than expected, while the EU and Japan have shown some improvement. Meanwhile, the growth rate of developing countries continues slowing down, but the growth rate among various economies has narrowed. In 2015 the global growth rate of contribution of developed countries is likely to rise, therefore, change its continued downward trend since the last century 80's.

First, the US economy maintains the growth momentum. Second, European economy continues to improve in short-term. Third, the downturn of Japan's economy is a slight recovery, emerging economies. Forth, the growth of the newly-emerging economy is still slowing. Under the background of global economy growing slowly, the growth of the world trade is more sluggish, and the global supply chain and trade rules speeds up to reconstruct. Despite the international economic situation is likely to be generally stable and slightly better than last year, China's export growth in the second half of the year will also be slightly better than the first half of the year, and the growth in June has been positive from negative, the annual growth rate will at about 5%.

#### **IV.4.2 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.

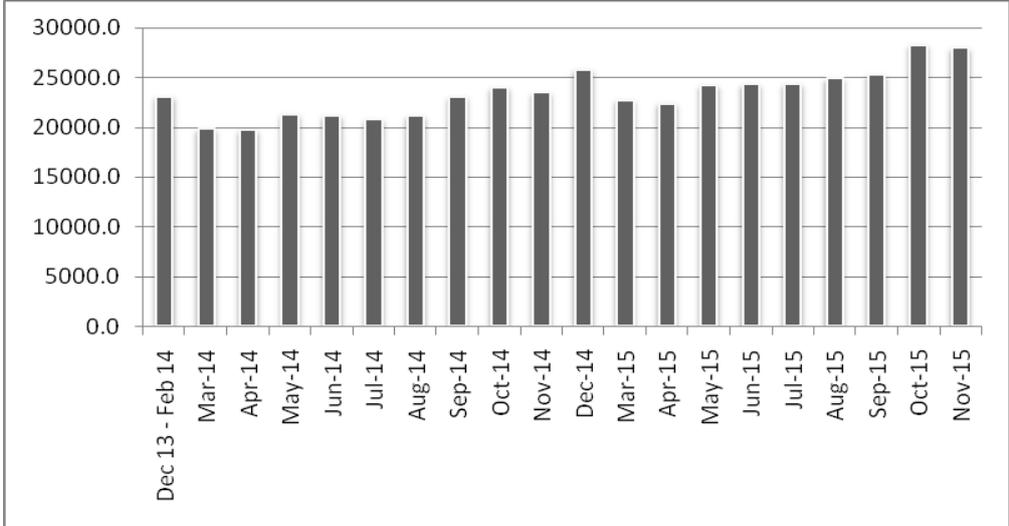
In addition, after years of rapidly increasing, the growth rate of the service industry and other types of investment is also significantly reduced in the first half, and it was only 13.8% rising, which is significantly lower than the average growth rate of the past 5 years. It is worthy of high attention 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.

#### **IV.4.3 Consumption Growth**

Consumer grows basically stable, maintaining an upgrade and differentiation. In June the actual

growth rate of the total retail sales of social consumer goods is 10.6%, 0.4 percentage points higher than the previous month, and the index of consumer confidence has improved. It is worthwhile to note that the consumption structure continues to differentiate in the upgrade, and the traditional consumer grows relatively stable, while the emerging consumption patterns with the represent of information, E-commerce and tourism grows rapidly. By the impact of the overall economic growth and development stages, the traditional consumer growth rate decreased year by year. Influenced by the turn of the real estate market trend, the consumption of furniture and home appliances is difficult to have a big improvement. Affected by the local government’s purchase limitation and increasing parking fees, the consumption of automobile has a speed-up decrease after the period of a rapid growth. Meanwhile, the concept of automobile consumption has changed from processing the car to using the car. The growth rate of car consumption is difficult to recover to a high level, so it will not change a lot in the second half. With the fluctuations of the stock market, it cannot be ignored that the disappearance of the wealth effect has a negative impact on consumption. Since this year, the growth rate of food industry has continuously increased, which plays a certain role to stabilize the consumer. Considered synthetically to the impact of income and other basic factors on consumption, as well as the impact of industry changes, the real growth of the annual consumption is expected to close to 11%, which is basically the same as last year.

**Figure 16: Total Retail Sales of Consumer Goods (100 million yuan)**



Source: National Bureau of Statistics of the People’s Republic of China

**IV.5Expand The Policy's Priorities**

Efforts are needed to expand the policy's priorities on the steady growth

China's economy is still in the process of slowing economic growth, thus the new growth center and the new phase of economic balance have not been established, and the downward pressure will continue for some time. With the gradual appearance of macroeconomic policies and reform effects, accumulation of positive factors has increased, so the pressure in the second half will be slightly less than the first half of the year, which laid a good foundation for achieving the expected goal of the year. Macroeconomic policy in the second half of the year in the general tone of stable but processing should concentrate efforts on playing a good role of "buffer" policy, appropriate to increase the fiscal policy and reduce the damage degree of transformation, so as to avoid the economic stall. Concentrate

efforts on stabilizing the market confidence, optimizing and standardizing the supervision and preventing financial risk from asset prices sharply down. Concentrate efforts on dealing with the relationship between the stock and incremental, across-the-board cut excess capacity as a breakthrough so as to speed up the asset reorganization. Concentrate efforts on expanding the new growth point, tapping potential and releasing energy in the beneficiary potential department and backward areas, in order to promote the economic operation steady overall.

#### **IV.5.1 Fiscal Policy and Monetary Policy**

Keep strength of fiscal policy and flexibility of monetary policy. Actively play the fiscal policy role of stabilizing growth and adjusting structure. First, in the case of local finance limited, the central government can appropriately expand the deficit scale, and increase the intensity of major infrastructure projects. Second, set a clear transitional period for the transition of the local financing platform, at the same time, and appropriately release the cap of local debt scale to the area where the debt ratio is overall low. Third, establish PPP (Public—Private—Partnership) to guide the development funds, and accelerate the improvement of the legal environment of the PPP project. Forth, appropriately increase exemption standards for the amount of taxable income and the exempt sales standards for the VAT of small-size enterprises. Maintain monetary conditions moderate tight, and take flexible measures to stabilize market expectations. Maintaining a moderately loose monetary condition is very necessary, although the stimulation effect from the current loose monetary policy is limited and increasingly weak to the real economy, taking into account factors such as replacing the local government debt and defusing financial risks.

#### **IV.5.2 Increasing Potential**

Dig new growth point in the field of increasing potential. Adhere to strengthen structural reform of the supply of efficiency improvement, and release the growth potential of the low efficiency sectors. One, promote the rural homestead to transact in a wider range on the basis of ownership, preferred in the pilots of Beijing, Tianjin and Hebei. Two, pay attention to coordination and synchronization of streamline administration and institute decentralization, strengthen supervision and inspection and accountability, truly implement streamline administration and institute decentralization. Three, based on big data, cloud computing, industrial Internet, support the transformation of traditional industries with the Internet and smart technology, and actively promote to disclose the government data. Four, accelerate the pace of opening up the service industry, actively promote negotiations of FTA (Free Trade Agreement) and investment agreements, sum up useful experience of Free Trade Area and gradually spread to the whole country. Five, accelerate the promotion of civil and military industry, and release the space of growth and efficiency. Six, comply with the rapid escalation of resident consumer trends, encourage and support products of smart residential, saving energy, environmental protection, information consumption, tourism and health consumption, and foster and form multi consumer hot spots.

#### **IV.5.3 Innovation Mechanism System**

Innovation mechanism system promotes to reduce the excess capacity. One, though improving standards of energy efficiency, emissions and environmental protection, strictly control the incremental growth of excess capacity. Two, referred to the serious overcapacity industry such as iron and steel, coal, and petrochemical, formulate a nationally unified program of output reduction. Three,

establish a national trading mechanism. Four, set up a fund for output reduction of surplus industry raised capital by issuing long-term special bonds, which are mainly used to guidance and subsidies for the closure of enterprises, restructuring and reducing production capacity, as well as training subsidies for employee's placement and re-employment, etc.. Five, in terms of funds use and output reduction, for instance, leave a certain amount of space for independence and innovation to the local government. Six, support the bankruptcy reorganization and relative provision for the bad debts, it is recommended for the coordination appropriate guidance introduced by the People's Bank of China, Banking Regulatory Commission and the Ministry of Finance.

#### **IV.5.4 Real Estate Market**

Maintain the basic stability of the real estate market. One, further reduce taxes and fees in the real estate transaction link, reduce the cost of housing for residents to buy, and encourage residents to improve the living conditions through selling the old to buy new, and selling the small for a big. Two, put more emphasis on the implementation of neutral housing finance policy, while the interest rate is reducing, appropriate increase the ratio of down payment to avoid long-term risk. At the same time, delegate part of the regulatory authorities to the local for regional differences of the real estate. Three, promote the transformation of housing security mode. Compress construction tasks of low-income housing, and rebuild shanty areas should follow the way of more pulling down with less building up and monetary subsidies. For the large number of low-income housing held by the government, the government may retain about 20% of them directly held by the government, and transfer the low-income housing to total property rights through the method of changing rent to sale, which could recover the government funds and ease issues such as the financial pressure on local governments.

#### **IV.5.5 Stock Market**

Promote the healthy development of the capital market. The stock market "roller coaster" under the effect of leverage ratio and the rescue operation after the stock market crash, have exposed the shortcomings of our country in the regulatory system, risk management, signal release, expected management and personnel reserve. From the known data, the current round of the stock market fell, does not affect the banking system a lot, the loss of OTC distribution main body is limited. It has not shown that financial redistribution among investors has impact on the real economy. It is need to further stabilize market expectations and confidence, avoid system financial risks caused by a sharp drop in asset prices, and promote a long-term healthy development of the capital market, better perform functions of resources allocation for capital market, promoting the development of the real economy and industrial upgrading and scientific and technological innovation.

#### **IV.5.6 Support Exports**

Actively support exports and stabilize the international share. Focus on stabilizing export for short term and promoting transformation for long term. One, accelerate the Single Window construction of international trade, expand the facilitate policy of foreign trade integrated service platform, and allow the traditionally professional foreign-trade companies to enjoy the same treatment. Two, simplify the program of Export Rebates, speed up the progress of Export Rebates, and form the national traffic mechanism of the tax rebate of departure port as soon as possible. Meanwhile, cautiously introduce the policy for adjusting subject of tax rebate of foreign trade enterprises. Three, according with the direction of industrial upgrading, it is recommended to restore and promote the profit and investment

tax rebate policy, and encourage enterprises to invest in equipment updating and upgrading in order to encourage foreign investment to expand in China. Four, strengthen IPR (intellectual property protection) and law enforcement, promote foreign investment enterprises to introduce the most advanced products to China to produce, encourage domestic enterprises to innovate and upgrade technology. Five, focus on improving the business environment.

## **V. Conclusion: Where We Stand and Where We Go?**

In the year of 2015, China's economy will continue to run smoothly. It is expected that the annual economic growth rate is about 7%, CPI rises around 1.8%, and 13 million urban jobs is newly increased. Investment in fixed assets continues to be stable with lightly falling, and it is expected to increase about 14% which is down to the lowest point of this century. Consumption remains stable, and it is expected that the total retail sales of social consumer goods grows about 12%. The growth rate of exports is about 6%, and that of imports is about 4%, which leads that the annual foreign trade surplus has been slightly expanded, and the proportion of GDP remains stable.

### **V.1 Advantages**

There have been four advantages in the economic development in 2015.

The world economy will continue to recover. The International Monetary Fund (IMF) predicts that the global economy will grow 3.5% in 2015, which is 0.2% up compared to 2014. However, it should also be noticed that the overall economic growth in developed economies is still relatively weak, so it is difficult to really get out of the trough in a short term, and the main economy of the emerging market appears the differentiation, and the financial market intensifies the instability.

Effect of pre-policy gradually releases. Most of the policies introduced by central authorities in 2014 will be implemented cross year which are targeted RRR cuts, structural tax cuts, rebuild shanty areas, railway construction in Midwest China, stable foreign trade, expenditure of information consumption, as well as overall rate cut and a number of policies (PPP) in the field of the infrastructure to encourage social capital to participate implemented before the end of that year.

The fundamental of China's economic is good, and the growth of domestic demand has great potential. For supply, the population of labor force and the savings rate are decreasing, but the quality of supply for human capital and capital stock are improving. For consumption, the situation of current employment is good, and the growth rate of resident income is over that of economy. For investment, "Twelfth Five-Year Plan" is about to end up, therefore, some constructions of planning projects will accelerate progress, and a recovery in exports will also drive a growth of related fixed asset investment. China has vast territory, the implementation of the strategies can create huge investment demand, which are "the Belt and Road" (the Silk Road Economic Belt and the 21st-Century Maritime Silk Road, and B&R for short), "Yangtze River Economic Belt" and "the Beijing-Tianjin-Hebei region". Benefits reform has shown. The central government launched a series of major reform measures in 2014, and will implement a number of major reforms in 2015, where benefits reform will gradually release.

### **V.2 Disadvantages**

There are also four negative factors for economic developments in 2015.

The differentiation of global economy and its policy affects China's exports. The U.S. Economy increases stably, and the unemployment rate decreased steadily. The Chinese economy may adversely affect by the EU economy starts to stabilize stopping falling. Japan's economy keeps growing at low speed. Growth in emerging markets recovers to rise, but the recovery is weak. In particular, the U.S. Federal Reserve lifting interest rates, the euro area quantitatively easing policy and the geopolitical crisis in Ukraine.

The growth of fixed asset investment is weak. Affected by overcapacity in the manufacture, and insufficient demand, the willingness of private investment debased. In a short term, the real estate market is difficult to get out of the downturn, which restricts the growth of investment and related industries. Tax and land transfer income decreases, debt service goes into the peak period, and the investment capacity of leverage for the local government is limited. In some areas there are many building projects and reserve projects.

Enterprises have operating difficulties. PPI continuing negative growth raises the real interest rate of corporate finance. The overall debt ratio of enterprises is high, the economy is with a downturn, and affected by the balance sheet contraction, which causes the corporate debt leverage, will increase. Subject to major industrial prices fell, the finish goods inventories of industrial enterprises increases, the turnover rate of inventories decreases, and the pressure of inventory reduction for enterprises increases. Enterprise's capital, labor, land and transportation costs rise, financial input increases into environmental protection, technological innovation and energy-saving emission reduction, and so on. In some areas the pressure of increasing financial income is quite high, and there is a phenomenon of increasing burden on enterprises.

Bound by environmental indicators has a negative impact on economic growth.

### **V.3 Policy Recommendations**

There are some policy recommendations for the economy into a period of new normal.

The macro-control in 2015 should actively adapt to new normal of the economic development, leading new normal of the economic development, put "changing the method and adjusting the structure" in a more important position, persist in overall consideration of "growing steady, adjusting structure, promoting reform, improving people's livelihood, preventing risk, expanding opening-up", adhere to the general tone "steady economic development" of work, stick to the bottom line, uphold the speed following the quality, focus on reform releasing energy, and lay a good foundation for the economy smoothly into the period of new normal and "Thirteenth Five-Year Plan" smoothly starting.

Continue to implement the proactive fiscal policy, and accelerate the reform of fiscal and taxation system. Appropriately expand the central government spending and deficit scale. In the year of 2015, the budget deficit of central government increases to 1.7~1.9 trillion yuan, which expands the deficit rate to the proportion of 2.5~2.7. Achieve a smooth conversion between local government debt and financing system, and protect the reasonable investment for local public services and stable construction of public infrastructure. Around the central and western infrastructure, promote coordinated development of a number of major projects. Arrange special funds to support technological transformation and innovation of key industries and the integration of informatization and industrialization. Take the way of the government purchasing commercial housing as a means of protection, and maintain the normal operation of the real estate market. Increase credit and tax incentives for first-time home buyers, and appropriate to relax the two mortgage policies. Lower tariffs for part of consumer goods imports, narrow the price difference of high - grade consumer goods between domestic and foreign markets, and promote the consumption of foreign luxury consumer goods back to domestic market. Promote the consumption of electronic information, rural service, green recycling and other new types. Fulfill the "reveal all the details" requirement to implement the social policy. For financial expenditure, a number of major livelihood projects have been introduced. Perfect the function of transfer payment. Expand the scope of the reform program to replace the business tax with a value-added tax. Expand tax cuts for small and micro enterprises.

Reduce import tariffs, and promote structure adjustment of export production. Adjust the tax structure, and support the development of enterprises and the transformation of the results. Rationalize the relationship between the central and local taxation, regulate the issuance of local bonds, and change the dependence of the local government to land financial.

Continue to implement prudent monetary policy, and steadily push forward financial reform and opening up. Pay great attention to the expansive fiscal policy, directional control and reform innovation. Play the role of credit policy in changing the method and adjusting the structure. Increase corporate debt restructuring to avoid the risk of proliferation. Promote the interest rate market, improve the formation mechanism of the exchange rate market, and maintain the relative stability of the RMB exchange rate on the basis of equilibrium. Using pilot free trade zone, steadily promote to open capital accounts, and promote the internationalization of RMB. Strengthen the monitoring and supervision of cross-border flowing to foreign exchange funds, and enrich the varieties of foreign exchange hedging. Prevent the risk of capital flowing, and maintain the stability of the domestic financial. Accelerate the development of multi-level financial services system.

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