

2 China

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2.1 Introduction

A) Geographical Features

The People's Republic of China (PRC, thereafter referred as China) is located in the east part of Asia. In area, it is the second largest country in Asia and the third largest country in the world. It has a total area of 9,596,960 sq.km. Its position in the map, excluding offshore islands, is roughly 18°9'N to 53°34'N latitude and 73°38'E to 135°5'E longitude. At the extremes, China's territory extends about 5,000 km. from east to west. There is a four-hour time difference between east and west. The extent of territory from north to south is about 5,500 km. China's coastline forms a large curve that stretches a distance of 5,774 km and land boundary is 28,072 km long. Countries bordering China to the north and northeast are the Mongolian People's Republic, the Russian Federation and the Democratic People's of Korea; to the east are the Yellow and East China seas and Japan; to the south are the South China sea, the Gulf of Tonkin, and the Socialist Republic of Vietnam; to the southwest are Laos, Burma, India, Bhutan, and Nepal; and to the west and northwest are Pakistan, Afghanistan, Tajikistan, Kyrgyzstan and Kazakhstan. A cross-section of the China shows a landmass lying at low levels in the east and higher in the west, rising in three major levels of elevation. The major levels consist of low coastal plains and hills, plateaus, mountains, and highlands. China's principal lowlands cover over 1,000,000 sq.km of territory. As primary agricultural regions, they possess rich soil, have a warm, humid climate, and good water sources. Plateaus comprise about 26% of the country's total area. Mountain ranges and highlands occupy about 33% of the country's area. The Yangtze, in central China, is Asia's longest river with the total length of 6,380 km. The HuangHe is the second longest river in China, with a course of about 4,845 km. The soils of China can be classified into three major groups: pedocals; neutral soils; and pedalfers. During winter, the average difference on temperature between the north and south is at least 28- centigrade degrees. In the summer, the average temperature for all of China is 20⁰C.

B) Population

China's population is the largest in the world. By the end of 1999, total amount is 1,259,090,000; nearly one in every five persons on earth is a citizen of the China. Average population density is 130 persons per square km. From 1978, Family-Plan policy was implemented in China to control the population growth. The birth rate of the year is 15.23 persons per 1,000 people, and the death rate of the year is 6.46 persons per 1,000 people, and actual growth rate of the year is 8.77 persons per 1,000 people (by the end of 1999). Average life longevity is 70.80 years (68.71 for men and 73.04 for women). About 94% of the population of China comprises ethnic Chinese, known as "Han". Non-Chinese ethnic groups are 55, referred to in China as "national minorities". While the Han Chinese are concentrated mainly in the densely settled eastern lowlands, the minorities are spread out along the western reaches of China, their domains comprising about half the total national territory. In the case birth-control programs, exception has been made for the minorities, who have been encouraged to allow their populations to increase. The official spoken language of the China is *putonghua*, or "standard speech".

Cantonese is also the dialect family common to many overseas Chinese, including a majority of the population of Hong Kong and most Chinese-American. The Chinese written language is the unifying element among all the dialects.

C) Administrative Division

Administratively, China is divided into 31 provincial-level localities, including 22 provinces, 4 municipalities directly under the central government, and 5 autonomous regions. After the Chinese government resumed the sovereignty over Hong Kong and Macao in July 1, 1997 and December 20, 1999 respectively, both of them are Chinese Special Administrative Regions. Below the provincial level, there are three administrative levels. They include: 335 prefectures and municipalities at the prefectural level; 2,142 counties, autonomous counties, and cities at the county level; and several tens of thousands of townships, towns and city districts. Chinese currency is called Renminbi (RMB), literally “people’s money”.

D) Culture and Religious

In the religious beliefs among the various nationalities of China, the four principal religions are comparatively widespread. They are Buddhism, Taoism, Islam and Christianity. China has introduced nine-year compulsory education. A six-year system is generally adopted by primary school. The stipulated age for entry is seven years old. But in the cities and some well-developed rural areas with suitable conditions, primary schools are allowed to enroll children at six. Secondary education lasts for six-year, three years are for junior secondary education and three years are for senior secondary education. Vocational and technical educational form is an important part of the Chinese educational system. It is conducted at the elementary, secondary and tertiary level, with the focus on the secondary level. High education is divided into four levels: short-cycle specialized college education, undergraduates, masters’ and doctoral. Full-time general universities and colleges mainly enroll graduating senior middle-school graduates and also some young school-leavers below 25 years of age with an equivalent level of high school education. The national unified entrance examination is a basic means for the universities and colleges to select new entrants.

E) Political Structure

China is ruled by the Chinese Communist Party (CCP). Its main decision-making body is a Central Committee that is elected at a five-yearly party congress. The most recent party congress, the 15th, was held in September 1997. The Central Committee meets in plenary session about twice a year. In the interim most of its power is vested in a Politburo that currently has 22 members. The Politburo Standing Committee of the CCP that has seven members is the centralized leadership collective. The supreme organ of state power is the National People’s Congress (NPC). It is elected every five years, passes laws and treaties, nominates the executive and approves the constitution. It has roughly 3,000 members, indirectly elected from lower-level people’s congresses. It meets in plenary session for two to three weeks each year, usually in March-April. Between sessions many of its powers are vested in a standing committee of around 200 members which drafts laws and handles NPC business when the parliament is not in session. The latest national election was March 1998. The highest organ of state administration is the State Council. Its composition is decided by the NPC and concurrent with the five-year life of the NPC.

2.2 Overview of Macroeconomic Activity and Fiscal Position

In order to analyze the current situation of China's economy, the review of different period of its development is necessary.

1) The Three Year Recovery Period 1949–1952

The People's Republic of China was founded in 1949. The Chinese Communists in the first years after coming to power not only counted on Soviet aid, but also utilized Soviet experience in practically all fields, especially the economic. During this period the foundations of agricultural collectivization were laid, in the form of the mutual aid teams. In the cities, about a third of industry was left in private hands after the nationalization of the largest concerns remained private. By 1952 considerable progress had been made in rehabilitating the economy: industrial output had risen by 145% since 1945, and that of agriculture by 48% (both at constant prices).

2) The First Five Year Plan 1953–1957

The strategy that emerged was straightforward. The aim was high growth to be achieved by a high rate of investment (set at 20% of National Income in the first plan and to rise thereafter), most of it in heavy industry and transport and relying almost exclusively on imported machinery from the Soviet Union and other Eastern Bloc countries. During this period, investments in heavy industry made up 38.7% of total investments, but adversely affect agriculture and light industry. Agriculture developed slowly, with very little increase in the per capita production of agricultural product. Light industrial production also fell far short of meeting demand. For the heavy industry, China did achieve a great deal with the 156 items of capital construction and built the initial foundation of national industrialization.

3) The Great Leap Forward 1958–1960

In order to achieve greater economic self-reliance, China started the Great Leap in 1958. As a result industrial output fell by 38% in 1961 and by a further 17% in 1962, leaving output at barely more than half its 1960 level. Heavy industry suffered most with output in 1962 only 41% the level of 1960. In agriculture, 14% drops in output in 1959 had been followed by another of 13% in the following year and output had eased down still further in 1961. In 1962 a rise of 6% carried it back close to its 1952 level and agricultural output did not surpass that 1958 until the eve of the Cultural Revolution in 1965.

4) Five Year Adjustment 1961–1965

From 1961, the massive cutback in heavy industrial production continued into 1962. By 1963 both branches of industry had begun to recover and by 1965 output stood 64% above the 1962 level. Throughout these years the accumulation rate had crept up again. Having fallen from 39.6% in 1960 to 19.2% in 1961 and further to 10.4% in 1962, it climbed by an average 5–6% a year to reach 27.1% in 1966. In the years 1963–65, a far higher proportion of investment was in agriculture and related activities than in 1958–62. As the share of agriculture rose from 11.3% to 17.7%, that of industry fell from 60.4% to 49.8%.

5) The Cultural Revolution 1966–1976

The ten-year "culture revolution" brought China the biggest setback and losses since 1949. Industrial production had fallen by 15% since 1966, and there had also been a marginal decline in agricultural production. But for the remainder of the Cultural Revolution decade progress in output was steadily upwards. Behind this lay an increase in the accumulation rate from the 21.1%

of 1968 to the figures of over 30% consistently recorded between 1970 and 1976. Improvements on living standards were not only restrained by this, but the emphasis on industrial production resulted in a much faster increase in the living standards of industrial workers over peasants. Such a tendency appears to have been effectively inbuilt in the post-Liberation Chinese economic structure, though it is noticeable that the decline in industrial output in 1967–68 did not produce a similar marked decline in non-agriculture incomes as had been the case in 1961–62. While the incomes of urban residents grew by 30% in real terms between 1968 and 1976, those of peasants grew by just over half as much at 16%.

6) The new period of developing socialism with Chinese characteristic 1977-now

The historic decision on “reform and opening up” made at the Third Plenum of the Eleventh Congress of the Chinese Communist Party on December 1978 is a turning point in China’s economic development. Since then, China has concentrated its efforts on remedying the disproportion in the national economy. The economic restructuring started first in the countryside. A major breakthrough was affected in the rural areas by the widespread institution of the contracted responsibility system based on the household, which served to greatly emancipate the productive forces. In the cities, the reform had centered on invigorating enterprises, and varying degrees of reform had been implemented in the areas of planning, finance, taxation, pricing, banking, commerce, labor and wages. As a result, the urban economy has thrived as never before. Along with the successful domestic economic reform, China’s policy of opening to the outside world is being carried out, four special economic zones were established in ShenZhen, ZhuHai, XiaMen and ShanTou, and later 14 cities were opened further to the outside world. All this made China’s coastal areas become the foremost regions opening to the outside world. Now, China has shifted its strategy to develop the west areas in formulating the 10th Five-Year Plan (2001-2005). It is a key step in achieving the country’s strategic goal of building a well-to-do society in all areas of life in the new century.

2.2.1 Macroeconomic Activity

In the past two decades, China has successfully transformed itself from a centrally planned economy to an emerging market economy and at the same time had achieved nearly a 10 percent average growth rate. During this period, China’s per capita GDP has more than quadrupled and the living standard of ordinary Chinese people had improved significantly.

Table 2.1 Selected China’s economic main indicators, 1995-1999

	1995	1996	1997	1998	1999
Gross Domestic Product (GDP)	5,847.8	6,788.5	7,446.3	7,939.6	8,205.6
Real GDP growth	10.5	9.6	8.8	7.8	7.1
Retail price index	14.8	6.1	0.8	-2.6	-3.0
Consumer price index	17.1	8.3	2.8	-0.8	-1.4
Urban per capital income (RMB)	4,283.0	4,838.9	5,160.3	5,425.0	5,854.0
Rural per capital income (RMB)	1,577.7	1,926.1	2,090.1	2,162.0	2,210.0
Urban unemployment rate (%)	2.9	3.0	3.1	3.1	3.1
Total Industrial Output	9,189.4	9,959.5	11,373.3	11,904.8	3,535.7
Total Fixed investment	2,001.9	2,291.4	2,494.1	2,840.6	2,987.6

Source: State Statistical Bureaus *China Statistical Yearbook*, 2000.

A. International Environment

A.1) Trade Balance

When China's started to implement reform and opening-up policy in 1978, the total trade amounted only to US\$20.6 billion. It rose to US\$165.5 billion in 1992, an increase of over eight times. Exports grew at a similar pace, rising from US\$4.75 billion in 1978 to US\$84.9 billion in 1992. Since the late 1980s a rising share of exports and imports has been accounted for by reexports from foreign invested enterprises (FIEs); FIEs' share of exports and imports had risen from 1.9 percent, 5.5 percent in 1986 to 44 percent, and 56 percent in 1998. FIEs had played a very important role in China's foreign trade. Exports grew rapidly by 24 percent in 1994 and 23 percent in 1995 with a trade surplus of US\$5.1 billion and US\$16.7 billion respectively. These were the results of the foreign trade system reform, which contributed to the rapid expansion of China's foreign trade. However, China's foreign trade declined for the first time in 1998, dropping 0.4 percent from 1997 to US\$324 billion. While exports inched up 0.5 percent to US\$183.8 billion, the lowest annual growth rate since 1983; imports slid 1.5 percent to US\$140.2 billion, giving China a trade surplus of US\$43.6. One reason for the decline in foreign trade is the Asian financial crisis, which resulted in a drop in demand. Another factor is the depreciation of currencies in other Asian countries, which has raised the competitiveness of their export products relative to China's.

In 1999, China's government adopted a series of incentive policies to boost export, including the improvement of export tax rebate policies, raising export tax rebate rates, expanding the foreign trade rights of productive enterprises, improving export credit insurance mechanisms and increasing banks' support to foreign trade enterprises. At the same time, most Asian countries and regions recovered from the financial crises. So China's total trade amount were US\$360.7 billion, up 11.3% from the previous year. Exports totaled US\$194.9 billion, up 6.1%, while imports amounted to US\$165.8 billion, up 18.2%. There was a surplus of US\$29 billion. In the first half of 2000 year, the total foreign trade amounted to US\$216.6 billion, 37.3 percent higher than the previous year. Exports amounted to US\$114.5 billion, up 38.3 percent and imports amounted to US\$102.1 billion, up 36.2 percent compared with that of the same period last year. There was a surplus of US\$12.3 billion, an increase of US\$ 4 billion over the corresponding period last year. For the first time, imports and export exceeded US\$100 billion simultaneously. All these were resulted from the effective implementation of expansion export policy in China. Now China's foreign trade ranks ninth in the world and its economic scale is seventh.

Imports are dominated by manufacture. Their share of the total was 83.6% in 1999, compared with 16.4% for primary products. This pattern is unlikely to undergo a radical change in the next five years, although food imports may well rise in years of bad harvest, even if the overall goal of increased grain production is met. Crude oil imports are likely to raise sharply, as domestic production fails to keep pace with demand, and, in particular, as new refining and petrochemical capacity comes on stream.

Table 2.2 Export (\$ m; fob)

	1994	1995	1996	1997	1998
Primary goods	19,708	21,487	21,925	23,930	20,600
Food & live animals etc	10,015	9,954	10,232	11,054	10,619
Beverages & tobacco	1,002	1,369	1,342	1,049	976
Non-edible raw materials	4,127	4,375	4,406	4,193	3,517
Mineral fuels, lubricants etc	4,069	5,335	5,929	6,987	5,181
Animal & vegetable oils, fats, waxes	495	454	376	647	307
Manufactured goods	101,298	127,283	129,141	158,767	163,157
Chemicals & related products	6,236	9,094	8,879	10,225	10,316
Light industrial products, rubber, minerals, iron etc	23,218	32,243	28,511	34,406	32,383
Machinery & transport equipment	21,895	31,391	35,313	43,702	50,233
Miscellaneous products	49,937	54,548	56,426	70,430	70,219
Products not classified elsewhere	12	7	12	4	5
Total	121,006	148,770	151,066	182,697	183,757

Source: State Statistical Bureau, *China Statistical Yearbook*, 1999.

Table 2.3 Imports (\$ m; cif)

	1994	1995	1996	1997	1998
Primary goods	16,486	24,411	25,440	28,620	22,952
Food & live animal etc	3,137	6,131	5,672	4,304	3,793
Beverages & tobacco	68	394	497	320	179
Non-edible raw materials	7,437	10,158	10,697	12,006	10,716
Mineral fuels, lubricants etc	4,035	5,127	6,877	10,306	6,773
Animal & vegetable oils, fats, waxes	1,809	2,601	1,697	1,684	1,945
Manufactured goods	99,128	107,667	113,398	113,741	117,214
Chemicals & related products	12,130	17,300	18,106	19,297	20,166
Light industrial products, rubber, mineral, iron etc	28,084	28,772	31,391	32,224	31,071
Machinery & transport equipment	51,467	52,638	54,771	52,759	56,768
Miscellaneous products	6,768	8,264	8,484	8,552	8,455
Products not classified elsewhere	679	693	646	909	754
Total	115,614	132,078	138,838	142,361	140,166

Source: State Statistical Bureau, *China Statistical Yearbook*, 1999.

A.2) Current Account Balance

The current-account surplus fell from US\$6.9 billion in 1994 to only US\$1.6 billion in 1995; it rose back up to US\$7.2 billion in 1996 and then rocketed US\$29.7 billion in 1997, thank to another surge in export revenue. In 1998, the current-account surplus had remained above US\$29 billion, thanks to a continuing large trade surplus. In 1999, the current-account surplus reduced to US\$15.7 billion. The exports of goods were US\$194.7 billion and the imports of goods were US\$158.5 billion, there was a surplus of US\$36.2 billion. The revenues of service were US\$23.8 billion and the expenditures of service were US\$31.3 billion, there was a deficit of US\$7.5 billion. The revenues of income and profit were US\$10.6 billion, while the expenditures of income and profit were US\$28.5 billion, there was a deficit of US\$17.9 billion. In current transfer account, there was a surplus of US\$4.9 billion.

Table 2.4 Balance of Payments (\$ m)

	1993	1994	1995	1996	1997
Export: goods fob	75,659	102,561	128,110	151,080	182,670
Import: goods fob	-86,313	-95,271	-110,060	-131,542	-136,448
Trade balance	-10,654	7,290	18,050	19,538	46,222
Exports of services	11,146	16,503	19,130	20,601	24,581
Imports of services	-12,014	-16,201	-25,223	-22,585	-30,306
Income credit	4,437	5,854	5,191	7,318	3,174
Income debit	-5,696	-6,873	-16,965	-19,755	-19,097
Transfers credit	1,290	1,269	1,827	2,368	5,477
Transfers debit	-118	-934	-392	-239	-333
Current-account balance	-11,609	6,908	1,618	7,246	29,718
Direct investment abroad	-4,400	-2,000	-2,000	-2,114	-2,563
Direct investment in China	27,515	33,787	35,849	40,180	44,236
Portfolio investment assets	-597	-380	79	-628	-899
Portfolio investment liabilities	3,646	3,923	710	2,372	7,703
Other investment assets	-2,114	-1,189	-87	-1,126	-33,929
Other investment liabilities	-576	-1,496	4,122	1,282	8,430
Financial balance	23,474	32,645	38,673	39,966	22,978

Source: IMF, *International financial Statistics*

A.3) Exchange Rate and Exchange System

China's officially posted foreign-exchange reserves stood at US\$22 billion at the end of 1993, less than the US\$46 billion recorded in September 1992. Foreign-exchange reserves rose healthily in 1994 as export growth picked up from the slowdown in 1993. By end-1994 reserves (excluding gold) stood at US\$52.9 billion, and they continued to rise during 1995, reaching US\$75.4 billion by the end of the year and soaring to US\$107 billion by the end of 1996. During 1997 they continued to mount, reaching US\$142.8 billion by the end of the year. They then remained at just over this level for most of 1998 before rising further during 1999 to reach US\$154.7 billion as a result of the imposition of controls on outflows of foreign currency in late 1998.

The pre-reform exchange system of China was characterized by strict control of foreign exchange transactions and rigidity of the RMB exchange rate. It could neither respond flexibly to the change of price parities between China and the rest of the world, nor make prompt adjustment according to the changing supply and demand of foreign exchange. In 1981, China introduced a dual exchange rate system: one is for non-trade transactions; and another rate is more favorable for the internal settlement of trade transactions with the establishment of the foreign exchange adjustment centers (FEACs) at which approved enterprises were permitted to buy and sell retention quotas. In 1991, China altered its foreign exchange policy from the relatively large one-step currency devaluation of the past to more frequent, small-scale adjustments as ways of fine-tuning the RMB value according to prevailing conditions. The unification of China's two main currency rates (the swap rates and the official rates) in the beginning of 1994 and deregulation on foreign invested enterprises in exchanging funds freely at selected banks without approval from the State Administration for Exchange Control (SAEC) drive the RMB a step further toward the full convertibility. The ultimate goal of the reform is convertibility of the currency and integration

of the economy with international currency market. China's foreign exchange system has been, since the mid-1980s, classified as a more flexible management system.

Table 2.5 Exchange Rates

(Rmb per unit of currency; annual averages)

	1994	1995	1996	1997	1998	1999
US dollar	8.615	8.351	8.314	8.290	8.279	8.279
HongKong dollar	1.115	1.080	1.075	1.071	1.069	1.065
Japanese yen('000)	84.37	89.23	76.35	68.60	63.50	80.72

Source: State Statistical Bureau, *China statistical Yearbook*

Table 2.6 Foreign Reserves

(\$ m; end-period)

	1994	1995	1996	1997	1998
Foreign exchange	51,620	73,579	105,029	139,890	144,959
SDR	539	582	614	602	676
Reserve position in the IMF	755	1,216	1,396	2,270	3,553
Total reserves excl gold	52,914	75,377	107,039	142,762	149,188
Gold	646	660	637	601	634
Gold (m fine troy oz)	12.7	12.7	12.7	12.7	12.7

Source: IMF, *International Financial Statistics*.

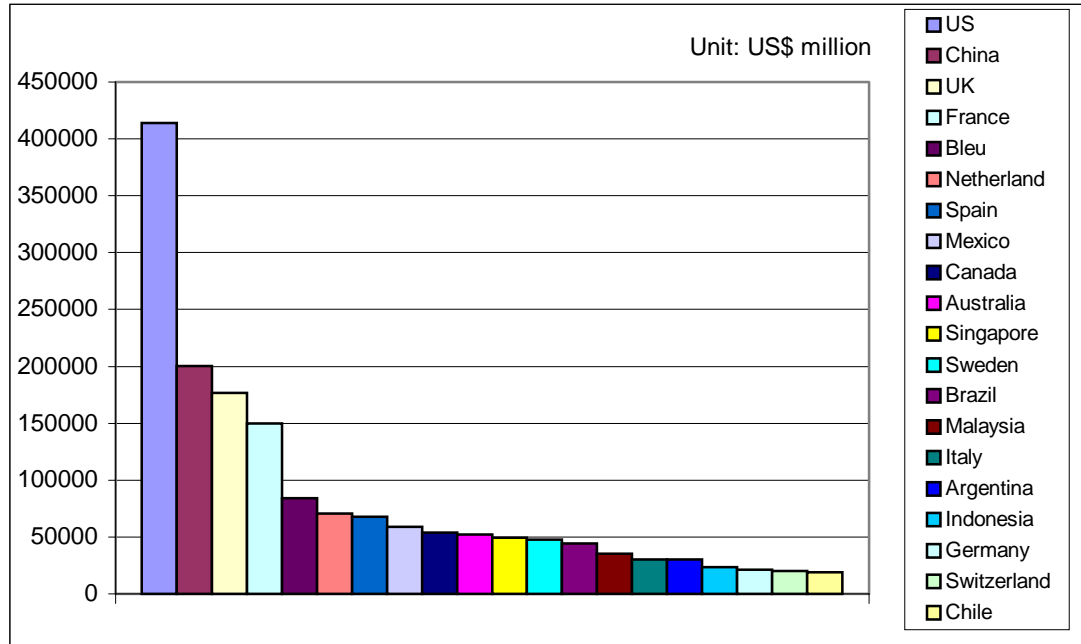
A.4) Foreign Direct Investment

From the beginning of 1990s, China absorbed foreign direct investment with big scale. In 1991, China was the thirteenth popular host country of foreign direct investment worldwide and ranked third position among the developing countries. After 1993, China became the second host country of foreign direct investment in the world, just followed US, and ranked the first position of the developing countries. China has been the largest recipient of foreign direct investment in the developing countries for seven years in row since 1993. However foreign direct investment in China decreased gradually from the mid-1990s. In the first half of 2000, China had absorbed a contractual foreign investment of US\$27.6 billion, an increase of 24.0 percent over the corresponding period last year; foreign investment in the region accounted for more than 10 percent of the national's total. The economies in the countries and regions which were affected by the Asian financial crisis were recovering rapidly since the second half of 1999. That had resulted in an active effect on the inflow of foreign funds into China, as two-thirds of the foreign investment in China had come from 10 Asian countries and regions. In the process of developing its western region, China had granted the area preferential treatment in terms of opening more areas to foreign investment and establishing foreign-funded enterprises. Furthermore, China is now carrying out a strategic readjustment of its economy, and encourages foreign businesses to participate in the reform of state enterprises in various forms. China also encourage foreign investors to set up research and development centers in China, and pour funds into high-tech industries, which is in accordance with the global development strategy of multinational corporations. The series of preferential policies attract more and more inflow of foreign investments into China. This indicates that the decrease of foreign investment in China has been initially held back.

There are three main vehicles for foreign direct investment in China: Contractual Joint Venture (CJV), Equity Joint Venture (EJV) and Wholly Foreign-Owned Venture (WFOV). Of the three main kinds of foreign direct investment, the Wholly Foreign-Owned enterprises have become an

increasingly popular investment vehicle during the 1990s, rising from 17.8% of the total number of projects signed in 1992 to 36.9% in 1996, further increased to 38.7% in 1999; while the Equity Joint Ventures kept decreasing from 70.5% in 1992 to 51.5% in 1996 and continually declined to 39.2% in 1999.

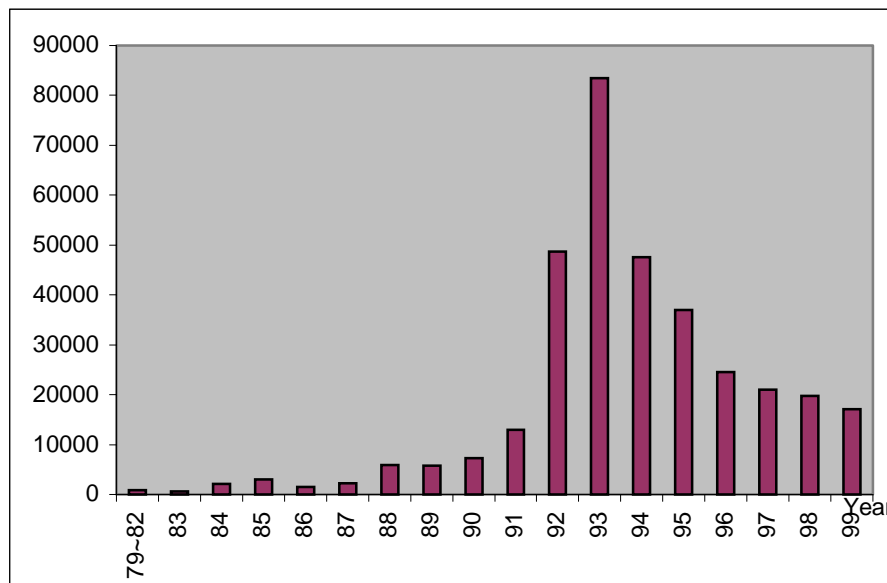
Figure 2.1 Total FDI Inflows by Country, 1990-97



Source: OECD, IMF.

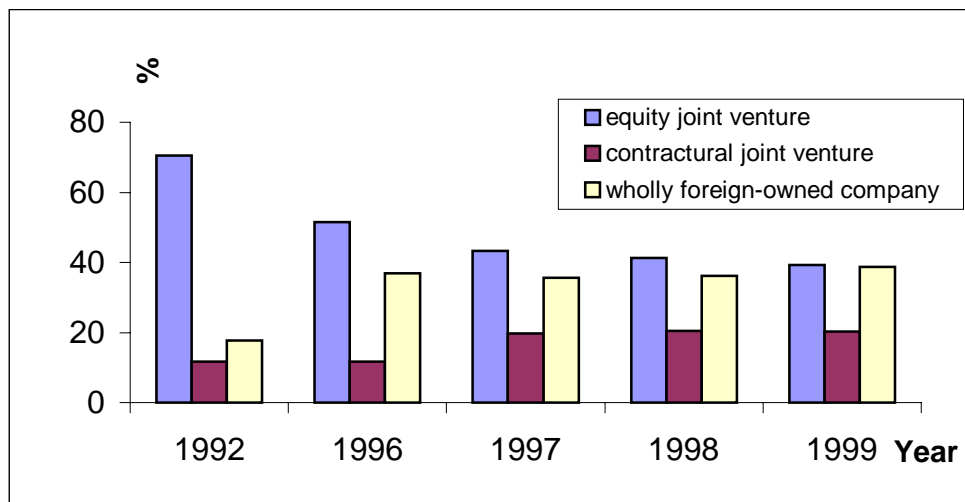
Note: Total FDI inflows to China didn't include Hong Kong and Taiwan.

Figure 2.2 Projects of FDI in China, 1979-99



Source: Ministry of foreign Trade and Economic Cooperation

Figure 2.3 FDI by Types of Investment 1992, 1996-99



Source: Ministry of Foreign Trade and Economic Cooperation.

A.5) Borrowing from Abroad and Aid

In the whole period of 1980s, borrowing from abroad accounted for a bigger share in the inflow of foreign capital. From 1979 to 1982, the share of borrowing from abroad to total inflow of foreign capital was 86.2 percent. Although the ratio decreased slightly from 1983 to 1985, it reached to 54.0 percent, 47.6 percent and 57.8 percent respectively. The ratio further increased to 69.0 percent and 68.8 percent in 1986 and 1987. This indicates that, from the beginning of 1980s, China's government started to open up its capital market indirectly through issuing government bonds and permitting foreign investment inflow into China. The international capital inflow was established on the basis of government credit, and borrowing from abroad was the main feature during this periods. The ratio of borrowing abroad reduced to around 26 percent in 1997.

From 1993 to 1997, China's total external debt increased at 14 percent annually. Of which, the long-term debt decreased from 17 percent in 1994 to 11 percent in 1997, while the short-term debt increased from 14 percent to 24 percent during the same period with the average growth rate of 20 percent. In the public and publicly guaranteed long-term debt, the debt from official creditors declined from 28 percent in 1995 to 1 percent in 1997, while the ratio from private creditor grew from 8 percent in 1995 up to 16 percent in 1997. Total payment for the debts was imbalance during the different year, which was 35 percent in 1995, then reduced to 5 percent in 1996. Both the liability ratio, which is the percentage of total external debt to GDP, and the debt-service ratio, which is the percentage of the payment of principal and interest of external debts to the earnings from exports of goods and services, kept stable during the past few years. The average liability ratio was 17.7 percent and debt-service ratio was 9.4 percent from 1993 to 1997. The official development assistances to China shown a decline trend, both bilateral OECD aid and multilateral nations aid increased negatively recent years.

By the end of 1999, the total balance of foreign debt was US\$151.8 billion, increased by 0.4 percent to US\$5.8 billion than 1998. The medium and long-term foreign debt was US\$136.7 billion, up US\$7.8 billion than 1998; the short-term foreign debt was US\$15.2 billion, down US\$2.2 billion than 1998. The payment for the principal and interest of foreign debt was US\$310 billion in 1999.

Table 2.7 External Debt (\$ m)

	1993	1994	1995	1996	1997
Total external debt	85,928	100,457	118,090	128,817	146,697
Long-term debt	70,632	82,974	95,764	103,410	115,233
Short-term debt	15,296	17,483	22,325	25,407	31,464
Public & publicly guaranteed					
Long-term debt	70,076	82,391	94,675	102,206	112,821
Official creditors	24,339	28,973	36,982	39,433	39,755
Multilateral	10,690	13,588	16,302	17,695	18,973
Bilateral	13,650	15,385	20,680	21,737	20,782
Private creditor	45,737	53,418	57,693	62,828	73,066
of which:					
banks	20,678	21,475	23,869	24,437	34,873
bonds	7,715	11,087	10,684	11,106	12,616
Total debt service	10,168	11,135	15,066	15,756	18,445
Principal	6,729	6,343	9,070	10,260	11,527
Interest	3,439	4,792	5,996	5,496	6,918
of which:					
short-term debt	809	948	1,340	812	1,465
Ratios (%)					
Total external debt/GNP	19.9	18.6	17.2	16.0	16.6
Debt-service ratio	11.1	8.9	9.9	8.7	8.6
Short-term debt/total external debt	17.8	17.4	18.9	19.7	21.4
Concessional long-term debt/ total long-term debt	19.0	19.2	18.8	18.1	15.7
Variable interest long-term debt/ total long-term debt	229.2	28.0	29.6	29.6	39.2

Source: World Bank, *World Debt Tables*.

Table 2.8 Aid

Official development assistance (\$ m)

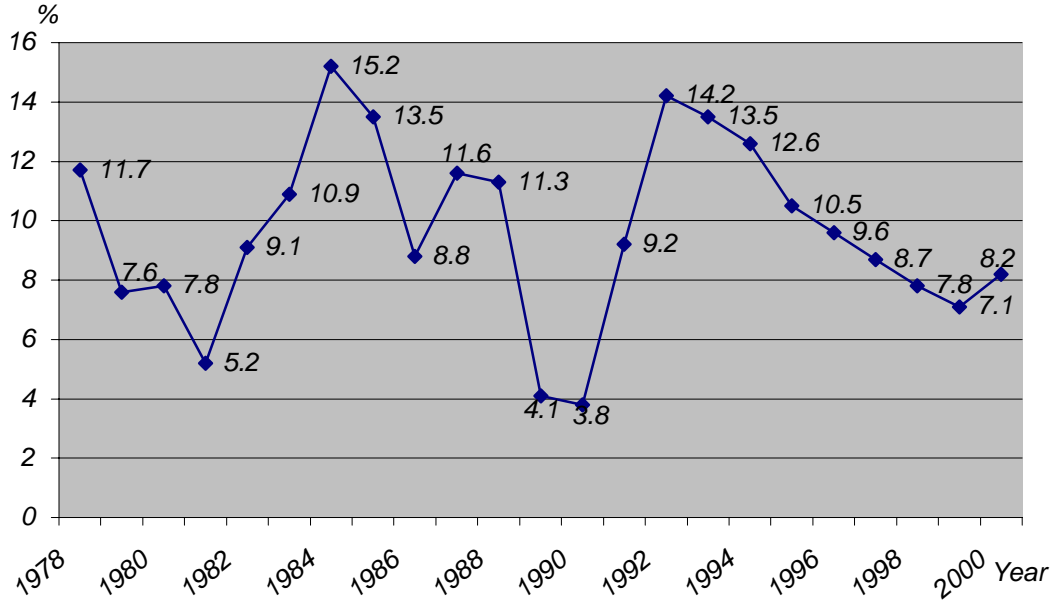
	1993	1994	1995	1996	1997
Bilateral OECD	2,239.8	2,393.9	2,531.3	1,670.9	1,228.6
of which:					
Germany	247.8	300.0	684.1	461.1	381.9
France	102.6	97.7	91.2	97.2	50.1
Austria	10.1	32.4	66.2	4.9	3.3
Arab countries	1.5	24.4	35.7	18.4	-29.2
Multilateral	1,030.0	820.0	967.3	928.3	841.0
of which:					
IDA	865.1	671.0	798.2	790.7	687.1
UNDP	44.8	38.4	38.3	28.7	43.2
EN	19.5	14.1	32.7	34.8	15.5
Total	3,271.2	3,238.4	3,534.4	2,617.6	2,040.3

Source: OECD Development Assistance Committee,
Geographical Flows to Aid recipient.

B. Domestic Environment

B.1) Economic Growth Rate (GDP)

Figure 2.4 GDP Growth Rate in Recent Years



In the 1990s China's economy started on the base of a low growth rate which was produced during the rectification of the overheated economy in the late 1980s. The annual growth rate of GDP rose rapidly from 3.8 percent (the lowest point) in 1990 to 14.2 percent (the highest point) in 1992. Up to 1993 when the growth rate fell steadily to 7.1 percent in 1999, a continuous decrease was recorded for 7 years. The economic growth in the 1990s can be divided into two periods. From 1993-1996, China adopted modest and flexible policy to cool down the overheat economy. It controlled the domestic overheat economy and inflation effectively. But from 1997, economic environment changed dramatically both domestically and abroad. The outbreak of Asian financial crises, the exposure of economic structure contradiction, the change of supply and demand relationship led to China's economic growth decrease continually compared with the previous years. China's government adjusted into proactive fiscal policy combined with moderate monetary policy in 1998 accordingly to broaden investment, stimulate demand and improve export. These measures play the role of preventing the economic slowdown and improving the economic benefit. Thank to the expansionary policy based on the steady fall of the growth rate, the development of China's economy still remained in the high rank with regard to the speed in the world. In the first half of 2000, as a result of the proactive fiscal policy adopted by the government, China's economy has increased by 8.1 percent, 0.6 percentage points higher than that of the same period last year. This shows China's economy has stopped its slid and made a turn for the better.

Table 2.9 Gross Domestic Product

(billion yuan)

Year	Gross National Product	Gross Domestic Product	Primary Industry	Secondary Industry		Tertiary Industry	Per Capital GDP (yuan)	
				Industry	Construction			
1990	1859.8	1854.8	501.7	771.7	685.8	85.9	581.5	1634
1991	2166.3	2161.8	528.7	910.2	808.7	101.5	722.7	1879
1992	2665.2	2663.8	580.0	1170.7	1028.5	141.5	913.9	2287
1993	3456.1	3463.4	688.2	1642.9	1414.4	228.5	1132.4	2939
1994	4667.0	4675.9	945.7	2237.2	1936.0	301.3	1493.0	3923
1995	5749.5	5847.8	1199.3	2853.8	2471.8	382.0	1794.7	4854
1996	6685.1	6788.5	1384.4	3361.3	2908.3	453.1	2042.8	5576
1997	7314.3	7446.3	1421.1	3722.3	3241.2	481.1	2302.9	6053
1998	7696.7	7834.5	1455.2	3869.3	3338.8	523.2	2517.4	6307
1999	8042.3	8191.1	1445.7	4041.8	3497.5	544.3	2703.6	6534

Source: State Statistical Bureau, *China Statistical Yearbook*, 2000.

B.2) Inflation Rate

China's rapid economic growth (until 1996-97) led to high rates of price inflation. In 1994 overall national retail-price inflation was nearly 22% per year, a rate previously seen only briefly in 1988, when it helped to provoke panic buying and storing. Austerity measures, mainly administrative, aimed at cooling down the economy were applied in mid-1993. Inflation was reduced to single-digit rates in 1996. From September 1997, the inflation rate for retail price became zero. The overall price operated among the negative area all the time. By the end of July 1999, compared with the same period of previous year, the social retail-price indices, the resident consumption price indices and means of production price indices had increased negatively for 20 months, 14 months and 38 months respectively. Most commodities price indices decreased simultaneously to reach the peak of the history. Because the overall price level kept declining for a long time, China's government started to shift its policy from preventing the inflation to deterring the deflation from 1998. The decrease of the overall prices in these years is a reflection to the oversupply of productions resulting from the unrealistic investments, repeat constructions etc. in the previous years. In the first half of 2000, the consumption price indices grow by 0.1 percent, stopping the long time negative increase. The prices change from negative to positive becomes a signal that China's economy is emerging a favorable turn.

Table 2.10 Price Indices

(1978=100)

	1994	1995	1996	1997	1998	1999
Overall retail prices ^a	310.2	356.1	377.8	380.8	370.9	359.8
% change on previous year	21.7	14.8	6.1	0.8	-2.6	-3.0
Overall consumer prices ^b	258.6	302.8	327.9	337.1	334.4	329.7
% change on previous year	24.1	17.1	8.3	2.8	-0.8	-1.4
Urban consumer prices	367.8	429.6	467.4	481.9	479.0	427.8
% change on previous year	25.0	16.8	8.8	3.1	-0.6	-10.7
Rural consumer prices	248.0	291.4	314.4	322.3	319.1	314.3
% change on previous year	23.4	17.5	7.9	2.5	-1.0	-1.5
Farm products purchasing prices	440.3	527.9	550.1	525.3	483.3	424.3
% change on previous year	39.9	19.9	4.2	-4.5	-8.0	-12.2
Rural retail prices of industrial products	239.4	274.6	291.6	294.8	288.3	280.5
% change on previous year	17.2	14.7	6.2	1.1	-2.2	-2.7

^a Includes prices of consumer goods and agriculture producer goods sold to farmers.

^b 1985=100, includes consumer goods and services considered necessities of daily life.

Source: State Statistical Bureau, *China Statistical Yearbook, 2000*.

B.3) Consumption

Table 2.11 The Growth Rate of Household and Government Consumption in Recent Years

Year	Growth Rate of Household Consumption Expenditure(%)			Growth Rate of Government Consumption Expenditure(%)
	Rural House Holds (%)	Urban House Holds (%)		
1986	13.9	9.9	17.8	15.5
1987	15.9	13.1	18.6	9.0
1988	29.4	23.2	35.6	15.9
1989	12.0	10.0	14.0	17.7
1990	12.2	4.3	10.1	10.8
1991	13.7	10.0	17.4	25.7
1992	21.2	16.5	25.9	23.4
1993	26.2	19.7	32.7	28.8
1994	32.7	31.0	34.4	33.0
1995	29.5	28.5	30.4	11.8
1996	19.4	23.8	15.0	17.4
1997	8.5	6.3	10.6	11.1
1998	5.9	1.3	10.5	8.7

Source: State Statistical Bureau, *China Statistical Yearbook, 1999*.

From 1992 to 1996, China household consumption expenditure kept higher increase, and then became a decline tendency. In 1998, the growth of final consumption demand to GDP was only more than 30 percent, apparently lower than the world average consumption level. Household consumption increased only by 5.5 percent compared with 6.7 percent GDP growth per capita. In 1999, China's fiscal stimulus only prevented the growth decline. Weak income and consumption growth in rural areas remain considerable drags on the economy. In 1998, rural household consumption increased by 1.3 percent compared with 10.5 percent in urban household. On the

other hand, the share of rural household expenditure to GDP decreased gradually from 33.3 percent in 1984 to 22.3 percent in 1998, while urban household expenditure increased gradually from 18.0 percent to 24.2 percent in the same period.

Consumption remains weak due to increased unemployment caused by the laying off of redundant workers from state-owned enterprises (SOEs) and to the uncertainties inherent in the reform measures initiated in housing, pensions and other social-welfare provision. Between May 1, 1996, and June 10, 1999, China lowered deposit interest rates 7 times from 3.78 percent to 2.25 percent. The interest-rate cuts were intended to encourage household to move money out of bank accounts and into cash registers. On October 14, 1999, China announced details of a new tax on interest income from bank deposits. The government hopes that the new tax will compel consumers to start spending their savings or to make other types of investments.

B.4) Investment

The structure of China's fixed asset investment changed greatly since the early 1990s. The most important sign was the investment change between industry and tertiary industry. In the state-owned units investment, the ratio of industry investment declined from 58.9 percent in 1990 to 37.7 percent in 1997, reducing nearly 15 percentage points. Of which the decline of manufacture investment was especially apparent, down nearly 15 percent. On the contrary, the ratio of tertiary industry investment increased straightly from 39.7 percent in 1990 to 59.3 percent in 1999, up 19.6 percent. Of which the transportation and telecommunication investment went up much faster. However, the change of investment did not bring about the change of production accordingly. Compared with 1990, the ratio of industrial value added to GDP grew by 13 percent in 1997. But the ratio of tertiary industry to GDP only increased from 31.3 percent to 32.1 percent during same period.

In 1999, fixed asset investment kept a slow growth rate. The total social investments were 2987.6 billion yuan, only up 5.2 percent than last year. The scale of growth reduced 8.7 percentage points, which was the lowest year of increase level since 1990. It also became a main factor that China's economy increased slowly in 1999. In the first half of 2000, fixed asset investment in the total investment grew at a rate of 10.1 percent. Of which the collective and individual investment were started.

Table 2.12 Total Investment in Fixed Assets

Item	1991	1992	1993	1994	1995	1996	1997	1998	1999
Total Investment	23.9	44.43	61.8	30.4	14.9	14.5	8.8	13.9	5.1
Grouped by Ownership									
State-Owned Units	24.4	48.1	44.1	21.3	13.3	10.2	9.0	17.4	3.8
Primary Industry	31.2	22.8	-37.6	22.1	26.7	45.4	29.7	44.9	25.0
Secondary Industry	30.0	38.5	12.0	9.8	14.8	8.7	1.1	-5.5	-1.4
Tertiary Industry	28.2	92.4	39.7	33.2	18.5	10.8	14.7	32.1	5.8
Collective-Owned Units	31.8	94.8	70.5	19.1	19.2	11.0	5.5	8.9	3.5
Individuals	18.1	3.3	20.8	33.5	29.9	25.4	6.8	9.2	7.9
Others				99.4	21.3	23.6	13.0	11.6	21.4
Grouped by Channel of Management									
Capital Construction	24.2	42.4	53.2	39.5	15.0	15.8	15.7	20.2	4.5
Innovation	23.2	42.8	50.3	32.9	13.0	9.6	8.5	15.2	-0.7
Real Estate Development	23.6	39.8	-67.1	93.0	23.3	2.1	-1.2	13.7	13.5
Others	11.3	36.7	387.4	18.7	20.1	21.8	5.5	5.5	5.4
Grouped by Source of Funds									
State Budgetary Appropriation	-3.2	-8.7	39.2	9.5	17.3	0.8	11.3	71.9	54.7
Domestic loans	48.5	68.4	38.8	30.1	5.0	8.9	4.6	15.9	3.3
Foreign Investment	12.0	47.0	103.6	85.4	29.8	19.6	-2.3	-2.5	-23.3
Fundraising and Others	21.2	41.0	69.6	34.7	16.3	14.9	10.9	13.2	2.18

Source: State Statistical Bureau, *China Statistical Yearbook*, 2000.

B.5) Capital Stock

Along with the decrease of fixed asset investment in recent years, the investment in capital construction by sector also shows a decline trend. But the investment in different sector changes differently. Of which, the investment in farming, forestry, animal husbandry and fishery increases steadily with the average growth rate of 32.1 percent from 1992 to 1999. So does the investment in geological prospecting, water conservancy and social services, while the former ratio is 32.1 percent and the later one is 41.5 percent during the same period. The investment in construction changed greatly from the highest 395 percent in 1993 to the lowest -18 percent in 1997 and rebound to 41 percent in 1999. Meanwhile, the investment in real estate reduced from 150 percent in 1993 to -42 percent in 1995, and then recovered gradually in the recent years. Because the investment plays a very important role in China's economic growth, the continual decline of growth pace become a disadvantage factor in China's economic development.

Table 2.13 Investment in Capital Construction by Sector

(billion yuan)

	1992	1993	1994	1995	1996	1997	1998	1999
Total	301.3	461.6	643.7	740.4	857.1	991.7	1,191.6	1,245.5
Farming, Forestry Husbandry and Fishery	4.4	4.6	5.7	7.7	10.9	15.4	22.5	29.9
Mining and Quarrying	30.3	35.1	39.5	47.8	49.9	64.9	54.1	47.4
Manufacturing	59.9	88.5	121.6	154.0	168.0	153.2	148.4	118.3
Production and Supply of Electric, Gas and Water	55.6	76.9	115.1	125.8	154.6	193.9	214.5	219.3
Construction	2.3	11.5	13.8	14.6	18.3	15.1	15.8	22.4
Geological Prospecting and Water Conservancy	8.2	9.8	12.1	16.6	22.8	27.7	43.3	55.7
Transportation, Storage, Postal and Telecom Services	45.8	90.1	137.3	158.8	184.5	219.7	325.2	342.9
Wholesale & Retail Trade and Catering Services	13.7	20.3	25.4	24.9	25.1	26.5	29.5	27.9
Banking and Insurance	3.0	6.7	9.6	12.6	13.5	14.3	14.8	12.7
Real Estate	5.6	14.1	31.6	18.3	14.0	14.6	18.6	18.5
Social Services	15.4	30.2	41.7	49.0	60.8	82.0	112.4	135.6
Scientific Research, Arts, Education, Health Care, etc.	22.8	31.9	40.8	52.6	60.6	74.5	87.6	99.9
Others	34.3	41.8	49.4	61.8	74.2	89.7	104.9	115.2

Source: State Statistical Bureau, *China Statistical Yearbook*, 2000.**B.6) Money Supply**

A moderate monetary policy, which is characterized by cautious currency supply and careful supervision, benefits the China's economic situation in the last few years. The implementation of a "moderate" monetary policy means China will increase currency supply gradually based on actual market conditions. Until recent years, the money supply has been out of pace with the economy. Given the already excessive money supply, the further extension of the money supply may trigger financial problems and undermine the financial order. So the appropriate increase of money supply while pushing forward financial services and taking serious precautions against financial risks is playing a leading role in China's financial policy. In 1998, the central bank launched a sweeping reshuffle to give full play to its role in financial adjustment and as a financial regulator. The restructuring involved the abolition of all its provincial- and municipal-level branches and the setting up of nine regional branches in main cities. The new branches, which started operation at the beginning of 1999, are expected to drive the wheels of regional economic development and protect the central bank from interference by local governments. As a result, the central bank will implement monetary policies and regulate banks more independently.

During the past few years, although the supply of M1 (including circulating cash and institutional deposits) and M2 (including cash in circulation and an array of deposits) kept rising in a relative large percentage, the scale of growth reduced gradually. Of which, M1 decreased from 28.5 percent in 1994 to 12.7 percent in 1998; meanwhile, M2 declined from 35.1 percent in 1994 to 14.9 percent in 1998. The slowdown of money supply is a reflection of the implementation of the moderate monetary policy. One reason is that the total amount of money supply and money stock is a surplus, rather than shortage in China. The average growth rate of M2 is 23.6 percent for 1978-1999, while that of GDP and retail price is 9.7 percent and 6.2

percent respectively during the same period. The growth rate of M2 exceeds the sum of both GDP and retail price by 7.7 percent. In the long run, it will result in the risk of payments and affect the stable financial operation. On the other hand, the main reason that causes the continual decline of overall prices is the uneven economic structure, rather than the lack of money supply. So the emphasis of China's government is focused on the adjustment of economic structure and the expansion of effective demand.

In 1999, money supply increased properly and the liquidity of money improved obviously. M1 grew by 17.7 percent compared to 12.7 percent in 1998. M2 increased by 14.7 percent compared to 14.9 in 1998, the growth scale was slowdown by 0.6 percent than 1998. M0 (including cash in circulation) increased by 20.1 percent compared to 10.1 percent in 1998. The reasons for the increase in M0 were that the interest rate was reduced and the interest tax was recovered in 1999. So the households keep more cashes in hand. The monetary circulation ratio (M1/M2) was 38.23 percent, going up by 0.95 percent. The aggregate cash which was put into circulation in 1999 was 225.1 billion yuan.

By the end of 1999, financial institutions issued various loans 9373.4 billion yuan which was increased 12.5 percent calculated at comparable prices, but it was reduced 64.4 billion yuan compared to 1998. Outstanding savings deposits by enterprises in 1999 grew 14.5 percent compared to 13.4 percent in 1998. Meanwhile, outstanding personal savings deposits for 1999 were up 11.6 percent, down from 17.1 percent from the year before. Increased savings growth by firms indicates the growing activity of corporate circles, while the dwindling personal savings expansion means people are spending more for consumption and investments.

Table 2.14 Money Supply and Credit (Rmb bn; end-period)

	1994	1995	1996	1997	1998
Currency in circulation	728.4	788.2	879.8	1,017.5	1,120.1
Demand deposits	1,239.0	1,520.2	1,876.5	2,381.0	2,648.6
Money (M1) incl others	2,154.0	2,559.7	3,066.3	3,834.3	4,321.7
M1 growth (%)	28.5	18.8	19.8	25.0	12.7
Quasi-money	2,538.0	3,514.7	4,543.3	5,352.4	6,234.3
Money (M2)	4,692.0	6,074.4	7,609.6	9,186.7	10,556.0
M2 growth (%)	35.1	29.5	25.3	20.7	14.9
Domestic credit	4,310.4	5,333.4	6,641.1	7,950.3	9,542.4
Domestic credit growth (%)	23.8	23.7	24.5	19.7	20.0
Claims on central government (net)	133.3	166.7	218.0	243.8	584.9
Claims on other domestic ransactors	4,177.1	5,1667	6,423.0	7,706.4	8,957.6
Net foreign assets of monetary authorities	506.5	637.0	921.4	1,366.1	1,504.2

Source: IMF, *International Financial Statistics*.

B.7) Employment

China's population increases more than 10,000,000 annually. It has abundant labor resources. Employment rate goes up steadily. During the Eight-Five-Year (1991-1995) periods, it reached the historical highest level. In 1952, China's employment rate was only 36.1 percent. After 1990, it kept around 56 percent. Owing to the oversupply of labors and keeping increase annually, the employment pressure became more and more heavily in recent years. By the end of 1999, the total amount of employment was 705,860,000, going up 0.9 percent than 1998. Of which the urban employment amount increased more quickly than the rural. In 1999, the urban employment

amount was 210,140,000, 530,000 more than the rural. The layoff- workers from state-owned enterprises increased 5,640,000; re-employment amount was 4,920,000. The total SOEs layoff-workers reached 6,500,000; the registered urban unemployment rate was 3.1percent, maintaining the same level with 1998. The employment tendency mainly transfers to the three-foreign-funded enterprises, private enterprises, township enterprises, high-tech industry and tertiary industry.

Table 2.15 Labor Force

	(millions; year-end)					
	1994	1995	1996	1997	1998	1999
Urban state-owned units	112.1	112.61	112.4	110.4	90.6	85.7
of which:						
manufacturing	33.2	33.26	32.18	30.11	n/a	n/a
government agencies & people's organisations	10.1	10.2	10.9	10.4	n/a	n/a
Collectives in towns	32.8	30.8	29.5	28.2	19.6	17.1
of which:						
manufacturing	15.1	14.2	13.5	12.4	n/a	n/a
trade & food services	7.2	6.9	6.7	6.4	n/a	n/a
Urban private enterprises	3.3	4.8	6.2	7.5	9.7	10.5
Self-employed in towns	15.6	8.8	17.1	19.2	22.6	24.1
Rural employed	487.9	488.5	490.3	493.9	498.8	495.7
of which:						
township & village industries	120.2	128.6	135.1	130.5	125.4	127.0
Total incl others	672.0	679.5	688.5	696.0	699.9	705.9
Primary industries	346.9	354.7	347.7	347.3	348.4	353.6
Secondary industries	152.5	156.3	161.8	165.0	164.4	162.4
Tertiary industries	154.6	168.5	179.1	183.7h	186.8	189.9

Source: State Statistical Bureau, *China Statistical Yearbook*, 2000.

C. Fiscal Position

China's state budget consists of the central budget and the local budgets. The central budget is approved by the National People's Congress (NPC), and the local budgets are approved by the people's congresses at the local levels. The local budgets include the provincial, county, and municipal budgets. Before 1980, China's fiscal system was characterized by centralized revenue collection and centralized fiscal transfers, that is, most taxes and profits were collected by local governments and were remitted to the central government, and then in part transferred back to the local governments according to expenditure needs approved by the center. In 1980, the highly central centralized system was changed into a revenue-sharing system in which the central and provincial governments each began to "eat in separate kitchens." This system was called the contract responsibility system. But under this fiscal contract system, the local governments controlled the effective tax rates and bases. They offered varying degrees of tax concessions to enterprises and shifted budgetary funds to extrabudgetary funds, thus minimizing tax sharing with the central government. So in order to strengthen the central government's ability to use tax and expenditure policy instruments, the central government decided in late 1993 to replace the fiscal contract system with a tax assignment system, which redefined the sources of revenue for the central and local governments. Taxes are divided into national taxes, shared taxes and local taxes.

National taxes as well as shared taxes are levied by the state tax bureaus, and local taxes are levied by local tax bureaus.

Table 2.16 The Division of Chinese National Taxes and Local Taxes

National Taxes	Customs duties, Consumption Tax and Value Added Tax (VAT) collected by Customs, Consumption Tax, Enterprise Income Tax collected from banks, financial institutions and enterprises owned by the National Government, and taxes (including Business Tax, Enterprise Income Tax) collected from the Ministry of Railways, head offices of national banks, insurance companies and foreign trade corporations
Shared Taxes	The VAT, Securities Transaction Tax, and Natural Resources Tax. The VAT revenue is divided with 75 percent going to the central government and 25 percent to local governments. Securities transaction tax, currently collected only in Shanghai and Shenzhen in the form of a stamp duty, is divided equally between the central and local coffers. Proceeds of the Natural Resources Tax are largely kept by local governments.
Local Taxes	Business tax (except for Business Taxes of banks, railways, and insurance companies), Income tax of locally-owned state enterprises, Individual Income tax, Urban Land Use Taxes, Fixed Asset Investment Direction Adjustment Tax, Vehicle and Vessel Use Tax, Stamp Tax, Slaughter Tax, Agriculture and husbandry Tax, Farmland Use Tax, Deed Tax, Inheritance Tax and Land Appreciation Tax.

C.1) Government Expenditure

Table 2.17 Growth Rate of Government Revenue and Expenditure

Year	Growth Rate of Total Revenue	Growth Rate of Total Expenditures	Growth Rate of	
			Central Government	Local Governments
1980	1.2	-4.1	3.2	-3.2
1981	1.4	-7.5	0.7	-0.7
1982	3.1	8	-2.0	2.0
1983	12.8	14.6	0.9	-0.9
1984	20.2	20.7	-1.4	1.4
1985	22.0	17.8	-12.8	12.8
1986	5.9	10.0	-1.8	1.8
1987	3.6	2.6	-0.5	0.5
1988	7.2	10.1	-3.5	3.5
1989	13.1	13.3	-2.4	2.4
1990	10.2	-9.2	1.1	-1.1
1991	7.2	9.8	-0.4	0.4
1992	10.6	10.5	-0.9	0.9
1993	24.8	24.1	-0.3	3.0
1994	20.0	24.8	2.0	-2.0
1995	19.6	17.8	-1.1	1.1
1996	18.7	16.3	-2.1	2.1
1997	16.8	16.3	0.3	-0.3
1998	14.2	16.9	1.5	-1.5
1999	15.9	22.1	2.6	-2.6

Source: State Statistical Bureau, *China Statistical Yearbook*, 2000.

China started its economic reform and structure transform in 1978. At the same year, China's government expenditure increased by 33 percent, breakthrough 100 billion yuan. In the first five years of 1980s, government expenditure annual growth rate was 10.3 percent, 1.3 percent lower than the revenue growth rate. In the last five years, the increase rate of expenditure became average 9.0 percent, exceeding the growth rate of revenue 1.1 percent. For the year 1991-1999, the government expenditure increased greatly. The total expenditure expanded from 338.7 billion yuan to 1251.5 billion yuan. The annual growth rate reached 17.1 percent, surpassing both the average GDP growth rate (10.8 percent) and revenue growth rate (16.5 percent) at the same period. On the whole, China's economic growth became more and more dependent on the expansion of government expenditure. On the other hand, the expenditure of local government was the main force to the expansion of total government expenditure. In the most part of years, the growth rate of local government expenditure exceeded that of central government and the country. Whenever there was a fiscal system adjustment, the government expenditure fluctuated greatly. For example, when the new taxation system was adopted in 1994, the government expenditure increased to 24.8 percent of the total expenditures.

In the process of reform from 1978, the structure of government expenditure had changed substantially. The expenditure for economic construction decreased, while expenditure for social, cultural and educational development increased greatly. The highest proportion of the expenditure spent on capital construction was 50 percent, but it was reduced to 11 percent in 1997; the average proportion of the expenditure spent on operating expenses for culture, education science and health care was around 12 percent before 1978, but it was increased to 21 percent in 1997. The share of government administration to the total expenditure was also gone up from average 5 percent before 1978 to 14.7 percent in 1997. In China, no certain items in government expenditure took the principal position, and some of them fluctuated corresponding to the deepening of the reform.

Table 2.18 Government Finances

	(Rmb bn)								
	1991	1992	1993	1994	1995	1996	1997	1998	1999
Revenue	314.9	348.3	434.9	521.8	624.2	740.8	865.1	987.6	1,144.4
of which:									
tax	299.0	329.7	425.5	512.7	603.8	691.0	823.4	881.6	1,068.3
net subsidies to enterprises ^a	-51.0	-44.5	-41.1	-36.6	-32.8	-33.7	-36.8	-33.4	-29.0
Borrowing ^b	46.1	67.0	73.9	117.5	155.0	196.7	247.8	331.1	371.5
Expenditure	338.7	374.2	464.2	579.3	682.4	793.7	923.3	1,079.8	1,318.8
of which:									
capital construction	56.0	55.6	59.2	64.0	78.9	90.7	101.9	138.8	211.7
defense	33.0	37.8	42.6	55.1	63.7	72.0	81.2	93.5	107.6
culture, health & education	70.8	79.3	95.8	127.8	146.7	170.4	190.3	215.4	240.8
administration	34.4	42.5	53.6	72.9	87.3	104.1	113.7	132.7	152.6
price subsidies	37.4	32.2	30.0	31.4	36.5	45.4	55.2	71.2	69.8
Debt service	24.7	43.9	33.6	49.9	88.8	131.2	191.8	235.3	192.3
Balance	-23.7	-25.9	-29.3	-57.5	-58.2	-52.9	-58.2	-92.2	-174.4

^aThe net of direct income from enterprises and subsidies to cover their losses. ^bIt is Chinese practice to include borrowing and the principal element of debt service in the budget. The measured deficits would be higher without these.

Source: State Statistical Bureau, *China Statistical Yearbook*, 2000.

C.2) Public Borrowing

From 1981, China initiated to issue national bonds. It is one resource for central government to collect revenue, which is listed in the central government budgetary and is unified distributed in the country. By the end of 1999, the accumulative amount of national bonds was more than 600 billion yuan, approximately standing for 7.3 percent of GDP. Recent years, the issuing amount of China's public bonds increased at the rate of 30 percent. In 1994, 1995, 1996, the increase rate was 59.0 percent, 31.9 percent and 27.0 percent respectively. The share of national debts to total government expenditure was around 25 percent, approaching the international generally recognized line (below 30 percent). But the share of national bonds to central government expenditure is pretty high. In 1994-1997, it reached 52.1 percent, 53.7 percent, 55.6 percent and 57.8 percent (budgetary figure), going up 1.9 percent annually.

The revenue from issuing national bonds is used mainly for two purposes. One is to make up the fiscal deficits. In the old fiscal system, China took two measures-borrowing from banks and issuing national bonds- to offset its deficits. From 1994, out of the policy consideration of controlling the inflation, China's government changed the "double-track system" into "single-path system". That is the only way to offset the total fiscal deficits is to issue national bonds. This led to the rapid increase of issuing national debts from billions in 1980s to tens of billions in the early 1990s and breakthrough hundreds of billions recent years. The other purpose is to raise funds for special use. From 1998, China initiated pro-active fiscal policies. The government had issued 360 billion yuan in treasury bonds. The money was mainly used to build infrastructure projects in areas of water conservancy, transportation and power; to support technological advancement in enterprises; to increase investment in an ambitious national program to develop China's western areas as well as biological and environmental construction; and to increase input in education, scientific and technologic infrastructure. In other words, issuing national bonds contributed to economic growth by 1.5 percent in 1998 and by 2 percent in 1999.

Table 2.19 The Ratios Related to the GDP and Government Expenditures

(Billion yuan)

Year	Fiscal Deficit	The Ratio of Fiscal Deficit to GDP (%)	Amount of National Debts	The Ratio of National Debts to Total Government Expenditures (%)
1990	14.6	0.8	37.5	12.8
1991	23.8	1.1	46.1	14.6
1992	25.9	1.0	67.0	19.2
1993	29.3	0.8	73.9	17.0
1994	57.5	1.2	117.5	22.5
1995	58.2	1.0	155.0	24.8
1996	52.9	0.8	196.7	26.6
1997	58.2	0.8	247.7	28.6
1998	92.2	1.2	331.1	33.5
1999	174.4	2.2	371.5	32.5

Source: State Statistical Bureau, *China Statistical Yearbook*, 2000.

C.3) Aggregate Tax Revenue

China implemented the new tax system since 1994. The total tax revenues amounted to 4572.6 billion yuan by the end of 1999 from 411.8 billion yuan in 1994 up to 1031.2 billion yuan in 1999.

Tax revenues increased 103.2 billion yuan annually, with the growth rate of 10.5 percent; exceeded 100 billion yuan in 6 consecutive years. The Value-added taxes and consumption taxes played a very important role in the total tax revenues, which were 284.1 billion yuan in 1994 and increased to 484.6 billion yuan in 1999 with the growth rate of 11.8 percent annually. The ratio of tax revenues from domestic enterprises to the total tax revenues declined gradually from 87.6 percent in 1994 to 80.6 percent in 1998. But it is still the main source of tax revenues. During these periods, tax revenues from foreign enterprises and individuals increased rapidly. The ratio of foreign taxes to total tax revenues grew from 6.4 percent in 1994 to 13.6 percent in 1998, while that of individuals taxes to total tax revenues increased from 30.33 billion yuan in 1994 to 53.69 billion yuan in 1998 at an average growth rate of 15.3 percent. The export rebates showed the trend of wave. The total export rebates were 45.0 billion yuan in 1994, substantially up to 82.77 billion yuan in 1996 with an average growth rate of 35.6 percent. From 1997 to 1998, export rebates reduced to around 43.0 billion yuan, the scale of decline was about 90 percent. In 1999, the total export rebates increased to 62.8 billion yuan, 43.6 percent higher than last year, which played an active role in promoting China's exports.

Table 2.20 Part Years of Chinese Total Tax Revenues

Year	Total Tax Revenue (Billion Yuan)	Ratio of Tax Revenue to Government Revenue	Ratio of Tax Revenue to GDP
1978	51.93	45.9	14.3
1980	57.17	49.3	12.7
1986	209.07	98.5	20.5
1990	282.19	96.1	15.2
1991	299.02	94.9	13.8
1992	329.69	94.6	12.4
1993	425.53	97.8	12.3
1994	512.69	98.3	11.0
1995	603.80	96.7	10.4
1996	690.14	93.7	10.2
1997	782.50	90.6	10.5
1998	924.91	94.5	11.6
1999	1031.2	90.4	12.4

Source: State Administration of Taxation

2.3 Tax Structure: Institutions and The Reality

2.3.1 Institution

The responsibility for tax administration, apart from customs matters, is vested with the State Administration of Taxation, under the direction of the State Council. The primary duties of the State Administration of taxation include determining and implementing tax policies, drafting tax legislation for approval by the State Council or the National People's Congress, and negotiating tax treaties with other countries. The State Administration of Taxation is also responsible for the supervision of tax bureau at the provincial, municipal, prefectural, and county levels. During 1994, the tax administration system was restructured. Separate state tax bureaus and local tax bureaus have been established in order to implement the new state/local tax sharing system. State

tax bureaus at local levels are directly under the control of the SAT, whereas local tax bureaus are part of local governments.

China's customs regulations are administered by the General Administration of Customs of the PRC, under the direction of the State Council. The Customs Law provides a legal framework within which the General Administration of Customs carries out its functions. It empowers the General Administration of Customs with approval of the State Council to draw up detailed rules and regulations for the implementation of the Customs law. The General Administration of Customs conducts its work through offices located at major ports, railway stations, and airport, as well as at international post offices.

Figure 2.5 Chart of China's Tax System

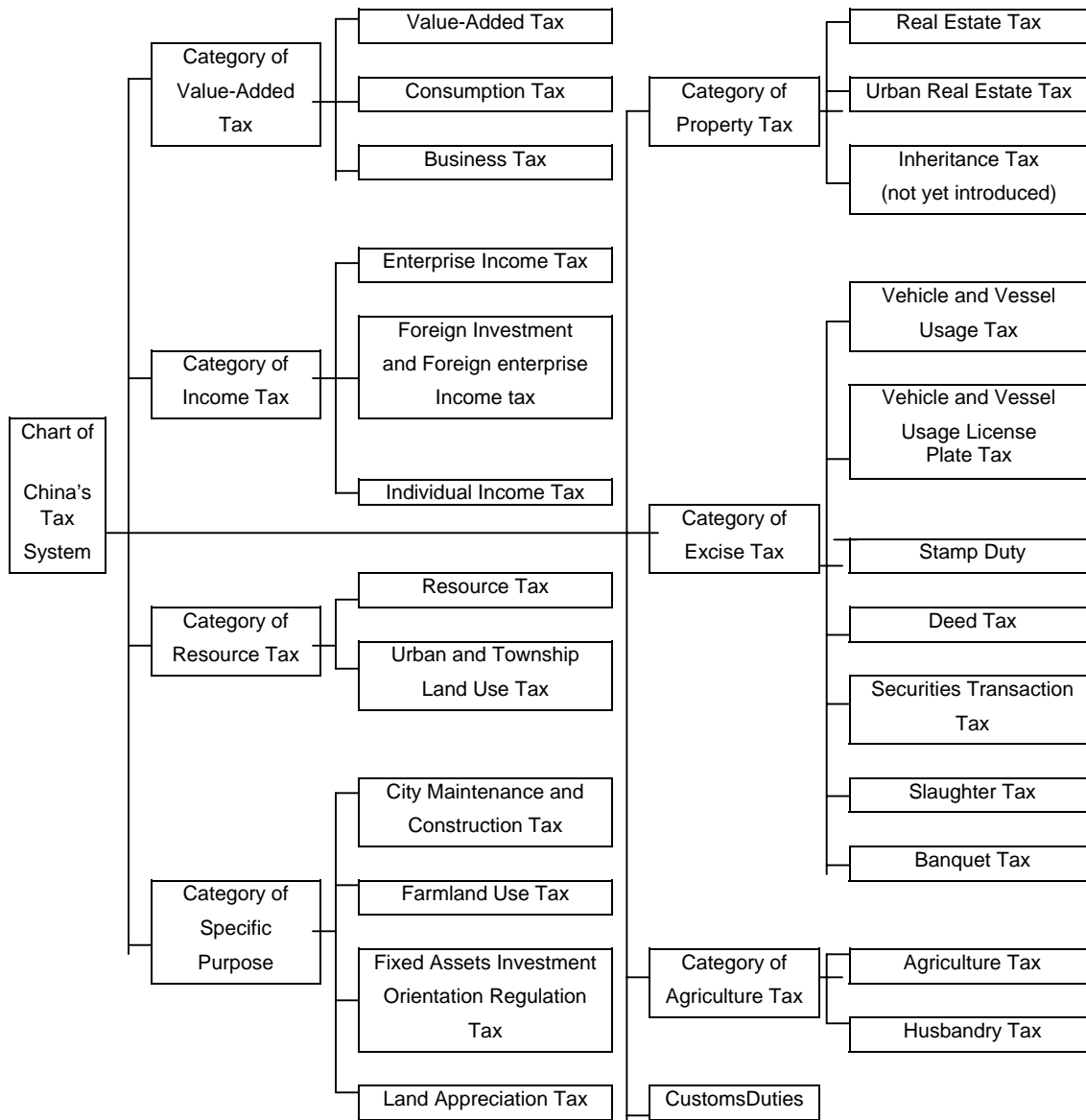


Table 2.21 Chinese Main Tax Revenues in 1999

Tax Items	Amount of Revenue (billion)	Ratio to Total Tax Revenue(%)
Value-Added Tax	400.1	44.3
Business Tax	169.6	18.8
Consumption Tax	84.5	9.4
Enterprise Income Tax	100.9	11.2
Foreign Investment and Foreign Enterprise Income Tax	21.8	2.4
Individual Income Tax	41.4	4.6
Resource Tax	6.3	0.7
Urban and Township Land Use Tax	5.9	0.7
City Maintenance and Construction Tax	31.5	3.5
Fixed Assets Investment Orientation Regulation Tax	13.0	1.4
Land Appreciation Tax	0.7	0.1
Real Estate Tax	18	2.0
Vehicle and Vessel Usage Tax	2.1	0.2
Stamp Duty	3.8	0.4
Others	2.9	0.3

Source: State Administration of Taxation

2.3.2 Tax Legislation

China has no single law or code which sets forth the rules governing the various taxes. Consequently, the rules pertaining to each tax are contained for the most part in separate statutory regimes. Each regime typically includes (a) basic, or fundamental, legislation, (b) supplementary regulations, and (c) specific rulings or interpretative notices issued from time to time by the State Administrative of Taxation.

Basic, or fundamental, legislation generally includes a basic tax law and implementing regulations. The basic tax law typically consists of a set of general principles setting forth the scope of the tax, the computation of taxable income, tax rates, and tax administration and payment provisions. Basic tax laws are generally promulgated by China's legislature, the National People's Congress (NPC), or the Standing Committee of NPC. The implementing regulations are usually issued by the State Council. In China, "Income Tax Law of the People's Republic for Enterprises with Foreign Investment and Foreign Enterprise", "Individual Income Tax Law of the People's Republic of China", and "the Law of the People's Republic of China's Concerning Tax Administration and Tax Collection" are three basic tax laws.

Supplementary regulations consist of rules issued from time to time to amend, supplement, or clarify the application of existing statutory provisions. Many of these regulations, which are generally issued by the Ministry of Finance, State Administration of Taxation with the approval of the State Council.

According to the regulation of Chinese law, the NPC and the Standing Committee of NPC at provincial and autonomous levels as well as provincial governments can issue some local tax regulations and rules under the premise of not contradicting the national tax laws.

2.3.3 The Present Tax Items

a) Value-Added Tax

Promulgated by the State Council on December 13, 1993 and effective from January 1, 1994.

Taxpayer

Work units and individuals that sell goods, provide processing or repair and replacement services or import goods in the PRC shall be the VAT taxpayers.

Scope and Liability

VAT is levied on the transfer of taxable goods and services at each stage of the production and sales process. It is also charged on the importation of goods into China. The VAT paid on purchase of goods and services (“input VAT”) can offset the VAT collection on sales (“output VAT”). The difference will be the VAT payable to tax authorities.

Tax Rates

The general VAT rate is 17%. It applies to the sale of goods, the import of goods and the supply of processing, repairing and installation services by VAT taxpayers (“general taxpayers”). For food, running water, heating, gas, books and agricultural fertilizer, the reduced VAT rate of 13% applies. Export of goods is zero-rated except for crude oil, sugar, bezoar, musk, copper and platinum which are subject to VAT at 17%. Small enterprises with annual turnover less than Rmb 1 million (production) or Rmb 1.8 million (wholesale or retail) (“small-scale taxpayers”) are subject to VAT at a special rate of 6%. However, they are not entitled to claim any input VAT against output VAT.

Administration

Under the VAT law and regulations, taxpayers are classified into “small-scale taxpayers” and “general taxpayers”.

Small-scale taxpayers are defined as:

- taxpayers engaged in the production of goods with annual sales amount below Rmb 1 million.
- taxpayers engaged in wholesaling or retailing of goods with annual sales amount below Rmb 1.8 million.

General taxpayers are those taxpayers other than small-scale taxpayers. Small-scale taxpayers with a sound accounting system which can produce accurate assessment of output tax and input tax can also be registered as general taxpayers with the approval of the tax authorities.

A VAT invoice is an important document reflecting a taxpayer’s business activities. It is a certificate for accounting records, claiming tax credit and tax refund.

Unified special VAT invoices are printed by the State Tax Bureau and distributed to taxpayers by the tax bureau. Only general VAT taxpayers can obtain and issue special VAT invoices. Small-scale taxpayers can only use ordinary invoices.

Filing schedule

Generally, a VAT return is filed on a monthly basis. In some circumstances, it may be filed on a one-day, three-day, 10-day or 15 day basis. The actual assessment period is determined by the tax authorities according to the magnitude of the tax amount payable by the taxpayer. Where VAT cannot be assessed regularly, it should be assessed on a transaction-by- transaction basis.

Taxpayers who adopt one month as an assessment period should report and pay VAT within 10 days following the end of the period. If a one-day, five-day, 10-day or 15 day period is adopted, VAT must be prepaid within five days following the end of the period and a monthly return should be filed within 10 days from the first day of the following month.

Taxpayers who import goods should pay tax within seven days after the issuance of the tax payment certificates by the customs authority.

b) Consumption Tax

Promulgated by the State Council on December 13, 1993 and effective from January 1, 1994 as part of the overhaul of the turnover tax system.

Taxpayers

Work units and individuals that produce, subcontract for processing, and import of specified consumer goods within the PRC shall be the Consumption Tax taxpayers.

Categories

Five main categories of taxable consumer goods are subject to the Consumption Tax:

- Luxury goods (jewellery and stones)
- Gasoline-powered vehicles (motor cars and motorcycles)
- Non-necessities (wines and spirit, tobacco, cosmetics and skin-and hair-care products)
- Petroleum products and diesel fuels
- Special items (firecrackers, firework, ethyl alcohol and automobile tyres).

Consumption Tax applies to the production, subcontracting for processing, and importation of specified consumer goods within the PRC. Since Consumption Tax is imposed on finished products, it is payable either at the import level where the imported goods are finished products or at the production stage after the completion of the production process. For imported goods, consumption tax is levied in addition to customs duty, but before the imposition of VAT.

Tax Rates

Consumption Tax rates range from 3% to 45%. There are 15 scales (shown on Page 29).

Liability

Liability to pay the Consumption Tax vest as follows:

- For the importers: at customs clearance by the importers and is collected by the Customs Department as agent
- For the producers: when sold by the producers or when transferred to non-production use
- For the subcontractors: when goods are delivered to the contractor and payable by the subcontractors as paying agent. Where the processed goods are used by the contractor in the continuous production of taxable consumer goods, credit will be given for the Consumption Tax paid.

Administration

The administration of Consumption Tax can be summarized as follows:

The assessment method could vary from one day to one month and is to be determined by the tax authorities in charge on the basis of the size of the tax payable. Where the tax term is one month, the taxpayer must pay the Consumption Tax within 10 days of filing the tax returns

Where the tax term is one, three, five, 10 or 15 days, the taxpayer must prepay the Consumption Tax within five days from the expiry of the term and then file a tax return within 10 days from the beginning of the following month and settle the balance of any tax owed.

Consumption Tax on taxable consumer goods imported into the PRC is paid to the Customs Department within seven days of issuance of a statement of custom duty payable.

Table 2.22 Consumption Tax Rates

Taxable Items	Scope	Tax Rate
1. Tobacco	Including all imported cigarettes	
a. Grade A, Cigarettes		45%
b. Grade B, Cigarettes		40%
c. Cigars		40%
d. Shredded tobacco		30%
2. Alcohol		
a. White wine (made from grain/ cereals)		25%
b. White wine (made from potato)		15%
c. Yellow wine		Rmb240/tonne
d. Beer		Rmb220/tonne
e. Other alcoholic beverages		10%
f. Ethyl alcohol		5%
3. Cosmetics		30%
4. Skin-care and hair care products	including cosmetic sets	17%
5. Precious jewelry and precious jade and stone	including all kinds of gold, silver, jewelry, and precious stone ornaments	10%
6. Fireworks		15%
7. Petrol		Rmb0.2/litre
8. Diesel		Rmb0.1/litre
9. Vehicle tyres		10%
10. Motorcycles		10%
11. Cars		
a. Above 2200 cc		8%
1000-2200cc		5%
Under 1000cc		3%
b. Off-road vehicle (four wheel drive)		5%
Above 2400 cc		3%
Below 2400 cc		
c. Small passenger, Van	For fewer than 22 passengers	5%
Above 2000 cc		3%
Below 2000 cc		

c) Business Tax

Promulgated by the State Council on December 13, 1993 and effective from January 1, 1994.

Taxpayers

Work units and individuals that provide labour services, assign intangible assets or sell immovable property in the PRC shall be Business Tax taxpayers.

Scope of Business Tax

The Business Tax is imposed on all units and individuals. “Units” include state-owned enterprises, collectively enterprises, private enterprises, shareholding enterprises, other enterprises and administrative units, institutions, military units, social organizations and other units. “Individuals” include individual industrial and commercial household operations and other individuals who conduct business operations.

Tax Rates

There are nine categories of taxable items under the Business Tax

Table 2.23 Business Tax Rates

Taxable Items	Scope	Tax Rate
1. Transportation	Land, sea and river, air, pipeline transport, loading and unloading	3%
2. Construction	Construction, installation, repairs, decorations and other construction projects	3%
3. Finance and Insurance		5%
4. Posts and Telecommunications		3%
5. Cultural activities and sports		3%
6. Entertainment	Ballrooms, night clubs, kalaoke bars, lounges, billiard room, golf course, bowling alleys and venues for shows and performances	5% to 20%
7. Services	Agency services, hotels, restaurant and catering services, tourist services, warehousing, rental and leasing services, advertising and other services	5%
8. Assignment of intangible assets	Assignment of land use rights, patent rights, non-patented techniques and know-how, trademarks, copyright and brand names Sale of buildings and other subjects and structures built on land	5%
9. Sale of immovable properties		5%

Time Limit for Payment

The time limits for the payments of Business Tax shall be five days, 10 days, 15 days or one month. The applicable payment period shall be verified and determined by the tax authority on the basis of the amount of Business Tax payable by the taxpayer. If payments of Business Tax cannot be made on a fixed period basis, Business Tax may be paid on a transaction basis.

A taxpayer with a Business Tax payment period of one month shall declare and pay the Business Tax for that period within 10 days of the end of that period. A taxpayer with a Business Tax payment period of 5 days, 10 days or 15 days shall make a provisional payment of Business Tax within five days of the end of the period, and settle the Business Tax payable for the previous month.

d) Enterprise Income Tax

Promulgated by the State Council in December 13, 1993 and effective from January 1, 1994.

Taxpayers

Enterprises or organizations which are independently economically accountable entities, including state-owned enterprises, collective enterprises, private enterprises, joint enterprises, joint-stock companies and other organizations which are entities with production, operation and other income should be Enterprise Income Tax taxpayers.

Taxable Income

Enterprise Income Tax apply to a taxpayer's income from production, operation and other sources both inside and outside China. A taxpayer's total income includes income from interest, rent, royalties, dividends and other income.

Interest Rate

The enterprise income tax reform cut income tax rates for large- and medium SOEs from 55% to a uniform 33%. The proportional 33% includes a 30% national tax and a 3% local surcharge. The latter is designed to be flexibly applied by the localities.

Tax Year

The "tax year" is the calendar year from January 1 to December 31.

When a taxpayer's actual business operation period is less than 12 months in a tax year in its initial year of operation, or because of a merger or dissolution, the actual period of its business operation should be counted as a tax year.

Tax Collection

An enterprise's income tax must be calculated annually but prepaid in monthly or quarterly installments. The installments should be prepaid within 15 days after the end of a month or a quarter. The settlement of its annual income tax is done within four months after the end of the tax year. Overpayments shall be refunded. A supplementary must be made for any deficiency. A taxpayer must submit his accounting statements and income tax pre-payment statements to the responsible tax agency in the area where the enterprise is located within 15 days after the end of a month or a quarter. The annual accounting statement and income tax return must be submitted and income tax must be paid to the responsible tax agency in the area where the enterprise is located within 45 days after the close of a tax year.

e) Foreign Investment Enterprise and Foreign Enterprise Income Tax

Passed by the National People Congress on April 9, 1991 and effective from July 1, 1991.

Taxpayers

Taxpayers include foreign investment enterprises (FIEs) and foreign enterprises (FEs). FIEs are defined as Equity Joint Ventures, Cooperative Joint Ventures and Wholly Foreign-owned Enterprises. FEs refers to foreign enterprises with establishments or places of operation in China engaging in production or business operations and those which do not have any establishment or place of operation in China but have income derived from China.

Taxable Income

The taxable income of FIEs or FEs with establishments in China shall be the amount of gross income in a tax year after costs, expenses and losses.

Tax Rate

The Enterprise Income Tax payable by foreign investment enterprises and the Enterprise Income Tax payable by foreign enterprises on the income of their establishments of sites set up in the China to engage in production or business operations shall be calculated on the amount of taxable income of the enterprises, at the rate of 30%. Local income tax shall be calculated in the amount of taxable income, at the rate of 3%.

Tax Collection

Foreign Investment Income Tax and Foreign Enterprise Income Tax shall be computed on an annual basis and prepaid in quarterly installments. Prepayments shall be made within 15 days after the end of each quarter. An annual settlement shall be made within five months after the end of each tax year, at which time excess payments shall be refunded and deficiencies shall be made up. FIEs and FEs shall file annual income tax returns and final accounting statements within four months after the end of each tax year.

f) Individual Income Tax

Passed by the Standing committee of the eighth National People's Congress on October 31, 1993 and effective from January 1, 1994.

Evolution of the Individual Income Tax

Prior to the PRC tax reform in 1994, the Individual Income Tax Law was only applicable to foreign nationals, while Chinese nationals were taxed under the Individual Income Regulatory Tax Law. Entrepreneurs receiving income from individually owned businesses were liable to the Income Tax Law of Individually Owned Industrial and Commercial Enterprises. From January 1, 1994, the three tax legislations were consolidated into one law to unify and simplify the income tax system for individuals in China. The new PRC Individual Income Tax Law is applicable to both foreign and local Chinese nationals.

Scope of Charge

According to the Individual Income Tax Law and Regulations. There are 11 categories of taxable income:

- income from wages and salaries;
- income from production or business operation derived by individual industrial and commercial households;
- income from contracted or leased operation of enterprises or institutions;
- income from remuneration for personal service;
- income from author's remuneration;
- income from royalties;
- income from interest, dividends and bonuses;
- income from lease of property;
- income from transfer of property;
- contingent income; and
- other income specified as taxable by the Ministry of Finance

Liability

The extent which an individual, either foreign or local Chinese national, is subject to PRC Individual Income Tax depends on the Individual's residence status and source of income. Generally, if an individual is considered to be a resident of China for tax purposes, he is subject to Individual Income Tax in respect of all his taxable income regardless of the income source. That is, his worldwide income would be entirely subject to tax in China. If he is not a Chinese resident, only his China source income is taxable.

Tax Rates

- 1) Income from wages and salaries shall be taxed at progressive rates ranging from 5% to 45%.

Table 2.24 Individual Income Tax Rates

Grade	Monthly Taxable Income	Tax Rate (%)
1	Income of 500 yuan or less	5
2	That part of income in excess of 500 to 2000 yuan	10
3	That part of income in excess of 2000 to 5000 yuan	15
4	That part of income in excess of 5000 to 20000 yuan	20
5	That part of income in excess of 20000 to 40000 yuan	25
6	That part of income in excess of 40000 to 60000 yuan	30
7	That part of income in excess of 60000 to 80000 yuan	35
8	That part of income in excess of 80000 to 100000 yuan	40
9	That part of income in excess of 100000 yuan	45

- 2) income from production and business of individual industrialists and merchants and income from contracted or leased operation of enterprises or institutions shall be taxed at progressive ranging from 5% to 35%.

Table 2. 25 Individual Income Tax Rates

Grade	Annual Taxable Income	Tax Rate(%)
1	Income of 5000 yuan or less	5
2	That part of income in excess of 5000 to 10000 yuan	10
3	That part of income in excess of 10000 to 30000 yuan	20
4	That part of income in excess of 30000 to 50000 yuan	30
5	That part of income in excess of 50000 yuan	35

- 3) income from author's remuneration shall be taxed at a flat rate of 20%, the amount of tax payable, however, shall be reduced by 30%.
- 4) income from remuneration for personal service shall be taxed at a flat rate 20%. Where a specific payment of income from remuneration for personal service is excessively high, additional tax can be levied at a rate to be specifically determined by the State Council.
- 5) income from royalties, interest, dividends, bonuses, lease of property and transfer of property, as well as contingent income shall be taxed at a flat rate of 20%.

Management

For income from wages and salaries, the tax shall be levied on monthly basis. The tax shall be withheld by the withholding agent or paid by the self-reporting taxpayers to the State Treasury within the first seven days of the following month.

For income from production or business operation derived by individual industrial and commercial households, the tax payable shall be computed on annual bases and paid in advance in monthly installments. Such payments shall be made within three months after the end of each tax year. Any excess payment shall be refunded and any deficiency repaid.

For income from contracted or leased operation of enterprises and institutions, the tax payable shall be computed on annual basis and paid to the State Treasury within thirty days after the end of each tax year.

For taxpayers who derive income outside China, the tax payable shall be paid to the State Treasury within thirty days after the end of each tax year.

g) Resource Tax

Promulgated on December 13,1993 and came into effective on January 1,1994.

Taxpayers

All units and individuals engaged in the exploitation of mineral products or production of salt within the territory of the PRC shall be taxpayers of Resource Tax.

Tax Rates

There are seven types of taxable items subject to different tax rates.

Table 2.26 Resource Tax Rates

Taxable Item	Tax Rate
1. Crude Oil	Rmb8 to Rmb30 per tonne
2. Natural gas	Rmb2 to Rmb15 per 1,000 cubic metres
3. Coal	Rmb0.3 to Rmb5 per tonne
4. Ferrous metallic mineral ore	Rmb0.5 to Rmb20 per tonne or cubic metres
5. Non-ferrous metallic mineral ore	Rmb2 to Rmb30 per tonne
6. Other non-metallic mineral ore	Rmb0.4 to Rmb30 per tonne
7. Salt: Solid salt	Rmb10 to Rmb60 per tonne
Liquid salt	Rmb2 to Rmb10 per tonne

Withholding Agents

Independent mines, united enterprises and other units who purchase untaxed mineral products shall be the Resource Tax withholding agents. The taxes withheld by the withholding agents shall be paid to the local competent tax authorities.

h) Agriculture Tax

The tax is charged on all units and individuals engaged in agricultural production. This tax is payable in cash or in kind. It is imposed on income from the production of grain, varieties of cash crops such as potatoes, cotton, hemp, tobacco, sugar-and oil-bearing crops, as well as horticultural products.

The tax is assessed on two bases: normal yield for agricultural crops, of gross production for other native agricultural products. The normal yield is the estimated average annual yield for grain determined in the basis of the natural conditions of the land, ordinary level of management and production level of normal years.

The Agriculture Tax Law only provides for an average national rate of 15.5% (the effective average rate is 11%), authorizing local governments to determine the actual rate (up to a ceiling of 25%) applicable in the locality. In practice, regional rates vary from 13% to 19%.

i) Customs Duties

Approved and promulgated by the Standing Committee of the Sixth National People’s Congress and effective on July 1,1987.

Customs duties are charged on consignees of import goods, consignors of export goods, and owners of inward and outward articles in China. However, agents of consignees or consignors are also responsible for paying import or export duties as the case may be.

Rate of Import and Export Duties

Rate of import and export duties are specified in the “Import and Export Tariff of the People’s Republic of China” which is an integral part of the Regulations for Import and Export Duty. The tariff consists of 21 sections and 99 chapters. In each chapter, goods are further classified into items. For each item contained in the Import and Export Tariff, two import duty rates, the general tariff rate and the minimum tariff rate may be applied. The general tariff rates apply to imports originating in countries with which China has not concluded trade treaties with reciprocal favorable tariff clauses therein. The minimum tariff rates apply to imports originating in countries with which China has concluded trade treaties with reciprocal favorable tariff clauses therein. In addition, a special tariff will be levied on imports originating in countries which charge discriminating import duties or have discriminated in their treatment of imports originating in China

The total dutiable items contained in the Import and Export Tariff can be broadly divided into four categories: basic necessities, necessities, unnecessary goods and goods of restricted import. The tariff rates applicable to each category are shown in the following table.

Table 2.27 PRC Tariffs

Categories	Minimum Tariff Rate (%)	General Tariff Rate (%)	Typical Dutiable Goods
Basic Necessities	Exempt	Exempt	Goods that are not readily produced or in short supply in China, for example, advanced technology equipment, radio reactors, cereals, and cotton
	3	8	
	6	11	
	9	14	
	12	17	
Necessities	15	20	Goods that are not basic necessities but are needed for daily use, for example, machinery, computers, cotton yarns, animal fats, and milk powder.
	20	30	
	25	35	
	30	40	
Unnecessary Goods	35	45	Goods that are readily produced in China or unnecessary for daily use, for example, textile products, plastic materials, fish, meat, and vegetables
	40	50	
	50	70	
	60	80	
Goods of Restricted Import	70	90	Luxurious goods, for example, tobacco and wines and spirits
	80	100	
	100	130	
	120	150	
	150	180	

An export duties rate is specified in the Import and Export Tariff only if an item is chargeable to export duty. A small percentage of items are subject to export tariff. These items include silk and waste silk, bones and horn-cores of animals, and certain metallic ores and metallic articles. Current export tariff rates range from 10% to 100%.

2.4 Country-Specific Fiscal Issue

Despite the partial success of the 1994 fiscal and tax system reform, which improved the transparency and stability of the central–local fiscal relations, several issues remain outstanding and need to be addressed in the short and medium term:

- The division of taxing powers and expenditure responsibilities between levels of the government is still determined by the central government, rather than through legislation of the National Congress. This allows the central government to change the rules frequently in its own interest. Without a commitment to a more stable division of powers, the local governments tend to react strategically to expected policy changes, thereby leading to unexpected outcomes.
- The share of central government revenue in total government revenue has continued to decline since the 1994 tax reform. The 1994 reform did, to some extent, strengthen the central government’s ability to use tax and expenditure policies by recentralizing some taxing powers from the local governments. The share of central government revenue in total government revenue increased from 33 percent in 1993 to 57 percent in 1994. However, since 1994, the growth rate of central revenues has been significantly lower than that of local revenues. As a result, the center’s share in total government revenue declined to 49 percent in 1997. The center’s original objective of increasing its share of total revenue to 60 percent is unlikely to be achieved anytime soon.
- As a result of the tight budgetary situation, the central government has not been able to set up a sizable equalization transfer program for redistribution purposes. China’s regional disparity in income level and fiscal capacity is one of the largest in the world. However, its fiscal transfer system has played almost no role in equalization, with most transfers determined on the basis of vested interests and political influences.
- Under the fiscal contract system before 1994, many local governments and line departments found various ways to shift budgetary revenues to these funds in order to avoid revenue sharing with the central government. After the tax reform of 1994, local governments and line departments continue to use extra–budgetary and off–budgetary funds as a way to avoid central government restriction on the use of these funds. The consequence of almost half of the public sector revenue wandering outside the budgetary is that the fiscal authority has limited control over the allocation of resources, particularly when budgetary expenditures are largely “entitlements” with little flexibility. The redistributive role of fiscal allocation is thus seriously constrained by the government’s inability to control extrabudgetary and off–budgetary funds.

Table 2.28 Central–Local Fiscal Status, 1979–1999

	Revenue		Expenditure	
	Central	Local	Central	Local
	(In percent)			
1979	20.2	79.8	51.1	48.9
1980	24.5	75.5	54.3	45.7
1981	26.5	73.5	55	45
1982	28.6	71.4	53	47
1983	35.8	64.1	53.9	46.1
1984	40.5	59.5	52.5	47.5
1985	38.4	61.1	39.7	60.3
1986	36.7	63.3	37.9	62.1
1987	33.5	66.5	37.4	62.6
1988	32.9	67.1	33.9	66.1
1989	30.9	69.1	31.5	68.5
1990	33.8	66.2	32.6	67.4
1991	29.8	70.2	32.2	67.8
1992	28.1	71.9	31.3	68.7
1993	22	78	28.3	71.7
1994	55.7	44.3	30.3	69.7
1995	52.2	47.8	29.2	70.8
1996	52.2	47.8	27.1	72.9
1997	48.8	51.2	27.4	72.6
1998	49.5	50.5	28.9	71.1
1999	51.1	48.9	31.5	68.5

Source: Calculated using data from the province from Statistical Bureau(2000)

Note: Revenue does not include (exclude) fiscal transfers from (to) the center.
Expenditure equals revenue plus fiscal transfers from the center to the province,
and minus fiscal transfers from the province to the center.

2.5 Conclusion: Where We Stand and Where We Go

China's macro-economic control measures during the Ninth-Five-Year period (1996-2000) have achieved prominent results, with the national economy maintaining sustained growth. These measures have created a beneficial environment for promoting reforms, exploiting existing productive forces, easing employment problems and protecting social stability. 2000 is a key year for China which is the completion of Nine-Five-Year Plan and the beginning of Ten-Five-Year Plan. A sustained national economic growth is especially important in this year. China faces many advantages and disadvantages in its economic development.

From the advantageous point of view, deflation is fading as China's government measures take effect. Holiday consumption, tourism and celebrations will regale the economy with extra money. Also, the recovery of the Asian economy and the soundness of the economies in Europe and America have helped China increase exports. And the acceleration of reforms will improve the efficiency and increase the profits of State-owned enterprises. Large-scale development in western China will also promote economic growth.

From the disadvantageous point of view, the main problems are insufficient market demand coexisted with unreasonable structure, fierce international competition and the deflationary pressure.

First, a buyer's market has taken shape in China. The economic development is entering into a new stage; both economic system and economic growth mode are in a transition period. Many problems and contradictions formed in the past are exploded, which need to be reformed and adjusted gradually. The trend of economic slid cannot be changed in a short time.

Second, the problems of irrational structure are still very obvious, especially the long term of construction projects and their low yields. The similarity of regional industry structure and slow adjustment of State-owned asset reserves impose severe impact on the change of supply structure and improvement of supply quality. They also affect the promotion of enterprises technological innovation, the advancement of market competition and the smooth operation of bank loans.

Third, the main reason why the State's efforts to the consumer market had not achieved the desired result was that the people had no idea what impact the new reform measures would have on social expectations. Because the social security systems have not completed, the expenditure pressure in housing, medical and education for urban households cannot be alleviated. On the other hand, the slowness in the growth of farmer's income restricts the operation of domestic demand market.

Fourth, under the support of government policies, the non-government investment goes up gradually. But because the trend of supply over demand cannot be changed in a short run, together with the limitation of funding channels, which will restrict the increase of non-government investment. The economic growth will still depend on the support of government investment. This will increase the burden of government debts.

In the last few years, the China's economic development benefits from the co-ordination between fiscal policy and monetary policy. Chinese Government would continue its proactive fiscal policy and moderate monetary policy in the near future to maintaining the momentum of growth. As a developing country, China must successfully deal with the special relationship between reform, development and stability.

- 1) Increase the social demand. The general level of consumption and standard of living still remain quite low in China. Therefore the State should encourage enterprises to cultivate consumer demand with new and high-tech products. The State should also draw up policies to support the development of small and medium-sized enterprises and create an environment for fair competition between enterprises of various sizes and ownerships.
- 2) Accelerate the pace of industries adjustment. In order to avoid the repeat construction of projects, the State should make rational industry arrangements throughout the country. The readjustment should include readjusting agricultural planting structure, increasing investment in infrastructure, guiding enterprises to increase input in technological upgrading, supporting medium- and small-sized enterprises and promoting the development of China's western areas.
- 3) Further improve the household revenues. From the second half of 1999, the State took measures to increase the household revenues, but the results are not ideal. Under the circumstances of the rapid growth of government revenues, the State should implement a series of policy measures including wage increases, compensation for laid-off workers, pensions for the retirees and increases in farmers' incomes to readjust income distribution. This can improve the revenue expectations for the lower income households, and also make up the arrears based on the low salary system in China.
- 4) Rapidly establish a comprehensive social security system. Social security reform is critical for enhancing labor mobility, for providing adequate social safety nets, and for shifting the financing of social security increasingly away from government and towards individual

employees and their employers. The emphasis should be focus on unemployment insurance and providing low-income residents a minimum living subsidy. The establishment of social security system can heighten the public's confidence in their future. A framework of the overall reform of the social security might help alleviate most worries about the future and promote consumption.

Since China initiated its opening-up policy in 1978, it brings a large amount of funds which the country needs urgently, and technology, talented people with management experience. In the return of new century, China still needs the world's high technology and management experience in the development of its western region, pushing forward the adjustment of economic structure and reforming the state enterprises. So China's opening-up will be expanded from a restricted scope and areas to an all-round openness. The important decision to speed up negotiation process of China's accession into the WTO is a significant symbol and the embodiment of the determination of the Chinese government to raise the opening-up to a higher level. The next five to ten yeas is an important period for China's economic and social development. Reform of the economic system, adjustment of the economic structure and economic growth mode all facilitate the possibility that China's opening-up sill move to a high level

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