

1 China

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I. Introduction

Geography

Situated in the southeastern part of the Eurasian Continent, bordering East China Sea, Korea Bay, Yellow Sea, and South China Sea, the People's Republic of China has a coastline of 32,000km (mainland shore: 18,000km; island shore: 14,000km), with a total land area of 9.6 million square kilometers, next only to Russia and Canada. It shares land borders with Vietnam (1,281km), Laos (423km), Burma (2,185km), India (3,380km), Bhutan (470km), Nepal (1,236km), Pakistan (523km), Afghanistan (76km), Tajikistan (414km), Kyrgyzstan (858km), Kazakhstan (1,533km), Russia (northeast) (3,605km), Mongolia (4677km) and North Korea (1,416km). Its territory extends over 50 latitudes from north to south, embracing the equatorial belt, the tropics, the subtropics, the moderate temperate zone and the cold temperate zone. And from east to west, it covers over 62 longitudes, and has longitudinal regular divisions of forests, grasslands, deserts, plains, hilly lands and high lands.

China can be divided into 8 regions:

1. At the top of the staircase are the plateaus of Tibet and Qinghai in the southwest. The Tibetan Highlands average 4500m above sea level, referred to as the "Roof of the World". The Himalaya mountain range peaks averaging 6000m high, among which Mount Everest, reaches 8848m, the highest mountain peak in the world.
2. The Xinjiang-inner Mongolian Uplands include the eastern Ordos Desert, the southern part of the Gobi Desert and the Turpan depression – 505 feet below sea level. It is the largest inland basin in the world, the Tarim Basin, where the Taklamakan Desert (the largest in China) as well as China's largest shifting salt lake is situated.
3. Inner Mongolian Border Uplands include the Gobi and eastern lowlands, distinguished by rugged terrain and little agriculture, though the southern area has fertile loess soil deposited by wind.
4. Eastern highlands includes the Shandong Peninsula and the northeast coastal region, the region is hilly and full of coal.
5. Eastern lowlands provide the best farming for the country. The three main plains in this region are the Manchurian Plain with large coal and iron deposits, the North China plain productive in wheat though subject to flooding, and the Yangtze River valley, flat land with good rainfall, including the fertile delta among Nanjing, Shanghai and Hangzhou.
6. Central Uplands, located between the eastern lowlands and the Tibetan plateau, drop to less than 1000m above sea level.
7. The Sichuan Basin, with mild climate and long growing season, makes it good area for agriculture.
8. Southern Uplands cover Southeast China and Hainan. The only level area in this region is the delta of Pearl River where Guangzhou is located.

Most of China's rivers flow east. Rivers flow from west to east into the Pacific Ocean except a few in the southwest China that flow to the south. Melting snow and ice from the mountains of western China and the Qinghai-Tibet Plateau are the main source of the headwater for many the country's largest rivers: the Yangtze (Chang Jiang), Yellow (Huang He), Mekong (Lancang Jiang) and Salween (Nu Jiang) rivers.

There are 22 provinces (exclude Taiwan), 5 autonomous regions (Tibet, Sinkiang, Ningxia, Inner Mongolia and Guangxi), 4 municipalities directly under the Central Government (Beijing,

Shanghai, Tianjin and Chongqing) and 2 special administrative regions (Hongkong and Macao). There are Han Chinese (93% of Chinese) and 55 recognized minorities.

Climate and Resources

China's climate varies from bitter coldness in winter to unbearable heat in summer. The Yangtze River serves as China's official dividing line between north and south. China has a climate dominated by dry and wet monsoons, which make clear temperature differences in winter and summer. In winter, northern winds coming from high latitude areas are cold and dry; in summer, southern winds from sea areas at lower latitude are warm and moist. Besides, climates differ from region to region because of the country's extensive territory and complex topography. In the south of the Nanling Mountains, rains are plenty and the temperature is high all year round. In the Yangtze and Huaihe river valleys in the central part of China, there are full distinctive seasons. In northeast China, summer is short but there is much sunshine, while winter is long and cold. Precipitation is limited in northwest China where it is cold in winter and hot in summer. In southwest China of low latitudes, the land is elevated high, and has characteristically vertical seasonal zones.

China has abundant natural resources such as coal, iron ore, petroleum, natural gas, mercury, tungsten, antimony, manganese, vanadium, molybdenum, aluminum, lead, zinc, uranium, hydropower potential (world's largest).

Brief History and Political Structure

China, representing one of the earliest civilizations in the world, has a recorded history of about 3,600 years. It possesses rich historical documents as well as ancient relics. Like other nations, China, in its development, passed through the stages of primitive society, slave society, and feudal society. During the middle decades of the 19th century, capitalist forces of foreign countries invaded China, and China was slowly transformed into a semi-colonial and semi-feudal society. In the 19th and early 20th centuries, China was beset by civil unrest, major famines, military defeats, and foreign occupation. After World War II, the Communists under Mao Zedong established a socialist system. After 1978, his successor Deng Xiaoping and other leaders focused on market-oriented economic development.

In March 2003, a long-expected transition in China's political leadership took place. Hu Jintao assumed the country's presidency, as well as chairmanship of the ruling Communist Party. Wen Jiabao became the new premier. In March 2005, Hu Jintao replaced former president Jiang Zemin as chairman of the Central Military Commission, completing the leadership transition.

Under the Chinese Constitution, State organs comprise the National People's Congress (NPC), the President, the State Council, the Central Military Commission, the Highest People's Court and the Highest People's Procuratorial Office. The NPC is the highest organ of state power in China. It meets annually for about 2 weeks to review and approve major new policy directions, laws, the budget, and major personnel changes. When the NPC is not in session, its permanent organ, the Standing Committee, exercises state power. The Chinese Government is subordinate to the Chinese Communist Party (CCP), which is established on July 1st 1921 in Shanghai; its role is to implement party policies. There are more 60 million party members and 3.3 million grassroots organizations in China. One of the fundamental political systems is the system of multiparty cooperation and political consultation led by CCP.

Language, Religions and Beliefs

There are seven major dialects and many sub-dialects in China. Dialect spoken in Beijing, known as "Mandarin" or Putonghua, is the predominant dialect, widely used by over 70% of the population. Except these dialects, some minorities such as Mongolian, Tibetan and Uygur also have their own language. However, by the means of the cultural and economic exchange, more and more minorities begin to learn Putonghua.

Among a variety of religions in China, there are now mainly five religions, including Buddhism, Taoism, Islam, Catholicism and other Christian religions. Confucianism, founded by Confucius, a philosophy rather than a religion, surprisingly ruled China for 2,000 years.

Population, People's Welfare and Social Security

As the most populous country in the world, the population of China is 1.3 billion by end-2004. The total live births in 2004 is 15.93 million, with birthrate of 12.29‰; the total death population in 2004 is 8.32 million, with mortality of 6.42‰; the net increase of population in 2004 is 7.61 million, with natural rate of increase of 5.87‰, reducing 0.14 point per 1,000 compared to 2003, due to the excellent performance of Birth Control policy "one couple, one child".

While China as a whole has been experiencing rapid GDP growth, China has been experiencing increased wealth and higher standards of living at a breakneck pace. By the end of 2004, per capita income of rustics in China increased by 6.8% to 2936 RMB, without adjusting for rise in prices, the highest year since 1997; the disposable income per capita of towners increased by 7.7% to 9422 RMB. Engel's coefficient of rustic family is 47.2%, while 37.7% for towners. The rural population in absolute poverty reduced 2.9 million to 26.1 million (by standard of net income per capita less than 668 RMB) compared to previous year-end; the rural population with low income reduced 6.4 million to 49.77 million (by standard of net income per capita within 669 ~ 924 RMB) compared to previous year-end.

By end-2004, the population who took out the basic endowment insurance, unemployment insurance and medical insurance, increased 8.36 million, 2.11 million and 14.84 million to 163.42 million, 105.84 million and 123.86 million respectively, compared to 2003. The population who got pension and unemployment insurance, are 37.7 million and 4.19 million respectively. 22.01 million towners got the minimum insurance of living from government, reducing 460 thousand compared with previous year.

Table 1 Population and Its Composition (10 thousand)

Year	Total Population (year-end)	By Sex				By Residence			
		Male		Female		Urban		Rural	
		Population	Proportion (%)	Population	Proportion (%)	Population	Proportion (%)	Population	Proportion (%)
2001	127,627	65,672	51.46	61,955	48.54	48,064	37.66	79,563	62.34
2002	128,453	66,115	51.47	62,338	48.53	50,212	39.09	78,241	60.91
2003	129,227	66,556	51.50	62,671	48.50	52,376	40.53	76,851	59.47
2004	129,988	66,976	51.50	63,012	48.50	54,283	41.80	75,705	58.20

1. Data in this table exclude the population of Hong Kong SAR, Macao SAR and Taiwan Province.

2. Data in 2001-2004 have been estimated on the basis of the annual national sample surveys on population changes.

3. Total population and population by sex include the military personnel of Chinese People's Liberation Army; the military personnel are classified as urban population in the item of population by residence.

Source: National Bureau of Statistics of China

Education

Since 1949 when the People's Republic of China was founded, Chinese government has always been placing the education on its higher agenda. The 9-year compulsory education is being implemented nationwide by stages in a planned way; primary schooling has been prevailed in areas concentrating 91% of Chinese population; higher education, occupational and polytechnic education, diversified adult education and ethical education have been developed rapidly. In 2004, the total new postgraduate's enrollment is 326 thousand, the postgraduate's enrollment is 820 thousand, and the graduates are 151 thousand. The total new student's enrollment in higher education is 4.47 million, the student's enrollment is 13.34 million, and the graduates are 2.39 million. The total new student's enrollment in secondary vocational education is 5.48 million, the student's enrollment is 13.68 million, and the graduates are 3.51 million.

Transportation and Travel

The value-added of the transportation, post and telecommunications sectors reached 7777.7 billion yuan in 2004, up by 14.9 percent over the previous year.

The travel industry in China has been growing rapidly, with travel in the Asia-pacific region growing 40% in 2004, faster than any other region in the world. In 2004, a total of 109.04 million international visitors came to China for tourist, business of family reunion purposes, an increase of 19.0% year on year. Of this total, 16.93 million were foreigners, up 48.5%; 92.11 million were Chinese compatriots from Hong Kong, Macao and Taiwan, up 14.8%. Foreign exchange earnings from international tourism topped 25.7 billion US dollars, up 47.9%. They year 2004 saw 1.1 billion domestic tourists, up 26.6%. Revenue from domestic tourism totaled 471.1 billion yuan, up 36.9%.

Table 2 Transportation Statistics

Transportation	1989	1997	2002	2003	2004
Passenger Traffic (100 million persons)	79.14	132.61	160.82	158.75	176.65
Railways	11.38	9.33	10.56	9.73	10.73
Highways	64.45	120.46	147.53	146.43	162.89
Waterways	3.18	2.26	1.87	1.71	1.81
Civil Aviation	0.13	0.56	0.86	0.88	1.21
Freight Traffic (100 million tons)	98.84	127.82	148.34	156.14	161.10
Railways	15.15	17.21	20.50	22.12	21.78
Highways	73.38	97.65	111.63	116.00	121.36
Waterways	8.75	11.34	14.18	15.81	17.94
Civil Aviation (10 000 tons)	31	125	202	219	273

Source: National Bureau of Statistics of China

II. Overview of Macroeconomic Activity and Fiscal Position

II.1 Macroeconomic Activity

China is the world's most populous country, with a rapidly growing economy. Economic development has proceeded unevenly, with urban coastal areas, particularly in the southeast, experiencing more rapid economic development than in other areas of the country. China has a mixed economy, with combination of state-owned and private enterprises. A number of state-owned enterprises have undergone partial or full privatization in recent years. The Chinese government has encouraged foreign investment – in some sectors of the economy and subject to constraints – since the 1980s, offering several “special economic zones” in which foreign investors receive preferable tax, tariff and investment treatment.

With China's entry into the World Trade Organization (WTO) in November 2001, the Chinese government made a number of specific commitments to trade and investment liberalization which, if fully implemented, will substantially open the Chinese economy to foreign firms. In the energy sector, this will mean the lifting or sharp reduction of tariffs associated with imports of some classes of capital goods, and the eventual opening to foreign competition of some areas such as retail sales of petroleum products.

Despite moves toward privatization, much of China's economy remains controlled by large State Owned Enterprises (SOE's), many of which are inefficient and unprofitable. Restructuring of the SOE sector, including the privatization of some enterprises, is a major priority of the government, as is restructuring of the banking sector. Many Chinese banks have had to write off large amounts of delinquent debts from state-owned enterprises.

Layoff is part of the restructuring of the SOEs, as many were severely overstaffed. This has created unemployment, and also has been a burden on the government budget, as the government

begins to provide social benefits which were previously the responsibility of the SOEs. The geographic concentration of privately-owned industry in the urban centers along the coast also has created social strains.

China's real gross domestic product (GDP) grew at a rate of 9.5% in 2004, held steady from 2003's growth rate. Real GDP for the first quarter of 2005 was up 9.5% year-on-year. Much of the incentive in the GDP growth rate has come from excessive spending on capital goods and construction, particularly in the state sector. In an effort to cool an economy seen as overheating, the Chinese government took a number of steps in 2004 designed to counter this trend, including tightening bank lending policies. China's banking sector remains a key concern for the country's economic stability, as the ratio of problem loans has been rising.

Inflows of foreign direct investment (FDI) into China in 2004 totaled \$60.6 billion, a new record, but up modestly from the 2003 figure of \$53.5 billion. Japan, South Korea, Taiwan, and the United States are China's most important sources of FDI.

China's merchandise trade surplus rose in 2004 to \$32.6 billion, from \$25.3 billion in 2003. Imports increases by 35.8% in 2004, largely capital goods being acquired to refurbish outdated industrial facilities. Exports increased by 35.4% in 2004.

The per capita disposable income of urban households in 2004 was 9,422 yuan, a real growth of 7.7%, while the per capita net income of rural households was 2,936 yuan, a real increase of 6.8%, both representing the highest growth since 1997. By the end of the year, the savings deposit of urban and rural households totaled 11,955.5 billion yuan, an increase of 1,592.9 billion as compared at the beginning of the year.

China has benefited from a huge expansion in computer Internet use, with 94 million users at the end of 2004.

Table 3 Selected Macroeconomic Indicator

Item	Aggregate Data					2004 as% of the following years		
	1978	1989	1997	2003	2004	1989	1997	2003
Population at year-end (10000 persons)	96,259	112,704	123,626	129,227	129,988	115.3	105.1	100.6
Employment (10000 persons)	40,152	55,329	69,820	74,432	75,200	135.9	107.7	101.0
Urban Registration Unemployment	530	378	577	800	827	218.8	143.4	103.4
Gross National Income (100 million yuan)	3,624.1	16,917.8	73,142.7	116,741.2	136,584.3	380.2	177.1	109.9
Gross Domestic Product (100 million yuan)	3,624.1	16,909.2	74,462.6	117,390.2	136,875.9	380.1	174.1	109.5
Gross Domestic Expenditures (100 million yuan)	3,605.6	16,466.0	74,894.2	121,730.3	142,394.2			
Investment in Fixed Assets (100 million yuan)		4,410.4	24,941.1	55,566.6	70,477.4	1,598.0	282.6	126.6
Government Revenue (100 million yuan)	1,132.3	2,664.9	8,651.1	21,715.3	26,396.5	990.5	305.1	121.6
Government Expenditures (100 million yuan)	1,122.1	2,823.8	9,233.6	24,650.0	28,486.9	1,008.8	308.5	115.6
Consumer Price Index (preceding year=100)		118.0	102.8	101.2	103.9			
Retail Price Index (preceding year=100)	100.7	117.8	100.8	99.9	102.8			
Total Energy Production (10000 tons of SCE)	62,770	101,639	132,410	159,912	184,600	181.6	139.4	115.4
Total Energy Consumption (10000 tons of SCE)	57,144	96,934	137,798	170,943	197,000	203.2	143.0	115.2
Total Retail Sales of Consumer Goods (100 million yuan)	1,559	8,101	27,299	45,842	53,950	665.9	197.6	113.3
Total Value of Exports and Imports (USD 100 million)	206.4	1,116.8	3,251.6	8,509.9	11,545.5	1,033.8	355.1	135.7
Exports	97.5	525.4	1,827.9	4,382.3	5,933.2	1,129.3	324.6	135.4
Imports	108.9	591.4	1,423.7	4,127.6	5,612.3	949.0	394.2	136.0
Foreign Direct Investments (USD 100 million)		33.9	452.6	535.0	606.3	1,787.4	134.0	113.3
Deposits of National Banking System (100 million yuan)	1,135	10,786	82,390	208,056	241,424	2,238.3	293.0	116.0
Loans of National Banking System (100 million yuan)	1,850	14,360	74,914	158,996	178,198	1,240.9	237.9	112.1

Source: National Bureau of Statistics of China

A. International Environment

Trade Balance

In 2004, with total trade volume surpassed 1.15 trillion US dollars, China has become the third largest trading nation, only after the United States and Japan. Since the early 1980s China has adopted export-oriented strategy of development. The aim is to gradually integrate the Chinese economy with the global economy on the basis of comparative advantages. As a result, China's trade/GDP ratio has rose from a negligible small figure in the early 1980s to more than 70% in 2004. China's openness has already surpassed almost all the major trading nations and become one of the most open economies in the world. Total value of import and export in 2004 reached 1,154.7 billion US dollars, up 35.7% over the previous year. The value of export was 593.4 billion US dollars, up 35.4%, and the value of import was 561.4 billion US dollars, up 36.0%. As a result, China had a trade surplus of 32 billion US dollars, or 6.5 billion US dollars as compared with that in previous year. The main factors contributing to such growth are due to below:

- Rising external demand resulting from better world economic performance.
- The export rebate system has helped optimize the export product mix and thus stimulated the growth of exports.
- The stable Reminbi (RMB) exchange rate has had a favorable impact on export trade.
- The impact of the big rises in raw materials prices on the international market.

The value of merchandise exports by China expanded by 35.4% in 2004, compared with a year earlier, a marginal increase from the already high 34.6% for 2003. Machinery and electronic products were the major export items, accounting for around 54% of total export. Despite the uncertain external environment and rising international oil prices, China continues to attract a large volume of FDI to expand its productive capacity in the export sector. Exports by foreign-funded companies accounted for around 57% of total exports in 2003-2004. The exports of privately owned enterprises showed strong momentum whereas the share of SOEs in total exports declined in 2004.

China's merchandise imports soared by 36% in 2004 compared with a year earlier, down moderately from the 39.7% growth in 2003. Imports surged earlier in 2004 in response to a further reduction in tariff implemented under WTO entry terms, but growth moderated subsequently. Crude oil imports accounted for about 6% of total imports, up from 5% in 2003 and 4% in 2002 but appeared to be leveling off. The deceleration in import growth since mid-2004 combined with robust export growth generated a trade surplus of \$32 billion in 2004, down from 3.2% in 2003. The EU maintained its position as China's largest trading partner, while the United States overtook Japan to become the second largest.

Table 4 Import and Export by Major Categories (Value Unit: 100 million USD)

Item	2001	2002	2003	2004	% Increase over 2003
Total Import and Export	5098	6208	8512	11548	35.7
Export	2662	3256	4384	5934	35.4
of which: General Trade	1119	1362	1820	2436	33.9
Processing Trade	1475	1799	2419	3280	35.7
Mechanical and electronic products	1188	1571	2275	3234	42.3
High and New-tech Products	465	679	1103	1655	50.2
Import	2436	2952	4128	5614	36.0
of which: General Trade	1135	1291	1877	2482	32.3
Processing Trade	940	1222	1629	2217	36.1
Mechanical and electronic products	1205	1556	2250	3019	34.2
High and New-tech Products	641	828	1193	1614	35.3
Trade Balance	225.4	303.5	255.4	319.8	25.6

Source: Customs Office of the People's Republic of China

Department of Planning and Finance, Ministry of Commerce of the People's Republic of China

Table 5 Import and Export by Major Countries and Regions 2003, 2004

(Unit: 100 million USD)

Countries and Regions	Export		Increase over 2003 (%)	Import		Increase over 2003 (%)
	2003	2004		2003	2004	
Hong Kong SAR	763	1009	32.3	111	118	6.1
Japan	594	735	23.7	742	944	27.3
Republic of Korea	201	278	38.4	431	622	44.3
ASEAN	309	429	38.7	473	630	33.1
European Union	722	1072	36.9	531	701	28.8
Russia	60	91	51	97	121	24.7
United States	925	1249	35.1	339	447	31.9

Source: National Bureau of Statistics of China

Current Account

China's surplus in its broadest measure of trade and foreign investment income jumped 50% in 2004 to US\$68.7 billion, compared with US\$45.9 billion in 2003, mainly due to the overall trade surplus. During 2001-2004, Chinese exports grew at a remarkable rate of about 30% on average each year (imports grew at a similar rate, but the level of imports has remained lower than that of exports). While this rapid export growth since 2001 can be attributed partly to China's low labor costs and accession of the World Trade Organization, there has been a contentious debate about the significance of the role of its currency regime in generating this trade expansion.

Current account surpluses and net inflows of FDI have been consistently quite large over the last decade. Until 2000, these factors were offset by the non-FDI financial account balance plus errors and omissions, the latter being the residual balancing category in the balance of payments that typically captures unrecorded flows in both the current and capital accounts. Since 2001, the sum of errors and omissions and the non-FDI capital account balance has swung around markedly, turning sharply positive in 2003-2004. Indeed, this category has been the dominant contributor to the surge in the pace of reserve accumulation since 2001. A likely reason for the turnaround is that it represents large inflows of speculative capital in anticipation of a possible appreciation of the RMB.

Table 6 Balance of Payment (unit: 1000 US dollar)

Item	2000	2001	2002	2003	2004
Current Account	20,519,248	17,405,275	35,421,968	45,874,812	68,659,162
A. Goods and Services	28,873,485	28,086,220	37,382,671	36,078,977	49,283,643
a. Goods	34,473,606	34,017,234	44,166,574	44,651,626	58,982,275
b. Services	-5,600,122	-5,931,014	-6,783,903	-8,572,648	-9,698,632
1. Transportation	-6,725,148	-6,689,078	-7,891,696	-10,326,425	-12,476,266
2. Travel	3,117,313	3,883,174	4,986,584	2,218,728	6,589,704
3. Telecommunication	1,103,482	-54,858	79,688	211,026	-31,735
4. Construction Service	-392,131	-16,815	282,587	106,416	128,662
5. Insurance Service	-2,363,620	-2,483,687	-3,036,793	-4,251,432	-5,742,792
6. Monetary Service	-19,637	21,662	-38,832	-80,565	-44,151
7. Computer and Information	90,934	116,752	-494,687	66,363	384,401
B. Income	-14,665,541	-19,173,258	-14,945,148	-7,838,360	-3,522,669
1. Compensation of Employees	-477,490	-554,145	-276,575	162,362	632,191
2. Investment Income	-14,188,051	-18,619,114	-14,668,573	-8,000,722	-4,154,861
C. Current Transfer	6,311,305	8,492,313	12,984,445	17,634,195	22,898,189
Capital and Monetary Items	1,922,224	34,775,427	32,290,837	52,725,942	110,659,756
A. Capital Items	-35,283	-53,540	-49,631	-48,083	-69,345
B. Monetary Items	1,957,507	34,828,966	32,340,469	52,774,024	110,729,101
1. Direct Investment	37,482,887	37,355,893	46,789,569	47,228,993	53,131,430
Domestic Direct Investment	-915,777	-6,885,398	-2,518,407	152,274	-1,805,053
Foreign Direct Investment	38,398,664	44,241,291	49,307,977	47,076,719	54,936,483

2. Security Investment	-3,990,732	-19,405,929	-10,342,485	11,426,757	19,689,873
Assets	-11,307,470	-20,654,278	-12,094,510	2,983,121	6,486,438
Debts	7,316,738	1,248,349	1,752,025	8,443,636	13,203,436
3. Other Investment	-31,534,648	16,879,003	-4,106,616	-5,881,725	37,907,798
Reserves Assets	-10,548,400	-47,325,130	-75,507,060	117,023,100	-206,364,000
Errors & Omissions	-11,893,073	-4,855,572	7,794,255	18,422,347	27,045,082

Source: the People's Bank of China

China is becoming increasingly important in the Asian region in terms of both trade and financial flows. It now accounts for 40% of all foreign direct investment (FDI) inflows into emerging market economies in Asia (including FDI flowing between Asian economies). This pattern of intraregional capital flows are tied in to developments on the trade front, where China has become a major processing hub for goods manufactured in other Asian economies and destined for industrial country markets. Indeed, over the period 2000-2004, the increase in China's combined bilateral surpluses with the United States and the European Union was offset to a significant extent by the increase in its trade deficit with other Asian economies.

Exchange Rate and Exchange System

The objective of monetary policy is to maintain the stability of the Renminbi and thereby promote economic growth. By the end of 2004, China's foreign exchange reserves reached 609.9 billion US dollars, an increase of 206.7 billion US dollars as compared with that at the end of the previous year, owing to substantial capital inflows and the continued current account surplus. The exchange rate of RMB remained stable, the year-end exchange rate was 8.2765 RMB to 1 USD, which was 2 basic points higher over that at the end of the previous year.

Breaking with previous policy, China revalued the Yuan by 2.1% against the dollar on July 21st 2005 and replaced the peg with a link to a basket of currencies, allowing the currency to move by as much as 0.3% against the US dollar either side of a daily fixing rate set by the central bank.

Table 7 Exchange Rate and Gold & Foreign Reserves

Item	2000	2001	2002	2003	2004
Yuan per SDR (end of year)	10.7856	10.3923	11.2123	12.2989	12.8535
Yuan per US dollar (end of year)	8.2781	8.2766	8.2773	8.2767	8.2765
Yuan per US dollar (Period Average)	8.2772	8.2770	8.2772	8.2770	8.2765
Gold (10,000 Fine Troy Ounce)	1267	1608	1929	1929	1929
Foreign Exchange Reserves (100 million USD)	1655.74	2121.65	2864.07	4032.51	6099.32

Source: the People's Bank of China

Foreign Direct Investment

China's attraction of foreign direct investment has been still kept at a higher level, ranking the first place in the use of foreign investment among developing countries and regions in the world for 12 consecutive years. The year 2004 witnessed the approval of establishment of 43,664 foreign direct invested enterprises in China, up by 6.3% over the previous year (2003: 41,081); the contracted foreign capital through foreign direct investment stood at 153.5 billion US dollars, up 33.4% (2003: 1,150.7), and the foreign capitals actually utilized were 606.3 billion US dollars, up 13.3% (2003: 535.05).

Table 8 Amount of Foreign Investment by Type (USD 100 million)

Item	2003			2004		
	Number of Projects	Contracted Value	Actually Utilized Value	Number of Projects	Contracted Value	Actually Utilized Value
Total	41081	1169.01	561.40	43664	1565.88	640.72
Foreign Direct Investments	41081	1150.70	535.05	43664	1534.79	606.30
Joint Ventures Enterprises	12521	255.06	153.92	11570	276.41	163.86
Cooperative Operation Enterprises	1547	74.79	38.36	1343	77.88	31.12
Foreign Investment Enterprises	26943	816.09	333.84	30708	1172.75	402.22
Foreign Investment Share Enterprises	37	3.89	3.28	43	7.74	7.77
Cooperative Development	8	0.86	0.32	---	---	1.09
Others	25	---	5.31	---	---	0.24
Other Foreign Investment	---	18.32	26.35	---	31.09	34.43
Sale Share	---	0.42	2.75	---	4.48	6.95
International Lease	---	1.29	1.29	---	0.36	0.38
Compensation Trade	---	---	0.07	---	---	0.05
Processing and Assembly	---	16.61	22.25	---	26.25	27.05

Source: National Bureau of Statistics of China

The companies cover almost all trades, including manufacturing, agriculture, infrastructure, and service industries. Among the top 500 transnational companies in the world, nearly 450 have invested in China, and some of them have also set up regional headquarters in the country. In the first eight months of this year, the state approved 28,393 foreign-funded enterprises with a combined actual foreign investment reaching 27.993 billion USD. In 2004, the accomplished business revenue through contracted overseas engineering projects was 17.5 billion US dollars, up by 26.0%, and the business revenue through overseas labor contracts was 3.8 billion US dollars, up by 13.4%.

A two-way opening situation of “going out and bringing in” is forming in the country. By the end of 2004, China had an accumulated overseas direct investment of 44.9 billion USD in more than 160 countries and regions. The continuous expansion of China’s foreign direct investment scale and region has drawn wide attention internationally.

Table 9 Foreign Direct Investment by Sector 2004 (USD 100 million)

Sectors	Contracted Projects	Contracted Value	Actually Utilized Value
Total	43664	1534.8	606.3
Farming, Forestry, Animal, Husbandry and Fishery	1130	32.7	11.1
Mining and Quarrying	279	11.6	5.4
Manufacturing	30386	1097.4	430.2
Production and Supply of Electricity, Gas and Water	455	39.6	11.4
Construction	411	17.7	7.7
Transport, Storage, Post and Telecommunication Services	638	23.7	12.7
Information Transmission, Computer Services and Software	1622	20.2	9.2
Wholesales & Retail Trade	1700	25	7.4
Hotel & Catering Services	1174	21.7	8.4
Financial Intermediation	43	5.8	2.5
Real Estate Development	1767	134.9	59.5
Leasing and Business Services	2661	67.4	28.2
Scientific Research, Technical Services and Geological Prospecting	629	10.1	2.9
Water Conservancy, Environment Protection and Public Facilities Management	164	8.2	2.3
Services to Households and Other Services	251	5.4	1.6
Education	59	1.7	0.4
Health, Social Securities and Social Welfare	21	1.5	0.9
Culture, Sports and Recreation	272	10.1	4.5
Public Management and Social Organization	2	0.1	0

Source: National Bureau of Statistics of China

Borrowing and Aid from Abroad

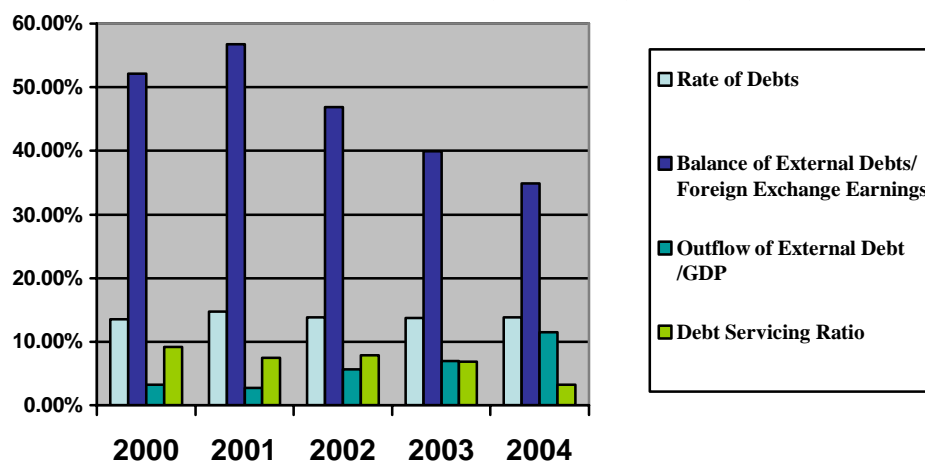
Table 10 Balance of Debt (Unit: USD 100million)

Type of Debts	2000	2001	2002	2003	2004
Loans from Foreign Government	246.05	237.04	244.23	254.20	322.08
Loans from International Financial Institutions	263.49	275.66	277.02	264.67	251.01
Loans from Foreign Banks and other Financial Institutions	202.22	334.88	289.10	424.03	437.55
Buyer's Credit	132.34	130.51	124.02	112.53	118.90
Borrowing from Foreign Exporters, Foreign enterprises or Individuals	227.54	235.40	235.57	274.89	325.90
Debts Issuance	122.94	126.69	107.94	111.67	133.32
Delayed Payment	15.59	27.49	31.99	12.39	96.34
Ultramarine Private Deposits	0.10	15.34	14.03	24.73	42.38
International Financial Lease	118.86	100.96	92.07	77.14	72.64
Trade Credit		216.10	263.23	365.74	465.04
Total	1457.27	1701.13	1713.60	1936.34	2285.96
By Repayment Terms					
Balance of Long Term Debts	1326.50	1195.30	1155.60	1165.90	1242.90
Balance of Short Term Debts	130.80	505.80	558.00	770.44	1043.10

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

The yuan RMB's peg against the United States dollar has been under discussion for some time in view of China's sustained current account surplus with that country. Some FDI inflows and external borrowing seem to have been partly motivated by heightened speculative interest in addition to the attraction of the strong economic performance of the Chinese economy. Gross inflows of FDI reached a record level of \$60.6 billion in 2004, up 14% from 2003. China's total external debt at the end of 2004 reached \$229 billion, including \$104 billion in short-term liabilities, an increase of 18% compared to 2003. Debt-service payments due in 2004 were \$22 billion, less than 4% of total exports of goods and services, indicating a broadly stable external debt situation.

Figure 1 Flow of External debts, GDP and Foreign Exchange Earnings



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

B. Domestic Environment

Economic Growth Rate

China is right on a track of fast economic growth. China's truly remarkable pace of growth for a period of over two decades has been punctuated with concern about bouts of deflation or overheating. As a result, macroeconomic management in China appears to have more to do with dealing with these cycles around a relatively high trend rate of growth, rather than with realizing and/or sustaining that trend itself.

Beginning from 2003, the nation put an end to its deflation prevention efforts that last five years from 1998 to 2002, and entered a new cycle of growth. This round of macro-control policy works along two lines, checking excessive investment in some sectors on the one hand and encouraging grain production on the other hand. So it's by no means a simply tight policy, let alone all-round austerity. The fundamental aim of macro-control is to smooth out economic fluctuations and to preventing big rises and falls. Its effects had been proved by the national economy growth rate of the four quarters in 2004, which stood at 9.8%, 9.6%, 9.1% and 9.5% respectively, showing a balanced development throughout the year without major fluctuations.

The GDP growth of the fourth quarter of 2004 was 9.5%, 0.4 percentage points higher than the 9.1% of the third quarter. Although during the fourth quarter the growth speeds of both above-scale industries (i.e. all state-owned or controlled industrial companies as well as non state-owned industrial companies with an annual product sales of 5 million yuan or above) and total investment in fixed assets slowed down, agricultural production increased, specially autumn grain (up 10.35%). While seeing a higher added value of the primary industry, the fourth quarter also witnessed fairly fast growth in the tertiary industry (1 percentage point higher in growth speed). Faster developing speeds in the two industries were just an outcome of macro-control measures.

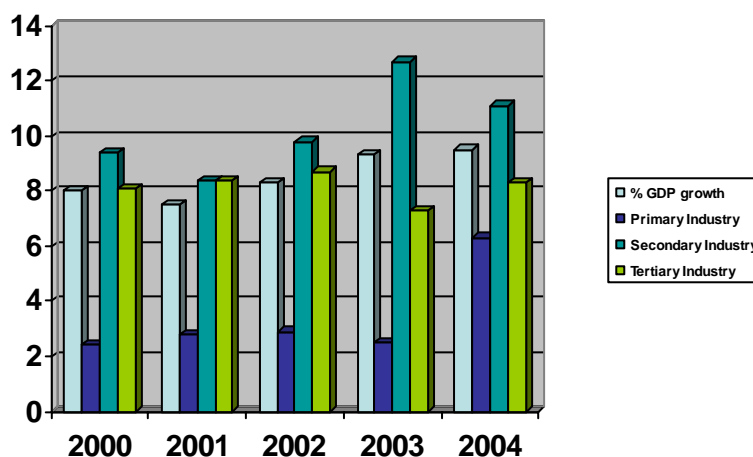
What's more, the Chinese economy enjoys strong internal strength with vigorous investment demands, and consumption also grows exuberant along with a higher living standard and income of the people. Especially, the huge potential of rural market has been continuously tapped as agricultural economy was accelerated and farmers' income kept rising. China's export also benefited from a better international environment as the world economy recovered last year.

In a word, the investment-consumption-export troika remains a strong driving force of the national economy, which inevitably results in a high growth rate. The final result of 9.5% GDP growth reflected both the fruit of macro-control and the level of China's economic development.

It was indicated that the gross domestic product (GDP) of China in 2004 was 13,651.5 billion yuan, up by 9.5% over the previous year without showing big ups and downs. Of this total, the value added of the primary industry was 2,074.4 billion yuan, up by 6.3%; the value-added of the secondary industry was 7,238.7 billion yuan, up by 11.1%; and the value-added of the tertiary industry was 4,338.4 billion yuan, up by 8.3%.

In 2004, the total value-added of the industrial sector was 6,281.5 billion yuan, up by 11.5% over the previous year. The value-added of industrial enterprises above designated size, the value-added of state-owned and state-controlled enterprises rose by 14.2%. The growth of heavy industry was 18.2% while that of the light industry was 14.7%. Analyzed by product, the production of coal and power generation was up by 15.0% and 14.9% respectively, the production of pig iron, crude steel and rolled steel was up 24.1%, 23.2% and 23.5% respectively, and the production of micro computers, mobile phones and air-conditioners rose between 29.1% to 42.6%. China produced 5.2 million motor vehicles in 2004, up by 14.0%. The sales ratio of industrial enterprise above designated size was 98.1%. Industrial enterprises in total made a profit of 1,134.2 billion yuan after compensating for losses by some enterprises, up by 38.1%.

Figure 2 Percent GDP Growth by industries



Source: National Bureau of Statistics of China

Table 11 Value-added of Industrial Enterprises above Designated Size, 2004

Item	Value-added	(100 million yuan)
		Increase over 2003(%)
Value-added of industrial enterprises above designated size	54,804	16.7
of which: State-owned and state -controlled enterprises	23,213	14.2
of which: Collective enterprises	2,877	9.9
Share-holding enterprises	24,054	16.5
Enterprises invested by foreigners or investors from Hong Kong, Macao and Taiwan	15,241	18.8
of which: Private Enterprises	8,290	22.8
of which: Light industry	17,762	14.7
Heavy industry	37,043	18.2

Source: Statistical Communiqué of the People's Republic of china on the 2004 National Economic and Social Development

Inflation Rate

This structure of growth is of relevance because, despite the overall high trend rate of growth, discussions on the need to manage bouts of deflation or “overheating” recur periodically in Chinese economic discussions. Thus, the Chinese economy is seen to have experienced a long period of deflation from 1997 to 2001, and recovered from that only in the second half of 2002.

The consumer prices in 2004 were up by 3.9% over the previous year, or 2.7 percentage points higher than in 2003, which were mostly caused by the lagging effect of price increase in 2003. Of this total, the consumer price level in urban areas was up by 3.3%, and it was up by 4.8% in rural areas. Analyzed by category of commodities, the prices for food increased by 9.9%, of which prices for grain were up by 26.4%, meat, poultry and related products by 17.6%, and eggs by 20.2%. The retail prices of commodities were up by 2.8%, while the purchasing prices for raw materials, fuels and power were up by 11.4%, and the producers’ prices for manufactured goods increased by 6.1%. The prices for investment in fixed assets were up 5.6, and prices of housing rose by 9.7%.

Table 12 Change in Consumer Prices (preceding year=100)

Item	2001	Urban	Rural	2002	Urban	Rural
General Level of consumer prices	0.7	0.7	0.8	-0.8	-1.0	-0.4
Food	0.0	0.1	-0.2	-0.6	-0.5	-0.7
of which: grain	-0.7	-0.8	-0.3	-1.7	-1.7	-1.6
Tobaccos and alcohols	-0.3	-0.3	-0.4	-0.1	-0.1	0.0
Clothing	-1.9	-2.2	-1.1	-2.4	-2.7	-1.6
Household appliances and services	-2.3	-2.5	-1.6	-2.5	-2.7	-2.2
Medical, health & personal articles	0.0	-0.7	1.1	-1.2	-2.0	0.1
Transportation and telecommunication	-1.0	-0.9	-1.3	-1.9	-2.0	-1.8
Recreation, education, culture articles and services	6.6	6.7	6.4	0.6	0.2	1.2
Residence	1.2	1.7	0.3	-0.1	-0.2	0.1
Item	2003	Urban	Rural	2004	Urban	Rural
General Level of consumer prices	1.2	0.9	1.6	3.9	3.3	4.8
Food	3.4	3.4	3.4	9.9	9.1	11.5
of which: grain	2.3	2.3	2.2	26.4	25.7	27.7
Tobaccos and alcohols	-0.2	-0.2	-0.1	1.2	1.2	1.3
Clothing	-2.2	-2.6	-1.4	-1.5	-1.5	-1.6
Household appliances and services	-2.6	-3.0	-1.7	-1.4	-1.9	-0.3
Medical, health & personal articles	0.9	-0.2	2.5	-0.3	-0.8	0.5
Transportation and telecommunication	-2.2	-2.6	-1.4	-1.5	-2.1	-0.2
Recreation, education, culture articles and services	1.3	0.5	2.8	1.3	0.8	2.1
Residence	2.1	2.8	1.0	4.9	4.3	5.8

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

Consumption

With a booming economy and 1.3 billion people, China is now the world's largest consumer of grain, meat, coal and steel.

In 2004, the total retail sales of consumer goods reached 5,395.0 billion yuan, up by 13.3% over the previous year, or a real growth of 10.2% if price factor were deducted. This is one percentage point higher than the growth rate of 2003. Of this total, the retail sales of consumer goods in urban areas were up by 14.7%, and the retail sales of consumer goods at and below county level were up by 10.7%. In terms of different sectors, the sales of the wholesale and retail industry reached 4,484.0 billion yuan, rose by 12.5%; the sales of the catering industry was 748.6 billion yuan, up 21.6%; and sales of other industries was 162.4 billion yuan, up 1.5%.

Of total retail sales by wholesale and retail enterprises above designated size, the sales of cultural and office goods was up 22.7%; that of the electric and electronic appliances for household use and audio-video equipment was up by 13.7%; that of the building and decoration materials went up by 27.1%; that of furniture was up 21.8%; that of food, beverages tobacco and liquor grew by 17.9%; that of clothing shoes, hats, knitwear and textiles was up by 18.7%; that of motor vehicles was up by 23.4% and that of petroleum and related products was up by 45.9%.

Investment

The investment in fixed assets of the country in 2004 was 7,007.3 billion yuan, up by 25.8% over the previous year, a decline of 1.9 percentage points as compared with the growth of previous year. This trend of decline was stable over the year, represented by a 43% growth in the first quarter, a 28.6% growth for the first 6 months and a growth of 27.7% during the first 9 months. Of this total, the investment in urban areas was 5,862.0 billion yuan, up by 27.6%, and that in rural areas rose by 17.4%.

The structure of investment improved. Investment in the primary industry rose by 20.3% in 2004 as compared with a decline of 19.6% in 2003, while the investment in the secondary and tertiary industries grew by 38.3% and 21.6% respectively, a drop of 8 percentage points and 0.5 percentage points. In particular, the investment growth in some fast-growing industries slowed

down significantly. Growth of investment dropped by 38.5 percentage points in non-metal mineral products producing industry, 65.5 percentage points in ferrous metal dressing, smelting and pressing industry, and 43.5 percentage points in non-ferrous metal dressing, smelting and pressing industry. On the other hand, investment in agriculture and energy industry was strengthened. Analyzed by region, the investment in eastern areas was up by 26.1%; that in central areas and western areas was up by 32.9% and 29.3% respectively.

Table13 Investment in Fixed Assets (Unit: 100million yuan)

Item	Actually finished		Over same period last year	
	2004	2003	Value	Percentage
Total investment	70072.71	55701.68	14371.03	25.8
Of which: State-owned & State Share-holding Companies	33713.19	29443.83	4269.36	14.5
Residential Buildings	10920.79	8715.71	2205.08	25.3
1.By Industry				
Primary industry	643.32	534.76	108.56	20.3
Secondary industry	22989.3	16622.78	6366.52	38.3
Tertiary	34987.66	28772.75	6214.91	21.6
2.By Administrative relationship				
Central projects	6453.91	6259.85	194.06	3.1
Local projects	52166.37	39670.24	12496.13	31.5
3.By Type of construction--of which				
New construction	25425.35	18626.63	6798.72	36.5
Expansion	11943.5	10251.93	1691.57	16.5
Replacement	5743.2	4934.02	809.18	16.4
4.Grouped by source of funds				
State budgetary appropriation	2664.85	2360.36	304.49	12.9
Domestic loans	12779.85	11230.1	1549.75	13.8
Foreign investment	2693.52	2211.43	482.09	21.8
Fundraising	32172.33	23621.39	8550.94	36.2

Source: National Bureau of Statistics of China

Stock Market

Capital markets are centered on the Shanghai and Shenzhen stock exchanges. By the end of 2004, the number companies listed on the Chinese stock exchanges totaled 1377, with a total market capitalization of 3705.6 billion yuan which was 27.14% of GDP. Since 2003, foreign investors have been admitted into the securities market under the QFII (Qualified Foreign Institutional Investors) scheme. To date, there are 12 such institutions with aggregate investment limits reaching US\$2 billion.

Three types of shares are sold on the Shanghai and Shenzhen stock exchanges. "A shares" are held by residents of China (and a select number of designated qualified foreign institutional investors). "B shares" are open to foreign investors. They are denominated in RMB but payable in foreign currency. "C shares" are wholly owned by SOEs and are not publicly traded.

The Chinese government has undertaken measures to improve the liquidity and transparency of its domestic capital markets. The State Council has set forth a list of reforms necessary for achieving these goals. These include strengthening institutional investors, increasing new sources of funds into the market. The PRC has also recruited foreigners to help upgrade its securities market.

In February, 2004, the PRC State Council issued a capital markets stability and development declaration laying out the guiding principles and tasks to promote capital market development. The strategy calls for the development of a multi-layered capital market and the development of an enabling legal and regulatory framework for equity offerings, listed companies and market intermediaries.

Oversight of the sector is provided by the China Securities Regulatory Commission (CSRC). In addition to supervision of capital market participants, the CSRC also has supervisory oversight of other key industry organizations while sharing a degree of market supervision responsibility with

the Shanghai and Shenzhen stock exchanges, China Securities Depository and Clearing Co Ltd and the Securities Association of China.

Table 14 Trading Summary for Stocks

Item	2000	2001	2002	2003	2004
No. of Members	631	547	437	382	350
No. of listed companies	1088	1160	1224	1287	1377
No. of listed Stocks	1174	1240	1310	1372	1463
A Shares	1010	1130	1199	1261	1353
B Shares	114	110	111	111	110
Total Issued Capital (100 million share)	3613.39	4838.35	5462.99	5997.93	6714.74
A Shares	3439.6	4650.45	5283.64	5808.31	6508.83
B Shares	173.79	187.9	179.34	189.62	208.91
Negotiable Shares (100 million share)	1233.32	1480.88	1679.94	1897.32	2194.15
A Shares	1078.33	1315.21	1508.43	1717.93	1996.65
B Shares	154.99	165.67	171.51	179.39	197.50
Total Market Capitalization (100 million yuan)	48091	43522	38329	42458	37056
A Shares	47456	42246	37527	41520	36309
B Shares	635	1277	803	937	746
Negotiable Market Capitalization (100million yuan)	16088	14463	12485	13179	11689
A Shares	15524	13345	11719	12306	10998
B Shares	563	1118	766	873	690
Total Turnover (100 million yuan)	60827	38305	27990	32115	42334
A Shares	60279	33242	27142	31270	41576
B Shares	548	5063	848	845	758
Trading Volume (100 million share)	4758.36	3152.28	3016.19	4163.08	5827.73
A Shares	4558	2463.41	2859.49	3992.28	5672.91
B Shares	200.36	688.88	156.7	170.8	154.83
Shenzhen Composite Index					
High	654.37	664.85	512.38	449.42	470.55
Low	414.69	439.36	371.79	350.74	315.17
Close	635.73	475.94	388.76	378.63	315.81
Shanghai Composite Index					
High	2125.72	2245.44	1748.89	1649.6	1783.01
Low	1361.21	1514.86	1339.2	1307.4	1259.43
Close	2073.48	1645.97	1357.65	1497.04	1266.50

Source: 2004 China Statistical Yearbook, National Bureau of Statistics of China

Money Supply

In 2004, the People's Bank of China (PBC) used various monetary policy instruments, including strengthened open market operations and differentiated required reserve ratios for financial institutions, to appropriately control the growth of base money and the faster-than-desired expansion of money and credit. But there is a time lag between the supply of money and the changes in economic activities. The higher-than-desired level of money supply in 2003 had its special background. The new leadership of the central government was formed in March 2003, followed by the outbreak of the war on Iraq and the SARS epidemic. These uncertainties prevented China from adopting a tight monetary policy stance. After initial progress was achieved in fight against SARS, China began to take measures to control money and credit growth. Nevertheless, given that all sectors of the economy wanted to make up for the slack from the SARS epidemic through expanded economic activities, those control measures were only moderate in nature. Against such a background, money supply in 2003 was unduly high, with the effects lingering into 2004. Money supply was tightened somewhat in 2004. The average growth rates of broad money (M_2) and narrow money (M_1) during 2003 and 2004 were 17% and 16.3% respectively, slightly higher than the average growth rate for the previous five years which is 15%.

Table 15 Money Supply (Unit: 100 Million Yuan)

Items	2000	2001	2002	2003	2004
Money & Quasi-money (M ₂)	132,487.52	143,787.30	183,246.94	219,226.81	253,207.70
Money (M ₁)	54,147.15	55,808.92	70,882.19	84,118.81	95,970.82
Currency in Circulation (M ₀)	14,652.65	14,370.13	17,278.43	19,746.23	21,468.30

Source: the People's Bank of China

Table 16 Savings Deposit and Loans in All financial Institutions (100million yuan)

Item	end-2000	end-2001	end-2002	end-2003	end-2004
Savings Deposit	123,804	143,617	170,917	208,055	253,188
Of which: by enterprises	44,094	51,547	60,029	72,487	89,438
by urban and rural residents	64,332	73,762	86,911	103,618	126,196
Loans	99,371	112,315	131,293	158,996	188,566
Of which: Short-term	65,748	67,327	74,248	83,661	90,808
Medium and long-term	27,931	39,328	48,642	63,401	81,010

Source: the People's Bank of China

Agriculture

The country saw an important turn for the better in grain production in 2004. The total output of grain in 2004 was 469.5 million tons, an increase of 38.8 million tons or 9.0% over the previous year, reversing the consecutive declining trend since 1999. The average yield of grain crops was 308 kilograms per mu (or 4,620 kilograms per hectare), up 6.6%. The total grain production and the average yield of grain crops both broke the historical record. The total cotton production was 6.32 million tons, an increase of 30.1%; the production of oil bearing crops was 30.57 million tons, up by 8.8%; the production of sugar crops was 95.28 million tons, a decrease of 1.2%; the production of meat totaled 72.60 million tons, up 4.7%; and the output of aquatic products was 48.55 million tons, up 3.2%. Steady progress was seen in vegetable and fruit production due to expanded use of high quality varieties.

This favorable turn in agriculture can be attributed to "correct policy, hard work, good climate and high grain price". In the fourth quarter the central authority adopted a series of measures to encourage grain production and bring full play to farmers' enthusiasm. In 2004, the sown areas of grain was 101.61 million hectares, an increase of 2.2 million hectares as compared with that in the previous year, which contributed 25% to the nation's grain production rise, and contribution of higher unit yield was 75%. Taking higher grain price into account, farmers got more real benefits from grain growing, with the per capita net income rose 6.8% in real term, setting a record since 1997. And the sown areas of cotton were 5.69 million hectares, an increase of 580,000 hectares. The sown areas of oil-bearing crops was 14.52 million hectares, a decline of 470,000 hectares, the sown areas of sugar crop was 1.57 million hectares, a decrease of 90,000 hectares; and that for vegetables stood at 17.67 million hectares, a decline of 290,000 hectares.

Table 17 Output of Major Farm Products (Unit: 10,000 tons)

Item	2000	2001	2002	2003	2004	Increase over 2003(%)
Grain	40,522	39,648	39,799	37,429	46,947	9.0
Oil-bearing crops	2,955	2,865	2,897	2,811	3,057	8.8
Peanuts	1,444	1,442	1,482	1,342	1,431	6.6
Rapeseed	1,138	1,133	1,055	1,142	1,304	14.2
Cotton	442	532	492	486	632	30.1
Sugar corps	7,635	8,655	10,293	9,642	9,528	-1.2
Sugarcane	6,828	7,566	9,011	9,024	8,948	-8.0
Beetroot	807	1,089	1,282	618	580	-6.1
Cured tobacco	224	205	214	202	214	6.2
Tea	68	70	75	77	84	8.7
Fruits	6,225	6,658	6,952	14,517	15,243	5.0

Source: Ministry of Agriculture of the People's Republic of China

Employment

Statistics from the Ministry of Labor and Social Security indicated that 9.8 million new jobs were provided to urban residents in 2004, 800,000 more than the expected target. Urban registered unemployment rate was 4.2%, down 0.1 percentage points from 2003 but lower than the 0.5 percentage points predicted earlier in 2004. This is the first drop of unemployment rate in the past ten years. The slight fall of the registered urban unemployment rate was the result of, first, the sustained rapid growth of China's economy brought increase to jobs; second, governments and departments at all levels conscientiously carried out the policies concerning employment and unemployment; and third, a number of new job opportunities were created through flexible employment ways. Currently the number of China's urban unemployment people is calculated by using the number of unemployment people registered at the government departments concerned to divide the total sum of the year's number of employed people and the number of registered unemployment people. However, there are people who lost their jobs but have not or are not willing to register, such as laid-off workers worrying their contracts with the original work places are terminated and unemployed college graduates.

II.2 Fiscal Position

The fiscal system in China is characterized by the sharing of tax revenues between the central government and local governments. According to their respective responsibilities, the central government is responsible mainly for expenditures for national defense, foreign affairs, and the operation of central government agencies, as well as expenditures for economic restructuring, development coordination among regions and macroeconomic adjustment, and the local governments are mainly responsible for expenses on the operation of government agencies under their respective jurisdictions, as well as expenditure for economic and social development in their regions.

From a base of just over 2 trillion yuan for 2003, national revenue rose to 2.635588 trillion yuan (exclude revenue from generation of debt), 464.063 billion yuan or 21.4% more than the previous year and representing 111.8% of the budgeted figure. National expenditures totaled 2.836079 trillion yuan, an increase of 371.084 billion yuan or 15.1% year-on-year and representing 105.9% of the budgeted figure. Expenditures exceeded revenue by 200.491 billion yuan.

Total revenue in the central budget amounted to 1.508154 trillion yuan, up 215.071 billion yuan (after deducting the additional 127.532 billion yuan used for export tax rebates), or 16.6% over the previous year and representing 109.1% of the budgeted figure. Total expenditures in the central budget came to 1.827439 trillion yuan (including 1.037877 trillion yuan in tax rebates and subsidies for local authorities), up 214.588 billion yuan or 13.3% more than the previous year and representing 107.4% of the budgeted figure. The deficit in the central budget was 319.285 billion yuan, 545 million yuan less than the 319.83 billion approved at the Second Session of the Tenth NPC. Total revenue in local budgets amounted to 2.225853 trillion yuan (including tax rebates and subsidies granted by the central government), an increase of 414.714 billion yuan or 22.9% year-on-year and representing 112.6% of the budgeted figure. Total expenditures in local budgets came to 2.107059 trillion yuan or 18.1% more than the previous year and representing 106.6% of the budgeted figure. Local revenue exceeded expenditures by 118.794 billion yuan and this surplus is to be rolled over into the budget for 2005.

National revenue increased by 464.063 billion yuan. If the additional 127.532 billion yuan used for clear up overdue payments on export tax rebates is included, national revenue would increase by 591.595 billion yuan, a 27.2% year-on-year increase. The main taxes collected in 2004 are as follows. Domestic value added tax (VAT) increased by 178.118 billion yuan over the previous year, or 100.231 billion yuan over the projected figure. Import tax collected by customs agencies was 90.079 billion yuan more than last year's figure, all of which is in excess of the

projected figure. Corporate income tax grew by 103.078 billion, 71.03 billion yuan more than the projected figure. Individual income tax increased by 31.787 billion yuan, 11.591 billion yuan over the projected figure. Domestic consumption tax rose by 31.905 billion yuan or 25.131 billion yuan in excess of the projected figure; business tax 73.616 billion yuan, or 35.061 billion yuan more than the projected figure. The revenue increase resulted from the collection of these six taxes totaled 508.583 billion yuan, accounting for 86% of the total revenue increase of 591.595 billion yuan.

At the same time, it should be noted that around 200 billion yuan of the surplus was due to special and one-time factors. First, part of the revenue increase for 2004 occurred due to overheated investment in some industries and price rises. A total of 70 to 80 billion yuan more was collected in the form of VAT than in most years due to the introduction of the “production-side VAT”, which increases in line with the overheated growth of investment and added value of industry, where the new VAT is mainly collected. Second, the reform of the export tax rebate mechanism resulted in the loss of a quarter from the fiscal year of 2004 and reduction of export tax rebates by 3 percentage points on average, thereby cutting expenditures by nearly 100 billion yuan in the budget. Third, nearly 30 billion yuan in additional revenue was generated when tax departments cleared up transitional accounts.

The revenue in the central budget was 253.771 billion yuan (including the additional amount used to pay export tax rebates) in excess of the figure projected for 2004. It is deemed inappropriate to use the surplus to increase regular expenditure. The surplus was therefore mainly used to clear up payments in arrears and to increase spending to balance economic and social development. Specifically, the additional 127.532 billion yuan that was to be spent on export tax rebate payments was used to clear up overdue payments. The 3.57 billion yuan from increased collection of the vehicle purchase tax was used for special purposes as required by relevant regulation. An additional 32.103 billion yuan was spent on education and science, on tax rebates and general transfer payments for local authorities and on transfer payments for ethnic minority regions as required by relevant laws and regulation and by the regulations governing the system of public finance. Another 15.604 billion yuan was used to support the reform of rural taxes and administrative charges as well as grain production. A total of 40.485 billion yuan was spent to pay overdue grain compensation for returning cultivated land to forests. A further 3.25 billion yuan was used to pay basic old-age pensions for workers retiring from state-owned enterprises and fund subsistence allowances for urban residents. A total of 14.856 billion yuan was paid into the national social security fund, 3 billion yuan was used for subsidies to support the closing down or bankruptcy of enterprises, and an additional 13.371 billion was spent to fight disasters and provide relief. The revenue in excess of the projected figures in local budgets was used by local authorities mainly to alleviate financial difficulties in counties and townships, fund expenses for science, education, culture and health, support agriculture and clear up overdue debts.

The central government gave top priority to supporting agriculture, rural areas and farmers through increased investment and preferential policies. The Ministry of Finance increased spending to support agriculture by 15.604 billion yuan. Financial authorities at all levels adopted concrete measures on their own initiative to fully implement the policy of “two reductions or exemptions, and three subsidies” [exempting all taxes on native agricultural products except for tobacco, exempting or basically exempting the agricultural tax, directly subsidizing grain producers and subsidizing the purchase of improved crop strains and large agricultural machinery and tools].

Taking into consideration the necessity of maintaining the “five balances” [balancing urban and rural development, development among regions, economic and social development, development of man and nature, and domestic development and opening wider to the outside world], the Ministry of Finance took the initiative to adjust the orientation of funds for bond-financed projects, expanding investment in some sectors and reducing it in others. The focus was to ensure adequate funding for key ongoing projects and projects in agriculture, forestry, water

conservancy, science and education, culture and health, energy and road building in counties and townships. MOF put off other investment projects where possible, and in particular, suspended funding for projects in certain overheated industries.

MOF conscientiously carried out the fiscal and tax preferential policies formulated by the central authorities to promote employment and reemployment and continued to support implementation of the program for college student volunteers to serve in the western region. The central government increased funding for reemployment subsidies by 2.225 billion yuan, up 54.6% year-on-year. MOF continued to maintain the “two guarantees” [guarantee of a basic living allowance for workers laid off from state-owned enterprises and guarantee that the pensions of retirees are paid on time and in full] and work to ensure that the urban poor receive subsistence allowances. The central government spent 14.4 billion yuan on basic living allowances for laid-off workers and 52.4 billion yuan in transfer payments for old-age insurance.

Following a principle of “preventing new arrears, clearing up old arrears, improving the mechanism, sharing the financial burden, accelerating reform and intensifying development”, financial departments at all levels and concerned government departments closely followed progress of the reform. A total of 218.774 billion yuan of export tax was rebated or exempted on schedule to ensure normal demand level and prevent new arrears. Export tax rebates due to enterprises and local governments that had accumulated over a number of years were cleared up using the amount of revenue over the budgeted figure and the increase in the balance in the central treasury resulting from the reform to set up a centralized treasury payment system. The successful implementation of this reform improved the reputation of the country and safeguarded the image of the government.

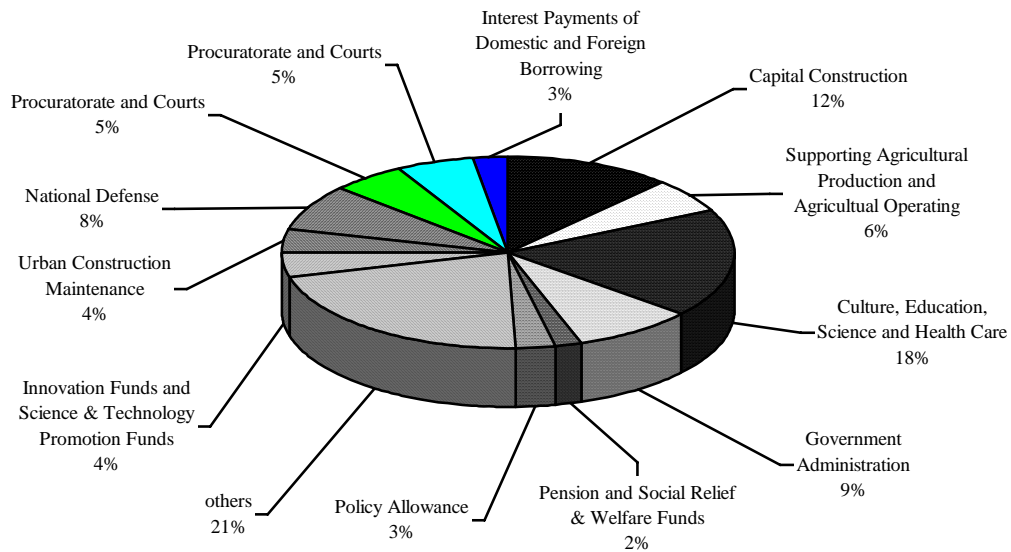
Table 18 Government Revenue and Expenditure by Item (unit: 100 million yuan)

Item	2000	2001	2002	2003	2004
Total Government Revenue	13,395.23	16,386.04	18,903.64	21,715.25	26,396.47
Taxes	12,581.51	15,301.38	17,636.45	20,017.31	24,165.68
Subsidies to Loss-making Enterprises	-278.78	-300.04	-259.60	-226.38	-217.93
Revenue from Extra-charges for Education	147.52	166.60	198.05	232.39	300.40
Other Revenue	944.98	1,218.10	1,328.74	1,691.93	2,148.32
Increase Rate(%) of Government Revenue	17.0%	22.3%	15.4%	14.8%	21.6%
Total Government Expenditure	15,886.50	18,902.58	22,053.15	24,649.95	28,486.89
Expenditure for Capital Construction	2,094.89	2,510.64	3,142.98	3,429.30	3,437.50
Additional Appropriation for Circulating Capital of Enterprises	71.06	22.71	18.97	11.95	12.44
Innovation Funds and Science and Technology Promotion Funds	865.24	991.56	968.38	1,092.99	1,243.94
Geological Prospecting Expenses	88.12	99.01	102.89	106.94	115.45
Operating Expenses of the Departments of Industry, Transport and Commerce	150.07	200.12	232.38	285.23	368.21
Expenditure for Supporting Rural Production	766.89	917.96	1,102.70	1,134.86	1,693.79
Expenses on Culture, Education, Science and Public Health	2,736.88	3,361.02	3,979.08	4,505.51	5,143.65
Expenditure for Pension and Social Welfare	213.03	266.68	372.97	498.82	563.46
Expenditure for National Defense	1,207.54	1,442.04	1,707.78	1,907.87	2,200.01
Administrative Expenses	1,787.58	2,197.52	2,979.42	3,437.68	4,059.91
Expenditure on Policy-related Subsidies	1,042.28	741.51	645.07	617.28	795.80
Increase Rate (%) of Government Expenditure	20.5%	19.0%	16.7%	11.8%	15.6%
Balance	-2,491.27	-2,516.54	-3,149.51	-2,934.70	-2,090.42

Source: Ministry of Finance of the People's Republic of China

- 1) Government revenue exclude revenue from domestic and foreign borrowings.
- 2) Government expenditure include the payment for interest of domestic and foreign debts.
- 3) Administrative Expenses includes the expenditure for public security, judicial expenditure, law court expenditure, procuratorial expenditure and expenditure for foreign affairs.

Figure 3 State Fiscal Expenditure Distribution, 2004



Source: Ministry of Finance of the People's Republic of China

Table 19 Tax Revenue by Item (Unit: 100 million yuan)

Item	2000	2001	2002	2003	2004
Total Taxes	12,665.8	15,165.5	16,996.6	20,466.1	25,718.0
Of which: State Tax Revenue	8,932.1	10,194.3	11,324.3	13,688.2	17,854.3
Local Tax Revenue	3,733.7	4,716.3	5,308.7	6,303.6	7,863.7
1. Value Added Tax	6,149.3	7,090.8	8,141.2	10,096.3	12,588.9
Domestic VAT	4,667.5	5,452.5	6,275.4	7,341.4	8,930.1
VAT on Imports	1,481.8	1,638.2	1,865.8	2,754.9	3,658.8
2. Consumption Tax	877.3	946.2	1,072.5	1,221.7	1,550.5
Domestic Consumption Tax	863.9	931.2	1,046.6	1,183.2	1,503.1
Consumtion Tax on Imports	13.4	15.0	25.9	38.5	47.4
3. Business Tax	1,885.7	2,084.7	2,467.6	2,868.9	3,583.5
4. Company Income Tax	1,444.6	2,121.9	1,972.6	2,342.2	3,141.7
5. Income Tax of Enterprises with Foreign Investment and Foreign enterpriese	326.1	512.6	616.0	705.4	932.5
6. Individual Income Tax	660.4	996.0	1,211.1	1,417.3	1,737.1
7. Resource Tax	63.6	67.1	75.1	83.1	99.1
8. Tax of Adjustment for the Orientation of Fixed Investment	46.1	15.6	8.0	4.8	3.4
9. Urban Maintenance and Construction Tax	352.1	384.4	470.9	550.0	674.0
10. Housing Property Tax	209.6	228.6	282.4	323.9	366.3
11. Stamp Duty	521.9	337.0	179.4	215.0	290.2
12. City and Town Land Use Tax	64.9	66.2	76.8	91.6	106.2
13. Increment Tax on Land Value	8.4	10.3	20.5	37.3	75.1
14. Vehicle and Vessel Usage Tax	23.4	24.6	28.9	32.2	35.6
15. Tax on Vehicle Purchases		254.8	363.5	474.3	533.9
16. Slaughter Tax	31.8	24.7	9.9	2.3	
17. Feast Tax	0.4	0.1			
Export Rebates	-810.0	-1,071.5	-1,259.4	-2,039.0	-2,195.9

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

III. Tax Structure: Institutions and The Reality

Overview of China's tax system

Tax is the most important source of fiscal revenue of China. It is also an important economic lever utilized by the State to strengthen macroeconomic regulation, which produces important impacts on China's economic and social development.

In more than 50 years since the foundation of China in 1949, the development of China's tax system reform has roughly experienced three historical stages:

1. The first stage (1949-1957) is the period of the recovery of the national economy and transformation of socialism and is the period of establishment and consolidation of the tax system of new China.
2. The second stage is the period from 1958 to the end of 1978 at the eve of the holding of the 3rd Plenary Session of the 11th Central Party Committee, which is the period of tortuous development of China's tax system.
3. The third period is the period since the end of 1978 when the 3rd Plenary Session of the 11th Central Party Committee was held, which is the new period of China's reform and opening to the outside world and the period of full strengthening of China's tax system construction and nonstop moving forward of the tax system.

After the tax system reform in 1994 and the fine-tuning of it in subsequent years, China has preliminarily built up a tax system adaptable to the socialist market economy, which has been playing an important role in assuring China's fiscal revenue, broadening the opening to the outside world and promoting the sustained, fast and healthy development of China's national economy.

1) Type of taxes

Under the current tax system in China, there are 25 types of taxes, which, according to their nature and function, can be divided into the following 8 categories.

In accordance with the principle of matching responsibilities with revenues and some other principles, taxes are divided into central government taxes, local government taxes and taxes shared between the central and local governments. Central taxes are those needed for protecting national interests and undertaking macroeconomic regulation. Shared taxes are those directly related to economic development. Local taxes are those that are suitable for collection by local governments. The details are as follows:

Table 20 China's current Tax system

Category of Taxes	Type of Taxes	Classified by revenue
Turnover Taxes	VAT	Central; Shared tax revenue
	Consumption Tax	Central tax revenue
	Business Tax	Central; Local tax revenue
Income Taxes	Enterprise Income Tax	Central; Shared tax revenue
	Income Tax on Enterprises With Foreign Investment and Foreign Enterprise	Shared tax revenue
	Individual Income Tax	Local tax revenue
Resource Taxes	Resource Tax	Shared tax revenue
	Urban and Township Land Use Tax	Local tax revenue
Special Purpose Taxes	City Maintenance and Construction Tax	shared tax revenue
	Farmland Occupation Tax	Local tax revenue
	Tax on Adjusting Direction of Fixed Assets	Local tax revenue
	Increment Tax on Land Value	Local tax revenue
Property Taxes	Housing Property Tax	Local tax revenue
	Urban Real Estate Tax	Local tax revenue
	Inheritance Tax	Local tax revenue
Behavioral Taxes	Vehicle and Vessel Usage Tax	Local tax revenue
	Vehicle and Vessel Usage License Plate Tax	Local tax revenue
	Stamp Tax	Shared tax revenue
	Deed Tax	Local tax revenue
	Security Exchange Tax	
	Slaughter Tax	Local tax revenue
Agriculture Taxes	Banquet Tax	Local tax revenue
	Agriculture Tax	Local tax revenue
Customs Duties	Animal Husbandry Tax	Local tax revenue
	Customs Duties	Central tax revenue

Source: State Administration of Taxation PRC

Notes:

1. Slaughter Tax, Banquet Tax and Animal Husbandry Tax are now decentralized to the local governments for administration. Whether levying or not shall be at the discretion of the governments at provincial level for decision by taking into account the local conditions.
2. Inheritance Tax and Security Exchange Tax have not yet legislated to date.
3. Domestic VAT is Shared tax revenue; imported VAT is Central tax revenue.
4. Business Tax: the part consolidatedly paid by the railway department, the headquarters of various banks and the headquarters of various insurance companies, and the additional 3% Business Tax paid by financial and insurance enterprises belong to the Central Government, and the rest is assigned to the local governments.
5. Enterprise Income Tax paid by Central enterprises, income tax paid by local banks and non-banking financial institutions, and the part consolidatedly paid by the railway department, the headquarters of various banks and the headquarters of various insurance companies belong to the Central Government; and the rest for local governments.

2) Tax Legislation

For the time being, the State Organs having authority to formulate tax laws or tax policy mainly include National People's Congress and its Standing Committee, State Council, Ministry of Finance, State Administration of Taxation, Tariff and Classification Committee of the State Council, and General Administration of Customs.

- Tax laws are enacted by the National People's Congress, e.g. the Individual Income Tax Law of PRC; or enacted by the Standing Committee of the National People's Congress, e.g., Law on Administration of Taxation of PRC.
- The administrative regulations and rules concerning taxation are formulated by the State Council, e.g. the Detailed Rules for the Implementation of Law on Administration of Taxation of PRC, the Detailed Regulations for the implementation of the Individual Income Tax Law of PRC, the Provisional Regulations of PRC on Value Added Tax.
- The department rules concerning taxation are formulated by the Ministry of Finance, the State Administration of Taxation, the Tariff and Classification Committee of the State Council, and the General Administration of Customs, e.g., the Detailed Rules for the

Implementation of the Provisional Regulations of PRC on VAT, the Provisional Measures for Voluntary Reporting of the Individual Income Tax.

Table 21 China's Current Tax Legislation

Legislation	Effective Date
1. Provisional Regulations of the People's Republic of China on Value Added Tax and Detailed Rules for Its Implementation	1 Jan. 1994; 1 Jan. 1994
2. Provisional Regulations of the People's Republic of China on Consumption Tax and Detailed Rules for Its Implementation	1 Jan. 1994; 1 Jan. 1994
3. Provisional Regulations of the P.R.C. on Business Tax and Detailed Rules for Its Implementation 4.Provisional Regulations of the People's Republic of China on Enterprise Income Tax and Detailed Rules for Its Implementation	1 Jan. 1994; 1 Jan. 1994
5. Income Tax Law of P.R.C. on Enterprises with Foreign Investment and Foreign Enterprises and Detailed Rules for Its Implementation	1 Jul. 1991; 1 Jul. 1991
6. Individual Income Tax Law of the P.R.C. and Regulations for Its Implementation	1 Jan. 1994
7. Provisional Regulations of P.R.C. on Resource Tax and Detailed Rules for Its Implementation	1 Jan. 1994;
8. Provisional Regulations of P.R.C. on Urban and Township Land Use Tax Detailed Rules for Its Implementation	1 Nov. 1998
9. Provisional Regulations of P.R.C. on City Maintenance and Construction Tax and Detailed Rules for Its Implementation	1985
10.Provisional Regulations of P.R.C. on Farmland Occupation Tax Detailed Rules for Its Implementation	1 Apr.1987
11.Provisional Regulations of P.R.C. on Increment Tax on Land Value and Detailed Rules for Its Implementation	1 Jan. 1994; 27 Jan.. 1995
12.Provisional Regulations of P.R.C. on Housing Property Tax Detailed Rules for Its Implementation	1 Oct. 1986
13.Provisional Regulations Governing Urban Real Estate Tax Detailed Rules for Its Implementation	8 Aug. 1951
14.Provisional Regulations of P.R.C. on Vehicle and Vessel Usage Tax Detailed Rules for Implementation	1 Oct. 1986
15.Provisional Regulations Concerning the Vehicle and Vessel Usage License Plate Tax Detailed Rules for Its Implementation	20 Sep. 1951
16.Provisional Regulations of P.R.C. Concerning Stamp Tax Detailed Rules for Its Implementation	1 Oct. 1988;
17.Provisional Regulations Concerning Deed Tax and Detailed Rules for Its Implementation	1 Oct. 1997
18.Provisional Regulations Concerning Slaughter Tax (administered by local governments)	
19.Provisional Regulations of P.R.C. on Banquet Tax (administered by local governments)	
20.Provisional Regulations of P.R.C. on Agriculture Tax Detailed Rules for Implementation	3 Jun. 1958
21. Animal Husbandry Tax: no national legislation	
22. Regulations of P.R.C. on Import and Export Customs Duty	1 Apr. 1992
23. Rules of Levying Customs Duty on Entry Passengers ' Luggage and Personal Postal Articles	1 Jul. 1994
24. Provisional Regulations of P.R.C. on Vehicle Purchase Tax	1 Jan. 2001
25. Law on Administration of Taxation of P.R.C. and Detailed Rules for its Implementation	1 May 2001; 15 Oct. 2002
26. Supplementary Rules of the Standing Committee of NPC of P.R.C. on Punishing Tax Evasions and Refusal to Pay Taxes	1 Jan. 1993
27.Measures of the People's Republic of China on Invoice Management and Detailed Rules for Its Implementation	23 Dec. 1993; 23 Dec. 1993

Source: State Administration of Taxation

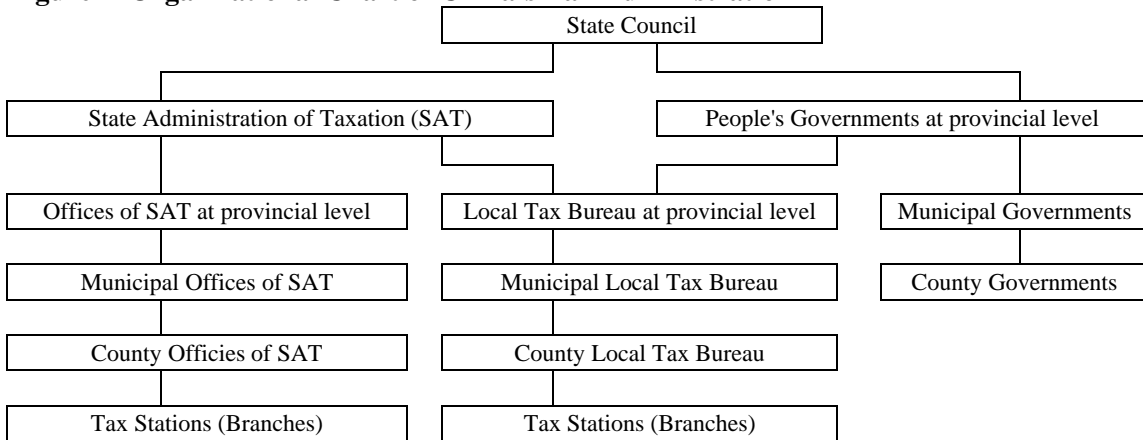
The formulation of tax laws shall follow four steps: drafting, examination, voting and promulgation. The four steps for the formulation of tax administrative regulations and rules are: planning, drafting, verification and promulgation. The four steps mentioned above shall take place in accordance with laws, regulations and rules.

Besides, the laws of China stipulates that within the framework of the national tax laws and regulations, some local tax regulations and rules may be formulated by the People's Congress at provincial level and its Standing Committee, the People's Congress of minority nationality autonomous prefectures and the People's Government at provincial level.

3) Organization of Tax Administration

Since system of tax division was established in 1994, China clearly partitioned the relation of distribution between central and local governments. State tax agencies and local tax agencies have been established separately. In principle, central taxes and shared taxes are collected by State tax agencies while local taxes are collected by local tax agencies.

Figure 4 Organizational Chart of China's Tax Administration



Source: State Administration of Taxation

Notes:

1. The Headquarters of SAT conducts vertical leadership over its offices across China, and assists People's Governments at provincial level in form of dual leadership over local tax bureau.
2. The local tax bureau below provincial level are under the dual leadership of both the higher local tax bureau and the People's Governments at the same level with the formers as the predominant one.

Direct tax

1) Enterprises Income Tax

-- Taxpayers

The taxpayers of Enterprise Income Tax refer to enterprises or other organizations which independently account for their respective financial results in China, including any state-owned enterprise, collective enterprise, private enterprise, joint venture enterprise, joint equity enterprise, and other organizations deriving income from production and business operation and other income, but not foreign investment enterprises and foreign enterprises.

-- Tax base

The taxpayers' world-wide income from production and business operations and from other sources shall be subject to Enterprise Income Tax according to law. The Enterprise Income Tax is computed on the basis of the taxable income which is equal to the total income earned by the taxpayers in a tax year less allowable deductions for the same tax year.

-- Taxable Income

This refers to the amount remaining from the total income of a taxpayer in a tax year after the deductible items have been deducted.

The total income is composed of 7 items:

- (i) Income from production and business operation;
- (ii) Income from transfer of property;
- (iii) Income from interest;
- (iv) Income from leasing;
- (v) Income from royalty and license fees;
- (vi) Income from dividend;
- (vii) Other income.

The deductible amount refers to cost, expense and losses concerning the income of taxpayer, which includes:

- (i) Cost, namely the cost concerning production and business operation;

- (ii) Expense, namely all the sales expense, management expense and financial expense concerning the production and business operation and labor service supply;
- (iii) Tax, which refers to the tax paid such as consumption tax, business tax, resource tax, land appreciation tax, and additional educational fees and so on;
- (iv) Loss, which refers to non-business expense in the course of production and business operation, business loss, investment loss incurred and other losses.

The following item shall not be deductible in computing taxable income:

- (i) Expenditure of a capital nature;
- (ii) Expenditure on acquisition and development of intangible assets;
- (iii) Fines in relation to illegal business operation and losses incurred on confiscation of property;
- (iv) Surcharge on overdue tax payments, fines and penalties in relation to various types of taxes;
- (v) That portion of losses incurred due to natural disasters or accidents, which is covered by compensations receivable;
- (vi) Donations for community benefits and charitable donations in excess of deductible amounts; and donations other than those for community benefits or charitable donations;
- (vii) Expenditure for any sponsorship, which refers to one for non-advertisement purpose;
- (viii) Other items of expenditure that are not incurred in the earning of income.

-- Tax rates and computation of tax payable

Normally, the amount of Enterprise Income Tax payable is computed on the basis of the taxable income and by applying the rate 33%. The formula for computing the tax payable is:

$$\text{Income tax payable} = \text{Taxable income} \times 33\%$$

Besides the statutory rate, two lower rates of 18% and 27% are designed for some less profitable enterprises.

-- Major tax exemptions and reductions

- Enterprises operating in autonomous regions requesting for preferential treatment and incentives may be, upon the approval of the People's Government at provincial level, given tax reductions or exemptions for a specified period;
- Tax exemption or tax reduction may be granted to enterprises or businesses that meet the relevant rules of the State, such as high-technology enterprises and enterprises engaged in tertiary industry set up in line with the relevant regulations of the State, enterprises using wastes as their key raw materials, newly-registered enterprises located in the revolutionary base areas, minority nationality areas, remote areas and poor areas approved by the State, enterprises suffering from serious natural disasters, newly-registered service enterprises providing social employment opportunities, factories and farms run by schools under the educational administration departments, welfare production enterprises belonging to the civil administration department, township enterprises, State-owned agricultural enterprises, etc.

-- Tax credit

A taxpayer shall be allowed, when filing a consolidated income tax return, to deduct from the amount of income tax payable the foreign income tax already paid abroad in respect of the income derived from source outside China. The deductible amount shall, however, not exceed the amount of income tax otherwise payable under the Provisional Regulations of the PRC on Enterprise Income Tax.

2) Income Tax on Enterprises with Foreign Investment and Foreign Enterprise

-- Taxpayers

- Enterprises with foreign investment include Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures and wholly-foreign owned enterprises.
- Foreign enterprises include foreign companies, enterprises and other economic organizations which have establishments or places in China engaged in production or business operations or which, though without establishments or places in China, have income from sources within China.

-- Tax base

The enterprises with foreign investment with head office in China pay income tax on their world-wide income. Foreign enterprises pay income tax only on their income derived from sources with China.

The income tax base for enterprises with foreign investment and foreign enterprises is the taxable income which is the amount remaining from its gross income in a tax year after allowable deduction for costs, expenses and losses.

Any foreign enterprises which has no establishment or place in China but derives income or profits, interest, rental, royalties and other income from sources within China or which, though it has an establishment or place in China, the said income is not effectively connected with such establishment or place, is taxed on the basis of the gross amount of such income.

-- Tax rates and calculation of the amount of tax payable

The income tax on enterprises with foreign investment and foreign enterprises is 30% of the taxable income plus 3% local income tax, totaling 33% rate. Any foreign enterprises which has no establishment or place in China but derives income of profits, interest, rental, royalties and other income from sources within China or which, though it has an establishment or place in China, the said income is not effectively connected with such establishment or place, pays tax of 20% on such income. The formula for computing the amount of tax payable is:

$$\text{Amount of tax payable} = \text{Taxable income} \times \text{applicable tax rate}$$

-- Main tax incentives

- Tax exemptions or tax reductions may be granted to enterprises with foreign investment of a production nature, export-oriented enterprises with foreign investment, technologically advanced enterprises with foreign investment, and enterprises with foreign investment and foreign enterprises established in the Special Economic Zones, the Economic and Technological Development Zones, the Coastal Open Economic Zones and the New and High-technology Industrial Development Zones specified by the State.
- The share of profits earned by foreign investors from their invested enterprises may be exempted from tax. The foreign investor who reinvests its share of profits from enterprises with his investment directly into that enterprise by increasing its registered capital or who uses the profit as capital investment to establish another enterprise with foreign investment may receive some tax refund.
- The exemption from or reduction of local income tax for any enterprise with foreign investment engaged in an encouraged industry or project may, in accordance with the actual situation, be granted by the People's Government of the relevant Province, Autonomous Region or Municipality directly under the State Council.

3) Individual Income Tax

-- Taxpayers

The Individual Income taxpayers are classified into the following two types:

a. Any individual who has domicile in China or who has no domicile in China but has resided in China for one year or more shall pay Individual Income Tax on his world-wide income.

b. Any individual who is neither domiciled nor resident in China or who has resided in China for less than one year shall pay Individual Income Tax on the income from sources inside China.

-- Taxable items and calculation of Individual Income Tax payable

China's method of levying Individual Income Tax is different from those used in Western countries where taxes are calculated on an annual lump-sum basis. China has adopted the method of itemized deductions and fixed rate items, and levies taxes on a monthly, annual or specified time basis. The method of levy was selected in light of actual conditions in China, with the main advantages being that is conducive to the realization of source withholding, and blocking loopholes in tax collection and management.

i. Wages and Salaries

Wages and salaries are taxed on the basis of the balance of taxpayer's monthly wages and salaries after lump-sum deduction of 800 yuan as expenses and by applying the nine-grade progressive rates as shown in the table below.

Table 22 Individual Income Tax Rates Schedule (1)

Grade	Monthly Taxable Income	Tax Rate (%)	Quick Deduction
1	Income of 500 yuan or less	5	0
2	That part of income in excess of 500 to 2,000 yuan	10	25
3	That part of income in excess of 2,000 to 5,000 yuan	15	125
4	That part of income in excess of 5,000 to 20,000 yuan	20	375
5	That part of income in excess of 20,000 to 40,000 yuan	25	1,375
6	That part of income in excess of 40,000 to 60,000 yuan	30	3,375
7	That part of income in excess of 60,000 to 80,000 yuan	35	6,375
8	That part of income in excess of 80,000 to 100,000 yuan	40	10,375
9	That part of income in excess of 100,000 yuan	45	15,375

Source: State Administration of Taxation

The formula for computing the amount of tax payable is:

$$\text{Monthly taxable income} = \text{Monthly aggregate wages/salaries} - 800 \text{ yuan}$$

$$\text{Monthly amount of tax payable} = \text{Monthly taxable income} \times \text{applicable tax rate} - \text{Quick Deduction}$$

The taxpayers who have no domiciles in China but earn wages and salaries from China or who have domiciles in China and earn wages and salaries from outside China may enjoy additional expense deduction (currently 3200 yuan per month) in addition to the regular monthly deduction of 800 yuan in computing the taxable income.

ii. Individual household production or business operation income

with respect to the individual household production or business operation income, the amount of tax payable is computed on the basis of the balance of the gross annual production and business operation income after deduction of the related cost, expenses and losses and by applying the five-grade progressive tax rates as listed in the table below.

Table 23 Individual Income Tax Rates Schedule (2)

Grade	Annual Taxable Income	Tax Rate (%)	Quick Deduction
1	Income of 5,000 yuan or less	5	0
2	That part of income in excess of 5,000 to 10,000 yuan	10	250
3	That part of income in excess of 10,000 to 30, 000 yuan	20	1250
4	That part of income in excess of 30,000 to 50, 000 yuan	30	4250
5	That part of income over 50,000 yuan	35	6750

Source: State Administration of Taxation

The formula for computing the tax payable is:

Annual taxable income = Gross annual income of production/business – Costs, expenses and losses

Tax payable for the year = Annual taxable income × applicable tax rate – Quick deduction

iii. Income from contracted or leased operation of enterprises or institutions

The income from contracted or leased operation of enterprises or institutions is taxed on the basis of the balance of the gross annual income after deduction of the necessary expenses (currently 800 yuan per month) and by applying the suitable tax rate in Individual Income Tax Rates Schedule (2) above.

iv. Remuneration for personal service, author's remuneration, royalties, income from lease of property

The income of remuneration for personal service, author's remuneration, royalties and income from lease of property are taxed on the basis of remaining sum of the income after deduction of 800 yuan when each payment of the income is not over 4,000 yuan or on the basis of the remaining sum of the income after deduction of 20% of the income as the expenses when each payment of the income is over 4,000 yuan and by applying the rate of 20%.

The formula for that is:

Taxable income = Gross value of taxable items – 800 yuan (or 20% of gross value of taxable items)

Amount of tax payable = Taxable income × 20%

v. Income from transfer of property

The tax base is the balance of the proceedings derived from transfer of property after deducing the original value of the property and the reasonable expenses. The applicable rate is 20%. The formula for computing the amount of tax payable is:

Taxable income = Proceedings from transfer of property – Original value of property – Reasonable expenses

Amount of tax payable = Taxable income × 20%

vi. Interest, dividend, bonus and contingent income

The tax on interest, dividend, bonus, contingent income and other income is based on each receipt of the income with the rate of 20%.

The formula for computing the income tax payable is:

Tax payable = The full amount in each receipt × 20%

-- Main tax exemptions

The following income is exempt from income tax:

1. Awards for achievements in science, education, technology, culture, public health, physical culture and environmental protection granted by the Provincial People's Governments, Ministries and Commissions under the State Council, China's People's

- Liberation Army Units at army level and above and by foreign and international organizations;
2. Interest income on National Bonds issued by the Ministry of Finance and interest income on financial bonds issued upon approval by the State Council;
 3. Special government allowances provided in accordance with the uniform regulations of the State Council and the subsidies and allowances stipulated as being exempt by the State Council;
 4. Welfare benefit, survivor's pensions and relief payments;
 5. Insurance indemnities;
 6. Military severance payment and demobilization payment received by members of the armed forces;
 7. Settlement payment, severance payment and retirement payment received by public servants and workers under uniform provisions of the State;
 8. Medical insurance pension and the basic retirement pension saved and withdrawn according to relevant rules;
 9. Income derived by diplomatic agents and consular officers and other personnel who are exempt from tax under the provisions of the relevant Laws of the P.R.C.
 10. Income exempt from tax as stipulated in the international conventions to which Chinese Government is a party and in the agreements it has entered into.

-- Tax credit

According to the provisions of the Individual Income Tax Law of China, income tax paid abroad in accordance with the law of the source country or region by taxpayers on income derived from sources outside China shall be credit against the amount of income tax payable. The creditable amount, however, shall not exceed the amount of tax otherwise payable under China's tax law in respect of the income derived from the source outside China. In computing tax, it should be computed separately for each different country or region and for each different income categories, in accordance with the standards for the deduction of expenses and the applicable tax rates stipulated in China's tax law, the sum of the amounts of tax payable in the different income categories within the same country or region shall be the limit of deductions for that country.

Indirect tax

In China's multiple taxes, the turnover tax is the main source of tax revenue. The previous tax consisted of the value added tax (VAT), and product and business taxes, with the tax rate ranging between 3% and 60%. The present reform focuses on implementation of a standardized VAT and appropriately establishing consumption and business taxes. The effect centers on a new pattern of a dual-level turnover tax system based on the VAT as wide-ranging regulation and the consumption tax as special regulation.

1) Value Added Tax

China started to implement VAT in 1984 on 24 specified taxable items. In 1994, corresponding with reform goal of building up socialist market economy system and pursuant to the guideline of "unification of taxation management, equity of tax burden, simplification of tax system, rationalization of revenue distribution relations and guarantee of the financial revenue", the former taxation system undertook an overall and structure reform. On December 13, 1993, the State Council of China promulgated "The Provisional Regulation of the People's Republic of China on Value Added Tax", which put into effect on January 1, 1994 and is currently effective in China.

VAT is administered by the State Administration of Taxation (the import VAT is collected by the customs on behalf), and the revenue from it is shared between the central government (75%)

and local government (25%). VAT is the major source of fiscal revenue for the Government of China, particularly the central government. In 2004, the revenue from VAT is 1.26 trillion Yuan, accounting for 48.9% of the state total tax revenue of the year, which is the first biggest tax in China.

a) The current VAT system of China

-- Taxpayers

According to “the Provisional Regulation of PRC on VAT”, VAT should be paid by enterprises or individuals who sell merchandise, provide processing, repairing, or assembling service, or import goods within the territory of the People’s Republic of China on the added value derived from their production, selling merchandise, providing industrial repairing or assembling service.

-- Taxable items and tax rates

Based on different taxable goods, services, different flat rates and zero rate are adopted. The table of the taxable items and rates is as following:

Table 24 VAT Taxable Items and Rates

Coverage of collection	Rate
Exportation of goods (except otherwise stimulated by the state)	0
Agriculture, forestry, products of animal husbandry, aquatic products; Edible vegetable and grain duplicates; Tap water, heating, cooling, hot air supplying, hot water, gas, liquefied petroleum gas, natural gas, coal/charcoal products for household use;	13%
Book, newspapers, magazines (excluding the newspapers and magazines distributed by the post department) Feeds, chemical fertilizers, agricultural chemicals, agricultural machinery and plastic converting film for farming; Selected metal mineral products, Selected non-metal mineral products, coal. Crude oil, mine salt and goods other than those listed above;	17%
Taxable services.	

Source: State Administration of Taxation

-- Computation of tax payable

There are two kinds of VAT taxpayers in China by the criterion of turnover of sale goods & services and condition of accounting system. One is normal taxpayer, the other is small taxpayer. The standard of decision of small taxpayer is ① where the taxpayer is engaged in the production of goods or in the provision of taxable service as his sole or principle business and his annual turnover is less than RMB 1,000,000; or ② where the taxpayer is engaged in the wholesale or retail of goods and his annual turnover is less than RMB 1,800,000. However, a small taxpayer who maintains a sound accounting system and is able to provide accurate accounting records for taxation purposes may be registered as a normal taxpayer.

Normal taxpayer

To compute the VAT payable, the normal taxpayer needs to separately calculate the output tax and the input tax for the current period. Then the difference between the output and the input tax shall be the actual amount of VAT payable. The formula for computing the tax payable is:

Tax payable = Output tax payable for the current period – Input tax payable for the current period; Output tax payable = Sales volume in the current period × Applicable tax rate.

Small taxpayer

Small taxpayers are taxed on the basis of the revenue derived from sales of goods or provision of taxable services by applying proper rates (4% for commercial sector, and 6% for other sectors). The computing formula of tax payable is:

Tax payable = Sales amount × Applicable rate.

Importation

The importation goods are taxed on the basis of the composite assessable price by applying the applicable tax rate. The formula for computing the tax payable is:

Tax payable = Composite assessable price × Applicable VAT rate

Composite assessable price = Customs completion price + Custom Duty

Where the taxpayers import the taxable goods under the Consumption Tax, the Consumption tax payable shall be included in the composite assessable price.

VAT refund for exporters

In case of 0 rate applicable to the exported goods, the exporters may apply to the tax authorities for the input tax refund on those goods exported. At present, the refund rates consist of 3%, 5%, 8%, 13% and 17%.

-- Major tax exemptions

The exempted items include: the agricultural production materials as ruled, the self-produced primary agricultural products sold by agricultural producing units and individuals; contraceptive medicines and devices; antique books purchased from the public; instruments and equipment imported for direct use in scientific research, experiment and education; imported materials and equipment granted, gifted by foreign governments or international organization; materials imported directly to support the poverty relief and charity cause donated freely by overseas natural persons, legal persons and other organizations; articles imported directly by organizations for the disabled for exclusive use by the disabled; and the taxable services provided by individual disabled laborers.

b) The main problems of VAT

Broadly speaking, there are three major types of value added taxes in the world corresponding to the gross national product, net national product, and consumption basis. They are the GNP type, income type and the consumption type. In China, the type of VAT is the GNP type. That is to say, the input tax of fixed-assets, such as houses, construction and equipment, can't be deducted from the output tax when computing the tax payable. The VAT of GNP type ensures that the government can get more tax revenue, but would limit the increase of investment. Thus, this is one problem of China's VAT that should be settled in the short future.

Secondly, in some industries of China, such as construction, transportation, and services etc, the state doesn't collect VAT but Business Tax. Business Tax is levied as a percentage of sales, not just value added. In China, taxable services for Business Tax include transportation, construction, finance and insurance, post and telecommunications, cultural activities and sports, entertainment businesses and services. It is not equitable and increases the difficulties of computing taxes that different industries are levied on different type of tax.

c) The preparative reform for VAT in China

For making an equitable market environment and stimulating the investment, the government of China prepares to make a reform of VAT, which will change the type of China's VAT from the GNP type to the consumption type. On July 1, 2004, the state selected several northeast provinces as experimental area to implement the VAT of consumption type. In these provinces, the taxpayers of VAT in eight selected industries can deduct the input tax of equipment used for

production. With the development of Chinese economy and the increase of reform experiences, the central government will implement the VAT reform in all industries and provinces of China. What's more, for setting up a uniform and equitable turnover tax system, some industries subjected to Business Tax would be levied on VAT at an opportune time.

2) Consumption Tax

The Consumption Tax is a new tax category of the turnover tax system resulting from reform. On the basis of a general VAT levy on commodities, a consumption tax is further levied on a small number of selected consumer goods mainly for the purpose of adjusting the consumption pattern, providing guidance to consumers and guaranteeing the country's financial revenue.

-- Taxpayers

The taxpayers of Consumption Tax include all enterprises, units, household businesses and other individuals engaged in production or importation of taxable consumer goods within the territory of the People's Republic of China. The taxable consumer goods exported by the taxpayers are exempt from Consumption Tax, unless the taxable consumer goods are restricted by the State from exportation.

-- Taxable items and tax rates

The selection of the scale of tax levies for the consumption tax considers the following main factors:

- Products with a relatively substantial reduction in tax burden as a result of readjustments in the pattern of the turnover tax system;
- Some high quality, luxury consumer products considered nonessential daily necessities;
- Certain consumer goods which are required for keeping fit and protecting the ecological environment, but excessive consumption of which is discouraged and deemed unadvisable;
- Various special resource consumer goods.

Table 25 Consumption Tax Taxable Items and Rates

Taxable items	Tax rates (tax amount)	Comments
1. Tobacco (1) Grade A Cigarettes (2) Grade B Cigarettes (3) Grade C Cigarettes (4) Cigars (5) Cut tobacco	50%, 40%, 25%, 25%, 30%	
2. Alcoholic drinks and alcohol (1) white spirits made from cereal (2) white spirits made from potatoes (3) yellow spirits (4) beer (5) other alcoholic drinks (6) alcohol	25%, 15%, 240 yuan per tonne; 220 yuan, per tonne, 10%, 5%	
3. Cosmetics	30%	
4. Skin-care and hair-care products	8%	Perfumed soap currently taxed at 5%
5. Precious jewellery, pearls, precious jade and stones (1) Gold and silver jewellery (2) Other jewellery, pearls, precious jade and stones	5%, 10%	
6. Firecrackers and Fireworks	15%	
7. Gasoline (1) Unleaded (2) Leaded	0.2 yuan per litre, 0.28 yuan per litre	
8. Diesel	0.1 yuan per litre	
9. Motor Vehicle Tyres	10%	
10. Motor-cycles	10%	
11. Motor cars	3%, 5%, 8%	Rate applied on the basis of the type and cylinder capacity of the car

Source: State Administration of Taxation

-- Computation of Tax payable

The computation of Consumption Tax payable shall follow either the ad valorem principle or quantity-based principle, the producers of taxable consumer goods are the taxpayers and the Consumption Tax shall be paid on sales of the goods by the producers. The computing formula is:

$$a. \text{Tax payable} = \text{sales amount of taxable consumer goods} \times \text{Applicable tax rate, or}$$

b. Tax payable = sales volume of taxable consumer goods × Tax amount per unit

Imported taxable consumer goods to which ad valorem method is applied in computing the tax payable shall be assessed according to the composite assessable price and the applicable rate.

3) Business Tax

-- Taxpayers

Taxpayers of Business Tax include all enterprises, units, household businesses and other individuals engaged in provision of taxable services, transfer of intangible assets or sales of immovable properties within the territory of the People's Republic of China.

-- Taxable items and tax rates

Table 26 Business Tax Taxable Items and Rates

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

Source: State Administration of Taxation

-- Computation of tax payable

The amount of Business Tax payable is equal to the turnover times the applicable tax rate. The computing formula is:

$$\text{Tax payable} = \text{Turnover} \times \text{Applicable tax rate}$$

-- Major exemptions

Business Tax may be exempt for: nursing services provided by nurseries, kindergartens, old people's homes, welfare institutions for the handicapped, matchmaking and funeral services; services provided individually by the disabled to the public; medical services provided by hospitals, clinics, and other medical institutions; educational services provided by schools and other educational institutions, and services provided by students in part-time work; agricultural mechanical ploughing, irrigation and drainage, prevention and treatment of plant diseases and insect pests, plant protection, insurance for farming and animal husbandry, and related technical training services, breeding and the prevention and treatment of diseases of poultry, livestock and aquatic animals; admission fees for culture activities conducted by memorial hall, museum, cultural centre, art gallery, exhibition hall, academy of painting and calligraphy, library and cultural protective units, admission fees for cultural and religious activities taking place at religious premises.

Foreign Investment Taxation

There are 15 kinds of taxes currently applicable to the enterprises with foreign investment, foreign enterprises and/or foreigners, namely: VAT, Consumption Tax, Business Tax, Income Tax on Enterprises with Foreign investment and Foreign Enterprises, Individual Income Tax, Resource Tax, Increment Tax on Land Value, Urban Real Estate Tax, Vehicle Purchase Tax,

Vehicle and Vessel Usage License Plate Tax, Stamp Tax, Deed Tax, Slaughter Tax, Agriculture Tax, and Customs Duties.

Compatriots from Hong Kong, Macao and Taiwan and overseas Chinese and the enterprises with their investment are taxed in reference to the taxation on foreigners, enterprises with foreign investment and/or foreign enterprises.

In order better to encourage inward flow of funds, technology and intelligence, China provides numerous preferential treatments in foreign taxation, and has successively concluded tax treaties with 79 countries and regions (by August, 2004).

Table 27 Tax Treaty Agreement Statuses

Japan	Bulgaria	Belarus	Seychelles
U.S.A.	Pakistan	Slovenia	The Philippines
France	Kuwait	Israel	Ireland
U.K.	Switzerland	Viet Nam	South Africa
Belgium	Cyprus	Turkey	Barbados
Germany	Spain	Ukraine	Moldova
Malaysia	Romania	Armenia	Cuba
Norway	Austria	Jamaica	Kazakhstan
Denmark	Brazil	Iceland	Indonesia
Singapore	Mongolia	Lithuania	Oman
Finland	Hungary	Latvia	Tunis
Canada	Malta	Uzbekistan	Iran
Sweden	United Arab	Bangladesh	Bahrain
New Zealand	Luxembourg	Yugoslavia	Kyrgyzstan
Thailand	Korea	Sudan	Venezuela
Italy	Russia	Macedonia	Sri Lanka
The Netherlands	Papua New Guinea	Egypt	Albania
Czechoslovakia	India	Portugal	
Poland	Mauritius	Estonia	Hong Kong
Australia	Croatia	Laos	Macao

Source: State Administration of Taxation

IV. China-Specific Fiscal Issues

Banking restructure issue

When China joined WTO in 2001, Beijing agreed to open up its banking system to foreign investors by the end of 2006. A flood of foreign investment into China's largest state-owned commercial banks (SCBs) since 2004 has signally the start of a process that will have major economic ramifications.

At the end of 2003, foreign equity stakes in Chinese banking institutions were just \$500 million or 0.3% of total banking capital. Foreign banks held only about 1% of total banking assets. By contrast, China's five largest SCBs—the Industrial & Commercial Bank of China, the Agricultural Bank of China, the China Construction Bank, the Bank of China and the Bank of Communications – controls over 60% of the country's loans and deposits.

International investors are rapidly changing this landscape. In 2004, the British-based Hong Kong and Shanghai Banking Corporation (HSBC) bought 19.9% of the Bank of Communications for \$2.25 billion. In June 2005, the Bank of America invested \$3 billion for a 10% stake in the China Construction Bank (CCB). In July 2005, the Royal Bank of Scotland bought another 10% of the Bank of China for \$3.1 billion, while Singapore's Temasek committed \$2.5 billion to the CCB. In August 2005, the US-investment house Goldman Sachs paid out \$3 billion for a 10% stake in the Industrial & Commercial Bank of China.

Paradoxically, the major Chinese SCBs are weighed down by huge bad debts and are technically insolvent. The capital adequacy ratio of the four largest SCBs was only 4.6 % in 2003, compared to the 8% international standard. However, international financial institutions are pouring money into the SCBs in a bid to capture a key strategic sector of the Chinese economy and exploit the financial opportunities opening up.

Agriculture, energy consumption, and environment issues

Deep-rooted contradictions in economic growth remain an arduous task. The tests before China is still how to cope with deep-rooted problems in economic growth, since our growth pattern remains an extensive one with a heavy task of structural adjustment.

The favorable trend in agriculture and rural economy in 2004 didn't change the nation's long-term weak agricultural foundation. Room is limited for the four factors leading to even higher grain production this year – bigger seeded area, higher unit yield, stronger financial support and higher grain price, and climate conditions are uncertain. Farmers still face a shortage of channels to increase their incomes.

The year 2004 impressed people deeply by its tight supply of coal, electricity, oil and transportation capacity, and situation in 2005 will be still tougher. In 2004, China's power growth rate reached 15%, with 49.3 million KW newly added generation capacity and the total installation capacity reaching over 440 million KW. Although our installation capacity amounts to the total of Britain, France and Germany and higher than Japan's (280 million KW), the GDP we created with it lagged far behind due to our unreasonable economic structure, with too many sectors of high energy consumption.

China suffers from major energy-related environmental problems. According to a report by the World Health Organization (WHO), seven of the world's ten most polluted cities are in China. The country's heavy use of unwashed coal leads to large emission of sulfur dioxide and particular matter. China also is important to any effort to curb emission of greenhouse gases, as it is projected to experience the largest absolute growth in carbon dioxide emission between now and the year 2025.

China is a non-Annex I country under the United Nations Framework Convention on Climate Change, meaning that it has not agreed to binding targets for reduction of carbon dioxide emissions under the Kyoto Protocol. While the Chinese government is concerned with its environmental problems, it tends to be more concerned with local problems, such as particulate matter and sulfur dioxide emissions. Thus, it is undertaking efforts to lesson emissions of pollutants such as sulfur dioxide and nitrogen oxide, through improved pollution controls on power plants as well as policies designed to increase the share of natural gas in the country's fuel mix, particularly around major metropolitan areas.

Contradictions and problems of current tax structure

1. Tax policies in domestic and foreign-funded enterprises, or in varying enterprises are different – a structure unfair to equal competition.
2. The general level of tax is on the high side; too many tariff concessions and tax reduction or exemptions linked to imports results in a narrow scope of export tax rebate and processing trade with supplies materials is weak. The problem of taxation avoidance is serious.
3. Individual income tax did not play a good role as expected in adjusting individuals' income and mitigating the unequal social distribution. Loopholes still exist in administration and taxation is seriously insufficient.
4. The burden of value-added taxes to different trades is distributed unreasonably; the prevention and clampdown on tax evasion and avoidance are not powerful enough; the applicable scope of VAT and business tax calls for readjustment; consumption tax is

- collected in a very limited way and the business and consumption taxes are not strong enough to adjust high consumption.
5. The competence of central and local tax administrations are not been determined clearly; local tax systems need to be perfected, and the agricultural tax system could not meet the demands of the developing market consumption.

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

First, China was endeavoring to realize win-win of domestic and foreign enterprises through open-up.

27 yeas ago, China implemented the policy of “Open-up” to the outside under the advocacy of Mr. Deng Xiaoping. The policy enjoyed popular support and was welcomed extensively. 280 thousand foreign investment enterprises engaged in business in China with total actual foreign investment of US\$600 billion, 450 of the World’s Top 500 enterprises came to China and a batch of small and medium sized enterprises in foreign countries found development opportunities in China. Through the open-up, industries like electron, telecommunication, home appliance and textile developed rapidly, and competitiveness of manufacture was improved. In 2004, foreign investment enterprises attributed 20% to our tax revenue, 28% to industrial added value, 57% to exports, over 50% to introduced technology, and even more than 24 million employment opportunities.

Since the entry into WTO, China was earnest to perform the commitment, China’s overall tariff level decreased to 9.9% and most of non-tariff measures were canceled. Manufacture in China was completely open to the outside world. Among 160 service trade departments classified in WTO rules, more than 100 were opened up and the proportion was close to that of some developed countries. The open-up of some fields such as banking, insurance, securities and distribution have been implementing as scheduled.

In the process of China’s open-up, foreign investors obtained high return. In 2004, foreign investment sold over US\$400 billion commodities at Chinese market and exported US\$350 billion products originated from China. Therefore, China became a platform of production and sales of many foreign investment enterprises. More and more transnational enterprises viewed China as a main market of the global strategy and got obvious achievements, they purchased from China, undertaking production, processing and exports. Meanwhile, Chinese enterprises began to “Go global”, which was certainly a start, compared with the attraction of foreign investment, overseas investment accounted for only a small part with a value of less than US\$50 billion.

Second, China will go on adhering strictly to the basic state policy of open-up.

Chinese government attached much importance to the open-up, and took it as the strong driving force to deepen the reform and promote economic development. Recently, President Hu Jintao and Premier Wen Jiabao pointed out that China should adhere strictly to the basic state policy of open-up and push forward the reform and development by open-up. China has entered into a stage in open-up; there are 5 major cooperation points:

1. Actively promote the foreign cooperation in service trade. China will be the biggest market with the highest development speed in service trade worldwide, but now the level of development in China is still lower and only accounted for 30%, therefore, China has great potential and most possibility of development.
2. Endeavor to develop cooperation in high-tech. China is drafting a series of policies to encourage foreign investment enterprises to set up Research and Development centers and it is believed that the policies are in accordance with the long-term interests of foreign investors.

3. Encourage foreign investment enterprises to invest in Central, Western and Northeast China. The above-said areas are extensive and have abundant resources, infrastructure construction there has been improved, science, technology and education are competitive and economic development has much potential. The Ministry of Commerce is assisting foreign investment enterprises to realize new development in the areas together with relative departments.
4. Welcome foreign investment to participate reform of state-owned enterprises. Chinese state-owned enterprises have achieved encouraging progress after experiencing reform. On the other hand, the reform is open up to the outside and never refuses but welcomes foreign investment enterprise to cooperate with China.
5. Encourage Chinese enterprises to go out for investment. Many countries hoped that Chinese enterprise could invest and establish factories there. In the past, China did much in overseas investment but that was only the beginning, in the future, Chinese government will provide more beneficial conditions for Chinese enterprises to “Go global”.

Third, China will be the focus in the coming several years for investment and has conditions to cooperate with foreign enterprises at a higher level.

It experienced for 26 years to implement open-up in China and was very successful, with which domestic and foreign enterprises were satisfactory and the cooperation turned to be more pleasant. Now, China is to implement the eleventh-five-year plan and go up to a new stage in foreign trade and economic cooperation, which means, scale of cooperation should be bigger and technological cooperation should be further improved.

The requirements put forward at this time were not only necessary but also properly reasonable. For which reasons are the following:

1. China has a new and flourishing big market, and it will develop with stability and fast growth.
2. China has professional labors. In the past, foreign investors came to China for the low-cost labor force, but now, specialized workers with professional skills are the advantage.
3. Infrastructure construction in China was improved day by day.
4. Law system in China was also perfected gradually. In the 3 years since the entry into WTO, China cleared up and revised about 3000 laws and regulations, established a consummate, open and transparent foreign investment law system.

In the process of enlarging the scale and improving level of foreign trade and economic cooperation, China still encouraged developing labor-intensive industries, it was decided by the national situation that employment was still the great pressure for Chinese government. Meanwhile, while encouraging foreign big enterprises investing in China, China also welcomes small and medium sized enterprises to come to China. China’s system reform brought up thousands of small and medium sized enterprises, which was a driving force for the sustainable development and also the important condition to realize cooperation among such enterprises worldwide.

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