

# 1 China

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## I. Introduction

China is a big country with 9.6 million square kilometres's dominion and 1.3 billion's population. Also, China is one of the oldest countries in the world which has a long history of at least 5000 years.

People's Republic of China was proclaimed by Mao Zedong who was the first president of P.R.C on October 1, 1949. Since initiating the reforms and open policy in 1978, China introduced market economy and people's life has changed greatly. Now China has becoming one of the fastest growing economics and second largest exporter and third largest importer of goods in the world.

However, our situation still remains as a large population, weak economic foundation and lack of resources. It's a long way to go to build a better life for all the citizens.

### **Political Structure, State Structure and Government Organizations**

People's Republic of China adopts a political system of democracy and collective leadership. The party in power is the Communist Party of China (CPC) which was established on July 1st 1921 in Shanghai. Since the foundation of the People's Republic of China in 1949, CPC has been the ruling party of the country. Except the CPC, there are other eight big democratic parties in China which also participate in national politics. Multi-party cooperation and political consultation under the leadership of the CPC is the basic political system in China.

About the State structure, according to the Chinese Constitution, the following six parts are comprised of the State organs of China: the National People's Congress (NPC), the President, the State Council, the Central Military Commission, the Supreme People's Court, and the Supreme People's Procuratorate. Usually, the President of the People's Republic of China is not only the Head of our State but also the supreme representative of China.

Every five year, all NPC commissaries vote to decide the president of People's Republic of China. The president is subordinate to the NPC and directly receives instructions from the supreme organ of State power. The same person can only extend another five years' time once to be the president if he gets a strong agreement from the NPC.

The NPC of the People's Republic of China is the highest organ of state power. The commissaries of NPC are elected by all Chinese citizens and will change every 5 years. Once a year, all commissaries get together in Beijing to hold conferences on the most important national affairs and make decisions. These conferences are usually held in March and last one month. When NPC's conferences are closed, a permanent organ of the NPC called the Standing Committee will be in charge of national affairs to take the place of NPC. Commissaries of the Standing Committee are also voted by five years' turn. The NPC and its Standing Committee are empowered with the rights of legislation, decision, supervision, election and removal.

Chinese central government is often called "The State Council" which is the highest executive organ of State power. It also holds the highest power of State's normal administration. The State Council is composed of a premier, vice-premiers, State councilors, ministers in charge of ministries and commissions, the auditor-general and the secretary-general. Among which, the premier of the State Council is appointed and nominated or removed by the president. He is responsible for the president but also be reviewed by the NPC.

Under the State Council, there are 27 Ministries and Commissions, 16 direct organizations, 4 administrative offices and 14 direct institutions. Besides, another 22 administrations or bureaus are under the Ministries & Commissions charge.

## **Administrative Divisions**

China's regionalism system includes the following parts: twenty-three provinces; five autonomous regions of minority folks (Tibet, Xinjiang, Ningxia, Inner Mongolia and Guangxi) ; four municipalities (Beijing, Shanghai, Tianjin and Chongqing) which are directly under the charge of central government; and two special administrative regions (Hongkong and Macao) which have autonomy to some extent. The capital city is Beijing.

A province or an autonomous region is subdivided into autonomous prefectures, counties, autonomous counties and /or cities. A county or an autonomous county is subdivided into townships, ethnic townships and/or towns. There are 333 regions at prefecture level, 2859 regions at county level and 40813 regions at townships level till the end of 2007.

## **Geography and Climate**

The People's Republic of China is located in east Asian, on the western shore of the Pacific Ocean. With a land boundary of about 22,800 km, China is bordered by The South Korea to the east; Mongolia to the north; Russia to the northeast; Kazakhstan, Kyrgyzstan and Tajikistan to the northwest; Afghanistan, Pakistan, India, Nepal and Bhutan to the west and southwest; and Myanmar, Laos and Vietnam to the south. Across the seas to the east and southeast are the Republic of Korea, Japan, the Philippines, Brunei, Malaysia and Indonesia.

With a general height trend of highlands in the west and plains in the east, China has a varied topography including a vast land of lofty plateau, large plains, rolling land, big and small basins surrounded by lofty mountains, etc.. All the five basic topographic types in the world exist in China to create the conditions for developing industry and agriculture. Mountainous land and very rough terrains make up 2/3 of whole Chinese territory which bring some problems of transportation and economic developments. However such topographical features are conducive for forestry, mineral, hydropower resources and tourism.

Extending over 50 latitudes from north to south, the territory of China embraces 6 climate zones including the tropics, the subtropics, the warm temperate zone, the moderate temperate zone, the cold temperate zone and Qinghai-Tibet plateau zone. General speaking, the climate of east China has a strong feature of monsoon weather, while the northwest part falls into temperate and continental weather, and Qinghai-Tibet plateau belongs to Frigid Zone. In winter northwest wind from Siberia prevails in north China, bringing cold and dryness, but it's usually kept around 10 centigrade in general south China and even above 20 centigrade during the winter in some places. From April to September, warm and humid summer monsoons blow from the seas in the east and south, resulting in high temperatures and plentiful rainfall in south and east China, and little temperature difference between north and south during the summer. The average annual precipitation varies greatly from place to place. In southeastern coastal areas, it reaches over 1,500 mm, while in northwestern areas it drops to below 200 mm.

## **Resources**

There are totally 130.04 million hectares' land cultivated, mainly on the Northeast Plain, the North China Plain, the Middle-Lower Yangtze Plain, the Pearl River Delta and the Sichuan Basin. Forests cover only 175 million hectares' area and another 400 million hectares for grasslands stretching more than 3,000 km from the northeast to the southwest. China's cultivated lands, forests and grasslands are among the largest in terms of sheer area in the world. But due to China's large population, the per-capita areas of cultivated land, forest and grassland are small, especially in the case of cultivated land -- only one third of the world's average.

China is rich in mineral resources, and all the world's known minerals can be found here. To date, geologists have confirmed reserves of 158 different minerals, putting China third in the world in terms of total reserves. Reserves of the major mineral resources, such as coal, iron, copper, aluminum, stibium, molybdenum, manganese, tin, lead, zinc and mercury, are in the world's front rank.

China is also one of the countries with the greatest diversity of wildlife in the world. There are more than 6,266 species of vertebrates accounted 10 percent of the world's total. Among them, 2,404 are

terrestrials and 3,862 fishes. There are more than 100 wild animal species unique to China including such well-known rare animals as the giant panda, golden-haired monkey, South China tiger, brown-eared pheasant, red-crowned crane, red ibis, white-flag dolphin and Chinese alligator.

China is also one of the countries with the most abundant plant life in the world. There are more than 32,000 species of higher plants here, among which more than 7,000 species are woody plants especially 2,800-odd tree species. The metasequoia, Chinese cypress, Cathay silver fir, China fir, golden larch, Taiwan fir, Fujian cypress, dove-tree, eucommia and camptotheca acuminata can be only found in China.

### Demographics and Language

There are 1,328.02 million people in the PRC by the end of 2008 according to statistics data. About 19% of the population is 14 years old or younger, 73% of the population is between 15 and 64 years old, and 8% of it is over 65 years old. The natural growth rate in 2007 is 0.517%.

There are 56 distinct ethnic groups, the largest of which is the Han Chinese constituted about 91.9% of total Chinese population. Besides, Zhuang, Manchu, Hui, Miao, Uyghur, Yi, Tujia, Mongols, Tibetans, Buyei, and Koreans are main ethnic minorities.

**Table 1 Composition of Population (2008)**

| Items                       | Population (Year-end figure) | Percentage (%) |
|-----------------------------|------------------------------|----------------|
| National Total              | 132802                       | 100.0          |
| Of which: Urban             | 60667                        | 45.7           |
| Rural                       | 72135                        | 54.3           |
| Of which: Male              | 68357                        | 51.5           |
| Female                      | 64445                        | 48.5           |
| Of which: 0-14 years        | 25166                        | 19.0           |
| 15-59 years                 | 91647                        | 69.0           |
| 60 years                    | 15989                        | 12.0           |
| Of which: 65 years and over | 10956                        | 8.3            |

Source: National Bureau of Statistics of China

Language system can be divided into Standard Chinese and dialects. Standard Chinese is used throughout China but many provinces even cities also has respective local dialects used by native speakers in their daily lives. The most famous ones include Mandarin (Putonghua, based on the Beijing dialect), Yue (Cantonese), Wu (Shanghainese), Minbei (Fuzhou), Minnan (Hokkien-Taiwanese), Xiang, Gan, and Hakka dialects. Generally, most northern dialects are very close to the standard Chinese while southern ones are usually different language system and hard to understand. There are more than 80 languages in 56 ethnic groups totally and about 30 characters all over China including ethnic groups' ones.

### Religion and Culture

Chinese government always respects people's personal religions and made China is a country of great religious diversity and free of religious belief. It has over 100 million followers of various faiths, more than 100,000 sites for religious activities, about 300,000 religious personnel and over 3,000 religious associations. These associations run 76 religious schools and colleges to train religious personnel. In China, all regular religious activities - such as worshipping Buddha, chanting scriptures, praying, expounding on scriptures, baptism, initiation into monk- or nun-hood, Ramadan and observance of religious festivals - are all managed by the religious personnel and adherents themselves, are protected under the law and free from interference. The holy books of each religion are published and distributed by religious associations. Each religion in China has its own national periodical, which is also circulated abroad.

The main religions are Buddhism, Islam, Roman Catholic and Protestant Christianity, China's indigenous Taoism, Shamanism, Eastern Orthodox Christianity and the Naxi people's Dongba religion. The Hui, Uygur, Kazak, Kirgiz, Tatar, Uzbek, Tajik, Dongxiang, Salar and Bonan peoples adhere to Islam; the Tibetan, Mongolian, Lhoba, Monba, Tu and Uygur, to Tibetan Buddhism (also known as Lamaism), and the Dai, Blang and Deang to Hinayana Buddhism. Large numbers of Miao, Yao and Yi are

Catholic or Protestant Christians. Religious Han Chinese tends to practice Buddhism, Christianity, or Taoism.

About traditional culture, accumulated during over 5,000 years' time, Chinese literature, music, painting, calligraphy, dancing, architecture, natural sciences are all unique in the world. Along with Chinese open-up policy, the internationalization makes people know more about China and her culture. To many foreigners, Chinese traditional opera, Kungfu, embroidery, cheong-sam, red lantern and the dragon dance have become classical symbols of Chinese culture.

## II. Overview of Macroeconomic Activity

From 2009, Chinese economy saw a recovery from the shock of global financial crisis and regained an upward trend, which was attributed to the timely and effective macro-policies taken by central government of China in a big extent. These policies included proactive fiscal policy, a moderate loose in monetary policy and also a package of plans such as carrying out structural tax reduction, increasing investments, implementing industrial adjustments, etc.

Though the general economic performance is positive, situation both in domestic and international level is still complicated. Firstly, there are great international pressures on China's currency appreciation which would make a negative impact on China's exports and employment. Secondly, a deficiency in domestic demand has already brought some problem; Thirdly, the income level of labor should be increased in accordance with economic growth, but it would also huff labor cost leading operation of enterprises more difficult. Fourthly, it's necessary to slow down the excessive development of real estate market to maintain the economy stability, but the economy would lack growth momentum if the estate market is restricted too much. Fifthly, the price of resources should be raised for energy saving and environment protection, but it would raise the price level which may fuel the inflation. Finally, there is still uncertainty in the debt crisis of European economy. If the debt crisis worsened, it would have significant negative impact on China's exports.

According to CPC Central Committee's Proposal of the Twelfth Five-Year Plan of China, Chinese government will focus on expanding domestic consumption, investment and export next five years. The policies would include encouraging and guiding private capital to invest in fields such as infrastructure, utilities and financial sector, reforming distribution system to increase average income, promoting rural areas' developments.

### II. 1 Macroeconomic Activity

#### 1.1 International Environment

##### A. Trade Balance

The total value of imports and exports in 2009 reached 2,207.2 billion US dollars, down 13.9 percent from the previous year. Inside, the exports was 1,201.7 billion US dollars, which show 16 percent's decrease; and the imports was 1,005.6 billion US dollars which was 11.2 percent lower. China had a trade surplus (exports minus imports) of 196.1 billion US dollars, 99.4 billion US dollars less than the previous year.

**Table 2 Total Value of Imports and Exports and the Growth Rates (2009)**

| Item   | Value | 100 million USD        |
|--|-------|------------------------|
|  |       | Increase over 2008 (%) |
| Total imports and exports                    | 22072 | -13.9                  |
| Exports                                      | 12017 | -16.0                  |
| Of which: General trade                      | 5298  | -20.1                  |
| Processing trade                             | 5870  | -13.1                  |
| Of which: Mechanical and electronic products | 7131  | -13.4                  |
| High & new-tech products                     | 3769  | -9.3                   |
| Of which: State-owned                        | 1910  | -25.8                  |
| Foreign-funded                               | 6722  | -15.0                  |
| Others                                       | 3384  | -11.6                  |
| Imports                                      | 10056 | -11.2                  |
| Of which: General trade                      | 5339  | -6.7                   |
| Processing trade                             | 3223  | -14.8                  |
| Of which: Mechanical and electronic products | 4914  | -8.7                   |
| High & new-tech products                     | 3098  | -9.4                   |
| Of which: State-owned                        | 2885  | -18.5                  |
| Foreign-funded                               | 5452  | -12.0                  |
| Others                                       | 1719  | 7.9                    |
| Trade surplus                                | 1961  | ---                    |

Source: National Bureau of Statistics of China

There are great diverse in export commodities, such as coal, rolled steel, textile articles, furniture, and electronic equipment. The products with label Made in China can be seen all over the world nowadays, from laptop computer to all kinds of daily products, such as clothing and toys. In 2009, There was an significant influence of the financial crisis on China's foreign trade. In table3, the volume of most export items declined, some of which had a big drop such as coal, rolled steel, containers and motor vehicles. In contrast, the import situation was more positive. Seen from Table 4, more than half items' imports increased, some even in a significant boost such as Coal and Iron ore.

**Table 3 Main Export Commodities in Volume and Value and the Growth Rates (2009)**

| Item  | Unit            | Volume | Increase over 2008 (%) | Value (100 million USD) | Increase over 2008(%) |
|---|-----------------|--------|------------------------|-------------------------|-----------------------|
| Coal  | 10000 tons      | 2240   | -50.7                  | 24                      | -54.7                 |
| Rolled steel  | 10000 tons      | 2460   | -58.5                  | 223                     | -64.9                 |
| Textile yarns and textile articles                      | ----            | --     | --                     | 600                     | -8.4                  |
| Clothes and clothing accessories                        | ----            | --     | --                     | 1071                    | -11.0                 |
| Footwear  | ----            | --     | --                     | 280                     | -5.7                  |
| Furniture   | ----            | --     | --                     | 253                     | -6.0                  |
| Automatic data processing machines and components       | 10000 sets      | 131331 | -8.5                   | 1224                    | -9.4                  |
| Handheld mobiles and car telephones                     | 10000 sets      | 58280  | 9.4                    | 396                     | 2.7                   |
| Containers  | 10000 units     | 69     | -77.2                  | 19                      | -78.6                 |
| Integrated circuit                                      | 1 million units | 56608  | 16.8                   | 233                     | -4.2                  |
| Liquid crystal display panels                           | 10000 units     | 192414 | -5.1                   | 192                     | -14.1                 |
| Motor vehicles (including a complete set of spare sets) | 10000 sets      | 35     | -45.2                  | 47                      | -47.3                 |

Source: National Bureau of Statistics of China

**Table 4 Main Import Commodities in Volume and Value and the Growth Rates (2009)**

| Item                       | Volume (10000 tons) | Increase over 2008 (%) | Value (100 million USD) | Increase over 2008(%) |
|----------------------------|---------------------|------------------------|-------------------------|-----------------------|
| Cereals and cereal flour   | 315                 | 104.6                  | 9                       | 22.7                  |
| Soybean                    | 4255                | 13.7                   | 188                     | -13.9                 |
| Edible vegetable oil       | 816                 | 8.4                    | 59                      | -30.1                 |
| Coal                       | 12583               | 211.9                  | 106                     | 201.3                 |
| Iron ore                   | 62778               | 41.6                   | 501                     | 501                   |
| Aluminum oxide             | 514                 | 12.1                   | 13                      | -26.6                 |
| Crude oil                  | 20379               | 13.9                   | 893                     | -31.0                 |
| Petroleum products refined | 3696                | -5.4                   | 170                     | -43.7                 |
| Plastics in primary forms  | 2381                | 34.5                   | 348                     | 2.2                   |
| Paper pulp                 | 1368                | 43.7                   | 68                      | 2.1                   |
| Rolled steel               | 1763                | 14.3                   | 195                     | -16.9                 |
| Copper and copper alloys   | 429                 | 62.7                   | 226                     | 18.0                  |

Source: National Bureau of Statistics of China

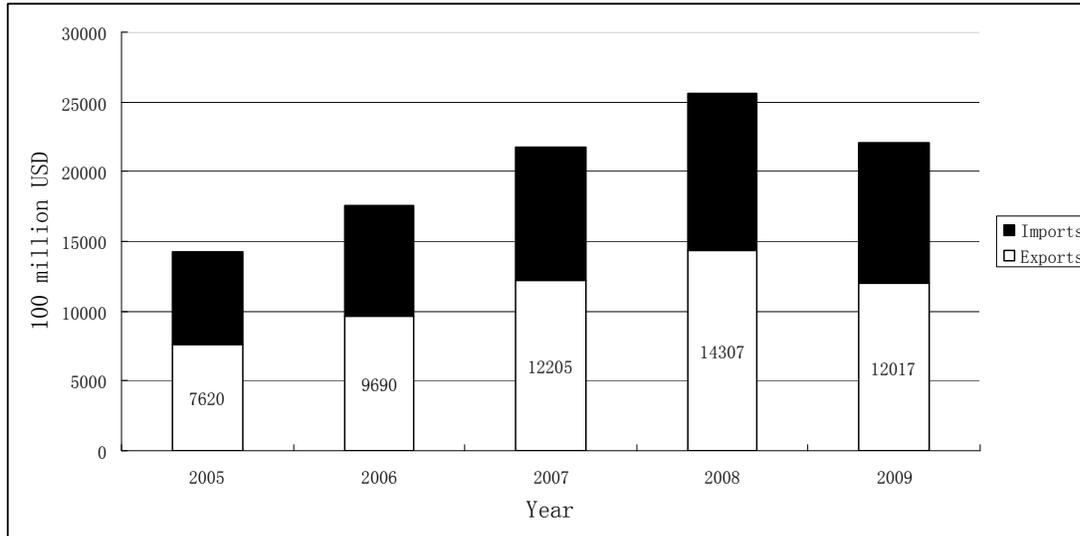
Most of products are exported to developed countries like European Union, United States and Japan in 2009. The imported items are mainly from Japan, European Union, Republic of Korea and The Association of Southeast Asian Nations (ASEAN). The decline rate in imports was less than that in exports by major countries and regions.

**Table 5 Imports and Exports by Major Countries and Regions and the Growth Rates (2009)**

| Country or region | Exports | Increase over 2008 (%) | Imports | Increase over 2008(%) |
|-------------------|---------|------------------------|---------|-----------------------|
| European Union    | 2363    | -19.4                  | 1278    | -3.7                  |
| United States     | 2208    | -12.5                  | 774     | -4.8                  |
| Hong Kong, China  | 1662    | -12.8                  | 87      | -32.6                 |
| Japan             | 979     | -15.7                  | 1309    | -13.1                 |
| ASEAN             | 1063    | -7.0                   | 1067    | -8.8                  |
| Republic of Korea | 537     | -27.4                  | 1026    | -8.5                  |
| Russia            | 175     | -47.1                  | 213     | -10.7                 |
| India             | 297     | -6.1                   | 137     | -32.3                 |
| Taiwan, China     | 205     | -20.8                  | 857     | -17.0                 |

Unit: 100 million USD  
Source: National Bureau of Statistics of China

The overall value of exports and imports had kept increasing from 2005 to 2008, but this trend became negative in 2009. The growth rate in import-export decreased from 23.2% in 2005 to 17.8% in 2008, and then to -13.9% in 2009 in the previous years' basis.

**Figure 1 Imports and Exports and the Growth Rates (2005-2009)**

Source: National Bureau of Statistics of China

## B. Balance of Payment

The statistics, which is from China's Balance of Payments (BOP) Statement for the year 2009 released by the State Administration of Foreign Exchange(SAFE), of the current account and the capital & financial account has shown some negative information though overall situation is good and international reserves maintained a growing momentum.

In 2009, China's surplus under the current account totaled US\$ 297.1 billion. Specifically, according to statistical coverage of the balance of payments, the surpluses in goods, income, and current transfers respectively reached US\$ 249.5 billion, US\$ 43.3 billion, and US\$ 33.7 billion, whereas the deficit in services mounted to US\$ 29.4 billion.

Meanwhile, China's surplus under the capital & financial account was US\$ 19 billion in 2008, increased US\$ 135.8 over previous year. In particular, net inflows of direct investments, portfolio investments and other investments amounted to US\$ 34.3 billion and US\$ 38.7 billion respectively.

Furthermore, China's international reserves continued to grow. By the end of 2009, China registered a total of US\$ 2.399 trillion in foreign exchange reserves, an increase of USD\$382.1 billion over that at the end of 2009.

In addition, the BOP Analysis Team of the SAFE released China's Balance of Payments Report for the year 2009 in order to facilitate understanding of the data and analysis of China's balance of payments among all groups in the society.

**Table 6 Balance of Payment (2009) \***

| Items                             | US dollars (billions) |         |         |
|-----------------------------------|-----------------------|---------|---------|
|                                   | Balance               | Credit  | Debit   |
| I. Current Account                | 297.1                 | 1,484.6 | 1,187.4 |
| A. Goods and Services             | 220.1                 | 1,333.3 | 1,113.2 |
| a. Goods                          | 249.5                 | 1,203.8 | 954.3   |
| b. Services                       | -29.4                 | 129.5   | 158.9   |
| B. Income                         | 43.3                  | 108.6   | 65.3    |
| C. Current Transfers              | 33.7                  | 42.6    | 8.9     |
| II. Capital and Financial Account | 144.8                 | 746.4   | 601.6   |
| A. Capital Account                | 4                     | 4.2     | 48.1    |
| B. Financial Account              | 140.9                 | 742.2   | 601.4   |
| 1. Direct Investment              | 34.3                  | 114.2   | 79.9    |
| 2. Portfolio Investment           | 38.7                  | 98.1    | 59.4    |
| 3. Other Investment               | 67.9                  | 529.9   | 462     |
| III. Reserves Assets              | -398.4                | 0       | 398.4   |
| IV. Net Errors and Omissions      | -43.5                 | 0       | 43.5    |

\* This BOP statement employs rounded-off numbers.

Source: State Administration of Foreign Exchange

### C. Exchange Rate and Exchange System

Starting from July 21, 2005, China reformed the exchange rate regime by moving into a managed floating exchange rate based on a market supply and demand with reference to a basket of currencies. Recent years, the People's Bank of China (PBC) has continued to improve the managed floating exchange rate reform based on market demand and supply with reference to a basket of currencies and to maintain the RMB exchange rate broadly stable in a self-initiated, controllable and gradual manner.

In 2009 and the first five months of 2010, RMB exchange rate movement remained stable. The spot rate of RMB against the U.S. dollar fluctuated in the band of 6.825~6.838. Then the exchange rate of RMB against U.S. dollar was appreciated by 7 percent from June to September in 2010. In 2009, RMB cumulatively appreciated by 1.6 percent against U.S. dollar, and 6.8 percent against the Euro over 2008, but depreciated by 8.2 percent against the Japanese Yen compared with 2008.

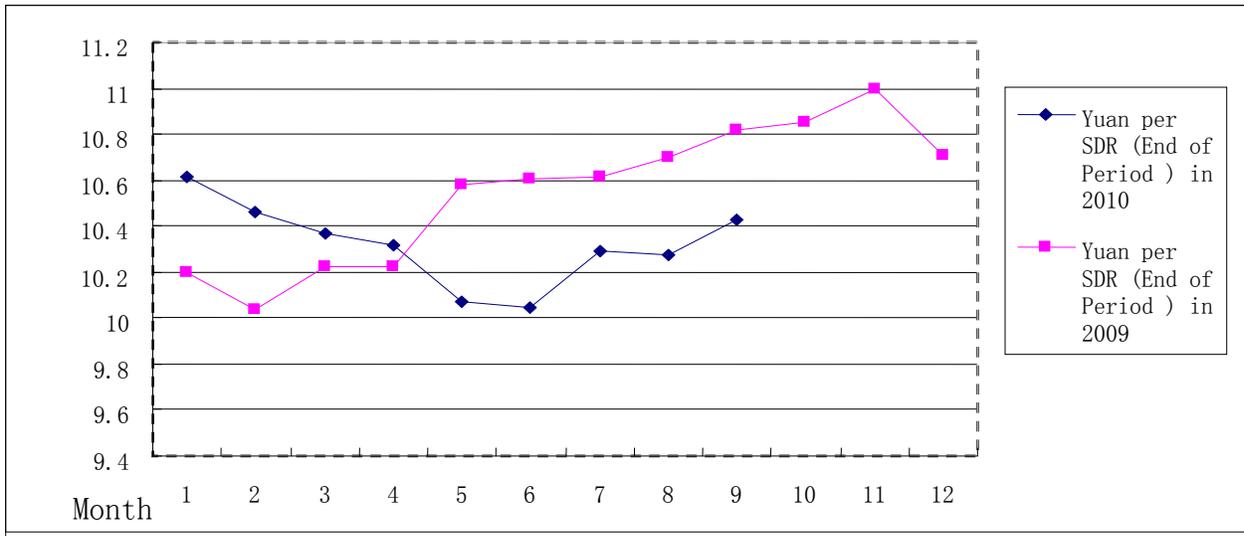
**Table 7 Exchange Rate of Renminbi Yuan (Period Average)**

| Year | (RMB yuan)     |                  |                       |           |
|------|----------------|------------------|-----------------------|-----------|
|      | 100 US Dollars | 100 Japanese Yen | 100 Hong Kong Dollars | 100 Euros |
| 1994 | 861.8700       | 8.4370           | 111.53                |           |
| 1995 | 835.1000       | 8.9225           | 107.96                |           |
| 1996 | 831.4200       | 7.6352           | 107.51                |           |
| 1997 | 828.9800       | 6.8600           | 107.09                |           |
| 1998 | 827.9100       | 6.3488           | 106.88                |           |
| 1999 | 827.8300       | 7.2932           | 106.66                |           |
| 2000 | 827.8400       | 7.6864           | 106.18                |           |
| 2001 | 827.7000       | 6.8075           | 106.08                |           |
| 2002 | 827.7000       | 6.6237           | 106.07                | 800.58    |
| 2003 | 827.7000       | 7.1466           | 106.24                | 936.13    |
| 2004 | 827.6800       | 7.6552           | 106.23                | 1029.00   |
| 2005 | 819.1700       | 7.4484           | 105.30                | 1019.53   |
| 2006 | 797.1800       | 6.8570           | 102.62                | 1001.90   |
| 2007 | 760.4000       | 6.4632           | 97.46                 | 1041.75   |
| 2008 | 694.5100       | 6.7427           | 89.19                 | 1022.27   |
| 2009 | 683.1          | 7.2986           | 88.12                 | 952.70    |

a) ECU entered into circulation in 2002

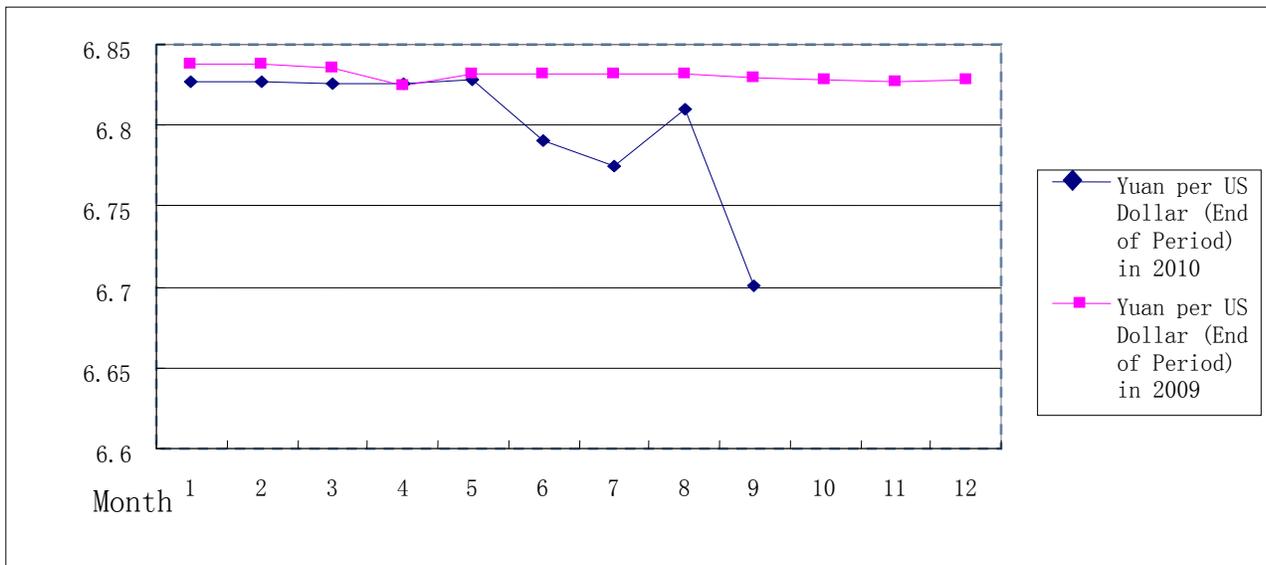
Source: China Statistical Yearbook 2010

**Figure 2 Exchange Rate in 2009 and 2010 [Yuan per SDR (End of Period )]**



Source: the People's Bank of China

**Figure 3 Exchange Rate in 2009 and 2010 [Yuan per US Dollar (End of Period)]**



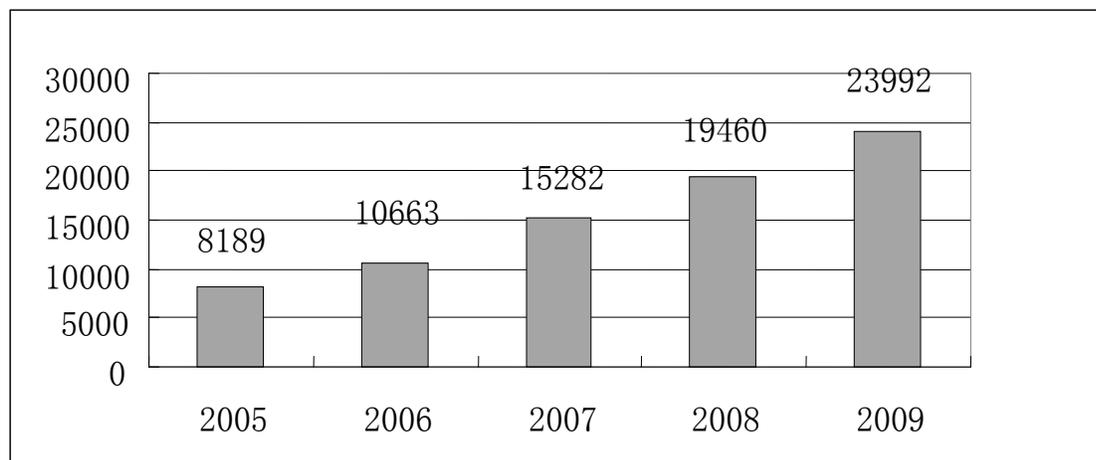
Source: the People's Bank of China

Because of the acceleration of international capital flows, Chinese government amended “The Regulations on the Foreign Exchange System of the People’s Republic of China” to strengthen the supervision of capital flows in August 2008. The new regulations have multiple policy objectives. Initially, it intends to slow down the growth of foreign exchange reserves and to ease RMB appreciation by removing mandatory requirements in transfer and settlement of foreign exchange. Under the new law, foreign exchange income of a domestic institution or individual may be transferred back to China (either to be reserved in a foreign exchange account or sold to qualified financial institutions) or deposited overseas. Secondly, it tries to crack down on illegal foreign exchange activities. Unauthorized collection and settlement of foreign exchange (such as hot money poured into China without due approval or filing) is subject to the same penalty as unauthorized purchase of foreign exchange and remittance offshore: 30% of the amount of violation. To verify the legality of such cross-border foreign exchange, the supervision authority applies the authenticity and lawfulness of underlying transaction test. Moreover, it strengthens

the control over use of settled foreign exchange, which should be strictly in line with the purpose as approved by the foreign exchange administration authority or qualified financial institution. Finally, new law establishes a new emergency protection system for international balance of payment, which specifies that in certain emergencies, such as serious unbalance of payment or economic crisis, the state may take necessary protection or control measures.

By the end of 2009, China's foreign exchange reserves reached 2,399.2 billion US dollars, enjoyed 453.2 billion US dollars' increase compared with previous year. Also, the exchange rate was 6.831 RMB to 1 USD in Dec. 2009, which was appreciated by 1.6 percent over contemporaneous time of 2008.

**Figure 4 Year-end China's Foreign Exchange Reserves, 2005-2009**



Source: National Bureau of Statistics of China

#### **D. Foreign Direct Investment**

2009 witnessed the establishment of 23,435 enterprises with foreign direct investment in non-financial sectors, down by 14.8 percent compared with 2008; and foreign capital actually utilized was 90.03 billion US dollars, a 2.6 percent's decrease upon the basis of 2008. Compared with the foreign direct investment actually utilized in 2008 by sectors, the foreign direct investment actually utilized in manufacturing sector was down by 6.3 percent, while 9.7 percent's fall in the real estate and also 11.4 percent's decline in storage, transportation and post service. On contrary, leasing and business service was up by 20.2 percent, and wholesales and retail trade also enjoyed a 21.6 percent's increase.

**Table 8 Total Value of Foreign Direct Investment and the Growth Rates (2009)**

| Sector  | Enterprises | Increase<br>over 2008<br>(%) | Actually Utilized<br>Value (100<br>million USD) | Increase<br>over<br>2008 (%) |
|---|-------------|------------------------------|---|------------------------------|
| Total   | 23435       | -14.8                        | 900.3   | -2.6                         |
| Farming, Forestry, Animal Husbandry and Fishery                               | 896         | -2.3                         | 14.3  | 20.0                         |
| Mining and Quarrying  | 99          | -33.6                        | 5.0   | -12.6                        |
| Manufacturing   | 9767        | -15.6                        | 467.7   | -6.3                         |
| Production and Supply of Electricity, Gas and Water                           | 238         | -25.6                        | 21.1  | 24.5                         |
| Construction  | 220         | -16.0                        | 6.9   | -36.7                        |
| Transport, Storage, Post and Telecommunication Services                       | 395         | -24.5                        | 25.3  | -11.4                        |
| Information Transmission, Computer Services and Software                      | 1081        | -15.9                        | 22.5  | -19.0                        |
| Wholesales & Retail Trade   | 5100        | -12.9                        | 53.9  | 21.6                         |
| Lodging & Catering Services   | 502         | -20.7                        | 8.4   | -10.1                        |
| Banking   | 502         | -20.7                        | 8.4   | -10.1                        |
| Real Estate   | 569         | 25.9                         | 168.0   | -9.7                         |
| Leasing and Business Services   | 2864        | -8.7                         | 60.8  | 20.2                         |
| Scientific Research, Technical Services and Geological Prospecting            | 1066        | -42.0                        | 16.7  | 11.2                         |
| Water Conservancy, Environment Protection and Public Facilities<br>Management | 183         | 32.6                         | 5.6   | 63.4                         |
| Services to Households and Other Services                                     | 207         | 1.0                          | 15.9  | 178.3                        |
| Education   | 20          | -16.7                        | 0.1   | -63.0                        |
| Health, Social Security and Social Welfare                                    | 18          | 80.0                         | 0.4   | 127.0                        |
| Culture, Sports and Entertainment   | 158         | -7.1                         | 3.2   | 23.0                         |
| Public Management and Social Organization                                     | --          | --                           | --  | --                           |
| International Organization  | --          | --                           | --  | --                           |

Source: National Bureau of Statistics of China

### E. Borrowing From Aboard

In 2009's year-end, China's outstanding external debt (excluding that of Hong Kong SAR, Macao SAR, and Taiwan Province) reached US\$ 428.6 billion, US\$ 38.4 billion or 9.8%'s increase compared with 2008. In specific, the outstanding long-and-medium-term external debt reached US\$ 169.3 billion, which accounts for 39.5% of the total outstanding external debt, saw an increase of US\$ 5.4 billion or 3.3% based on 2008. The outstanding short-term external debt totaled US\$ 259.3 billion, also increase by US\$ 33 billion or 14.6% upon the previous year.

Among the outstanding registered external debt of US\$ 266.9 billion, the outstanding sovereign debt borrowed by ministries under the State Council totaled US\$ 37.4 billion, accounting for 14%; the outstanding debt of Chinese-funded financial institutions was US\$ 94.1 billion, taking a percentage of 35; the outstanding debt of foreign-funded enterprises was US\$ 93.2 billion, representing as 35%; the outstanding debt of foreign-funded financial institutions in China was US\$ 37.4 billion, reaching to 14%; the outstanding debt of Chinese-funded enterprises was US\$ 5.338 billion, only by 2%.

Initial calculations reveal that the ratio of debt service was 2.9% in 2009. The outstanding external debt to foreign exchange income, outstanding external debt to GDP, and the ratio of the short-term external debt to foreign exchange reserves was 32.2%, 8.7% and 10.83% respectively. All of these indexes are within the safe range of international standards. Table 10 shows the major indicators of foreign debts from 2003 to 2009.

**Table 9 Major Indicators of Foreign Debts**

| Item  | Year | 2003   | 2004   | 2005   | 2006   | 2007  | 2008  | 2009   |
|---|------|--------|--------|--------|--------|-------|-------|--------|
| Total Foreign Debts (Billion USD)             |      | 193.6  | 228.6  | 281.1  | 323.0  | 373.6 | 390.2 | 428.6  |
| Balance of Long-term Debts                    |      | 116.6  | 124.3  | 124.90 | 139.4  | 153.5 | 163.9 | 169.3  |
| Share in the Total, (%)                       |      | (60.2) | (54.4) | (44.4) | (43.2) | (41)  | (42)  | (39.5) |
| Balance of Short-term Debts                   |      | 77.0   | 104.3  | 156.2  | 183.6  | 220.1 | 226.3 | 259.3  |
| Share in the Total, (%)                       |      | (39.8) | (45.6) | (55.6) | (56.8) | (59)  | (58)  | (60.5) |
| Ratio of Debt Service to Exchange Earning (%) |      | 6.9    | 3.2    | 3.1    | 2.1    | 2.0   | 1.8   | 2.9    |
| Ratio of Debt Balance to Exchange Earning (%) |      | 39.9   | 34.9   | 33.6   | 30.4   | 27.8  | 24.7  | 32.2   |
| Ratio of Debt Balance to GDP (%)              |      | 13.7   | 13.9   | 12.6   | 12.3   | 11.5  | 8.6   | 8.7    |

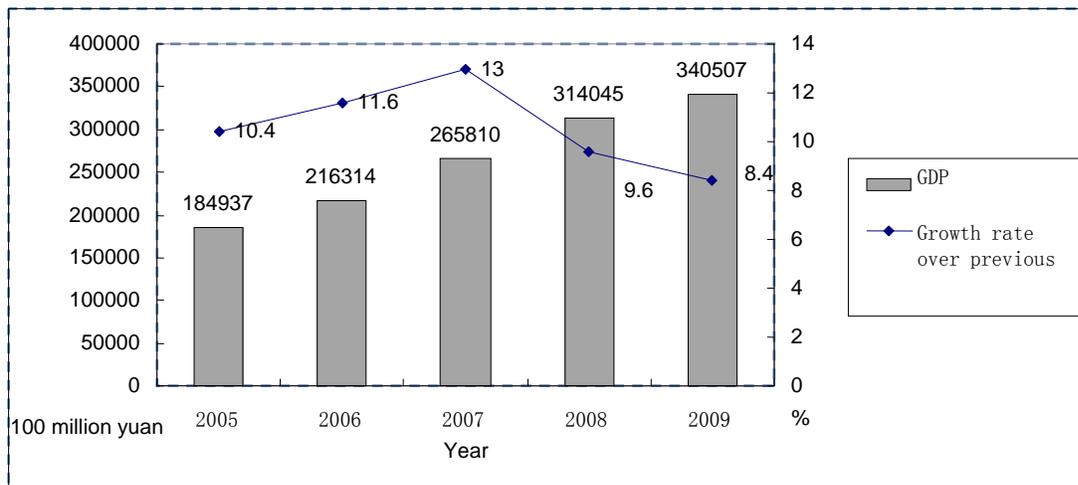
Source: State Administration of Foreign Exchange

## II.1.2 Domestic Environment

### A. Economic Growth Rate

The gross domestic product (GDP) of 2009 was 34,050.7 billion yuan, which increased by 8.4 percent over the previous year. Analyzed in different industries, the value added of the primary industry was 3522.6 billion yuan with a 4.5 percent's climb; the secondary industry was 15763.9 billion yuan, up by 5.8 percent and the tertiary industry was 14764.2 billion yuan, enjoyed 12.4 percent's raise.

Seen from the ratio, the value added of the primary industry accounted for 10.3 percent of total GDP, down by 1 percentage compared with previous year; the secondary's ratio also declined by 2.3 percentage, accounting for 46.3 percent while the tertiary industry shown a rise by 3.3 percentage, taking 43.4 percent totally.

**Figure 5 Gross Domestic Product and Its Growth, 2005-2009**

Note: Data of GDP Growth Rate are calculated at constant prices.

Source: National Bureau of Statistics of China

**Table 10 Main Indicators of GDP**

| Item                              | 2005    | 2006    | 2007    | 2008    | 2009    |
|-----------------------------------|---------|---------|---------|---------|---------|
| GDP (Billion Yuan)                | 18493.7 | 21631.4 | 26581   | 31404.5 | 34050.6 |
| Primary Industry(Billion Yuan)    | 2242.0  | 2404.0  | 2862.7  | 3370.2  | 3522.6  |
| Secondary Industry (Billion Yuan) | 8759.8  | 10372.0 | 12583.1 | 14900.3 | 15763.9 |
| Tertiary Industry(Billion Yuan)   | 7491.9  | 8855.5  | 11135.2 | 13134.0 | 14764.2 |
| GDP per capita (Yuan)             | 14185   | 16500   | 20169   | 23708   | 25575   |
| GDP Growth Rate (%)               | 10.4    | 11.6    | 13      | 9.6     | 8.4     |

Note: Data of GDP Growth Rate are calculated at constant prices, others are calculated at current prices.  
Source: China Statistical Yearbook 2010, National Bureau of Statistics of China

## B. Inflation Rate

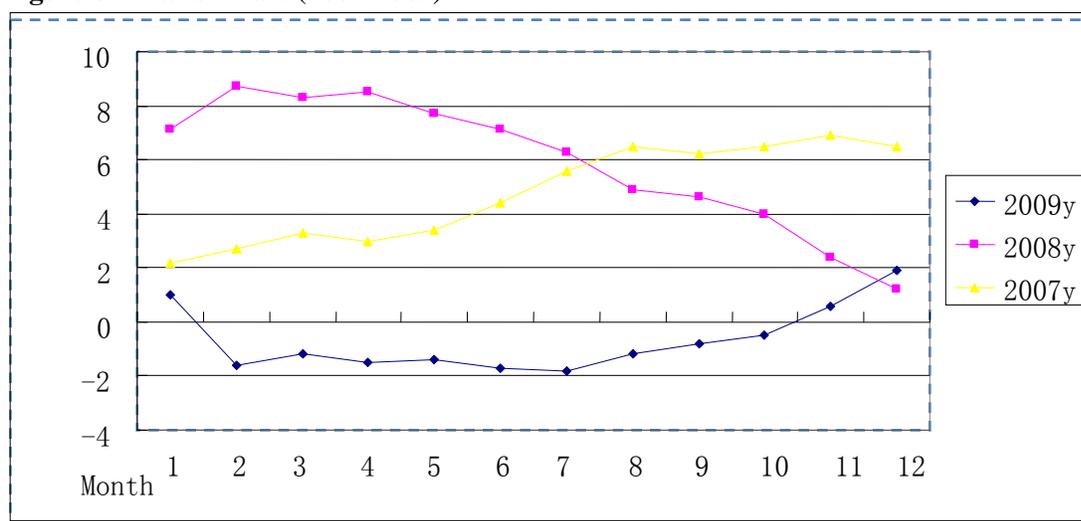
In February 2009, China's inflation rate was -1.6 percent, representing the first negative growth these years. Then in November and December, inflation rose by 0.6 and 1.9 percent respectively and made annual inflation rate -0.7 percent in the end.

**Table 11 Chinese Inflation Rate**

| Year | Month | Jan  | Feb  | Mar  | Apr  | May  | Jun  | Jul  | Aug  | Sep  | Oct  | Nov  | Dec  |
|------|-------|------|------|------|------|------|------|------|------|------|------|------|------|
| 2009 |       | 1.0  | -1.6 | -1.2 | -1.5 | -1.4 | -1.7 | -1.8 | -1.2 | -0.8 | -0.5 | 0.6  | 1.9  |
| 2008 |       | 7.10 | 8.70 | 8.30 | 8.50 | 7.70 | 7.10 | 6.30 | 4.90 | 4.60 | 4.00 | 2.40 | 1.20 |
| 2007 |       | 2.20 | 2.70 | 3.30 | 3.00 | 3.40 | 4.40 | 5.60 | 6.50 | 6.20 | 6.50 | 6.90 | 6.50 |

Source: National Bureau of Statistics of China

Figure 6 shows an increasing trend of inflation rate in 2007 and a decreasing trend after February 2008. It began to rise from November, 2009.

**Figure 6 Inflation Rate (2007-2009)**

Source: National Bureau of Statistics of China

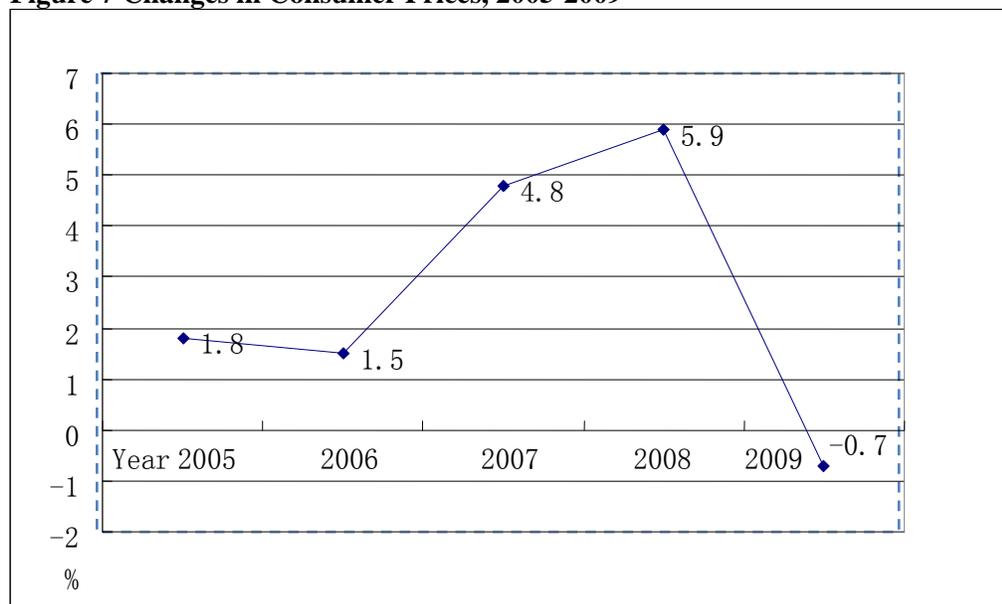
## C. Consumption

The general level of consumer prices in China was down by -0.7 percent from previous year. Among this total, investment in fixed assets declined by 2.4 percent; producer prices for manufactured goods also drop by 5.4 percent; purchasing prices for raw materials, fuels and power went down by 7.9 percent; farm

products and agricultural production decreased slightly by 2.4 percent and 2.5 percent respectively. On the contrary, housing prices in 70 large and medium-sized cities were up by 1.5 percent and the food's price also increased by 0.7 percent.

Figure 7 shows how the consumer price diving in 2009.

**Figure 7 Changes in Consumer Prices, 2005-2009**



Source: National Bureau of Statistics of China

Table 12 shows price changes of main items in 2009 on a basis of 2008.

**Table 12: General Level of Consumer Prices (2009)**

Unit: %

| <i>Item</i>   | National Average | <i>Urban</i> | Rural |
|---|------------------|--------------|-------|
| General level of consumer prices                          | -0.7             | -0.9         | -0.3  |
| Food  | 0.7              | 1.0          | 0.1   |
| Of Which: Grain   | 5.6              | 5.7          | 5.5   |
| Meat, poultry and related products                        | -8.7             | -8.5         | -9.2  |
| Oil   | -18.3            | -17.9        | -18.8 |
| Fresh eggs  | 1.5              | 1.3          | 2.0   |
| Fresh vegetables  | 15.4             | 15.0         | 16.7  |
| Fresh fruits  | 9.1              | 9.0          | 9.5   |
| Tobaccos and alcohols                                     | 1.5              | 1.7          | 1.3   |
| Clothing  | -2.0             | -2.2         | -1.6  |
| Household appliances and services                         | 0.2              | 0.3          | 0.0   |
| Medical, health and personal articles                     | 1.2              | 1.1          | 1.5   |
| Transportation and telecommunications                     | -2.4             | -2.7         | -1.8  |
| Recreational, educational, cultural articles and services | -0.7             | -1.2         | 0.6   |
| Housing   | -3.6             | -4.6         | -1.5  |

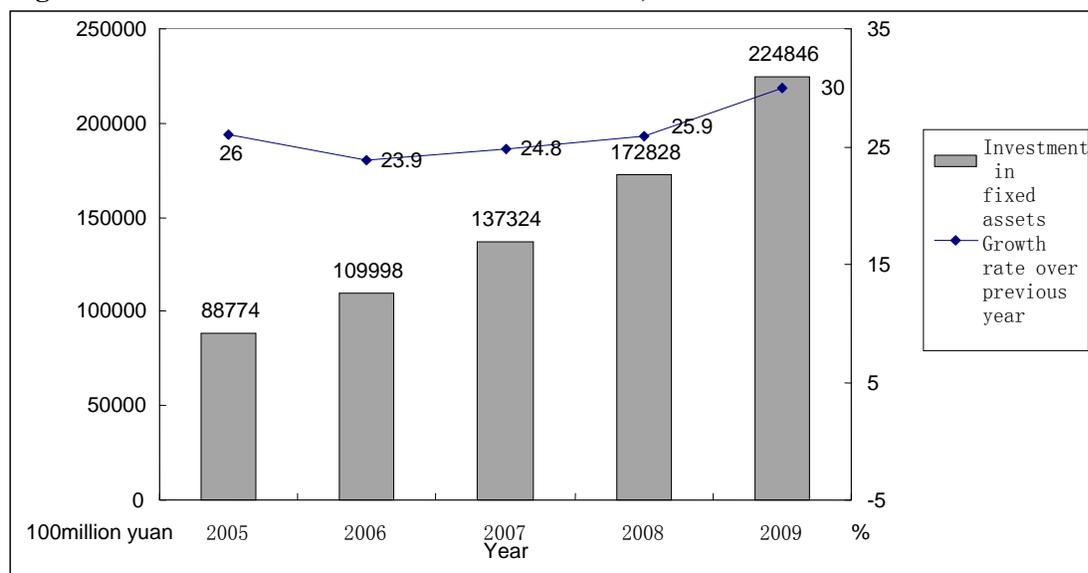
Source: National Bureau of Statistics of China

#### **D. Investment**

The total completed investment on fixed assets was 22484.6 billion yuan in 2009, enjoyed 30 percent's rise over previous year. In specific, that in urban areas was 19413.9 billion yuan with 30.5 percent's increase; and that in rural areas reached 3070.7 billion yuan, also raised by 27.5 percent. Seen from regions, the eastern areas took the largest share of investment with 9565.3 billion yuan, followed by the central areas with 4984.6

billion yuan. The western part are more or less with the center, taking 4966.2 billion yuan. The northeastern areas had least which was only 2373.3 billion yuan.

**Figure 8 Investment in Fixed Assets and Its Growth, 2005-2009**



Source: National Bureau of Statistics of China

In 2009, the production capacity increased in the following fields through fixed assets investment, such as power transformer equipment, railways, electrified railways, lines of optical-fiber cable and digital cellular mobile phone switchboards.

**Table 13 Newly Increased Production Capacity through Fixed Assets Investment (2009)**

| Item   | Unit                    | Volume |
|--|-------------------------|--------|
| Newly increased power generating capacity                          | 10,000 kilowatts        | 8970   |
| Power transformer equipment with a capacity of over 220 kilovolts  | 10,000 kilovolt-amperes | 27161  |
| New railways put into operation                                    | Kilometer               | 5557   |
| Double-track railways put into operation                           | Kilometer               | 4129   |
| Electrified railways put into operation                            | Kilometer               | 8448   |
| New highways   | Kilometer               | 121013 |
| Of which: Expressways  | Kilometer               | 4391   |
| New cargo-handling capacity of berths for over 10000-tonnage ships | 10,000 tons             | 31318  |
| New lines of optical-fiber cables                                  | 10,000 km               | 149    |
| New capacity of digital cellular mobile phone switchboards         | 10,000 subscribers      | 27580  |

Source: National Bureau of Statistics of China

**Table 14 Fixed Assets Investment in Urban Areas and Its Growth by Sector (2009)**

(Unit: 100 million yuan)

| Sector   | Investment | Increase over 2008 (%) |
|--|------------|------------------------|
| Total  | 194139     | 30.5                   |
| Agriculture, Forestry, Animal Husbandry and Fishing                            | 3373       | 49.9                   |
| Mining   | 8093       | 18.2                   |
| Of Which: Mining and Washing of Coal   | 3021       | 25.9                   |
| Extraction of Petroleum and Natural Gas  | 2793       | 4.4                    |
| Manufacturing  | 58817      | 26.8                   |
| Of Which: Processing of Food from Agricultural Products                        | 2826       | 38.2                   |
| Manufacture of Foods   | 1513       | 32.4                   |
| Textile Industry   | 1768       | 14.8                   |
| Manufacture of Textiles, garments, shoes and hats                              | 1051       | 17.0                   |
| Processing of Petroleum, Coking, Processing Nuclear Fuel                       | 1835       | 0.4                    |
| Manufacture of Raw Chemical Materials and Chemical Products                    | 6006       | 26.9                   |
| Manufacture of Non-Metallic Mineral Products                                   | 5948       | 43.5                   |
| Smelting and Pressing of Ferrous Metals  | 3206       | -1.3                   |
| Smelting and Pressing of Non-Ferrous Metals                                    | 2202       | 16.8                   |
| Manufacture of Metal Products  | 2836       | 29.2                   |
| Manufacture of General Machinery   | 4465       | 37.6                   |
| Manufacture of Special Purpose Machinery                                       | 3111       | 37.3                   |
| Manufacture of Transport Equipment   | 4965       | 31.3                   |
| Manufacture of Electric Machinery and Equipment                                | 3545       | 51.2                   |
| Manufacture of Communication Equipment, Computers & Other Electronic Equipment | 2627       | 6.7                    |
| Production and Supply of Electricity, Gas and Water                            | 13482      | 28.5                   |
| Of Which: Production of Electric Power and Heat Power                          | 11078      | 22.8                   |
| Construction   | 1884       | 57.6                   |
| Transport, Storage and Post  | 23278      | 48.3                   |
| Information Transmission, Computer Services and Software                       | 2515       | 18.0                   |
| Wholesale and Retail Trade   | 4451       | 39.4                   |
| Lodging and Catering Services  | 2333       | 34.4                   |
| Banking  | 349        | 38.2                   |
| Real Estate  | 43065      | 19.9                   |
| Leasing and Business Services  | 1887       | 50.4                   |
| Scientific Research, Technical Service and Geologic Prospecting                | 1066       | 48.5                   |
| Water Conservancy, Environment and Public Facilities Management                | 17814      | 45.1                   |
| Services to Households and Other Services                                      | 506        | 61.8                   |
| Education  | 3231       | 37.2                   |
| Health, Social Security and Social Welfare                                     | 1689       | 58.5                   |
| Culture, Sports and Entertainment  | 2117       | 47.4                   |
| Public Management and Social Organization                                      | 4189       | 29.3                   |

Source: National Bureau of Statistics of China

In 2009, the total investment in real estate was 3623.2 billion yuan. Among them, commercial residential buildings reached 2561.9 billion yuan, 137.8 billion yuan for office buildings and another 417.2 billion yuan for commercial business buildings.

**Table 15 Main Indicators for Real Estate Development and Sales (2009)**

| Item                                     | Unit                | Volume | Increase over 2008 (%) |
|--|---------------------|--------|------------------------|
| Finished Value of Investment             | 100 million yuan    | 36232  | 16.1                   |
| Of which: residential buildings          | 100 million yuan    | 25619  | 14.2                   |
| Of which: under 90 square meters         | 100 million yuan    | 8351   | 24.1                   |
| Of which: economic housing               | 100 million yuan    | 1139   | 17.3                   |
| Floor space of houses under construction | 10000 square meters | 319650 | 12.8                   |
| Of which: residential buildings          | 10000 square meters | 250804 | 12.5                   |
| Floor space of houses newly started      | 10000 square meters | 115385 | 12.5                   |
| Of which: residential buildings          | 10000 square meters | 92463  | 10.5                   |
| Floor space of houses completed          | 10000 square meters | 70219  | 5.5                    |
| Of which: residential buildings          | 10000 square meters | 57694  | 6.2                    |
| Sales of commercial buildings            | 10000 square meters | 93713  | 42.1                   |
| Of which: residential buildings          | 10000 square meters | 85294  | 43.9                   |
| Sources of capital this year             | 100 million yuan    | 57128  | 44.2                   |
| Of which: domestic loans                 | 100 million yuan    | 11293  | 48.5                   |
| Individual mortgage                      | 100 million yuan    | 8403   | 116.2                  |
| Land space purchased this year           | 10000 square meters | 31906  | -18.9                  |
| Land space developed this year           | 10000 square meters | 23006  | -19.9                  |
| Purchase of land                         | 100 million yuan    | 6039   | 0.7                    |

Source: National Bureau of Statistics of China

### E. Stock Market

The first stock exchange of China was founded in Shenzhen in 1990. Till now two stock exchanges have appeared: Shenzhen Stock Exchange and Shanghai Stock Exchange.

In 2009, 496.8 billion yuan were raised by issued shares, of which 24.4 billion issued A shares (including reissued shares and convertible debts) raised 389.5 billion yuan. For details, 99 A-shares were issued to receive 206.2 billion yuan, while refinancing A-shares (including rationing shares, public newly issued, nonpublic newly issued and warrants) contributing 159.1 billion yuan. The listed companies financed 81.3 billion yuan through convertible bonds, bonds with attached warrants and corporate bonds. 36 GEM-shares were initially public offered after the Venture Board was established in 2009, raising 20.4 billion yuan together.

In 2009, 15.6 billion's issued H and N shares brought 107.3 billion yuan. By the end of 2009, the quantities of listed companies (A shares and H shares) in China have reached 1718 with the total market value of 2439 3.9 billion yuan, which is as about 2 times as the last year.

Table 16 shows the developing trend of stock market from 2003 to 2009 in China.

**Table 16 General Statistics on Stock Market 2003-2009**

| Year | Raised Capital (Billion Yuan) |          |                | Quantities of Listed Companies | Total Market Value of Stocks (Billion Yuan) |
|------|-------------------------------|----------|----------------|--------------------------------|---|
|      | Total                         | A Shares | B and H Shares |                                |   |
| 2003 | 135.8                         | 82.0     | 53.7           | 1287                           | 4257.8                                      |
| 2004 | 151.1                         | 83.6     | 67.5           | 1377                           | 3705.6                                      |
| 2005 | 188.3                         | 33.8     | 154.5          | 1381                           | 3243.0                                      |
| 2006 | 559.4                         | 246.3    | 313.1          | 1434                           | 8940.4                                      |
| 2007 | 868.0                         | 772.3    | 95.7           | 1550                           | 32714.1                                     |
| 2008 | 385.2                         | 353.5    | 31.7           | 1625                           | 12136.6                                     |
| 2009 | 496.8                         | 389.5    | 107.3          | 1718                           | 24393.9                                     |

Source: China Statistical Yearbook 2010

### F. Money Supply

In late 2009, money supply of broad sense (M2) was 60.6 trillion yuan, reflecting a year-on-year increase of 27.7 percent. Money supply of narrow sense (M1) was 22 trillion yuan, with 32.4 percent's upturn. Cash in circulation (M0) was 3.8 trillion yuan, increased by 11.8 percent. Savings deposit in RMB and foreign currencies in all items of financial institutions totaled 61.2 trillion yuan, 27.7 percent's enlarged over the beginning of 2009. Loans in RMB and foreign currencies in all items of financial institutions reached 42.6

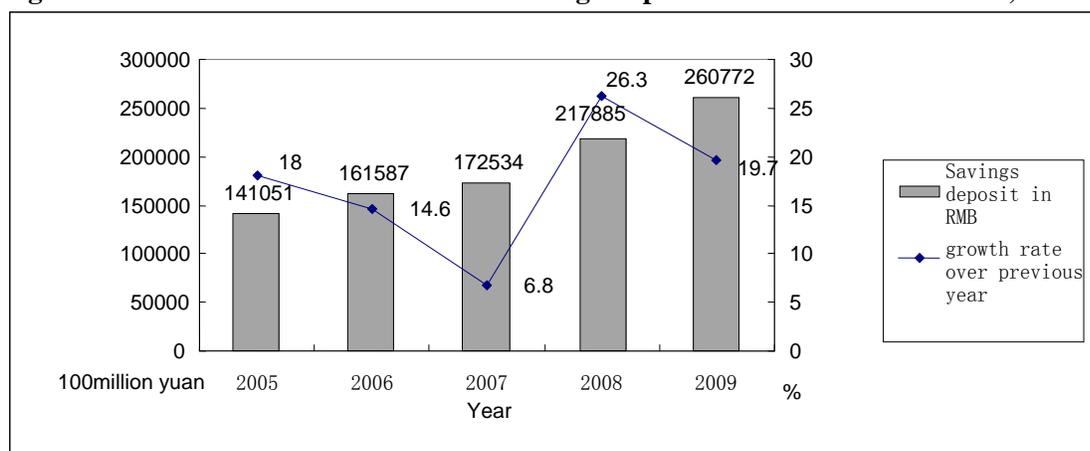
trillion yuan, showing 33 percent's climb.

**Table 17 Savings Deposit and Loans in RMB and Foreign Currencies in All Financial Institutions and the Growth Rates (2009)**

| Item                          | (Unit: 100 million yuan) |                        |
|-------------------------------|--------------------------|------------------------|
|                               | Year-end figure          | Increase over 2008 (%) |
| Savings deposit               | 612006                   | 27.7                   |
| Of which: By enterprises      | 224357                   | 36.5                   |
| By urban and rural households | 264761                   | 19.5                   |
| Of which: Deposits in RMB     | 260772                   | 19.7                   |
| Loans                         | 425597                   | 33.0                   |
| Of which: Short-term          | 151353                   | 17.7                   |
| Medium and long-term          | 235579                   | 43.5                   |

Source: National Bureau of Statistics of China

**Figure 9 Urban and Rural Households' Savings Deposit in RMB and Its Growth, 2005-2009**



Source: National Bureau of Statistics of China

Loans in RMB from rural financial cooperation institutions (i.e. rural credit cooperatives, rural cooperation banks, and rural commercial banks) totaled 4.7 trillion yuan by the end of 2009, an increase of 972.7 billion yuan compared with the beginning of the year. The loans in RMB for consumption use from all financial institutions were 5.5 trillion yuan, with 1797.6 billion yuan's increase. In all consumption loans, short-term loans for individuals gathered 0.6 trillion yuan, 4.9 trillion yuan from individuals for the medium- and long-term loans.

The premium received by the insurance companies totaled 1113.7 billion yuan in 2009, 13.8 percent up over the previous year. Of this total, life insurance premium amounted to 745.7 billion yuan, health and casualty insurance premium 80.4 billion yuan, and property insurance premium 287.6 billion yuan. Indemnity paid by insurance companies was worth 312.5 billion yuan, of which life insurance indemnity was 126.9 billion yuan, health and casualty insurance indemnity 28.1 billion yuan, and property insurance indemnity 157.6 billion yuan.

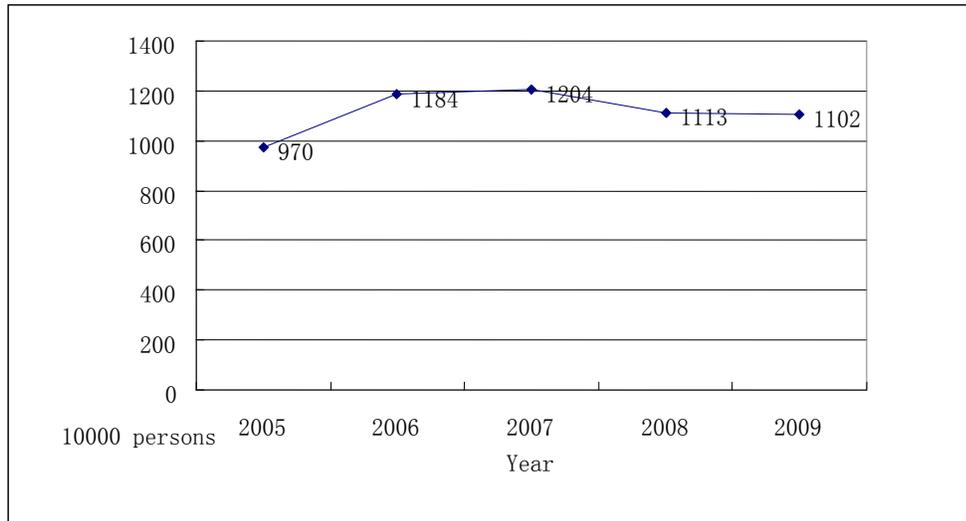
## G. Employment

The employment was more optimistic in 2009 than 2008. Though Urban registered unemployment ratio was 4.3 with an increase of 0.1 percent over 2008, but the PMI (Purchase Management Index) employment index in December 2009 was 52.2 percent, over 50 percent for 7 months in a row, showing that the economy was expansionary.

National employment at year-end of 2009 stood at 779.95 million, went up 5.15 million persons year-on-year. In specific, the employment in primary industry reached 297.08 million persons, occupied 38.1 percent of national employment; that of secondary industry amounted for 216.84 million persons, taking 27.8 percent;

266.03 million persons are engaged in tertiary industry, sharing 34.1 percent. The employment at year-end in urban areas valued at 311.2 million persons, increased 9.1 million persons comparing with 2008.

**Figure 10 The national new employment in urban area, 2005-2009**



Source: National Bureau of Statistics of China

## II.2 Fiscal Position

Mainly due to the impact of the global financial crisis, economic growth slowed down and corporate profits became weakened. After a big cut in the corporate income tax rate in 2008, a series of policies to reduce or exempt taxes and fees were introduced to strengthen and improve macro-control through management of public finance and promote steady and rapid economic growth. This led to a slower growth in national revenue.

National revenue reached 6.8477 trillion yuan, increased 714.7 billion yuan or 11.7% over 2008. In details, central government revenue was 3.5896 trillion yuan with 9.8 percent's climb. That for local governments was 3.2581 trillion yuan, 13.7 percent or 393.1 billion yuan more than the previous year. Another 50.5 billion yuan was taken from central budget stabilization fund.

National expenditures amounted to 7.5874 trillion yuan, showing 1.3281 trillion yuan's rise. Among which, central government shared 1.5280 trillion yuan and 6.0594 trillion yuan for the local governments. Expenditures carried forward to next years was 260.8 billion yuan.

### II.2.1 Government Expenditure

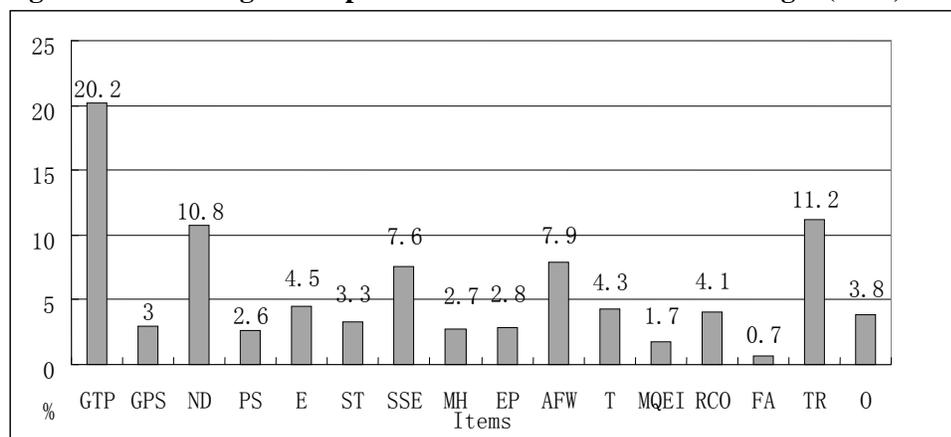
In 2009, total spending by the central government in areas such as education, medical and health care, the social safety net, employment, low-income housing and culture that directly affect the people's lives came to 742.256 billion yuan with an increase of 31.7%. Central government expenditures for agriculture, rural areas and farmers totaled 725.31 billion yuan, expanded 21.8% comparing with 2008. This figure includes 267.92 billion yuan for agricultural production; 127.45 billion yuan for direct subsidies to grain producers, general subsidies for purchasing agricultural supplies, subsidies for planting superior crop varieties and subsidies for purchasing agricultural machinery and tools; 272.32 billion yuan for social programs such as education, medical and health care, the social safety net, employment, low-income housing and culture in rural areas; and 57.62 billion yuan for expenses and interests related to stockpiles of major agricultural products.

The central government's tax rebates and fiscal transfer payments to local governments totaled 2.856379 trillion yuan, the bulk of which went to the people's wellbeing, agriculture, rural areas, and farmers.

Figure11 shows the expenditure item charts in central budget of 2009. The general transfer payment to

local governments from the central government is obvious more than other items. The expenditure for the tax rebates to local government, national defense, general public services and social safety employment keep an important role in the central government's expenditure.

**Figure 11 Percentages of expenditure items in the Central Budget (2009)**



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

Note: TP-Transfer Payments to Local Governments, GPS-General Public Services, ND-National Defense, PS-Public Security, E-Education, ST-Science and Technology, SSE-Social Safety Employment, MH- Medical and Health Care, EP-Environmental Protection, AFW-Agriculture Forestry and Water conservancy, T-Transportation, MQEI-Mining and Quarrying, Electricity and Information Technology, RCO- Reserve for cereals and oils , FA- Financial Affairs, TR-Tax Rebates to Local Government, O- Others

In the following table, the expenditures of central government and local government are showed from 1996 to 2009. That of local government has kept an overwhelming majority of the whole expenditure.

**Table18 National Government Expenditure and Ratio of Central and Local Governments**

|      | National Government(100 million yuan) |                    |                   | Ratio (%)          |                   |
|------|---------------------------------------|--------------------|-------------------|--------------------|-------------------|
|      | Expenditure                           | Central Government | Local Governments | Central Government | Local Governments |
| 1996 | 7937.55                               | 2151.27            | 5786.28           | 27.1               | 72.9              |
| 1997 | 9233.56                               | 2532.50            | 6701.06           | 27.4               | 72.6              |
| 1998 | 10798.18                              | 3125.60            | 7672.58           | 28.9               | 71.1              |
| 1999 | 13187.67                              | 4152.33            | 9035.34           | 31.5               | 68.5              |
| 2000 | 15886.50                              | 5519.85            | 10366.65          | 34.7               | 65.3              |
| 2001 | 18902.58                              | 5768.02            | 13134.56          | 30.5               | 69.5              |
| 2002 | 22053.15                              | 6771.70            | 15281.45          | 30.7               | 69.3              |
| 2003 | 24649.95                              | 7420.10            | 17229.85          | 30.1               | 69.9              |
| 2004 | 28486.89                              | 7894.08            | 20592.81          | 27.7               | 72.3              |
| 2005 | 33930.28                              | 8775.97            | 25154.31          | 25.9               | 74.1              |
| 2006 | 40422.73                              | 9991.40            | 30431.33          | 24.7               | 75.3              |
| 2007 | 49781.35                              | 11442.06           | 38339.29          | 23.0               | 77.0              |
| 2008 | 62427.03                              | 13374.31           | 49052.72          | 21.4               | 78.6              |
| 2009 | 75874                                 | 15280              | 60594             | 20.1               | 79.9              |

Note:

- The expenditure of the central and local governments refers to the expenditure disbursed by the central government and that by the local governments.
- Expenditures before 2000 in this table do not include the payment on the principal and interest of domestic and foreign debts and the expenditure for capital construction using foreign loans. Expenditures of central government and local governments since 2000 include all payment on the principal and interest of domestic and foreign debts.

Source: National Bureau of Statistics of China

China government has been implementing diverse development strategies on different regions based on the specific regional circumstances. For western area, they focused on the development in infrastructure

construction, ecological environment construction, education industry and featured industry based on resource advantages. For northeastern part, the key points were reformation of state-owned enterprises, modern agriculture, equipment manufacturing and the economy transformation of cities that had exhausted resources. About the middle, it focused on developing constructions of major grain producing areas, energy and manufacturing industry, and the infrastructure construction. And for eastern region, the strategy was to improve the capacity of innovation and the international competitiveness of enterprises.

The central government has adopted a variety of methods to raise funds for key projects to promote regional developments. Table 21 shows main government expenditures by typical region in 2009. As following table shown, Beijing and Shanghai is representative of developed areas in eastern region; Henan and Shanxi represent the places in the central region; the data of Guizhou and Ningxia reflects the economic situation in undeveloped regions of western China. The expenditure items in various field in east and middle region are distinctly more than that of west region , though great efforts and policies have been made to develop the economy of the west.

**Table 19 Main Government Expenditure by Typical Region of East, Middle and West Zone in China (2009)**

(Unit: 100 million Yuan)

| Item   | Region | Beijing | Shanghai | Henan   | Shanxi | Guizhou | Ningxia |
|--|--------|---------|----------|---------|--------|---------|---------|
| General Budget Expenditure                                   |        | 2319.37 | 2989.65  | 2905.76 | 1561.7 | 1372.27 | 432.36  |
| General Public Service                                       |        | 212.21  | 206.68   | 459.01  | 247.94 | 196.78  | 46.97   |
| National Defense   |        | 5.29    | 6.06     | 2.56    | 2.7    | 2.81    | 0.49    |
| Public Security  |        | 161.38  | 163.41   | 167.14  | 98.44  | 82.95   | 24.17   |
| Education  |        | 365.67  | 346.95   | 526.14  | 278.07 | 256.72  | 63.50   |
| Science and Technology                                       |        | 126.31  | 215.31   | 35.52   | 17.61  | 14.27   | 4.40    |
| Culture Sport and Media                                      |        | 74.75   | 53.12    | 58.67   | 27.97  | 23.62   | 9.03    |
| Social Security Net and Employment Effort                    |        | 234.29  | 336.08   | 403.62  | 236.94 | 150.04  | 47.68   |
| Medical and Health Care                                      |        | 166.63  | 132.85   | 223.15  | 101.73 | 102.84  | 22.92   |
| Environment Protection                                       |        | 54.05   | 33.96    | 92.98   | 70.61  | 55.31   | 22.59   |
| Urban and Rural Community Affairs                            |        | 347.82  | 602.36   | 130.89  | 85.31  | 43.74   | 42.56   |
| Agriculture Forestry and Water Conservancy                   |        | 142.01  | 107.45   | 361.60  | 198.47 | 204.13  | 68.68   |
| Transportation   |        | 147.07  | 81.84    | 177.62  | 93.68  | 120.80  | 20.39   |
| Mining and Quarrying, Electricity and Information Technology |        | 110.31  | 294.47   | 74.77   | 28.55  | 36.02   | 14.29   |
| Reserve for cereals and oils                                 |        | 19.58   | 39.86    | 80.89   | 22.15  | 19.58   | 14.31   |
| Financial Affairs  |        | 2.44    | 22.82    | 6.69    | 12.99  | 0.13    | 6.41    |

Source: China Statistical Yearbook 2010

## II.2.2 Public Borrowing

The outstanding balance of government bonds in central budget by the end of 2009 totaled 6023.728 billion yuan, of which domestic debts reached 5973.695 billion yuan and foreign debts was 50.073 billion yuan. They accounted 99.17% and 0.83% respectively of the total debts. The proportion of total debts to GDP was roughly 17.7 percent. The table 22 shows that there was a significant decrease in the proportion of total debts to GDP compared with 2008.

**Table 20 Debts of Central Government (Billion Yuan)**

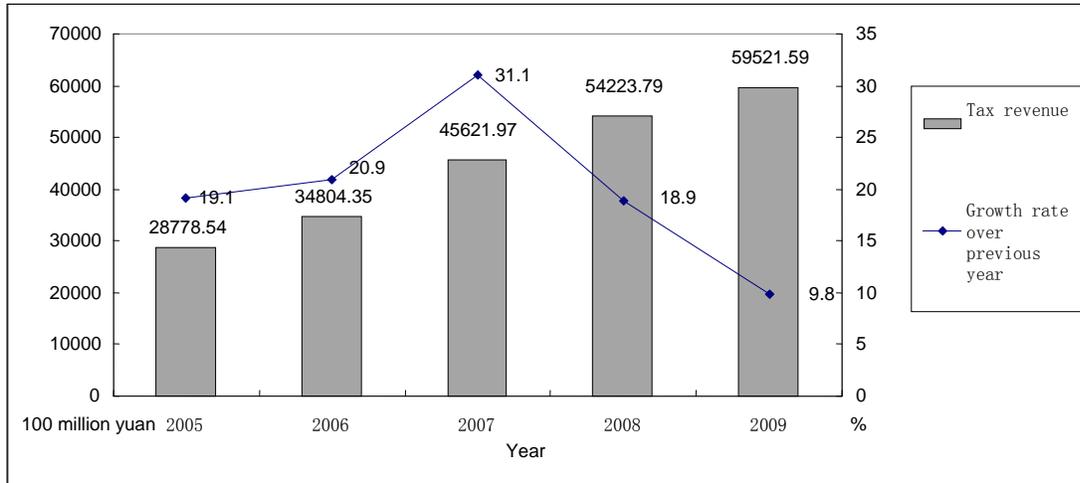
| Year | Total    | Domestic Debts | Foreign Debts | Proportion of Total Debts to GDP (%) |
|------|----------|----------------|---------------|--------------------------------------|
| 2005 | 3261.421 | 3184.859       | 76.552        | 17.7                                 |
| 2006 | 3501.528 | 3438.024       | 63.502        | 16.6                                 |
| 2007 | 5207.465 | 5146.739       | 60.726        | 20.87                                |
| 2008 | 5327.876 | 5279.932       | 47.144        | 20                                   |
| 2009 | 6023.728 | 5973.695       | 50.073        | 17.7                                 |

Source: China Statistical Yearbook 2010

### II.2.3 Tax Revenue

The taxes levied in 2009 was totally 5952.159 billion yuan (excluding tariffs, farm land taxes and deed taxes), enjoyed 9.8 percent or 529.78 billion yuan's increase over 2008. Figure 12 describes the growth rate decreasing apparently in 2009 on the previous year's basis.

**Figure 12 Tax Revenue and Its Growth, 2005-2009**

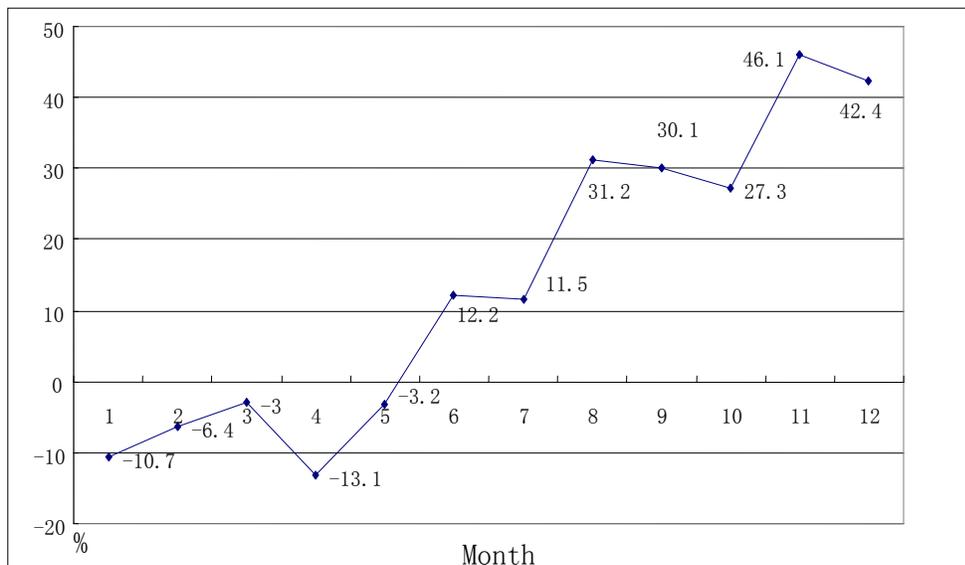


Source: China Statistical Yearbook 2010

In 2009, tax revenue continued showing a negative growth at the first five months as it did in the second half of 2008, owing to the effect of global financial crisis and domestic tax reform. But the growth rate turned positively from June, due to the economic recovery and reformation of consumption tax policies on products such as refined oil, cigarette and white spirit.

Figure 13 shows the overall increasing rate of tax revenue in 2009, which releases an optimistic sign of economy.

**Figure 13 Growth Rate of Tax Revenue Monthly (2009)**



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

### III. Tax Structure: Institutions and the Reality

#### III.1 Overview of Tax System in China

As time goes by, the previous system was no longer to meet the needs of financial and tax administration. In 1994, Chinese government adopted a new comprehensive finance-tax administration system. In that reform, it changed a lot of the previous industrial and commerce tax system in order to accommodate with economic situation. As a result of the reform, the foundation of current tax system was established, and the way of tax administrations also was improved.

Additionally, a series of new tax laws and regulations were carried into effect gradually to stimulate economy growth and improve tax administration level. “The enterprise income tax law of the People’s Republic of China” has been operated since January 1, 2008. Then the interim VAT regulations and interim business tax regulations were also revised.

Hence, presently there are 20 different types of taxes levied in China which can be divided according to their nature and function as follows:

1. Category of taxes on goods and services. It includes value-added tax (VAT), excise tax, vehicle acquisition tax, business tax and customs duty. The levies of these taxes are based on the value (volume) of turnover or sales or import & export value (or quantity) of the goods of the taxpayers in the manufacturing, circulation or service sectors.
2. Category of income taxes. It includes enterprise income tax, individual income tax and the land appreciation tax that is of income tax nature. These taxes are levied on the bases of the profits gained by producers or dealer, or of the income earned by individuals.
3. Category of property taxes. It consists of house property tax, urban real estate tax, urban and township land use tax, farmland occupation tax, deed tax, resource tax, vehicle and vessel tax, vessel tonnage tax. These taxes are levied on the properties kept and used by taxpayers.
4. Other taxes. These taxes include stamp tax, city maintenance and construction tax, tobacco leaf tax, and fixed asset investment orientation regulation tax.

**Table 21 Types of Taxes by category**

| Categories of Taxes         | Type of Taxes  |
|-----------------------------|--|
| Goods and Service Taxes (5) | Value-Added Tax, Business Tax, Consumption Tax, Vehicle Acquisition Tax, Customs Duty  |
| Income Taxes (3)            | Enterprise Income Tax, Individual Income Tax, Land Appreciation Tax  |
| Property Taxes (8)          | House Property Tax, Urban Real Estate Tax, City and Township Land Use Tax, Farmland Occupation Tax, Deed Tax, Resource Tax, Vehicle and Vessel Usage Tax, Vessel Tonnage Tax |
| Other taxes (4)             | Stamp Tax, City Maintenance and Construction Tax, Fixed Asset Investment Orientation Regulation Tax, Tobacco Leaf Tax  |

Note: The levying of the Fixed Asset Investment Orientation Regulation Tax has been suspended in order to encourage investment and expand the domestic demand since 2000.

Source: Liu Zuo, *Tax System of China*, P420, China Taxation Press, 2008

In addition to taxes, the non-tax revenue collected by the tax department by State uniform rules include three items: educational surcharge, mining district use fee and culture construction fee. The People’s Government at provincial level may rule that the tax department collects the social insurance fee (at present including basic pension, basic medical insurance, unemployment insurance, work injury insurance and maternity insurance).

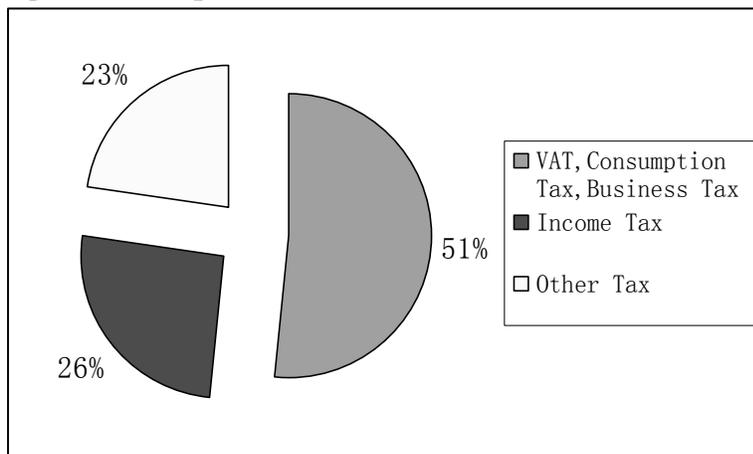
In 2009, The total amount of China’s tax revenue is 6.31036 trillion yuan (customs duty is not included) which increased by 9.1% compared with the same period last year. Thereinto, the VAT revenue is 2.610983 trillion yuan, business tax revenue is 901.519 billion yuan, and consumption tax revenue is 521.889 billion yuan. In income taxes, corporate income tax revenue reached 1.215626 trillion yuan, and personal income tax revenue is 394.359 billion yuan. These five types of taxes contributed approximately 5.644376 trillion yuan in total. In addition, the VAT revenue takes the first place in all taxes which followed by corporate income tax. The customs duty collected 148.38 billion yuan last year.

**Table 22 Tax Revenue 2009 by Composition (Billion Yuan)**

| Item                           | Tax Revenue | Weight in the Total Tax Revenue (%) |
|--------------------------------|-------------|-------------------------------------|
| Total Taxes                    | 6310.37     | 100                                 |
| Domestic VAT                   | 1881.99     | 29.82                               |
| Consumption Tax                | 476.12      | 7.55                                |
| Import VAT and Consumption     | 774.73      | 12.28                               |
| Business Tax                   | 901.52      | 14.29                               |
| Enterprise Income Tax          | 1215.68     | 19.26                               |
| Individual Income Tax          | 394.36      | 6.25                                |
| Resource Tax                   | 33.83       | 0.54                                |
| Stamp Duty                     | 90.15       | 1.43                                |
| City and Township Land Use Tax | 92.1        | 1.46                                |
| Land Appreciation Tax          | 71.96       | 1.14                                |
| Vehicle Acquisition Tax        | 116.39      | 1.84                                |
| Farmland Occupation Tax        | 28.1        | 0.45                                |
| Customs Duty                   | 826.17      | 13.09                               |
| Deed Tax                       | 54.23       | 0.86                                |
| Other Taxes                    | 85.37       | 1.4                                 |

Note: Export rebates are not counted in the total tax revenue.

Source: Ministry of Finance

**Figure 14 Composition of Tax Revenue (2009)**

Source: Ministry of Finance

### III.2 Framework of Tax Legislation in China

Currently in China, tax laws and tax policies are formulated by the following state organs: National People's Congress and its standing committee, the State Council, Ministry of Finance, State Administration of Taxation, Tariff Regulations Committee under the State Council and General Administration of Customs, etc..

1. Tax laws are formulated by National People's Congress (e.g. Individual Income Tax Law of the People's Republic of China) or its standing committee (e.g. Tax Administration Law of the People's Republic of China).
2. Tax Regulations are formulated by the State Council (e.g. Detailed Implementation Rules for Tax Administration Law of the People's Republic of China, Implementation Rules for Individual Income Tax Law of the People's Republic of China, Value-added Tax Provisional Regulations of the People's Republic of China).
3. Departmental Rules are formulated by the Ministry of Finance, State Administration of Taxation, Tariff Regulations committee under the State Council and General Administration of Customs (e.g. Detailed Implementation Rules for Value-added Tax Provisional Regulations of the People's Republic of China).

The formulation of tax laws takes four steps, namely, legislative proposing, reviewing, adoption and promulgation. The four steps for the formulation of tax regulations and departmental rules are: planning, drafting, verification and promulgation. Both shall proceed in accordance with relevant laws, regulations and rules.

In addition, people's congresses at the provincial level and their standing committees, people's congresses of minority autonomous regions, prefectures and counties, and people's governments at the provincial level are entrusted by law with the authority to formulate local regulations and rules provided that they do not contradict with tax laws and regulations mentioned above. The central government does not levy taxes in Hong Kong and Macao Special Administrative Regions which practice their own independent tax regimes.

Here provide some China's main current tax laws, regulations and rules:

**Table 23 Main Chinese Current Tax Laws, Regulations and Rules**

| Legislation  | Issued or Revised by  | (date)   | Effective on (date)   |
|--|---|--|---|
| Value added Tax Provisional Regulations<br>Detailed Implementation Rules   | The State Council   | 5 Nov., 2008   | 1 Jan., 2009  |
| Excise Tax provisional Regulations<br>Detailed Implementation Rules  | MOF and SAT<br>The State Council  | 15 Dec., 2008<br>5 Nov., 2008                              | 1 Jan., 2009<br>1 Jan., 2009  |
| Provisional Regulations of the People's<br>Republic of China on Import and Export<br>Duty  | MOF and SAT<br>The State Council  | 15 Dec., 2008<br>23 Nov., 2003                             | 1 Jan., 2009<br>1 Jan., 2004  |
| Business Tax Provisional Regulations<br>Detailed Implementation Rules  | The State Council   | 5 Nov., 2008   | 1 Jan., 2009  |
| Enterprise Income Tax Law  | MOF and SAT<br>The 4 <sup>th</sup> session of the 10 <sup>th</sup><br>National People's Congress                                  | 15 Dec., 2008<br>16 Mar., 2007                             | 1 Jan., 2009<br>1 Jan., 2008  |
| Regulations for Its Implementation<br>Individual Income Tax Law  | The State Council<br>Latest Revision at the 18 <sup>th</sup><br>session of the Standing<br>Committee of the 10 <sup>th</sup> NPC  | 6 Dec., 2007<br>27 Oct., 2005                              | 1 Jan., 2008<br>1 Jan., 1994  |
| Implementation Rules<br>Resource Tax Provisional Regulations<br>Detailed Implementation Rules  | The State Council<br>The State Council  | 9 Oct. 2008<br>25 Dec., 1993                               | 28 Jan., 1994<br>1 Jan., 1994   |
| Tax Administration Law   | Ministry of Finance<br>Latest Revision at the 21 <sup>st</sup><br>session of the Standing<br>Committee of the 9 <sup>th</sup> NPC | 30 Dec., 1993<br>28 Apr., 2001                             | 1 Jan., 1994<br>28 <sup>th</sup> Feb., 1995<br>4 <sup>th</sup> Aug., 1993 |
| Detailed Implementation Rules<br>NPC Standing Committee's Supplementary<br>Regulations on Punishing Crimes<br>Concerning Tax Evasion and Refusal to Pay<br>Taxes | The State Council<br>The 27 <sup>th</sup> session of the 7 <sup>th</sup> NPC<br>standing committee                                | 7 Sep., 2002<br>4 <sup>th</sup> Sep., 1992                 | 1 Jan., 1993  |
| Measures of the Customs of the PRC on<br>Collection and Administration of Duty on<br>Goods Import & Export   | General Administration of<br>Customs of PRC (Decree No.<br>124)   | 4 Jan., 2005   | 1 Mar., 2005  |
| Invoice Administration Rules   | Approved by the State Council<br>on 12 Dec. and issued by<br>Ministry of Finance<br>SAT   | 23 <sup>rd</sup> Dec., 1993                                | 23 <sup>rd</sup> Dec., 1993<br>23 <sup>rd</sup> Dec., 1993                |
| Detailed Implementation Rules<br>NPC standing committee's Regulations on<br>Punishing False Issuance, Forgery or Illegal<br>Sales of VAT Invoices                | 16 <sup>th</sup> session of the 8 <sup>th</sup> NPC<br>standing Committee   | 28 <sup>th</sup> Dec., 1993<br>30 <sup>th</sup> Oct., 1995 | 30 <sup>th</sup> Oct., 1995   |
| Rules on Tax Administrative Appealing  | SAT   | 24 Feb., 2004  | 1 May, 2004   |

### III.3 Organizations of Tax Administration

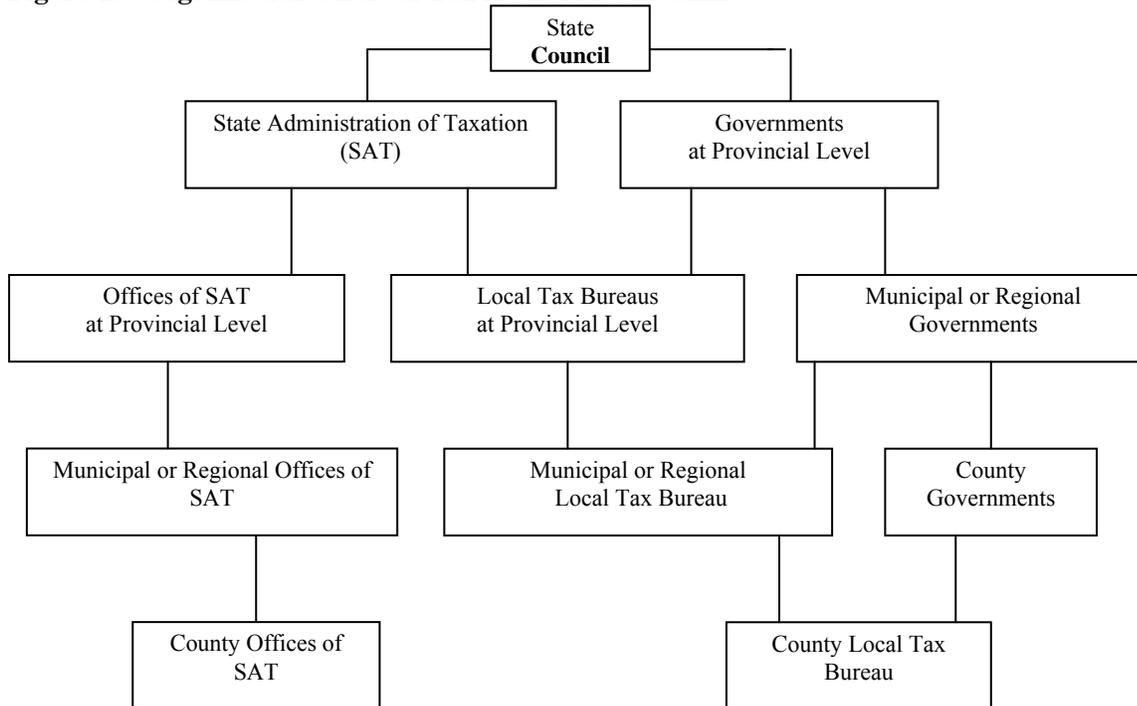
The duty of tax collection and administration has been divided into three parts in China, and be taken charge of separately. The three authorities are: the tax authorities, the financial authorities and the customs.

In details, most of taxes are collected by tax authorities, except farmland occupation tax and deed tax are levied by local financial authorities. The customs mainly take the responsibility of customs duty and vessel tonnage tax. VAT and consumption tax on import are also collected by the customs on behalf of the tax authorities.

In addition to taxes, tax authorities also take the responsibility of some fee imposition, such as the Educational Surcharge, Mining District Use Fee, and Culture Construction Fee. Besides, the provincial Governments may assign tax bureaus to collect social insurance fees (including basic pension, basic medical insurance, unemployment insurance and work injury insurance) as well.

The State Administration of Taxation (SAT) is headquarter of the whole tax administration system. Under SAT, tax authorities are composed by the national tax bureaus and local tax bureaus. Both national and local tax bureaus include three levels of organizations which are at provincial level, city level and county level. A vertical administration model is applied to national tax bureaus directly by the SAT. But the local tax bureau system adopts a dual-administration way. The SAT implements the dual leadership over the local tax services at the provincial level. For details that is the executive administration (such as budget, personnel and organization) part ruled by the parallel government, while the business administration part guided by higher local tax authority.

**Figure 15 Organization Chart of Tax Authorities in China**



Note:

1. The Headquarter of SAT conducts vertical leadership over its offices across China, and assists provincial governments in form of dual leadership over local tax bureau.
2. The local tax bureaus below provincial level are under the dual leadership of both the higher local tax bureaus and the governments at the same level, and the former takes the predominant position.

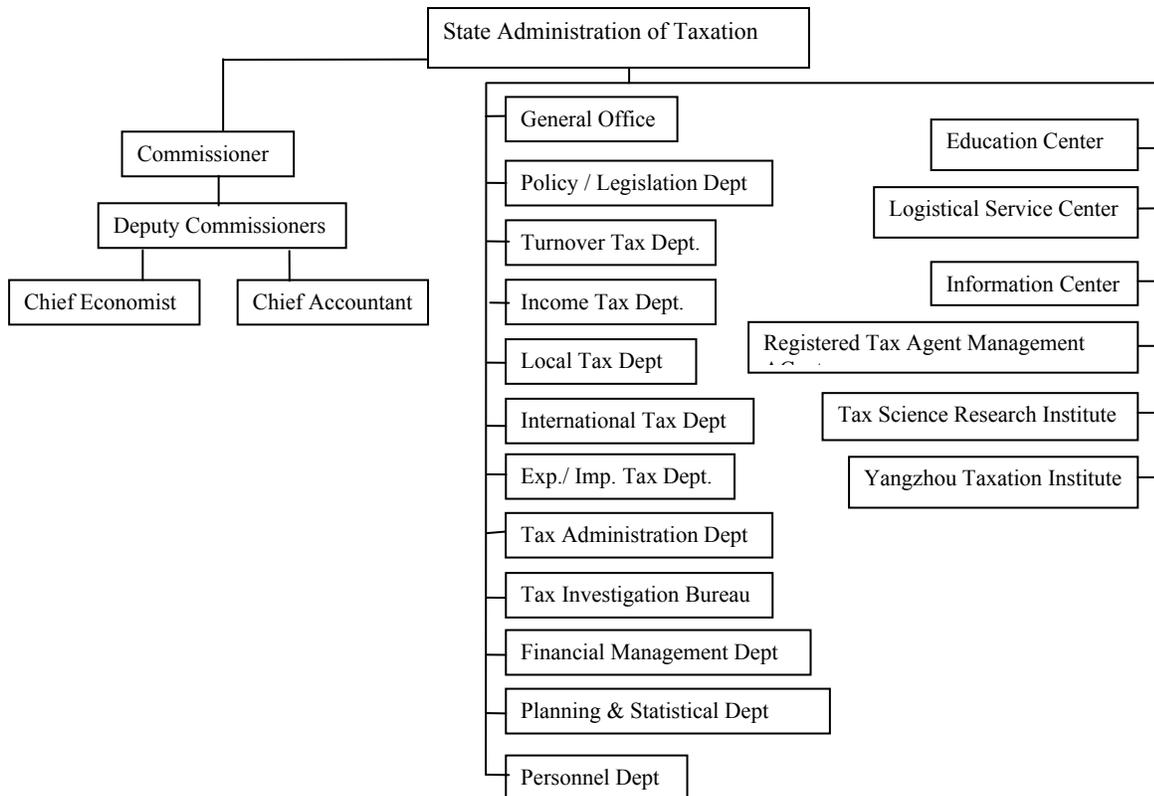
Source: Liu Zuo, *Tax System of China 2008*, P426, China Taxation Press, 2008

The State Administration of Taxation (SAT) is a ministerial level organization directly under the State Council which is in charge of the state's tax work. Its main duty is as follows: drafting and explaining tax laws, regulations, and detailed implementation rules for those tax laws and regulations; undertaking the responsibility of organizing and carrying out the collection and administration of taxes; conducting the taxation business on imported and exported goods and the export refund business; conducting

international exchange and cooperation in tax field; participating in the tax relationship negotiations between China and other countries (regions), initialing and implementing relevant treaties and agreements; exercising vertical administration of the SAT national tax offices; together with the provincial governments, implementing the dual leadership over the local tax services.

In SAT, the top management is composed of 1 Commissioner and 4 Deputy Commissioners, 1 Leader of Disciplinary Inspection Group, 1 Chief Economist, 1 Chief Accountant and 1 Chief Auditor. The SAT headquarters has 12 functional departments and 6 other departments, each consisting of several divisions:

**Figure 16 Organization Structure of the SAT**



Source: State Administration of Taxation of China

The division of taxation power between national and local tax bureaus is made according to different tax types. For details, the national tax bureaus are taking responsibility mainly on: the domestic VAT; domestic excise tax; vehicle acquisition tax; business tax; income tax on companies administered by the central government; income tax paid by joint operation enterprises and shareholding enterprises with investment from both the central and local enterprises and/or non-profit institution; income tax paid by local banks and non-bank financial institutions; income tax and resource tax paid by offshore oil enterprises.

The local tax bureaus' part are: business tax; enterprises income tax; individual income tax; resource tax; stamp tax; city maintenance and construction tax (besides the part collected by the national tax bureaus as mentioned above); house property tax; urban real estate tax; city and township land use tax; land appreciation tax; vehicle and vessel use tax.

By the end of 2006, there are totally 91 tax offices at provincial level, 945 tax offices at municipal level, 5391 tax offices at county level. In service staffs in tax authorities as a whole amounted to 854,000, of which national tax staffs and local tax staffs were 460,000 and 394000 respectively.

### III.4 Local Tax System

The current local tax system of China was set up in 1994 and kept quite stable till nowadays.

#### III.4.1 Legal Foundation and Administration of Local Taxes

In 1993, the State Council established two circulars named the Decision on Implementation of Financial Administration System of Tax Distribution (GF [1993]85) and the Notice of Implementation of Industrial and Commercial Tax Reform (GF [1993]90) to validate the establishment of local tax authorities and definitize how to allocate taxation powers and taxes revenue between central government and local government.

According to the above circulars, taxes are divided into national taxes, local taxes and sharing taxes according to different types. The local tax bureaus are under charge of the local tax authorities. Correspondingly national taxes are assigned to the national tax bureaus. The sharing taxes are firstly levied by national tax bureaus and then partly transferred to local treasury.

#### III.4.2 Structure of Local Taxes and Other Taxes

In accordance with the mentioned principles, national taxes, local taxes and sharing taxes are allocated as follow:

**Table 24** Composition of National Taxes, Local Taxes and Sharing Taxes

| Item               | Composition of Different Groups of Taxes  |
|--------------------|---|
| National Taxes (4) | Consumption Tax, Vehicle Acquisition Tax, Customs Duties, Vessel Tonnage Tax  |
| Local Taxes (9)    | House Property Tax, Urban Real Estate Tax, City and Township Land Use Tax, Farm Land Occupation Tax, Deed Tax, Vehicle and Vessel Usage Tax, Land Appreciation Tax, Tobacco Leaf Tax and Fixed Assets Investment Orientation Tax  |
| Sharing Taxes (7)  | VAT: Central government and local government respectively possess 75 percent and 25 percent of the total domestic VAT, and VAT collected by Customs at import belongs to the central government.<br>Business Tax: Revenue collected from the Railway Department, the headquarters of banks, and the headquarters of insurance companies goes to the central government, and the rest turns to local governments.<br>Enterprise Income Tax: Except for the part belonging to the central government as ruled (The following income revenue is assigned to central government: income paid by railway companies, national postal services, Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, Construction Bank of China, State Development Bank, Agricultural Development Bank of China, Import & Export Bank of China, China Oil and Natural Gas Company Limited, China Oil Chemical Company Limited and offshore oil and natural gas enterprises ), the rest is shared by the central government and local governments at the ratio of 6:4.<br>Individual Income Tax: 60% of it belongs to the central government and 40% of it belongs to local government.<br>Resource Tax: The revenue from the offshore oil enterprises belongs to the central government (not levied for the time being). The rest is to local governments.<br>Stamp Duty: 97% of tax on security transactions belongs to the central government, the other 3% of tax on security transactions and the rest revenue of Stamp Duty flows to local governments.<br>City Maintenance and Construction Tax: Tax revenue paid by Railway Department, headquarters of banks and insurance companies is assigned to the central government, and the rest to the local government. |

Note: Fixed Assets Investment Orientation Tax has been suspended since 2000.

Source: Liu Zuo, *Tax System of China 2008*, China Taxation Press, 2008

### III.5 Rights and Obligations of a Taxpayer

#### III.5.1 Rights of a Taxpayer

- To know the information about tax laws, tax regulations and tax collection procedures;
- To receive professional service and assistance from tax authority;
- To entrust an enrolled tax agent to handle the tax affairs on behalf of taxpayer himself or herself;
- To enjoy tax preferences and tax exemptions according to tax laws or ordinances;
- To postpone tax declare and tax payment when requirements are satisfied;
- To request tax authority to refund over collected tax payment;
- To apply for tax administrative review and conduct administrative litigation if he/she disagrees with the decision by tax authority;
- To sue the tax authority to the court or apply for an arbitrament from the State Council if he/she disagrees with the tax executive review;

- To request compensation for his or her unwanted losses;
- To ask for tax authority to keep his or her information secret;
- To make a representation or averment when necessary;
- To request tax authority to hold a hearing when necessary;
- To impeach and accuse tax staffs if they misuse laws;
- Other rights authorized by laws.

### **III.5.2 Obligations of a Taxpayer**

To make tax registration, alternation, or logout according to tax laws and ordinances, and use tax registration certificate as required. Subtenancy, obliteration, damage, buying and selling, or forgery of tax registration certificate is absolutely forbidden;

To set up accounting books as required. If not, it should be approved by tax authority;

To make tax declaration and submit tax returns, accounting statements, and other materials in accordance with tax laws and ordinances. If not, it should be allowed by tax authority;

To pay taxes within tax term. If not, it should be approved by county tax bureaus at least and tax term can be extended three months longer at most;

To keep and use invoices in compliance with tax laws and administrative regulations;

To settle his or her tax liabilities or provide guarantee to tax authority if he/she owe taxes and need to go aboard.

To accept tax examination and furnish related materials according to the facts without refusal and concealment;

To pay off taxes and delinquency charges before applying for tax administrative judge, when dispute occurs between taxpayer and tax authority;

Other obligations regulated by tax laws and rules.

These rights and obligations of a taxpayer are also applicable to withholding agents.

### **III.6 Tax Enforced Collection**

The tax authorities shall always be in accordance with the following principles: depositing the full amount of State taxes in the State treasury in a timely manner, making convenient arrangements for taxpayers and minimizing the cost of tax collection.

A taxpayer or withholding agent shall pay or remit tax within the time limit prescribed by the law or the administrative regulations, or as determined by the tax authorities in accordance with the law or the administrative regulations. Where a taxpayer is unable to pay tax within the prescribed time limit as a result of encountering special difficulties, it may, upon approval of a tax bureau (or a branch bureau thereof) above the county level, defer the payment of tax for a period of not more than three months.

Where a taxpayer fails to pay tax or a withholding agent fails to remit tax within the time limit as prescribed in the preceding paragraph, the tax authorities shall, in addition to ordering the taxpayer or withholding agent to pay or remit the tax within the prescribed time limit, impose a fine on a daily basis at the rate of 0.05% of the amount of tax in arrears, commencing on the day the tax payment is in default.

Taxpayers that are entitled to tax reduction or exemption under laws or administrative regulations or with the approval of a statutory examination and approval authority shall carry out tax reduction or exemption procedures with the tax authorities on the strength of the relevant documents. Taxpayers shall resume normal payment of taxes upon the conclusion of the tax reduction or exemption term.

When the tax authorities collect tax payments and the tax withheld or collected by withholding agents, tax payment receipts must be issued to the taxpayers, such as tax receipts, payment memos, tax stamps, withholding (collection) certificates and other evidence of tax payment.

In the event that one of the following circumstances should arise in respect of a taxpayer, the tax authorities shall have the right to assess the amount of tax payable by the taxpayer: accounting books are not kept in accordance with the law; accounting books are required to be kept by the law but have not been kept; although accounting books have been kept, the accounting entries have not been entered in an appropriate manner or the information on costs, receipt vouchers and expense vouchers are incomplete,

causing difficulties in conducting an audit; a taxpayer who is obligated to pay tax fails to go through tax filing procedures within a prescribed time limit and, after having been ordered by the tax authorities to file tax returns within the prescribed time limit, still fails to file the tax returns within the prescribed time limit.

The tax authorities have the power to use any of the following methods to determine the amount of tax to be paid: making reference to the tax burden of a taxpayer with a similar scale of business and revenue level among enterprises in the same or a similar industry in the same locality; using the method of business revenue or cost plus reasonable expenses and profit; extrapolation or estimation on the basis of raw materials, fuel and power, which are consumed; or other reasonable methods. If the use of any single method set forth above is insufficient to determine the amount of tax to be paid, two or more methods may be used simultaneously.

### **III.6.1 Liens and Levies**

If a taxpayer engages in production and business activities without registration to tax authority, taxes can be assessed and collected by tax authority directly. If he/she refuses to pay taxes after tax assessment, tax authority can levy on his or her goods or products equal to the value of overdue taxes for 15 days. After the taxpayer has paid taxes, tax authority must release the levied goods or products promptly and return them back to the taxpayer. If the taxpayer still pays no taxes after lien, tax authority may sell the goods or products subject to levy to satisfy tax debts by auction or other means with approval by director general of county tax bureau at least. In the case of food or other live goods, the period of levy can be shortened.

### **III.6.2 Tax Protective Measures**

If tax authority deems the collection of taxes to be at risk, the taxpayer should be asked to pay taxes within a prescribed period before the legal tax term comes due. During this period if taxpayer is observed to escape tax payment by concealing or transferring goods, products, and other properties or income from the reach of tax authority, he/she is required to provide tax warrant to tax authority. If the taxpayer can not observe the rule, following tax protective measures should be taken with the approval of the director general of county tax bureau at least:

First, informing banks or other financial institutions to freeze an amount of money equal to the value of owed taxes from the account of taxpayer in written.

Second, goods, products or other properties of the taxpayer equal to the value of owed taxes should be levied by lien or seizure.

If the taxpayer has paid taxes during the prescribed period, the tax protective measures should be released within 1 day from the day of payment. If the prescribed period comes due however the taxpayer has not paid the owed taxes yet, tax authorities may inform banks or other financial institutions to deduct an amount of money equal to the value of the owed taxes from the frozen account, or sell the goods, products, and other properties subject to levy or seizure by auctions or other means.

If there is some money left after the payment of overdue taxes, fines, late fees and disposal charges, it should be returned to the taxpayer within 3 working days.

If the taxpayer has paid taxes during the prescribed period, nevertheless the tax authority has not released tax protective measures promptly which causes damage to the rights of taxpayer, the tax authority should take the responsibility of compensation.

### **III.6.3 Tax Enforcement Measures**

If a taxpayer engaging in production and business activities does not pay taxes or a withholding agent does turn over taxes to tax authority in stated period, furthermore the tax warrantor does not pay taxes on behalf of them on time either, the tax authority will inform the taxpayer and the withholding agent to pay taxes in a prescribed period. If he/she has not paid taxes during the time limit, tax authority may take the following tax compulsory measures after these measures have been approved by the director general of county tax bureau at least:

First, banks or other financial institutions should be informed to deduct the amount of money equal to

the value of overdue taxes and late fees from the account of taxpayer or withholding agent directly.

Second, to levy, seize, auction or sell goods, products or other properties equal to the value of overdue taxes and late fees to satisfy tax debts.

When tax authority conducts the enforcement measures like lien, levy or seizure of goods, products or other properties, there must be more than two tax officials to execute the mission together. Taxpayer or his/her adult relatives or representative must be informed in advance to come to the spot. However, even if they refuse to come, the enforced actions will be executed as planning.

Tax protective measures and tax enforcement measures should be executed by tax administration within the extent of authority and in accordance with the legal procedure. Personal effects, household goods less than 5000 yuan per unit, and the residence of taxpayer and his/her dependent necessary for life are exempted from tax protective measures and tax compulsory measures. However automobiles, gold or silver jewelries or decorations, antiques, luxury houses are excluded from the necessary household goods and residences.

### III.6.4 Restricted to Leave Country

If a taxpayer or legal representative of taxpayer with overdue taxes applies for going abroad, he/she must settle the owed taxes and late fees in advance or supply a receivable warrant to tax authority. Otherwise, the tax authority may inform the immigration bureau to prevent him from leaving country.

### III.6.5 Retroactive Collection

If a taxpayer or withholding agent has not paid taxes or only paid fewer taxes because of the fault of tax authority, he/she will be asked to pay overdue taxes without any penalty within three years since it occurred. If such a matter happened on account of calculation errors or others caused by taxpayers, tax authority may ask them to pay overdue taxes plus late fees within three years, and it can be extended to 5 years in special cases.

### III.7 Brief Introduction of Main Taxes

The main taxes are Value Added Tax, Consumption Tax, Business Tax, Individual Income Tax, and Enterprise Income Tax in China.

#### III.7.1 Value Added Tax

VAT taxpayers include businesses, organizations and individuals that sell or import goods, or provide processing, repairing and replacing services within the Chinese territory.

VAT is charged at a standard rate of 17%. The sale of certain necessity goods and the importation of certain special equipment may be exempt from VAT (zero rates) or be subject to VAT at a reduced rate of 13%, as specified in the VAT regulations.

**Table 25 VAT Taxable Items and Rates**

| Coverage of collection  | Rate (%) |
|---|----------|
| Selling or importing goods ( other than those stipulated in items bellow)   | 17       |
| Exportation of goods (except otherwise stipulated By the State Council)   | 0        |
| Agriculture, forestry, products animal husbandry, aquatic products;<br>Edible vegetable oil and food grains duplicates;   | 13       |
| Tap water, heating cooling, hot applying, hot water, coal gas, liquefied petroleum gas, natural gas, methane gas,<br>coal/charcoal products for household use;  |          |
| Books, newspapers, magazines (excluding the newspapers and magazines distributed by the department);<br>Feeds, chemical fertilizers, agricultural chemicals, agricultural machinery and plastic covering film for farming;<br>Dressing metal mineral products, dressing non-metal mineral products, coal. |          |
| Crude oil, mine salt and goods other than those listed above;   | 17       |
| Providing processing, repairs and replacement services  |          |

Source: Provisional Regulations of the People's Republic of China on Value Added Tax (2008)

Except for commodities listed in the “Catalogue for Prohibited Commodities for Processing Trade”

and those whose export VAT refund entitlement have been withdrawn, most types of goods that are manufactured and exported by foreign investment enterprises are effectively tax exempt under the “exempt, credit, refund” mechanism. However, this does not mean that all input VAT will be refunded because the refund rates vary depending on the type of product. At present, the refund rates of VAT consist of 5%, 9%, 11%, 13%, and 17% to different goods respectively.

According to the business amount, VAT tax payers are divided into two types: the general tax payer and small-scale tax payer. The small-scale taxpayers can enjoy a benefit tax rate of 3% since January 1, 2009 if meets the following standards:

(1) the sales amount liable to annual VAT is below 0.5 million yuan for a taxpayer who produces goods or the providing taxable services or who produces goods or providing taxable services as the main line and also operates wholesale or retail business as a sideline;

(2) the sales volume liable to annual VAT is below 0.8 million yuan for taxpayers who do not belong to item (1).

For these small-scale taxpayers selling goods or taxable services, the tax payable shall be calculated based on the sales amount and the according rate. No input tax shall be creditable. The formula for calculating the tax payable is as follows:

Tax payable = Sales amount × tax rate

The exempted items are listed below:

- the agricultural production materials as regulated;
- self-produced primary agricultural products sold by agricultural producing units and individuals;
- imported goods being processed for exportation;
- self-use equipment imported out of the total investment for the projects with foreign investment or domestic investment which are encouraged by the State;
- contraceptive medicines and devices; antique books purchased from the public;
- imported materials and equipment granted by foreign governments or international organizations;
- 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;
- the taxable services provided by individual disable laborers

The VAT assessable period shall be one day, three days, five days, ten days, fifteen days, one month or one quarter. The actual assessable period of the taxpayer shall be determined by the competent tax authorities according to the magnitude of the tax payable of the taxpayer; tax that cannot be assessed in regular periods may be assessed on a transaction-by-transaction basis.

The State Council made a decision to implement the VAT transformation reform on a nationwide basis as from 1st January 2009. The main changes of VAT regulations both on policy and administration sides are as follows:

- To allow deduction of the input VAT for purchased fixed assets which was not permitted before. The old production type VAT system virtually increased enterprises’ tax burden of buying machinery and equipment which obviously stroke on their positivity of technical innovation.
- To definitize no deduction allowed for consumables’ input because it is easy to mix up corporate consumption with personal use which is not relevant to the technological improvement of the enterprise.
- To reduce the tax burden for small-scale taxpayer. Comparing with the old regulation which only provided 4% or 6%’s benefit rate to small-scale taxpayers, the revised edition made a 3%’s general rate for all small-scale taxpayer.
- To improve VAT administration. These changes mainly included below measures: to extend the VAT filing deadline. Based on the previous 10 days’ duration calculated from the end of a month, another 5 days are provided to make this time limit 15 days for taxpayers’ convenience; to clarified tax liabilities’ arising time, the location of tax payment, the cognizance of VAT general taxpayer, etc.

### III.7.2 Consumption Tax

The taxpayers of consumption tax include businesses, organizations, self-employed individuals and other individuals that produce or import taxable consumer goods within the Chinese territory. Exported consumer goods are exempt from excise tax, except for items whose exportation is limited by the State.

Consumption tax shall be assessed under the rate on value method or the amount on volume method. The formula for assessing the tax amount is:

The amount of tax under the rate on value method = volumes of sales × tax rate.

The amount of tax under the amount on volume method = volume of sales × unit tax amount. The third way is to combine the above two and use them together.

When Consumption Tax was introduced in 1994, it was imposed on 11 types of special consumer goods after VAT had been levied on them first. Then to keep accordance with economic growth, a new consumption tax regulation has been come to effect since January 2009 and there are totally 14 taxable items shown as follows:

**Table 26 Table of Consumption Tax Taxable Items and Rates**

| Taxable items   | Tax rates (tax amount per unit)                     |
|---|---|
| 1. tobacco  | (1)0.03 Yuan per piece + sales value × 45%          |
| (1) Grade A Cigarettes  | (2) 0.03 Yuan per piece + sales value × 30%         |
| (2) Grade B Cigarettes  | (3) 25%   |
| (3) Cigars  | (4)30%  |
| (4) Cut tobacco   |   |
| 2. alcoholic drinks and alcohol                               |   |
| (1) white spirits   | (1) 0.5 Yuan per Jin or 500ml + factory price × 20% |
| (2) yellow spirits  | (2)240 Yuan per ton                                 |
| (3) beer of class one   | (3)250 Yuan per ton                                 |
| (4) beer of class two   | (4)220 Yuan per ton                                 |
| (5) other alcoholic drinks                                    | (5) 10%   |
| (6) alcohol   | (6)5%   |
| 3. cosmetics  | 30%   |
| 4. precious jewellery, pearls, precious jade and stones       |   |
| (1) cold and silver jewellery, diamond and decoration thereof | (1) 5%  |
| (2) other jewellery, pearls, precious jade and stones         | (2) 10%   |
| 5. firecrackers and fireworks                                 | 15%   |
| 6. finish oil products  | (1.a) 0.2 Yuan per litre                            |
| (1) gasoline: a. unleaded; b. leader                          | (1.b) 0.28 Yuan per litre                           |
| (2) diesel oil, fuel oil, aviation oil                        | (2) 0.10 Yuan per litre                             |
| (3) naphtha, solvent-oil, lubricating oil                     | (3) 0.20 Yuan per litre                             |
| 7. motor vehicle tyres  | 3% □  |
| 8. motor-cycles   |   |
| (1) cylinder capacity less than 250 ml                        | (1)3%   |
| (2) cylinder capacity over 250 ml                             | (2)10%  |
| 9. cars   |   |
| (1) passenger cars (with 9 seats or less)                     | 1%,3%, 5%, 9%, 12%, 25%,40% ②                       |
| (2) medium and light commercial cars (with 10 to 23 seats)    | 5%  |
| 10. golf and tools  | 10%   |
| 11. high-class watches  | 20%   |
| 12. yachts  | 10%   |
| 13. wood chopsticks for use only once                         | 5%  |
| 14. wood floor  | 5%  |

Note: □ Meridian tyres and renovated tyres are excluded.

□ Rate applied to cars is based on the cylinder capacity of the car in item 9.

Source: Interim Regulation of the People's Republic of China on Consumption Tax (2008)

### III.7.3 Business Tax

Business tax is imposed on services, transfer of intangible assets and immovable property taking place within China, which is the main tax source of local governments.

**Table 27 Taxable Items and Rates of Business Tax**

| Taxable items                         | Tax rates (%) |
|---------------------------------------|---------------|
| 1. communications and transportation  | 3             |
| 2. construction                       | 3             |
| 3. financial and insurance businesses | 5             |
| 4. post and telecommunications        | 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: Interim Regulation of the People's Republic of China on Business Tax (2008)

### III.7.4 Individual Income Tax

The Individual Income Tax payers are classified into the following two types:

- Individuals who have residence in China or who have no residence in China but have lived in China for one year or above shall pay individual income tax on their world-wide income;
- Individuals who has no residence in China and does not live in China or has lived in China for less than one year shall pay individual income tax on their income from sources in China.

Details are as follows:

First, non-residents or resident foreign expatriates who reside in China for less than one year will be taxed only on their China-source income;

Second, foreign expatriates who reside in China for more than one year but no more than five years will be subject to tax on both their China-source income and their foreign-source income. However, upon application to and approval from the tax authorities, the taxation of foreign-source income can be limited to that received from Chinese enterprises, Chinese establishments, Chinese economic organizations, and Chinese individuals;

Third, foreign expatriates who reside in China for more than five consecutive years will be subject to tax on their worldwide income from the sixth year onward;

Forth, foreign expatriates who travel in China and derive income from an overseas employer with no permanent establishment in China will be tax exempt if they do not physically stay in China, consecutively or cumulatively, for more than 90 days in a calendar year. The 90-day test is extended to 183 days if the individual is a tax resident of a country/region that has executed a taxation treaty/arrangement with China.

Taxable income of an individual has been classified into 11 items:

- (1) Wages and salaries;
- (2) Income derived by industrial or commercial households from production or business operation;
- (3) Income from contracted or leased operation of enterprises or institutions;
- (4) Income from labor service payment;
- (5) Income from author's remuneration;
- (6) Income from royalties;
- (7) Income from interest, dividends, bonuses;
- (8) Income from lease of property;
- (9) Income from transfer of property;
- (10) Occasional income; and
- (11) Other income specified as taxable by the finance department of the State council

The tax liability computation differs according to different categories:

- (1) Wages and salaries

Monthly taxable income = monthly aggregate wages/salaries – 2000 yuan – other deductions

In addition to the 2000 yuan, an extra amount (currently 3200 yuan per month) is deducted for taxpayers who have no residence in China but earn wages and salaries from China and those who have residence in China but earn wages and salaries from outside China.

Monthly amount of tax liability = monthly taxable income × tax rate – quick deduction

Here, a nine-grade progressive rates schedule is applied.

**Table 28 Individual Income Tax Rate (applicable to income from wages and salaries)**

| Grade | Taxable Income of the Month (yuan)                   | Tax Rate (%) | Quick Deduction |
|-------|--|--------------|-----------------|
| 1     | Less than 500  | 5            | 0               |
| 2     | The portion of income in excess of 500 to 2,000      | 10           | 25              |
| 3     | The portion of income in excess of 2,000 to 5,000    | 15           | 125             |
| 4     | The portion of income in excess of 5,000 to 20,000   | 20           | 375             |
| 5     | The portion of income in excess of 20,000 to 40,000  | 25           | 1,375           |
| 6     | The portion of income in excess of 40,000 to 60,000  | 30           | 3,375           |
| 7     | The portion of income in excess of 60,000 to 80,000  | 35           | 6,375           |
| 8     | The portion of income in excess of 80,000 to 100,000 | 40           | 10,375          |
| 9     | The portion of income in excess of 100,000           | 45           | 15,375          |

Note: “The taxable income of the month” in this table refers to the amount of a monthly income after deduction of 2,000 yuan for expenses or additional deductions for expenses.

Source: Liu Zuo, *Tax System of China 2008*, P148, China Taxation Press, 2008

(2) Income from self-employed businesses

Annual taxable income = Gross income from production and sales – Costs, expenses and losses

Annual tax liability = Annual taxable income × tax rate – Quick deduction

Here, a five-grade progressive tax rates schedule is applied.

**Table 29 Individual Income Tax Rate (Applicable to income of individual industrial or commercial operators from production and business operation or income from business operations leased or contracted from an enterprise or undertaking)**

| Grade | Taxable Income of the Year (yuan)                   | Tax Rate (%) | Quick Deduction |
|-------|---|--------------|-----------------|
| 1     | Not exceeding 5,000                                 | 5            | 0               |
| 2     | The portion of income in excess of 5,000 to 10,000  | 10           | 250             |
| 3     | The portion of income in excess of 10,000 to 30,000 | 20           | 1,250           |
| 4     | The portion of income in excess of 30,000 to 50,000 | 30           | 4,250           |
| 5     | The portion of income in excess of 50,000           | 35           | 6,750           |

Note: The “taxable income of the year” in the table refers to the taxable income based on the gross income of a tax year after the deductions for costs, expenses and losses.

Source: Liu Zuo, *Tax System of China 2008*, P156, China Taxation Press, 2008

(3) Income from contracted or leased operation of companies or governmental agencies partly financed by the state (vs. those fully financed by the state).

Annual taxable income = Gross income – expenses (currently 2000 yuan per month)

Annual tax liability = Annual taxable income × tax rate – Quick deduction

Here again, the above five-grade progressive tax rates schedule is applied.

(4) Income from remuneration for personal service, income from author’s remuneration, income from royalties and income from lease of property

Tax liability = Taxable income × 20%

For payment not over 4,000 yuan, taxable income = payment – 800 yuan

For payment over 4,000 yuan, taxable income = payment – 20% of the payment

(5) Income from property transfer

Taxable income = income from property transfer – value of the transferred property – a reasonable amount

Tax liability = taxable income × 20%

(6) Interests, dividends, bonuses and contingent income

Tax liability = payment × 20%

The following categories of income shall be exempted from individual 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, the People's Liberation Army Units at army level and above and by foreign or international organizations;

(2) Interest income on saving deposits and national debt obligations and other financial debentures issued by the state;

(3) Subsidies and allowances received under the state uniform provisions;

(4) Welfare benefits, survivor pensions and relief payments;

(5) Insurance indemnities;

(6) Military severance pay and demobilization pay received by members of the armed forces;

(7) Settlement payment, severance payment, retirement payment and retirement living allowances received by public servants and workers under state uniform provisions;

(8) Income derived by the diplomatic agents and consular officers and other personnel who are exempt from tax under the provisions of the relevant Laws of China;

(9) Income exempt from tax as stipulated in the international conventions to which the Chinese Government is a party and in agreements it has entered into;

(10) Income exempt from tax with the approval of the finance department of the State Council.

China also adopts a withholding system on individual income especially on salaries and wages. The tax withheld by the withholding agent on a monthly basis, and the tax paid by the self-reporting individual, shall be paid to the state treasury within the first seven days of the following month together with the tax returns filed with the tax authorities. A handling fee of 2% of the amount of tax withheld shall be paid to the withholding agent.

In general, individual income tax payers do not need to file the tax return because almost all kinds of income have been withheld by withholding agents. However, the following taxpayers are obliged to declare their income to tax authorities:

(1) Individuals gain annual income more than RMB120000;

(2) Individuals earn salaries or wages from more than two sources within China;

(3) Individuals derive income from outside China;

(4) Individuals earn income without withholding agents.

### **III.7.5 Enterprise Income Tax**

The new Law of the People's Republic of China on Enterprise Income Tax came into effect on January 1, 2008. Before this, there were two different enterprise income tax regimes, one (so-called Income Tax on Foreign Enterprises and Enterprises with Foreign Investments Foreign) is applicable to foreign investment enterprises and foreign enterprises and the other (named Enterprise Income Tax) applicable to domestic enterprises.

According to the new law, taxpayers of enterprise income tax include enterprises and other organizations that obtain income within the People's Republic of China. Enterprises are divided into resident enterprises and non-resident enterprises. The term "resident enterprises" refer to enterprises which are established in accordance with the laws of China, or enterprises established in accordance with the laws of a foreign country (region) whose effective management is located within China. The term "non-resident enterprises" refer to enterprises which, though established in accordance with the laws of a foreign country (region) and with its effective management located outside China, have an establishment or a place in China or derives income that is sourced from China even if without an establishment or place in China.

The Enterprise Income Tax is computed on the basis of the taxable income. A Resident Enterprise shall pay Enterprise Income Tax on income derived from sources inside and outside China. A Non-Resident Enterprise which has an establishment or a place in China shall pay Enterprise Income Tax on income that is derived by such establishment or place in China from sources inside China as well as on income that, although derived from sources outside China, is effectively connected with such establishment or place. A

Non-Resident Enterprise which has no establishment or place in China or which has an establishment or place in China but the income derived is not effectively connected with such establishment or place shall pay Enterprise Income Tax on income derived from sources inside China.

The rate of enterprise income tax is 25%. Where a non-resident enterprises which has no establishment or place in China or which has an establishment or place in China but the income derived is not effectively connected with such establishment or place shall pay Enterprise Income Tax on income derived from sources inside China, the applicable tax rate is 20%.

The payable tax of enterprises shall be the balance derived from the taxable income of enterprises multiplies the applicable rate and minus the tax amount of tax reduction and exemption pursuant to the preferential tax treatment hereof. The following income from the total income shall not be taxable:

(1) Financial funding;

(2) Administrative fees and government funds obtained and included in financial management in accordance with the law;

(3) Other non-taxable income prescribed by the State Council.

The following expenses may not be deducted from the taxable income:

(1) Income from equity investment paid to investors such as dividend and bonus;

(2) Payment of enterprise income tax;

(3) Late payment fines;

(4) Penalties; fines and losses from confiscated property;

(5) Expenses from donations other than those prescribed in Article 9 hereof;

(6) Sponsorship fees;

(7) Expenses for non-verified provisions;

(8) Other expenses irrelevant to the income obtained.

Where Enterprises compute the taxable income, the depreciation of fixed assets calculated in accordance with provisions may be deducted. However, no depreciation may be deducted for the following fixed assets:

(1) Fixed assets other than premises and buildings which have not been used yet

(2) Fixed assets leased from other parties by means of business lease;

(3) Fixed assets leased to other parties by means of lease financing;

(4) Fixed assets that have been depreciated in full but are still in use;

(5) Fixed assets that are irrelevant to business activities;

(6) Land credited as fixed assets after independent price valuation;

(7) Other fixed assets whose depreciation may not be calculated.

The industries and projects with key support and under encouraged development by the State may be given preferential enterprise income tax treatment. Tax reduction and exemption treatments are targeted primarily towards: agriculture, forestry and animal-husbandry, fishery projects; basic infrastructure projects; environment protection projects and energy/water conservative projects; qualified technology transfer. Moreover, "Super deduction" is allowed for R&D expenses for new technology, new products, and new craftsmanship. Taxable income may be reduced by a deemed deduction calculated as a percentage of investment amounts for venture capital businesses engaged in encouraged industries. Shorter tax depreciation life or accelerated depreciation is allowed for particular types of fixed assets due to advancement of technology.

The following income of Enterprises shall be tax-exempted income:

(1) Income from interests on government bonds;

(2) Income from equity investment income such as dividend and bonus between qualified resident enterprises;

(3) Income from equity investment such as dividend and bonus obtained from resident enterprises by non-resident enterprises that have set up institutions or establishments in China with an actual relationship with such institutions or establishments;

(4) Income of qualified non-profit organizations.

The following income may be subject to exempted or deducted from enterprise income tax:

- (1) Income from engaging in projects of agriculture, forestry, animal husbandry and fisheries by Enterprises;
- (2) Income from investment and operation of infrastructure projects with key state support such as harbor, pier, airport, railway, highway, electricity and hydroelectricity by Enterprises;
- (3) Income from engaging in qualified projects of environmental protection and energy and water conservation;
- (4) Income from qualified transfer of technology by Enterprises.

Enterprise income tax shall be calculated in accordance with the taxable year which starts from 1 January to 31 December of a calendar year. Enterprise income tax shall be prepaid on a monthly or quarterly basis. Enterprises shall submit a prepaid enterprise income tax return to the tax authority within 15 days of the completion of the month or the quarter to make tax prepayment and submit an annual enterprise income tax return to the tax authority within five months of the completion of the year and make the settlement of the payable and refundable tax payment.

### III.7.6 Resource Tax

Tax taxpayers of resource tax include businesses, organizations, or individuals that exploit taxable mineral resources or produce salt within the Chinese territory.

Here, the tax rate schedule is provided:

**Table 30 Tax Rate of Resource Tax**

| Taxable items          | Guidelines for tax amount per unit                   |
|------------------------|--|
| Crude oil              | 8-30 yuan per ton                                    |
| Natural gas            | 2-15 yuan per 1000 cubic metres                      |
| coal                   | 0.3-5 yuan per ton and 8 yuan per ton of coking coal |
| Other non-metal ores   | 0.5-20 yuan per ton or per cubic metre               |
| Ferrous metal ores     | 2-30 yuan per ton                                    |
| Non-ferrous metal ores | 0.4-30 yuan per ton                                  |
| Salt                   |  |
| (1) solid salt         | 10-60 yuan per ton                                   |
| (2) liquid salt        | 2-10 yuan per ton                                    |

### III.7.7 Land Appreciation Tax

The taxpayers of land appreciation tax include businesses, organizations, or individuals that gain income through compensable transfer of the right to use state-owned land and ownership of the improvements on the land.

The tax base is the appreciation amount derived from transferring the real estate, which equals the income gained through the transfer minus allowable deductions.

Here a 4-grade progressive tax rates schedule is applied:

**Table 31 Tax Rate of Land Appreciation Tax**

| Grade | Tax base   | Tax rates |
|-------|--|-----------|
| 1     | The part of the appreciation amount not exceeding 50% of the deduction amount                | 30%       |
| 2     | The part of the appreciation amount exceeding 50% but not over 100% of the deduction amount  | 40%       |
| 3     | The part of the appreciation amount exceeding 100% but not over 200% of the deduction amount | 50%       |
| 4     | The part of the appreciation amount exceeding 200% of the deduction amount                   | 60%       |

### III.7.8 Urban Real Estate Tax

At present, the urban real estate tax is imposed on businesses with foreign investment, foreign businesses, businesses established by people from Hong Kong, Macao, Taiwan and overseas Chinese, and individuals and on the house part only. The taxpayers include the owners, mortgagees, custodians and /or users of the house.

When the tax is based on the house price, a tax rate of 1.2% is applied;  
 When the tax is based on the rental of the house, the tax rate is 18%.

$$\text{Tax liability} = \text{tax base} \times \text{tax rate}$$

### III.7.9 City and Township Land Use Tax

Taxpayers of this tax include the units and individuals using land in cities, counties, towns and mining districts within the Chinese territory.

The tax payable shall be computed on the basis of the actual land size occupied by the taxpayers and collected in accordance with the computed tax payable.

Here, a tax rate schedule is provided:

**Table 32 Tax Rate of Land Appreciation Tax**

| Land situated in                     | Tax range                 |
|--------------------------------------|---------------------------|
| Large cities                         | 1.5-30 yuan/square meters |
| Mid-size cities                      | 1.2-24 yuan/square meters |
| Small cities                         | 0.9-18 yuan/square meters |
| Counties, towns and mining districts | 0.6-12 yuan/square meters |

### III.7.10 Farmland Occupation Tax

Taxpayers of this farmland occupation tax are units and individuals who occupy the farmland within the Chinese territory for house building or non-agricultural construction.

The tax liability is computed on the basis of the actually occupied land size and collected on a lump sum basis in accordance with stipulated tax range.

The tax rate schedule is as follows:

**Table 33 Tax Rate of Land Appreciation Tax**

| Per capita farmland on county basis | Tax range                |
|-------------------------------------|--------------------------|
| Less than 1 mu ( 1mu=0.066 hectare) | 10-50 yuan/square meters |
| 1-2 mu                              | 8-40 yuan/square meters  |
| 2-3 mu                              | 6-30 yuan/square meters  |
| Over 3mu                            | 5-25 yuan/square meters  |

### III.7.11 Vehicles and Vessels Tax

Taxpayers of the vehicles and vessels tax are owners or custodians of taxable vehicles and vessels within the territory of the People's Republic of China.

This tax can be calculated by following this formula:

$$\text{Tax liability} = \text{tax base} \times \text{tax amount per unit}$$

**Table 34 Tax rate of vehicles and vessels tax**

| Items   | units                 | Annual tax payable | remarks  |
|---|-----------------------|--------------------|--|
| passenger vehicles                                | Each vehicle          | 60-660 yuan        | including electric car                           |
| cargo vehicles                                    | per ton (net tonnage) | 16-120 yuan        | including half-traction engine cars and trailers |
| three-wheel vehicles and low-speed cargo vehicles | per ton (net tonnage) | 24-120 yuan        |  |
| motor tricycles                                   | each vehicle          | 36-180 yuan        |  |
| vessels   | Per net tonnage       | 3-6 yuan           | 50% for towboats and barges                      |

### III.7.12 Stamp Tax

Stamp tax taxpayers include units and individuals that execute or receive specified economic documents within the Chinese territory.

The tax liability can be compute in this way:

$$\text{Tax liability} = \text{tax base} \times \text{tax rate/tax amount per unit}$$

The tax base is the amount of payment, fees and receipt recorded in the taxable documents or the number of taxable documents.

Here provides the tax rates schedule:

**Table 35 Tax Rate of the Stamp Tax**

| Taxable items   | Tax rates (tax amount per unit) |
|---|---------------------------------|
| Sales contracts   | 0.03%                           |
| Processing contracts  | 0.05%                           |
| Survey and design contracts for engineering and construction projects | 0.05%                           |
| Construction and installation contracts                               | 0.03%                           |
| Property leasing contracts  | 0.1%                            |
| Goods transportation contracts  | 0.05%                           |
| Warehousing contracts   | 0.1%                            |
| Loans contracts   | 0.005%                          |
| Property insurance contracts  |                                 |
| 1. Property insurance contracts                                       | 0.1%                            |
| 2. responsibility, guaranty and credit insurance contracts            | 5 yuan per piece provisionally  |
| Technology contracts  | 0.03%                           |
| Property title transfer documents                                     | 0.05%                           |
| Business accounting documents   |                                 |
| 1. capital recording documents  | 0.05%                           |
| 2. other accounting documents   | 5 yuan/piece                    |
| Permits and licenses  | 5 yuan/piece                    |
| Stock exchange  | 0.1%                            |

### III.7.13 Deed Tax

Deed tax taxpayers include businesses, organizations, self-employed individuals and other individuals that are transferees of the land and house transferred within the Chinese territory.

For the tax liability computation, we use the following formula:

$$\text{Tax liability} = \text{tax base} \times \text{tax rate}$$

For the sales of state-owned land use right and the house on it, the tax base is the sales price;

For the presentation of land use right and the house on it as gift, the tax base is decided by tax authorities in reference to their sales price;

For the exchange of land use right and the house on it, the tax base is the difference between the prices of the exchanged land use rights and the houses.

The tax rate is decided by the government of the provinces, autonomous regions and provincial-level municipalities within the range of 3%-5%.

### III.7.14 Vehicle Acquisition Tax

Deed tax taxpayers include businesses, organizations, self-employed individuals and other individuals who acquire motor vehicles, motorcycles, trams, trailers and/or transportation vehicles for farm use within China.

The Tax is calculated in this way:

$$\text{Tax liability} = \text{taxable price} \times \text{tax rate}$$

The vehicle acquisition tax liability is computed on the basis of the taxable price of the taxable vehicle and by applying the applicable tax rate. The tax is paid in one lump sum. The current tax rate is 10%.

### III.7.15 Customs Duties

Customs duties payers include consignees who import goods permitted by China, consigners who pay export duties for legal exports permitted by China and the owners of the goods entering or exit China as permitted.

The computation of the duty liabilities is as follows:

Computed on ad valorem basis:

$$\text{Duties liability} = \text{the amount of taxable imports or exports} \times \text{tax-inclusive price per unit} \times \text{tax rate}$$

□ Computed on quantity basis:

Duties liability = the amount of taxable imports or exports × duties amount per unit

For imports, we have preferential tariff rates that are applied to imports produced in countries or regions that have tariffs agreement with China, and general tariff rates that are applied to imports produced in countries or regions that don't have tariffs agreement with China.

### **III.7.16 Vessel Tonnage Tax**

The tax payers of Vessel Tonnage Tax are the users or their entrusted foreign vessel agent companies of the following vessels: the foreign vessels going within China's harbor, Chinese vessels chartered to foreign businessmen, the Chinese or foreign vessels used by Chinese-foreign joint operation enterprises, and the foreign vessels chartered to China sailing overseas or both sailing overseas and engaged in domestic coastal trade.

To compute the tax liability, the following formula is adopted:

Tax liability = Net tonnage of taxable vessels × applicable tax amount per unit

The taxable vessels are divided into motored vessels and non-motored vessels. The tax is based on the registered net tonnage capacity of the vessels.

The vessel tonnage tax is based on quantity by applying the proper tax amount per unit of quantity that is determined in line with the type of the taxable vessels, net tonnage and relevant rules. The normal tax amount per unit for motored vessel is: 3.15 yuan – 9.30 yuan per ton if the vessel tonnage tax license is valid for 90 days; 1.50 yuan – 4.65 yuan if the validity is 30 days. The preferential amount of tax per unit for motored vessel is: 2.25 yuan – 6.60 yuan if the validity of license is 90 days; 1.20 yuan – 3.30 yuan if the validity is 30 days.

The preferential treatment is given to the taxable vessels whose national country has concluded most-favored nation convention or treaty with China for the tax and charges on vessels. Otherwise, the normal tax amount per unit shall apply.

### **III.8 Foreign taxation**

According to the existing tax laws and regulations in China, foreign businesses, businesses with foreign investment and foreign individuals in China are subject to the following taxes: value-added tax, excise tax, vehicle acquisition tax, customs duty, business tax, enterprise income tax, individual income tax, land appreciation tax, urban real estate tax, deed tax, resource tax, vehicles and vessels tax, vessel tonnage tax, stamp tax.

Chinese nationalities from Hong Kong, Macao, Taiwan and overseas and businesses with their investment are taxed with reference to laws and regulations on taxing foreign individuals, foreign businesses and businesses with foreign investment.

With the idea to better facilitate China's reforms and open-up policy, China has entered into double tax treaties to prevent double taxation and tax evasion with 90 countries, namely, Japan, the U.S., France, the U.K., Belgium, Germany, Malaysia, Norway, Denmark, Singapore, Finland, Canada, Sweden, New Zealand, Thailand, Italy, the Netherlands, former Czechoslovakia, Poland, Australia, Bulgaria, Pakistan, Kuwait, Switzerland, Cyprus, Spain, Romania, Austria, Brazil, Mongolia, Hungary, Malta, the United Emirates of Arab, Luxembourg, South Korea, Russia, Papua New Guinea, India, Mauritius, Croatia, Belarus, Slovenia, Israel, Vietnam, Turkey, Ukraine, Armenia, Jamaica, Iceland, Lithuania, Latvia, Uzbekistan, Bangladesh, Yugoslavia, Sudan, Macedonia, Egypt, Portugal, Estonia, Laos, Seychelles, Philippines, Ireland, South Africa, Barbados, Moldova, Qatar, Cuba, Venezuela, Nepal, Kazakhstan, Indonesia, Oman, Nigeria, Tunisia, Iran, Bahrain, Greece, Kyrgyzstan, Morocco, Sri Lanka, Trinidad & Tobago, Albania, Brunei, Azerbaijan, Georgia, Mexico, Saudi Arabia, Algeria, Tajikistan, 87 of these tax treaties are already in force (by 1 Dec. 2008).

## IV. Country-Specific Fiscal Issues

Because of the recent financial crisis, the total amount of China's exports has reduced sharply comparing with previous years. A big gap between demand and supply has already shown in current economy and will slack up the growth pace if can't be solved appropriately. As many scholars mentioned, the best way to settle this problem should pin to an increase of Chinese domestic consumption.

But as it known to all, Chinese tend to save more than other countries' people. It is actually a mixture of the particular culture and the average economic situation of our general public. Though most populace holds a very positive attitude to Chinese economy, they still take many other factors into account such as unemployment, sickness and also life standard after retirement. The key point here is the composing of our public, employment situation and also the distemperedness of social welfare system.

As mentioned above, China currently has 1.3 billion's citizens and among them rural population takes a percentage of about 50%. Comparing people living in cities, they have much lower average income. Also if are self-employed or engaged with agricultural affairs, they can't expect retirement pension from the government or company this forces them to save for their afterlives.

Employment is another problem occurred in today's economy. Few work opportunity comparing with huge amount of young graduates and jobless person, makes fierce competition and thus a further strike on the average wage. What's more, unfortunately people especially the youth tend to take less career risks under current economic situation that means they prefer to be hired rather than self-employment. Then a vicious circle starts.

The social welfare also matter a lot to this issue. There are several problems in present social welfare system: First, current system doesn't include all the people across the country especially the rural population; Second, this system is based on a province-level, both the regulation and administration may differ from place to place; Third, since there is no universal identification number for social insurance payers all around the country which makes information of their payment record very difficult to exchange between provinces or cities. Thus if a person goes to another city, he may be probably unable to quote for his social insurance payment and has to pay more in that city. And it also becomes a causation that some people are unwilling to pay especially for those who move frequently between cities. Fourth, because of lacunas mentioned above, an inefficient administration can be imagined too.

These two factors share a high weight in stimulating China's domestic consumption. If it just remains the same, few distinct changes would appear in our home market.

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

As mentioned above, increasing China's domestic consumption is an efficient and necessary way to promote the economy growth. There are several things needed to achieve the goal:

Create more work opportunities. In recent years, Chinese government has invested a lot in fundamental construction and public institution areas and got some positive responds. But that's not enough still. The government should not only augment investment amount but also be more careful to choose focusing fields, such as shifting attention from programs stimulated rapid growth in GDP like realty to public institutions which can improve general life standard like community hospitals, education to improve the macro-economic environment.

Promote average wage level. Now more measures are done to increase general salary standard in labor-sensitive industries such as construction or agriculture. But an improvement only in low-income households can not provide strong motivity to domestic consumption. If there are no developments in knowledge- and technique-sensitive industries to create an innovative economy, may all other measures are done but little effect is seen. To have the most people in middle-income level and reduce gap between the rich and the poor, that's the best way to pull the internal consumption.

Perfect the social welfare system and medical care system. For the former one, a country-wide system should be spread as soon as possible, including a specific regulation, normative administration, an unitive information database across the country and an unique identification number each person for his/her whole life. This goal will be difficult to achieve in short period but a necessary approach in economic development. The government should take gradual steps from now on.

And the medical care system also has an important effect on people's consumption behavior. A mature medical care system can not only be sure of a lower healthy burden for individual but also provide public more confidence for this government and economy which is of vital importance in personal consumption.

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