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CHINA

Key Economic Indicators
(Billions of Dollars)

	1998	1999	2000
Income, Production 'and Employment 1/			
Nominal GDP 2/	960.8	986.9	1,065.7
Real GDP Growth (pct) 3/	7.8	7.1	8.0
GDP by Sector: 4/			
Agriculture	172.7	174.1	173.8
Manufacturing	472.8	486.0	539.3
Services 5/	291.0	325.7	352.1
Government	N/A	N/A	N/A
Per Capita GDP (US$)	772	787	839
Labor Force (millions)	705.0	711.6	717.8
Unemployment Rate (pct) 6/	3.1	3.1	3.1
Money and Prices (annual growth):			
Money Supply (M2)	14.8	15.3	13.0
Consumer Price Inflation (pct)	-0.8	-1.4	0.2
Exchange Rate (RMB/US$ avg.)	8.3	8.3	8.3
Balance of Payments and Trade:			
Total Exports (FOB) 7/	182.7	183.7	214.4
Exports to U.S. (customs)	71.2	81.9	92.8
Total Imports CIF	142.4	140.2	197.8
Imports from U.S. FAS	14.3	15.0	17.0
Trade Balance	40.3	43.5	16.6
Balance with U.S.	56.9	66.9	75.8
External Public Debt 8/	146.0	151.8	152.0
Fiscal Deficit/GDP (pct)	3.5	2.8	3.0
Current Account Surplus/GDP (pct)	3.1	3.0	2.3
Debt Service Payments/Export (pct)	12.6	9.6	9.0
Debt Service Payments/GDP (pct)	2.4	2.2	2.0
Gold and Forex Reserves	145.0	154.7	163.0
Aid from U.S.	0	0	0
Aid from Other Sources	0.6	0.6	0.6

1/ All income and production figures are converted into dollars at the exchange rate of RMB 8.3 = US$1.00. Figures are in US$billions unless otherwise stated.
2/ GDP figures for year 2000 are estimates based on data available in October 2000.

3/ Official growth rate published by State Statistical Bureau based on constant renminbi (RMB) prices using 1978 weights.

4/ Production and net exports are calculated using different accounting methods and do not tally to total GDP. Agriculture includes forestry and fishing; manufacturing includes mining.

5/ Available Chinese GDP data do not disaggregate services provided by the government from overall services.

6/ "Official" urban unemployment rate for China's approximately 200 million urban workers; agricultural laborers are assumed to be totally employed in China's official labor data. Many economists believe the real rate of urban unemployment is much higher.

7/ U.S. Department of Commerce for U.S.-China bilateral trade data; PRC Customs for Chinese global trade data; Embassy estimate for full-year 2000 trade.

8/ Includes loans from foreign government, loans from international financial institutions, international commercial loans, and other unspecified international liabilities.

Sources: China Statistical Bureau Yearbook; People's Bank of China Quarterly Statistical Bulletin; U.S. Department of Commerce Trade Data; Embassy estimates.

1. General Policy Framework

For two decades, in the aftermath of a quarter-century of "politics in command" as the failed guiding principle of economic development, China has pursued policies designed to achieve rapid growth and higher living standards. During this period, China has made a gradual transformation from a centrally planned, socialist economy toward a more market-based economy. Though state-owned industry remains dominant in key sectors, the government has "privatized" many small and medium state-owned enterprises (SOEs) and has allowed the non-state sector, including private entrepreneurs, increasing scope for economic activity. The International Monetary Fund (IMF) estimates that the non-state sector accounts for three-fourths of industrial output, 50 to 60 percent of Gross Domestic Product (GDP), and about 60 percent of nonagricultural employment.

China weathered the Asia Financial Crisis well. Most analysts expect GDP growth to be about eight percent this year. As in the past, exports were the primary engine for China's economic growth. For the January-August 2000 period, they were 35 percent greater than for the same period in 1999. The rapid export expansion reflected in part the recovery from the Asia Financial Crisis of China's Asian markets. The United States remains China's most important market; it takes more than 40 percent of China's total exports. Imports also increased rapidly. By value, they were up 39 percent in JanuaryAugust 2000 (year-on-year), due largely to the effect of higher prices for petroleum and non-ferrous metals. China's accession to the World Trade Organization (WTO) will likely further boost trade and accelerate China's integration into the world trading system.

To reverse the slowdown in economic growth, especially since 1998, the Chinese government has used deficit-financed fiscal stimulus to encourage domestic economic expansion. This program has contributed an estimated 1.5-2.0 percentage points to GDP annually. In August 2000 the Chinese government announced a $6 billion treasury bond issue, primarily to finance additional infrastructure projects and to ensure the completion of projects already underway. Reflecting the effects of the fiscal stimulus package and major increases in 1999 in social welfare expenditure and civil service salaries, urban consumer spending picked up somewhat in 2000. Supply of many industrial and consumer products greatly exceeds demand. Chinese policymakers, who for years made fighting inflation a major macroeconomic target, spent the last two years combating deflation. In 2000 many prices, especially for food and consumer goods, continued to fall. Charges for services and fuel showed substantial increases.

The Chinese government recognizes that major structural reform is needed in three key areas: it must reform the SOEs, completely overhaul the financial system, and create and fund a social safety net. SOE earnings rose in 2000, although this appears to be largely the result of state-owned petroleum industry profits from higher oil prices, increased SOE exports, and a government-engineered reduction in interest paid by SOEs on bank debt. The large stock of non-performing loans to SOEs remains a critical obstacle to financial reform. Bank loans to non-agricultural SOEs accounted for about 60 percent of total outstanding short-term lending in 1999. The four state-owned, commercial banks that dominate China's financial system established asset management companies (AMCs) in 1999 to assume the burden of the non-performing loans. By September 2000 the AMCs had done little to restructure or to liquidate their holdings. The failure of the Guangdong Trust and Investment Corporation (GITIC) in late 1998 prompted the Chinese government to rein in the operations of more than 200 other trust and investment companies and toughen the supervision of domestic banks, securities firms, insurance companies, and other financial institutions. Stock and bond markets are immature. Reform of the financial system will help allocate more efficiently China's huge pool of domestic savings and fund creation of pension, unemployment, and health care systems.

China enjoys large inflows of foreign capital. Lured by a market with over one billion potential consumers, foreign companies have made China the world's second largest destination for foreign direct investment (FDI). New inflows of FDI slumped 10 percent in 1999, to total $41 billion. In the January-October 2000 period, contractual foreign investment was $43 billion, up 37 percent over the corresponding period in 1999. Note that realized FDI is substantially lower than contractual totals reported by Chinese authorities.

2. Exchange Rate Policies

Foreign-Invested Enterprises (FIEs) and authorized Chinese firms have generally enjoyed liberal access to foreign exchange for trade-related and approved investment related transactions. FIEs may set up foreign currency deposits for trade and remittances. Since 1997, Chinese firms earning more than $10 million a year in foreign currency have been allowed to retain in foreign currency up to 15 percent of their receipts. The Asia-wide economic slowdown and growing evidence of unauthorized capital outflows prompted the government to tighten documentation requirements in mid-1998. U.S. firms reported that the extra delays caused by these measures had for the most part ended by mid-1999. China introduced currency convertibility for current account (trade) transactions in December 1996 (in accord with the IMF charter's Article VIII provisions). Capital account liberalization has been postponed indefinitely.

Chinese authorities describe the exchange rate as a "managed float." For the past three years, it has behaved like a rate pegged to the dollar, with a trading range of ±0.3 percentage points; since 1996 the renminbi (RMB) has traded consistently at about RMB 8.3 per dollar. China uses the RMB/dollar exchange rate as the basic rate and sets cross rates against other currencies by referring to international markets. China's central bank, the People's Bank of China (PBOC), continues to set interest rates on all deposits and loans in domestic currency. In September 2000, however, the authorities lifted controls on interest rates on all foreign currency loans and on foreign currency deposits in excess of $3 million. A newly established association of Chinese banks, moreover, was granted the authority to set interest rates on foreign currency deposits under the $3 million level. Following several years of successive reductions, interest rates on Chinese currency loans and deposits are significantly below U.S. levels. As a result, "black market" trading continues to be a small albeit regular feature of the Chinese system. Forward rates are available in the small, offshore market.

3. Structural policies

A. Investment

China has historically attempted to guide new foreign investment to "encouraged" industries. Over the past five years, China has implemented new policies introducing new incentives for investments in high-tech industries and in the central and western, less developed parts of the country. In 2000 China published revised lists of sectors in which foreign investment would be encouraged, restricted or prohibited. Regulations relating to the encouraged sectors were designed to direct FDI to areas in which China could benefit from foreign assistance or technology, such as in the construction and operation of infrastructure facilities. Policies relating to restricted and prohibited sectors were designed to protect domestic industries for political, economic or national security reasons. The number of restricted industries—currently including many service industries such as banking, insurance, and distribution—should decrease as China opens its service sector upon accession to the WTO. The production of arms and the mining and processing of certain minerals remain prohibited sectors.

Foreign-Invested Enterprises (FIEs) continue to report being forced to accept export performance requirements in investment contracts; they say that failure to meet these requirements can result in loss of licenses for foreign exchange or contract termination. Similarly, some firms report being forced to accept contracts mandating increased local content. Chinese government agencies strongly encourage firms under their control to "buy Chinese."

B. Industrial Policies

In 1994, China issued a "Framework Industrial Policy for the 1990s." The framework included plans to issue policies for the key automotive, telecommunications, transportation, machinery, electronics, high technology, and construction sectors. Of these, only the automotive industrial policy has been published to date and is currently under extensive revision. The delay stems from the Chinese government’s recognition that these policies must be reconciled with the obligations China will incur when it accedes to the WTO.

C. China EXIM Financing

Regulations promulgated in July 1995 established guidelines for buyer’s and seller’s credit programs operated by the Export and Import Bank of China (China EXIM). China EXIM announced in early 1999 that it would expand it program to finance the export of mechanical and electrical products, particularly to Africa and South East Asia.

D. Price Controls

The Chinese government, as part of its comprehensive reform of the economy, is committed to gradually phasing out remaining price controls. It nevertheless continues to influence prices of sensitive goods such as grain. To curb surplus production in 2000, the government allowed grain and cotton prices to fall by more than 20 percent, bringing domestic prices closer to international levels. China maintains discriminatory pricing practices with respect to some services and inputs offered to foreign investors in China. On the other hand, foreign investors benefit from investment incentives, such as tax holidays and grace periods, which allow them to reduce substantially their tax burden.

E. Taxation

China’s accession to the WTO is likely to accelerate the phaseout of its two-tier tax system for domestic and foreign enterprises. Domestic enterprises have long resented rebates and other tax benefits enjoyed by foreign-invested firms. The move toward national treatment will mean the gradual elimination of special tax breaks enjoyed by many foreign investors. In addition, more sophisticated collection methods should help reduce loopholes for all market participants.

As part of a national campaign to standardize tax treatment and increase collection rates, the State Administration of Taxation began work on a planned unification of the tax system in 1998. China’s weak trade performance during most of 1999 and questions relating to China’s WTO obligations have delayed the completion of this exercise. The Chinese government, in fact, increased rebates of value-added taxes (VAT) for selected exports twice in 1999. Despite the 1999 reprieve, State

Administration of Taxation officials plan eventually to phase out VAT rebates to increase tax revenues.

F. A Growing Concern for Transparency

It is increasingly easy to find information about economic and trade regulations in the print and electronic media. Economic newspapers routinely carry the text of government policies and regulations; MOFTEC, for example, has its own website. Access to information, nevertheless, continues to be a problem. Chinese ministries routinely implement policies based on "guidance" or "opinion" that are not available to foreign firms. Officials are frequently unwilling to consult with Chinese and foreign industry representatives before new regulations are implemented. The opaque nature of customs and other government procedures also complicate the ability of businesses to take full advantage of opportunities in China.

4. Debt Management Policies

As of June 2000, China's external debt stood at $149 billion, according to official Chinese data. Given China's export performance, investment inflows, and high level of foreign exchange reserves (nearly $160 billion at the end of June 2000), the debt burden seems likely to remain within manageable limits.

China's local bond market is in its infancy, with virtually no secondary market. This prevents the central bank from effectively regulating the money supply through indirect means. Interest rates on government bonds are fixed at about one percentage point above the comparable bank deposit rates, which are also fixed. As the government has increased its deficit, the percentage of the budget devoted to debt servicing has increased to about 17 percent of total expenditures (based on the Finance Minister's March 2000 annual budget report to China's national legislature).

5. Aid

The United States has no development assistance program in China. However, the United States has provided occasional disaster-relief assistance to China to support flood relief and other humanitarian efforts in recent years. In 1999-2000 the United States donated 200,000 tons of grain to the World Food Program in China. In 1999 it donated $500,000 to the International Federation of the Red Cross to assist in flood relief efforts in the Yangtze River Valley. In addition, the United States operates a modest Peace Corps program, called the Friendship Volunteers, which offers English -language and environmental protection training. China is a major recipient of assistance from other countries and multilateral donors. China's largest bilateral aid donor is Japan. Multilateral assistance includes programs operated by the World Bank; the World Food Program; United Nations Development Program and other United Nations affiliated agencies and programs; and the Asian Development Bank. Domestic and international non-governmental organizations have also expanded their presence in recent years, thanks in part to a 1998 law giving them official status.

6. Significant Barriers to U.S. Exports

China concluded a bilateral market access agreement with the United States on November 15, 1999 but is not yet a member of the WTO. Once it becomes a member, it must fulfill its commitments to reduce substantially existing barriers to the entry into China of U.S. goods and services. Meanwhile, in an effort to cope with a slowing economy and relatively weak external demand, China continued its unilateral reform efforts in 1999 and 2000. Some of the policies adopted will improve market access for U.S. goods and services. For example, a huge expansion in the number of firms with trading rights, reduction in the number of products subject to import quotas, and an improved system of distribution rights will all benefit foreign firms.

Despite this progress, other measures have effectively closed existing markets for imported goods and services. Non-tariff barriers to trade and trade-distorting measures persist. Nontariff barriers (NTBs) include quotas, tariff rate quotas, import licensing, import substitution and local content policies, and unnecessarily restrictive certification and quarantine standards. Extra-legal trade barriers, such as export performance requirements, also distort trade; all of these nontariff barriers to trade will have to be eliminated when China accedes to the WTO.

In several cases, such as the initial public draft of encryption regulations introduced in late 1999, Chinese ministries tried to address national security issues in ways that resulted in the creation of new barriers to trade. The vague wording of many Chinese laws and regulations often leads to conflicts with other laws or broader trade and investment policies. Nonspecific language also makes it difficult for companies and individuals to be certain they are obeying the provisions of a given law.

Regulatory initiatives introduced since the completion of the November 1999 bilateral market access agreement on China's WTO accession appear to limit access for some goods and services. Examples of these problems include the following.

Technical Barriers to Trade: For manufactured goods, China requires quality licenses before granting import approval, with testing based on standards and specifications often unknown or unavailable to foreigners and not applied equally to domestic products. China continues to operate a dual inspection system that differentiates between imported goods and those produced domestically. This practice violates the principle of national treatment. A further complication is that imported products are sometimes required to be tested both at the port of entry by China Inspection and Quarantine (CIQ) and by the domestic testing authority, resulting in delays and increased costs for the importer.

Chain Stores: The U.S.-China agreement on China's WTO accession contains provision for the gradual liberalization of wholesale, retail, franchising, and direct sales services over three years. The language excepts large department stores and chain stores with over 30 outlets. New chain store regulations appear to call these commitments into question by greatly broadening the definition of what constitutes a chain store.

Pharmaceuticals: The Chinese government banned the import of nine generic medicines, including several varieties of antibiotics, pain relievers, and Vitamin C, in mid 1999 in an effort to control falling prices in the domestic market. In late 1998 it implemented price caps on pharmaceuticals, claiming it was doing so to contain health care costs. The regulations may drive some multinationals and bulk pharmaceutical exporters out of the $12-billion Chinese pharmaceutical market and push others into the red. The price caps are calculated only on the basis of each drug's production costs, ignoring research spending and other shared overheads.

7. Export Subsidies

China abolished direct subsidies for exports on January 1, 1991. Nonetheless, exports of agricultural products, particularly corn and cotton, still receive direct export subsidies. China agreed to stop such subsidies once it becomes a member of the WTO. There continue to be reports that some manufactured exports benefit from indirect subsidies through preferential access to or access at below market rates to inputs such as energy, raw materials or labor. Some companies also may enjoy de facto indirect subsidies by not repaying their bank loans.

8. Protection of U.S. Intellectual Property

China is a member of the World Intellectual Property Organization (WIPO) and is a signatory to the Paris Convention for the Protection of Intellectual Property, the Bern Convention for the Protection of Literary and Artistic Works, the Universal Copyright Convention, the Patent Cooperation Treaty, and the Madrid Protocol. China has also committed to bringing its laws and regulations on the protection of intellectual property rights (IPR) into full compliance with the WTO agreement on Trade-Related Intellectual Property (TRIPS) at the time of its accession to WTO. A new Patent Law was completed in August 2000, and new draft Trademark and Copyright Laws are currently under discussion in interagency meetings.

After signing the U.S.-China agreement on the protection of intellectual property rights in February 1995, and the June 1996 agreement on procedures for ensuring implementation of the bilateral, China made progress in implementing IPR regulations and improving enforcement and education. The United States took China off Special 301 lists in 1996, but continues to watch China under Section 306 of the Trade Act, which allows the United States to monitor China's compliance with its obligations. If China is found wanting in its IPR regime, the United States can begin a fast-track examination, which can result in penalties.

China revised its laws to provide criminal penalties for IPR violations. The United States, nevertheless, remains concerned that penalties imposed by Chinese courts are insufficient to deter violations. Some U.S. companies estimate losses from Chinese counterfeiting equal 15 to 20 percent of total sales in China. One U.S. consumer products company estimates that it loses $150 million annually due to counterfeiting. The destructive effect of counterfeiting has discouraged additional direct foreign investment and threatened the long-term viability of some U.S. business operations in China. The inferior quality of counterfeit products also creates serious health and safety risks.

China's State Council, the highest executive organ of the government, issued a decree in 1999 admonishing Chinese government agencies to purchase only legal computer software. Nevertheless, end-user piracy of computer software continues to cost U.S. companies millions of dollars. A PRC study on China's software industry published in September 2000 identified piracy as the major obstacle to the development of China's software industry. Regulations on the use of copyright agents by foreign companies have not yet been finalized; this effectively prevents foreign companies from using agents to register copyrights. Foreigners registering trademarks face a shortage of agents authorized to accept trademark applications from foreign companies. The lack of clear procedures to protect unregistered well-known trademarks makes it difficult to oppose or cancel well-known marks registered by an unauthorized party.

9. Worker Rights

a. *The Right of Association:* China's constitution provides for "freedom of association," but in practice this provision does not entitle workers to organize freely. The Trade Union Law states that workers who wish to form a union at any level must receive approval from a higher-level trade organization. Approved trade unions are legally required to join the All-China Federation of Trade Unions (ACFTU), a national umbrella organization controlled by the Communist Party. Independent trade unions are illegal. Since China's signing of the International Covenant on Economic, Social, and Cultural Rights in 1997, several labor activists have petitioned the government to establish free trade unions, as allowed under the covenant. China has not yet ratified the Covenant nor approved any of these petitions to date.

b. *The Right to Organize and Bargain Collectively:* The 1995 National Labor Law permits collective bargaining for workers in all types of enterprises. The law also provides for workers and employers to sign individual as well as collective contracts. Collective contracts are to be negotiated between ACFTU or worker representatives and management and specify such matters as working conditions, wage distribution, and hours of work. Individual contracts are then to be drawn up in line with the terms of the collective contract. According to the ACFTU, 72 million workers in over 310,000 enterprises held contracts that were negotiated in this fashion as of June 1999.

c. *Prohibition of Forced or Compulsory Labor:* Forced labor in penal institutions is a problem. The Chinese government employs judicial procedures to sentence criminals to prisons and reform-through-labor facilities. The government also maintains a network of reeducation-through-labor camps, to which persons are sentenced, without judicial review, through administrative procedures. Inmates of reeducation-through-labor camps generally are required to work. Most reports conclude that work conditions in the penal system's light manufacturing facilities are similar to those in ordinary factories, but conditions on farms and in mines can be harsh.

d. *Minimum Age of Employment of Children:* China's National Labor Law forbids employers to hire workers under 16 years of age and stipulates administrative review, fines, and revocation of licenses for businesses that hire minors. Good public awareness, a surplus of legal adult workers, and nearly universal primary schooling have reduced incentives to hire child workers. A national government campaign in mid-2000 against women and child trafficking, however, revealed that child labor was perhaps a more significant problem than previously thought. The International Labor Organization (ILO) and UNICEF have been unable to collect statistics on child labor, but they do not believe the problem is systemic. Some Chinese academics maintain that child labor problems exist in agricultural and mining areas, where it is sometimes difficult to enforce labor law and where, in the agricultural areas in particular, families, including children, have always labored alongside one another during the critical planting and harvesting seasons.

e. *Acceptable Conditions of Work:* The Labor Law codifies many of the general principles of labor reform, setting out provisions on labor contracts, working hours, wages, skill development and training, dispute resolution, legal responsibility, supervision, and inspection. The law does not set a national minimum wage, but allows local governments to determine their own minimum wage standards. China has a 40-hour workweek, excluding overtime, and a mandatory 24-hour rest period per week. The Chinese government claims to have implemented in over 600 cities a system that ensures disbursement of unemployment benefits to laid-off workers and basic living stipends for the poorest urban residents. In September 1999 the government raised both unemployment benefits and basic living stipends by thirty percent, despite reports that some cities had insufficient funds to provide these entitlements even before the hike.

Every Chinese work unit must designate a health and safety officer, and the ILO has established a training program for these officers. China's Trade Union Law recognizes the right of unions to "suggest that staff and workers withdraw from sites of danger" and to participate in accident investigations. According to statistics released in 1999 by the Ministry of Labor and Social Security, industrial accidents declined 16 percent in 1998 to 15,372. Deaths stemming from such accidents likewise declined to 16 percent to 14,660. The improvement in industrial safety was due largely to a national campaign to shut down illegal mines, which perennially account for more than half of all industrial accidents.

f. *Rights in Sectors with U.S. Investment:* Worker rights practices in sectors with U.S. investment do not appear to vary substantially from those in other sectors of the economy. Unlike their Chinese counterparts, however, a number of U.S.-invested businesses have voluntarily adopted codes of conduct that provide for independent inspections of working conditions in their facilities.

Extent of U.S. Investment in Selected Industries—U.S. Direct Investment Position Abroad on an Historical Cost Basis—1999

(Millions of U.S. dollars)

Category		Amount
Petroleum		991
Total Manufacturing		4,789
Food & Kindred Products	150	
Chemicals & Allied Products	259	
Primary & Fabricated Metals	203	
Industrial Machinery and Equipment	946	
Electric & Electronic Equipment	2,343	
Transportation Equipment	123	
Other Manufacturing	765	
Wholesale Trade		201
Banking		69
Finance/Insurance/Real Estate		784
Services		260
Other Industries		673
TOTAL ALL INDUSTRIES		7,766

Source: U.S. Department of Commerce, Bureau of Economic Analysis.