2001 Country Reports on Economic Policy and Trade Practices
Released by the Bureau of Economic and Business Affairs
U.S. Department of State, February 2002

CHINA

Key Economic Indicators

(Billions of U.S. dollars unless otherwise indicated)

	1999	2000	2001
Income, Production and Employment 1/			
Nominal GDP 2/	986.9	1,077.1	1160.0
Real GDP Growth (pct) 3/	7.1	8.0	7.5
GDP by Sector: 4/			
Agriculture	174.1	171.2	176.0
Manufacturing	486.0	548.0	597.5
Services	325.7	357.9	386.5
Government 5/	123.9	141.0	N/A
Per Capita GDP (US$)	787	829	892
Labor Force (millions) 6/	711.6	717.8	724.0
Unemployment Rate (pct) 7/	3.1	3.1	3.5
Money and Prices (annual growth):			
Money Supply (M2) (pct)	15.3	12.3	13.5
Consumer Price Inflation (pct)	-1.4	0.4	1.0
Exchange Rate (RMB/$US avg.)	8.3	8.3	8.3
Balance of Payments and Trade:			
Total Exports (FOB) 8/	194.7	249.1	269.2
Exports to United States (U.S. data)	81.8	100.0	107.2
Exports to United States (Chinese data)	41.9	52.1	55.2
Total Imports CIF	158.7	214.7	241.3
Imports from United States FAS (U.S. data)	13.1	16.2	19.5
Imports from United States (Chinese data)	19.5	22.4	26.2
Current Account Balance	15.7	20.5	12.4
Balance with United States (U.S. data)	68.7	83.8	87.7
Balance with United States (Chinese data)	22.4	29.7	29.0
External Public Debt 9/	151.8	145.7	145.0
Fiscal Deficit/GDP (pct)	2.8	2.8	2.7
Current Account Surplus/GDP (pct)	3.0	2.2	2.0
Debt Service Payments/Export (pct)	11.3	9.2	9.0
Debt Service Payments/GDP (pct)	2.2	4.0	3.0
Gold and Foreign Exchange Reserves	155.3	166.1	200.6
Aid from United States	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 2001 are estimates based on data available in October 2001.

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. Estimates for government contribution to GDP provided in the table have been calculated on an expenditure basis. They are not components of the aggregate or sectoral GDP figures, calculated on a production basis, given above. As GDP calculated on an expenditure basis differs only slightly from that using production figures, the figures do give a reasonable approximation to the contribution of government spending to the economy.

6/ "Economically active population" as presented in the China Statistical Yearbook (2001). Both 2000 and 2001 are Embassy estimates.

7/ "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.

8/ IMF for PRC global trade data; IMF estimates for full-year 2001 global trade; U.S. Department of Commerce for U.S.-China bilateral trade data; PRC Customs for U.S.-China bilateral trade data; Embassy estimate for full-year 2001 bilateral trade.

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

Sources: China Statistical Yearbook (2000, 2001); China Statistical Abstract (2001), People's Bank of China Quarterly Statistical Bulletin; U.S. Department of Commerce Trade Data; Asian Development Bank; Embassy estimates.

1. General Policy Framework

For two decades, 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, increased 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.

Most analysts expect China's GDP growth to be between seven and eight percent in 2001, slightly slower than the eight percent rate recorded in 2000. Increased domestic demand, fueled in large part by government-directed fixed-asset investment, played the key role in generating gross domestic product growth. Fixed-asset investment rose over 15 percent year-on-year during the first half of 2001, and the government's target was 10 percent for the full year.

Exports, which made a strong contribution to output in 2000, grew only 7.3 percent year-on-year through August 2001, a decline of over 20 percentage points from the growth rate recorded for the full year 2000. In addition, supply of many industrial and consumer products in the domestic market continued to exceed demand. As a result, prices for those commodities continued to fall, although higher prices for services and some food products led to an increase of about one percent in the overall consumer price index.

The Chinese government has used deficit-financed fiscal stimulus to encourage domestic economic expansion since 1998. This program has contributed an estimated 1.5-2.0 percentage points to GDP annually. In 2001, the Chinese government planned to issue "special construction bonds" worth the equivalent of about $US 18 billion to provide partial funding for projects designed to promote economic growth. The government issued roughly $US 43 billion in similar bonds from 1998 to 2000. As of the end of 2001, the total value of these projects was approximately $US 290 billion. Because the yield on government bonds exceeded that of Chinese currency bank deposits, authorities have faced no difficulties in financing either the government deficit of about $US 31 billion or its fiscal stimulus program through increased domestic issuance of government debt. At the end of 2000, the balance of China's national debt equaled approximately 15 percent of gross domestic product.

The Chinese government recognizes, however, that major structural reform is needed in three related areas: the inefficient state-owned industrial sector, the financial system, and the social safety net. The earnings of state-owned enterprises (SOEs) rose in 2001, although the bulk of profits were concentrated in a handful of industries such as petroleum (helped by high world oil prices) and electric power (where government price controls ensure strong earnings). The large stock of non-performing loans poses a critical obstacle to financial reform. Short-term bank loans primarily to (often unprofitable) SOEs accounted for about 60 percent of total outstanding lending in 2001, and government controls over interest rates as well as policy directives channeling bank credit to preferred industries and enterprises remained in effect. Outside observers estimate non-performing debt to be 30-50 percent of outstanding loans -- even after the transfer in 1999 of the equivalent of nearly $US 170 billion in non-performing loans to four state-owned asset management companies (AMCs). As of the end of June 2001, the AMCs had "disposed of" the equivalent of almost $US 33 billion in non-performing loans with a recovery rate of around 50 percent of asset value. Stock and bond markets remained immature and highly sensitive to government policy changes or insider manipulation. 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 one of the world's largest destinations for foreign direct investment (FDI). Realized foreign direct investment reached $US 27 billion by the end of August 2001, a 20 percent increase over the same period of the previous year.

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 $US 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 and transactions in December 1996 (in accordance 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 percent; 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. In September 2000, the Chinese authorities lifted interest rate controls on all foreign currency loans and on foreign currency deposits in excess of $US 3 million. A newly established association of Chinese banks, moreover, was granted the authority to set interest rates on foreign currency deposits under the $US 3 million level. Interest rates on foreign currency deposits have declined since the beginning of 2001 to match the low rates on domestic currency savings. Nevertheless, China's closed capital account means that "black market" trading continues to be a regular feature, albeit small, of the Chinese system. Forward rates are available in the small, offshore market.

3. Structural Policies

Price Controls

The Chinese government, as part of its comprehensive reform of the economy, is committed to gradually phasing out remaining price controls. As of mid-2001, only thirteen categories of goods remained subject to price controls, down from 141 in 1992. The government nevertheless continues to apply direct price controls over commodities deemed strategically important such as petroleum and to influence the prices for 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 also maintains discriminatory pricing practices with respect to some services and inputs offered to foreign investors in China. China agreed to eliminate these practices when it became a member of the World Trade Organization (WTO). 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.

Taxation

China's accession to the WTO will accelerate the phaseout of tax preferences for foreign-invested 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. The National People's Congress (China's national legislature) passed a series of amendments to the country's tax collection law in April 2001 designed to make the tax code more standardized and transparent. Although State Administration of Taxation officials plan eventually to phase out rebates of Value-Added Tax payments for selected exports as a way to increase tax revenues, the authorities are likely to keep this measure in place at least through 2002 to spur exports.

Regulatory Environment

Many of the most significant barriers to trade and investment in China are not the result of explicit laws or regulations aimed at keeping out foreign products or capital. Rather, they are systemic problems that stem from a bloated, secretive, and interventionist bureaucracy inherited from the past. China has committed to address many of these problems when it joins the WTO (in December 2001) through increased transparency, notice and comment procedures for new laws and regulations, and the availability of judicial review of administrative actions. At present, however, Chinese ministries routinely implement policies based on internal "guidance" or "opinions" that are not available to new market entrants. Authorities usually are unwilling to consult with Chinese and foreign industry representatives before new regulations are implemented. Likewise, the lack of a clear and consistent framework of laws and regulations is an effective barrier to the participation of foreign firms in the domestic market. Even in areas where the law is clear, government bureaucracies often "selectively apply" regulations; China has many rules on the books that are ignored in practice until a person or entity falls out of official favor. Official corruption, particularly at provincial and local levels, is acknowledged to be a serious problem in China, as demonstrated by a series of recent crackdowns.

4. Debt Management Policies

At the end of 2000, China's external debt stood at just under $US 146 billion, according to official Chinese data. Long-term lending made up over 90 percent of the outstanding balance. Given China's relatively strong export performance, investment inflows, and large foreign exchange reserves (over $US 190 billion at the end of August 2001), China can easily service its foreign debt obligations.

5. Significant Barriers to U.S. Exports

China's impending accession to the WTO would oblige it to address comprehensively many trade-distorting practices that limit the access of foreign firms to China's market. In preparation for accession, the Chinese government has undertaken a massive effort to revise its laws and regulations to bring them into compliance with WTO rules. China's 2001-2005 Tenth Five-year Plan calls for an improved legal and regulatory framework and increased transparency. Meanwhile, in an effort to cope with a slowing economy and relatively weak external demand, China continued its reform efforts in 2000 and 2001. Some of the policies adopted have improved 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, China still has substantial barriers. Furthermore, while China's trade liberalization efforts represent a step forward, China also introduced regulations that erected new or worsened existing trade barriers.

Import licenses: Since the early 1990s, China has eliminated many import license requirements, a process that is continuing as preparations are made for China's WTO accession. Licenses are still required, however, for a number of items important to the United States, including grains, vegetable oil, cotton, iron and steel products, commercial aircraft, passenger vehicles, hauling trucks, and rubber products. China is considering adding more license requirements in an effort to combat smuggling of certain agricultural goods. Although Chinese regulations state that the issuance of most import licenses is "automatic," the license applicant must prove that there is "demand" for the import and that there is sufficient foreign exchange available to pay for the transaction. The issuing entity is left with a large degree of discretion. In effect, this allows a local official to block license approval without offering an explicit reason. However, this system should be changing once China joins the WTO, as it has made commitments not to use its import licensing system as a trade barrier and to observe the principles of non-discrimination and national treatment.

Services barriers: China's services sector has been one of the most heavily regulated and protected parts of the national economy. At present, foreign service providers are largely restricted to operations under the terms of selective "experimental" licenses. Strict operational limits on entry and restrictions on the geographic scope of activities severely constrain the growth and profitability of these operations.

The commitments included in China's WTO accession agreement would provide access of foreign businesses to many services sectors. For example, China has committed to gradually phasing out geographical restrictions on insurance and banking services. Foreign banks can conduct local currency business with Chinese companies two years after China's WTO accession (subject to certain geographical restrictions), and with Chinese individuals five years after accession; all restrictions on foreign banks are to be removed five years after China's entry to the WTO. The Chinese have promised upon accession to allow foreign firms to distribute and service their own products made in China, and provide related services. After a three-year period, foreign enterprises will be able to engage in distribution services for most products (including providing related services).

Standards, testing, labeling, and certification: China's testing and standards regimes are an area of serious concern for foreign producers. It is often difficult to ascertain what inspection requirements apply to a particular import, as China's import standards are not fully developed and often differ substantially from requirements imposed on domestic goods. New requirements are usually not released to traders with sufficient advance notice, making it difficult to sign long-term contracts and plan production. The United States and other countries have complained that safety and inspection procedures applied to imports are often more rigorous and expensive than those applied to domestic products. Furthermore, standards testing and inspection for domestic and imported goods were carried out by separate entities until August 2001 when the domestic testing and quarantine agencies merged. Of most serious concern, China's standards and quarantine requirements may not always be based on internationally accepted norms and sound science, resulting in serious burdens for foreign suppliers. However, many aspects of China's testing and standards regime should be changing when China joins the WTO. China has committed to ensure that its testing and standards bodies operate with transparency, apply the same technical regulations, standards and conformity assessment procedures to both imported and domestic goods, and use the same fees, processing periods, and complaint procedures for both imported and domestic goods. In addition, China has committed to accept the Code of Good Practice within four months after accession, and it will speed up its process of reviewing existing technical regulations, standards, and conformity assessment procedures and harmonizing them with international norms.

Investment barriers: 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 China's central and western regions. In 2000, China published revised lists of sectors in which foreign investment would be encouraged, restricted or prohibited; further revisions are expected in 2001. 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.

The law governing wholly foreign-owned enterprises (WFOEs) was revised in April 2001 to eliminate requirements regarding export performance; technology transfer and import substitution; foreign exchange balancing; direct domestic sales; and domestic sourcing, whenever possible, of raw materials, fuel, capital equipment, and technology. Under its accession agreement, China has also agreed not to enforce these types of requirements in existing contracts. Also, under the revised WFOE law, China may reject a WFOE application for several reasons, including nonconformity with the development requirements of China's national economy, potentially affording the government leverage in "encouraging" export performance, technology transfer, and import substitution. The law on Sino-foreign joint ventures was revised in March 2001 to eliminate a domestic procurement requirement. Chinese government agencies have, however, traditionally encouraged enterprises under their control to "buy Chinese."

Government procurement practices: Government procurement in China has for many years been an opaque process. Foreign suppliers face overt and covert discrimination. Even when procurement contracts have been open to foreign bidders, such suppliers have often been discouraged from bidding by the high price of participation. The Chinese government has routinely sought to obtain offsets from foreign bidders in the form of local content requirements, technology transfers, investment requirements, countertrade, or other concessions. The problem extends beyond traditional government procurement to encompass China's many "state-controlled" entities. The State Economic and Trade Commission (SETC), in 1999, issued regulations requiring state-owned enterprises (SOEs) to purchase all capital equipment from either domestic manufacturers or foreign-invested enterprises in China except where the equipment is not available domestically. In its accession agreement, however, China has agreed that SOEs must make purchases and sales based solely on commercial considerations, such as price, quality, marketability and availability, and that the government will not directly or indirectly influence the commercial decisions of SOEs.

China has made some efforts to open its government procedures to competitive bidding. On January 9, 2001, the Ministry of Finance (MOF) issued a document stressing that noncompetitive or protectionist ploys are strictly prohibited while selecting a procurement company for a loan project. However, as written the provisional procedures offer insufficient protection to foreign participants in government procurement projects.

Customs procedures: In August 1998, the Customs Administration launched an ambitious program to standardize enforcement of customs regulations throughout China as part of a larger campaign to combat smuggling. The program was introduced to control and ultimately eliminate "flexible" application of customs duty rates at the port of entry. While foreign businesses selling goods into China at times have benefited from lower import duty rates, lack of uniformity made it difficult to anticipate in advance what the applied duty would be. The scale of the smuggling problem itself is illustrated by the continuing prosecution of China's largest ever smuggling case, in which $US 10 billion in automobiles, oil, and other goods was imported illegally. The antismuggling campaign has reduced significantly the flexibility of the local customs officials to "negotiate" duties.

6. Export Subsidies

China abolished subsidies conditioned directly on export performance for most goods on January 1, 1991. Nonetheless, exports of agricultural products, particularly corn and cotton, still receive direct export subsidies as of 2001. There continue to be reports that some manufactured exports benefit from indirect subsidies through preferential or below-market rate access to inputs such as energy and raw materials. Many state-run companies also enjoy export subsidies through loans at preferential rates, forgiven or deferred loans, and preferential access to loans from the domestic banking sector. China has agreed to stop all export subsidies on agricultural and industrial goods as soon as it becomes a WTO member.

7. Protection of Intellectual Property

China has made progress in protecting intellectual property rights (IPR) since it signed IPR agreements with the United States in 1992 and 1995. It has committed to bringing its IPR laws and regulations into full compliance with the WTO agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) at the time of its accession to WTO. A new Patent Law came into effect on July 1, 2001, and new Trademark and Copyright Laws were passed October 27, 2001. 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 Berne Convention for the Protection of Literary and Artistic Works, the Universal Copyright Convention, the Patent Cooperation Treaty, and the Madrid Protocol. The United States took China off Special 301 lists in 1996, but continues to monitor China under Section 306 of the Trade Act, which allows the United States to begin a fast-track examination, if necessary.

Still, inadequate procedures for registering trademarks and copyrights continue to create difficulties for foreign companies doing business in China. The destructive effect of widespread IPR violations has discouraged additional direct foreign investment and threatened the long-term viability of some U.S. business operations in China. Some U.S. companies claim losses from Chinese counterfeiting equal 15 to 20 percent of total sales in China. One U.S. consumer products company estimates that it loses $US 200 million annually due to counterfeiting.

Patents. U.S. pharmaceutical companies continue to experience difficulties obtaining protection for their products. It can take months for a foreign patent application for administrative protection to be approved in China. Domestic imitation or similar pharmaceuticals can legally be approved for marketing while a foreign manufacturer's application for administrative protection is pending.

Trademarks. Counterfeiting trademarks of brand-name products in China remains prevalent. Chinese counterfeiters market unauthorized copies of a wide variety of products, from motorcycles and designer-label clothes, to VCD's and computer hardware under U.S. trademarks. The inferior quality of fake and unauthorized products poses serious health and safety risks to consumers. While regional and interagency cooperation on IPR protection has improved, it is still inadequate. Insufficient administrative sanctions and infrequent use of criminal sanctions remain major enforcement problems.

Copyrights. China is gradually recognizing the economic cost of copyright infringement. The past few months have witnessed a concerted anti-piracy crackdown effort, led by public security authorities and including all relevant ministries. Growing interest in copyright enforcement aside, significant problems still exist. The software industry lacks clear procedures for addressing corporate end-user software piracy; retail software revenue lost to piracy was estimated to total $US 1.1 billion at the end of 2000.

8. Worker Rights

a. *The Right of Association:* China's constitution provides for "freedom of association," but in practice workers are not free to organize or join unions of their own choosing. Independent unions are illegal. Only official trade unions, affiliated with China's Communist Party and Government, are legal. By law, the All-China Federation of Trade Unions (ACFTU) is the sole national labor organization. The ACFTU has control over all subsidiary union organizations and activities throughout the country. Workers are free to choose whether or not to join one of these official unions.

b. *The Right to Organize and Bargain Collectively:* The law permits collective bargaining for workers in all types of enterprises. In practice, unions in the public sector have not traditionally engaged in collective bargaining, but rather acted as partners of management in determining wages, hours, and other conditions of work. In the private sector, where official unions are few and independent unions unavailable, workers face substantial obstacles to bargaining collectively with management. In 2001, changes to the Trade Union Law were proposed that could strengthen official unions' organizing and collective bargaining powers. On October 27, 2001, China amended its labor law recognizing limited rights for workers to strike.

c. *Prohibition of Forced or Compulsory Labor:* Despite theoretical legal prohibitions against forced labor, China maintains penal facilities that require labor, to which individuals are sentenced through administrative process, without judicial review. In addition, individuals imprisoned through China's official judicial process are regularly forced to work while in prison. Reports suggest that, in some cases, authorities in penal institutions compel inmates to produce commercial goods and that working conditions for prisoners, especially on farms and mines, may be harsh.

d. *Minimum Age of Employment of Children:* China's Labor Law bans children under 16 from most forms of work and bans dangerous work, like mining, for children aged 16 to 18. The law provides punishment for violation of these standards. Instances of child labor exist in China, although the problem is believed not to be widespread. The existence of a large surplus of adult workers, many of whom work long hours for low pay, probably reduces the attractiveness of child labor for employers. In 2001, the Chinese Government undertook an official investigation of the child labor issue.

e. *Acceptable Conditions of Work:* China's Labor Law covers commonly accepted conditions of work. However, some workers, especially in the fast-growing private sector, work under illegal or unacceptable conditions. Workplace health and safety have been a particular problem. The Chinese Government has increased its efforts to enforce workplace health and safety regulations and, in 2001, proposed laws that would, for the first time, set consistent national workplace health and safety standards.

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. U.S. companies in China are, in general, favorably regarded for their employment practices. Some have voluntarily adopted codes of conduct that provide for independent inspection 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 **--** 2000

(Millions of U.S. Dollars)

Category		Amount
Petroleum		1,846
Total Manufacturing		5,663
Food & Kindred Products	181	
Chemicals & Allied Products	245	
Primary & Fabricated Metals	183	
Industrial Machinery and Equipment	931	
Electric & Electronic Equipment	3,208	
Transportation Equipment	147	
Other Manufacturing	768	
Wholesale Trade		362
Banking		78
Finance/Insurance/Real Estate		740
Services		295
Other Industries		594
TOTAL ALL INDUSTRIES		9,577

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