1999 Country Reports on Economic Policy and Trade Practices
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PEOPLE'S REPUBLIC OF CHINA

Key Economic Indicators

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

	1997	1998	1999 1/
Income, Production and Employment:			
Nominal GDP	903.1	960.8	1,016.8
Real GDP Growth (pct) 2/	8.8	7.8	6.9
GDP by Sector: 3/			
Agriculture	168.7	172.7	176.1
Manufacturing	444.1	472.8	510.7
Services	267.9	291.0	304.3
Government	22.3	24.3	25.7
Per Capita GDP (US$)	734.2	772.0	797.0
Labor Force (millions)	697.0	705.0	713.0
Unemployment Rate (pct) 4/	3.1	3.1	3.1
Money and Prices (annual percentage growth):			
Money Supply (M2)	19.6	14.8	15.3
Consumer Price Inflation	2.8	-0.8	-1.4
Exchange Rate (RMB/US$ annual average)	8.3	8.3	8.3
Balance of Payments and Trade:			
Total Exports FOB 5/	182.7	183.7	198.4
Exports to U.S.	62.5	71.2	81.9
Total Imports CIF 5/	142.4	140.2	156.0
Imports from U.S. FAS	12.8	14.3	15.0
Trade Balance	40.3	43.5	42.4
Balance with U.S.	49.7	56.9	66.9
External Public Debt	131.0	146.0	149.0
Fiscal Deficit/GDP (pct)	1.5	3.5	3.2
Current Account Surplus/GDP (pct)	4.5	3.1	0.0
Debt Service Payments/Exports (pct)	7.3	10.9	9.0
Payments/GDP (pct)	1.5	2.4	2.4
Gold and Foreign Exchange Reserves	139.9	145.0	152.0
Aid from United States	0	0	0
Aid from All Other Sources	0.4	0.6	0.6

1/ Estimated from third quarter and end October 1999 data.

2/ Official growth rate published by State Statistical Bureau based on constant renminbi (RMB) prices using 1978 weights. All other income and production figures are converted into dollars at the exchange rate. Economic experts continue to debate the accuracy of these figures, with some arguing that real growth may be half or less the official rate.

3/ 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.

4/ "Official' urban unemployment rate; agricultural laborers are assumed to be totally employed in China's official labor data. Many economists believe the real rate is much higher.

5/ U.S. Department of Commerce (U.S.-China bilateral trade data for U.S. trade; PRC Customs (Chinese global trade data and 1999 estimates.)

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

1. General Policy Framework

China's official GDP growth rate was 7.4 percent for the first three quarters of 1999, continuing the gradual slowdown from the double-digit economic growth of the early 1990s. Consumer spending languished despite a special two-year infrastructure spending program and a separate social welfare and civil service spending increase in mid-1999. State-Owned Enterprise (SOE) reform may have slowed, particularly in terms of shifting employment from the over-invested state-owned manufacturing sector to the underdeveloped services sector. Price deflation has persisted in 1999, with the retail price index down 2.6 percent in October from a year earlier (up from a low of -3.5 percent in the second quarter of 1999.) New bank lending grew more slowly in 1999, perhaps reflecting increased prudence on the part of the dominant state-owned banks, whose poor financial condition was a major concern.

Export growth was the one bright spot in the overall economic picture. Exports grew 2.1 percent in the third quarter after consecutive declines through the end of June. China has maintained competitiveness in many of its major export products, although there are signs of weakness in textiles and steel. Chinese imports increased by 15.8 percent in the first three quarters, as China implemented an anti-smuggling campaign announced in late 1998 and official statistics captured former gray market imports. Real import levels are widely believed to have remained stable, and may have actually declined in some sectors. Inflows of foreign direct investment slumped by about ten percent, year on year, through the end of July. New commitments dropped even more substantially, by 20.5 percent through the end of July.

Since late 1998, the Chinese government has employed a deficit-financed fiscal stimulus program to encourage the expansion of the domestic economy. The stimulus program financed efforts to broaden the social safety net for retired and laid off workers, salary and pension increases for government workers, and infrastructure expenditures. In addition, the government experimented with policies to curb falling prices, stimulate household consumption, and promote exports and investment. While the program has had limited impact on economic expansion so far, the National People's Congress agreed in August of 1999 to have the central government issue an additional RMB 60 billion in treasury bonds to underwrite more projects.

As part of its effort to increase the profit making capability of state-owned enterprises, the Chinese government has experimented with administrative measures to counter falling prices for SOE products. The Government announced in mid-1999 that it would prosecute enterprises selling at below cost and limit approvals to build additional capacity in a range of over-saturated industries. Firms in industries in which competition has led to excessive price cuts have also been encouraged to limit production. An anti-smuggling campaign, begun in the fall of 1998, has shut down black and gray market competition for domestically-produced products such as televisions and home entertainment systems.

China is committed to reforming its financial system in order to allocate the large amount of savings in the economy more efficiently. 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, insurance, and other financial institutions. The huge stock of non-performing loans to SOE's has complicated attempts to commercialize the state-owned banks. New lending to non-agricultural SOE's was about $72 billion in 1998, or 64 percent of total lending. This percentage seemed to drop in 1999, a sign that banks were trying to find other customers. China's four large state banks also set up asset management companies in 1999, to liquidate or restructure older, non-performing loans.

Increased access to China's financial markets for foreign institutions has grown slowly. China now has 165 foreign bank branches and sub-branches, including 20 U.S. bank branches. These offices are concentrated in coastal areas and large inland cities such as Beijing and Chengdu. Chinese authorities have expanded the number of provinces in which foreign banks are allowed to conduct local currency (Renminbi) business but severely circumscribe the activities in which foreign banks may engage. Foreign securities firms have also been barred from underwriting or trading domestic stocks or bonds. A few insurance firms have been granted experimental licenses.

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 late 1997, Chinese firms earning more than 10 million dollars a year in foreign currency have been allowed to retain in foreign currency up to 15 percent of their receipts. However, the Asia-wide economic slowdown and the 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 ended for the most part 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.

The current exchange rate is described as a "managed float" by the authorities; it has behaved more like a pegged rate for the past three years. Since 1996, the renminbi has traded consistently at about RMB 8.3 per U.S. dollar. China uses the RMB/dollar exchange rate as the basic rate and sets cross rates against other currencies by referring to international markets. The central bank sets interest rates on all deposits and loans. Local interest rates in 1999 were now considerably lower than in the United States. As a result, "black market" trading is a small albeit regular feature of the Chinese system. Forward rates are available in the small, off-shore market.

3. Structural 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. Evidence suggests that the government may develop policies for the other industries that combine local content and other performance requirements and tax and investment incentives. In addition, 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 its program to finance the export of mechanical and electrical products, particularly to Africa and South East

Asia.

China announced in August of 1999 that it was considering new measures to attract additional foreign direct investment. The State Council is currently reviewing new investment stimulus measures that would provide tax breaks for high-technology industries, incentives to invest in China's central and western regions, and streamlined oversight of foreign investor operations. Frequent changes to and poor publication of investment guidelines contribute to a lack of transparency and uneven implementation. In the promotion of foreign investment, the Chinese government puts major emphasis on the so-called "pillar industries", i.e., capital-intensive and technology-intensive manufacturing industries. Foreign investment is restricted or prohibited in some areas including agricultural, forestry, telecommunications, and news media.

The Chinese government, as part of its comprehensive reform of the economy, is gradually phasing out price controls. It nevertheless continues to influence prices of certain sensitive goods such as grain. To curb surplus production in 1999, grain and cotton prices were allowed to fall by as much as 20 percent, bringing domestic prices much 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.

China provides to domestic and foreign investors a comprehensive program of tax incentives and concessions based primarily on such considerations as total investment, output, export potential, economic management and development, technology development, and general conduciveness to China's economic goals. Both foreign and domestic enterprises pay either value-added tax (VAT) or business tax depending on the nature of the their business and the type of products involved. The VAT of 17 percent applies to enterprises engaged in import-export, production, distribution or retailing activities. Under current regulations, different types of VAT refund methods apply to different enterprises. In an attempt to stimulate exports, the State Tax Administration increased VAT rebates several times in 1999, up to a full 17 percent for certain kinds of processed goods.

4. Debt Management Policies

In mid-1999, China's external debt stood at $149 billion, or 78 percent of exports, according to official Chinese data. In the context of China's export performance, investment inflows, and high foreign exchange reserve levels (projected at $153 billion by the end of 1999), the debt burden should remain in acceptable limits, absent external shocks that could force a devaluation. Still, the debt service ratio (principal and interest payments as a percentage of foreign exchange receipts) jumped four percentage points in 1998 to 11 percent.

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 28 percent of total expenditures.

5. Aid

The United States has provided occasional disaster-relief assistance to China to help flood relief and other humanitarian efforts in recent years. In 1999, the U.S. Government 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-affiliated English-language training program in southwestern China's Sichuan and Guizhou provinces. China is a major recipient of assistance from other countries and multilateral donors. China's largest bilateral aid donor is Japan. Multilateral assistance includes but is not limited to 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. Non-governmental organizations have also expanded their presence in recent years, thanks in part to the promulgation of a new law in 1998 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 current substantial barriers to the entry into China of U.S. goods and services. Meanwhile, China continued in 1999 its own unilateral reform efforts -- a round of tariff cuts, reductions in the number of products subject to import quotas, a huge increase in the number and type of firms granted trading rights, an improved system of distribution rights, and an increase in the number of cities in which foreign bank branches are allowed to conduct Renminbi banking business. These measures improved access for U.S. goods and services, but liberalization of China's import regime still lags far behind that for exports.

Despite considerable progress in the 1990s, non-tariff barriers to trade and trade-distorting measures persist. Non-tariff 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, still distort trade. 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;" government agencies strongly encourage firms under their control to "buy Chinese."

China's Customs General Administration announced an anti-smuggling campaign in the fall of 1998. The campaign has reduced trade through black and gray market channels and resulted in an increase in imports through legitimate channels. It has not, however, addressed the tariff and non-tariff barriers that created an environment conducive to smuggling in the first place. Further, in an effort to control illegal foreign exchange transactions and prevent capital flight, the Ministry of Finance announced regulations in late 1998 that place strict controls on foreign exchange transactions by foreign-invested firms.

New regulatory initiatives announced in 1999 may also create significant barriers to the entry of U.S. goods and services into the Chinese market. Examples of these include:

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 addition, 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 on each drug's production costs, ignoring research spending and other shared overheads.

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. For example, in mid-1999, the Ministry of Health imposed strict testing standards on imports of cosmetic products containing sunscreens, skin lighteners or hair restorers. Industry sources say the testing requirements create an effective import barrier as they are both obscure and expensive to carry out.

Regulations published by the State Statistical Bureau (SSB) in July, 1999, require all foreign companies conducting market surveys in China to go through an annual registration process. Furthermore, the regulations stipulate that all survey activities undertaken by foreign institutions, or domestic agencies employed by foreigners, must first be approved by provincial statistical bureaus or the SSB. Finished survey results must also be cleared with the approving agency. The regulations are alarming not only because they will be expensive and time consuming to comply with but also because they have the potential to limit the freedom of legitimate firms to conduct market research. In addition, the potential for compromise of confidential business information is substantial.

Regulations implemented in June 1999 further restrict the importation of certain commodities related to the processing trade. These measures are designed to shift the direction of China's processing trade towards products with higher technological content and higher value added potential. The regulations prohibit the import of used garments, certain kinds of used publications, toxic industrial waste, junk cars, used automobiles or components, seeds, seedlings, fertilizers, feed, additives, or antibiotics used in the cultivation or breeding of any export commodity. The regulations also restrict imports of plastic raw materials, raw materials for chemical fibers, cotton, cotton yarn, cotton cloth, and some steel products.

7. Export Subsidies

China abolished direct subsidies for exports on January 1, 1991. Nonetheless, many of China's manufactured exports receive indirect subsidies through guaranteed provision of energy, raw materials or labor supplies. Exports of agricultural products, particularly corn and cotton, currently benefit from direct export subsidies. China has agreed to stop such subsidies once it becomes a member of the WTO, however. Other indirect subsidies are also available, for example bank loans that need not be repaid.

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 Berne Convention for the Protection of Literary and Artistic Works, the Universal Copyright

Convention, and the Patent Cooperation Treaty. China has also acceded to the Madrid Protocol.

Since the signing of a U.S.-China agreement on the protection of intellectual property rights in February 1995, and the agreement in June 1996 on procedures for ensuring implementation of the bilateral, China has made progress in implementing IPR regulations, education, and enforcement. China was taken off all Special 301 lists in 1996. However, China's practices continue to be watched under Section 306 of the Trade Act, which allows the United States to monitor China's compliance with its obligations.

Although China has revised its laws to provide criminal penalties for IPR violations, the United States remains concerned that penalties imposed by Chinese courts do not act as a deterrent. 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 for consumers.

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 each year. 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. A shortage of agents authorized to accept trademark applications from foreign companies makes it difficult for foreigners to register trademarks. The lack of clear procedures to protect unregistered well-known trademarks makes it extremely 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. The Government 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 worked out 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-though-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, nearly universal primary schooling, and more effective law enforcement reduce opportunities and incentives to hire child workers. The ILO and UNICEF maintain that there is not a significant child labor problem in the formal sector. Some Chinese academics, however, believe that child labor problems might exist in remote agricultural and mining areas, where labor law enforcement is sometimes difficult.

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 had trouble providing 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 16 percent to 14,660. The improvement in industrial safety was largely the result of a national campaign to shut down illegal mines, which have perennially accounted 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 **--** 1998

(Millions of U.S. Dollars)

Category		Amount
Petroleum		911
Total Manufacturing		3,729
Food & Kindred Products	122	
Chemicals & Allied Products	325	
Primary & Fabricated Metals	167	
Industrial Machinery and Equipment	463	
Electric & Electronic Equipment	1,472	
Transportation Equipment	175	
Other Manufacturing	1,005	
Wholesale Trade		372
Banking		127
Finance/Insurance/Real Estate		771
Services		31
Other Industries		407
TOTAL ALL INDUSTRIES		6,348

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