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COUNTRY ECONOMIC REVIEW

PEOPLE'S REPUBLIC OF CHINA

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CURRENCY EQUIVALENTS

(as of 5 August 2002)

Currency Unit	–	Yuan (CNY)
CNY1.00	=	\$0.1208
\$1.00	=	CNY8.2770

The exchange rate of the yuan is determined under a managed floating exchange rate system.

ABBREVIATIONS

ADB	=	Asian Development Bank
AMC	=	asset management company
CPI	=	consumer price index
CSRC	=	China Securities Regulatory Commission
DMC	=	Developing Member Country
DRC	=	Development Research Center of the State Council
FDI	=	foreign direct investment
GDP	=	gross domestic product
IMF	=	International Monetary Fund
NCSSF	=	National Council for the Social Security Fund
NPL	=	nonperforming loan
NSSF	=	National Social Security Fund
PRC	=	People's Republic of China
SETC	=	State Economic and Trade Commission
SME	=	small and medium-sized enterprise
SOE	=	state-owned enterprise
TA	=	technical assistance
US	=	United States
WTO	=	World Trade Organization

NOTES

- (i) The fiscal year of the Government ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

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EXECUTIVE SUMMARY

Despite the global economic slowdown, the People's Republic of China (PRC) maintained its robust economic growth. As domestic demand recovered, stimulated by four years of expansionary fiscal policy and accommodative monetary policy, gross domestic product (GDP) grew by 7.3% in 2001. While the performance of the industry and service sectors was strong, agricultural growth remained slow. Although the world economic slowdown had obvious impacts on external trade, particularly during the second half of 2001, rising domestic consumption and investment largely offset the negative impact of slower export growth. Economic growth slowed in the second half of 2001 but recovered in the first half of 2002 when the economy grew by 7.8%. The economy is now expected to grow by 7.4% in 2002.

Investment continued to grow quickly due to strong public investment and acceleration of foreign direct investment inflows. Consumption maintained double-digit growth attributed partly to wage increases for civil servants. The global slowdown caused external trade to drop sharply in the second half of 2001, interrupting the export expansion that began in 1999. However, robust economic growth and accession to the World Trade Organization (WTO) have made the PRC a favorable destination for foreign investment. Contracted and actual foreign investments grew strongly, largely offsetting the negative impacts of slower export growth. Investment also rose sharply in the western region, which has economically lagged far behind the eastern and central regions.

The expansionary fiscal policy that started in 1998 was maintained but the overall fiscal deficit has fallen since 2000. Better-than-expected revenue collection further reduced the fiscal deficit in 2001. However, if the Government's social security obligations and the costs associated with nonperforming loans of state-owned commercial banks had been included, the fiscal deficit would have been much higher.

Driven largely by domestic factors, the PRC economy will continue to grow robustly over the next three years. The PRC's accession to WTO and Beijing's successful bid to host the 2008 Summer Olympic Games will further stimulate investment and growth. Various studies estimate that the PRC's annual long-term gain from WTO membership will be equivalent to 1% of GDP. Huge investments will be made to build the infrastructure for the Olympics. Driven by strong domestic consumption and investment, the economy is forecast to grow by about 7.4-7.5% per year during 2002-2004. Inflation will be about 0.5-1.8%.

These projections are subject to a number of risks and uncertainties. The main external risks relate to the world economy's pace of recovery. While there is evidence that the economy of the United States moved out of recession in the first quarter of 2002, Asian countries, including Japan, may recover more slowly. If external conditions do not improve as much as expected or if the global economy deteriorates due to some unexpected event, the PRC economy, particularly external trade and financial markets, will suffer.

Even though WTO accession will have long-run positive welfare effects, the short-term adjustment costs could be significant. In particular, the highly protected domestic banks could lose some of their market share. Some estimates suggest that 10 years after the PRC's accession to WTO, foreign banks could capture one quarter to one third of the total market share. Foreign banks have competitive advantages in providing a wide range of financial services, data processing, management information systems, and skilled human resources. Some high-quality, creditworthy clients, particularly in the coastal areas, could shift to foreign banks, leaving the less creditworthy clients and some policy-based business

to the domestic banks. The increased competition from international banks would adversely affect local banks' profitability and liquidity. The Government must tackle the problem of nonperforming loans, accelerate commercialization of state-owned banks, and encourage the development of community-based and privately owned banks.

Despite the country's remarkable achievements, the PRC's fight against poverty is far from over. The PRC has already achieved the international development goal of reducing poverty by half of that in 1990. Based on the official poverty line, the number of absolute poor fell dramatically from 80 million in 1994 to below 30 million or about 3% of the rural population by end-2001. However, the PRC's attempts to reduce poverty face new challenges. The poverty line was set in the mid-1980s and is substantially lower than international norms. About 195 million rural residents or 22.2% of the rural population still consumed less than CNY860 per capita in 2000. This proportion of poor is higher than that of many Asian countries. Urban poverty emerged in the mid-1990s as reforms of state-owned enterprises deepened and required workers to be laid off. The official estimate of urban unemployment at end-2001 was 6.8 million, about 3.6% of the urban labor force. However, this estimate does not cover the urban unemployed workers who are not registered with the Ministry of Labor and Social Security. About 7.1 million laid off workers were laid off but had not found new jobs at the end of 2001. Including laid off workers who had not been reemployed, urban unemployment was about 14 million, or about 7.3% of the urban labor force. According to an ADB study, there were 43 million urban residents or 11.1% of urban population whose per capita expenditure less than CNY2,310 in 2000.

Establishing a market-oriented and well-functioning pension system is crucial to reducing poverty. Social security reform is essential for the transition from a centrally planned to a market economy, for capital market development, and for labor mobility. More fiscal support for the social security system, and investment guidelines for funded pension schemes are needed.

A dynamic private sector will drive the PRC's future economic growth and job generation. Private enterprises will dominate the high-growth sectors, including services and the high-technology sector. The private sector could grow even faster if an environment were created that protects private investors' rights and allows the private sector to flourish.

I. RECENT ECONOMIC DEVELOPMENTS

A. Growth, Employment, Saving, and Investment

1. Despite the global economic slowdown in 2001, the People's Republic of China (PRC) maintained robust economic growth. As domestic demand recovered strongly, stimulated by 4 years' expansionary fiscal policy and accommodative monetary policy, gross domestic product (GDP) grew by 7.3% (Table 1). Economic growth slowed in the second half of 2001. GDP growth decelerated from 8.1% in the first quarter to 6.6% in the fourth quarter of 2001. However, this trend was reversed in the first half of 2002 when the economy grew at 7.8%.

Table 1: Aggregate and Sector Annual Growth Rates
(%)

Item	1996	1997	1998	1999	2000	2001	2002 1st Half
Gross Domestic Product	9.6	8.8	7.8	7.1	8.0	7.3	7.8
Primary	5.1	3.5	3.5	2.8	2.4	2.8	2.6
Secondary	12.1	10.5	8.9	8.1	9.6	8.7	9.6
Service	7.9	9.1	8.3	7.7	7.8	7.4	6.6

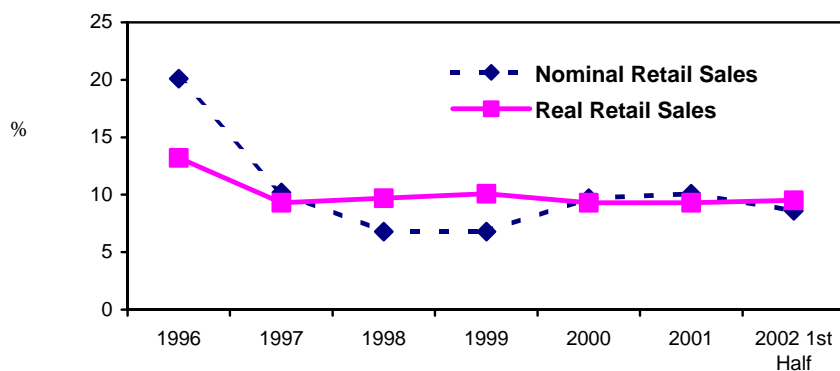
Source: National Bureau of Statistics.

2. The industry sector grew by 8.7% in 2001, led by the good performance of foreign-funded enterprises. The value added of such enterprises rose by 11.9% in the year, compared with 8.1% for state-owned enterprises (SOEs). The value added of collective-owned enterprises and shareholding corporations grew by 7.2% and 10.4%. In the first half of 2002, industrial sector showed a rapid growth at 9.6% due mainly to fast growth of investment and exports. The service sector grew by 7.4% in 2001, mainly supported by high growth in the transport and telecommunications sectors. Because of a severe drought and a decrease in planted area, the agriculture sector grew by only 2.8% in 2001. Grain output was declined by about 2.1% following the 9.1% drop of output in 2000. Agriculture sector growth remained slow in the first half of 2002.

3. Public sector investment increased rapidly, but nonstate sector investment grew moderately. The fixed-asset investment growth rate increased from 9.3% in 2000 to 12.1%. The Government's western region development strategy spurred investments in the western region, which grew by 19.3%, 6 and 3 percentage points higher than investments in the eastern and central regions, respectively. As a result of housing reforms and an increase in mortgage lending, investment in real estate development grew rapidly by 25.3% in 2001, accounting for about 1.3 percentage points of GDP growth. In the first half of 2002, the fixed assets investment grew by 21.5%.

4. Consumption continued its double-digit growth. Two wage increases for civil servants in 2001, totaling 30%, helped increase domestic demand and provided CNY92 billion (\$11 billion) more in income to civil servants. Another salary increase for civil servants is planned in the second half of 2002. The gap between rural and urban incomes continued to widen. The growth rate of farmers' income recovered after declining for two years, but is still much lower than that of urban residents' income. Farmers' per capita net income increased by 4.2% while urban per capita disposable income rose by 8.5% in 2001. Rural retail sales increased by 7.7%, compared with 11.5% in urban areas (Figure 1).

Figure 1: Annual Percentage Change in Retail Sales of Consumer Goods
(1996–First Half of 2002)



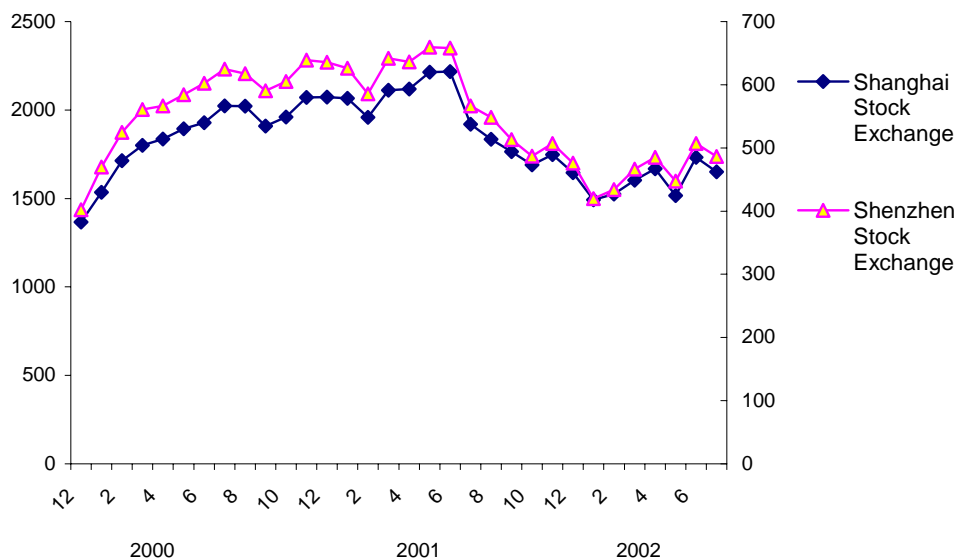
Source: National Bureau of Statistics.

5. The consumer price index increased by 0.7% in 2001 compared with 0.4% in 2000. While clothing prices continued to decline, service sector and housing prices rose moderately. The increase of civil servants' salaries and the upward adjustment of Government-controlled prices of utilities and services also contributed to the slight increase in prices. Food prices, which have an important impact on farmer's income, were largely unchanged. The consumer price index declined slightly by 0.8% in the first half of 2002, partly because of the reduction on imports tariff.

6. In early July 2001, the Government-controlled prices of 107 products and services were liberalized. Due largely to these adjustments, overall prices increased slightly. However, recent market surveys conducted by the State Economic and Trade Commission found that among 603 commodities, 500 were oversupplied while 103 had a balance between supply and demand. No shortages existed. The survey results and price data for the first half of 2002 suggest that, in the short term, deflation rather than inflation is the major policy concern in the PRC.

7. The asset market fluctuated widely in 2001. Strong domestic demand and a better economic outlook were reflected in asset prices in the first half of the year. Unlike most other Asian markets, the Shanghai and Shenzhen stock exchange indexes had increased since end-1999 (Figure 2). Despite some fluctuation, the indexes kept an upward trend and increased by 7% in the first half of 2001. In February 2001, the B-share market, which was restricted to foreign investors, was opened to domestic investors with foreign currency. From February to June 2001, the B-share market index of the Shanghai and Shenzhen stock exchanges increased by about 200%, narrowing the price gap with the A-share market. In line with the PRC's accession to the World Trade Organization (WTO), the Government announced a policy to allow foreign joint-venture companies to be listed in the A- or B-share market. Besides letting foreign joint ventures access the domestic capital market, the measure will improve the quality of listed companies.

Figure 2: Composite Stock Price Indices
(December 1999–July 2002)



Source: National Bureau of Statistics.

8. In 2001, the China Securities Regulation Commission focused on promoting transparency, disclosure, and corporate governance. To finance the social security pool and improve listed companies' corporate governance, the Government promulgated a policy in June 2001 to sell 10% of the newly listed SOEs, which were nontradable shares in the past. The increasingly strict regulations and enforcement mechanisms should help the sound development of the stock market in long run. However, in the short term, these policies put some pressures on the market. The market experienced a significant downturn after July 2001, triggered by reduction of state-owned shareholding, restriction of banking funds from being injected into stock markets, and punishment of a number of listed companies for misconduct. From June to the end of December, the A-share indexes in the Shanghai and Shenzhen stock exchanges had declined by 25.9% and 30.3%. The B-share indexes in the two stock exchanges also dropped by about 21%. Since October 2001, reduction of state-owned shareholdings through share rules has been suspended until a new mechanism is found that balances the interests of various market players. For stable development of stock market, the Government announced to cancel the sell-off plan of state-owned shareholdings late in June of 2002.

9. Property prices in most cities recovered gradually, although some excess supply of high-quality commercial property remains. Stimulated by the Government's privatization of housing, real estate selling prices increased by 2.2% in 2001, compared with 1.1% in 2000, stagnation in 1999, and a decline in 1998. The prices of residential buildings and public apartments recovered significantly in many cities.

B. Fiscal Developments

10. To contain the effects of the Asian financial crisis, three fiscal stimulus packages (CNY100 billion in 1998, CNY110 billion in 1999, and CNY150 billion in 2000) were implemented and largely used to increase investment in infrastructure. These investments helped build some key projects, including the rural power network, flood protection structures along major rivers and lakes, environment protection projects, and roads and infrastructure in the western region.

11. Despite the expansionary fiscal policy, the overall deficit has fallen since 2000 (Table 2). An additional CNY150 billion worth of bonds were issued in 2001, with CNY50 billion for central Government expenditures, CNY50 billion for onlending to local governments, and CNY50 billion to support the western region development strategy. To combat the global economic slowdown and stimulate domestic demand, the Government continued the expansionary fiscal policy in 2002 by issuing long-term construction bonds worth CNY150 billion, CNY125 billion of which will be allocated for the central Government's budget expenditure, and CNY25 billion onlent to local governments. These funds will be mainly used for (i) projects in the western region; (ii) technological improvement of key enterprises; (iii) projects to divert water from the south to the north and protect the water resources of Beijing and Tianjin; (iv) rural infrastructure; and (v) universities and other higher education facilities. The 2002 budget includes provision for the issuance of CNY592.9 billion treasury bonds and forecast the deficit to be CNY309.8 billion or 3% of GDP.

Table 2: Trends in Public Finance
(as % of gross domestic product)

Item	1996	1997	1998	1999	2000	2001	2002 (budget)
Government Revenues	11.4	12.1	13.0	14.3	15.3	17.4	17.7
Tax Revenues	9.7	11.1	11.8	13.0	14.1	15.9	16.3
Nontax Revenues	1.7	1.1	1.2	1.3	1.2	1.4	1.4
Government Expenditures	12.8	13.6	15.1	17.2	18.1	20.0	20.6
Current Expenditures	9.6	10.3	11.6	13.0	14.0	15.6	16.1
Capital Expenditures	3.1	3.3	3.5	4.2	4.1	4.4	4.5
Fiscal Balance	(1.4)	(1.5)	(2.1)	(2.9)	(2.8)	(2.6)	(3.0)
Financing	1.4	1.5	2.1	2.9	2.8	2.6	3.0
Domestic	1.3	1.5	2.1	3.0	2.8	2.6	3.1
Foreign	0.1	0.0	0.0	(0.1)	0.0	0.0	(0.1)

Sources: Ministry of Finance, National Bureau of Statistics, and Asian Development Bank staff estimates.

12. Government revenue increased by 22.2% in 2001 (or 17.4% based on the IMF definition). The ratio of actual budget deficit to GDP was 2.6% in 2001, 0.2% lower than that in 2000. The better-than-expected revenue collection reflected higher profitability of enterprises and better tax collection. A number of one-time measures also helped increase revenue: (i) replacement of automobile purchase surcharges; (ii) receipts from selling shares of SOEs; and (iii) receipts from the People's Bank of China. Excluding these special factors, revenue increased by 17.9%. To carry out the commitments of WTO accession, the Government cut duty rate from 15.3% to 12.2% at the beginning of 2002. This resulted in a sharp decline of import duties collections in the first half of 2002. Fiscal revenue increased only by 9.2% in the first half-year, one of the slowest growth rates in recent years. At the same time, expenditure increased by 17.8% compared with the same period of previous year.

13. The abovementioned figures give only a partial picture of the actual fiscal position (Appendix, Table A. 4). Depending on the assumptions used, extrabudgetary revenues of local governments are about 4–7% of GDP. Large-scale extrabudgetary operations undermine fiscal discipline to implement accountability and good governance, and encourage spending in favor of revenue-generating sectors, leaving less funds for other sectors such as health, education, and the environment. Off-budget revenue and expenditures also increase regional disparities in public spending since the more prosperous local governments can better raise such revenue. The off-budget revenues and expenditures should be brought within the budgetary framework to improve the oversight and supervision of such funds, reduce the potential for corruption, and better match expenditures with Government priorities. Since 1996, the Government has phased out some of the extrabudgetary operations by incorporating them into the formal budget. However, this task has been difficult because some lower levels of government, where most of the off-budget revenues and expenditures occur, resist the idea of bringing these funds within the budgetary framework.

14. Fiscal vulnerability is a medium- to long-term concern. As of end-2001, Government debts outstanding under the formal fiscal framework were CNY1,560.8 billion or 16.3% of GDP, much lower than in most developing countries. However, a large amount of amount of fiscal liabilities exist outside of the formal budget framework, such as the nonperforming loans (NPLs) of the state-owned commercial banks and the unfunded liabilities of the social security system. The official estimate shows that by the end of June 2002 the ratio of NPLs of the four state-owned commercial banks is about 23.1% of their total loan portfolio, excluding the 10% equivalent of the total portfolio of NPLs transferred to the four asset management companies. Unofficial estimates put the NPL figure even higher. Some estimates put the financial gaps in social security system at 50–150% of GDP. The real fiscal situation is, therefore, much worse than shown in the formal budget. The Government is aware of the implications of these contingent liabilities and is accelerating financial reforms and restructuring of the social security system.

C. Monetary Developments and Exchange Rate

15. Monetary policy remained accommodative to stimulate domestic demand. By end-2001, the outstanding broad money (M2) was CNY15.8 trillion, up by 14.4%, compared with the 14% increase in 2000. Narrow money (M1) increased by 12.7%, and money in circulation by 7.1%. The aggregate loan balance of all financial institutions amounted to CNY11.2 trillion at end-2001, up by 11.6% in 2000. The increase in bank lending was due mainly to consumer credit and agriculture loans. Total consumer credit reached CNY699 billion, 65% higher than in 2000. At the end of June 2002, M2, M1 and M0 increased by 14.7%, 12.8% and 8.3% respectively over the same period of last year.

16. Interest rates remained stable in 2001 after seven reductions from May 1996 to December 2001. The domestic 1-year bank deposit rate was 2.25%, and the prime lending rate of financial institutions, 5.85%, compared with the 6-month London Inter Bank Offered Rate (LIBOR) rate of 1.98% at end-2001. Because the economy had slowed in the second half of 2001 and inflation was not a worry, the central bank reduced the saving rate by 25 base points and the lending rate by 50 base points in early 2002.

17. During the Asian financial crisis, the Government intensified financial risk control. To improve the quality of lending, the career path of bank staff reflected the quality of loans approved under their direction. As a result, commercial banks, particularly the four state-owned commercial banks, which account for 72% of outstanding loans, became cautious about making loans, particularly to private small and medium-sized enterprises (SMEs). To encourage commercial banks to lend to SMEs, local governments set up over 200 SME guarantee funds.

18. Since 1998, the exchange rate remained virtually unchanged at about CNY8.3 to the dollar. Although making Renminbi (RMB) freely convertible is a long-term goal, a detailed time schedule has not been announced. The Government is preparing to revise the 1996 foreign exchange administration rules. WTO requires domestic and foreign financial institutions to be governed by the same rules for buying and selling foreign currency.

D. Poverty Reduction and Unemployment

19. Poverty has been significantly reduced during the past 5 years. The 8-7 Poverty Reduction Plan of 1994–2000 brought the number of absolute poor down from 80 million to below 30 million (about 3% of the rural population) by end-2001. The PRC has achieved the international development goal of reducing poverty by half of the 1990 level, as measured by the Government's official poverty line and the \$1-per-day poverty line.

20. Despite these achievements, the PRC's fight against poverty is far from over. In May 2001, the PRC adopted a new 10-year poverty strategy (2000–2010), which designates 592 key counties for poverty reduction development work based on income, social, geographic, and physical conditions. Remote and mountainous areas and minority areas are given priority, and poor villages in non-key counties are also eligible for national poverty funding. The Asian Development Bank (ADB) has helped the Government develop its methodology to identify poverty villages.¹

21. Poverty reduction faces new challenges. The country's poverty line was set in the mid-1980s and is substantially lower than international norms. Table 3 shows that in most DMCs, poverty is defined more stringently using a national poverty line than using the international poverty line. Broader diagnostic poverty lines in PRC are important to formulate poverty reduction policies and better target the efforts of the Government and the donor community in the fight against poverty.

22. For the rural poverty line, a food basket was developed to provide this caloric intake and priced using available rural prices. In addition to expenditures on food, the poor also make non-food expenditures. An Engels coefficient, the ratio of food to non-food expenditures, of 0.60 was used. These calculations resulted in a poverty line of CNY860 per

¹ ADB. 2000. Technical Assistance to the People's Republic of China for *Preparing a Methodology for Development Planning in Poverty Blocks under the New Poverty Strategy of PRC*. Manila.

year in per capita expenditure.² About 195 million rural residents live under this poverty line in 2000, equivalent to a poverty incidence of 22.2 percent of the rural population.³

Table 3: Poverty Incidence in Selected Developing Member Countries

Country	National Poverty Line			International Poverty Line		
	Rural %	Urban %	National %	Survey Year	Below \$1/Day PPP %	Survey Year
Azerbaijan	–	–	68.1	1995	–	–
Bangladesh	39.8	14.3	35.6	1995–1996	29.1	1996
India	36.7	30.5	35.0	1994	44.2	1997
Indonesia	22.0	17.8	20.3	1998	15.2	1999
Kyrgyz Republic	64.5	28.5	51.0	1997	–	–
Lao People's Democratic Republic	53.0	24.0	46.1	1993	–	–
Mongolia	33.1	38.5	36.3	1995	13.9	1995
Nepal	44.0	23.0	42.0	1995–1996	37.7	1995
Pakistan	36.9	28.0	34.0	1991	31.0	1996
People's Republic of China	4.6	<2	4.6	1998	18.5	1998
Philippines	51.2	22.5	40.6	1997	–	–
Sri Lanka	38.1	28.4	35.3	1990–1991	6.6	1995
Thailand	15.5	10.2	13.1	1992	<2	1998
Turkmenistan	–	–	–	–	20.9	1993
Uzbekistan	–	–	–	–	3.3	1993
Viet Nam	57.2	25.9	50.9	1993	–	–

– = not available

Source: World Bank data.

23. Urban poverty began to rise in the mid-1990s as SOE reforms deepened and redundant workers were laid off. An ADB financed study, undertaken in partnership with the Development Research Center (DRC) of the State Council, analyzed urban poverty in PRC.⁴ The study used international best practice to estimate urban poverty lines for each province. Drawing on the 1998 national urban household sample survey data⁵, poverty lines were calculated for all 31 provinces and 35 major cities. A national urban poverty line of CNY2,310 per year per person was estimated based on a weighted average of the provincial poverty lines. The number of urban poor was estimated at 37 million in 2000, equivalent to an urban poverty incidence of 11.1%. However, the incidence of urban poverty varies across provinces, ranging from a low of 1.1% to a high 25.9%.

24. The official estimate of urban unemployment at end-2001 was 6.8 million, about 3.6% of the urban labor force. However, the estimate does not cover unemployed workers who are not registered with the Ministry of Labor and Social Security. About 7.1 million unemployed (laid off) workers were laid off but had not yet found new jobs at end-2001. Including the laid

² See Sheng Laiyun (2000), Rural Poverty Standard in new Area, Journal of Chinese Statistics, 12.

³ Asian Development Bank staff estimates.

⁴ The Urban Poverty Study (TA 3377-PRC) was completed in December 2001.

⁵ The Urban Household Survey sample included about 17,000 households in 146 of the 668 cities and 80 of the 1,700 urbanised counties.

off workers who had not been reemployed, 13.9 million people or 7.3% of the urban labor force were unemployed (Table 4).

25. The laid off worker reemployment rate is an important determinant of urban unemployment. The reemployment rate declined from 50% in 1998 to 40% in 1999 to 35.4% in 2000 and continued declining in 2001. Beginning in 2001, the Government provided unemployment insurance directly to newly laid-off workers and used the term “unemployed” rather than “laid off.”

Table 4: Urban Unemployment

Item	1997	1998	1999	2000	2001
Registered Urban Unemployed (million)	5.7	5.7	5.8	6.0	6.8
Registered Urban Unemployed Rate (%)	3.1	3.3	3.1	3.1	3.6
Laid off Workers (end of period, million)	9.9	9.0	9.4	9.0	7.1
Adjusted Unemployment Rate (%)	8.5	8.5	8.1	7.8	7.3

Sources: National Bureau of Statistics, International Monetary Fund, and Asian Development Bank staff estimates.

E. External Trade and Balance of Payments

26. With the global economic slowdown, exports rose by only 6.8% in 2001, compared with 27.8% in 2000, due to lower demand in the PRC’s major trading partners—the US (from 24.2% export growth rate in 2000 to 4.2% in 2001), European Union (26.4% to 7.1%), Japan (28.6% to 7.9%), and Hong Kong, China (20.7% to 4.6%). Imports grew by 8.2% in 2001 compared with 35.8% in 2000. The drop in imports reflected a decline in the demand for intermediate inputs by exporters. The Government took several measures to stimulate exports. In July 2001, the tax rebate rate for some textile materials increased from 15% to 17%, and the efficiency of the rebating system was improved. In August 2001, the central bank allowed commercial banks to issue short-term loans to export enterprises as long as the banks provided the necessary tax rebate documents. Foreign-funded enterprises and nonstate enterprises were given increased export rights and offered special export loans. Both exports and imports rebounded strongly in the first half of 2002. Exports grew by 14.1% while imports rose by 10.4% due partly to a recovery of the world market for PRC products and partly to the positive impacts of WTO accession.

27. The trade surplus (custom basis) reached \$22.6 billion in 2001, \$1.5 billion less than in 2000. The current account balance is estimated at \$19.6 billion or 1.7% of GDP, compared with 1.9% in 2000 (Tables 5 and 6).

28. Robust economic growth and accession to WTO have made the PRC an attractive destination for foreign investment. Contracted foreign direct investment (FDI) reached \$69.2 billion, a 10.4% increase over 2000, while actual foreign investments totaled \$46.8 billion, up by 14.9%. In the first half of 2002, actually utilized FDI increased by 18.7%. The new regulations on the Directing of Foreign Investment Provision and the Catalogue for the Guidance of Foreign Investment Industries came into effect in April 2002. These regulations,

which are designed to allow for further opening of sectors in line with WTO agreements, encourage the use of advanced technology, investment in the poor interior provinces and more investments in infrastructure.

Table 5: Exports, Imports, and Current Account Balance

Item	1996	1997	1998	1999	2000	2001
	(\$ billion)					
Exports	151.1	182.7	183.5	194.7	249.1	266.1
Imports	131.5	136.4	136.9	158.5	214.7	232.1
Trade Balance	19.5	46.2	46.6	36.2	34.4	34.0
Current Account Balance	7.2	36.7	29.3	15.6	20.5	17.4
Adjusted Current Account Balance ^b	45.3	78.3	70.4	52.6	58.0	60.0 ^a
	(annual % change)					
Exports	17.9	20.9	0.5	6.1	27.9	6.8
Imports	19.5	3.7	0.3	15.8	35.5	8.2
	(percent of gross domestic product)					
Current Account	0.9	4.1	3.1	1.6	1.9	1.5 ^a
Adjusted Current Account	5.5	8.7	7.4	5.3	5.4	5.2 ^a
	(\$ billion)					
Memo Items:						
Exports (FOB, customs basis)	151.0	182.8	183.6	194.9	249.2	266.2
Imports (CIF, customs basis)	138.8	142.4	140.2	165.7	225.1	243.6

FOB = free on board; CIF = cost, insurance, and freight.

^a Asian Development Bank staff estimates.

^b Defined as current account balance plus net foreign direct investments.

Sources: National Bureau of Statistics and State Administration of Foreign Exchange.

Table 6: Capital Inflows and Balance of Payments Position
(\$ billion)

Item	1996	1997	1998	1999	2000	2001
Net Capital Receipts	40.0	21.0	(6.3)	5.2	2.0	34.8
Of which:						
Net Foreign Direct Investment	38.1	41.7	41.1	37.0	37.5	37.4
Errors and Omissions	(15.5)	(22.3)	(18.7)	(17.8)	(11.9)	(4.9)
Capital Receipts Net, except Errors and Omissions	24.5	(1.3)	(25.0)	(12.6)	(9.9)	29.9
Change in Foreign Assets	31.7	35.7	6.4	8.5	10.5	47.3

Source: State Administration of Foreign Exchange.

29. Foreign exchange reserves reached \$212.2 billion at end-2001, a \$46.6 billion increase from the beginning of the year. This increase reflects the surge of funds raised by the PRC's firms through listings in international markets, and FDI inflow. By the end of June 2002, the foreign exchange reserves reached \$242.8 billion. The external debt fell in 2000 to \$145.7 billion, 1.8% less than in 1999, of which short-term debt amounted to \$13.1 billion, \$2.1 billion less than in 1999. The debt-service ratio was around 10%, 1.5% less than in 1999 (Table 7).

Table 7: External Debt and Debt Service

Item	1996	1997	1998	1999	2000
Total External Debt (\$ billion)	116.3	131.0	146.0	151.8	145.7
Medium- and Long-Term Debt	102.2	112.9	128.7	136.7	132.7
Short-Term Debt	14.1	18.1	17.3	15.2	13.1
External Debt (percent of gross domestic product)	14.2	14.6	15.4	15.3	13.5
External Debt-Service Ratio (percent of exports)	6.0	7.3	10.9	11.5	10.0 ^a

^a = Asian Development Bank staff estimates.

Source: State Administration of Foreign Exchange.

II. SHORT- AND MEDIUM TERM ECONOMIC PROSPECTS

A. Growth, Investment, and Saving

30. In the next three years, two factors will promote the PRC's economic development: WTO accession and Beijing's successful bid to host the 2008 Summer Olympic Games.

31. The PRC's accession to WTO will increase the country's rule-based participation in the global economy. Various studies estimate that the PRC's long-term gain from WTO membership will be equivalent to 1–2% of GDP annually. However, some of these benefits will take time to materialize. In the short term, WTO membership will pose significant challenges, particularly for heavily protected sectors. Substantial structural adjustments will be required in the agriculture, automobile, banking, insurance, telecommunications, and industry sectors. Hundreds of laws and regulations need to be revised to make them consistent with WTO rules. All these changes will prepare the PRC for full integration into the world economy. However, adjustment costs will be considerable and must be kept within tolerable social bounds.

32. Beijing's winning of the bid to host the 2008 Summer Olympic Games will require huge infrastructure investments which will stimulate economic growth in the next seven years.

33. At the fifth session of the ninth National People's Congress on 6 March 2002, the Government announced its major targets for national economic and social development in 2002: (i) economic growth rate of around 7%; (ii) increase in total fixed-asset investment of around 10%; (iii) rise in the consumer price level of 1–2%; (iv) increase in imports and exports; (v) control central budget deficit under CNY309.8 billion or 3% of GDP; (vi) increase in M2, the broad money supply, of about 13%; (vii) registered urban unemployment rate of around 4.5%.

34. Driven largely by strong domestic consumption and investment, as well as gradual recovery of the world economy, economic growth is forecast to be 7.4% in 2002, 7.5% in both 2003 and 2004. The industry and service sectors should grow by 8–9% annually, and the agriculture sector by 3%. Domestic consumption and investment will remain strong as the domestic economic environment remains buoyant. The current boom in the real estate sector will continue for the next three years, supported by housing reform and expansion of mortgage lending. Strong domestic consumption and growth will exert some pressure on prices. However, inflation will be moderate at 1–2% due to (i) significant excess capacity in many industry sectors; (ii) large, unutilized supply potential in the agriculture sector; and (iii) cheap imports after trade liberalization required by WTO.

35. The expansionary fiscal policy will continue in 2002 and be gradually phased out in 2003–2004 as the external environment improves. The fiscal deficit will be about 3% of GDP in 2002 and remain at 2.7–2.8% in 2003–2004. Considerable public resources will be needed to eliminate NPLs of the state-owned commercial banks and to implement social security reforms. Substantial funding will also be needed to develop the western region, reduce poverty; and address environmental and human resource development problems. Monetary policy will continue to be accommodative. Money supply (M2) will continue growing by 14–15% in 2002–2004.

36. Exports will grow at 8–12% annually during the next three years. The PRC's entry into WTO will require trade liberalization, including reductions of tariffs and nontariff barriers. Consequently, imports will continue to grow faster than exports, and the trade and current

account surpluses will gradually decline. The current account may have a slight deficit in 2004. However, the decline in the current account surplus will be offset by foreign investment inflows as the PRC opens up many sectors to foreign investment to fulfill WTO commitments. The overall surplus in the balance of payments will thus continue to be positive in the coming years. The PRC's official foreign exchange reserves will be close to \$250 billion by 2004. The debt service ratio will be below 8% (Table 8).

Table 8: Projection of Key Economic Indicators (2002–2004)

Item	Unit	Projection			
		2001	2002	2003	2004
Overall GDP	% growth	7.3	7.4	7.5	7.5
Gross Domestic Investment	% of GDP	36.3	36.1	36.4	36.5
Gross Domestic Saving	% of GDP	38.1	37.9	37.6	36.0
Consumer Price Index	% growth	0.7	0.5	1.5	1.8
Money Supply	% growth	14.4	14.6	15.0	15
Overall Fiscal Balance	% of GDP	(2.6)	(3.0)	(2.8)	(2.7)
Exports (Customs)	\$ billion	266.2	292.8	322.1	360.8
	% growth	6.8	10.0	10.0	12.0
Imports (Customs)	\$ billion	243.6	272.8	311.0	357.7
	% growth	8.2	12.0	14.0	15.0
Trade Balance (Customs)	\$ billion	22.6	20.0	11.1	3.1
Current Account Balance	\$ billion	19.6	12.6	4.5	(3.5)
	% of GDP	1.7	1.0	0.4	(0.3)

Source: 2001. *Statistical Communique. Beijing* and ADB staff estimates.

B. Risks and Uncertainties

1. External Environment

37. These economic projections are subject to a number of risks and uncertainties. The main external risks relate to the world economy's pace of recovery. The United States (US) and Asia are the PRC's largest export markets. While there is some evidence that the US economy moved out of recession in 2002, Asian countries, including Japan, may recover more slowly (Table 9). If the improvement of external conditions is significantly slower than expected, or if the global economy deteriorates due to unexpected events, the PRC economy, particularly external trade and the financial markets, will suffer.

38. While Asia recovered in 1999–2000, the PRC's net exports declined because imports grew faster than exports. The contribution of net exports to GDP growth was negative 1.5% in 1999, negative 0.5% in 2000, and negative 0.4% in 2001. This trend will continue in the next 2–3 years since imports are forecast to grow faster than exports.

Table 9: Selected Asian Gross Domestic Product Growth Rates
(%)

Location	2001	2002	2003
Hong Kong, China	(0.2)	2.0	3.7
Japan	(0.6)	(0.4)	1.1
Malaysia	0.4	4.3	5.8
Republic of Korea	3.0	6.2	6.4
Singapore	(2.0)	4.3	5.8
Taipei, China	(1.9)	3.1	4.1
Thailand	1.8	3.9	4.2

Source: 2002. Consensus Economics Inc.

2. Impact of Accession to the World Trade Organization on Banking

39. The 2000 Country Economic Review analyzed the possible economic impacts of the PRC's accession to WTO, which, along with trade liberalization, will have long-term positive welfare effects but also short-term negative impacts, especially in the highly protected banking sector. In the short- to medium-term, local banks' net interest margins will narrow and profitability will be squeezed. Weak banks with low capital bases and poor asset quality may have to restructure or exit the market.

Box 1: Impact of Accession to the WTO on Banking

In the long run, the domestic banking sector will benefit from WTO accession by:

- Catalyzing financial sector reform
- Providing more sophisticated services
- Opening up of domestic banks to international operations
- Stimulating the development of the industry, agriculture, and service sectors

However, WTO accession and the removal of protective measures will have short-term costs such as:

- Squeezing the market share of domestic banks
- Reducing the profits of local banks
- Increasing local banks' risks as their liquidities decrease
- Weakening their operations due to "brain drain"

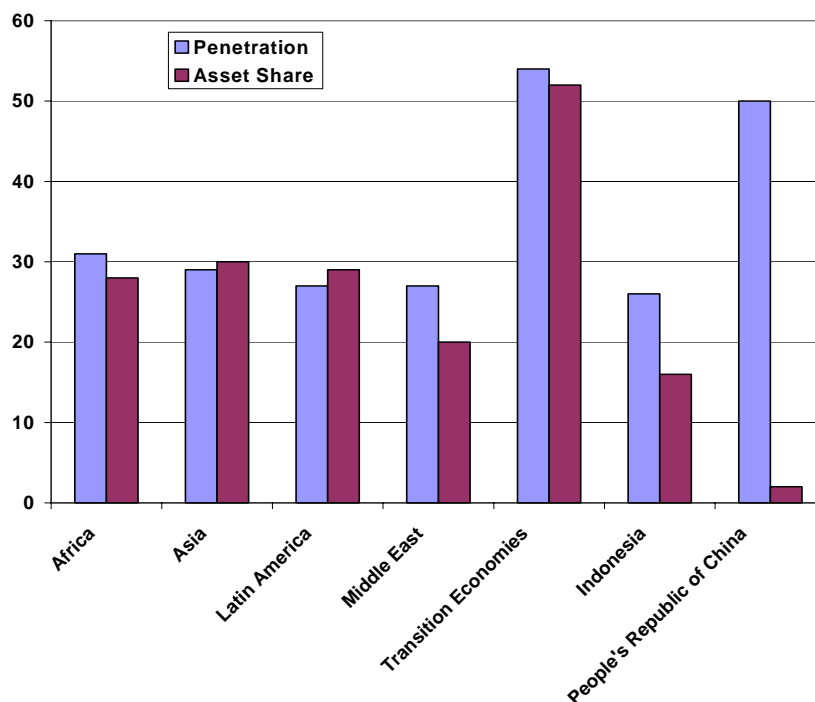
The government should adapt the following policy measures to address those challenges :

- Resolving NPLs problem
- Improving corporate governance
- Developing new products and areas of operation
- Accelerating the development of private banks

40. Among the PRC's substantial WTO commitments was opening the country's financial markets step by step. According to WTO agreement, the restrictions of regions and customers on foreign banks' foreign currency banking will be gradually removed. At formal accession, foreign banks in Dalian, Shanghai, Shenzhen, and Tianjin were allowed to do local currency banking. In the year of entry, foreign banks are allowed to do local currency business in Guangzhou, Nanjing, Qingdao, Wuhan. A similar arrangement will be extended to Chengdu, Chongqing, Fuzhou, and Jinan, two years after WTO entry; and in Beijing, Kunming, Xiamen, and Zhuhai, three years after. Four years after WTO entry, foreign banks in Ningbo, Shantou, Shenyang, and Xi'an will be allowed to do local currency business. By the end of the fifth year, all regional restrictions will be removed and foreign banks will receive nondiscriminative treatment of banking service nationally, without geographic, branching, or scope restrictions.

41. By end-2000, the PRC was host to 178 foreign banking institutions with total assets of \$34.6 billion, including \$18.8 billion in foreign currency loans. Foreign banks accounted for 22.7% of all foreign currency loans. However, because of various restrictions, foreign banks account for only 2% of total banking business in the country, compared with about 30% in most developing countries and 54% in transitional economies (Figure 3). The Administrative Rules of Foreign Funded Institutions, which became effective in February 2002, classified matters related to establishment and scope of activity.

Figure 3: Foreign Banks' Share in the Domestic Banking System
(by region, %)



Source: World Bank. 1999. *Foreign Banks in China and Implication of WTO Membership*, Wang Jun, *World Bank Policy Note*

42. International experience shows that in the long run, increased foreign participation in banking has a positive effect on countries as a whole. Banking will also benefit from global financial integration:

- (i) Global integration and competition will catalyze financial sector reform and improve efficiency, and thus accelerate economic development.
- (ii) Internationalization can help build robust and efficient financial systems by
 - (a) introducing international best practices and standards and governance;
 - (b) improving the quality and efficiency of financial services; and
 - (c) attracting more stable sources of funds.
- (iii) Domestic banks that survive the competition will learn to provide more sophisticated services and establish systems that meet international standards and increase productivity.
- (iv) Global financial integration will facilitate the PRC's access to international markets and the opening up of domestic banks to international operations.
- (v) A liberalized and efficient financial sector will contribute to overall economic development. Better and more efficient banking services will stimulate the development of the industry, agriculture, and service sectors.

43. Foreign banks have competitive advantages in providing a wide range of services, including financial intermediation and data processing, and skilled human resources. Foreign banks are experienced in market competition, invest much in research, and are strong technically and in the area of developing new products. WTO accession and the removal of protective measures will have short-term costs:

- (i) The market share of domestic banks will fall. Some estimates suggest that 10 years after the PRC becomes a WTO member, foreign banks' market share will increase from the current 2% to 20–30%.
- (ii) Local banks will become less profitable. Some high-quality, creditworthy clients, particularly those in the coastal areas, will shift to foreign banks, leaving the less creditworthy clients for the domestic banks. The shift will pose a major threat to the domestic banks as a large proportion of their profits come from the top 20% of quality clients.
- (iii) Increased competition from international banks will adversely affect the performance of the local banks as funds gradually shift from local to foreign banks. Given the high proportion of bad assets of the local banks, especially state-owned commercial banks, the loss of liquidity will increase their risks.
- (iv) Foreign banks, given their flexible management and better pay, will attract skilled personnel from domestic banks. The "brain drain" will threaten their operations and management and force up domestic salary scales. Competition for personnel has already started, with about one third or more of foreign bank managers in Beijing and Shanghai now coming from local banks.

44. Domestic banks must be strengthened by resolving NPLs, which officially form about 26.6% of the four state-owned commercial banks' total loan portfolio, excluding the 10% equivalent of total portfolio of NPLs transferred to the four asset management companies established in 1999. The disposition of these assets by the four companies is shown in Table

10. A stricter international standard of classification would show that NPLs are even higher than the official figure. The NPLs of other commercial banks are lower due to their shorter operational history and less exposure to SOEs. However, rural and urban credit cooperatives have NPLs that could be as high as or higher than those of the four state-owned banks.

Table 10: Assets Status of the Four Assets Management Companies as of 30 June 2002
(CNY billion)

Asset Management Company	Nonperforming Loans	Disposed	Recovered
Huarong	500	38.9	12.4
Great Wall	346	76.0	6.6
Cinda	373	63.5	19.0
Orient	350	32.0	7.4

Source: 2002. www.pbc.gov.cn.

45. The NPL ratio is higher in the PRC than in many Asian countries (Table 11). However, a large proportion of NPLs is part of the cost of the transition from a centrally planned to a market economy, particularly SOE reforms. The NPL problem will require a complex long-term solution.

Table 11: Comparison of NPLs between PRC and other Asian Developing Countries in 2001
(%)

	People's Republic of China	Indonesia	Republic of Korea	Malaysia	Philippines	Thailand
NPLs	26.6	18.0	4.1	10.3	17.0	12.6
NPLs including Transfers to AMCs	37.0	55.2	19.2	16.6	NA	25.1

NA=not available.

Source: ADB. 2002. Asian Recovery Report. Manila

46. Under the WTO accession agreement the domestic banking system has a 5-year adjustment period to meet these challenges. State-owned banks need to be restructured and corporate governance improved to enhance their competitiveness. In the next few years a number of domestic banks will be listed in the stock exchange if they operate under market rules and improve their disclosure and transparency.

47. Domestic banks must develop new areas of business and improve their economic efficiency. The main line of business of local banks is taking deposits and issuing loans. Local banks could consider going into consumer credit, electronic-banking, the international settlement business, and service charge collection. Domestic banks have diversified their products and provide intermediate business and consumer credit. Domestic banks also need to develop better human resource management systems, compensation systems, and incentive packages. High-quality employees and senior specialists familiar with modern

commercial bank management are in short supply. The personnel system needs to be changed to respond to the changing environment. Domestic banks and brokerages will be allowed to accelerate their development as commercially run entities by hiring out of country professionals as department heads.

48. To make domestic banks more competitive, many scholars suggest accelerating the development of private banks, which would have two main benefits. First, they would provide competition and end the near-monopoly of the major state-owned banks. A competitive environment would improve efficiency, innovation, and development of new services. Second, private banks would help solve the distortion in credit allocation, which benefits the State sector at the expense of the nonstate sector, particularly SMEs. State-owned industrial enterprises produce less than 30% of total industrial output but receive more than 70% of banking credit. A private bank system would give SMEs, private enterprises, and consumers better access to credit.

III. POLICY AND DEVELOPMENT ISSUES

49. The transition from a centrally planned to a market economy involved many policy challenges. The Government's policy agenda covers many areas, including improving governance, developing the legal and regulatory system needed in a market economy, reforming SOEs and the financial sector, fighting poverty, solving environmental problems, and undertaking structural reforms in virtually all sectors. Two of the important development challenges are discussed here: (i) establishing a social security system and social safety-net, (ii) developing the private sector, and (iii) improving the accuracy of statistics.

A. Prospects and Challenges of Social Security Reform

1. Challenges

50. The PRC's social security system used to be designed to serve a centrally planned economy. SOEs provided lifetime jobs and housing, health care, and pensions. Enterprises collected and delivered pension contributions, made pension payments, and managed retirees' pensions.

51. Establishing a well-functioning, market-oriented social security system is crucial for the transition from a centrally planned to a market economy. Social security reform is essential to (i) reduce urban poverty by providing adequate protection for the elderly, sick, and unemployed; (ii) maintain sound public finances; and (iii) ensure that the social costs associated with SOE reform remain within tolerable limits. Social security reform is also linked to capital market development and labor mobility, which improve economic productivity by efficiently allocating capital and labor resources on the basis of market signals.

52. As in many other countries, the aging population is a major challenge for the pension system. Life expectancy increased from 57 years⁶ in 1957 to 71 in 2000. Longer lifespans, and the one-child policy introduced in the early 1980s have resulted in a rapidly aging population, especially in urban areas. The population-dependency ratio⁷ is almost 9%, and many studies estimate that it will reach 25–30% by 2030, the same level as in most Organization for Economic Co-operation and Development (OECD) countries. Fewer and fewer workers will thus be supporting retirees, which will bankrupt the pay-as-you-go pension system sooner or later.

53. The pension system also faces the problem of poor financial performance of SOEs, many of which cannot even afford to pay employees' salaries, let alone pensions for retired workers. Enterprise restructuring has led to more layoffs and "young" pensioners who opt or are forced to retire early. This has resulted in a high system-dependency ratio of about 33%: three workers support one retiree—a ratio that is close to that in OECD countries and among the highest in developing countries.

⁶ Based on a survey of 11 provinces, autonomous regions, and municipalities.

⁷ Defined as a ratio of the population aged 60 years and above, to the population aged 15–59 years.

Box 2: Establishing a comprehensive social security system in PRC

Establishing a well-functioning, market-oriented social security system is crucial for the transition from a centrally planned to a market economy. With an aging population and the poor financial performance of SOEs, the current social security system faces great challenges.

To reform the social security reforms, the Government should:

- (i) provide more fiscal resources for the Social Security System;
- (ii) pass a national social security law;
- (iii) develop more flexible investment guidelines for funded pension schemes; and
- (iv) establish a fully funded, competitive, and privately managed supplementary pension system.

2. 1997 Reforms

54. The Government has intensified its efforts to improve the social security system. An important reform⁸ was the replacement of the pay-as-you-go pension system with a multipillared system, which was also adopted for health insurance.⁹ ADB's technical assistance (TA)¹⁰ provided some advice on the policy support and capacity building of the urban pension system. An ongoing TA¹¹ addresses some issues related to rural social security. However, implementation of social security reform will focus on the urban areas during the 10th Five-Year Plan.

55. The experience of the past four years of social security system reform has been mixed. The system's design and management have the following problems: (i) the incentive structure does not encourage contribution compliance, (ii) collection of payments is not well supervised, and (iii) the system is not financially viable.

56. Under the decentralized system, the collection and distribution of pensions at the provincial or municipal levels limit the scale of sharing financial resources and risks, and inhibit labor mobility across provinces. The system administration follows broad guidelines established by the central Government, but administration takes place at the provincial or municipal level. A uniform nationwide system for pension contribution collection, and the institutional capability to ensure contribution compliance and law enforcement are lacking.

57. Individuals and enterprises have insufficient incentives to make payments to the pension system as benefits do not depend on the amount of contributions made. When the system faces financial difficulties, individuals tend to look to enterprises, enterprises to local governments, and local governments to the central Government to provide the necessary funds.

⁸ State Council Document 26, Decision on Establishing a Unified Pension Insurance System for Enterprise Workers, promulgated on 16 July 1997.

⁹ State Council Document 44, Decisions on the Development of Medical Insurance System for Urban Employees, issued in December 1998.

¹⁰ ADB. 1998. Technical Assistance to the People's Republic of China for *Pension Reform*. Manila.

¹¹ ADB. 2000. Technical Assistance to the People's Republic of China for *Policy Support for Social Security Reform under the Tenth Five-year Plan*. Manila.

58. The pension system is too generous when benefits and contributions are compared. Early retirement places additional unfunded obligations on the pension system. When early retirement is appropriate as part of the strategy to deal with redundant SOE labor, the cost should be funded by the budget and not by the heavily burdened pension system.

59. Due to weak administrative structures and regulatory frameworks, many provinces have had difficulties in collecting, covering, pooling, and funding individual accounts. Since the Government has made no direct fiscal transfer to resolve the implicit pension debt, many local governments divert funds from individual accounts to pay the pensions of current retirees.¹² By end-2000, unfunded individual accounts totaled CNY199 billion.¹³ The diversion of money from individual accounts undermines the objective of establishing a multipillared system, and the public's confidence in the Government's promise to provide fully funded pensions, thus reducing the incentive to contribute to the pension fund.

3. Recent Reforms

60. The PRC is undertaking a new round of social security reforms. At end-2000, the Government started a pilot program in Liaoning Province to improve the urban social security system. Liaoning is a major industrial province; its urban social security system covers 14 cities and 100 counties and districts. The transition from a centrally planned to a market economy is especially difficult for Liaoning since its economy was largely dependent on SOEs. Liaoning's social security system has 7.5 million employees and 2.8 million retirees. Liaoning's dependency ratio is about 6% higher than the national average. Liaoning's social security reform has lagged behind that of many provinces. Many cities did not establish individual accounts until recently.¹⁴

61. The pilot program includes pensions, unemployment and medical insurance, and minimum living standard payments for urban citizens. The pension system has three pillars: (i) a modest pay-as-you-go component; (ii) individual accounts (funded defined contribution scheme); and (iii) supplementary pension funds (sponsored by employers, insurance companies, or pension funds). The first and second are mandatory while the third is voluntary.

62. The pilot program targets a replacement rate more affordable than the old one by developing a full-fledged pension system dominated by the funded pension schemes, which will contribute from one half to two thirds of the pensions. As part of the reform, in the second half of 2000 Liaoning started to collect social security contributions through the local tax bureaus, which should improve compliance.

¹² Pension contribution rates for enterprises are set at no more than 20% of payroll. The individual contribution rate is set at no less than 4%, to be increased by 1% every 2 years until it reaches 8%. All individual contributions are to be put into individual accounts while the rest are to be made up by enterprise contribution for a combined 11% of contributory wages.

¹³ This was estimated at CNY100 million at end-1999.

¹⁴ Provincial officials doubt that social pooling can be done at the provincial level in the near term. Over half the enterprises either do not make social security contributions or do so only partially.

4. Some Suggestions

63. ADB has supported the development and design of social security reforms in the PRC since 1995.¹⁵ ADB has supported the review of pension reform issues and the design of a blueprint for social security reform. ADB is also helping formulate and implement the administrative, legal, regulatory, and supervisory frameworks of the new pension system, and develop financial and insurance markets to support pension reform. With ADB assistance, the Government is examining the possibility of extending pension and medical insurance to rural areas.

64. While moving from a largely unfunded to a partly funded pension system is a step in the right direction, financing the implicit pension debt is a major challenge. Many estimates show that the implicit pension debt is in the range of 50–150% of GDP. Although the amount is substantial, it can be amortized over the next 20–30 years, depending on the detailed design of the pension reforms. At the aggregate level, the PRC will not have difficulty meeting the financing requirements, given its strong economic performance and sound macroeconomic fundamentals.

65. Fiscal support for the social security system needs to be strengthened. Unfunded pension liabilities can be met by (i) reorienting and rationalizing public expenditures; (ii) restructuring taxes, including adjusting rates and introducing new taxes such as a broad-based social security tax; and (iii) earmarking additional fiscal resources to meet pension obligations. However, increasing the already high payroll tax rate will reduce incentives for compliance and place the enterprises covered by the payroll tax at a competitive disadvantage.

66. A national social security law is needed to set out rules to (i) ensure national consistency in basic policy and standards, (ii) ensure the establishment of a national information sharing system, and (iii) resolve regional disputes. The law should clearly define who is liable to contribute or receive benefits, the appropriate basis for determining payment, and how disputes can be resolved.

67. More flexible investment guidelines for funded pension schemes are also needed. The rate of return on accumulated funds can make a major difference to the long-term viability of pension reforms. The relaxation of investment constraints must be accompanied by prudent and improved fund management, and a better regulatory, legal, and institutional framework. The fastest way to develop a pension fund management industry is to allow foreign participation by experienced and qualified companies.

68. The pace of relaxing investment guidelines for funded pension schemes needs to be consistent with the depth and absorptive capacity of the domestic capital markets. Before the markets mature and deepen, the Government could consider allowing a limited portion of the funds to be invested in international markets to diversify the portfolio risk by finding creative ways to get around the renminbi's nonconvertibility on the capital account. Options could include swaps and allowing the funds to purchase shares in PRC companies or bonds issued abroad.

¹⁵ ADB. 1995. Technical Assistance to the People's Republic of China for *Fiscal and Regulatory Framework for Social Security System Reform*. Manila; ADB. 1998. Technical Assistance to the People's Republic of China for *Pension Reform*. Manila; ADB. 2000. Technical Assistance to the People's Republic of China for *Policy Support for Social Security Reform under the Tenth Five-Year Plan*. Manila; ADB. 1999. Technical Assistance to the People's Republic of China for *Capacity Building for the Insurance Sector Regulatory and Supervision System*. Manila; and ADB. 1999. Technical Assistance to the People's Republic of China for *Capacity Building of the Capital Markets' Regulatory System*. Manila.

69. A fully funded, competitive, and privately managed supplementary pension system will help broaden the coverage of social security without spending public resources. Supplemental pensions, with an independent and autonomous regulatory infrastructure, are increasingly important in many countries to relieve the pressure on state-sponsored pension schemes. These supplemental pensions should be commercially managed. They can help develop the capital markets and institutional investor base. The supplemental pension system can lay the groundwork for eventual investment of individual accounts in capital markets. This type of investment is increasingly being considered in other countries to maintain the related expense charges at a reasonable level.

70. The National Social Security Fund (NSSF) will be administered by the National Council for the Social Security Fund (NCSSF), which will manage funds raised by the Government for social security financing and help settle contingent liabilities of social security.¹⁶ NCSSF's functions include (i) determining asset allocation of NSSF; (ii) managing investment in Government bonds, and bank deposits; (iii) selecting and evaluating the performance of investment managers and external service agents such as custodian banks; and (iv) controlling various financial and operational risks involved in social security fund management.¹⁷

71. NCSSF could provide a model for future management of funded individual accounts and supplementary pensions. However, NCSSF needs to (i) strengthen its fund management capability, governance structure, and investment and risk management capability; (ii) establish an efficient back office support system and institute proper objectives and operational strategies for accounting and auditing; and (iii) ensure that the front and back offices efficiently coordinate their investment and risk management operations.

72. Institutional strengthening and better administration of the social security system are two other important components of the social security reforms that ADB is supporting.¹⁸ These components will involve (i) developing management information systems, (ii) consolidating administration of different social security programs, (iii) collecting contributions, (iv) streamlining accounting and auditing mechanisms, and (v) establishing special inspection and reporting requirements to prevent and detect fraud and corruption.

B. Private Sector Development

73. The emergence of a significant private sector is one of the most important aspects of the PRC's market-oriented reforms. Official statistics show that the domestic private sector, comprising formally registered private firms and small individual businesses, accounts for 13% of GDP. However, if shareholding companies, foreign firms, private township and village enterprises, and private agricultural entities are included, the private sector generates more than 60% of GDP (Figure 4).

74. The private sector will continue to create most of the jobs necessary to absorb new labor market entrants, redundant SOE and government workers, and underemployed agricultural workers. Since 1994, the private sector has created an average of 8.2 million jobs every year. Employment in the State sector is shrinking. Aside from foreign joint ventures, only the domestic private sector has created jobs in the past five years. The

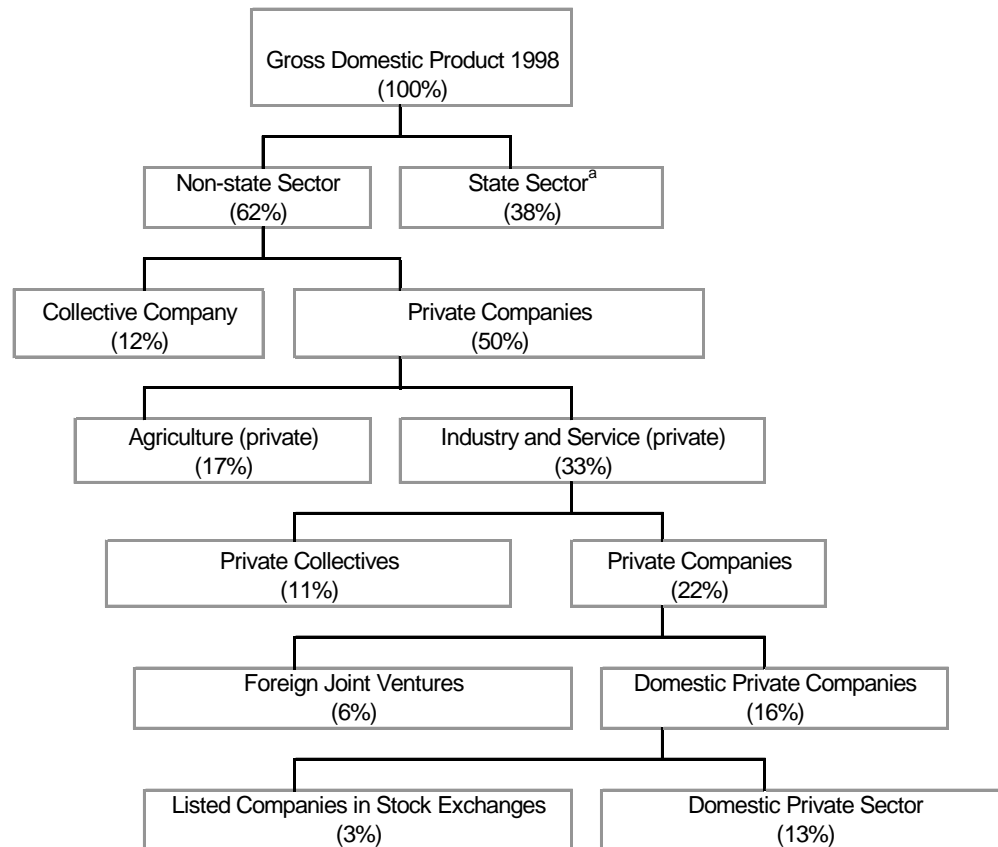
¹⁶ The Government originally intended to use NSSF as a centralized investment vehicle for individual accounts (similar to Singapore's Provident Fund), but could not as many preconditions do not exist in the PRC.

¹⁷ These include policy, operational, credit, market, liquidity, and governance risks.

¹⁸ ADB. 2001. Technical Assistance to the People's Republic of China for Policy and Institutional Support for the Social Security Reform Pilot Program. Manila

nonstate sector employs 83 million people, as many as those employed by the Government, Government-affiliated organizations, and SOEs combined.

Figure 4: Gross Domestic Product Composition in 1998



^a State sector include state-owned agriculture and public services

Source: International Finance Corporation, 2000. *The PRC's Emerging Private Sector*. CITY.

75. Most private enterprises are SMEs, of which 8 million are in the industrial sector and over 90% are private businesses. An increasing number of state-owned SMEs are becoming private companies.

76. Provinces and cities with large private sectors generally have a much lower incidence of poverty than places where the State sector is dominant. A recent study of the relationship between per capita GDP and the share of private sector employment shows that the private sector significantly contributes to higher average income levels in all the provinces.

Box 3: Policy Changes Supporting Private Sector Growth

The Government has taken some steps to stimulate private sector development:

- In 1999, the National People's Congress amended the Constitution to recognize the private sector.
- A law on sole proprietorship, which became effective at the beginning of 2000. It is the first law governing private investment in the PRC and protects the interests of investors and creditors.
- In 2000, the Government eased the registration rules for private businesses, and lowered their minimum capital requirement to one yuan (\$0.12).
- In 2001, the China Securities Regulatory Commission announced that all qualified firms, including private firms and joint ventures, would be allowed to list on the A- or B-share market.

While the PRC is making progress, more improvements are needed to create an enabling environment for the private sector, including market entry, finance, land-use rights, and enforcement of private property rights.

Private firms are still prohibited from operating in a number of sectors, while the legal environment affects private sector development. Enforcement of the rule of law, particularly of laws needed to resolve commercial conflicts, as well as legal recourse, is more difficult for private enterprises than for SOEs.

77. A dynamic private sector will drive the PRC's economic growth and job generation. More than half of the 200 million urban workers are self-employed, or employed in private firms, privatized collective enterprises, foreign firms, or joint ventures. This proportion will increase. In the next few years, the PRC needs to create 8 million to 10 million jobs annually for new labor market entrants and to find jobs for more than 15 million workers who have been made redundant by SOE reforms. Most of these jobs will be created in the private sector. Private enterprises also dominate high-growth sectors, including services, the tertiary sector, and the high technology sector.

78. Constraints on entrepreneurs need to be removed so that the private sector can develop to its full potential. International experience shows that to create a pro-business environment that protects investor rights and allows the private sector to flourish, governments must do the following:

- (i) Ensure that the rules of the game are clear, transparent, and impartially enforced;
- (ii) Ensure that the judicial system disposes of cases efficiently;
- (iii) Stamp out corruption;
- (iv) Honor contracts;
- (v) Reduce the risk of expropriation and nationalization;

- (vi) Protect intellectual property rights;
- (vii) Revise the taxation system to convert the legitimate fees and charges into taxes, and abolish the illegal and arbitrary fees;
- (viii) Revise administrative laws and regulations to reduce the red tape that hampers businesses;
- (ix) Remove barriers to interprovincial trade; and
- (x) Employ good accounting and auditing standards.

79. While the PRC is making progress in these areas, more improvements are needed to develop the private sector. Private firms must be given equal access to market entry, finance, land-use rights, and enforcement of private property rights. Private firms are excluded from operating business in a number of sectors. The numerous licensing and certification requirements, particularly for land use, pollution control, health and safety supervision, technology, and product quality standards, need to be enforced evenhandedly, with the potential for arbitrary judgment by government officials minimized. Various government departments and agencies at different administrative levels levy unwarranted and unpredictable fees and charges on private companies. Such fees and charges must be converted, where appropriate, into transparent taxes.

80. The legal environment also affects private sector development. The enforcement of the rule of law, particularly to resolve commercial conflicts, and legal recourse are more difficult for private enterprises than for SOEs. Arbitration is not well developed. Private firms have limited access to capital markets, and SOEs have priority for listing in the stock exchanges. Private enterprises also face shortages of skilled human resources and management, and information weaknesses. Business and technical skills are often inadequate and difficult to acquire as business and technology support services are not well developed.

81. WTO accession will help develop the private sector. The PRC is committed to amending existing laws, regulations, and administrative practices to comply with WTO rules and obligations, and to codifying administrative practices to increase predictability and transparency. Achieving these will reduce the private sector's business risks by improving the legal and regulatory environment in which private companies, foreign and domestic, operate. Many barriers hinder interprovincial trade and need to be removed to complement WTO-related improvements and to make domestic policies friendlier to business.

82. After the accession to WTO, macro- and micromanagement standards across a wide range of sectors must be improved. The legal and regulatory frameworks need to be aligned to meet the requirements of a market economy. Laws and regulations need to be made consistent with WTO agreements and the protocol of accession. The fundamental obligations are (i) nondiscrimination between suppliers in accordance with the most-favored-nation principle; (ii) nondiscrimination between domestic and foreign enterprises in accordance with the national-treatment clause; and (iii) abolition of most nontariff barriers to trade, and development of a trade regime based on tariffs as the key policy instrument.

83. Other requirements include (i) a transparent trade regime, (ii) judicial review of administrative decisions, (iii) phasing out of the general restrictions on trading rights, (iv) elimination of multitiered pricing systems, and (v) enterprise purchase and sales decisions made solely on a commercial basis. Over time, WTO membership will also require the implementation of WTO-consistent policy regimes in intellectual property rights, customs

valuation, and safeguard procedures and standards. WTO membership should lead to improved legal, supervisory, accounting, and auditing standards across a wide range of sectors to cope with a more competitive environment.

84. The Government is aware of the problems facing the private sector and is working to solve them. In 1999, the National People's Congress amended the Constitution to recognize the private sector, thereby paving the way for future changes in the legal, policy, and regulatory environment to support the sector's development. A law on sole proprietorship, which became effective at the beginning of 2000, was the first law governing private investment in the PRC and should protect the interests of investors and creditors. In 2000, the Government eased the requirement for the registration of private businesses. The minimum capital requirement for private businesses was lowered to CNY1, doing away with the need to provide bank certificates and obtain bureaucratic approvals to prove sufficient capitalization of a small firm. In 1999, the Ministry of Foreign Trade and Economic Cooperation issued import and export permits to 450 private companies, allowing them to bypass the state trading organizations. In July 2001, these permits were extended to all private firms with a certain scale of operation. The China Securities Regulatory Commission announced in 2001 that all qualified firms, including private and foreign joint ventures, would be allowed to be listed in the A- and B-share markets. In July 2001, private businesspersons were allowed to join the Communist Party.

85. To better protect intellectual property rights and comply with WTO contained in the Trade Related Aspects of Intellectual Property Rights, the new trademark, patent and copyright laws all became effective in 2001. Consistent with WTO obligations, new anti-dumping regulations, which were drafted with ADB assistance, came into force in January 2002.

86. As an important development partner of the PRC, ADB is supporting private sector development by helping (i) create a supportive legal, regulatory, and policy framework as well as an institutional environment that responds to private sector demands in a transparent and accountable manner; and (ii) improve access to sources of capital such as venture capital funds, private sector investment funds, and domestic capital markets.

87. ADB has helped prepare major economic laws, including the 1998 Securities Law, Land Administration Law, and Trust Law, which became effective in 2001. ADB is also helping formulate several key laws on government procurement, corporations, bankruptcy, social security, registration of commercial and industrial organizations, and administrative licensing. ADB also provides assistance to identify the legal changes needed for the PRC's WTO membership.

88. ADB is helping the Government develop a policy and regulatory framework to promote the development of SMEs and to solve their financing problems. ADB is working with the State Economic and Trade Commission to (i) advise on suitable SME financing policies and mechanisms; (ii) survey and review SME credit guarantee fund operations to strengthen their policy framework; and (iii) identify strategies and conditions to facilitate the provision of capital for SMEs from nongovernment sources, including venture capital funds, specialized commercial SME investment funds, and domestic capital markets. ADB is helping the Shanghai Municipal Government develop a comprehensive SME credit and credit guarantee system. ADB is also working with the All-China Federation of Industry and Commerce to (i) identify and promote appropriate policies and conditions for private enterprise development, and (ii) strengthen business support services.

89. ADB joined forces with two strong partners—the New World Development Company Limited of Hong Kong, China, and the Liberty Mutual Insurance Company of the US—to create a \$150-million equity investment fund to identify high-growth SMEs and help increase

their competitiveness by initiating the best corporate governance and management practices, thus bringing the SMEs in line with international standards.

C. Improving the Accuracy of Statistics

90. The accuracy of PRC statistics has been questioned recently. An internal investigation from May to October 2001 by the National Bureau of Statistics uncovered more than 60,000 violations of the statistics law of the PRC. About 20,000 of the cases were pursued through the legal system and some CNY30 million (\$3.6 million) in fines have been collected.

91. Under the traditional centrally planned economy, the statistical apparatus aimed at 100% coverage. The comprehensive reporting system was effective when large SOEs dominated the economy but it is not suited to a market economy. It does not capture the rapidly growing private activity. The comprehensive reporting system also creates opportunities for distortion. Local governments at successive levels can exaggerate performance to demonstrate that targets or quotas have been met. Also economic units can underreport to avoid taxes and fees.

92. To improve the accuracy of the national accounts, a new system of measuring industrial output has been applied since 1998, with three strata for gathering information. The first stratum, which remains a direct comprehensive reporting system, captures all SOEs (including share holding corporations in which the State holds a controlling interest) plus nonstate enterprises that generated revenues exceeding CNY5 million (\$600,000) in the previous year. The second stratum includes all enterprises with revenues for the preceding year of less than CNY5 million, but not individual businesses. Estimates of the economic activity for this "below-scale" stratum are obtained by sampling from provincial registration lists. The third stratum is designed to capture information on individual businesses and any nonstate enterprises missed in the provincial list. This stratum is to be covered under a sample frame defined on rural villages and urban neighborhoods.

93. The adoption of sample survey methods will allow better data to be collected on a wider range of variables. Appropriate statistical techniques are now under development, supported by the ADB and others (e.g. IMF, World Bank, the Canadian International Development Agency). ADB is providing on going assistance to help establish a methodology that involves creating sample frames of enterprises and villages at the provincial level to form the basis of sampling. A pilot survey is being undertaken in Jiangsu Province. This pilot survey focuses on value added rather than gross output value because gross output value is not additive across firms or sectors and results in double counting.

94. In 2002, the Government committed to participate in the General Data Dissemination System developed by the International Monetary Fund. This sets standards to guide member countries in publicly disseminating economic and financial data and to improve data accuracy. In the medium term this will help to improve PRC's statistics.

Table A. 1 : Key Macroeconomic Indicators

Item	1996	1997	1998	1999	2000	2001
A. Income and Growth						
1. GDP per Capita (\$, current)	620.0	710.0	750.0	791.7	855.8	911.9
2. GDP Growth (% in constant prices)	9.6	8.8	7.8	7.1	8.0	7.3
a. Agriculture	5.1	3.5	3.5	2.8	2.4	2.8
b. Industry	12.1	10.5	8.9	8.1	9.6	8.7
c. Services	7.9	9.2	8.3	7.5	7.8	7.4
B. Saving and Investment (current market prices)						
1. Gross Domestic Investment	39.6	38.2	37.7	37.4	36.1	36.3
2. Gross Domestic Saving	41.1	41.5	40.8	39.4	38.9	38.1
C. Money and Inflation						
1. Consumer Prices (annual average)	8.3	2.8	(0.8)	(1.4)	0.4	0.7
2. Broad Money (M2) (end-of-period)	25.3	19.6	14.8	14.7	13.4	14.4
3. Broad Money (M2) (annual average)	18.9	17.3	15.3	16.1	12.7	13.3
D. Government Finance						
1. Total Revenue ^b	11.4	12.1	13.0	14.3	15.3	17.4
2. Total Expenditure ^c	12.8	13.6	15.1	17.2	18.1	20.0
3. Overall Surplus/Deficit (-)	(1.4)	(1.5)	(2.1)	(2.9)	(2.8)	(2.6)
E. Balance of Payments						
1. Merchandise Trade Balance (% of GDP)	2.4	5.1	4.9	3.7	3.2	2.0
2. Current Account Balance (% of GDP)	0.9	4.1	3.1	1.6	1.9	1.7
3. Export (\$) growth (annual percent change)	17.9	20.9	0.5	6.1	12.8	6.8
4. Import (\$) growth (annual percent change)	19.5	3.7	0.3	15.8	35.5	8.2
F. External Payments Indicators						
1. International Reserves (billion dollars, end of period) ^d	105.0	139.9	145.0	154.7	165.6	212.2
- months of imports	9.6	12.3	9.5	11.5	8.8	10.5
2. External Debt Service (% of exports)	6.0	7.3	10.9	11.5	10.0 ^b	-
3. External Debt (% of GDP)	14.2	14.6	15.4	15.3	13.5	-
G. Memorandum Items						
1. GDP (current prices, CHY billion)	6,788.4	7,446.3	7,834.5	8,206.7	8,940.4	9,593.3
2. GDP (current prices, \$ billion)	816.5	898.2	946.4	991.4	1,077.1	1,155.8
3. GNP (current prices, CHY billion)	6,685.1	7,314.3	7,696.7	8,057.9	8,819.0	-
4. Exchange Rate (yuan per dollar, annual average)	8.3	8.3	8.3	8.3	8.3	8.3
5. Population (end-period, million)	1,223.9	1,236.3	1,248.1	1,259.1	1,265.8	1,276.3

- = Not available, ADB= Asian Development Bank, GDP = gross domestic product, GNP = gross national product.

^a Based on World Bank Atlas. For 1999, ADB estimate.

^b Total revenue means general governmental revenue, including central, provincial and local government revenues. Extrabudgetary revenues are not included, and subsidies to SOEs are not calculated as negative revenues.

^c Total expenditure means general governmental expenditure, including central, provincial, and local government revenues. Includes extrabudgetary capital construction of CNY5.4 billion in 1987, CNY3.1 billion in 1988 and CNY4.3 billion in 1989. Budgetary expenditures are not included. Subsidies to SOEs and debt interest payments are calculated as expenditures.

^d Beginning July 1992, foreign exchange holdings of the Bank of China are excluded.

Source: People's Republic of China government database, World Bank, and Asian Development Bank staff estimates.

Table A. 2: National Accounts, by Sector

Item	1996	1997	1998	1999	2000	2001
(CNY billions, in current prices)						
Gross Domestic Product	6,788.4	7,446.3	7,834.5	8,206.7	8,940.4	9,593.3
Primary	1,384.4	1,421.1	1,455.3	1,447.2	1,421.2	1,461.0
Secondary	3,361.3	3,722.3	3,861.9	4,055.8	4,548.8	4,906.9
Industry	2,908.3	3,241.2	3,338.8	3,508.7	3,957.0	4,260.7
Construction	453.0	481.1	523.1	547.1	591.8	646.2
Tertiary	2,042.8	2,302.9	2,517.4	2,703.8	2,970.4	3,225.4
Net Factor Income	(103.4)	(132.0)	(137.8)	(148.8)	(121.4)	(130.0) ^a
Gross National Product	6,685.1	7,314.3	7,696.7	8,057.9	8,819.0	9463.3 ^a
(Index, 1978=100)						
Gross Domestic Product	544.1	592.2	638.5	684.1	738.8	792.7
Primary	245.6	254.2	263.1	270.5	277.0	284.8
Secondary	759.8	839.4	914.2	988.6	1,083.7	1,178.0
Industry	774.3	861.9	938.6	1,018.6	1,119.9	1,220.7 ^a
Construction	648.2	665.2	725.2	756.2	802.9	851.1 ^a
Tertiary	629.4	687.1	744.1	801.6	864.1	928.0
(% change, in constant prices)						
Gross Domestic Product	9.6	8.8	7.8	7.1	8.0	7.3
Primary	5.1	3.5	3.5	2.8	2.4	2.8
Secondary	12.1	10.5	8.9	8.1	9.6	8.7
Industry	12.5	11.3	8.9	8.5	9.9	9.0 ^a
Construction	8.5	2.6	9.0	4.3	6.2	6.0 ^a
Tertiary	7.9	9.2	8.3	7.5	7.8	7.4

^a Asian Development Bank estimates

Sources: National Bureau of Statistics, 2001. *China Statistical Yearbook-2001*. Beijing.

Table A. 3: National Accounts, by Expenditure Share

Item	1996	1997	1998	1999	2000
(CNY billions, in current prices)					
Gross Domestic Product ^a	6,788.5	7,446.3	7,834.5	8,206.8	8,940.4
Total Consumption	4,000.4	4,357.9	4,640.6	4,972.3	5,461.7
Public	785.2	872.5	948.5	1,038.8	1,170.5
Private	3,215.2	3,485.5	3,692.1	3,933.4	4,291.2
Total Investment	2,686.7	2,845.8	2,954.6	3,070.2	3,225.5
Gross Fixed Investment	2,333.6	2,515.4	2,763.1	2,985.5	3,262.4
Public	1,610.2	1,766.1	2,047.0	2209.3 ^b	2304.3 ^b
Private	723.4	749.3	716.1	776.2 ^b	987.5 ^b
Change in Stocks	353.1	330.3	191.5	122.6	(36.9)
Net Exports of Goods and Nonfactor Services	145.9	285.7	305.2	224.9	224.0
Statistical Discrepancy	(44.540)	(43.120)	(65.810)	(60.600)	(29.100)
Saving	2,788.1	3,088.4	3,193.9	3,234.5	3,478.7
Gross National Product	6,685.1	7,314.3	7,696.7	8,042.3	8,819.0
(% of Gross Domestic Product)					
Total Investment	39.6	38.2	37.7	37.4	36.1
Saving	41.1	41.5	39.8	39.4	38.9
Memo Item:					
Total Consumption	58.9	58.5	59.2	60.7	61.1

^a Production-based gross domestic product.

^b Asian Development Bank estimates.

Sources: National Bureau of Statistics. 2001. *China Statistical Yearbook-2001*. Beijing

Table A. 4: State Budgetary Operations

Item	1996	1997	1998	1999	2000	2001	2002 Budget
	(CNY billion)						
Total Revenue ^a	774.5	901.9	1,020.9	1,173.4	1,367.5	1,667.0	1,830.5
Tax	657.1	823.4	926.3	1,068.3	1,258.1	1,529.1	1,689.6
Nontax	117.4	78.5	94.6	105.1	109.4	137.9	140.9
Total Expenditure ^b	866.7	1,015.0	1,188.2	1,409.6	1,616.6	1,914.3	2,140.3
Current ^c	653.6	769.6	909.8	1,065.0	1,253.4	1,498.1	1,676.8
Capital ^c	213.1	245.4	278.4	344.6	363.2	416.2	463.5
Overall Balance: Deficit(-)/Surplus(+)	(92.2)	(113.1)	(167.3)	(236.2)	(249.1)	(247.3)	(309.8)
Financing (Net)	92.2	113.1	167.3	236.2	249.1	247.3	309.8
Domestic	85.5	112.3	165.3	243.5	249.6	243.7	320.8
Foreign	6.7	0.8	2.0	(7.3)	(0.5)	3.6	(11.0)
<u>Memorandum Items</u>							
	(% of GDP)						
Total Revenue ^a	11.4	12.1	13.0	14.3	15.3	17.4	17.7
Tax	9.7	11.1	11.8	13.0	14.1	15.9	16.3
Nontax	1.7	1.1	1.2	1.3	1.2	1.5	1.4
Total Expenditure ^b	12.8	13.6	15.1	17.2	18.1	20.0	20.7
Current ^c	9.6	10.3	11.6	13.0	14.0	15.6	16.2
Capital ^c	3.1	3.3	3.5	4.2	4.1	4.4	4.5
Overall Balance: Deficit(-)/Surplus(+)	(1.4)	(1.5)	(2.1)	(2.9)	(2.8)	(2.6)	(3.0)
Financing	1.4	1.5	2.1	2.9	2.8	2.6	3.0
Domestic	1.3	1.5	2.1	3.0	2.8	2.6	3.1
Foreign	0.1	0.0	0.0	(0.1)	(0.0)	0.0	(0.1)

ADB= Asian Development Bank, GDP = gross domestic product, PRC= People's Republic of China.

^a Total revenue means general governmental revenue, including central, provincial, and local government revenues.

Extrabudgetary revenues are not included, and subsidies to SOEs are not calculated as negative revenues.

^b Total expenditure means general governmental expenditure, including central, provincial, and local government revenues. Includes extrabudgetary capital construction of CNY5.4 billion in 1987, CNY3.1 billion in 1988, and CNY4.3 billion in 1989. budgetary expenditures are not included, subsidies to SOEs and debt interest payments are calculated as expenditures.

^c Current and capital expenditures are estimated by ADB staff in line with PRC definitions. Capital expenditures means productive expenditures, current expenditures means nonproductive expenditures.

Sources: Ministry of Finance, National Bureau of Statistics, and Asian Development Bank staff estimates.

Table A. 5: Monetary Developments^a

Item	1996	1997	1998	1999	2000	2001
	(CNY billion, end of period)					
Total Assets	7,609.5	9,099.5	10,449.9	11,989.8	14,172.6	15,627.5
Net Foreign Assets	921.4	1,366.1	1,504.2	1,702.8	2,052.3	2,668.5
Net Domestic Assets	6,688.1	7,733.5	8,945.7	10,287.0	12,120.3	12959.0
Net Credit to Government ^b	218.0	161.7	484.5	587.7	586.3	1097.8
Claims on NFIs	6,423.1	7,706.4	8,957.6	9,993.0	10,192.6	10415.3
Other Items, Net ^c	47.0	(134.7)	(496.4)	(293.7)	1,341.4	1,445.9
Broad Money (M2)	7,609.5	9,099.5	10,449.9	11,989.8	13,248.8	15,288.9
Narrow Money (M1)	2,851.5	3,482.6	3,895.4	4,583.7	5,314.7	5,987.2
Currency in Circulation (M0)	880.2	1,017.8	1,120.4	1,345.6	1,465.3	1,568.9
Demand Deposits	1,971.3	2,464.9	2,775.0	3,238.2	3,849.4	4,418.3
Quasi-Money	4,758.0	5,616.9	6,554.5	7,406.1	7,934.0	9301.7
Time	504.2	673.9	830.2	947.7	1,126.1	1,418.0
Savings	3,852.1	4,628.0	5,340.8	5,962.2	6,433.2	7376.2
Other	401.7	315.1	383.5	496.2	374.7	507.4
Memorandum Items						
Reserve Money	2,689	3,063	3,134	3,362	3,649	-
Velocity Ratio ^d	0.89	0.82	0.75	0.68	0.67	0.6
	(Annual % change)					
Net Domestic Assets	23.0	15.6	15.7	15.0	17.8	6.9
Broad Money (end-period)	25.3	19.6	14.8	14.7	12.3	14.4
Broad Money (annual average)	25.3	17.3	15.3	14.7	13.2	13.3
Narrow Money	18.9	22.1	11.9	17.7	15.9	12.7
Currency in Circulation	11.6	15.6	10.1	20.1	8.9	7.1
Demand Deposits	22.4	25.0	12.6	16.7	18.9	14.8
Quasi-Money	29.4	18.1	16.7	13.0	7.1	17.2

NFI = nonfinancial intermediaries.

^a The series beginning 1997 has breaks to expand the statistical coverage of operations of the People's Bank of China, deposit money banks (including state-owned commercial banks, Agricultural Development Bank of China, other commercial banks, credit cooperatives, and finance companies), and specific depository institutions (financial trust and investment companies, and policy banks—State Development Bank and Import and Export Bank of China).

^b Claims related to state budget operations less Government deposits, which include extrabudgetary deposits of local governments.

^c Includes financial bonds issued by banks and owner's equity.

^d Ratio of broad money to gross domestic product.

Sources: The People's Bank of China, and International Monetary Fund.

Table A. 6: Balance of Payments ^a
(Billion)

Item	1996	1997	1998	1999	2000	2001
Current Account	7.2	36.7	29.3	15.6	20.5	17.4
Resource Balance	5.1	31.5	25.0	10.7	14.2	8.9
Trade Balance	19.5	46.2	46.6	36.2	34.5	34.0
Exports ^b	151.1	182.7	183.5	194.7	249.1	266.1
Imports ^b	131.5	136.4	136.9	158.5	214.6	232.1
Nonfactor Services, Net	(2.0)	(3.7)	(4.9)	(7.5)	(5.6)	(5.9)
Receipts	20.6	24.6	24.1	23.8	30.4	33.3
Payments	22.6	28.3	29.0	31.3	36.0	39.2
Factor Income, Net	(12.4)	(11.0)	(16.6)	(18.0)	(14.7)	(19.2)
Receipts	7.3	5.7	5.6	10.6	12.5	9.4
Payments	19.8	16.7	22.2	28.5	27.2	28.6
Unrequited Transfers, Net	2.1	5.1	4.3	4.9	6.3	8.5
Official, Net	0.3	0.5	0.1	0.1	0.1	(0.1)
Private, Net	1.8	4.7	4.2	4.8	6.2	8.6
Capital and Financial Account	40.0	21.0	(6.3)	7.6	1.9	34.75
Capital Account	-	(0.0)	(0.0)	(0.03)	(0.04)	(0.05)
Financial Account	40.0	21.0	(6.3)	7.7	1.96	34.8
Direct Investment	38.1	41.7	41.1	37.0	37.5	37.3
Inflow	42.4	45.4	45.6	41.0	38.4	44.2
Outflow	4.3	3.8	4.5	4.0	(0.9)	(6.9)
Portfolio Investment	1.7	6.9	(3.7)	(11.2)	(4.0)	(19.4)
Assets	(0.6)	(0.9)	(3.8)	(10.5)	(11.3)	(20.6)
Liabilities	2.4	7.8	0.1	(0.7)	7.3	1.2
Other Investments, Net	0.2	(27.6)	(43.7)	(18.1)	(31.5)	16.9
Errors and Omissions	(15.5)	(22.0)	(16.6)	(14.8)	(11.9)	(4.9)
Overall Balance	31.7	35.7	6.4	8.5	10.5	47.3
Changes in Reserves and Related Items ^c	(31.7)	(35.7)	(6.4)	(8.5)	(10.5)	(47.3)
Gold	0.0	0.0	0.0	0.0	0.0	0.0
Foreign Exchange	(31.5)	(34.9)	(5.1)	(9.7)	(10.9)	(46.6)
Reserve Position in IMF	(0.2)	(0.9)	(1.3)	1.3	0.4	(0.7)
SDRs	(0.0)	0.0	(0.1)	(0.0)	(0.1)	(0.0)
<u>Memorandum items</u>						
Exports (FOB, customs basis)	151.0	182.7	183.7	194.9	249.2	266.2
Imports (CIF, customs basis)	138.8	142.4	140.2	165.7	225.1	243.6

FOB = freight on board; CIF = cost, insurance, and freight; IMF = International Monetary Fund;
SDR = special drawing rights.

^a Starting 1997, data have been compiled based on the fifth edition of the IMF Balance of Payments Manual and, therefore, are not comparable with historical data as items, accounting methods, and definitions have changed significantly.

^b Excludes reexports and imports for reexport.

^c The parentheses indicate an increase. Includes Bank of China reserves as well as People's Bank of China reserves before 1992; from 1992, includes state reserves only.

Source: State Administration of Foreign Exchange.