

## MACROECONOMIC ENVIRONMENT

## A. MACROECONOMIC OVERVIEW

The People's Republic of China (PRC) has grown at an average rate of 7.6% during the last 5 years, making it the fastest growing economy in the world. The substantial growth in private sector activity has brought about changes in market fundamentals to address the gaps and inefficiencies of state-owned enterprises (SOEs) and harness the entrepreneurial drive of the population.

Thus far, the PRC has tackled macroeconomic management well. The PRC's low vulnerability to external shocks has helped it maintain macroeconomic stability despite structural distortions both at the output and input levels and at the financial and enterprise levels. Contributory factors include the large internal market, large foreign exchange reserves, low dependence on high technology, use of expansionary fiscal and monetary policy, and high consumer and investor confidence (Table 1).

Table 1: Selected Macroeconomic Indicators

Item	1998	1999	2000	2001	2002	2003	2004
Real GDP Growth Rate (% in constant prices)	7.8	7.1	8.0	7.3	8.0	7.3	7.6
Agriculture	3.5	2.8	2.4	2.8	2.9	2.8	2.9
Industry	8.9	8.1	9.6	8.7	9.9	10.0	11.0
Services	8.3	7.5	7.8	7.4	7.3	6.2	7.1
Gross Domestic Investment (% of GDP)	37.7	37.4	37.1	38.6	38.5	38.2	38.5
Gross Domestic Savings	39.8	39.4	38.0	38.6	38.7	38.2	38.5
Current Account Balance/GDP (%)	3.1	1.6	1.9	1.7	1.9	1.6	1.5
Fiscal Balance/GDP (%)	(2.1)	(2.9)	(2.8)	(2.6)	(3.0)	(2.8)	(2.6)
International Reserve (gross, \$ billion)	145.0	154.7	165.6	212.2	286.4		
Consumer Price Index	(0.8)	(1.4)	0.4	0.7	(0.8)	0.5	1.0
Money Supply (M2) Growth (%)	14.8	14.7	12.3	14.4	16.8	15.5	16.0
Debt-Service Ratio (% of export)	10.9	11.5	10.0	10.0	7.3	–	–
Exchange Rate (CNY/\$, average)	8.3	8.3	8.3	8.3	8.3	–	–
GDP Per Capita (\$ current)	750.0	792.0	856.0	912.0	964.0	–	–
Official Unemployment Rate (%)	3.3	3.1	3.1	3.6	4.0	4.5	4.6
Urban Unemployed (millions)	5.7	5.8	6.0	6.8	–	–	–
Xiagang Workers (millions) <sup>a</sup>	9.0	9.4	9.0	7.1	–	–	–
Adjusted Unemployment Rate (%)	8.5	8.1	7.8	7.3	7.1	–	–

– = data not available, CNY = yuan, GDP = gross domestic product.

<sup>a</sup> Officially defined as "temporary leave" requested by SOEs, but in reality Xiagang means laid-off.

Sources: International Monetary Fund; *Asian Development Outlook*; Asian Development Bank Key Indicators 2002; EIU Country Profile 2003.

Macroeconomic stability is a precondition for attracting private investment and creating pro-poor markets. Macroeconomic reforms should continue to be carefully managed and sequenced to preserve macroeconomic stability. This macroeconomic environment will continue to attract foreign direct investment (FDI) and mobilize domestic private investment.

At the 10<sup>th</sup> National People's Congress (NPC) held in March 2003, new macroeconomic targets were set forth for 2003 including (i) achieving real gross domestic product (GDP) growth rate at 7%; (ii) creating 8 million new jobs for urban residents and confining the rate of registered urban employment to 4.5%; (iii) containing inflation at 1%; and (iv) keeping the fiscal budget deficit within 3% of GDP (China Daily 2003).

## B. PROFILE OF THE PRIVATE SECTOR

### I. Private Sector Contribution to the Economy

It is very difficult to quantitatively measure the role of the private sector in the PRC. The current "narrowly defined" method, which is used in official government statistics, is based on the number of employees and ownership structure of an enterprise and does not accurately take into account the role of the private sector in the transitional economy. However, a broader definition may lead to double counting.

The narrowly defined method includes only (i) self-employed (*geti hu*), the first business category that the State Council defined as "private sector" in 1981; and (ii) private enterprises (*siying qiye*), a new business category introduced in 1988 as "for profit" organizations that are owned by individuals and employ more than eight people. This method does not take into account a significant number of "private firms" that opt to be defined as collectives or town and village enterprises (TVEs) by sharing ownership with local governments. These firms, which put on a hat of collective ownership ("red hat firms"), have better access to land, assets, finance, and markets. Some experts estimate that 50–75% of red hat firms are in fact private firms.<sup>1</sup>

Foreign-funded enterprises (e.g., equity joint ventures [JVs]) can be SOEs or private enterprises, depending on their shareholding structure. Wholly owned foreign enterprises do not fall within the narrowly defined definition of "private enterprise," neither do enterprises in transition from collectives to privately owned companies (e.g., shareholding cooperative enterprises, joint ownership enterprises). To better understand the role of these firms in the economy, the term "nonstate sector firm" is thus used to refer to all firms that are not SOEs.

Using this terminology raises major statistical challenges. First, because the economy is in transition it is difficult to obtain accurate statistical data on private sector activities, particularly data comparable with the state sector. Second, it is difficult to determine with any degree of certainty how many red hat firms are private companies or how many foreign-funded firms are nonstate sector firms. Thus there is a strong possibility for double counting in available statistics (Appendix 1).

Table 2 shows the number of "narrowly defined" domestic private enterprises for 1993–2001. In 2001, there were about 26 million such private enterprises operating in the PRC. Dwarfed by the absolute number of individually owned enterprises, privately owned enterprises increased at an average annual growth rate of 32% over the past 8 years.

Table 3 illustrates recent trends in the number of enterprises above the designated size (annual income over 5 million yuan [CNY]), divided by sector. State-owned and state-held companies declined from 2000 to 2001, both in absolute number and as a share of total enterprises. The

<sup>1</sup> The International Finance Corporation (IFC) has concluded generally that about half of collectives are in fact private companies, although some areas and sectors have a higher proportion of private companies. (IFC 2000b). Experts interviewed for this report responded that about 70–100% of collectives are actually private companies.

nonstate sector increased in importance, with private enterprises as the main contributors to this change. Private enterprises grew by 64% in number and their share of the total number of enterprises increased from 14% to 21%.

**Table 2: Number of Domestic Private Enterprises**  
(million)

Year	Individually Owned Enterprises (Geti Hu)		Privately Owned Enterprises (Siying Qiye)	
	No.	Growth Rate (%)	No.	Growth Rate (%)
1993	17.70	–	0.238	–
1994	21.90	24	0.432	82
1995	25.30	16	0.654	51
1996	27.00	7	0.819	25
1997	28.50	6	0.960	17
1998	31.20	9	1.201	25
1999	31.60	1	1.509	26
2000	25.71	-19	1.762	17
2001	24.33	-5	2.029	15
<b>Average Growth Rate</b>		<b>5</b>		<b>32</b>

Sources: China Statistical Yearbook 2001 and 2002; and ADB. 2002. Draft Report on Technical Assistance to the PRC for Private Sector Development. Manila.

**Table 3: Number of State and Nonstate Sector Industrial Enterprises<sup>a</sup>**

Item	2000		2001		Growth (%)
	No.	Share (%)	No.	Share (%)	
<b>National Total of All Industrial Enterprises</b>	<b>162,886</b>	<b>100.0</b>	<b>171,256</b>	<b>100.0</b>	<b>5</b>
State-Owned and State-Held Enterprises	43,652	26.8	35,902	21.0	-18
Nonstate Sector Enterprises	119,234	73.2	135,354	79.0	14
Collective-Owned Industry	37,842	23.2	31,018	18.1	-18
Shareholding Cooperatives and Joint Ownership Enterprises	13,362	8.2	13,098	7.6	-2
Limited Liability Corporations	11,989	7.4	17,584	10.3	47
Shareholding Enterprises	5,086	3.1	5,692	3.3	12
Private Enterprises (Siying Qiye)	22,128	13.6	36,218	21.1	64
Foreign/Special Administration Regions Funded Enterprises	16,490	10.1	18,257	10.7	11
Enterprises from Hong Kong, China; Macao, China; and Taipei, China					
Foreign-Funded Enterprises	11,955	7.3	13,166	7.7	10
Others	382	0.2	321	0.2	-16

<sup>a</sup> Includes only industrial enterprises with annual sales income of more than CNY5 million.

Source: China Statistical Yearbook 2002.

#### a. Gross Domestic Product

The economy has undergone a fundamental change since the reform process began in 1978, from complete reliance on state-owned and collective enterprises to a mixed economy where private enterprises play an increasing role. The economic transformation is evident from the falling ratio of GDP contributed by SOEs from 58% to 37%. Private enterprises and those in transition grew at a compound annual growth rate of 26% from CNY19 billion (\$2.29 billion) in 1978 to CNY2,950 billion (\$356 billion) in 2000. Their share of the total economy increased from 5% to 33% during this period (Table 4).

**Table 4: Gross Domestic Product for 1978-2000**  
(CNY billion)

Item	1978	1985	1990	1995	1997	2000 <sup>a</sup>	Growth Rate <sup>b</sup> (%)
<b>Total</b>	<b>362</b>	<b>896</b>	<b>1,858</b>	<b>5,848</b>	<b>7,345</b>	<b>8,940</b>	<b>16</b>
State-Owned Sector	209	429	904	2,222	3,078	3,308	13
Share (%)	57.7	47.8	48.6	38.0%	41.9	37.0	–
Nonstate Sector	153	468	954	3,626	4,268	5,632	18
Share (%)	42.3	52.2	51.4	62.0	58.1	63.0	–
Collectives	134	363	711	2,327	2,490	2,682	15
Share (%)	37.0	40.5	38.2	39.8	33.9	30.0	–
Private (and others)	19	104	244	1,299	1,778	2,950	26
Share (%)	5.2	11.6	13.1	22.2	24.2	33.0	–

<sup>a</sup> ADB estimates: Breakdown for 2000 is derived from data disclosed by the National Bureau of Statistics (China Daily). Break down for 1978-1997 (Zhongguo Jingji Zhuangui 20 Nian).

<sup>b</sup> Compound annual growth rate between 1978 and 2000.

Sources: Zhongguo Jingji Zhuangui 20 Nian (Chinese Economic Transformation for Twenty Years). 1999. p.57, National Bureau of Statistics; and Tongji Ziliao (Statistical Data) 1999. No. 9, China Daily, 26 March 2002.

#### Box 1:

### Zhejiang Province—The Most Developed Private Economy in the PRC

Zhejiang Province has the most developed private economy in the PRC. The economic output of the private sector accounts for 95% of the province's total. In 2000, 6.8% of the PRC's GDP came from this province, which has only 3.7% of the national population. The private economy has developed at a rate of 34% over the last 10 years. In July 2002, Zhejiang Province overtook Shanghai, the PRC's largest industrial city, in exports. The province's stellar economic development over the past 20 years is regarded as a miracle throughout the PRC.

Before 1978, Zhejiang Province was an undeveloped agricultural province with a weak industrial base and limited natural resources. The success of this province is attributed to the role of the private sector, the driving force of economic growth over the past 20 years.

Currently, there are more than 1,000 specialized villages and towns throughout this province, each engaged in the manufacture of a single product (shoes, glasses, lamps, and clothes). These products have captured a large share of the national market and some products (cigarette lighters, ties) are exported. Many enterprises from this province have become the leading companies in the PRC. In addition to the entrepreneurial drive of its residents, the local government has extended strong support to help the private sector develop and taken measures to stimulate growth of small and medium enterprises.

Zhejiang Province's GDP has ranked among the top five in the PRC for more than 10 years, its farmers per capita average income has been included in this list for the last 16 years, and its tax revenue also ranks highly.

Sources: "Zhejiang Benefits from Private Economy," CRI Online, 17 July 2002; "China's Private Economy Seeking Wider Development Space," People's Daily, 7 April 2002; and "Zhejiang Province Overtakes Shanghai in Exports," People's Daily, 28 August 2002.

## b. Industrial Output

An increasing trend of the private sector contribution to gross industrial output is shown in Table 5. Between 2000 and 2001 the share of the state sector, including state-holding industries, in industrial output decreased both in absolute and relative terms. The State accounted for only 23% of gross industrial output in 2001, while the nonstate sector, which includes private and foreign-funded enterprises, accounted for about 77%.<sup>2</sup> Empirical evidence also indicates that gains in productivity in the economy have come from the private sector. Overall labor productivity of foreign-funded enterprises in 2001 was CNY98,413/person a year, about 1.8 times higher than SOEs. (China Statistical Yearbook 2002).

**Table 5: Gross Industrial Output Value of Enterprises with Sales Over CNY5 Million (CNY billion)**

Item	2000		2001		Growth
	Value	Share (%)	Value	Share (%)	Rate (%)
National Total	8,567	100.0	9,545	100.0	11.4
State-Owned and State-Holding Industry	2,466	28.8	2,237	23.4	-9.3
Nonstate Sector Enterprises	6,101	71.2	7,308	76.6	19.8
Collective-Owned Industry	1,191	13.9	1,005	10.5	-15.6
Shareholding Cooperatives/Joint Ownership Enterprises	380	4.4	385	4.0	1.3
Limited Liability Corporations	642	7.5	1,039	10.9	61.8
Shareholding Enterprises	1,009	11.8	1,270	13.3	25.9
Private Enterprises (Siying Qiye)	522	6.1	876	9.2	67.8
Foreign/Special Administrative Regions Funded Enterprises					
Enterprises from Hong Kong, China; Macao, China; and Taipei, China	1,057	12.3	1,185	12.4	12.1
Foreign-Funded Enterprises	1,289	15.0	1,537	16.1	19.2
Others	11	0.1	11	0.1	0.0

Source: China Statistical Yearbook 2002.

## c. Fixed Investment

The state sector historically accounted for the bulk of investment in fixed assets. However, investments by the private sector, individuals, and other types of enterprises including foreign-funded firms have increased rapidly over the past 6 years, except in 1998. By 2001 the share of the nonstate sector surpassed that of the state sector (Table 6).<sup>3</sup>

## d. Employment

The nonstate sector is the major source of employment, accounting for over 80% of total employment between 1997 and 2001. Its share of total employment reached 90% in 2001 and 2002 (Table 7). Although modest in terms of its share of total employment, between 1997 and 2001 the private sector accounted for 13% of total employment, of which private enterprises created jobs at an average growth rate of 19%, as opposed to the national growth rate of 1.2%. Over the same period, employment by the state sector and urban collectives fell by 8.8% and 18.2%, respectively, and their shares declined steadily over time. The private sector thus has a potential for absorbing a significant number of workers from other sectors, particularly laid-off SOE workers.

<sup>2</sup> A new statistical system adopted by the National Bureau of Statistics to measure industrial output includes only firms with more than CNY5 million in output. Therefore, a consistent historical comparison is not available. For historical data starting from 1980 up to 1999, see Appendix 2.

<sup>3</sup> However, it is difficult to gauge recent trends because the share of the state sector has now been combined with other types of nonstate sector firms.

**Table 6: Total Investment in Fixed Assets by Ownership**  
(CNY billion)

Item	1997	1998	1999	2000	2001	2002	Average Growth Rate (%) <sup>a</sup>
<b>Total</b>	<b>2,494</b>	<b>2,841</b>	<b>2,985</b>	<b>3,292</b>	<b>3,721</b>	<b>4,320</b>	<b>11.7<sup>b</sup></b>
State-Owned Sector	1,309	1,537	1,595	1,650	1,760	3,102 <sup>c</sup>	7.9
Share (%)	52.5	54.1	53.4	50.1	47.3	71.8	–
Nonstate Sector	1,185	1,304	1,391	1,641	1,961	1,218	12.5
Share (%)	47.5	45.9	46.6	49.9	52.7	28.2	–
Collectives	385	419	434	480	528	590.1	7.7
Individual	15.4	14.8	14.5	14.6	14.2	13.7	–
Other Types	343	374	420	471	543	628	11.1
Share (%)	13.8	13.2	14.1	14.3	14.6	14.5	–
Other Types	457	510	537	690	890		17.1
Share (%)	18.3	18.0	18.0	21.0	23.9		–

<sup>a</sup> 5-year average growth rate for 1996-2001.

<sup>b</sup> 6-year average growth rate for 1997-2002.

<sup>c</sup> State-owned units and others.

Source: China Statistical Yearbook 2002, p.176 and <http://www.stats.gov.cn>.

**Table 7: Employment by Ownership Unit**  
(share)

	1997	1998	1999	2000	2001	2002	Growth Rate <sup>a</sup>
<b>Total Employment (million)</b>	<b>696</b>	<b>700</b>	<b>706</b>	<b>712</b>	<b>731</b>	<b>729</b>	<b>1.2%</b>
State-Owned Sector	110 (15.9%)	91(12.9%)	86 (12.1%)	81(11.4%)	76 (10.4%)	71 (9.7)	-8.80%
Nonstate Sector	586 (84.1%)	609 (87.1%)	620 (87.9%)	630 (88.6%)	655 (89.6%)	658 (90.3)	2.80%
Urban Collective Owned Units	29 (4.1%)	20 (2.8%)	17 (2.4%)	15 (2.1%)	13 (1.8%)		-18.20%
Other Urban Units <sup>b</sup>	25 (3.6%)	48 (6.8%)	54 (7.7%)	63 (8.8%)	92 (12.6%)		38.50%
TVEs	131 (18.8%)	125 (17.9%)	127 (18.0%)	128 (18.0%)	131 (17.9%)		0.00%
Rural Households <sup>c</sup>	322 (46.3%)	322 (46.0%)	321 (45.4%)	330 (46.4%)	322 (44.0%)		0.00%
Private Sector Total	79 (11.3%)	95 (13.6%)	101(14.3%)	95 (13.3%)	97 (13.3%)		5.30%
Private Enterprises	13.5 (1.9%)	17.1(2.4%)	20.2(2.9%)	24.0(3.4%)	27.0(3.7%)		18.90%
Self-Employed	54.4(7.8%)	61.1(8.7%)	62.4(8.8%)	50.7(7.1%)	47.6 (6.5%)		-0.40%
Others <sup>d</sup>	10.9(1.6%)	16.7(2.4%)	18.2(2.6%)	19.8(2.8%)	21.9(3.1%)		19.10%

TVE = town or village enterprise.

<sup>a</sup> Average growth rates over 1997-2001.

<sup>b</sup> There are differences between the aggregate (or subtotal) and the sum of relevant categories in data sources: residual between total urban employment and the sum of all categories in urban employment.

<sup>c</sup> The difference between total rural employment and the sum of all rural categories.

<sup>d</sup> Including cooperative units, joint ownership units, limited liability corporations, shareholding corporations units with funds from Hong Kong, China; Macao, China; and Taipei,China; foreign-funded units.

Sources: China Statistical Yearbook 2002, p.117; Asian Development Bank Outlook 2003.

Gross job creation between 1997 and 2001 is estimated to be about 92 million, to which the private sector contributed 24 million (about 26%). Over the same period, 57 million jobs were lost. Thus, the economy generated net 35 million new jobs.

In the next decade, the PRC needs to generate between 90 and 300 million new jobs depending on different assumptions (Dahlman and Aubert 2001) for 40-50 million people to be redeployed from agriculture, SOEs, TVEs, and for new entrants to the labor force. The private sector needs to be further developed to create these jobs. Without these new jobs, the economic transformation will cause large numbers of people to fall into poverty, resulting in rising social tensions and social instability.

## C. SMALL AND MEDIUM ENTERPRISES

There are more than 8 million small and medium enterprises (SMEs) in the PRC accounting for 99% of total business establishments and 60% of industrial output.<sup>4</sup> SMEs also account for 60% of all sales and 57% of all profits generated, pay approximately 40% of all taxes, and account for more than 60% of all exports (ADB 2001d). For comparison, about 40 million SMEs throughout the Asia-Pacific Economic Cooperation (APEC) economies account for more than 95% of all business establishments, 35% of exports, and from 30% to 60% of gross national product (GNP). As of 2000, SMEs provided about 75% of the jobs in the PRC. Most of the 200 million labor force that migrated from rural areas to urban areas from 1978 to 1996 was hired by SMEs (ADB 2002c).

## D. FOREIGN DIRECT INVESTMENT

For more than a decade, the PRC has attracted the highest FDI in the region and has been the second largest recipient of FDI in the world, after the United States (US) (Figure 1). Continuing robust economic growth and entry to the World Trade Organization (WTO) has made the PRC more attractive to foreign investors. Despite the deterioration in the global corporate environment, followed by the 11 September tragedy in 2001, the PRC overtook the US as the largest recipient of FDI in the world. On an actual basis, \$52.7 billion was invested in 2002, a 12.5% increase from 2001. In 2002, contracted FDI was \$82.8 billion, a 19.6% increase from 2001 (Table 8) (ADB 2003).

Table 8: Foreign Direct Investment, 1996–2002  
(\$ million)

Item	1996	1997	1998	1999	2000	2001 <sup>a</sup>	2002
Total—Actual	41,726	45,257	45,462	40,319	40,715	46,850	52,700
(Contracted)	(73,276)	(51,003)	(52,102)	(41,200)	(62,400)	(69,200)	(82,800)
Regional Total	41,880	44,901	45,284	39,935	40,333	–	–
Coastal Area	36,206	37,679	38,604	34,415	34,886	–	–
Share (%)	86.5	83.9	85.2	86.2	86.5	–	–
Central Area	3,914	4,714	4,329	3,683	3,594	–	–
Share (%)	9.3	10.5	9.6	9.2	8.9	–	–
Western Area	1,759	2,507	2,351	1,837	1,852	–	–
Share (%)	4.2	5.6	5.2	4.6	4.6	–	–

– = Data not available.

<sup>a</sup> Ministry of Foreign Trade and Economic Cooperation (MOFTEC). *China Daily*. 15 January 2002.

Sources: *China Statistical Yearbook*, 1998, p.642; 1999, p.599; 2001, p.607. MOFTEC. <http://www.stats.gov.cn>

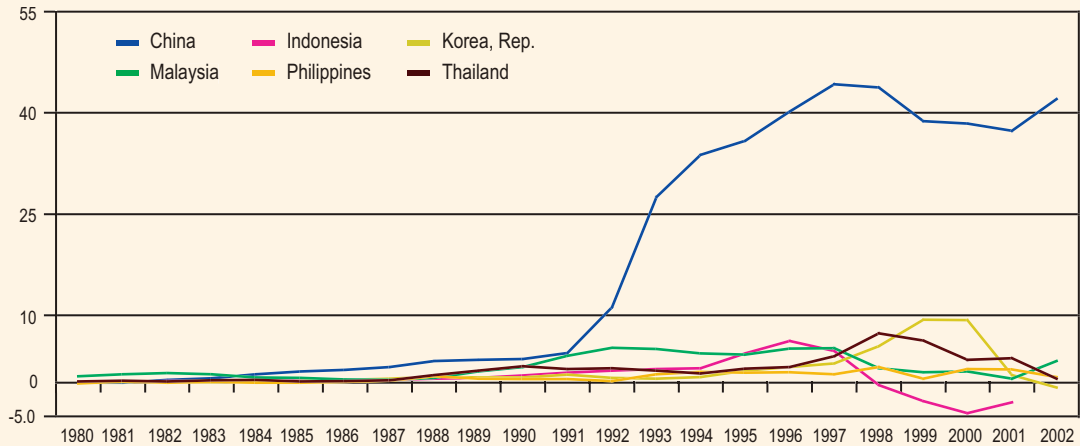
As of end-October 2002, the PRC had approved 417,655 foreign-funded enterprises, with contracted foreign investment reaching \$820.28 billion and actual foreign investment utilization amounting to \$439.94 billion. Foreign invested enterprises (FIEs) currently account for 10% of the PRC labor force, employing 23 million people (Trade Point Beijing 2003).

FDI has played a major role in the PRC's transition to a market-oriented economy and has been an effective way to transfer technology and managerial expertise to the PRC, although it is

<sup>4</sup> See data released by the State Economic and Trade Commission (SETC). SME statistics include both state sector and nonstate sector SMEs.

highly concentrated geographically and its sectoral distribution is uneven. In 2000, about 86% of investments went to the coastal provinces, and the central and western regions accounted for about 9% and 5%, respectively (Table 8). The manufacturing sector attracts about 60% of FDI, followed by real estate management (11.4%) and social sectors (5.4%) (Appendix 2). One empirical analysis found that FDI's geographical distribution is determined mostly by the level of GNP, infrastructure development, level of general education, and coastal location (Broadman and Sun 1997).

Figure 1. Foreign Direct Investment, Net Inflow  
(\$ Billion)



Sources: Global Development Finance 2002, CD-ROM, and Asian Development Outlook 2003.