

SECTOR OVERVIEW

A. Economic Overview

1. Economic growth in the People's Republic of China (PRC) has averaged 9.9% annually since reforms to open up and reform the economy were implemented in 1978. Neither the Asian Financial Crisis in 1997–1998 nor the global financial crisis in 2008 broke this general trend, and strong economic growth is expected to continue. The World Bank projects that annual gross domestic product (GDP) growth will average 8.6% during 2011–2015.¹ The Asian Development Bank (ADB) estimates that GDP growth will be between 7.7% and 8.1% in 2012–2013, compared with a projection of between 7.5% and 8.5% by Moody's Investors Service (Moody's) for the same period.² The government's 12th Five-Year Plan set an annual GDP growth target of 7.0% for 2011–2015 but actual GDP growth has consistently exceeded official targets in the past.

2. The PRC's rapid economic growth has lifted more than 500 million people out of poverty. The World Bank estimates that the share of the population living on less than \$1.25 a day (2005 Purchasing Power Parity) dropped from 60.2% in 1990 to 13.1% in 2008. It projects a further decline to 7.3% in 2015. At end 2010, 128 million people in the PRC lived beneath the official poverty line—which was set at an annual income of CNY2,300 (equivalent to about USD1.0 a day based on the current market exchange rate).³

3. The foreign currency sovereign rating for PRC is AA- by Standard & Poor's, Aa3 by Moody's, and A+ by Fitch Ratings.

B. Urban Transport Sector Overview

4. Strong economic growth in the PRC has been partly driven by massive urbanization. In 1979, the urban population of 203.0 million accounted for 21% of the total population. By the end of 2011, 690.8 million people—51% of the country's population—were living in urban areas and the percentage is expected to grow to 58%–60% by 2020.⁴

5. This rapid urbanization, along with government support for the development of the auto industry, has generated massive growth in the use of motor vehicles.⁵ The PRC has become the largest producer and consumer of automobiles in the world. Annual production capacity reached 18.3 million vehicles in 2010, and sales hit 18.1 million units. During 2006–2010, the number of registered automobiles in the PRC grew by an average 9.5 million units a year. It passed the 100 million mark in September 2011.⁶

6. Although automobiles bring enormous benefits to both the economy and the users, these benefits are accompanied by a range of serious logistic, health, and climate-related problems at the city, national, and international levels. Most passenger cars are now privately owned and their extensive use in cities is causing congestion, air and noise pollution, and road accidents. In the early 1990s, these problems affected only the country's larger cities but they are now common and growing more serious in almost all of the PRC's big urban centers.

7. The large, dense concentrations of motor vehicles and their emissions in relatively small areas have raised air pollution in many cities to levels considered harmful to human health. The

¹ World Bank. 2012. *China 2030. Building a Modern, Harmonious, and Creative High-Income Society*. Washington, DC.

² ADB. 2012. *Asian Development Outlook 2012*. Manila; Moody's. 2012. *Banking System Outlook*. Beijing.

³ China Academy of Science. 2012. *2012 China Sustainable Development Strategy Report*. Beijing.

⁴ Bloomberg. 2012. *China's Urban Population Exceeds Countryside For First Time*. Hong Kong. 17 January.

⁵ In its eighth five-year plan for 1991–1995, the government made automotive manufacturing a pillar industry.

⁶ China Daily. 2011. *Number of cars in China hits 100m*. Beijing. 17 September.

fine particles often associated with vehicular emissions can increase morbidity and premature mortality. According to the national government, about one-fifth of urban dwellers breathe heavily polluted air. Air pollution and smog occasionally shut down airports in such large cities as Beijing and Shanghai due to poor visibility. In metropolitan areas, the transport sector is estimated to account for one-third or more of total emissions of greenhouse gases (GHGs), which include carbon dioxide (CO₂), methane, and nitrous oxide and impact climate change. The PRC is already the world's largest GHG emitter, and its CO₂ emissions have doubled since 2003. In 2010, CO₂ emissions were the equivalent of 9 billion tons, a 10% jump from 2009.⁷ Rapid motorization and the country's moderate success in controlling emissions from industrial and energy sources has made the PRC's urban transport sector the fastest growing source of GHG emissions. The International Energy Agency estimates that CO₂ emissions from the PRC's light-duty transport fleet will rise from 65 million tons in 2005 to nearly 300 million tons in 2020, an increase of 290%. Most of this growth will come from urban transport.

8. Since 1990, the response of most cities in the PRC to rapid growth in population, income, and private car ownership has been to invest massively in roads. Now, a consensus is gradually emerging at both the national and city government levels that this strategy conflicts with the need to make urban development sustainable. Public transport is increasingly recognized as the solution to a potential urban transport crisis. By encouraging urban residents to shift from the use of private cars to public transportation, governments can alleviate congestion and air pollution, including the GHG emissions that contribute to global climate change. Developing public transport will also directly benefit the poor, who frequently face problems in accessing safe, affordable public transport. The government now pays special attention to the social function of public transport and heavily regulates and subsidizes fares in most cities. In addition, generous discounts are often offered to senior citizen, students, and low-income groups.

9. In December 2006, the Ministry of Construction, the National Development and Reform Commission (NDRC), the Ministry of Finance, and the Ministry of Labor and Social Security adopted a policy that made the development of urban public transport a priority.⁸ This central directive meant that public transport became an important component in planning urban infrastructure, which led to plans by many cities to promote the development of public transport. In Beijing, for example, the municipal government developed a program in 2006 to develop a public transport system, using an urban rail system as the backbone, supplemented by improved and expanded bus systems and other transport modes.⁹ Municipal governments in Shanghai, Shenzhen, Guangzhou, and many other cities have prioritized and made great improvements in public transport, including the development of urban rail and bus rapid transit systems.

10. The number of public buses, trams, and subway cars in operation in Beijing grew at an annual average of 8.9% between 1995 and 2007. The overall length of the public transport routes grew from 59,961 kilometers in 1995 to 125,845 kilometers in 2007.¹⁰ The public transport's share measured by passenger trips increased from 28% in 2002 to 37% in 2008. In the city of Langzhou, the number of passengers on public buses increased to 473 million in 2007 from 426 million in 2006 and 359 million in 2005 and is expected to grow by 2.1 times

⁷ PBL Netherlands Environmental Assessment Agency. 2011. *Long-term Trend in Global CO₂ Emissions: 2011 Report*. The Hague.

⁸ Government of PRC. 2006. *Advice on Economic Policy for Priority Development of Urban Public Transport*. Beijing.

⁹ Municipal Government of Beijing. 2006. *Opinions on the Development of Public Transport Priority*. Beijing.

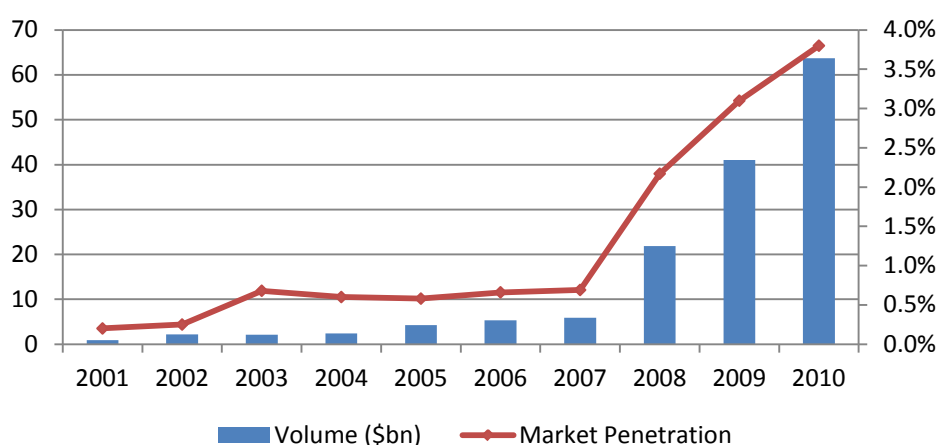
¹⁰ ADB. 2012. *Urban Transport Strategy to Combat Climate Change in the People's Republic of China*. Manila.

during 2005–2020. Public transport's share measured by passenger trips is expected to increase from 22% in 2006 to almost 40% in 2020.¹¹

C. Financial Leasing Industry Overview

11. The financial leasing industry in the PRC has grown exponentially since 2001. According to the World Leasing Yearbook, new leasing sales expanded by about 71 times from \$0.90 billion in 2001 to \$63.72 billion in 2010, an annual compound growth rate of 161%. Market penetration, measured by leasing's share of all fixed investments in plant and equipment, increased from 0.2% in 2001 to 3.8% in 2010. Figure 1 illustrates the industry's growth.

**Figures 1: Financial Leasing Industry in the
People's Republic of China
Volume and Market Penetration, 2001-2010**



12. This dramatic growth was mainly due to a decision in August 2007 by the China Banking Regulatory Commission (CBRC) to allow commercial banks to set up financial leasing subsidiaries. Following the CBRC move, ICBC Financial Leasing, a wholly owned subsidiary of ICBC, became the country's first CBRC-regulated financial leasing company owned by a bank. CCB Financial Leasing, Mingsheng Financial Leasing, Bank of Communications Financial Leasing, and CMB Financial Leasing were among other similar companies formed next. With their large capital base and strong shareholder support, these bank-owned FLCs have grown at an extraordinary pace and have underpinned the expansion of the entire leasing industry.

13. Three types of FLCs were operating in the PRC at the end of 2011: (i) 20 special FLCs, regulated by the CBRC; (ii) 66 domestic FLCs, jointly regulated by the Market System Development Department, the Ministry of Commerce (MOFCOM), and the State Administration of Taxation (SAT); and (iii) 200 FLCs with foreign investment participation, which are regulated by MOFCOM's foreign investment department. The special FLCs regulated by the CBRC accounted for more than 50% of the firms' overall registered capital of CNY102.2 billion. The value of outstanding leasing contracts was CNY930 billion.¹²

14. Despite rapid growth, the PRC's financial leasing industry is still in early development. Market penetration in 2010 was only 3.8%, compared with an average rate of 13.8% in the

¹¹ ADB. 2009. *Report and Recommendation of the President, Proposed Loan People's Republic of China: Lanzhou Sustainable Urban Transport Project*. Manila.

¹² PRC Leasing Industry Research Center. 2012. *2011 PRC Financial Leasing Industry Development Report*. Tianjing.

world's 10 other largest financial leasing markets. The industry is also much smaller than the banking industry, whose assets totaled CNY118.6 trillion at the end of the first quarter of 2012. According to the CBRC, the assets of the FLCs under its supervision totaled around CNY0.6 trillion at the same time, and the assets of the leasing industry overall were estimated at only about CNY1.0 trillion.

15. To maintain rapid growth and fulfill its potential to become the second most important source of financing after bank credit, the financial leasing industry needs to overcome several constraints:

- i) **An evolving legal and regulatory framework.** The PRC does not have a single law to govern financial leasing. The three types of FLCs are regulated separately by the CBRC and MOFCOM, which results in different requirements for each kind of FLC on approval processes, investor eligibility, registered capital, business scope, and governmental supervision and intervention. While a contract law promulgated in 1999 has separate provisions for operating leasing contracts and financial leasing contracts, the country's supreme court only began issuing detailed legal interpretations on financial leasing contracts in 2011. No central registration system for leased assets exists yet in the PRC, even though this would protect legal rights over leased assets from being contested by third parties.
- ii) **Inconsistency in tax treatment.** Under SAT circulars issued in 2000, 2003, and 2004, FLCs are supposed to be subject only to the business tax. However, local tax authorities have applied different interpretations in the application of business tax and the value added tax (VAT), depending on whether the title of the leased property was eventually transferred to the lessee. In 2011, the SAT issued a new a circular on a pilot basis that replaced the business tax with the VAT for certain service industries in Shanghai. The pilot test covers the leasing industry and is generally expected to benefit the industry. However, ambiguity at the operational level and inconsistency in the issuance of VAT invoices continue.
- iii) **Data, human resource, and funding challenges.** FLCs lack a unified industry association and have no comprehensive, coherent statistical system to collect data on financial leasing. Because the industry is relatively young and growing rapidly, it suffers from a shortage of management and staff with the necessary experience and expertise. Financial leasing is capital intensive but many FLCs lack capital and funding. This limited access to the capital markets and long-term bank financing causes severe mismatches between the maturities of assets and liabilities.

16. Strong government support keeps the outlook for the financial leasing industry positive despite these constraints. The government has committed to further developing the financial leasing industry in its 12th Five-Year Plan for 2011–2015. MOFCOM and the NDRC have issued implementation guidelines and a blueprint for developing the FLCs regulated under MOFCOM.¹³ They include specific measures to i) encourage innovative business models, ii) optimize market structures, iii) support fledgling business lines, iv) explore overseas markets, v) diversify funding sources, vi) strengthen risk management capabilities, and vii) accelerate the development of relevant industries. In December 2011, the NDRC and MOFCOM jointly issued revised guidelines that permitted foreign investment in the special financial leasing companies regulated by the CBRC. This had previously been restricted.

¹³ Government of PRC. 2011. *Guiding Opinions on Encouraging the Development of Financial Leasing Industry in the 12th Five- Year Period*. Beijing.

17. To develop human resource capacity, leasing companies such as ICBC Financial Leasing, Far East Horizon, GBU Financial Leasing, and Bohai Financial Leasing have teamed up with leading universities and research institutes to set up research centers, develop specialized courses on the leasing business, and provide scholarships to talented students to study financial leasing. Many of these companies have also invested heavily in risk management systems and in information technology. Through innovation, FLCs are now able to offer a wider range of direct-lease, sale-and-lease-back, vendor-backed leasing, syndicated leasing, and other products. Leasing companies are also increasing cooperation and alliances with commercial banks and other financial institutions to tap additional funding sources and use other financial services, such as factoring and securitization, to increase efficiency of their balance sheet.