

I. ECONOMIC ENVIRONMENT

(1) MAIN ECONOMIC DEVELOPMENTS

1. During the period under review (2010-12), China's economy continued to grow rapidly. Supported by a substantial fiscal stimulus amounting to ¥4 trillion (12.7% of GDP in 2008), China emerged from the global financial and economic crisis with strong growth in 2010 and 2011 (Table I.1). At the same time, with increasing world prices of primary commodities and domestic food and energy prices, rising property prices in urban areas, and increasing wages, consumer price inflation (5.4% in 2011) became a pressing social and economic issue. At the People's National Congress in March 2012, China lowered its prospects for annual growth to 7.5% for 2012; in 2011, growth had been projected officially at 8% and in fact was recorded at 9.2%. In 2010 and 2011, China's nominal GDP per capita (in U.S. dollar terms) increased from around US\$4,430 to US\$5,417.

2. China continues to face various economic imbalances. One is its large and persistent surplus of national savings over domestic investment, which has as its international counterpart China's current account surplus in its balance of payments. The second is China's heavy dependence on overseas demand for its manufactured exports to sustain economic growth.

Table I.1
Selected macroeconomic indicators, 2007-11

	2007	2008	2009	2010	2011 ^a
Nominal GDP (¥ billion)	26,581.0	31,404.5	34,090.3	40,151.3	47,156.4
Nominal GDP (US\$ billion)	3,495.7	4,521.8	4,990.5	5,931.2	7,298.6
Real GDP (¥ billion, 2005 prices)	23,789.3	26,081.3	28,484.5	31,460.3	34,354.6
Real GDP (US\$ billion, 2005 prices)	3,128.5	3,755.4	4,169.9	4,647.4	5,317.2
GDP per capita (¥)	20,169.5	23,707.7	25,607.5	30,015.0	34,999.4
GDP per capita (US\$)	2,652.5	3,413.6	3,748.7	4,433.9	5,417.0
National accounts (%age change)					
Real GDP	14.2	9.6	9.2	10.4	9.2
Consumption ^b	5.6	4.2	4.4	3.8	..
Investment ^b	6.1	4.6	8.4	5.6	..
Net exports ^b	2.5	0.8	-3.6	0.9	..
Unemployment rate (%) ^c	4.1	4.4	4.3	4.1	4.1
Prices and interest rates					
Inflation (CPI, %age change)	4.8	5.9	-0.7	3.3	5.4
Lending rate (% , period average)	7.47	5.31	5.31	5.81	6.56
Deposit rate (% , period average)	4.14	2.25	2.25	2.75	3.50
Exchange rate					
Yuan per US\$ (period average)	7.604	6.945	6.831	6.770	6.461
Real effective exchange rate index (%age change) ^d	4.0	9.2	3.4	-0.5	..
Nominal effective exchange rate index (%age change)	1.4	6.6	5.0	-1.9	..
Fiscal policy^e (% of GDP)					
Government balance	0.6	-0.4	-2.3	-1.7	..
Total revenue	19.3	19.5	20.1	20.7	22.0
Tax revenue	17.2	17.3	17.5	18.2	19.0
Total expenditure	18.7	19.9	22.4	22.4	..
Central government total debt	19.6	17.0	17.7	16.8	..
Domestic debt	19.4	16.8	17.5	16.7	..

Table I.1 (cont'd)

	2007	2008	2009	2010	2011 ^a
Saving and investment					
GDP by expenditure approach (¥ billion)	26,309.4	31,490.1	34,631.7	39,430.8	..
Final consumption expenditure (¥ billion)	12,879.4	15,234.7	16,682.0	18,690.5	..
Gross capital formation (¥ billion)	11,091.9	13,832.5	16,446.3	19,169.1	..
Net export of goods and services (¥ billion)	2,338.1	2,422.9	1,503.3	1,571.2	..
Savings (¥ billion)	13,430.0	16,255.5	17,949.7	20,740.2	..
Savings to expenditure approach GDP (%)	51.0	51.6	51.8	52.6	..
Investment to expenditure approach GDP (%)	42.2	43.9	47.5	48.6	..
Savings-Investment gap (% of GDP)	8.9	7.7	4.3	4.0	..
External sector (% of GDP, unless otherwise indicated)					
Current account balance	10.1	9.1	5.2	5.2	2.8
Net merchandise trade	9.0	8.0	5.0	4.3	3.3
Value of exports	34.9	31.7	24.1	26.7	26.1
Value of imports	25.9	23.7	19.1	22.4	22.7
Services balance	-0.2	-0.3	-0.6	-0.4	-0.8
Capital account	0.1	0.1	0.1	0.1	0.1
Financial account	2.6	1.0	3.5	3.7	3.0
Direct investment	4.1	2.7	1.4	2.1	2.3
Balance-of-payments	13.2	10.6	8.0	8.0	5.3
Merchandise exports ^f (%age change)	25.8	17.6	-16.1	31.4	20.4
Merchandise imports ^f (%age change)	20.3	18.7	-11.1	39.1	25.1
Service exports ^f (%age change)	32.8	20.4	-11.9	32.2	6.8
Service imports ^f (%age change)	29.0	22.1	0.0	21.6	23.2
Gross official reserves ^g (US\$ billion; end period)	1,530.3	1,949.3	2,416.0	2,866.1	..
Foreign exchange ^h (US\$ billion; end period)	1,528.2	1,946.0	2,399.2	284.7	..
Total external debt (US\$ billion; end period)	389.2	390.2	428.7	548.9	..
Debt service ratio ⁱ	2.0	1.8	2.9	1.6	..

.. Not available.

a Estimates.

b Contribution to annual growth in per cent. Figures are taken from the National Bureau of Statistics of China, *Statistical Yearbook 2011*, Table 2-20.

c Registered unemployment in urban areas.

d A positive increase in the real effective exchange rate means an appreciation of the renminbi relative to the other major currencies in the index.

e Including central and local governments.

f Growth rates on merchandise and service trade are based on US\$.

g Excluding gold, including SDRs and Reserve Position in the Fund.

h Excluding gold, SDRs and Reserve Position in the Fund.

i Debt service ratio refers to the ratio of the payment of principal and interest of foreign debts to the foreign exchange receipts from foreign trade and non-trade services of the current year.

Source: National Bureau of Statistics of China, *Statistical Yearbook (various issues)*; IMF, *International Financial Statistics database*; and data provided by the Chinese authorities.

3. During the period under review, China adopted few measures to liberalize its international trade and investment; its simple average applied MFN tariff rate (9.5%) as well as the main measures related to trade and investment remained unchanged. Like most other WTO Members, China resisted a trade-restrictive response overall to the effects of the global economic crisis. However, in a number of instances, China introduced measures that restrict or may restrict trade, notably exports.¹ China's export regime remains complex, and measures continue to be used to manage certain exports.

¹ See WTO documents WT/TPR/OV/13, 24 November 2010 and WT/TPR/OV/14, 21 November 2011.

4. China considers its participation in regional and bilateral agreements to be complementary to its membership in the multilateral trading system and to offer it additional ways of expanding and diversifying its trade.

5. China is moving back gradually toward fiscal tightening after the expansive ¥4 trillion fiscal stimulus package introduced in 2008-10.² According to the 2011 Budget, the central government budget and local government budgets combined for 2011 will produce collectively a fiscal deficit of 2.0% of GDP, down from 2.2% in 2010; central government gross debt is estimated at around 16.8% of GDP for 2011, down from 17.7% in 2009.³

6. Against the background of the global financial crisis in 2008, the People's Bank of China (PBC) employed accommodative monetary policy to help stimulate domestic demand.⁴ In 2010 and 2011, as recovery of economic growth set in and domestic price inflation began accelerating, the PBC raised its benchmark interest rates on both deposits and loans five times and raised the deposit reserve ratio 12 times. The rate of increase in money supply declined in 2011 and new bank lending also declined.⁵ Subsequently, the PBC lowered the deposit reserve ratio by 0.5 percentage point on 5 December 2011.

7. Between July 2005 (when China's exchange rate reform started) and December 2011, the renminbi appreciated in nominal terms by about 31% against the U.S. dollar. The renminbi's annual average nominal exchange rate was ¥6.77 per US\$ for 2010 and 6.46 for 2011.

8. In their most recent public evaluation of China's exchange rate, IMF directors welcomed the authorities' commitment to move gradually to more price-based tools of monetary policy and continue to improve the monetary policy framework and the interest rate structure; they saw room for a further tightening of monetary conditions through greater reliance on interest rates and nominal exchange rate appreciation, while taking care to safeguard financial system stability. They generally agreed that, over the medium-term, a stronger RMB would be an important component in rebalancing the economy toward domestic demand, and a number of the directors saw this as a prerequisite for reforms to strengthen the macroeconomic policy framework and promote financial liberalization. IMF directors stressed that the appreciation of the exchange rate would need to be supported by wide-ranging reforms to bring about a transformation of China's economic growth model.⁶

² In the ¥4 trillion stimulus package, the authorities state that the Government substantially increased its input to, *inter alia*, livelihood projects, infrastructure, and reconstruction efforts after disasters; its pool of public investment resources came from, *inter alia*, budgetary allocations from the public finance, governmental funds' revenue, and earnings from business operations of state-owned assets. Meanwhile, a series of measures, like structural tax reductions, and the cancelation or termination of multiple administrative fees, were taken to substantially reduce the burden on businesses and ordinary people.

³ IMF (2011a). The central government debt is estimated to be around 60% of GDP when off-budget government debt is included, such as debt owed by policy banks, local governments, asset management companies, pension, and banks' non-performing loans.

⁴ This involved, *inter alia*, cuts in interest rates and reserve requirements, reduction in foreign exchange sterilization operations, and "windows guidance", which, according to the authorities, involves the PBC convening meetings with financial institutions, or holding talks with them, to, *inter alia*, obtain information on their credit loans, provide information on the macro-economy and industrial development, prompt industry risks so that financial institutions will take the initiative to adjust the direction of credit loans.

⁵ In 2011 (January-May), M2 rose by 15.1% year-on-year, down 4.6 percentage points compared with the same period in the previous year.

⁶ IMF online information. Viewed at: <http://www.imf.org/external/np/sec/pn/2011/pn1194.htm> [01/09/11].

9. The PBC maintains that under China's "managed floating" exchange rate regime, the RMB rate is based on market supply and demand and is adjusted with reference to a basket of currencies. The authorities consider that against the background of the global economic recession, when, according to the PBC, many governments allowed their currencies to depreciate in order to mitigate the negative impact of the crisis on their exports, China maintained a stable RMB exchange rate. According to the authorities, on 19 June 2010, China began a reform of the renminbi exchange rate mechanism with a view to gaining more flexibility in renminbi exchange rates. Emphasis was laid on the law of supply and demand and adjustments based on a basket of currencies within a specified floating range on the foreign exchange market. The authorities state that efforts should be made to promote a proper balance between international income and expenditure and maintain the stability of the macro-economy as well as that of the financial market; they consider that RMB is converging towards its equilibrium and expect this process to continue over the medium term. According to the Government Report submitted to the National People's Congress in March 2012, China intends to: improve the exchange rate determination mechanism for renminbi and maintain the stability of renminbi exchange rates around its equilibrium level; push forward the convertibility of renminbi under the capital account gradually and enlarge the scope of renminbi usage in cross-border trade settlement and investment.⁷

(2) STRUCTURAL POLICIES

10. As stated in the Secretariat's report for the previous Review, despite China's important economic achievements against the background of its transition from a centrally planned to a market-based economy, it continues to face various economic imbalances, including a large surplus of national savings over domestic investment and overcapacity in several core industries (Chapter IV(4)(ii)). Managing and correcting these imbalances represents a challenge for China's policymakers, both for domestic purposes and from an international perspective, because of China's size and the depth of its integration into the global economy.

11. China continues to maintain a large surplus of national savings over domestic investment, which produces its international counterpart in China's current account surplus in its balance of payments. This continues to frustrate the authorities' efforts to reduce China's reliance on exports as a source of growth. The national saving rate was estimated at 54.0% of GDP in 2011, compared with the domestic investment rate of 48.5% of GDP.⁸ The high national savings rate is attributable to both high household savings, including precautionary saving for education, health and old age, and high enterprise saving, partly due to high retained income (so as not to rely on the underdeveloped capital market), lack of competition for state-owned enterprises (SOEs), and a lack of incentives for SOEs to pay dividends.⁹

12. Reform of China's capital market has continued with a view to creating more efficient allocation of savings in the economy and reducing the need for discretionary saving by private enterprise. One indication of this is a gradual shift from non-tradeable to tradeable equities. In the past, China's stock market had a split-share structure, with large volumes of non-tradeable shares for listed enterprises (including SOEs); only around one third of the shares were tradeable. China began converting non-tradeable shares into tradeable shares from 2005; according to the authorities, 99% of listed companies had undergone the split-share structure reform by the end of 2011, on both the Shanghai and Shenzhen stock exchanges. Once the reforms are completed, original non-tradeable

⁷ Xinhua net online information (in Chinese). Viewed at: http://news.xinhuanet.com/politics/2012lh/2012-03/15/c_111660147.htm.

⁸ IMF (2011a).

⁹ IMF (2011b).

shares become tradeable after a specified period; no data on the percentage of total shares already floated were made available to the Secretariat. China's corporate bond market remains small; outstanding bonds issued as a form of debt were valued at only 9.8% of GDP in 2011.¹⁰

13. The 12th Five-Year Plan aims to reform China's economy into one that is more driven by growth of domestic demand. It is anticipated that this will have the effect of increasing the consumption of imported goods and services (Chapter II(2)(ii)). Further steps to liberalize trade in various sectors can assist in this process, including services which accounted for 43% of GDP in 2010 (Table I.2).

Table I.2
GDP by sector, 2007-10

	2007	2008	2009	2010
GDP by industry at 1978 indices (annual %age change)				
Agriculture, forestry and fishing	3.7	5.4	4.2	4.3
Industry ^a	14.9	9.9	8.7	12.2
Construction	16.2	9.5	18.6	13.7
Services	16.0	10.4	9.6	9.6
Transport, storage and communication	11.8	7.3	4.2	8.9
Wholesale and retail trade	20.2	15.8	12.1	14.3
Restaurants and hotels	9.6	9.6	5.5	10.0
Financial intermediation	27.6	13.3	18.2	10.0
Real estate	24.4	1.0	11.3	5.8
Other	11.3	11.0	7.8	8.0
Share of main sectors in GDP (%)				
Agriculture, forestry and fishing	10.8	10.7	10.3	10.1
Industry ^a	41.6	41.5	39.7	40.1
Construction	5.8	6.0	6.6	6.7
Services	41.9	41.8	43.4	43.1
Transport, storage and communication	5.5	5.2	4.9	4.7
Wholesale and retail trade	7.9	8.3	8.5	8.9
Restaurants and hotels	2.1	2.1	2.1	2.0
Financial intermediation	4.6	4.7	5.2	5.2
Real estate	5.2	4.7	5.5	5.6
Other	16.6	16.7	17.2	16.7

a Including mining and quarrying, manufacturing, production and supply of electricity.

Source: Data provided by the Chinese authorities.

14. High household and enterprise savings in China have kept capital costs low. Input prices (such as energy, water, and land) have also been regulated and kept low as the Government has emphasized the development of manufacturing, especially heavy industry. Thus, China's manufacturing, including steel, aluminium, and cement, has continued to tend towards over-investment and overcapacity (Chapter IV(4)(ii)). The privileged position of SOEs (e.g. in their access to bank lending) has also contributed to over-investment and overcapacity in the economy.

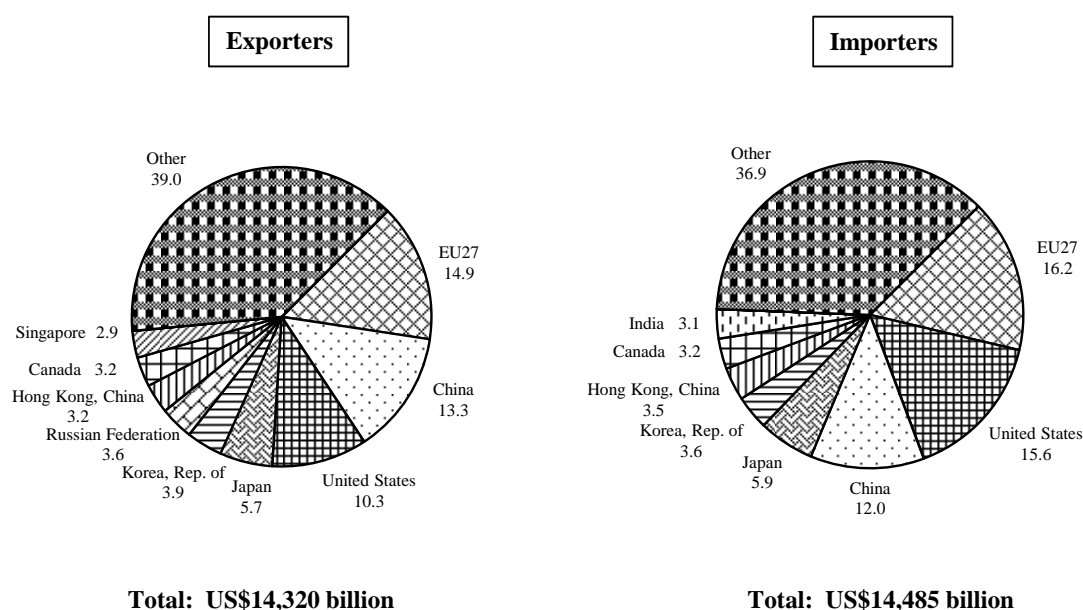
¹⁰ Data provided by the Chinese authorities.

(3) DEVELOPMENTS IN TRADE AND FOREIGN DIRECT INVESTMENT

15. China has become the world's second largest exporter and third largest importer of goods (excluding intra-EU trade) (Chart I.1).¹¹ Its merchandise exports contracted more sharply than its imports in 2009, and exports recovered less quickly than imports in 2010 and 2011, with the result that China's net trade surplus has continued its declining trend and stood at 3.3% of GDP in 2011 (based on China's balance of payments statistics).

Chart I.1
World merchandise trade, 2011

Per cent



Note: Figures exclude intra-EU27 trade.

Source: WTO press release, *PRESS /658*, 12 April 2012.

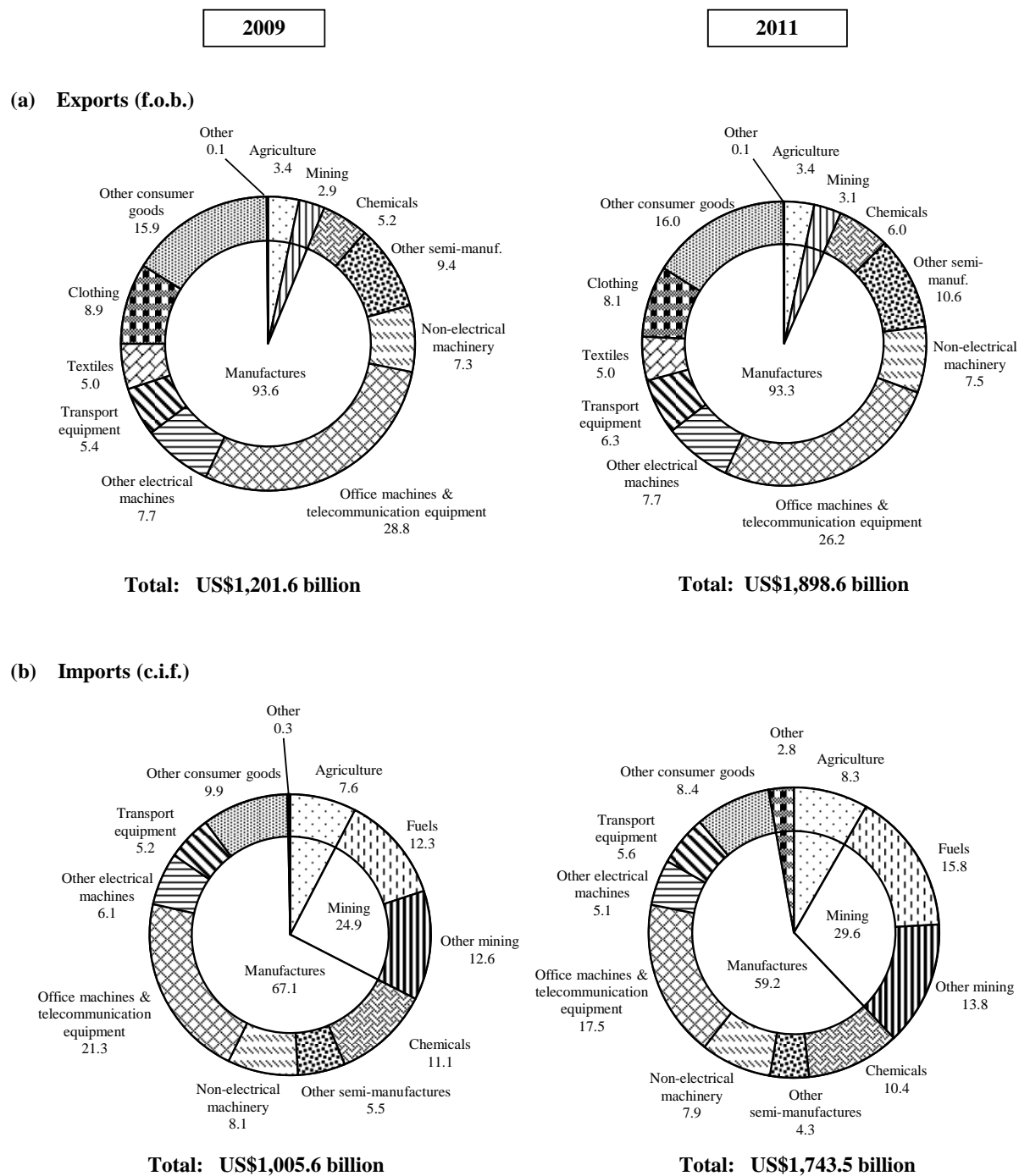
16. In 2011, manufactured products remained the dominant component of China's exports (Table AI.1). Of manufactured products, office machines and telecommunication equipment and textiles and clothing were its main exports (Chart I.2). Exports under "processing trade" (under which enterprises import inputs, assemble them in bonded areas, and export the assembled products) accounted for about 44% of total trade. Processing trade recovered in 2010 after a fall in 2009, reflecting the difficulties of foreign invested enterprises (FIEs) after the outbreak of the global crisis in 2008.

17. In 2011, imports under processing trade accounted for 26.9% of China's total merchandise imports (down from 32.1% in 2009) (Table AI.2). China's main merchandise imports include office machines and telecommunication equipment, fuels, and chemicals (Table AI.3).

¹¹ China was also the world's second largest exporter and third largest importer of goods and services (excluding intra-EU trade) in 2011.

Chart I.2 Product composition of merchandise trade, 2009 and 2011

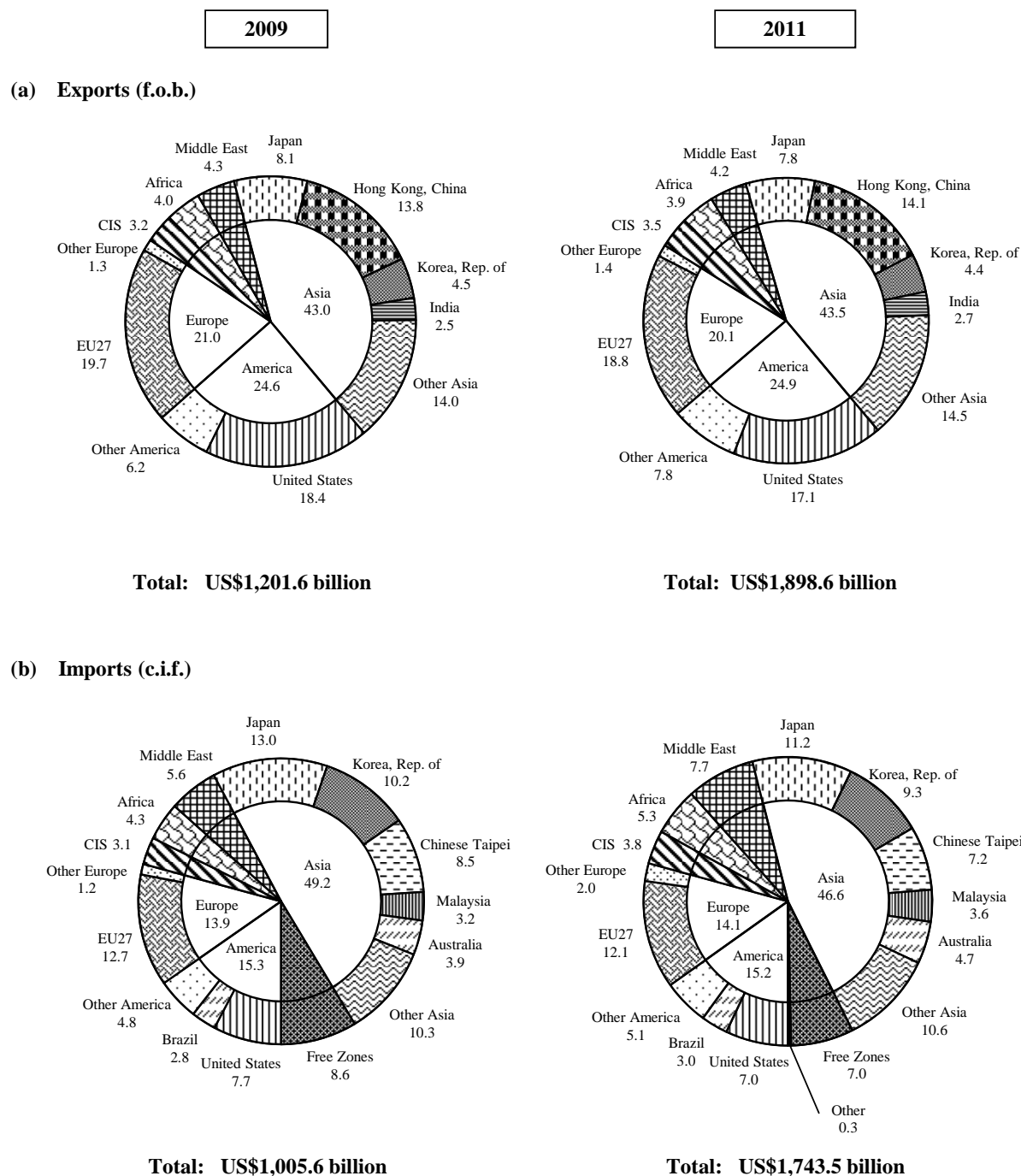
Per cent



Source: UNSD, Comtrade database (SITC Rev.3), and General Administration of Customs (2011), *China's Customs Statistics: Monthly Exports & Imports, 12, Series No. 268.*

Chart I.3
Direction of merchandise trade, 2009 and 2011

Per cent



Source: UNSD, Comtrade database (SITC Rev.3), and General Administration of Customs (2011), *China's Customs Statistics: Monthly Exports & Imports*, 12, Series No. 268.

18. In 2011, the main destinations for China's merchandise exports remained the EU, the United States, Hong Kong SAR, and Japan (unchanged since 2009) (Chart I.3), as well as ASEAN countries (Table AI.4). The main sources of its imports were Japan, the EU, the Republic of Korea, Chinese Taipei, and the United States, as well as ASEAN countries (unchanged since 2009) (Table AI.5).

19. Over the past five years, China's net merchandise trade surplus (exports minus imports) has fallen significantly as a share of GDP; it fell from 9% in 2007 to 3.3% in 2011 (Table I.1).

20. Nevertheless, frictions remain with some of China's main trading partners over the levels of their bilateral trade balances with China. When measured by traditional trade statistics, which attribute the entire commercial value of an exported good to the last country of origin in the global supply chain, China continues to have particularly large bilateral trade deficits with some Asian economies, notably Chinese Taipei, Korea, and Japan, from which it imports components for its export processing activities, and large bilateral trade surpluses with the United States and the EU, to which it exports final products.

21. Those bilateral surpluses are significantly smaller when measured net of the imported components used in China's exports. This gives a better measure of the level of domestic economic activity in China that is actually supported by its much vaunted success as an exporting nation. One study has estimated that, for 2008, the average import content of China's total production was 37% (Table I.3). The implication of this is that, after adjusting to net out this import content, China's bilateral trade surplus with the United States would have been recorded in 2008 at US\$225 billion rather than the US\$285 billion shown in traditional trade statistics, a reduction of 21%. When additional adjustments were made to the data to capture the very high import content of output from China's export processing zones (56%), thereby attributing to China only the domestic value added incorporated in its exports, the bilateral trade surplus recorded with the United States would have been reduced even further, by 40%, to US\$165 billion (Table I.4).

Table I.3
Import content of Chinese exports, 2008
(US\$ billion and %)

	Exports	Imports
Total	1,429	1,133
Processing and assembling	111	90
Processing with imported materials	565	288
Total processing trade	676	378
Total non-processing trade	753	755
Import content of Chinese exports:		
1. From processing zones = 56%		
2. From non-processing zones = 19.7%		
3. Weighted average of processing and non-processing zones = 37%		

Source: Degain, C. and A. Maurer, (2010), *Globalization and trade flows: what you see is not what you get!*, WTO Working Papers, ERSD-2010-12.

22. In other words, in 2008, exports from China to the United States were valued by traditional trade statistics at US\$356 billion. However, only US\$224 billion of that total represented value added generated within the Chinese economy – the remaining US\$132 billion originated in other countries that were supplying imported components to China, which ended up in final goods sold in the U.S. market.

23. In 2011, services comprised 8.8% of China's total exports (merchandise and services) and 12.5% of its imports.¹² China's exports of travel increased by 5.9% and transportation by 4.1% in 2011. Imports of transportation increased by 27.0% and travel by 32.2%.

Table I.4
US-China trade balance, 2008 - adjusted for China's processing trade
(US\$ billion and %)

	Not adjusted	Adjusted ^a
	2008 ^b	2008 ^b
U.S. exports to China (traditional statistics)	71	71
U.S. share of domestic content in exports (%)	84	84
U.S. exports to China (in value-added terms)	60	60
U.S. imports from China (traditional statistics)	356	356
China's share of domestic content in exports (%)	80	63
U.S. imports from China (in value-added terms)	285	224
Trade balance (traditional statistics)	-285	-285
Trade balance (in value-added terms)	-225	-165
Ratio trade balance (value added/traditional) (%)	79	58

a To reflect high import intensity of exports from processing zones.

b Excluding the "construction" sector.

Source: Degain, C. and A. Maurer (2010), *Globalization and trade flows: what you see is not what you get!*, WTO Working Papers, ERS-2010-12.

24. China remains one of the largest recipients of FDI in the world. In 2010, it attracted US\$105.7 billion of FDI, up 11.3% from 2009. In 2009, FDI inflows fell by 12.3%.¹³

25. China has become an important source of FDI. In 2010, it ranked fifth in the world, with outward FDI of US\$68 billion, up 20% from 2009. The Government continues to encourage Chinese companies to invest abroad, in energy, raw materials, agriculture, manufacturing, services, and infrastructure.¹⁴

¹² WTO Secretariat calculation, based on SAFE online information on balance of payments. Viewed at: http://www.safe.gov.cn/model_safe_en/tjsj_en/tjsj_list_en.jsp?ID=3030400000000000&id=4 (in Chinese) [05/12/11].

¹³ UNCTAD (2011).

¹⁴ Xinhua net online information (in Chinese). Viewed at: http://news.xinhuanet.com/politics/2012lh/2012-03/15/c_111660147.htm.