

# PEOPLE'S REPUBLIC OF CHINA

A combination of expansionary fiscal policy and interest rate reductions enabled the People's Republic of China (PRC) to weather the Asian financial crisis, maintain a stable exchange rate, and sustain robust growth. The main challenge over the medium term is effective implementation of recently initiated reforms in state-owned enterprises.

Economic Indicator (percent)	1997	1998	1999	2000	2001
GDP growth	8.8	7.8	7.1	7.5	7.2
Inflation rate	2.8	-0.8	-1.4	1.0	2.0
Current account/GDP	4.1	3.1	1.6	1.5	1.3

**Economic Assessment.** Strong economic growth continued in the first half of 2000 in the PRC when GDP grew by 8.2 percent, driven mainly by domestic consumption. After slowing for six consecutive years, retail sales expanded by 10.1 percent in the first six months of 2000, compared with growth of 6.8 percent for the whole of 1999. Due to the pickup in domestic consumption, the deflationary trend of the previous two years was arrested in the first half of 2000.

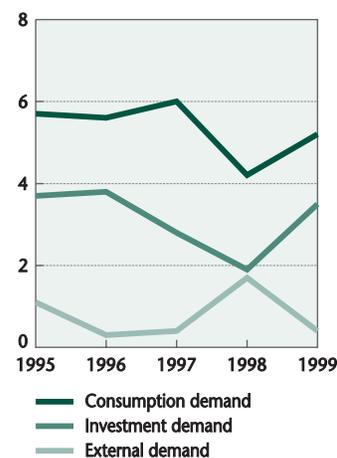
With the recovery in Asian economies, the PRC's external trade has improved substantially. Exports, which rose by 6.2 percent in 1999, surged by 38.3 percent during the first half of 2000. Imports showed equally strong growth of 36.2 percent, but despite this, the PRC will still post a current account surplus in 2000, close to the \$16.0 billion surplus achieved in 1999.

Since 1998, monetary and fiscal policies have supported domestic demand and growth. Monetary policy has been eased by the lowering of interest rates and reserve requirements for banks. This policy stance continued into 2000 with targets for broad money supply growth (14–15 percent) remaining similar to those achieved in 1999. As of end-June 2000, broad money supply increased at an annual rate of 13.7 percent. The 2000 budget continues the expansionary fiscal stance. For 2000, government expenditures (according to the IMF definition) are targeted to increase by 17.8 percent, and revenues by 14.2 percent. The planned fiscal deficit in 2000 is 3.6 percent of GDP as compared with an actual deficit of 4.1 percent in 1999.

**Structural Issues.** Over the medium term, effective implementation of recently initiated reforms in the financial sector and state-owned enterprises (SOEs), and the development of the legal and regulatory framework required for a market economy, will continue to be the principal tasks. The Government will also have to address two other challenges, namely, managing the post-WTO reform program, and reducing interregional socioeconomic disparities.

The PRC is likely to become a member of WTO by the end of 2000. Over the long term, the country's adherence to WTO commitments should lead to significant efficiency gains and higher consumer choice. However, during the initial years, accession to WTO will pose several challenges, which

Decomposition of GDP Growth by Quarter (percent)



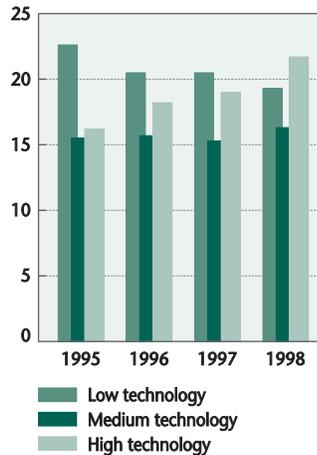
will be particularly important in sectors such as agriculture, manufacturing, banking, insurance, and telecommunications.

WTO obligations will also require the Government to further reform its laws and regulations to (i) honor the immediate obligations of being a WTO member, (ii) accord equal treatment to domestic and foreign enterprises as required by the national treatment clause, and (iii) improve the legal framework, and the supervisory and regulatory systems, to cope with a more competitive environment.

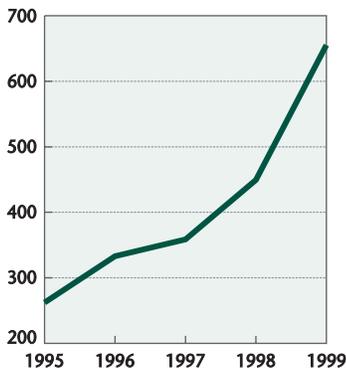
Within the country, not all regions have benefited equally from the rapid economic growth of the last two decades: disparities in regional living standards have widened. Per capita GDP in western PRC remains at about two thirds of the national average and only one third of that in the coastal region. Regional disparities are also reflected in other socioeconomic indicators, including a higher incidence of poverty.

The Government is aware of the need to promote development in the poorer interior provinces. The March 2000 session of the National People's Congress endorsed the "Go west" policy, a proactive strategy to promote growth and development in the western region. The formulation of the Tenth Five-Year Plan is an opportune time to develop an integrated strategy to address the relatively high poverty incidence in the central and western regions.

Technology Exports as Share of Total (percent)



Ratio of Reserves to Short-Term External Debt (percent)



**Forecast.** For the whole of 2000, GDP growth is estimated at 7.5 percent. Strong growth is likely to continue in 2001 with GDP improving by 7.2 percent. Inflation is estimated at about 1 percent in 2000 and 2 percent in 2001. Although the current account surplus is likely to narrow in 2001, it will still be about \$10 billion, or close to 1.3 percent of GDP. With foreign exchange reserves of about \$165–170 billion, an external debt of \$155–160 billion, and a debt-service ratio of close to 10 percent, the external payments situation will remain comfortable in 2000.

A slowdown in global economic growth would have an adverse impact on the PRC's exports, foreign investment inflows, and GDP growth. There are two main domestic risks for the economic outlook. First is a deterioration in the fiscal situation. This is due to the large unfunded pension liabilities and social security obligations of the Government and the resources required for bank recapitalization. The second risk is the failure to contain the social costs of SOE reform at manageable levels. The official estimate of urban unemployment is 3.1 percent. However, it covers only the workers registered with the Ministry of Labor and Social Security. It does not include workers who have lost their jobs but keep a legal link to their enterprises and receive a small fraction of their original salary and benefits. Adjusting for these limitations, the urban unemployment rate could be close to 10 percent. The social security system therefore has to be reformed to prevent many of the workers laid-off from SOEs from falling into poverty. Until this reform is complete, the country's economic system contains an element of vulnerability.