

Section 2 Major countries and regions: current status and issues

3. The Chinese Economy

(A) Overview of the Chinese economy

China has maintained strong growth, supported by factors such as robust domestic demand and government measures implemented as part of both economic stimulus policies and financial relaxation policies strengthened after the world financial crisis. The country registered 8.7% GDP growth in 2009 and 11.9% in the first quarter of 2010. In 2010, it is estimated that China will mark a 10% growth and its GDP is expected to exceed that of Japan.

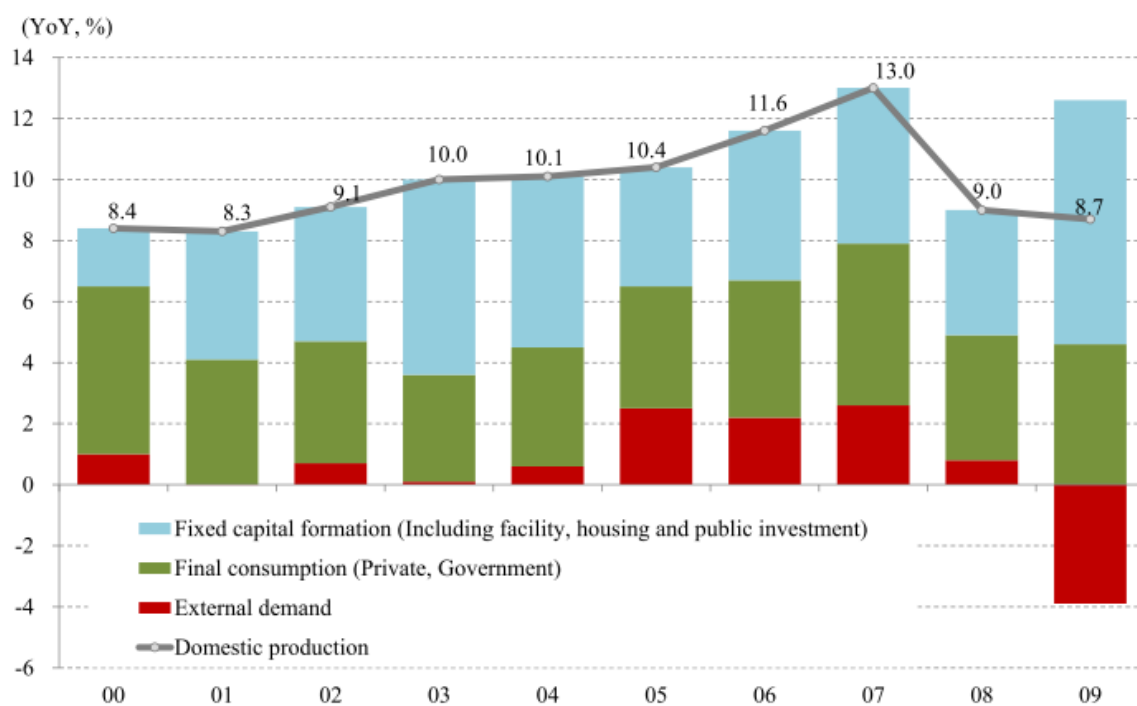
[Expansion of fixed asset investment and robust personal consumption after the crisis]

China's real GDP growth by demand component in 2009 shows an increase of fixed asset investment and vigorous growth in personal consumption (see Figure 1-2-3-1). While exports increased, imports also took a favorable turn (see Figure 1-2-3-2), and exceeded exports in March 2010. It had been 6 years since the last time a trade deficit was recorded in a single month (April 2004 being the last time). However, some people regard the trend of imports exceeding exports as only temporary.

(B) Economic measures

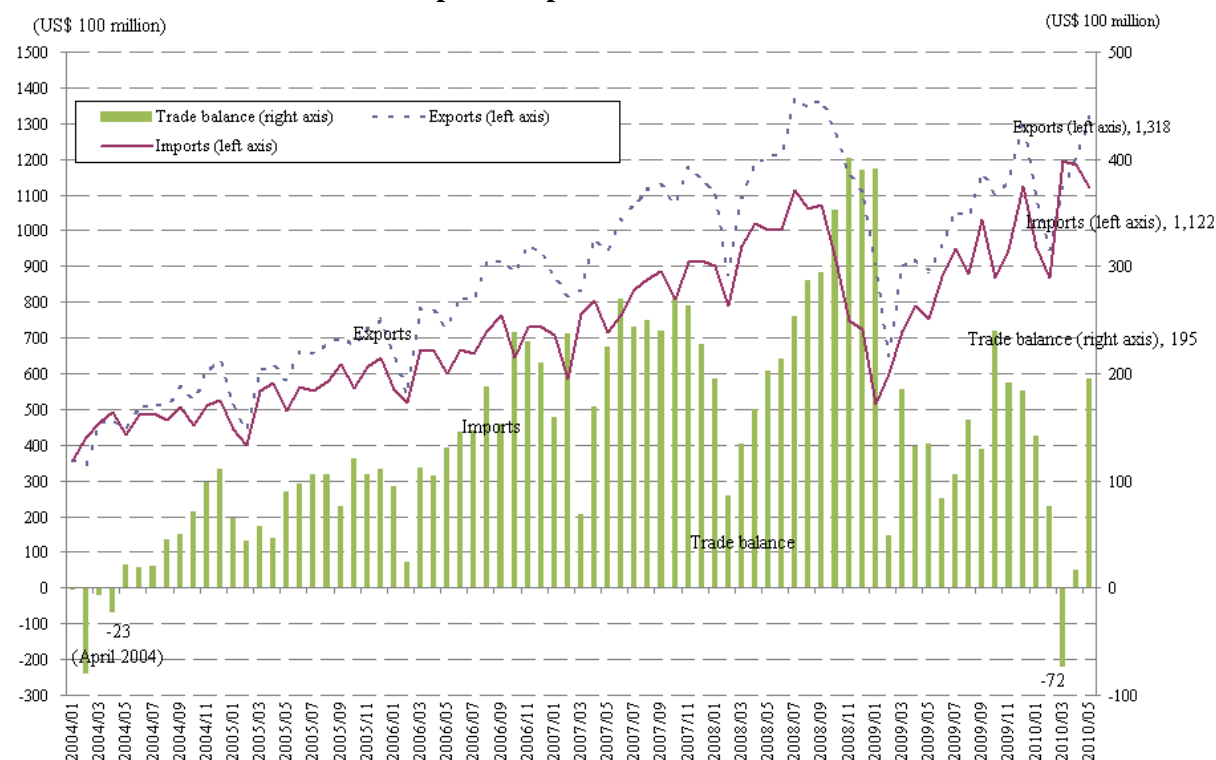
The recovery has largely been due to the effect of economic measures put in place after the world financial crisis. The government started strengthening government measures to maintain its economic growth in August 2008, and implemented a 4 trillion yuan domestic demand stimulus plan, mainly for the facilitation an overhaul of infrastructure such as railroads, roads, airports and the power supply network (see Table 1-2-3-3). In addition to the 4 trillion yuan from the domestic demand stimulus plan, in order to expand personal consumption the government implemented the "Subsidy Program for Electronic Appliances for Homes in Rural Areas " (which subsidizes 13% of the product price when a consumer in a rural area purchases a domestic electronic appliance), the "Old Domestic Electronic Appliance Replacement Subsidy Program" (which offers a subsidy to help replace old electronic appliances with new ones), and the "Rural Auto Subsidy" (which grants a subsidy when a resident in a rural area disposes of an powered tricycle or an old-model truck and purchases an automobile, and awards a subsidy to help replace energy-saving products (see Table 1-2-3-4). Consequently, sales of domestic electronic appliances and automobiles increased (see Figure 1-2-3-5 and Figure 1-2-3-6). The increase in the sale of automobiles above 1600cc, which are not covered by the "Rural Auto Subsidy", also demonstrates an expansion of market consumption.

1-2-3-1 Chinese Real Economic Growth Rate and Contributions of Items of Demand



Source: National Bureau of Statistics of China

1-2-3-2 Trends in Real Chinese Exports/Imports



Source: CEIC Database

1-2-3-3 Chinese Economic Policies

| Item | Remark |
|---|---|
| 1. Housing construction for low income segment | Strengthening of support for housing construction for low income segment, renovation of barrack areas, settlement project for nomad and expansion of experiment for the renovation of dangerous houses in rural areas |
| 2. Facilitation of foundation in agricultural village | Methane gas usage in rural areas, safe drinking water project, facilitation of electric power network in rural areas, crucial water projects including a project to utilize the water originated in Chang Jian in the northern area with water shortage problem |
| 3. Construction of infrastructure including railroads, roads and airports | Focusing on the facilitation of passenger-only airflight services, coal transport routes, and main railroads in Western region. Development of highway network. Arrangement of main and sub-airports in Central and Western region. Remodelling of urban electric power grid |
| 4. Medical and sanitation services, cultural and education projects | Strengthening of local medical and sanitation service systems, remodelling of Junior-high school buildings in rural areas in Central and Western regions, construction of special education centers in Central and Western regions and cultural centers for tow |
| 5. Environment measures | Construction of facilities to process sewage and waste in urban areas, watercontamination measures for focused areas, strengthening of projects for focusedprotection forest and natural forest conservation, support of construction offacilities to conser |
| 6. Technology renovation and structural adjustment | Support the progress of industrialization of high-tech businesses and industrytechnology and development of the service industry |
| 7. Revival of disaster-stricken areas | (None) |
| 8. Increase of income for people in urban and rural areas | In 2009, increase of food minimum purchase prices, increase of the levels for direct subsidy for the agricultural material purchase, subsidy for good breeds and subsidy for agricultural machinery purchase. Increase of subsidy level for people on welfare |
| 9. Reduction of Value-Added tax | Full implementation of reform to change value-added tax types in every industry in all areas in the country. Encouragement of companies' technology renovation through reducing the burden of companies by 120 billion yuan (1 yuan = about 14 yen) |
| 10. Enhancement of bank loans | Abolishment of size restriction to extend loans at commercial banks. Rational expansion of lending target size. Strengthening of the support for focused projects, "three agricultural points (villages, agriculture and farmers)", small-and medium-sized company |
| Investment size: About 4 trillion yuan by the end of 2010 | |

Source: China News Service, November 11, 2008 (Tuesday) Vol. 10826

1-2-3-4 China: Policies to Expand Consumer Demand

| Contents | Period |
|--|--|
| <p>◆ "Home Electronics Appliances subsidy program in Rural Areas" Offering preferential arrangement of 13% of purchased prices for residents in rural areas.</p> <ul style="list-style-type: none"> • From three items (TV, refrigerator and mobile phone) at the beginning of experiment, the item number was increased to 7 adding washing machine, PC, air conditioner and water heater. • Adding microwave oven and electronic stove, subject items were expanded to 9 items resulting in a larger coverage. <p>(From one unit to two units. TV price limit from 2,500 yuan to 3,500 yuan)</p> | <p>From Feb 2009</p> <p>for 5 years</p> <p>Late February</p> |
| <ul style="list-style-type: none"> • Substantial increase of subsidy limit. <p>(TV price limit 3,500 yuan to 7,000 yuan)</p> | Dec 2009 |
| <p>◆ Eco-point ("A subsidy to purchase an energy-saver product to replace an existing item")</p> <ul style="list-style-type: none"> • Provision of subsidies for 10 items including energy-saving air conditioner, refrigerator, slim TV and washing machine at the time of purchase. | <p>May 2009</p> <p>for 3 years</p> |
| <p>◆ "Old Home Electronic Appliances Replacement Subsidy Program" (Note. 2)</p> <ul style="list-style-type: none"> • Maximum 10% of the prices of new home electric appliances for each item will be granted as subsidy at the time of purchase. The items include TV, refrigerator, washing machine, air conditioner and PC. Fixed amount of subsidy is offered for old home ele | <p>June 2009 to 2010</p> <p>Till May 31, 2009 (Period extension)</p> |
| <p>◆ "Rural Auto Subsidy" (Note. 3)</p> <ul style="list-style-type: none"> • Residents in rural areas are to receive 10% of purchase prices of automobiles that are replaced with electronic tricycles and old model trucks. | <p>Mar 2009 to 2013</p> <p>Jan 31, 2013</p> |
| <p>◆ Automobile purchase preferential measure (Nation-wide application) (Note.4)</p> <ul style="list-style-type: none"> • Reduction of vehicle purchase tax for cars that are 1600 cc or less. • One year extension of preferential measure by the end of 2010 as well as the reduction of the tax reduction from 10 % to 7.5%. • Substantial increase of subsidy for replacement from 5,000 yuan to 18,000 yuan. | <p>Jan 2009</p> <p>(by the end of 2010)</p> |
| <p>◆ "Building Material Subsidy Program in Rural Areas"</p> <ul style="list-style-type: none"> • Housing promotion measure for rural areas (Demand for cement, porcelain and glass) | Planned execution in 2010 |

Note: 1. After the experiment in Shangdon, Henan and Sichuan, expanded to nationwide.

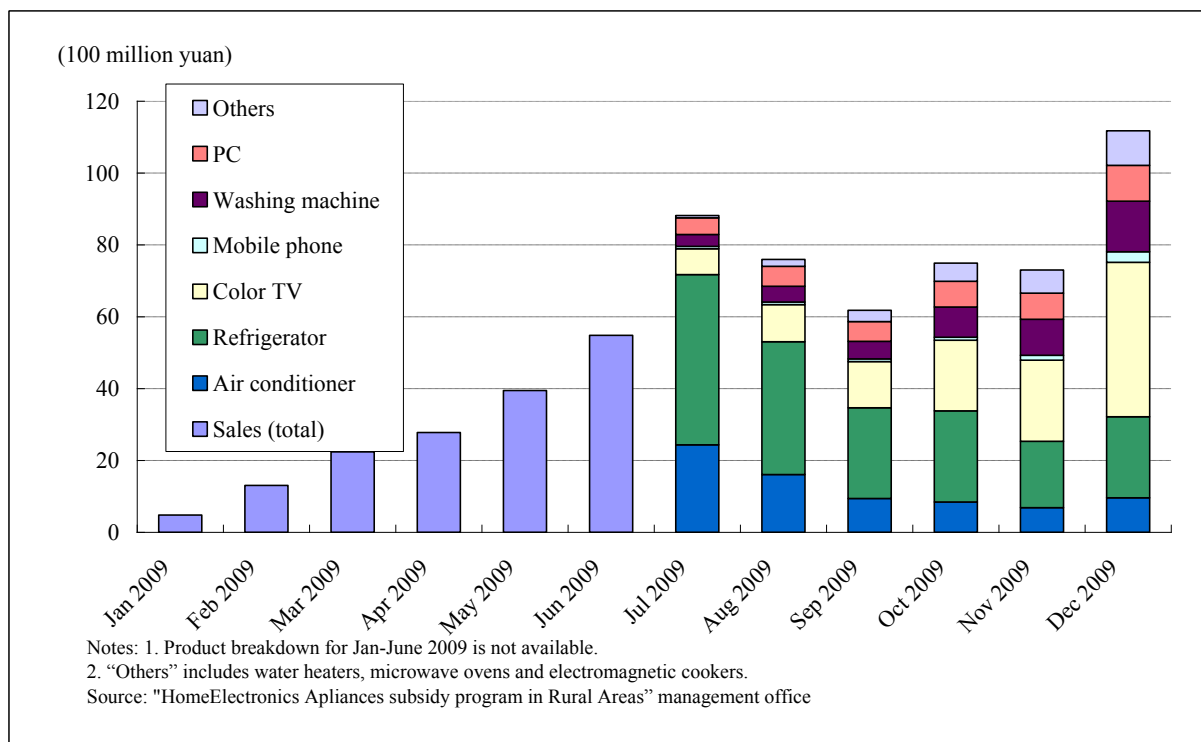
2. Experimented in Beijing, Tianjin, Shanghai, Jiangsu, Zhejiang, Shandong, Kuangtun, Fuzhou and Changsha.
The project was continuously executed after the experiment and expanded to other areas.

3. For unit price over 50,000 yuan, fixed amount of 5,000 yuan is applied.

4. Limitation of subsidy so far: 6,000 yuan

Source: Ministry of Commerce of the People's Republic of China, People's Bank of China, Economic Daily July 21, 2009 and other news articles.

1-2-3-5 China: Monthly Sales for “Home Appliances”



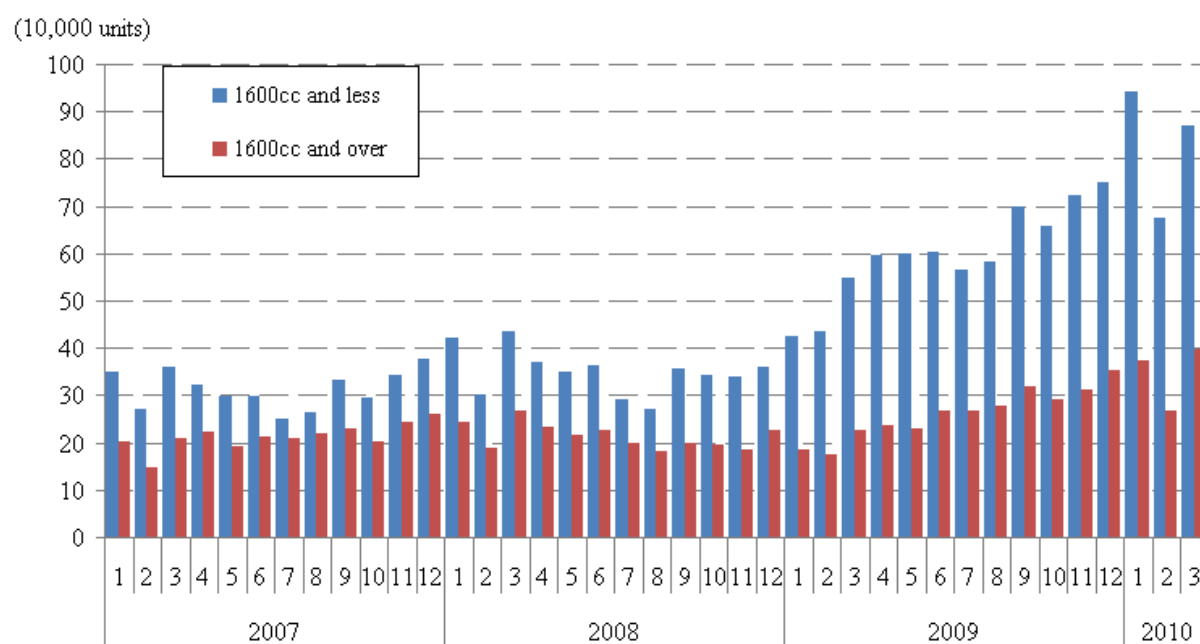
[Burgeoning infrastructure construction and recovery of real estate investment]

Looking at the breakdown of fixed asset investment, which is a driving force behind growth, we see the recovery of real estate investment and the surge in the construction of infrastructure (railroads, roads, ports etc), which was implemented as a part of the economic stimulus plan (see Figure 1-2-3-7). Furthermore, the production of value-added industrial products clearly shows both the recovery in raw materials used in infrastructure construction, and automobiles (transportation machinery) (see Figure 1-2-3-8).

[Decline of trade surplus due to increased imports]

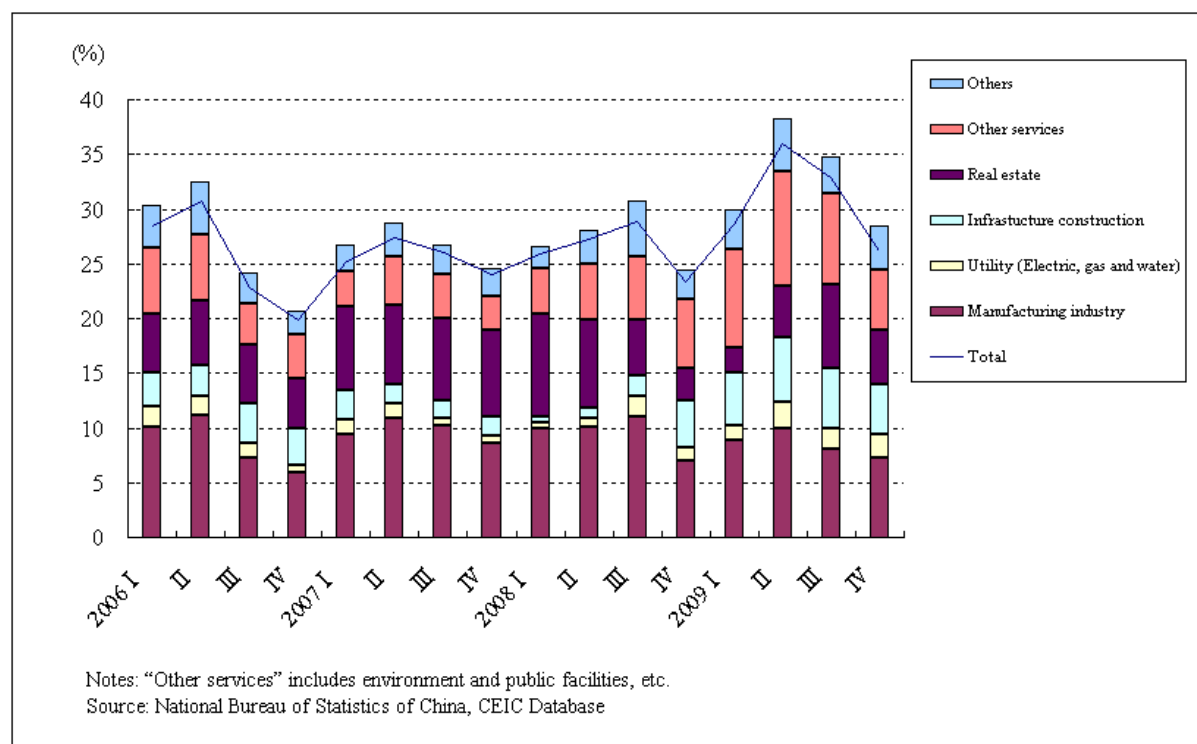
As for trade, both imports and exports are recovering. In 2009, partly due to the increase of imports, the trade surplus declined drastically to \$196 billion, down 34.1% from the previous year (see Figure 1-2-3-2). With regard to export destinations, the share of final products exported to the U.S. and developed countries in Europe is high (see Figure 1-2-3-9), and the proportion of final product exports in general is increasing.

1-2-3-6 China: Trends in Sale of Passenger Vehicles

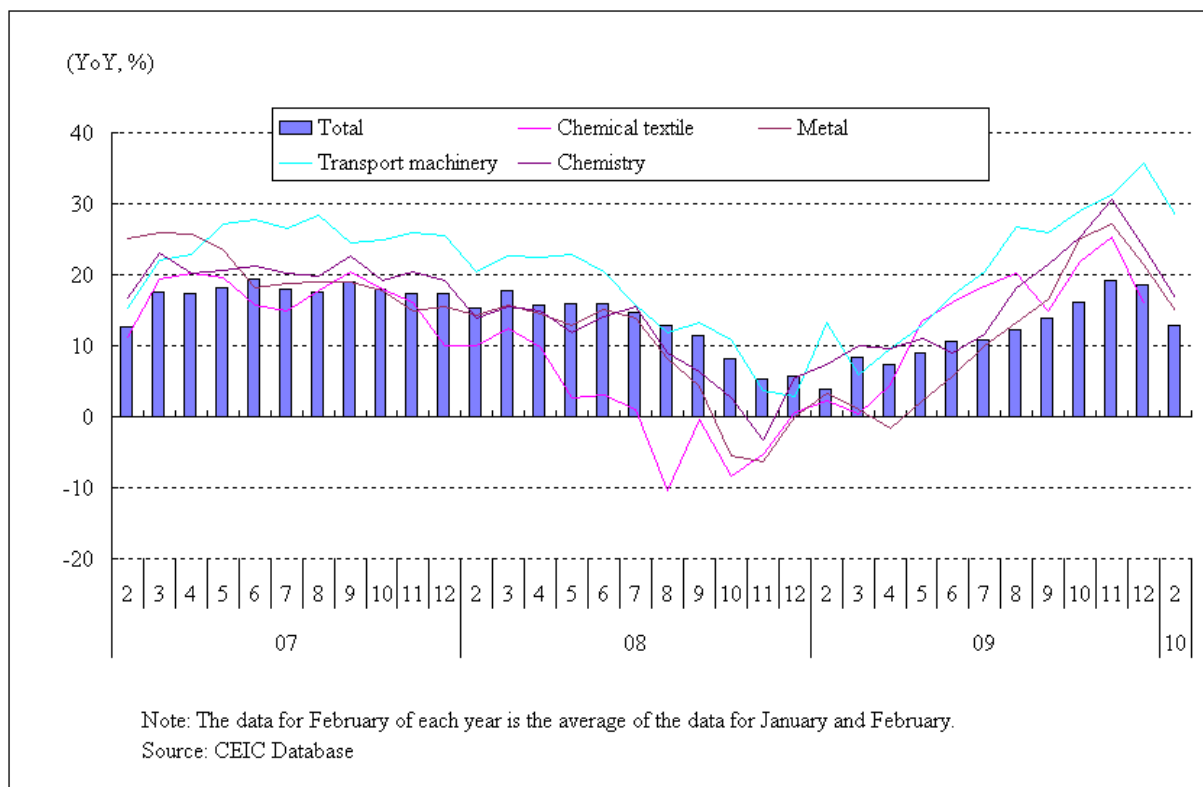


Source: CEIC Database

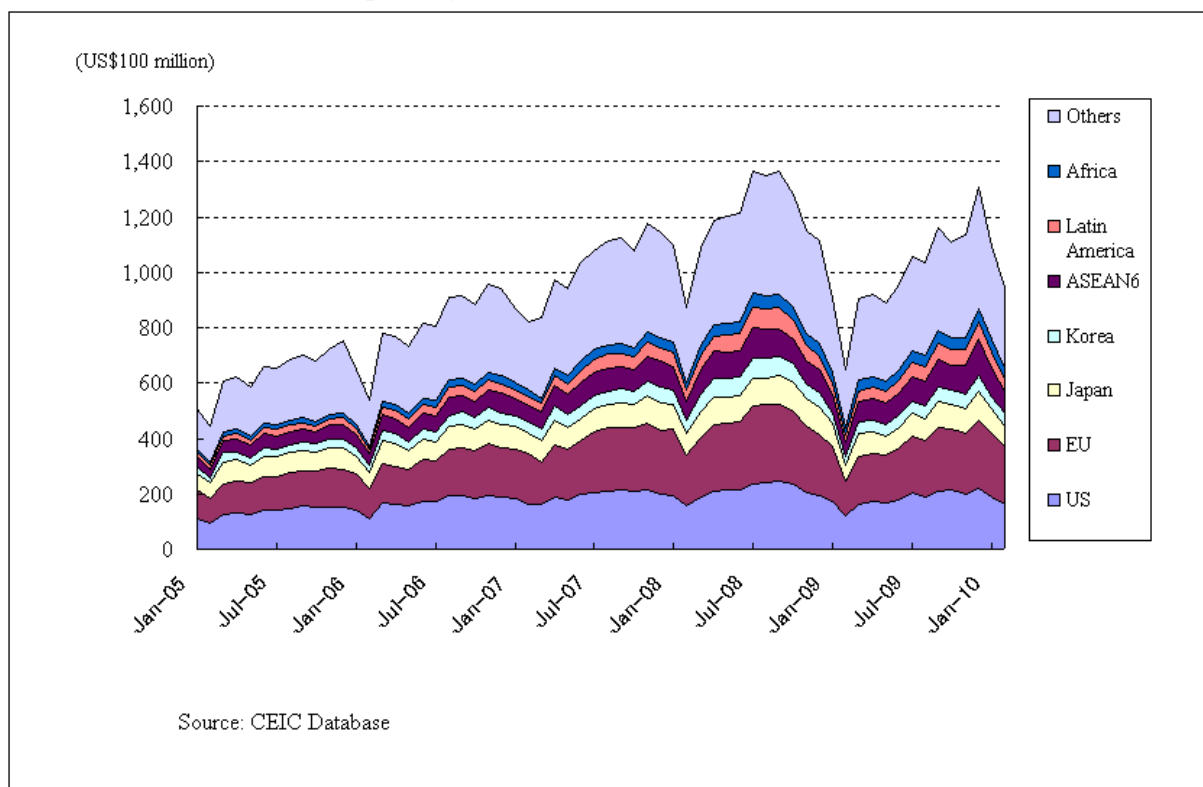
1-2-3-7 Rate of Increase in Fixed Capital Investment in China, and Contributions by Industry to Total Fixed Capital Investment



1-2-3-8 Value of Chinese Industrial Added Value to Production



1-2-3-9 Trends in Chinese Exporting Countries (Actual)

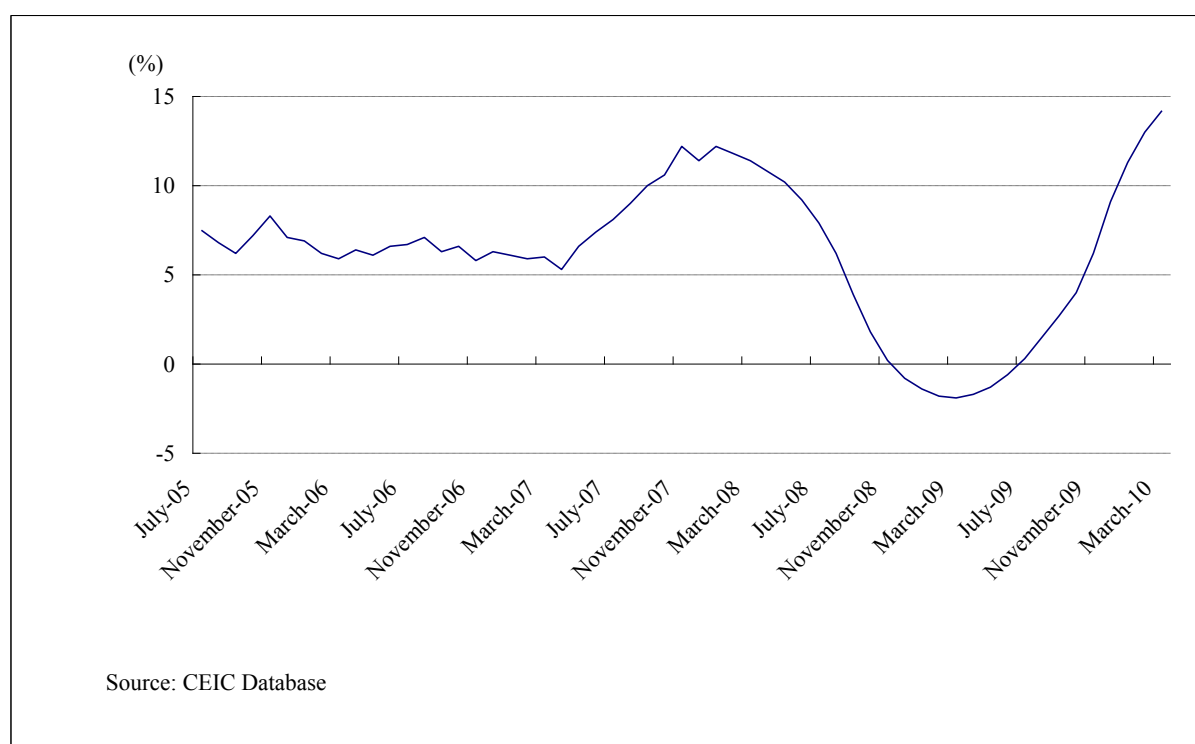


[Stricter control for stock and real estate markets]

The real estate market revived as a result of economic stimulus measures. Some of the real estate

prices which have shown a sharp increase are however regarded as overheating⁶⁵. The growth rate for both housing prices and the total area of houses sold declined in 2008, but bounced back again in 2009 (see Figures 1-2-3-10 and 1-2-3-11). The reasons for this trend are purchasing at bottom value and improved capital liquidity due to a large-scale monetary easing policy and rebounding stock prices (see Figure 1-2-3-12). Under these conditions, the government launched preventive measures to avoid overheating in the stock and real estate markets (see Table 1-2-3-13). In July 2009, the People's Bank of China began making subtle adjustments to fiscal policy, such as strengthening liquidity absorption by issuing Central Bank Bills. In addition, at the end of July 2009 the China Banking Regulatory Commission issued a document that stressed tighter control of debt exposure, warned banks against the of risk debt exposure related to the construction of infrastructure by local governments, and called for stricter credit management⁶⁶.

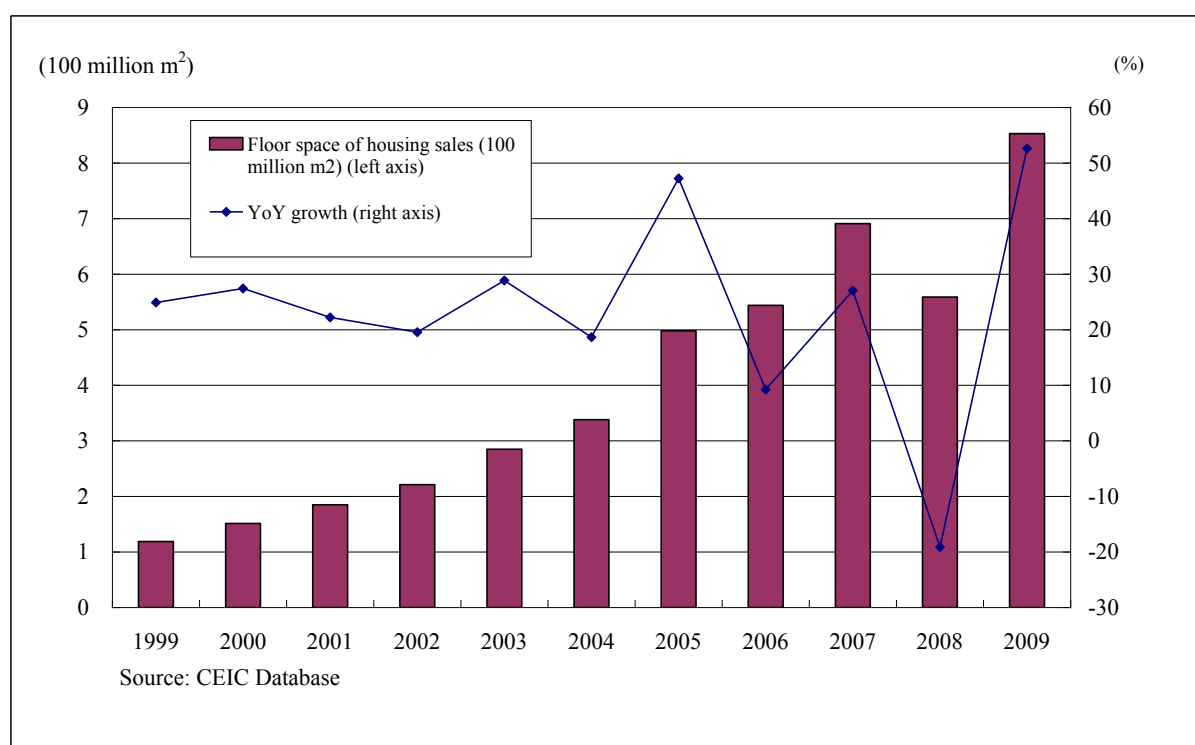
1-2-3-10 Trends in Cost of New Home Construction in China's 70 Major Cities (Compared to Prev. Year)



⁶⁵ IMF has warned that the risk of the real estate market bubble is increasing in Asian emerging countries including Korea, China and India. IMF released its comment as "In countries such as China where its currency is evaluated low, there is a possibility that a real estate market bubble occurs due to the foreign capital's a large amount of investment which expects the appreciation of the currency that expands the liquidity in the market."

⁶⁶ The Economic Observer, July 25, 2009 "警示地方融資風險"

1-2-3-11 Trends and Growth Rate of Floor Space of Homes Sold in China



1-2-3-12 Trends in Major Stock Price Index (Re-Published)

| | Areas | Government agencies | Contents | Period | Effects and comments |
|-----------|----------|---|---|-------------------------------------|-----------------------------|
| Announced | Industry | Ministry of Industry and Information Technology of the People's Republic of China | * Instructed to reduce the steel production | 2009/5/1 | |
| | | The State Council of the People's Republic of China | * To handle excessive production issues and guide the healthy development of industries with excessive investment, strengthen the management of project assessment, production approval, provision of land and bank loans. | 2009/8/26 | |
| | | Subject | * Steel, cement, sheet glass, coal chemistry, polycrystalline silicon, and wind power * Containment of excessive production capacity and investment. Comments on the guidance of industries' healthy development. - Subject industries: 6 industries mentioned above. Aluminium and shipbuilding. | 2009/9/26 | |
| | Finance | Bank of China | - Resumed the issuance of one-year maturity Central Bank Bonds (after 8 months) | 2009/7/9 | Absorption of 200 |
| | | | * Increase of reserve requirements | 2009/1/18 2009/2/23 2010/3/10 | |
| | | China Banking Regulatory Commission | - Warned risks for the loans for local government infrastructure construction | Mid July, 2009 | "Guidance over the counter" |

1-2-3-13 Chinese Government Policies to Prevent Asset Bubbles/Economic Downturn

| | Areas | Government agencies | Contents | Period | Effects and comments |
|--------------------------------------|---------------------|---|--|-------------------------------------|--|
| Announced | Industry | Ministry of Industry and Information Technology of the People's Republic of China | • Instructed to reduce the steel production | 2009/5/1 | |
| | | The State Council of the People's Republic of China | • To handle excessive production issues and guide the healthy development of industries with excessive investment, strengthen the management of project assessment, production approval, provision of land and bank loans. | 2009/8/26 | |
| | | Subject industry | • Steel, cement, sheet glass, coal chemistry, poly crystal line silicon, and wind power generator. | | |
| | | | • Containment of excessive production capacity and investment. Comments on the guidance of industries' healthy development. • Subject industries: 6 industries mentioned above. Aluminium and shipbuilding. | 2009/9/26 | |
| | Finance | Bank of China | • Resumed the issuance of one-year maturity Central Bank "Dqpf u*chgt": 'o qpj u+ | 2009/7/9 | Absorption of 200 billion yuan of funds |
| | | | • Increase of reserve requirements | 2009/1/18 2009/2/25 2010/5/10 | |
| | | China Banking Regulatory Commission | • Warned risks for the loans for local government infrastructure construction | Mid July, 2009 | "Guidance over the counter" Executed on 10/23 Implemented on three months after the announcement |
| | | | • Temporary act to control fixed asset lending | 2009/7/27 | |
| | | | • Guidance of project finance business | Mid July, 2009 | |
| | Real estate | The State Council of the People's Republic of China | Announcement of a policy to contain investment-purpose real estate purchase | 2009/12/14 | |
| | | | Announced measures to contain the real estate prices increase through limiting investment and speculation | 2010/4/17 | |
| Policies to be adopted in the future | Real estate | | Strengthening control over real estate procurement and sales | | |
| | Share price | | Increase of tax on security trading | | |
| | Individual industry | | Curbing loans and investment by industry, Adding and strengthening production decrease guidance | | |
| | Monetary policy | | Implementing additional increase of reserve requirements Increasing lending rates Control of total loan volume | | |

Source: Bank of China, China Banking Regulatory Commission, various news articles, CEIC Database

(C) Seeking a new direction for development

As a result of government measures implemented under fiscal policy and monetary easing, etc., the Chinese economy bottomed out in the period from January to March 2009, and then began to recover. There are however concerns over the sustainability of growth.

A comparison of the ratios of fixed asset formation, household consumption and exports to GDP for China, the U.S. and Japan shows the ratios of fixed asset formation and exports are relatively high, while the ratio of consumption is low (see Figure 1-2-3-14).

Major issues include a decline in consumption growth due to long-term dependence on exports and investment as economic driving forces, and the gap between cities and rural areas. The Chinese government is trying to direct the course of its expansion away from this path. It was pointed out at the National People's Congress, where government policies are put forward, that in order to enable the Chinese economy to achieve sustainable growth, it will be necessary to establish a demand structure

| | | | | |
|--------------------------------------|---------------------|--|---|--|
| | | - Temporary act to control fixed asset lending | 2009/7/27 | Executed on 10/23 |
| | | - Guidance of project finance business | Mid July, 2009 | Implemented on three months after the announcement |
| | Real estate | The State Council of the People's Republic of China | Announcement of a policy to contain investment-purpose real estate purchase Announced measure to contain the real estate prices increase through limiting investment and speculation | 2009/12/14 2010/4/17 |
| Policies to be adopted in the future | Real estate | Strengthening control over real estate procurement and sales | | |
| | Share price | Increase of tax on security trading | | |
| | Individual industry | Curbing loans and investment by industry, Adding and strengthening production decrease guidance | | |
| | Monetary policy | Implementing additional increase of reserve requirements Increasing lending rates Control of total loan volume | | |

Source: Bank of China, China Banking Regulatory Commission, various news articles, CEIC Database

with a well-balanced dependence on investment, consumption and net exports.

China employs a system of five-year economic plans. Year 2010 is the final year of the 11th Five-Year Plan (2006-2010) and as such a time for discussing the direction of the 12th five-year plan. A summary of the 11th Five-Year Plan and an overview of government policy in 2010 are given below.

[Summary of the 11th five-year plan]

The “Outline of the 11th Five-Year Plan: National economy and social development” was adopted at the fourth session of the 10th National People’s Congress held in March 2006.

The outline set out guidance policies for economic and social development in order to: (i) maintain stable and fast economic development (ii) accelerate the transformation of the economic growth system (iii) improve the nation’s capacity for independent creativity and innovation (iv) promote harmonized development between cities and rural areas, and across regions (v) strengthen the establishment of a harmonious society, and (vi) ensure the continued progress of economic reform. In addition, the outline established clear numerical targets for economic and social progress⁶⁷ (see Table 1-2-3-15).

[Fulfilment of the 11th Five-Year Plan and ongoing issues]

While some of the plan’s economic targets and environmental goals have already been achieved, the accomplishment of others seems less feasible. For example, the target reduction in energy consumption during the period of the plan is 20%, but the total reduction achieved in the four years up to 2009 was only 14.38%⁶⁸.

[Direction in 2010 and major issues]

Under these conditions, the third session of the 11th National People’s Congress was held in March 5,

⁶⁷ Osamu Tanaka “CHUUGOKU DAI 11 JI 5KANEN KEIKAKUNO KENKYU – DAI 10 JI 5KANEN KEIKAKUTONO TAIHINIOITE”(Economic and Social Research Institute, Cabinet Office, government of Japan, Discussion Paper Series No.170, October 2006)

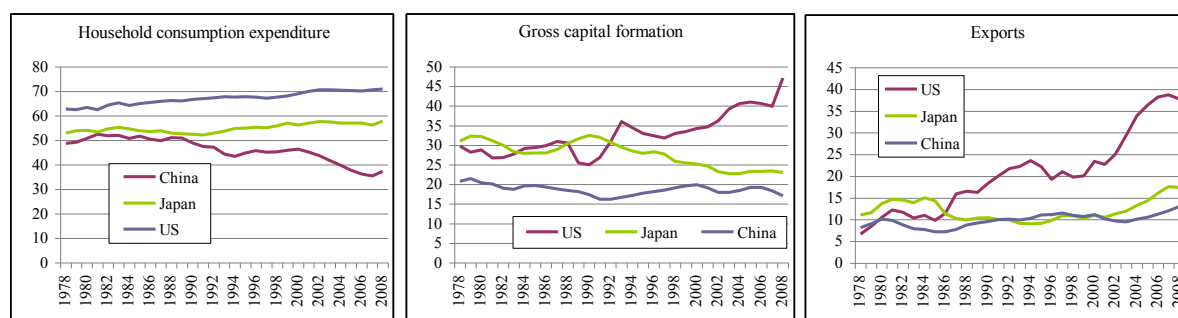
⁶⁸ Osamu Tanaka “2010NEN SEIFUKATSUDOHOUKOKUNO POINTO” (Japan-China Organization for Business, Academia & Government Partnership, March 11, 2010)

2010, at which Chinese Premier Wen Jiabao presented the government work report. At the session, reviewing 2009, he remarked that it had been “the most challenging year so far of the new century for our economic development,” but went on to say, “[China has] handled the shock of the world economic crisis calmly and achieved economic recovery ahead of the rest of the world.” He then clarified basic government policy for 2010.

(A) Basic government policy for 2010 – four foci and major tasks

The government work report presented the following points of focus for basic government policy in 2010: (i) Strengthening the management of the macroeconomy (ii) Transformation of the economic development system and accelerating structural change (iii) Promotion of economic reform and independent innovation, and (iv) Improving people’s quality of life and steady promotion of social harmony. In addition, some major tasks for 2010 were also set out, and these are given below. (See Table 12-3-16.)

1-2-3-14 Fixed Capital Formation, Household Consumption and Exports as Proportion of GDP for China, Japan and the US



Note: China in this chart indicates only mainland China.

Source: *National Accounts Statistics Database* (The United Nations)

The following section provides more detail on “Transformation of the economic development system and modification and optimisation of the economic structure”, regarded as crucial to understanding the direction of China’s future economic development.

(B) Transformation of the economic development system and modification and optimisation of the economic structure

(a) Policies stated in the government work report

The government work report stressed the importance of rapidly promoting the transformation of the economic development system and securing independent economic growth driven by innovation. The report acknowledged that economic growth has thus far been overly dependent on, amongst other things, the expansion of investment, and that the proposed “Transformation of the economic development system” was based on a critical awareness that such a system would deepen the contradiction between resourcing and environmental concerns, and would therefore not be sustainable. In other words, the report preached the necessity of shifting the industrial structure from a model with high-energy consumption, high pollution and massive resource consumption to

a more value-added model.

1-2-3-15 China: Major Elements for Economic and Social Expansion as part of the 11th 5 Year Plan

| Area | Index | 2005 | 2010 | Average annual growth rate (%) |
|-----------------------------------|---|---------|---------|--------------------------------|
| Economic growth | GPD Total (Trillion yuan) | 18.2 | 26.1 | 7.5 |
| | GDP per capita (yuan) | 13,987 | 19,270 | 6.6 |
| Economic structure | The ratio of service industry to value added (%) | 40.3 | 43.3 | [3.0] |
| | The ratio of service industry to total jobs (%) | 31.3 | 35.3 | [4.0] |
| | R&D cost of GDP ratio (%) | 1.3 | 2 | [0.7] |
| | Urbanization ratio (%) | 43 | 47 | [4.0] |
| Population | Total population (10,000 people) | 130,756 | 136,000 | |
| Sources and environment | Decrease of energy unit consumption volume (%) | | | [20.0] |
| | Reduction of water usage per industrial value added unit (%) | | | [30.0] |
| | Effective usage of irrigation for agriculture | 0.45 | 0.5 | [0.05] |
| | Total usage of industrial solid waste (%) | 55.8 | 60 | [4.2] |
| | Owned cultivated land (100 million ha) | 1.22 | 1.2 | -0.3 |
| | Reduction of total emission of major contaminating substances (%) | | | [10.0] |
| | Forest land coverage ratio (%) | 18.2 | 20 | [1.8] |
| Public services and nation's life | Average year of education of people (year) | 8.5 | 9 | [0.5] |
| | Basic pension holder ratio (%) | 1.74 | 2.23 | 5.1 |
| | New Rural Cooperative Medical Scheme (NCMS) coverage ratio (%) | 23.5 | >80 | >[56.5] |
| | Increase of workers in urban areas in 5 years (10,000 people) | | | [4,500] |
| | Agricultural labor transfer in 5 years (10,000 people) | | | [4,500] |
| | Registered unemployment ratio in urban areas | 4.2 | 5 | |
| | Disposal income per residence in cities (yuan) | 10,493 | 13,390 | 5 |
| | Net income per farmer (yuan) | 3,255 | 4,150 | 5 |

Note: 1. The data of GDP and income of city residents are as of 2005.

2. The data in bracket [] shows the cumulative figure of 5 years.

3. Main contaminating substances are sulfur dioxide (SO₂) and Chemical Oxygen Demand (COD).

Source: Tanaka, O (2006), *CHUGOKU DAIJIJI SKANENKEIKAKUNO KENKYUU-DAIIOJISKANENKEIKAKUTONO TAIHINIOITE*, Economic and Social Research Institute, Cabinet Office, Government of Japan, Discussion Paper Series No.170, October 2006

1-2-3-16 Major Missions of China in 2010

- 1) Increase micro-control level and maintain peaceful and rather speedy economic development.
- 2) Accelerate the shift of economic progress method and adjust and optimize economic structure.
- 3) Strengthen the unification program for the development in urban and rural areas for stronger foundation for the development of agricultural sector and rural areas.
- 4) Full implementation of strategies to build a country based on advanced science and education and to strengthen human resources power.
- 5) Promote a large progress in culture.
- 6) Promote the facilitation and improvement of people's life to accelerate the balanced development of society.
- 7) Resolutely execute renovation and further expand open policy.
- 8) Endeavor the establishment of service-oriented government that satisfies people.
- 9) Others (minority races, religion, overseas Chinese policy, national security, Hong Kong, Macao, Taiwan and diplomacy).

Source: Tanaka, O (2010) *2010NEN SEIFUKATSUDONO POINT*, Japan-China Organization for Business, Academia & Government Partnership, March 11, 2010

1-2-3-17 Issues for the Conversion of China's Economy and the Acceleration Building an Economic Infrastructure

- 1) Adjustment of focused industry and arrangement of continuous promotion
- 2) Active development of strategic burgeoning industry
- 3) Further promotion of the development of small-and medium-sized companies
- 4) Strengthening the progress of the service industry
- 5) Facilitation of energy conservation and reduction of contaminating substance emission
- 6) Promotion of cooperative development of local economies

Source: Tanaka, O (2010) 2010NEN SEIFUKATSUDONO POINT, Japan-China Organization for Business, Academia & Government Partnership, March 11, 2010

Furthermore, the government work report listed promotion and change of key industries, strategic fostering of emerging industries, and the development of the service industry as important issues in achieving the transformation of the economic development system and accelerating change of the economic structure. (See Table 1-2-3-17.)

With regard to the promotion and change of key industries, the report listed as targets promoting companies' research and development into new products and energy conservation, breaking up industrial monopolies through the promotion of corporate reorganization and mergers, and the improvement of product quality. With relation to the strategic fostering of emerging industries, the report indicated policies to bolster the development of new energy sources, new materials, energy and environmental conservation, biotechnology, health care, information networks and leading-edge manufacturing. , There was also a policy to support the development the service industry and increase its share of GDP. A breakdown of GDP by industry shows that, although the proportion of secondary industries has fallen, they still accounted for around 50% of GDP in 2008, and that the proportion of the service industry sector should be increased. Another key objective is to promote industrial sophistication through the integration of the service and manufacturing industries, by advancing the service industry specifically for the benefit of the manufacturing industry in the areas of finance, logistics, business services, energy-saving and environmental protection.

(b) Productivity of the Chinese economy

Increased industrial sophistication is also an objective for some developed countries. In China, the background for this is structural factors in its economic society.

As mentioned earlier, fixed asset investment has recently been playing a major role in driving China's economic growth. The breakdown of the GDP growth rate into capital stock, labor input and total-factor productivity (TFP) shows the large contribution capital stock has made over time (see Table 1-2-3-18). On the other hand, TFP shows poor growth if the effects of transfer of labour between industries are ignored, and the improvement in productivity as a result of technological advances is also assumed to be low. In fact, labor population by industry in China shows a shrinking number of laborers in the agricultural sector, as contrasted with rising numbers working

in the manufacturing and service industries. (See Figure 1-2-3-19.)

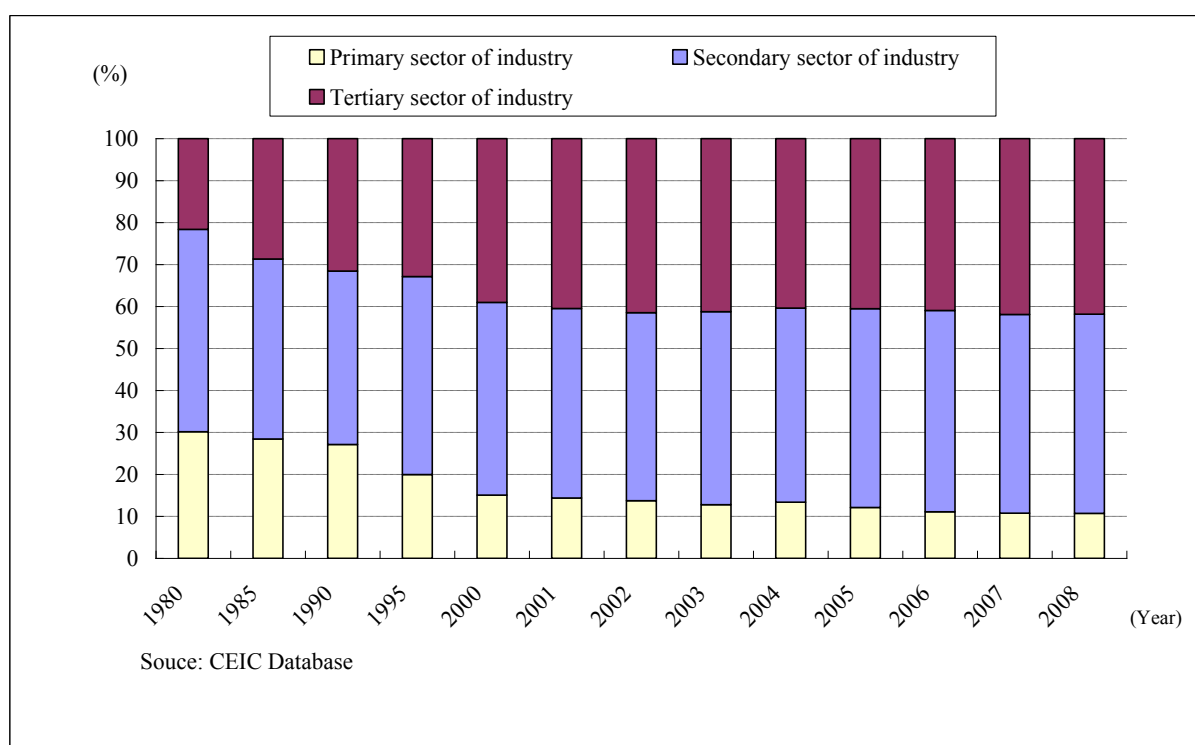
1-2-3-18 Chinese GDP Growth Rate and the Contributions of Capital, Labor and Productivity

(Unit: %)

| | 1988-1993 | 1993-1998 | 1998-2003 | 2003-2008 | 2008 | Changes from the period of 1998-2003 to that of 2003-2008 |
|---|-----------|-----------|-----------|-----------|------|---|
| GDP growth rate | 9.0 | 10.2 | 8.7 | 10.8 | 9.0 | 2.1 |
| Capital stock | 4.4 | 5.4 | 4.7 | 6.0 | 6.0 | 1.3 |
| Labor input | 0.7 | 0.5 | 0.5 | 0.4 | 0.3 | -0.1 |
| Productivity of all elements | 3.6 | 4.0 | 3.2 | 4.1 | 2.6 | 0.9 |
| Including labor transfer among industries | 1.6 | 1.3 | -0.1 | 2.7 | 1.5 | 2.9 |

Source: "Economic Surveys China, Feb 2010" (OECD)

1-2-3-19 China: Population Employed by Industry



1-2-3-20 GDP, Employees and Labor Productivity for Chinese Industries (2008)

| | | Primary sector of industry | Secondary sector of | Tertiary sector of industry | All industry |
|--------------------------|--|-------------------------------|------------------------|--------------------------------|--------------|
| GDP (a) | Value (yuan) | 34,000 | 146,183 | 120,487 | 300,670 |
| | Share (%) | 11.3 | 48.6 | 40.1 | 100.0 |
| | Average annual growth from 1991 - | 4.0 | 12.5 | 10.4 | 10.3 |
| Number of employees (b) | People (10,000) | 30,654 | 21,109 | 25,717 | 77,480 |
| | Share (%) | 39.6 | 27.2 | 33.2 | 100.0 |
| | Average annual growth from 1991 - | -1.3 | 2.4 | 4.3 | 1.0 |
| Labor productivity (a/b) | Productivity (yuan) | 11,092 | 69,252 | 46,851 | 38,806 |
| | Average ratio to industry total (%) | 28.6 | 178.5 | 120.7 | 100.0 |
| | Average annual growth from 1991 - | 5.4 | 9.9 | 5.9 | 9.3 |

Source: Chi Hung KWAN (2009) *SEICHOUNO SEIYAKUTONARU ROUDOURYOKUKYUUKYUU-SEISAKUMOKUHYOUWA KOYOUSOUSHUTSUKARA SEISANSEINO JOUSHOU*, (China in Transition, November 11, 2009

As for labor productivity trends in each industrial sector, looking at the average annual growth rate for amount of value added (GDP) per employee, from 1991 to 2008 the rates were 9.9% for the manufacturing industry, 5.9% for the service industry and 5.4% for the agricultural sector (see Table 1-2-3-20). While the average annual growth rate of the number of employees in the manufacturing industry during the period was low (2.4%), the sudden increase in the amount of value added, supported by the growth of fixed asset investment, is considered a contributing factor for the strong growth seen in labor productivity. In the service industry on the other hand, fixed asset investment did not grow as much as it did in the manufacturing industry; however, there was a strong increase in numbers of employees. As a result, productivity improvement in the service industry remains at a level not so different from that seen in the agricultural sector.

Since the proportion of the working-age population in China is expected to decrease after 2010⁶⁹ (see Chapter 2), the improvement of productivity will become all the more crucial for sustainable growth.

(C) Towards sustainable expansion of domestic demand

With government support, following the world financial crisis, investment leaped in the first half of 2009, but is forecast to slow gradually with the recovery of export and personal consumption. Among the 4 trillion yuan set aside for the economic stimulus plan, the 1.18 trillion yuan allocated to central government spending programs is scheduled to end by the end of 2010. From the point of view of sustainable growth in China, it is important that domestic demand, and in particular personal consumption, continue to expand. The increase in personal consumption despite an environment where motivation to consume is low, has so far largely been due to government measures, and the “Subsidy Program for Electronic Appliances for Homes in Rural Areas” is regarded as having had

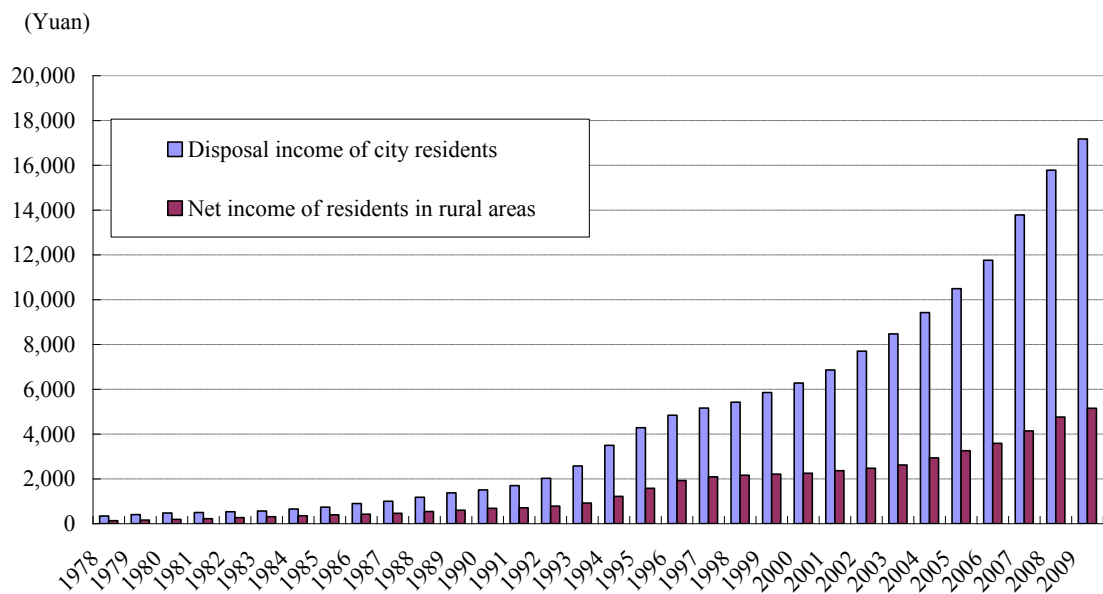
⁶⁹ The United Nations (2008) “World Population Prospects, The 2008 Revision”

only a limited effect⁷⁰.

Increasing income in rural areas and enhancing social security are essential to the conversion to a structure driven by domestic demand. China’s “economic reforms” have focused on economic growth, and are causing distortions in society such as a widening income gap between cities and rural areas (see Figure 1-2-3-21 and Figure 1-2-3-22).

Up to the present, China’s infrastructure and social systems have not kept up with the pace of economic growth, and this has resulted in the eruption of various social contradictions affecting people’s everyday lives, such as a widening economic gap between cities and rural areas, and underdeveloped systems welfare, social security, healthcare, poor housing, environmental problems and issues of law and order.

Since assuming leadership under these conditions, Hu Jintao and Wen Jiabao have adopted policies aimed at balanced economic growth designed to correct the distorted economic structure. Among these policies, two concepts have been given as concrete goals, namely a “Harmonious society” and “Planning progress from the starting point of the pursuit of the fundamental benefit of all people, with a view to sharing the fruits of that progress among the whole nation” (see Table 1-2-3-23).

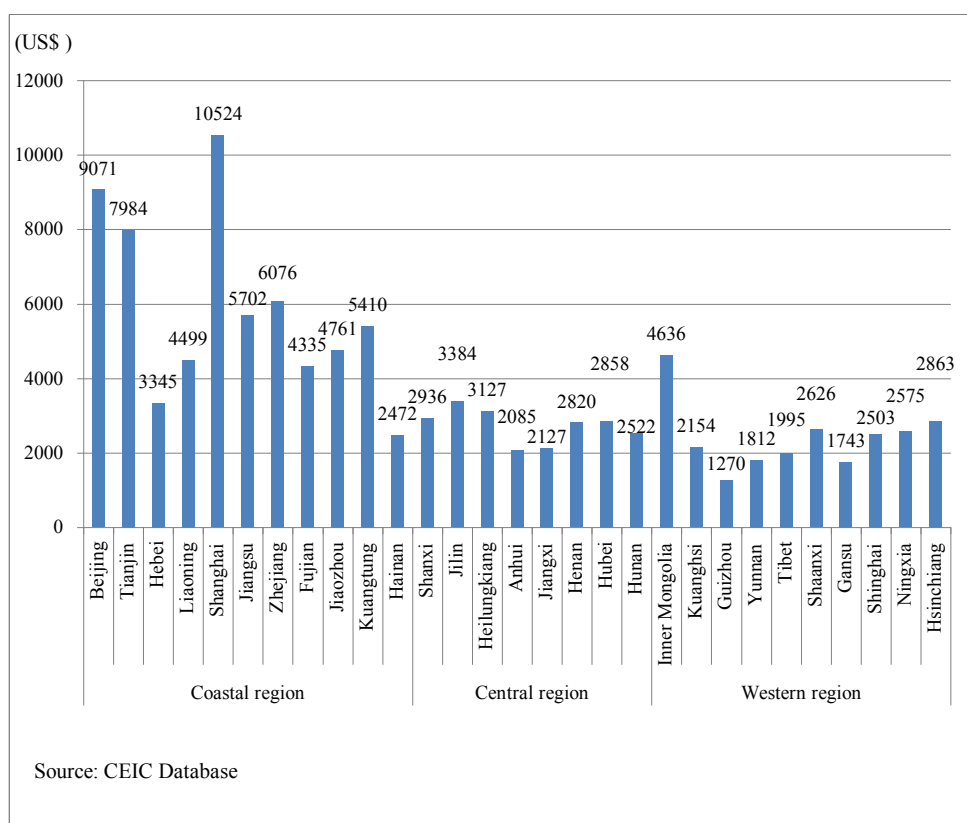


Source: CEIC Database

1-2-3-22 China’s GDP Per Capita by Provinces (Government-ruled municipalities, Autonomous areas)

⁷⁰ Since the consumption ratio of cities and rural areas is 7:3 (from January to June 2009) and the ratio of rural areas is low.

GDP China's nominal GDP per capita by province (direct-controlled municipality, autonomous region)



1-2-3-23 Construction of a “Harmonious Society”

| |
|--|
| 1) Establishment of new socialistic village |
| 2) Execution of total strategy for regional development |
| 3) Active employment policy |
| 4) Provision of priority to the development of education, promotion of fairness in education |
| 5) Strengthening of medical and sanitation services |
| 6) Progress of cultural events and industries |
| 7) Environment protection, promotion of harmony between people and nature |

Source: *Party Decision on Critical Issues on the Establishment of Socialistic Society in Harmony*, People's Daily October 19, 2006

1-2-3-24 Measures in China for Past 10 Years to Reduce Burden on Agriculture

| Start | Item | Contents | Reduction of farmers' burden/government spending |
|-------|--|--|---|
| 2000 | Rural area tax cost reform | • "Four taxes" for agriculture (Note.1) to be abolished over 6 years. | Reduction of burden about 125 billion yuan (Note.2) |
| 2004 | Direct support for farmers | a. Direct subsidy to grow foods b. Subsidy for good breeds c. Subsidy to purchase machinery for agricultural uses d. Direct subsidy for agricultural materials | Total Four subsidy funded by the Central Government in 2009 was about 123 billion yuan. |
| 2006 | Indemnity for compulsory education costs in rural areas | • Exemption of education and miscellaneous fee for compulsory education and provision of free • Subsidy for living cost for boarders from households in financial trouble • Increase of the share of public expenses and the subsidy for the remodelling of school building in rural areas in Central and Western regions. | Compulsory education costs in rural areas in 2009: 66.2 billion yuan |
| 2003 | Expansion of coverage for Rural cooperative medical care system | • Starting with annual 30 yuan per person gradually increasing to 50 yuan, then 100 yuan. • Number of members is 815 million covering most of agricultural population | Subsidy funded by the Central Government in 2009: 25.3 billion yuan |
| 2007 | Social security system to insure the minimum standard of living in rural areas | • Establish widely in the country. Planning to target 44.72 million people in the first half of 2009. Provision of 60 yuan per person a month. | (First half of 2009: 16.1 billion yuan) (Note 3) |

Note: 1. Agricultural tax (Imposed on the area of cultivated land, production volume of grain and plants), special agricultural production tax (Imposed on production other than grain), contract tax and land usage tax

2. Total reduction of burden including prevention of various allocation, money collection and fine: about 160 billion yuan

3. Based on the number of subject people, calculate assuming the provision period to be 6 months.

Source: Hosokawa. M (2009) "KYOURYOKUNA SEISAKUTAIOUNIYORU CHUUGOKUKEIZAINO KAIFUKU", Mizuho Research Institute Ltd. *Mizuho Asia Oceania Insight*, October 2, 2009

To reduce inequality and expand domestic demand, it is crucial that disposable income in rural areas continue to be raised. In recent years, various measures concerning the tax system, education, health and insurance services and assistance for producers have been undertaken in rural areas (see Table 1-2-3-24). At the “Meeting for Nationwide Experimentation in Rural National Pension and Insurance Systems”, held in August 2009, it was decided to begin running experiments in rural social pension insurance systems in 10% of China’s provinces, cities and wards. The improvement of the income environment through an enhanced social security system is expected to expand growth in personal consumption in rural areas.