

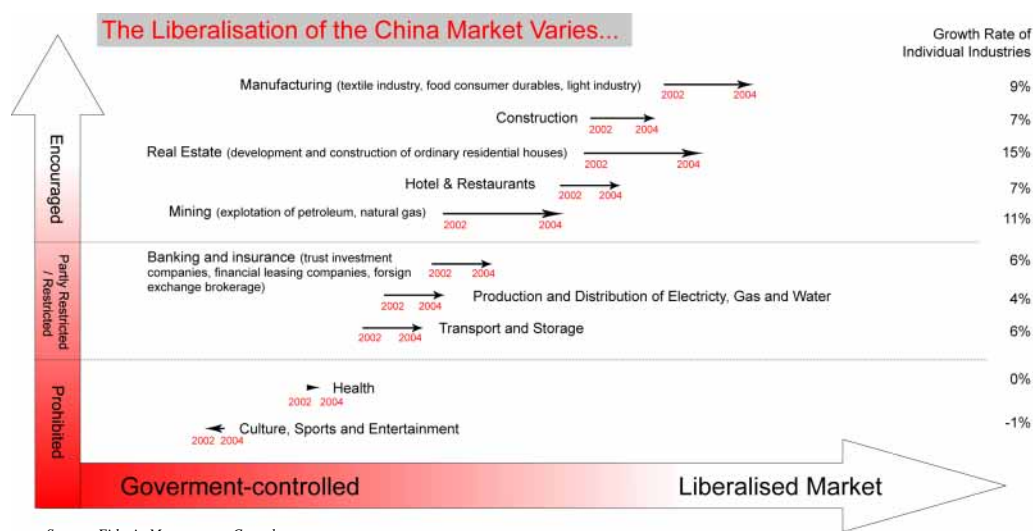
Centrally-planned Liberalisation

After another strong year of growth for the Chinese economy, Florian Ramp assesses the current state of economic liberalisation.

Business in China is booming.” “The burgeoning economy is one of the largest in the world and is seeing non-stop growth year after year.” “China has successfully made the transition from a centrally-planned, state-controlled economy to a market economy in a little more than a decade.” Or has it? Expressions like this abound in the media. But how accurate are they? Just how free are businesses to operate in China? As free as those in developed countries, or

are there still prohibitions? Do the prohibitions apply equally to all?

The current state of liberalisation and trends of China’s economy as a whole can be gauged by looking at individual key industries, using recent figures* as a measuring tool. We can also attempt to illustrate the degree of liberalisation as well as the changes in the last three years.



Explanation of the Chart:

1. The basis for this analysis is the change in number of workers employed in the non-state sector in various key industries in China between 2002-2004.

2. The left side of the chart represents the Chinese government’s official stance towards certain selected Chinese industries, in terms of encouraging or prohibiting foreign investment as laid out in the Ministry of Commerce’s Catalogue for the Guidance of Foreign Investment Industries.

3. Leaving aside the vast majority of Chinese industries, which are

unclassified and, therefore, said to be allowed, the chosen industries that fall into the Encouraged section constitute the largest number; those that are in the Partly Restricted/Restricted section are fewer; and the number of those in the Prohibited category is comparatively small.

4. It is important to note that this categorisation of Chinese industries is not necessarily based on any figures (output, size, production), but simply the intentions of the Chinese government in its overall economic plan and might not necessarily reflect actual industrial growth.

Grade of Liberalisation

The length of the arrows indicates the size of the change in that industry over time, showing the grade of liberalisation. For example, the rise in the number of employees working in the non-state sector of China's health industry was nowhere near as large as that in the non-state sector of the mining industry, thus showing that the mining industry is becoming more and more liberalised. Indeed, the government is clearly planning to strengthen the mining industry by placing it in the Encouraged category.

In addition, the state of the market is not necessarily uniform throughout the whole country. In 1999, China initiated its Western Development Strategy to help its underdeveloped areas – which includes 12 provinces, autonomous regions and Chongqing Municipality – to catch up with eastern China. Known as the Go West Policy, China will continue to invest huge sums into its western region over the next five years to develop it into a magnet for both domestic and overseas investors. As such, certain preferential policies meant to attract foreign and domestic firms alike offer tax breaks for those willing to expand production/management bases to these regions. This means that the figures for these areas must be taken into account when trying to quantify the level of liberalisation of the market since these areas will seem more liberal.

Looking at the chart, it is clear that growth in the Prohibited category has been slow, featuring almost no growth and even some negative growth. There has been moderate growth witnessed in the Restricted category with Production and Distribution of Gas, Electricity and Water up 4 per cent. As a rule, the largest growth has been seen in the Encouraged category, where some industries have experienced a three-year growth of nearly 15 per cent.

Industry Sector Analysis

The manufacturing industry has always been the focal point of the Chinese government and great efforts are still being made to promote manufacturing. Based on this, the figures indicating the portion of those working in non-state-owned enterprises rose from 66 per cent

in 2002 to 75 per cent in 2004, showing that the non-state-controlled sector is getting comparatively larger and the public sector diminishing. This trend is also evident from the number of areas of the manufacturing industry still left in the Prohibited category. Moreover, this finding is corroborated by the figures (from *A Report on the Development of China's Market Economy 2005*, Research Institute of Economics and Resource Management, Beijing Normal University) for foreign direct investment (FDI) in the manufacturing sector over the same time period, which reveal a marked increase of 9 per cent between 2001-2003.

Another current hot topic is real estate, which saw great changes in 2004 influenced by its connection to the construction industry. The construction industry was one of the two main tools used by the Chinese government to try to cool down the economy. This sector has seen the largest upsurge in the number of workers in the selected industries. While further substantiated by its being in the Encouraged category, this industry shows an increase of almost 15 per cent. Foreign direct investment figures back this up, however their increase is rather smaller, at one per cent, explained by the discrepancy between contractual investment and actual utilised investment.

2004 figures for construction clearly show the impact of macroeconomic tightening, including stricter capitalisation requirements, controls on bank credit to the property sector, and the recently removed moratorium on agricultural land development indicating government attempts to slow down growth in the real estate and construction sectors. The dip in the residential property market was engineered by a government worried about the risks of a property bubble.

In the banking sector, we can see that despite this industry being partially government-controlled, it still saw a rise in the proportion of workers in its non-state sector. Correspondingly, investment flowing into the industry was partly restricted. This notwithstanding, foreign direct investment increased by 56 per cent, in part due to next year's anticipated opening up of China's banking industry attracting substantial investment.

Transport and storage saw a small

growth of around 6 per cent from 2002 to 2004 in the quantity of people working in the non-state sector of the economy. As noted from the chart, this industry is in the partly restricted area where FDI is only allowed to a degree. However, the situation has recently changed, with the opening up of the industry last year.

Summary and Outlook

Those industries that once fell into the government-controlled category have progressed into more liberal sections to the point where there are very few industries/parts of industries that are subject to a total prohibition of foreign investment.

Market liberalisation in China is very much industry-dependent. The differences between the degree of liberalisation of various industries hinges on the level of investment encouraged by the Chinese government. But beware of the exceptions between the industries and between the regions, which make the figures hard to decipher.

As has been shown by the chart, the grade of liberalisation is directly linked to the growth of an industry sector. The Chinese government's adherence to the stipulations of China's WTO regulations is not simply superficial or cosmetic. Instead, it helps the Chinese economy to maintain its growth momentum. Furthermore, the Prohibited and Partly Restricted industries represent an untapped growth potential for the years to come. □

* *China Statistical Yearbook 2003; China Statistical Yearbook 2004; China Statistical Yearbook 2005, National Bureau of Statistics of China; A Report on the Development of China's Market Economy 2005, Research Institute of Economics and Resource Management, Beijing Normal University; Catalogue for the Guidance of Foreign Investment Industries, Ministry of Commerce, People's Republic of China.*

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