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Quarterly Update

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The World Bank quarterly update provides an update on recent economic and social developments and policies in China, and present findings from ongoing World Bank work on China. The update is produced by a team from the Beijing Office with support from the China country team. Questions and feedback can be addressed to Li Li (lli2@worldbank.org).

OVERVIEW

Although growth again surprised on the upside, the pattern of growth and the implications for policy have remained largely unchanged. In the first quarter of 2007, growth continued to be industry-led, powered by external trade and investment. With export growth to the EU and the developing world surging, the trade surplus continued to rise, and foreign reserves soared further in the first quarter. Inflation picked up on the back of international food prices, while China's stock markets are booming.

Prospects for growth this year are good, both globally and in China. The international environment remains largely favorable, although there is a risk of a further rise in global food prices. With China's export prospects improved, and a policy stance that is less tight than expected, we have revised up our forecast for GDP growth in 2007 to 10.4 percent and our projection for the current account surplus to almost 11 percent of GDP.

With no obvious need to tighten overall demand, policy would best focus on the financial sector and rebalancing the economy. From the macroeconomic perspective, the real economy does not appear overheated, as overall demand and supply are growing broadly in line with each other. The key macro issue in the real economy remains the widening trade surplus. Macro policies to tighten overall demand are therefore not obvious, although draining excess liquidity from the banking system will remain necessary. Concerns about asset market valuations strengthen the case for tighter monetary policy and higher interest rates, while the authorities need to avoid food price pressures spilling over to more general price increases. The need for tighter monetary policy has strengthened the case for more rapid RMB appreciation, although a lower trade surplus will have to come largely from policies to rebalance the economy.

The rapid rise in the stock market index has drawn the attention of policymakers. While the authorities can be agnostic about the stock market index level, a sharp negative correction would have policy implications. The new-found confidence in the Chinese capital market could be damaged, and although the impact on the real economy and the banking sector is likely to be modest, large losses of financial wealth for specific groups could lead to pressure to bail them out. The authorities have already taken several types of measures to stem price increases by containing inflows into the stock market and stimulating outflows. Possible additional measures could further moderate price rises, while other measures and structural reforms can mitigate volatility in financial markets and make markets (and the economy) more robust to shocks.

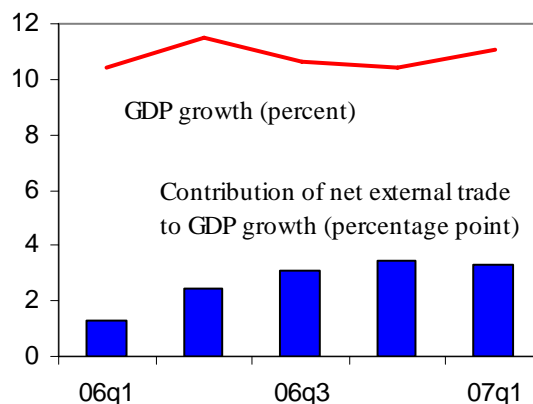
China's key economic challenge is to rebalance the economy. This requires a shift in production from industry towards services, more reliance on domestic demand, and more equally shared and environmentally sustainable growth. The State Council's document on stimulating the service sector sets the stage for future policy action in this area, while many new policy initiatives could potentially support rebalancing, including policies for more equitable growth, administrative policies to reduce energy intensity, and price and tax mechanisms to address environmental and energy issues. China could debate what forms of taxes are best used to improve energy efficiency.

RECENT ECONOMIC DEVELOPMENTS

Growth again surprised on the upside in the first quarter of 2007. GDP growth was 11.1 percent (yoy), up from 10.5 percent in the second half of 2006. Key reasons for strong performance include higher than expected exports and lower imports, and less policy tightening and rebalancing than expected, including via a not fully sterilized injection of liquidity in the banking system.

However, economic developments, the pattern of growth, and policy implications remain largely unchanged. Growth continues to be powered by the traditional engines of external trade and investment. The contribution of net trade to growth was 3.3 percentage point in the first quarter, broadly the same as in the second half of 2006, and higher than expected (Figure 1).¹ Within domestic demand, investment growth continued to outpace consumption (Figure 2). From the production side, growth continued to be industry-led, with heavy industry particularly buoyant, under a policy setting that underprices key inputs (including land, energy, resources, and the environment). Value added in industry increased 13.2 percent in real terms in the first quarter, compared to 9.9 percent in services and 4.4 percent in agriculture (Figure 3). Within industry, heavy industry continued to outpace other industries. Prime Minister Wen Jiabao noted that the six industrial sectors that consume 70 percent of total industrial energy use, and emit a similar share of total SO₂ emission, expanded by 20.6 percent in the first quarter.²

Figure 1. Strong growth, with a large contribution of external trade



Source: National Bureau of Statistics.

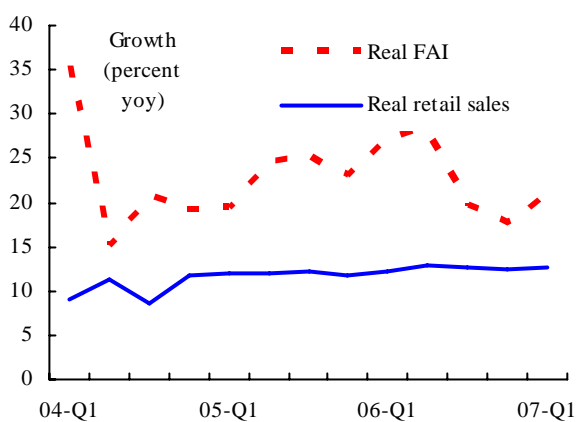
With little tightening and no change in the general policy setting, investment remained attractive and buoyant. While there were some policy tightening measures in the second half of 2006, these were largely administrative in nature. The underlying incentives for investment, including a strong economy, respectable underlying profitability and strong cash flows, but also the pricing issues mentioned above and loose monetary conditions and low interest rates, have remained intact. Thus, with average profit margins

¹ These calculations assume unchanged terms of trade and, in the absence of quarterly data on expenditure side GDP, use the production side GDP numbers. Decomposing nominal activity into volume and price components using the custom authorities' trade deflator data would show similar results for the first quarter of this year but would give a larger increase in the contribution of net trade to growth in the second half of 2006, because of a large loss in the terms of trade (which implies a higher contribution in volume terms to the growth in current prices).

² Xinhua, May 8, 2007. Separately, NBS data shows that among industrial enterprises "above designated size", output of heavy industry grew 19.6 percent in the first quarter (yoy), compared to 15.6 percent for light industry, with production of metals particularly strong.

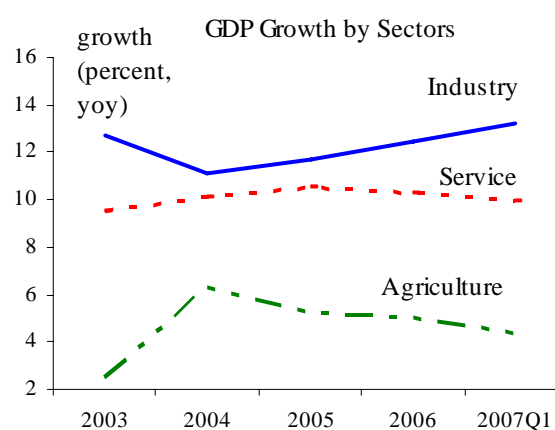
in industry back to peak levels seen in 2004 and industrial profits rising by a remarkable 44 percent (yoy) in the first quarter, real FAI growth picked up to 21 percent (yoy) in the first quarter, compared to 18.6 percent in the second half of 2006 (Figure 2), and urban FAI growth remained picked up further in April. Investment in industry continued to outstrip that in other sectors.³ Sectors with particularly strong profit growth were steel, electric power, chemical industry, transport equipment, and petroleum processing and coking.

Figure 2. Investment outpaces consumption



Source: NBS, staff estimates.

Figure 3. Industry outpaces services



Source: NBS, staff calculation.

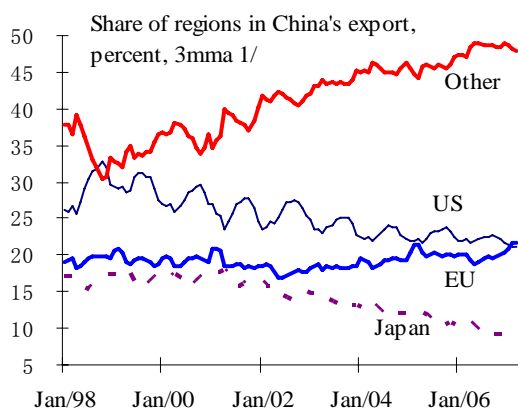
Consumption remains solid, but is lagging behind. Real retail sales growth has remained broadly constant since 2005, with higher nominal accompanying higher inflation (Figure 2). Nominal rural incomes rose swiftly in the first quarter of 2007, boosted by high grain prices. But costs for farmers are also rising rapidly, including from soaring fertilizer prices, moderating the real income gains.

With exports still finding new markets, the trade surplus continues to rise. Merchandise exports rose by 30 percent (yoy), in dollar terms, in the first four months, much faster than the import growth of 19 percent. As a result, the trade balance almost doubled from a year ago to over \$63 billion. As China's exporters are penetrating new markets across the world, the importance of different export markets is changing (Figures 4 and 5). In the first quarter a slowdown of growth of exports to the US and Japan was offset by a pick up in export growth to the EU—which is as large, as an export market, now as the US—to 37 percent yoy, while export growth to the rest of the world also remained strong at over 30 percent. Some temporary factors may have boosted exports in the first quarter, including firms advancing exports before expected changes in VAT rebate policies on energy and resource intensive products. However, trade developments show continued trend towards larger external surpluses driven by China's capacity to leverage its

³ Nominal urban investment in industry was up 27 percent (yoy) in the first quarter, compared to 24 percent in the tertiary sector.

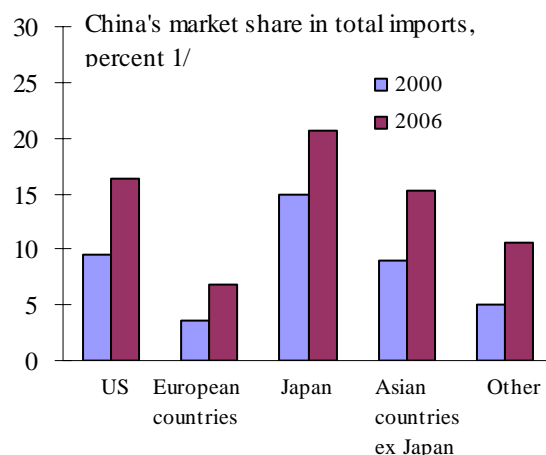
relatively low unit labor costs onto a growing number of sectors and production stages, as well as into a growing number of countries.⁴

Figure 4. New markets are getting more important



Source: NBS, staff estimates.

Figure 5. China's existing market share differs across regions



Source: IMF Direction of Trade, staff calculation.
1/ For groupings of countries, this measures the weighted average share of China in countries' total imports, as opposed to China's share in the imports of the consolidated region.

The debate on which segment of the economy is responsible for the surging trade surplus does not change the policy implications. Many argue that, because the largely foreign owned processing sector is responsible for much of the trade surplus, the rising surplus should be interpreted differently, among others because it would mean that much of the surplus is accruing to profits of foreign companies. However, China's balance of payment statistics suggest that these profits appear to be modest, compared to the size of the trade surplus. Total gross income outflows—which should largely consist of repatriated earnings on inward FDI—increased from US\$23 billion to US\$39 billion between 2002 and 2006, compared to an increase in the trade surplus from US\$44 billion to US\$218 billion. Indeed, the current account surplus, which includes repatriated earnings on the outflow side, increased from 2.4 percent of GDP in 2002 to 9.5 percent of GDP in 2006, and the current account surplus has become a key driver of the foreign exchange reserve accumulation that has become a policy issue. This means that the economic impact of the trade surplus does not seem to depend much on the source.

Foreign exchange reserves surged, complicating monetary policy. In addition to a steady stream of foreign exchange from the trade surplus and inward FDI, net non-FDI capital flows soared in the first quarter of 2007, although a significant amount seems to

⁴ Most studies find that the wage gap between China and OECD countries is only partially offset by lower labor productivity. Ceglowski and Golub ("Just how low are China's labour costs?", *The World Economy*, 2007) estimate that in 2002 China's relative unit labor costs in manufacturing were between 27-42 percent of those in the US.

have come from one-off transactions including the unwinding of SWAP positions between commercial banks and the PBC and repatriation of IPO proceeds. In all, foreign reserves increased by a record US\$136 billion in the first quarter.

Monetary expansion remained rapid while the pace of RMB appreciation vis-à-vis the dollar slowed. The record pace of foreign exchange accumulation, combined with a large drawdown of government deposits at the central bank at the turn of the year, injected a lot of liquidity. The PBC did not sterilize all of this. As a result, base money growth rose to 20 percent (yoy) early in the year and the one month interbank rate declined to 2.5 percent in the first quarter. As the PBC stepped up sterilization, in March base money growth came down to 17 percent while the one month interbank rate picked up in April to 3 percent. In these conditions, banks are keen to lend. Credit growth increased to 16 percent (yoy) in April, up from 14.4 percent at the end of 2006, while M2 growth has remained broadly unchanged at around 17 percent since the fall of 2006. So far in 2007, the RMB has been strengthening against the dollar at an annualized pace of around 2 percent, far lower than market expectations and the implied offshore non-deliverable forward market, which prices in around 6 percent appreciation for the year as a whole. Against the euro, the RMB depreciated by 2 percent since the end of 2006.

Inflation picked up, because of international food price increases. CPI inflation was 3.0 percent in April (yoy), boosted by a 7.1 rise in food prices as international grain prices surged.⁵ Excluding food, inflation remains low at around 1 percent. PPI inflation, which is influenced less by grain but more by other raw materials, was 2.9 percent in March.

Stock markets are booming, posing challenges to policymakers. After several years of lackluster performance, stock prices started to recover in 2006 after reforms reducing the overhang on non-tradable shares. With households' enthusiasm for equity investment soaring, and large amounts of new money flowing into the market, the A share index has so far risen 50 percent in 2007, after a 130 percent rise in 2006. This rise was interrupted only briefly by a sharp sell off in late February which, together with negative news on the US economy, appeared to have triggered a worldwide sell off. Although there appears to be some loan financing of share transactions taking place, the bulk of funds entering the market are being channeled out of bank deposits.

ECONOMIC PROSPECTS AND POLICIES

Economic prospects for 2007

Overall, global prospects remain good, but risks remain. Among developed countries, most growth forecasts for 2007 US GDP growth have been revised downwards. However, those for Japan have remained broadly unchanged while projections for Europe have been revised upwards. Projected growth for developing countries, which are increasingly

⁵ Food has a 1/3rd weight in the consumption basket, with grain 1/3rd of that.

important for China as export markets, also remains healthy. With risk aversion historically low on most measures, financial markets are jittery at times, but global monetary conditions remain broadly favorable. Global imbalances have remained and remain a key risk for the world economy. Other risks include a sharper than expected slowdown in the US; renewed turmoil on financial markets; and renewed rises in commodity prices after recent pick ups, including oil, minerals, and grain prices (Box 1).

This climate supports further robust Chinese export growth, despite signs of cost pressure in some industries.

In general, exporters have so far been able to absorb the currency appreciation, rising wages, and higher raw material prices without reducing profit margins, because of rapid productivity growth and some export price increases.⁶ Cost pressures are also likely to arise from adjustment in land fees and taxes, VAT export rebates, and export taxes on energy intensive products. More rebalancing measures are likely to come, as well as further currency appreciation, but implementation is likely to be gradually, so that most of the cost pressures can be absorbed by productivity growth and upgrading of the production structure.

In China, domestic demand prospects remain robust, while the current account surplus is set to enter new territory. The 2006 administrative measures to contain investment have reduced the number of and spending on newly launched projects, at least temporarily. However, previously approved projects will continue to support investment this year, as will strong profits and good profitability. Consumption growth is likely to be more moderate, particularly in rural areas.⁷ On the back of the strong first quarter data, we revise up our GDP forecast for 2007 to 10.4 percent (Table 2). With much of the upward revision coming from net trade, and the 2006 current account higher than expected, we also revise up our projection for the current account surplus, to a massive almost 11 percent of GDP.⁸ The apparent further reduction of overcapacity could eventually moderate export growth (see footnote 9). Domestic price pressures remain largely absent, but further surges in international grain prices could push up inflation further (Box 1).

Table 1. Global conditions remain favorable.

(percent change, unless otherwise indicated)

	2005	2006	2007
World GDP 1/	3.5	4	3.3
World trade (volume)	7.6	10.2	7.5
Oil price (\$/bbl)	54	64	60
Non-oil commodity prices	13.4	24.7	6.0

Source: World Bank DEC Prospects Group (May 2007).

1/ Market exchange rates.

⁶ Margins in light manufacturing eased at the turn of the year, but it may be too early to read much into that.

⁷ The CASS and the NBS jointly project a rise in per capita real rural income of 6 percent this year, far lower than urban income growth (in the Green book of China's Rural Economy).

⁸ This assumes merchandise export growth of 23 percent from May onwards, in dollar terms, resulting in 24 percent average growth for 2007, and import growth of 21 percent from May onwards, resulting in 20 percent for 2007. These projections for export and import growth in 2007 are very similar to the recent projections of the Chinese Academy of Sciences (CAS) (reported by Xinhua in May). CAS expects exports of technology products to increase 29 percent, faster than other categories, while expecting exports of clothing, textiles and shoes to slow to gains between 13 percent and 16 percent.

Table 2. China: Main Economic Indicators

	2003	2004	2005	2006	2007 1/
The real economy (change in percent)					
Real GDP (production side)	10.0	10.1	10.4	10.7	10.4
Real GDP (expenditure side) 2/	10.5	9.9	13	13.6	...
Consumption 2/	6.6	7.1	9.4	10.3	...
Gross capital formation 2/	17.2	13.4	11.6	13.2	...
Fixed capital formation	17.0	11.7	13.6	13.3	...
Exports (goods and services) 3/	26.8	28.4	23.6	23.6	20.6
Imports (goods and services) 3/	24.9	22.7	13.4	18.6	17.0
Consumer prices (period average)	1.2	3.9	1.8	1.5	3.2
GDP deflator	2.6	6.9	3.8	3.0	3.8
Fiscal accounts (percent of GDP) 4/					
Fiscal balance	-2.2	-1.3	-1.2	-0.5	-0.9
Total revenue	16.2	16.6	17.8	18.9	18.8
Total expenditure	18.3	18.0	19.0	19.4	19.7
External account (US\$ billions)					
Current account balance	46	69	161	250	340
As share of GDP (%)	2.8	3.6	7.1	9.5	10.8
Capital account balance	71	138	47	-3	-20
(including errors & omissions)					
of which: FDI (net)	47	53	68	60	50
Change in reserves (increase =+)	117	206	207	247	320
Foreign exchange reserves	403	610	819	1066	1389
Other					
Broad money growth (M2), e-o-p, in percent	19.6	14.6	17.6	16.9	17.0

Sources: NBS, PBC, Ministry of Finance, and staff estimates.

1/ Projection.

2/ Estimations are based on the newly released national account data (Table 3-13 in China Statistical Yearbook 2006).

3/ Estimates based on trade deflators for goods published by the Custom Administration.

4/ GFS basis; central and local governments, including all official external borrowing. The data are not adjusted for accumulation of arrears in tax rebates to exporters during 2000-2002, and the repayment of these arrears in 2004 and 2005. Such an adjustment would increase the deficit in 2000-02 and lower it in 2004-05.

Economic and Financial Policies

While the pace of growth surprised in the first quarter, policy issues have largely remained the same. The key economic policy issues have remained the same, with the exception of the risks and policy challenges of possible large increases in international grain prices and increased risks stemming from the stock market boom. Rebalancing the economy remains a key challenge, requiring structural reform.

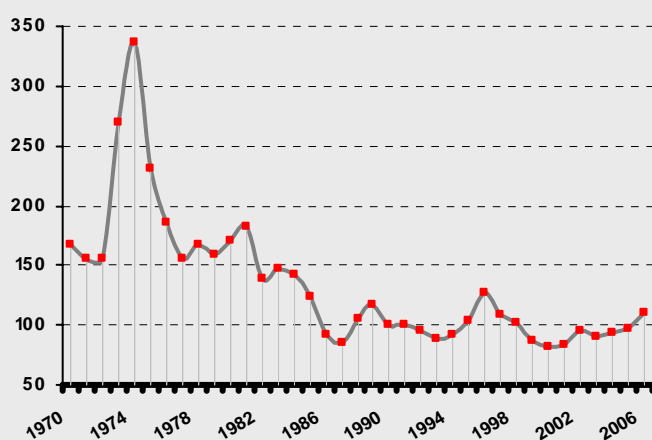
From the macroeconomic perspective, the real economy does not appear overheated. With the fundamental drivers for investment still in place (profits, liquidity, pricing of inputs), the risks remain of too rapid investment growth, concerns about the quality of investment, and possible problems this may cause for the banking system.

Box 1. How much could grain prices rise? */

International grain prices have increased sharply recently. Continuing an upturn, grain prices rose around 20 percent in the year to April 2007, with maize price rises particularly high. Grains account for a large share of food intake, directly and indirectly, including via feed for livestock and poultry. In China, the share of grains in the CPI—measuring only the direct consumption—is around 10 percent. Real grain prices have tended to decline over the long run, but occasionally they increase sharply when stocks fall to low levels, production is reduced by drought, or when policies in key producing or consuming countries change dramatically (Box figure 1).

The last time a substantial grain price spike occurred was in 1994-96. At that time, maize and wheat prices doubled and rice prices increased by half due to low stocks, high fertilizer prices, and rapid economic growth which raised demand. We are now at a similar point, except that stocks are even lower, fertilizer prices are higher and economic growth stronger. We have also had two major policy changes which contribute to lower stocks (in China) and higher consumption (in the U.S. for biofuels). Moreover, energy prices are near record highs, and that increases the cost of producing grains and reduces supply. Maize prices are up 75 percent since the summer of 2006, and the upcoming northern hemisphere crop will be critical to grain prices and food supplies.

Box figure 1. Real grain prices have trended lower but are subject to substantial spikes
(1990-U.S. dollars per tonne)



Source: DECPG Commodities Team

International grain stocks are very low now (Box figure 2). They are projected to fall to 15.8 percent of total use by the end of the current marketing year (in mid-2007), compared to an average 27 percent since 1990. This is only slightly higher than 15.4 percent in 1972/73 which was followed by a more-than-doubling of grain prices and a global food crisis in 1974/75. Maize stocks are particularly low.

What will happen to supply in 2007? It is too early for a good estimate of this year's grain crop, but high fertilizer and energy prices will increase production costs, reducing yields, and thus supply. In the last five years fertilizer prices have risen steadily to levels higher than in 1994-96, with a particularly rapid surge in the last 6 months (Box figure 3). Energy prices are well above the levels of 1994-96, and about equal to the levels of the mid-1970s after adjusting for inflation. In addition to concerns that yields may not increase enough to rebuild stocks there is the concern that demand for maize for ethanol production in the United States will outstrip supply increases and cause maize and other food crop prices to increase further.

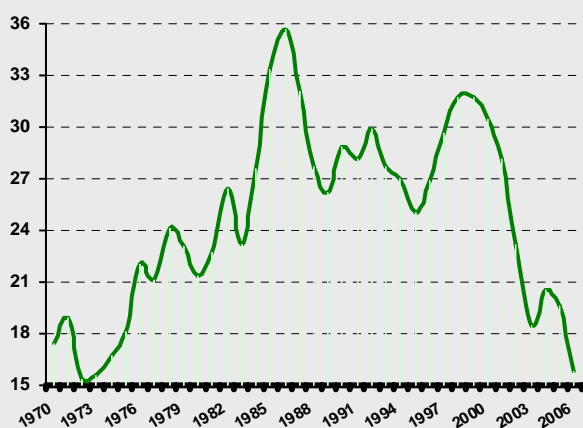
Ethanol production competes for maize. The United States is the largest maize producer and accounts for two-thirds of world exports. Normally the U.S. has a large production surplus and can supply any shortfall in other countries from stocks or increased output. However, the increase in oil prices combined with government tax incentives has led to a surge in demand for ethanol produced from maize, and this use now accounts for 20 percent of U.S. maize production and a projected 25 percent of the 2007 crop. In response to the surge in ethanol demand, farmers are expected to increase maize plantings in the United States by 15 percent. But this increase will largely come from shifting land out of other crops (primarily cotton and soybeans) and this poses the prospect of higher prices for those crops as well...(continued overleaf)

Box 1 (continued)

With demand for grains also increasing rapidly, price pressures may persist.

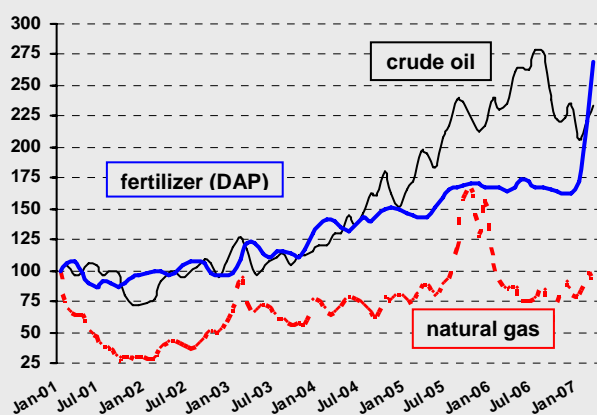
Strong export earnings among the oil producing countries have boosted OPEC grain consumption by 17 percent from 2000 to 2005. Sub Saharan African countries increased grain consumption by 25 percent due to faster economic growth. China, which accounts for 20 percent of world grain consumption, now holds less than one-third the stocks it had in 1999, leaving little buffer against a production shortfall. India has low stocks due to drought. When taken together, low stocks, strong demand growth, and higher fertilizer and energy prices raise the concern that the world is heading for another food price spike.

Box figure 2. World grain stocks are critically low
(Stocks as a percent of global consumption)



Source: DECPG Commodities Team.

Box figure 3. Cost of production skyrockets on higher fertilizer and energy prices
(\$/mt, Index Jan-2001 = 100).



Source: DECPG Commodities Team.

* Based on the Focus article in the April External Environment for Developing Countries from the World Bank's Development Economics Prospects Group.

However, policymakers should determine their macro stance not based on whether growth is high, but based on whether growth in demand exceeds potential growth.⁹ Overall, demand and supply are now growing broadly in line with each other, which explains low core inflation and the absence of current account deficits and systemic bottlenecks in the real economy. While headline inflation has increased, this has so far been purely due to food prices, and non-food consumer price inflation has remained around 1 percent. The key macro issue in the real economy is that a significant share of the demand is coming not

⁹ Some remain concerned about overcapacity. China's rapid development, combined with distortions affecting the behavior of some enterprises, at times result in overcapacity in particular industries, typically temporary. However, recent developments suggest that there is no widespread overcapacity in China's industry. Profitability and profit growth developments have been favorable. Indeed, some of the sectors, including steel, that were not too long ago identified as having overcapacity enjoyed record profit increases in the first quarter of 2007. PPI inflation (factory gate) was at 2.9 percent still somewhat lower than that of purchasing price of raw materials, fuel, and power, at 4.1 percent. However, the fact that the gap between them has narrowed considerably is consistent with lower systemic overcapacity.

from Chinese households and firms, but from abroad, which results in a large trade surplus that is posing increasing challenges to policymakers, also in the international arena. Much of the desired reduction in the trade surplus will have to come from policies to rebalance the economy, including fiscal, labor market, and pricing policies and a stronger real exchange rate.

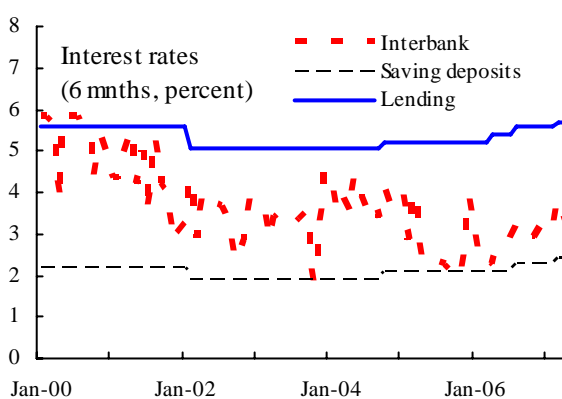
This means there is no obvious need for macro policies to tighten demand in the real economy. Thus, it would be appropriate for fiscal policy to focus on the structural rebalancing of expenditures and the economy, as opposed to short term demand management. Since tightening overall domestic demand does not appear necessary but would aggravate the external imbalance, the preferred measures to lower investment growth would be those that strengthen consumption at the same time.

Monetary and exchange rate policy

Monetary policy will continue to focus on draining excess liquidity out of the banking system and contain lending.

With continued large balance of payment surpluses, liquidity remains ample, although inter bank rates increased in April.¹⁰ Base money growth is likely to be brought down further. In addition, further reserve rate increases are likely, to reduce liquidity.¹¹ The PBC has in the past been reluctant to raise inter bank rates, for fear of attracting non-FDI capital inflows. However, there are increasing indications that such flows are not very interest rate sensitive (Figure 6).

Figure 6. Inter-bank interest rates remain low



Source: People's Bank of China.

More exchange rate flexibility will help in getting better control over the monetary stance. It would reduce the balance of payment surpluses and provide more room for monetary policy to operate to mop up liquidity without triggering renewed capital inflows. The apparent decoupling of the real economy from the US underscores the need for an independent monetary policy—with room for interest rates do decouple from the US. In May, the PBC widened the daily bilateral trading band for the RMB against the dollar,

¹⁰ Estimates of excess reserves differ between analysts. In addition, with structural changes affecting efficiency in the banking system, it is difficult to compare levels of effective excess reserves over time. Thus, interbank rates may be a better measure of excess liquidity.

¹¹ The PBOC last raised the reserve requirement ratio (RRR) on May 18 by 50 basis points to 11.5 percent, effective from June 5, 2007. The increase is the 8th RRR adjustment in the last year.

although it noted that “widening the trading band does not mean the RMB will fluctuate by a lot or appreciate by a large magnitude.” Indeed, even the previous band of 0.3 percent per day was never tested. In the meantime, continued controlled relaxation of restrictions on capital outflows is understandable, given the need to stem foreign reserves accumulation and pressures on the domestic stock markets. However, exchange rate flexibility is still limited. In these circumstances, it would be inappropriate to relax controls on outflows (and inflows) too quickly (Box 2).

Concerns about asset market valuations (see below) would strengthen the case for tighter monetary policy. The bulk of funds channeled into the stock market come from the stock of existing deposits, rather than new bank liquidity. Nonetheless, ample liquidity does add to pressures and expectations of more asset price inflation at a time when expansion in the production capacity of the economy keeps down goods prices. Moreover, higher returns on deposits would dampen the flows out of deposits, whereas tightening liquidity is unlikely to have a large effect on the real economy for now.

The case for further appreciation against the dollar has strengthened. The current account surplus continues to rise. Moreover, so far the appreciation against the dollar does not seem to have hurt the economy, judging from the continued strong export growth and high profitability in manufacturing. In addition, the RMB has depreciated against most European currencies, with the weakening against the Euro through end April 2 percent.

How to respond to higher inflation stemming from higher international grain prices? While food price increases and overall CPI inflation edged down in April, risks remain of substantial further price increases. Since food prices are largely exogenous to the economy, many central banks tend to not gear monetary policy towards them, basing policy instead on core inflation, which typically excludes food prices. However, in China food makes up one-third of consumer spending and the CPI basket. Avoiding or limiting second round impact of food prices via other prices and wages is important.

Structural and social policies

The NPS and NPC meetings in March resulted in many new policy initiatives that could potentially support the rebalancing agenda. The Government Work report, the Planning speech and the Budget speech all reflected the government’s priorities to establish a harmonious society and strive for more equitable and environmentally sustainable growth. The Government work speech also recognizes the need to rebalance demand from investment to consumption and to boost domestic demand.

These are good times to tackle the rebalancing agenda. Growth in GDP, profits, and wages alike remain very high, which means that the impact of the measures that need to be taken can be easily born by those affected, or can be compensated for by a government that has abundant tax revenues and revenue increases in recent years. In fact, the longer the delays in taking measures—in particular those aimed at pricing correctly inputs such as energy, utilities, and the environment—the more costly it will be. This is because currently many investment decisions are made based on current prices and standards. Some of the

Box 2. Ten years after the Asian Crisis: Lessons for China.^{1/}

Ten years ago a massive reversal of capital flows triggered the East Asia crisis, which brought growth to a halt. It all started in Thailand, where in early July the Government was forced to float the Bhat, after a protracted defense of the fixed exchange rate had exhausted international reserves. The depreciation of the Bhat spilled over to Indonesia, which was forced to float its currency, and then to Malaysia, Korea, and to a lesser extent the Philippines. The sharp depreciation of these countries' currencies triggered widespread defaults of companies that were heavily exposed to unhedged external debt, accumulated in a time of relatively stable exchange rates combined with domestic sterilization policies that kept domestic interest rates higher than those abroad. In turn, these corporate defaults affected the local banks, and the financial crisis turned into an economic crisis, and a social and political one in Indonesia. In Korea, the lack of information on the extent of foreign debt caused the first rescue package to fall short, and the crisis to be deeper than needed.

Ten years after the crisis, the affected countries look very different. Growth has been restored in all countries, and per capita incomes are well above pre-crisis levels. Poverty reduction has resumed, and in most countries the share of population in poverty is now below pre-crisis levels. The countries affected by the crisis are now also much less vulnerable to a crisis of the 1997 type: Ten years ago they had all large current account deficits, whereas now they all have large surpluses. Ten years ago reserves were low, particularly compared to short term foreign exchange debt due. Now, reserves are at a comfortable level. A decade ago, many enterprises were heavily indebted, domestically and abroad, and vulnerable to currency and interest rate shocks. Today, debt to equity ratios are well below pre-crisis levels. Ten years ago, financial sectors throughout the region were weak and insufficiently supervised. Today, after much restructuring, particularly in Thailand and Indonesia, the financial sector is stronger, has seen more foreign investment, and is better supervised. And ten years ago some of the affected countries lacked a safety net to counter the impact of the crisis on the poor, whereas now these safety nets are much stronger.

China has already drawn many lessons from the Asian crisis. The country was far less affected than the rest of the region, mostly because it had strict controls of capital flows, and most capital inflows come in the form of FDI rather than more easily pulled portfolio capital. During the crisis, China contributed to restoring stability in the region by not devaluing its exchange rate, and its expansionary fiscal policy contributed to the region's recovery. Since then, China has started financial sector reforms in earnest to reduce vulnerability, and state enterprise reforms were a critical complement to that. China has built up its international reserves to a level that is more than safe by any standards, and the authorities have increased their capacity to monitor capital flows. And while it has opened up the capital account for outflows, it has done so in a controlled manner, by allowing only limited quotas for overseas investment for banks and individuals, whereas capital inflow rules have actually tightened in recent years, in part to make speculation on an exchange rate appreciation more difficult. China seems to have wisely chosen for further financial sector reforms before further liberalizing capital flows. Of particular importance is a more developed bonds market—a market that was sorely lacking in many of the former crisis countries. As China goes along the path of further opening up, a more flexible exchange rate will be desirable, as it can partially isolate the domestic economy from the impact of large movements of capital that an increasingly global economy is prone to. Even with all the safeguards in place, though, vigilance remains required, because if there is one lesson that countries can draw from the Asian Crisis it is that it is never enough to prepare for the *last* crisis.

1/ "The" Asian crisis is a bit of a misnomer, because in many ways each of the countries had their own specific weaknesses and the crisis took their own specific shape in each individual country.

associated projects would not be economically viable based on adjusted prices and standards.

The leadership continues to emphasize energy and environmental policies as a priority. Energy intensity fell by 1.2 percent over 2006.¹² Many observers felt this was falling short of what was needed to reduce energy intensity by 20 percent over the course of the 11th five year plan. Mr. Xie, deputy director of the NDRC noted that failure to meet targets on energy intensity and pollution was because of “slow progress in industrial restructuring and fast growth in sectors that consumed more energy and discharged more pollutants, as well as “insufficient investment in energy efficiency projects, weak supervision and law enforcement and a lack of tax and financial policies that support energy efficiency” (Xinhua, March 16 2007). Arguably, though, the turnaround of energy intensity after four years of rapid increases is remarkable, especially in light of the continued shift of the industrial structure towards heavy industry.

Rebalancing the economy can help improve overall energy efficiency. A recent World Bank research paper points out that the remarkable reduction in energy intensity since 1978 was largely due to better energy efficiency, but that in the richer provinces structural change had contributed as well.¹³ This is good news for China, as it implies that achieving the country’s objectives on the services sector development would indeed contribute to lower energy use as well. Improved energy efficiency has also been associated with higher relative prices for energy and a lower share of state enterprises in the provincial economy.

Price and tax mechanisms is increasingly debated and used to address environmental and energy issues. Vice Premier Zeng Peiyan at the China Development Forum in March called for “more reforms of pricing mechanisms and tax incentives as well as increased efforts to encourage energy saving and environmental protection.” The reduction in VAT rebates on energy intensive goods implemented last February, following an earlier similar move in September 2006, will be further complemented by export taxes on similar good starting this June. VAT rebates on goods dubbed to be energy intensive are now 0-5 percent, as against VAT paid of 17 percent. The additional export taxes of 5-15 percent are intended to further reduce the incentives to export energy intensive goods, although they are also a reaction against the very high export growth in those products recently.

China faces the question whether it should use export taxes or some other form of taxes to contain energy intensity. True, much of China’s energy use in the end makes it into exports and taxing energy intensive exports seems one way of bringing down energy use.¹⁴ However, some industry sources say that, for instance in steel and aluminum, two of sectors affected, China’s cost advantage on the international market is large enough to absorb the increase. In the meantime, the same energy intensive production for the domestic market is not taxed in the case of an export tax. An excise tax would tax

¹² Compared to a target of 4 percent, and increases in emissions of OCD and SO2 of 1.2 percent and 1.8 percent

¹³ Structural change and energy intensity, *China Working Paper No. 6*, by Bert Hofman and Kelly Labar

¹⁴ Preliminary estimates suggest that more than 40 percent of energy consumption in China is in the end on behalf of exported goods.

production regardless of the destination. Both export taxes and excise taxes tax outputs rather than inputs. Thus, energy efficient as well as energy inefficient production capacity in one sector is equally taxed, which is not desirable. Even if production in China is affected—which would be good for China’s energy use and as importantly, local pollution, this could simply imply that production moves to other countries, which are perhaps less energy efficient than China. Thus, the world as a whole may end up with more pollution and higher prices for polluting industries. The best instrument to foster energy efficiency within industry is taxation of *inputs* of energy rather than outputs of energy intensive production or exports. In that China is still only at the start of meaningful measures.

The government is pursuing additional policies to improve within-industry energy efficiency. More efforts are made on the expenditure side of the budget, and the Government has announced a special fund for energy efficiency improvements in industry. Although details are lacking at this point, such a fund has proven to be effective in introducing energy saving measures in other countries. In addition, the government is pursuing a more aggressive campaign to close down inefficient production capacity in the power industry and in energy intensive industries such as steel and cement. China has announced that over the 11th five year plan period, it will close 50 million KW small thermal generating capacity (equal to 10 percent of the capacity built over the last 5 years), will retire 100 million tons of iron production capacity, and 55 million tons of steel capacity. How this will be done, and what this will cost the State was not revealed. Finally, the central government has signed energy reduction agreements with each province, and the government has started a “Top-1000 Energy-Consuming Enterprises program.” The comprehensive energy consumption of these 1000 enterprises accounted for 33% of national and 47% of industrial energy usage in 2004. Under the Top-1000 program, 2010 energy consumption targets were announced for each enterprise. Activities to be undertaken include benchmarking, energy audits, development of energy saving action plans, information and training workshops, and annual reporting of energy consumption.¹⁵

In the area of social policies, China announced a range of policies aimed at more equitable growth. The key policies, the 9 year basic education policy and the rural health insurance, are to be implemented more rapidly than previously planned. In education, the policy to abolish rural education fees that started in 2006 is to be implemented nationwide this year, three years ahead of the plan announced in the 11th Five Year Plan approved last year. Total central government spending for 2007 is planned to be RMB 27 billion (almost \$8 billion). This abolition of fees is undoubtedly good for access to education, notably of the poorest segment of the rural population. The next step is quality improvement, and for that more resources are likely to be needed: the current transfer only (partially) replaces the resources county governments have lost due to the abolition of the fees, and the overall resource envelope for education—which on a per capita basis is much lower than in urban areas—has not changed.

¹⁵See for more detail: *Constraining Energy Consumption of China’s Largest Industrial Enterprises Through the Top-1000 Energy-Consuming Enterprise Program*, Lynn Price, Lawrence Berkeley National Laboratory and Wang Xuejun, Peking University, 2007.

In rural health insurance, the government now aims to meet the 80 percent county coverage target by 2007—three years ahead of target. The policy subsidizes rural health insurance with RMB 40 per person (20 from central government, 20 from local government). Spending on this program will depend on the actual take-up.¹⁶ Overall central government spending on health in 2007 will increase to RMB31 billion, up from RMB 16.5 billion in 2006. At the same time, even with the increase subsidies for rural areas, total spending on health will still lag urban level spending (public or private) with a considerable amount. This issue of inequitable treatment is high on the agenda for the more comprehensive health reforms that the government is currently debating.

Policies to stimulate the service sector could improve the business climate in several subsectors. As part of the rebalancing agenda, the State Council released a document in March 2007 with guidelines to stimulate China's service sector.¹⁷ The government set measurable indicators, including an increase in the share of the service sector in GDP of 3 percentage points from 2005 to 2010 and a level of 50 percent by 2020. The government's strategy and policies differ between market services and public services. The document calls for reforms of public service units (PSUs), an increase of competition in services, leveling of the playing field for domestic and foreign private participation in some services, and tax and regulatory benefits for services development. As is usual, the State Council Opinion does contain few specific policy measures, but it provides the platform on which the various departments and regions can develop specific measures and policies to turn vision into reality. The State Council will create a "Leading Group for Service Sector Development", with an office being set up in the NDRC.

There are many concrete measures that the government could take to promote the services sector. First of all, reducing the implicit subsidies for manufacturing industry, including tax credits, below market prices for land, energy, utilities, and resources would increase the growth potential for services. Second, lowering the relative price of (formal) labor by shifting some payroll taxes to general taxes would reduce the price of labor, which is used more by the relatively labor-intensive services sector. Third, increasing migration by further relaxing the *hukou* system would increase competition in the urban labor market, and lower the relative price of services. Migration would further boost the services sector because urban people spend a higher share of their income on services than rural people. Fourth, the government could consider expanding the VAT to the services sector. While this would increase the price of services, it would also provide strong incentives for local governments to pursue services sector development. Fifth, the government could open up certain services for more competition, with the government focusing on its regulatory function.

FINANCIAL SECTOR POLICIES AND DEVELOPMENTS

Stock market developments have drawn policymakers' attention. Several commentators and policymakers have expressed concerns about the rapid increase in stock

¹⁶ The rural medical insurance is voluntary, while personal contributions are RMB 10 per year.

¹⁷ State Council Opinion on Accelerating the Development of the Services Sector

prices.¹⁸ There are several reasons for a rapid rise in the stock market valuation. First, the long-standing issue of non-traded shares was resolved last year in a way that benefited tradable share holders. Second, profit growth has been very strong, with the latest available data for manufacturing industry suggesting profits growing at more than 40 percent on an annual basis, and prospects remaining good. Third, the dearth of investable assets in China puts a premium on stock investment. This dearth of asset may have been exacerbated by recent government measures to contain real estate speculation. Further, the perceived large difference between expected stock market returns and deposit rates has started to draw part of the large amount of bank deposits (totaling RMB 30 trillion in all) into the stock market.¹⁹ Indeed, before the recent increase, the one-year deposit rate had fallen below annualized CPI inflation, which contributed to the search for higher yields on the stock of savings by people who had shied away from the stock market for years while it was in the doldrums. And finally, some observers believe that irregular activities, including bank credit diverted to stock transactions and foreign capital inflows have boosted the A share market.

If prices were to continue to rise rapidly, risks of a sudden change in mood and sharp negative correction could increase. Such a correction could have several effects. The main impact could be damage to the new-found confidence in the Chinese capital market. The impact on the real economy via reduced consumption and investment is likely to remain limited. Because of the still modest exposure to equities, wealth and balance sheet effects that could drive domestic demand downwards are likely to be limited: at end April 2007, market capitalization of the Shanghai and Shenzhen exchanges combined was a little over 3/4th of GDP, with the market capitalization of tradable shares about 1/4th of GDP. An estimated 2/3rds of that (1/6th of GDP) is held by individual investors. In addition, the exposure of the banking system to the stock market, directly or indirectly, seems limited: although there are no good data on this, CASS estimated that the exposure may add up to RMB 300 billion, which is a modest 1 percent of the total deposit base and 5.5 percent of stock market capitalization of tradable shares. Nevertheless, large losses of financial wealth for specific groups, especially vulnerable groups like retirees and low income earners, could be a policy risk, as it could lead to pressure to bail them out, resulting in fiscal costs on the one hand, and moral hazard on the other.

The authorities have already taken several types of measures to stem price increases. Such measures either contain the inflows into the stock market or stimulate outflows away from the stock markets. Measures containing inflows include temporarily halting approval for new mutual funds and better enforcing the ban on bank credit for buying stocks. The authorities also tightened monetary policy further, including by modestly raising interest rates, hiking reserve requirement ratios, and mopping up liquidity. Measures stimulating outflows include a change in the QDII initiative that will allow banks to invest part of their QDII quota in foreign equity. Finally, CSRC, the capital markets supervisor, has also launched an investigation into insider trading and price manipulations.

¹⁸ Of the 6 prominent Chinese economists invited by the State Council, 4 were less concerned.

¹⁹ Technically, there is no net inflow of money into the stock market unless there is an IPO. The reason is that for every buyer there must be a seller. However, desired reallocations of people's portfolio's towards larger shareholding would in the end result in higher prices, even if there is no net flow.

Possible additional measures could further moderate price rises. Monetary policy could be tightened to increase the yield on other investments including deposits and mop up liquidity, although, with the bulk of funds entering the market channeled out of bank deposits, the effect of tightening banks' excess liquidity will be moderate. Increasing the supply of assets could also help reduce price pressures, and absorb some of the inflows into the capital markets in terms of volume. More IPOs, if well managed, could achieve this, as well as accelerated implementation of the recent policy reforms regarding corporate bonds. The latter are quite promising, as already the central bank has established an information disclosure based system for issuing short-term corporate bonds, a mechanism that can also be used for the longer term bonds for which approval has shifted from NDRC to CSRC. Firms that are already listed could also increase the number of listed shares, although this process needs to be carefully managed to avoid insider issues as well as protect minority shareholders. A further controlled opening up to capital outflows, including by increasing QDII quotas and extending QDII to securities firms would also broaden the palette of assets available for investors. In the unlikely case that a stock market correction would significantly undermine economic growth and confidence, an easing of the macroeconomic policy stance may be appropriate, for instance via an easing of fiscal policy, with the exact channel best depending on the source of the weakness. In current circumstances of excess liquidity, the authorities would understandably be reluctant to further ease the monetary stance, but assuring that the payments and clearance system continues to function will be important in the case of a sharp correction.

Other measures and structural reforms can mitigate volatility in financial markets and make markets (and the economy) more robust to shocks. The authorities could consider taking more aggressive measures to enforce the ban on credits for share transactions. Encouraging financial institutions to develop more long term contractual savings and increasing interest rates on longer term deposits could tie up more liquidity in the banking system, and prevent it from flowing in the stock market. The authorities need to continue to act decisively and transparently against illegal market activity, including insider trading, price manipulation, and provision of false information. Meanwhile, strengthening risk management and the credit monitoring system would make the banking system more robust to potential shocks from the stock market. Short term monitoring of trades is also at a premium in times of high volatility, as systemic selling by one type of market party, e.g. security firms, might signal a correction in the making. Investor education could be strengthened further, and, to promote a focus on fundamentals, there may be scope to improve the disclosure of company information and its enforcement.

In the debate on the stock market move, various tax measures have been proposed. Among others, abolition of the income tax on interest rates, imposition of a capital gains tax, and an increase in the transaction tax on stock transactions have been suggested. In general, any change in the taxation system can best be motivated in line of the goals of that system rather than as a measure to address a short-term phenomenon such as a stock market surge. Interest on deposits is an income like any other, and it is difficult to argue that this type of (capital) income should not be taxed, whereas wage income is. The only footnote here is that even people with total incomes below the income tax threshold are taxed. The authorities could consider simplifying procedures for return of income tax paid

over interest for those that do not meet the threshold. Capital gains are lightly taxed in China compared to most other countries, including the United States, which has a capital gains tax on capital market investment. Indeed, taxing unearned income similarly to earned income is a good principle for taxation. Until now, China has hesitated to introduce a capital gains tax in part because such a tax is less easy to administer. At the same time, China introduced a capital gains tax on real estate already, and there seems little reason to exclude stock market gains from the more general principle of taxing capital gains. Finally, a transaction tax, such as the stamp tax that China has already, is generally frowned upon by most investors, and is generally not a big revenue raiser in countries with a developed stock market.

CORPORATE SECTOR POLICIES AND DEVELOPMENTS

The implementation of a dividend policy in the SOE sector is now high on the agenda. While this is certainly the right thing to do, two implementation issues appear to be critical to ensure it is done in the right way. The first is on the decision making mechanism. Dividend policy is a policy of the state shareholder, to be formulated in line with the general strategy of state assets management and state sector reform. While the state shareholder must have a position regarding the dividend ratio in companies in which it holds a stake, Company Law requires that the decision on the ratio must be left to their boards of directors (or their equivalents in cases where boards of directors have not been created). The central role of the boards also resolves the concern of high administrative cost of one-to-one negotiation.

Second, leaving part of profit with a companies' management is in effect a policy on the company's investment. Thus, when formulating a policy on the dividend ratio, the state shareholder would want to ensure that the investment to be financed by retained profit is (i) in line with national guidelines for the direction and scope of state ownership adjustment, and (ii) judged to be able to provide a rate of return higher than a hurdle rate pre-determined by the state shareholder in view of sector specific conditions. This approach typically results in different dividend ratios in different sectors. For example, a higher dividend ratio is justified for companies running mature businesses than those in high-growth businesses. Investment of retained profit in high-risk but promising innovation project should be particularly encouraged by the state shareholder's dividend policy. The implication is that a unified dividend ratio that applies to different companies and sectors can hardly be the right one. If a specific classification is needed to reduce the administrative cost of the state shareholder, growth potential would be a good criterion.

Pricing of IPOs

Stock prices tend to soar right after IPOs. China's stock exchanges have experienced not just a surge in price, but also one in number and volume of initial public offerings (IPOs). In the year to date, the total amount of money raised through 45 IPOs on China's

stock exchanges add up to RMB104.3 billion or \$13.5 billion. No small amount, but it could have been a lot more, if the pricing of those IPOs would have been closer to what the market perceived to be the value of the shares issued, which is a lot higher than the average IPO price. Indeed, the “debut price” of IPOs, the price on the first day of listing of the new shares on the stock exchange, was on average some 70 percent higher than the IPO price in the first two months of this year, according to *Dealogic* an investor information service.²⁰

This is known as “IPO underpricing” or “Initial IPO Returns.” Since the first months of 2007, large IPOs like BOCOM and CITIC saw similar rises of the debut price over the IPO price (Table 3). CITIC’s price almost doubled and China Life’s price even more than doubled on the first day of listing.

Table 3: China: Selected IPOs 2005-7

	Amount of IPO	Price increase on debut (percent, Shanghai SE)
BOCOM	\$3.3 bn	70
Chongqing Steel	\$130 million	98
Ping An	\$ 5.1 billion	38
CITIC	\$5.4 billion	96
		(14 percent in H shares)
Industrial Bank Fujian	\$2 billion	38.8
China Life	\$3.6 billion	106.2
ICBC	\$21 billion	15
Beijing North Star	\$460 million	51
BOC	\$11.2 billion	6.8 (H Share)
CCB	\$9.2	0 (H Share)

Source: Various newspaper and wire service articles through *Factiva* news service.

Heavy underpricing of IPOs represent a loss to the State. Management of the IPO companies often quote the sharp price increase as a sign of success, but in reality, they represent foregone revenues for the State. Extrapolating *Dealogic’s* findings to all IPOs thus far this year, this would imply that if the IPO prices would have been as high as debut prices, the State could have raised some \$9.5 billion more in revenues, or \$1.5 billion more than the total sum the central government spends on the free rural education program this year. Of course, in China no IPO money is actually paid to the budget, but the foregone revenues still constitute a loss to the state. IPOs in China are usually done through a dilution of share capital rather than through the sale of existing shares. So the company gets to keep the cash generated by the IPO. Irrespective, if the IPO would have raised more cash, the remaining shares held by the state would have been more valuable, because even if the company receives the extra cash, this would accrue in the price of the remaining shares the state holds.²¹ Use of IPO money by the company may be fine by itself, as long it is used in sensible expansion plans with good returns. At the same time, channeling more cash into companies that already are prone to over-investment at the moment may not be in the interest of macroeconomic management, and government could consider collecting part of the money for the budget.

²⁰ Financial Times, March 5, 2007, electronic version.

²¹ Although not all of the extra cash revenues from IPOs would be owned by the state, because those that bought shares in the IPO now own shares in the company. In other words, they get to own part of the cash they paid themselves.

Underpricing of IPOs happens also in other countries. The discrepancy between IPO and debut price in Hong Kong was some 14 percent in the first few months, and in Tokyo it was even as high as 40. In the USA, underpricing was 7 percent in the 1980s, 15 percent in the 1990s, and even 65 percent in the “dot com” bubble of 1999-2000, only to fall back to a more normal 10-20 percent since. European countries between 1990 and 2003 showed a discrepancy between 10-40 percent.²² But no other country beats the China numbers. In fact, looking back to 1999-2002, the underpricing of China’s IPOs even averaged 132 percent, almost double that of recent months.²³ Apart from the very high difference in IPO and debut price in China, the country differs in another respect from mature market economies: in the latter, the revenues are foregone by private individuals, but in the case of China, where mostly State-owned companies do IPOs, it is the State that loses out. Admittedly, the China IPOs in recent months were more or less priced in line with what industry experts saw as feasible based on indicators such as price-earnings and earnings expectation. This, together with the US experience during the dot-com boom, suggests that it is hard to price IPOs in booming markets. And there are signs that China’s immature secondary market causes some of the increase—witness the much lower post-IPO price increase for stocks on the Hong Kong market. If IPOs could fetch the higher debut price, this would be a reason to list more of the shares domestically rather than abroad.

Who benefits? Beneficiaries of low IPO prices are first and foremost those lucky ones that were allocated IPO shares as they receive a windfall gain on the first trading day. These include some retail investors, but most shares in IPOs go to institutional and other large investors. According to the rules, allocation of shares is proportional to the subscription—i.e. the amount of shares requested.²⁴ Others that seem to benefit from the price increase are the management of companies being listed. In some cases, their rewards package is linked to share price increases, which gives them an interest in a low IPO price with upward potential.²⁵ The State itself may have some interest in underpricing, as it would create enthusiasm for future IPOs and share sales. In some countries, like in Britain in the 1980s, low IPO prices for companies such as *British Telekom* were used to popularize the privatization program and broad share ownership. In that case, however, painstaking efforts were taken to distribute the bulk of the shares to small individual investors, who reaped the capital gains.

²² Alexander Ljungqvist, IPO Underpricing, Chapter III.4 in B. Espen Eckbo (ed.) *Handbook in Corporate Finance: Empirical Corporate Finance*, September 2004 (Internet version).

²³ Ti Liu, *Investment Without Risk: An Empirical Investigation of IPO Underpricing in China* The China Project Report No. 4, Cambridge University, July 2003.

²⁴ In other countries including the U.S., the disproportional allocation of shares to good clients of the underwriter became an issue in the past.

²⁵ For instance, one Chinese bank listed in Hong Kong and Shanghai has a “share appreciation rights plan” for its senior management, which gives managers the right to receive an amount equal to the appreciation of the market value of the shares. It is unclear what the date is on which the benchmark price is chosen.

Recently released World Bank studies on China:

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- ***China's Information Revolution: Managing the Economic and Social Transformation***
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- ***Trade Integration in East Asia: The Role of China and Production Networks (WPS No. 4160)***
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The paper examines the role of production networks in the recent growth in trade in East Asia. Full text available at: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2007/03/06/000016406_20070306101249/Rendered/PDF/wps4160.pdf

- ***Extending Health Insurance to the Rural Population: An Impact Evaluation of China's New Cooperative Medical Scheme (WPS No. 4150)***
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The paper analyzes factors affecting enrollment in China's heavily subsidized voluntary health insurance program for rural residents and estimates its impact on households and health facilities uses. Full text available at: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2007/02/22/000016406_20070222160135/Rendered/PDF/wps4150.pdf