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China's Economic Conditions

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SUMMARY

Since the initiation of economic reforms in 1979, China has become one of the world's fastest growing economies. From 1979-2003, China's real annual GDP averaged 9.3%. Chinese officials estimate that real GDP rose by 9.1% in 2003. Many economists speculate that China could become the world's largest economy at some point in the near future, provided that the government is able to continue and deepen economic reforms, particularly in regards to its efficient state-owned enterprises (SOEs) and state banking system. Progress in reforming these sectors in recent years has been somewhat mixed.

After many years of difficult negotiations, China became a member of World Trade Organization (WTO) on December 11, 2001. WTO accession commits China to significantly reducing a wide variety of tariff and non-tariff barriers over the next few years. If fully implemented, the terms of China's WTO accession will likely have a significant impact on China's economy. The level of Chinese trade protectionism will be greatly diminished over then next few years, and nearly all sectors of China's economy (including agriculture, manufacturing, and services) will increasingly be subject to great competition. Several of China's heavily protected industries, such as autos, and certain agricultural sectors, could be negatively affected by China's WTO membership. China's labor-intensive industries, especially textiles and apparel, will likely benefit significantly with China's WTO accession. A major challenge for the government is to develop an adequate social safety net to assist laid-off workers.

China's economy continued to grow sharply in 2004, with real GDP growth projected at 9.1%. Foreign investment continued to pour into China, and trade grew rapidly. However, China experienced some inflationary pressures in 2004, fueled in part by speculation in real estate, over-investment in certain industries, and rising costs for energy and raw materials.

China's economy continues to be a concern to U.S. policymakers. On the one hand, China's economic growth presents huge opportunities for U.S. exporters. On the other hand, the surge in Chinese exports to the United States has put competitive pressures on many U.S. industries. Many U.S. policymakers have charged that greater efforts should be made to pressure China to change various economic policies deemed harmful to U.S. economic interests, such as its pegging of its currency (the *yuan*) to the U.S. dollar.

MOST RECENT DEVELOPMENTS

On December 7, 2004, IBM Corp. announced that would sell its personal computer division for $1.75 billion to Lenovo Group Limited, a computer company primarily owned by the Chinese government.

On November 29, 2004, China and the 10 countries that make up the Association of Southeast Asian Nations (ASEAN) signed a free trade agreement covering goods.

In an effort to fight rising inflation, the Chinese Central Bank, on October 28, 2004, raised its one-year lending rate by a 0.27 percentage point, the first rate hike by the bank in more than nine years.

BACKGROUND AND ANALYSIS

An Overview of China's Economic Development

China's Economy Prior to Reforms

Prior to 1979, China maintained a centrally planned, or command, economy. A large share of the country's economic output was directed and controlled by the state, which set production goals, controlled prices, and allocated resources throughout most of the economy. During the 1950s, all of China's individual household farms were collectivized into large communes. To support rapid industrialization, the central government during the 1960s and 1970s undertook large-scale investments in physical and human capital. As a result, by 1978 nearly three-fourths of industrial production was produced by centrally controlled state-owned enterprises (SOEs) according to centrally planned output targets. Private enterprises and foreign invested firms were nearly non-existent. A central goal of the Chinese government was to make China's economy relatively self-sufficient. Foreign trade was generally limited to obtaining only those goods that could not be made or obtained in China.

Government policies kept the Chinese economy relatively stagnant and inefficient, mainly because there were few profit incentives for firms and farmers, competition was virtually nonexistent, and price and production controls caused widespread distortions in the economy. Chinese living standards were substantially lower than those of many other developing countries. The Chinese government hoped that gradual reform would significantly increase economic growth and raise living standards.

The Introduction of Economic Reforms

Beginning in 1979, China launched several economic reforms. The central government initiated price and ownership incentives for farmers, which enabled them to sell a portion of their crops on the free market. In addition, the government established four special economic zones for the purpose of attracting foreign investment, boosting exports, and importing high technology products into China. Additional reforms followed in stages that sought to decentralize economic policymaking in several economic sectors, especially trade.

Economic control of various enterprises was given to provincial and local governments, which were generally allowed to operate and compete on free market principles, rather than under the direction and guidance of state planning. Additional coastal regions and cities were designated as open cities and development zones, which allowed them to experiment with free market reforms and to offer tax and trade incentives to attract foreign investment. In addition, state price controls on a wide range of products were gradually eliminated.

China's Economic Growth since Reforms: 1979-2004

Since the introduction of economic reforms, China's economy has grown substantially faster than during the pre-reform period (see **Table 1**). Chinese statistics show real GDP from 1979 to 2003 growing at an average annual rate of 9.3%, making China one of the world's fastest-growing economies.[1] Real GDP is projected to grow by 9.1% in 2004. The World Bank estimates that China's economic reforms and resulting economic growth have help raise 400 million people out of extreme poverty.

Table 1. China's Average Annual Real GDP Growth Rates, 1960-2004

Time Period	Average Annual % Growth
1960-1978 (pre-reform)	5.3
1979-2003 (post-reform)	9.3
1990	3.8
1991	9.3
1992	14.2
1993	13.5
1994	12.7
1995	10.5
1996	9.7
1997	8.8
1998	7.8
1999	7.1
2000	8.0
2001	7.3
2002	8.0
2003	9.1
2004 (projected)	9.1

Sources: Official Chinese government data. Projection made by Global Insight.

[1] China's statistical methods and standards have come under criticism by various international agencies, especially regarding how China measures its GDP growth, which, many analysts contend, is often overstated.

Causes of China's Economic Growth

Economists generally attribute much of China's rapid economic growth to two main factors: large-scale capital investment (financed by large domestic savings and foreign investment) and rapid productivity growth. These two factors appear to have gone together hand in hand. Economic reforms led to higher efficiency in the economy, which boosted output and increased resources for additional investment in the economy.

China has historically maintained a high rate of savings. When reforms were begun in 1979, domestic savings as a percentage of GDP stood at 32%. However, most Chinese savings during this period were generated by the profits of SOEs, which were used by the central government for domestic investment. Economic reforms, which included the decentralization of economic production, led to substantial growth in Chinese household savings (which now account for half of Chinese domestic savings). As a result, savings as a percentage of GDP has steadily risen; it was 42% in 2002, among the highest savings rates in the world.

Several economists have concluded that productivity gains (i.e., increases in efficiency in which inputs are used) were another major factor in China's rapid economic growth. The improvements to productivity were largely caused by a reallocation of resources to more productive uses, especially in sectors that were formally heavily controlled by the central government, such as agriculture, trade, and services. For example, agricultural reforms boosted production, freeing workers to pursue employment in more productive activities in the manufacturing sector. China's decentralization of the economy led to the rise of non-state enterprises, which tended to pursue more productive activities than the centrally controlled SOEs. Additionally, a greater share of the economy (mainly the export sector) was exposed to competitive forces. Local and provincial governments were allowed to establish and operate various enterprises on market principles, without interference from the central government. In addition, foreign direct investment (FDI) in China brought with it new technology and processes that boosted efficiency.

Measuring the Size of China's Economy

The actual size of the China's economy has been a subject of extensive debate among economists. Measured in U.S. dollars using nominal exchange rates, China's GDP in 2003 was about $1.5 trillion; its per capita GDP (a commonly used living-standards measurement) was $1,130. Such data would indicate that China's economy and living standards are significantly lower than those of the United States and Japan, considered to be the number one and number two largest economies, respectively (see **Table 2**).

Many economists, however, contend that using nominal exchange rates to convert Chinese data into U.S. dollars substantially underestimates the size of China's economy. This is because prices in China for many goods and services are significantly lower than those in the United States and other developed countries. Economists have attempted to factor in these price differentials by using a purchasing power parity (PPP) measurement, which attempts to convert foreign currencies into U.S. dollars based on the actual purchasing power of such currency (based on surveys of the prices of various goods and services) in each

respective country. This PPP exchange rate is then used to convert foreign economic data in national currencies into U.S. dollars.

Because prices for many goods and services are significantly lower in China than in the United States and other developed countries (while prices in Japan are higher), the PPP exchange rate raises the estimated size of Chinese economy to about $6.6 trillion, significantly higher than Japan's GDP in PPPs ($3.5 trillion), and about 60% the size of the U.S. economy. PPP data also raise China's per capita GDP to $5,120. The PPP figures indicates that, while the size of China's economy is substantial, its living standards fall far below those of the U.S. and Japan. The International Monetary Fund estimates that (using PPP measurements) China could surpass the United States as the world's largest economy as early as the year 2007. Yet, even if that were to occur, it would take China significantly longer to achieve U.S. standard of living levels.

Table 2. Comparisons of U.S., Japanese, and Chinese GDP and Per Capita GDP In Nominal U.S. Dollars and PPP, 2003

Country	Nominal GDP ($ billions)	GDP in PPP ($ billions)	Nominal Per Capita GDP	Per Capita GDP in PPP
U.S.	10,978	10,978	37,810	37,810
Japan	4,318	3,512	33,940	27,600
China	1,467	6,631	1,130	5,120

Sources: Economist Intelligence Unit Data Services. Data are estimates.
Note: PPP data for China should be interpreted with caution. China is not a fully developed market economy; the prices of many goods and services are distorted due to price controls and government subsidies.

Foreign Direct Investment in China

China's trade and investment reforms and incentives led to a surge in foreign direct investment (FDI), which has been a major source of China's capital growth.[2] Annual utilized FDI in China grew from $636 million in 1983 to nearly $52.7 billion in 2002. China's FDI is estimated to have grown to about $53.5 billion in 2003 (up by 1.5% over 2002 levels), an indicator that SARS may have temporarily slowed the growth of FDI in China.[3] However, contracted FDI for 2003 was up by 39% over the same period in 2002, an indicator that actual FDI will likely pick up in the near term.[4] Actual FDI going into China during the first six months of 2004 ($33.9 billion) was 12% higher over the same period in 2003. The Economist Intelligence Unit projects FDI in China will rise to $57 billion in 2004. Analysts

[2] It is estimated that in 2003, there were over 465,000 foreign-funded enterprises in China, with a cumulative level of FDI of over $500 billion.

[3] Despite the slowdown, China was the world's largest recipient of FDI in 2003.

[4] Contracted investment is an indicator of new investment that is pledged for the future, while actual FDI indicates the amount of investment flows going to China in a given year

predict that FDI will continue to pour into China as investment barriers are reduced under China's WTO commitments and Chinese demand for imports continue to increase.

Based on cumulative FDI (1979-2003), about 45% of FDI in China has come from Hong Kong. The United States is the second-largest investor in China, accounting for 8.8% ($44 billion) of total FDI, followed by Japan, the European Union, and Taiwan (see **Table 3**). U.S. FDI in China for 2002 was $4.2 billion, accounting for 7.9% of FDI for that year.

Table 3. Major Foreign Investors in China: 1979-2003
($ billions and % of total)

Country	Cumulative Utilized FDI: 1979-2003		Utilized FDI in 2003	
	Amount ($ billions)	% of Total	Amount ($ billions)	% of Total
Total	501.7	100.0	53.5	100.0
Hong Kong	223.4	44.5	17.8	22.1
United States	44.0	8.8	4.2	7.9
Japan	41.7	8.3	5.1	9.5
European Union	37.2	7.4	3.9	7.3
Taiwan	36.6	7.3	3.4	6.4

Source: Chinese government statistics. Top five investors according to cumulative FDI from 1979 to 2003.

China's Trade Patterns

Economic reforms have transferred China into a major trading power. Chinese exports rose from $14 billion in 1979 to $438 billion in 2003, while imports over this period grew from $16 billion to $413 billion (see **Table 4**). According to the World Trade Organization, China is now the world's fourth-largest trading nation (based on 2003 data), the fourth-largest exporter, and the third-largest importer. China's trade continues to grow dramatically: In 2003, exports rose by 35%, while imports grew by 40%, over 2002 levels. During the first 10 months of 2004, China's trade continued to boom: exports and imports were up by 35% and 37%, respectively over the same period in 2003.

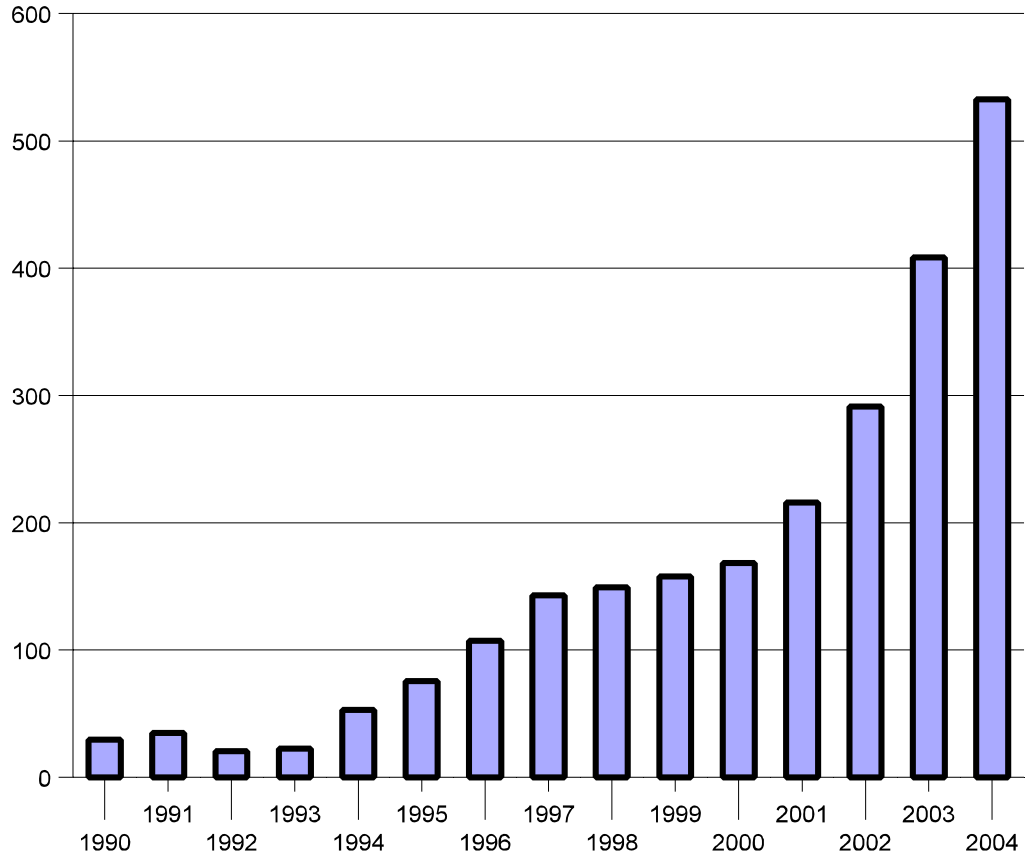
Table 4. China's Merchandise World Trade, 1979-2004($billions)

	Exports	Imports	Trade Balance
1979	13.7	15.7	-2.0
1980	18.1	19.5	-1.4
1981	21.5	21.6	-0.1
1982	21.9	18.9	2.9
1983	22.1	21.3	0.8
1984	24.8	26.0	-1.1
1985	27.3	42.5	-15.3
1986	31.4	43.2	-11.9
1987	39.4	43.2	-3.8
1988	47.6	55.3	-7.7
1989	52.9	59.1	-6.2
1990	62.9	53.9	9.0
1991	71.9	63.9	8.1
1992	85.5	81.8	3.6
1993	91.6	103.6	-11.9
1994	120.8	115.6	5.2
1995	148.8	132.1	16.7
1996	151.1	138.8	12.3
1997	182.7	142.2	40.5
1998	183.8	140.2	43.6
1999	194.9	165.8	29.1
2000	249.2	225.1	24.1
2001	266.2	243.6	22.6
2002	325.6	295.2	30.4
2003	438.4	412.8	25.6
2004 (projection)	589.6	566.4	23.2

Source: International Monetary Fund, Direction of Trade Statistics and official Chinese statistics. Projection based on actual data for January-October 2004.

Historically, China has run trade deficits in some years and surpluses in others. However, over the past nine years, China has run trade surpluses; in 2003 that surplus was $25.6 billion. Merchandise trade surpluses and large-scale foreign investment have enabled China to accumulate the world's second-largest foreign exchange reserves (after Japan), estimated to have reached $515 billion at the end of September 2004. As seen in **Figure 1**, China's accumulation of foreign exchange reserves has been particularly acute over the past three years.

Figure 1. China's Foreign Exchange Reserves, 1990-2004 ($ billions)



Data for 2004 estimated, based on actual data for January-September 2004.

China's Major Trading Partners

China's trade data often differ significantly from those of its major trading partners. This is due to the fact that a large share of China's trade (both exports and imports) passes through Hong Kong (which reverted back to Chinese rule in July 1997, but is treated as a separate customs area by most countries, including China and the United States). China treats a large share of its exports through Hong Kong as Chinese exports to Hong Kong for statistical purposes, while many countries that import Chinese products through Hong Kong generally attribute their origin to China for statistical purposes. According to Chinese trade data, its top five trading partners in 2003 were Japan, the United States, the European Union, Hong Kong, and the 10 nations that make up the Association of Southeast Asian Nations (ASEAN)(see **Table 5**). Its largest export markets were Japan, the United States, and Hong Kong, while its top sources for imports were Japan, the Europan Union, and Taiwan (the United States ranked sixth).

U.S. trade data indicate that the importance of the U.S. market to China's export sector is likely much higher than is reflected in Chinese trade data. Based on U.S. data on Chinese

exports to the United States (which, as noted, do not agree with Chinese data), and Chinese data on total Chinese exports, it is estimated that Chinese exports to the United States as a share of total Chinese exports grew from 15.3% in 1986 to an estimated 37.4% in 2003.

A growing level of Chinese exports are from foreign funded enterprises (FFEs) in China. According to Chinese data, about half of its trade in 2002 was conducted by FFEs. A large share of these FFEs are owned by Hong Kong and Taiwan investors, many of whom have shifted their labor-intensive, export-oriented, firms to China to take advantage of low-cost labor. A significant share of the products made by such firms are exported to the United States. Chinese data indicate that the share of China's exports produced by foreign-invested enterprises in China has risen from 2% in 1986, to 41% in 1996, to 55% in 2003.

Table 5. China's Top 5 Trading Partners: 2003
($ billions)

Country	Total Trade	Chinese Exports	Chinese Imports	China's Trade Balance
Japan	133.6	59.4	74.2	-14.8
United States	126.3	92.4	33.9	58.5
European Union	125.2	72.1	53.1	19.0
Hong Kong	87.4	76.3	11.1	65.2
ASEAN*	78.3	31.0	47.3	-16.3

*Association of Southeast Asian Nations (ASEAN) member countries include Indonesia, Malaysia, the Philippines, Singapore, Thailand, Brunei, Cambodia, Laos, Myanmar, and Vietnam.
Source: Official Chinese trade data.
Note: Chinese data on its bilateral trade often differ substantially from the official trade data of other countries on their trade with China.

Major Chinese Trade Commodities

China's abundance of cheap labor has made it internationally competitive in many low cost, labor-intensive, manufactures. As a result, manufactured products comprise an increasingly larger share of China's trade. The share of Chinese manufactured exports to total exports rose from 50% in 1980 to 92% in 2003, while manufactured imports as a share of total imports rose from 65% to 82%. A large share of China's manufactured imports are comprised of intermediates (e.g., steel, electronic components, and textile machinery) used in manufacturing products in China.

China's top five imports in 2003 included electrical machinery and parts, petroleum and petroleum products, computers and parts, iron and steel, and specialized machinery (see **Table 6**). China's top five exports in 2003 included computers and parts, articles of apparel and clothing, telecommunications equipment, electrical machinery and parts, and miscellaneous manufactured articles (toys, games, dolls, etc) (see **Table 7**).

Table 6. Major Chinese Imports: 2003

Commodity	Total ($ billions)	% of Total Imports	% Change over 2002 Levels
Electrical machinery, apparatus and appliances, and parts	77.9	18.9	42.9
Petroleum and petroleum products	26.2	6.3	53.3
Office machines and automatic data processing machines (mainly computers and parts)	23.6	5.7	40.8
Iron and steel	21.9	5.3	62.9
Machinery specialized for particular industries	20.6	5.0	35.1
Total top 5	170.2	41.2	—

Estimated, based on actual data for January-November 2003.
Source: Official Chinese trade data.

Table 7. Major Chinese Exports: 2003

Commodity	Total ($ billions)	% of Total Exports	% Change over 2002 Levels
Office machines and automatic data processing machines (mainly computers and parts)	60.3	13.8	71.6
Articles of apparel and clothing accessories	51.4	11.7	25.2
Telecommunication & sound record & reproduce app. & equip.	43.0	9.8	37.2
Electrical machinery, apparatus and appliances, and parts	41.1	9.4	30.3
Miscellaneous manufactured articles (e.g., toys, games, etc.)	31.3	7.1	16.3
Total top 5	227.1	51.8	—

Estimated, based on actual data for January-November 2003.
Source: Official Chinese trade statistics.

China's Accession to the World Trade Organization

China's growth as a major economic and trading power has expanded U.S.-China commercial ties, although disputes have arisen over a number of issues, such as trade investment barriers, China's most-favored-nation (MFN), or normal trade relations (NTR), status, and the terms for China's accession to the World Trade Organization (WTO). The World Bank projects that by the year 2020, China will be the world's second-largest trading

economy after the United States. China's continued rapid growth has increased concerns among U.S. policymakers that China's trade regime must be brought in compliance with multilateral rules to ensure that U.S. firms are given access to China's growing markets.

China has made its accession to the World Trade Organization (WTO) a major priority. On November 15, 1999, U.S. and Chinese officials reached a bilateral agreement on China's WTO bid. China completed its bilateral WTO negotiations when it signed an agreement with Mexico on September 13, 2001, the last of the 37 WTO members that had requested such an accord. On September 17, 2001, China completed negotiations with the WTO Working Party handling its WTO application. China's WTO membership was formally approved by the WTO on November 10, 2001, and on November 11, China informed the WTO that it had ratified the WTO agreements. As a result, China officially joined the WTO on December 11, 2001. U.S. government and business representatives have argued that China's record on implementing its WTO obligations has been mixed (see CRS Issue Brief IB91121).

Major Long-Term Challenges Facing the Chinese Economy

China's economy has shown remarkable economic growth over the past several years, and many economists project that it will enjoy fairly healthy growth in the near future. However, economists caution that these projections are likely to occur only if China continues to make major reforms to its economy. Failure to implement such reforms could endanger future growth.

- **State-owned enterprises (SOEs)**, which account for about one-quarter of Chinese industrial production and employ nearly two-thirds of urban workers, put an increasingly heavy strain on China's economy. Over half are believed to lose money and must be supported by subsidies, mainly through state banks. Government support of unprofitable SOEs diverts resources away from potentially more efficient and profitable enterprises. In addition, the poor financial state of many SOEs makes it difficult for the government to reduce trade barriers out of fear that doing so would lead to wide-spread bankruptcies of many SOEs.

- **The banking system** faces several major difficulties due to its financial support of SOEs and failure to operate solely on market-based principles. China's banking system is regulated and controlled by the central government, which sets interest rates and attempts to allocate credit to certain Chinese firms. The central government has used the banking system to keep afloat money-losing SOEs by pressuring state banks to provide low interest loans, without which a large share of the SOEs would likely go bankrupt. Currently, over 50% of state-owned bank loans now go to the SOEs, even though a large share of loans are not likely to be repaid. *Ernst & Young* estimates that the level of nonperforming loans by Chinese banks

in 2002 was $480 billion (equal to about 43% of China's GDP).[5] The high volume of bad loans now held by Chinese banks poses a serious threat to China's banking system. Three out of the four state commercial banks are believed to be insolvent. The precarious financial state of the Chinese banking system has made Chinese reformers reluctant to open its banking sector to foreign competition Corruption poses another problem for China's banking system because loans are often made on the basis of political connections. This system promotes widespread inefficiency in the economy because savings are generally not allocated on the basis of obtaining the highest possible returns.

- **China's agricultural system** is highly inefficient due to government policies that seek to maintain a 95% self-sufficiency rate in grains, mainly through the extensive use of subsidies and restrictive trade barrier. These policies divert resources from more productive economic sectors and keep domestic prices for many agricultural products above world prices.

- **Infrastructure bottlenecks**, such as inadequate transportation and energy systems, pose serious challenges to China's ability to maintain rapid economic growth. China's investment in infrastructure development has failed to keep pace with its economic growth The World Bank estimates that transportation bottlenecks reduce China's GDP growth by 1% annually. Chronic power shortages are blamed for holding China's industrial growth to 80% of its potential. Transportation bottlenecks and energy shortages also add inflationary strains to the economy because supply cannot keep up with demand.

- **The lack of the rule of law** in China has led to widespread government corruption, financial speculation, and mis-allocation of investment funds. In many cases, government "connections," not market forces, are the main determinant of successful firms in China. Many U.S. firms find it difficult to do business in China because rules and regulations are generally not consistent or transparent, contracts are not easily enforced, and intellectual property rights are not protected (due to the lack of an independent judicial system). The lack of rule of law in China limits competition and undermines the efficient allocation of goods and services in the economy. In addition, the Chinese government does not accept the concept of private ownership of land and assets in China

- **A wide variety of social problems** have arisen from China's rapid economic growth and extensive reforms, including pollution, a widening of income disparities between the coastal and inner regions of China, and a growing number of bankruptcies and worker layoffs. This poses several challenges to the government, such as enacting regulations to control pollution, focusing resources on economic development in the hinterland, and developing modern fiscal and tax systems to address various social

[5] Ernst & Young Asia Pacific Financial Solutions, *Nonperforming Loan Report, Asia,* 2002.

concerns (such as poverty alleviation, education, worker retraining, and pensions). In addition to SARS, China faces a series HIV/AID crisis. A 2002 report by the United Nations stated that China was on the verge of "catastrophe that could result in unimaginable suffering, economic loss and social devastation," due to the rapid rise of HIV/AIDS in China.

Outlook for China's Economy and Implications for the United States

The short term outlook for the Chinese economy appears to be positive, but will likely be strongly influenced by the government's ability to reform the SOEs and banking system to make them more responsive to market forces, fully implement its WTO commitments, and to assist workers who lose their jobs due to economic reforms (in order to maintain social stability). Global Insight, a private international forecasting firm, projects China's GDP will grow at an average annual rate of nearly 7.0% over the next several years. At this rate, China would be able to double its GDP every 10 years.

China's rise as an economic superpower is likely to pose both opportunities and challenges for the United States and the world trading system. China's rapid economic growth has boosted incomes and is making China a huge market for a variety of goods and services. The U.S. Commerce Department projects that by the year 2005, China will have more than 230 million middle-income consumers (i.e., those earning $1,000 or more annually), whose combined retail spending will exceed $900 billion. In addition, China's abundant low-cost labor has led multinational corporations to shift their export-oriented, labor intensive manufacturing facilities to China. This process has lowered prices for consumers, boosting their purchasing power. It has also lowered costs for firms that import and use Chinese-made components and parts to produce manufactured goods, boosting their competitiveness. Conversely, China's role as a major international manufacturer has raised a number of concerns. Many developing countries worry that growing FDI in China is coming at the expense of FDI in their country. Policymakers in both developing and developed countries have expressed concern over the loss of domestic manufacturing jobs that have shifted to China (as well as the downward pressures on domestic wages and prices that may occur from competing against low-cost Chinese-made goods). Japan has complained that China's currency peg and low-cost manufacturing has contributed to deflationary pressures on the Japanese economy, which, they claim, has forced Japan to intervene in currency markets to keep the yen weak against the dollar in order to stay competitive with Chinese goods in U.S. markets.

China is attempting to establish and promote companies that can compete globally, especially in advanced technologies. For example, on December 7, 2004, Lenovo Group Limited, a computer company primarily owned by the Chinese government, purchased IBM's personal computer division. U.S. firms are likely to face increasing competitive pressures from China in a variety of goods and services industries and not just those that are labor intensive.

China's rapid economic growth and continued expansion of its manufacturing base are fueling a sharp demand for energy and raw materials, which is becoming an increasingly

important factor in determining world prices for such commodities. According to the International Energy Agency, China accounted for one-third of the rise in daily global oil consumption in 2003 and is projected to account for one-third of the rise in consumption in 2004. China has become the world's second-largest oil importer, and is reportedly the largest consumer of steel, cement, and copper.

During the past year, the Chinese government has expressed concern that the economy could be growing too quickly, which could ignite inflation and threaten future economic growth.[6] One major problem is that in order to maintain the currency peg, the government has had to infuse large amounts of yuan into the economy. Many analysts charge that this flood of money has substantially raised the level of speculative investments in the economy, which has threatened to ignite inflation in some sectors. Analysts are also concerned that banks are making poor lending decisions, which could increase the level of non-performing loans. Chinese officials have sought to lower inflationary pressures by slowing down the pace of investment in various industries (such as steel and construction) and raising interest rates in order to obtain a "soft landing." However, analysts warn that if inflation cannot be effectively brought under control, stronger administrative and macroeconomic measures may be implemented, which could lead to a significant slowdown in China's economy (a "hard landing") and could negatively affect the world economy.

[6] Global Insight projects the inflation rate in China in 2004 at 4.5%.