



Financial Markets Crisis Task Force

Bringing Legal Clarity to the Economic Crisis

International

Alert I – November 21, 2008

China Announces 4-Trillion-Yuan Stimulus Package

To offset the effect of adverse global economic conditions on the world's third-largest national economy, China announced a 4-trillion-yuan (\$586 billion) stimulus package on November 9 to expand its domestic demand and boost the slowing economy. The investment package will be spent over the next two years to finance programs in the ten following major areas:

- ▶ Accelerate the build-out of the social safety network (support low-end public housing, upgrade old urban neighborhoods, upgrade dangerous housing in rural areas)
- ▶ Accelerate the build out of the rural infrastructure (methane gas safety, drinking water safety, rural highways, power grids, "transferring water from south to the north," hydro projects, large-scale irrigation);
- ▶ Accelerate the build out of railways, highways, airports, and other large infrastructure projects (passenger routes, coal transportation routes, railways in Western China, city power grid upgrades);
- ▶ Accelerate the development of health care and education systems (improve medical services at a grass-roots level, improve education infrastructure in Mid Western China);
- ▶ Strengthen environmental and ecological infrastructure projects (waste treatment, garbage treatment, fight water pollution, protect natural vegetation, encourage energy saving);
- ▶ Encourage innovation and structural adjustment in the economy (support high-tech industries and the service sector);
- ▶ Accelerate the rebuilding of earthquake-affected zones;
- ▶ Boost rural income (increase the minimum purchase price of grain for next year; increase direct subsidies for farmers, including subsidies for better seeds and farming equipment; improve social welfare and subsidies for low-income group; increase pension money for retired people);
- ▶ Countrywide reform on corporate value-added tax (VAT);
- ▶ Ease credit to sustain economic growth (scrapping loan quota restriction for commercial banks; "reasonably" expand credit growth; strengthen support to major projects, rural areas, farmers, agriculture, technological improvement and M&A among small and medium enterprises; and selectively encourage and strengthen consumer credit growth).

With an incremental 100 billion yuan being allocated from the current-year central government budget funds and another 20 billion yuan pulled forward from next year's budget for post-disaster reconstruction identified thus far, we expected to see a total investment across the nation of 400 billion yuan (\$58.6 billion) in the fourth quarter. Additional business and local government investment would bring the total to 4-trillion-yuan by the end of 2010.

As part of the stimulus plan, the State Council of China also passed revised regulations concerning the value-added tax (VAT), consumption tax, and business tax; these measures will cut VAT for all industries beginning January 1, 2009 and reduce the tax burden on companies by more than 120 billion yuan (\$17.57 billion) next year. This is in addition to the VAT rebate policy changes that took

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effect on November 1, 2008, which applied to 3,486 export products, including textiles, garments, toys, furniture, and some plastic products, and effectively reduced the VAT paid by exporters of these products.

The VAT revisions aim to further move the VAT away from being a production-based tax and closer to being a consumption-based VAT regime, which will enable companies to get tax deductions on spending on fixed assets. The revisions also scrapped policies that exempted imported equipment from VAT, and ended rules that gave foreign-invested enterprises (FIE) tax rebates on domestic equipment purchases, putting FIE on equal footing with local companies. The new VAT regulations also reduce the VAT rate for small businesses from 6 percent to 3 percent for industrial firms and to 4 percent for commercial companies, and increase the VAT rate for mineral products to 17 percent.

The 4-trillion-yuan investment package is the largest economic stimulus effort ever undertaken by the Chinese government. The plan differs from the \$700 billion financial rescue package approved by the Congress of the United States, which helped strengthen bank balance sheets but did not directly support specific investment projects. The Chinese stimulus plan, though driven by domestic concerns, represents a fresh commitment by China to keep from adding to the economic and financial woes of the United States and Europe. It is also likely to cheer foreign investors in China's economy by ensuring that the country remains a source of growth.

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