

I. ECONOMIC ENVIRONMENT

(1) INTRODUCTION

1. The period since Macau, China's previous Review in late 1994 has been marked by two main events. The most important of these was Macau's reversion to the People's Republic of China (PRC), on 20 December 1999, and its designation as a Special Administrative Region (SAR). Under the Basic Law of the Macau Special Administrative Region (MSAR) of the People's Republic of China (Basic Law), which provides for "one country, two systems", the MSAR has a high degree of autonomy for 50 years in the administration of all its affairs, except defence and foreign policy. The MSAR will retain its status as a free port and will be exempt from all taxes imposed by the Central Government of the PRC.

2. Macau's reversion to China took place subsequent to the second main event during the review period, namely the outbreak of the economic crisis in Thailand in July 1997 and its spread to other countries in (and beyond) South-East Asia. This crisis has seriously impaired Macau, China's economic performance, which had already started to deteriorate in 1996; real GDP contracted in four successive years (1996-99), with largest negative growth, of 4.6%, in 1998. Concurrently, the unemployment rate has more than doubled since 1997 (reaching 7.1% in the second quarter of 2000). At the same time, the MSAR has experienced mild deflation since 1998. As for the external sector, although Macau, China's merchandise trade account has been in deficit, this has been more than offset by a large surplus in services trade.

3. Trade is critical to the economy; exports and imports (of goods and services) were equivalent to roughly 80% and 50% of GDP, respectively, in 1999 (Table I.1). In addition to keeping the MSAR economy open to trade and foreign direct investment (FDI), the authorities have largely refrained from interfering with the normal functioning of the free-market system.

Table I.1
Major features of Macau, China's economy

Area	23.8 sq. km.	GDP (1999)	P 51.1 billion
Population (1999) ^a	437,455	GDP per capita (1999)	US\$14,145
Population growth (1994-99)	9.7%	Exchange rate (fourth quarter 1999)	P 8.0/US\$
Labour force participation rate (1999)	64.7%	Exports of goods and services/GDP (1999)	79.4%
Employment distribution (1999)		Imports of goods and services/GDP (1999)	51.6%
Manufacturing	22.0%		
Construction	8.1%		
Services	69.3%		

a End of year.

Source: Information provided by the Macau, China authorities.

(2) RECENT ECONOMIC DEVELOPMENTS

(i) Macroeconomic performance

4. After experiencing 3-4% growth in 1994-95, Macau, China recorded negative growth in 1996 partly as a result of weak demand in the real estate market. With the Macau economy already in recession, the outbreak of the Asian financial crisis in mid 1997 seriously compounded the difficult economic situation facing Macau, China, particularly by reducing the number of tourists and, hence, revenues from gambling and other tourism-related services. Real GDP growth remained negative

during the period 1996-99 (Table I.2). The main factors behind this GDP shrinkage were the sharp drop in business investment and weak private consumption; public consumption was the only factor contributing positively to growth during the period 1994-99. The unemployment rate has been rising since 1997, recording 6.4% in 1999, and reaching an unprecedented high of 7.1% in the second quarter of 2000. Inflation, measured by the General Consumer Price Index (excluding rents), has been moderate or negative during the period under review; in 1999, the Index declined by 3.2%.

Table I.2
Performance of Macau, China's economy, 1994-99

	1994	1995	1996	1997	1998	1999
	(Annual percentage change)					
Real GDP	4.3	3.3	-0.4	-0.3	-4.6	-2.9
Private consumption	6.1	2.8	4.0	1.4	-0.9	1.7
Public consumption	7.2	6.9	4.5	4.1	2.4	9.5
Gross fixed capital formation	0.6	-7.5	-22.1	1.9	-12.7	-9.2
Exports	5.0	5.7	-0.6	-1.7	-2.5	0.9
Goods	7.2	3.6	0.8	3.8	3.5	4.4
Services	3.7	7.1	-1.4	-5.1	-6.6	-1.6
Imports	5.5	-0.8	-7.9	-1.1	-1.0	8.1
Goods	8.8	-0.7	-9.1	-4.3	-1.0	7.8
Services	-8.6	-1.2	-1.6	13.9	-0.7	9.4
	(Index 24-28 October 1983 = 100)					
Effective exchange rate	107.3	106.0	107.7	112.9	110.5	111.5
	(Annual percentage change)					
Money supply (M2) ^a	13.1	13.5	7.9	4.8	10.0	4.6
Consumer price index (excluding rent of housing)	6.3	8.6	4.8	3.5	0.2	-3.2
Rent of housing	..	..	..	..	..	-3.2
	(Per cent)					
Interest rates ^a						
Prime rate (Hong Kong dollar)	8.5	8.5	8.5	9.5	9.0	8.5
Interbank rate (Macau Pataca) ^b						
1-month	6.0	6.0	5.5	7.3	5.3	5.7
3-months	6.5	6.0	5.6	9.4	5.3	5.9
Unemployment rate	2.5	3.6	4.3	3.2	4.6	6.4

.. Not available.

a End of year.

b Macau Interbank Offered Rate.

Source: Information provided by the Macau, China authorities.

(ii) Macroeconomic policies**(a) Monetary and exchange rate policies**

5. The autonomy of the MSAR in formulating its monetary policy is stipulated by the Basic Law¹; the Law further stipulates that neither foreign exchange nor capital controls can be used.² The objective of monetary policy is to maintain the stability of both the currency and the financial system. Accordingly, the Basic Law requires that the territory's currency, the Macau pataca, be fully backed by a reserve fund. The exchange rate is pegged at 1.03 to the Hong Kong dollar, and hence indirectly to the US dollar, under a currency-board type of arrangement (Box I.1).³ Foreign reserves stood at US\$2.9 billion at the end of 1999 (more than 13.4 times the Macau pataca notes issues) compared with US\$ 2.0 billion at the end of 1994.

6. The pegging of the pataca to the Hong Kong dollar means that the authorities have little, if any, scope for controlling the money supply and therefore interest rates. The outcome is relatively high real interest rates, which constitutes a potential impediment to the territory's economic recovery. The peg to the Hong Kong dollar and thus the U.S. dollar has also resulted in an effective appreciation of the pataca, particularly in relation to the devalued currencies of those countries in the region much more heavily affected by the Asian financial crisis; nevertheless, the low share of these countries in the MSAR's exports of goods and services may explain the moderate appreciation of the overall effective exchange rate of the pataca.⁴ The authorities believe that the advantages of the peg outweigh its disadvantages. One possibly major disadvantage is that the effective appreciation of the pataca, particularly vis-à-vis the devalued currencies of neighbouring countries, due to the Asian crisis and associated high real interest rates, may hamper both the Territory's economic recovery and the Government's efforts to diversify the economy. On the other hand, the authorities consider that maintenance of the peg between the pataca and the Hong Kong dollar imparts a high degree of stability to the financial system and the economy as a whole.

7. There are no exchange controls. Nor are there any restrictions on capital flows or controls on the use of payments or invisible receipts, apart from the obligation imposed on merchandise exporters to convert 40% of their export proceeds in foreign currency into pataca. The authorities maintain that the sole objective of this regulation is to encourage local currency circulation, and that there are no other restrictions imposed on either fund flows or foreign exchange operations.

(b) Fiscal policy

8. The Basic Law requires the MSAR Government to strive to achieve fiscal balance, which accords with Macau, China's traditional practice of prudent fiscal policy. There has been a fiscal surplus, albeit declining, since 1994; the surplus in 1999 was P 306 million (0.6% of GDP), about one fifth of that in 1994. The share of public expenditure in GDP, including by autonomous bodies⁵,

¹ Article 107: the Macau SAR Government shall, "on its own, formulate monetary and financial policies".

² Article 109.

³ The Hong Kong dollar pegged at 7.80 to the U.S. dollar.

⁴ For example, in 1997, Macau's exports to East Asian economies, except to Hong Kong, China; Chinese Taipei; Japan; and China, were about 1.5% of its total exports.

⁵ Autonomous bodies involve the Services with Administrative Autonomy, which are directly funded by the central budget, and the Autonomous Services and Funds, which are either funded by the central budget or may be financed by other sources of income. In 2000, there were five Services with Administrative Autonomy and 38 Autonomous Services and Funds.

has been increasing since 1994, representing some 20% in 2000. The accountability of the Government and its autonomous bodies for expenditures, including those involving the procurement of goods and services, could be improved.

Box I.1: Monetary institutions and arrangements

The framework of monetary institutions and arrangements in Macau, China has remained essentially unchanged since the reversion of the territory to China. Macau pataca banknotes are issued by two banks: the Bank of China and Banco Nacional Ultramarino, SA. These two banks are required to surrender Hong Kong dollars to the Monetary Authority of Macau (AMCM) in return for the Certificates of Indebtedness (CIs) required by law as backing for the bank notes issued by them, at the fixed rate of 1.03 pataca per Hong Kong dollar. The surrendered Hong Kong dollars are deposited in the official foreign exchange reserves held by the AMCM. The Macau pataca is legal tender in Macau, China, but the Hong Kong dollar circulates widely alongside them. Data provided by the authorities indicate that by the end of June 2000, Macau patacas and Hong Kong dollars, respectively, accounted for 27.1% and 53.9% of M2, compared with 42.9% and 46.8% of M1.

The principle mandates conferred on the AMCM are to:

- (i) advise the Chief Executive in the formulation and conduct of monetary, exchange-rate, financial, and insurance policies in Macau, China;
- (ii) ensure internal monetary stability and the external solvency of Macau's currency;
- (iii) guide, coordinate and oversee money, foreign exchange, financial, and insurance markets in line with the relevant rules, regulations, and laws;
- (iv) monitor and ensure the stability of the financial system;
- (iv) act as the central monetary depository and manage the territory's foreign exchange reserves and other foreign assets;
- (v) perform the duty of lender of last resort; and
- (vi) serve as the intermediary in the monetary and external financial relations of the MSAR.

Macau, China has operated a currency-board type of system since 1977, when the Territory switched its currency peg from the Escudo, the legal tender of Portugal, to the Hong Kong dollar. Bank notes and coins must be fully backed by foreign reserves. As a result of such backing requirements, the AMCM cannot provide an overdraft facility for the Government and thereby monetize any budget deficit.

In addition to the mandates described above, the AMCM may provide short-term liquidity to banks.

The AMCM has also been responsible for the management of the MSAR fiscal reserve fund (formerly known as land fund) since 1 April 2000.

Source: Macau SAR Government.

9. Taxes on gambling and other exclusive concessions accounted for about 31% of government revenue in 1998 (Table I.3). As about 95% of the land in the MSAR is owned by its Government, the leasing of land is another major source of government revenue. Profits from land concessions and the renewal of previous concessions are allocated in equal shares to the Reserve Fund and the budget of the MSAR.⁶

⁶ The Reserve Fund amounted to about P 10 billion in April 2000; responsibility for the management of the Fund rests with the Monetary Authority of Macau (AMCM).

Table I.3
Government budget, 1994-99
(Pataca million)

	1994	1995	1996	1997	1998	1999
Spending	11,251.3	15,468.4	14,681.3	14,240.7	15,505.7	16,636.2
Revenues	12,811.2	16,191.0	14,711.3	15,000.6	15,548.4	16,942.6
Direct tax	6,060.4	6,716.0	6,425.6	7,583.5	6,346.0	5,978.9
Corporate tax	623.4	595.1	555.5	569.6	632.7	573.9
Professional tax	242.9	258.4	292.2	308.6	296.5	293.1
Industrial tax	26.8	27.1	27.2	27.2	26.7	26.8
Property tax	120.4	134.3	162.9	199.0	230.4	260.2
Property transfer tax	402.1	324.5	325.7	344.2	260.7	346.6
Gifts and inheritance tax	14.3	19.4	10.9	7.5	13.3	13.4
Gambling and other exclusive concessions ^a	4,630.6	5,357.3	5,051.2	6,127.4	4,885.6	4,464.9
Indirect tax	715.7	648.9	712.3	644.4	573.0	578.8
Consumption tax	401.0	343.0	371.8	172.6	139.7	159.1
Vehicle tax	-	-	-	156.5	126.1	96.2
Stamp duties	190.6	202.6	227.7	213.8	214.1	238.9
Tourism tax	124.1	103.3	112.8	101.5	93.1	84.6
Other sources	6,035.1	8,825.1	7,573.4	6,772.7	8,629.4	10,385.0
Entrepreneurial and property income ^b	2,505.3	746.4	628.4	463.8	482.9	838.7
Export-related fees ^c	24.9	9.1	7.2	8.0	7.1	0.0
Other tax	780.6	2,734.9	908.6	1,874.5	3,141.7	2,547.3
Autonomous	2,724.3	5,334.8	6,029.2	4,426.3	4,997.7	6,999.0

a Concessions of exclusiveness for exploration, gambling, telecommunications, electricity, water supply and others; gambling accounted for 95% of total revenue from concessions in 1999.

b Receipts from land concessions.

c Levied for the issuance of certificates of origin.

Source: Information provided by the Macau, China authorities.

(iii) Structural/industrial policies

10. During the period under review, it appears that the Government has not attempted to materially influence the long-run structural evolution of Macau, China's economy either through border protection or internal measures. Applied tariffs are zero, and non-tariff border measures are almost absent (Chapter III(2)(v)); non-tariff border measures that do exist stem from Macau, China's obligations under various international undertakings (for health, safety, security or environmental reasons). At the same time, little, if any, direct assistance is provided to specific firms or industries (Chapter III(4)(ii)); the Government has instead focused on the provision of support for the development of infrastructure and the adoption of new technologies. The Government does use various tax incentives as instruments of industrial policy (Chapter III(4)(i)). More importantly, however, the MSAR's internal tax system is characterized by a low level of taxation and heavy reliance on direct taxes, particularly those derived from gambling; low tax rates contribute to the attractiveness of the MSAR for domestic and foreign investors. The stance of minimum interference with market forces extends to competition policy, with the authorities eschewing a comprehensive competition law; competition thus appears to be lacking in several services sectors, such as electricity, water, telecommunications, transport, and gambling.

11. Macau, China's industrial structure remains largely services oriented; services' share of GDP rose from some 88% in 1995 to about 90% in 1998. The share of manufacturing also rose from 7.9% to 9.3% during the same period, while that of construction declined (Chapter IV). With manufacturing accounting for only 9.3% of GDP and employing roughly 20% of workforce, labour productivity in the sector is much lower than in services, for example; manufacturing's relatively low labour productivity constitutes an impediment to the sector's competitiveness.

(3) TRADE DEVELOPMENTS

12. Exports of goods and services by Macau, China were equivalent to 79.4% of its GDP in 1999, a substantial increase from 72.9% in 1994; imports of goods and services were equivalent to 51.6% of Macau, China's GDP, compared with 49.9% in 1994.⁷

13. Macau's merchandise trade was in deficit during 1994-99; its trade deficit amounted to US\$299 million in 1999 (Table I.4).⁸ In the period 1994-97, exports grew, on average, by 4.8% annually; exports remained almost unchanged in 1998, but increased again in 1999. Reflecting weak domestic demand, imports declined between 1994 and 1998, except in 1997. Imports rebounded in 1999; however, the authorities ascribe this rebound to the one-off purchase of aircraft equipment and expenditure made in relation to the transfer of sovereignty process.

14. By contrast, Macau's services trade has shown a large surplus; exports of services were considerable higher than those of goods during the period under review. More than 90% of services exports comprised non-residents' expenditure in the domestic market, e.g. on gambling and tourism (Table I.5).

Table I.4
Estimates of Macau, China's external sector, 1994-99
(US\$ million)

	1994	1995	1996	1997	1998	1999
1. Merchandise exports (f.o.b.)	1,863.6	1,998.2	1,995.3	2,146.1	2,140.9	2,196.2
2. Merchandise imports (c.i.f.)	2,673.5	2,669.3	2,514.1	2,521.6	2,397.5	2,495.5
3. Trade balance (1-2)	-809.9	-671.1	-518.7	-375.5	-256.6	-299.3
4. Services exports	2,719.8	3,155.1	3,251.7	3,160.6	2,844.1	2,683.1
5. Services imports	466.1	506.1	529.8	628.1	633.6	677.6
6. Services balance (4-5)	2,253.7	2,649.0	2,721.9	2,532.5	2,210.6	2,005.5
7. Balance of goods and services trade (3+6)	1,443.8	1,977.9	2,223.2	2,157.0	1,953.9	1,706.2
Foreign exchange reserves	..	..	..	..	..	..
(in months of imports of goods and services)	..	..	..	..	..	..
Memorandum: Exchange rate (Patacas per US\$)	7.96	7.97	7.97	7.97	7.98	8.0

.. Not available.

Source: Information provided by the Macau, China authorities.

⁷ Data provided by the Macau, China authorities.

⁸ The current account was in surplus and grew annually by 7.5% on average during the period 1994-98. The Monetary Authority of Macau (AMCM) began compiling balance-of-payments data at the end of 1998. The authorities indicate that, owing to the lack of data for some financial and other variables, the current, capital and financial accounts can be misleading.

Table I.5
Exports and imports of services by category, 1993-99
(Pataca million and per cent)

	1993	1994	1995	1996	1997	1998	1999
Total exports (P million)	19,754.8	21,676.7	25,128.7	25,908.3	25,226.5	22,696.3	21,477.7
Share in total (%)	100	100	100	100	100	100	100
Gambling	67.6	68.5	66.7	61.4	68.2	64.5	61.1
Accommodation	3.8	3.8	3.7	3.9	3.2	3.3	3.3
Other expenditure of non-residents in the domestic market	26.6	25.8	28.0	30.0	22.1	25.2	27.5
Postal and telecommunication services	0.9	0.9	0.9	0.8	0.8	0.9	0.8
Industrial services	1.1	0.9	0.7	0.8	0.9	1.4	1.3
Non-industrial services	0.0	0.0	0.1	3.1	4.8	4.8	6.1
Total imports (P million)	3,593.6	3,715.3	4,031.4	4,220.6	5,012.9	5,055.8	5,423.9
Share in total (%)	100	100	100	100	100	100	100
Household final consumption expenditure abroad	24.0	28.3	30.5	33.8	30.9	33.1	34.3
Government expenditure abroad	4.2	4.6	4.5	3.6	2.9	3.4	3.5
Postal and telecommunication services	7.3	7.6	8.1	7.5	6.5	6.4	5.2
Transport services	10.7	11.5	12.5	11.6	10.4	9.1	8.2
Industrial services	7.4	10.4	11.8	11.9	13.8	12.0	12.0
Non-industrial services	17.9	7.5	4.8	6.7	14.4	16.0	17.3
Insurance and freight	28.6	30.2	27.8	25.0	21.1	19.9	19.4

Source: Information provided by the Macau, China authorities.

(i) Composition of merchandise trade

15. Macau's exports exhibit high product concentration (Table AI.1). During 1994-99, the shares of clothing and textiles in total exports increased from 64.4% to 74.2% and from 8.6% to 10.4% (Chart I.1). The share of other consumer goods, which was 12% in 1994, declined to about 5.6% in 1999; machinery and transport equipment increased from 3.5% in 1994 to 4.8% in 1999.

16. Imports are considerably more diversified. The share of textiles in total imports increased during the period 1994-98, before declining slightly in 1999 to around 40% (Table AI.2). Other major imports include machinery and transport equipment, food, clothing, fuels, and other consumer goods.

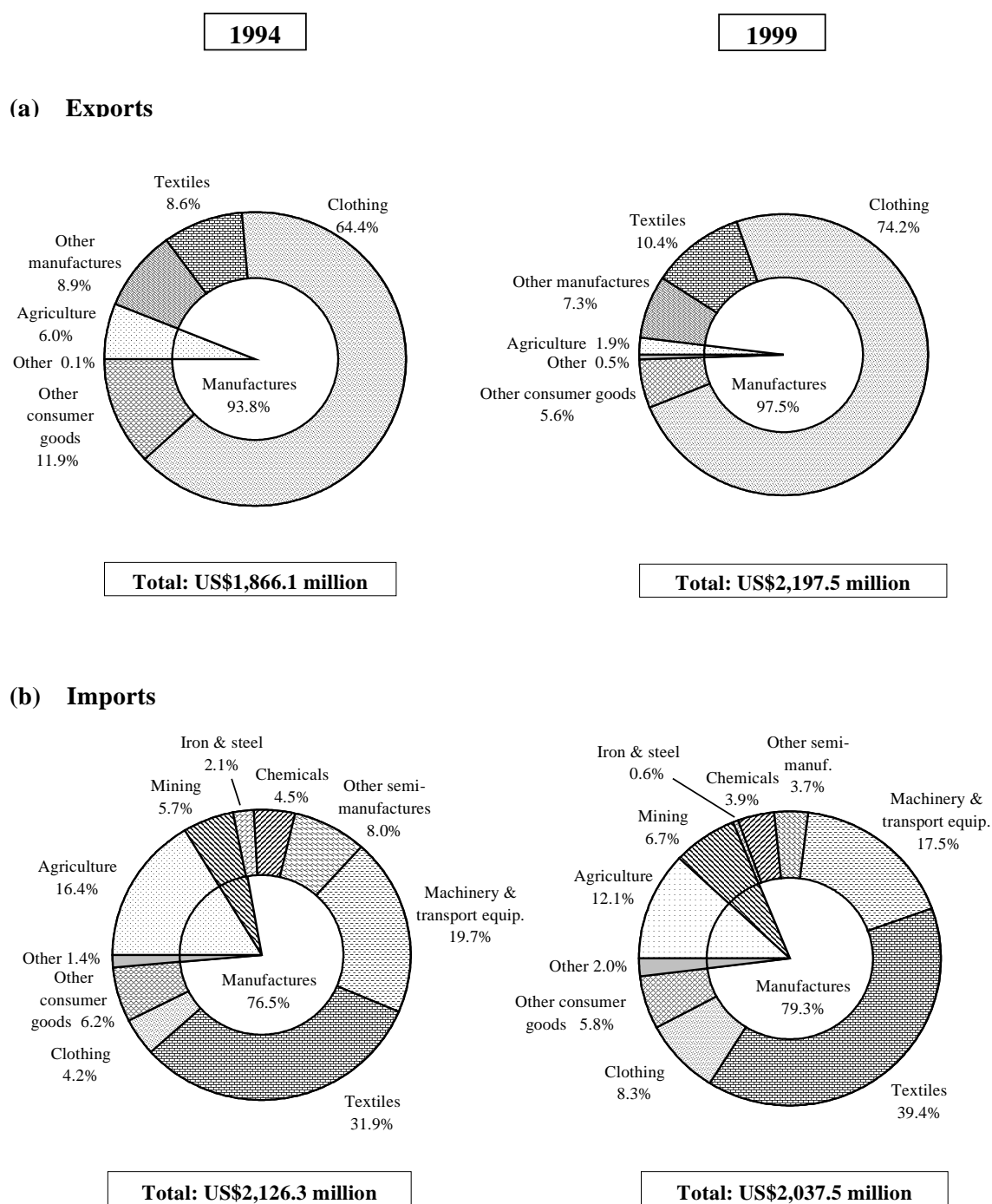
(ii) Direction of merchandise trade

17. Macau, China's major export destinations are the United States, the European Union, and Hong Kong, China (Table AI.3). During 1994-99, the United States' share of exports increased from 37.2% to 46.9%, while that of the European Union declined slightly, from 32.6% to 30.2%. Mainland China's share of Macau's exports also declined, from 12.7% to 9.2% (Chart I.2).

18. The major suppliers of merchandise to Macau, China are Mainland China; Hong Kong, China; and Chinese Taipei (Table AI.4). Reflecting the economic integration of Macau, China with the Mainland, the share of imports from the Mainland in Macau's total imports increased from 18.8% in 1994 to 35.6% in 1999. However, the share from Hong Kong, China has declined considerably; the authorities state that this may reflect a decline of Hong Kong's role as the source of raw materials originally produced in the Mainland, and of semi-manufactures, due possibly to the relocation of Hong Kong manufacturers to China in the 1990s.

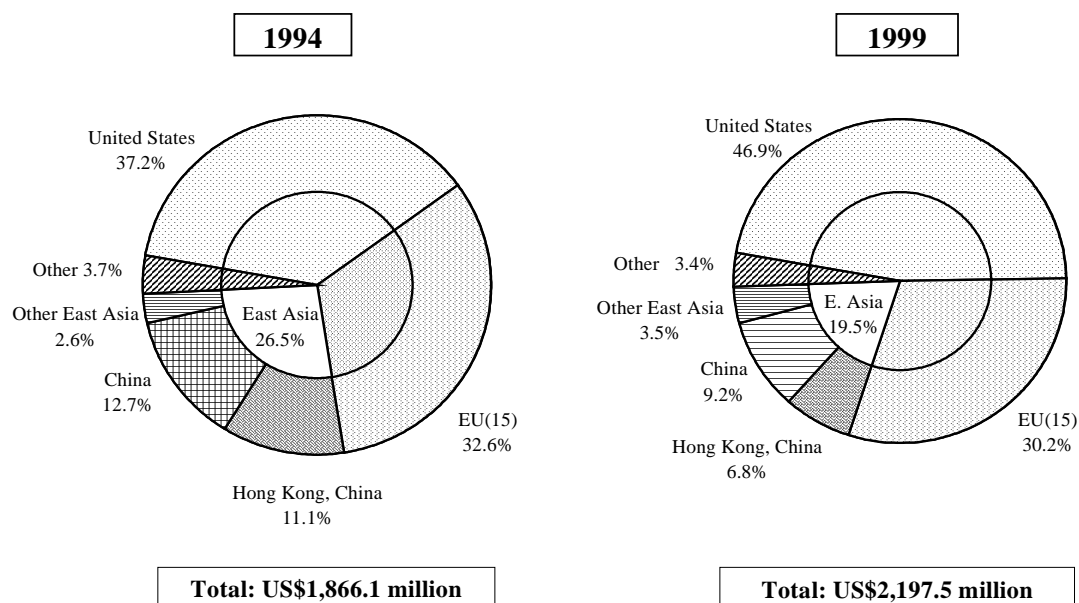
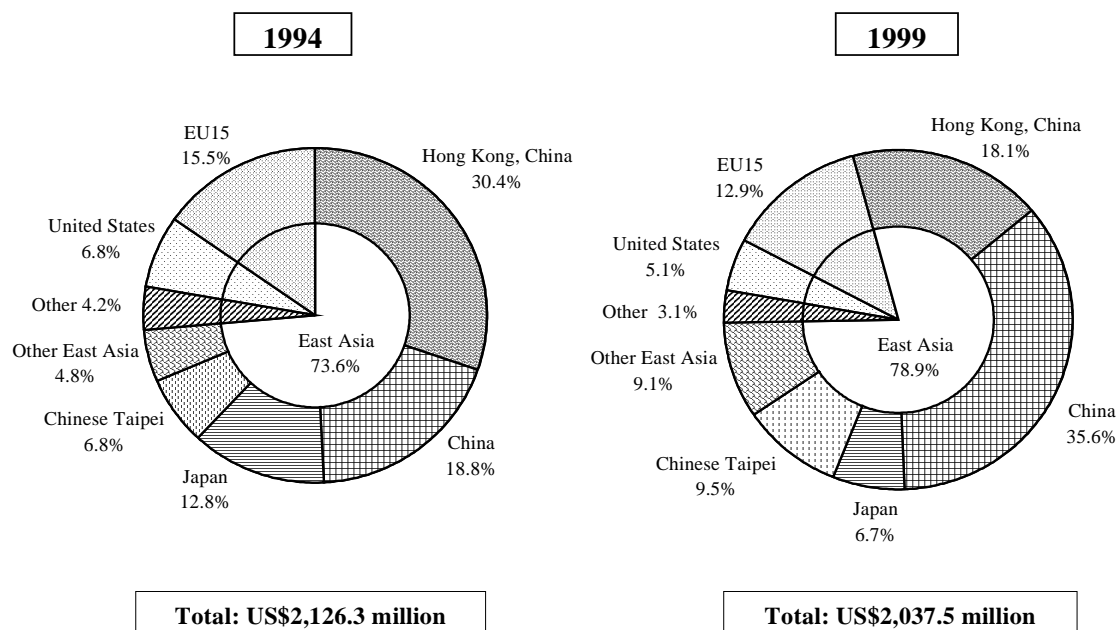
Chart I.1

Product composition of merchandise trade, 1994 and 1999



Note: Export figures for "other" include mining.

Source: Data provided by the authorities of Macau, China.

Chart I.2**Merchandise trade by main origin and destination, 1994 and 1999****(a) Exports****(b) Imports**

Source: Data provided by the authorities of Macau, China.

(4) FOREIGN DIRECT INVESTMENT

19. According to a recent survey by the Government⁹, more than half of the total stock of foreign direct investment (FDI) into Macau, China up until 1998 came from Hong Kong, China; the next largest source of FDI was Mainland China, followed by France, Singapore, and Portugal.¹⁰ About 58% of the inbound FDI went to electricity, gas, and water supply, 20% to manufacturing and 18% to hotels and tourism (Table I.6).¹¹ No official data on Macau's outbound FDI were available.

Table I.6
Stock of foreign direct investment into Macau, China, 1998
(Pataca million)

	Total FDI ^a	
	(Net book value)	(Historical cost)
Country/Territory		
Total	3,122.4	6,756.6
Hong Kong, China	1,631.1	3,744.4
China (mainland)	558.7	856.9
France	318.5	738.6
Singapore	294.0	681.8
Portugal	293.2	612.0
Others	27.0	123.0
Sectors^b		
Total	3,122.4	6,756.6
Mining and quarrying industries	28.2	48.9
Manufacturing	697.6	1,397.3
Tobacco products	62.6	84.2
Textiles	163.6	352.8
Garments, dressing and dyeing of fur	147.7	283.8
Other non-metallic mineral products	151.1	299.0
Office, accounting and computing machinery	44.7	76.2
Electrical machinery and apparatus n.e.c.	60.6	77.4
Furniture; manufacturing n.e.c.	14.2	134.7
Electricity, gas and water supply	1,705.0	3,927.4
Hotels and similar	557.0	1,195.3
Air transport	134.5	187.6

n.e.c. Not classified elsewhere.

a Data concern foreign direct investment in industrial, hotel, and air transport subsectors.

b According to the Macau Classification of Economic Activities.

Source: Information provided by the Macau, China authorities.

⁹ IPIM (1998).

¹⁰ On a historical cost basis.

¹¹ FDI refers to all investments in Macau, China made by non-resident, direct investors holding 10% or more of a company's equity capital. The country of residence of the investor refers to: in the case of the investor being an individual, the place where the investor has resided the longest during the period of analysis, and where the investor is a company or a public entity, the place where the branch office is situated or the place of production or business (if the company does not carry out any production, e.g. in the case of holding company, the country of residence then refers to the place of registration of the company).

(5) PROSPECTS

20. The Government forecasts growth of 2.4% for 2000, which is considerable lower than that of Macau's neighbours, including Mainland China and Hong Kong, China. But, there are some other positive signs of economic recovery; the number of visitors between January and September 2000 increased by 24.3% compared with the same period of the previous year, and exports increased by about 17% in the first eight months of the year, compared with the growth of imports (+8.7% for the same period). However, in the first quarter of 2000, the real estate sector was still weak. In order to alleviate high unemployment, the Government has, *inter alia*, been encouraging more public infrastructure projects, reducing the amount of quotas on foreign workers, and providing additional employment training and re-training courses.

21. The envisaged recovery of the Hong Kong SAR and several other South-East Asian economies, the major sources of tourists to Macau, China (Table IV.3), as well as, the strong recent growth in the United States and the European Union, where most of Macau, China's clothing exports are directed, also augurs well for economic recovery. These developments complement the gradual rebound in consumer spending and corporate activity. It remains to be seen whether the high real interest rates prevailing in Macau, China and the related high level of the real effective exchange rate hinder that recovery.

22. The authorities maintain that China's accession to the WTO would be broadly beneficial, helping to create more business opportunities in the MSAR. Nonetheless, as China is a major exporter of textiles and clothing, its accession to the WTO appears to pose a major threat to the future of the Territory's textile and clothing sector, which currently accounts for a lion's share of its merchandise exports. China's accession to the WTO, together with the termination in 2004 of the Agreement on Textiles and Clothing and the consequent removal of the long-standing quota system, may well increase the need for the economy to diversify.