China - Corr & docs.
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ASIANBK 742507I

MR ERNEST STURC

INTERFUND

WASHINGTON

RECEIVED OCT 28 1970 EXCHANGE & TRADE RELATIONS DEPARTMENT

139735

WE WOULD APPRECIATE YOUR CONFIRMING FOR OUR RECORDS THE FOLLOWING REGARDING THE CURRENCY STATUS OF REPUBLIC OF CHINA AND REPUBLIC OF VIETNAM STOP AAA WHETHER PARVALUE OF THE CURRENCY OF REPUBLIC OF CHINA HAS BEEN ESTABLISHED WITH IMF AND IF SO, THE PARITY RATE AND THE DATE FROM WHICH IT IS EFFECTIVE STOP BBB THAT THE CURRENT AGREED PROVISIONAL RATE WITH IMF FOR REPUBLIC OF VIETNAM IS 80 PIASTRES PER USDOLLAR 1 STOP PLEASE ADVISE NEW RATE IF THIS IS CHANGED REGARDS

KAZMI

TREASURER

ASIANBANK

RECEIVED I. M. F. OCT 28 1970 CABLE ROOM

Tom - Treas.
4166.

September 4, 1970

MEMORANDUM

To: Treasurer
Director, Asian Department
Director, Exchange and Trade Relations Department
General Counsel
Internal Auditor

From: The Secretary W. Lawrence Hebbard

Subject: China - Initial Par Value

The Government of the Republic of China has proposed, and the Fund has agreed to, an initial par value for the new Taiwan dollar. The par value expressed in terms of gold and in terms of the U.S. dollar of the weight and fineness in effect on July 1, 1944, is as follows:

0.022 216 8	gram of fine gold per new Taiwan dollar;
1,400.00	new Taiwan dollars per troy ounce of fine gold;
40.000 0	new Taiwan dollars per U.S. dollar;
2.500 00	U.S. cents per new Taiwan dollar.

RECEIVED
SEP 8 1970
EXCHANGE & TRADE RELATIONS DEPARTMENT

SEP 4 1970

Sir:

This is to inform the CONTRACTING PARTIES to the General Agreement on Tariffs and Trade that the Government of the Republic of China has proposed, and the Fund has agreed to, an initial par value for the new Taiwan dollar.

The par value of the new Taiwan dollar expressed in terms of gold and in terms of the United States dollar of the weight and fineness in effect on July 1, 1944, is as follows:

0.022 216 8	gram of fine gold per new Taiwan dollar;
1,400.00	new Taiwan dollars per troy ounce of fine gold;
40.000 0	new Taiwan dollars per U.S. dollar;
2.500 00	U.S. cents per new Taiwan dollar.

Very truly yours,

W. Lawrence Hebbard
Secretary

Mr. Olivier Long
Director-General
CONTRACTING PARTIES to the General
Agreement on Tariffs and Trade
Villa le Bocage
Palais des Nations
Geneva 10, Switzerland

cc: MD
DMD
Mr. Tann
ASD
SEC
ETRD
LEG
UN Rep.
RES
Mr. Gerhard
Mr. Lang
TRE

JKay:mw 9/3/70

Mr. Chandavarkar September 3, 1970

Günter Wittich

Republic of China - External Debt

We are attempting to improve reporting of external debt data and to insure reasonable consistency between our reports and those of the IBRD. A comparison of data contained in a recent IBRD report (EAP-17, dated 8/12/70: Vol. III Tables 4-1 and 4-2, attached) and our last consultation report (SM/70/101, dated 5/19/70: Table 26, p. 47) reveals considerable differences in coverage:

1. Our report appears not to include suppliers' credits to the public sector. It refers to Government Obligations and perhaps excludes suppliers' credits because they were extended to autonomous bodies or public enterprises. It would seem preferable to extend our coverage, as otherwise the misleading impression could arise that no other public sector obligations exist.

2. There are differences in data on debt owed to the U.S. Government. Especially, are "loans not in service" and "loans with repayment terms not settled" included in our data?

3. We report a debt service ratio of "about 6 per cent" (SM/70/100, 5/18/70, page 9), while the Bank refers to one of 4.5 per cent. The difference is the opposite from what one would expect as debt outstanding shown by the Bank is higher than that shown by us and payments on undisbursed parts of foreign debt are included in the Bank calculation of the ratio.

4. The staff has at various times been questioned on similar discrepancies in the Executive Board. The reporting of different debt service ratios in particular has frequently attracted attention. As presumably the data reported in our consultation paper were provided by the Chinese authorities as the most reliable, one might at the occasion of the next Article XIV Consultation discussions seek an explanation of the differences. It may be noted in this context that Bank data are also based on debtor reporting. Perhaps it may also be worthwhile to state explicitly in our section Recent Economic Developments what has been used as denominator in calculating the debt service ratio (e.g., receipts for goods and services in 1969).

cc: Mr. Palmer
Mr. Rose
Mr. McLenaghan

16

135033

RECEIVED
JUL 24 1970
EXCHANGE & TRADE RELATIONS

Orig: ASD
cc: MD
DMD
Mr. Tann
TRE
LEG
RES
~~ETR~~ 2
SEC

24331 INFUND

RC2 AZCZC YW1694 FBD3380 FUS313 22224

URWA CT CNTA 039

TAIPEI ORD 39 24 NFT

INTERFUND WASHINGTONDC

REOUR CABLE 23RD TEXT SHOULD BE REVISED AS FOLLOWS QUOTE
THIS IS TO ADVISE YOU THAT TODAY WE HAVE RECEIVED INSTRUCTION
FROM EXECUTIVE YUAN AUTHORIZING SUSPENSION OF TRANSFER UNDER
REGISTERED FOREIGN EXCHANGE EFFECTIVE JULY 1ST UNQUOTE

GOVERNBANK

RECEIVED
I. M. F.
JUL 24 1970
CABLE
ROOM

OFFICIAL **OUTGOING MESSAGE** OFFICIAL

Cable Room

FOR PREPARING OFFICER

☐ Night Letter
☐ Full Rate
☐ Code

SPECIAL INSTRUCTIONS

OR DISPATCH AFTER CLOSE
F BUSINESS ON 7/20/70
EBD/70/139, 7/14/70)

cc: MD
Mr. Tann
ASD
LEG
RES
ETR
SEC
TRE

CNM

Drafted by CNMarsh:bjo
Department Secretary's
Date 7/20/70

AUTHORIZATION

Signature

Second Signature When Required

FOR CODE ROOM

Time Received
Time Dispatched
Number of Words
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Operator

INTERNATIONAL MONETARY FUND
WASHINGTON D.C.

To: His Excellency, K. T. Li, Minister of Finance
Ministry of Finance, Nanchang Street, Taipei, Taiwan
Republic of China

Executive Board took following decision July 20:

QUOTE After consideration of the information presented by the Ministry of Finance of China, the Fund determines on the basis of such data that the net official holdings of gold and U.S. dollars of China under Article III, Section 3(b)(ii), on September 12, 1946 were:

	(In U.S. dollar equivalents)	
Gold	178,058,467.09	
U.S. dollars	420,586,373.99	
	$598,644,841.08	UNQUOTE

Hebbard
Interfund

Transmitted via the Embassy by letter 7/22/70

DO NOT TYPE BELOW THIS LINE

Mr Palmer

Office Memorandum

Mr. Rose -
(While you were away, Norris & Frank commented on a draft from Woodley - Suggest you become familiar with this.

TO : Mr. Woodley

DATE: July 17, 1970

FROM : James G. Evans, Jr.

SUBJECT : China - Initial Par Value

I have the following comments on the draft of the paper for the Executive Directors on China's proposal for an initial par value for its currency:

1. The title should be:

"China - Initial Par Value for the Currency of China"

2. The following is suggested as a substitute for the introductory section:

"I. Introduction

In a letter to the Managing Director dated June 23, 1970, which is attached, the Minister of Finance of the Republic of China proposes on behalf of its Government that a par value for the currency of China be established at NT$40 to the United States dollar of the weight and fineness in effect on July 1, 1944. This is the equivalent of 0.022217 grams of fine gold or US$0.025 per new Taiwan dollar.

China is an original member of the Fund with a Schedule A quota of $550 million. China has not consented to any increase in its quota and has indicated that it does not wish to have an increase as part of the Fifth General Review.

As an original member of the Fund, China is required when so requested by the Fund under Article XX, Section 4(a) to communicate the rate of exchange of its currency prevailing on the sixtieth day before the entry into force of the Articles of Agreement, i.e., on October 28, 1945. Article XX, Section 4(a) stipulates an exception to this requirement, however, in accordance with which a member whose metropolitan territory had been occupied by the enemy was not required to make this communication for such period as the Fund may determine. After the Fund had requested original members to make the communication, China was deemed to have availed itself of this exception (Executive Board Decision No. 187-3 adopted July 16, 1947). In the attached letter, the Minister of Finance communicates the rates of exchange in effect on October 28, 1945 and notifies the Fund, in accordance with Article XX, Section 4(b), that China regards these rates as unsatisfactory as the basis for an initial par value. With the adoption of the recommended decision by which the Fund would agree to the initial par value proposed, the periods during which China would not be required either to communicate a par value under Article XX, Section 4(a) or to agree a par value under Article XX, Section 4(d) will be terminated and China will become eligible to buy the currencies of other members to the full extent permitted by the Fund Agreement.

The Fund was aware of the unusual difficulties which confronted the monetary and exchange authorities in China during the years immediately following the Second World War and recognized that because of the unusual circumstances China might not be able to inform the Fund well in advance of rate changes and that the Fund ordinarily would not be in a position to pass on changes. The Executive Directors in Executive Board Meeting No. 329 (6/18/48), adopted a special procedure under which changes in China's exchange system were notified to the Managing Director who was to reply at once on behalf of the Fund, unless he preferred to raise the matter with the Executive Board. The procedure was discontinued by Executive Board Decision No. 1129-(60/54), adopted December 28, 1960. Many changes were made during the period the special procedure was in effect, including the introduction of the new Taiwan dollar (NT$), in June 1949, as part of a monetary reform. The exchange system was changed from time to time and subsequently simplified effective June 1, 1961 when the official buying and selling rates were set at NT$40.00 and NT$40.20, respectively (EBS/6/67, 5/26/67, and Sup.1, 5/29/61). The Fund did not object to newly communicated buying and selling rates (Executive Board Decision No. 1205-(61/28) adopted June 7, 1961). On September 30, 1963 the exchange rate system was unified and the buying and selling rates were set at NT$40.00 and NT$40.10 per US$1, respectively (EBD/63/113, 10/1/63). These rates are still in effect."

3. I would suggest the following in place of the first paragraph in Part II:

"The 1969 Article XIV Consultation with China was held on June 9, 1970, (Executive Board Meeting 70/52), on the basis of the report prepared by the staff mission that visited Taipei in March 1970, and of the staff memorandum on recent economic developments (SM/70/100, 5/8/70; and SM/70/101, 5/9/70)."

4. In the last full sentence on page 3 states:

"...the exchange rate was set at NT$40 to US$1."

This appears to be incorrect and should refer to

"the buying and selling rates which were set at NT$40.00 and NT$40.10 to US$1, respectively."

5. On page 4.

(a) The third sentence in the only full paragraph might read:

"However, the exchange and trade systems continue to involve extensive controls and restrictions."

(b) The last two sentences in the same paragraph require clarification. If the foreign exchange is sold freely for certain transactions, the situation cannot be described as one involving a restriction. It is my understanding that the multiple currency aspect of the registered foreign exchange scheme was to have been abolished on July 1, 1970.

(c) The opening clause of the last sentence might read:

"During the preparatory staff discussions for the last Article XIV consultation,...."

6. Page 5. Again, with regard to the registered foreign exchange scheme, we should have a notice from the Chinese authorities stating that at least the multiple currency aspects of this scheme have in fact been abolished on July 1, 1970.

7. The par value implies, although it does not require, rates of exchange within possible margins of NT$39.60 to NT$40.40 per US$1. The paper appears to assume that there will not be any change in the effective buying and selling rates in the immediate future. If this is so, it might be confirmed or else this possibility raises the questions whether the new situation has implications for the immediate future.

8. The staff recommendation and decision could be revised as follows:

"III. Staff Recommendation

The proposed initial par value has been the effective buying rate for the last decade. During these years exports have grown substantially and the balance of payments has improved. The staff believes that China can further simplify the restrictive system and eliminate substantially all of its restrictions on the basis of the proposed par value. Therefore, the staff recommends that the Fund agree to the initial par value for the currency of China proposed by the authorities of the Republic of China. Accordingly, the following decision is submitted for the consideration of the Executive Directors:

1. The Government of the Republic of China has proposed to the Fund an initial par value for the currency of China. Expressed in terms of gold and in terms of the U.S. dollar

of the weight and fineness in effect on July 1, 1944, the initial par value for the currency of China is:

0.022217	grams of fine gold per new Taiwan dollar;
1,400.00	new Taiwan dollars per troy ounce of fine gold;
40.00	new Taiwan dollars per U.S. dollar;
2.50000	U.S. cents per new Taiwan dollar.

2. The Fund agrees to the proposed par value."

cc Mr. Savkar
Mrs. Yang
Mr. Palmer
Mr. Familton

134982

RC11

AAZCZC YW1435 FBC2889 FUS259 22211

URWA CO CNTA 030

TAIPEI 30 23 2125

Orig: ASD
cc: MD
DMD
Mr. Tann
TRE
LEG
RES
ETR
SEC

INTERFUND WASHINGTON DC

THIS TO ADVISE YOU THAT TODAY WE HAVE RECEIVED INSTRUCTION FROM EXECUTIVE YUAN SUSPENSION OF TRANSFER UNDER REGISTERED FOREIGN EXCHANGE AUTHORIZED BY MOEA EFFECTIVE JULY 1ST

GOVERNBANK

24331 INFUND
1141 23.JUL

RECEIVED
I. M. F.
JUL 23 1970
CABLE ROOM

Mr. Hughes July 7, 1970

Maria O. Tyler

China--Initial Par Value for the New Taiwan Dollar

It seems to me that the paper requires several revisions even in the new version of July 7.

1. Page 1. Para. 1

The par value should be expressed in terms of the gold content of the currency unit. Therefore the following is a suggested replacement for the first paragraph.

"In the attached communication to the Managing Director, dated June 23, 1970, the Minister of Finance of the Republic of China proposes on behalf of his Government that a par value for the new Taiwan dollar be established equal to 0.022217 gram of fine gold. This corresponds to an exchange rate in terms of U.S. dollars of NT$40 per US$1 or NT$1 equals US$0.025."

2. Page 1. Para. 2 Second sentence

The meaning of this paragraph is obscure and I suggest the following addition should be made after the first sentence.

"Only the U.S. dollar payment for administrative expenses, amounting to one hundredth of one per cent of the quota, has been made in accordance with Article XX, Section 2 (d) of the Fund agreement."

3. Page 1. Para. 2

Also a reference should be included to the Executive Board discussion of the 1970 Article XIV Consultation report; during the meeting the Executive Director for China indicated that the Chinese Government had instructed him to discuss with the Fund the procedure for payment of the gold subscription and for determining a par value. This would appropriately be the penultimate sentence.

4. Page 1. Para. 3

The special procedure referred to in the second paragraph should perhaps be described briefly and the Board decisions on its adoption and discontinuance should be quoted.

5. Page 2. Line 7.

For "subsequently" read "substantially".

6. Page 2. Incomplete paragraph

Should there not be some reference to the exchange certificate system which is mentioned without explanation in the middle of the full paragraph on page 3.

7. Page 2. Final paragraph Line 2

For "in" read "at"

8. Page 2. Final paragraph Line 3

Delete "at"

9. Page 3. Full paragraph line 3

Insert "was" between "aid" and "discontinued"

10. Page 3. Full paragraph Line 9

Delete "that of"

11. Page 3. Full paragraph Line 12

The reference to the setting of the exchange rate in 1963 at NT$40 per US$1 is not consistent with the description of the changes in exchange rates at the top of page 2.

12. Page 4. First full paragraph

The impression given is somewhat at variance with the appraisal in the 1970 Staff Report. It might be more consistent to replace this paragraph with something along the following lines:

" The exchange and trade control systems were developed during years of balance of payments pressures. In recent years restrictions have been liberalized to a considerable extent. However, the exchange and trade system continues to be subject to extensive controls and to restrictions. The trade system involves restrictive licensing of over 40 per cent of classified import commodities, and prohibition of a large number of commodities; application of a self-sufficiency ratio for certain industries, with a required percentage of domestic inputs in their production; and an import deposit requirement applied to certain categories of transactions. The exchange control system involves restrictions on current transactions although for a number of these foreign exchange is sold freely while for others foreign exchange may be bought up to fixed limits. Moreover, the registered foreign exchange scheme, which is an export/import link device applied to certain industries with facilities for the transfer of import entitlements between manufacturers, gives rise to a multiple currency practice.

Recently, China reduced the import deposit requirement from 50 per cent to 25 per cent and terminated its last bilateral payments agreement, that with Spain.

During the staff discussions for the last Article XIV Consultation, the Chinese authorities indicated their willingness to maintain a continuing review of exchange and trade policies with the aim of liberalizing existing restrictions, and introducing a comprehensive rationalization of the tariff. Moreover, in the decision of the Executive Board in concluding the 1970 Article XIV Consultation with China it was stated that 'The Fund welcomes the intention of the Chinese authorities to eliminate the multiple currency aspects of registered foreign exchange, beginning July 1, 1970' ."

13. Page 4. [After above insert]

The staff should ascertain whether this intention has been carried out, and a statement to this effect should be included in the paper.

14. Page 4.

A short paragraph should be added on the viability of the proposed par value. (The Thai case [EBS/63/145, Sup.1] provides a parallel).

15. Page 4. Recommendation

A small drafting point in line 1. Insert "in" after concur.

ATTACHMENT

Ministry of Finance
Republic of China

Office of the Minister

June 23, 1970

Sir:

On behalf of the Government of the Republic of China I have the honor to communicate, pursuant to Article XX, Section 4, a proposal for the establishment of an initial par value for the currency of China. Article XX, Section 4(a) requires a member to communicate the rates of exchange for its currency prevailing on the sixtieth day before the entry into force of the Articles of Agreement, that is, on October 28, 1945. The rate of exchange on that date was Chinese yuan 20 per U.S. dollar. In the light of developments since that time, this rate of exchange is not, of course, a satisfactory basis for the establishment of an initial par value.

China experienced unusual difficulties in the years immediately after the second World War which were recognized by the Fund in Executive Board Meeting 329 (June 18, 1948), with the adoption of a special procedure under which the Fund dealt with changes in China's exchange system. This procedure was discontinued by the Fund on December 27, 1960. Many changes were made during that period including the introduction of the new Taiwan dollar (NT$), in June 1949, as part of a monetary reform. The exchange system was changed from time to time and subsequently simplified effective June 1, 1961 when the official buying and selling rates were set at NT$40.00 and NT$40.20, respectively. The Fund did not object to these new official rates. On September 30, 1963 the buying and selling rates were set at NT$40.00 and NT$40.10 per US$1 respectively. These rates are still in effect.

I propose, on behalf of the Government of the Republic of China, that the initial par value of the currency of China be NT$40 per US$1 of the weight and fineness in effect on July 1, 1944.

Very truly yours,

K. T. Li
Minister of Finance

Mr. P. -P. Schweitzer
Managing Director
International Monetary Fund
Washington, D.C. 20431
U. S. A.

308778

MINISTRY OF FINANCE
REPUBLIC OF CHINA

Office of the Minister

Orig: SEC
cc: Mr. Tann
ASD
LEG
ETR
TRE

July 3, 1970

RECEIVED
JUL 9 1970
EXCHANGE & TRADE RELATIONS DEPARTMENT

Mr. W. Lawrence Hebbard
Secretary
International Monetary Fund
Washington, D.C. 20431
U. S. A.

Dear Mr. Hebbard:

I have received with thanks Mr. Anderson's letter dated June 23, 1970 sending me a copy of the decision taken by the Executive Board concerning the recent consultation.

The consultation was one of the most successful meetings with the Fund experts and the conclusions are both satisfactory and useful for reference to our government. I wish to take this opportunity to express our sincerest thanks to the Fund for continuous cooperation and assistance.

Sincerely yours,

K. T. Li

K. T. Li
Minister of Finance

SY:ey

INTERNATIONAL MONETARY FUND

June 5, 1970

Mr. Palmer:

Your immediate comments would be appreciated.

Mr. Habermeier intends to consult Mr. Tann on this matter today.

Thank you.

CBF

C. B. Fink

DRAFT

June 4, 1970

Sir:

On behalf of the Government of China I have the honor to communicate, pursuant to Article XX, Section 4, a proposal for the establishment of an initial par value for the currency of China. Article XX, Section 4(a) requires a member to communicate the rates of exchange for its currency prevailing on the sixtieth day before the entry into force of the Articles of Agreement, that is, on October 28, 1945. The rate of exchange on this date was Chinese yuan 20 per U.S. dollar. In the light of developments since that time this rate of exchange is not, of course, a satisfactory basis for the establishment of an initial par value.

China experienced unusual difficulties in the years immediately after the second World War which were recognized by the Fund in Executive Board Meeting 329 (June 18, 1948), with the adoption of a special procedure under which the Fund dealt with changes in China's exchange system. This procedure was discontinued by the Fund on December 27, 1960. Many changes were made during this period including the introduction of the new Taiwan dollar (NT$), in June 1949, as part of a monetary reform. The exchange system was changed from time to time and subsequently simplified effective June 1, 1961 when the official buying and selling rates were set at NT$40.00 and NT$40.20 respectively. The Fund did not object to these new official rates. On September 30, 1963 the remaining multiple currency practice was abolished and the buying and selling rates were set at NT$40.00 and NT$40.10 per US$1 respectively. These rates are still in effect.

I propose, on behalf of the Government of China, that the initial par value of the currency of China be NT$40 per US$1 of the weight and fineness in effect on July 1, 1944.

Very truly yours,

Minister of Finance

Mr. P.-P. Schweitzer
Managing Director
International Monetary Fund
Washington D.C. 20431

DRAFT

June 4, 1970

Dear Mr. Schweitzer:

I am pleased to be able to inform you that the Government of the Republic of China wishes to complete payment of the gold portion of its subscription to the International Monetary Fund pursuant to Article III, Section 3 before China becomes eligible under Article XX, Section 4 to buy currencies from the Fund by the establishment of an initial par value.

Data on China's net official holdings of gold and United States dollars as of September 12, 1946 were furnished to the Fund by the Executive Director for China on November 16, 1948. Further information on these holdings was provided by the Alternate Executive Director for China on June 15, 1950. In this connection, I wish to state that to the best of the knowledge and belief of the Chinese authorities, the holdings of other official institutions and other banks in Chinese territory on September 12, 1946 were no more than working balances.

Upon receipt of the Fund's determination of the net official holdings of gold and United States dollars of the Republic of China as of September 12, 1946, the Central Bank of China will arrange for the payment of the appropriate amount of gold to the Fund under Article III, Section 3(b). I will be writing to you concerning the establishment of an initial par value for the new Taiwan dollar.

Sincerely yours,

Minister of Finance

Mr. P.-P. Schweitzer
Managing Director
International Monetary Fund
Washington D.C. 20431

INTERNATIONAL MONETARY FUND

Return to Mr. Rose.

S

V.

Our files or front office?

Donald K. Palmer

INTERNATIONAL MONETARY FUND

6/3/70

Mr ~~Rose~~.

Mr ~~Palmer~~.

My caveat failed to stop this going off.

I am surprised ~~that~~ we don't have to make some reference to the existing unapproved m.c.p. covered in current Consultation report decision.

I have not spoken to Mr Evans.

James G. Evans, Jr.

6/4

5/22

INTERNATIONAL MONETARY FUND

Mr Evans

China - Par Value

We spoke about Mr Finch's draft letter.

Perhaps I may come & see you when you have read attached? I have not shown it to Mr Palmer at this stage.

Rose

J. W. Rose

DRAFT
JWRose
May 22

China - Par Value

Substitute second paragraph for Mr. Fink's draft letter.

The monetary unit existing on October 28, 1945 was the Chinese Yuan with a rate of exchange of Yuan 20 per U.S. dollar. This unit and exchange rate, however, now have no appropriateness to the proposal for the establishment of a par value. Briefly, you will recall that the years following 1945 were years of monetary instability in China. This was evidenced by depreciation in the value of the currency and the maintenance of a complex multiple exchange rate system. The particular difficulties facing the monetary and exchange authorities were recognized by the Fund by initiation of a special procedure for consultation with China on changes in exchange rates and the exchange rate structure. Notification of such changes was given to the Managing Director, who as far as possible replied at once on behalf of the Fund without reference to the Executive Board. This system operated between 1948 and 1960. In the earlier part of this period - in June 1949 - a new currency unit, the New Taiwan dollar (NT$) was introduced as part of a monetary reform but it was not until June 1961 that the exchange rate system was effectively unified at the still current official buying rate of NT$40 per US$1. (Recently, the status of the unitary rate system has been fully established by the elimination of the multiple currency aspects of a registered foreign exchange scheme operated as an export incentive). This exchange rate has therefore demonstrated its viability over a period of years in which the Chinese economy has developed the characteristics of high growth rates in circumstances of monetary stability.

Mr. Palmer

Messrs. Evans and Finch May 19, 1970

C. B. Fink CBF

China - Payment of Initial Gold Subscription and Establishment of Par Value

Attached are two draft letters which could serve as a basis for further discussions with Mr. Tann on the above subjects. It would seem appropriate that ETR prepare the detailed recital of changes in the exchange system which Mr. Gold, in his memorandum of April 16,1970, says is necessary.

As regards the preparation of the necessary Board papers, the one on "Net Official Holdings of the Republic of China" could be prepared in the Treasurer's Department and the one on "Establishment of Initial Par Value" will need to be prepared by the Asian Department in consultations with Legal, ETR and Treasurer's. An outline of such a paper is attached, assuming a par value of NT$ 40.00 per U.S. dollar. Of course, there is no need to prepare these papers until after further discussions with Mr. Tann.

Your early comments on the attachments would be appreciated.

Attachments

Dear Mr. Schweitzer,

On behalf of the Government of the Republic of China, I have the honor to propose to the International Monetary Fund, a par value for the new Taiwan dollar of new Taiwan dollars ______ per U.S. dollar of the weight and fineness in effect on July 1, 1944. It may be recalled that in response to the Managing Director's cable communication to member countries on September 4, 1946 the Government of China, on October 7, 1946 furnished the rate of exchange for Chinese currency prevailing on October 28, 1945 (and subsequent changes in the rate on March 4, 1946 and August 19, 1946). It may also be recalled that China availed itself of the provisions of Article XX, Section 4(a). The Government now proposes that the period available to it under Article XX, Section 4(a) be terminated and that the further period available under Article XX~~X~~ Section 4(~~a~~ d) also be terminated.

The rate of exchange on October 28, 1945 was Chinese yuan 20 per U.S. dollar. The Government of the Republic of China does not regard that rate as a satisfactory par value in view of the significant changes in the economy since that date including substantial changes in the exchange system ~~and the adoption of a new monetary unit~~. It will be recalled that the unusual difficulties which the monetary authorities faced in 1948 had earlier been recognized by the Fund at Executive Board Meeting 329 (June 18, 1948), when a special procedure was decided whereby China would be required to ~~recognized the responsibility of~~ notify~~ing~~ ed the Fund of contemplated changes in exchange rates and the exchange structure. Under this procedure, which was reaffirmed by the Fund at Executive Board Meeting 53/54 (November 6, 1953) and discontinued on December 27, 1960, the Fund was notified accordingly.

Changes made in the exchange system in the period 1948-1960 are listed in the attachment to this letter. I wish to draw attention particularly to the adoption of the new Taiwan dollar in 1949 and to the successive changes that were made in the official exchange rates and the exchange certificates rates that culminated, on April 14, 1958, in the establishment of official rates of NT$ 24.58 buying, and NT$ 24.78 selling per U.S. dollar. The official rates applied to major exports, essential imports, and to invisibles for the account of the Government. The official rates plus the value (NT$ 11.50 buying, and NT$ 11.60 selling) of an exchange certificate were applied to the settlement of all other exports, imports, and invisibles. Other rates were abolished. Subsequently, the exchange system was further simplified and from November 21, 1958 transactions previously effected at the official rate took place at the rates of NT$ 36.08 buying and NT$ 36.38 selling, per U.S. dollar. These rates were ~~subsequently~~ later changed, effective June 1, 1961 to NT$ 40.00 and NT$ 40.20 respectively and on May 29, 1961 the Fund "did not object to the proposed change in the official rate of the new Taiwan dollar." On September 30, 1963 the exchange certificate system was abolished and the buying and selling rates were changed to NT$ 40.00 and NT$ 40.10 per U.S. dollar. These rates are still in effect.

I look forward to learning of the Fund's decision to terminate the respective periods under Article XX, Sections 4(a) and 4(d) and of its agreement on the proposed initial par value for the new Taiwan dollar.

Sincerely yours,

Minister of Finance

Mr. P.-P. Schweitzer
Managing Director
International Monetary Fund
Washington, D.C. 20431

Attachment

Dear Mr. Schweitzer:

I am pleased to be able to inform you that the Government of the Republic of China proposes to complete payment of its subscription to the International Monetary Fund pursuant to Article III, Section 3.

Data on China's net official holdings of gold and United States dollars as of September 12, 1946 were furnished to the Fund by the Executive Director for China on November 16, 1948. Further information on these holdings was provided by the Alternate Executive Director for China on June 15, 1950. The total net official holdings were about $598.6 million and, in this connection, I wish to state that to the best of the knowledge and belief of the Chinese authorities, the holdings of other official institutions and other banks in Chinese territory on September 12, 1946 were no more than working balances.

Upon receipt of the Fund's determination of the net official holdings of gold and United States dollars of the Republic of China as of September 12, 1946, the Central Bank of China will arrange for the payment of the appropriate amount of gold to the Fund under Article III, Section 3(b). I am writing separately concerning the establishment of an initial par value for the new Taiwan dollar and the Central Bank of China will expect to receive a communication from the Fund concerning the payment of the balance of China's quota in its own currency.

Sincerely yours,

Minister of Finance

Mr. P.-P. Schweitzer
Managing Director
International Monetary Fund
Washington, D.C. 20431

Par Value of the New Taiwan Dollar

In his letter of ________, the Minister of Finance of the Republic of China, on behalf of the Government of the Republic of China, proposed to the Fund a par value for the new Taiwan dollar of NT$ 40.00 per US$1.00 of the weight and fineness in effect on July 1, 1944 (see attachment).

China is an original member of the Fund. After correspondence between the Fund and China in 1946 and 1947 it was made clear in Executive Board Document No. 235, Revision 2, Supplement 1, February 25, 1948 that China had not yet communicated to the Fund the par value of its currency and that the period during which China will not be required to communicate the par value had yet to be determined by the Fund. In regard to this latter step, the Chinese authorities now propose the termination of the period under Article XX, Section 4(a), as well as the further period for agreement available under Article XX, Section 4(d). Since October 28, 1945, there were substantial changes in the exchange rate system of China culminating in the establishment of official buying and selling rates for the U.S. dollar of NT$ 40.00 and NT$ 40.10 respectively, on September 30, 1963, which have been maintained unchanged since then. China's quota is $550 million. On March 29, 1946 one one-hundredth per cent of quota, namely U.S. $55,000, was paid to the Fund in accordance with Article XX, Section 2(d).

(Section on exchange rate system summarizing the main changes, including adoption of the gold yuan and ~~subsequently~~ the use of the new Taiwan dollar ~~which is the~~ as means of settlement.)

(Section of main economic developments.)

It is recommended that the Fund should concur in the par value communicated to the Fund by the Government of the Republic of China, and the following draft decision is submitted for consideration by the Executive Board:

0.022 216 8	grams of fine gold per new Taiwan dollar
1400.00	new Taiwan dollars per troy ounce of fine gold
40.00	new Taiwan dollars per U.S. dollar
2.500 00	U.S. cents per new Taiwan dollar

2 · AJF
3 file

cc: CGF
DW
CEJ

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

DEPUTY MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

April 9, 1970

MEMORANDUM

TO: Mr. Habermeier

FROM: Frank A. Southard, Jr.

SUBJECT: China's Gold Payment to the IMF

Today Mr. Tann informed me that President Chang Kai-shek has approved the payment to the Fund of approximately $60 million in gold on account of China's subscription. He indicated that the Chinese authorities would probably want to complete this payment before the Copenhagen meeting. He mentioned to me that there seemed to be some question of the currency which would be used in the currency portion of the total arrangement. As I understand it, there may be a question as to whether the New Taiwan Dollar would be used at an appropriate rate of exchange (40 to 1?), or whether the currency which existed in 1946 would be used. I am not at all clear about this but I do not see why the problem should be difficult. Mr. Tann says that the World Bank is using the New Taiwan Dollar.

I suggest that Mr. Gold and you, or persons representing you both, should explore this matter further with Mr. Tann.

cc: Mr. Gold
Mr. Hebbard

(c) the present currency of China and the rates of exchange, and the names and values for the separate currencies, if any, in terms of this currency;

(d) that China requests an extension under Article XX, Section 4(d)(i) of the ninety-day period referred to in Article XX, Section 4(b), but without suggesting a terminal date.

[At this point China would be able to make purchases if permitted by the Fund to do so under Article XX, Section 4(d)(ii).]

7. If China wished to establish an initial par value for its present currency by the most expeditious procedure it could send a communication to the Fund by which it would propose the termination of the period under Article XX, Section 4(a), as well as the further period for agreement available to it under Article XX, Section 4(d) and an initial proposed par value for its currency. This communication would also have to include a recital of the developments with respect to the currency of China beginning with the rates of exchange prevailing on the sixtieth day before the Articles entered into force, i.e., October 28, 1945, a statement that they are not satisfied with this 1945 rate as a par value, and the subsequent history of the currency, including the adoption of any new monetary unit. If there were separate currencies, appropriate reference would have to be made to these. On the basis of such a communication the Fund could decide to terminate the respective periods and agree on the proposed initial par value if it were deemed satisfactory.

Office Memorandum

TO : Mr. Habermeier DATE: April 16, 1970

FROM : Joseph Gold JG

SUBJECT : Possible Action under Article XX, Section 4 with Respect to China

1. This note outlines the steps specified in the Articles that could be taken in order to make it possible legally for China to engage in exchange transactions with the Fund. China can become eligible under Article V, Section 3 in accordance with Article XX, Section 4(c) by establishing an initial par value in agreement with the Fund under the procedure of Article XX, Section 4(b) and (d). Alternatively, after the communication of a par value under Article XX, Section 4(a) but without the establishment of an initial par value, China could rely on Article XX, Section 4(d)(ii) which authorizes the Fund to permit transactions on such conditions and in such amounts as the Fund may prescribe. In either event, pursuant to Article III, Section 3(a), China would have to pay its subscription in full on or before the date that it could engage in transactions with the Fund.

2. Beginning procedure for initial par value or purchases under Article XX, Section 4(d)(ii). China is now in the position of not having been required to communicate a par value under the second sentence of Article XX, Section 4(a). The decision of the Fund that China was deemed not to have communicated a par value under this provision also stated that China and the Fund will consult at a later date as to the time when a par value should be communicated. After consultation, the Fund could determine when the period of noncommunication is to end, and therefore by what date China must communicate "the par value of its currency based on the rates of exchange prevailing on the sixtieth day before the entry into force" of the Fund Agreement, that is, the rates of exchange for the currency of China on October 28, 1945.

3. A communication under Article XX, Section 4(a) in response to the Fund's decision to end the period of noncommunication in accordance with paragraph 2 above should state: (i) the rate for the Chinese currency as of October 28, 1945 and the value of any separate currencies in terms of the Chinese currency (see Article XX, Section 4(g)); (ii) that the rates have been changed and new monetary units, if any, have been introduced since that date (see Article XX, Section 4(e)); (iii) the name of the present currency of China and the present rates of exchange; and (iv) the names and values of separate currencies, if any, in terms of the present currency of China.

4. Initial par value. If China wishes to establish an intial par value, agreement on the termination of the extended period referred to in Section 4(d)(i) would be necessary. In the communication referred to in paragraph 3 above, China could suggest what extension

Mr. Palmer

Mr. Beue Tann May 6, 1970

W. John R. Woodley

China - 1969 Article XIV Consultation--Modified Decision Relating to Registered Foreign Exchange

The following refers to our discussion this morning.

In the light of the new formulation of Fund Decisions Relating to Exchange Practices of Member Countries approved by the Board (SM/70/60, Supplement 1, April 22, 1970), the following "proposed draft decision" will be contained in the Staff Report.

"The Fund welcomes the assurance of the Chinese authorities of their intention to eliminate the system of registered foreign exchange described in SM/ / , which gives rise to a multiple currency practice. In view of the circumstances the Fund grants approval of the measure until June 30, 1971.

The Fund will review these measures on the occasion of the next Article XIV consultation with China."

cc: Mr. Palmer
Mr. Evans
Mr. Chandavarkar
Far Eastern Div.

WJRW:fj

Mr Palmer

Mr. Chandavarkar   May 5, 1970

James G. Evans, Jr.

<u>China: Registered Foreign Exchange System</u>

In your note of May 1 on this subject you state:

> "In the year immediately following the adoption of a unitary rate system in September 1963, transactions under the registered exchange system were negligible. However, they assumed larger dimensions in 1968 when exports of processed goods had grown to a substantial amount together with the increase in the number of raw materials entitled to such special treatment and in the percentage of export earnings allowed to be registered."

The 1964 Article XIV consultation report (SM/64/85 - 10/8/64) states on page 3 of Part I:

> " In the exchange field, the foreign exchange certificate system was abolished in September 1963 and thus the exchange rate system was simplified."

and an almost identical sentence is found on page 31 of Part II. This is also reported (but with October 1 as the date) in the <u>Fifteenth Annual Report on Exchange Restrictions</u> (1964).

No reference is made to this scheme until the 1968 Article XIV consultation report (SM/69/23 - 2/18/69), and the <u>Twentieth Annual Report on Exchange Restrictions</u> (1969).

On the basis of the above it would appear that the reappearance of this retention scheme is an introduction of a multiple currency practice and we are not now asking the Board to condone a multiple rate, that was just overlooked for years, but a proliferation of the rates in what was a unitary rate system. This should be made explicit in the paper.

cc Mr. Woodley
   Mr. Palmer

Mr. Palmer

The Managing Director
The Deputy Managing Director

May 4, 1970

W. John R. Woodley

China - 1969 Article XIV Consultation - Decision Relating to Exchange Practices

The adoption of the revised formulation for Fund decisions relating to exchange practices (SM/70/61, Sup. 1, effective April 24, 1970) raises questions for the draft decision on China. China has a minor multiple currency practice arising from exporters receiving transferable import entitlements. Transactions in these have occurred at exchange rates slightly outside the one per cent margin. The staff's judgment is that the practice is not so objectionable as to warrant Fund disapproval.

The draft Board decision under the new formulation would read:

"The Fund welcomes the assurance of the Chinese authorities of their intention to eliminate the system of registered foreign exchange described in SM/ / , which gives rise to a multiple currency practice. China has requested the Fund to approve the exchange measure described in SM/ / . In view of the circumstances which have led to the request, the Fund grants approval of the measure until June 30, 1971.

"The Fund will review these measures on the occasion of the next Article XIV consultation with China."

The difficulty with this form is that China has not requested Fund approval of the exchange scheme described in the staff report. Consequently the submission of this formulation to the Board would require seeking from the Chinese authorities, through Mr. Tann, a request for approval. Since the Chinese authorities are likely to be sensitive on this issue and even to deny that the practice is a multiple currency practice, obtaining such a request is likely to be difficult, if not impossible.

One way out of this dilemma would be to delete references to a China request in the formulation above, i.e., "China has requested the Fund to approve the exchange measure described in SM/ / ," and in the next sentence "which led to the request." Such an alteration could attract Board attention but could be explained as due to the mission occurring before the new decision.

If you agree with this proposal which has been cleared with ETR and Legal, we will explain it to Mr. Tann and seek his agreement.

cc: Legal
ETR
Far Eastern Div.
Mr. Chandavarkar

Mr. Evans May 1, 1970

A. G. Chandavarkar

China - Article XIV Consultation Paper--Registered Foreign Exchange

The following information provided by Mrs. Wu Yang is in response to the second paragraph of your comment of April 30, 1970.

At the end of August 1956, a set of "Measures to Encourage the Processing of Imported Raw Materials for Export" was introduced to promote industrial exports. This was discussed during Article XIV consultations in the late fifties and early sixties. At that time, it went without Fund approval for two reasons: (1) Prior to December 27, 1960, changes in the exchange system of China were under special procedure (Board Decision No. 329-1 on June 18, 1948), no Board approval was needed if the Managing Director deemed so; (2) Prior to September 30, 1963, China had an extensive multiple rate system, but presumably the "Export-Import Link System" which added one more rate to an already complicated rate structure, was not regarded as of material consequence. In the years immediately following the adoption of a unitary rate system in September 1963, transactions under the registered exchange system were negligible. However, they assumed larger dimensions in 1968 when exports of processed goods had grown to a substantial amount together with the increase in the number of raw materials entitled to such special treatment, and in the percentage of export earnings allowed to be registered.

cc: Mr. Palmer

AGC:fj

Office Memorandum

pao

TO : Mr. Palmer DATE: April 22, 1970

FROM : John W. Rose

SUBJECT : China: Part I Consultation Report

I mentioned to you Mr. Woodley's concern that we shouldn't seem remiss over coverage of China's commercial policies in the light of what the IBRD may produce, partly as the result of studies which Bela Belassa is seemingly undertaking.

There is no difference in our basic analysis and one completed by the Tax Reform Commission in China itself: there should be a tariff rationalization as a basis for the dismantlement of import controls. I have therefore sent Mr. Woodley the attached note.

But I think it necessary to focus on the implications of our coverage of the tariff system in this way. What we are illustrating is that in the case of China we have been looking at nontariff barriers when the tariff itself on a large range of items may be prohibitive. This raises the question of the adequacy of our coverage of trade restrictions in the whole field of our reporting. The Chinese have produced the following analysis of effective rates of tariff protection (in per cent) for six developing countries, presumably the choice of countries being determined by the availability of data. (I have not tried to check the source and reliability of the data).

	China	Argentina	Pakistan	Brazil	Philippines	Mexico
Consumer goods	432	220	465	155	1,011	34
Intermediate goods	71	315	95	112	89	28
Capital goods	21	194	143	91	96	35
Over-all	91	246	212	126	300	33

If we draw attention fairly dramatically to tariff barriers in China, what do we do about the Philippines on which we have not commented or focused? What is our capacity to mount studies in this field and to refine a better analysis of integrated tariff and nontariff restrictive systems?

I raise these questions, on which I have had some preliminary discussion with Mr. Gerhard, only because I think we are contingently introducing a new dimension into our analysis which might excite the Executive Board but which we are not equipped to undertake. And it gets introduced for a country which is doing well.

Attachment

cc: Mr. Hughes
Mr. Gerhard

Mr. Woodley April 21, 1970

John Rose

China: Part I Consultation Report

In the light of our discussion this morning I suggest the following additions to the present draft report.

(1) Page 17: second paragraph add sentence at end:

"..... (with Spain). Against this background and in the light of the highly satisfactory economic performance of the Chinese economy, the staff team at the request of the Chinese authorities placed greater emphasis this year on discussion of the restrictive system."

(2) Page 18: delete last 6 lines and substitute appendix A.

(3) Page 25: delete lines 10 to 13 and substitute:

there is no presumption

"......... changed circumstances of the external sector. In the light of the highly satisfactory performance of the economy as a whole and the export sector in particular, i~~t cannot be maintained~~ that the systems have unduly handicapped development but the staff believes that economic performance would benefit from liberalization of the restrictive system. Most importantly this would involve~~s~~ a dismantlement of import controls in favor of reliance on the tariff as a protective instrument. The staff therefore welcomes the indications given by the Chinese authorities of their willingness to keep exchange and trade policies under review with the aim of liberalizing existing restrictions. The present consideration of a comprehensive rationalization of the tariff on the basis of effective tariff rates seems a courageous initiative which might give rise to a beneficial precedent to other industrializing countries. As an early measure of liberalization, the staff believes that the termination of the import ......"

2, on
1, on
3, on

6, on

CHINA - Draft Part I Report

"........(com)putation of effective tariff rates.

(of the Tax Reform Commission)

The tariff study indicates that the effective rates of protection extended to categories of processing are 132 per cent for consumption goods, 71 per cent for intermediate goods, and 21 per cent for capital goods with a mean over-all rate of 91 per cent. Food and clothing industries receive a very high degree of protection; cement products, iron and steel, machinery, shipbuilding, chemical products and electrical products receive relatively moderate protection; cement and chemical fertilizers receive virtually no protection. Some processing receives negative effective protection. The study draws attention to the fact that the protective function of the tariff has been compounded by the heavy reliance on import controls and comments forcefully on the adverse implications of such protection for resource allocation and social welfare. Accordingly, it embodies recommendations for the dismantlement of controls and the rationalization of the tariff to extend a reasonable degree of protection on the basis of (i) reduction of rates on raw materials and capital goods which cannot be produced domestically and on essential consumption goods, (ii) avoidance of negative effective rates of protection, (iii) reduction of long-standing high protection extended to some industries which is no longer justified and reduction of protection for low efficiency industries which are really not economically viable, (iv) increase in protection for new industries, and (v) reliance on domestic business tax rather than the tariff to penalize consumption of luxury goods. The report embodies some interim recommendations for tariff reform.

The staff team endorsed the broad analysis and conclusions of the study, commenting that while there was availability of unemployed labor, it might be possible to pursue policies of import substitution and export promotion concurrently with some present economic advantage from inefficient substitution through protection. But the real cost of such substitution would be demonstrated when full employment were attained and a dynamic export sector was in competition with an uneconomic substitution sector for labor. Already some economic production was apparently being burdened by requirements to use less satisfactory domestic inputs in preference to imports so that the efficiency of these industries was in turn handicapped.

The Chinese representatives stated that the need for a comprehensive tariff reform was under consideration. In the meantime, in order to avoid unnecessary protection and the encouragement of inefficient production, a brake was to be applied to the extension of the policy of self-sufficiency ......

(continue to existing page 19)

Mr. Duncan Ridler April 14, 1970

A. G. Chandavarkar

Commodity Problems - Republic of China 1969 Article XIV Consultation March 16-26, 1970

The following observations might be of interest to you in the context of Mr. Polak's recent circular to the area departments concerning difficulties encountered by developing countries in marketing their primary products in industrialized countries.

In the case of China, the problems relate to the high rate of import duty (60 per cent ad valorem) imposed by Japan on imports of bananas from the Republic of China as well as to the fact that the importation is not done through competitive market channels, but is organized through a group of importers (The Japan Banana Importers Cooperative). Bananas from the Ryukyus group of islands (Japanese territory at present under U.S. Government control) are, however, admitted free of duty. A major reason for the high duty on bananas is the protection of the market for domestic apples and oranges. Part of the proceeds of the import duty on bananas are earmarked for development of apple and orange cultivation.

Japan is at present the only export market for Chinese bananas and therefore enjoys a monopsonistic position vis-a-vis China while also being in a position to import bananas from other sources such as Latin America. The Chinese authorities feel that a lowering of the tariff as well as competitive importation may help to increase their offtake. The export of Chinese bananas is, however, also done through an organized group. It is difficult to judge the potentialities of the Japanese market for further absorption of Chinese bananas, a pertinent consideration in the context of the limited possibilities of absorbing exportable supplies "from already planned productive capacity at remunerative prices," which appears to be a world-wide problem (World Trade in Bananas - Ian Brown - DM/70/11, p. 16).

The other problems mentioned by the Chinese authorities regarding import restrictions relate to (i) the import duties imposed by the European Common Market on canned mushrooms (23 per cent), canned pineapples (23 per cent), and canned asparagus (25.2 per cent); (ii) the import quotas on the same products imposed by Denmark, Sweden and the U.S. (canned mushrooms).

cc: Mr. Woodley
Mr. Savkar (on return)
Mr. Kanesa-Thasan
Mr. ~~Ross~~
Mrs. Wu Yang

AGC:fj

1969 Art. XIV Consultation with China; Taiwan 3/19/1970

file

Minutes of Fourth Session of Technical Meeting

In response to a question by the staff team the Chinese representatives stated that the increase in 1969 in "other services" in the balance of payments resulted from larger earnings by Chinese crews crews of foreign shipping companies and by remittances for the maintenance of local offices by foreign companies, predominantly Japanese companies. The increase in the long-term capital inflow of the private non-monetary sector derived from larger imports under long-term supplier credit. The "currency and bank deposits" in the short-term capital account related to movements in foreign balances held by private concerns, predominantly transport and insurance companies, maintained abroad for the financing of their operations. The import "prepayments" in the short-term capital account resulted partially as actual prepayments for imports, but predominantly as a balancing factor between the actual flow of imports (on arrival at customs basis) and the financing flow. Although the bulk of imports were financed on a sight letter of credit basis, the advance deposit required against imports were recorded as an import prepayment in the balance of payments data. The decline in the prepayment item in 1969 was related to the reduction in August 1969 in the advance deposit requirement.

As regards external debt, it was explained that private guaranteed loans were accounted on the basis that most foreign commercial lenders required guarantees by domestic banks and therefore the guarantees by the banks could be regarded as an adequate basis for assessing medium- and long-term commercial debt liabilities; it was reckoned?? reckoned that at least 90 per cent of this commercial credit was bank guaranteed. The amount amount listed as short-term supplier credit in fact related only to normal usance credit of up to one-year term; for this there was no repayment schedule as it was regarded as a stock of normal revolving trade financing. The debt repayment schedules for both the government debt and the guaranteed debt covered both interest and repayment, but it was not possible to give a breakdown of these factors. It was confirmed that there was no short-term government external debt and therefore data given for the governmental debt was total debt. The Central Bank had data on private unguaranteed debt for only 1969, from which date it had assumed the responsibility for approving such loans, but as stated such debt was a small element of the total private debt.

fragmented

The staff team observed that in the face of the somewhat fragmented nature of external debt accounting, it was hoped that the same data would be provided to both the IBRD and Fund missions in order to avoid any reporting contradictions. The Chinese representatives undertook to ensure this and commented that they themselves were aware of the existing deficiencies in their external data accounting. The Executive Yuan had in fact instructed that there was to be coordination and consolidation of external debt accounting and this was being implemented by the Foreign Exchange ~~Bureau~~ Department ~~under the chairmanship of Dr. Sun, Deputy Governor~~ of the Central Bank. It was confirmed that the data relating to government debt given to the staff team was on a disbursed debt basis; as for private debt guaranteed by banks, the Chinese representatives promised to check into the nature of the data.

The Chinese representatives described the impact—or cash—loans for which data had been supplied. These cash loans for conversion into NT$ for domestic finance needs were predominantly provided by the American banks and, because the borrowing rates were linked to the Euro dollar rates, they provided a somewhat cheaper borrowing facility for local industry compared with domestic bank credit. There was no repayment schedule available, but the total outstanding of such borrowing had not reached significant proportions. The Central Bank did not encourage these arrangements but equally well, whilst it remained of manageable proportions, did not discourage it. The arrangements provided medium-term financing which was not always readily available from domestic banks. Besides the concerned private corporations found the association with large foreign banks useful in other ways, e.g., in effecting improvement in management. The Asian dollar market had, as yet, not had much impact in China; the Central Bank had in fact received a request for deposits there but deposit rates available in New York had been found to be higher than those available on the Asian $ market. The outstanding amount of the foreign currency cash loans to private enterprises was put at about $25-30 million and repayments under this borrowing were estimated at between $7-8 million in 1970.

As regards the new foreign trade policy applied in 1969, it was stated that the main elements of this were (1) liberalization of import controls; (2) promotion of exports; (3) international cooperation; (4) coordination of production and marketing; (5) quality control; (6) high quality marketing; (7) establishment of new markets; (8) overseas marketing assistance, and (9) shipping industry development. At the moment export insurance (which covered credit and non-credit risks) only applied to Latin American countries but the extension of this to the whole world was under consideration; such insurance was managed by the Central Trust.

As regards the balance of payments projections for 1970 and 1971, it was stated that these were based on (1) the Four-Year Economic Plan adjusted for recent balance of payments developments; (2) projections of increases of exports of 17.5 per cent in 1970 and 15.4 per cent in 1971, and of imports

1969 Art. XIV Consultation with China;
Factual Info received; March - 1970

File

Supplement
to
Background Material for 1969 Article XIV Consultation

(Page 55 - Table 23)

(1) Guaranteed Loans Outstanding:

Date	Outstanding Amount
Dec. 31, 1967	US$89,642,000
Dec. 31, 1968	US$147,756,000
Dec. 31, 1969	US$304,449,000

(2) Repayment Schedule of Guaranteed Loans for 1970-74

Date	Repayment Amount
1970	US$49,544,000
1971	US$45,611,000
1972	US$45,816,000
1973	US$42,504,000
1974	US$36,333,000

(3) Short-term and ~~Medium-term~~ Commercial Credit Including Suppliers Credit Outstanding.

Date	Outstanding Amount
Dec. 31, 1967	US$42,907,000
Dec. 31, 1968	US$78,340,000
Dec. 31, 1969	US$123,774,000

Mrs. Lachman

A. G. Chandavarkar

March 31, 1970

China - 1969 Article XIV Consultation -- Gold Production and Registered Foreign Exchange

I attach (i) copies of answers to the questions agreed during our pre-China mission meeting on gold production in China together with other relevant mission material on this subject; (ii) mission material relative to the Chinese "registered foreign exchange scheme (see pages 12 and 15 of SM/69/23).

When you have reviewed this material perhaps you will call a meeting to decide what action is appropriate on these matters.

cc: Mr. Sturc
Mr. R. Miller

Mr. Palmer

March 30, 1970

Bdo

Mr. Sturc:

China: 1969 Article XIV
Consultation

I attach a copy of the paper given to the Chinese authorities in response to their request for a review of the restrictive system as part of the recent consultation.

J. Roze

Attachment

cc: Mr. Palmer
Mr. Hughes

Dr. I. S. Sun
Deputy Governor
Central Bank of China

March 24th, 1970

1969 Article XIV Consultation

Attached is a review of the restrictive system in the terms requested by the Chinese authorities. It is submitted now in case it warrants some discussion at our final meeting.

I would like to give the following extract from the final statement I intend to make tomorrow in order to put the review into perspective:

"............

As regards the restrictive system, we have already given you our general analysis in a review responding to your request for this particular focus to this year's consultation. We are anxious that this review should not be read as being overly critical of your external sector policies. From what I have already said you will be aware of how impressed we are with your performance. Our review was in response to your particular request and has been drafted only to direct attention to areas which we think may usefully be re-examined; in some cases we are aware that this is already being done. But emphatically it is meant to be a possible contribution to policy formulation rather than a criticism of it.

.........."

A. G. Chandavarkar
IMF Staff Team.

INTERNATIONAL MONETARY FUND

Republic of China - 1969 Article XIV Consultation

Review of the Restrictive System

The Chinese authorities requested that the Fund team should direct particular attention in the consultation this year to the following aspects of the restrictive system:

1. The structure of the present trade restrictive measures and its effect on economic development;
2. Identification of areas where the present restrictive measures could be gradually liberalized in the best interests of the economy without losing sight, however, of the fact that a large import surplus is likely to remain in the future. By what ways and means?
3. Making a review of the present management of foreign exchange and recommending ways and means for its improvement.

These aspects of the system follow a natural progression for its examination but, as a whole, need to be related to the consistency of trade and exchange policies with the over-all objective of economic development. The broad objectives of the Fifth Development Plan are to achieve the optimum rate of growth with increasing employment in circumstances of domestic price stability and a sustainable balance of payments. The growth is to be derived from a strategy of balancing development in the industrial, agricultural and infrastructural sectors with recognition of China's heavy reliance on external trade for attainment of its objectives. It is particularly noticeable that in this latter respect trade policy indicated in the Plan is dynamically oriented toward export promotion. While the increasing competitiveness in export markets and the barriers to entry into foreign markets are recognized, the reaction to these conditions is a striving for greater competitive efficiency and a cautiousness in growth aspirations. While there is some endorsement of policies for self-manufacture of parts and components and protection for infant industries, the intention is that in general the efficiency of domestic production should be tested by removing direct import restrictions and relying on an appropriate tariff.

The appropriateness of this development strategy, both as regards resource allocation between sectors and the relative benefits of export-oriented or import substitution production, ~~are~~ is for our counterparts in the IBRD to adjudge. Our assessment is concerned as to whether the structure of trade restrictions satisfactorily reflects the development and trade policy intentions and thereby contributes toward the attainment of the desired allocation of resources.

Official influence through the trade system on the course of foreign trade is exercised through five main weapons:

(1) Import duties (and exemptions from import duties);

(2) Import margin deposit requirements;

(3) Direct controls over imports and exports;

(4) Tax concessions related to export sales, and

(5) An export/import link system ("registered foreign exchange").

(Supplementarily, controls and inducements for investment may incidentally have implications for influencing imports of capital goods but primarily these weapons are conceived in terms of their effects on investment rather than on trade.)

Historically, the <u>tariff</u> has seemingly been seen as a revenue instrument rather than a protective instrument. Consequently, its protective function is only now being deeply analysed (Commission on Taxation, Dr. F. C. Liu

"Tariff Protection Under the Present Tariff Structure of China").[1/]
Nevertheless, because of budgetary reliance on tariff revenues and the resultant "accumulators" applied to the nominal tariff rates (the 20 per cent addition to c.i.f. value for duty-paying value computation and the 26-30 per cent duty surcharge), the accumulated nominal tariff rates themselves are high. But, more importantly, as has been illustrated by Dr. Liu, the effective tariff rates (i.e. the real amount of protection enjoyed by a manufacturer on the domestic value added) reach levels for some processing that must be regarded as prohibitive of imports in the face of even very inefficient domestic production and the rates have not been rationalized by the extension of uniform encouragement or conscious differentiated protection between different productive processes. Thus, even without additional restrictive or protective measures the existing tariff could be providing in a large number of instances a barrier behind which inefficient production could prosper for the domestic market, drawing resources toward those areas of production contrary to both the optimum economic allocation of resources or the allocation desired by the authorities.[2/] Furthermore, in some instances the tariff system operates perversely by giving a negative effective tariff rate, i.e., the protection on the raw materials and intermediary goods used in processing outweighs the protection enjoyed on the processed product.

1/ This study, in fact, embodies a comprehensive statement of the economic objections to direct import controls so that they do not require to be restated in this paper. The study also makes specific recommendations as to guidelines for a tariff reform on which it is not appropriate to comment here. But it is to be noted that the conclusion of the study is the advisability of disposing with direct controls in favor of appropriate tariff protection; this is essentially the case presented by the Fund team.

2/ Protection itself does not, of course, per se induce production growth as has been illustrated by Dr. T. S. Sun "Trade Policies and Economic Development in Taiwan".

Where, because of the ruling levels of import duty, the tariff exercises a strong influence on resource allocation, development strategy cannot be superimposed on the tariff as given; the tariff must be restructured in the light of the strategy as a weapon in its implementation. Such a restructuring is clearly necessary in China as a basis for comprehensive liberalization of the import system.

As a result of the progressive reduction of the import margin deposit requirement to its current level of 25 per cent and the increased eligibility to import on other than sight payment terms (by documents against acceptance and documents against payment) which do not incur the deposits, this instrument may not now be so significant as a restrictive device. But it may be associated with the tariff in that it is a price-reliant rather than a direct control. Its primary effect is to increase the cost of imports by the amount of the interest cost incurred on the respective deposit; where credit itself is not freely available to the import sector, there may be a more direct impact on imports by the "squeeze" on importers' liquidity as a result of the deposit. While the measure may be seen to have some merit as a temporary expedient to dampen import demand during a period of balance of payments pressures, it is not an appropriate permanent feature of the trade system. In effect, in its permanency and its generalized impact on the bulk of imports it supplements the pricing function of the exchange rate. Seemingly, in the case of China, there has been some feeling that the requirement is justified to ensure the credit-worthiness and standing of the importer; this is a proper function of the banks who incur the credit risks of their customers. The elimination of the requirement would be desirable; if this were to cause an expansion in liquidity in the absence of counter-availing measures, an appropriate counter-availing adjustment in over-all monetary management could be made.

An initial reaction to the existence of quantitative controls over imports must be to ask why they are being applied. Such application on an extensive scale is normally evidenced when the currency is over-valued and there is a consequent across-the-board excess demand for imports; in these circumstances aggregate imports have to be restricted and the allocation of exchange between commodity items has to be administratively determined. In China quantitative import controls originated from a balance of payments motivation. But following an exchange reform, a stabilization of the economy and a strengthening of the national currency this purpose for the controls has weakened. Nevertheless while there has been a policy orientation toward import liberalization, the control system has continued in existence "with a view to giving protection to, or rendering assistance for the development of domestic productive enterprises and in consideration of the requirements of national plans and the people's livelihood" (Foreign Exchange and Trade Handbook 1968). The control system has continued seemingly for both balance of payments reasons and a protective function for domestic production.

The balance of payments objectives in the continuance of the control system are stated "to attain a favorable balance of payments position," "to achieve equilibrium in foreign trade," "to conserve foreign exchange and to make the best utilization of foreign capital" (Factual Information for the 1969 Fund Consultations). Briefly, it is not clear that these objectives are consistent with a realistically valued currency in circumstances of economic equilibrium. Apparently it is felt that a developing economy, *per se*, cannot be expected to eliminate import controls (Factual Information). Why this is so may be questioned. It is not necessary to expound the theory of demand management; it is, of course, the very essence of the consultations conducted between China and the Fund over the years. The balance of payments should not be a function of direct management of the external sector itself by controls but should rather be a function of demand management in terms of domestic fiscal and monetary policies. With the stabilization of the Chinese economy and the dynamic export performance, there is no clear reason why appropriate domestic policies will not ensure the desired balance of payments performance. In this general context reference is made in the request to the Fund (page 1) of the fact that a large import surplus is likely to remain in the future. This observation invites the comment that such a surplus is not in itself an impediment to import liberalization. In fact, accepting that China is appropriately a capital importer, the mobilization of foreign resources should be an element in formulating demand management policies. The essential criterion for determining the level of this import surplus is the capacity to service the debt which it involves so that it is the structure of the balance of payments—current and projected—which influences demand management to attain the desired external balance.

As regards the protective function of direct controls, the fundamental question as to whether the tariff or direct control over imports is the better means of providing protection is, economically, readily answered on two main counts.[1/] Firstly, direct controls bestow on the recipient of an import licence for restricted items a privilege with monetary worth. Scarce import items demand a scarcity premium in the domestic market; this import premium is effectively a transfer to the importer of the tariff revenue which would accrue to Government under an equivalent tariff barrier. Secondly, and more importantly, the tariff gives a price measurement of the extent of protection being accorded; there is some test of relative efficiencies in terms of what

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1/ As stated earlier, Dr. F. C. Liu has already presented more comprehensive arguments.

level of effective tariff respective industries require. Quantitative restrictions give no such satisfactory price measurement and when imports are effectively prohibited there is even an absence of demonstration of the quality of the domestically produced item against import competition. The application of direct import controls in China involves this weakness. While it does not appear to be a prime objective of development strategy itself as presented in the Development Plan, the import control system seems strongly geared to a concept of the desirability of self-sufficiency. Comment will be made later on the criteria for the control of imports but there is a reluctance to import goods which can be supplied within China perhaps without due regard to the real economic benefit of import substitution. At the present time this benefit may be deceptive. In circumstances where although development strategy is oriented towards export promotion the export sector is not growing fast enough to absorb the available unemployed labor, there may be attraction in using this labor in import substitution production, albeit that it is recognized that this production is not efficient against import competition. Here there is the delicate judgement as to whether one is then fostering an infant industry which will develop into competitive efficiency and possibly export production, or whether encouragement is being given to an industry which will perpetually require a high and even increasing protective barrier to preserve it. The economic consequences of the pattern of investment which is now being developed will really be tested when China becomes a full employment economy. Already there are seemingly some signs of competition for labor between export industries. As the reserve of unemployed labor depletes, this competition will accentuate and when resources are fully employed, the danger is that China may then find itself vesting resources on import substitution which might otherwise be more economically employed in the export sector. At that point of time there are strong lobbies of resistance to a correction in the pattern of investment by withdrawal of protection and writing-off uneconomic industry.

A further observation which should be made is the transference of the burden of uneconomic production to economic production through linkage dependencies. To deny an efficient industry necessary import inputs and regulate its acceptance of more costly and/or less satisfactory domestic counterpart inputs lessens the efficiency of the industry. In the export market such an industry then becomes less competitive and in the domestic market it in turn may require protection. This transference of inefficiency would appear to have particular application in the practice of setting self-sufficiency ratios for specified industries. (It has been explained that the control system serves a further purpose as an instrument for domestic production and market organization—effectively as a "dampener" for excessive optimism as regards the profitability of investment leading to over-investment and wastage of imports. This tends then to stretch these controls into domestic controls and raises wider questions as to what basic doubts the authorities may have about the appropriateness of a free economy.)

In principle, then, an import control system which operates expressly as a protective instrument (rather than for balance of payments reasons) is inferior to the tariff instrument and the interests of China would seem to be best served by a restructuring of the tariff to reflect the development strategy and the elimination of direct controls currently maintained for economic reasons. This apparently is the intention of the authorities within the Fifth Plan period. In the meantime it would be desirable to ensure some flexibility in avoiding outright import prohibitions for the self-sufficiency objective so that by import demonstration there is consciousness of relative domestic and international prices and quality standards.

It is advantageous to consider the efficiency of the present criteria for control of imports. These criteria are geared to the infant industry concept, i.e., protection is to be accorded for a basic period of two years during which the industry is to establish its viability. The temporary nature of such protection is clearly desirable but apparently protection once given has tended to be left undisturbed. But the criteria themselves may have some weakness. These criteria basically test two economic standards—that (1) there should be an adequate supply of the necessary items from domestic sources (2) at prices not higher than 10 per cent above their corresponding import cost after duty. The possible weakness in a striving for self-sufficiency has already been commented upon and what is left to question in these criteria is the cost-testing of domestic production. The test is unusual because it is a price-reliant mechanism for establishing direct controls. In effect it compounds the protective nature of tariff taxation (so that the import "handicap" becomes basic tariff rate plus 30 per cent surcharge on [c.i.f. price plus 20 per cent] plus 10 per cent of foregoing aggregated landed cost!) as a justification for a control over imports; this control may amount to effective prohibition if there is adequate domestic supply or if the goods are final demand goods of interest to traders rather than end-users but traders are excluded from import eligibility. Furthermore, the criteria does not take account of the deficiencies of the tariff and applies equally to products irrespectiveof the differing effective tariff protection which they enjoy. Simply, the question which the formulation invites is why not impose a further 10 per cent super-import surcharge (undesirable as that may in fact be in terms of excessive tariff protection) without any supplementary dependence on direct controls? Such a course would have the essential character of the present criterion but would avoid the administrative discretion in assessing comparative quality and specification in applying the criterion as a test for the imposition of direct control. However, if, in fact, there are no further transferences of items to the controlled import list pending the early implementation of a tariff reform, there need be no revision of the control criteria. (It is understood that there are anyway administrative difficulties in attempting a comprehensive review of the controlled import list but as the conceptual approach to such a review would be similar to that of a tariff reform it would seem better not to disturb the existing balances in the economy by control and tariff reforms both in a short interval of time. Therefore, rather than temporarily adjust protection by basic changes in existing direct controls, it would be better to await dismantlement of those controls in the context of the tariff reform.)

As regards direct controls over exports, these may be economically justified to the extent that they are imposed only for exchange accounting within the existing requirement for the surrender of foreign exchange and for quality control to ensure that a good "national image" is preserved for exports as a whole. The requirements of export control in China seemingly are intended largely to serve these purposes and call for no particular comment. An aspect of the export trade system which does warrant comment is the export assistance which is being accorded through the tax and credit systems and by the export/import link mechanism of registered foreign exchange. The degree of real or implicit export subsidization which is being practised internationally is a sensitive issue on which it is not necessary to dwell now although it does, of course, affect China's competitive export position. But examined from the economic point of view, the measures of export assistance must be judged in terms of the distortions in the pricing system which they induce. For traditional exports and for new exports which are fully competitive as a result of their employment of real comparative advantages, financial assistance is difficult to justify except perhaps for some initial period of market penetration. Such assistance should therefore be temporary and selective. In the case of China, the concessions against income tax and business tax for export production do not fulfill these conditions and there is an apparent weakness in the concession against income tax (exemption for 2 per cent of export earnings) in that the concession is not related to value added but to gross earnings; thus, somewhat perversely, the concession is worth more to processing which produces marginal value added than to that involving large value added. It is understood that this particular concession is being reviewed; this is to be welcomed as it is budgetarily expensive in terms of foregone revenues.

Discussions have taken place between Chinese and Fund officials on the <u>registered foreign exchange scheme</u> with the conclusion that it is not an appropriate measure for export promotion and will therefore be eliminated in due course. This decision only needs to be supplemented by reference to the <u>cooperative agreements</u> maintained by certain associations of manufacturers involving cash transfers between members according to export sales. The operation of these agreements distorts the pricing of production for the domestic and export markets; effectively the domestic consumer is "taxed" to "subsidize" the foreign consumer. It is difficult to see why China's best interests are not served by fully competitive manufacturing, for both the domestic and the export market without such distortional schemes. The advantages of discouraging such schemes should therefore be considered.

The request for <u>"a review of the present management of foreign exchange"</u> enables the foregoing to be set in an over-all conceptual framework for the exchange and trade system. As has been observed, import controls have a weak balance of payments justification in a market economy. In such circumstances it is necessary to ask why there is need of specific "management" of the external sector additional to the management of aggregate demand by fiscal and credit policies. What would happen if import and exchange controls were eliminated? In China the behaviour of the unofficial rate for foreign exchange acts as a special indicator. While exchange is controlled through an official market, it is available in an unofficial market at only a small premium. The volume of transactions in the unofficial market and the nature of supply and demand is not fully known: but, prima facie, given the satisfactory balance of payments performance, the unofficial market evidences the viability of the NT$40 rate by the absence of any excessive demand for exchange to push the unofficial rate to a significant premium. If demand for exchange in the official market which is frustrated by exchange restrictions is satisfied at virtually the same rate in the unofficial market, what purpose are the restrictions serving? Why are there surrender requirements for exports and exchange earnings? In what sense is foreign exchange itself being "managed" if actual demand and supply are in over-all balance at the current rate of exchange? It is understood that the foreign exchange budget is no longer a budget in the sense of an accounting for the controlled allocation of exchange. It now serves the purpose of balance of payments forecasting as an element in the determination of appropriate aggregate demand management. Thus, the control machinery now appears to have no immediate function for existing balance of payments purposes. This is not to recommend its dismantlement. Countries which are free of restrictions on current transactions may nevertheless maintain control systems for actual or possible use in controlling capital flows. In fact, currently, there is no evidence of capital flight from China: but the maintenance of a control system against such an eventuality may seem desirable. This apparently is the thinking of the Chinese authorities and a liberalization of the restrictions on current transactions is under consideration; this seems sustainable and desirable.

To supplement this form of liberalization, there may be advantage in considering the liberalization of the exchange market system itself. It might be questioned as to whether the exchange system still meets the requirements of a fast developing trading economy. There is no exchange market as such between the banks in Taipei; there is no forward market or system for provision of forward cover for traders' positions; the bankers' exchange relationships with foreign banks are not fully developed; the rationale for the selection of prescribed currencies between equally convertible currencies and that for control over the terms for import payments may be questioned. What is at issue is whether in the competitiveness of export markets traders should not be more conscious and demanding over the price of exchange and the provision of exchange cover and whether the banking community itself could not achieve a greater corresponding efficiency in competition for exchange business. What would be lost if the Central Bank, in principal, acted only as residual buyer and seller of foreign exchange at outside margins permitted under the Fund agreement; if the prescribed currency arrangements were revoked; if the banks could engage freely in overseas exchange markets; if traders were permitted to trade on the most advantageous payment terms? Again, it is understood that this sort of question is under review and this is to be welcomed.

These comments derive from observations made on a brief examination by people who lack the day-to-day experience of local circumstances of the officials who administer the trade and exchange systems. On the other hand, such officials sometimes lose sight of changing circumstances which require reorientations in policies and administrative procedures; they may therefore welcome a questioning of the rationales of the existing policies and administration. As a summary of the foregoing, in response to the requests to the Fund mission, the analysis is that:

1. The structure of the trade restrictive measures has some lingering characteristics of trade management for balance of payments reasons. Such management is no longer appropriate and such protection of domestic production as may be economically justified is a function of a tariff rather than a direct control system. Admittedly, there is evidence that the existing tariff is inadequate for this purpose; but the principle on which direct controls are being applied may even compound this inadequacy given a development strategy based on export promotion. The effect of the restrictive structure is that the objectives of development strategy may be subverted by an attraction of resources toward import substitution behind a high or prohibitive import barrier.

2. Fundamentally, on the import side, what is required is a tariff restructuring as a basis for the elimination of quantitative restrictions. There is no conceptual "gradual" course for such liberalization because the criteria for the liberalization are those for the tariff restructuring. But pending such a restructuring it would be appropriate to suspend further movement of items to the controlled list; to avoid effective import prohibition of controlled items; and to suspend the extension of the application of self-sufficiency ratios. The import margin deposit requirements should be revoked. On the export side, the registered foreign exchange scheme should be eliminated as early as possible and an examination of tax concessions for export ~~wages~~ sales and cooperative financial arrangements between exporters should be undertaken so that inappropriate assistance is withdrawn and pricing distortions are avoided.

3. Reliance should be placed on demand management as the source of external equilibrium. The "management of foreign exchange" should not be regarded as requiring direct trade and exchange controls. In fact, with the evidence of economic equilibrium the liberalization of exchange restrictions on current transactions should be kept under review and the desirability of developing an exchange market in circumstances of a more liberalized exchange system should be considered.

cc: Mr. Rose

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MINISTRY OF FINANCE
REPUBLIC OF CHINA

Orig: ASD
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Office of the Minister

February 4, 1970

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EXCHANGE & TRADE RELATIONS
DEPARTMENT

Mr. Frank A. Southard, Jr.
Deputy Managing Director
International Monetary Fund
Washington, D.C. 20431
U. S. A.

Dear Mr. Southard:

Reference is made to your letter dated January 21, 1970 informing me that, as agreed with our Executive Director, a Fund staff team, consisting of Mr. A. G. Chandavarkar, Mr. Kanesa-Thasan, Mr. John W. Rose, Mrs. Hui-Chen Wu Yang, and a secretary will come to Taipei to hold the 1969 article XIV consultation discussions, from March 18-25, 1970, and that Mr. Rose will come ahead of the other members around March 3.

I take great pleasure to welcome the Team's visit and hope that you would send the Questionnaire and the Background Paper to us as soon as possible, so that we may have sufficient time to make the necessary preparations.

A copy of this letter is being sent to Mr. Beue Tann, Executive Director for China, for his information.

Sincerely yours,

K. T. Li

K. T. Li
Minister of Finance

SY:aw

Mr. Chandavarkar February 12, 1970

J.W. Rose

<u>China Restrictive System: Mr. Tann's Memorandum of February 6</u>

I read Minister K.T. Li's response to our concept of the China restrictive review as a bit bad and a bit good. It is clear that he wants something more than generalities across a consultation table; while his framework can be read as permitting us to avoid a deep involvement in tariff policy, it does require (item 2) some involvement in import allocation for which I don't think we are competent. At the general policy level there are some implicit concepts in his "areas of study" which require some refinement.

It is clear that we are going to have to give him a paper on the exercise: I see this in two parts, a general policy appraisal and a statement of technical/administrative comments and recommendations. There is no wealth of material on China's commercial system and I shall have to do the technical appraisal there. But I think we have a broad enough understanding of the policy aspects of the system to put together some sort of draft statement now from which we can refine a briefing paper position and around which we can build in Taipei; this I have done in the attached Appendix A. There is the question of whether we give the Chinese authorities papers while we are there or send them after our return and any necessary clearance among the staff. Either way we are going to have to have a framework within which to discuss the exercise at the consultation table: the attached draft serves also to provide that framework. This involves a number of policy areas which are sensitive or which I don't think normally come within a consultation purview.

(1) We can't talk restrictions in any depth without talking exchange rate: our China experts no doubt have views on the realism of the rate, and, if it is realistic, why the restrictions are maintained. In this respect the balance of payments analysis I have attempted is inconclusive. (Appendix B attached). From my little reading I have some feeling that the exchange rate may not be able to sustain liberalization: in which case we should have in reserve a recommendation for adjustment strategy--floating or fixed devaluation. In view of the long history of restrictions I do not see that it is possible to determine a realistic rate from the import side: it may be possible to cost the various export concessions and get something from that side but flexibility during normalization of the trade system seems to be best arrived at by allowing the rate to float.

(2) While the terms in which we have urged liberalization of China's restrictions--economic "resource allocation" and assurance of a "sound footing for industrial growth"--involve the standard concepts, I am not clear that we have in the Fund ever related these judgments to any formal position on development strategy itself. I feel that the advantages of income and employment generation from highly protected uncompetitive industry in an import substitution

strategy have to be carefully weighed against the so-reckoned uneconomic nature of the industry in terms of comparative advantage. [In this context it is interesting that at the Board discussion for the 1967 China Article XIV Consultation, Mr. Handfield-Jones commented on the staff position on this saying that "in the area of the relationship between trade restrictions and growth there was danger in generalization."] In the attached paper, I merely say that protection should be extended through the tariff: it seems, however, that China, like others, may regard the tariff weapon as inadequate. There may be some staff who have a more/positive response to advocates of protection by direct restrictions and it is an area in which we need to be in step with the Bank.

(3) On the tariff itself (extract sampling Attachment C), I have not found anyone who can offer any appraisal of it: but, as far as dialogue with the Chinese authorities is concerned, we have already agreed that we should avoid technical discussions of the tariff because of GATT sensitivities. But there are the revenue aspects of the tariff and surcharge which are important to China and FAD may wish to offer some comments on these fiscal aspects. Similarly, we may get involved in comparative exercises with other countries on the extent of duty and tax concessions (and other incentives) for both investment and export production: it might be helpful if we could get some analysis on these scores from FAD.

(4) My suggested line of argument in the attached draft is this because it only refines the Minister's requirements as needing a tariff expert/(and presumably, as a precursor, an industrial economist to determine investment priorities) and presumably a financial analyst for the review of export subsidies. The I.B.R.D. have some of these skills already at work on Taiwan. Mr. Yang has added an industrial economist (Mr. Baranson) to his mission. Although Mr. Baranson is specifically concerned with examination of the automotive industry, this will involve him in some comparative analysis of the efficiency of this industry against alternative investment and against foreign industry so that he is concerned with the protective barrier. In the I.F.C., Mr. Gupta, a financial analyst, has recently been in Taipei. He is now reviewing the efficiency of the Bank's underlying industrial interests through loans to the Chinese Development Corporation and is therefore looking at protection; Mr. Qureshi shares this interest.

Mr. Woodley was checking what we could say about the recruitment of a tariff expert; while we had in mind GATT relationships in this context, I think the whole project, which is so much in the field of development strategy, needs to be coordinated with the Bank.

APPENDIX A

<u>Draft Skeleton Position on Trade System for China Consultation Mission</u>

The Chinese authorities requested that we should direct particular attention in our consultations this year to the following aspects of the restrictive system.

1. The structure of the present trade restrictive measures and its effect on economic development.

2. Ways and means for the gradual liberalization of the system without losing sight of the fact that a large import surplus is likely to remain in the future.

3. Recommendations for the improvement of the management of foreign exchange.

We are submitting to you separately a statement of technical observations on these matters but at the policy level the concepts which are implicit in these terms require some examination in the light of your broad economic objectives. These objectives are primarily related to development strategy: you endeavor to encourage an optimum rate of economic growth in circumstance of domestic price stability and a sustainable balance of payments. The growth itself is to be derived from a strategy which is a blend of import substitution and export-oriented policies. In the pursuance of these policies you effectively regulate the external sector by the implementation of a foreign exchange budget: you project your foreign exchange inflow on an annual basis and allocate available exchange between your necessary payments. In this projection, the allocation for imports tends to become a residual after provision has been made for nonmerchandise payments which are themselves closely controlled. The allocation of exchange between categories of imports is determined on an an analysis of over-all demand for the various categories and the availability of the items from domestic sources of supply: actual imports are therefore the result of an administrative determination of priorities within a given exchange availability, including that arising from your prepardness to incur foreign debt. On the export side, performance is not the result only of your real competitiveness in international markets but also reflects direct official assistance to export production through income tax and other tax concessions; preferential credit facilities; and an export/import link system.

In these circumstances the free competition between foreign and domestically produced goods is frustrated so that the efficiency of domestic production and the relative efficiencies between various types of production is not tested in the market in terms of price competitiveness. The testing of this competitiveness in export markets is also undermined to the extent that export prices may be depreciated by inappropriate subsidies. The effect on economic development of your restrictive system is to be seen, then, primarily in the implications the system has for the price mechanism and to the extent that this becomes distorted, the implications it has in influencing an uneconomic pattern of development. This may be seen as a purely theoretical appraisal and certainly we have not the capacity to point to illustrative demonstrations of distortions and uneconomic development; this is an aspect of development analysis more appropriate to our friends in the I.B.R.D. But the [high] level of administrative regulation of external trade and the evidence of excess import demand requiring such regulation are, we think, now as much evidence of distortions as spontaneous manifestations of conscious planning.

Focusing then on your request for a review of the management of foreign exchange, this seems necessarily to involve an acceptance of the foreign exchange budget concept. You will appreciate, however, that we feel an exchange budget in the terms in which you apply it, necessitating a physical allocation of exchange resources, to be incompatible with the proper allocation of those resources and total resources. Your budget concept is clearly different from the balance of payments projections undertaken by more open economies in which such projections are undertaken as element in determining over-all demand management policies. In fact, this is our essential philosophy; that the balance of payments should not be a function of direct management of the external sector itself but should rather be a function of demand management in terms of domestic fiscal and monetary policies. [While therefore we are submitting some technical observations on your present system of exchange management], in broad terms we recommend that your management of the external sector by direct controls should be limited to controlling capital movements and the objective should therefore be liberalization of the exchange and trade systems as far as current transactions are concerned. In this context, you made reference in your request to us that a large import surplus is likely to remain in the future. This observation invites the comment that such a surplus is not in itself an impediment to import liberalization. In fact, accepting that China is appropriately a capital importer, the mobilization of foreign resources should be an element in formulating demand management policies. The essential criterion for determining the level of this surplus is the capacity to service the debt which it involves so that it is the structure of the balance of payments--current and projected--which influences demand management to attain the desired external balance.

In addition to the purpose of rationing foreign exchange, direct controls have consciously been used as a means of protecting domestic production. Techniques have been evolved for endeavoring to ensure that such controls do not give too high a degree of protection [the price of the domestic product must not be more than 10 per cent higher than the imported product]. We are not clear how effective these techniques are but do not see why the protective role of direct restrictions should not be transferred to the tariff system where it properly belongs. Such a course would provide a real measure of the competitiveness of domestic production with imports which direct restrictions fail to do. We have not concerned ourselves in any detail with the tariff but it does seem that appropriate tariff policy is the necessary concomitant to appropriate over-all demand management policies in a dismantlement of trade restrictions. The necessity of direct controls to supplement the tariff in its protective role suggests that the tariff is itself inadequate for this purpose and therefore needs to be reviewed. But tariff policy is also an important element of fiscal policy itself because of the heavy reliance on import duties for budgetary revenues. A tariff review would, therefore, have to take account of both the protective and revenue aspects and would involve a review of budgetary policy itself and be related to basic development strategy.

To propose ways and means for the gradual liberalization of nontariff restrictions in the import system requires an isolation of those restrictions maintained for balance of payments reasons and those maintained for protective reasons. The strategy would then be for the transference of the protective role into the tariff with such revision as is necessary and a process of progressively more liberal licensing of items restricted for balance of payments reasons, having regard to the over-all balance of payments situation, and culminating in full liberalization. Intrinsically the restrictions maintained for balance of payments reasons have involved assessments of essentiality: at the extremes, necessary food goods have received the highest priority and luxury goods the lowest priority in import licensing and there has been a gradation of essentiality and priority between these extremes. The objective of this system, reflecting social as well as economic considerations, may also be transferred to the tariff by appropriate revision so that adjudged priorities in the import pattern may be indirectly influenced on a cost basis. This transference incidentally gives the budget a revenue benefit from the increased tariff instead of the unwarranted import profit which accrues under the present system to the recipients of import licenses for items in high demand. Thus it is the tariff review which we propose which is the very core of the liberalization project.

Whilst aware of the sensitivities which shroud the topic, it would be a serious omission not to comment on the exchange rate implications of direct restrictions. In circumstances where import demand is being severely restrained on a continuous basis by direct restrictions for balance of payments reasons, there must be some inference that imports are too cheap because the underlying exchange itself is too cheap. In such circumstances import liberalization can normally only be undertaken concurrently with an exchange rate adjustment. While China has been controlling imports continuously, if such controls have not resulted in too severe a level of actual restrictions, there is no reason why the exchange rate should be called into question.1/

On the export side, the dynamic export performance has, of course, been one of the most notable features of the Chinese development experience. In terms of the official assistance extended to exporters through the tax system and by other means, we would draw attention to the fact that these concessions seem to be rather more broadly based than is economically justifiable in so far as many of them are extended to all exporters. For traditional exports and new exports which have arisen as a result of China's real comparative advantages, notably by way of a cheap labor force, there should be little economic need for financial assistance. Even if some assistance were deemed appropriate for market penetration by new exports, such assistance should be selective, temporary and given in such a way that there are not induced distortions between pricing production for the domestic market and for the export market. Furthermore, regard must be paid to the heavy contribution the tax concessions make to the existing weakness of the budgetary position.

In summary, we recommend that there should be a movement away from commercial policy formulation on the basis of a budgeted and regulated external sector; that the tariff system should be reviewed with a view to

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1/ This formulation assumes that the suggestion of exchange rate adjustment is to be avoided at this time.

its adequacy and appropriateness for fulfillment of its protective and revenue functions; and that the necessity for financial supports for exports should be re-examined.

APPENDIX B

<u>China: Balance of Payments as an indicator of the realism of the Exchange Rate</u>

China has never declared a par value. Prior to 1961 there was a complex multiple exchange rate system which was effectively unified in that year: in this process exchange rates which in 1959 ranged between NT$20.35-NT$36.00 per U.S. dollar were unified at the still current level of NT$40.00 per U.S. dollar. At the time of the unification and in the early 1960's the balance of payments structure was one in which, with imports running at about $300-$330 million per annum, deficits on goods and services of the order of $110-$130 million were being largely offset by U.S. aid receipts: the over-all balance showed small surpluses or deficits. In 1963, there was a surge in exports largely consequent upon the marked rise in sugar prices, but a more broadly based export growth was maintained in 1964: in these years the payments for goods and services were in rough balance and although U.S. aid was being phased downwards, its continuance led to a strong rise in reserves. In the mid-1960's the structure of the balance of payments changed. While sugar prices fell causing an initial stagnancy in exports, exports of manufactures started to grow sharply and exports to Viet-Nam became a feature of the merchandise account. However, imports also rose strongly and China again entered a phase of large deficits on goods and services, the deficit in 1968 amounting to $130 million. These deficits now, however, arose primarily on account of services: the deficits on account of merchandise freight and insurance and the residual "other services" rose fairly sharply and a surplus on Government services declined. In the financing of the deficits there was increasing recourse to foreign borrowing: the receipt of private long-term credits rose from $12 million in 1964 to $48 million in 1966, jumped to $136 million in 1967 (when monetary movements showed an increase of $59 million) but fell to about $60 million in 1968 (when monetary movements showed a decrease of $43 million.

It is difficult to analyze the impact of official policies on the balance of payments experience of the 1960's. Following a period of domestic price stability, in the last two years there have been some domestic price pressures reflecting a high rate of credit expansion: while imports might also be expected to reflect the excessive demand, the balance on the merchandise account has not deteriorated: as recently as 1965 there was a deficit of $70 million on merchandise with imports (f.o.b.) at $450 million and there was the same deficit in 1968 with imports at $825 million (nevertheless this has, of course, involved larger payments on freight and insurance). Over-all there has been a marked decline in export prices* but as an available measure of price experience with manufactures, after declining sharply in 1963/64 the export index price of plywood was 100 at the end of 1966, 103 at the end of 1967, 103 at the end of 1968 and 105 at mid-1969. What is uncertain, however, is to what extent the external

* since 1963 but this has reflected primarily the sharp fall in sugar prices:

sector is managed independently of the domestic economy. On the import side there is complex structure of quantitative restrictions, cost restrictions (tariff surcharge introduced for fiscal reasons and import margin requirements) and regulation of importers themselves; because the quantitative restrictions are applied through a largely administrative control system we have no yardstick in measuring the changes in their level. On the export side assistance is extended by income tax and other tax concessions; cheap credit facilities; priority access to imports; and an export/import link system. We have no costing of the worth of these measures per dollar of exports but as there does not appear to have been any material changes in the assistance in recent years, the implicit export rate may have been constant in these terms. But it is not known how profitable exporting is and to what extent export production, with official incentives, is being subsidized from returns on domestic market production.

While the balance of payments structure does not demonstrate the viability of the exchange rate, the need for import restrictions and export assistance does suggest that the rate cannot be accepted without question as being realistic. However, available data on the free exchange market does not in itself indicate any over-valuation of the NT dollar; the rate for U.S. banknotes has fallen on balance from NT$47 per U.S. dollar at the end of 1962 to NT$41.08 at the end of 1968.

[The only time the staff appear to have explicitly passed judgment on the exchange rate was in the 1964 Article XIV Consultation Report--"The exchange rate appears realistic."]

China: Import Tariff

The following broad range of tariff rates have been extracted from the 1965 tariff. (In per cent).

Cotton and Cotton Manufactures

Raw cotton	$12\frac{1}{2}$
Cotton yarn	25
cotton piecegoods	$42\frac{1}{2}$-45
Cotton clothing	55-70

Other Fibres and their Manufactures

Natural vegetable fibres 15
Wool: Greasy 12, Scoured 25, Carded and Combed 35
Manufactured woolen goods 85-100
Artificial staple fibres 40
Manufactured artificial fibre goods 80-100

Metals and their Manufactures

Metallic ores	5
Metals	15-35
Iron and steels	$7\frac{1}{2}$-30
Machinery	10-15
Motor vehicles	25-50
Other Metal Manufactures	15-50

Foods, Beverages, and Tobacco

Fish	50-100
Cereals	Free-15
Animal products and groceries	30-80
Tobacco leaf	30
Manufactured tobacco	100
Wines	100

Chemicals

Chemical fertilizers	5
Hydrocloric acid	80
Dyes	20-35

Wood, paper and their Manufactures

Wood and paper pulp	10
Paper board	40
Timber	20-30
Wood manufactures	25-50

Leather and Leather Manufactures

Leather	15-40
Leather manufactures	70

China and Glass

Chinaware	80
Glassware	60

Luxury Goods

Perfumes, cosmetics, etc.	120
Jewelry	120

INTERNATIONAL MONETARY FUND

February 6, 1970

Mr. Sturc:

You will no doubt want to put this in the hands of Mr. Rose.

F.A.S.

Attachment

RECEIVED
FEB 6 1970
EXCHANGE & TRADE RELATIONS
DEPARTMENT

Mr. Southard

Office Memorandum

cc: Mr. Rose

TO : The Deputy Managing Director

DATE: February 6, 1970

FROM : B. Tann

SUBJECT : China - Technical Assistance

With reference to your letter of January 21, 1970, addressed to Minister K. T. Li in connection with your proposal to have Mr. John W. Rose arrive in Taipei about March 3, 1970 to assist in studying the restrictive system of trade and exchange in Taiwan, Minister Li has asked me to inform you that the Chinese authorities are particularly interested in the following areas of study:-

1. The structure of the present trade restrictive measures and its effect on economic development;

2. Identification of areas where the present restrictive measures could be gradually liberalized in the best interests of the economy without losing sight, however, of the fact that a large import surplus is likely to remain in the future. By what ways and means?

3. Making a review of the present management of foreign exchange and recommending ways and means for its improvement.

noted

Office Memorandum

TO : Mr. John Rose

DATE: February 4, 1970

FROM : R. H. Miller

SUBJECT : Republic of China: Article XIV Consultation

The problem remaining to be solved with regard to gold production and marketing techniques in China is set out in Mr. B. Tann's memorandum of January 28, 1969 (copy attached). The proposal was made that more detail of the operations should be obtained by the next consultation mission. The question is whether the present scheme under which the Central Trust buys the gold at a price of $35 p.f.o., sells it at approximately $44 p.f.o., retains 2 per cent of the difference as commission, and distributes the remainder to the producers as subsidy falls within the scope of EBD No. 233-2 of December 11, 1947. If it does, it would need to be submitted to the Executive Board for approval. (See Selected Decisions pp. 14/15.) As much detail of the Scheme as possible should be obtained so that a judgment can be made.

In addition to this particular problem, the usual paragraph should be inserted in the brief concerning imports and exports of gold, countries of origin and destination, and prices involved. Details of use of gold by industry with quantities and types of use, e.g., jewelry, dentistry, electronics, etc., should also be obtained. Any quantitative statistics will be useful, particularly if a series say back to 1960 could be obtained.

Attachment

cc: Mrs. Lachman
Mr. Williams

Office Memorandum

TO : Mr. Tun Thin

FROM : B. Tann

DATE: January 28, 1969

SUBJECT : Gold Regulations of China

In reply to your inquiry regarding the operation of the purchase and sale of domestic gold in China, I have just received the following information:

(1) The basic feature of the arrangements for gold is Article IV of the "Regulation Governing the Purchase and Sale of Ornamental Gold" (1959, amended 1963 and 1968):

> "The raw material for ornamental gold shall be bought from the gold mines according to the official price fixed by the Central Bank. This gold material will be melted by the Central Mint to convert to a fineness of 0,875 and delivered to the Central Trust for sale to the registered ornament manufacturers. The remainder of the price charged by the Central Trust, after deducting 2 per cent for melting and commission and refunding the Central Bank for its official purchase price, will be paid to the gold producers as subsidy."

Buying Agent

(2) The official purchase price per troy ounce of fine gold fixed by the Central Bank is NT$ 1,400 (equivalent to US$ 35 at NT$ 40 per US$). This official price has never been changed.

(3) The sale price of ornamental gold by the Central Trust is at present NT$ 1,570 per troy ounce, which is based on the production cost of the mines. (The annual amount of gold production is about 35,000 ounces.)

Since the question of the actual operations of domestic gold was not discussed in great detail and may still need to be clarified, I would like to suggest that it be taken up with the Chinese authorities at the next Article XIV consultation.

cc: Mr. Southard

Mr. Sturc

Mr. Finch February 4, 1970

Samir Makdisi S.M.

Paper on Fluctuating Rates:
China--Fluctuating Rate System Introduced on May 31, 1948

As agreed the following summarizes the Fund's attitude toward the introduction, by China, of a fluctuating rate system on May 31, 1948. On that day the Fund was informed that exporters, on selling exchange at the Exchange Equalization Fund (EEF) rate, were to receive an exchange surrender certificate equal to 100 per cent of the exchange sold. The EEF rate was an open market rate which was adjusted from time to time by the Foreign Exchange Equalization Fund in accord with market conditions. All imports, with the exception of certain essential commodities, were to be paid for at the EEF rate.

The Fund's decision (meeting No. 329 of June 18, 1948) in connection with the proposed change in the exchange rate system set out the Fund's understanding of how the system was to operate. In addition it was noted "The Fund is aware of the unusual difficulties which confront the monetary and exchange authorities of China. In the circumstances the Fund will interpose no objection to the exchange certificate system. At the same time the Fund recognizes that because of the unusual circumstances, China may not be able to inform the Fund well in advance of changes in the exchange rate for the yuan and the exchange structure; similarly, the Fund ordinarily will not be in a position to pass upon the substance of the change. Accordingly, the following procedure is agreed to replace the usual procedure of consultation in such cases: The Fund understands that China recognizes the responsibility of notifying the Fund of contemplated changes in exchange rates and the exchange structure sufficiently in advance of such action to give the Fund an opportunity to express its views if it so desires. Until new arrangements are made between China and the Fund, any such notification will be given to the Managing Director, and so far as possible he will reply at once on behalf of the Fund. If the Managing Director prefers to raise the matter with the Executive Board, he will not reply immediately but will endeavor to obtain the most rapid possible action by the Executive Board."

cc: Mr. Sturc

Office Memorandum

TO : Mr. Ernest Sturc

DATE: January 22, 1970

FROM : B. Tann

SUBJECT : Termination of Payments Agreement Between China and Spain

I am happy to inform you that, as a result of the exchange of notes between China and Spain on December 9, 1969, the payments agreement under Article 2 of the Trade Agreement between the two countries, dated December 3, 1956, was terminated. Hereafter, financial settlements of trade and services between the two countries will be made in freely convertible currencies.

cc: Mr. Carlos Bustelo
Alternate Executive Director

① Mr. Gerland
② Mr. De Lupus
OK.

Mr Rose

Office Memorandum

Jw

TO : The Deputy Managing Director

DATE: January 22, 1970

FROM : B. Tann

SUBJECT : China - 1970 Article XIV Consultation

I have been instructed by Minister Kwoh-Ting Li to inform you that the Chinese authorities agree to hold the consultation discussions in Taipei from March 16 to 25, 1970.

It is hoped that the questionnaire and background paper concerned will be sent to Taipei at the Fund's earliest convenience.

RECEIVED
ASIAN
JAN 22 1970
DEPARTMENT

3

cc: Mr. Rose

cc: MD
DMD
Mr. Tann
ASD
LEG
RES
ADM
SEC
ETRD

JAN 21 1970

Dear Sir:

As agreed with your Executive Director, we plan to hold the 1969 Article XIV consultation discussions in Taipei from March 16 to March 25, 1970.

The Fund staff team as of now will consist of Mr. A. G. Chandavarkar, Advisor, Asian Department, Mr. S. Kanesa-Thasan, Assistant Chief, Far Eastern Division, Asian Department, Mr. John W. Rose, Senior Economist, Exchange and Trade Relations Department, Mrs. Hui-Chen Wu Yang, Economist, Far Eastern Division, Asian Department, and a secretary.

With reference to Mr. L. Y. Kung's letter of November 27, 1969, we propose to have Mr. Rose arrive in Taipei around March 3. His task will be to examine policy and administrative aspects of the restrictive system in greater detail than would normally be possible in the course of the staff discussions. Mr. Rose's work would then provide the basis for a more substantive consultation on the restrictive system in the context of the general consultation discussion.

The Questionnaire and the Background Paper will be forwarded shortly, and details of the mission's arrival will be communicated to you at a later date.

Very truly yours,

(Signed) Frank A. Southard, Jr.

Frank A. Southard, Jr.
Deputy Managing Director

His Excellency
K. T. Li
Minister of Finance
Ministry of Finance
Taipei, Taiwan
Republic of China

JAhrensdorf:er
January 21, 1970

INTERNATIONAL MONETARY FUND

M. Hughes

Copy sent to Mr. Rhomberg

11/20

Ernest

I would prefer to go ahead with this draft, not mentioning either Smith or the GATT. Do you agree?

DKP

Yes

EJ

Donald K. Palmer

INTERNATIONAL MONETARY FUND

Mr. Palmer.

The attached draft is a compromise between Ahrensdorf, Rose & me. Ahrensdorf does not want a mention of liberalization, GATT or tariffs, all of which are far from the minds of the Chinese. He believes the Chinese want merely to talk about possibilities of simplification. But his draft (A att'd) seems to me to ask for a frame of reference in just the manner we should avoid. John & I being still concerned to protect his position on arrival in Taipei, are reasonably satisfied with a pre-consultation formula as in the redraft.

WFH.

W. F. Hughes

DRAFT
Jan.16

Dear Sir:

As agreed with your Executive Director, we plan to hold the 1969 Article XIV consultation discussions in Taipei from March 16 to March 25, 1970.

The Fund staff team as of now will consist of Mr. A.G. Chandavarkar, Advisor, Asian Department, Mr. S. Kanesa-Thasan, Asst.Chief, Far Eastern Division, Asian Department, Mr. John W. Rose, Senior Economist, Exchange and Trade Relations Department, Mrs. Hui-Chen Wu Yang, Economist, Far Eastern Division, Asian Department and a secretary.

With reference to Mr. L.Y. Kung's letter of November 27, 1969 we propose to have Mr. Rose arrive in Taipei around March 3. His task will be to examine policy and administraive aspects of the restrictive system in greater detail than would normally be possible in the course of the staff discussions. Mr. Rose's work would then provide the basis for the formal consultation on the restrictive system in the wider framework of economic and financial policies.

The Questionnaire and the Background paper will be forwarded shortly, and details of the mission's arrival will be communicated to you at a later date.

Very truly yours,

Frank A. Southard, Jr.

His Excellency
K.T. Li
Minister of Finance
Ministry of Finance
Taipei, Taiwan
Republic of China

A

China - Draft
January 16, 1970

Dear Sir:

As agreed with your Executive Director, we plan to hold the 1969 Article XIV consultation discussions in Taipei from March 16 to March 25, 1970.

The Fund staff team as of now will consist of Mr. A.G. Chandavarkar, Advisor, Asian Department, Mr. S. Kanesa-Thasan, Asst. Chief, Far Eastern Division, Asian Department, Mr. John W. Rose, Senior Economist, Exchange and Trade Relations Department, Mrs. Hui-Chen Wu Yang, Economist, Far Eastern Division, Asian Department and a secretary.

With reference to Mr. L.Y. Kung's letter of November 27, 1969 we propose to have Mr. Rose arrive in Taipei around March 3. His task will be to examine policy & administrative aspects of the restrictive system in greater [In the meantime we should appreciate it if you would indicate as soon as possible a specific frame of reference as to a study of the restrictive system of Taiwan which Mr. Rose might undertake, as he is to leave for a mission to Afghanistan around February 10.]

The Questionnaire and the Background Paper will be forwarded shortly, and details of the mission's arrival will be communicated to you at a later date.

Sincerely yours,

Frank A. Southard, Jr.

His Excellency
K.T. Li
Minister of Finance
Ministry of Finance
Taipei, Taiwan
Republic of China

detail than would normally be possible in the course of the staff discussions. ~~It would be~~ Mr. Rose's work would then provide the basis for the formal conversation on the restrictive system ~~[illegible]~~ in the wider framework of economic & financial policies.

DRAFT
JWRose
Jan.14

Taiwan: Review of Restrictive System

We, of course, welcome your intention to liberalize the trade system and wish to assist in any way we can. In the first stage this, we think, is best done by sending someone a few days in advance of the consultation mission. He would conduct a survey of the policy and administrative aspects of the system, which although broad would be deeper than can normally be undertaken during the consultation mission. This survey would then provide the basis for the formal consultation on the restrictive system which could be viewed in the wider framework of economic and financial policies. If it were the case that you then saw the need for some specific form of technical assistance, e.g., someone to assist with a tariff revision, we would be happy to see if we could help in providing or finding such assistance.

We therefore propose that J. W.Rose from the Exchange and Trade Relations Department should arrive in Taipei on   to make the proposed survey and then participate in the formal consultation discussions scheduled to commence on March 16.

Top passed to Mr. Ahrensdorf: he to decide whether it should be cleared with Mr. Goode (and Mr. Mladek) 1/15

M. Hughes to see.

Taiwan: Review of Restrictive System

We, of course, welcome your intention to liberalize the trade system and wish to assist in any way we can. In the first stage this, we think, is best done by sending a staff member in advance of the consultation mission. He would conduct a survey of the policy and administrative aspects of the system, which although broad would be deeper than can normally be undertaken during the consultation mission. This survey would then provide the basis for the formal consultation and advice on the restrictive system which could be viewed in the wider framework of economic and financial policies. If it were the case that you then saw the need for some specific form oftechnical assistance, e.g., someone to assist with a tariff revision, we would be happy after any necessary consultation with GATT secretariat to see if we could help in providing or finding such assistance.

We therefore propose that J.W. Rose, senior economist from the Exchange and Trade Relations Department should arrive in Taipei on March 3 to make the proposed survey and then participate in the formal consultation discussions scheduled to commence on March 16.

INTERNATIONAL MONETARY FUND

M. ~~Palmer~~

I don't think this need be shown to Messrs Goode/Mladek at this stage?

Jose

~~John~~:

Since our advising on tariff matters is a sensitive issue I consulted Mr. Shaw to see whether we should pay homage to GATT in this connection even though Taiwan is not a contracting party. The two memos resulted from this consultation!

Hans

H. W. Gerhard

INTERNATIONAL MONETARY FUND

~~Mr Gerhard~~

O.K.?

A

~~J Rose~~

I agree with the idea but not the specific wording. Please re-draft the paragraph, per our conversation.

Don Palmer

Clear w/ Gerhard & then give to Ahmadul.

~~Mr Palmer.~~

Draft attached.

A.

Donald K. Palmer

OK – I would put in the date you mentioned to me.

DRAFT
JWRose
Jan.14

Taiwan: Review of Restrictive System

We, of course, welcome your intention to liberalize the trade system and wish to assist in any way we can. In the first stage this, we think, is best done by sending a staff member ~~someone a few days~~ in advance of the consultation mission. He would conduct a survey of the policy and administrative aspects of the system, which although broad would be deeper than can normally be undertaken during the consultation mission. This survey would then provide the basis for the formal consultation and advice on the restrictive system which could be viewed in the wider framework of economic and financial policies. If it were the case that you then saw the need for some specific form of technical assistance, e.g., someone to assist with a tariff revision, we would be happy after and if necessary consultation with GATT secretariat to see if we could help in providing or finding such assistance.

We therefore propose that J. W.Rose senior economist from the Exchange and Trade Relations Department should arrive in Taipei on March 3 to make the proposed survey and then participate in the formal consultation discussions scheduled to commence on March 16.

The Managing Director January 14,1970

W.John R. Woodley /s

China--Addition to Mission

At the time of the Governor's Conference Mr. K.T.Li, Minister of Finance, spoke to us about the possibility of re-examining the system of import and exchange restrictions in Taiwan. He requested that we add someone to the Article XIV mission scheduled for March. Mr. Sturc has agreed that Mr. Rose could be made available for this assignment. In view of the complexity of the restrictive system our plan is that Mr. Rose would go to Taiwan sometime before the mission in order to do preparatory work. Could we have your agreement to an additional man for the Article XIV mission.

~~Mr. Palmer — I did not know about this: (1) was Mr. Hughes consulted (?)~~

cc: Mr. Sturc
Admin
Far Eastern Division

WJRW/clc/1/13/70

RECEIVED
JAN 14 1970
EXCHANGE & TRADE RELATIONS DEPARTMENT

Mr Palmer. I share JWR's feeling that we should prevent any undue expectations on the part of the Chinese. I understand that Ahrensdorf would like to send a letter to Taipeh soon - it seems that the last paragraph would fit
W.B.X. 13.1.70

Office Memorandum

W.B.X.

TO : Mr. Hughes

DATE: January 12, 1970

FROM : J. W. Rose JR

SUBJECT : China--Review of Restrictive System

You informed me a few days ago that I would go to Taiwan some time ahead of the next consultation mission, to review the restrictive system and then to join in the staff discussions.

I have looked for background papers on the review of the restrictive system. The most relevant appear to be memoranda of September 29 and October 3, 1969, copies of which are attached. From these I think it is clear that it is the trade system which is to be reviewed and seemingly Mr. Savkar thought initially that a tariff specialist from FAD would best fill the need: Mr.Gerhard who is mentioned in the memorandum of October 3, 1969 tells me that at that meeting the task to be undertaken was not defined very specifically and last week Mr. Ahrensdorf described it to me only in general terms.

I assume that the most helpful service which could be given in a relatively short period would be to try to define the objectives of the Chinese authorities for their import control system; to determine whether the objectives are sound in economic terms and whether there are pertinent noneconomic factors; to try to reach a determination as to whether the policies being followed are appropriate in the light of the objectives; and to investigate whether the authorities need any particular form of technical assistance. I would envisage such assistance as being advice either on the tariff system (presumably involving a further visit from someone from FAD) or on import control (presumably by employment of an expert from outside the Fund as we do not have this expertise).

To avoid any risk of confusion and unwarranted expectations I suggest it would be helpful if we were to tell the Chinese authorities what it is that we have in mind.

In our letter to them we should indicate some broad terms of reference in the following form:

"We see the immediate requirement as being a broad survey to determine the possible form of a rationalization of the restrictive system both in terms of policy and administration. This might result in your deciding that there are specific areas in which you would benefit from outside expertise or assistance--e.g., import allocation within a more limited import control system or tariff revision; if such seemed the case after the staff visit we would be happy to see if we could help in providing or finding such people."

Mr. Mladek
Mr. Goode

September 29, 1969

D.S.Savkar

China - Request for Technical Assistance

Mr. K.T. Li, Minister of Finance for China, told me yesterday that they needed two experts, one to help in the drafting of a new banking law, and another for a review of quotas and tariffs. I told him that we had heard about his needs in these areas and now that he had formally made a request we would do our best to be helpful. Would the Central Banking Services and Fiscal Affairs Department consider Mr. Li's request favorably?

cc: Managing Director
Deputy Managing Director
Administration
Far Eastern Division
ETRD

DSS/clc/9/29/69

Office Memorandum

TO: Mr. Savkar

DATE: October 3, 1969

FROM: W. John R. Woodley

SUBJECT: China

We had a meeting with Mr. K. T. Li this morning at 10 a.m. The Minister reiterated his thanks for FAD help. He said that T. C. Lieu was looking into the question of income tax and that possibly the Fund could in the future give some help on land tax. The Minister also confirmed what Mr. Chang had said about the Banking Commission and welcomed the plans for the mission in February.

With regard to the restrictive system, the Minister said that he had come to the Ministry only a few months ago and at that time control over trade policy had been shifted to the Ministry of Finance. He was aware that Fund consultation teams had urged relaxation of restrictions earlier, and his feeling was that, at the least, there was room for considerable rationalization of the present system. Perhaps it would be better to use tariffs for protective purposes instead of the present system. He suggested that it would be helpful if the Fund could send one or perhaps two people to look at the restrictions in more detail than was possible during the consultation procedure. In response to this, I replied that it might be possible to have someone look at the situation for a few weeks preceding the next consultation and that his conclusions could then be incorporated in the consultation discussions. I indicated that I did not think it was a good idea simply to revise tariffs or to remove controls without looking at the over-all situation.

Mr. Gerhard attended the meeting and is raising this question with Mr. Palmer. I would support very strongly the idea of sending someone ahead of the mission. I think that with the new minister there is a real opportunity for us to give technical assistance and to get closer to policy-making.

Minister Li asked if we had agreed to sending a person to look into the restrictive system. I said that I preferred to discuss it thoroughly with the departments concerned before making any firm promises. I agreed with him that we would indicate to Mr. Tann within the next week whether we were prepared to send someone. Assuming an affirmative reply, Mr. Li agreed to send a formal request through Mr. Tann if it was thought desirable.

cc: Mr. Goode
Mr. Palmer
Mr. San Lin
Mr. Ahrensdorf
Mr. Chandavarkar
Mr. Gerhard

Office Memorandum

TO : Mr. Hughes

DATE: January 8, 1970

FROM : J. W. Rose

SUBJECT : China: Review of Restrictive System

You informed me this morning that I would go to Taiwan a few days ahead of the next consultation mission to review the restrictive system.

I have very quickly looked for background papers on this, the most relevant of which I can find are memoranda of September 29 and October 3, 1969, copies of which are attached. From these I think it is clear that it is the trade system which is really subject to review and seemingly Mr. Savkar initially thought that a tariff specialist from FAD best filled the need: Mr. Gerhard who is mentioned in the memorandum of October 3, 1969 tells me that at the meeting referred to the task to be undertaken was not very specifically defined and Mr. Ahrensdorf described it to me only in general terms.

Needless to say I am anxious to do it--whatever it is! -- but I think it would be useful to indicate some more specific terms of reference in corresponding with the Chinese authorities. My concern is on two fronts:

(1) the project seemingly stems from Fund exhortation to relax trade restrictions. While I have read and written these exhortations in consultation reports in the usual jargon of "fostering uneconomic industry" and "causing a misallocation of resources" I have never found a Fund policy statement of principle or analytical appraisal supporting this position. In the circumstances of a developing country the advantage of employment and income generation from protected uncompetitive industry has to be weighed very carefully against the disadvantage of the so-reckoned "uneconomic" nature of the industry in terms of comparative advantage. I fear we may make these judgments too easily;

(2) the structuring and restructuring of import controls is, in the light of my past limited association with such an exercise, a task requiring considerable expertise which I don't think we have in the Fund (and perhaps we should have).

When, therefore, in the terms of the memorandum of October 3, one talks of "rationalizing the present system" I see some need to rationalize amongst ourselves the philosophy of our advice to China and some need to avoid a technical task for which we do not have the competence.

I suggest that in our letter to the Chinese authorities we indicate some broad terms of reference in the following form:

"We see the immediate requirement as being a broad survey to determine the form of a rationalization of the restrictive system both in terms of policy and administration. This might result in your deciding that there are specific areas in which you would benefit from outside expertise or assistance--e.g., import allocation within a more limited import control system or tariff revision; if such were the case we would be happy to see if we could help in providing or finding such people."

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Edited by Theodore Morgan and Nyle Spoelstra

The University of Wisconsin Press
Madison, Milwaukee, and London

To Mr. Rose

I-Shuan Sun

Mar. 18, 1970

CHAPTER 4

TRADE POLICIES AND ECONOMIC DEVELOPMENT IN TAIWAN

I-SHUAN SUN

GENERAL BACKGROUND OF TAIWAN'S ECONOMY

Taiwan is an island with limited natural resources. Its arable land has been fully utilized. During the early years of Japanese occupation,[1] Taiwan's economy remained almost exclusively agricultural, complemented by small-scale handicraft industries. Large-scale manufacturing started around 1910, when mechanized sugar plants were established; later there was development of a chemical-fertilizer industry, a canning industry, and a cement industry. Due to Japanese colonial policy, however, industrial development during the period before the Second World War was limited mainly to the processing of agricultural products. Exports were heavily concentrated on agricultural products and were exclusively destined for Japanese markets. In return, Taiwan imported manufactured goods from Japan. In short, Taiwan's economic development during this period followed the direction of increasing dependence upon Japan. The Taiwan economy became an agricultural component of the Japanese economy.

With the withdrawal of the central government from the Chinese mainland to Taiwan in 1949, attention was focused on the development of the island as an independent economy. The total dependence of Taiwan's economy on its agricultural sector was found to be a handicap to economic progress. Nevertheless, the steady growth of the economy during fifty years of Japanese occupation did lay some structural foundations for further development. According to an estimate made by the Joint Commission on Rural Reconstruction, the national product of Taiwan grew in real terms over the period 1911–40 at an average rate of 4 percent per year.[2] During this period, infrastructure and social capital began to take form, a modern educational system was popularized, and production technologies improved. These changes formed the basis for recovery from the physical devastation of the Second World War.

After 1949, technical, managerial, and administrative talents from mainland China supplied much-needed leadership in the reorganization of the economy. Helped by a continuous and sizeable inflow of United States aid, production levels recovered the prewar peak by 1952, and per capita income reached the prewar high in 1956. Industrial progress had led to a steady change in the structure of the economy in order to attain self-sustained growth.

Immediately after the war, the island needed large imports of chemical fertilizer to increase its agricultural production for domestic consumption and exports. Industrial goods were also scarce. At the same time, defense requirements put a heavy burden on the government budget. The result was serious inflationary pressure that suffocated development potentials. United States aid imports, however, provided foreign exchange to finance urgently needed imports, and the sales proceeds of the commodities financed by United States aid were used to meet budget deficits. In both ways, United States aid in those years helped stabilize the economy and therefore facilitated reconstruction.

Accelerated industrialization took place thereafter. First came the development of immediate import-substituting industries such as chemical fertilizer, cement, pulp and paper, leather, and textiles. With an increasing supply of fertilizer and the success of the "Land to the Tiller" program,[3] agricultural production recovered its prewar level. The revival of agricultural processing industries helped to expand export capacity to earn more foreign exchange. At this stage of development, however, the economy was neither able to yield domestic savings sufficient to meet investment requirements nor capable of earning enough foreign exchange to finance necessary imports. United States aid continued to play the double role of providing additional resources to fill both the savings-investment gap and the foreign-exchange gap. At the same time, monetary and trade policies rendered strong support to the accelerated growth of the economy. A high-interest-rate policy successfully channelled savings into financial organizations to be used for industrial development. A careful loan policy and a strict import-screening system succeeded in allocating the limited resources of capital and foreign exchange to the most desired uses. Export-promotion measures brought about a remarkable fourfold increase in exports from 1952 to 1964.

This stage of development extended to the early sixties, covering the period of the first three "Four-Year Plans for Economic Development."[4] Per capita real income increased at a rate of 4 percent per year, with the result that both the domestic market and domestic savings expanded tremendously. The structure of the economy was greatly changed. The production share of the agricultural sector fell from 35 percent in 1952 to 25.5 percent in 1964, while that of the industrial sector increased from 17.6 percent to nearly 30 percent during the same period. This structural change is reflected also in the composition of exports. In recent years, the relative share of industrial exports has increased very rapidly, while the share of agricultural products has declined substantially. Capital has become more intensively used in production, as indicated by a steady increase in the marginal capital coefficient of manufacturing industries. Capital-goods imports increased their share in total annual imports.

Near the end of the Third Plan for Economic Development (1961–64), Taiwan experienced a phenomenal expansion in the value of exports, which went up to nearly 19 percent of GNP, thus bringing that ratio close to the ratio of imports to GNP. Expansion of the volume of exports in 1963 and 1964, plus high sugar prices, gave high export values. If further export expansion can be achieved to compensate for the decline in the international sugar price, a positive trade balance is in sight.

With the termination of United States aid, there must be a shift in development policy from import substitution to export expansion. At the same time, a more ambitious plan might be established to undertake structural changes in the economy. To attain the goal of self-sustaining economic growth, it may be necessary to promote capital-intensive production in order to expand gradually the domestic supply of capital goods.

THE TRADE PATTERN OF TAIWAN'S ECONOMY SINCE 1950

Commodity Patterns

The exports of Taiwan before the end of the Second World War were composed mainly of rice, sugar, and other agricultural or processed agricultural products; imports were manufactured products such as cotton textiles and chemical fertilizers. Both the trade pattern inherited from the prewar period and the structure of the domestic economy have changed gradually. In 1950, exports of agricultural and processed agricultural products were as high as 90 percent of total exports, and imports of manufactured consumer goods were nearly 50

TABLE 4.1—Composition of Taiwan's imports, 1950–65

(Percent)

Year	Capital goods	Raw material	Consumer goods	Total
1950	12.46%	37.90%	49.64%	100.00%
1951	13.39	50.98	35.63	100.00
1952	12.14	54.00	33.86	100.00
1953	16.17	48.18	35.65	100.00
1954	17.97	51.46	30.57	100.00
1955	17.64	56.97	25.39	100.00
1956	22.90	57.44	19.66	100.00
1957	25.17	53.50	21.33	100.00
1958	24.26	50.99	24.75	100.00
1959	28.96	51.77	19.27	100.00
1960	25.55	49.27	25.18	100.00
1961	26.53	49.13	24.34	100.00
1962	23.79	54.11	22.10	100.00
1963	22.72	51.97	25.31	100.00
1964	22.99	54.04	22.97	100.00
1965	27.34	52.46	20.20	100.00

Sources: *Taiwan Export and Import Exchange Settlement Statistics 1950–1964* (includes U.S. aid imports and other imports), compiled and published by the Foreign Exchange and Trade Commission, Republic of China (Taipei, 1965), pp. 570–75; Bank of Taiwan, *Export and Import Exchange Settlements for the Year 1965* (includes U.S. aid import arrivals and other imports) (Taipei, 1966), p. 67.

percent of total imports. Japan still remained the most important trade partner, importing sugar, rice, and other agricultural products, and supplying textiles, medicines, and other manufactured goods. At this stage, the major development policy was to expand import-substitute industries for such consumer and capital goods as textiles, cement, fertilizers, and steel products. Reflecting this development policy, the import pattern gradually changed. During the period 1950–65, the percentage share of consumer-goods imports showed a decreasing trend, while that of capital-goods imports increased steadily (see Table 4.1).

Of particular interest is the share and composition of raw-materials imports. Development of import-substitute industries meant a decreased demand for semiprocessed raw materials and an increase in demand for crude raw materials. Since the country is poor in natural resources, crude raw materials still had to be imported. Imports of raw cotton increased to replace those of cotton yarns and other textile products; raw wools to replace wool yarns and fabrics; crude oil to

TABLE 4.2—Composition of Taiwan's exports, 1950–65

(Percent)

Year	Agricultural products	Processed agricultural products	Industrial products	Other products	Total
1950	4.84%	84.55%	6.21%	4.40%	100.00%
1951	22.58	65.52	8.33	3.57	100.00
1952	28.18	66.99	3.62	1.21	100.00
1953	13.64	78.98	6.39	0.99	100.00
1954	15.38	76.53	6.83	1.26	100.00
1955	30.04	62.08	6.19	1.69	100.00
1956	15.31	71.15	12.00	1.54	100.00
1957	17.14	73.98	7.30	1.58	100.00
1958	24.32	62.38	11.34	1.96	100.00
1959	24.59	52.90	20.91	1.60	100.00
1960	12.32	55.15	30.42	2.11	100.00
1961	15.75	42.00	39.70	2.55	100.00
1962	14.14	35.23	47.17	3.46	100.00
1963	14.66	42.54	39.48	3.32	100.00
1964	16.62	40.74	40.74	1.90	100.00
1965	27.51	29.03	41.32	2.14	100.00

Sources: *Taiwan Export and Import Exchange Settlement Statistics 1950–1964* (includes U.S. aid imports and other imports), compiled and published by the Foreign Exchange and Trade Commission, Republic of China (Taipei, 1965), pp. 2–3; Bank of Taiwan, *Export and Import Exchange Settlements for the Year 1965* (includes U.S. aid import arrivals and other imports) (Taipei, 1966), p. 5.

replace fuel oils and other petroleum products; chemicals to replace pharmaceuticals, chemical fertilizers, and other chemical products; and raw rubber to replace rubber products. But the establishment of new industries created a demand for other kinds of imported raw materials. For instance, synthetic-textile factories required the import of vinyl yarns, and the plywood industry required a large volume of *luan* timber imports. Thus, while the share of raw materials imports has remained constant, the composition has changed substantially.

The change in the structure of the economy also had a quite remarkable effect on exports (see Table 4.2). Before 1956, exports of industrial products were below 9 percent of total exports. After that year, the percentage share increased (except in 1957) steadily and rapidly every year up to 1962. It achieved a level of about 40 percent after 1962. During approximately the same period, the percentage share of annual exports of agricultural and processed agricultural products declined from a high of 92 percent in 1955 to 56 percent in 1965. There have been only a few new kinds of canned-food products in recent years, and the export of sugar, the most important agricultural item, has not increased. Several new varieties of raw agricultural products, such as bananas, other fresh fruits, bamboo shoots, ramie, sisal, and hogs have entered the export trade, however, and have increased in volume very quickly.

Concentration Patterns

Efforts during the period 1950–65 to industrialize Taiwan have involved a gradual change in the agricultural production pattern inherited from the period of Japanese occupation. However, Japan will remain the most important country in Taiwan's export trade as long as exports of agricultural and processed agricultural products remain over 50 percent of total exports, and as long as sugar and rice, which were the two main exports from Taiwan to Japan during the prewar period, maintain an important position in the total exports of Taiwan (see Table 4.3 for Japan's total share). This pattern is reenforced by the newly developed banana exports, the sole market for which is Japan.

Japan has also been a major source of Taiwan's imports (see Table 4.4), and it is probable that Japan will remain so in the near future. The causes are threefold: the former bilateral trade agreement between the two governments, the traditional market preference for Japanese products, and the geographic proximity of the two countries.

Relationships between Taiwan's trade pattern and its economic growth can be seen by calculating various coefficients of trade concentration. The coefficient of commodity concentration of exports, C_x, can be defined by the following formula:

$$C_x = 100 \sqrt{\sum_i (X_i/X_o)^2},$$

where

X_i = value of exports of commodity i to the rest of the world, and
X_o = total value of all exports to the rest of the world.

TABLE 4.3—Taiwan's exports by countries and areas of destination, 1954–65

(Percent)

Year	Far East and Southeast Asian countries: Japan	Far East and Southeast Asian countries: Others	Middle and Near East	Africa	Europe	Australia and New Zealand	North America	South America	Total
1954	54.40%	27.17%	4.53%	1.33%	5.74%	0.33%	4.87%	1.63%	100.00%
1955	60.99	18.77	9.30	0.59	5.42	0.14	4.39	0.40	100.00
1956	35.89	32.12	14.81	6.08	5.61	0.11	4.92	0.46	100.00
1957	39.31	31.89	16.74	5.91	3.14	0.08	2.60	0.33	100.00
1958	44.76	25.12	15.82	2.89	4.69	0.08	6.22	0.42	100.00
1959	44.32	26.03	10.93	2.97	5.79	0.11	9.79	0.06	100.00
1960	39.03	28.53	10.12	2.33	6.36	0.24	13.33	0.06	100.00
1961	30.62	31.75	3.38	2.93	8.25	0.29	22.71	0.07	100.00
1962	26.26	34.11	2.30	1.63	8.55	0.38	26.65	0.12	100.00
1963	34.91	33.65	1.49	1.41	8.11	1.00	18.45	0.98	100.00
1964	31.53	28.70	5.70	3.40	8.46	1.01	20.44	0.76	100.00
1965	32.99	25.69	3.01	3.22	10.80	1.31	22.51	0.47	100.00

Sources: *Taiwan Export and Import Exchange Settlement Statistics, 1950–1964* (includes U.S. aid imports and other imports), compiled and published by the Foreign Exchange and Trade Commission, Republic of China (Taipei, 1965), pp. 416–19; Bank of Taiwan, *Export and Import Exchange Settlements for the Year 1965* (includes U.S. aid import arrivals and other imports) (Taipei, 1966), pp. 8–19.

TABLE 4.4—Taiwan's imports by countries of origin, 1954–65

(Percent)

Year	Far East and Southeast Asian countries: Japan	Far East and Southeast Asian countries: Others	Middle and Near East	Africa	Europe	Australia and New Zealand	North America	South America	Total
1954	56.09%	8.19%	2.08%	0.56%	11.59%	1.92%	19.24%	0.33%	100.00%
1955	40.90	4.63	4.16	0.37	10.70	1.70	37.08	0.46	100.00
1956	41.13	5.10	5.34	1.03	11.04	0.90	34.84	0.62	100.00
1957	38.31	5.23	6.86	0.23	9.46	1.08	38.63	0.20	100.00
1958	43.13	5.51	8.47	0.47	10.07	1.13	31.03	0.19	100.00
1959	43.37	6.73	6.26	0.53	13.30	1.55	28.03	0.23	100.00
1960	34.63	7.37	3.84	0.52	10.28	1.36	41.59	0.41	100.00
1961	32.16	8.57	2.05	0.38	10.29	1.87	44.11	0.57	100.00
1962	32.75	6.84	2.80	0.41	9.35	1.83	44.07	1.95	100.00
1963	28.91	8.65	3.64	0.87	9.30	1.89	46.24	0.50	100.00
1964	34.36	8.77	3.79	2.10	10.55	2.37	35.99	2.07	100.00
1965	37.10	8.35	3.56	1.15	9.76	2.24	35.42	3.33	100.00

Sources: *Taiwan Export and Import Exchange Settlement Statistics, 1950–1964* (includes U.S. aid imports and other imports), compiled and published by the Foreign Exchange and Trade Commission, Republic of China (Taipei, 1965), pp. 722–25; Foreign Exchange and Trade Commission, *Foreign Trade Quarterly*, June, 1966, pp. 42–45, statistical tables.

The more a country's exports are concentrated in a few commodities, the higher is the value of the coefficient. At the limit, when a country exports only one commodity, the value of the coefficient becomes exactly 100. The coefficient of commodity concentration of imports, C_m, can be defined by the same formula, with M_i as the value of imports of commodity i and M_o as the value of total imports.

TABLE 4.5—Coefficients of commodity concentration in Taiwan's foreign trade, 1950–65

Year	C_x	C_m	C_x/C_m
1950	80.1	28.2	2.84
1951	56.9	22.5	2.53
1952	62.0	26.0	2.38
1953	70.5	24.6	2.87
1954	61.7	26.1	2.36
1955	57.0	26.7	2.13
1956	60.0	27.5	2.18
1957	67.2	28.2	2.38
1958	55.1	27.1	2.03
1959	45.4	28.1	1.62
1960	46.8	27.3	1.71
1961	35.0	27.3	1.28
1962	31.0	27.8	1.12
1963	35.8	26.6	1.35
1964	36.0	26.2	1.37
1965	28.9	27.9	1.04

C_x = Coefficient of commodity concentration of exports.
C_m = Coefficient of commodity concentration of imports.
Source: Calculated by the author on the basis of statistics provided in Tables 4.1 and 4.2.

Table 4.5 shows both coefficients of concentration and their ratio to each other for the period 1950–65. The ratio C_x/C_m was higher than unity for the entire period but declined sharply after 1959. Since the value of C_m remained very stable over the entire period, the sharp decline in the ratio was the result of a fall in C_x. The decreased concentration of Taiwan's exports coincided with an increasing share of industrial products in exports.

Two factors contributed to the stability of C_m: government control over allocation of foreign exchange helped prevent too much import concentration, and the development of import substitutes gave rise to increasing imports of raw materials and capital goods. Had development policies led to an acutely unbalanced industrialization, this ratio would have fluctuated noticeably during the period under study. Its stability therefore suggests a well-balanced industrialization process.

We can also calculate the coefficient of geographic concentration for Taiwan's exports and imports. The coefficient of geographic concentration of exports, G_x, is defined as

$$G_x = 100 \sqrt{\sum_s (X_s/X_o)^2},$$

where

X_s = exports to country s, and
X_o = total exports.

The more evenly exports are distributed among many trading countries, the lower the coefficient. If all exports are destined to one country, the value will be 100. A coefficient of geographic concentration of imports, G_m, can be similarly defined. Table 4.6 shows these two coefficients, together with the ratio G_x/G_m, for the period 1954–65.

TABLE 4.6—Coefficients of geographic concentration in Taiwan's foreign trade, 1954–65

Year	G_x	G_m	G_x/G_m
1954	55.9	59.3	0.94
1955	61.9	55.2	1.12
1956	40.2	54.1	0.74
1957	43.2	54.5	0.79
1958	47.2	53.2	0.89
1959	46.4	52.1	0.89
1960	42.8	53.9	0.79
1961	38.8	54.2	0.72
1962	38.3	54.5	0.70
1963	40.1	53.8	0.75
1964	38.1	48.9	0.78
1965	39.7	50.8	0.78

G_x = Coefficient of geographic concentration of exports.
G_m = Coefficient of geographic concentration of imports.
Source: Calculated by the author on the basis of statistics provided in Tables 4.1 and 4.2.

The geographic concentration of exports, G_x, remained fairly stable, except for the first two years, 1954 and 1955. On the other hand, the geographic concentration of imports, G_m, was stable over the period 1955–63 but showed a slight drop in 1964 and 1965. The ratio G_x/G_m was less than unity, with the exception of the 1955 ratio

TABLE 4.7—Composition of Taiwan's exports to developing ECAFE countries

(Percent)

Year	Agricultural products	Processed agricultural products	Industrial products	Other products	Total
1954	2.16%	74.44%	15.28%	8.12%	100.00%
1955	4.25	71.14	9.88	14.73	100.00
1956	3.62	74.57	20.61	1.20	100.00
1957	10.99	75.17	9.86	3.98	100.00
1958	6.23	57.35	26.90	9.52	100.00
1959	14.39	37.83	44.92	2.86	100.00
1960	10.36	31.73	56.82	1.09	100.00
1961	11.77	16.07	65.88	6.28	100.00
1962	14.46	10.48	70.13	4.93	100.00
1963	14.74	13.74	65.22	6.30	100.00
1964	7.43	19.88	67.66	5.03	100.00
1965	9.30	14.74	71.45	4.51	100.00

Sources: *Taiwan Export and Import Exchange Settlement Statistics, 1950–1964* (includes U.S. aid imports and other imports), compiled and published by the Foreign Exchange and Trade Commission, Republic of China (Taipei, 1965), pp. 420–90; Bank of Taiwan, *Export and Import Exchange Settlements for the Year 1965* (includes U.S. aid import arrivals and other imports) (Taipei, 1966), pp. 8–10.

—which reflects an exceptionally high degree of concentration of exports to Japan.

The high value of the coefficient G_m is explained by the fact that imports from Japan and the United States added up to more than 70 percent of total imports each year.

In his book *Concentration in International Trade,*[5] Michael Michaely made a study of the degree of trade concentration in several countries and correlated these figures with the size and the stage of development of those countries. This study shows that, by 1965, Taiwan's coefficient of geographic concentration was typical of small developed countries, and its coefficient of commodity concentration was considerably lower than the average of small developed countries.

Regarding the trade relationship of Taiwan with all Far East and Southeast Asian countries (excluding Japan), it can be seen from Table 4.3 that this region offered a large market for Taiwan's exports: the percentage share of this region fluctuated between 19 and 34

TABLE 4.8—Composition of Taiwan's imports from developing ECAFE countries

(Percent)

Year	Capital goods	Raw materials	Consumer goods	Total
1954	1.89%	51.41%	46.70%	100.00%
1955	0.31	63.44	36.25	100.00
1956	0.99	72.42	26.59	100.00
1957	1.90	76.83	21.27	100.00
1958	0.37	79.17	20.46	100.00
1959	0.70	71.46	27.84	100.00
1960	0.61	58.65	40.74	100.00
1961	0.38	46.80	52.82	100.00
1962	0.61	78.12	21.27	100.00
1963	0.60	74.31	25.09	100.00
1964	0.94	72.97	26.09	100.00
1965	2.83	77.25	19.92	100.00

Sources: *Taiwan Export and Import Exchange Settlement Statistics, 1950–1964* (includes U.S. aid imports and other imports), compiled and published by the Foreign Exchange and Trade Commission, Republic of China (Taipei, 1965), pp. 726–39; Bank of Taiwan, *Export and Import Exchange Settlements for the Year 1965* (includes U.S. aid import arrivals and other imports) (Taipei, 1966), pp. 70–74.

percent of total exports. The composition of exports to this region has shown a noticeable shift. Industrial products gained rapidly and replaced the processed agricultural products that were the main exports to this region in the early 1950's. On the other hand, imports from this region remained lower than 9 percent of Taiwan's total imports throughout the period 1954–65 (Table 4.4) and were composed mainly of raw materials. The trade pattern with this region is a reflection of the fact that hitherto Taiwan has industrialized more rapidly than many of these countries. In Tables 4.7 and 4.8, we show the composition of Taiwan's exports to and imports from the developing ECAFE countries.

TRADE POLICIES AND ECONOMIC GROWTH

Our analysis of Taiwan's trade pattern suggests that foreign trade has furnished effective support for economic growth. It seems appropriate, therefore to review the trade policies , because, in my opinion, the remarkable results achieved could have been obtained only by sound trade policies.

The process of economic growth in Taiwan can be roughly divided into two stages. Economic stabilization and rehabilitation characterized the first stage, which ended in 1956, and a second stage of accelerated industrialization followed. Trade policies can also be divided into two stages, although the year dividing these stages was 1958 instead of 1956.

In the early 1950's, price inflation proceded vigorously—partly because of an acute shortage of consumer goods, particularly of necessary manufactured goods. At the same time, imports of capital goods and raw materials were urgently needed to rehabilitate war-damaged equipment and to restore production capacity. Faced with the serious problem of allocating the limited foreign exchange to meet urgent requirements, the government exercised strict control over imports by means of a quota system of foreign-exchange allocation. Goods from abroad were classified into three categories: prohibited, controlled, and permissible. Luxury consumer goods and goods that were deemed seriously competitive with domestic products belonged in the first category. Secondary necessities were included in the second category, and principal daily necessities and production goods in the third. This policy succeeded in limiting imports of consumer goods to a minimum and in allocating more foreign exchange to importing capital goods and raw materials. At the same time, a system of multiple exchange rates gave lower rates to producers' goods in order to accelerate industrial development. This system was necessary because, in the presence of import quotas, tariffs could not work effectively to influence trade patterns.

The development of import substitutes became the major policy guideline, and, following the transfer of four big government-owned enterprises to private ownership, the government established a policy of encouraging and protecting private enterprises. Trade policy was used, among other measures, to encourage industrial investment activities and to protect infant industries. Several goods produced by the emerging import-substitute industries have been shifted from the permissible-import category to the controlled category or directly to the prohibited category. For example, cotton yarn appeared on the permissible list until 1953, when it was shifted to the controlled list. Many other textile products, several kinds of paper products, small-capacity watt-hour meters, and polyvinyl chloride resins were also shifted to the prohibited list as soon as they were produced domestically.

It is interesting to consider at this point how far the policy of protection has been effective in promoting industrial development. To measure the protective effect of a tariff structure, Bela Balassa[6] has developed the formula

$$f_j = \frac{t_j - \sum_i a_{ij}\, t_i}{v_j},$$

where

f_j = rate of protection of value added in industry j;
v_j = value-added coefficient in industry j, at world prices;
t_j = tariff rate on the product of industry j;
a_{ij} = input coefficient of industry i to industry j, at world prices; and
t_i = tariff rate on the i^{th} input to industry j.

This formula is designed to evaluate the extent to which primary factors of production are protected by a tariff on the final goods, after tariffs on imported intermediate inputs have been taken into account.

In the case of developing a new industry in an underdeveloped country, protection is often used to overcome the competition from advanced countries. Some of the important factors subjecting the new industry to severe competition are inferior technology, deficiencies in managerial experience, and a small volume of production due to a limited market size.

Protection of a new infant industry must be able to maintain the domestic price of the industry's products as high as required to provide entrepreneurs with incentives to organize the primary factors of low productivity into profitable production. The effective rate of protection is a useful guide in determining the extent to which the tariff structure provides these incentives.

Before turning to some rough estimates of the rate of protection of several industries in Taiwan, we feel obliged to give a short explanation of the data used and the necessary changes made in Balassa's formula. The basic data for the cost structure of each industry were obtained from a 55-sector input-output table prepared by the Council for International Economic Cooperation and Development (CIECD). The table itself is still in draft form and hence will be subject to change.

The input-output table does not divide input items into domestic and imported sources. For the present purpose, supplementary data were collected to make a preliminary division into domestic or imported inputs. Time did not permit further refinement of the data. Estimates based on the data should be considered nothing more than tentative, for which CIECD bears no responsibility.

Because Taiwan's imports have been more strongly influenced by the quota system of foreign-exchange allocation than by tariff policies, the domestic prices of several products are far higher than the international prices adjusted for the published tariff rates. When this happens, the rate of protection based on Balassa's formula gives an underestimation. The tariff rates on the products given in the formula should be replaced with the rates of actual differences between the domestic and the international prices, in order to obtain more accurate estimates of the protection rates.

Rough estimates of the rate of protection in thirty-seven major industrial groups of Taiwan are given in Table 4.9. The rates of effective protection shown in the table cover a very wide range, from as low as 6.3 percent for chemical fertilizers up to more than 400 percent for miscellaneous processed foods and beverages. As a general rule, there is heavy protection for the food-processing industries that use domestic agricultural products as the main raw materials, for the industries producing necessities, for the raw materials for these necessities, and for the basic capital-goods industries. Strong protection to the import-substitute industries is obviously aimed at the development of agriculture. Undoubtedly, the rapid growth of the food-processing industries (particularly the canning industries) has been of great help in bolstering agricultural production and in increasing the varieties of agricultural products. Consequently, it has contributed to the achievement of a balanced growth between the agricultural and nonagricultural sectors.

It is not correct, however, to deduce that the industry that is

TABLE 4.9—Rates of effective protection and output growth for selected industries of Taiwan, 1954–65
(Percent)

Major industrial group	Rate of effective protection, 1965	Rate of growth, 1954–64
Metallic ores	13.31%	n.a.
Crude petroleum and natural gas	15.82	n.a.
Salt	111.36	n.a.
Nonmetallic minerals	32.38	n.a.
Sugar	218.81	6.60%
Canned pineapple	293.61	10.69
Canned mushrooms	264.38	16.13
Miscellaneous canned foods	368.31	32.64
Tobacco	131.95	6.33
Wine	129.16	6.59
Monosodium glutamate	74.00	4.67
Miscellaneous processed foods and beverages	423.45	7.10
Synthetic and artificial fibre	88.44	8.81
Textiles	248.79	9.76
Lumber and plywood	99.44	11.20
Furniture (wood, bamboo, and rattan)	148.46	n.a.
Pulp paper and paper products	155.22	16.89
Leather and leather products	228.62	19.18
Rubber products	112.48	14.56
Chemical fertilizers	6.29	20.63
Drugs	55.33	n.a.
Plastic products	197.91	15.75
Petroleum products	32.72	5.55
Miscellaneous chemicals	115.62	17.38
Cement	103.18	20.62
Cement products	15.52	18.70
Glass and glass manufactures	83.92	17.38
Miscellaneous nonmetallic products	36.60	13.52
Iron and steel	132.45	13.57
Iron and steel products	93.74	10.33
Aluminum	70.68	40.14
Aluminum products	91.01	8.50
Miscellaneous metal products	104.56	5.51
Machinery and instruments	40.55	33.61
Electrical machinery and equipment	80.93	29.29
Transportation equipment	68.21	13.55
Miscellaneous manufactures	134.00	12.18

n.a.: Not available.

Source: Data obtained from a draft input-output table prepared by the Third Department, Council for International Economic Cooperation and Development, Republic of China.

provided with greater protection will necessarily grow more rapidly than those industries that are less protected. Protection only provides a condition that will permit industries to grow at the rate warranted by factors such as available market size, potential shift of commercial tastes, and the potential advancement of production technologies. Table 4.9 indicates that there is a negligible correlation between the rate of protection and the average growth rate of several major industrial groups of Taiwan.

The chemical-fertilizers group grew very quickly with increasing domestic demand, yet its price had to be maintained low enough to help the development of agriculture. Fertilizer imports have been exclusively handled by government agencies. The aluminum industry is a monopolized industry owned by the government and has been protected by strict import control. Its high growth rate has been assured, however, by an enlarged market due to new uses of aluminum. High growth rates in the machinery-and-instruments group and the electrical-machinery-and-equipment group have been the result of growing domestic and foreign demand in recent years.

Industrialization of the economy accelerated after 1956, indicating remarkable progress. Internally, GNP grew, with remarkable price stability, on the average of 7–8 percent per year. Externally, annual exports have expanded very quickly since 1960. Since 1958, the government has set forth a new trade policy aimed at lessening controls on the one hand and at simplifying exchange rates on the other. The import-screening system has operated with greater flexibility, and, in 1963, a unified exchange rate was established. The phenomenal expansion of exports during the past few years has given rise to the prospect that trade can be gradually liberalized without damaging the balance of trade.

Because Taiwan is a small island economy, its further development depends heavily on external factors. Taiwan requires resources from abroad (capital goods and raw materials) for productive uses, and it needs foreign markets to sustain profitable production. At its present stage of economic development, Taiwan has enough domestic savings to finance investments which are considered necessary to sustain economic growth at a rate of 5–6 percent per year. Indeed, the marginal propensity to save in Taiwan in recent years has been as high as 30 percent; there is reason to believe that it will rise in the future. The key to channelling potential domestic savings into real investment rests on trade expansion. As modern technology continuously enlarges the economic scale of production, Taiwan's dependence on trade expansion becomes more and more significant. Taiwan has, at present, a trade-limited type of economy. Therefore, how quickly trade expansion can be accelerated will be the main concern of the Republic of China's trade policy, or, more accurately, of its development policies during the next stage of growth.

THE PROSPECT OF FOREIGN TRADE AND FURTHER ECONOMIC DEVELOPMENT

Taiwan's external trade during the sixteen-year period 1950–65 increased more than fourfold. Imports rose from US$125 million in 1950 to US$555 million in 1965 and exports went up from US$93 million in 1950 to US$488 million in 1965. Trade acted as a catalyst to rapid economic growth, accounting for over 30 percent of GNP. The key to Taiwan's economic development in the next stage lies in accelerated expansion of its external-trade sector.

Despite the steady growth of both exports and imports during the period under review, there has been a fairly large trade deficit, totaling about US$100 million each year. Ninety percent of this deficit was financed by United States concessional aid. The exceptional years were 1963 and 1964; they did not show a trade deficit, primarily because of the windfall profit from sugar exports sold at exceedingly high prices. Consequently, heavy foreign-exchange reserves were built up during those two years.

It is probable that with the discontinuation of United States aid, the trade gap will not be eliminated overnight. For the foreseeable future, other outside assistance will have to be solicited to help finance the trade gap. It was contended by the United States aid authorities that Taiwan had already established a credit worthiness able to attract needed capital from conventional foreign sources such as the United States and Japanese export-import banks, American banks and firms, and international institutions such as the International Bank for Reconstruction and Development (IBRD) and the Asian Development Bank (ADB). The Republic of China has passed a very liberal investment statute for foreign investment and has made great efforts to seek medium- and long-term capital flows from foreign investors. These efforts have proved quite successful, as exemplified by an amount of US$150 million credit in yen from Japan and the more than US$80 million loans from the IBRD and the Export-Import Bank of the United States.

A country with a large amount of foreign commercial debt will soon find, however, that its total debt service accelerates to a point where the gross capital inflow resulting from incurring new debts may be barely enough to finance the debt servicing charges, or may even reflect a net outflow. In order that Taiwan may depend less on foreign loans that will ultimately become a heavy drain on her foreign exchange, exports must increase at a faster rate than imports. For instance, if (as assumed in the Fifth Four-Year Plan for Economic Development) imports for the next ten years were to grow at an annual rate of 7 percent, the same growth rate as that projected for GNP, total imports would reach US$1,090 million by 1974 (slightly less than doubling the 1965 total of US$555 million). If total exports were to attain the same level as imports by 1974 so that the trade gap would then be closed, the annual export growth rate would have to be about 8.5 percent. A greater margin in the export surplus will help to increase Taiwan's external debt-servicing capacity.

In the Fourth Plan for Economic Development of Taiwan (1965–68), the excess of the annual average growth rate of exports over that of imports was much smaller than the above projection; the export growth rates for 1967 and 1968 were projected at less than the import growth rates. No attempt was made in the Plan to close the trade gap either within or beyond the planned period.

In the past, invisible imports have usually been greater than invisible exports. Anticipated receipts from the increases of tourism, shipping industries, and other activities among invisible exports will probably cover only the anticipated increases in service expenditures such as royalties, dividends, freight, and foreign travel. The projection of a surplus in invisibles to offset a portion of the visible trade deficit seems to be unrealistic.

Table 4.10 shows that, except in 1957, 1963, and 1964, there has been a protracted deterioration since 1953 in Taiwan's commodity terms of trade. The years that registered better terms of trade were those of high sugar export prices, while other years, which registered worsening terms of trade, corresponded to the low sugar prices. Thus, Taiwan's external sector is still dominated by sugar exports.

Had the index of the commodity terms of trade for Taiwan been kept at 100 percent during 1965, the total export value would have gone up from the actual US$488 million to US$575 million. The difference of US$87 million could have been used for additional imports of capital goods to help achieve a higher level of subsequent growth or to strengthen the balance-of-payments position. The annual loss sustained from the deterioration in terms of trade almost equals

TABLE 4.10—Index of Taiwan's terms of trade[a]

(1952 = 100)

Year	Terms of trade
1952	100.0
1953	98.0
1954	95.0
1955	97.5
1956	97.2
1957	103.0
1958	92.2
1959	89.5
1960	83.6
1961	87.6
1962	87.1
1963	105.2
1964	111.1
1965	84.6

[a] The index is used to measure the change in the volume of imports that could be received, on the basis of price relations only, in exchange for a given volume of exports.

Sources: *Index Numbers of the Import and Export Trade of China*, March, April, 1965, no. 60, p. 2; *Statistics of Foreign Trade of China*, July, August, 1965, no. 1, p. 2. Both were published by the Department of Statistics, Ministry of Finance, Republic of China.

the present yearly capital inflow, or almost the entire trade gap. We may, therefore, draw the inference that, in planning the development of the external sector of Taiwan's economy, one priority should be improving the terms of trade.

Protracted deterioration in the terms of trade is very common among the underdeveloped countries, which import industrial products and export primary goods. Some economists contend that the accrual of the gains from trade is biased in favor of the advanced industrial countries.[7] The arguments are inconclusive, but Taiwan's own experience supports the above contention. The only way to alleviate the bias favoring the advanced industrial countries seems to be to stress further development in the industrial sector. With the added weight of industrial products in Taiwan's exports, the high geographic and commodity concentrations in export trade patterns would be effectively reduced. Industrial growth would also end the buyers' market in some of Taiwan's export products.

The effort to bring about such a change in the trade pattern seems to be, at first sight, in conflict with the principle of international specialization. But countries can attempt specialization only in those items that will yield high returns in trade. Industrialization is not an inherent asset of a nation. For example, in the past twenty years, a pastoral economy like Australia's has had high achievements in industrialization.

The emphasis on industrialization by no means aims to minimize the past achievement of balanced development. A prosperous agricultural community is essential to the industrial sector, both as its raw-material supplier and as its market for finished products. A shift of emphasis to industrialization is appropriate, however, not only because Taiwan's external trade requires further diversification, but also because of the high component of marginal capital in the agricultural sector. This high capital coefficient is the result of optimum use of the limited land; of the relatively high cost for developing marginal land; and of the low labor productivity on land, implying high underemployment for manpower.

Taiwan does not intend, however, to abandon its efforts to strive for continuing development in the agricultural sector. Technical innovations—such as developing plant and animal varieties, introduction of new cash crops, soil preservation, and better application of fertilizer—should be encouraged. On the other hand, development of marginal and tidal land should first undergo a thorough cost-benefit analysis. Development of a perishable crop product for a single foreign market—such as the very extensive increase in bananas destined for Japan—should be handled with extreme caution, since the inevitable result is to place the large crop at the mercy of a sole buyer.

The industrialization process during the years ahead may differ substantially from industrial development during the past. In the past, industries were import substitutes, characterized by low capital, limited technical knowledge, high labor concentration, and heavy government protection. Most of the export industries developed at later dates are either an extension of those import-substituting industries, such as textiles, or industries making products containing a high labor-factor cost, such as plywood. Some of these export industries have been heavily subsidized in the past by domestic sales, but there are fewer profitable projects of this type at present. For future industrialization, large-scale and high-risk projects may eventually become the only alternatives. Numerous stumbling blocks will have to be removed before Taiwan can embark on the development of heavy industries.

Large-scale, capital-intensive industries require very extensive capitalization, calling for the mobilization of public savings. Taiwan will need enlightened entrepreneurship, the underwriting services of investment companies or stockbrokers, the establishment of public confidence by full and truthful disclosure of company financial statements, and rigid supervision of the listed stocks by the Securities Exchange Commission. These are but some of the many conditions essential to ensure the successful organization and operation of large enterprises. The society does not as yet provide all these facilities.

Another, equally important, condition is the technical knowledge associated with large-scale industries. Taiwan still lags far behind the advanced industrial countries in the technical field. The purchase of foreign patents is the most expedient way to make up this deficiency. Research personnel must be recruited and trained, however, and facilities must be acquired in order that technology may take roots in Taiwan's soil to provide for future growth.

Foreign investments are, of course, welcome to help accelerate economic growth. Taiwan's own capital resources must also be channelled into capital-intensive projects, however, so that there will not be complete foreign domination. At present, due to lack of a long-term capital market, there appears to be no effective method of pooling public savings to finance such large-scale projects. The nation needs the guidance of government and business leaders to bring about conceptual as well as structural changes that will induce a continuous high rate of growth through industrialization.

In implementing capital-intensive projects, careful preparation should be made to ensure their successful and uninterrupted operation. Necessary steps before launching these large-scale investments are preproject planning, feasibility studies, cost-benefit analysis, financing, construction and management plans, marketing research (particularly foreign-market potentials), analysis of the impact on other industries, and alternative-project studies.

In the meantime, labor-intensive projects should also be explored to alleviate the problem of the ever-increasing labor force. Projects that call for greater use of skilled labor are preferred, for they will not adversely affect the terms of trade. Labor quality should be improved through extension of compulsory education from six to nine years. Quantitative and qualitative improvements in the vocational-education system and installation of in-service training courses are required to increase labor productivity further.

In the Fourth Four-Year Plan (1965–1968), export growth was projected at an annual average rate of 9.1 percent. Table 4.11 shows

TABLE 4.11—Taiwan's actual and projected export composition, 1965–68

(Percent)

Year	Agricultural products	Processed agricultural products	Industrial products	Other	Total
1965 (actual)	27.5%	29.0%	41.3%	2.2%	100.0%
1965	22.3	27.5	47.3	2.9	100.0
1966	23.3	25.1	48.9	2.7	100.0
1967	22.5	24.0	50.9	2.6	100.0
1968	22.6	22.7	52.3	2.4	100.0

Source: *The Fourth Four-Year Plan for Economic Development*, published by the Council for International Economic Cooperation and Development, Republic of China (Taipei, 1965), pp. 262–63, table VI–1.

that actual industrial exports during 1965 lagged far behind the planned target (41.3 instead of 47.3 percent), and it seems doubtful that industrial exports reached 52.3 percent of total exports in 1968. This is disheartening because the rate of increase in industrial exports projected for the period 1965–68 was already extremely slow.

If we assume that there will be an average growth rate of 9.1 percent per annum in total exports for the ten-year period 1965–75, and that industrial exports will increase by 2.5 percent each year as a percentage of total exports, we can expect that industrial exports will constitute 66.3 percent of total exports by 1975, compared with 41.3 percent for 1965. Industrial exports will have to grow at a very fast rate, averaging 14.4 percent yearly to attain this goal. (See Table 4.12 for details.) If we recall that industrial exports rose from between 6 percent and 12 percent of total exports in the middle fifties to about 40 percent in the middle sixties (see Table 4.2), then the seemingly ambitious projection of a shift in the export pattern toward a larger industrial composition is not totally impossible.

With respect to the import composition, the Fourth Four-Year Plan estimated a fairly constant level of capital-goods imports at about 29 percent of total imports for the three years 1966 to 1968. This level is higher than the average of 25 percent for the ten preceding years (see Table 4.1). High capital-goods imports must be planned for the years ahead, however, in order to accelerate industrialization.

TABLE 4.12—Estimate of Taiwan's industrial exports, 1965–75

Year	Total exports (million US$)	Industrial exports as % of total exports	Industrial exports (million US$)	Growth rate of industrial exports (%)
1965	488	41.3	202	—
1966	532	43.8	233	15.3
1967	580	46.3	269	15.4
1968	633	48.8	309	14.9
1969	691	51.3	354	14.6
1970	754	53.8	406	14.7
1971	823	56.3	463	14.0
1972	898	58.8	528	14.0
1973	980	61.3	601	13.8
1974	1,069	63.8	682	13.5
1975	1,166	66.3	773	13.3

Source: Data obtained from a draft input-output table prepared by the Third Department, Council for International Economic Cooperation and Development, Republic of China.

Because the trade of the developed countries grows much faster than that of the underdeveloped countries, and because the underdeveloped countries trade more with developed countries than among themselves, a closer regional trade relationship among the ECAFE countries and the ultimate goal of establishing a common market for the region appear to be rather remote. Nevertheless, because of geographical proximity, the ECAFE countries are the best potential buyers of Taiwan's increasing industrial exports. With the ending of United States economic assistance, Taiwan's demand for certain agricultural commodities such as soybeans, corn, and coconut oil (as a substitute for beef tallow if the price is competitive) could be met by imports from Thailand and the Philippines. The aim of promoting regional trade would be furthered, and part of the increased exports of industrial products to these countries would be offset.

Increased exports of industrial and finished products will require active government support of aggressive marketing and advertising; timely commercial intelligence; a coordinated distribution system, including the best location of dealers; inventory control over the dealers; prompt transportation; improved packaging; and marketing research. The market potential in the new African countries and in Latin America should be explored and promoted, while the established markets in North America and Europe should be enlarged. Foreign trade in the future is the frontier of the economy and presents a major challenge to the people of the Republic of China.

NOTES

1. Taiwan was occupied by Japan after the Sino-Japanese War of 1894–95 and was recovered by the Republic of China after the Japanese surrender in 1945.
2. S. C. Hsieh and T. H. Lee, "Agricultural Development and Its Contributions to Economic Growth in Taiwan," mimeographed (Taipei: Joint Commission on Rural Reconstruction, 1966).
3. The Taiwan "Land to the Tiller" program was first instituted in 1954. The essence of this program was to limit ownership of land by absentee landlords and to sell their excess holdings to the farmers, with the government advancing funds. The farmers paid back capital and interest in ten yearly installments.
4. The Republic of China launched its First Four-Year Plan for Economic Development in 1953. The Fourth Four-Year Plan for Economic Development ended in 1968. The Fifth Plan runs 1969–73.
5. Michael Michaely, *Concentration in International Trade* (Amsterdam: North Holland Publishing Co., 1962).
6. Bela Balassa, "Tariff Protection in Industrial Countries: An Evaluation," *The Journal of Political Economy*, 73, no. 6 (1965): 576–77.
7. For example, Raul Prebisch, "The Economic Development of Latin America and its Principal Problems," *Economic Bulletin for Latin America*, 7, no. 1 (1962); and Gunnar Myrdal, *Development and Underdevelopment*, National Bank of Egypt Fiftieth Anniversary Commemoration Lectures (Cairo, 1956).