6

OFFICIAL **OUTGOING MESSAGE** **OFFICIAL**

INTERNATIONAL MONETARY FUND
WASHINGTON D.C.

FOR PREPARING OFFICER
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SPECIAL INSTRUCTIONS

cc: ASD
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ETR
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DISPATCHED DEC 27 1974 IMF CABLE ROOM

Drafted by ~~WGLEvers/AAbadjis:~~ jp
Department ~~Asian~~
Date ~~December 27, 1974~~

AUTHORIZATION

Andreas Abadjis
Signature
AAbadjis

Second Signature When Required

FOR CODE ROOM
Time Received 5:00 P.M.
Time Dispatched 5:40 P.M.
Number of Words 731
Log 244060
Route RCA
Operator RC

To: Hon. K. T. Li
Minister of Finance
~~Ministry of Finance~~
Taipei (Taiwan)

RECEIVED DEC 30 1974 EXCHANGE & TRADE RELATIONS

First. A press release (P.E. 74-965, dated December 21, 1974), of the Chinese information service in New York states that strict control has been imposed on that date on imports from Japan in order to reduce the large bilateral trade deficit. Accordingly, 774 import items can no longer be purchased from Japan, but must be purchased from Europe and the United States.

a. Please indicate the major import items or categories included in the 774 items; please provide data on the value of imports of these items from Japan in 1973 and the first ten months of 1974 and the value of imports of these items from the rest of the world during the two periods. Were the 774 items transferred from the permissible to the controlled list?

b. Please explain the rationale of this measure?

c. The press release mentions that an economic and trade delegation recently visited Japan. What was the outcome of the discussions?

d. Can the 774 items be imported now only from the United States and Europe but not from other countries? If so, why?

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INTERNATIONAL MONETARY FUND
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To:

Second. The same press release states that quote 829 import items should be put on a licensed basis unquote.

a. Are these different items than the 774 items or is there any overlapping between the two lists?

b. Were these 829 items transferred from the permissible to the controlled group of imports? On what date?

c. What are the major items or categories included in the 829 items? What was the total value of imports of these items in 1973 and the first ten months of 1974?

d. What were the reasons for the transfer of these items to the controlled list?

Third. China Post of December 16 mentioned that imports of black and white television picture tubes, enamel-coated wire, and printed circuit boards will be prohibited quote unless a proper reason is given. A BOFT spokesman said that the import controls were taken to comply with the recently adopted Cabinet stipulation that imports of raw materials and electronic components, which have local supplies, should be restricted unquote.

a. Please explain what quote a proper reason unquote means.

DISPATCHED DEC 27 1974 IMF CABLE ROOM

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Time Received 5:00 P.M.
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Number of Words 731
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SEC-17

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INTERNATIONAL MONETARY FUND
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To: ______

b. Were these prohibitions introduced under point 11 of the 14-point program introduced on November 15, 1974?

c. Please explain the reasons for prohibiting the importation of these products; was it in order to protect domestic industries?

d. If the above prohibitions have not in fact been introduced under point 11, we would like to clarify further the mission's discussions on point 11. In the minutes of meeting number six, it was mentioned that the authorities were extremely reluctant to force domestic manufacturers to use relatively expensive domestic raw materials. Does this mean that if the applicant for an import license finds it more advantageous to buy raw materials abroad even after the price negotiations with the domestic raw material producers, ~~will~~ the authorities will grant him a license? Exceptions to this may be made only in cases of dumping when time would be needed to establish conclusively that dumping was taking place and introduce countervailing duties. In such cases the refusal of import licenses would be temporary. Please confirm whether ~~an~~ our understanding ~~xxxxxxxxxxx~~ of the above points is correct.

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INTERNATIONAL MONETARY FUND
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To:

e. Please cable the list of raw materials which are covered under point 11.

Fourth. The same issue of the China Post mentions that imports of certain kinds of fish were prohibited. Is this correct?

Fifth. We would be grateful if you would cable us information on any other measures you have taken in the foreign trade and payments field, as well as measures taken in the monetary and fiscal fields. Please send copies of circulars or regulations by airmail.

Sixth. Please provide the number of items now on the prohibited, controlled and permissible lists. Of those on the permissible list, how many can be imported under the automatic approval system by appointed banks? Regards

Abadjis
Interfund

Drafted by

Department

Date

AUTHORIZATION

Signature

AAbadjis

Second Signature When Required

FOR CODE ROOM

Time Received 5:00 P.M.
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Number of Words 731
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OFFICIAL OUTGOING MESSAGE OFFICIAL

INTERNATIONAL MONETARY FUND
WASHINGTON D.C.

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SPECIAL INSTRUCTIONS

[Code]

To: Andreas Abadjis
Grand Hotel
Taipei (Taiwan)

RECEIVED DEC 10 1974 EXCHANGE & TRADE RELATIONS

[Korea] has informed the Fund of its intention to [~~devalue~~ depreciate by 17.5 per cent from Won 400 to Won 485 per U.S. dollar] on December 7 [Korean] time and that this [rate will be maintained within margins of] one per cent on either side. Authorities intended to [float] in response to strong market forces, expecting the [rate] to be relatively stable in the immediate future; however, since they were not clear with regard to objectives of [floating], we encouraged them to postpone this action. The staff paper will be issued on Thursday and Board discussion is scheduled Friday. You may inform [Chinese authorities Korea] time Saturday morning. As for advice to [Chinese authorities], we still feel page 8 of the briefing paper applies. In particular, subject to your up-to-date assessment of [BOP] position and prospects, you should encourage [authorities not to respond immediately to Korean] action. Regards

Tun Thin

Cleared with: ETR
LEG

DISPATCHED DEC - 5 1974 IMF CABLE ROOM

Drafted by PRNarvekar/TT:md
Department Asian
Date December 5, 1974

AUTHORIZATION

Signature

Tun Thin

Second Signature When Required

FOR CODE ROOM
Time Received 6:00 PM
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Number of Words 93 P
Log 241764
Route ITT
Operator JE

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SEC-17

China

Office Memorandum

TO : Mr. Abadjis

DATE: November 22, 1974

FROM : Brian C. Stuart

SUBJECT : Reconciliation of Central Bank and Official Reserves and Central Bank Foreign Assets in IFS

I had a discussion with Mr. Y. Okuma of the Bureau of Statistics this afternoon regarding the differences in lines 1 and 11 of the China page in IFS. Mr. Okuma informed me that a change in the reserve data provided by the Chinese did occur about June 1973, as can be seen by quickly glancing at the two attached pages. The data provided for the November 1973 issue shows a marked difference in the reserves reported for May 1973 and earlier. These higher reserve figures probably reflect the new series promised by the authorities during the last consultations.

However, Mr. Okuma noted there is still a discrepancy between lines 1 and 11, though smaller than before. He would like us to request that future data provided to IFS provide a breakdown of line 11 in order to better understand the remaining discrepancy. The Bureau would also like a breakdown of lines 17r and 27r, particularly the latter, which are fairly large entries for "other items net". They would also like the authorities to check the footnotes on page 99 of the November issue (attached).

Attachments

	1972 I	1972 II	1972 III	1972 IV	1973 I	1973 II	1973 III	1973 Feb	1973 Mar	1973 Apr	1973 May	1973 June	1973 July	1973 Aug	1973 Sept		
End of Period (Period Average for line ra)																**Exchange Rates**	
	40.10	40.10	40.10	40.10	38.10	38.10	38.10	38.10	38.10	38.10	38.10	38.10	38.10	38.10	38.10	Selling Rate	a
	40.00	40.00	40.00	40.00	39.32	38.00	....	40.00	38.00	38.00	38.00	38.00	38.00	38.00	....	Trade Conversion Factor	ra
End of Period Millions of U.S. $																**International Liquidity**	
	779	827	965	1,039	1,229	1,241	1,191	1,199	1,229	1,207	1,233	1,241	1,197	1,211	1,191	Central Bank & Official Reserves	1
	87	87	87	87	97	97	97	97	97	97	97	97	97	97	97	Gold	1a
	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	Reserve Position in the Fund	1c
	692	740	878	952	1,132	1,144	1,094	1,102	1,132	1,110	1,136	1,144	1,100	1,114	1,094	Foreign Exchange	1d
																Fund Position	
	597	597	597	597	664	664	664	664	664	664	664	664	664	664	664	Credit Tranche Position	2bc
	65	65	65	65	72	72	72	72	72	72	72	72	72	72	72	Drawings Outstanding	2de
	597	597	597	597	664	664	664	664	664	664	664	664	664	664	664	Quota	2f
	114	126	126	128	114	306	....	110	114	106	132	306	....	....	....	Commercial Banks' Assets	7a
	320	383	541	675	816	843	....	783	816	830	830	843	788	....	....	*Dollar Assets Reported by US*	9a
End of Period Billions of NT $																**Central Bank**	
	3.70	40.04	48.00	55.02	62.62	61.97	....	60.77	62.62	64.09	65.91	61.97	56.01	57.12	....	Foreign Assets	11
	3.38	3.58	3.62	3.24	3.37	3.44	....	3.26	3.37	3.42	3.46	3.44	3.42	3.45	....	Claims on Government	12a
	.47	.36	.36	.36	.25	.25	....	.25	.25	.25	.25	.25	.25	.25	....	Claims on Official Entities	12b
	7.19	16.82	16.59	14.97	15.59	23.78	....	13.72	15.59	17.50	17.93	23.78	34.64	36.01	....	Claims on Commercial Banks	12e
	32.05	36.26	42.68	46.39	51.24	53.76	....	49.59	51.24	52.73	53.13	53.76	56.59	56.35	....	Reserve Money	14
	16.56	17.12	17.86	20.34	21.67	23.43	....	21.35	21.67	21.46	21.95	23.43	23.76	24.74	....	*of which: Currency Outside Banks*	14a
	11.91	13.13	13.99	14.78	16.38	17.79	....	16.00	16.38	16.67	16.99	17.79	18.17	18.40	....	Time and Savings Deposits	15a
	9.71	10.41	10.92	10.89	13.64	15.70	....	12.16	13.64	15.35	17.16	15.70	17.06	19.18	....	Government Deposits	16d
	1.15	1.24	1.42	1.73	1.42	1.53	....	1.60	1.42	1.36	1.24	1.53	1.51	1.44	....	Counterpart Funds	16e
	−.08	−.24	−.46	−.20	−.84	.67	....	−1.34	−.84	−.85	−.97	.67	1.00	1.48	....	Other Items (Net)	17r
End of Period																**Commercial Banks**	
	17.13	21.01	26.56	27.74	31.31	....	....	30.95	31.31	33.44	34.04	....	....	....	....	Reserves	20
	9.71	I 5.59	5.58	5.70	4.82	12.93	....	4.64	4.82	4.48	5.61	12.93	18.71	19.04	....	oFreign Assets	21
	6.67	6.62	6.45	6.44	6.51	6.68	....	6.43	6.51	6.68	6.65	6.68	6.76	7.12	....	Claims on Government	22a
	21.60	I 23.14	23.41	22.54	22.84	23.81	....	22.76	22.84	22.88	23.74	23.81	24.36	24.65	....	Claims on Official Entities	22b
	80.94	I 93.78	95.60	106.01	115.57	136.47	....	110.47	115.57	123.30	127.64	136.47	141.25	145.48	....	Claims on Private Sector	22c
	29.42	I 29.46	28.94	34.73	36.39	45.92	....	34.81	36.39	38.56	40.11	45.92	44.70	45.02	....	Demand Deposits	24
	58.16	68.29	74.13	80.88	85.75	92.01	....	84.01	85.75	87.02	90.44	92.01	93.77	96.68	....	Time & Foreign Currency Deposits	25
	13.67	I 2.42	2.38	2.38	3.78	4.78	....	3.90	3.78	4.47	4.07	4.78	4.85	4.29	....	Foreign Liabilities	26c
	9.18	10.61	11.43	11.86	13.26	15.80	....	12.44	13.26	14.48	14.72	15.80	16.37	17.06	....	Government Deposits	26d
	12.35	I 16.82	16.59	14.97	15.40	23.78	....	13.54	15.40	17.29	17.93	23.78	34.64	36.01	....	Credit from Central Bank	26g
	12.67	I 22.55	24.13	23.62	26.47	29.84	....	26.67	26.47	28.93	30.41	29.84	30.77	30.06	....	Other Items (Net)	27r
End of Period																**Monetary Survey**	
	35.42	I 43.21	51.20	58.34	63.66	70.12	....	61.51	63.66	64.10	67.45	70.12	69.87	71.87	....	Foreign Assets (Net)	31
	94.15	I 107.05	107.73	116.69	122.63	140.22	....	119.52	122.63	127.70	130.93	140.22	143.78	146.04	....	Domestic Credit	32
	−9.44	−10.82	−12.28	−13.07	−17.02	−21.38	....	−14.91	−17.02	−19.74	−21.77	−21.38	−23.25	−25.67	....	Claims on Government (Net)	32a
	22.07	I 23.50	23.77	22.90	23.09	24.06	....	23.01	23.09	23.13	23.99	24.06	24.61	24.90	....	Claims on Official Entities	32b
	81.52	I 94.37	96.24	106.86	116.56	137.54	....	111.42	116.56	124.31	128.71	137.54	142.42	146.81	....	Claims on Prviate Sector	32c
	45.98	I 46.58	46.80	55.07	58.06	69.35	....	56.16	58.06	60.02	62.06	69.35	68.46	69.76	....	Money	34
	70.07	81.42	88.12	95.66	102.13	109.80	....	100.01	102.13	103.69	107.43	109.80	111.94	115.08	....	Quasi-Money	35
	1.15	1.24	1.42	1.73	1.42	1.53	....	1.60	1.42	1.36	1.24	1.53	1.51	1.44	....	Counterpart Funds	36e
	12.36	I 22.03	22.57	22.58	24.69	....	....	23.39	24.69	26.71	27.65	....	....	....	....	Other Items (Net)	37r
	....	....	....	....	....	....	....	55.17	58.94	61.00	62.81	67.86	69.15	70.89	....	*Moneyi Seasonably Adjusted*	34..B
	100.10	112.71	119.80	132.66	152.03	176.91	....	127.72	167.72	165.84	176.80	188.09	203.80	....	....	*Bank Debits (Monthly Averages)*	39d
																Other Financial Institutions	
End of Period																Savings Institutions	
	16.73	18.94	19.85	21.59	22.45	25.62	....	22.15	22.45	23.05	23.87	25.62	25.82	....	....	Cash	40
	10.20	10.31	10.66	11.35	11.82	12.58	....	11.57	11.82	11.98	12.18	12.58	12.82	....	....	Claims on Private Sector	42c
	19.63	20.72	21.78	22.38	23.55	25.22	....	23.40	23.55	23.91	24.64	25.22	25.50	....	....	Time & Savings Deposits	45
	.37	.28	.40	.42	.48	.38	....	.43	.48	.50	.39	.38	.55	....	....	Credit from Commercial Banks	46h
	6.92	8.26	8.34	10.14	10.25	12.60	....	9.89	10.25	10.63	11.01	12.60	12.58	....	....	Other Items (Net)	47r
																Development Banks	I
	2.49	2.64	2.67	2.69	2.65	2.79	....	2.62	2.65	2.71	2.76	2.79	2.77	2.85	....	Claims on Private Sector	42c
	2.03	2.16	2.24	2.27	2.21	2.33	....	2.20	2.21	2.22	2.27	2.33	2.32	2.35	....	Borrowing	46aq
End of Period																Life Insurance	S
	.61	.94	.94	1.11	1.27	1.34	....	1.26	1.27	1.25	1.27	1.34	1.38	....	....	Cash	40
	1.71	1.87	2.10	2.04	2.28	2.41	....	2.23	2.28	2.38	2.43	2.41	2.50	....	....	Claims on Private Sector	42c
	.12	.28	.30	.16	.42	.32	....	.12	.09	.09	.12	.11	.14	....	....	*Increase in Total Assets (Within Pd.)*	49z
Period Averages																**Interest, Prices, Production**	
	12.0	12.0	11.3	11.3	11.3	11.3	12.00	11.3	11.3	11.3	11.3	11.3	12.0	12.0	12.0	Call Loan Rate (*End of Period*)	60
	109.9	110.1	110.9	113.9	123.7	126.8	....	124.3	125.5	125.3	126.3	128.9	132.9	138.9	....	Wholesale Prices	63
	128.0	129.8	135.0	130.6	135.1	139.1	....	135.9	135.5	137.4	139.2	140.6	144.7	147.8	....	Consumer Prices	64
	453	502	503	523	587	604	....	517	640	583	613	617	....	....	....	Industrial Production	66
Millions of NT Dollars																**International Transactions**	
	22,178	27,136	32,703	34,633	31,833	36,519	....	9,371	11,450	12,131	11,931	12,457	15,857	....	....	Exports	70
	1,031	1,266	1,456	1,711	1,672	1,771	....	387	836	668	716	789	....	....	....	Plywood	70a
	34	239	797	141	....	159	....	1	....	2	26	219	....	....	....	Bananas	70b
	780	859	819	779	868	1,205	....	230	546	696	202	307	....	....	....	Sugar	70c
	76	234	160	148	65	292	....	26	15	43	173	76	....	....	....	Tea	70d
	21,291	26,055	24,836	28,609	24,262	36,138	....	6,768	8,704	12,198	11,323	12,617	12,221	....	....	Imports, cif	71
	19,181	23,473	22,375	25,774	21,858	32,557	....	6,097	7,841	10,989	10,201	11,367	11,010	....	....	Imports, fob	71v

20ff, 30ff } I Prior to 1972 II, Foreign Assets and Foreign Liabilities include claims on and liabilities to domestic sectors incurred by foreign exchange transactions, and Money includes remittances payable.

OCTOBER 1973

China

1972 I	1972 II	1972 III	1972 IV	1973 I	1973 II	1972 Dec	1973 Jan	1973 Feb	1973 Mar	1973 Apr	1973 May	1973 June	1973 July	1973 Aug		
End of Period (Period Average for line ra)															**Exchange Rates**	
40.10	40.10	40.10	40.10	38.10	38.10	40.10	40.10	38.10	38.10	38.10	38.10	38.10	38.10	38.10	Selling Rate	a
40.00	40.00	40.00	40.00	39.32	38.00	40.00	40.00	40.00	38.00	38.00	38.00	38.00	38.00	38.00	Trade Conversion Factor	ra
End of Period					Millions of U.S. $										**International Liquidity**	
561	606	682	738	772	1,241	738	730	755	772	779	792	1,241	1,197	....	Central Bank & Official Reserves	1
87	87	87	87	97	97	87	87	97	97	97	97	97	97	....	Gold	1a
—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	Reserve Position in the Fund	1c
474	519	595	651	675	1,144	651	643	658	675	682	695	1,144	1,100	....	Foreign Exchange	1d
															Fund Position	
597	597	597	597	664	664	597	597	664	664	664	664	664	664	664	Credit Tranche Position	2bc
65	65	65	65	72	72	65	65	72	72	72	72	72	72	72	Drawings Outstanding	2de
597	597	597	597	664	664	597	597	664	664	664	664	664	664	664	Quota	2f
74	93	57	94	30	....	94	51	22	30	....	....	....	....	....	Commercial Banks' Assets	7a
320	383	541	675	816	843	675	679	783	816	830	830	843	....	....	*Dollar Assets Reported by US*	9a
End of Period						Billions of NT $									**Central Bank**	
39.38	46.72	56.04	62.69	66.26	....	62.69	63.20	63.86	66.26	67.63	70.09	....	....	....	Foreign Assets	11
3.38	3.58	3.62	3.24	3.37	....	3.24	3.31	3.26	3.37	3.42	3.46	....	....	....	Claims on Government	12a
.47	.36	.36	.36	.25	....	.36	.36	.25	.25	.25	.25	....	....	....	Claims on Official Entities	12b
12.35	10.92	9.73	8.20	11.69	....	8.20	12.28	10.45	11.69	13.67	14.04	....	....	....	Claims on Commercial Banks	12e
32.05	36.26	42.68	46.39	51.24	....	46.39	50.28	49.59	51.24	52.73	53.13	....	....	....	Reserve Money	14
16.56	17.12	17.86	20.34	21.67	....	20.34	26.92	21.35	21.67	21.46	21.95	....	....	....	*of which: Currency Outside Banks*	14a
11.91	13.13	13.99	14.78	16.38	....	14.78	15.21	16.00	16.38	16.67	16.99	....	....	....	Time and Savings Deposits	15a
9.71	10.41	10.92	10.89	13.64	....	10.89	10.71	12.16	13.64	15.35	17.16	....	....	....	Government Deposits	16d
1.15	1.24	1.42	1.73	1.42	....	1.73	1.70	1.60	1.42	1.36	1.24	....	....	....	Counterpart Funds	16e
.75	.54	.73	.70	−1.10	....	.70	1.25	−1.52	−1.10	−1.13	−.68	....	....	....	Other Items (Net)	17r
End of Period															**Commercial Banks**	
17.13	21.01	26.56	27.74	31.37	....	27.74	24.25	30.99	31.37	33.51	34.09	....	....	....	Reserves	20
9.71	12.10	13.23	15.20	13.37	....	15.20	13.86	13.03	13.37	15.22	16.17	....	....	....	Foreign Assets	21
6.67	6.62	6.45	6.44	6.51	....	6.44	6.34	6.43	6.51	6.68	6.65	....	....	....	Claims on Government	22a
21.60	22.56	22.75	21.95	22.08	....	21.95	22.25	22.13	22.08	21.98	22.83	....	....	....	Claims on Official Entities	22b
80.94	86.01	86.83	95.48	104.92	....	95.48	100.72	100.37	104.92	110.87	114.81	....	....	....	Claims on Private Sector	22c
29.42	33.85	33.92	40.47	43.34	....	40.47	39.87	41.33	43.34	45.66	47.95	....	....	....	Demand Deposits	24
58.16	64.21	69.46	75.46	79.22	....	75.46	75.83	77.85	79.22	80.27	83.20	....	....	....	Time & Foreign Currency Deposits	25
13.67	16.23	18.02	20.71	23.10	....	20.71	18.60	19.47	23.10	27.19	30.67	....	....	....	Foreign Liabilities	26c
9.78	10.61	11.43	11.86	13.26	....	11.86	10.62	12.44	13.26	14.49	14.72	....	....	....	Government Deposits	26d
12.35	10.92	9.73	8.20	11.50	....	8.20	12.18	10.27	11.50	13.47	14.04	....	....	....	Credit from Central Bank	26g
12.67	12.50	13.26	10.13	7.83	....	10.13	10.31	11.59	7.83	7.19	3.96	....	....	....	Other Items (Net)	27r
End of Period															**Monetary Survey**	
35.42	42.59	51.25	57.18	56.53	....	57.18	58.46	57.42	56.53	55.66	55.59	....	....	....	Foreign Assets (Net)	31
94.15	98.69	98.22	105.48	111.03	....	105.48	112.41	108.61	111.03	114.16	116.92	....	....	....	Domestic Credit	32
−9.44	−10.82	−12.28	−13.07	−17.02	....	−13.07	−11.68	−14.91	−17.02	−19.74	−21.77	....	....	....	Claims on Government (Net)	32a
22.07	22.92	23.11	22.31	22.33	....	22.31	22.61	22.38	22.33	22.23	23.08	....	....	....	Claims on Official Entities	32b
81.52	86.59	87.39	96.24	105.72	....	96.24	101.48	101.14	105.72	111.67	115.61	....	....	....	Claims on Private Sector	32c
45.98	50.98	51.78	60.81	65.01	....	60.81	66.79	62.68	65.01	67.12	69.90	....	....	....	Money	34
70.07	77.34	83.45	90.24	95.60	....	90.24	91.04	93.85	95.60	96.94	100.19	....	....	....	Quasi-Money	35
1.15	1.24	1.42	1.73	1.42	....	1.73	1.70	1.60	1.42	1.36	1.24	....	....	....	Counterpart Funds	36e
12.36	11.75	12.81	9.90	5.54	....	9.90	11.33	7.91	5.54	4.42	1.17	....	....	....	Other Items (Net)	37r
46.70	49.88	52.94	58.58	66.00	....	58.58	61.90	61.57	66.00	68.21	70.75			....	*Money, Seasonally Adjusted*	34..B
100.10	112.71	119.80	132.66	152.03	176.91	140.97	160.66	127.72	167.72	165.84	176.80	188.09	203.80	....	*Bank Debits (Monthly Averages)*	39d
															Other Financial Institutions	
End of Period															Savings Institutions	
16.73	18.94	19.85	21.59	22.45	....	21.59	21.14	22.15	22.45	23.05	....	....	....	....	Cash	40
10.20	10.31	10.66	11.35	11.82	....	11.35	11.78	11.57	11.82	11.98	....	....	....	....	Claims on Private Sector	42c
19.63	20.72	21.78	22.38	23.55	....	22.38	22.49	23.40	23.55	23.91	....	....	....	....	Time & Savings Deposits	45
.37	.28	.40	.42	.48	....	.42	.53	.43	.48	.50	....	....	....	....	Credit from Commercial Banks	46h
6.92	8.26	8.34	10.14	10.25	....	10.14	9.92	9.89	10.25	10.63	....	....	....	....	Other Items (Net)	47r
															Development Banks	I
2.49	2.64	2.67	2.69	2.65	....	2.69	2.65	2.62	2.65	2.71	2.76	....	....	....	Claims on Private Sector	42c
2.03	2.16	2.24	2.27	2.21	....	2.27	2.22	2.20	2.21	2.22	2.27	....	....	....	Borrowing	46aq
End of Period															Life Insurance	S
.61	.94	.94	1.11	1.27	1.34	1.11	1.13	1.26	1.27	1.25	1.27	1.34	....	....	Cash	40
1.71	1.87	2.10	2.04	2.28	2.41	2.04	2.23	2.23	2.28	2.38	2.43	2.41	....	....	Claims on Private Sector	42c
.12	.28	.30	.16	.42	.32	.07	.22	.12	.09	.09	.12	.11	....	....	*Increase in Total Assets (Within Pd.)*	49z
Period Averages															**Interest, Prices, Production**	
12.0	12.0	11.3	11.3	11.3	11.3	11.3	11.3	11.3	11.3	11.3	11.3	11.3	12.0	12.0	Call Loan Rate (*End of Period*)	60
109.9	110.1	110.9	113.9	123.7	126.8	116.2	121.3	124.3	125.5	125.3	126.3	128.9	132.9	....	Wholesale Prices	63
128.0	129.8	135.0	130.6	135.1	139.1	131.5	133.9	135.9	135.5	137.4	139.2	140.6	144.7	....	Consumer Prices	64
453	502	503	523	587	....	554	604	517	640	583	613	....	....	....	Industrial Production	66
Millions of NT Dollars															**International Transactions**	
22,178	27,136	32,703	34,633	31,833	36,519	12,654	11,013	9,371	11,450	12,131	11,931	12,457	....	....	Exports	70
1,031	1,266	1,456	1,711	1,672	....	689	450	387	836	668	....	....	....	....	Plywood	70a
34	239	797	141	....	....	29	....	....	....	....	....	....	....	....	Bananas	70b
780	859	819	779	868	....	279	92	230	546	696	....	....	....	....	Sugar	70c
76	234	160	148	65	....	33	23	26	15	43	....	....	....	....	Tea	70d
21,291	26,055	24,836	28,609	24,262	36,138	10,160	8,790	6,768	8,704	12,198	11,323	12,617	....	....	Imports, cif	71
9,181	23,473	22,375	25,774	21,858	32,557	9,153	7,919	6,097	7,841	10,989	10,201	11,367	....	....	Imports, fob	71v

INTERNATIONAL MONETARY FUND

November 5, 1974

TO : Mr. Palmer

FROM: Brian C. Stuart

Mission to the Republic of China

Please find attached my memorandum on what I consider to be the most important developments in the exchange and restrictive system of the Republic of China. I also attach for your convenience a draft of the exchange and trade arrangements chapter for the background paper.

I would appreciate having the opportunity to discuss these issues with you at your earliest convenience.

Attachments

Office Memorandum

Tal- Chin

TO : Mr. Palmer

DATE: November 5, 1974

FROM : Brian C. Stuart

SUBJECT : Mission to the Republic of China

The reversal of China's trade balance is not unlike that of most of the oil importers throughout the world. However, part of the problem may be viewed as a result of the particular exchange rate regime being observed by the Republic of China. The mission chief, Mr. Abadjis, believes that one of the main topics of discussion during the mission will be the exchange rate policy of China, what the alternative regimes are, and how the Fund views the various alternatives. I would find it very useful to review current department thinking regarding the various alternatives and to discuss the various implications, especially regarding the guidelines for floating, that follow from each of the various alternatives.

The recent turn around in the Republic of China's balance of trade has been marked. Compared to a surplus of SDR 272 million for the first half of 1973, China showed a trade deficit of SDR 259 million during the same period in 1974. This has led to two specific changes in the restrictive system. In June, the imports of color television sets and cars from Japan were prohibited and the imports of color television sets from the United States and Europe were restricted. In July, the tax concessions given to exporters per dollar of exports were increased in an attempt to promote exports. reserves

Following the announcement of the devaluation by 10 per cent of the U.S. dollar in February 1973, the Chinese authorities announced a central rate that represented a devaluation of 5.3 per cent against the SDR and an equal appreciation vis-à-vis the U.S. dollar, from NT$40 = US$1 to NT$38 = US$1. There was some questioning by the Executive Board of the devaluation against the SDR by a country experiencing significant trade surpluses, but it was pointed out at the time that the depreciation was only 1 per cent on a trade-weighted basis. Since February 1973, the new Taiwan dollar has been pegged to the U.S. dollar. This has caused difficulties in the recent past following the depreciation of the Japanese yen vis-à-vis the U.S. dollar. This development has serious implications for China, as Japan is the leading source of imports for Taiwan (supplying 38 per cent of 1973 imports) and the second leading market for exports (19 per cent of 1973 exports compared to 39 per cent going to the United States). As a result of being pegged to the U.S. dollar, the rate of the Japanese yen in terms of the new Taiwan dollar has declined from approximately ¥ 7 per new Taiwan dollar at the end of March 1973 to ¥ 8 per new Taiwan dollar at the end of September 1974. As calculated by the Asian Department, the trade-weighted effective rate of the new Taiwan dollar appreciated by 3 per cent from May 1974 to the end of August 1974. This has worsened Taiwan's chronic balance of payments deficit with Japan and has led to the discriminatory action of prohibiting imports of certain goods from Japan.

Still U.S. dollar is more important

3.5 months imports end of 1973

If it is felt that the recent effective appreciation necessitates a change in the U.S. dollar rate of the new Taiwan dollar, it appears that three options are open.

(1) Devaluation of the new Taiwan dollar and repegging it to the floating currencies of one of China's major trading partners, most likely the U.S. dollar. This development would leave the exchange rate developments of the new Taiwan dollar subject to developments in other markets--particularly the rate of the yen vis-à-vis the U.S. dollar.

(2) The new Taiwan dollar could be allowed to float freely. In evaluating this option it would be most helpful for the mission to explain specific Fund interpretations of the guidelines for floating that would be applicable.

(3) The new Taiwan dollar could be pegged to a basket of currencies (category 4). One question that arises involving this alternative is how detailed a disclosure the Chinese authorities have to make regarding the composition of the basket in order that the new Taiwan dollar be considered as part of category 4, instead of category 1 (a freely floating currency).

Regarding the restriction of imports, Mr. McLenaghan is of the opinion that the system is much more complicated than the simple classification of imports into prohibited, controlled and permissible would suggest. The underlying complications become apparent when it is noted that the controlled list includes items that are licensed restrictively as well as goods imported by government agencies. It will be necessary to go beyond a simple renumeration of items classified according to the three main categories to see if a change within the broad classifications have resulted in greater restrictions at a time of a worsening trade balance.

As part of its anti-inflationary effort, the authorities have continued their policy of tariff reductions throughout 1973 and 1974, although a press release of May 31, 1974 indicated a list of tariff increases were being considered because of the developments in the trade balance. So far such a series of tariff increases has not been enacted. On the export side, prohibitions on exports of certain foodstuffs, fertilizers, chemicals and paper products were introduced in September and October of 1973. If these prohibitions are attempts to relieve supply shortages at a time of serious inflationary pressures, how seriously do we view these developments and what alternative policies could we suggest?

China also maintains an advance settlement requirement ranging from 10 per cent to 25 per cent on the value of imports depending on the various types of foreign financing arrangements to be used, for example letters of credit, documents-against-payment, documents-against-acceptance, usance letters of credit. These were introduced during periods when China employed a more favorable balance of payments in order to discourage the use of foreign short-term financing which was having an inflationary impact on domestic liquidity. Do we view this type of arrangement as a capital restriction or do we concern ourselves with its potential for interfering with generally accepted importing procedures? In this context, it will be important to assess any change in the availability of domestic finance for imports. On the more general question of regulation of foreign borrowing, the mission would seek an elaboration of the brief announcement of March 24, 1974, that foreign loans for any purpose other than those that were to be used as revolving funds were henceforth to be accepted.

Finally, I would find it useful to discuss the specific aspects of the regulations of the gold market that should be of particular concern to the mission.

V. Exchange and Trade Arrangements

During 1973, the policy of import liberalization and tariff reductions continued. A worsening of the balance of payments position in 1974 led to the imposition of some new import controls and the increase of export incentives. The restrictions on short-term foreign borrowing that had been introduced in 1972 and 1973 were relaxed in 1974. To assist in moderating the effect of foreign inflation on domestic prices, further tariff reductions were introduced and the export of certain products in short domestic supply was prohibited.

A detailed description of the exchange and trade system is given in the 25th Annual Report on Exchange Restrictions. The more important recent developments are described below.

1. Exchange rate developments

On December 21, 1971, China informed the Fund that the exchange rate of NT$40.00 per U.S. dollar would be maintained. On May 8, 1972, the par value of the new Taiwan dollar was changed from 0.0222168 gram of fine gold to 0.0204628 gram of fine gold per new Taiwan dollar, corresponding to NT$43.4286 per SDR 1 and NT$40 = US$1; this represented a devaluation of 7.89 per cent. At the same time, China announced that it was availing itself of wider margins. On February 16, 1973 China established a central rate of SDR 0.0218144 per new Taiwan dollar corresponding to NT$45.8413 = SDR 1 or NT$38 = US$1 and continued to avail itself of wider margins. The new rate represented a devaluation of 5.26 per cent from the par value expressed in gold. Taking into account the exchange rate changes in other currencies at that time, the new rate implied an effective trade-weighted depreciation of 1 per cent.

Although official actions by the Chinese authorities and the developments in the rate of the U.S. dollar (especially since February 1973) have caused changes in the effective rate of the new Taiwan dollar, these changes have been relatively small when compared to many other Asian countries and countries throughout the world. The effective rate had declined by 2.6 per cent from its May 1971 value by the end of 1971, declining a further 0.5 per cent by the end of 1972. Following the devaluation of February 1973 and the repegging to the U.S. dollar, the effective rate declined a further 1.5 per cent in the period March-July 1973. Following an appreciation of less than 1 per cent by October 1973, the strength of the U.S. dollar against most world currencies during the period October 1973-January 1974 caused the effective rate of the new Taiwan dollar to increase by over 4 per cent by January 1974. The effective rate declined by approximately 3.0 per cent by March 1974 where it remained relatively unchanged until a gradual appreciation began in May. By the end of September 1974, this most recent appreciation totaled 2.5 per cent and meant that the effective rate was virtually unchanged from its May 1971 value. Buying and selling rates for certain other currencies are officially posted and are based on the buying and selling rates for the U.S. dollar in markets abroad. Forward cover facilities are limited to import and export transactions and to the officially posted currencies, with the exception of the U.S. dollar. The authorities feel that since the U.S. dollar is the intervention currency for the NT dollar, and the official buying and selling rates are fixed in terms of the U.S. dollar, there is no need to quote daily forward rates for U.S. dollars. Such a practice could give rise unnecessarily to uncertainty.

2. Trade arrangements

Imports are divided into three groups: (1) prohibited, (2) controlled and (3) permissible. The prohibited list includes not only narcotics and some other goods excluded by most countries but also a wide range of pharmaceuticals. The controlled list contains such items as arms and ammunition, ships and poisonous chemicals which are licensed restrictively. The controlled list also contains a number of luxury goods, less essential items and goods subject to domestic regulation and allocation which are often imported by government agencies. Goods on the permissible list are licensed liberally. Following the shift of over 2,000 items from the controlled list to the permissible list in March 1973, 14,787 items are classified as permissible, 461 are controlled and 13 are prohibited. In June 1974, imports of automobiles and color television sets from Japan were prohibited, and the number of color television sets imported from the United States and Europe were restricted.

The imports of some products from certain countries are prohibited to effectively control imports from mainland China. During 1973, the authorities eliminated the country of origin requirements on over 3,200 items. Requirements were dropped for most of the items which were shifted from the controlled to the permissible list in March 1973. The authorities also eliminated the country of origin requirements on imports of certain bulk goods and raw materials in July 1973 and on imports of more than 1,200 consumer items in October and December of that year. These goods may now be imported from any country except mainland China.

Most imports require individual licenses. A general (covering) licensing procedure applies to a few items on the controlled list. Under this procedure direct end-users are granted authorization semiannually for the importation of listed items specified by value and by quantity. Exchange for such imports is obtainable automatically each time the importer presents the general approved license at an appointed bank. Also, an automatic approval system applies to certain items on the permissible list. Under this system, importers may obtain foreign exchange at any appointed bank by submitting import licenses which are automatically approved. During 1973, the coverage of this automatic system was increased from 3,955 items to 10,271 items. For other imports, license applications are screened and licenses are issued by the Application Receipt and Dispatch Center at the Board of Foreign Trade.

Importers of goods on the permissible list may contact on documents-against-payment (D/P), documents-against-acceptance (D/A), or usuance letter of credit terms. An advance settlement requirement is a condition for the issuance of a letter of credit. Exchange settlement corresponding to 25 per cent of the f.o.b., c.&.f., or c.i.f. value of imports must be made within 28 days of approval of the license for all imports under sight letter of credit; the requirement is 15 per cent for usance letters of credit; 15 per cent for letters of credit financed by self-provided exchange; 20 per cent for letters of credit on an installment payment basis; and 10 per cent for letters of credit covering bulk imports specially approved by the Ministry of Economic Affairs.

Customs collections as a proportion of total imports showed a steady decline during the period 1968-72 and the reduction of tariff rates continued through 1973 and 1974. In August 1973, tariff reductions of up to 50 per cent on grains and steel scrap that had been introduced in February were extended for six months; in addition, tariff reductions of about 50 per cent on imports of nine industrial raw material products were introduced. The reductions on the 19 items were extended in February 1974. Import duties on 36 categories of foodstuffs and other basic consumer goods were reduced by 25-50 per cent for a period of one year in December 1973 and reductions of up to 62 per cent on approximately 200 agricultural items were announced in October 1974.

With minor exceptions exporters are required to surrender exchange earnings and all exports require licenses, mainly in order to ensure the surrender of exchange receipts. Quota limitations exist on the export of mushrooms, asparagus, and bananas and there are ceilings on the export of textiles to Canada, the United States and the EEC. In September and October of 1973, exports of certain foodstuffs, chemicals and paper products were prohibited.

Manufacturers who use imported raw materials to produce goods for export are, after export of the processed goods, refunded various charges imposed on such raw materials. These charges include import duties, harbor dues, and commodity tax. Some preferential treatment is accorded to payers of income tax related to the production of goods for export, provided that the taxpayers submit satisfactory proof of such exports; complete exemption from the tax is not granted, however. Prior to July 1974, these duty and tax rebates had been based on the f.o.b. price of the exports. As of

July 1974, rebates are to be calculated on the basis of 120 per cent of the f.o.b. price. This enables exporters to obtain higher rebates without raising prices. Earlier, in May 1974, the availability of export credit had been increased and the interest rate charged was reduced from 12 per cent to 10 per cent.

3. Invisibles

All payments for invisibles require approval from the Central Bank. Payments for invisibles directly related to trade are permitted freely when the basic trade transaction has been approved. The transfer of interest, profits and earnings on authorized foreign investments in the Republic of China may be made without restriction.

Foreign exchange for payments of certain other invisibles is allocated up to established limits or on a percentage basis. In July 1973, certain limits were increased. These included a US$1,200 a year increase to US$3,600 a year in the amount of tuition and living expenses that can be remitted for students in the second to fifth academic years. The full amount of tuition and living expenses of students in the first academic year may be remitted. There was also a US$200 increase to US$1,200 a month for up to three months for business travel abroad and a US$400 increase to US$1,000 a trip for tourist travel. There is, however a continuing policy of not normally granting visas for tourist travel to Chinese nationals.

4. Capital

The policy of active encouragement of direct investment continues in accordance with the Foreign Investment Law of 1954, as amended in 1959, and the 1971 Statute for Encouragement of Investment. To obtain the benefits of the investment laws, investments by nonresidents must be made in enterprises conducive to the economic and social development of the country, such as mining, communication, and manufacturing for domestic needs. Preference is given to investors who intend to produce goods for export or for replacing imports. Transactions by nonresidents in stocks and bonds must be made through the intermediary of registered brokers.

Direct investment abroad is subject to approval. Applications that receive sympathetic treatment include those which would assist in assuring a stable supply of raw materials for domestic industries. Portfolio investment abroad by private residents is not normally permitted.

Restrictions on short-term foreign borrowings were adopted during 1972 and early 1973 to reduce the external surplus and its expansionary impact on domestic liquidity. However, in March 1974, the Central Bank announced that foreign borrowings for any purpose were now permitted, except borrowings to be used as revolving funds.

5. Gold

Producers of gold must sell their output to ornamental gold processors through open tenders conducted by the Central Trust of China. All newly produced gold that remains unsold must be kept by institutions designated by the Government. Other residents may hold gold but its use as collateral for loans is prohibited. Imports of gold by travelers are permitted but amounts above a certain limit must be declared; other imports of gold are not permitted. Residents may take out gold in the form of jewelry subject to a weight limitation. Other exports of gold are not normally permitted.

6. Changes during 1973 and 1974

1973

January 1. A number of luxury goods and less essential items were shifted from the prohibited import list to the controlled list. They included certain Chinese luxury foods, cigarettes, cigars, liquor, certain jewelry, certain medicines, tea, sugar, and molasses.

January 1. The tenth edition of the classification of import and export commodities came into effect. It covered 15,261 import items. Of these, 14 items were prohibited, 2,864 were controlled, and 12,383 were permissible. These numbers took into account the shifts from the prohibited to the controlled list that are indicated in the first entry for January 1, above.

January 15. The Central Bank ceased to approve new borrowing abroad in the form of short-term foreign currency loans for working capital purposes.

January 15. Foreign exchange settlement arrangements with banks were changed to provide for the simultaneous payment of domestic currency upon the surrender of export proceeds and other foreign exchange earnings to the Central Bank. Previously, the Central Bank provided domestic currency up to 15 days in advance of the surrender.

January 22. For letters of credit opened by appointed banks under foreign currency loans for imports, importers were required to settle in advance not less than 10 per cent of the total amount of the letter of credit.

January 23. Exports of wheat flour were suspended for one year, and exports of steel were suspended indefinitely.

January 24. It was announced that the Central Bank would extend US$400 million in foreign exchange loans for the import of daily necessities and of industrial raw materials and capital equipment. Of this amount, one half would be loaned by various banks at 7 1/2 per cent per annum for the importation of machinery. The remaining US$200 million would be loaned through banks to traders and manufacturers for imports of necessities and raw materials, also at 7 1/2 per cent per annum. In addition, to curb rising prices of certain imported products, direct financing would be available at 5 1/2 per cent per annum through the Board of Foreign Trade.

February 1. Foreign banks in China were permitted to accept local currency demand deposits, but not time or savings deposits. Each bank's local currency deposits could not exceed 12 1/2 per cent of capital, and there was an overall ceiling on the deposits of all foreign banks combined.

February 16. Following the announcement that the U.S. dollar was being devalued, the Republic of China established a central rate of NT$1 = SDR 0.0218144, corresponding to NT$45.8413 = SDR 1 or NT$38 = US$1, and continued to avail itself of wider margins. The official buying and selling rates for the U.S. dollar, previously NT$40.00 and NT$40.10, were set at NT$37.90 and NT$38.10, respectively, per US$1.

February 17. The conversion rate for Japanese banknotes was changed from ¥ 8.5 = NT$1 to ¥ 7.5 = NT$1.

February 25. Import duties were reduced by up to 50 per cent on ten import items, including barley, corn, soybeans, molasses, wheat bran, and steel scrap. On August 24, these reductions were extended for six months.

March 7. The value of bona fide gifts and commodity samples which may be sent abroad, subject to approval, was increased from US$100 to US$200. Tourists leaving the Republic of China were allowed to take out domestic products valued at up to US$200, compared with US$100 previously, without providing evidence that they had surrendered foreign exchange.

March 15. The Board of Foreign Trade began to make foreign currency loans available to importers through the Central Bank. The total amount was initially set at US$200 million. From July 1, unlimited foreign currency loans were made available for imports of wheat, soybeans, corn, and iron and steel.

March 16. Over 2,000 items were shifted from the list of controlled imports to the permissible list, and one item from the prohibited list to the controlled list. As a result, 13 import items were prohibited, 461 were controlled, and 14,787 were permissible. Most of the shifted items henceforth could be imported from all sources except mainland China.

March 16. The requirement was withdrawn that in certain manufacturing industries a stipulated minimum ratio of the value of manufactured products must be met by the use of domestic resources. However, the use of local materials continued to be required for certain domestic industries.

April 1. Approval was no longer given for the renewal of maturing short-term foreign currency loans for working capital. Refinancing of such loans was to be obtained in domestic currency through local banks.

April 1. Advance settlement requirements for imports were increased; for sight letters of credit the increase was from 20 per cent to 25 per cent of the value.

April 1. Export financing loans by banks to manufacturers, other than loans for exports of machinery, were provided only up to 80 per cent of the amounts previously made available.

April 1. The acceptance by domestic importers and manufacturers from foreign suppliers or banks abroad of short-term financing and/or usance letters of credit of less than one year was suspended. After meeting the advance settlement requirement, domestic importers and manufacturers could apply to appointed banks for loans in domestic currency for settlement of the balance. The rate of interest on these loans was vixed at 7 1/2 per cent per annum.

April 1. Imports of machinery and equipment had to be made on a cash settlement basis when the amount involved was less than US$3 million and the terms of repayment were less than five years. After advance settlement of 20 per cent of the foreign exchange amount, importers and manufacturers could obtain domestic bank financing at 7 1/2 per cent a year for the remaining 80 per cent of the import value.

May 3. The limitations imposed on April 1 on imports on a documents against acceptance (D/A) basis or a documents against payments (D/P) basis were removed.

July 1. Consular invoices ceased to be required for imports.

July 4. Certain limitations on permitted countries of origin for imports of bulk goods and industrial raw materials were lifted. Henceforth, these could be imported from any source other than mainland China, while previously restricted sources of origin included Hong Kong, Japan, Macao, Malaysia, and Singapore.

July 17. The remittance facility for individuals was increased from US$100 to US$200 per transfer.

July 17. The exchange allowances for study abroad were increased. Those for approved travel abroad were increased from US$600 to US$1,000 a person a trip (from US$300 to US$500 for children). The living expenses allowance for business travel was increased from US$1,000 to US$1,200 a month.

August 10. The Central Bank made available domestic finance up to a total of NT$1 billion to facilitate the financing of imports by small and medium-size enterprises of basic consumer goods and industrial raw materials. Such enterprises were, in addition, urged to avail themselves of foreign currency loans of the Central Bank at preferential interest rates of 5 1/2 - 7 1/2 per cent.

August 22. Tariff reductions of about 50 per cent were announced for imports of nine industrial raw material products.

September 22. Exports of certain foodstuffs and fertilizers were prohibited.

October 9. Export controls were imposed on additional commodities. These included chemicals, foodstuffs, and paper products.

October 23. The country of origin requirement for 824 categories of consumer goods imports was removed. These goods could now be imported from any country except mainland China, while previously the restricted sources of origin included Hong Kong, Japan, Macao, Malaysia, and Singapore.

December 7. Import duties on 36 categories of foodstuffs and other basic consumer goods were reduced by 25-50 per cent, for a period of one year.

December 22. The country of origin requirement for another 404 categories of consumer goods imports was removed. These goods could now be imported from any country except mainland China.

1974

January 20. Saudi Arabia assured China that it would continue to receive oil imports at the same level as during the first nine months of 1973. Extensive technical assistance for Saudi Arabia's development program was promised in return.

February 19. The reductions of up to 50 per cent in the import duties on 19 industrial items including sulphur, phosphorous and raw steel materials that were introduced initially in February and August of 1973 were extended.

March 24. The Central Bank announced that foreign loans for any purpose were to be accepted except loans that were to be used as revolving funds.

May 4. A new policy of providing loans to exporters against export letters of credit was announced; the Central Bank would provide funds to commercial banks for this purpose. Also, the Central Bank's interest rate on advances to commercial banks for export financing was reduced from 12 per cent to 10 per cent.

May 31. Official sources indicated that the Minister of Economic Affairs was preparing a list of products whose import tariffs were to be raised to reduce China's trade deficit. The list was to include television sets and refrigerators. The Ministry of Finance was to be responsible for the details of the tariff increases once the list was prepared.

June 19. Imports of automobiles and color television sets from Japan were suspended and the number of color television sets imported from the United States and Europe were restricted.

July 9. In order to increase the amount of import duties and taxes refunded to exporters, 120 per cent of the f.o.b. price could be used in calculating the rebates. Previously, the f.o.b. price was used.

October 14. Import duties on approximately 200 agricultural items were reduced, including fruits and vegetables; the reductions ranged from 62 per cent on corn and other bran cereals to 6 per cent on inedible animal oils and grease.

Republic of China

Date of Admission to the Fund: An original member.

Current Exchange Rate System: Currency unit is the new Taiwan dollar; an initial par value at NT$40.00 to one U.S. dollar was approved by the Executive Board on September 4, 1970. On December 21, 1971, China informed the Fund that the exchange rate of NT$40.00 per U.S. dollar would be maintained. This represented a decrease in the gold value of the new Taiwan dollar of 7.89 per cent. On May 8, 1972, this rate, which corresponds to NT$43.4286 per SDR 1 was agreed with the Fund as the new par value. On the same date, China notified the Fund that it availed itself of wider margins under Executive Board Decision No. 3463-(71/126), adopted December 18, 1971. On February 16, 1973, China communicated to the Fund a rate of 0.0218144 special drawing rights per new Taiwan dollar to be a central rate in accordance with paragraph 2(a) of Executive Board Decision No. 3463-(71/126), adopted December 18, 1971. This rate, which corresponds to NT$38.00 per U.S. dollar, to 0.0193858 gram of fine gold per new Taiwan dollar, and to NT$45.8413 per special drawing right, represents a devaluation of 5.26 per cent from the par value expressed in gold. The new Taiwan dollar has, since, been floating with the U.S. dollar.

Quota: China has a quota of SDR 550 million. In the past it has not consented to any increase in it's quota. Payment of the gold portion of its original subscription to the Fund pursuant to Article III, Section 3 was completed on August 14, 1970.

Special Drawing Rights: China is a participant in the Special Drawing Account but opted not to receive an allocation.

Use of Fund Resources: A gold tranche purchase of SDR 60 million was made on October 20, 1971. Present Fund holdings of new Taiwan dollars amount to 100 per cent of China's quota.

Article XIV Consultation: The 1973 discussions were held in Taipei during April 11-20, 1973.

Current Economic Developments

Domestic developments

Gross national product: Real GNP increased by 12.3 per cent in 1973, compared with about 11.4 per cent in the previous two years; in the first half of 1974 it increased by 6.5 per cent over the corresponding half of 1973. For the whole year 1974, growth rate is expected to be 8 per cent. Supply shortages and high costs of agricultural and industrial materials, including oil and related products, are responsible for the slower growth. In the first half of 1974 agricultural output rose by 2.6 per cent over the corresponding half of 1973. The first rice crop was 11 per cent higher than in 1973. The growth in industrial output was 8 per cent compared with 24 per cent. The slowdown was particularly pronounced in industries requiring petrochemicals.

Government finance: The FY 1973 budget yielded a larger surplus than estimated, mainly because tax collections exceeded projections. No information is available for the fiscal year ended June 1974.

Monetary conditions: Money supply rose by 47 per cent in 1973. The major expansionary factor was credit to the private sector which rose by 50 per cent. In January 1974, the rediscount rate of the Central Bank was raised from 10.75 to 14.00 per cent. Money supply, following a sharp increase in January, declined by 12 per cent during February-April. It again took an upward turn in May and June. The growth of credit to the private sector slowed to 18 per cent in the first half of 1974. There was a loss in net foreign assets (equivalent to 12 per cent of the money supply at the beginning of the year). Money supply at the end of June 1974 was at about the same level as at the end of 1973.

Balance of payments and reserves

Balance of payments: During the first eight months of 1974 the trade deficit amounted to SDR 620 million in contrast with a surplus of SDR 385 million during the corresponding period of the previous year. Imports rose in the first half of 1974 by around 45 per cent each in volume and price over the same period last year; for exports the increase in price was much larger than the increase in volume. The Government took measures in April and May to speed up exports, including reduction of interest rates for loans to exporters and lifting restrictions on exports of certain commodities, and special loans to medium and small export industries. Despite some official statements expressing concern about current deterioration of the balance of payments, it is expected that exports will do better in the latter part of the year. The outcome for the year as a whole is still highly uncertain.

International reserves: In the first seven months of 1974, gross official gold and foreign exchange reserves declined by SDR 244 million to SDR 850 million at the end of July 1974. Their ratio to imports fell to 36 per cent in 1973 and to about 23 per cent in 1974.

Restrictive system: Since the substantial liberalization in March 1973, imports have been rising at accelerated rates. In May 1974, the Government proposed to the Legislative Yuan reduction of import duties on raw materials and fool grains and increases in duties on less essential commodities. In June 1974, the Government suspended imports of automobiles and color TV sets from Japan and restricted the number of color TV sets imported from the United States and Europe.

External debt service: Debt service payments on public and publicly guaranteed external debt were about 6.5 per cent of exports of goods and services in 1972. The percentage was not expected to change much.

<u>Effective exchange rate</u>: The trade-weighted effective rate of the new Taiwan dollar vis-a-vis the currencies of China's major trading partners had appreciated by less than 1 per cent by August 1974 compared with May 1971. In August 1974 Chinese professors of economics from universities in the U.S. recommended to the Government inter alia flotation of the new Taiwan dollar and creation of a forward foreign exchange market.

<u>Prices and wages</u>: Following relative price stability for many years, inflation accelerated in 1973. At the end of the year, wholesale prices were 40 per cent and consumer prices 30 per cent higher than a year earlier. The main causes were rising costs of imports and high rates of credit expansion to the private sector. In January 1974, the Government introduced a stabilization program allowing substantial increases in prices with intention to stabilize them subsequently at a higher level. As a result, wholesale prices rose by 16 per cent in February and consumer prices by 19 per cent; since then through June they have declined. It is believed that wages have increased considerably; however, recent data are not available.

<u>Technical Assistance</u>: Mr. Quinton from the fiscal panel assisted in the adoption of the Brussels Tariff Nomenclature from May 1971 to November 1973. Mr. J.C. Duignan from the fiscal panel prepared a report on a value-added tax for the Republic of China in 1970 and visited Taipei in January 1974 to assist in the preparations for the introduction of the tax. A CBS mission visited Taipei during March 1974 to assist in revision of the Central Banking Act.

Republic of China

Basic Data

IMF (as of August 31, 1974)

Exchange rate system[1/]	NT$38 = US$1 (central rate)
Quota	SDR 550 (million)
Fund holding of national currency	100 per cent[2/]

	1972		1973		1974	
Population (in millions)	15.2	(2.0)	15.5	(1.9)	15.8	(1.9)
Per capita GNP						
At current prices (NT$)	19,201.0	(14.9)	23,014.0	(19.9)	25,536.0	(10.9)
At current U.S. dollars	480.0	(14.9)	606.0	(26.2)	672.0	(10.9)
GNP (NT$ billion)						
At constant prices	227.3	(11.4)	255.3	(12.3)	275.7	(8.0)
At current prices	292.4	(17.3)	356.9	(22.1)	403.5	(13.0)
Inflation (Annual rate)						
Consumer prices	4.3		29.6		35.0	
Wholesale prices	7.3		40.3		32.0	
Central Government Budgets (NT$ billion)						
Revenues	63.8	(19.0)	68.9	(8.0)	...	(...)
Expenditures	60.2	(15.9)	68.7	(14.1)	...	(...)
Budget surplus or deficit (-)	3.6	(108.9)	0.2	(-94.4)	...	(...)
Money and Credit (growth rate)						
Narrow money	34.6		47.0		35.0	
Quasi-money	30.5		21.7		21.2	
Domestic credit (net)	20.3		36.0		38.7	
Balance of Payments (SDR)						
Exports	2,744.0	(34.0)	4,328.0	(57.7)	4,821.0	(11.4)
Imports	-2,148.0	(22.4)	-3,766.0	(75.3)	4,915.0	(30.5)
Balance of trade	596.0	(103.4)	562.0	(-5.7)	-94.0	(-126.7)
Current account balance	472.0	(176.6)	562.0	(19.1)	-100.0	(-117.8)
Capital account balance	-5.0	(-77.3)	-356.0	(612.0)	-160.0	(-55.1)
Overall balance	467.0	(135.1)	206.0	(-55.9)	-260.0	(-226.2)
Gross International Reserves (SDR)						
As percentage of imports	50		36		23	

1/ Following the devaluation of the U.S. dollar in February 1973, a central rate pegged to the U.S. dollar was established for the new Taiwan dollar. The new Taiwan dollar has since been floating with the U.S. dollar.

2/ No drawing other than the gold tranche purchase.

Mr. Tun Thin

October 19, 1973

Donald K. Palmer

China and Nepal

On my return from Paris, I found Mr. Mattera's memorandum of September 26 reporting on the additional meeting with Governor Sharma on Nepal during which the question of the timing of the prospective Fund mission was raised. The suggestion is made in the memorandum that the mission should take place earlier than the time (January/February) originally discussed with the Nepalese delegation. From my point of view this is a question of relative priorities which the Asian Department can best decide. As you know, we have planned that Mr. McLenaghan would go on a somewhat similar mission to China possibly in late November/December. I simply do not have any well qualified individual who could do the job in Nepal before February. If, for some reason, it should be decided not to proceed at this time with the special study on China, then from a personnel availability point of view, it would be possible for Mr. McLenaghan to go to Nepal in late November.

Since there are a number of people in the Asian Department involved in this question, I thought it best to do this memorandum.

cc: Mr. Woodley
Mr. Narvekar
Mr. Mattera
Mr. McLenaghan

Office Memorandum

TO : Mr. Palmer

DATE: September 17, 1973

FROM : J. B. McLenaghan

SUBJECT : Republic of China

The attached is an updated version of the earlier note prepared by Mr. Ahrensdorf and is now described as a briefing paper for the Annual Meeting. The following points should be noted:

1. Latest trade data indicate that there was an easing of the trade surplus in the three months to end-July 1973, largely as a result of a sharp rise in imports. This suggests that the March 1973 import liberalization may by now have had some effect. On the other hand, the increase in net foreign assets of the banking system in the seven months to July 1973 indicates that there has been a continuation of pressures on domestic monetary management, although recent revisions to the series on reserves are large and difficult to interpret. Clearly, however, the rate of growth in money in the seven months to July (see page 3) was uncomfortably high.

2. The suggestion on page 5 (first full paragraph) with respect to higher rates of interest on foreign vis-à-vis domestic currency deposits is made, of course, in the context of the disposition of banks' existing deposit liabilities within the existing interest rate structure. It is not intended to suggest that banks should offer high rates in order to attract foreign currency deposits.

3. It is now understood that this note is not to be given to Minister Martin Wong. Presumably, however, the relevant issues will be raised by the Chinese authorities in Nairobi.

4. I have been given a copy of Mr. Brau's recently prepared memorandum in which he puts forward a suggestion for an in-depth study of exchange and trade system policies in Korea. My initial reaction is that there are certain striking similarities in this area between Korea and the Republic of China, although the latter's system is probably a good deal less complex. Nevertheless, it may be worthwhile to consider whether such an approach with respect to China is warranted.

China - Briefing Paper for Annual Meeting

Background

Around early August the Chinese authorities considered options to restrain the influx of liquidity from abroad as the substantial import liberalization of March 1973 did not seem to have had an immediate effect. Consideration had been given to either revalue the NT dollar or to let it float.

Apart from external cost-push factors, the liquidity influx from the external sector in 1972 had been a major source of inflation. The trade surplus of about US$647 million was a considerably more important source than inflows of short-term capital. In fact, there was a net outflow including net errors and omissions of US$21 million against US$48 million in 1971.[1/]

In February 1973, the NT dollar was revalued vis-a-vis the U.S. dollar by 5.26 per cent, resulting in an effective depreciation of the NT dollar vis-a-vis the currencies of China's principal trading partners of 0.1 per cent from the end of 1972. From end-February to end-August there was a effective depreciation of about 2 per cent.[2/] From end-April 1971 to end-August 1973, the effective depreciation was about 9 per cent.

The trade data for April-July 1973 indicate that imports increased by 49 per cent over the same period of 1972. In the first quarter the corresponding increase had been 17 per cent. The respective increases in 1972 had been 57 per cent in the first quarter and 36 per cent in April-July (Table 11). This seems to preclude seasonal factors and suggests that the

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1/ Exchange settlement data for 1972 show inward remittances "Other companies and corporations" of US$326 million against about US$220 million in 1971. The nature of this item is not clear, nor is the extent to which it is convered in balance of payments statistics. The swing in errors and omissions between the two years was only US$25 million.

2/ Calculations for various subperiods, as well as separated for exports and imports, are shown in Tables 1-10.

import liberalization of last March, in conjunction with related measures such as easing of financing and some tariff reductions, has indeed been effective rather quickly. Total exports as well as those to the United States increased in April-July 1973 at about the same rate as in the first quarter (over the respective periods of 1972). Exports to Japan rose in both periods by well over 100 per cent compared with 1972. The overall trade surplus in April-July 1973 was US$140 million compared with US$214 million in the first quarter. Imports from the U.S. in this period were more than twice as large as in the same period of 1972 and China's trade surplus was nearly 40 per cent less.

In January-June 1973 export and import volume was 23 per cent and 10 per cent above the same period last year; unit values for exports were 13 per cent and for imports 15 per cent higher, compared with increases of 9 per cent and 12 per cent, respectively, in the whole of 1972.

Between end-1972 and end-July 1973 the net foreign assets (NFA) of the banking system increased by NT$11.5 billion against an increase of about NT$9 billion in the same period last year. As the Central Bank's (CB) and "other" banks' NFA changed little, almost all of the increase was due to the rise in the Bank of Taiwan (BOT) gross foreign assets in June and July of almost NT$12 billion. In both months CB advances to BOT increased by practically the same amount and CB-NFA declined by about NT$9 billion. It is difficult to interpret this development; such large swings have not occurred in the past.1/ One possibility is that the BOT acquired a substantial amount

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1/ In July the Central Bank published new series' of net foreign assets. The old series had shown for the period December 1972-May 1973 a decline in total net foreign assets of about NT$1.6 billion. It would seem that a large item accounting for the change has been the exclusion of presettlement requirements for imports from foreign liabilities. Such requirements increased by over NT$6 billion between end of 1972 and July 1973. Furthermore, advances against export bills were apparently reclassified as domestic assets and inward remittances bought and outward remittances sold were shifted to domestic assets and liabilities respectively. These items cannot be identified at present. The remaining increase in total net foreign assets, after allowing for the reclassification of prepayment requirements for imports, would be about NT$6 billion. This may imply that the shift to domestic liabilities of outward remittances sold may have been much larger than the shift of inward remittances bought to domestic assets.

of foreign exchange from the CB to finance imports on easy terms in the near future. It is also possible that the BOT has been allowed to hold foreign assets in forms other than working balances.

CB net domestic assets increased in January-July in contrast to declines in earlier periods and there was a further substantial expansion of bank credit to the private sector. By July monetary expansion had increased to an annual rate of 53 per cent (Table 12).

In August, the Minister of Finance reportedly stated that inflationary pressure generated by the increase of foreign assets had eased and that there was no immediate need to revalue the new Taiwan dollar.

Options

1. In April, the time of the consultation discussions, some quarters in Taiwan argued for another revaluation of the NT dollar vis-a-vis the U.S. dollar of about 5 per cent. Compared with the pre-February situation, this would have amounted to an effective appreciation of about 3 per cent (other things, including exchange rates, remaining equal). It would seem doubtful whether this would have an appreciable effect on trade flows, although it might help restrain somewhat the rise in import prices; (the experiences of other revaluing countries do not encourage much optimism in this respect). On the other hand, it may strengthen expectations of further rate adjustments and induce inflows of unwanted capital and thus aggravate the liquidity problem. A substantial revaluation on the other hand may call for some reversal before long in the light of evolving conditions in international markets.

2. According to Mr. Martin Wong, thought has been given to the option of letting the NT dollar float by creation of a foreign exchange certificate market. Negotiable certificates of limited maturity were envisaged to be traded by all (?) users of foreign exchange in a free (?) market. (Limitations on the purchase of certificates could, under present conditions, lead to an undue appreciation.) The merit of such certificates is not clear, except perhaps if banks have relatively little experience in foreign exchange operations (as in Korea in 1964). The Chinese authorities seemed to consider this aspect.

3. Taking this consideration into account as well as the uncertainties on the international currency scene, a case could be made for allowing for the time being free foreign exchange trading at the present rate. China availed itself of wider margins in February. Use of this facility would introduce, and pave the way toward, a greater degree of flexibility.[1/] Such a system would involve dismantling of surrender requirements for proceeds from exports and invisibles against local currency and of other remaining exchange restrictions on current payments and transfers. Furthermore, there may be scope for strengthening and speeding up the effects of the import liberalization in March by a more liberal administration, and for further reductions in tariffs and certain financial export incentives. Some controls over certain inward capital movements might be retained or even strengthened. Banks might be allowed to make short- or even longer-term foreign investments. Such facilities would permit interest arbitrage operations, which could be encouraged by providing forward cover on sufficiently attractive terms to, in the current situation, place funds abroad. This would also help obviate reductions in domestic interest rates which, for internal reasons, seem to be

1/ The spread on quotations for the U.S. dollar is at present NT$38.10 and NT$37.90.

undesirable as forward operations would have the same effect on the external side and ease the dilemma situation as regards interest rate policies, (although it may result in losses of the monetary authorities). In April the Chinese authorities referred to unfamiliarity of traders with use of forward facilities. This probably holds less for banks. In any case, in the current situation, moves in this direction could prove useful, although significant immediate results seem doubtful.

Banks could be induced to offer more attractive interest rates on foreign currency deposits; these rates are generally lower than rates on domestic currency deposits and have been reduced several times in recent years. Also, differential reserve requirements favorable to holding of foreign balances could be applied. In some areas a liberalization of controls over capital exports by nonbanks might be feasible. In April, the authorities considered relaxing restraints on remittances of capital gains and were encouraging certain forms of Chinese direct investment abroad.

A relatively free exchange system with an at least initially fairly stable exchange rate would facilitate introduction of floating (or some form of crawling peg) if this should be considered desirable in the light of evolving conditions. Initially, by effectively liberalizing the restrictive system, it would, among other things, tend to help restrain the influx of liquidity from abroad. Quantification of effects does not seem possible.

Treasury bills

Efforts to activate operations in Treasury bills by creation of machinery and market might well be intensified in order to absorb liquidity. Reportedly, it is intended to issue bills at face value and a fixed interest rate to meet seasonal budgetary requirements, with the Government meeting the interest cost. In addition, bills are to be issued on a discount basis to mop up liquidity, with the Central Bank meeting interest costs. Pertinent legislation has been passed. (The authorities may consider requiring exporters to invest a certain proportion of their proceeds in Treasury bills. In the mid-1960s there was a similar practice with regard to exporters of certain products.)

Table 12. China: Changes in Monetary Aggregates, 1970-73

(In billions of NT dollars)

	1970	1971	1972	January-July 1972	January-July 1973
Central Bank					
Net foreign assets	9.7	7.3	24.0	11.0	0.5
Net domestic assets	-6.9	-1.3	-14.1	-2.1	8.7
Reserve money	2.8	6.0	9.9	8.9	9.2
Banking system					
Net foreign assets	9.2	7.1	23.1	9.3	11.5
Domestic credit	13.4	20.5	21.5	12.0	28.3
Public (net)	1.0	3.1	-3.6	-0.1	-8.1
Private	12.4	17.4	25.1	12.1	36.4
Quasi-money	12.2	20.0	24.6	13.5	18.1
Money	5.9	6.4	14.2	3.8	13.4

Source: The Central Bank of China; Financial Statistics Monthly, August 1973 (revised data), Taipei, Taiwan, China.

Mr. Palmer August 28, 1973

John B. McLenaghan

Republic of China--Exchange System

To acquaint you with the latest position.

The attached note was prepared by Mr. Ahrensdorf after several discussions with Mrs. Yang and me; I have added some further thoughts in a separate note, also attached. The arguments put forward for a change in the exchange rate depend, of course, on the verification of a strengthening of the pressures arising from the influx of foreign exchange. This still awaits the receipt of recent data on international reserves, balance of payments, money supply, etc. requested through Minister Wong at the Chinese Embassy.

A recent press report indicates that there was a sharp increase in the rate of growth of imports in the second quarter of 1973--49 per cent higher than in the same quarter of 1972; the comparable increase in the March quarter of 1973 was only 17 per cent. Whether this reflects the import liberalization earlier this year must await other supporting evidence.

Attachments

August 23, 1973

Republic of China--Further Thoughts on the Exchange System

The basis for discussion is the argument that the influx of foreign exchange (export surplus) is providing the major stimulus to price increases. We need to know:

a. The extent of the increase in foreign reserves in 1973 to date.
b. The extent of the price increases.
c. The extent to which growth in money supply has accelerated.
d. The influence of using import prices in domestic price increases.

Answers to these questions must await the arrival of relevant data.

Assuming, however, that a case can be made for a (fundamental?) disequilibrium in the balance of payments, then the following aspects need to be considered: A freeing of the exchange and trade system and controls would work in the direction of easing the pressure of inflows of foreign exchange. That is, China's controls on exchange and trade historically have been directed at conserving foreign exchange--e.g., the use of multiple currency practices and the use of fairly restrictive administrative controls. What is needed, therefore, is in effect a reversal of this "conservationist" approach. Emphasis can be placed on the need not only to provide for a more liberal set of controls and regulations, but also for a more liberal approach in administering the system. This applies not only to the payments system but also to trade (especially import) controls.

On the exchange rate side the options seem to be:

(i) To revalue the NT dollar--a range of between 5 and 10 per cent would seem the most that could be expected; (ii) To allow the NT dollar to float--but limitations on the purchase of foreign exchange certificates, in the sense that they would be reserved for registered traders, would not necessarily lead to an appreciation of the NT dollar. In fact, such limitations could have the reverse effect. (iii) The use of wider margins could indeed be beneficial. Indeed, the spread on quotations for the U.S. dollar, at present NT$38.10 and NT$37.90, could be widened.

As to the foreign exchange operations of banks, various alternatives exist which could prove helpful in discouraging the conversion of foreign exchange receipts into domestic currency. Differential reserve requirements, favorable to the holding of foreign currency, could be applied. Banks could be induced to offer higher rates of interest on foreign currency deposits.

Such actions presuppose, of course, that banks are given freedom to hold foreign assets.

In the field of capital controls, as well as the measures already mentioned, there could be scope for tightening requirements on the terms of commercial payments. Thus, on the import side, advance payments could be encouraged and deferred payments discouraged, while for exports, the reverse could apply, i.e., a less liberal approach to advance receipts and encouragement of deferred receipts, etc.

In terms of sequence, there is a case for arguing for a loosening up of the exchange and trade system. In the present situation this should have wholly beneficial effects. As well as the areas already mentioned there is the possibility of tightening controls on capital inflow although this does not appear to be a major cause of the build up in reserves. If necessary, of course, measures along these lines may need to be accompanied by exchange rate action on one of the levels suggested. A judgment on this needs to await data on developments in 1973.

John B. McLenaghan
Exchange Restrictions Division

Mr. Palmer

August 8, 1973

MEMORANDUM FOR FILES

Subject: Republic of China--Central Banking Law

The attached memorandum from Mr. Khatkhate to Mr. San Lin of July 31, 1973 was referred to me for comment by Mr. Ahrensdorf. I told him that with respect to item 4 of the memorandum, I was not aware of "the many foreign exchange restrictions which do not permit foreign exchange operations as an instrument of monetary policy." The problems for domestic monetary management arising from substantial inflows of foreign exchange were discussed at length during the Article XIV consultation discussions in Taipei during April 1973. The Chinese authorities had already taken some measures toward the end of 1972 to offset these influences by placing limits on foreign borrowing. They were conscious, however, of the need to adapt their techniques of foreign exchange management in support of monetary policy, e.g., by permitting the commercial banks to hold increased amounts of foreign exchange. (See Mr. Ahrensdorf's memorandum to Mr. Tun Thin, August 6, 1973 attached).

I subsequently discussed the matter with Mr. Khatkhate and passed these views over to him.

John B. McLenaghan
Assistant Division Chief

Attachment

cc: Mr. Palmer
Mr. de Looper
Mr. Ahrensdorf

JBMcLenaghan:mo

Mr. Tun Thin

August 6, 1973

J. Ahrensdorf /S/

Mr. Khatkhate on Reform of China's Central Banking Law

1. Mr. McLenaghan and myself have some doubts about the desirability of enabling "the Central Bank to extend medium- and long-term credit to the banking system," considering likely effects on the flexibility of monetary management (para. 3). In the present situation of external surpluses, for example, large Central Bank holdings of non-marketable long-term domestic assets would make appropriate adaptations in monetary policy still more difficult.

2. Regarding para. 4, the problem is not so much "foreign exchange restrictions which do not permit exchange operations as an instrument of monetary policy." Rather it is some lack of instruments to curb, for instance, undesired capital inflows. More broadly, the Chinese authorities are aware of the desirability of refining techniques of foreign exchange management so it can give stronger support to monetary policy.

cc: Mr. McLenaghan
Mrs. Yang

JA:hm

Office Memorandum

TO : Mr. San Lin

DATE: July 31, 1973

FROM : Deena R. Khatkhate

SUBJECT : Taiwan's request for technical assistance for the reform of the Central Banking Law

After I received your request to gather some more information from the Taiwan authorities as to the nature of their request for technical assistance in regard to the Central Banking Law, I could gather from them the following.

At the first meeting our IFC team had with the Taiwan authorities, both Governor Yu and Deputy Governor Dr. Kan Lee were present. Before the meeting started I mentioned to them that I would call on them later to discuss matters arising out of their request to the Fund for technical assistance. Accordingly, the meeting with Governor Yu and Dr. Kan Lee was fixed for the afternoon of July 25, 1973. At this meeting they stated that the banking law, about which the Fund had offered technical assistance, is at an advanced stage of discussion in the Executive Yuan, i.e., their Parliament. They expect no great difficulties in its passage. Probably it will go through by the end of January 1974 with some minor modifications. The Law of Negotiable Instruments, on which the Fund had also offered technical assistance, has already been passed and some of the recommendations of the CBS mission have been accepted, again in modified form.

In the last two years, partly as a result of further developments in the Taiwan economy, and partly as a result of acceptance of a variety of recommendations made by the IFC mission on capital markets, many changes have come about with implications for the Central Bank. Hence, the urgency is felt about the reform of the Central Banking Law. In their view the following are the main imperatives in this regard:

1. The Central Banking Law has to take into account the changes which are necessitated by the passage of the banking law and the Law of Negotiable Instruments.

2. There have been many useful ideas on the instruments of monetary policy contained in the papers of the CBS--one on central banking operations as a part of the CBS mission in 1970 and my paper on "Evolving Instruments of Monetary Policy in a Developing Economy--the Case of China." It is their feeling that these ideas could be given shape in the new Central Banking Law, in addition to many others that might emerge.

3. The Central Bank currently concerns itself with merely short-term lending. The situation as is developing in Taiwan seems to suggest the need for the Central Bank to extend medium- and long-term credit to the banking system. This may call for an appropriate provision in the Central Banking Law.

4. At present there are many foreign exchange restrictions which do not permit exchange operations as an instrument of monetary policy. Currently Taiwan is flooded with foreign exchange due to a tremendous rise in exports. This has created quite an inflationary situation. The authorities feel that if they had some instrument on the foreign exchange side that might have enabled them them to follow a restrictive policy much more efficiently. This is again a task for the Central Banking Law.

5. There is a rather vague clause in the banking law which refers to the need for deposit insurance. I raised this point in the discussion, trying to elicit from the authorities their ideas on this subject. It turned out that they are thinking of having a deposit insurance scheme introduced. I suggested to them that we can think of various models--the latest being my own experience in Afghanistan--and they would like the CBS mission to undertake this also.

They expect the mission to arrive there some time in the second or third week of November. Before then they themselves will send us briefing documents spelling out the main elements which need to be taken into account in the central banking law and in the deposit insurance scheme. This material is expected to reach here by the first week of October. This would leave about four weeks for us to mull over the material. About the exact timing and other material, Governor Yu said that he would discuss this at length with Mr. Mladek in Nairobi in terms of Mr. Mladek's letter to him.

cc: Mr. Mladek

MINISTRY OF FINANCE
REPUBLIC OF CHINA
TAIPEI. TAIWAN
CHINA

OFFICE OF THE MINISTER

353069
cc: Mr. Palmer

August 9, 1973

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

Orig: ETR
cc: SEC
ASD

Dear Mr. Hebbard:

Thank you very much for your letter dated July 20, 1973 and the enclosure concerning the Executive Board Decision for the recent consultation with my government.

I would like to extend to IMF my sincere gratitude for sending the delegates to the consultation meeting and deeply appreciate their contribution to the fair evaluation of our economy.

We are looking forward to the continuation of this harmonious relationship.

Yours sincerely,

K. T. Li

K. T. Li
Minister of Finance

August 8, 1973

MEMORANDUM FOR FILES

Subject: Republic of China--Central Banking Law

The attached memorandum from Mr. Khatkhate to Mr. San Lin of July 31, 1973 was referred to me for comment by Mr. Ahrensdorf. I told him that with respect to item 4 of the memorandum, I was not aware of "the many foreign exchange restrictions which do not permit foreign exchange operations as an instrument of monetary policy." The problems for domestic monetary management arising from substantial inflows of foreign exchange were discussed at length during the Article XIV consultation discussions in Taipei during April 1973. The Chinese authorities had already taken some measures toward the end of 1972 to offset these influences by placing limits on foreign borrowing. They were conscious, however, of the need to adapt their techniques of foreign exchange management in support of monetary policy, e.g., by permitting the commercial banks to hold increased amounts of foreign exchange. (See Mr. Ahrensdorf's memorandum to Mr. Tun Thin, August 6, 1973 attached).

I subsequently discussed the matter with Mr. Khatkhate and passed these views over to him.

JMcLenaghan

John B. McLenaghan
Assistant Division Chief

Attachment

Mr. Tun Thin August 6, 1973

J. Ahrensdorf /S/

Mr. Khatkhate on Reform of China's Central Banking Law

1. Mr. McLenaghan and myself have some doubts about the desirability of enabling "the Central Bank to extend medium- and long-term credit to the banking system," considering likely effects on the flexibility of monetary management (para. 3). In the present situation of external surpluses, for example, large Central Bank holdings of non-marketable long-term domestic assets would make appropriate adaptations in monetary policy still more difficult.

2. Regarding para. 4, the problem is not so much "foreign exchange restrictions which do not permit exchange operations as an instrument of monetary policy." Rather it is some lack of instruments to curb, for instance, undesired capital inflows. More broadly, the Chinese authorities are aware of the desirability of refining techniques of foreign exchange management so it can give stronger support to monetary policy.

cc: Mr. McLenaghan
Mrs. Yang

JA:hm

Office Memorandum

TO : Mr. San Lin DATE: July 31, 1973

FROM : Deena R. Khatkhate

SUBJECT : Taiwan's request for technical assistance for the reform of the Central Banking Law

After I received your request to gather some more information from the Taiwan authorities as to the nature of their request for technical assistance in regard to the Central Banking Law, I could gather from them the following.

At the first meeting our IFC team had with the Taiwan authorities, both Governor Yu and Deputy Governor Dr. Kan Lee were present. Before the meeting started I mentioned to them that I would call on them later to discuss matters arising out of their request to the Fund for technical assistance. Accordingly, the meeting with Governor Yu and Dr. Kan Lee was fixed for the afternoon of July 25, 1973. At this meeting they stated that the banking law, about which the Fund had offered technical assistance, is at an advanced stage of discussion in the Executive Yuan, i.e., their Parliament. They expect no great difficulties in its passage. Probably it will go through by the end of January 1974 with some minor modifications. The Law of Negotiable Instruments, on which the Fund had also offered technical assistance, has already been passed and some of the recommendations of the CBS mission have been accepted, again in modified form.

In the last two years, partly as a result of further developments in the Taiwan economy, and partly as a result of acceptance of a variety of recommendations made by the IFC mission on capital markets, many changes have come about with implications for the Central Bank. Hence, the urgency is felt about the reform of the Central Banking Law. In their view the following are the main imperatives in this regard:

1. The Central Banking Law has to take into account the changes which are necessitated by the passage of the banking law and the Law of Negotiable Instruments.

2. There have been many useful ideas on the instruments of monetary policy contained in the papers of the CBS--one on central banking operations as a part of the CBS mission in 1970 and my paper on "Evolving Instruments of Monetary Policy in a Developing Economy--the Case of China." It is their feeling that these ideas could be given shape in the new Central Banking Law, in addition to many others that might emerge.

3. The Central Bank currently concerns itself with merely short-term lending. The situation as is developing in Taiwan seems to suggest the need for the Central Bank to extend medium- and long-term credit to the banking system. This may call for an appropriate provision in the Central Banking Law.

4. At present there are many foreign exchange restrictions which do not permit exchange operations as an instrument of monetary policy. Currently Taiwan is flooded with foreign exchange due to a tremendous rise in exports. This has created quite an inflationary situation. The authorities feel that if they had some instrument on the foreign exchange side that might have enabled them them to follow a restrictive policy much more efficiently. This is again a task for the Central Banking Law.

5. There is a rather vague clause in the banking law which refers to the need for deposit insurance. I raised this point in the discussion, trying to elicit from the authorities their ideas on this subject. It turned out that they are thinking of having a deposit insurance scheme introduced. I suggested to them that we can think of various models--the latest being my own experience in Afghanistan--and they would like the CBS mission to undertake this also.

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cc: Mr. Mladek

353069
cc: Mr. Palmer

MINISTRY OF FINANCE
REPUBLIC OF CHINA
TAIPEI, TAIWAN
CHINA

OFFICE OF THE MINISTER

August 9, 1973

Mr. W. Lawrence Hebbard
Secretary
International Monetary Fund
Washington, D.C. 20431
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We are looking forward to the continuation of this harmonious relationship.

Yours sincerely,

K. T. Li

K. T. Li
Minister of Finance

Mr McLenaghan

Office Memorandum

TO : Mr. Ahrensdorf

DATE: May 24, 1973

FROM : Donald K. Palmer DKP

SUBJECT : Staff Report on Republic of China

I have only two comments on the draft staff report for the 1973 consultation with the Republic of China.

First, I could find no mention in the staff appraisal of the "question of the appropriateness of the new exchange rate in the light of recent trends and prospective developments in the balance of payments" (the quotation is from page 7 of the briefing paper). It will be recalled that the decision to depreciate in February 1973 was seriously questioned by several members of the Executive Board, with the result that the Managing Director promised that the planned consultation would explore the adequacy of the current central rate and the liberalization program. There is good discussion of the liberalization efforts in the paper but, my impression is that the paper is virtually silent on the question of the adequacy of the rate. While in other times this might have been considered too sensitive an issue for comment in the paper, it was my understanding that in this case the Executive Board (and the Management) expected that the staff report would contain at least a brief analysis on this issue.

My second point relates to the absence of any text tables. I am well aware that we are all under pressure to keep the length of staff reports to manageable proportions but no one has suggested that this be done at the expense of text tables. Indeed, one frequently hears Directors praising reports which contain short but helpful text tables. I would have thought that this report should include a table on the balance of payments and on money and credit.

cc: Mr. Tun Thin

Mr. Mohammed May 31, 1973

J. B. McLenaghan

China - Recent Economic Developments

The economy grew in 1972 by about 11 per cent, only slightly less than the rate of growth in the previous two years. Industrial production increased at a record rate of more than 26 per cent. On the other hand, agricultural production increased little and was below expectations. After many years of price stability, price performance deteriorated sharply in the closing months of 1972 and early 1973, when the wholesale price index was 10 per cent ahead of a year earlier. Higher import costs played some part in domestic price developments, but there was also an element of demand pull, reflected in the sharply higher rate of growth of money supply, which by March 1973 was some 40 per cent greater than a year earlier. External developments were extremely favorable in 1972, when for the third successive year there was a substantial surplus (of almost SDR 540 million) in the balance of payments, compared with a surplus of SDR 220 million in the previous year.

Following the announcement on February 12, 1973 that the U.S. dollar was to be devalued, the New Taiwan dollar was devalued by 5.26 per cent from the par value, representing an effective over-all depreciation of a little more than 1 per cent. For the sake of flexibility the Chinese authorities established a central rate (rather than a par value) corresponding to NT$38 = US$1 (previously NT$40 = US$1).

Policy actions in late 1972 and early 1973 were almost wholly devoted to stemming the rate of price increase, and to ease the burden on domestic monetary management of rapidly rising foreign exchange holdings of the banking system. In September 1972, the Central Bank no longer approved short-term foreign currency loans for working capital purposes (although such capital could still enter China, but without the right to repatriation). Debt management policies were employed in a compensatory manner for the first time to absorb excess liquidity, and new credit instruments were introduced by the Central Bank for the same purpose. Fiscal performance remained sharply contractionary. Encouragement was given to importers to avoid reliance on foreign financing for their imports; in this respect US$400 million was made available by the Central Bank through the domestic banks for imports. And in a major trade liberalization measure in March 1973, the Government transferred 2,370 import items from the controlled to the permissible list, leaving only 460 items (of a total of about 15,000) on the controlled list, largely imports kept under control in most developed countries.

External debt increased in 1972 by SDR 230 million, a much faster rate than in the previous two years; more than half of the increase was in short-term debt. At the end of 1972, total outstanding external debt amounted to about SDR 1.3 billion, almost 80 per cent of which was medium-term and long-term. Debt servicing in 1973 is estimated at 6.5 per cent of exports of goods and services, a low proportion by international standards.

Mr. Sturc May 15, 1973

J.B. McLenaghan

China: Real wages

The following table may be of some assistance in assessing recent trends in real wages. Note that the data relate only to wages in the manufacturing sector.

Index of Real Wages in the Manufacturing Sector

(Jan. 1968 = 100)

		Increase (Per cent)
December 1968	109	9.0
December 1969	112	2.8
December 1970	123	9.8
December 1971	126	2.4
December 1972	132	4.8

Source: Data provided by the Chinese authorities during the 1973 Article XIV Consultation.

The staff team was told that the increase in real wages over the last four years was probably fairly close to, if not in excess of, the increase in productivity, at least in some sectors. In contrast, over the period 1952-68, the increase in real wages had been a good deal less than the rise in productivity.

An interesting comment provided outside of the consultation discussions was that maintaining a high rate of growth in the medium- to longer-term may depend to some extent on the policy towards increasing real income. On the basis of this argument, given that recent rates of growth in exports may not be sustained, it may be more appropriate for the authorities to seek to increase demand in the domestic market.

cc: Mr. Palmer
Mr. de Looper

Mr. Goode May 8, 1973

Tun Thin T.T.

China - Request for Technical Assistance

During my recent visit to Taipei the Minister of Finance expressed his desire for further Fund technical assistance in the fiscal field. After my return to Washington the Minister reiterated this request through the Financial Minister of the Chinese Embassy in Washington.

As conveyed to me the Chinese authorities would appreciate technical assistance in the following areas:

1. For the last 10 years there has been a limit on the corporate income tax rate of 25 per cent under the Statutory for Encouragement of Investment. This limit is to remain in effect until the next revision of the Statutory due by the end of 1970s. The authorities are considering modifying this limit.

2. There are provisions under which firms having their headquarters in Taiwan are exempt from payments of business tax for business conducted by their branches or agents abroad and may charge expenses for sending personnel abroad to promote export business as operational expenses. There seem to have been abuses of this type of tax relief, e.g., by declaring relatives of firms' management residing abroad as branches or agents in order to secure tax relief. The authorities are considering closing such loopholes.

3. The authorities anticipate certain problems related to an introduction of the value-added tax, e.g., as to price effects. (The recent staff team in Taipei learned that the authorities are considering sending several officials to Ireland in order to study various implications of the value-added tax.)

4. To curb the recently accelerated price increases, the authorities have reduced or are considering reductions in various indirect taxes affecting imports. At the same time they have become increasingly concerned about the revenue effects of such reductions. In the light of this they are considering restructuring the system of indirect taxes.

It might be possible to meet the Minister's request by offering to send one or two experienced staff members to Taipei for a period of, say, four weeks, subject, of course, to more detailed information regarding the nature of the assistance desired. Incidentally, the Chinese authorities seem to prefer U.K. or U.S. experts for assignment in this field.

cc: Mr. Martin Wong

Mr. Palmer.

The Acting Managing Director June 4, 1973

Tun Thin and Donald K. Palmer DP

China

Attached for your approval is the Staff Report on China for 1973 Article XIV consultation. It has been cleared with the various functional departments.

Attachment:

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

REPUBLIC OF CHINA

Staff Report for the 1973 Article XIV Consultation

Prepared by Staff Representatives for the 1973 Article XIV Consultation with the Republic of China

(Reviewed by the Committee on Article XIV Consultations)

Approved by Tun Thin and Donald K. Palmer

June 4 , 1973

I. Introduction

The 1973 Article XIV consultation discussions with the Republic of China were held in Taipei during April 11-20, 1973. The Chinese delegation was headed by Mr. S.Y. Wang, Vice Minister, the Ministry of Finance and included senior officials of the various Ministries concerned with economic policy and of the Central Bank. The staff team consisted of Messrs. J. Ahrensdorf, John B. McLenaghan, and Mrs. Hui-Chen Wu Yang. Mr. Martin Wong, Minister of the Chinese Embassy in Washington, D.C. attended the meetings as an advisor of the Chinese delegation. The staff team had discussions with Mr. K.T. Li, Minister of Finance, Mr. K.H. Yu, Governor of the Central Bank, and Mr. K. Lee, Deputy Governor.

II. Background

The economy grew in 1972 by about 11 per cent, only marginally less than in the previous two years. Industrial output increased at a record rate of over 26 per cent. However, the increase in agricultural production was small, falling short of expectations. External transactions registered growing surpluses in trade and in the overall balance of payments, considerably in excess of what had been projected. The rate of monetary expansion was the highest in many years. There was a large increase in the net foreign assets of the banking system which somewhat exceeded the increase in bank credit to public and private enterprises. Fiscal operations yielded a substantial surplus. From about mid-1972 price developments became increasingly a matter of concern. Following average annual increases of less than 2 per cent in the last decade or so, the annual rate of increase in wholesale prices was well over 10 per cent in the early months of 1973. The pronounced acceleration in price increases was related both to the marked increase in domestic liquidity and to external factors, such as generally rising primary product prices and the currency realignments, particularly the revaluation of yen.

III. Report on Discussions

1. Development and price policies

The Fifth Four-Year Plan period ended in 1972. Almost all targets were exceeded, except in agriculture. The Chinese representatives said that they regarded the projections made in the Sixth Four-Year Plan as generally being somewhat less conservative than in earlier plans. An annual average growth rate of about 9.5 per cent was projected. In 1973 the rate might come close to 12 per cent. The Plan was focussing on the development of heavy and more capital-intensive industries rather than on labor-intensive industries. Emphasis was also placed on development of infrastructure which had been lagging. While public investment was projected to increase at a higher rate than private investment, the Chinese representatives emphasized that the policy was to continue to encourage private investment; the approach was in the nature of contingency planning should private investment show signs of weakening.

The share of agriculture in GNP was projected to decline further. However, intensified efforts were being made to strengthen this sector which was considered as having been lagging in recent years. The objective was to raise productivity and relative income of farmers by hastening the mechanization process before encouraging a shift of labor resources from agriculture to sectors with relatively higher productivity. The Government announced in December 1972 a nine-point plan in order to cope with certain structural problems that had arisen, such as reduction in farmland taken up by industry and other sectors, higher wage costs, and declining productivity in the rural sector. The ramifications of this plan had been likened to the major land reform in the early 1950s.

The authorities continued to encourage agricultural exports as these returned a very high percentage in terms of net value added compared with industrial goods, given the relative scarcity of raw materials in Taiwan. The Government was also endeavoring to diversify its markets for agricultural products, in view of the problems experienced in certain markets. As to the policy of maintaining self-sufficiency in rice, The Chinese representatives said that there was no intention to encourage farmers to change from rice production to the production of livestock even though the authorities were anxious to increase livestock production. Since 1972 government purchases of rice were made at the market price rather than at the official price which usually had been lower.

The authorities still considered export expansion as the main driving force for Taiwan's economic growth. However, there had been some concern as to over-reliance on exports which represented at present about 45 per cent of GNP and might rise to around 50 per cent during the Plan period, one of the highest in the world, except perhaps for some oil producing countries. The Chinese representatives stressed that some restraining measures might be appropriate to slow down exports if domestic economic, and in particular financial, conditions should warrant this.

Higher import prices had been a significant factor in the rise of domestic prices. In 1972, import prices had increased by about 12 per cent compared with a rise in wholesale prices of about 8 per cent. The higher prices for imports, especially from Japan, were considered a more significant factor than the relatively large increases in the dollar prices of primary products.

The large monetary expansion had added appreciably to the momentum of price increases. The Chinese representatives agreed that the decline in income velocity of money over many years had been an important factor in the high degree of price stability achieved until recently. At the same time the real rate of return on financial assets such as time and savings deposits had remained attractive and helped sustain a fairly continued rise in the ratio of private savings to GNP and in capital formation. In 1972, there had been a very pronounced drop in this real rate of return. Indeed, with further price increases this rate may well have become negative in the early months of 1973, for the first time since 1955. They shared the staff team's concern that such a development would make stabilizing financial policies more difficult and, perhaps still more important, if prolonged it would induce changes in those behavior patterns which had been key elements in the outstanding economic performance in the last decade or so. A reversal of such changes would be most difficult and take much time.

In the light of such considerations certain ad hoc measures had been taken to reduce pressures on prices, besides efforts to restrain liquidity expansion and to facilitate imports. Although the Government preferred not to interfere with the price mechanism it had for the first time taken steps to control the domestic price of an imported foodstuff such as wheat through the establishment of a price stabilization fund for wheat flour. There was also a tariff reduction of 50 per cent for wheat. Another second measure had been the fixing of the price of soybeans. Furthermore, all public utilities and enterprises had been directed to maintain their prices at existing levels for the remainder of this year. Any losses arising from this or other price stabilization schemes would be borne by the budget.

The staff team asked whether the authorities no longer considered unemployment and underemployment a problem and if, in fact, the major problem was now a labor shortage. The Chinese representatives said that there was still underemployment in the agricultural sector but believed it had not increased. In the nonfarm sector shortages had emerged because of the rapid development of certain labor-intensive industries such as electronics and textiles. There was a need to improve manpower management and some measures had been taken toward this end. There was a potential reservoir of manpower in the labor-intensive industries, the productivity of which could be raised by a shift to capital-intensive industries and through the training process. Generally, they regarded the employment situation as satisfactory.

2. Financial policies

Financial policies have increasingly been geared to offset the influx of liquidity through external transactions and to reduce the inflow from such sources. Fiscal, debt management and monetary policies have generally been adapted toward this end. As a result there was in 1972 and early 1973 a further substantial reduction in the Central Bank's net domestic assets. The principal factors in this development were increases in government and postal savings deposits with the Central Bank and the placement of newly created certificates of deposit with commercial banks. The reduction in net domestic assets in 1972 and in the first quarter of 1973 was equivalent to about 60 per cent of the increase in the Central Bank's net foreign assets. The increase in reserve money of about NT$10 billion in 1972 supported an increase in money of about NT$15 billion or 33 per cent, suggesting a fall in the money multiplier from nearly 2 in the previous year (Table 1).

a. Fiscal and debt management policies

The original estimates for the fiscal year ending June 1973 had indicated a roughly balanced budget. The staff team noted that monetary data for the first nine months of the fiscal year (July 1972-March 1973) suggested a surplus of receipts over expenditures of more than NT$6 billion including proceeds from net bond issues, partly to the nonbank public, of the order of NT$0.5 billion. The Chinese representatives

Table 1. China: Changes in Monetary Aggregates, 1970-1973

(In billions of NT dollars)

	1970	1971	1972	1st quarter 1972	1st quarter 1973
Central Bank					
Net foreign assets	8.2	9.4	26.6	2.9	3.3
Net domestic assets	-4.6	-4.0	-16.4	-0.6	-2.1
Reserve money	3.6	5.4	10.2	2.3	1.2
Banking system					
Net foreign assets	7.3	8.7	23.7	1.6	-0.7
Domestic credit	12.0	18.5	16.8	4.3	5.9
Public	0.9	3.0	-3.7	-0.4	-3.9
Private	11.1	15.5	20.5	4.7	9.8
Quasi-money	12.2	15.6	23.6	4.0	6.8
Money	6.2	10.6	15.1	0.3	4.2

Source: The Central Bank of China: Financial Statistics Monthly, Taipei, Taiwan, China.

said there was a larger increase in revenues than budgeted as imports had increased more than estimated, partly reflecting the rise in import prices and the resulting rise in the base for customs duties. The effects of import liberalization for certain items also helped to increase tax collections. Generally, for the central government budget a much larger surplus was expected than in the previous fiscal year while the provincial government budget would again be in deficit. The surplus in the consolidated budget was mainly being used to reduce Treasury overdrafts with the Central Bank and other government debt. Furthermore, there was a large increase in Treasury deposits with the Central Bank. The Chinese representatives said that a bond issues of NT$1 billion had been floated in March solely for the purpose of absorbing excess liquidity and it was expected that the remaining NT$600 million authorized in the Budget would also be issued for the same purpose before the end of the fiscal year. They stressed that the issue in March was the first occasion that bonds had been used as a monetary instrument rather than for financing expenditure.

With respect to the trend of capital expenditures in relation to total expenditures the expectation was that the relative increase in the former in recent years would continue. Policy was to restrain current expenditures with perhaps some exception regarding salary increases for government employees. In the coming fiscal year these were to be raised by some 20-25 per cent at a cost of around NT$4 billion.

The central government budget for the fiscal year beginning July 1973 was still under deliberation by the Legislative Yuan. On the basis of incomplete estimates for local governments a deficit of about NT$500 million was envisaged in the consolidated budget. Revenue increases were estimated at about 17 per cent and expenditures at about 18 per cent. Even if a surplus should emerge the intention was to place proposed bond issues of NT$2.8 billion, as far as necessary, to mop up excess liquidity, notwithstanding some increase in debt service payments. Asked about plans to issue Treasury bills--authorized at the end of March 1973, with no provision of tax benefits--as a means of mopping up liquidity, the Chinese representatives said that the same purpose could be met by selling government bonds. The staff team referred to past discussions about the desirability of making available to the nonbank public a greater variety of financial assets. It observed that there was a wide spread between the maximum maturity of Treasury bills of 180 days and the lowest maturity of government bonds of six years and that certificates of deposit could be sold only to banks while Treasury bills could be placed also with nonbank entities. Agreeing with this, the Chinese representatives recognized the need to develop a bill market. They expected to begin with issues at face value rather than on a discount basis.

The staff team asked about the outlook for the ratio of tax receipts to GNP which had declined steadily from 18.3 per cent in FY 1969 to 16.7 per cent in FY 1972. The Chinese representatives said this reflected the rapid growth in nominal GNP and the dominance of indirect taxes which still provided over 70 per cent of tax revenue. Revenue from income taxes had increased by some 30 per cent each year in the last three years, following some adaptations in legislation and administration. It was expected that the tax/GNP ratio would tend to rise but not significantly. The Chinese representatives said that it was the Government's policy to reduce revenue losses due to tax exemptions to encourage investments by "streamlining" the system of exemptions by administrative action. Tax rebates on imported materials for export manufacture were quantitatively more important than exemptions and consideration was being given to reduce such rebates. As to tariff rates, a new law introduced in 1971 authorized the Government to adjust tariff rates upward or downward within a limit of 50 per cent for a period of no more than one year. No such discretionary powers were provided for other taxes.

The introduction of a value added tax to replace the present business tax and part of the commodity tax and stamp tax had been approved by the Government. A bill had been drafted and was to be submitted to the Legislative Yuan by July 1973. If the bill was passed the tax was expected to be put into force in July 1974.

b. Monetary policies

Since the second half of 1972 the authorities have taken a number of measures to restrain monetary expansion which by March 1973 had reached an annual rate of over 40 per cent. From August 1972 the Central Bank sold certificates of deposit to commercial banks as legal reserve requirements were virtually at their statutory limits. The draft of a new banking law which proposed higher limits still awaited submission to the Legislature. By the end of March outstanding certificates amounted to over NT$9 billion, equivalent to about 14 per cent of outstanding reserve money. The C/D's were available with maturities of one, three and six-months, carrying interest rates of 5.25, 6.25, and 7.25 per cent per annum. They were nontransferable and could be cashed before maturity without penalty.

The staff team asked about further scope for reducing central bank accommodation to banks. The reply was that the reduction in 1972 was related to the increased liquidity of banks. As excess reserves were run down banks could reduce their holdings of C/D's before seeking central bank accommodation. To further reduce bank liquidity the Central Bank had discontinued the practice of advancing free of cost local currency to banks for acquisition of foreign exchange. It had also sold slightly over US$100 million to banks so they were to carry out their foreign exchange business with their own resources. Banks' working balances were still regarded as being low and there appeared to be scope for further sales of exchange to them. Moreover, banks were no longer permitted to use credit lines with foreign banks which had been in the order of US$300 million. In addition, approval of applications by public and private enterprises for short-term foreign loans for working capital purposes had been suspended and the Central Bank had been authorized to lend up to US$400 million (at 6.5 per cent to banks and at 7.5 per cent to final borrowers) to finance imports of certain consumer goods and essential raw materials (with repayment within nine months) and capital goods (repayment within five years). The suspension of foreign cash loans took the form of refusal of the authorities to guarantee reconversion and repatriation. If no such guarantees were requested, there was at present no way of barring such capital inflows.

The authorities were studying means of closing this loophole. Other steps taken were increases in presettlement requirements for imports and arrangements to avoid deferred payments on imports. The Chinese representatives thought these various measures would slow down the monetary expansion. There was a tentative estimate that it might be brought down in 1973 to around 20-25 per cent.

The staff team referred to the inconsistency between efforts to mop up liquidity on the one hand and bringing down interest rates further on the other hand, noting the adverse effects of a decline in real interest rates on certain important behavior variables. It also observed that interest rates in Taiwan were not any more significantly out of line with those in foreign financial centers, considering also that Chinese banks generally did not seem to require compensating balances. The Chinese representatives said that in mid-1972 there had been a choice between reducing interest rates and strengthening direct controls over the inflow of short-term capital in order to restrain such inflow. At that time it was decided to reduce interest rates which was also consistent with longer-term objectives. Subsequently limits had been placed on short-term capital inflows.

The staff team said that attention had been directed in previous years toward devising a greater variety of savings instruments, giving savers a wider choice of assets than one confined to time/savings deposits with banks and six-year government bonds and asked if there had been any new developments in this area, other than the recent measures authorizing the issue of Treasury bills. The Chinese representatives said that the development of the capital market and of suitable instruments to promote savings as well as provide for a wider range of financial assets continued to be afforded a high degree of importance. In the last two years, seven trust and investment companies had been established in Taiwan. Trust certificates issued by the companies amounted to five times their paid-up capital. Under the existing regulations, these companies were entitled to acquire medium- and long-term trust fund holdings, i.e., in excess of one-year maturity. The companies' assets were held predominantly in the form of loans to industry and corporate securities.

3. External developments and policies

a. Balance of payments 1/

As to the effects of the December 1971 currency realignment on overall economic developments as well as the balance of payments, the Chinese representatives said that the implications of the realignment a year or so after the event had to some extent been blurred by the recent second U.S. devaluation. The decision taken by the Chinese authorities in December 1971 was to maintain the relationship between the new Taiwan dollar and the U.S. dollar to prevent the immediate emergence of a fundamental disequilibrium. The Japanese yen was at that time very much undervalued and this provided a means of attempting to correct China's trade imbalance with Japan. In the first few months of 1972, exports rose at a fast pace while the domestic price level remained comparatively stable. From mid-1972, however, the Chinese authorities held the view that the undercurrents evident in international financial markets presaged a further period of instability in world exchange rates. These views were reflected in the evolution of the Central Bank's policy adaptations. It was fair to say that this feeling of uncertainty heightened as the year progressed. Nevertheless, apart from these considerations, 1972 was a year in which the balance of payments performance was particularly favorable, providing an opportunity

1/ Percentage changes in trade data calculated on SDR basis.

to liberalize the restrictive system. There were, however, increasing problems for domestic monetary management arising from growing foreign exchange holdings.

The Chinese representatives stated that their balance of payments projections for 1972 had proved quite conservative. Exports and imports had in fact increased by 34 per cent and 23 per cent, respectively (Table 2). There were more favorable opportunities for trade, particularly with Japan, but at the same time costs of imports necessarily rose; this factor tended to mitigate against the increase in exports. However, to the extent that Japanese suppliers had absorbed part of the effects of the revaluation of the yen, these effects were not as large as had been expected. Although import costs had increased, Taiwan's exports had gained some competitive edge. The prices of imports rose by 12 per cent in 1972 while the prices of exports increased by about 9 per cent.1/ Two policy measures had been taken recently to offset the effects of higher import costs. These were the allocation by the Central Bank of foreign exchange for the financing of imports of raw materials at low interest rates and, secondly, efforts to induce manufacturers to shift their importing requirements from Japan to United States and European sources.

The staff team pointed to the substantial increase in exports to Japan (40 per cent) and to the EEC (46 per cent) in 1972, and inquired as to what extent these increases were related to the overall depreciation of the new Taiwan dollar and to what extent there was a favorable impact from the import liberalization by Japan. The Chinese representatives said that considerable emphasis had been placed on improving market prospects in the EEC which was considered to offer a good deal more potential than the Japanese market.

1/ In the first quarter of 1973 export and import prices were about 9 per cent higher than a year earlier.

A major factor in the increase in exports to Japan was the exchange rate adjustment. China's industries had become encouraged to shift production to the export of finished goods to Japan where advantage could be taken of Japan's relatively high labor costs.

Asked about the substantial increase in trade with Japan in the first quarter of 1973, the Chinese representatives said that there appeared to have been an extraordinary increase in demand of Japanese importers. For example, they were now importing textiles and also even paper and paper pulp from Taiwan. However, the increase in exports to Japan in the first quarter of 1973 of 162 per cent (on an exchange settlement basis) was not expected to continue since exports to Japan in the same period of 1972 had been relatively low compared to the average quarterly level for 1972. Moreover, the authorities had now placed a number of export items under some control, primarily to restrain the increase in domestic prices. Imports from Japan had risen in January-March 1973 by about 57 per cent over the same period of the previous year, reflecting particularly imports of raw materials. As to the recent moderate revaluation of the NT$ vis-a-vis the US$, it was felt that this was conducive to reducing China's trade surplus with the United States and that it would also help mitigate somewhat increases in import costs stemming from the further appreciation of the yen, considering the relatively inelastic demand for imports from Japan.

The staff team asked how the exchange rate adjustment in February 1973 had been accounted for in the balance of payments projections. The reply was that as a result of the very small overall depreciation of the new Taiwan dollar, the effects on the trade account were expected to reflect still somewhat higher import costs. The decision to devalue the new Taiwan dollar by 5.26 per cent from the par value was based not only on balance of payments and price considerations but also on other factors having a bearing on future economic growth, such as increased scope for import liberalization. This was considered to be the optimum position that could be taken at that time. The authorities chose setting a central rate rather than changing the par value as they considered this as providing more scope for flexibility.

Discussing the major items in the detailed exports and import projections for 1973, the Chinese representatives said that textile products, the leading export item, showed the largest increase while for imports the significant increases were those for corn, soybeans, metals, textiles and chemicals. The increased imports of corn and soybeans reflected the additional feed requirements for livestock. There were some grounds for arguing that the trade balance in 1973 could be considerably less favorable than expected. Many countries had imposed import quotas and in such markets it was unreasonable to expect a continuation of the recent

Table 2. China: Balance of Payments Summary, 1968-72

(In millions of SDRs)

	1968	1969	1970	1971	1972
Exports f.o.b.	826	1,081	1,465	2,047	2,744
Imports f.o.b. 1/	-900	-1,100	-1,376	-1,756	-2,152
Balance on trade	-74	-19	89	291	592
Services (net)	-60	-30	-104	-131	-181
Unrequited transfers (net)	16	8	14	11	16
Balance on current account	-118	-41	-1	171	427
Nonmonetary capital	63	113	182	43	85
Direct investment and other private long term	78	159	124	87	77
Other private short term	-52	-34	68	-48	-11
Government	37	-12	-10	4	19
Errors and omissions	12	17	1	5	25
Monetary movements (increase -)	43	-89	-183	-219	-537

Source: IMF, Balance of Payments Yearbook.
1/ Includes nonmonetary gold.

high rate of growth of China's exports. Japan, however, was an exception as it now for example ceased to export all but high priced and high quality textiles and met its requirements increasingly by imports, including those from Taiwan.

As to the assumption behind the anticipated decline in net capital inflow in 1973, the Chinese representatives said that other than suspension of short-term foreign borrowings no other direct policy measures had been taken to curb capital inflow. However, some encouragement was now being given to foster certain forms of Chinese investment abroad. The Government was considering the provision of some kind of insurance as an incentive to Chinese businesses to invest abroad. Some financing facilities of a preferential nature were also provided for projects involving assistance to certain African countries. An additional opportunity was likely to emerge from Chinese participation in the postwar reconstruction of Viet-Nam. In addition, whereas foreign investors at present could repatriate only the amount of their original investment, the authorities were contemplating the granting of permission to repatriate capital gains. Some allowance had been made for this in the projections. So far as long-term borrowing was concerned, the debt service ratio, i.e., the ratio of service commitments on public and publicly guaranteed debt to exports of goods and services had fallen from 7.3 in 1970 to about 6.5 in 1972. Little change was anticipated in the ratio.

b. Trade and exchange arrangements

The staff team asked whether attempts to diversify trade, particularly the sources of imports, would have an unfavorable impact on internal costs by way of adding to freight costs. The Chinese representatives felt that this was a factor in the short run but that in the longer term the effects would not necessarily be unfavorable. It was of the utmost importance to reduce the trade surplus position with the United States in order to avoid any export quotas being placed by that country on Taiwan's exports. This consideration applied to some extent also to Canada. Other factors were involved as well. While it was true that freight costs from Japan were less, domestic manufacturers were now shifting to machinery available from the United States and Europe. A direct comparison of costs was not always conclusive, given the differing terms of import financing available from various sources.

The staff team asked about the effects of EEC tariff preference arrangements in the granting of preferential treatment to all developing countries other than China. The Chinese representatives replied that the effects of the preference arrangements were at this time very small, primarily because the base for the calculation of the quotas concerned was very small. However, there was an understanding that the EEC would shift the base from imports in 1968 to those in 1971 or 1972 and, when this occurred, Taiwan's exports to the EEC could expect adverse effects.

As to the policy with respect to export incentives, the Chinese representatives said that some consideration was being given to a modification or a simplification, and perhaps a reduction in the impact of the incentives. For example, refunds of import duties on raw materials were now given for goods which were exported; this was a complicated and rather inefficient system. At times the whole of the amount of the duty concerned had been refunded and exporters still maintained stocks of the imported raw materials. The present regulations stipulated that any investment for production of items entirely for export entitled the exporter to a five-year tax holiday, even for categories of exports which were not specified for encouragement. The Government planned to modify this provision. They agreed that steps in this direction would also help improve resource allocation.

In March 1973 imports of 2,367 items had been liberalized. In 1972 the value of imports of these items was about SDR 140 million. The remaining 460 items still on the controlled list, included goods normally restricted in other countries, such as gold, silver, medicines, military hardware, domestic animals, etc. With respect to the liberalized items, limitations were still imposed on certain imports according to source as a means of reducing imbalances vis-a-vis major trading partners. However, since the liberalization initial limitations as to source had been relaxed somewhat. The limitation on individual import orders for machinery placed in Japan to US$20,000 had been in force for two months following its introduction in September 1972. The limit was subsequently raised to US$200,000. Applications were screened on a case-by-case basis and in the case of essential imports approval was readily given. For small amounts such approval was automatic.

As to the removal of the requirement of a minimum domestic content in manufactured goods, the Chinese representatives said that the use of local materials was still required for certain domestic industries; generally, however, the continuation of this policy on a wide-ranging scale was no longer warranted. The requirement that imported goods maintain a marginal price advantage over domestically produced goods had been in force for a number of years. Originally the margin had been set at 25 per cent; it had been reduced gradually to 5 per cent. By an internal administrative decision it had now been removed completely.

The staff team referred to the decline in recent years in effective tariff rates and inquired about the likely trend in these rates, as well as the authorities' views on general tariff policy in the coming year. The Chinese representatives said that a major factor in the decline was the increase in the proportion of raw materials in total imports which attracted relatively low rates of duty. Effective rates were expected to continue their downward trend. The Government's thinking on tariff policy was in the direction of effecting further reductions in duties on raw materials, e.g. coal and iron ore.

The staff team asked about the effects of quotas on Chinese textiles and other products in the United States, Canada and the EEC, and their competitive position vis-a-vis goods from countries which in February 1973 had depreciated their currencies pari passu with the U.S. dollar, e.g. Korea. The reply was that Korea was an important competitor with China in the fields of textiles and some other products. It was true that recent exchange rate adjustments had disadvantaged China in this respect. An important consideration for the exchange rate adjustment in February 1973, had been related adjustments elsewhere.

On payments for foreign travel, the Chinese representatives said that allowances for travel abroad had been increased considerably in recent years, approvals in excess of allowances were given liberally, and that certain other elements of travel expenses had been added to the permissible items. In addition to business travel, foreign travel expenses were now permitted for medical care, for emigrants and for expenses of civic organizations. The staff team noted that the policy of not normally approving tourist travel was being continued. On the general question of invisible payments, approval was given in special cases for payments in excess of the usual limits. Each case was considered on its merits. The staff team pointed to the desirability of relaxing such remaining restraints on current payments. With respect to controls on capital transactions, the intention was to liberalize the restraints on transfers of capital gains. However, there had been no relaxation of restrictions on the transfer abroad of emigrants' assets or on transactions such as gifts, inheritances, etc.

With respect to the use of forward exchange cover from banks, the staff team asked why such limited use had been made of these facilities since their introduction in April 1972, and why the range of currencies available for cover did not include U.S. dollars. The Chinese representatives said that as most trade transactions were denominated in U.S. dollars, the demand for exchange cover in transactions in other currencies was necessarily small. Another factor was the limited knowledge among traders that these facilities were available. As to the noninclusion of U.S. dollars in the facilities, the authorities felt that as the U.S. dollar was the intervention currency for the NT dollar, and the official and selling rates were fixed in terms of U.S. dollars, there was no point in quoting daily forward rates for U.S. dollars. Such a practice could, in fact, give rise unnecessarily to uncertainty.

The staff team asked if banks were encouraged to hold foreign assets as a means of reducing domestic liquidity. In this context, it was worth noting the techniques used in some other countries to encourage banks to acquire short-term foreign assets by providing them with forward cover facilities attractive enough to encourage a move in this direction. The objective of such a policy was to aid domestic monetary management. The Chinese representatives indicated that at present banks were permitted only to hold short-term foreign deposits with correspondent banks, and were not allowed to buy foreign securities. Some thought had been given to the feasibility of introducing such a facility as well as for allowing short-term foreign investments.

IV. Staff Appraisal

China's economy in 1972 again experienced a very good performance, particularly if viewed against a number of uncertainties at the beginning of the year. A somewhat disturbing feature has been price developments since the second half of the year which appear particularly striking if viewed against the background of prolonged virtual price stability. The accelerating price increases coupled with increasing balance of payments surpluses pose a relatively new problem to the Chinese authorities and present a challenge to policy-makers. Rising inflation rates threaten to erode the behavior patterns which developed over a fairly long period and have been most conducive to the achievement of very high rates of economic growth. This has generally enhanced much the state of confidence both at home and abroad, and has contributed to the rise in private savings in relation to GNP.

The increases in price rises since mid-1972 have been related both to excessive effective demand and to certain cost-push factors, some, if not most, of which have been beyond the control of the authorities. The excess demand was related to the unusually high rates of monetary expansion experienced lately. These developments have been a matter of increasing concern and the authorities have taken a number of measures to restrain the monetary expansion. The techniques employed have been geared to curb increases in primary liquidity by reducing the Central Bank's net domestic assets in order to compensate for the expansion generated by the increases in net foreign assets. The authorities have also endeavored to restrain in various ways the growth of such net foreign assets. The staff welcomes that debt management policies have been deliberately employed, apparently for the first time, in a truly compensatory sense. On the monetary side, Central Bank lending has been curbed and, furthermore, liquidity has been absorbed by the introduction of the new instrument of certificates of deposit by the Central Bank. Steps have been taken to reduce the inflow of short-term capital and some restrictions on payments for invisibles and on some outward transfers of capital have been or are considered to be relaxed. Consideration is also being given to gradually simplify and reduce certain incentives given to export industries. These policies should help to restrain increases in foreign assets and also facilitate achievement of the objectives of further improving the allocation of productive resources and increasing tax revenues.

Certain other measures have been geared to mitigate the impact of certain cost-push factors, in particular those stemming from developments abroad. As foremost among such adaptations in supply policies, the staff considers the recent substantial liberalization of imports and reductions in certain tariffs. Some financial steps have been taken in order to facilitate the inflow of imports. In the staff's view both demand and supply policies have been in the right direction under the circumstances which have emerged.

The outlook for 1973 suggests that the general direction of financial and other policies should well remain the same for the time being. A large balance of payments surplus is again projected for 1973. This surplus may generate an increase in foreign assets only slightly less than experienced in 1972. Furthermore, the rapid increases in domestic prices may for various behavioral reasons gain a momentum of their own. Such developments would warrant, if not call for, a further strengthening of both demand and supply policies.

As regards monetary policy, the scope for reducing further the Central Bank's net domestic assets by reducing its loans appears to be rather limited. There may well be more scope for increasing Central Bank liabilities. Continued adaptations in fiscal management might usefully be geared to further accumulation of government deposits with the Central Bank. Efforts to place additional certificates of deposit with banks and other financial institutions would serve the same purpose. There is scope for the issue and placement of Treasury bills for the purpose of mopping up liquidity. In addition, further increases in the redeposit of savings deposits with the Central Bank would also contribute toward the same end. Consideration is being given to strengthen the recently introduced restraints on the inflow of short-term capital. Advancing import payments, and further reducing recourse to deferred import payments, would also be helpful.

There exists a certain dilemma as regards interest rate policy. Reductions in domestic interest rates to international levels appear a reasonable objective over the long run. Such reductions would also help in curbing inflows of short-term capital from abroad, although effective domestic interest rates are not any more far out of line with international rates. The staff considers that further reductions of nominal interest rates in the present situation of rather rapidly rising prices would tend to have certain unwanted effects.

As regards offsetting the effects of foreign asset accumulation on liquidity, there appears to be scope for further sales of foreign exchange held by the Central Bank to banks and other financial institutions, and also to extend the range of foreign assets that may be held by banks. Encouragement to Chinese direct investment abroad appears compatible with both short- and longer-term objectives. A strong case can be made for liberalizing further certain restrictions on invisible transactions. Success in implementing intentions to simplify and perhaps gradually reduce certain tax incentives should also be helpful. As regards supply policies, there appears to be scope for further reductions in tariff rates and perhaps also for strengthening and speeding up the effects of the recently announced liberalization of imports. Controls of exports of certain commodities in short supply are part of these policies, but it is to be hoped that they will be a very temporary expedient.

The rate adjustment and related financial and other measures adopted in recent months are expected to show their effects on the balance of payments and domestic prices in due course. The staff hopes that the Chinese authorities will review the remaining restrictions on current payments in the light of China's strong balance of payments position.

Some, if not most, of these policies which are being considered at this time mainly from the viewpoint of meeting requirements of the current situation, i.e., slowing down the growth of liquidity and price increases, would also be helpful with respect to the attainment of the longer-term objectives of raising the efficiency of the economy and changing its structure.

Various efforts are being made to tackle some of the current problems by efforts to diversify China's external trade. This by and large may well be a legitimate and, in some respects, necessary objective. The staff considers, however, that it is not necessarily in the interest of any one country, nor of the world economy as a whole, to endeavor to achieve balancing of trade on a strictly bilateral basis.

V. Proposed Decision

The following draft decision is submitted for consideration by the Executive Directors:

1. This decision is taken by the Executive Directors in concluding the 1973 consultation with the Republic of China pursuant to Article XIV, Section 4, of the Articles of Agreement.

2. During 1972 economic growth continued at a high rate. Since about mid-1972 price increases tended to accelerate and toward the end of the year became a matter of concern. Both cost-push factors related mainly to external developments and demand pull factors due to substantial monetary expansion generated in large part by the external sector played a role. The Fund welcomes the authorities' efforts to restrain the growth of liquidity including the more active use of debt management and monetary policy and to take other measures to curb price increases and recommends further strengthening of such policies.

3. The balance of payments strengthened further in 1972 with a growing current account surplus and some revival of net capital inflow. Exports and imports significantly exceeded expectations. Developments in the first part of 1973 suggest a continuation of these trends. Some of the policies adopted recently should have some countervailing effects. The Fund welcomes the authorities' continuing intention to adapt policies in the light of changing circumstances.

4. Both internal and external developments facilitated the recent substantial liberalization of restrictions on imports and some relaxation of restrictions on current payments. The Fund believes there still remains scope for moves in this direction, and that further liberalization would be conducive to achievement of internal and external policy objectives.

APPENDIX

Fund Relations with China

China is an original member of the Fund and has a quota of SDR 550 million. During the Fifth General Review of Quotas, China indicated that it did not wish to have its quota increased. China completed its payment of the gold portion of its subscription to the Fund on August 14, 1970.

An initial par value of NT$40 per U.S. dollar was established on September 4, 1970. On December 20, 1971, China informed the Fund that the exchange rate of NT$40 per U.S. dollar would remain unchanged. This represented a decrease in the gold value of the new Taiwan dollar of 7.89 per cent. On May 8, 1972, this rate, which corresponds to NT$43.4286 per SDR 1, was agreed with the Fund as the new par value. On the same date, China notified the Fund that it availed itself of wider margins under Executive Board Decision No. 3463-(71/126), adopted December 18, 1971. On February 16, 1973, China communicated to the Fund a rate of 0.0218144 special drawing right per new Taiwan dollar to be a central rate in accordance with paragraph 2(a) of Executive Board Decision No. 3463-(71/126), adopted December 18, 1971. This rate, which corresponds to NT$38 per U.S. dollar, to 0.0193858 gram of fine gold per new Taiwan dollar, and to NT$45.8413 per special drawing right, represents a devaluation of 5.26 per cent from the present par value expressed in gold.

A gold tranche purchase of SDR 60 million was made on October 20, 1971. Present Fund holdings of new Taiwan dollars amount to 100 per cent of China's quota. China is a participant in the Special Drawing Account but opted not to receive an allocation.

The Fund has provided substantial technical assistance to the Chinese authorities in relation to the introduction of a sales tax, the drafting of a general banking law, the preparation of an operation manual for the Central Bank, and the management of public debt. Mr. Quinton from the fiscal panel was assigned for two one-year terms beginning in May 1971, to assist the Chinese Customs in the adoption of the Brussels Tariff Nomenclature. The services of Mr. Quinton have been extended for a term of six months with effect from May 4, 1973.

Staff discussions for the last Article XIV consultation with the Chinese authorities were held in Taipei during March 6 - 16, 1972 (SM/72/111, 5/22/72; SM/72/117, 6/5/72; and Correction 1, 6/12/72). The Executive Board's decision, taken on June 14, 1972 was as follows (EBM/72/53-Decision No. 3679):

1. This decision is taken by the Executive Directors in concluding the 1971 consultation with the Republic of China pursuant to Article XIV, Section 4, of the Articles of Agreement.

2. During 1971 the growth rate continued at a high level and the price increase was moderate. Although the rate of expansion of money supply in 1971 was high mainly because of the accumulation of exchange reserves and the expansion of credit to the private sector and government enterprises, timely measures of credit control by the authorities kept the monetary expansion consistent with price stability. The Fund hopes that the authorities will continue their program of improvement of financial markets.

3. The balance of payments remained strong in 1971 as improvement in the current account offset some deterioration in the capital account. The high growth rate of exports was maintained despite a number of unfavorable developments abroad.

4. Although a number of steps were taken in 1970 and 1971 to liberalize restrictions on trade and current payments, this trend was interrupted in the latter part of 1971 as the authorities responded to uncertainties abroad. In view of the strong balance of payments and reserve position, the Fund believes that there is considerable scope for relaxing restrictions on trade and current payments and hopes that the present suspension of the liberalization program will be ended soon.

Basic Data

Area: 35,961 square kilometers

Population: Total (at end of 1972) 15.2 million
1972 growth rate: 2.0 per cent

	1969	1970	1971	1972
GNP at 1966 prices (NT$ Bn.)	164.6	183.0	203.9	226.4
Rate of increase (per cent)	8.7	11.2	11.4	11.0
Per capita income at current prices	NT$10,449 (US$261)	NT$11,727 (US$293)	NT$13,148 (US$329)	NT$14,887 (US$372)

	FY 1970	FY 1971	FY 1972	FY 1973
Consolidated budget (NT$ Bn.)				
Revenues	48.7	53.7	63.8	68.9
Expenditures	47.4	52.2	60.2	68.7
Surplus or deficit (-)	1.3	1.5	3.6	0.2
Net bond issues	0.7	0.1	-1.3	...

	1969	1970	1971	1972
Money and related data at end of period				
Money supply	28.9	35.1	45.7	60.8
Rate of change (per cent)	+16.2	+21.3	+30.2	+33.1
Total credit	77.8	90.8	107.3	128.2
Rate of change (per cent)	+18.3	+16.7	+18.2	+19.5
Quasi-money	48.5	60.8	76.4	99.9
Rate of change (per cent)	+21.3	+25.2	+25.7	+30.8
Wholesale price index (At end of period; 1966 = 100)	102.9	103.3	105.9	113.6
Rate of change (per cent)	+1.6	+0.4	+2.5	+7.3
Balance of payments (US$ Mn.)				
Exports, f.o.b.	1,081	1,465	2,047	2,744
Imports, f.o.b.	1,100	1,376	1,756	2,152
Trade balance	-19	+89	291	592
Net services and transfers	-22	-90	-120	-165
Net current account	-41	-1	171	427
Net capital (including errors & omissions)	130	184	47	110
Monetary movements (increase -)	-89	-183	-218	-537
International reserves (US$ Mn. at end of period)				
Gold	82	82	87	87
Gross foreign exchange holdings	350	425	545	745
Gold tranche position with IMF	--	60	--	--

IMF

Quota:	SDR 550 million	
Par value:	NT$40.00 per U.S. dollar	(May 8, 1972)
Central rate:	NT$38.00 per U.S. dollar	(February 16, 1973)

Office Memorandum

TO : Mr. Mohammed

DATE: May 31, 1973

FROM : J. B. McLenaghan

SUBJECT : China - Recent Economic Developments

The economy grew in 1972 by about 11 per cent, only slightly less than the rate of growth in the previous two years. Industrial production increased at a record rate of more than 26 per cent. On the other hand, agricultural production increased little and was below expectations. After many years of price stability, price performance deteriorated sharply in the closing months of 1972 and early 1973, when the wholesale price index was 10 per cent ahead of a year earlier. Higher import costs played some part in domestic price developments, but there was also an element of demand pull, reflected in the sharply higher rate of growth of money supply, which by March 1973 was some 40 per cent greater than a year earlier. External developments were extremely favorable in 1972, when for the third successive year there was a substantial surplus (of almost SDR 540 million) in the balance of payments, compared with a surplus of SDR 220 million in the previous year.

Following the announcement on February 12, 1973 that the U.S. dollar was to be devalued, the New Taiwan dollar was devalued by 5.26 per cent from the par value, representing an effective over-all depreciation of a little more than 1 per cent. For the sake of flexibility the Chinese authorities established a central rate (rather than a par value) corresponding to NT$38 = US$1 (previously NT$40 = US$1).

Policy actions in late 1972 and early 1973 were almost wholly devoted to stemming the rate of price increase, and to ease the burden on domestic monetary management of rapidly rising foreign exchange holdings of the banking system. In September 1972, the Central Bank no longer approved short-term foreign currency loans for working capital purposes (although such capital could still enter China, but without the right to repatriation). Debt management policies were employed in a compensatory manner for the first time to absorb excess liquidity, and new credit instruments were introduced by the Central Bank for the same purpose. Fiscal performance remained sharply contractionary. Encouragement was given to importers to avoid reliance on foreign financing for their imports; in this respect US$400 million was made available by the Central Bank through the domestic banks for imports. And in a major trade liberalization measure in March 1973, the Government transferred 2,370 import items from the controlled to the permissible list, leaving only 460 items (of a total of about 15,000) on the controlled list, largely imports kept under control in most developed countries.

External debt increased in 1972 by SDR 230 million, a much faster rate than in the previous two years; more than half of the increase was in short-term debt. At the end of 1972, total outstanding external debt amounted to about SDR 1.3 billion, almost 80 per cent of which was medium-term and long-term. Debt servicing in 1973 is estimated at 6.5 per cent of exports of goods and services, a low proportion by international standards.

Mr. Ahrensdorf May 24, 1973

Donald K. Palmer

Staff Report on Republic of China

I have only two comments on the draft staff report for the 1973 consultation with the Republic of China.

First, I could find no mention in the staff appraisal of the "question of the appropriateness of the new exchange rate in the light of recent trends and prospective developments in the balance of payments" (the quotation is from page 7 of the briefing paper). It will be recalled that the decision to depreciate in February 1973 was seriously questioned by several members of the Executive Board, with the result that the Managing Director promised that the planned consultation would explore the adequacy of the current central rate and the liberalization program. There is, good discussion of the liberalization efforts in the paper but, my impression is that the paper is virtually silent on the question of the adequacy of the rate. While in other times this might have been considered too sensitive an issue for comment in the paper, it was my understanding that in this case the Executive Board (and the Management) expected that the staff report would contain at least a brief analysis on this issue.

My second point relates to the absence of any text tables. I am well aware that we are all under pressure to keep the length of staff reports to manageable proportions but no-one has suggested that this be done at the expense of text tables. Indeed, one frequently hears Directors praising reports which contain short but helpful text tables. I would have thought that this report should include a table on the balance of payments and on money and credit.

cc: Mr. Tun Thin

INTERNATIONAL MONETARY FUND

May 22, 1973

To: ETR ✓
Legal
Treasurer
FAD

Please may I have your comments by the close of business, Thursday, May 24.

J. Ahrensdorf

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

REPUBLIC OF CHINA

Staff Report for the 1973 Article XIV Consultation

Prepared by Staff Representatives for the 1973 Article XIV Consultation with the Republic of China

(Reviewed by the Committee on Article XIV Consultations)

Approved by Tun Thin and Donald K. Palmer

May , 1973

I. Introduction

The 1973 Article XIV consultation discussions with the Republic of China were held in Taipei during April 11-20, 1973. The Chinese delegation was headed by Mr. S.Y. Wang, Vice Minister, the Ministry of Finance and included senior officials of the various Ministries concerned with economic policy and of the Central Bank. The staff team consisted of Messrs. J. Ahrensdorf, John B. McLenaghan, and Mrs. Hui-Chen Wu Yang. Mr. Martin Wong, Minister of the Chinese Embassy in Washington, D.C. attended the meetings as an adviser of the Chinese delegation. The staff team met with Mr. K.H. Yu, Governor of the Central Bank and Mr. K.T. Li, Minister of Finance at the beginning of the consultation and Mr. Ahrensdorf had discussions with Governor Yu and Deputy Governor Lee of the Central Bank toward the end of the mission.

II. Background

The economy grew in 1972 by about 11 per cent, only marginally less than in the previous two years. Industrial output increased at a record rate of over 26 per cent. On the other hand, agricultural production increased little and fell short of expectations. External transactions registered growing surpluses in trade and in the overall balance of payments, considerably in excess of what had been projected. The rate of monetary expansion was the highest in many years. There was a large increase in the net foreign assets of the banking system which somewhat exceeded the increase in bank credit to public and private enterprises. Fiscal operations yielded a substantial surplus. From about mid-1972 price developments became increasingly a matter of concern. Following average annual increases of less than 2 per cent in the last decade or so, the annual rate of increase in wholesale prices was well over 10 per cent in the early months of 1973. The pronounced acceleration in price increases was related both to the massive increase in domestic liquidity and to external factors such as generally rising primary product prices and the currency realignments, particularly the revaluation of yen.

III. Report on Discussions

1. Development and price policies

The Fifth Four-Year Plan period ended in 1972. Almost all targets were exceeded, except in agriculture. The Chinese representatives said that they regarded the projections made in the Sixth Four-Year Plan as generally as being somewhat less conservative than in earlier plans. An annual average growth rate of about 9.5 per cent was projected. In 1973 the rate might come close to 12 per cent. The Plan was focussing on the development of heavy and more capital-intensive industries rather than on labor-intensive industries. Emphasis was also placed on development of infrastructure which had been lagging. While public investment was projected to increase at a higher rate than private investment the Chinese representatives emphasized that the policy was to continue to encourage the private investment and there was no plan to hold it back. Rather the approach was in the nature of contingency planning in the event private investment should become hesitant. As regards an agreement with Korea in the late 1960s on some specialization in certain petro-chemicals for supply to both markets the Chinese representatives said that the idea was a good one but did not work out as demand had justified that China produce a wider range of such products than considered feasible at that time.

The share of agriculture in GNP was projected to decline further. However, intensified efforts were being made to strengthen this sector which was considered as having been lagging in recent years. The objective was to raise productivity and relative income of farmers by hastening the mechanization process before encouraging a shift of labor resources from agriculture to sectors with relatively higher productivity. The Government announced in December 1972 a nine-point plan in order to cope with certain structural problems that had arisen, such as reduction in farmland taken up by industry and other sectors, higher wage costs, and declining productivity in the rural sector. The ramifications of this plan had been likened to the major land reform in early 1950s.

As to the policy of maintaining self-sufficiency in rice, the Chinese representatives said that there was no intention to encourage farmers to change from rice production to the production of livestock even though the authorities were anxious to increase livestock production. Since 1972 Government purchases of rice were made at the market price rather than at the official price which usually had been lower. The authorities continued to encourage agricultural exports as these returned a very high percentage in terms of net value added in contrast to a relatively small proportion received with respect to industrial goods, given the relative scarcity of raw materials in Taiwan. The Government was also endeavoring to diversify its markets for agricultural products, in view of the problems experienced in certain markets.

The authorities still considered export expansion as the main driving force for Taiwan's economic growth. However, there had been some concern as to over-reliance on exports which represented at present about 45 per cent of GNP and might rise to around 50 per cent during the Plan period, one of the highest in the world, except perhaps for some oil producing countries. The Chinese representatives stressed that some restraining measures might be appropriate to slow down exports if domestic economic, and in particular financial, conditions should warrant this. Indeed, the authorities were considering to reduce or simplify some of the extensive tax and financial incentives provided for exports. They agreed that such steps would also help improve resource allocation. In fact, recently temporary controls on the exports of a number of commodities had been introduced in order to help mitigate pronounced price increases.

Higher import prices had been a significant factor in the rise of domestic prices. In 1972, import prices had increased by about 12 per cent compared with a rise in wholesale prices of about 8 per cent. The higher prices for imports from Japan were considered a more significant factor than the relatively large increases in the dollar prices of primary products. Another factor was the comparatively relatively large increase in wage rates in some industries during the year which was probably fairly close to productivity gains.

The large monetary expansion had added appreciably to the momentum of price increases. The Chinese representatives agreed that the decline in income velocity of money over many years had been an important factor in the high degree of price stability achieved until recently. At the same time the real rate of return on financial assets such as time and savings deposits had remained attractive and helped sustain a fairly continued rise in the ratio of private savings to GNP and in capital formation. In 1972, there had been a very pronounced drop in this real rate of return. Indeed, with further price increases this rate may well have become negative in the early months of 1973, for the first time since 1955. They shared the staff team's concern that such a development would make more difficult stabilizing financial policies and, perhaps still more important, if prolonged it would induce changes in those behavior patterns which had been key elements in the outstanding economic performance in the last decade or so. A reversal of such changes would be most difficult and take much time.

In the light of such considerations certain ad hoc measures had been taken to reduce pressures on prices, besides efforts to restrain liquidity expansion and to facilitate imports. Although the Government preferred not to interfere with the price mechanism it had for the first time taken steps to control the domestic price of an imported foodstuff such as wheat through the establishment of a price stabilization fund for wheat flour. There was also a tariff reduction of 50 per cent for wheat. A second measure had been the fixing of the price of soybeans. Furthermore, all public utilities and enterprises had been directed to maintain their prices at existing levels of the remainder of this year. Losses arising from this and the other price stabilization schemes, if any, were to be borne by the budget.

The staff team asked whether the authorities considered that unemployment and underemployment were no longer a problem and, in fact, the major problem area now was one of a labor shortage. The Chinese representatives said that there was still underemployment in the agricultural sector but it had not increased. In the nonfarm sector shortages had emerged because of the rapid development of certain labor-intensive industries such as electronics and textiles. A feature of the employment situation was the need to improve manpower management and some measures had been taken toward this end. They agreed that there was a potential reservoir of manpower in the labor-intensive industries, the productivity of which could be raised by a shift to capital-intensive industries and through the training process. Generally, they regarded the employment situation as satisfactory.

2. Financial policies

Financial policies have increasingly been geared to offset the influx of liquidity through external transactions and to reduce the inflow from such sources. Fiscal, debt management and monetary policies have generally been adapted toward this end. As a result there was in 1972 and early 1973 a further substantial reduction in the Central Bank's net domestic assets. The principal factors in this development were increases in government and postal savings deposits with the Central Bank and the placement of newly created certificates of deposit with commercial banks. The reduction in net domestic assets in 1972 and in the first quarter of 1973 was equivalent to about 60 per cent of the increase in the Central Bank's net foreign assets. The increase in reserve money of about NT$10 billion in 1972 supported an increase in money of about NT$15 billion or 33 per cent.

a. Fiscal and debt management policies

The original estimates for the fiscal year ending June 1973 had indicated a roughly balanced budget. The staff team noted that monetary data for the first nine months of the fiscal year (July 1972-March 1973) suggested a surplus of receipts over expenditures of over NT$6 billion including proceeds from net bond issues of the order of NT$0.5 billion in this period. The Chinese representatives said there was a larger increase in revenues than budgeted as imports had increased more than estimated, partly reflecting the rise in import prices and the resulting rise in the base for customs duties. The effects of import liberalization for certain items also helped to increase tax collections. Generally, for the central government budget a much larger surplus was expected than in the previous fiscal year while the provincial government budget would again be in deficit. The surplus in the consolidated budget was mainly being used to reduce Treasury overdrafts with the Central Bank and other government debt. Furthermore, there was a large increase in Treasury deposits with the Central Bank. The Chinese representatives said that a bond issue of NT$1 billion had been floated in March solely for the purpose of absorbing excess liquidity and it was expected that the remaining NT$600 million authorized in the Budget would also be issued for the same purpose before the end of the fiscal year. They stressed that the issue in March was the first occasion that bonds had been used as a monetary instrument rather than for financing expenditure. Policy was to restrain current expenditures with perhaps some exception regarding salary increases for government employees. In the coming fiscal year these were to be raised by some 20-25 per cent at a cost of ~~about~~ around NT$4 billion. With respect to the trend of capital expenditures in relation to total expenditures the expectation was that the relative increase in the former in recent years would continue.

The central government budget for the fiscal year beginning July 1973 was still under deliberation by the Legislative Yuan. On the basis of incomplete estimates for local governments a deficit of about NT$500 million was envisaged in the consolidated budget. Revenue increases were estimated at about 17 per cent and those of expenditures at about 18 per cent. Even if a surplus should emerge the intention was to place proposed bond issues of NT$2.8 billion, as far as necessary, to mop up excess liquidity, ~~even if this resulted in~~ notwithstanding some increase in debt service payments. Asked about plans to issue Treasury bills--authorized at the end of March 1973, with no provision of tax benefits--as a means of mopping up liquidity, the Chinese representatives said that the same purpose could be met by selling government bonds. (~~There was a problem as to the interest rates to be set for Treasury bills which to some extent would be competing with the Central Bank's certificates of deposit.~~) The staff team noted that there was a wide spread between the maximum maturity of Treasury bills of 180 days and the lowest maturity of government bonds of six years and that certificates of deposit could be sold only to banks while Treasury bills could be placed also with nonbank entities. Agreeing with this, the Chinese representatives recognized the need to develop a bill market. They expected to begin with issues at face value rather than on a tap basis, given the present nature of the capital market.

The staff team asked about the outlook for the ratio of tax receipts to GNP which had declined steadily from 18.3 per cent in FY 1969 to 16.7 per cent in FY 1972. The Chinese representatives said this reflected the rapid growth in nominal GNP and the dominance of indirect taxes which still provided over 70 per cent of tax revenue. Revenue from income taxes had increased by some 30 per cent each year in the last three years, following some adaptations in legislation and administration. It was expected that the tax/GNP ratio would tend to rise but not significantly. The Chinese representatives said that it was the Government's policy to reduce revenue losses due to tax exemptions to encourage investments by "streamlining" the system of exemptions by administrative action. Tax rebates on imported materials for export manufacture were quantitatively more important than exemptions and consideration was being given to reduce such rebates. As to tariff rates, a new law introduced in 1971 authorized the Government to adjust tariff rates upward or downward within a limit of 50 per cent for a period of no more than one year. No such discretionary powers were provided for other taxes.

The introduction of a value added tax to replace the present business tax and part of the commodity tax and stamp tax had been approved by the Government. A bill had been drafted and was to be submitted to the Legislative Yuan by July 1973. If the bill was passed the tax was expected to be put into force in July 1974.

b. Monetary policies

Since the second half of 1972 the authorities have taken a number of measures to restrain monetary expansion which by March 1973 had reached an annual rate of over 40 per cent. From August 1972 the Central Bank sold certificates of deposit to commercial banks as legal reserve requirements were virtually at their statutory limits. The draft of a new banking law which proposed higher limits still awaited submission to the Legislature. By the end of March outstanding certificates amounted to over NT$9 billion, equivalent to about 14 per cent of outstanding reserve money. [illegible] equivalent to about 14 per cent of outstanding reserve money. The C/D's were available with maturities of one, three and six-months, carrying interest rates of 5.25, 6.25, and 7.25 per cent per annum. They were nontransferable and could be cashed before maturity without penalty.

The staff team asked about further scope for reducing central bank accommodation to banks. The reply was that the reduction in 1972 was related to the increased liquidity of banks. As excess reserves were run down banks could reduce their holdings of C/D's before seeking central bank accommodation. To further reduce bank liquidity the Central Bank had discontinued the practice of advancing free of cost local currency to banks for acquisition of foreign exchange. It had also sold slightly over US$100 million to banks so they were to carry out their foreign exchange business with their own resources. Banks' working balances were still regarded as being low and there appeared to be scope for further sales of exchange to them. Moreover, banks were no longer permitted to use credit lines with foreign banks which had been in the order of US$300 million. In addition, approval of applications by public and private enterprises for short-term foreign loans for working capital purposes had been suspended and the Central Bank had been authorized to lend up to US$400 million (at 6.5 per cent to banks and at 7.5 per cent to final borrowers) to finance imports of certain consumer goods and essential raw materials (with repayment within nine months) and capital goods (repayment within five years). It was noted that the suspension of foreign cash loans took the form of refusal of the authorities to guarantee reconversion and repatriation. If no such guarantees were requested, there was at present no way of barring such capital inflows.

The authorities were studying means of closing this loophole. Other steps taken were increases in presettlement requirements for imports and arrangements to avoid deferred payments on imports. The Chinese representatives thought these various measures would slow down the monetary expansion. There was a tentative estimate that it might be brought down in 1973 to around 20-25 per cent.

The staff team noted the inconsistency between efforts to mop up liquidity on the one hand and bringing down interest rates further on the other hand, noting the adverse effects of a decline in real interest rates on certain important behavior variables. It also noted that interest rates in Taiwan were not any more significantly out of line with those in foreign financial centers, considering also that Chinese banks generally did not seem to require compensating balances. The Chinese representatives said that in mid-1972 there had been a choice between reducing interest rates and strengthening of direct controls over the inflow of short-term capital in order to restrain such inflow. At that time it was decided to reduce interest rates which was also consistent with longer-term objectives. Subsequently limits had been placed on short-term capital inflows, but interest rates had been kept unchanged.

The staff team said that attention had been directed in previous years toward devising a greater variety of savings instruments, giving savers a wider choice of assets than one confined to time/savings deposits with banks and seven-year government bonds. It would be interested in any developments in this area, other than the recent measures authorizing the issue of Treasury bills. The Chinese representatives said that the development of the capital market and of suitable instruments to promote savings as well as provide for a wider range of financial assets continued to be afforded a high degree of importance. In the last two years, seven trust and investment companies had been established in Taiwan. Trust certificates issued by the companies amounted to five times their paid-up capital. Under the existing regulations, these companies were entitled to acquire medium- and long-term trust fund holdings, i.e., in excess of one-year maturity. The companies' assets were held predominantly in the form of loans to industry and of corporate securities.

3. External developments and policies

a. Balance of payments

As to the effects of the December 1971 currency realignment on overall economic developments in China as well as the balance of payments, the Chinese representatives said that the implications of the realignment a year or so after the event had to some extent been blurred by the recent second U.S. devaluation. The decision taken by the Chinese authorities in December 1971 was to maintain the relationship between the new Taiwan dollar and the U.S. dollar on the grounds that the Japanese yen was at that time very much undervalued and that this provided a means of attempting to correct China's imbalance in its trade with Japan. In the first few months of 1972, exports rose at a fast pace while the domestic price level remained comparatively stable. From mid-1972, however, the Chinese authorities held the view that the undercurrents evident in international financial markets presaged a further period of instability in world exchange rates. These views were reflected in the Central Bank's policy formulation and in its administration of foreign exchange holdings. It was fair to say that this feeling of uncertainty heightened as the year progressed. Nevertheless, apart from these considerations, 1972 was a year in which the balance of payments performance was particularly favorable, providing an opportunity to liberalize the restrictive system. There were, however, increasing problems for domestic monetary management arising from growing foreign exchange holdings.

The Chinese representatives indicated that their balance of payments projections for 1972 which had proved quite conservative had been based on an unchanged relationship between the new Taiwan dollar and the U.S. dollar, which implied an overall depreciation of the new Taiwan dollar with respect to the currencies of its other major trade partners. There were more favorable opportunities for trade particularly with Japan, but at the same time costs of imports necessarily rose; this factor tended to mitigate against the increase in exports. However, to the extent that Japanese suppliers had absorbed part of the effects of the revaluation of the yen ~~they~~ these effects were not as large as had been expected. Although import costs had increased, China's exports had gained some competitive edge. The prices of imports rose by 12 per cent in 1972 while the prices of exports increased by about 9 per cent. Two policy measures had been taken recently to offset the effects of higher import costs. These were the allocation by the Central Bank of foreign exchange for the financing of imports of raw materials at low interest rates and, secondly, efforts to induce manufacturers to shift their importing requirements from Japan to United States and European sources.

Discussing developments in exchange markets in early 1973, the Chinese representatives said that imports from Japan had risen in January-March 1973 by about 57 per cent over the same period of the previous year, reflecting particularly imports of raw materials from that country. The authorities were attempting to encourage industries which would avoid excessive reliance on Japanese imports; this would have the additional benefit of helping to stabilize prices. As to the recent moderate revaluation of the NT$ vis-a-vis the US$, it was felt that this was conducive to reducing China's trade surplus with the United States and that it would also help mitigate somewhat increases in import costs stemming from the further appreciation of the yen, considering the relatively inelastic demand for imports from Japan.

The staff team pointed to the substantial increase in exports to Japan (52 per cent) and to the EEC (56 per cent) in 1972, and inquired as to what extent these increases were related to the overall depreciation of the new Taiwan dollar and to what extent there was a favorable impact from the import liberalization by Japan. The Chinese representatives said that considerable emphasis had been placed on improving market prospects in the EEC which was considered to offer a good deal more potential than the Japanese market. Although Japan had announced measures to free its import regime, they felt it continued to exercise stricter import controls than did the EEC. The liberalization in Japan dealt largely with items such as computers and automobiles, which did not benefit China. Thus, the major factor in the increase in exports to Japan was the exchange rate adjustment. China's industries had become encouraged to shift production to the export of finished goods to Japan where advantage could be taken of Japan's relatively high labor costs. Asked about the substantial increase in trade with Japan in the first quarter of 1973, the Chinese representatives said that there appeared to have been an extraordinary increase in demand of Japanese importers. For example, they were now importing textiles and also even paper and paper pulp from Taiwan. It should be noted, however, that the increase in exports to Japan in the first quarter of 1973 of 162 per cent (on an exchange settlement basis) was not expected to continue since exports to Japan in the first quarter of 1972 had been relatively low compared to the average quarterly level for 1972. Moreover, the authorities had now placed a number of export items under some control. In answer to a question, the Chinese representatives said that the imposition of these export controls was primarily to restrain the increase in domestic prices.

The staff team asked how the exchange rate adjustment in February 1973 had been accounted for in the balance of payments projections. The Chinese representatives replied that as a result of the very small overall depreciation of the new Taiwan dollar, the effects on the trade account were expected to reflect still somewhat higher import costs, particularly in the field of machinery and metal products. ~~In reply to a question~~ They said that their calculations, which had formed the basis for the decision to depreciate the new Taiwan dollar, had turned out approximately the same as those prepared by the Fund staff. The rate adjustment in February and related financial and other measures adopted since then are expected to show their effects on the balance of payments and domestic prices in due course. The authorities chose setting a central rate rather than changing the par value as they considered this as providing more scope for flexibility.

Discussing some of the more important items in the detailed exports and import projections for 1973, the Chinese representatives said that textile products, the biggest export item, showed the largest increase while for imports the significant increases were those for corn, soybeans, metals, textiles and chemicals. The increased imports of corn and soybeans reflected the additional feed requirements for livestock. There were some grounds for arguing that the trade balance in 1973 could be considerably less favorable than expected. Many countries had imposed import quotas and in such markets it was unreasonable to expect a continuation of the recent high rate of growth of China's exports. Japan, however, was an exception as it now for example ceased to export all but high priced and high quality textiles and met its requirements increasingly by imports, including those from Taiwan.

As to the assumptions behind the anticipated decline in net capital inflow in 1973, the Chinese representatives said that other than suspension of short-term foreign borrowings no other direct policy measures had been taken to curb capital inflow. However, some encouragement was now being given to foster certain forms of Chinese investment abroad. As to the financial incentives to Chinese businesses to invest abroad, the Chinese representatives said that the Government was considering the provision of some kind of insurance for investment of this kind. Some financing facilities of a preferential nature were also provided for projects involving assistance to certain African countries. An additional opportunity was likely to emerge in terms of Chinese participation in the postwar reconstruction of Viet-Nam. In addition, whereas foreign investors at present could repatriate only the amount of their original investment, the authorities were contemplating the granting of permission to repatriate capital gains. Some allowance had been made for this in the projections. So far as long-term borrowing was concerned, the debt service ratio, i.e., the ratio of service commitments on public and publicly guaranteed debt to exports of goods and services had fallen from 7.3 in 1970 to about 6.5 in 1972. Little change was anticipated in the ratio.

b. Trade and exchange arrangements

The staff team asked whether attempts to diversify trade, particularly the sources of imports, would have an unfavorable impact on internal costs by way of adding to freight costs. The Chinese representatives felt that this was a factor in the short run but that in the longer term the effects would not necessarily be unfavorable. It was of the utmost importance to reduce the trade surplus position with the United States in order to avoid any export quotas being placed by that country on Taiwan's exports. This consideration applied to some extent also to Canada. Other factors were also involved. While it was true that freight costs from Japan were less, domestic manufacturers were now shifting to machinery available from the United States and Europe. A direct comparison of costs was not always conclusive, given the differing terms of import financing available from various sources. It was difficult to make meaningful comparisons on import costs when differing import financing arrangements were involved.

The staff team asked about the effects of EEC tariff preference arrangements, ~~and~~ the granting of preferential treatment to all developing countries other than China. The Chinese representatives replied that the effects of the preference arrangements were at this time very small, primarily because the base for the calculation of the quotas concerned was very small. However, there was an understanding that the EEC would shift the base from imports in 1968 to those in 1971 or 1972 and, when this occurred, Taiwan's exports to the EEC could expect adverse effects.

As to the policy with respect to export incentives, the Chinese representatives said that some consideration was being given to a modification or a simplification, and perhaps a reduction in the impact of the incentives. For example, refunds of import duties on raw materials were now given for goods which were exported; this was a complicated system. At times the whole of the amount of the duty concerned had been refunded and exporters still maintained stocks of the imported raw material. The present regulations stipulated that any investment for production of items entirely for export entitled the exporter to a five-year tax holiday, even for categories of exports which were not specified for encouragement. The Government planned to modify this provision. This was not to suggest, however, that the Government did not want to maintain the growth rate of exports.

In March 1973 imports of 2,367 items had been liberalized. In 1972 the value of imports of these items was about US$150 million. Of the remaining 460 items still on the controlled list, goods included therein covered those normally restricted in other countries, such as gold, silver, medicines, military hardware, domestic animals, etc. With respect to the liberalized items, limitations continued to be imposed on certain imports according to source in pursuit of the objective of reducing imbalances vis-a-vis major trading partners. However, since the liberalization initial limitations as to source had been relaxed somewhat. The limitation on individual import orders for machinery placed in Japan to US$20,000 had been in force for two months following its introduction in September 1972. The limit was subsequently raised to US$200,000. Applications were screened on a case-by-case basis and in the case of essential imports approval was readily given. For small amounts such approval was automatic.

As to the removal of the requirement of a minimum domestic content in manufactured goods, the Chinese representatives said that the use of local materials was still required for certain domestic industries; generally, however, the continuation of this policy on a wide-ranging scale was no longer warranted. The requirement that imported goods maintain a marginal price advantage over domestically produced goods had been in force for a number of years. Originally the margin had been set at 25 per cent; it had been reduced gradually to 5 per cent. By an internal administrative decision it had now been removed completely.

The staff team referred to the decline in recent years in effective tariff rates and inquired about the likely trend in these rates, as well as the authorities' views on general tariff policy in the coming year. The Chinese representatives said that a major factor in the decline was the increase in the proportion of raw materials in total imports which attracted relatively low rates of duty. Effective rates were expected to continue their downward trend. The Government's thinking on tariff policy was in the direction of effecting further reductions in duties on raw materials, e.g. coal and iron ore.

The staff team asked about the effects of quotas on Chinese textiles and other products in the United States, Canada and the EEC, and the competitive position ~~of these goods~~ vis-a-vis goods from countries which in February 1973 had depreciated their currencies pari passu with the U.S. dollar, e.g. Korea. The reply was that Korea was an important competitor with China in the fields of textiles and some other products. It was true that recent exchange rate adjustments had disadvantaged China in this respect. Some protection, however, was afforded by way of the quotas. For example, in the last agreement year for textile exports to the United States, Korea had used only 60 per cent of its quota, while China had used 99 per cent. In markets where quotas were not applicable, Chinese products remained quite competitive. An important consideration for the exchange rate adjustment in February 1973, had been related adjustments elsewhere. It was understood that Korea at that time was removing some export incentives, a fact which tended to offset the additional benefit Korea had obtained from its relative exchange rate depreciation vis-a-vis the NT dollar.

On payments for foreign travel, the Chinese representatives said that allowances for travel abroad had been increased considerably in recent years, approvals in excess of allowances were given liberally, and that certain other elements of travel expenses had been added to the permissible items. In addition to business travel, foreign travel expenses were now permitted for medical care, for emigrants and for expenses of civic organizations. The staff team noted that the policy of not normally approving tourist travel was being continued. On the general question of invisible payments, approval was given in special cases for payments in excess of the usual limits. Each case was considered on its merits. With respect to controls on capital transactions, the intention was to liberalize ~~Chinese representatives said that they were thinking of liberalizing~~ the restraints on transfers of capital gains. However, there had been no relaxation of restrictions on the transfer abroad of emigrants' assets or on transactions such as gifts, inheritances, etc.

With respect to the use of forward exchange cover from banks, the staff team asked why such limited use had been made of these facilities since their introduction in April 1972, and why the range of currencies available for cover did not include U.S. dollars. The Chinese representatives said that as most trade transactions were denominated in U.S. dollars, the demand for exchange cover in transactions in other currencies was necessarily small. Another factor was the limited knowledge among traders that these facilities were available. As to the noninclusion of U.S. dollars in the facilities, the authorities felt that as the U.S. dollar was the intervention currency for the NT dollar, and the official and selling rates were fixed in terms of U.S. dollars, there was no point in quoting daily forward rates for U.S. dollars. Such a practice could, in fact, give rise unnecessarily to uncertainty.

The staff team asked if banks were encouraged to hold foreign assets as a means of reducing domestic liquidity. In this context, it was worth noting the techniques used in some other countries to encourage banks to acquire short-term foreign assets by providing them with forward cover facilities attractive enough to encourage a move in this direction. The objective of such a policy was to aid domestic monetary management. The Chinese representatives indicated that at present banks were permitted only to hold short-term foreign deposits with correspondent banks, and were not allowed to buy foreign securities. Some thought had been given to the feasibility of introducing such a facility as well as for allowing short-term foreign investments.

IV. Staff Appraisal

China's economy in 1972 again experienced a very good performance, particularly if viewed against a number of uncertainties at the beginning of the year. A somewhat disturbing feature has been price developments since the second half of the year. These developments appear particularly striking if viewed against the background of prolonged virtual price stability. The accelerating price increases coupled with increasing balance of payments surpluses pose a relatively new problem to the Chinese authorities and present a challenge to policy-makers. Rising inflation rates threaten to erode the behavior patterns which developed over a fairly long period and have been most conducive to the achievement of very high rates of economic growth. This has generally enhanced much the state of confidence both at home and abroad, and has contributed to the rise in private savings in relation to GNP.

The increases in price rises since mid-1972 have been related both to excessive effective demand and to certain cost-push factors, some, if not most, of which have been beyond the control of the authorities. The excess demand was related to the unusually high rates of monetary expansion experienced lately. In 1972 this expansion was generated by a rapid rise in the net foreign assets of the banking system and also by the growth of bank credit to enterprises. The increases in net foreign assets in turn reflected mainly the growing trade surpluses, and also some inflow of short-term capital. These developments have been a matter of increasing concern and the authorities have taken a number of measures to restrain the monetary expansion.

The techniques employed have been geared to curb increases in primary liquidity by reducing the Central Bank's net domestic assets in order to compensate for the expansion generated by the increases in net foreign assets. The authorities have also endeavored to restrain in various ways the growth of such net foreign assets. The staff welcomes that debt management policies have been deliberately employed, apparently for the first time, in a truly compensatory sense. Although the budget remained in a fairly strong surplus position, bonds were issued in order to mop up liquidity by retiring government debt held by the Central Bank and by building up government deposit balances. On the monetary side, Central Bank lending has been curbed and, furthermore, liquidity has been absorbed by the introduction of the new instrument of ~~issuing~~ certificates of deposit by the Central Bank as a substitute for increases in legal reserve requirements against deposits which are virtually at their statutory maximum. As regards the rise in foreign assets, steps have been taken to reduce the inflow of short-term capital and some restrictions on payments for invisibles and on some outward transfers of capital have been or are considered to be relaxed. Consideration is also being given to gradually simplify and reduce certain incentives given to export industries. This policy should help to restrain increases in foreign assets and also facilitate achievement of the objectives of further improving the allocation of productive resources and increasing tax revenues. In this context the authorities keep in mind the importance of not braking the momentum developed over many years in the economy as regards exports.

Certain other measures have been geared to mitigate the impact of certain cost-push factors, in particular those stemming from developments abroad, that is, the general rise in world market prices of primary products and certain effects of the appreciation of the yen. As foremost among such adaptations in supply policies, the staff considers the recent substantial liberalization of imports and reductions in certain tariffs. Certain financial steps have been taken in order to facilitate the inflow of imports. In the staff's view both demand and supply policies have been in the right direction under the circumstances which have emerged.

The outlook for 1973 suggests that the general direction of financial and other policies should well remain the same for the time being. A large balance of payments surplus is again projected for 1973. This surplus may generate an increase in foreign assets only slightly less than experiened in 1972. Furthermore, the rapid increases in domestic prices may for various behavioral reasons gain a momentum of their own. Such developments would warrant, if not call for, a further strengthening of both demand and supply policies.

As regards monetary policy, the scope for reducing further the Central Bank's net domestic assets by reducing its loans appears to be rather limited as its domestic assets, both public and private, have come down to rather low levels. There may well be more scope for increasing Central Bank liabilities. Continued adaptations in fiscal management might usefully be geared to further accumulation of government deposits with the Central Bank. Efforts to place additional certificates of deposit with banks and other financial institutions would serve the same purpose. Treasury bills are an instrument competing to some extent with the newly created certificates of deposit; however, there is scope for the issue and placement of Treasury bills for the purpose of mopping up liquidity. In addition, further increases in the redeposit of savings deposits with the Central Bank would also contribute toward the same end and the scope for achieving this might usefully be explored. Consideration is being given to strengthen the recently introduced restraints on the inflow of short-term capital for conversion into local currency. Advancing import payments, and further reducing recourse to deferred import payments, would also be helpful.

There exists a certain dilemma as regards interest rates policy. Reductions in domestic interest rates to international levels appear a reasonable objective over the long run. Such reductions would also help in curbing inflows of short-term capital from abroad, although it might be kept in mind that domestic interest rates are not any more far out of line with international rates. Further reductions in the present situation of rather rapidly rising prices would tend to have certain unwanted effects. Given the relatively high interest rates and very low price increases during the last decade or so, the real rate of interest has, although declining somewhat, generally remained rather high. In 1972 the real rate of return dropped sharply to slightly over 1 per cent both as a result of reductions in nominal interest rates and increasing price rises. In the early months of this year, this real interest rate may well have become negative, a development which is likely to slow down the decline in the income velocity of money, if not actually raise it. Such a development clearly would complicate very much the pursuit of financial policies geared to reducing the rates of price increases. Furthermore, it would tend to erode savings habits which would have adverse effects on the financial climate for capital formation and economic development. As the staff considers the latter aspect of interest rate reductions more important in the current economic situation of China than the first one, it urges caution as regards further reductions in nominal interest rates as long as present circumstances prevail.

As regards offsetting the effects of foreign asset accumulation on liquidity, there appears to be scope for further sales of foreign exchange held by the Central Bank to banks and other financial institutions, and also to extend the range of foreign assets that may be held by banks. Encouragement to Chinese direct investment abroad appears compatible with both short- and longer-term objectives. A strong case can be made for liberalizing further certain restrictions on invisible transactions.

Success in implementing intentions to simplify and perhaps gradually reduce certain tax incentives, such as rebates of customs duties paid on imports to be used by export industries, should also be helpful. As regards supply policies, there appears to be considerable scope for further reductions in tariff rates and perhaps also for strengthening and speeding up the effects of the recently announced liberalization of imports. Controls of exports of certain commodities in short supply are part of these policies, but it is to be hoped that they will be a very temporary expendient.

Some, if not most, of these policies which are being considered at this time mainly from the viewpoint of meeting requirements of the current situation, i.e., slowing down the growth of liquidity and price increases, would also be helpful with respect to the attainment of the longer-term objectives of raising the efficiency of the economy and changing its structure.

Various efforts are being made to tackle some of the current problems by efforts to diversify China's external trade. This by and large may well be a legitimate and, in some respects, necessary objective. The staff notes, however, that it is not necessarily in the interest of any one country, nor of the world economy as a whole, to endeavor to achieve balancing of trade on a strictly bilateral basis.

V. Proposed Decision

The following draft decision is submitted for consideration by the Executive Directors:

1. This decision is taken by the Executive Directors in concluding the 1973 consultation with the Republic of China pursuant to Article XIV, Section 4, of the Articles of Agreement.

2. During 1972 economic growth continued at a high rate. Since about mid-1972 price increases tended to accelerate and toward the end of the year became a matter of concern. Both cost-push factors related mainly to external developments and demand pull factors due to substantial monetary expansion generated in large part by the external sector played a role. The Fund welcomes the authorities' efforts to restrain the growth of liquidity including the more active use of debt management and monetary policy and to take other measures to curb price increases and urges further strengthening of such policies.

3. The balance of payments strengthened further in 1972 with a growing current account surplus and some revival of net capital inflow. Exports and imports significantly exceeded expectations. Developments in the first part of 1973 suggest a continuation of these trends. Some of the policies adopted recently may have some counteracting effects. The Fund welcomes the authorities' continuing intention to adapt policies in the light of changing circumstances.

4. Both internal and external developments facilitated and warranted the recent substantial liberalization of restrictions on imports and some relaxation of restrictions on current payments. The Fund believes there still remains some further scope for moves in this direction which should be conducive to achievement of internal and external policy objectives.

APPENDIX

Fund Relations with China

China is an original member of the Fund and has a quota of SDR 550 million. During the Fifth General Review of Quotas, China indicated that it did not wish to have its quota increased. China completed its payment of the gold portion of its subscription to the Fund on August 14, 1970. An initial par value of NT$40 per U.S. dollar was established on September 4, 1970.

On December 20, 1971, China informed the Fund that the exchange rate of NT$40 per U.S. dollar would remain unchanged. This represented a decrease in the gold value of the New Taiwan dollar of 7.89 per cent. On May 8, 1972, this rate, which corresponds to NT$43.4286 per SDR 1, was agreed with the Fund as the new par value. On the same data, China notified the Fund that it availed itself of wider margins under Executive Board Decision No. 3463-(71/126), adopted December 18, 1971. On February 16, 1973, China communicated to the Fund a rate of 0.0218144 special drawing right per new Taiwan dollar to be a central rate in accordance with paragraph 2(a) of Executive Board Decision No. 3463-(71/126), adopted December 18, 1971. This rate, which corresponds to 38 new Taiwan dollars per one United States dollar and to 0.0193858 gram of fine gold per new Taiwan dollar, represents a decrease of 5.26 per cent from the present par value expressed in gold and corresponds to NT$45.8413 per special drawing right.

A gold tranche purchase of SDR 60 million was made on October 20, 1971. Present Fund holdings of New Taiwan dollars amount to 100 per cent of China's quota. China is a participant in the Special Drawing Account but opted not to receive an allocation.

The Fund has provided substantial technical assistance to the Chinese authorities in relation to the introduction of a sales tax, the drafting of a general banking law, the preparation of an operation manual for the Central Bank, and the management of public debt. Mr. Quinton from the fiscal panel was assigned for two one-year terms beginning in May 1971, to assist the Chinese Customs in the adoption of the Brussels Tariff Nomenclature. The services of Mr. Quinton have been extended for a term of six months with effect from May 4, 1973.

The last Article XIV Consultation with the Chinese authorities was held in Taipei during March 6-16, 1972 (SM/72/111, 5/22/72; SM/72/117, 6/5/72; and correction 1, 6/12/72). The Executive Board's decision, taken on June 14, 1972 was as follows (EBM/72/53-Decision No. 3679):

1. This decision is taken by the Executive Directors in concluding the 1971 consultation with the Republic of China pursuant to Article XIV, Section 4, of the Articles of Agreement.

2. During 1971 the growth rate continued at a high level and the price increase was moderate. Although the rate of expansion of money supply in 1971 was high mainly because of the accumulation of exchange reserves and the expansion of credit to the private sector and government enterprises, timely measures of credit control by the authorities kept the monetary expansion consistent with price stability. The Fund hopes that the authorities will continue their program of improvement of financial markets.

3. The balance of payments remained strong in 1971 as improvement in the current account offset some deterioration in the capital account. The high growth rate of exports was maintained despite a number of unfavorable developments abroad.

4. Although a number of steps were taken in 1970 and 1971 to liberalize restrictions on trade and current payments, this trend was interrupted in the latter part of 1971 as the authorities responded to uncertainties abroad. In view of the strong balance of payments and reserve position, the Fund believes that there is considerable scope for relaxing restrictions on trade and current payments and hopes that the present suspension of the liberalization program will be ended soon.

cc: Mr. Palmer

May 31, 1973

MEMORANDUM

TO: Mr. Tun Thin

FROM: Frank A. Southard, Jr.

SUBJECT: Viet-Nam--Resident Officer

Mr. Schweitzer and I have considered your memorandum of May 24 on the above subject. We agree that it should not be our purpose to provide a resident officer in Saigon who would be concerned with mobilizing multilateral aid. However, we have assured the Vietnamese authorities (and Mr. Schweitzer did so in his recent talk with President Thieu) that we would be prepared to send a Fund representative if we were requested to do so. It does seem to both of us that the terms of reference which you have indicated, namely, "to work on technical problems in the areas of monetary, fiscal and exchange policy", are rather narrow. We are not aware that we have given any such restricted terms of reference to the representatives we have in Cambodia and Laos. What I believe we would favor instead of the words, "to work on technical problems", would be something like the words, "to advise on problems arising".

cc: Mr. Goode
Mr. Mládek
Mr. Sturc

Mr. Mohammed May 31, 1973

J. B. McLenaghan

China - Recent Economic Developments

The economy grew in 1972 by about 11 per cent, only slightly less than the rate of growth in the previous two years. Industrial production increased at a record rate of more than 26 per cent. On the other hand, agricultural production increased little and was below expectations. After many years of price stability, price performance deteriorated sharply in the closing months of 1972 and early 1973, when the wholesale price index was 10 per cent ahead of a year earlier. Higher import costs played some part in domestic price developments, but there was also an element of demand pull, reflected in the sharply higher rate of growth of money supply, which by March 1973 was some 40 per cent greater than a year earlier. External developments were extremely favorable in 1972, when for the third successive year there was a substantial surplus (of almost SDR 540 million) in the balance of payments, compared with a surplus of SDR 220 million in the previous year.

Following the announcement on February 12, 1973 that the U.S. dollar was to be devalued, the New Taiwan dollar was devalued by 5.26 per cent from the par value, representing an effective over-all depreciation of a little more than 1 per cent. For the sake of flexibility the Chinese authorities established a central rate (rather than a par value) corresponding to NT$38 = US$1 (previously NT$40 = US$1).

Policy actions in late 1972 and early 1973 were almost wholly devoted to stemming the rate of price increase, and to ease the burden on domestic monetary management of rapidly rising foreign exchange holdings of the banking system. In September 1972, the Central Bank no longer approved short-term foreign currency loans for working capital purposes (although such capital could still enter China, but without the right to repatriation). Debt management policies were employed in a compensatory manner for the first time to absorb excess liquidity, and new credit instruments were introduced by the Central Bank for the same purpose. Fiscal performance remained sharply contractionary. Encouragement was given to importers to avoid reliance on foreign financing for their imports; in this respect US$400 million was made available by the Central Bank through the domestic banks for imports. And in a major trade liberalization measure in March 1973, the Government transferred 2,370 import items from the controlled to the permissible list, leaving only 460 items (of a total of about 15,000) on the controlled list, largely imports kept under control in most developed countries.

External debt increased in 1972 by SDR 230 million, a much faster rate than in the previous two years; more than half of the increase was in short-term debt. At the end of 1972, total outstanding external debt amounted to about SDR 1.3 billion, almost 80 per cent of which was medium-term and long-term. Debt servicing in 1973 is estimated at 6.5 per cent of exports of goods and services, a low proportion by international standards.

Mr. Ahrensdorf May 24, 1973

Donald K. Palmer

Staff Report on Republic of China

I have only two comments on the draft staff report for the 1973 consultation with the Republic of China.

First, I could find no mention in the staff appraisal of the "question of the appropriateness of the new exchange rate in the light of recent trends and prospective developments in the balance of payments" (the quotation is from page 7 of the briefing paper). It will be recalled that the decision to depreciate in February 1973 was seriously questioned by several members of the Executive Board, with the result that the Managing Director promised that the planned consultation would explore the adequacy of the current central rate and the liberalization program. There is good discussion of the liberalization efforts in the paper but, my impression is that the paper is virtually silent on the question of the adequacy of the rate. While in other times this might have been considered too sensitive an issue for comment in the paper, it was my understanding that in this case the Executive Board (and the Management) expected that the staff report would contain at least a brief analysis on this issue.

My second point relates to the absence of any text tables. I am well aware that we are all under pressure to keep the length of staff reports to manageable proportions but no one has suggested that this be done at the expense of text tables. Indeed, one frequently hears Directors praising reports which contain short but helpful text tables. I would have thought that this report should include a table on the balance of payments and on money and credit.

cc: Mr. Tun Thin

bcc: Mr. McLenaghan

Office Memorandum

TO : Mr. Sturc

DATE: May 15, 1973

FROM : J.B. McLenaghan

SUBJECT : China: Real wages

The following table may be of some assistance in assessing recent trends in real wages. Note that the data relate only to wages in the manufacturing sector.

Index of Real Wages in the Manufacturing Sector

(Jan. 1968 = 100)

		Increase (Per cent)
December 1968	109	9.0
December 1969	112	2.8
December 1970	123	9.8
December 1971	126	2.4
December 1972	132	4.8

Source: Data provided by the Chinese authorities during the 1973 Article XIV Consultation.

The staff team was told that the increase in real wages over the last four years was probably fairly close to, if not in excess of, the increase in productivity, at least in some sectors. In contrast, over the period 1952-68, the increase in real wages had been a good deal less than the rise in productivity.

An interesting comment provided outside of the consultation discussions was that maintaining a high rate of growth in the medium- to longer-term may depend to some extent on the policy towards increasing real income. On the basis of this argument, given that recent rates of growth in exports may not be sustained, it may be more appropriate for the authorities to seek to increase demand in the domestic market.

cc: Mr. Palmer
Mr. de Looper

Financial measures taken on April 1, 1973

Governor of the Central Bank announced on March 31, 1973 the introduction of the following measures for the purpose of moderating credit expansion and maintaining monetary stability. The measures became effective on April 1, 1973.

1. The suspension of accepting short-term loans which have to be repaid in less than one year and letters of credit with a year maturity from foreign banks and suppliers. After an advanced settlement of import foreign exchange, domestic importers and manufacturers may apply to appointed banks for new Taiwan dollar loan for settlement of the balance. The rate of interest charged by appointed banks in this connection is fixed at 7.5 per cent per annum. The terms of repayment is the same as for usance letter of credit.

2. Domestic manufacturers are required to import machinery and equipment on cash settlement basis, when the amount involved is under US$3 million with terms of repayment less than five years. After an advanced settlement of the 20 per cent of import foreign exchange, manufacturers may apply to banks for the financing of the 80 per cent. The rate of interest charged by banks in this connection is fixed at 7.5 per cent per annum. The other terms and conditions are similar to the "Procedures for Foreign Exchange Provided for purchasing machinery" published recently by the bank.

3. Margin requirements for opening letters of credits for imports were raised by 5 per cent, i.e. (1) 25 per cent for ~~r~~ S ight letter of credit, (2) 15 per cent for usance of L/C, (3) 20 per cent for import on installment payment basis, and (4) 15 per cent for import L/C financed by self-provided foreign exchange. But for the purpose of stabilizing prices, margin requirement for bulk imports ~~of~~ handled by MOEA remained at 10 per cent.

4. Outward remittances should be made upon expiration for approved working capital obtained from foreign sources. Extension could be made only with special approval of the Central Bank.

5. A 20 per cent discount is applied to export loans in accordance with the regulations governing such loans. Loans for machinery exports are not subject to the discount rule.

6. The Ministry of Finance will issue various kinds of bonds and Treasury bills, and the Central Bank will issue savings certificates for the purpose of tightening money supply. The details will be announced at a later date.

Source: Central Daily News, Taipei, Taiwan, China, April 1, 1973

Ban on D/A and D/P Import Acceptance Lifted

The Central Bank of China announced on May 3, 1973 the lifting of the ban on D/A and D/P imports. The bank has resumed accepting imports on a document acceptance (D/A) or document against payments (D/P) basis. The ban, which was intended to curtail the influx of short-term foreign capital, was introduced on March 31, 1973 together with some other measures. The Central Bank decided to lift the ban on D/A and D/P imports which accounted for nearly one-sixth of Taiwan's total imports in 1972.

57

The Central Bank of China

FOREIGN EXCHANGE DEPARTMENT
TAIPEI, TAIWAN
REPUPLIC OF CHINA

April 2, 1973

62FED-LO-0085

Mr. Ernest Sturc
Director
Exchange and Trade Relations Department
International Monetary Fund
Washington D.C. 20431
U. S. A.

Dear Mr. Sturc:

In compliance with the request contained in your letter of March 14, 1973, we are pleased to enclose herewith the draft of the Twenty-Fourth Annual Report on Exchange Restrictions with some proposed alterations which, we hope, will have your concurrence.

With assurance of our cooperation,

Sincerely yours,

YC

Y. C. Tso
Asst. General Manager

Encl.

COPY

Original Text	Proposed Alteration
page 1 footnote*	
New buying and selling rates for U.S. dollar were set at ... and ... per US$1, respectively.	New buying and selling rates for U. S. dollar were set at NT$37.90 and NT$38.10 per US$1, respectively.
page 2 lines 14-16	
...import applications and licenses are screened and issued by <u>11</u> appointed banks and their branches. Export applications are screened, and export permits issued, by <u>22</u> appointed banks.	...import applications and licenses are screened and issued by <u>15</u> appointed banks and their branches. Export applications are screened, and export permits issued, by <u>24</u> appointed banks.
page 4 line 16	
...; these goods do not require an import license.	...; these goods are automatically approved for an import licence.
page 4 lines16-21	
Imports normally must be settled on a sight letter of credit basis. End-users and traders with an export record of over US$500,000 a year, however, may contract imports of machinery and equipment or raw materials on documents against payment, documents against acceptance, or usance letter of credit terms, provided that interest charges are not included in the price.	deleted (effective August 26, 1972, traders may contract imports of commodities in permissible list on D/P, D/A or Usance letter of credit terms).
page 4 last line	
	(insert) The holder of an import licence is entitled to obtain the necessary foreign exchange from an appointed bank.
page 5 line 3	
... for all imports <u>not taking place on a deferred payment or consignment basis, i.e., for all imports under letter of credit or on documents against payment terms;</u>..	...for all imports under sight letter of credit; ;... (deferred payment, consignment basis, D/P or D/A do not require advanced settlement of foreign exchange)
page 5 lines 8-10	
Provided that the foregoing requirement ... from an appointed bank.	deleted (as it is the requirement for issuing letter of credit and not as a condition for allocating foreign exchange)
page 5 line 17	
Certain commodities <u>which still can be</u> financed with U. S. aid funds...	Certain commodities financed with U.S. aid funds....
page 5 line 23 - page 6 line 2	
...and a number of luxury goods and less essential items, such as certain Chinese luxury foods, cigarettes, cigars, liquor, jewelry, certain medicines, tea, sugar (and its substitutes), and molasses.	deleted (since January 1st, 1973, they are changed to be in controlled list)

page 5 line 8 require a bank guarantee.	require a bank guarantee. * *footnote Effective April 1, 1973 the requirements of the advanced settlement of foreign exchange for opening import L/Cs are as follows; sight L/C, 25% of the L/C amount; usance L/C 15%; L/C financed by self-provided foreign exchange, 15%; L/C under installment payment basis, 20%; and L/C of bulk import especially approved by Ministry of Economic Affairs, 10%.
page 6 lines 2-5 Liquor and cigarettes....of these commodities.	(This sentence should be moved out and inserted into page 6 line 12 after the word "Auction".)
page 6 line 17 the corresponding figures were...prohibited, ...controlled, and ...permissible.	the corresponding figures were 14 prohibited, 2013 controlled, and 9557 permissible and 11584 in all.
page 6 * remark	The tenth edition of the classification of Import and Export Commodities of the Republic of China was put into effect at the beginning of 1973, and the corresponding figures classified as follows: 14 prohibited 2864 controlled 12383 permissible 15261 in all. Effective March 16, 1973, the corresponding figures were as follows: 13 prohibited 461 controlled 14787 permissible and 15261 in all.
page 7 lines 4-6 On December 31, 1971, the procedure applied to some 30 items, and on December 31, 1972 to ....items.	deleted
page 7 line 13 Speciall regulations apply to some 7 commodities normally imported in bulk shipments and imports of which exceed 40,000 metric tons a year,	Specially regulations apply to 4 commodities normally imported in bulk shipments.
page 7 line 12 .....items	3955 items
page 7 line 19-21 Commercial imports handled by government trading agencies include chemical fertilizers, tinplate, crude oil, and automobiles.	The import of crude oil is confined to Chinese Petroleum Corp.
page 7 foot-note 7/ Including soybeans, wheat, barley, corn, sorghum, rapeseed, and raw cotton.	Including soybeans, wheat, barley, corn.
page 8 lines 7-9 ...and be registered by the Taiwan Provincial Department of Reconstruction or the Reconstruction Department of Taipei City	deleted

page 8 line 10	... ave a minimum capital of NT$200,000 and	have a minimum capital of NT$500,000. (Effective as from Oct. 31, 1972)
page 8 line 11	....more than US$50,000 for the last two years.	...more than US$100,000 for the last year. (Effective as from Oct. 31, 1972)
page 8 line 13-14	They also must be approved by the Board of Foreign Trade.	They also must be registered by the Board of Foreign Trade.
page 9 line 2-4	In certain....resources.	deleted (as cancelled on March 16, 1973)
page 10 line 18	US$2,400 a year in the subsequent academic years.	US$2,400 a year in the subsequent 2nd to 5th academic years.
page 11 line 18	...on the export of canned mushrooms.	...on the export of canned mushrooms and asparagus.
page 12 lines 1-2	export of cotton textiles to Canada, Italy, the United Kingdom, the United States, and the Federal Republic of Germany.	export of textile to Canada, the United States, and the member countries of EEC.
page 12 line 15	value of US$100 may....	value of US$200 may... (effective as from March 7, 1973)
page 12 line 17	US$100 without providing evidences...	US$200 without providing evidences.... (effective March 7, 1973)
page 13 line 20-21	...calculated in relation to the originally invested funds;	...calculated in relation to the invested funds;
page 16 line 5-8	Travelers may bring in any amount of gold; other imports of gold, including imports for investment purposes, require Central Bank approval and are not normally permitted.	Travelers may bring in any amount of gold, but have to declare upon entry if it exceed 5 shin liang, i.e. 156.25 grams; other imports of gold are not permitted.
page 16 last line	...by less than 10 per cent.	...by less than 10 per cent; (continued) where the commodities or substitutes are produced domestically and where they are produced locally of good quality and in sufficient quantity to domestic demand.
page 17 lines 14-15	..., for all currencies for which the latter quoted spot rates, with the exception of the U. S. dollar.	deleted

MARCH 24 1973 VIA ITT WORLD COMM

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MR FRANK A SOUTHARD JR

INTERFUND

WASHINGTONDC(USA)

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REURLET MARCH THIRTEEN I TAKE GREAT PLAEASURE TO WELCOME THE TEAM'S VISIT REGARDS

KT LI MINISTER OF FINANCE

COL MR FRANK A SOUTHARD JR INTERFUND
WASHINGTONDC(USA

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EXCHANGE & TRADE RELATIONS DEPARTMENT

cc: Mr. McLenaghan

MAR 13 1973

Dear Mr. Minister:

As agreed with Mr. Martin Wong we propose to hold the 1973 Article XIV consultation discussions in Taipei from April 11 to 20, 1973.

The Fund staff team for the discussions will consist of Mr. J. Ahrensdorf, Assistant Director, Mrs. Hui-Chen Wu Yang, Economist, Far Eastern Division, of the Asian Department, Mr. John B. McLenaghan, Economist, Exchange and Trade Relations Department, and a secretary.

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

Sincerely 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

cc: MD
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cc: Mr. Martin Wong

JA/cu/2/27/73

OFFICIAL **OUTGOING MESSAGE** OFFICIAL

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WASHINGTON D.C.

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SPECIAL INSTRUCTIONS

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EBS/73/56 (2/17/73)

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To: ~~His Excellency~~
The Minister of Finance
~~Ministry of Finance~~
Nanchang Street
Taipei, Taiwan, Republic of China

Exeuutive Board took following decision February 17, 1973:

QUOTE

1. The Government of the Republic of China has communicated to the Fund a rate of 0.0218144 special drawing right to one new Taiwan dollar to be effective as a central rate as of February 16, 1973, local time. This rate corresponds to 0.0193858 gram of fine gold per new Taiwan dollar, 1,604.45 new Taiwan dollars per troy ounce of fine gold, and to 45.8413 new Taiwan dollars per special drawing right.

2. The Fund notes the central rate communicated by the Government of the Republic of China and that it continues to avail itself of wider margins under Executive Board Decision No. 3463-(71/126) dated December 18, 1971.

UNQUOTE

Hebbard
Interfund

Drafted by ~~PHonohan/ag~~

Department ~~Secretary's~~

Date 2/17/73

AUTHORIZATION

Signature
W. Lawrence Hebbard

Second Signature When Required

FOR CODE ROOM

Time Received 7:30 P.M.
Time Dispatched 8:47 P.M.
Number of Words 136
Log 182765
Route RCA
Operator PD

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FEB 16 1973 VIA ITT WORLD COMM

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cc: MR PALMER
MR DE LOOPER
MRS TYLER

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MR PIERRO-PAUL SCHWEITZER THE MANAGING DIRECTOR

INTERFUND

WASHINGTONDC20431(USA)

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EXCHANGE & TRADE RELATIONS DEPARTMENT

PURSUANT TO PARAGRAPH 2(A) OF EXECUTIVE BOARD DECISION NUMBER 3463-(71/126) COMMA ON CENTRAL RATE COMMA EYE HEREBY COMMUNICATE TO THE FUND A RATE OF 0.0218144 SDR TO ONE NEW TAIWAN DOLLARS AS A CENTRAL RATE TO BE EFFECTIVE AS OF FEBRUARY 16 1973 TAIPEI TIME STOP THIS RATE CORRESPONDS TO US

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E OF ABOVE MENTIONED BOARD DECISION DECISION
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COL ETAT MR PIERRE-PAUL SCHWEITZER THE MANAGING DIRECTOR
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cc Mr. Palmer
Mr. ... Loser

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MR TUN THIN

DIRECTOR

ASIAN DEPT

INTERFUND

WASHINGTONDC

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MANY THANKS FOR YOUR CABLE OF FEBRUARY 13 STOP MY GOVERNMENT HAS DECIDED TO CHANGE THE EXCHANGE RATE FROM NT DOLLAR 40 EQUAL ONE US DOLLAR TO NT DOLLAR 38 EQUAL ONE US DOLLAR EFFECTIVE FEBRUARY 16 1973 STOP OUR MINISTRY

RECEIVED FEB 15 1973 EXCHANGE & TRADE RELATIONS DEPARTMENT

OF FINANCE WILL OFFICIALLY CABLE IMF REQUESTING CENTRAL RATE BE CHANGED THIS AFTERNOON STOP REGARDS

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cc: Mr. Palmer
Mr. de Larosière

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MR PIERRE-PAUL SCHWEITZER THE MANAGING DIRECTOR INTERFUND WASHINGTONDC20431USA

SUBSEQUENT TO DEVALUATION OF US DOLLAR BY TEN PERCENT IN RELATION TO SDR ON FEBRUARY 12 1973 COMMA THE GOVERNMENT OF THE REPUBLIC OF CHINA HAS DECIDED TO CHANGE THE CENTRAL RATE OF THE NEW TAIWAN DOLLAR EFFECTIVE FEBRUARY 16 1973

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EXCHANGE & TRADE RELATIONS DEPARTMENT

FROM 0.0230263 SDR TO ONE NEW TAIWAN DOLLAR TO 0.021844 SDR TO ONE NEW TAIWAN DOLLAR STOP THIS RATE CORRESPONDS TO US DOLLAR ONE EQUIVALENT TO NT DOLLARS THIRTYEIGHT STOP YOUR CONCURRENCE IS SOLICITED KT LI MINISTER OF FINANCE ROC

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cc: 342945 File
Mr. McLenaghan

MINISTRY OF FINANCE
REPUBLIC OF CHINA

Office of the Minister

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February 6, 1973

Mr. Pierre-Paul Schweitzer
The Managing Director
International Monetary Fund
19th & H Streets, N.W.
Washington, D.C. 20431
U. S. A.

Dear Mr. Schweitzer:

With the old year already run out and the new year ushered in, it is again the time for business and industry to take stock of things past and map out their strategies for the months ahead. Since current performance of our economy and its future prospects are matters of concern to you and your associates, I feel certain that you would like to keep abreast of how we have fared and are faring here in the Republic of China.

Economically, 1972 continued to be a magnificent year for this country. Real growth of gross national product was 11.0 per cent and that of per capita income, 7.5 per cent, according to preliminary estimates. Particularly noteworthy was the performance in trade and industrial production. Both sectors had moved ahead at a record-breaking pace, registering an increase respectively of 42.9 per cent and 26.2 per cent over a year ago.

But while we have addressed ourselves to the promotion of industrialization, fresh efforts are being made to reinvigorate our agriculture, with a new NT$3.8 billion rural reconstruction program scheduled for implementation in the first two years under the current four-year (1973-76) economic development plan.

Increasing emphasis is also being laid on improvement of infrastructural facilities and development of manpower, as demands on these two sectors are rising rapidly as a result of the fast expansion of production and trade. You must already have been informed, of course, of the renewed efforts made by my government under the leadership of Premier Chiang Ching-Kuo to improve public administration, promote social justice and make the government machinery more responsive to the needs of the masses as well as of business and industry.

And I am happy to inform you that, irrespective of whatever is taking place on the international political scene, no letup in the momentum of our rapid economic growth has been predicted for the foreseeable future. For the current year, a forecast made by the Institute of Economics of the Academia Sinica puts the economic growth again at a highly satisfying rate of 11 per cent.

I am enclosing here a copy of the January issue of "Taiwan Industrial Panorama", which contains some very important statistics of interest to you. If there is any other information you should like to have, please feel free to communicate with me and I will be happy to provide it.

Finally, let me assure you of our deep appreciation of your active interest in our economic development and our readiness to continue to work closely with you for our mutual benefit.

With the compliments of the season,

Sincerely yours,

K. T. Li

K. T. Li
Minister of Finance