FOR AGENDA

SM/84/221
Supplement 1

CONTAINS CONFIDENTIAL
INFORMATION

November 1, 1984

To: Members of the Executive Board

From: The Acting Secretary

Subject: People's Republic of China - Staff Report for the 1984 Article IV Consultation

The attached supplement to the staff report for the 1984 Article IV consultation with China has been prepared on the basis of additional information.

This subject has been tentatively scheduled for discussion on Wednesday, November 7, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. De Wulf (ext. (5)7343).

Att: (1)

Other Distribution:
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INFORMATION

INTERNATIONAL MONETARY FUND

PEOPLE'S REPUBLIC OF CHINA

Staff Report for the 1984 Article IV Consultation
Supplementary Information

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Contents

I. Economic Reforms

On October 20, 1984, the Central Committee of the Communist Party of China issued a Decision on the Reform of the Economic Structure (issued as EBD/84/277). This document contains broad guidelines for the continuing implementation of the economic reforms, first introduced in December 1978. When these reforms were originally launched, following a decision by the Central Committee, no such accompanying guidelines were issued. Since then, the various reform measures have been introduced step by step, often on an experimental basis. The issuance of this Decision by the Central Committee reflects the resolve of the authorities to pursue the reform policy; it is an assurance of continuity which should assist implementation of the reform measures at the local level. Publication of this Decision signifies, therefore, that the economic reforms are to be regarded as a comprehensive, ongoing undertaking, backed by the full authority of the Central Committee.

During the mission to China in July-August 1984, the staff held extensive discussions with the authorities on both the general orientation of the reform and on many of the specific measures that have now been published in the Decision. The content of these discussions was incorporated in both the Staff Report and the Recent Economic Developments paper (SM/84/221 and SM/84/229). The Decision provides greater detail on some of these reform measures and announces the implementation of some previously postponed measures. In particular, the basic political decision has now been made to proceed with the price reform. Although the Decision does not provide a timetable for the introduction of the newly-announced measures, it states that these measures should be largely in place within five years.

This confirmation of the authorities' strong intention to proceed with the reforms must be warmly welcomed. The presentation below highlights the essential points of the Decision.

1. Focus of the future reform

The intent of the reform is to build on the system of public ownership of factors of production while adjusting to the present-day conditions in China. As the reform in the rural areas is basically completed, the emphasis will from now on be on the urban areas, where productivity is low and the incentive system inadequate.

2. Planning

The Central Committee's Decision states that under present circumstances, it is impossible to plan all economic activities and implement planning through administrative orders alone. In the future, planning will concentrate on broadly outlining the direction the economy should take, and will rely increasingly on macroeconomic policy instruments, such as prices, taxes, credit, profits, and wage differentials. Mandatory planning will be restricted to major products that have a direct bearing on the economy as a whole, and on the living standards of the population; other economic activities will either be guided by macroeconomic instruments combined with indicative planning, or simply by market forces. In a separate statement, the State Planning Commission has announced that the number of products under central state planning will be reduced from 120 to 60 for industrial goods and from 29 to 10 for agricultural and sideline products. The central plan will include output targets for energy, rolled steel, cement, basic raw materials for the chemical industry, and synthetic fiber. Agricultural targets will include those for cereals, cotton, edible oil, tobacco, jute, pigs and some aquatic products.

3. Enterprise management

The move toward giving enterprises greater autonomy will be accelerated; they will be given greater responsibility for their own profits and losses. Government departments will no longer manage enterprises directly. Although appointed by higher authorities, managers will assume full responsibility for the operations and the results of their enterprises. So that they may more effectively exercise this responsibility, they would be given greater authority in determining personnel policies and in pricing and marketing their output.

4. Competition

Enterprises are urged to compete among themselves, and thus to be subject to consumer preferences; this could mean that some enterprises will not be able to survive. Barriers to trade between different areas will be abolished, and state enterprises will have to compete with collective enterprises and private entrepreneurs.

5. Prices

The price system will be reformed. According to the Central Committee Decision, the present price system makes it difficult to assess enterprise performance correctly, hampers the introduction of technological advance and the rationalization of the production mix, and distorts consumption patterns; as a result, it complicates the implementation of the ongoing economic reform. To remedy this situation, the scope of the state-fixed prices will be gradually reduced, while that of floating prices and market-determined prices will be enlarged. Consumer subsidies will be gradually eliminated, but not at the expense of real incomes. In fact, as productivity increases, real incomes are expected to continue to increase. The price reform will entail both price increases and price reductions, but no details are provided. It is the firm intention of the authorities to prevent the price reform from leading to an acceleration of inflation. In the staff's view, the successful pursuit of this intention will require adherence to a policy of financial restraint.

6. Wages and employment

Enterprises are already authorized to link the amount of bonuses given to their workers with the profitability of the enterprise, and the ceiling on these bonuses has recently been abolished. In the future, this link between enterprise performance and bonuses will be strengthened. In addition, the wage structure itself will be adjusted, allowing greater differentiation between wages in various occupations, so as to better reflect the qualifications, skills, and effort required. The wage system in government organizations will also be reformed so as to better link wages with responsibility and performance.

Enterprise managers would be given greater freedom in the recruitment and dismissal of workers. As the state sector will not be able to guarantee automatic employment to all workers in the future, both the collective sector and individual enterprises are encouraged to provide additional employment.

7. Private sector

The private sector's importance in complementing the activities of the state and collective sectors is now fully recognized, not only as a provider of employment, but also as a supplier of essential goods and services; its ability to adjust quickly to the shifting demand of the market, without reliance on state support and intervention, is recognized. The private sector will also be invited to lease small state-owned enterprises, or run them on a contract basis.

8. Policy of opening up to the outside world

Opening the country to the outside world is a fundamental long-term state policy, one that will continue to rely on flexibility in dealing with foreign investors. The favorable treatment of direct foreign investment in the Special Economic Zones and the investment regimes being provided to foreign investors in the 14 coastal cities are essential elements of this policy.

II. Recent Economic Developments Update

1. Developments in production and distribution

Information received since the issuance of the Staff Report and the Recent Economic Developments paper confirms that national income and its components are evolving in line with the staff's earlier projections. During the first nine months of 1984, industrial production rose by 12.5 percent over the same period last year, with light industry rising by 12.0 percent and heavy industry by 12.9 percent. The growth in light industry continued to be backed by rapid expansion in personal income. The growth of heavy industry continued to be supported by rapidly rising investment; investment in capital construction rose faster than planned. Growth in energy output, though still lagging behind industrial production, continued the accelerated trend of recent years; coal production was up 9.8 percent, oil, 7.3 percent, and electricity, 7.2 percent. Agricultural production also appears to be broadly in line with the staff's estimate of a 6 percent growth for 1984. Grain production is now estimated at 400 million tons, 3.3 percent more than last year. Cotton output is estimated to grow by 8 percent. Because of the rapid growth in both light industry and agriculture, retail sales grew rapidly, and during the first eight months of the year were 12 percent higher than during the same period of 1983.

Enterprise performance has improved during the first half of the year, compared with the same period last year. The losses of state-owned industrial enterprises dropped by 26 percent, and the number of loss-making enterprises fell from 23 percent of the total to 17 percent. Losses of state-owned commercial enterprises fell by 3 percent.

2. Financial developments

Because of the improved performance of the enterprise sector, contributions to the budget rose rapidly, and the targets for budgetary revenue will most likely be exceeded. In the area of monetary policy, new measures were recently announced for implementation in 1985. The redeposit requirements that were imposed on the specialized banks when the Central Bank was established at the beginning of 1984 will be lowered, and differential interest rates on the specialized banks' deposits with and loans from the Central Bank will be introduced. No specifics are available at this time. These measures were discussed during the staff's visit to China. Previously, as the result of the high redeposit requirements, the specialized banks required continuous advances from the Central Bank. However, the authorities have recognized that such continuous recourse was not necessary to assure the implementation of the desired credit policy, and the redeposit requirements have consequently been reduced. The differential interest rates are designed to strengthen credit control by discouraging borrowing by the specialized banks.

3. Exchange rate arrangements

At the time of the issuance of the Staff Report, the margin between the official exchange rate and the internal settlement rate had dropped to 8 percent, down from the 80 percent that prevailed when the internal settlement rate was introduced in January 1, 1981. The official exchange rate depreciated further to Y 2.708 per U.S. dollar by October 16, narrowing the margin to 3.4 percent; it has since appreciated to Y 2.667 per U.S. dollar on October 30, widening the margin to 5 percent.

III. Outline of the Seventh Five-Year Plan (1986-1990)

A special meeting of delegates of the Communist Party will be convened in September 1985 to discuss and adopt the essentials of the Seventh Five-Year Plan (1986-1990). The broad outlines of this Plan, which have just been announced, are summarized below:

1. Agriculture will continue to receive priority. However, now that the food problem is largely solved, efforts will be made to diversify crops according to market demand, and to stimulate the breeding of livestock and poultry, so as to improve the people's diet.

2. The energy sector will be further developed with an emphasis on electricity production. In the immediate future, the heaviest reliance will be on thermal power plants, but hydropower is expected to play a larger role in the medium term. Nuclear power stations will also be developed, but as a supplementary source of energy. By 1990, coal supply should reach 900 million tons (25 percent higher than in 1983), while oil production should reach 150 million tons (50 percent over 1983).

3. In the sector of transportation, trunk lines for railroads will be given priority, although efforts to develop other transportation lines will be continued.

4. The consumer goods sector will be especially stimulated. Past policies that relied on controlling consumption in the face of a supply shortage, will be replaced by a policy aimed at encouraging production. Special attention will be paid to food processing, electrical home appliances, motor vehicles, motorcycles, and the building industry.

5. The emphasis in investment will continue to be on the renovation of existing productive capacity, rather than on the construction of new capacity.

6. The industrial structure will be adjusted, giving greater emphasis to new technology, research and the service sector.

7. Higher education will receive priority, and the Plan anticipates expanded spending on colleges and universities.

8. Foreign trade will be expanded further, and foreign borrowing will be increasingly relied upon. Imports of new technology will expand faster than during the 1980-85 period; particular attention will be paid to the purchasing of patents, joint design, and co-production.