SUR/84/110

CONFIDENTIAL

November 15, 1984

The Chairman's Summing Up at the Conclusion of the 1984 Article IV Consultation with the People's Republic of China Executive Board Meeting 84/162, November 7, 1984

Directors expressed their admiration for the remarkable achievements of the Chinese economy in recent years. Income growth in 1983 and 1984 had been again impressive, permitting a substantial improvement in both urban and rural living standards. The recorded rate of price increases had remained low. The balance of payments continued to be strong, despite an unfavorable world economic situation and a strong growth of imports, and external reserves had risen to a comfortable level. Fiscal policies had remained cautious, and budget deficits had been kept to a level well below 2 percent of GDP, of which less than half had been financed by the banking system. Directors noted, however, that there were indications of excess demand pressures and that shortages and bottlenecks continued in some areas.

Directors welcomed the reform measures introduced in recent years, and expressed appreciation of the pragmatism and flexibility shown by the authorities. They recognized the contribution of the reforms to stimulating production by forging a stronger link between the efforts of peasants and workers and the rewards received by them. Reforms had, thus far, been most extensive in the rural areas, where production and distribution were now regulated by contracts between the peasants and the communes, and where the results, in terms of output growth, had been most impressive. Directors welcomed the recent decision of the authorities to proceed with further reforms, concentrating on the urban economy. They supported the authorities' resolve to reduce the scope of mandatory planning, to extend the roles of indicative planning and market forces, to strengthen incentives, and to provide greater autonomy to state enterprises. The intentions to encourage competition and give greater scope to the private sector were also welcomed. At the same time, it was observed that the scope of mandatory planning in industry and agriculture would remain important.

Directors noted that, despite the generally favorable developments, the economy still faced a number of difficulties, and that economic success, by itself, created new problems. Foremost among the challenges were the low level of enterprise efficiency and a somewhat distorted price structure. The authorities' determination to tackle those problems was greatly welcomed. Success in those efforts would benefit budgetary revenues, which were heavily dependent on enterprise profitability. A number of Directors stressed that the reabsorption of excess labor arising from increased productivity in the course of economic reform constituted a major challenge to the authorities.

Another area of concern noted by Directors was the continuation of excess demand pressures, leading to shortages, delays in project implementation, and unauthorized price increases. A number of Directors found it difficult to pass judgment on the question whether recent growth rates in liquidity might have been somewhat excessive. However, the priority attached by the authorities to the avoidance of inflation argued for a cautious monetary policy, which required limiting credit expansion to a rate reasonably in line with the growth of production, taking into account the increasing monetization of the economy. In that context, Directors noted that it was difficult to gauge how much further the reduction in the velocity of circulation could be expected to go. Directors believed that a cautious monetary policy would be an essential complement to the proposed price reform and to measures granting increased financial responsibility to enterprises. They also believed that, in light of recent increases in the proportion of total savings generated in the household and enterprise sectors, development of new savings instruments and means of financial intermediation would contribute to a better allocation of investment resources. The recent division of the central banking and the commercial functions of the People's Bank of China had established the basis for the development of the necessary monetary instruments to regulate credit expansion. In that connection, Directors welcomed the recent announcement of differential interest rates on the specialized banks' deposits with and loans from the People's Bank. They agreed with the staff's suggestion that additional sales of treasury bonds could contribute to the containment of liquidity growth. Directors also welcomed the greater use of macroeconomic measures to increase the share of investment financed by the Central Government. They agreed on the need to ensure adequate financing for priority projects, which in previous years had borne the brunt of measures to restrain demand.

Directors welcomed the recent decision to initiate a price reform that would considerably expand the scope of flexible and market-determined prices. They stressed that an appropriate price system was indispensable to the success of other elements of the reform process. To provide appropriate signals to enterprises, the system should yield prices that reflected both costs of production and relative shortage, and that were more in line with prices prevailing internationally. They also welcomed the decision to reduce subsidies through price adjustments. Several Directors noted that a price reform was a delicate matter that could only be put into place gradually; nevertheless, they emphasized the substantial benefits that early action could bring. Many Directors observed that the present favorable economic situation provided a timely opportunity for tackling price and subsidy problems. It was also observed that improvements in the quality and timeliness of the price indices would assist the authorities in the early identification of incipient inflation.

More generally, Directors commented on the multiple linkages between the various aspects of the reform process, which made it a complex task for the authorities to move forward in a balanced and coherent manner. They stressed the need to develop more diversified macroeconomic tools in

addition to the fundamental price reform. In that context, they noted that the prospective substantial impact of the reforms on budgetary revenue and expenditure called for continuous cautious fiscal policies in the coming years.

Directors noted that the balance of payments position was strong, despite the marked increases in imports since 1983. They commended the authorities for their policies of gearing the expansion of imports to the absorptive capacity of the economy and to the alleviation of supply bottlenecks. Some Directors believed that, in conjunction with the price reform and considering the present high level of reserves, there was scope for a prudent further expansion of imports in the short term. Directors welcomed the new measures to attract foreign direct investment, as such investments could play an important role in attracting foreign savings, technology, and managerial skills.

The internal settlement rate used for foreign trade transactions had been introduced in 1981 on an experimental basis, Directors noted. It had not been changed since, and remained a temporary measure that was under active review by the authorities. Directors observed that the differential between the official exchange rate and the internal settlement rate had gradually narrowed to about 5 percent, and a number of Directors expressed the hope that the authorities would seize the present opportunity to unify the exchange rate. Directors endorsed the view that the selection of an exchange rate system that corresponds to China's needs was an important complement to the price reforms.

Directors welcomed the improvements in statistics supplied for Fund publications and for the consultation reports. They supported the ongoing efforts of the authorities and of the staff to improve statistics further and to broaden the coverage of Chinese data in Fund publications.

It is expected that the next Article IV consultation with China will be held on the standard 12-month cycle.