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September 27, 1985

To: Members of the Executive Board

From: The Acting Secretary

Subject. People's Republic of China - Staff Report for the 1985  
Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with the People's Republic of China, which has been tentatively scheduled for Executive Board discussion on Friday, November 2<sup>nd</sup>, 1985. A draft decision appears on page 25

Mr. Saito (ext. 7365) or Mr. Fetherston (ext. 8761) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

PEOPLE'S REPUBLIC OF CHINA

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives for the  
1985 Consultation

Approved by P. R. Narvekar and Manuel Guitian

September 26, 1985

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## I. Introduction

Staff discussions for the 1985 Article IV consultation with China were held in Beijing from July 19 to August 2, 1985. The Chinese delegation was led by Mr. Shang Ming, Advisor to the People's Bank of China and member of its Council, and Mr. Che Peiqin, Director of the International Department and also member of the Council. It included representatives of the following institutions: the People's Bank of China, the Ministries of Finance, Foreign Affairs, Foreign Economic Relations and Trade, Commerce, Labor and Personnel, the State Commission on Restructuring the Economic System, the State Planning Commission, the State Economic Commission, the State Statistical Bureau, the State Price Bureau, the Bank of China, the Industrial and Commercial Bank of China, the Agricultural Bank of China, and the People's Construction Bank. The staff team <sup>1/</sup> also met with Mme. Chen Muhua, Governor of the People's Bank of China and member of the State Council. Mr. Zhang Zicun, Executive Director for China, participated as an observer.

## II. Background

China's economy has been undergoing dramatic changes since the economic reforms were begun in 1979. The ongoing reforms are transforming the economic system and have already brought substantial benefits in terms of rapid economic growth and better living standards. At the same time, the shift to more decentralized economic decision making and greater reliance on market forces has given rise to new problems for macroeconomic management and has necessitated the development of new policy instruments.

The reforms were begun in the rural areas and are now being extended to the urban economy. The agricultural system has already shifted almost completely to production arrangements based on individual households rather than on collectives; the incentives and production autonomy given to individual farmers have been greatly increased. In industry, state-owned enterprises are being given greater independence in the organization of production, the purchasing of inputs, and the disposal of output, and have been allowed to retain a larger share of their profits. A system of enterprise income taxation has recently replaced the requirement that profits be turned over to the state. In commerce, administrative barriers to the internal movement of goods have been substantially reduced, and a large number of state shops and restaurants have been turned over to collective and individual operation. The conduct of foreign trade business has been partly decentralized, and some large enterprises have been permitted to engage directly in foreign trade.

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<sup>1/</sup> Messrs. Narvekar, Saito, Fetherston, Sassanpour (all ASD), Hino (ETR), Goldsbrough (RES), and Miss Rosario (ASD).

In October 1984, the Chinese authorities issued a Decision on the Reform of the Economic Structure aimed at strengthening the momentum of the reforms (EBD/84/227, 10/29/84). The major points of the Decision were: the scope of mandatory planning was to be further reduced in favor of indicative planning to be implemented by indirect policy instruments acting primarily through market mechanisms; the expansion of enterprise autonomy was to be accelerated and the financial accountability of enterprises increased; the links between wages and both individual and enterprise performance were to be strengthened; and the policy of opening the country to the outside world was to be continued. Also, the price system would be reformed to provide better resource allocation signals, but the price reform would not be allowed to lead to an acceleration of inflation or a deterioration in living standards.

The reforms have entailed major changes in the system of macro-economic management. The role of administrative controls has declined and the importance of policy tools relying on market mechanisms has increased. The organizational structure of the banking system has been changed and, at the beginning of 1984, the People's Bank of China was transformed into a separate central bank. The relative importance of the banking system as a channel for investment funds has increased while that of the budget has declined, and interest-bearing loans have largely replaced budgetary grants. New taxes have been introduced to influence enterprises' investment expenditures and wage payments. Despite these changes, administrative directives still play a significant part in macroeconomic management, and in recent years the authorities have continued to rely on the tightening of administrative controls as well as using more market-oriented policy tools when faced with internal or external imbalances.

The response of the economy to the reforms has been striking. A rapid growth of agricultural output and rural incomes in turn stimulated the growth of industry; as a result, the growth rate of real national income averaged 7 percent per annum during 1979-83 and accelerated to 14 percent in 1984. Partly reflecting the system of price controls, the recorded rate of inflation generally remained low; after temporarily accelerating to about 8 percent in 1980, the official cost-of-living index registered annual increases of 2-3 percent over the period 1981-84. Surpluses on both the current account and the overall position of the balance of payments were recorded in every year of the period 1981-84. International reserves reached a peak of \$18.1 billion (nine months of imports) in July 1984, and total external debt and the debt service ratio remained low; the latter was only 3 1/4 percent of exports of goods and services in 1984.

The economy remains, of course, subject to numerous weaknesses. Supply and demand for many commodities are still mismatched, largely because of distortions in the price system. Various shortages and bottlenecks--particularly of energy, certain key raw materials, and

transportation--have persisted for many years, while excessive inventories of some other commodities--especially certain low-quality consumer goods--have been accumulated; there is also a large unsatisfied demand for imports. The efficiency of many industrial enterprises remains low; rates of energy and raw material use are generally high by international standards and factor productivity is often low, because of earlier emphasis on capacity-expanding investment rather than on increased efficiency and technological improvements. Also, the emphasis of previous years on local self-sufficiency has frequently resulted in the establishment of a large number of fairly small production facilities, with a consequent loss of economies of scale. The service sector is still relatively undeveloped and, despite recent progress, the storage and distribution systems for agricultural products, industrial inputs, and consumer goods are often not adequate to meet the needs of the more productive and more market-oriented economy that is evolving.

Moreover, the present economic system, which is the outcome of ongoing but still incomplete reforms, is subject to certain excess demand pressures. The greater decentralization of financial resources and decision making has heightened pressures to increase wages and investment. At the same time, because of the lack of adequate financial constraints on enterprises and the continuation of an inappropriate structure of relative prices, it is difficult to contain these pressures with the new, indirect tools of macroeconomic management. These problems form the background to the emergence of serious macroeconomic imbalances toward the end of 1984.

The development of macroeconomic policy instruments has increased the importance of accurate and comprehensive economic and financial statistics. Significant improvements have been made in recent years, although some weaknesses remain. In addition, recent data, particularly those relating to output and the balance of payments, are still preliminary.

### III. Developments Since the Last Consultation

#### 1. The last consultation

During the last consultation held a year ago, there was a broad measure of agreement among Executive Directors on the following four points:

- the decision of the authorities to proceed with further reforms, including a reduction in the scope of mandatory planning and an increased role for market forces, was welcome;

- the decision to initiate a price reform that would considerably expand the scope of flexible and market-determined prices was welcome; an appropriate price system was indispensable to the success of other elements of the reform and early action could bring substantial benefits;
- the priority attached by the authorities to the avoidance of inflation argued for a cautious monetary policy, which would also be an essential complement to the proposed price reform;
- adoption of an exchange rate system that corresponded to China's needs, and a strengthening of links between international and domestic prices, was also an important complement to the price reform; the recent narrowing of the differential between the official exchange rate and the internal settlement rate provided an opportunity to unify the two rates.

## 2. Recent economic developments

Since the last consultation, the implementation of economic reforms has continued, with particular emphasis on reducing the scope of mandatory planning and strengthening incentives. Some further steps have been taken to promote greater price flexibility and to adjust administered prices, mostly of agricultural products. As already noted, economic growth was remarkably rapid during 1984, and it remained at a high level during the first half of 1985. However, rapid increases in investment expenditures and wages, brought about in part by reduced central controls and an accommodating expansion of bank credit, caused substantial excess demand pressures beginning in late 1984. Inflation began to accelerate; bottlenecks in transportation and electricity supply worsened; and shortages of key raw materials, including steel and timber, became tighter despite greatly increased imports. The growing excess demand pressures also contributed to a sharp deterioration in the external payments position since mid-1984.

Real national income grew by 14 percent during 1984 and its growth continued at that pace in the first half of 1985 (Table 1). Gross agricultural production, which includes the sharply growing output of village-based industry, increased by 17 percent during 1984, far surpassing even the rapid growth rates of the two preceding years (Appendix Table 2). Gross industrial output also grew strongly, by 14 percent, in 1984 as a result of the ready availability of rurally-produced inputs for various processing industries and of strong consumption and investment demand. In the first half of 1985, industrial output was 23 percent above that of the same period in 1984.

Table 1. China: Major Economic Indicators, 1981-85

(Changes in percent, unless otherwise indicated)

	1981	1982	1983	1984	1985	
					First half <u>1/</u>	Year <u>2/</u>
Nominal national income	7	8	11	19	...	21
Consumption	10	9	11	14	...	23
Investment	-3	10	13	27	...	30
Real national income	5	8	10	14	15	12
Gross industrial production	4	8	11	14	23	17
Gross agricultural production	7	11	9	17	...	6
Public fixed investment	-10	27	13	24	43 <u>3/</u>	33
Budget financed	-25	8	25	19	...	10
Extrabudgetary	5	40	6	28	...	43
Cost-of-living index	3	3	2	3	7	9
Wages <u>4/</u>	1	3	3	20	...	...
Overall budget deficit in percent of GDP	1.2	1.3	1.6	1.6	...	1.2 <u>5/</u>
Domestic credit	13	12	15	36	43 <u>6/</u>	18 <u>7/</u>
Total liquidity	20	15	19	37	42 <u>6/</u>	19 <u>7/</u>
Exports (in terms of US\$)	19	2	-2	15	-2	1
Imports (in terms of US\$)	-5	-19	11	28	61	34
Current account (US\$ billion)	1.3	5.7	4.2	2.0	-5.3 <u>2/</u>	-5.3
(In percent of GDP)	(0.5)	(2.2)	(1.5)	(0.7)	(...)	(-2.3)
International reserves at end-year (US\$ billion)	5.6	11.8	15.4	15.5	12.0 <u>8/</u>	12.1
(In months of imports) <u>9/</u>	3.9	7.5	7.6	5.8	4.5 <u>10/</u>	4.1

Sources: Data provided by the Chinese authorities; and Fund staff estimates. More detailed data are shown in Appendix Tables 2 (Output and Incomes), 3 (Investment and Savings), 4 (Budget), 5 (Money and Credit), 6 (Balance of Payments), and 7 (Medium-Term Balance of Payments Scenario).

1/ Percentage change from the first half of 1984, unless otherwise indicated.

2/ Staff estimates.

3/ Capital construction investment only.

4/ Annual average wages of workers and staff in state-owned enterprises.

5/ Budget estimates.

6/ End-March.

7/ Official targets.

8/ End-June.

9/ In terms of imports of the following year.

10/ In terms of 1985 imports.



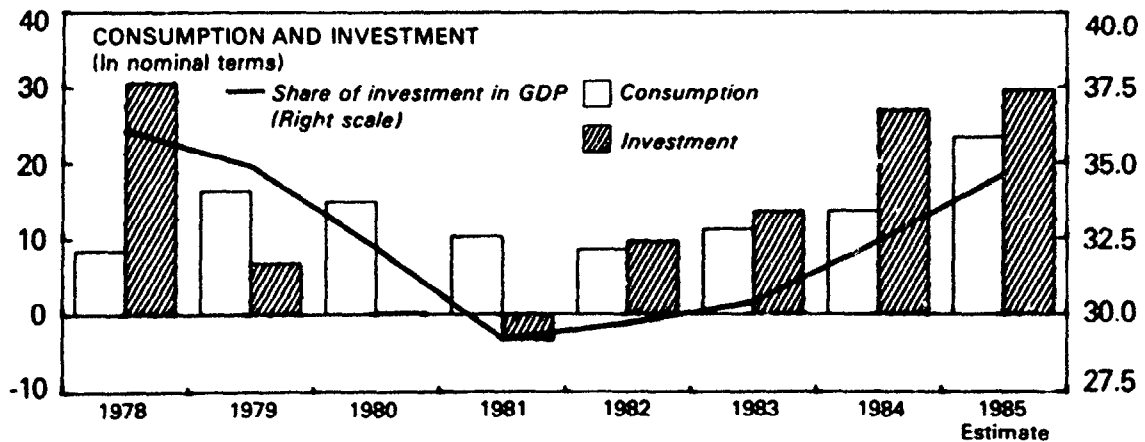
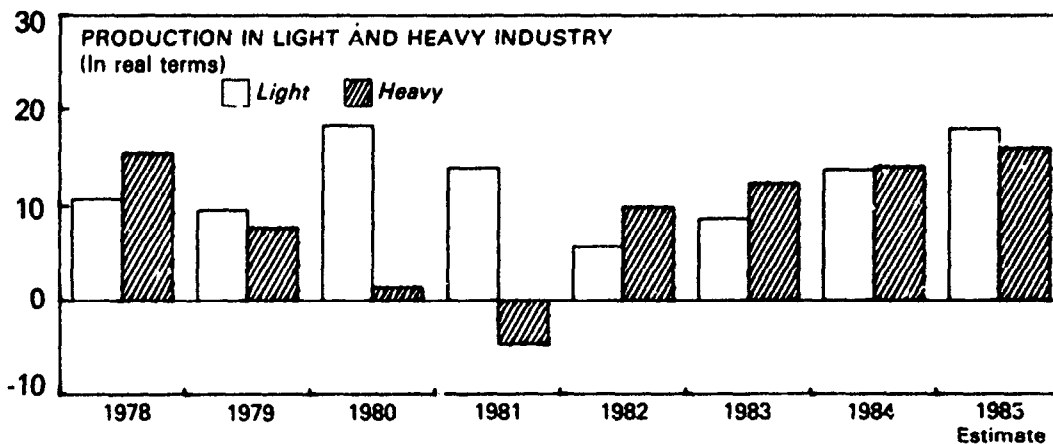
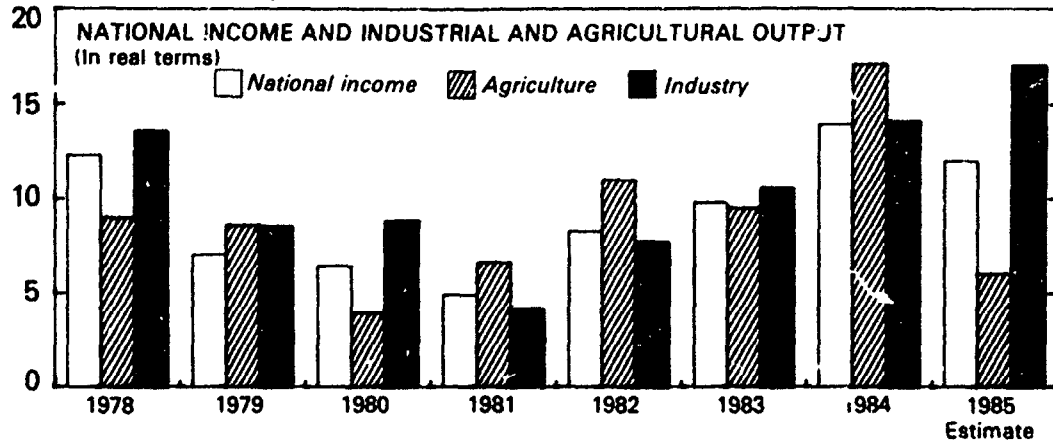
Investment expenditures rose sharply during 1984 and the share of investment in aggregate expenditures continued to increase (Chart 1 and Appendix Table 3). There were large increases in the fixed investment by state enterprises and local governments which is financed outside the budget (extrabudgetary investment), while budget-financed investment also continued to grow rapidly. Investment growth was broadly distributed among economic sectors, but the share of the energy and transport sectors continued to increase. Investment by collectives and by individuals both rose by more than 50 percent. Consumption expenditures also grew rapidly, but the overall savings rate continued to rise and was reflected in a further substantial increase in household financial savings. The rapid increase in household consumption and savings was fueled by the continued growth of rural incomes and by a sudden expansion of enterprise wage payments. The average earnings of employees in state-owned enterprises increased by about 20 percent in 1984, following three years of small increases; much of the expansion occurred in the last quarter of the year and was partly due to higher bonus payments. Tentative estimates for the first half of 1985 indicate that the growth of both investment and consumption expenditures accelerated further; extrabudgetary investment continued to grow strongly and the wage increases of late 1984 boosted household consumption.

The rapid increase in industrial production was reflected in improvements in the productivity and profitability of state-owned industrial enterprises. Output per worker in these enterprises, which had grown relatively slowly during 1979-82, accelerated during 1983 and 1984; however, the growth in labor productivity still lagged behind that of collective enterprises. Total profits of state industrial enterprises rose by 10 percent in 1984 and loss-making enterprises reduced their deficits. Reflecting the higher profits, total extrabudgetary funds--which consist primarily of the retained profits and depreciation funds of state enterprises--rose by about 18 percent.

The official cost-of-living index rose by nearly 3 percent in 1984, only slightly faster than in 1983. However, the rise accelerated in late 1984 and in the first half of 1985; in the latter period, the index was 7 percent higher than in the corresponding period of 1984. This acceleration reflected both the adjustment of prices under the reforms and the effects of demand pressures on prices influenced by market forces. The cost-of-living index covers primarily prices in state commercial outlets, but also includes negotiated and market prices of agricultural products, with weights based on the relative importance of these three types of prices for various commodities; free market sales currently account for about one eighth of total retail sales. Market prices of agricultural goods declined for much of 1984 due to favorable supply conditions, but by March 1985 they were 10 percent higher than a year earlier.

# CHART 1 CHINA OUTPUT, CONSUMPTION, AND INVESTMENT, 1978-85

(Percentage changes over the previous year, unless indicated otherwise)



Sources: Data provided by the Chinese authorities; and staff estimates

The growth of most credit and monetary aggregates accelerated sharply in 1984, especially in the last quarter. The growth of domestic credit more than doubled, to 36 percent, in 1984 (Chart 2 and Appendix Table 4). The fastest increases in bank lending were to rural and urban collective enterprises, to state-owned industrial enterprises for the financing of fixed investment, and to commercial units for financing purchases of the bumper crops. Bank financing of the budget deficit accounted for only a small part of the domestic credit expansion. The growth of total liquidity accelerated to 37 percent, from 19 percent in 1983. Currency in circulation, individual demand deposits, and deposits of enterprises all expanded by around 50 percent, more than double the rates of 1983. These trends continued in the first quarter of 1985. Total credit rose by more than 4 percent during the period, whereas a seasonal decline would normally be expected; total liquidity grew more rapidly than during the same period of other recent years. At end-March 1985, domestic credit and total liquidity were both more than 40 percent higher than a year earlier.

The budget deficit remained low in 1984, at 1.6 percent of GDP. Revenue and expenditure both grew by 15 percent, and capital expenditures grew more than twice as rapidly as current expenditures (Chart 2 and Appendix Table 5). Expenditures on various subsidies and income transfers remained virtually unchanged, but administrative expenditures rose sharply in part because of higher government employment. Sales of treasury bonds to the nonbank sectors and credit from the banking system each financed about two fifths of the overall deficit; in addition, a small amount of foreign finance was utilized.

The balance of payments continued to be in surplus during the first half of 1984, but weakened sharply during the second half of the year and the first part of 1985. From their peak in July 1984, total international reserves fell by \$2.5 billion in the last five months of 1984 and by a further \$3.5 billion in the first half of 1985; at end-June 1985, they stood at \$12.0 billion, equivalent to 4 1/2 months of projected 1985 imports. The overall payments position was in virtual balance for the year 1984 as a whole, compared with a surplus of \$4.1 billion in 1983 (Chart 3 and Appendix Table 6). The current account still showed a surplus in 1984, but at \$2.0 billion (0.7 percent of GDP) it was much smaller than the surplus of \$4.2 billion (1.5 percent of GDP) recorded in 1983; a deficit of \$5.3 billion is estimated for the first half of 1985.

After declining slightly in 1983, export earnings rose by 18 percent (in terms of U.S. dollars) in 1984, largely because strong domestic production, especially of crude oil and agricultural products, contributed to higher export volumes (Table 1). Exports of manufactured goods continued to increase, but at a slower rate than overall international demand, so that China experienced a small decline in its market share. Export earnings declined slightly in the first half of 1985, despite further substantial increases in export volumes of crude oil and agricultural products, because of a fall in prices for these products and a

substantial decline in the volume of manufactured exports. The recent weakening of manufactured exports is attributable to strong domestic demand, protectionist pressures, and relatively weak competitiveness.

Imports grew sharply in the second half of 1984 and the first half of 1985. The value of imports rose by 29 percent in 1984, with the fastest increase occurring toward the end of the year. The rapid import growth was due to a more liberal issuance of import licenses and utilization of foreign exchange quotas, accompanied by a large increase in demand for imported capital equipment and industrial inputs as a result of the rapid expansion of domestic investment and production; imports of consumer durables also increased. In contrast, imports of primary products declined owing to increased domestic production. These trends continued in the first half of 1985, when imports were 61 percent higher than in the same period of 1984.

The deficit on the capital account widened significantly, to \$1.0 billion, in 1984. This was primarily due to increased official purchases of foreign government bonds, which are not included in the national definition of international reserves, and to substantial advance payments for imports, outflows which amounted to about \$1.7 billion and \$940 million, respectively. Net foreign direct investment inflows more than doubled, to \$1.1 billion, and inflows on bilateral and multilateral loans remained essentially unchanged.

#### IV. Policy Discussion

The Chinese authorities stated that they intended to act firmly to correct the present macroeconomic imbalances while also continuing with the reforms. They had already taken a number of measures to reduce domestic excess demand pressures and to halt the decline in international reserves. As on previous occasions, the authorities' immediate policy response has involved a mix of administrative measures and indirect economic instruments. They recognized, however, that in the period ahead a key element of the reforms that would also greatly improve the efficiency of macroeconomic management would be to expand the role of price mechanisms in the allocation of real and financial resources.

##### 1. Macroeconomic balance and domestic financial policies

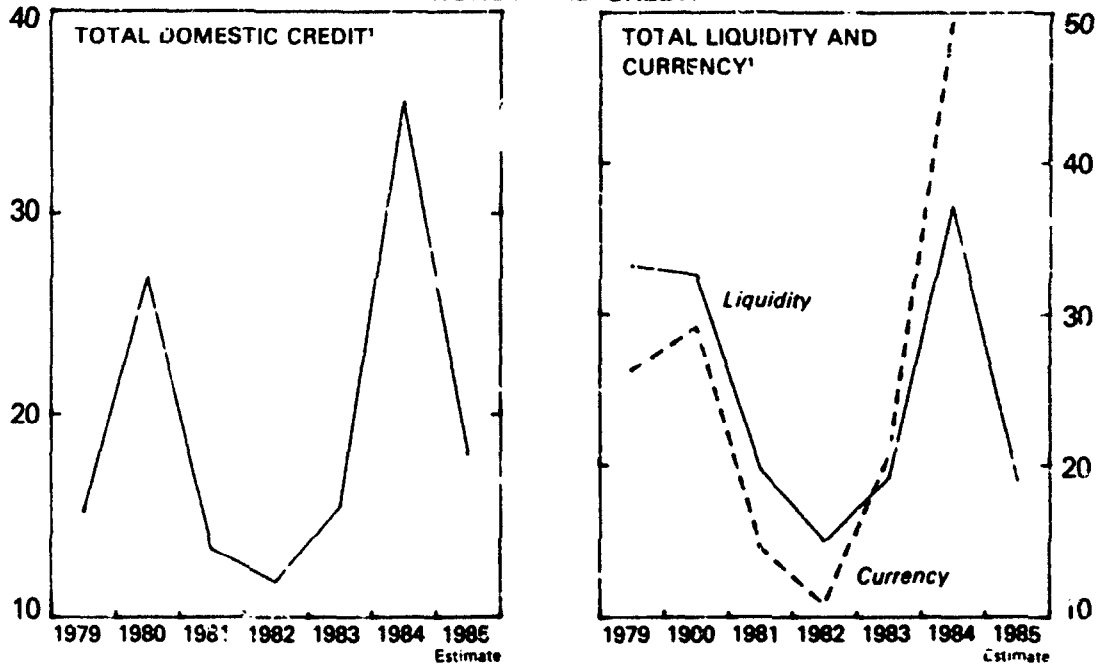
###### a. Macroeconomic balance

The authorities recognized that substantial excess demand pressures had built up since late 1984. The growth in both investment and consumption had been too rapid, while the current rate of growth of production was unsustainably high. They agreed that the accelerating rate of inflation--which the staff tentatively estimated at about

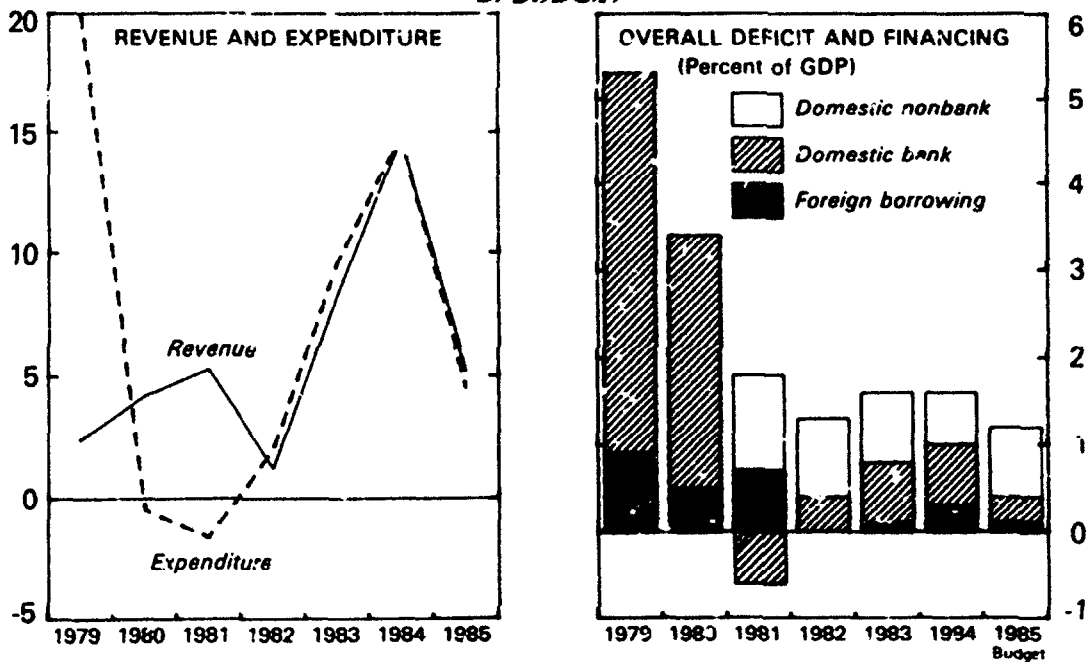
# CHART 2 CHINA FINANCIAL DEVELOPMENTS, 1979-85

(Percentage changes, unless otherwise indicated)

## A. MONEY AND CREDIT



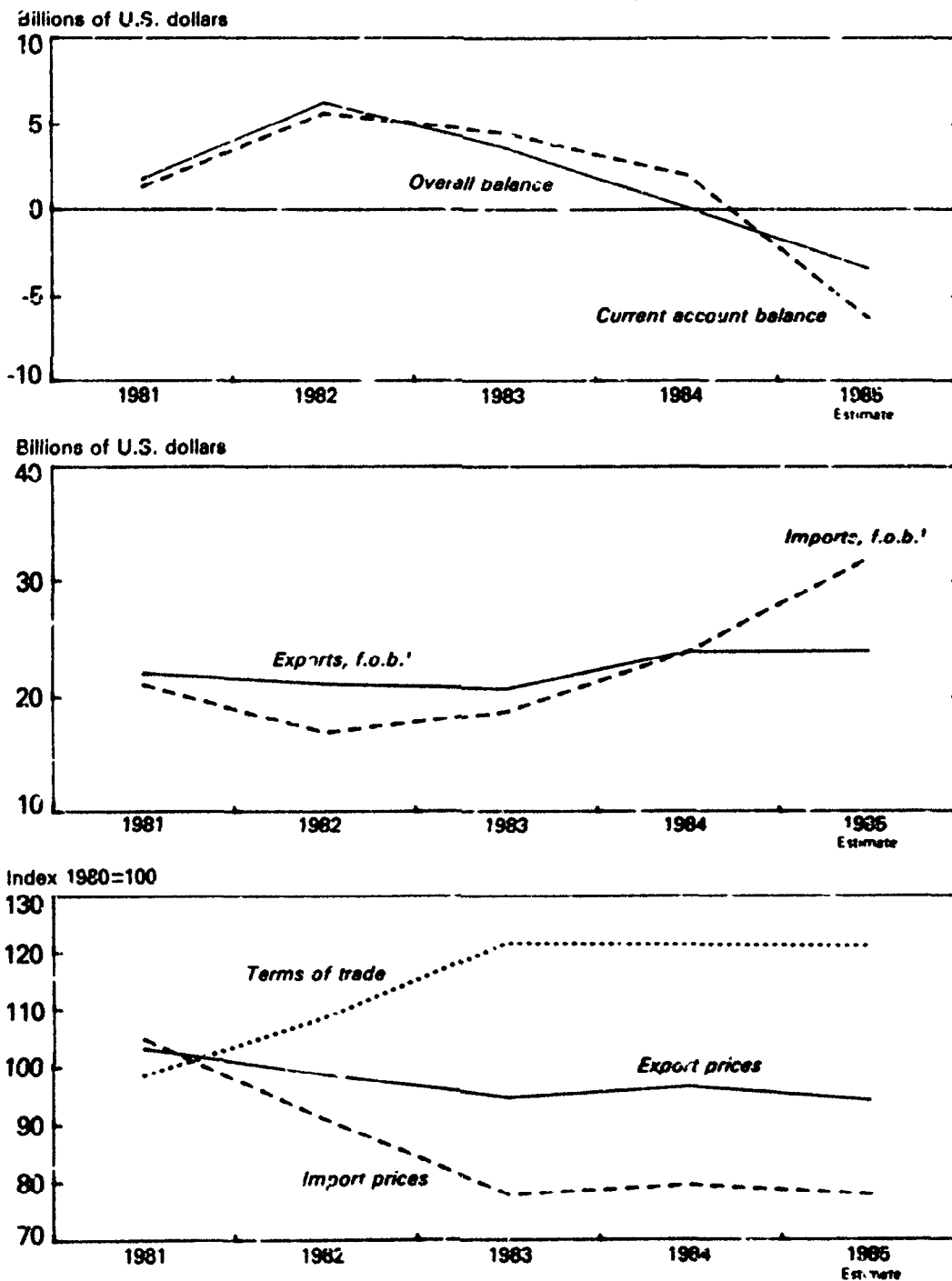
## B. BUDGET



Sources: Data provided by the Chinese authorities; and staff estimates.

<sup>1</sup>Changes in total domestic credit and liquidity from 1983 onward are based on data that include the operations of the People's Construction Bank; changes up to 1982 exclude this bank.

# CHART 3 CHINA BALANCE OF PAYMENTS, 1981-85



Sources: Data provided by the Chinese authorities, and staff estimates.

<sup>1</sup>Data for 1981 are not strictly comparable with those for the following years owing to difference in sources.

9 percent for 1985--the growing shortages and bottlenecks, and the declining international reserves were all signs of significant macroeconomic imbalances.

The authorities explained that these imbalances were due to strong underlying pressures to expand wages and investment that were released by the relaxation of central administrative controls, and to a temporary slackening of controls over bank credit during the reorganization of the banking system. The sustained pressures to increase wages and investment stemmed from the low cost of financial resources to enterprises and from the lack of adequate financial constraints on enterprise behavior. A number of steps have already been taken to address these longer-term problems: bank loans have largely replaced budgetary grants as a source of funds and interest rate policy is being used more flexibly; the authorities are preparing a law that will set out the terms and conditions for bankruptcy of state enterprises; and accounting regulations are being strengthened. However, the authorities agreed with the staff team that a key element in increasing the financial responsibility of enterprises would be a more rational price structure that would make profitability a more accurate guide to enterprise performance.

In early 1985, the authorities acted to slow the excessive growth in aggregate demand by tightening credit and by raising interest rates. Administrative measures were also taken; bank supervision of enterprise wage payments was strengthened by reintroducing the requirement that all enterprise wage funds be channeled through separate bank accounts, <sup>1/</sup> and ceilings on total wage payrolls were announced for some state enterprises. The vetting of investment projects by central and local authorities was tightened, and cuts in governmental units' administrative expenditures were announced. The authorities explained that their aim was to steadily correct the imbalances rather than to apply a sudden brake; consequently, the needed adjustment might take some time. However, they would not permit the trends experienced in late 1984 and early 1985 to continue. The staff team stressed that additional monetary and fiscal measures should be quickly adopted if the prevailing strong excess demand persisted. They emphasized the importance of firm financial policies as a prerequisite for successful continuation of the reforms, especially price reform.

#### b. Money and credit

China's banking system as well as the objectives and instruments of monetary policy have been undergoing considerable changes. The reduced scope of mandatory planning and the greater decentralization of economic decisions have greatly increased the influence of credit policy on

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<sup>1/</sup> This measure is described in the Recent Economic Developments paper which is to be issued shortly.

macroeconomic variables. 1/ Beginning in 1984, the central banking functions of the People's Bank were separated from its commercial banking functions. In its new role the People's Bank can influence monetary conditions by means of quantitative credit ceilings for the specialized banks, redeposit requirements, variation in the amount and terms of its own lending to the specialized banks, and control of the overall structure of interest rates.

However, during 1984, the authorities found it difficult to resist demands for credit, in part because of continuing pressures for credit to be accommodative to the needs of the real economy. Moreover, the People's Bank encountered technical difficulties in monitoring monetary targets and in using monetary instruments to achieve these targets, especially during the complicated process of dividing functional responsibilities between the People's Bank and the specialized banks. The credit ceilings were substantially exceeded toward the end of 1984, as lower-level bank branches expanded their lending in an attempt to maximize the base figure for their 1985 credit allocations. Meanwhile, the incomplete separation of the accounts of the People's Bank and the specialized banks hindered the operation of the required redeposits system and impeded strict control over the People's Bank's lending to the banks. Also, two institutions--the People's Construction Bank and the rural credit cooperatives--were not covered by the credit plan or the system of required redeposits, and their lending grew more than twice as rapidly as the lending of the other banks.

The authorities were in broad agreement with the staff team's view that the recent growth in money supply had outpaced the demand for money, even though the latter must have grown rapidly in recent years because of rapid income growth and increased monetization due to the economic reforms. Consequently, steps had already been taken to slow the growth of monetary aggregates. Most important, the authority of the People's Bank had recently been strengthened and it was better able to resist demands for credit expansion. In this regard, the credit plan for 1985 provides for credit expansion in the range of 15-18 percent and growth in money supply at about the same rate. The staff team stated that these targets appeared broadly consistent with the projected growth in real output and prices and an expected balance of payments deficit, and after taking account of the rapid growth in money supply during 1984. However, they emphasized that it was important to actually meet these targets and not allow the kind of substantial overshooting that had occurred in recent years. This would be a difficult task in light of the rate of credit expansion recorded in the first quarter of the year, and the staff team welcomed the authorities' determination to do everything possible to achieve it.

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1/ A fuller discussion of the changing role of monetary policy in China is contained in the accompanying Recent Economic Developments paper.



Interest rates on deposits and loans were raised in 1985. Rates on most deposits were raised by about 1 percentage point; rates on one-year deposits by individuals are now just under 7 percent, but rates paid on enterprise deposits are about 3 percentage points lower. Interest rates charged on working capital loans were raised by about 3/4 of a percentage point to just below 8 percent; rates on fixed asset loans were raised by almost 3 percentage points, so that they are now higher than the rates charged on working capital loans and range up to almost 11 percent for long-term loans. However, a large number of preferential lending rates, generally between about 2 and 4 percent, still exist for various high priority projects, for low profit activities, and for disadvantaged areas. The staff team encouraged the authorities to continue their more flexible approach to interest rates.

At the beginning of 1985, interest rates charged on banks' borrowing from the People's Bank were raised so that they are now higher than the rate paid on redeposits. The authorities explained that, more recently, institutional arrangements had also been changed so as to more clearly identify the People's Bank's lending to and deposits from the specialized banks. Also, for the first time, the People's Construction Bank has been incorporated into the credit plan and into the system of required redeposits. The staff team welcomed these changes, but said that it was too early to judge whether they would be sufficient to give the People's Bank full technical control of monetary developments, since many of them had only recently been introduced.

The staff team also commented that although the authorities' evident determination to slow down credit expansion was crucial, certain improvements in the techniques of credit control were also necessary. The most urgent among these was the establishment of close monitoring and control of People's Bank lending to the specialized banks and effective implementation of the system of redeposit requirements. In this regard, the staff team suggested that the incorporation of the rural credit cooperatives into the credit plan and into the system of required redeposits could further enhance the People's Bank's control of overall credit developments. They also suggested that further increases in the People's Bank lending rates be considered if the strong credit demand persisted. They also stressed the importance of comprehensive financial programming in the determination of credit targets. <sup>1/</sup>

c. Budget

The 1985 budget maintains the authorities' basic policy objective of containing the overall deficit, which is budgeted to decline moderately to about 1.2 percent of GDP. Revenue and expenditures are budgeted to grow only by about 5 percent. However, the trend of recent

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<sup>1/</sup> The authorities plan to undertake further work in this area with the assistance of a mission from the Central Banking and Asian Departments.

years has been for both revenues and expenditures to exceed budgetary projections. This trend continued during the first half of 1985; reflecting buoyant industrial production, revenues were 26 percent higher than in the same period of 1984, while expenditures were 15 percent higher. The staff team expressed the view that the overall macroeconomic situation warranted taking advantage of the good revenue performance to achieve a fiscal surplus that would contribute to the required restraint in aggregate demand. The authorities indicated that they would strive at least to eliminate domestic bank financing of the deficit; however, they stated that the buoyancy of revenue was already generating pressures for increased expenditures, so that firm expenditure control would be needed in the coming months.

Domestic nonbank financing from treasury bond sales is budgeted at Y 6 billion for 1985, a 50 percent increase over 1984. The terms of the bonds were altered in early 1985 to increase their attractiveness; interest rates were raised by 1 percentage point to 9 percent for individuals and 5 percent for enterprises, the maturity was shortened, and holders were permitted to rediscount their bonds at the People's Bank in certain circumstances. The staff team suggested that further increases in the amount of new bond issues should be considered, especially since repayments on previous issues will begin in 1986. Any increase would need to be supported by further measures to make the bonds more attractive, since the recent increase in interest rates on bank deposits has made the bonds less competitive and because the present procedures for rediscounting are cumbersome.

Total expenditures on various price subsidies and on income transfers to compensate for the impact of price increases have remained relatively stable since 1981, but still represent close to one fifth of all expenditures. In 1985, these expenditures are budgeted to rise by 11 percent, largely because of the introduction of income transfers to compensate urban consumers for the effects of the recent decoupling of meat prices. The authorities stated that, since a primary objective was to prevent any price reform from having an adverse impact on general living standards, it was unlikely that the combined budgetary burden of price subsidies and income transfers would decline substantially in the next few years; any reduction in price subsidies would probably be largely offset by higher income transfer payments. The staff team expressed understanding of the objective of maintaining living standards, but suggested that action to reduce price subsidies, even if not resulting in any overall reduction in the budgetary burden, would still yield important benefits in terms of improved resource allocation.

The authorities have continued to develop the tax system as part of the process of introducing more market-oriented policy tools. The second stage of enterprise tax reform was implemented in October 1984, virtually completing the changeover to taxation of state enterprises in place of profit transfers, and new taxes were introduced to regulate enterprise wage payments. The new taxes on enterprises are somewhat complex, because of the wide disparities in profitability resulting from

the present price structure. The staff team noted that the ongoing efforts to improve the tax system could make a major contribution to increasing economic efficiency, particularly when combined with price reform.

## 2. External policies

The authorities stated that the policy of opening the economy to the outside world remained a key element of their long-term economic strategy and so would be continued. A temporary tightening of controls in the face of substantial imbalances, or changes in particular policy experiments to improve their efficacy should not be regarded as implying a reversal of this long-term strategy.

The authorities emphasized that the sharp fall in international reserves that had occurred since mid-1984 needed to be halted. The main cause of the decline had been the surge in imports, but a weaker export performance was another contributing factor. Beginning in March 1985, they had already taken steps to restrain imports through more restrictive issuance of import licenses, stricter enforcement of foreign exchange allocations, and selective tariff increases. They said that while the poorer export performance of manufactured goods was due partly to increased protectionist pressures it also reflected in part inadequate competitiveness, and that therefore efforts to promote manufactured exports would be strengthened. While the staff team expressed understanding of the factors that led to the tightening of import controls, they stressed that a more efficient means of managing the balance of payments would be to allow a greater role for the price mechanism, in combination with more flexible exchange rate policies and firmer demand management. Such policies would also improve export performance, especially of manufactures.

Projections for 1985 as a whole are complicated by difficulties in evaluating the magnitude and the likely lag in the effects of the import restraint measures. Only very tentative staff estimates are possible; these suggest that imports in the second half of the year would be about 10 percent lower than in the first half. The current account deficit would narrow from \$5 1/2 billion in the first half to \$1 billion in the second half; and the overall balance would improve over the same period from a deficit of \$4.5 billion to a surplus of \$1 billion.

Reform of the foreign trade system would be an important element in allowing a greater role for the price mechanism in balance of payments management. In September 1984, the authorities introduced a system in which foreign trade corporations can import and export goods on an agency basis; the domestic prices set for such goods are normally equivalent to the international price adjusted for the trade corporation's commission. The authorities are now in the process of separating the overall policy and regulatory framework from the direct conduct of trade. On a trial basis, two foreign trade corporations have been given greater autonomy in deciding the commodity structure, volume, and prices

of their exports and imports. The staff team encouraged the authorities to pursue further the reform of the foreign trade system and to complement it with a liberalization of the foreign exchange control system.

The authorities stated that the basic principles governing China's use of foreign capital had not changed since the last consultation. They intended to utilize all forms of foreign capital to promote China's economic development, and expected the magnitude of capital inflows to increase as experience is gained in utilizing foreign capital. They stated that overall borrowing policy is guided by the principle that the future debt service ratio should not exceed 15 percent. During 1984, they had issued overseas bonds partly in order to familiarize the international market with these issues. Since the beginning of 1985, a loan agreement in the amount of \$2 billion has been signed with a consortium of international banks; a part of the loan might be drawn in 1985.

The People's Bank of China was recently made responsible for both the coordination and monitoring of all external borrowing, and all entities are now required to report their borrowing to the People's Bank. According to official data, China's outstanding medium- and long-term debt amounted to \$7.2 billion (2.6 percent of GDP) at end-1984. However, these data do not cover certain liabilities of local governments and enterprises, and no official data are available for short-term debt. The staff team stressed the importance of early action to strengthen the external debt management system, partly by collecting more comprehensive statistics.

The authorities affirmed that efforts to attract increased foreign direct investment were being continued. Favorable treatment for foreign investment was extended to 14 coastal cities in May 1984. Since then, the authorities had decided to concentrate primarily on four of these cities, which had the greatest immediate advantages for attracting foreign investment, but this did not imply that foreign investment in the other ten cities was being discouraged. In addition, in early 1985, three new river delta regions were permitted to offer foreign investors preferential treatment, and foreign participation in certain onshore oil exploration activities had also been invited. The authorities stated that, so far, not many of the projects established with foreign investment had employed advanced technology, while some ventures were relatively low value-added assembly operations based on imported inputs and producing mainly for the domestic market. The staff team expressed the view that the excessive orientation toward the domestic market was probably the result of the domestic market being heavily protected.

Output and foreign investment in the four special economic zones has grown rapidly in recent years. The authorities explained that, so far, exports from the zones had been lower than expected, and that the zones recorded a foreign trade deficit of about \$2 billion in 1984; however, a deficit was not surprising at this stage of the zones'

development, because of the requisite heavy investment in infrastructure. The authorities were concerned with the growth of various unauthorized trade and foreign exchange activities, particularly in the largest of the zones, Shenzhen; the possibility of issuing a special currency for Shenzhen was still being considered, but no decision had been taken. The staff team commented that the fundamental solution to these unauthorized activities lay not in issuing a special currency but rather in the reform of trade, exchange, and pricing policies.

The authorities stated that, since the last consultation, there had been no changes in the method of determining the official exchange rate for the renminbi, which is pegged to a basket of internationally traded currencies. During 1984, the renminbi depreciated substantially against the U.S. dollar to about Y 2.8 = US\$1 by end-December. At this stage, the internal settlement rate, which had been kept at Y 2.8 = US\$1 since the beginning of 1981 and which applied to all trade and trade-related transactions, was abolished (EBD/85/16, 1/14/85). All external transactions now take place at the official exchange rate. Between January and August 1985, the renminbi depreciated further to Y 2.91 = US\$1. The nominal effective exchange rate depreciated by 3 percent and the real effective exchange rate was virtually unchanged during this period (Chart 4). It should be noted, however, that final prices received by most export producers and paid by many import users still do not reflect the exchange rate, because a major, though declining, share of foreign trade is conducted through foreign trade corporations whose transactions with domestic enterprises are settled at officially determined domestic prices; the difference between international and domestic prices is reflected in the financial position of the foreign trade corporation.

The authorities recognized that the importance of appropriate exchange rate and pricing arrangements and policies increased as China's economy was increasingly opened to the outside world. The staff team stressed that the consequences of large divergences between domestic and international prices were becoming increasingly evident and that such policies would also be essential to ensure the competitiveness of exports.

China continues to maintain a 10 percent tax on profit remittances by joint ventures. However, the applicability of this tax is small at present since, as part of the scheme for promoting foreign direct investment, the tax is not applied to investment in the special economic zones and in certain designated areas in 14 coastal cities. Joint ventures in the three river delta areas designated for the promotion of foreign investment, which involve an investment of more than \$30 million or which are in certain high-priority sectors, are also exempt from the tax. The authorities stated that, effective January 1985, the bilateral payments arrangement with Egypt was abolished. No new arrangements with Fund members have been introduced since the last consultation, and it remains the authorities' intention to eliminate the remaining arrangements.

### 3. Economic system reforms

The Chinese authorities stated that the broad principles contained in the Decision on the Reform of the Economic Structure will continue to guide the reform process. The main priorities in 1985 are to reduce the scope of mandatory planning, to promote greater efficiency and flexibility in the larger state enterprises, and to take the first steps in reforming the wage and price systems.

The authorities have abolished the system of mandatory, fixed-quota sales to the state of grain, edible oil, and some other farm products, which had been in operation for over 30 years. State purchases of these products are now being made through a system of annual voluntary contracts for the purchase of specified amounts from individual producers. <sup>1/</sup> Such purchases will generally be smaller than the total state purchases of recent years; production in excess of the contracted amount can be sold on the free market. For the 1985 harvest, the state has announced contract prices for various crops that are weighted averages of the old within-quota and higher, above-quota prices.

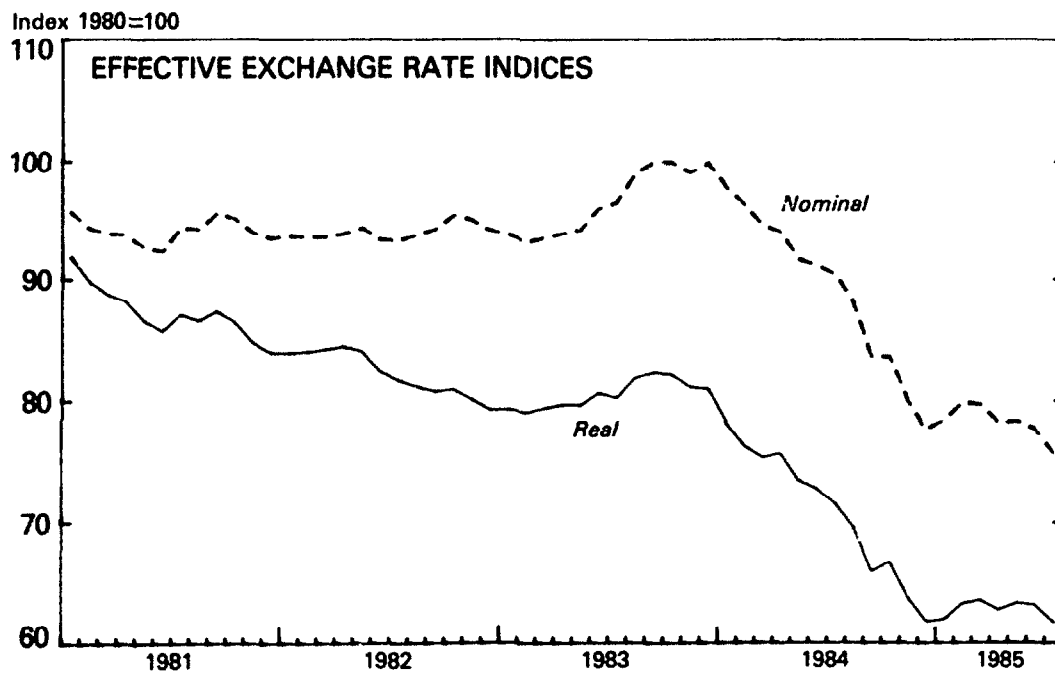
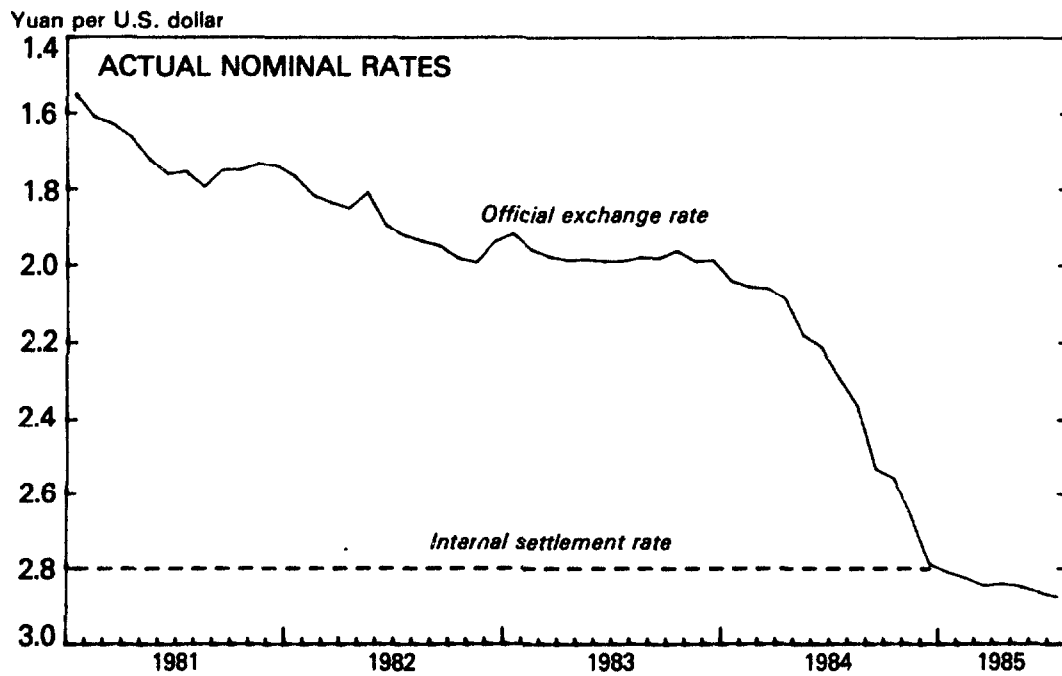
In industry, the number of products covered by the state mandatory plan has been cut in 1985 from 123 to about 60; the share of industrial production covered by these products has fallen from about one third to about 20 percent. However, additional products are subject to provincial level mandatory plans; the number of products covered varies widely by region and tends to be lower in the more developed regions. In general, products covered by the state or provincial mandatory plans now account for up to one half of total industrial production. The above-quota output of many of those products that are subject to mandatory plans can be freely disposed of by enterprises, at negotiated prices that are often about double the prices set for within-quota production. This disparity in prices caused some enterprises to avoid meeting their full quotas under the state plan, despite large increases in total production.

The authorities reaffirmed their objective of achieving increased output primarily through a more efficient use of resources. Several measures are now being adopted to improve the efficiency of large- and medium-sized state enterprises. To increase enterprise autonomy, supervisory departments are to be less involved in enterprises' business operations. Enterprise managers are being given increased independence and their remuneration is being more closely linked to their performance; to increase financial responsibility, large accounting units within industrial groups are being divided into smaller units. In addition, selective reductions in taxes and in mandatory production quotas will be granted to certain high-potential enterprises, so as to

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<sup>1/</sup> A discussion of the changes in agricultural procurement and pricing arrangements is contained in the Recent Economic Developments paper which will be issued shortly.

CHART 4  
CHINA  
EXCHANGE RATES, 1981-85<sup>1</sup>



Sources: Data provided by the Chinese authorities; and staff estimates.  
<sup>1</sup>Upward movement indicates appreciation.

increase their financial resources and their flexibility in choosing the most appropriate mix of output.

An important element in the authorities' efforts to promote greater efficiency is to reform the wage system so as to strengthen incentives, while taking measures to prevent a recurrence of the recent excessive wage increases. For a number of large- and medium-sized industrial enterprises, a proportion of the total wage bill is to be linked to some objective measure of enterprise performance, such as the level of tax and profit transfers to the state. Similar arrangements have already been introduced in many mining and construction enterprises, where the total wage bill is linked to gross output or value added. The distribution of wages within these enterprises will no longer be subject to central controls, but macroeconomic control of total wage payments will be retained through a special progressive tax imposed on the extent to which total wage payrolls exceed norms established for each enterprise. In addition, a new wage system for government employees, linking wages more closely to specific job content, was introduced in July 1985; this will result in both a widening of wage differentials and an average wage increase of about 20 percent. The staff team welcomed the strengthening of individual incentives that would result from these changes, and stressed that a more flexible wage policy increases the importance of effective financial constraints on enterprises.

The authorities recognized that, in many respects, China's price system still does not provide appropriate signals for resource allocation and that price reform is an essential prerequisite for the success of the other economic reforms. One of the major problems is that most energy and industrial raw material prices are too low, thereby hampering conservation efforts. State list prices for coal, crude oil, and fuel oil are only about one third of international prices at current exchange rates. However, it is difficult to make precise comparisons with international prices, because in China the price of a product can differ substantially depending on the source of production, the type of user, and whether the output is within or above the plan quota; such variations also contribute to inefficient resource allocation. The authorities also noted that charges for various public services, including housing, are too low; rents for housing in cities generally cover only about one fourth of the costs of management and repair, which makes it difficult to maintain the existing housing stock. Also, consumer prices for grain and edible oil are still below procurement prices.

The authorities intend to pursue price reform in small, gradual steps over a number of years, through a liberalization of price controls on some goods and adjustments in administered prices for others. During 1985, central controls on meat, vegetables, and other nonstaple agricultural commodities are being lifted; local governments are now responsible for periodically setting prices that match supply and demand for these products. To reduce transport bottlenecks, short-distance rail freight and passenger fares were raised; also, coal-deficit areas



have been allowed to set coal prices with a premium of 10-20 percent over state list prices so as to encourage local production. The authorities intend to raise housing rents so that they fully cover costs. However, the list prices of key industrial goods, including energy products, distributed under the mandatory plan are to remain unchanged for the present; transactions in above-plan output, as well as in goods not covered by the Plan, are to be determined more by market forces than in the past. The staff team stressed that an early rationalization of the price system, including strengthened links between international and domestic prices, would greatly improve economic efficiency.

#### 4. General direction of future economic development

In the authorities' view, the next five years will be an important period of transition as China's system of economic management moves toward one of indirect control through market-related policy instruments. Considerable attention will need to be given to the development of markets and to encouraging increased competition between enterprises. Institutional arrangements will need to be developed to encourage greater enterprise flexibility and financial responsibility while retaining public ownership, and a further expansion in the role of collectively and individually owned enterprises will be encouraged. Eventually, the planning mechanism would provide indicative targets, designed to guide enterprise behavior, including a growth target, conditions for macroeconomic balance, and certain key macroeconomic ratios such as the shares of consumption and investment in national income. Implementation of the plan would be achieved primarily through indirect economic instruments such as interest rates and credit and fiscal policies.

The authorities provided a preliminary outline of the Seventh Five Year Plan, covering the period 1986-90. The main thrust of the plan is to maintain balanced growth while continuing with the economic reforms and emphasizing increased economic efficiency. The average annual target growth rate of real national income will be 6-7 percent. Particular efforts will be made to alleviate shortages of energy, especially electricity. By 1990, crude oil output is targeted to reach 150 million tons and coal output 900 million tons (compared with 115 million tons and 788 million tons, respectively, in 1984). In agriculture, greater use of advanced technology will be promoted and supporting infrastructure, including irrigation facilities, will be further developed; the aim is to promote further diversification while ensuring adequate grain supplies. In industry, increased efforts will be made to expand the output of textile and other light industries to satisfy the domestic demand for consumer goods. Emphasis will be given to improving efficiency in existing enterprises by introducing advanced technology and upgrading equipment. The authorities also intend to expand further the volume of foreign trade.

In assessing possible medium-term developments in the external sector, the staff team prepared alternative medium-term balance of payments scenarios for the period 1986-90, based on the authorities' output targets and on world market conditions contained in the latest World Economic Outlook. One scenario shows that maintaining international reserves at a level the authorities consider adequate, while allowing imports to grow in line with economic growth targets, would require moderate increases in market share for China's non-oil exports. If the authorities' expectations of continued growth in the volume of oil exports are fulfilled, this would imply an 8 percent annual growth in total export volumes (Appendix Table 7). Even with this good export performance, moderately active external borrowing would still be required, although the debt service ratio would only reach about 7 1/2 percent by 1990. Alternative scenarios show that a failure to re-establish strong export growth would require an accumulation of external debt that might perhaps be too fast to be prudent, or a compression of imports that could hinder growth prospects. Such projections are especially tentative because of the lack of a stable relationship between foreign trade and domestic variables. Nevertheless, they do illustrate that a policy environment suitable for export promotion will be an essential part of the continued opening of the economy to the outside world.

The World Bank staff has recently prepared a report on long-term issues and options for the Chinese economy. They conclude that the authorities' long-term growth targets (to quadruple gross industrial and agricultural output and to raise per capita national income from about \$300 to \$800 between 1980 and 2000) are achievable with prevailing levels of investment efficiency, if the ratio of investment to national income prevailing in the early 1980s (about 30 percent) is maintained and if reasonable improvements in energy and raw materials use are achieved. However, greater emphasis on the relatively neglected service sectors could improve investment efficiency, reduce material input requirements, and make possible either a higher consumption level or a faster-than-targeted growth rate. They also conclude that energy production is likely to remain a key constraint for economic growth. Consequently, in the view of the Bank staff, one of the most pressing needs in the area of price reform is for substantial increases in the prices of most forms of energy as well as some other raw materials, so as to encourage conservation. They also support an early increase in the retail prices of subsidized foodstuffs and in rents, accompanied by more gradual but steady price decontrol in other areas. With regard to external policies, the Bank staff stresses that China is well placed to move toward a decentralized and mainly indirectly regulated foreign trade system, but they do not suggest that this be done immediately, since domestic enterprises do not yet have the appropriate motivation or independence to operate in such a system. In their view, progress toward such a system should proceed steadily, in parallel with internal economic reform.

## V. Staff Appraisal

The evolution of the Chinese economy continues to be marked by rapid growth, structural change, and higher living standards. The benefits of the rural reforms of the last several years are being reaped through buoyant production in agriculture and rural industry, while the increased autonomy granted to enterprises under the urban economic reforms has been a major factor behind the recent boom in industrial production. The present extension of the reforms, including the strengthening of incentives and the reduced scope for mandatory planning, should generate further substantial improvements in efficiency and an increased flexibility of the economic structure.

While thus progress is being made in many important respects, serious macroeconomic imbalances have emerged since mid-1984. Strong excess demand pressures have exacerbated bottlenecks and shortages of key raw materials, despite a large increase in imports, and have contributed to faster inflation and a sharp weakening of the external payments position. The proximate cause of the imbalances was an excessive expansion of credit, reflecting both an accommodative attitude toward loan requests and technical difficulties with the implementation of credit control under the more decentralized banking framework. However, the fundamental cause was that while the system of economic decision making was being increasingly decentralized, the price system still did not provide uniformly accurate signals for resource allocation, nor was there sufficiently strong financial discipline enforced on enterprises. Also, the existence of a substantial unmet demand for many imported goods at prevailing prices and exchange rates complicated the management of the balance of payments.

The background of the current economic situation and policies set out in the earlier pages points up a skein of issues, of which, for the present purpose, the staff would concentrate on three broad groups: (i) the degree to which financial policies should be tightened, whether measures additional to those already taken by the authorities should be adopted and, if so, which ones; (ii) the most appropriate external policy response to the recent rapid decline in international reserves; and (iii) the extent to which and pace at which the price mechanism should be harnessed for managing domestic resource allocation and the balance of payments. Staff views on each of these questions are provided in the following paragraphs:

(i) On the first group of issues, it is difficult to make precise judgments about the most appropriate rate of monetary growth when extensive changes in the economic structure are taking place because in these circumstances past relationships are a poor guide to the present and prospective demand for money. A year ago, the staff had thought that the authorities should err on the side of caution. Now, the staff can be less guarded. Currency in circulation, household bank deposits, and enterprise deposits have all grown extremely rapidly, even

in relation to fast-rising production and incomes. The growing shortages and accelerating rate of recorded inflation--although imperfect indicators--and the severe pressure on the balance of payments, provide strong corroborative evidence of significant excess demand in the goods market. Such an excess demand situation is particularly undesirable at the present time, when the authorities are taking the first steps of a price reform. Consequently, the growth of monetary aggregates needs to be slowed substantially, and this will require a sharp curtailment of credit expansion. The authorities have affirmed their determination to tighten credit, and have already taken some measures. Their targets for the growth in credit and money supply during 1985 seem broadly appropriate, but there is little leeway for the type of substantial overshooting that has occurred in recent years. In the light of developments in the first quarter of 1985, strict credit control is needed now if the targets for the year as a whole are not to be exceeded.

The authorities' evident determination to resist excessive credit demands is clearly fundamental, but needs to be accompanied by a close monitoring and control of the People's Bank lending to the specialized banks and by an effective implementation of the system of required redeposits. Also, the rural credit cooperatives should be more closely integrated within the framework of overall credit planning and control. The recent more flexible use of interest rates is a welcome development and should be continued, taking into account developments in inflation. Further increases in the People's Bank's lending rates to the specialized banks should be considered if the strong credit demand persists. The efficacy of the interest rate instrument should be strengthened by eliminating the large number of preferential lending rates that now exist.

Budgetary policy has been relatively cautious in recent years, only small deficits being incurred. Nevertheless, a year ago some Executive Directors had raised the question whether a surplus should not be aimed at. Under the circumstances then prevailing, the staff had not considered this necessary. In the light of the current macroeconomic situation, however, the staff believes that the good revenue performance so far this year should be used to generate a fiscal surplus rather than to finance additional expenditures.

(ii) China's international reserves are still at a fairly comfortable level; there has been some switch to other foreign assets; and external debt is low. Nevertheless, the recent rapid decline in reserves is not sustainable and the authorities are, therefore, right in acting to halt this trend. To this end, they are adopting firmer domestic financial policies, but they appear to be relying principally on a significant tightening of import controls through the licensing and foreign exchange allocation systems. As a temporary expedient, such an approach is understandable in the Chinese context, in which it may be the only effective--albeit costly--means to halt the decline in reserves quickly. The staff, however, believes that, in the period ahead, resort

to import controls should give way to reliance on firmer demand management and on more flexible exchange rate and pricing policies as instruments of balance of payments management. The fundamental solution to the balance of payments problems lies in sustained export growth, and recent performance on this front has not been favorable. China's policies will have to be fashioned to ensure that exports, particularly of manufactured goods, remain competitive, so that the envisaged medium-term export performance becomes feasible. It is equally essential, of course, that China's efforts are not thwarted by protectionist actions in its markets.

The authorities have restated their intention to pursue an active but prudent external borrowing policy. The present stock of external debt and the burden of debt service are sufficiently low that they are not a cause for concern. However, two comments can be made in the interests of establishing a sound external borrowing policy while debt is still low. First, the coverage and detail of external debt data should be improved and external debt management should be conducted within a macroeconomic framework that incorporates a medium-term balance of payments strategy. Early action in this area is essential. Second, the type of demand management, exchange rate, and pricing policies discussed in the preceding paragraph will be important in ensuring that additional resources made available by borrowing are channeled into the most productive uses. Consequently, it is important that China's present strong credit standing and the consequent ample availability of additional external financing should not lead to any postponement of these necessary policy adjustments.

(iii) In their discussion a year ago, most Executive Directors stressed the need for and potential benefits from early action to reform the price system. The authorities have since reiterated their intention to increase the role of market mechanisms in the economy and to proceed with a reform of the price system, although gradually. Recent progress in promoting greater price flexibility for many agricultural commodities and some secondary industrial goods as well as the intended adjustments in the prices of various services are important first steps in this process. A judgment on the appropriate pace of further reform of the price structure necessarily involves a large element of political and tactical considerations. The staff must abstract from these and, doing so, believes that high priority should now be given to promoting a more rational structure and greater flexibility for key industrial prices, including those for energy products. This would not only promote greater allocative efficiency, but would also improve the effectiveness of macroeconomic policy instruments by strengthening the financial accountability of enterprises. Reductions in consumer price subsidies would also improve resource allocation, even if such a reduction would not reduce the overall burden on the budget because of compensating increases in wages or income transfers.

As China's economy is opened to external trade and capital flows, the consequences of large divergences between domestic and international prices become increasingly evident. These price divergences underlie much of the large unsatisfied demand for imports and the reported growth of unauthorized trade and foreign exchange activities. Consequently, the staff views an exchange and trade system that effectively links the prices faced by domestic producers and consumers to international prices as an important element of the overall price reform. This would require a comprehensive implementation of the reforms of the foreign trade system, accompanied by a liberalization of the foreign exchange control system, to proceed in parallel with the domestic reforms. A reformed system need not always equate domestic and international prices; for instance, the authorities might wish to insulate the domestic prices of agricultural products from temporary fluctuations in world market prices or to provide moderate tariff protection for certain developing industries. However, too heavy a protection of domestic industry would only lead to a continuation of the excessive domestic market orientation that has already been encountered in some recent foreign investment projects.

The staff also believes that a system in which the price mechanism plays a greater role in balance of payments management would require a more flexible exchange rate policy. Since the last consultation, the internal settlement rate has been eliminated; the staff welcomes this development. All transactions are now conducted at the official exchange rate. The real effective rate of the renminbi depreciated by 3 percent between November 1984, when the Executive Board last discussed China's exchange rate policy, and July 1985.

The staff welcomes the termination, since the last consultation, of the bilateral payments agreement with Egypt. The tax on remitted profits of certain joint ventures gives rise to a multiple currency practice subject to approval under Article VIII; in view of the relatively limited scope of this practice there seems to be no balance of payments need for it and, therefore, the staff does not recommend its approval by the Executive Board.

The Chinese authorities must be commended for the considerable improvement made in recent years in the scope and quality of economic and financial statistics, and for providing an increasing number of these statistics for Fund publications. However, as indicated in Annex IV, information gaps remain, especially in respect of the coverage and detail of monetary and external debt data, as well as balance of payments data and foreign trade price indices. The staff continues to work with the authorities in improving data, including those for the Fund's statistical publications.

In conclusion, China has not found it altogether easy to simultaneously achieve the triple objectives of system reform, output growth, and economic stability. Although the progress made hitherto in system reform and output growth is by any standard impressive, already during this decade difficulties have been encountered in maintaining

economic stability. These difficulties reflected the immensity and complexity of the task the authorities face as well as policy lapses. China is a planned economy and much of this report has focused on the authorities' efforts to loosen some of the rigidities of such an economy. However, China is also a uniquely large, very low income, developing economy, with all the problems that that situation presents. The task of lifting standards of living is, therefore, daunting and involves more than the establishment of a rural responsibility system and implementing an urban enterprise reform--remarkable as those achievements and efforts are. The pragmatism and flexibility with which the authorities address problems as they arise is commendable and provides a good basis for optimism.

Executive Directors have often expressed interest in the international implications of national policies. In last year's consultation report, the staff had commented on these from the perspective of China's foreign trade. They noted that China's increasing integration with the world economy could only benefit both China and the rest of the world. This remains true although both China and its trading partners may encounter short-term difficulties in some sectors as resources are reallocated to other sectors so as to accommodate comparative advantages. However, it is the overall result of the Chinese efforts to achieve its triple objectives that will have the most far-reaching implications for the rest of the world.

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

## VI. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to China's exchange measures subject to Article VIII, Section 3, in concluding the 1985 Article XIV consultation with China, in the light of the 1985 Article IV consultation with China conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).
2. China continues to maintain restrictions on the making of payments and transfers for current international transactions in accordance with Article XIV. The Fund welcomes the termination of the bilateral payments arrangement with a Fund member, and notes with satisfaction the intention of the authorities to eliminate the remaining bilateral payments arrangements with Fund members. The Fund also welcomes the elimination of the internal settlement rate for trade transactions. The maintenance by China of an exchange tax on remitted profits of joint ventures, excluding most ventures in designated areas, gives rise to a multiple currency practice subject to approval under Article VIII, Section 3. The exchange restrictions, multiple currency practice and bilateral payments arrangements that relate to this decision are described in SM/85/266 (9/27/85) and in SM/85/ ( / /85).



Table 2. China: National Income and Output, 1981-85

	1981	1982	1983	1984	1985 Estimate
<u>(In percent change at constant 1980 prices)</u>					
National income	4.9	8.3	9.8	13.9	12.0
Gross agricultural output of which: rural industry	6.6 (12.1)	11.0 (9.4)	9.5 (23.7)	17.1 (53.5)	6.0 (...)
Gross industrial output	4.1	7.7	10.5	14.0	17.0
Light industry	14.1	5.7	8.7	13.9	18.0
Heavy industry	-4.7	9.9	12.4	14.2	16.0
State enterprises	3.6	7.1	9.4	8.9	...
Collective and individual enterprises	6.0	10.0	14.6	31.2	...
<u>(In millions of tons, unless otherwise specified)</u>					
Grain	325.0	353.4	387.3	407.3	405.0
Cotton	3.0	3.6	4.6	6.2	6.0
Oil bearing crops	10.2	11.8	10.6	11.9	13.5
Coal	622.0	656.0	715.0	789.0	882.0
Crude oil	101.2	102.1	106.1	114.6	127.0
Steel	35.6	37.2	40.0	43.5	...
Cotton cloth (bn. meters)	14.3	15.4	14.9	13.7	...
Television sets (mn.)	5.4	5.9	6.8	10.0	...
Household refrigerators (mn.)	0.1	0.1	0.2	0.5	...

Sources: Data provided by the Chinese authorities; and Fund staff estimates.

Table 3. China: Investment and Savings, 1981-85

	1981	1982	1983	1984	1985 Estimate
(In billions of yuan)					
Total investment	<u>133.9</u>	<u>146.7</u>	<u>166.5</u>	<u>211.3</u>	<u>273.7</u>
Fixed investment	<u>101.1</u>	<u>120.0</u>	<u>136.9</u>	<u>183.3</u>	<u>244.7</u>
Public fixed investment <u>1/</u>	66.8	84.5	95.2	118.5	154.0
Budget financed	28.7	31.0	38.7	46.2	50.8
Extrabudgetary	38.1	53.5	56.5	72.3	103.2
Other fixed investment <u>2/</u>	34.3	35.5	41.7	64.8	90.7
Stockbuilding and work-in-progress	32.8	26.7	29.6	28.0	29.0
Total savings	<u>135.2</u>	<u>156.5</u>	<u>174.3</u>	<u>215.0</u>	<u>254.6</u>
Balance on external trade in goods and services	<u>1.3</u>	<u>9.8</u>	<u>7.8</u>	<u>3.7</u>	<u>-19.1</u>
(In percent of GDP)					
Total investment	29.2	29.7	30.4	32.4	34.6
Total savings <u>3/</u>	29.5	31.7	31.9	33.0	32.2
Of which: Household financial savings <u>4/</u>	(3.6)	(4.3)	(5.7)	(9.0)	(...)
Current account surplus of the budget	(7.0)	(5.8)	(6.1)	(6.6)	(...)

Sources: Data provided by the Chinese authorities; and Fund staff estimates.

1/ This item corresponds to the sum of "capital construction" and "renewal of equipment and technical transformation" in national data.

2/ Investment in collectively owned units and by households.

3/ Because the production and expenditure sides of China's national accounts are estimated separately, there is a statistical discrepancy between the two that complicates estimation of the savings rate. For 1982 and 1983, alternate estimates of savings could be 1-2 percentage points lower.

4/ Change in savings deposits and currency holdings plus subscription to treasury bonds.

Table 4. China: Monetary Survey, 1982-85

	1982	1983	1984	1985 Est.	1983	1984	1985 Est.
	(In billions of yuan, end-year)				(Change in percent)		
Net foreign assets	16.1	24.0	27.0	17.0	49	13	-37
Domestic credit	347.8	401.3	543.9	644.0	15	36	18
Budget (net)	3.2	6.9	11.3	13.6	116	64	20
Other <u>1/</u>	344.6	394.4	532.6	630.4	14	35	18
Total liquidity	284.5	339.2	465.4	555.5	19	37	19
Currency and demand deposits	60.4	74.8	112.3	135.0	24	50	20
Currency	43.9	53.0	79.2	...	21	49	...
Individual demand deposits	16.5	21.8	33.1	...	32	52	...
Other deposits	224.1	264.4	353.1	420.5	18	34	19
Individual time deposits	53.7	69.8	92.9	...	30	33	...
Enterprise deposits	114.3	129.8	194.4	...	14	50	...
Other <u>2/</u>	56.1	64.8	65.8	...	16	2	...
Other liabilities (net)	79.5	86.1	105.5	105.5	8	20	...

Sources: Consolidated balance sheet of the People's Bank of China, the Bank of China, and the Agricultural Bank of China; the balance sheets of the People's Construction Bank of China and of the rural credit cooperatives; and staff estimates. The Monetary Survey differs from the one presented in previous reports in that it now incorporates the operations of the People's Construction Bank of China. Available data only allows this incorporation to be done from 1982 onward.

1/ Credit to the industrial, commercial, and agricultural production units, construction units, and households.

2/ Deposits of government units, organizations, the armed forces, and schools; and budgetary deposits of local authorities and enterprises with the People's Construction Bank of China earmarked for investment.

Table 5. China: Overall Budgetary Operations, 1981-85

(In billions of yuan)

	1981	1982	1983	1984		1985
				Budget	Actual	Budget
Revenue	<u>138.6</u>	<u>140.3</u>	<u>151.9</u>	<u>160.2</u>	<u>174.3</u>	<u>183.4</u>
Tax revenue <u>1/</u>	63.0	70.0	87.0	89.0	105.8	174.2
Gross profit remittances	72.3	65.9	59.1 <u>2/</u>	65.3 <u>2/</u>	61.5	4.3
Other	3.3	4.4	5.8	5.9	7.0	4.9
Expenditure	<u>143.9</u>	<u>146.8</u>	<u>160.9</u>	<u>168.9</u>	<u>184.7</u>	<u>193.0</u>
Current	<u>106.6</u>	<u>111.6</u>	<u>118.3</u>	<u>121.1</u>	<u>131.2</u>	<u>143.3</u>
Subsidies <u>3/</u>	36.9	36.3	35.0	35.5	35.5	39.4
Other	69.7	75.3	83.3	85.6	95.7	103.9
Capital	<u>37.3</u>	<u>35.2</u>	<u>42.6</u>	<u>47.8</u>	<u>53.5</u>	<u>49.7</u>
Capital construction	33.1	30.9	38.3	44.2	47.9	48.4
Other	4.2	4.3	4.3	3.6	5.6	1.3
Surplus (+)/Deficit (-)	<u>-5.3</u>	<u>-6.5</u>	<u>-9.0</u>	<u>-8.7</u>	<u>-10.4</u>	<u>-9.6</u>
Financing	<u>5.3</u>	<u>6.5</u>	<u>9.0</u>	<u>8.7</u>	<u>10.4</u>	<u>9.6</u>
Domestic	<u>2.1</u>	<u>6.7</u>	<u>7.9</u>	<u>6.4</u>	<u>8.6</u>	<u>8.4</u>
Bank <u>4/</u>	-2.8	2.3	3.7	2.4	4.4	2.3
Nonbank <u>5/</u>	4.9	4.4	4.2	4.0	4.2	6.0
Foreign <u>6/</u>	<u>3.2</u>	<u>-0.2</u>	<u>1.1</u>	<u>2.3</u>	<u>1.8</u>	<u>1.3</u>
Gross borrowing	7.3	4.0	3.8	5.1	3.5	3.5
Less: amortization	-4.1	-4.2	-2.7	-2.8	-1.7	-2.2

(As percent of GDP)

Subsidies	8.0	7.4	6.4	5.4	5.4	5.0
Capital construction	7.2	6.3	7.0	6.8	7.3	6.1
Overall deficit	-1.2	-1.3	-1.6	-1.3	-1.6	-1.2
Bank-financed deficit	0.6	-0.5	-0.7	-0.4	-0.7	-0.3

Sources: Data supplied by the Chinese authorities; and Fund staff estimates.

1/ Includes taxes on extrabudgetary revenues and investment introduced in 1983.

2/ Includes income tax on state enterprises introduced in 1983. Beginning with the 1984 actuals, income taxes on state enterprises are included under tax revenue.

3/ Price subsidies on living necessities and agricultural inputs, plus operating losses of state industrial enterprises.

4/ Gross borrowing less repayments to the People's Bank of China and use of deposits.

5/ Treasury bonds.

6/ Foreign borrowing by the Ministry of Finance through the Bank of China, including all official loans, deferred payments, energy credits, and buyers' credits.

Table 6. China: Balance of Payments, 1981-85

(In millions of U.S. dollars)

	1981	1982	1983	1984	Estimate 1985
Current account	<u>1,349</u>	<u>5,674</u>	<u>4,240</u>	<u>2,030</u>	<u>-6,300</u>
Exports, f.o.b. <u>1/</u>	22,027	21,125	20,707	23,905	24,000
Imports, f.o.b. <u>1/</u>	-21,047	-16,876	-18,717	-23,891	-31,900
Trade balance	980	4,249	1,990	14	-7,900
Services (net)	-203	939	1,739	1,574	1,200
(Credit)	(3,130)	(3,604)	(4,028)	(4,819)	(4,900)
(Debit)	(-3,333)	(-2,665)	(-2,289)	(-3,245)	(-3,700)
Net unrequited transfers	572	486	511	442	400
Capital account (net)	<u>-328</u>	<u>338</u>	<u>256</u>	<u>-1,003</u>	<u>2,900</u>
Medium- and long-term borrowing (net)	335	449	820	734	1,650
Drawings	(1,372)	(2,628)	(1,572)	(1,468)	(...)
Repayments	(-1,037)	(-2,179)	(-752)	(-734)	(...)
Foreign direct investment (net)	265	430	636	1,258	1,650
Portfolio investment abroad	...	-20	-641	-1,721	-1,000
Other medium- and long-term capital (net)	31	-470	-284	-384	-100
Short-term capital (net)	-959	-51	-275	-890	700
Errors and omissions	762	279	-366	-932	--
Allocation of SDRs	142	--	--	--	--
Overall balance	<u>1,925</u>	<u>6,291</u>	<u>4,130</u>	<u>95</u>	<u>-3,400</u>
Reserves and related items <u>2/</u>	<u>-1,925</u>	<u>-6,291</u>	<u>-4,130</u>	<u>-95</u>	<u>3,400</u>
Gold <u>3/</u>	55	--	--	--	--
Foreign exchange	-2,512	-6,352	-3,351	55	3,400
Reserve position in Fund <u>3/</u>	191	--	-121	-79	--
SDRs <u>3/</u>	-183	61	-176	-71	--
Use of Fund credit <u>3/</u>	524	--	-482	--	--

Sources: Data provided by the Chinese authorities; and Fund staff estimates.

1/ Data for 1981 are not comparable with those for 1982-85 because of a difference in the sources. The latter exclude re-exports.2/ (-) indicates increase.3/ Net of valuation adjustment.

Table 7. China: Medium-Term Balance of Payments Scenario, 1984-90

	Actual 1984	Est. 1985	Projections				
			1986	1987	1988	1989	1990
(In billions of U.S. dollars)							
Current account	2.0	-6.3	-7.1	-7.6	-8.1	-8.6	-8.6
Exports, f.o.b. <u>1/</u>	23.9	24.0	26.7	31.0	36.0	41.8	48.6
Imports, f.o.b. <u>2/</u>	-23.9	-31.9	-35.0	-39.7	-45.0	-51.0	-57.8
Services, transfers, net	2.0	1.6	1.2	1.1	0.9	0.6	0.6
Capital account	-1.0	2.9	7.1	8.4	9.7	10.5	10.7
Direct investment <u>3/</u>	1.1	1.5	1.7	2.0	2.2	2.5	2.7
Medium- and long-term capital, net <u>4/</u>	0.5	1.7	4.5	5.1	6.0	6.4	6.1
Short-term, net	-0.9	0.7	0.9	1.3	1.5	1.6	1.9
Bond purchases, net	-1.7	-1.0	--	--	--	--	--
Errors and omissions	-0.9	--	--	--	--	--	--
Overall balance <u>5/</u>	0.1	-3.4	--	0.7	1.6	1.9	2.1
Memorandum items:							
Reserves (end-year)	15.5	12.1	12.1	12.8	14.4	16.3	18.4
In months of imports <u>6/</u>	5.8	4.1	3.7	3.4	3.4	3.4	3.4
External debt outstanding	7.2	9.3	14.7	21.1	28.6	36.6	44.6
(In percent)							
Export growth	18.0	1.1	11.3	15.9	15.9	15.9	15.9
Import growth	28.5	31.6	9.7	13.4	13.4	13.4	13.4
Debt service ratio	3.2	4.5	4.6	4.8	5.0	6.7	7.4

Sources: Data provided by the authorities; and Fund staff estimates and projections.

1/ Non-oil export volume is assumed to increase by 8.5 percent per annum, compared with market growth of about 6 percent; growth of oil export volume is assumed to decline to 6 percent. Assumptions about unit values are taken from the latest World Economic Outlook.

2/ Import volume growth assumptions are as follows: heavy industrial and chemical products, 6 percent per annum; industrial materials, 6 percent; other imports, 4 percent. Unit value assumptions are taken from the World Economic Outlook.

3/ Net of Chinese investment abroad. Assumed to increase at 18 percent per annum initially and at a slower rate in later years.

4/ Residual.

5/ Target.

6/ End-year reserves in terms of months of projected imports for the following year.

China--Fund Relations  
(As of August 31, 1985)

I. Membership status

- a. Date of membership: Original member (the People's Republic of China assumed representation on April 17, 1980)
- b. Status: Article XIV

A. Financial Relations

II. General Department

- a. Quota: SDR 2,390.90 million
- b. Total Fund holdings of currency: SDR 2,085.8 million or 87.23 percent of quota
- c. Reserve tranche: SDR 305.1 million
- d. Current operational budget (September-November 1985):  
Maximum use of SDR 23.0 million
- e. Lending to the Fund: None

III. Stand-by or Extended Arrangement and Special Facilities

- a. Current stand-by: None
- b. Stand-by and extended arrangements in last ten years:  
Stand-by (first tranche), March 1981; SDR 450 million (25 percent of quota); China repurchased the full amount by end-August 1983
- c. Special facilities in last two years: None

IV. SDR Department

- a. Net cumulative allocation: SDR 236.8 million
- b. Holdings: SDR 433.0 million (182.9 percent of cumulative allocation)
- c. Current designation plan (September-November 1985):  
not included

V. Administered Accounts

- a. Trust Fund
  - (i) Disbursed: SDR 309.5 million
  - (ii) Outstanding: SDR 309.5 million
- b. SFF Subsidy Account: None

VI. Overdue obligations to the Fund: None

B. Nonfinancial Relations

VII. Exchange Rate Arrangement

China's currency, the renminbi, is linked to a basket of internationally traded currencies, weighted with reference to their importance in China's external transactions. The representative rate is determined as the mid-point between the buying and selling rate of the renminbi vis-a-vis the U.S. dollar. As of August 31, 1985, the representative rate for the renminbi was Y 2.9095 per U.S. dollar.

VIII. Last Article IV Consultation

The Executive Directors reviewed SM/84/221 on November 7, 1984 and adopted the following decision (excluding the first paragraph):

China continues to maintain restrictions on the making of payments and transfers for current international transactions in accordance with Article XIV. The Fund notes with satisfaction the intention of the authorities to eliminate the remaining bilateral payments arrangements with Fund members. The maintenance by China, in addition to the official rate, of an internal settlement rate for trade transactions and an exchange tax on remitted profits of joint ventures, gives rise to a multiple currency practice subject to approval under Article VIII, Section 3. The exchange restrictions, multiple currency practices and bilateral payments arrangements that relate to this decision are described in SM/84/221 (10/3/84) and in SM/84/229 (10/24/84).

IX. Technical Assistance

Since 1980, the IMF Institute has received more than 30 Chinese officials in its courses and seminars. In late 1983, the Institute organized a three-week course in Xian on "Banking and Monetary Policy." The Bureau of Statistics has sent three missions to discuss data presented in IPS, and in 1983 held a seminar in Beijing on balance of payments methodology. A two-week seminar on government finance statistics is scheduled for March 1986.

Two staff members of the Central Banking Department visited Beijing and Shanghai in May 1985 for discussions and lectures on central banking matters with officials and staff of the People's Bank. A CBD mission is scheduled to visit Beijing in March 1986 for advisory work relating to financial programming methods and monetary policy instruments.

X. Resident Representative/Advisor: None



Relations of China with the World Bank

**Representation:** The People's Republic of China assumed China's representation in the World Bank Group on May 15, 1980.

**Capital subscription:** China holds 23,482 shares or 3.28 percent of the total authorized capital of the Bank. China voted in favor of the Special Capital Increase under which it would be eligible to subscribe to 1,660 additional shares. No formal action has yet been taken to subscribe for these shares, but the Government is planning to complete subscription before the 1986 Annual Meetings.

**Lending activities:**

	<u>Commitments</u>		<u>Disbursements</u>	
	<u>IDA</u>	<u>IBRD</u>	<u>IDA</u>	<u>IBRD</u>

(In millions of U.S. dollars)

FY 1981	100.0	100.0	--	--
1982	60.0	--	--	--
1983	150.4	463.1	32.6	0.6
1984	423.5	616.0	100.9	19.6
1985	<u>442.3</u>	<u>661.2</u>	<u>146.2</u>	<u>235.7</u>
Total	1,176.2	1,840.3	279.7	255.9

Approved projects: FY 1981, university development project; FY 1982, North China Plain agricultural project; FY 1983, port facilities, agricultural education and research, China Investment Bank, two oilfields, and a land reclamation project; FY 1984, rural credit, rubber development, polytechnic/TV university, agriculture education, rural health and medical education, railways, hydropower, oilfield development, second credit for China Investment Bank and a technical cooperation credit; FY 1985, a second railways project, a second university development credit, coal mining, a second power project, fertilizer rehabilitation and energy saving, rural water supply, local development, highways, forestry development, seeds, agricultural research, and gas field technical assistance.

**Economic Development  
Institute:**

Since May 1981, the Economic Development Institute has held five courses a year for China, making it EDI's largest country program. Five additional courses were given by EDI in FY 1984 and are planned for each year in FY 1985 and FY 1986, using UNDP funds. Chinese participants have also been attending EDI regional courses and programs in Washington. In June 1985 a three-week seminar on development policy and management was held in Washington and New York for senior Chinese officials.

**Economic missions:**

The 1980 economic mission resulted in the publication of China: Socialist Economic Development (nine volumes). An updating country economic memorandum, China: Recent Economic Trends and Policy Developments (No. 4072-CHA), was distributed to the Bank's Executive Directors in March 1983. In early 1984 an economic mission visited China to focus on long-term economic issues and options. A Fund staff member participated in this mission. A report by this mission (No. 5206-CHA) entitled China: Long-Term Issues and Options was discussed with the Chinese authorities in March 1985 and approved by the Bank's Executive Directors in June 1985. In October the report will be published in book form by the Johns Hopkins University Press. A Chinese translation will be published concurrently in China.

**Resident mission:**

A resident IBRD office in Beijing will be formally opened in October 1985.

## CHINA

## Basic Data

<u>Area</u>	3,748,800 sq. miles (9,597,000 sq. km.)				
<u>Population (end 1984):</u>	1,035 million				
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u> <u>Est.</u>
<u>GDP (in billions of yuan, at current prices)</u>	458.7	493.7	546.9	652.5	790.0
<u>Population growth (in percent, mid-year)</u>	1.3	1.4	1.7	1.0	...
<u>GDP per capita (US\$)</u>	271	259	271	273	...
<u>Annual percentage changes</u>					
Real GDP	4.9	8.3	9.8	13.9	12.0
Real gross industrial output	4.1	7.7	10.5	14.0	17.0
Real gross agricultural output	6.6	11.0	9.5	17.1	6.0
Gross investment (current)	-3.3	9.6	13.5	26.1	29.5
Budgetary revenue	5.3	1.2	8.3	14.7	...
Budgetary expenditure	-1.6	2.0	9.6	14.8	...
Currency in circulation	14.5	10.8	20.7	19.4	...
Total liquidity	19.7	14.9	19.2	37.2	19.0
Domestic credit	13.5	11.7	15.4	35.5	18.0
Cost of living index	2.5	2.0	2.0	2.7	9.0
Agricultural procurement prices	5.9	2.2	4.4	4.0	...
Value of imports (balance of payments basis in U.S. dollars)	-4.5	-18.7 <u>1/</u>	10.9	27.6	33.5
Value of exports (balance of payments basis in U.S. dollars)	19.1	2.0 <u>1/</u>	-2.0	15.4	0.4
<u>Ratios to GDP (in percent)</u>					
Agricultural production	35.7	37.8	38.3	38.3	36.2
Industrial production	37.2	36.5	35.8	35.0	36.6
Total investment	29.2	29.7	30.4	32.4	34.6
Budgetary expenditure	31.4	29.7	29.4	28.3	27.7
Budgetary revenue	30.2	28.4	27.8	26.7	26.5
Budget deficit	1.2	1.3	1.6	1.6	1.2
Imports of goods and services (balance of payments basis)	9.1 <u>1/</u>	7.5	7.6	9.6	12.8
Exports of goods and services (balance of payments basis)	9.3 <u>1/</u>	9.5	8.9	10.2	10.4
Currency in circulation	8.6	8.9	9.7	12.1	...
Total liquidity	50.4	57.6 <u>2/</u>	62.0	71.3	70.3
Domestic credit	62.6	70.4 <u>2/</u>	73.4	81.4	81.5
<u>Balance of payments (US\$ mn.)</u>					
Exports, f.o.b.	22,027 <u>1/</u>	21,125	20,707	23,905	24,000
Imports, f.o.b.	-21,047 <u>1/</u>	-16,876	-18,717	-23,891	-31,900
Trade balance	980 <u>1/</u>	4,249	1,990	14	-7,900
Current account balance	1,349	5,674	4,240	2,030	-6,300
Capital account (net) <u>3/</u>	-328	338	236	-1,003	2,900
Overall balance	1,925	6,291	4,130	95	-3,400
<u>International reserves (US\$ mn.)</u>					
(In months of imports)	5.574	11.840	15.451	16.516	12.116
	4.0	7.6	7.8	5.8	4.1
<u>Debt service payments</u>					
(Percent of exports of goods and services)	8.5 <u>4/</u>	10.9 <u>4/</u>	5.5 <u>4/</u>	3.2	4.5
	5.4 <u>5/</u>	6.6 <u>5/</u>	3.7 <u>5/</u>		
<u>Official exchange rate</u>					
(Yuan per U.S. dollar, average during the year)	1.705	1.892	1.976	2.320	2.851 <u>6/</u>

1/ Not comparable with data for subsequent years, which exclude re-exports.

2/ Data from 1982 include operations of the People's Construction Bank and are not comparable with earlier years.

3/ Excluding errors and omissions.

4/ Includes early repayments/repurchases.

5/ Excludes early repayments/repurchases.

6/ Average for first eight months.

China--Statistical Issues

1. Outstanding Statistical Issues

a. Real sector

With the introduction of changes to the statistical system, the authorities have commenced publication of data on employment, earnings, and industrial production in the new monthly bulletin of the State Statistical Bureau (S.S.B.). The Bureau of Statistics is in touch with the authorities with a view to including new series in these areas in IFS, and to review further indices on foreign trade prices.

b. Monetary accounts

Monetary data are provided for the Monetary Survey on only a quarterly basis. There continues to be a need to improve the institutional coverage of these data as well as the reporting system, i.e., to establish separate report forms for the monetary authorities, the deposit money banks, and the nonmonetary institutions. Pending the completion of the separation of the accounts of the Industrial and Commercial Bank from the accounts of the People's Bank, revisions to the monetary survey remain in abeyance.

c. Government finance

No data were published for China in the 1984 Government Finance Statistics Yearbook. At the request of the Chinese authorities, a two-week seminar on government finance statistics will be presented in China starting mid-March 1986. Discussions with the authorities during the seminar in China will cover the Fund's GFS format and the methodology for the derivation of data from national sources as well as the availability of current data for publication in IFS.

d. Balance of payments

The authorities have recently authorized, for the first time, the publication of annual balance of payments data. The October 1985 issue of IFS will include balance of payments data for 1982-83; these data will also be published in the forthcoming annual issue of Balance of Payments Statistics.

## 2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for China in the September 1985 issue of IFS. The data are based on reports sent to the P.L.d's Bureau of Statistics by the People's Bank of China, which during the past year have been provided on a timely basis, with the exception of Monetary Survey data.

<u>Status of IFS Data</u>		<u>Latest Data in September 1985 IFS</u>
Real Sector	- National Accounts	1984 <u>1/</u>
	- Prices: wpi	1984
	- Production: cpi	1984
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1984
	- Financing	n.a.
	- Debt	n.a.
Monetary Accounts	- Monetary Authorities	n.a.
	- Deposit Money Banks	n.a.
	- Other Financial Institutions	n.a.
	- Monetary Survey	Q1 1985 <u>2/</u>
External Sector	- Merchandise Trade: Value	March 1985
	Prices	n.a.
	- Balance of Payments	n.a. <u>3/</u>
	- International Reserves	April 1985
	- Exchange Rates	July 1985

1/ The section on national accounts only includes line 99e (national income).

2/ Data for the Monetary Survey are available on a quarterly basis.

3/ Balance of payments data for 1982 and 1983 will be published in the October 1985 issue of IFS.