

INTERNATIONAL MONETARY FUND

June 4, 1947

To: Members of the Executive Board
From: The Secretary
Subject: Report on Visit to China

Attached is a confidential report on China which Mr. Koo has sent to the Managing Director with the request that it be circulated to the members of the Executive Board.

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INTERNATIONAL MONETARY FUND
Washington 6, D. C.

June 4, 1947

MEMORANDUM

To: Mr. Camille Gutt
From: Y. C. Koo
Subj: Report on the Visit to China

I left Washington for China on March 9 by train and boat and returned to the Fund on May 25 by plane. An absence of 78 days from my office was beyond my calculation but was necessitated by unavoidable demands on my time.

While interviewing the various officials of the Chinese government, I first outlined to them the achievements of the Fund and then negotiated for the Fund with regard to the work which the Chinese government was expected to perform. My mission was very much facilitated by the enthusiastic and cooperative attitude of the officials concerned. I was instructed to convey their congratulations and best wishes to the Fund.

Besides carrying on the strictly official negotiation between the Fund and the Chinese government, I had the privilege of interviewing President Chang Kai-Shek and being consulted on financial matters of China. I also engaged in discussion with leaders of the financial and industrial circle and was requested to speak in Nanking and Shanghai on several occasions on the work of the Fund and other financial problems.

At a reception given by the Ministry of Finance and the government banks to which the members of the Chinese Bankers Association were also invited, I conveyed greetings to them on behalf of the Fund.

From impressions gathered on my trip, I came to two important conclusions. The first is that some phenomena are much worse than and some not so bad as I had contemplated when viewed from a distance. My second conclusion is that the interaction of internal and external disequilibrium in China really constitutes an Oriental puzzle.

The budget for the current year was first put at 9 trillion yuan. This was bad enough, but Mr. Yui, Minister of Finance, told me that a new estimate would increase it to 20 trillion, mainly due to increasing military expenditures for the campaign against the Communists. During February and March, the Shanghai price index was held steadily at around 11,000 times the prewar level but, when I left China in May, it had jumped to 26,000 times. These unfortunate events were rather unexpected.

The picture, however, is not without its bright side. There has been much talk about the increasing issue of bank notes which has reached a figure of about 6 trillion. If we analyse this in more detail, it is not so bad as it appears. To convert this total issue into American currency according to its purchasing power parity, it amounts to only about \$200,000,000. Another gratifying point is that its 60 per cent legal reserve in gold and foreign exchange is still kept intact.

In connection with the Emergency Measures enforced since last February, some significant improvements have been made in the financial structure of China. Import and export controls are now under the able directorship of Governor K. N. Chang of the Central Bank, assisted by Messrs. Li Ming and K. P. Chen, all of them being veteran bankers of China. A Discount Committee has also been established within the Central Bank, to which leaders of commercial banks are recruited to sit side by side with officers of government banks. This has replaced the bureaucratic regime in trade and financial control and has pointed the way to directing national resources into

productive channels. The issue of gold bonds and treasury notes has proven successful. On the reconstruction side, mention must be made of the progress in transportation and communication. New steamship lines have been instituted and trains are running on schedule. The sleeping cars are the same as the Pullmans in other countries. Mail service has become very efficient in spite of the low pay of the postal employees. These are some of the comforting features in the recent economic development.

But the Oriental puzzle is by no means solved. To begin with, after a year's trade deficit of about U.S. \$500,000,000 for 1946, Chinese financial authorities were very much alarmed at the beginning of this year by the continuous receding of exchange reserve and tried every effort for its preservation and strengthening. After February 17 government purchase of gold and American bank notes was resorted to. Up to the end of April the total purchase of American notes amounted to \$60,000,000. While the government was jubilant over this reinforcement of its official holding, prices began to soar by leaps and bounds because this purchase of 60 million dollars forced eventually a new note issue of 720 billion yuan into circulation, or an addition of more than 10 per cent to the outstanding issue. Cost of living and wages rose rapidly and production in some branches of the national economy became paralyzed. In turn, internal disequilibrium is now carrying the day. A fear is entertained that increasing costs will very soon choke up the export market and bring about a greater trade deficit. In the absence of extraordinary force to bear on this situation, there will be no end to this interaction between external and internal disequilibrium.

This does not mean that the disease is beyond cure. Some healthy spots are constantly present. On the fiscal side, the salt revenue, customs duties and the consolidated taxes can be greatly improved. Government enterprises

such as the Chinese Textile Corporation and the Fushun and Fooshing Coal mines are faring very well in spite of hardships. As far as the international balance of payments is concerned, gold holdings in the hands of the public constitutes a potential source of strength. With regard to the national economy as a whole, the China of today is enjoying a much more balanced development than the China of prewar period, inasmuch as the tremendous resources of the Northeastern Provinces and Formosa, restored to China since V-J day, have now begun to be mobilized. There has developed a keenly felt desire towards stabilization of the currency. The only missing link is some sort of momentum which would restore the confidence of the public and help in cutting the vicious circle.