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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/181

3:00 p.m., November 12, 1986

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	E. T. El Kogali
Dai Q.	
	M. K. Bush
J. de Groote	
A. Donoso	
	M. Z. M. Qureshi, Temporary
	T. Morita, Temporary
	B. Goos
	J. Reddy
	J. R. N. Almeida, Temporary
T. P. Lankester	
	H. Fugmann
M. Massé	
	D. Saha, Temporary
	L. P. Ebrill, Temporary
	E. Ayales, Temporary
	S. de Forges
G. A. Posthumus	
C. R. Rye	
	C.-Y. Lim
	O. Kabbaj
	A. S. Jayawardena
	N. Kyriazidis

L. Van Houtven, Secretary
J. K. Bungay, Assistant

1. People's Republic of China - 1986 Article IV Consultation
 and Stand-By Arrangement. Page 3
2. Angola - Membership - Expression of Interest. . . . . Page 15

Also Present

IBRD: C. Wallich, East Asia and Pacific Regional Office. African Department: A. D. Ouattara, Director; G. B. Taplin. Asian Department: P. R. Narvekar, Director; H. Neiss, Deputy Director; M. J. Fetherston, D. J. Goldsbrough, F. Le Gall, M. A. Pinho, K. Saito. Exchange and Trade Relations Department: E. H. Brau, M. R. Kelly, P. J. Quirk. External Relations Department: G. P. Newman. Legal Department: P. L. Francotte, A. O. Liuksila, J. M. Ogoola. Research Department: C.-Y. Lin, M. c. Williamson. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. Péterfalvy, G. Pineau, I. Puro, I. Sliper, Song G., D. C. Templeman, A. Vasudevan. Assistants to Executive Directors: O. S.-M. Bethel, F. Di Mauro, G. K. Hodges, S. King, K.-H. Kleine, C. Noriega, V. Rousset, C. A. Salinas, H. van der Burg, Wang X., Yang W.

1. PEOPLE'S REPUBLIC OF CHINA - 1986 ARTICLE IV CONSULTATION AND STAND-BY ARRANGEMENT

The Executive Directors resumed from the previous meeting (EBM/86/180, 11/12/86) their consideration of the staff report for the 1986 Article IV consultation with China and China's request for a 12-month stand-by arrangement in an amount equivalent to SDR 597.725 million (EBS/86/230, 10/10/86). They also had before them a background paper on recent economic developments in China (SM/86/260, 10/24/86).

The staff representative from the Asian Department said that China currently had two types of economic management: the traditional centralized planning system, and the emerging system that gave greater autonomy to enterprises and permitted the exercise of profit maximization. Of course, under the latter system the enterprises had to follow certain regulatory arrangements established by the Central Government and would also be constrained by the authorities' financial policies. However, with the authorities' emphasis on a growing role for the market and price mechanisms, enterprises were becoming more responsive to market signals and price changes. Despite the increased role of the market mechanism in the Chinese economy, it was not likely that China would ever move entirely to that system.

China had made substantial progress in moving from the centralized planning system to a system that included greater autonomy under regulatory arrangements, the staff representative continued. For example, in 1985 the number of industrial commodities subject to strict mandatory planning had been reduced by half, to 60. The authorities planned to reduce that number further, but would keep certain essential key industries under the planning system.

Many enterprises were currently trying to maximize or increase profits profits, particularly those enterprises that were not subject to strict mandatory planning, the staff representative went on. Even those enterprises under the mandatory planning system were striving to exceed their output quota, and that had contributed to the tremendous increase in output in the past few years. Moreover, many enterprises were keen to increase investment with a view to increasing profits in the years ahead. The main issue under the new system was that when enterprises were not doing well or were registering losses, the authorities did not have the instruments to force the enterprises to reduce losses, rationalize their operations, or increase profits. As Directors had noted, the authorities had been reviewing the ultimate instrument available to them, namely, the bankruptcy law. However, for enterprises that showed more promise, the authorities could encourage them to manage inventories better, to restrain wage and bonus payments, and to improve their efficiency in general.

Although there had been no fundamental change in the Chinese authorities' attitude toward the principle of social ownership, a few modifications had been made in recent years, the staff representative pointed out. For example, in the agricultural sector, farmers were being granted leases of land for as much as 50 years for certain kinds of production, and those leases, which lasted on average for 10 to 15 years, gave farmers more freedom to make investments and better use of the land. Moreover, state-owned commercial and service outfits were being increasingly transferred to collectives and individuals, and those transfers had provided greater incentives. Some centrally owned, state enterprises had been shifted to local ownership, and although the difference was subtle, the shift provided additional incentives to local governments to increase output and profits of the enterprises.

The second area of modification with respect to ownership had been reported extensively in the press, namely, the emergence of a joint stock company, and the issuance of stocks to a selective group of individuals and enterprises, the staff representative added. The nature of such joint stock companies and their stocks was still being debated, but the latest modification was certainly an interesting development.

The next price reform that the authorities would be implementing in early 1987 involved both the deregulation of price control as well as the adjustment of fixed prices of many items, including energy, raw materials, and possibly retail prices of some food, the staff representative remarked. The authorities had also announced recently that a few hundred items had been deregulated, including manufactured consumer goods. Such price reforms were expected to have far-reaching effects on enterprise investment behavior, production behavior, and subsidies. In addition, deregulation would bring more competition. When prices had been fixed, some weaker enterprises had benefited from the system even though their products were inferior, but after the deregulation of the prices, those enterprises would find a change in the prices and demand for their products. The authorities intended to retain a few key items under state control and to adjust their prices from time to time. However, the majority of prices would be deregulated and would be determined on the basis of demand and supply. It was the staff's understanding that the fixed prices would continue to be determined on the basis of the cost-plus principle.

The recently announced enterprise reform measure involved three elements, the staff representative noted. Under the new system, responsibility that had previously rested with the state was extended to all enterprises; the functions of the party and enterprise administration were separated; and greater responsibility for operational matters was granted to the management of each enterprise. All three elements were important steps toward making enterprises more efficient and responsible for potential losses.

In extensive discussions with the authorities on credit developments in the second quarter of the year, the staff had expressed its concern about the matter, the staff representative recalled. The staff's understanding was that the credit expansion was a temporary phenomenon resulting from a delay in the enterprise adjustment process; the enterprises were in transition from a period of excessively rapid growth to one of more normal growth. In the process, some enterprises had accumulated huge inventories and had continued to pay large bonuses. As a result, a number of enterprises had experienced extreme liquidity shortages, and the banks had to some extent accommodated their credit demand. However, credit policies were being tightened in the second half of the year and that tighter stance would continue into 1987. Such credit tightening would force the enterprises to adjust further, and that process would then reduce credit demand.

Responding to a question about the relationship between reforms and adjustment, the staff representative noted that economic reform measures were an important part of the authorities' current economic adjustments. The progress in economic adjustment, in turn, provided a basis for further steps toward economic reforms.

Several Directors had alluded to the question of China's prospects after the current period of economic adjustment, the staff representative continued. A number of Directors had mentioned that the medium-term scenario might be too conservative, and had asked questions about the appropriateness of import growth in terms of the targeted growth rate over the medium term. The staff scenario was based on the assumption that the authorities would maintain their policy of cautious external borrowing and would reduce their dependence on short-term borrowing, that the reforms would continue so that economic efficiency in general would increase, and more specifically, that import dependence would decline and that the same rate of growth could be achieved with lower imports. Accordingly, the decline in import volume in 1986 and 1987 shown in the scenario was based on progress in reforms as well as on the large inventories built over the past two years when import growth had been rapid, averaging close to 40 percent a year. For the subsequent three years, the staff's assumption was that import volume would grow at a rate of 3 percent, or about half the targeted domestic economic growth. Of course, that relationship was based on the assumption that reforms would increase efficiency, especially with respect to imports of equipment and raw materials.

The adequacy of investments depended on the targeted growth rate as well as the constraints in implementing investments, the staff representative stated. Of course, it was difficult to determine what was adequate and what was not, but it was clear that China's recent investment growth had been excessive. The investment to GNP ratio had risen from 30 percent to 38 percent, and that excessive investment had created domestic inflationary pressures and balance of payments problems. The authorities were trying to reduce or slow investment growth by means of various policy measures.

Investment had to be classified into two categories for purposes of assessing its efficiency, the staff representative commented. Budget financed investment, including that in the narrowly defined mandatory plan, focused on priority sectors, mainly energy, transportation, and communications. Of course, it was difficult to assess the efficiency of such investment, although the World Bank was trying to develop a system for doing so. The other type of investment, which had been rising rapidly, was that financed from nonbudgetary sources by enterprises, local governments, and individuals. Much of that investment was in consumer goods production and residential construction. The recent World Bank study had stressed the importance of price reform to permit better allocation of investment. The report had also highlighted the importance of interest rate changes, both on the lending and deposit sides. The lending interest rate had to be rationalized in order to encourage more efficient investment, and the deposit rates were so low that many of the funds of enterprises had been invested in real assets because there was no attractive savings alternative.

The staff did not think that its position on the budget was too strong, because it had been derived in the light of the need for external adjustment, the staff representative explained. The balance of payments deficit was large, the domestic savings gap was large, the adjustment need was considerable, and, therefore, the staff had argued that the budgetary effort could not be neglected because the budget was an instrument that the authorities could use directly with the greatest degree of certainty.

The authorities were considering several areas of tax reform for 1987, including steps to rationalize enterprise taxation and both direct and indirect taxes, and ways to increase the scope of value-added taxes, the staff representative observed. The authorities would be considering new taxes on the use of land and real assets as well as taxes on personal incomes. Another measure under consideration was an increase in the rate of tax on extrabudgetary receipts and investment. As the staff's information on the tax reform and tax policies for 1987 was still limited, no assessment could be provided on the quantitative effect of those tax changes.

The authorities would need to implement an active and flexible interest rate policy by maintaining positive real interest rates, the staff representative noted. In addition, a number of measures had to be made in order to rationalize the interest rate structure. The enterprise deposit and lending rates needed to be raised, because they were considerably lower than the interest rates that applied to individuals and individually owned enterprises. The authorities also needed to introduce greater flexibility in interest rate policy through the use of floating interest rate arrangements.

It was difficult to explain why specialized banks maintained such large reserves, the staff representative said. One factor was the extremely large network of banking branches, each of which was required to maintain reserves. In addition, given the difficulties in transportation and communications, each bank branch tried to maintain an adequate reserve cushion, with the result that the banking system as a whole had considerable reserves.

Moreover, the history of the banking system played a role, the staff representative added. Until a few years earlier, bank branches and specialized banks had been asked to send all their deposit receipts to the headquarters of the People's Bank of China, and, in turn, they had received all the required funds for loans. At that time, the accounts did not show clearly what the central bank had received in terms of deposits and what amounts it had been lending. The banking system had been operating in effect like a family organization, and internal transactions had been handled informally. However, when the central bank was separated from the specialized banking system, the accounting system had been made more formal, and an effort had been made to determine which loans and deposits belonged to the central bank and which belonged to the specialized banks. In that process it was possible that the recorded level of the loans of the central bank to specialized banks and the deposits by specialized banks in the central bank had been on the high side. Regardless of the reasons, the fact remained that these reserves of the banking system as a whole, were large, which led to the potential danger of undesirable liquidation of those reserves to finance additional loans. Accordingly, the authorities had been considering a number of alternatives to liquidate those reserves, including the issuance of central bank bonds to the specialized banks.

The adequacy of the constant velocity of money assumption was difficult to assess, the staff representative went on. Although velocity had been declining in China, sharp fluctuations had occurred--for example, in 1985 velocity had actually increased. Given that unpredictability, together with the need to formulate monetary policy in a cautious manner, the staff and the authorities had agreed that the constant velocity assumption was probably best, so that if an error occurred, it would be on the cautious side.

Responding to the question about the benchmarks for both the credit of the total banking system and credit of the People's Bank of China, the staff representative indicated that China's adjustment was being implemented with instruments that were still being developed. Indirect control of banking system credit was one such developing instrument; only in the last year had the authorities established a full monetary survey with a breakdown of central bank accounts and specialized bank accounts, and since then they had been developing the system to control aggregate demand through total credit, and in turn through central bank credit. Against that background, the staff had thought it would be helpful to have two benchmarks as a way of improving the management of banking credit and aggregate demand. The staff recognized the risk of overdetermining two types of credit if the assumption behind the relationship between the two variables was not borne out by actual developments, but that possible disadvantage would be outweighed by the benefits of better management.

The developments in foreign direct investment had been impressive, with cumulative commitments thus far amounting to $15 billion and actual disbursements, $5 billion, the staff representative mentioned. About 240 foreign enterprises were operating in China, and a few thousand joint ventures existed, but investors had pointed out the difficulty in interpreting economic laws and in acquiring foreign exchange for the purpose of importing raw materials. The authorities had indicated that, to date, the foreign direct investment had been in areas on which the authorities placed little emphasis, such as services or import-substituting industries, but few investments had been made in the export industries. The authorities had also taken note of the recent weakening in foreign direct investment, particularly in the first half of 1986. The recently announced measures had been adopted against that background and were aimed at promoting further direct investment. Those measures were responsive to almost all the issues that foreign investors had raised, and the authorities hoped that the new measures would encourage further direct investment.

It was true that the World Bank's commitment of loans was far greater than the amount disbursed, the staff representative acknowledged. However, that was a normal situation and, in fact, disbursements had been made considerably more rapidly in China than in some other countries. There were no significant problems in terms of China's ability to absorb bank financing, implement bank-financed projects, or implement foreign-financed projects in general.

In the staff's discussions with the authorities on China's reserve tranche position, as a part of the overall reserve policy, the authorities had indicated that they considered the reserve tranche position as a backup and had no intention of utilizing those funds, the staff representative reported. However, there was always the possibility that the situation had changed since those discussions.

As many Directors had noted, China's economic scene had changed rapidly, particularly with respect to imports and the balance of payments outlook, the staff representative recalled. It was true that a few years ago the staff had urged China to increase its imports to enhance its long-term economic development, but the staff had certainly not envisaged that imports would increase by 60 percent in one year, as had occurred in 1985. Something had clearly gone amiss in the process of modifying import policy, and the authorities were currently taking measures to correct that situation.

As to whether China could have implemented measures to strengthen the branches of the specialized banks so that the branches and the banks could be more profit oriented and operate more rationally, the staff representative said that it was important to remember that the authorities were taking a pragmatic approach to implementing their reforms. The authorities were tackling the issues that were most urgent and that would give rise to relatively less social friction. As to the banking reform, what the authorities had needed most in 1983-84 was to establish a central bank that could implement macroeconomic policies. Since the establishment of the central bank and the new system of specialized banks in 1984, many efforts had been made to perfect the system, such as the separation of the accounting system and the introduction of a new management system. The authorities had been exploring ways in which new banks and new types of financial institutions might be useful.

The staff understood that one "private" bank had been set up in Shanghai in 1986 and that a number of nonfinancial institutions--such as investment and finance corporations, and trust departments of the specialized banks--had been established, the staff representative from the Asian Department indicated. Together with those new institutions, new financial instruments such as bonds, shares, and interbank monetary transactions, were also being introduced. Thus, the authorities were taking steps to strengthen the traditional banking system, but were also introducing new systems of financial institutions and were improving the institutions and the new instruments.

The staff representative from the Exchange and Trade Relations Department, recalling Mr. Peterfalvy's observation "that eventual performance criteria that are systemic in nature would not be added to, but rather would replace criteria on demand management," said that the systemic criteria to the demand management criteria might be more apt. The discussion had made clear that the demand management objectives expressed through credit policy were quite important. Moreover, it was noteworthy that the letter of intent from the authorities did contain strong commitments to structural reform; the price reform, to be implemented early in 1987, was prominently mentioned, for example. However, behind that specific question on China was a more general issue, namely, how best to adapt the customary monitoring criteria to programs emphasizing structural reforms. It would be helpful for Directors to give guidance to the staff on that question. An opportunity for further discussion of that issue would arise in early December 1986, when the Board was scheduled to consider a staff paper entitled, "Program Design and Performance Criteria" (EBS/86/211, 9/8/86).

China's arrangement would have been the same if it had drawn on the reserve tranche before applying for the credit tranche drawing, the staff representative from the Exchange and Trade Relations Department explained. The reserve tranche was available for use by a member at any time to meet a payments need, and was totally separate from the conditionality applicable to drawings in the first credit tranche.

Mr. Dai made the following statement:

> At the discussion of the 1985 Article IV consultation with China (EBM/85/162, 11/8/85), a number of Directors reminded us to adopt

effective measures to cool off our overheated economy. One year has passed, and I am pleased to say that the overheated economy has been put right and the situation is much more normal. However, although significant progress has been made, we are well aware that there are still shortcomings in our work and many difficulties still exist. For instance, we are still facing a situation in which aggregate social demand exceeds aggregate supply, and in the external sector, the current account deficit remains large. Thus, we need to continue strengthening macroeconomic control.

Despite our achievements, our tasks of reform are difficult and complex. Our recent reform efforts have become the focus of world attention and have gained wide support and cooperation from many foreign friends and the international community, including the Fund. In the recent years of economic development and reform, we have experienced swings similar to those in market economies. It apparently had always been difficult to pinpoint a break-even point between economic growth and inflation pressures in market and planned economies.

Since 1981, we have had a continuing increase in our current account surplus and our reserves have risen quite rapidly. During this time, we have held the same view as did many foreign friends who advised us to use part of our reserves to accelerate the pace of economic development. The resulting problem was that because of our lack of experience, especially in macroeconomic control, when decentralization was taking place, we used huge amounts of our foreign exchange surplus. In retrospect, it appears that unfortunately we did not make good use of this surplus. The surplus was used too hastily and some of the foreign exchange was not used properly.

I fully agree with the views of several Directors that the efficiency of investment is of crucial importance. The excessive investment surges that have emerged in our overheated economy since late 1984 resulted in three problems. First, the proper ratio of investment to national income was disrupted. Second, the quality of some investment was poor, and some investments were not productive. Third, since most investments were concentrated on infrastructure, they usually required a long time to yield a return.

Some Directors have observed that price reform should be comprehensive and should not be limited merely to a few raw material items. These observations are quite understandable. I wish to stress that owing to the long history of our traditional rigid pricing system, this is the most difficult, complicated task in the pricing reform. We are trying to straighten out the relations within the pricing system and simultaneously to avoid a dramatic increase in prices. We are carrying out the reform step by step, in a very cautious manner. In fact, our price adjustment effort began a few years ago. First, we adjusted and revised the purchase price of foodgrains and other main agricultural products purchased from farmers. Last year, we again lifted the control on prices for vegetables and other agricultural products and goods in daily use. Our next step will be to lift the control on prices for some raw materials. We plan to obtain a rational pattern of pricing in the future as well.

Our policy of opening China to the outside world is a long-term one. China needs to make use of foreign funds, to introduce technology, and to benefit from the managerial expertise of foreign countries. In this respect, foreign direct investment is emphasized, and in order to encourage it we have taken a series of measures to improve the investment climate in China. In early 1986, we instituted a new provision to tackle the problem of foreign exchange earnings of foreign investors. Recently, further steps to encourage foreign direct investment were announced, including more preferential taxes, concessional fees, and the liberalization of exchange controls for foreign investors.

It is still too soon to answer the questions about how the two different management systems--direct planning and market oriented--coexist in our economy and how ownership will develop in the course of China's economic reform. Needless to say, these important problems have not only practical but also theoretical significance. There are already multiple modes of ownership in our socialist economy--state-owned, collective-owned, privately owned, joint venture, and wholly foreign-owned--with state ownership being central and predominant. At the same time, there are multiple types of economic management coexisting in the economy, so that we have a combination of mandatory planning, guidance planning, market adjustment, and administrative measures. There appear to be some conflicts and contradictions among the different types of mechanisms in our economic management. With the progress of economic reform, the weight or ratio of each type will change; the final optimum combination will depend on many factors and will be evident only after a considerable amount of experience has been gained. We are experimenting with a new, historical transformation that is still in its early stages. Time is needed for us to understand the capabilities of our country and to accumulate experience in making such profound reforms.

The Chairman then made the following summing up:

Executive Directors expressed their admiration and warm support for the authorities' continuing progress in invigorating the Chinese economy through economic reforms. They noted that the task of transforming the economic system while maintaining economic stability was a challenging and difficult one, and commended the authorities' courage and determination in pursuing that goal. Directors particularly welcomed the authorities' timely adoption of an economic program designed to reduce the macroeconomic imbalances that had emerged in recent years and to establish a sound base for further reforms and steady growth.

Directors observed that the authorities had made considerable strides toward establishing a new framework of macroeconomic management that would progressively assume the role formerly played by direct planning controls. They noted that the process was complex and time consuming, and that during the transition phase--which had been a period of dramatic growth over the past years resulting precisely from the economic reforms, including the enhanced autonomy and incentives of production units--the economy had become more vulnerable to macroeconomic imbalances. A rapid expansion of money and credit in late 1984 had been followed by intensified excess demand pressures, reflecting in part a major investment boom, and a sharp deterioration in the People's Republic of China's external position.

In 1985 the authorities had acted promptly to correct those imbalances with tighter financial policies, exchange rate, interest rate, and other price adjustments, and some tightening of administrative controls. Directors observed that by the first half of 1986, those measures had brought the economy under better control, with demand and output growing at more sustainable rates, inflationary pressures moderating, and the external deficit showing signs of improvement. Directors noted that the external imbalances were still large, however, and felt that the authorities had acted prudently in implementing additional adjustment measures designed to reduce the current account deficit, maintain international reserves, and provide the necessary basis for sustainable growth. Directors considered that the authorities' chosen mix of policy measures was broadly suited to China's circumstances of transition in economic management. Indeed, they noted, the deployment of new macroeconomic instruments was itself an integral element of the authorities' strategy of economic reform. At the same time, many Directors recognized that a limited use of more traditional Chinese instruments of direct economic control might still be needed in areas where macroeconomic instruments had not yet become fully effective.

Directors stressed the important role of domestic financial policies in economic stabilization, and noted the contribution that had already been made in that area by improvements in credit and budgetary policies during 1985. While noting the untimely easing of financial conditions in the first half of 1986, Directors generally welcomed the authorities' decision to tighten financial policies in the remainder of the year and in 1987. Directors stressed in particular that credits to enterprises should be closely linked to their productivity and commercial effectiveness. Increased financial discipline of enterprises was essential, Directors said, to avoid financing of unproductive investment, including stock building of finished goods. In that connection, Directors raised a number of questions regarding the evolving role and work methods of banks and credit institutions in China that the authorities and the staff should clarify in future consultations. Directors noted that both the recent adjustments in the lending rates charged by the People's Bank on its lending to specialized banks and improvements in monetary management techniques should facilitate the task of overall credit control. The authorities' intention to maintain positive real interest rates so as to promote financial savings was welcomed.

Directors commended the authorities for the prudent budgetary policies pursued during recent years. Noting that the slowing of economic expansion in early 1986 had limited revenue growth, Directors considered that the authorities had acted appropriately in implementing measures to curb expenditures during the second half of the year. They welcomed the authorities' intention of maintaining a tight fiscal stance in 1987--through firm control of expenditure, including subsidies--while continuing to implement tax reforms. Directors considered that those expenditure and revenue measures would yield a smaller budgetary deficit and further improvement in the budget's position with the banking system. A number of Directors stressed the importance in the overall fiscal stance of a stronger revenue performance and reduced subsidies, to ensure that the required fiscal discipline would not be at the expense of high priority, public public investment to improve infrastructure.

Directors warmly endorsed the recent steps to improve external debt management and statistics, at a time when external debt had not yet become unduly large in relative terms, and noted that proper management of the volume and structure of external borrowing formed an essential element of policies to ensure a viable external position. Directors considered appropriate the authorities' objective of further improving the structure of external borrowing by limiting recourse to short-term and other nonconcessional sources of external finance. They also stressed the benefits for the economy of inflows of foreign equity capital and welcomed the authorities' recent further measures to improve the climate for direct investment.

China's medium-term prospects, Directors considered, were closely linked to an expansion of export earnings that would permit imports of raw materials and capital goods to increase at rates compatible with adequate economic growth. Directors therefore welcomed the authorities' emphasis on expanding non-oil exports, and observed that the recent devaluation of the renminbi constituted an important step toward that objective. Several Directors emphasized the vulnerability and uncertainty in China's external outlook in the longer run, noting among other things the changing relationship of imports to growth in a period of economic liberalization and the ambitious or perhaps too optimistic growth forecasts for exports in the medium term. Under the circumstances, Directors stressed that a flexible exchange rate policy over the period ahead would play an essential role in securing continued external adjustment. They considered that the authorities could enhance the effectiveness of exchange rate policy in promoting exports and containing import demand by making more determined strides in price reforms and reforms in the foreign trade regime so as to strengthen the links that thus far remained rather weak between world prices and production and trading decisions.

Directors were encouraged to note that the authorities intended to implement additional economic reforms early in 1987, and urged that those reforms include further liberalization of the price system. They fully endorsed the view that progress in economic system reform would require the further development of markets and price mechanisms that would supplant direct planning in guiding the allocation of resources. In addition to price reforms, Directors emphasized that it was important to clarify the evolving degree of operational autonomy of enterprises, to implement measures to increase their financial responsibilities, to establish disincentives to poor economic performance, including bankruptcy provisions, and to provide incentives to improve the quality of goods produced and the profitability of enterprises' investment.

Directors also urged further progress in labor market reforms, putting particular emphasis on wage differentiation, closer linkage of wages to developments in productivity, promotion of labor mobility and retraining, and a review of lifelong employment guarantees.

Directors recognized that the authorities had set themselves a challenging task to transform the economic system. They considered that the manner in which the authorities had approached their task, showing a prompt and flexible policy response and monitoring it continuously, gave confidence that the risk of overshooting or undershooting of the stabilization objectives could be minimized and that their long-term goals of reform and growth would ultimately be achieved. Directors considered that China's efforts merited the warm support of the international community; thus, there was general support for China's request for a stand-by arrangement with the Fund in the first credit tranche.

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

The Executive Directors then approved the following decisions:

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to the People's Republic of China's exchange measures subject to Article VIII, Section 3, and in concluding the 1986 Article XIV consultation with China, in the light of the 1986 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, as described in SM/86/260. The maintenance 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 Fund welcomes China's efforts to continue to simplify its exchange system and notes with satisfaction the intention of the authorities to eliminate the remaining bilateral payments arrangements with Fund members.

Decision No. 8446-(86/181), adopted
November 12, 1986

Stand-By Arrangement

1. The Government of the People's Republic of China has requested a stand-by arrangement for the 12-month period beginning November 12, 1986 for an amount equivalent to SDR 597.725 million.

2. The Fund approves the stand-by arrangement set forth in EBS/86/230, Supplement 2.

Decision No. 8447-(86/181), adopted
November 12, 1986

2. ANGOLA - MEMBERSHIP - EXPRESSION OF INTEREST

The Chairman, in accordance with the procedures to notify the Executive Board of expressions of interest in membership in the Fund, said that a delegation from Angola, headed by the Finance Minister, who was also the Governor of the Central Bank, had been in Washington at the time of the 1986 Annual Meeting. At the request of the delegation, Fund staff had met with the Angolan representatives to provide information on the Fund, including information on membership procedures.

APPROVED: June 30, 1987

JOSEPH W. LANG, JR.
Acting Secretary