

**MANAGING CHINA'S  
BALANCE OF PAYMENTS**

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## **Table of Contents**

- I. The Evolution of China's Balance of Payments
  - A. From 1949 to the Late 1970s: A Narrow Scope to the Balance of Payments
  - B. From the Late 1970s to the Present: A Broader Scope to the Balance of Payments
  
- II. Analysis of China's International Payments Over the Last Decade
  - A. The Changes and Developments of International Payments
  - B. Problems Existing in International Payments
  - C. Understanding the Imbalance of China's International Payments
  
- III. The Regulation of China's International Payments
  
- IV. The Prospects for China's International Payments

# MANAGING CHINA'S BALANCE OF PAYMENTS

Wu Nianlu and Mao Xiaowei

Management of the balance of payments is one of the main issues faced by all countries in the development of their national economies. In the past decade, as China has progressed with reform and opening up as well as economic development, this issue -- becoming more and more visible in China -- has attracted public attention and research. This article will examine the following four aspects of China's balance of payments:

- I. The evolution of the balance of payments;
- II. An analysis of the balance of payments over the last decade;
- III. The adjustment of the balance of payments; and
- IV. The future prospects for the balance of payments.<sup>1</sup>

## **I. The Evolution of China's Balance of Payments**

The "balance of payments" (that is, a record of a country's international earnings and expenditures) is an economic tool that has gradually evolved with the development of international economic, and economic relations. In the contemporary world, the social and economic development of a country cannot be isolated from international economic, political and cultural intercourse. The sum total of changes, over a given time period, in foreign currency receipts and expenditures, unrequited transfers, and debts and other financial obligations that arise from various international dealings constitute a country's balance of payments. International payments as an economic category can be understood in a narrow or a broad sense. When the commodity economy and international economic relations of a country are not well developed, its external contacts are few and mainly concentrated in commodity trade; therefore, the scope of the international payments of that country is narrow, only covering the foreign exchange revenue and expenditure in the settlement of merchandise trade. With the development of the commodity economy and

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<sup>1</sup> For the benefit of foreign readers, we have included an Appendix which provides a detailed description of the statistical basis of China's balance of payments.

international economic relations, and the daily improvement of the world market, a country's external contacts grow, and the substance of its dealings with other countries becomes richer. Consequently, the scope of its international payments is enlarged. It is no longer confined to the foreign exchange revenue and expenditure of merchandise trade, but expands to cover other kinds of international income and expenditure, including invisible trade and capital flows.

Since 1949, China's international payments have experienced an evolutionary process, moving from a narrow foreign exchange revenue and expenditure account towards a broader scope.

#### **A. From 1949 to the Late 1970s: A Narrow Scope to the Balance of Payments**

For three decades after the founding of New China, its international intercourse was very limited. Economic relations were limited to commodity import and export trade and a small flow of remittances from Overseas Chinese.

In these thirty years, commodity trade represented over 90% of all of China's foreign economic activities. Yet in fact trade was not large at all, and its development was very slow; the pattern of trade was simple. For example, the ratio between China's import and export volume and national income averaged 12.2% annually between 1953 and 1959, 8.4% in the 60s, and only 9% between 1970 and 1976. The share of China's export volume in world export volume averaged only 1.37% annually in the 50's, 1.08% in the 60s, and only 0.81% between 1970 and 1976. China's export volume occupied 28th place in the world total in 1950, but slid to 34th place in 1976. During this period, China's main trade partners were the Soviet Union, Eastern Europe, and the developing countries. (In the 50s, 70% of China's trade was conducted with the Soviet Union and Eastern Europe, but in the 60's, China's trade with the Soviet Union and Eastern Europe went down sharply, while that with developing countries rose to an annual share of 40% on average.) Barter or account trading methods were mostly used in handling business with these countries, so the transaction methods were quite simple.

In the thirty years after the founding of the PRC, China also participated in international borrowing and other forms of money raising activities. For instance, in the

early 1950s we borrowed from the Soviet Union long-term credits of 7.4 billion old rubles (U.S.\$ 1.9 billion) for key construction projects. In the 60s and 70s, China adopted the deferred payment method to import U.S.\$670 million worth of technology and equipment from the West, and provided economic and technical assistance to more than seventy countries around the world. However, these monies didn't form regular dealings, and as a whole, the amounts involved were not large. Besides, the foreign aid was not listed as part of foreign exchange revenue and expenditures, but was regarded in very general terms as part of the state's fiscal revenue and expenditures. In view of the low level of foreign economic development as a whole, China did not in fact maintain true balance of payments accounts, but only an accounting of foreign exchange revenues and expenditures from merchandise trade and remittances from Overseas Chinese.

There were many reasons for the backwardness of China's international payments accounting in the thirty years after the founding of the PRC. First of all, the national economic base was very weak in the early years, with a very low social and economic development level and a limited ability to either import or export. Second, New China was twice subjected to external pressures in its development of foreign economic relations. In the 50s, the economic embargo and blockade imposed by Western countries forced China to trade only with the Soviet Union, Eastern Europe and some developing countries. With the deterioration in Sino-Soviet relations in the 60s, economic relations between China and COMECON nearly disappeared. Third, there were weaknesses in the economic system and mistakes in macro-economic policy decisions. For thirty years, China practised a highly centralized, autarkic or semi-autarkic planned economic system. Such a system, which excluded the role of markets and currency in economic development, greatly restricted the enthusiasm and vitality of enterprises in the development of an outward-looking economy, and artificially severed the organic links between the domestic economy and world markets. For a long time, China's macro decision makers were governed by a philosophy which put undue emphasis on "self reliance". In drafting the economic development strategy, the decision-making agencies didn't proceed from the point of view of taking advantage of the international division of labour to give a proper role to external economic activities in national economic development. Instead, trade relations were regarded as a

means merely to adjust the surpluses and shortages of domestic products. The utilization of foreign capital was then regarded as a pitfall, and the concept of "no debts, internal or external" was highly praised. The tendency to autarky and self-sufficiency reached its peak during the Cultural Revolution and greatly delayed the development of China's foreign economic relations.

#### **B. From the Late 1970s to the Present: A Broader Scope to the Balance of Payments**

Since the late 70's and early 80's, the evolution of China's international payments has entered a new stage.

In 1976, China started a new historical period with the end of the "ten year chaos". In 1978, the third plenary session of the 11th Congress of the Chinese Communist Party set forth the strategic policy of shifting the work priority to socialist modernization and worked out the guidelines for implementing economic reforms, enlivening the domestic economy, and opening up to the outside world. As a result, historic changes have been occurring in China's economic system: (1) The old planned product economy is being shifted towards a planned commodity economy. (2) Changes are also taking place in the highly centralized mandatory macro-economic regulating mechanism, with the decentralization of powers and the streamlining of administration, as well as the introduction of market regulating means. (3) The traditional concept of using foreign trade merely as a means to cure surpluses and shortages has been converted to a new socialist commodity economic model -- that is, to actively take advantage of and take part in the international division of labour, to develop an outward looking economy, to bring the comparative advantage of the country into full play, to rationally absorb foreign capital and advanced technology, and to economize on social labour to achieve the greatest output with the least input so as to push forward the development of the national economy.

Changes in concepts and in the economic system have greatly emancipated the social productivity of labour, and coupled with the improvement in the international environment there has occurred an unprecedented upsurge of China's activities in the international community. Merchandise trade has greatly increased; tourism, financial activities, insurance, the contracting of overseas projects, culture and education, science and technology and other forms of non-trade contacts have been restored and further expanded;

foreign loans in various forms have flowed in and there has been a continuous expansion of all methods of utilizing foreign capital and providing assistance to foreign countries. The increase of international contacts indicates that great changes have occurred in the scope and scale of China's foreign income and expenditure. The older narrow definition of the balance of payments has been replaced by a broader one. The original foreign exchange revenue and expenditure accounts could no longer accurately and comprehensively reflect the situation of China's international payments; therefore the compilation of new international accounts became necessary.

## **II. Analysis of China's International Payments Over the Last Decade**

In 1980, China resumed its legitimate seat in the IMF and the World Bank. At the same time, China established its own statistical system for its balance of payments and began to publish this information. Ten years have now passed. This past decade saw encouraging changes in China's international payments, but some new problems have emerged which require our attention and research.

### **A. The Changes and Developments of International Payments**

The changes and developments of China's international payments are mainly manifested in the following four areas:

(1) The structure of international accounts has been changed and the contents have been greatly expanded (see Table 2.1). In the comprehensive accounts, apart from the two traditional items of merchandise trade and remittances by Overseas Chinese, other non-trade items like tourism, transportation, the contracting of labour services, and capital flows have been restored one after another and further developed, occupying a more and more important position in the international payments. For instance, in the thirty years after the founding of the PRC, non-trade items accounted for less than 5% in foreign exchange income and expenditure. But in the last decade, non-merchandise items other than remittances represented over 10% in the current account, of which tourism increased from 2.9% in 1980 to 4.7% in 1988. In the past, the capital account was almost empty, and it made up only 8% in the international payments in 1980, but reached 25.1% in 1988. Furthermore, the structure of the capital account is being constantly improved. The

proportion of direct and portfolio investment has increased year after year. The share of direct investment in the capital account went up from 3.3% in 1980 to 12.1% in 1988. There was no portfolio investment in China before 1985. In 1988, the proportion of portfolio investment represented 4.7% of the capital account.

(2) Our pattern in international payments has broadened, and economic co-operation and trade and financial co-operation with the developed countries have been continuously expanded, playing a greater and greater role in China's international payments. In the thirty years after the founding of the PRC, China established direct or indirect economic relations with 116 countries

and areas around the world, of which very few were developed countries in the West. Over the last ten years, the number of partners with whom China has established direct economic relations increased to almost 180 countries and areas, and the relations with the industrialized countries have been quickly restored and developed. For example, the trade with developed countries rose from about 10% in the 50s to about 20% in the 60s and reached at one time 45% in the 70s. It has stayed above 50% since 1980 and reached a record high of 57.94% in 1985. At present, apart from Hongkong and Macao, Japan, the E.E.C. and the U.S. have become China's three largest trade partners. Before 1980, there were no capital and credit relations between China and the developed countries in the West. Since 1980, most of China's borrowings have come from the governments or commercial banks of developed countries such as Japan, the Federal Republic of Germany, the U.S., Britain and France. Their direct investment occupies a very large share (next only to Hongkong) in the total direct investments China has absorbed from abroad.

(3) The scale of international payments has been enlarged and the level of foreign exchange reserves has been increased. We look first of all at the current accounts. In the last ten years, China's foreign trade has developed rapidly. Total import and export volume reached U.S. \$79.42 billion, an 2.8-fold increase over 1978. Over the ten years, the accumulated import and export volume was U.S. \$505.1 billion, or 2.98 times that in the 30 years after the founding of the PRC. Adjusted for inflation, the indices (1980=100) of import and export volumes rose to 236.6 and 249.5 respectively in 1987. In 1980 China's exports accounted for 0.92% and occupied 28th place respectively in the world's total



exports; they rose to 1.42% and 18th place in 1987. Now let us turn to capital flows. The size of the capital account was U.S.\$3.8 billion in 1980 and reached U.S. \$33.39 billion in 1988, an increase of 7.8 times. In the past ten years, the actual amount of foreign capital China has utilized has reached U.S. \$47.7 billion, or 20 times as much as that utilized in the past thirty years. Both the current account and the capital account sections of the balance of payments have grown substantially. The total international payments increased from U.S.\$47.63 billion in 1980 to U.S. \$136.58 billion in 1988, an increase of 186.8%. With the expansion of the international payments, the total level of the state's foreign exchange reserves (including those held by the Bank of China) has been increased. The foreign exchange reserves jumped from U.S.\$4.673 billion in 1981 to a breakthrough mark of U.S. \$11.125 billion in 1982, and remained above U.S. \$10 billion each year thereafter, reaching U.S.\$17.548 billion by the end of 1988.

(4) The international payments have become more and more important in the national economy. Their significance is mainly manifested in the following ways: (a) Foreign economic activities represent a growing share of the national economic activities. For example, the ratio of China's total import and export volume to national income rose from 10.4% in 1980 to 32.5% in 1988. The proportion of actually utilized foreign capital in the total increase of fixed assets rose from about 15.6% in 1980 to 35.1% in 1988<sup>2</sup>. (b) The reliance of the national economy on the foreign sector has constantly deepened. For instance, the growth increments of China's imports and exports as compared with the growth increment of national income were 17.6% and 14.3% respectively in 1980 (only 3.9% and 1.61% in 1977), reaching a level of 20.8% and 19.9% eight years later. The ratio between imports and domestic production of many basic raw materials and finished products (such as steel products, timber, chemical fertilizers, etc.) rose from a range of 10-80% in the early 80s to a range of 45%-100% recently. Now we turn our attention to the capital account. The ratio of actually utilized foreign capital to incremental national

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<sup>2</sup> The absolute figure for China's GNP is much lower than that of developed countries in the West, therefore the use of the above index to make a cross-sectional comparison between countries does not reflect the real strength of the Chinese economy. Nevertheless, the use of the above index to make a time-series analysis of the Chinese economy does reveal the changing degree of openness.

income went up from about 5% in the early 80s to 15.7% in 1988. (c) Foreign economic relations have clearly improved the structure of the national economy and upgraded the level of social productivity, thus narrowing the gap between the industrial level of China and that of the world. For example, thanks to the introduction of technology and the import of equipment, the basic industries in China have been strengthened, the processing industries (especially the newly emerging industries) have become prosperous, and agriculture, science and technology, and education have benefited greatly. According to the statistics released by relevant ministries, China has been able, through the use of foreign capital and the introduction of technology, to set up and put into production about 10,000 industrial projects into production in recent years. The introduction of foreign capital has made it possible for more than 400 key enterprises in the machinery industry to achieve advanced world levels, and for about 5,000 products to reach the technical level of the late 70s and early 80s.

The changes in and development of the international payments have proven that the "reform and open door" policy has enabled China to make much headway in its economic relations with foreign countries and promote the transition from a closed and inward looking economy to an open and outward looking economy, thus quickening its social and economic development.

## **B. Problems Existing in International Payments**

The past ten years of changes in the international payments have, generally speaking, produced positive effects on the Chinese economy but have also brought up a new problem--that is, the imbalance of international payments.

The so-called imbalance of international payments refers to the relatively big difference that remains after the offsetting between the current account and the capital account.<sup>3</sup> (This is also called the overall balance.) Such an imbalance happened twice in

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<sup>3</sup> Theoretically, the concept of "balance" in international payments means zero after the offsetting between income and expenditure. However such a case rarely happens in practise. Therefore, where there is a small surplus or deficit in the current account and the total income and expenditure of a country, we say the international payments of that country are basically in balance.

China's international payments after the mid 80s (one was from the latter half of 1984 to 1985, the other was in 1988), with characteristics similar to those of most developing countries, showing a relatively big deficit on merchandise trade, and hence a deficit in the overall balance.

We can see from Table 2.1 that in the early part of the 80s (1980-1983), with the exception of the single year of 1981, there was a significant surplus in merchandise trade and in the current account, and a limited surplus in the overall balance. The foreign exchange reserves increased steadily and the international payments were kept basically in balance. However, the situation changed after 1984. Though exports basically maintained an upward trend, imports grew at an alarming rate, much faster than exports. Exports grew by 15.4% in 1984, but imports by 27.6%. In 1985, exports grew by only 5%, but imports by 60%. In the years 1986 and 1987, the import growth slowed down markedly, because of government controls (though imports still exceeded exports). But in 1988, the import growth picked up again, with an increase of 18.2% in exports and 27.4% in imports. As a result, in 1985 and 1986 there were successive deficits in merchandise trade, the current account, and even in the overall balance. In 1987, the current account and the overall balance turned from red to black, but the merchandise trade was still in the red. In 1988, merchandise trade and the current account had deficits again, with the trade deficit \$3.66 billion greater than in 1987. Forty percent of the deficits sustained were met by drawing down foreign exchange reserves, and 60% were made up through foreign borrowings. Consequently, the state foreign exchange reserves (not including the reserves of the Bank of China) went down from U.S.\$8.901 billion in 1983 to U.S.\$2.644 billion in 1985. The reserves rose back a little to U.S.\$3.372 billion by year-end 1988. The inflow of capital greatly increased, with a growth rate of 30% from 1985 to 1988, greatly surpassing the development speed of the national economy in the same period. By the end of 1988, the foreign debt had already grown to over U.S.\$40 billion.<sup>4</sup>

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<sup>4</sup> The definition of foreign debts used in this article refers to all contracted debts in foreign currency owed by government institutions, groups, enterprises (including foreign-owned enterprises, Sino-foreign joint ventures or co-operative enterprises), financial institutions, or other organizations inside China to international financial organizations, foreign governments, financial institutions,

International experience has shown that there can be many reasons for the imbalance of international payments of a country. There are external reasons, like the cyclical changes of demand on international commodity markets, changes in the interest rate on capital markets, etc. There are also two types of internal reasons. The first is the choice of development model. In an open economy, if domestic savings fall short of investment needs (either in quantity or type), the country can borrow abroad to cover the gap. This makes obvious economic sense, especially for a country in the early stages of development. But the adoption of this model usually means that the country will show a rather large deficit on its current account for a number of years. The second is the influence of abnormal economic or policy factors, such as problems in the country's economic operations or structure, an inappropriate exchange rate, distorted prices in domestic markets, inconsistency between macroeconomic policy and managerial practices, etc. China's imbalance of international payments can be said to derive from internal and external factors, but primarily the former.

China is a developing country. Since the late 70s the government has adopted an open model of development, to speed growth, and has encouraged the use of foreign capital. Thus, in a real sense the imbalance of international payments in recent years is a natural consequence of the choice of development model. In the analysis that follows, we will see that this worsening deficit would not have been a "problem" if other economic factors had behaved normally. To be more specific, there were problems in the following five areas: aggregate economic activity, money supply, economic structure, prices, and macro-economic decision making.

(1) Aggregate economic activity: The economy was overheated, with total demand swollen. In an open economy, the gap in the income and expenditure of the trade of a country and the status of international payments is correlated with the total national income and the total national expenditure (or the absorption of domestic resources) of that country.

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corporations, enterprises or other organizations outside China. The funds in foreign exchange borrowed by domestic borrowing organizations from foreign invested or Sino-foreign invested banks inside the border are also regarded as foreign debts, but the funds in foreign exchange borrowed by the latter from outside the border are not regarded as foreign debts.

When total income is smaller than total expenditure, deficits occur in the trade accounts and are made up for by an inflow of capital, and vice versa for surpluses. The reason for total income being smaller than total expenditure may involve either supply or demand. With full employment, the main reason is an excess of total demand.

China, is a developing country, large in population and relatively short in economic resources. Since the mid 80s, an overheated economy has occurred twice, due to the influence of the traditional development strategy that encouraged people to pursue rapid growth of output. In these periods, social consumption and the demand for investment increased at rates much higher than that of the national income (please refer to Table 2.2). Domestic supply was far from being able to quench the thirst for consumption and investment, thus forming a huge gap in supply. Under these circumstances, governments at all levels and even enterprises turned to foreign markets to meet their needs, causing the influx of a large quantity of goods.

(2) The money supply: When government expenditures exceed revenues, credit is expanded. When enterprises increase their imports, they must have an accommodating expansion of their working capital. The relevant statistics show that in the 1980s there has been persistent overcommitment of national income, coupled with fiscal deficits. Since 1985 the growth of expenditures has accelerated and the deficits have grown ever larger. (Please refer to Table 2.3). These large fiscal deficits were financed through bank overdrafts and the issuing of treasury bills.<sup>5</sup> At the same time, outstanding bank loans increased day after day. Compared with 1983, the difference between deposits and loans in 1985 and 1988 was enlarged by 140% and 370% respectively. The fiscal deficit and the expansion of bank credit resulted in a rapid expansion of the money supply (please refer to Table 2.4), which stimulated domestic demand on one hand, and encouraged imports on the other.

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<sup>5</sup> The issuance by the government of bonds to banks to make up for the fiscal deficits in China can also lead to an increase in the money supply, because under the present financial system, banks will quite often prefer to lend money rather than buy these bonds. As a consequence, there must be an accommodating increase in the money supply if the bonds are to be sold.

The main economic indicators in Table 2.5 clearly reflect the correlation between the above two factors and the imbalance of international payments.

(3) Structural factors: The contradiction between supply and demand in China's economy displays obvious symptoms of structural imbalance. The irrational economic structure has caused the shortage in effective supply, which not only hampers the capacity to earn foreign exchange by exporting, but also strengthens the "armour-plating" of imports.

The irrationality of the economic structure is mainly manifested in the following two aspects:

(a) The commodity composition of foreign trade is irrational. Recent years have seen some improvement in China's import and export commodity structure, but primary products still represent a large proportion of exports. According to data classified by SITC categories, primary products represented about 30% of exports in 1988. Many of these products are basic goods urgently needed in domestic production and daily life, and their prices on international markets are volatile, so the potential for expanded export is limited.<sup>6</sup> At the same time, machinery and electrical equipment still comprise only a small share of exports, and the same is true for the more up-market products in textiles and light industry. Our competitive power on international markets, and hence our capacity to earn foreign exchange, is limited. Also, the repeated and blind import of goods is serious. For example, in recent years, various localities have, one after another, imported over 100 assembly and production lines for colour T.V. sets, refrigerators and washing machines, and over U.S. \$10 billion has to be spent annually to import parts and components to maintain the operation of these lines, causing a serious drain of foreign exchange. Besides, the ratio between the value of imported goods and equipment and the value of re-exports generated in turn is only 20%.

(b) The structure of industry and production is irrational. The general processing

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<sup>6</sup> Take for example, petroleum, which briefly ranked the first amongst all exported goods. The excessive exports of petroleum in 1985 caused serious shortages in the supply of gas and other fuels. As a result, many thousands of motor vehicles had to stop running.

industry has grown too fast, with many similar investments, so its output pattern exhibits redundancies. In the same industry, there is persistent co-existence of efficient and inefficient producers. The result is that, on the one hand, production capacity is idle with bulging warehouses; on the other, capacity is strained with goods in short supply. For instance, some industrial goods badly needed in domestic construction, like certain steel products, can not expand their production, while some unmarketable steel goods have gradually increased in stockpiles year after year. The irrational structure of industry and production is the main reason for the monotonous range of goods, and for specifications and quality that can not meet actual needs, which increases the reliance of enterprises on imported goods.

(4) Price factors: The market mechanism is imperfect and the function of the pricing mechanism has been distorted. Since the economic reform, China has introduced the market mechanism into the operation of its national economy and paid attention to the law of value and to the principle of profit maximization. However, due to imperfections of the socialist market, the irrational pricing system, the inconvertibility and overvaluation of the RMB, and the separation of domestic prices from international prices, the function of the pricing system is distorted to a certain extent and hasn't played its proper role in promoting and regulating foreign economic and trade activities.

For example, in import and export trade, the law of value and the principle of profit maximization require enterprises to pay attention to economic efficiency. However, owing to the mischief of the above mentioned factors, the costs for products that earn foreign exchange are often on the high end, and it is sometimes more profitable to sell goods on the domestic market than on foreign markets. Therefore the enthusiasm of enterprises for exporting has been very much constrained. On the other hand, the two-track domestic pricing system has been implemented for imported goods. That is, major goods imported inside the state import plan can be provided at a planned price lower than the price on the international market, which enables enterprises to secure badly needed means of production at a relatively low cost; goods imported outside the state import plan (their quantity is about 50% of the goods imported inside the state import plan) can be sold at a negotiated price, which enables the importers to use the overvaluation of the RMB and the gap between

domestic prices and international prices to sell their goods at huge profits. The two-track pricing system encourages production enterprises and local trade corporations to have a very keen enthusiasm for importing.

(5) Policy factors: The processes for macro-economic decision making and means of regulation are not perfect, which can be understood from two aspects. First, policy makers have laid undue stress on the pursuit of rapid economic development, accepted at one time the theory which asserted that "deficits do no harm", and adopted a deficit on the government budget, which further heightened the momentum of the overheated economy. Second, in recent years the government, in order to encourage exports and utilize foreign capital, has diluted the administrative intervention in foreign economic activities, given more autonomy to localities and enterprises, and decentralized the powers for foreign trade management, the use of foreign exchange and the raising of capital from abroad. All these measures have played a good role in arousing the enthusiasm of producers and invigorating the micro economy. But, because the decision makers neither fully recognize that the central government should keep some of its regulating functions during the transition from the old economic system to the new, nor know how to co-ordinate the relationship between "macro control" and "micro invigoration", they loosened the necessary macro administration by the central government on foreign economic activities while conducting the reform on the old economic system. As a result, the "overheated" economy and the expansion of credit were quickly transformed into pressure on the balance of payments. For instance, in recent years, the blind importation of goods, the indiscriminate introduction of foreign capital, the uncoordinated raising of money by various departments, and the introduction of redundant equipment, were all the results of the lack of a timely implementation of macro-economic controls along with the decentralization.

### **C. Understanding the Imbalance of China's International Payments**

As mentioned earlier, a perfect balance of a country's international payments is only a theoretical abstraction. Moreover, international experience has also proven that in an open economy, a certain amount of deficit in international payments is an unavoidable phenomenon.

The occurrence of deficits in a given year in the current account or the merchandise



trade of a country does not necessarily mean that its overall international payments are not in good shape. The key that we have to look at is the nature of the deficits and see whether they are sustainable or not.

The phrase "sustainable deficits" has two meanings. First, it refers to deficits caused by temporary factors, such as an increase in grain imports due to natural disasters. Once the temporary factors disappear, the balance can be quickly restored. As this type of deficit is random in nature, we will not discuss it much in the analysis that follows. Second, some deficits appear naturally or are deliberately induced due to the implementation of an open economic development strategy. The size of this type of deficit that can be sustained depends on the strength of the economy. Furthermore, from a dynamic angle, the foreign capital it embodies enjoys the following security:

(1) Foreign capital should only be used to point where the marginal return on investment still exceeds the interest cost of borrowing. In other words, the return on investment not only guarantees the repayment of principal and interest, but also enables the borrowing country to obtain higher net income.

(2) The investment will mean not only the increase of domestic output, but also the increase of exports and foreign exchange earnings.

(3) With the passage of time, the current account moves from deficit to balance and then to surplus, with the gradual elimination of foreign debt (please refer to Figures 2.1A and B).

So-called unsustainable deficits refer to persistent deficits caused by abnormal economic and policy factors which lead to low economic efficiency and aggregate imbalance. This type of deficit also leads to the net inflow of foreign capital. However, owing to various drawbacks in the economic system, the benefits of the foreign capital neither offset the cost of capital nor effectively increase foreign exchange earnings, so the current account deficit persists indefinitely. The country may run into difficulties repaying its foreign debts, or even encounter a debt crisis. (Please refer to Figures 2.2A and B.)

Whether the deficits of international payments of a country are sustainable or not can be judged by analyzing cause and effect or by examining certain conventional economic indicators. Commonly used indicators include: current account deficit/GNP;

foreign debt/GNP (the debt ratio); foreign debt/annual export earnings of commodities and labour services (the debt burden ratio); interest and principal due on foreign debt/annual export earnings (the debt service ratio); and the level of foreign exchange reserves. These indicators reflect the absolute debt bearing ability of a country. According to international practices, the prudent limits for the above indicators are 5%, 30%, 100%, 20%, and three months' imports respectively. Deficits which meet these criteria are sustainable. In addition, an indicator of the relative debt bearing ability is needed. That is, comparisons should be made between the growth rates of foreign debt and of exports, the growth rates of debt and GNP, and the growth rates of imports and exports. If the growth rates of debt and imports are low compared to the others, the deficits are sustainable, otherwise not.<sup>7</sup>

According to the foregoing point of view, we analyze the nature of the imbalance of China's international payments. Looked at one way, because the government has chosen an open economic model, the appearance of deficits in international payments is a natural result. At the same time, in recent years, China's absolute debt indicators are within the conventional international safety lines. (Please refer to Table 2.6.) So we can say that the deficits of China's international payments are sustainable. But, looked at from another side, the recent deficits of China's international payments are, to a large extent, caused by abnormal economic and policy factors. Therefore, the value of the relative debt indicators is not ideal. For many years, the growth rate of foreign debts has been much faster than those of exports and GNP; the growth of imports has also been faster than that of exports. This is an indication of the existence of unstable factors which might lead to unsustainable deficits.

Looking at the relative and absolute indicators in combination, we believe that the deficits in China's international payments are basically of the sustainable type--that is, there will not be any big problem for the moment, but there are also some unstable factors. If

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<sup>7</sup> These economic indicators and their prudent limits are defined by the international commercial banks according to the general experience in international lending activities. However, as economic situations vary from one country to another, the specific causes of deficits in international payments are quite different, and therefore these indicators are only for reference, and should not be used without analyzing the specific conditions of the country in question.

these unfavourable factors are not rectified in good time, there might occur a genuine worsening of the international payments. Therefore, in order to ensure a healthy development of the present situation, we must correct the existing unstable factors.

### **III. The Regulation of China's International Payments**

By the regulation of international payments, we refer to the process by which the economic decision making and administrative departments in the government use macro-economic levers to eliminate the causes of instability in social and economic development and thereby improve the international payments, so as to assist the national economy to develop in a sustained, steady and well co-ordinated way.<sup>8</sup> There are two types of macro-regulating method available to the government. One is the so-called indirect means, by which the government controls total demand by adjusting expenditure policy. The other is the so-called direct administrative regulation, by which the government forcefully adjusts the international payments by reinforcing the administrative control or legislation, such as the tightening of central planning, foreign exchange and foreign trade administrative laws and regulations, etc. Both methods have their own strong points. The former has an obvious advantage in an economy with a relatively developed commodity economy and a sound and relatively complete market mechanism; otherwise the latter has more significance.

Before 1978, the government used mandatory planning and administrative rules and regulations to control foreign exchange income and expenditure. After 1978, with the progress in the economic reform and opening up, because the old methods were no longer appropriate to the objective needs of economic life, China started to establish an economic system combining plan and market, and increasingly expanded the scale and complexity

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<sup>8</sup> Theoretically, the regulation of international payments has another meaning, that is, in an open economy which has a complete market mechanism, the imbalance of international payments will be automatically adjusted by mechanisms of the market, such as the price mechanism, the national income mechanism, etc. However, in reality, these market adjustments do not work perfectly even in the developed market economics. Therefore, the automatic adjustment of imbalanced international payments by the market is very much limited in practice, so we have not included this type of adjustment in our discussion.

of foreign economic activities. In keeping with these changes, the government no longer relied solely on direct regulation to control foreign economic activities and began to use a combination of direct and indirect means to manage international payments.

In recent years, the main measures adopted by China's macro-economic decision making and administrative departments to regulate the international payments are as follows:

(1) To scale back aggregate economic demand and cure the persistent illness of the "overheated" economy. From the mid-80s up to now, the State Council twice carried out economic retrenchment and adjustment (once was from the first half of 1985 to the first half of 1986; the second started from the end of 1988 to the present). The responsible departments used both administrative planning (such as the strengthening of administrative control over credit supply, taxes and expenditures, capital construction, etc.) and economic levers (like the raising of interest rates on deposits and loans, the reinforcing of tax collection, and the adjusting of prices for some products) to tighten government expenditure and bank credit, to screen capital construction projects, to "close, stop, merge and transfer" some enterprises, and to control the growth of investment in fixed assets, the purchasing power of social groups and the increase in individual consumption funds, as well as to increase domestic savings, in order to alleviate the contradiction between total social demand and total supply.

(2) To make foreign economic relations more orderly, on two fronts. First, we must use administrative means to strengthen macroeconomic regulatory functions. In view of the loss of macro-control in the management of international payments in recent years, the decision-making departments in the government, while still recognizing the need to encourage the enthusiasm of localities and enterprises, reiterated the necessity and the importance of reinforcing the functions of the central macro-economic administration over foreign trade, foreign debt, and foreign exchange. The relevant departments promulgated, one after another, a series of decrees and rules for the monitoring and control of import and export commodities, foreign debts and foreign exchange funds; made more strict the foreign economic planning, approval and verification system; and redefined the powers that state specialized foreign trade corporations, industry and trade integrated corporations, and

production enterprises enjoy over foreign trade management. The state foreign exchange and foreign trade bank (the Bank of China) and other state assigned financial organizations are the main channels for the state to conduct foreign trade business, foreign exchange dealings and the borrowing of funds from abroad. The state started to rectify the irrational business duplication among financial institutions; screened, reorganized and banned some trade companies and financial institutions; and centralized or recentralized part of the foreign trade management power which was not appropriate to delegate to the lower levels, or was too scattered after the decentralization.

Second, we should adjust the RMB exchange rate and tariffs and prices of some import and export commodities, so as to reduce the gap between domestic and world prices. Since 1985, the State Foreign Exchange Administration has adjusted the exchange rate downward by a big margin on three occasions. The exchange rate against the U.S. dollar went down from 2.80 yuan to 4.73 yuan, a depreciation of 69%. At the same time, the government raised procurement prices for export goods and made several adjustments of the tariffs for certain imports, as well as levying a "regulating tax" on imported colour T.V. sets, video cameras, VCRs, high grade consumer goods, and electronic goods.

The above policies and measures achieved clear results. From the latter half of 1989, there have been some improvements in the domestic economic environment. The excessive industrial development speed has slowed down, and the contradiction between aggregate supply and demand was diminished. At the same time, the foreign economic situation changed for the better. According to the State Statistical Bureau, in 1989 the growth rate of industrial production went down by 13 percentage points as compared with 1988. Excess aggregate demand decreased from 16.2% in 1988 to about 8% in 1989. According the Customs statistics, total exports in 1989 were U.S. \$52.5 billion, up 10.5% over 1988, while imports were U.S. \$59.1 billion, up 7%. After deducting processing with supplied materials, donations, and the import of equipment as part of the investment in joint ventures, the trade deficit came to U.S.\$2.85 billion, U.S. \$430 million less than in 1988. In the first quarter of 1990, exports increased 13.6% compared to the same period in 1989, and imports decreased 20.12%, creating a surplus of U.S. \$1.63 billion in merchandise trade. According to MOFERT statistics, the growth of foreign borrowing,

especially commercial borrowing, was brought under control in 1989, and only increased by about U.S. \$1.3 billion. The state foreign exchange reserves increased, and the overall situation of the international payments improved.<sup>9</sup>

China's present policies to regulate international payments have played a containing role in preventing the deficits of international payments from becoming more vulnerable to the unstable factors which lead to unsustainable deficits. But, due to the fact that there are still shortcomings in these policies and measures, complete elimination of these unfavourable factors requires further improvements of the regulating policies.

The five major drawbacks of the present policies and measures are as follows:

(1) There is no mid and long term plan. The experience of the two episodes of imbalanced international payments have shown that the imbalance in China's international payments is, as a matter of fact, a reflection of an imbalance of aggregate economic activity. This imbalance represents problems accumulated over several years, and two or three years will be needed to solve them. Therefore the adjustment of the balance of payments will be a relatively long process. We should work out a mid and long term readjustment plan and combine it with the national economic austerity program so that we can be in a good position to take initiatives in the course of adjustment. However, our past practices consisted more or less of just "mopping up spilt milk." That is, we looked for corrective measures after an imbalance occurred. This kind of practice is relatively passive and blind in nature, and people tend, in the selection of policy, to turn to short term actions (for example, there has appeared "indiscriminate cutting back" in the retrenchment of economic construction).

(2) There exists a contraction between "two dilemmas" in the implementation of the policy to retrench aggregate economic activity and the policy to adjust the international payments. On the one hand, in order to prevent persistent deficits in the current account

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<sup>9</sup> The decrease of imports and foreign borrowing in 1989 was related to international political factors after the June 4th incident in Beijing. Nevertheless, the regulating measures for the international payments adopted by the government did play a certain role. For instance, under the governmental control, the import of cars was reduced by 54.2%, colour T.V. sets 56.3%, washing machines 95%, and refrigerators 15.5%.

and the occurrence of difficulties in repaying foreign debts, we must ensure the steady development of exports and the construction of foreign-invested projects. However, the implementation of an overall economic retrenchment will generally slow down the growth of all sectors, including the foreign economic sector and its enterprises. The biggest difficulty that export production enterprises are facing now is the shortage of funds and raw materials, as well as energy. Most foreign exchange loans are overdue, but banks can not collect them. On the other hand, the main target of the retrenchment is to ease the contradiction between aggregate supply and demand and curtail price inflation. However, the measures adopted to adjust international payments, such as the devaluation of the exchange rate and the use of administrative means to encourage exports and restrict imports, may quite often run the risk of deepening the contradictions between supply and demand on the domestic market, and accelerate the inflation, because the extra exports will bring about competition between domestic markets and export corporations for the procurement of goods, and reduce the domestic supply. Besides, the devaluation has raised the RMB cost for enterprises to import needed goods, thus increasing the issue of currency,<sup>10</sup> and the price rise of the imports will bring about, to a certain extent, a price rise of some goods on the domestic market. The contradiction between these difficulties has weakened the effectiveness of the regulating measures.

(3) The imbalance of international payments obviously exhibits the characteristics of a structural imbalance, but present policies and measures lay stress on the strengthening of the management of aggregate demand, which has little effect on structural adjustment.

(4) Although a devaluation is one way to improve the balance of payments, in the absence of structural adjustment and stronger market forces, the impact of devaluation on the deficit is limited. Concretely speaking, China's export commodities have limited market potential, and it is difficult to cut back the import of many major products (grains, cotton, steel products, chemical fertilizers, chemical raw materials, etc.) which are related

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<sup>10</sup> China's present foreign exchange control law stipulates that all foreign exchange earnings must be sold to the banks unless there are some other regulations established by the state. When imports are needed, enterprises are required to use RMB to buy foreign exchange from the banks according to their foreign exchange quota allocated by the State.

to the national economy and people's livelihood. On the supply side, after so many years, the growth potential of the export of traditional products has also come to an end, yet it is not easy for new products to penetrate export markets. Moreover, price reform has been slow. All of these factors make it difficult for the exchange rate mechanism to play its full role.

(5) There is a lack of co-ordination between macro-economic policy and micro-economic policy. This is mainly manifested in the course of the actual adjustment of international payments. It has quite often been the case that foreign economic activities exhibit "morbidity after control" and "chaos after relaxation". In the last ten years, China has experienced several large economic adjustments. However, the weak handling of the above problems led the national economy and foreign economic activities to sink into a perverse cycle: "overheating-cutting back-overheating again-cutting back again" or "loosening-tightening-reloosening-retightening" [i.e., "stop-go"].

To improve the present regulating policies and measures, we put forward the following four suggestions:

(1) To draft a mid and long term plan for the balance of international payments and make sure the adjustment of international payments is clear in its objective, scientific, and always ready to take initiatives. The next three years are the years for China to conduct its economic adjustment and are also the peak time for China to pay back the principal and interest of its foreign debt.<sup>11</sup>

We should take the above situation into full consideration in the drafting of the mid and long term plan and with that as a basis, we should set the goal for the adjustment of international payments. In the near term, we should work to make sure the merchandise trade and current account are kept in balance or even have a little surplus to meet the needs of repaying the principal and interest of foreign debts; for the long term, we should aim for

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<sup>11</sup> Since 1985, China has borrowed quite an amount of mid and long term credits from abroad. They are due to be repaid in succession after 1990, hence the so-called "peak time for China to repay foreign debts". The "peak" time reminds us of the foreign debt problem, but does not necessarily mean that China will have difficulties in paying its debts, because "the peak time for paying debts" and "difficulties in paying debts" are totally different. As analyzed earlier, China is capable of bearing foreign debts in terms of its economic strength.



a sustainable deficit on the current account, as required by the policy of using foreign capital, so as to facilitate a quicker development of the national economy. The mid and long term plan should be fixed on the basis of fully listening to and considering the opinions of responsible departments in the central planning, fiscal, monetary, and foreign economic and trade sectors, and should be implemented under the supervision of the decision-making organizations in the government and amended according to changes in the objective environment.

(2) To correctly handle the relations between cutting back aggregate economic activity and sustaining an appropriate growth of the national economy and foreign economic dealings, the fundamental purpose of adjusting the economy and regulating the international payments should be to ensure the healthy development of the domestic economy and foreign economic relations. Therefore the "regulation" should be appropriate. We should not use the policy of "indiscriminate cutting back". On the one hand, we should screen and reduce those processing industries which are persistently constructed with low economic returns, high energy consumption and non-marketable goods. On the other hand, we should tilt our industrial policies to transfer economic resources from the above industries to foreign-oriented sectors, and we should continue to encourage the development of products which can earn foreign exchange or substitute for imports.

(3) To pay attention to structural adjustment while restraining aggregate demand. International experience has proven that the adoption of an adjustment package that includes both demand restraint and structural adjustment tends to be a successful way to adjust the international payments. This can minimize the adjustment cost, for the structural adjustment facilitates the realization of a rational distribution of resources and can ensure that supply will be increased with the implementation of the policy to transfer and cut back the expenditure, thus eventually eliminating the contradiction between demand and supply on the domestic market and the deficits in international payments.

For China, the structural adjustment should be focused on these three points: (a) Improving the industrial structure. General processing industries should be cut back, and basic industries developed (the development of basic industries is a prerequisite for the

development of the foreign economic sector). (b) Upgrading the foreign trade structure. We should improve the quality of export commodities and increase their variety, expand the export of highly processed mechanical and electric products, and properly develop the export of primary goods. We should strictly control and reduce the import of household electric appliances, expensive cosmetics and other high grade consumer goods, cars, and general mechanical and electric products which can be manufactured in China. In the past, we did not pay enough attention to this problem. We even relied on the importation of large quantities of high grade consumer goods and put them on the domestic market to absorb RMB. As a result, we not only wasted a lot of foreign exchange, but also encouraged the people to go on a consumption spree. For other means of production, we should also arrange them in order of importance and urgency, and put an end to blind imports. (c) Improving the structure of foreign investments. We should encourage foreign direct investments and guide foreign capital toward foreign exchange earning projects, thus facilitating the foreign exchange balance<sup>12</sup>.

(4) To persevere in and deepen the economic structural reform. The existence of the contradiction between macro-economic policy and micro-economic policy in the course of the adjustment of international payments is a reflection of the contradiction between the planning system and market mechanism in economic life. The solution to this problem lies

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<sup>12</sup> In the past, the foreign investment policies fixed by China paid more attention to the industrial nature of the investment projects, that is, China encouraged investments in productive industries and restricted investments in non-productive industries. Generally there was nothing wrong with the inclination of the policy, but there were some shortcomings, for example, when the export capacity was limited, a large amount of funds went to productive projects which could not generate foreign exchange and had a long construction period, which might cause an imbalance in foreign exchange income and expenditure. The co-existence of the deficits in the current account and the peak time for debt repayment is very much related to this. The adjustment of the foreign capital structure is aimed to overcome the phenomenon of "production expenditures getting ahead of themselves" and introduce foreign capital for domestic capital construction within the possibility of the strength of the country, which mainly refers to our foreign exchange generating ability and foreign debt bearing capacity. In the meantime, we will pay attention to the industrial nature of the investment projects and their ability to balance foreign exchange.

in deepening the economic structural reform, improving and perfecting a planned commodity economy, and organically combining planned regulation with market regulation to ensure the effective roles of various adjustment policies and measures. Thus a steady and balanced development will eventually be achieved in our foreign economic sector.

#### **IV. The Prospects for China's International Payments**

The next three to five years are critical to the improvement and rectification drive and the deepening of economic reform, and are also an important period for the adjustment of international payments. The reports published recently by the decision-makers at the central level have shown that the country will, during this period, continue to implement various set principles and policies, strengthen the control of aggregate demand, rectify the economic order, especially the order in the circulation fields, and root out the illness of "overheating" and "chaos" in the economy. At the same time, attention will be paid to improving the economic structure and to maintaining a proper growth of the national economy, and co-ordinating the development of the national economy and the foreign economic activities, so as to enable the national economy to embark on a good path towards a steady and balanced development.

The government will try to achieve an annual GNP growth of 5%-6% on average during the improvement and retrenchment period. Efforts will be made to enhance the foreign debt management, raise the economic returns on foreign investments, keep foreign trade income and expenditure in balance, and even have some surplus so as to meet the needs for debt repayment. Against this backdrop, we have made the following predictions for China's international payments from 1990 to 1992 (please refer to Tables 4A and B).

Table 4A presumes that the Chinese economy will develop at a low speed in the next three years. The annual growth rate of GNP will average 5%. Based on that, and taking into account the World Bank's projection of slower growth of world trade and the practical objectives set by the Party Central Committee for the economic improvement and rectification program, we estimate that China's export trade will not expand substantially in the three years ahead, but could still maintain an annual growth rate of 7%. The import

trade will continuously be scaled back with an annual growth rate of 5.4%.<sup>13</sup> Invisible trade might show a surplus at, however, the same level as in the past two years. Tourist income may go up again from 1990, but the net level of invisibles won't change much owing to the increased payment of interest on foreign debt. The inflow of foreign capital will be brought under control, and due to the increased repayment of principal, the net inflow of foreign capital will decrease; the ratio between foreign debts and GNP won't exceed 10%. Because the inflow of foreign capital will be under control and an appropriate export growth will be maintained, the debt service ratio will gradually be stabilized at a reasonable level. Of course the control of foreign capital inflow does not mean the stoppage of capital import. If the international environment permits, the inflow of foreign capital will be kept at a certain level which will be in conformity with the target of foreign exchange reserves sufficient to pay for three months' imports. In summary, China's merchandise trade and current account will have deficits (though gradually reduced deficits) in 1990 and 1991. The current account will start to register a surplus in 1992. As the inflow of foreign capital will be kept at a certain level, the balance of total income and expenditure will be in the black, and foreign exchange reserves will rise.

Table 4B shows predictions based on a GNP growth rate of 6%. Correspondingly, import growth is estimated at 6.5% and export growth at 8%. Other indicators are basically the same as in Table 4A.

Mid and long term projections of a country's international payments are affected by various uncertainties. For China, apart from changes in the external environment, mainly changes on international commodity and financial markets, the most important factor is whether the improvement and rectification drive and the deepening of the reform will go on smoothly and achieve success. If we can achieve what we wish, the adjustment of international payments will be accomplished smoothly, otherwise, it might take a longer time for us to achieve the goal of this adjustment. Therefore, the above projections should be constantly adjusted according to changes in the actual situation.

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<sup>13</sup> Analysis of recent data suggests that the income elasticity of demand for imports is very strong. When national income increases by 1%, imports increase by 1.07945%.

Table 2.1: CHINA'S BALANCE OF PAYMENTS, 1982-1989<sup>1</sup>  
(US \$ millin)

- I. Current Account
  - A. Merchandise
    - 1. Exports (FOB)
    - 2. Imports (FOB)
  - B. Services
    - 1. Income
    - 2. Expenditures
  - C. Transfers
    - 1. Private (net)
    - 2. Government (net)
- II. Capital Account
  - A. Long-Term
    - 1. Inflow
    - 2. Outflow
  - B. Short-Term
    - 1. Inflow
    - 2. Outflow
- III. Errors & Omissions
- IV. Change in Reserves

Footnotes: 1. All the summed numbers are net ones.

2. To June 30, 1989.
3. Separate subtotals not yet available.

Table 2.3: CHINA'S FISCAL SITUATION, 1980-1988 (RMB 100 Million)

Year	Govt. Income	(of which borrowing)	Expendi- tures	Deficit incl. borrow- ings	Nominal Deficit
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Notes: (1) The figures in parentheses are net of borrowings.

Source: China's Statistical Yearbook 1989, pp. 657 & 672.

Table 2.4: FLUCTUATIONS IN BANK CREDIT AND MONEY SUPPLY

(RMB 100 million)

Year	Loans <sup>1</sup> Made	Increase Over Year (%)	Short- <sup>2</sup> Previous Deposits	fall of of Currency	Increase <sup>3</sup> of Currency	Increase Over Year (%)	Increase Over Previous Year (%)
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Notes: <sup>1</sup> At year end.

<sup>2</sup> A minus sign indicates loans greater than deposits.

<sup>3</sup> Currency in circulation.

Source: China's Statistical Yearbook 1989, p. 679.



Table 2.1 **ITEMS IN CHINA'S INTERNATIONAL PAYMENTS**

**I. CURRENT ACCOUNT**

A. Merchandise Trade

1. Exports
2. Imports

B. Invisible Trade

1. Transportation
2. Port Supply and Labour Service
3. Tourist Income and Expenditure
4. Investment Income and Expenditure
  - (a) Profits
  - (b) Interest
  - (c) Earnings of banks
5. Other Invisible Trade
  - (a) Post and telecommunications
  - (b) Intergovernmental income and expenditures
  - (c) Labour service contracting
  - (d) Other

C. Unrequited Transfers

1. Dealings With International Organizations
2. Aid and Donations
3. Remittances by Overseas Chinese
4. Income and Expenditures of Expatriates

**II. CAPITAL ACCOUNT**

A. Long-Term Capital

1. Direct Investment
  - (a) Direct Investment in China from Foreign Countries and Hongkong and Macao
  - (b) Direct Investment by China in Foreign Countries and Hongkong and Macao

2. Portfolio Investment

(a) Portfolio Investment in China from Foreign Countries  
and Hongkong and Macao

(b) Portfolio Investment by China in Foreign Countries  
and Hongkong and Macao

3. Loans from Foreign Governments

5. Bank Loans

6. Borrowings by Localities and Ministries

7. Deferred Payments and Collections

8. Value of Equipment Provided by Foreign Business

People for Processing and Assembling Business

9. Leasing

10. Foreign Lending

11. Other

B. Short-Term Capital

1. Borrowings by Banks

2. Borrowings by Localities and Ministries

3. Deferred Payments and Collections

4. Other

**III. ERRORS AND OMISSIONS**

**IV. INCREASE/DECREASE OF RESERVES**

1. Gold

2. Foreign Exchange Reserves

3. Special Drawing Rights

4. Share Holdings in IMF

5. Utilization of IMF Credit

FOOTNOTE: As is conventional in balance of payments bookkeeping, an increase in reserves is shown as a (-), and a decrease in reserves is shown as a (+).

Chart 2.2 (1982-1989) BALANCE SHEET (IN GENERAL) OF CHINA'S  
INTERNATIONAL PAYMENTS<sup>1</sup>

Table 2.2 THE HIGH GROWTH RATES OF WAGES AND FIXED ASSETS (%)

	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
The growth rate of total workers' salary <sup>1</sup>	21.3	22.0	20.0	13.3	23.1
The growth rate of investments in fixed assets	28.2	38.8	18.7	20.6	23.5
The growth rate of the national income <sup>2</sup>	13.5	13.1	8.0	10.5	11.4

FOOTNOTES: <sup>1</sup> If the income of peasants in the countryside is taken into account, the growth rate of the consumption fund would be bigger.

<sup>2</sup> Based on 100 for the year before.

SOURCES: "China's Statistical Yearbook - 1989", pp 29, 124, 477.

Yao Yilin, "Draft Report on the National Economic and Social Development Plan for 1989".

Table 3.2 CHINA'S FISCAL REVENUES AND EXPENDITURES, 1980-1988.  
(RMB 100 million)

<u>Year</u>	<u>Total Income</u>		<u>Total</u> <u>Expenditures</u>	<u>Deficit</u>	
	Total	Debt			
1980	1,085.2	35.3	1,212.7	-170.5	(-127.5) <sup>1</sup>
1981	1,089.5	73.1	1,115.0	-98.6	(-25.5)
1982	1,124.0	83.9	1,153.3	-113.2	(-29.3)
1983	1,249.0	79.4	1,292.5	-122.9	(-43.5)
1984	1,501.9	77.3	1,546.4	-121.8	(-44.5)
1985	1,866.4	89.9	1,844.8	-68.4	(21.6)
1986	2,2260.3	138.2	2,330.8	-208.8	(-70.6)
1987	2,346.6	165.9	2,426.9	-246.2	(-80.3)
1988	2,587.8	261.0	2,668.3	-341.5	(-80.5)

FOOTNOTE: <sup>1</sup>The figures in brackets are the deficit after deducting borrowings.

SOURCE: "China's Statistical Yearbook - 1989" pp. 657, 672.

Table 3.3 FLUCTUATIONS IN STATE BANK CREDIT AND MONEY SUPPLY  
(RMB 100 million)

<u>Year</u>	<u>All Kinds of</u>	<u>Increase</u>	<u>Decrease between</u>	<u>Money</u>	<u>Increase</u>
<u>and Decrease</u>	<u>Lendings<sup>1</sup></u>	<u>&amp; Decrease</u>	<u>Deposits &amp; Lendings<sup>2</sup></u>	<u>Supply</u>	<u>Compared</u>
<u>with Previous</u>	<u>Compared to the</u>			<u>Year + - %</u>	
	<u>Previous Year</u>				
1980	2,414.3	14.5	-753.2	346.2	29.3
1981	2,764.7	18.4	-729.3	396.3	14.5
1982	3,052.3	10.4	=686.1	439.1	10.8
1983	3,431.1	12.4	-669.5	529.8	20.6
1984	4,419.6	28.8	-1,033.4	792.8	49.5
1985	5,905.5	33.6	-2632.5	987.8	24.7
1986	7,590.4	28.5	-2,208.5	1,218.4	23.3
1987	9,032.4	19.0	-2,460.3	1,454.5	19.3
1988	10,055.3	16.8	-3,125.7	2,134.0	46.7

FOOTNOTES: <sup>1</sup>The balance at the end of the year

<sup>2</sup>Minus means lendings are bigger than deposits

<sup>3</sup>Money in cash in circulation

PLEASE NOTE - CANNOT LOCATE FOOTNOTE #3

SOURCE; "China's Statistical Yearbook - 1989" p.679

Table 2.5: MAIN ECONOMIC INDICATORS (% change from previous year)

GNP

Total Industrial Output

Retail Price Index

Net Supply of Currency

Credit Outstanding

Exports

Imports

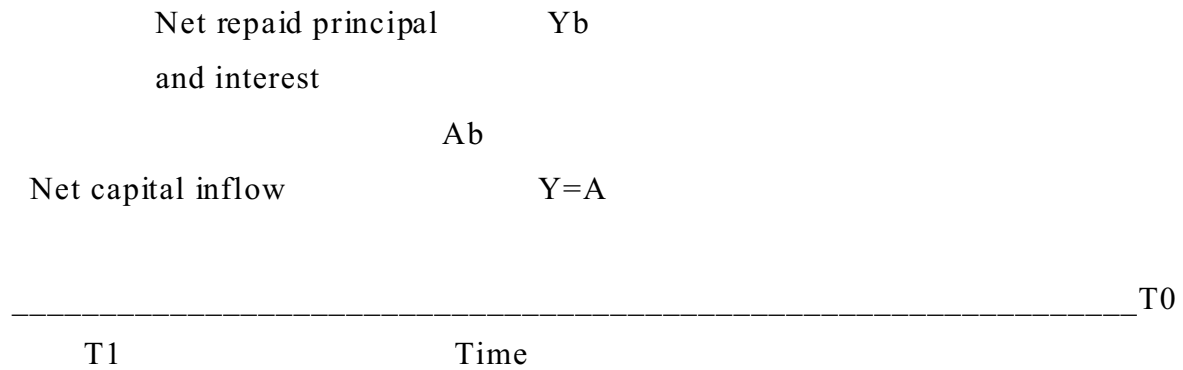
Current Account Income

Current Account Expend.

Source: China's Statistical Yearbook 1989

Chart 3.1.A The locus of the economic growth under maintainable deficits of international payments<sup>1</sup>

A, Y, Ab, Yb



Y=GNP

A=Total expenditure or the absorption of domestic resources

Yb=GNP under the existence of foreign capital

Ab=Total expenditure under the existence of foreign capital

Y=A: The locus of economic growth under non-existence of foreign capital.

Chart 3.1.B. The locus of changes in debt indicators under the maintainable deficits

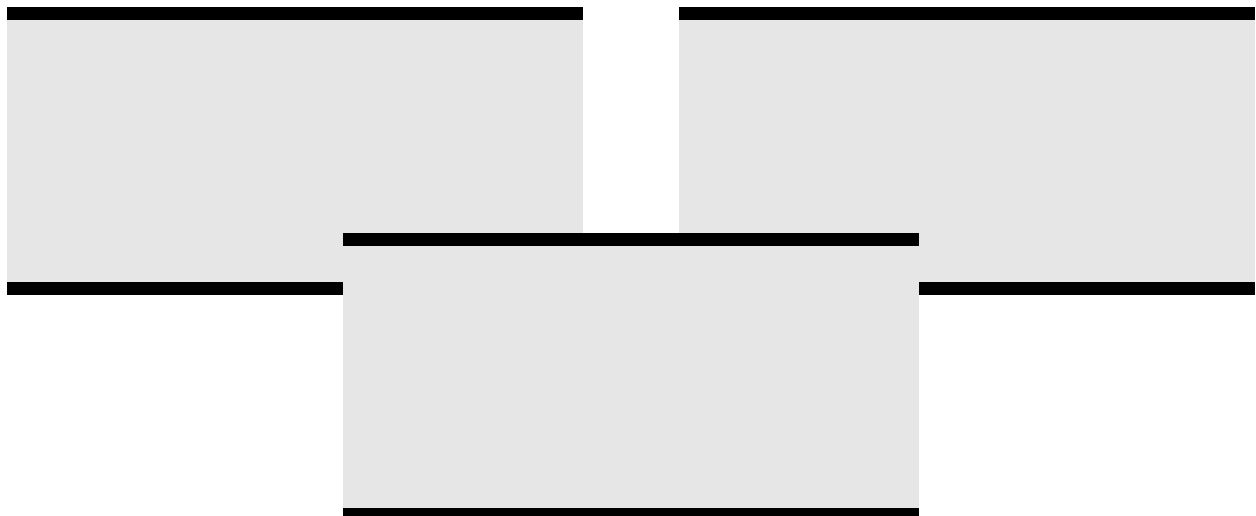
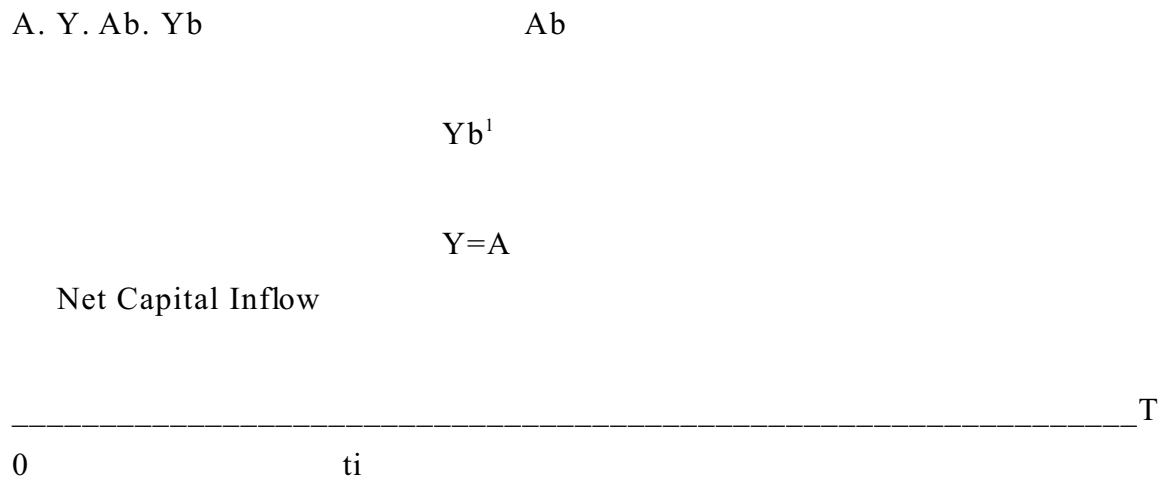






Chart 3.2A Locus of economic growth under unmaintainable deficits  
international payments.

o f



The definition of symbols in this chart is the same as that in Chart 3.1A.

¹Under the deficits,  $Y_b$ , though higher than  $Y=A$ , couldn't move upward and meet  $Ab$ , and  $Ab$  keeps moving ahead and leaves a wider and wider distance with  $Y_b$  until it arrives at **ti**, then  $Y_b$  and  $Ab$  both slide downward and net foreign capital inflow stops, which shows the worsening of international payments.

Chart 3.2B Locus of changes in debt indicators under the unmaintainable deficits.

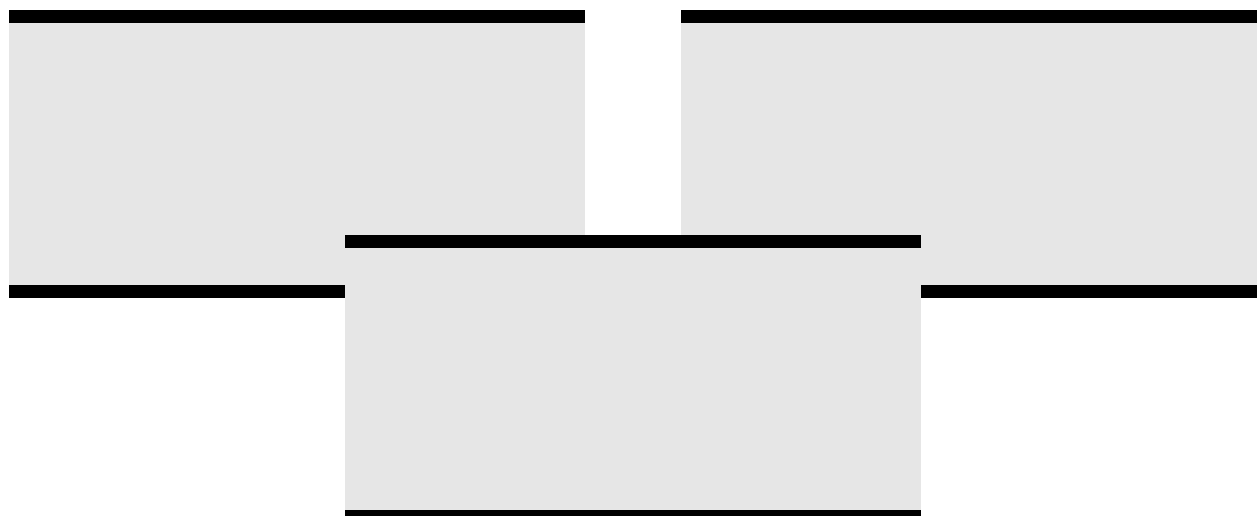


Table 2.6: SELECTED ECONOMIC INDICATORS (%)

Current Account Deficit/GNP

Foreign Debt/GNP

Foreign Debt/Exports

Debt Service Ratio

Foreign Exchange Reserves  
(= months of imports)

a/ Total

b/ Excluding Bank of China holdings

Table 4A: MID-TERM PREDICTIONS ON CHINA'S INTERNATIONAL PAYMENTS (1990-1992)

GNP Growth rate 5%	U.S.\$1 billion					
	1988 <sup>1</sup>	1989 <sup>2</sup>	1990	1991 <sup>3</sup>	1992 <sup>3</sup>	
I. Balance of Current Account		-3.8	-2.1	-1.1	-0.1	0.6
1. Foreign Trade (Net Value)		-5.3	-2.9	-2.2	-1.4	-0.6
Export	41.1	52.5	56.2	60.1	64.3	
Import	-46.4	-55.4	-58.4	-61.5	-64.9	
2. Non-Trade Income & Expenditure (Net Value)	1.1	0.8	1.1	1.3	1.2	
II. Balance of Capital Account		7.1	2.8	3.9	4.1	4.1
III. Balance of Total Income and Expenditure <sup>4</sup>	2.2	-0.5	1.7	1.9	2.0	
IV. Changes in Foreign Exchange Reserves ("-" means increase)	-2.2	-.5	-1.7	-1.9	-2.0	

FOOTNOTES: <sup>1</sup>Actual figures

<sup>2</sup>Estimated figures

<sup>3</sup>Predicted figures

<sup>4</sup>Including errors and omissions

SOURCE: Relevant predictions published by the State Statistical Bureau

Table 4B: MID-TERM PREDICTIONS ON CHINA'S INTERNATIONAL PAYMENTS (1990-1992)

GNP Growth Rate 6%	U.S.\$1 billion					
	1988 <sup>1</sup>	1989 <sup>2</sup>	1990	1991 <sup>3</sup>	1992 <sup>3</sup>	
I. Balance of Current Account		-4.2	-2.1	-1.1	-0.3	-0.5
1. Foreign Trade (Net Value)		-5.3	-2.9	-2.3	-1.6	-0.8
Export	41.4	52.5	56.7	61.2	66.1	
Import	-46.4	-55.4	-59.0	-62.8	-66.9	
2. Non-Trade Income & Expenditure (Net Value)	1.1	0.8	1.2	1.3	1.3	
II. Balance of Capital Account		7.1	2.8	4.0	4.1	4.1
III. Balance of Total Income and Expenditure <sup>4</sup>	2.2	-0.5	1.8	2.1	2.8	
IV. Changes in Foreign Exchange Reserves ("-" means increase)	-2.2	0.5	-1.8	-2.1	-2.8	

FOOTNOTES: <sup>1</sup>Actual figures

<sup>2</sup>Estimated figure

<sup>3</sup>Predicted figures

<sup>4</sup>Including errors and omissions

SOURCE: Relevant predictions published by the State Statistical Bureau

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