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Working Paper

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Working Paper, No. 14

Provided in Cooperation with:

IMB Institute of Management Berlin, Berlin School of Economics and Law

Suggested Citation: Tinggui, Cao (2001) : The People's Bank of China and its monetary policy, Working Paper, No. 14, Fachhochschule für Wirtschaft Berlin, Business Institute Berlin, Berlin

This Version is available at:

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The People's Bank of China and its Monetary Policy

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Paper No. 14, October 2001

Working Papers of the
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ISSN 1436 – 3151

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October 2001

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Abstract

Since 1984, the People's Bank of China has started to function as a central bank. In October 1998, the People's Bank of China carried out significant reform in the management system, abolishing the 31 provincial branches and establishing the 9 regional branches, in order for the People's Bank of China to strengthen the authority and independence in the execution of the monetary policy. Fundamentally speaking, a central bank's independence is given by the nature of the market economy. China is in the process of transforming itself from the old economic system to the new one, especially the reform of the state-owned enterprises has not been finished yet, therefore the economic foundation for the independence of the central bank in the execution of the monetary policy is under construction.

The People's Bank of China was established on 1. December 1948, just prior to the founding of the People's Republic of China. During the more than two decades before reform and opening to the outside world, the People's Bank of China was not only the only bank in China, but even its sole financial institution. The branches and sub-branches of the bank were scattered across the country, with the head office in Beijing and branches and sub-branches in every city, county and province. All the branches followed the directives given by the head office, taking deposits and making loans for the planned economy, handing in all the income to the superior and receiving funds for disbursement from it. The People's Bank of China was not only a financial supervisory agency, but also a financial institution for various banking businesses; it was both the central bank and a commercial bank. The planned financial system operated on the basis of executive management, thereby it was short of energy, especially for the institutions in the grass roots, and they could not exert initiatives.

Since the reform and opening to the outside world, the financial system of the People's Republic of China has changed significantly; the planned financial model is diminishing. From 1984, the People's Bank of China began to function exclusively as a central bank, the framework of the Chinese central bank was established. At present, the central bank is supervising the financial system, the commercial banks dominate finance, as various financial institutions coexist to play important roles. The commercial banks consist of state-owned commercial banks, regional stock commercial banks and city commercial banks. Until the end of October 1998, all the banks' deposits and loans amounted to 6938.7 billion

RMB and 5811.9 billion RMB respectively, the banks' total assets reached 6938.7 billion RMB that accounted for 72% of the assets of the financial institutions across the country¹. This reflects the dominant position of the commercial banks among the financial institutions.

The People's Bank of China is the central bank of China that is responsible for the supervision of the financial institutions under the leadership of the State Council. It has the same general characteristics of central banks all over the world. It is a note issuing bank, banks' banker and a government's bank.

The People's Bank of China Act that promulgated in March 1995 made clear the basic responsibilities of the People's Bank of China: 1. Working out and executing monetary policy under the law. 2. Issuing notes RMB and supervising the circulation. 3. Chartering and overseeing financial institutions according to the stipulation. 4. Supervising financial markets according to the stipulation. 5. Promulgating concerned directives and regulations of financial supervision and businesses. 6. Holding and managing state reserves of foreign exchanges and gold. 7. Managing national treasury. 8. Maintaining and securing payment system. 9. Taking responsibilities for financial statistics and investigations and analyses and projects. 10. Engaging in concerned international financial activities as a state central bank. 11. Other responsibilities given by the State Council. Until now the People's Bank of China has done a lot to fulfill the responsibilities and contribute greatly to the stabilization and development of the financial system and national economy.

In October 1998, the People's Bank of China reformed the supervisory system, abolishing 31 branches among the provinces and municipalities under central authority and autonomous regions. It established 9 trans-provincial regional branches and financial supervisory agencies in the capital cities of provinces without regional branches, canceling superfluous branches in same cities, making clear financial supervisory responsibilities and rights to the head office and branches and central sub-branches and sub-branches.

In public opinion, the reform will strengthen the financial supervisory function of branches and authorities of monetary policy executed by the central bank,

¹ Financial News, 30. Nov. 1998

enhance independence and justice of the financial supervisory function conducted by the central bank, and improve the management of the bank staff.

In some western countries, branches of central banks straddle two or more administrative regions, for example, in the United States, Australia and Canada. But in Germany and Japan, branches are established in almost every administrative region. In case of current situations, there is no close correlation between the effects of monetary policy as well as financial supervision and whether branches of a central bank straddle administrative regions or not. But one point deserves some attention, that branches of central banks tend to be straddled in administrative regions of a country with a vast area of territory. Why? Does this mean that straddling the branches in administrative regions is conducive to maintaining independence and empowerment of a central bank, and to increasing control of the head office, thereby to enhancing efficiency of a central bank as a whole? Because a central bank is not ultimately a profit-pursuing financial institution at all, it does not serve ordinary firms and individuals; the customers are financial institutions, mainly depository institutions. From an economic standpoint, it may not be necessary to establish branches in every administrative region, whatever the size of a country.

China is special relative to the western countries, although it is transforming into a country with a market economy; there are significant differences in terms of economic system between China and the western countries. As the governor of the People's Bank of China Dai Xianglong has said, our financial system must be suitable to the basic economic system with the main body of the public ownership as well as the development of various forms of ownership. It must also conform to the multiple-dimensions of our economic development and the imbalance between the regions². In the current situation, public ownership is governmental ownership or the ownership of governments at all levels. So public ownership means that it is necessary for the government to interfere in the economy. But this interference by the local governments in the economy has been vary disadvantageous. For example, they struggle for capital and investment projects and engage in repeated construction, wasting not only resources and polluting the environment, but also decreasing the efficiency of the national economy as a

² Financial News, 7. Jan. 1999

whole and distorting the economic framework. Some local governments do everything possible for their local economic development, including tacit consent or disguised support of smuggling and the sale of smuggled goods, as well as the production and sale of counterfeit bills. Local governments influence the local branches of the central bank, so that it is difficult for them not only to conduct a unified monetary policy, but also to carry out efficient financial supervision.

Nowadays it is inevitable that the local branches of the central bank are influenced by their local governments; therefore all of the capital cities in the provinces have struggled for the district branches to be located in their cities. The president of the regional branch of Wuhan said when he assumed office: weaken the idea of administration and strengthen the consciousness of financial services. As a local branch of the central bank, we must do our best to prevent the local governments and the concerned departments from interfering, we should fulfill the functions in the district consciously, by implementing all the directives given by the head office well. Of course, in order to improve our services we need also to accept the opinions and suggestions from the local committee of the Communist Party of China and the administrations. At the same time, we should make proposals to the local governments for economic development from the specific perspective of the central bank, through economic and financial surveillance and analyses of the district³. The president of the Shanghai district branch considers: maintaining a good financial situation in the district needs support from the local governments. We must pay more attention to keeping on good terms with the local governments. The central sub-branches in the capital cities should do financial statistics and analyses for the provincial and municipal governments. At the same time, the Shanghai regional branch must make every effort to analyze the economic and financial situations thoroughly and provide them with the information⁴. The two presidents are cautious in talking about the relationship with the local governments. This simply reflects a strong influence of the local governments on the branches of the central bank.

In fact, since the new round of financial reform started in December 1993, the head office has centralized concerned powers of execution of monetary policy,

³ Financial News, 7. Nov. 1999

⁴ Financial News, 3. Jan. 1999

the branches and sub-branches have lost the powers to make loans and distribute funds, so the problem of localization of monetary policy has not existed in general. The main responsibility of the branches and sub-branches is financial supervision. At present, establishment of the regional branches obviously indicates that the branches and sub-branches in every administrative region in the past could not fulfill the functions of financial supervision efficiently. As some people have said, whenever the provincial branches of the People's Bank of China existed, the branches would submit to the provincial governments and do something wrong⁵. Can the regional branches really reject the interference from the local governments? The fact that all the capital cities of the provinces struggled to have regional branches located in their cities might mean that there is the possibility of interference, since it could be easier for them to interfere in branches located in their own administrative regions.

Of course, the new supervisory system of the central bank will surely be more conducive to preventing the local governments and concerned departments from interference, because only daily financial supervision is undertaken by the local sub-branches, risk supervision and inspection to legal entities are conducted by regional branches and central sub-branches respectively. That is to say, inspectors and the inspected institutions may represent different cities or administrative areas. Besides as only 9 regional branches exist, it will be easier for the head office to control them.

Objectively speaking, it is impossible to resolve the problem of local governments and concerned departments interfering in the branches of the central bank under the current system of China completely. First, the local governments are shouldering the heavy burden of developing the local economies and stabilize the local communities; they are what the central government has to depend on, so they tend to be biased towards the local governments and against the branches of the central bank. Secondly, all the activities undertaken by the branches of the central bank depend on support from the local governments; otherwise the branches can do nothing at all. So the presidents new in office appear timid and lacking self-confidence when they talk about the relationship with local governments.

⁵ Analyzing the Reform of the Financial System, Reform, 4th 1997

Since the reform and opening to the outside world in China, the separation of administration from enterprises has been stressed and implemented, but the resulting effect is always not sufficient. Why? The root cause of the entanglement between enterprises and governments lies in the insecurity of ownership of the enterprises. The state-owned enterprises belong to the governments, but if these governments do not manage them, who can and should? This is because autonomous right is granted to the enterprises under the current ownership and the governments relax supervision of them, so that some managers of the enterprises become corrupt and public assets are abused. That is to say, there is reason for the enterprises to come entangled in the governments under opaque ownership. The ownership of the enterprises must be clarified; this is a precondition for the enterprises to become independent of the governments. The reform transforming the enterprises into joint stock companies aims to create the condition for this process. The authority of the central bank is related to the reform of the enterprises, whenever the enterprises belong to the governments, the central bank is only an instrument for the government to regulate the enterprises directly or indirectly, therefore it can not really be independent of the government. In addition, the governments are decision-makers and executors of the reform. Monetary policy of the central bank must conform to the reform measures implemented by the governments. This determines that the central bank cannot be independent of the governments. Nevertheless, the reason why the central bank remains dependent is due only of the relationship between the central bank and the central government, it does not mean that interference by the local governments in the branches should be tolerated. Keeping the branches of the central bank as independent of the local governments as possible will contribute to the implementation of monetary policy and stabilization of a macro-economy, and this is a necessary condition of deepening the reform movement.

In China, the discussion about the independence of the central bank began in the middle of the 1980s. The opinions that the central bank should be independent of the governments have dominated until now. The main viewpoints are as follows:

1. The central bank should be independent of the government and of the Treasury, and belongs to the national congress. The local branches are

independent of the local governments. The Treasury is not allowed to overdraw from the central bank by force.

2. It is not necessary for the central bank to be separated from the government and to be responsible for the national congress, because all the economic work is under the leadership of the State Council. The independence of the central bank lies in being independent of the Treasury, and of the national planning commission, and of other economy-regulating departments as well as of the local governments.
3. The subordinate relationship between the central bank and the government can be ignored, but the standing committee of the national congress should supervise the note-issuing right, and the note-issue must be subject to approval from the standing committee of the national congress. Some people advocate by the standing committee of the national congress the exercises of the note-issuing right. The overdraft by the Treasury to the central bank should be examined and approved by the special committee and the national congress, respectively.

The People's Bank of China Act accepts the second opinion in fact.

In terms of this subordinate relationship, the second article of the People's Bank of China Act stipulates: The People's Bank of China, under the leadership of the State Council, works out and executes monetary policy, and supervises the financial industry. That is to say, the People's Bank of China, as a ministry of the State Council, belongs to the central government directly, and has equal status with the Treasury.

With regard to the degree of autonomy, the fifth article of the Act stipulates: The People's Bank of China should report its decisions about money supply, interest rates and exchange rates, as well as other important affairs directly to the State Council and execute them after approval. The People's Bank of China can execute the specific decisions and file them with the State Council after the decisions about monetary policy – other than those specified by the former article – are made. Thereby the State Council is a top authority over the People's Bank

of China. Under these conditions, the People's Bank of China is short of autonomy. But the seventh article of the Act stipulates: When the People's Bank of China executes monetary policy, exercising the functions the business, it is free from interference by the local governments and the governmental departments at all levels and societies, as well as individuals.

In terms of the branches and personnel, the ninth article of the Act stipulates: „the governor of the People's Bank of China is nominated by the premier of the State Council and approved by the national congress. During the closed period of the national congress, the governor is appointed and dismissed by the national chairman of the People's Republic of China, and approved by the standing committee of the national congress. According to the eleventh article of the Act, the People's Bank of China establishes the monetary policy commission; the State Council specifies the function and composition as well as the working programs. The branches of the People's Bank of China belong to the head office, which exercises centralized and unified leadership and supervision.

In terms of ownership and businesses as well as financial affairs, the eighth article of the Act stipulates: „The People's Bank of China is a state-owned central bank”; all the capital belongs to the state. According to the twentieth and twenty-ninth articles of the Act, the People's Bank of China can not permit the Treasury to overdraw the account and is not allowed to subscribe for and underwrite national debts, and is not allowed to grant loans to the local governments and governmental departments at all levels. According to the thirty-seventh and thirty-eighth articles of the Act, the People's Bank of China exercises independent budget management, all the surplus after withdrawal of the total reserves under the Act is handed over to the Treasury, the loss is remedied by an appropriation of the Treasury.

As compared with „the Banking Supervision Regulation”, the People's Bank of China Act has made progress towards the independence of the central bank. Because it makes clear that the People's Bank of China is legally independent of the governmental departments, especially of the Treasury and local governments and societies as well as individuals. Nevertheless, legal stipulation does not necessarily mean that it exists. For example, „the Banking Supervision

Regulation” stipulated that the Treasury was not allowed to overdraw the account with the People’s Bank of China, but at the end of 1994, the overdraft and debt of the Treasury with the People’s Bank of China amounted to about 180 billion RMB, accounting for 12.2% of the total assets of the People’s Bank of China.

In short, the stipulation of independence of the central bank can only be viewed a direction of the reform, because the independence of a central bank is determined by economic conditions in the final analysis, and not determined by law. During the period of the highly centralized-planned economy, the People’s Bank of China, as a mixture of a central bank and a specialized bank, was only an instrument for the government to realize economic programs; it had no independence. Not that the planned economy is being gradually transformed into a market economy, and after it was separated from the specialized bank, the issue of the independence of the central bank was put on the agenda. Making true independence of the central bank before a profound reform of the enterprises is fulfilled is unrealistic, because other economic problems can not be resolved by the stabilization of money naturally. At present, the reform is approaching ownership of the enterprises, the core of the reform. As the budget constraints of the enterprises harden gradually, it is time for capital to be distributed on a market basis, thereby the central bank as a financial supervisory authority is needed to control the money supply and maintain a stable and efficient financial environment.

Since 1993, the People’s Bank of China has carried out a series of reforms and gained notable achievements, which are conducive for it to reach the relative independence.

1. The transformation of the goal of monetary policy

The transformation of the final goal of monetary policy

In 1993, the resolution about reform of the financial system made by the State Council stipulated the final goal of monetary policy of China as follows: Money should be kept stable, so as to push economic growth. The former dual long-term goal of stabilizing money and developing the economy was changed.

The historical evidence shows that the result of pursuing a dual goal would sacrifice the stabilization of money in a country like China where capital is short. The establishment of a unique goal allows the People's Bank of China to function as a central bank and to work out and execute monetary policy independently.

2. The transformation of the intermediary target of monetary policy

During more than 10 years after the People's Bank of China transformed into a central bank by the State Council, it did not announce its intermediary targets of monetary policy formally, but the loan quota for the specialized banks was in fact the intermediary and operational ones. Since 1985, the operation of the loan quota has played an important role in controlling the credit aggregate and in constraining the overheating of the economy as well as inflation. At the same time it has been solidified as the intermediary and operational target.

Recently, circumstances have changed a lot, the financial institutions other than the 4 state-owned commercial banks have mushroomed, and various forms of credit have been developed. If only controlling the loan size of the banks, especially of the 4 state-owned banks, the central bank can not control the credit aggregate and stabilize money. According to the rough statistics, the money supply from the loans of the 4 state-owned banks accounted only for about half of the money supply in the broad sense (M2) in 1994. So the reform scheme defines the intermediary targets to be money supply and credit aggregate, and defines the optional targets to be inter-bank offer rates and bank reserves for payment. Now the reserve account and the account of reserves for payment have been merged.

Defining the money supply as the intermediary target of monetary policy, it is possible and necessary for the central bank to regulate the macro-economy by financial instruments. This will create the precondition for the People's Bank of China to execute monetary policy by its own experiences and techniques of specialty management independently.

3. The reform of the instruments of monetary policy

The resolution about the reform of the financial system promulgated by the State Council in December 1993 defines the instruments of monetary policy to be reserve requirements, discount rates, open market operation, foreign exchange trading, loan quota, and rates of deposits and loans by the central bank. As the reform, deepened the loan quota as the instrument of monetary policy, faced more and more objections, the central bank canceled it as a legal instrument it is only used during certain specific periods as an other instrument defined by the State Council.

The People's Bank of China began to exercise foreign exchange trading in July 1993. After the two exchange rates of Renminbi were merged in 1. January 1994, exports increased significantly and a current account surplus emerged and foreign capital kept inflow. The People's Bank of China purchased foreign exchanges and supplied the base money as well as expanded the money aggregate for stabilization of the exchange rate of Renminbi. In order to offset the expansive effect of purchase of foreign exchanges, the People's Bank of China took back part of the loans and created a special deposit account for urban and rural credit cooperatives, and increased the quota of foreign exchanges held by the commercial banks, and so on.

In the past, whether the loan rates of the central bank remained unchanged for several years, or they were changed significantly, moreover the adjustment of interest rates of the central bank was completely in synchronization with that of the commercial banks. As a result, the purpose of monetary policy could not be shown. Since 1995, the People's Bank of China has made the adjustment of interest rates to the commercial banks different from the change of interest rates of the commercial banks, and kept adjusting slightly and frequently. Doing like this not only conforms to the requirement of monetary policy, but also nurses the market mechanism of interest rates influenced by the base rates of the central bank.

In 1994, extending the use of promissory notes among the coal and 4 other industries and developing the note-discounting market, the People's Bank of China did rediscount business at the same time. As of the end of 1995, the rediscount amount reached 32.6 billion RMB.

The People's Bank of China has done a lot of preparations for open market operation. It changed the issues of the Treasury bonds and approved 50 financial institutions to deal with the bonds for themselves and established a company for registration and settlement of the trading. After the issue of the Treasury bills in 1996, the People's Bank of China launched an open market operation formally on 9 April. In the past, the Treasury bonds were mainly issued to individuals, so the banks and other financial institutions held few of them, and the central bank itself had no Treasury bonds as yet. In 1998, the volume of the issues of the Treasury bonds reached the highest level since the founding of the People's Republic of China, the internal and external debts amounted to 659.07 billion RMB, creating a new record.

Since the establishment of the bond market between banks in June 1997, the inter-bank market has been developing, there are more and more participants and the transactions are flourishing. The commercial banks regard the market as a first place for funds to be lent and borrowed between themselves, so it provides the People's Bank of China with the necessary condition for the open market operation. From 26 May 1998, the Bank restarted the open market bond transaction. At the end of 1998, the Bank fulfilled 36 transactions, financing 176.13 billion RMB for the commercial banks and supplying 70.15 billion RMB of base money, which accounted for 2.22% of the total assets of the People's Bank of China. Treasury bonds and the central bank notes and governmental financial institutions bonds are the major financial instruments for the open market operation.

As from 1998, the central bank took a series of measures to increase the money supply. For example, abolishing the imposition of the loan quota on the state-owned commercial banks and reforming the reserve requirements system, decreasing the rates of reserve requirements and lowering the rates of deposits with the commercial banks twice, and so forth. But the effect is not as expected. Why? Because the foregoing monetary policy was mainly addressed to the state-owned enterprises, especially the state-owned productive enterprises, and as a result, the potential demand had not been stimulated adequately. Since the reform and opening to the outside world, the weight of the non-state-owned economy against the whole national economy has increased, since the 1990's the

contribution of the non-state-owned economy to the national economy has already exceeded 6%. According to the statistics in October of 1998, the addition of output value of the state-owned enterprises increased by 4.7% over the same month of last year, but increased by 15.1% for the joint stock companies and increased by 10.3% for the collective-owned enterprises. Nevertheless, the loans for the non-state-owned economy from the state-owned commercial banks does not reach 3% of the loan balance, it is necessary to adjust direction of monetary policy, so as to stimulate initiatives of the non-state-owned economy. In addition, promoting the increase of consumption should be the goal of monetary policy, for there is relative excess of supply over demand in the economy. From October of 1998, the People's Bank of China not only approved the China Construction Bank and other state-owned commercial banks to make automobile loans for individuals but also allowed the loan rates for the small and medium-sized enterprises to float in a broader band. In fact, the so-called adjustment of the direction of monetary policy is that the People's Bank of China introduces market mechanism into a broader financial area. This indicates that the marketisation of finance in China needs to be upgraded, and the base for this upgrade lies in the grade of marketisation of the national economy.

In the first half of last year, the People's Daily published the report entitled „the View about several issues of the current economic development” written by the Subject-Researching group at the Development Research Center of the State Council. According to the report, new measures of fiscal and monetary policies should be taken into consideration. The main ideas include:

Taking positive fiscal policy in order to expand domestic demand further and maintaining the situation of stable economic growth. First, we should fulfill the plan of the fiscal policy in 1999.

There is reason for a new fiscal policy measure to expand the demand, for example, the Treasury may consider issuing a reasonable amount of special longer term national debts to the state-owned commercial banks and other selected financial institutions. The fund from the issue could mainly be used to supplement the workers' pension, the rest may be used to subsidize the workers out of job and train them for reemployment. The national debts may be repaid by

the transfer of stocks of the state-owned enterprises (including the transfer income of the small enterprises) and the transfer of the usage right of the state-owned land and so on. Except for the small amount of the fund from the issue which is used to supplement the regions and industries suffering from serious difficulties, the main part is only to be used by the regions on the principle of who uses and who repays. Moreover, working out the yearly repayment scheme is executed under the supervision of the concerned department of the central government.

Monetary policy needs to take care to both expand the demand and improve the quality of credit assets of the commercial banks. The interest rates have been lowered several times in recent years, so the room for a further decrease is slight, but there may be a small chance to loose the control of hasten marketisation and interest rates. The People's Bank of China has relaxed the limitation of the loan rates being charged to small enterprises and it could consider further relaxation, gradually transforming to the system under which the loan rates of the commercial banks are adjusted by the market and controlled by the loan rates of the central bank.

At first sight, the outstanding national debt of China is small relative to its GDP. It was 9.5% in 1997, and about 10% in 1998. Therefore, room for the debt increase seems to be large for the size of the economy. Besides, the total deposits held by individuals now amount to more than 6 trillion RMB. It is much larger than the outstanding national debt in value. If considering the repayment and degree of reliance on the debt, it is difficult for anyone to be optimistic. In 1998, the repayment reached as high as 24.3% of GDP. This indicates that the repayment pressure for the Treasury is quite high. The degree of reliance on the debt was 76.3% of the GDP. This is too high. If calculating according to complete fiscal disbursement, the degree of reliance on the debt is not too high. With the external budget disbursement, the degree of reliance on the debt was 15.45% and 15.03% respectively, and could be decreased to 13.39%, if the 160 billion RMB of disbursement of the governmental fund is included. In the case of central finance, no matter how you calculate the degree of reliance on the debt, it reaches about 32%. In general, the distribution of the national income is badly distorted. It is reflected on two sides:

1. The fiscal revenue is a negligible amount of the national income.
2. The fiscal revenue belonging to the central finance does not account enough of the total fiscal revenue.

Although we seem to be in a position to take greater advantage of the national debt, we cannot forget how high the pressure of the repayment we shoulder is.

As a matter of fact, the sluggish domestic demands are still related to monetary control, and the decrease of the increment in money supply is concerned with the fall of the increment of the foreign reserves. From 1993, the People's Bank of China started to carry out the tight monetary policy in order to control the social aggregate demand. After 3 years' macro-economic rectification, a soft-landing was realized in 1996, in the national economy the aggregate supplies and demands were largely brought into equilibrium. The inflation rate was decreased from 21% in 1994 the highest period to 6% in 1996, and further to 0.8% in 1997. At the same time, the money supply was put under stringent control, whether the money in the broader sense M2 or the money in narrower sense M1. The increment of M2 was decreased from 34.6% in 1994 to 17.3% in 1997. The increment of M1 was decreased from 26.8% in 1994 to 16.5% in 1997. When arranging the money supply for the year 1998, the plan set by the central bank in early part of the year is that M2 increases by 16% to 18%, and M1 increases by 17%, which are all slightly higher than the numbers in 1997. But the actual results are that the increments of M2 and M1 fail to reach the targets, especially M1 increased only by 11.9%, which is the lowest increment since 1993. In June, M1 increased only by 8.7% over the same period of the last year. Obviously, the money supply was not enough. The reason lies in that the Chinese government adhered to the policy keeping RMB from devaluation in order to help Southeast Asia out of the financial crisis. Under the circumstances that the currencies in the neighboring countries vied one another to devalue, keeping RMB from devaluation, necessarily caused difficulties to the Chinese exports. In addition the expectation that RMB would devalue took place in the market. The combined two factors created a widespread phenomenon that the enterprises and people tried their best to acquire, store and cheat foreign exchanges. This led to a

strange situation under which there was surplus in foreign trade in 1998 but foreign exchange reserves did not increase accordingly. Since the market foreign exchange rate and the official one was merged in 1994, the foreign exchange reserves had increased significantly, the increment per year reached from \$20 billion to \$30 billion (in excess of \$30 billion in 1997). The purchase of foreign exchanges by the central bank became a main channel to inject base money, but the purchase volume decreased dramatically in 1998, causing an insufficient money supply.

Besides, there is something wrong with the stance of the monetary policy. The reasonably tight monetary policy was established in June and July 1993 by the central government against the overheating economy. In 1996, it was put into the „Ninth 5 Year Plan of the National Economy and Social Development“, thus the reasonably tight monetary policy became an important macro-economic guideline for a long run.

In October 1997, GDP was expected to grow at the rate of 9.5%, but 8.8% actually. Facing such a situation, at the end of 1997 and in early 1998, the central bank still announced its adherence to the reasonably tight monetary policy, so as to consider how to take back the loans to the commercial banks and prevent money supply from increasing too much when combining reserve requirements with the reserve for payments. Fiscal policy also focused on how to increase revenue and decrease disbursement in order to control deficit. Over 1998 the impact of the financial crisis in the Southeast Asia became increasingly more and more serious, the exceptional floods took place in the north and south at the same time, thereby the people's confidence to the future of economic growth suffered from a heavy blow. The reasonably tight monetary policy was extensively doubted. Until the second half of the year, the saying of the reasonably tight monetary policy was changed into a new one, the reasonable monetary policy, then into moderate monetary policy in early 1999 ⁶.

In summary, China is in the critical period of ownership reform; further deepening reform is encountering huge impediments and difficulties. A noted economist Wu Jinglian put forward: The reform of the state-owned enterprises

⁶ Feng Yan, About the Deflation and Solution

must resolve „no boss phenomenon”. In fact, the current reform of the enterprises is attending to touch this crucial issue. The strategy of „encouragement of merging, normalization of bankruptcy, decreasing labor force for efficiency, laying off some workers and staff and pushing reemployment can not deal with the „no boss phenomenon” of state-owned enterprises. As a matter of fact, the current bosses of most of the state-owned enterprises are still the governmental organizations at all levels. Even if the enterprises are joint stock companies, the superior administrations usually get their hands on the internal affairs of the companies, such as personnel, finance and production, etc. Once the superior administrations do not care, the enterprises tend to become an independent kingdom controlled by insiders, managers can do what they want, and state-owned assets are eroded and put into their pockets in large scale.

Theoretically, now the dominance of public ownership has been interpreted into keeping the influencing and controlling power of the public economy, not adhering to the public economy’s dominance in volume, so as to channel the development of other forms of ownership. The guideline of „focusing on the big enterprises and freeing the small ones” is the reflection of the aforementioned theory. „Focusing on the big enterprises” means controlling a small number of the influential state-owned enterprises. „Freeing the small ones” refers to releasing large numbers of small and medium-sized enterprises, letting their forms of ownership be determined by the market.

Resolving „the no boss phenomenon” of the state-owned enterprises is a long-term task, it can not be finished overnight. Because there are quite a few of people, especially some of the social elite, whose permanent interest is closely related to the state-owned economic system, they are never willing to see the reform going forward, and do nothing. If the multi-forms of ownership can not develop hand in hand, the elementary reform is not finished, it is impossible for the system of market economy to be built up and impossible for marketisation of finance to be realized, and the central bank can only serve the government as an instrument to stabilize the economy; no independence is certain.

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