

THE PEOPLE'S BANK OF CHINA

—FUNCTIONS, TASKS

AND MONETARY POLICY

June, 1993

The People's Bank of China (hereinafter referred to as PBC) was founded on December 1, 1948. With the approval of the State Council of the People's Republic of China, it has been exclusively functioning as China's central bank since 1984. Over the last forty years of socialist construction, especially since the start of the economic reforms, the PBC has been continuously improving its system of management and its methods of regulating currency and credit; and has thereby contributed greatly to maintaining the stability of currency and fostering the sustained, steady and coordinated development of the national economy.

I. History

The PBC was established in December, 1948, with its head office in Shijiazhuang, Hebei Province. Its principal functions in the initial period were: (i) to issue the Renminbi (People's currency) in order to unify the various currencies of the different regions under its jurisdiction; (ii) to make preparations for the institutional establishment of a new financial system after the founding of the People's Republic of China. In February, 1949, its head office was moved from Shijiazhuang to Beijing. During the period from 1953 to 1979, the PBC was the only state bank of the country, functioning both as the central bank and as a commercial bank. As approved by the State Council, it has, since early 1984, been functioning exclusively as the central bank, giving leadership to and exercising regulation of other banks and nonbank institutions across the country.

II. Organization

In 1984, with the approval of the State Council, the Council of the PBC was set up. It is composed of the Governor and Deputy Governors of the PBC; a number of experts and advisers from the PBC; and a leading official each from the Ministry of Finance, the State Planning Commission (SPC), everyone of the specialized banks, and the People's Insurance Company of China. The chairmanship of the Council is held by the Governor of the PBC. The principal function of the Council is the deliberation of major issues relevant to the country's general and specific financial policies, such as the state banks' comprehensive credit plan, cash plan, foreign exchange plan. However, important issues must be submitted to the State Council before any decision is made. The organizational structure of the PBC is as follows: the head office; branches in provinces, autonomous regions, municipalities directly under the central government, cities with independent annual plans and some special economic zones; second-level branches in prefectures and in cities under provincial governments; and sub-branches in counties and smaller cities.

By the end of 1992, branches and sub-branches of the PBC throughout the country numbered 2550, among which 30 were branches in provinces, autonomous regions and municipalities directly under the central government; 14 in cities with independent annual plans and some special economic zones; 315 in prefectures and cities under provincial governments; and 2,059 sub-branches. The branches in cities

with independent annual plans and the branches in some special economic zones are operationally subject to the leadership of both the head office of the PBC and the branches in the relevant provinces, autonomous regions and municipalities directly under the central government. The staff of the PBC nationwide numbered 170,622 at the end of 1992, with 2000 or so in the head office.

III. The Principal Functions and the Tasks of the PBC

1. Basic Functions and Status of the PBC

As stipulated in the Interim Banking Control Regulations of the People's Republic of China (hereinafter referred to as the Interim Banking Control Regulations) issued by the State Council of People's Republic of China on January 7, 1986, the PBC is the state organ through which the State Council directs and regulates financial and monetary affairs throughout the country, that is, the central bank of China.

As the central bank of China, the PBC functions as the issuing bank, the bank of banks, the regulator of money supply, and the bank of the government, which are the PBC's basic functions.

As the issuing bank, the PBC is the sole issuer of the Chinese legal tender — the Renminbi (RMB). It owns many printing factories and mints, and monopolizes the printing and minting of bank notes and fractional currency.

As the bank of banks, the PBC receives deposits from the specialized banks and other financial institutions and extends loans to them, provides cash to them, and organizes and handles the settlement of funds among them. Theoretically, the PBC performs the function of "lender of last resort", but so far there has not been any case in which an institution has required bailing out by the central bank.

The PBC is one of China's important organs responsible for macro-economic regulations. The PBC may make use of economic, legal and administrative means for the control over the aggregate credit ceiling and money supply in the country. The PBC is also responsible for formulating the social credit plan and the state banks' credit plan, which are the main instruments for the control of the credit ceiling. The credit activities of various financial institutions must be brought into line with those credit plans. In addition, the PBC is also in charge of drawing up policies for exchange rates and interest rates.

As the bank of the government, the PBC regulates the financial sector on behalf of the government and provides various banking services to the government. The PBC is in charge of (i) drawing up the general and specific policies for the country's financial work and organizing their implementation upon approval by the State Council; (ii) drafting financial and banking laws and regulations, and putting them into effect after approval by the National People's Congress (the legislature) or the State Council; (iii) laying down rules and regulations for the financial sector as authorized by the State Council, and organizing their implementation; (iv) examining and approving the establishment, dissolution and merger of domestic financial institutions, foundations, foreign-funded financial institutions, and Sino-foreign joint venture financial institutions, and the establishment of Chinese financial institutions and Sino-foreign joint financial ventures abroad and their dissolution and merger; (v) giving leadership to and exercising regulation, coordination, supervision and examination of state banks and other financial institutions; and (vi) examining and approving

the establishment of securities institutions while reporting such establishment to the State Council Securities Policy Committee (SCSPC) for its record, and regulating them; examining and approving the issuance of bonds by financial institutions and of securities for investment funds, and as entrusted by the State Council, drafting or revising rules and regulations related to their management; and regulating the financial markets and various credit instruments. The PBC and its branches and sub-branches provide banking services to governmental organs at various levels, namely, managing the state treasury and acting as agencies for the placement of bonds and their repayment. The PBC is responsible for the formulation of regulations regarding cash control and the control of the working capital of state-owned enterprises and for the supervision of their implementation. With the authorization of the State Council, the PBC also undertakes international financial activities on behalf of the Chinese Government, such as contacts and transactions with the International Monetary Fund (IMF), the Asian Development Bank (ADB), the African Development Bank (AfDB), the Bank for International Settlements (BIS) and other international and regional financial institutions. Furthermore, within the governmental framework of China, the PBC is in charge of the unified supervision and management of foreign exchange and gold and silver reserves, the supervision and registration of foreign debts and the collection of statistics thereto related, the examination and approval of external commercial borrowing, and the compilation of balance of payments statistics.

The PBC, as a member organ of the Chinese Government (the State Council), is a body at the ministerial level in charge of overall economic management. Its Governor is appointed by the President of the People's Republic of China upon the nomination by the Premier and after the approval by the National People's Congress; and is responsible to the Premier. The term of the Governor is five years, the same as that of the Government. As a member of the Government, the PBC's relations with other commissions and ministries are coordinated through the State Council. It should be noted, however, that the branches of the People's Bank across the country, rather than being part of the local governments, are agencies dispatched by the head office to implement in their respective localities the financial policies formulated by the head office.

As a member of the Government, the PBC must submit its major policies — such as credit plans, cash plans, foreign exchange plans and changes in interest rates and exchange rates — to the State Council for approval. At the same time, the PBC is involved in the discussion on issues related to internal and external economic policies, and the decision-making thereto related.

As a member of the Government, the PBC has several goals. The first one is to maintain monetary stability, to ensure the sustainable and steady development of the economy, and to increase social-economic efficiency and benefits. With this in view, the PBC has the responsibility for changing credit structure and channelling financial resources according to the industrial policy of the State. The second one is to support and foster the steady development of the financial sector. In this connection, the Interim Banking Control Regulations stipulates that the PBC should provide the specialized banks and other financial institutions with such services as financing arrangements, coordination of working relations among them, information and personnel training, in order to facilitate their business activities. As economic reform deepens, the PBC has been given more important mandate regarding financial reforms in order to nurture the evolution of the financial sector, such as helping financial institutions become genuinely accountable economic units and promoting the development of financial markets. Besides controlling the aggregates, the PBC also

has the responsibility for enhancing social-economic efficiency and benefits and for rationalizing the industrial structure.

2. Control over Money Supply

According to the Interim Banking Control Regulations, one of the PBC's tasks is to control money supply and ensure monetary stability. Therefore, the PBC is empowered to control credit ceilings and money supply by economic, administrative and legal means.

The PBC directly controls a portion of credit resources, in order to fulfil its responsibility of managing money supply. This includes reserve requirements deposited with it by the specialized banks and other financial institutions; excess reserves equal to 5-7% of their liabilities; fiscal deposits by public institutions, non-profit organizations and military units; and treasury deposits and funds raised through the issuance of PBC financing bills. These, together with the PBC's self-owned funds and currency issuance, constitute the total amount of financial resources available to the PBC. In implementing monetary policy, the PBC presently employs currency in circulation and aggregate credit ceiling as the major intermediate targets.

At present, instruments of monetary policy available to the PBC include credit plans, required reserve ratios, interest rates and central bank refinancing facilities, with credit plans (credit ceilings) being the most important one. The PBC is going to start the business of PBC financing bills in 1993 on an experimental basis as a means for the exploration of ways leading to open market operations. The PBC will henceforth move step by step towards the use of indirect means as major tools for the achievement of its monetary policy objectives.

3. Fiscal Agent

The Interim Banking Control Regulations provides that the PBC shall be mandated to manage the Treasury and to issue bonds on behalf of the Government.

In China, the Treasury is an agency which handles budgetary revenues and expenditures of the State. All budgetary revenues and expenditures are received and paid through the Treasury. Treasury agencies are established in line with the current fiscal management structure. In principle, each level of fiscal authorities has one Treasury on its behalf.

As fiscal agents, the PBC head office is responsible for the management of the Central Treasury, and its branches and sub-branches are responsible for the management of the Treasury of their respective provinces, autonomous regions, municipalities under the central government, cities with independent annual plans, prefectures, cities under provincial governments and counties. The Treasury below the county level is called the treasury agency and taken care of by outlets of the specialized banks. Presidents and vice presidents of the PBC branches at different levels serve as heads and deputy heads of the Treasury at their respective levels.

Treasury agencies through which the PBC manages the Treasury below the county level are established within branches and business offices at and below the city and county levels of the Industrial and Commercial Bank of China (ICBC), the Agricultural Bank of China (ABC), the Bank of China (BOC), and the People's Construction Bank of China (PCBC). These agencies handle the collection of budgetary revenues.

In the management of the Treasury, the PBC is also mandated to collect statistical information and make investigation on the implementation of the State Budget, and to carry out independent analysis on the status quo, the developments and trends of the budgetary revenues and expenditures of the State.

As the fiscal agent, the PBC is also responsible for the issuance and repayment

of such government securities as treasury bills, state bonds for key construction projects, fiscal bonds and indexed bonds; for the formulation of rules and regulations governing bond issuance, discounts and repayments, certificate design, fight against forgery and prevention of fabrication, and for the design of the related accounting systems.

At the same time, the PBC is in charge of the designing, printing and transporting of government bonds.

Vertical management is exercised within the PBC regarding currency issuance, i. e., cash can not be taken out of the issuance vault without the approval of the PBC office at the next higher level.

When other banks need to obtain cash from the issuance vault in the PBC, the acquisition must be in conformity with relevant rules governing the use of cash; and the amount must be less than the deposit balances they keep with the PBC in the form of ordinary deposits.

Banks are allowed by the PBC to meet their temporary cash needs through interbank activities without the involvement of the issuance vaults of the PBC, so that frequent inflows and outflows of cash into and from the vaults are avoided.

China has exercised centralized management of gold and silver over decades, and the PBC manages gold and silver reserves on behalf of the State.

Unless approved or designated by the PBC, no one can trade gold and silver. The PBC is the only authorized agency to purchase gold and silver in China. The need of gold and silver is met by the PBC in strict accordance with the plan on gold and silver uses which it has approved. Gold and silver prices are jointly determined by the PBC, the State Price Bureau and other government agencies concerned.

It is not allowed to take gold and silver out of China unless the holder has the permit from the PBC or the original declaration to the Customs.

4. Regulation of Financial Institutions and Markets

Before 1979, the PBC was the only national bank in China, and the rural credit cooperatives (RCCs) were the sole nongovernmental financial institutions.

Since the initiation of the economic reforms in China in 1979, first the BOC and then the ICBC have been separated from the PBC; and the ABC which had been abolished soon after its establishment was reestablished in March, 1979. In 1985, the credit plan of the PCBC which had been under the command of the Ministry of Finance was incorporated into the Overall Credit Plan of State Banks set out by and implemented under the surveillance of the PBC. In addition, several comprehensive and regional banks — such as the Bank of Communications, the CITIC Industrial Bank, the Everbright Bank of China and the Huaxia Bank — have been established, so have been many collective-owned Urban Credit Cooperatives (UCCs) and a great number of nonbank financial institutions including trust and investment companies (TICs), financial leasing companies, finance companies and securities companies. With all these financial institutions as well as the long-established People's Insurance Company of China and rural credit cooperatives, there has emerged in China a comprehensive financial system in which various kinds of financial institutions coexist, with the PBC as the leader and the state banks as the main body. Meanwhile, with the development of inter-bank and treasury bond markets and the growth of stock transactions in some parts of China, the financial market has also taken shape to certain extent. In accordance with the Interim Banking Control Regulations, the PBC has undertaken the responsibility for directing and supervising the financial institutions and markets across the country.

Coverage of surveillance over financial institutions by the PBC includes control

of financial resources and scope of business activities, and licensing and abolition of financial institutions. In addition to supervising Chinese financial institutions, the PBC's supervisory work also covers foreign-funded, overseas-Chinese-funded and joint-venture financial institutions in China.

(1) Control over the Funds of Financial Institutions

In China, the State Council has the supreme authority on the control over financial resources of financial institutions. The credit plan for state banks prepared by the PBC must be submitted to the State Council for approval after it has been reconciled by the State Planning Commission with other plans. In this connection, the PBC is in charge of preparing the overall credit plan, the cash plan and the social credit plan, and disintegrating the aggregate credit ceiling among the state banks and non-bank financial institutions; in the course of implementing the overall credit plan, putting forward detailed suggestions on the modification of the original plan in view of the change of the situation; supervising and taking part in the implementation of the credit plan via its branches.

Control over the funds of the State Banks. There are four specialized banks (the ICBC, the ABC, the BOC, and the PCBC) and four comprehensive banks (the Bank of Communications, the CITIC Industrial Bank, the Everbright Bank of China, and the Huaxia Bank). The former are state banks and are regulated as such; while the latter are not state banks in nature but are regulated as state banks and therefore referred to as such throughout this paper. The PBC exercises unified control over the sources and uses of their financial resources, with their annual credit plans as the fundamental instruments.

Since 1984, the PBC has been controlling the funds of the state banks by treating their credit plans and their credit funds separately, that is, the PBC stipulates the aggregate amount of credit for all banks through the compilation of the Overall Credit Plan for State Banks and sets up credit ceilings for each of them; while these banks have to raise their credit funds by way of taking deposits and issuing financial bonds. The PBC requires that each bank should balance the availability and the utility of funds on its own. At present, the PBC controls the credit ceilings of each bank mainly by way of mandatory plans.

In addition to management by way of credit plans, the PBC will also, in accordance with the industrial policy and regional economic development strategy of the State and the current economic situation, require that banks should, in extending loans, give priority to industries, enterprises and products encouraged by the State, and give them preferential treatment both quantitatively and in terms of interest rates. Therefore, the PBC will usually give banks which have made loans based on policy certain compensation in the form of central bank lending.

Control over the funds of other financial institutions. Over the past few years, other financial institutions which refer to financial institutions other than the eight state banks mentioned above have been growing rapidly. At the end of 1991, such financial institutions and their branches numbered more than 65,000 with deposits and loans accounting for more than 10 percent of the total deposits and loans nationwide. In view of this growth, the PBC started the compilation of Social Credit Plans in 1989 which determine the annual credit ceilings for TICs, UCCs, RCCs, regional banks and insurance companies. The PBC will then disintegrate such ceilings to its provincial branches which will make further disintegration among the other financial institutions under their jurisdiction. The Agricultural Bank of China is commissioned to organize the implementation of the credit plan for RCCs.

Different from the control by the PBC over the sources and the uses of the credit

funds of the state banks, the other financial institutions are not required to make policy-based loans.

The PBC regulates the deposits of the state banks and other financial institutions by determining required and excess reserve ratios, mainly for the purpose of implementing its monetary and financial policies.

The ninety-one operational branches established by foreign financial institutions from 1984 to June, 1993 in the five Special Economic Zones (SEZs) and the eight coastal cities in China do not subject the sources and uses of their funds to the planning control by the PBC. They are only required to deposit the required reserves with PBC branches in the places where they are operating.

(2) Administration over the Scope of Business and the Division of Activities of Financial Institutions

Control over the Division of Activities of the Specialized Banks. The Interim Banking Control Regulations provides that the PBC shall guide, coordinate, supervise and audit the business activities of the specialized banks and other financial institutions. In this connection, the PBC is responsible for drafting regulations, submitting relevant reports to the State Council for its approval; and then, in accordance with the guidelines confirmed by the State Council, arranges and readjusts the division of business activities of the various financial institutions in the light of changes in economic conditions, and examines and approves some of the business activities conducted by them on a case-by-case basis. From 1979 through 1986, there was a clear-cut division of business activities among the specialized banks. Since 1986, these banks have been allowed some degree of overlapping of business activities. Even though this overlapping has evolved over the past few years, the PBC, however, continues to emphasize that each specialized bank should focus on its conventional sphere of business activities and be involved to a lesser extent in lending activities in new areas, with the aim of maintaining the division of business activities among them. A few comprehensive banks, such as the Bank of Communications and the CITIC Industrial Bank which have been restored or established since 1986, have been allowed to do comprehensive business within the scope approved by the PBC.

Control over the Business Activities of UCCs and other Nonbank Financial Institutions. In addition to the urban and rural credit cooperatives, nonbank financial institutions mainly include insurance companies, TICs, finance companies, financial leasing companies and securities companies. In accordance with the Interim Banking Control Regulations, the PBC determines their scope and categories of business, and makes adjustments thereof according to changes in the economic situation. For instance, UCCs are only allowed to take sight deposits from collective-owned and individual-owned enterprises; TICs and insurance companies to be engaged in medium- and long-term credit activities with maturities of more than one year; finance companies to be involved in financing activities within their respective sponsoring enterprise groups; and securities companies to deal mainly with securities transactions. Also, the PBC sets up limits on loans which TICs can make as agents, restricting to a certain extent the activities of extending trustee loans disguised in the form of agent loans which could increase the magnitude of social credit.

Control over the Scope of Business of Foreign-funded and Joint-venture Financial Institutions in China. The PBC governs the business activities of foreign-funded and joint-venture financial institutions in China in accordance with the Rules Governing Foreign-funded and Joint-venture Banks in the Special Economic Zones of the People's Republic of China decreed by the State Council in 1985 and the Regulations Governing Foreign-funded and Sino-foreign Financial Institutions in Shanghai prom-

ulgated by the PBC in 1990 as approved by the State Council. At present, the PBC prohibits foreign-funded and joint-venture financial institutions from being involved in activities denominated in Renminbi. They, however, are allowed to accept fees in Renminbi resulting from business such as trade settlement services. Their activities are directed to enterprises with foreign investment. In this context, there is hardly any restriction regarding their business activities denominated in foreign currencies.

(3) Approval of the Establishment and Closure of Financial Institutions

In China, the State Council has the authority to approve the establishment and closure of state banks; while the establishment and closure of their branches and other financial institutions are subject to the approval of the PBC.

(4) Administration of the Financial Markets

The PBC's functions in regulating the financial market consist in (i) planning the institutional structure of the securities business and regulating the business activities of such institutions by working out procedures for their regulation, by examining and approving their establishment, closure or merger and that of their branches, their new business and business plans, by confirming their operational qualifications and coordinating their business relations, by supervising their behaviors, by investigating and dealing with their offenses against laws and regulations, so as to safeguard the regular and smooth operation and development of the securities markets; (ii) planning and regulating the bond market by working out the annual plan of bond issue for financial institutions as well as policies and procedures for the regulation of bonds, by organizing the implementation of the annual plan of bond issue, by examining and approving on a case by case basis the issuance of bonds of enterprises under the central government, financial bonds, house construction bonds, trust beneficiary bonds and short-term financing bonds, by studying and designing new variety of bonds, by ratifying rules on bonds, by investigating and dealing with illegal financing activities, and by supervising the use of funds, so as to safeguard the interests of investors; (iii) planning and regulating the development of investment funds by working out the annual plans for the issuance of such funds and procedures for their regulation, by examining and approving their sizes and ratifying their rules and prospectuses, by organizing the personnel training for the management of investment funds and supervising the uses of such funds so as to safeguard the interests of their holders.

5. Auditing and Supervision of the Operations of Financial Institutions

According to the Interim Banking Control Regulations, the PBC is responsible for the supervision and administration of the operations of financial institutions, itself included.

PBC's supervision is carried out mainly through auditing. For this function of the central bank, the PBC established in 1985 a special department responsible for auditing and supervision of the financial system and corresponding offices in its branches at the provincial and prefectural levels and in some sub-branches at the county level. These offices are authorized to examine, supervise, advise and penalize the supervised. By the end of 1990, there were 1930 auditing offices and 7,856 full-time auditors in the PBC at all levels.

PBC's audit of financial institutions includes the examination of their operational activities to see if they are in line with the rules and regulations and if they are safe and efficient; and the examination of their capital adequacy, credit orientation, assets quality, and solvency.

In recent years, PBC's supervision has been concentrating on whether the financial institutions overshoot the credit ceilings assigned to them, whether loans are re-

paid on schedule and whether the credit direction and interest rates meet the rules. At the same time, the PBC also takes a systematic assessment of financial institutions' performance according to the auditing regulations. As financial and economic reforms deepen, the emphasis of the supervision will be put on the management and efficiency of credit funds while conventional supervision continues. Through auditing, the PBC supervises and helps the financial institutions to take effective measures to reduce overdue loans, bad debts and losses and to ensure monetary and financial stability. For this purpose, the PBC will, by making use of other countries' scientific methods and advanced technology related to financial supervision, gradually impose prudential supervision on the RMB and foreign exchange operations of financial institutions on a selective basis.

Auditing by the PBC at the provincial, prefectural and county levels is carried out under a system under which the general auditor is in charge of the job of auditing under the leadership of the president at the same level. The General Auditor is an administrative officer of a vice president rank authorized to organize, plan, coordinate and handle auditing activities in the area under his jurisdiction. By the end of 1992, there were 1043 general auditors at the three levels.

6. Foreign Exchange Control

China is one of the countries where foreign exchange control is practised. The government exercises centralized control over foreign exchange.

Since 1979, the government has made a series of changes in the foreign exchange regime as an important part of the economic reforms and opening to the outside world. In 1979, the State Administration of Exchange Control (SAEC) was created with the approval of the State Council, and was given the responsibility for foreign exchange control. It used to be one of the departments of the PBC, and was made by the State Council in 1990 a state bureau at the viceministerial level still under the PBC's auspices. In April, 1993, the State Council decided that the SAEC be a state bureau administered by the PBC.

At the end of 1980, the Provisional Regulations on Foreign Exchange Control of the People's Republic of China was promulgated by the State Council, confirming in a statutory manner the measures to be taken in the reform of the foreign exchange control system. These regulations and the subsequent measures serve as basic rules for the current foreign exchange control system.

(1) Foreign Exchange Retention System

In the exchange regime in operation, there is a retention system for the allocation of exchange revenue. All entities that have foreign exchange income are allowed by the State to keep a certain proportion of the foreign exchange for their own use, selling the rest to the Bank of China (BOC) or any other designated bank at the official rate. The PBC is involved in laying down procedures for the management of the retained foreign exchange, setting different retention ratios for different industries. Over many years, foreign-funded enterprises are allowed to keep all their foreign exchange income, but are required to balance their foreign exchange receipt and expenditure on their own. In principle, the State does not provide them with foreign exchange.

The foreign exchange retention system is mainly a quota-based system except for foreign-funded enterprises and enterprises in some special economic zones in which case foreign exchange is retained in the form of cash.

The settlement and supply of foreign exchange by the BOC or other PBC-designated banks are conducted on an agent basis for the PBC.

(2) Foreign Exchange Receipt and Payment Plans

Since 1979 the non-trade foreign exchange receipt and payment plan has been worked out by the Ministry of Finance in collaboration with the SAEC, while the foreign exchange plan for trade has been formulated by the State Planning Commission (SPC) and the Ministry of Foreign Trade and Economic Cooperation (MOFTEC). The MOFTEC is responsible for the commodity export plan and the SPC for import. After consolidation and adjustment by the SPC, all these plans will be submitted to the State Council for discussion and approval. Once approved, these plans will be disintegrated by the SPC among the various government departments and local governments, and the SAEC will be responsible for the administration and supervision of the actual receipt and payment of foreign exchange according to the plans as disintegrated.

(3) Foreign Exchange Credit Plan

Due to the increase of foreign exchange credit of domestic banks and other financial institutions, the PBC started in 1990 the compilation of the Foreign Exchange Credit Plans of the State Banks and the Foreign Exchange Credit Plans of Other Financial Institutions as directed by the State Council. These plans cover all the receipts and payments related to foreign exchange credit extended by them.

The foreign exchange credit plans of the state banks include those of the ICBC, the ABC, the BOC, the PCBC, the Bank of Communications, the CITIC Industrial Bank, the Everbright Bank of China and the Huaxia Bank. That of the China Investment Bank is also included. The foreign exchange credit plans of the state banks are drafted by the above-mentioned banks in accordance with the PBC's requirements. After approval by the PBC, they will respectively disintegrate the foreign exchange credit plans to their own branches at various levels and organize their implementation.

The foreign exchange credit plans of other financial institutions are drafted by PBC branches in provinces, autonomous regions, municipalities directly under the central government and cities with independent annual plans; and after approval by the head office of the PBC, these branches will distribute them to the financial institutions under their jurisdiction and be responsible for their implementation.

A monthly report on the implementation of the foreign exchange credit plans has been instituted since 1991.

(4) Foreign Exchange Adjustment

After the establishment of the foreign exchange retention system, some entities have a surplus in exchange quotas or a shortage in RMB, while others are in dire need of foreign exchange. In order to accommodate the needs of different institutions having surplus or shortage in foreign exchange, the first foreign exchange swap center was established at the end of 1985 in Shenzhen with the approval of the State Council. Now, each province, autonomous region, municipality directly under the central government, city with independent annual plan or special economic zone has its own foreign exchange swap center. These centers operate under the direction of the SAEC.

There are two kinds of prices in the foreign exchange swap centers, that of the foreign exchange itself and that of the quota. They are all quoted in RMB. Determined by supply and demand, the prices in the swap centers may fluctuate. When fluctuations are too big, the PBC may intervene in the markets.

At present, entrance into the swap centers is limited to the state-owned and collective-owned enterprises, non-profit institutions, government agencies, military units, schools, and foreign-funded enterprises. Households and individuals can only participate in foreign exchange dealings in a limited fashion in some swap centers. The

SAEC examines the qualification of the participants and the source and usage of their foreign exchange. In China, any purchase and sale of foreign exchange outside the designated banks and agents or the swap centers are regarded as illegal.

(5) RMB Exchange Rates

For a long time, the determination of RMB exchange rate has been a very important part of foreign exchange control in China. Since 1979, the SAEC has been authorized to draft policies on RMB exchange rate; publish and adjust the exchange rate of RMB against other currencies as approved; and determine the unified conversion rates of various currencies against the U.S. dollar.

RMB is internationally unconvertible and its value is not determined by gold. Its exchange rates against other currencies are mainly determined by the comparison of the domestic purchasing power of the currencies concerned, taking into consideration the situation of balance of payments and changes in other currencies' exchange rates.

Currently, a managed floating exchange rate system is adopted in China. The SAEC publishes the RMB exchange rates against about 20 convertible currencies every day.

(6) State Foreign Exchange Reserves

According to the Interim Banking Control Regulations, the PBC is responsible for the management of China's foreign exchange and gold reserves. China's foreign exchange reserves refer to the foreign exchange balance of the State which comes chiefly from surplus in current account of balance of payments and can be used by the State at any time. At present, a major part of the state foreign exchange reserves and gold reserves are still managed by the BOC on PBC's behalf. The PBC's management of the foreign exchange reserves consists chiefly in policy making, that is, to determine the size of foreign exchange reserves, the proportion of the reserves which should be centralized, the forms in which the reserves should be held, and the currency composition, maturity and their adjustments.

(7) Foreign Exchange Certificate (FEC)

The State Council authorized the BOC in 1980 to issue foreign exchange certificate (FEC) in order to restrict the circulation of foreign currencies in China, guarantee materials supply to foreigners, overseas Chinese and compatriots from Hongkong and Macao who are traveling or living in China, facilitate the remittance by foreign-funded enterprises with the major part of their income coming from within China of their profits and capital to their home countries and the repayment of their foreign debts.

The FEC is on the par value with RMB, denominated in 100, 50, 10, 5, 1 yuan and 50, 10 fen respectively.

While in China, foreigners, overseas Chinese and compatriots from Hongkong and Macao can exchange their foreign currencies for FECs at BOC or other banks designated by the SAEC and receive an exchange memo. Within the amount indicated in the exchange memo, a holder can re-exchange his FECs into foreign currency at the current official rate. FECs can also be placed in a bank account as special RMB deposit or as foreign currency deposit.

The SAEC also has the following functions: administer foreign exchange held by foreign-funded enterprises and foreign institutions in China and their staff and by Chinese overseas enterprises and institutions, and foreign exchange for or from Chinese investment abroad; in collaboration with other departments concerned, examine and supervise the foreign exchange turned over to the central government by the local governments and various ministries; administer the foreign exchange quota

accounts; approve the opening of foreign exchange accounts; establish the general accounts of foreign exchange, both nationwide and central; approve the foreign exchange business scope of the specialized banks, the comprehensive banks and the nonbank financial institutions; issue foreign exchange business licenses to banks and nonbank financial institutions in China, and supervise their foreign exchange deposit and loan rates and their foreign exchange receipts and payments; formulate policies for foreign exchange adjustment, decide the scope of the adjustment and the guided price, and direct the flow of foreign exchange in accordance with the macro-economic policy and the foreign exchange expenditure plans of both the central and the local governments; administer the swap centers throughout the country; participate in the compilation of the balance of payments plan and supervise its implementation; compile balance of payments statement and collect balance of payments statistics.

7. Management of External Debt

China began to borrow internationally in 1979. The balance of China's foreign debt was US\$ 69.32 billion at the end of 1992, compared to US\$ 2.3 billion at the end of 1979 (established at the prevailing rate of RMB against U.S. dollar in 1979).

The PBC itself is responsible for borrowing from the International Monetary Fund and the Asian Development Bank. Besides, the SAEC under its leadership is charged with the following functions: register, monitor and collect statistics of the countries' external debts; supervise the use of funds borrowed by local governments, ministries and enterprises and formulate rules and regulations therefore; administer, supervise and examine the terms of securities denominated in foreign currencies and issued domestically and abroad (except those issued by government departments) and international commercial loans such as their maturities, interest rates, currency structures, and foreign exchange guarantees as well; make timely reports to the Government on the structure of China's foreign debt and its change as well as the indicators related to debt ratio, supplemented with analysis of the debt situation and countermeasures, for the reference of the decision-making bodies of the Government.

8. External Business

As authorized by the State Council, the PBC representing the Chinese Government undertakes related international financial activities. It is in charge of contacts and business transactions with the International Monetary Fund (IMF), the Asian Development Bank (ADB), the African Development Bank (AfDB), the Bank for International Settlements (BIS), and other international financial organizations; and formulates guidelines and policies for dealing with them. It is responsible for the organization of the annual Article 4 consultations with the IMF; and takes charge of ADB loans to China, including project fact-finding, project appraisal, loan negotiation, signing of loan agreements, supervision of project implementation, and loan disbursement and repayment. It undertakes the responsibility for the organization and coordination of the technical assistance given to China by the IMF, the ADB, other international financial organizations and foreign institutions. It takes care of China's assets in the IMF, the ADB, the AfDB and the BIS, and handles financial transactions with these organizations and foreign commercial banks and institutional investors concerned. The PBC has been establishing contacts and business relations with other central banks all over the world. The PBC has the authority to examine and approve the establishment of offices by foreign financial institutions in China and by Chinese financial institutions abroad and to formulate guidelines, policies and regulations for their supervision and administration. The PBC also undertakes investigation on the developments and trends of the international financial and economic

situation.

9. Payment and Clearance

China's payment system was established in the mid-1950s. At that time, the PBC undertook all the financial business in China including the issue of currency; and 95 percent of the fund transfers was realized through accounts with the PBC. The major means adopted by the PBC for payment within a city were commissioned payment, collection without acceptance, intracity collection against acceptance, and settlement by checks; for payment between cities and localities, the means adopted were intercity (interlocality) collection against acceptance, remittance (T/T, M/T) and payment under L/C. As these transfers were conducted among the branches of the PBC, the payment system at that stage was incomplete. There were only "intra-bank transfers" between the PBC branches, no settlement of funds among banks.

Since 1984, as China's financial system reform deepens, the PBC has been functioning exclusively as the central bank, and the funds of the specialized banks have been separated from the funds of the PBC. In order to change the situation of "eating from the same big rice pot" in the field of fund management and reform the credit fund administration system, the intra-bank system has been changed in such a way that each specialized bank has its own intra-bank system. Balance of remittance within the same intra-bank system will be cleared on a regular basis; while fund transfer between different intra-bank systems will be done by transferring fund from the system whose bank is the payer but not the holder of the payee's account to the other system whose bank holds the payee's account.

With the approval of the State Council, the PBC has organized and led reforms of the payment system since 1988, adopting new payment instruments, and expending the use of checks, promissory notes, bills of exchange and credit cards. Now, checks are used in cities and their peripheries, and their use will become more and more extensive. Promissory notes are used in some cities before the extension of their use. The use of bills of exchange, both bank bills and commercial bills, has been vigorously spreaded throughout the country. Moreover, the acceptance and discount of commercial bills by banks and the re-discount by the central bank have become a major financing instrument. Credit cards issued by the BOC, the ICBC, the ABC, and the PCBC successively are already in use. Besides, such means as telegraphic transfer, mail transfer, and commissioned collection are there for funds settlement between cities and localities.

Funds settlement within a city is conducted through the local clearance house run by the PBC with the net difference being settled on the same day by the PBC local branch.

Since each specialized bank has its own intra-bank transfer system, the links of funds transfer are multiplied and the time of clearance between cities and localities is lengthened, thus reducing the efficiency of funds utilization. For the solution of this problem, the PBC, with the approval of the State Council, started in 1989 the construction of a satellite communication network exclusively for funds clearance throughout the country. There will be two main stations in Beijing and Wuxi, Jiangsu Province respectively, which are to become general centers of clearance after completion. It is planned that minor stations will be built in 400 big and medium-sized cities over the country, which are to become sub-centers of clearance. After the completion of this project, all payments will be hopefully cleared through this system on time.

Payment between the PBC and foreign banks is executed by the specialized banks on an agent basis.

10. Earmarked Loans of the PBC

An earmarked loan of the PBC is a loan financed by the PBC within the quota of the consolidated national credit plan to meet the special requirements of local economic development, and extended by PBC branches via the specialized banks as agents.

Earmarked loans of the PBC include loans in support of the regional economic development in the old revolutionary base areas, minority nationality regions, remote and backward border provinces, and poverty-stricken regions; loans to develop the local economies in the 14 coastal port cities designated by the State Council and the special economic zones; loans for the purchase of foreign exchange quotas and loans against foreign exchange as securities; loans to industrial enterprises run by poor counties and to foreign-funded enterprises; and loans for gold and silver production and purchases. These loans generally have a term of one to three years, seven years at most; and their interest rates vary depending on their category.

11. Investigation and Statistics

Shortly after its establishment, the PBC set up a unified system for financial statistics. In 1986, for the adaptation to the change of the PBC's functions, the work of economic investigation and that of statistics were consolidated; and investigation and statistical units were established both in the head office and in the branches and sub-branches of the PBC, making up a nationwide network. Now, the PBC has instituted a rather complete investigation and statistical system which can meet the needs of macro-economic management by way of monitoring, analyzing and forecasting the monetary aggregates and the trend of the economy as a whole. With this system, the central bank is able to make its independent analysis of the economic and financial situation.

The investigation and statistical units of the PBC at all levels regularly collect data reflecting the business activities of the state banks and other financial institutions. Financial statistical figures are exclusively published by the Investigation and Statistical Department of the PBC head office. At present, figures of credit funding sources and disbursements of all banks, deposits and loans of RCCs, exchange rates, gold and foreign exchange reserves are published quarterly in the Financial Times and the China Finance. Along with the six important economic indicators jointly-published monthly by the State Statistics Bureau, the State Planning Commission, the Ministry of Finance and the PBC, is the item of the Total Balance of Loans Including Fixed Asset Loans at the End of the Preceding Month together with its Increase over the Beginning of the Year. According to an agreement reached with the IMF, the PBC provides it with quarterly data concerning monetary survey, assets and liabilities of the central bank, the specialized banks and the rural credit cooperatives respectively.

The PBC started the compilation of price index for means of production in 1986. In the same year, it began to conduct survey on the production, funds and business performance of key national industrial enterprises, taking it as the basis for economic analysis.

The PBC has made the development and improvement of the investigation and statistics system an important task in the time to come, and is devoting to building up a more comprehensive and detailed investigation system for industrial enterprises, and also an investigation system for residents' income and expenses.

The State Administration of Exchange Control is in charge of statistics of international balance of payments and external debts. It publishes the figures of balance of payments for the previous year in the second half of each year, and those of the

gross external debt, long-term and short-term external debts for the previous year in the third quarter of each year.

IV. Monetary Policy and Its Instruments

Pursuant to the Interim Banking Control Regulations, the PBC, as the central bank of China, studies and formulates the national financial guidelines and policies, and is in charge of their implementation after the approval of the State Council. Formulating and implementing the monetary policy is a primary function of the PBC.

1. The Objective of Monetary Policy

To maintain a sustained and rational economic growth with basically stable price is the most important objective of China's social and economic development, and also the long-term priority objective of the PBC. However, the monetary policy of the central bank alone is not sufficient for the achievement of this objective, which needs, in addition, the coordination of the fiscal policy, industrial policy, external economic policy, price policy, etc.

After summarizing the experience in monetary policy implementation over many years and studying the relation between the monetary policy and national economic development, the PBC has defined its chief objective as stabilization of currency value and creation of an environment favorable for balanced economic growth.

2. Formulation of the Monetary Policy

Option of the Intermediate Objective of the Monetary Policy. Currently, the PBC has the following intermediate objectives for the implementation of its monetary policy: aggregate credit ceiling, currency in circulation, and the newly established money supply. The PBC had all along taken currency in circulation as the major objective of monetary control before the economic reform in 1979; since then, more emphasis has been given to the indicator of aggregate credit ceiling which has been made the major intermediate objective of monetary policy.

As the economic reform deepens over more than ten years, budgetary allocations for fixed capital investment have been transformed into bank loans in addition to loans for working capital. Therefore, the various bank loans have become the main source of production funds in the economy, and the credit amount and composition can more closely reflect the situation and structure of the national economy as a whole. Since it began functioning exclusively as the central bank, the PBC has undertaken the task of managing and regulating the credit funds of the specialized banks, and the aggregate credit ceiling has therefore become a more exact reflection of the intention of the monetary policy of the central bank and the impact of monetary policy on economic activities. In addition, the aggregate credit ceiling has become the major intermediate objective of monetary policy implementation of the PBC at the current stage due to the continuous improvement of the collection, processing and analysis of the data on the national economy and on credit amount and also due to the strong empirical coherence between the fluctuations of the aggregate credit ceiling and those of money stock represented by currency in circulation.

At present, the PBC is attempting to make money supply the major intermediate objective of the monetary policy. This is because the former highly centralized planned economy has, after so many years' reform, evolved into a socialist market economy, which gives rise to the necessary condition for money supply to become the

intermediate objective of the monetary policy. Furthermore, money supply can more directly than aggregate credit ceiling reflect the impact of the expansion or contraction of credit of the financial system on the level of prices. Money supply will therefore replace aggregate credit ceiling as the key intermediate objective of monetary policy of the PBC.

3. Overall Credit Plan

The overall credit plan is a plan for credit funding source and demand and the amount of currency to be issued. It is drafted by the PBC, then consolidated and balanced with the other sectors' plans of the national economy by the State Planning Commission, and finally implemented by the PBC after approval by the State Council.

When the intermediate objective of monetary policy is designated, the important steps to implement the monetary policy of the central bank, then, will be the compilation and implementation of the overall credit plan, which covers the credit plans of all the specialized banks, the Bank of Communications and the other comprehensive banks, comprising the plan of credit funding sources and demand, that of gold, silver and foreign exchange reserves, and that of cash receipts and payments which is auxiliary in nature. The PBC started in 1989 to work out social credit program which includes the plan of fund sources and uses of state banks and other financial institutions as well as the enterprises' direct financing plans.

The overall credit plan consists of a yearly plan and 4 quarterly plans. The yearly plan sets up target for the whole year to be carried out in the quarterly plans.

To guide the issue and withdrawal of currency, the PBC also plans currency receipts and payments for the nation.

In conformity with the characteristics of China's economic system and economic performance, the PBC formulates the overall credit plan mainly on the basis of the macro-economic indicators such as the GNP growth rate and the impact of adjustment of the price structure on the price level, while making reference to the industrial production plan, the plan of procurement and sales of commodities, the plan of material allocation, the fiscal budget, the plan of fixed capital investment, the foreign exchange plan, the salary plan, the social purchasing power, and the historical data of credit fund sources and uses. This means that in China, the monetary policy of the central bank is restrained by the economic policies of the State.

The overall credit plan embodies the specific requirements and objectives of the monetary policy of the central bank within the plan period. Under the socialist market economic system as practised in China today, the credit plan is still of a compulsorily enforcing nature. The PBC ensures, within the framework of the plan, the achievement of the objective of the monetary policy embodied in the plan, by enforcing its monetary policy instruments and certain special measures.

4. The Administration System of Credit Funds

In China, the administration by the PBC of credit funds of all financial institutions, fund transfers between the PBC and financial institutions, and the application of the monetary policy instruments by the PBC have all been carried out by way of a given administration system of credit funds.

The evolution of the credit funds administration system of China has covered three stages since early 1950s. From 1953 to 1979, the PBC implemented a unified administration system of credit funds nationwide, a system of "centralized deposits and loans", because in most of the time during that period, the PBC was the only state bank functioning both as the central bank and a commercial bank. PBC branches at all levels had to hand in all deposit they had taken to, and had their plan