TREASURY MANAGEMENT IN THE PEOPLE’s REPUBLIC OF CHINA

Report on OECD -- Chinese Ministry of Finance Seminar
Beijing, 25-26 April 2001

The support of the Government of Japan for this activity is gratefully acknowledged

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OECD - Ministry of Finance of the People’s Republic of China

SEMINAR ON TREASURY MANAGEMENT

Beijing, 25-26 April 2001

I. Background

1. The OECD and the Ministry of Finance of the People’s Republic of China held a Seminar on Treasury Management in Beijing on 25-26 April 2001. This was part of the overall OECD-China co-operation program, which has as its objective to facilitate China’s smooth integration into the world economy by sharing OECD policy experiences and best practices.

2. The OECD Delegation consisted of Mr. Ken Carfine, Director, Cash Management, Department of the Treasury, United States of America, Mr. Ken Warren, Chief Accounting Adviser, The Treasury, New Zealand, and Mr. Jon Blondal, Principal Administrator, Budgeting and Management, OECD Secretariat.

3. The Chinese participants consisted of senior officials from the Ministry of Finance, and the 6 central government ministries and 10 provincial governments which are participating in the pilot treasury management reform initiative. A total of 60 Chinese officials attended the seminar. The Chinese side was led by Mr. Zhang Tong, Director-General, Treasury Department, Ministry of Finance.

4. The local organisation of the seminar and other arrangements for the Delegation were handled by the Ministry of Finance’s Department of International Affairs. The Delegation would wish to thank Mr. Ju Kui Lin, Deputy Director-General, Mr. Zhang Wencai, Head of Division, and Ms. Wang Ying for their excellent co-operation.

II. Treasury Management in China: Current Status

5. During the past two decades, China has embarked on a series of profound economic reforms aimed at transforming a centrally planned economy into a market-based economy. The modernisation of fiscal institutions and processes has, however, lagged behind in the overall economic reforms in China.

6. Treasury management can be defined as the manner in which the government implements the budget, i.e. how it manages its cash receipts and cash payments. At present, China can best be described as having no effective central treasury management system in place.

7. There are over 13,000 government organisations, at all levels of government in China, which operate a plethora of separate bank accounts in commercial banks. Each one of these accounts will have idle balances, often significant, with the Ministry of Finance having no ability to manage them.

8. Government revenue collection organisations first deposit revenue in their own accounts. The money often stays there for a long period of time before being turned over to the Ministry of Finance, as the revenue collection organisations benefit from the interest it earns in their accounts. There are also serious abuses, as significant amounts of revenue are never turned over to the Ministry of Finance.
9. In 1999, an investigation of 44 central government organisations revealed a total of 3,888 accounts in commercial banks. These included 338 billion Yuan (41 billion US Dollars) in off-budget revenue, of which 90 billion Yuan (11 billion US Dollars) was never turned over to the Ministry of Finance.

10. Government organisations receive moneys for their operations from the Ministry of Finance in bulk at regular intervals. The Ministry of Finance deposits the money in accounts held by central government organisations in commercial banks. They in turn deposit the money in the accounts of various subsidiary organisations. This is a cascading process, often involving 6 layers of organisations before the final end user, who pays invoices to third parties, receives the money necessary to do so. Delays in handling the money over are common, as all organisations along the way benefit from greater interest income the longer it stays in their accounts.

11. This system is also ripe to abuse, as there are no effective controls on what the money is actually spent on. All organisations are to report to the Ministry of Finance on their use of funds, but this takes place long after the fact, is highly aggregated, and incomplete. As noted, government organisations often collect their own revenue to finance extra-budgetary expenditures, which is completely outside the scope of the Ministry of Finance.

12. The legal framework for treasury management is incomplete. Although some extra-budgetary activities are clearly corruption-related and illegal, it is unclear what specifically constitutes government revenue for treasury management purposes. Furthermore, the exact role of the Ministry of Finance in supervising the treasury management system is not unequivocal at present.

13. The weakness with the current state of affairs are readily recognised by the Ministry of Finance. The State Council has approved a pilot project to be launched in order to reform the system.

III. Proposed Reforms in China

14. The State Council has approved reforms to the treasury management system in China that will bring in line with those of OECD Member countries. The reforms will be implemented in a step-by-step process, following an initial pilot project. A pilot project consisting of 6 central government ministries and 10 provincial government will be initiated on 1 July 2001. More ministries and sub-national government will be progressively included in the new treasury management system. No final date has, however, been set for the completion of this project, i.e. when all government organisations will be included in the new system. Chinese officials noted that there was strong resistance to the reforms by many government organisations.

15. The reforms can be summarised as encompassing four sets of measures:
   - Establishment of Treasury Single Account
   - Standardisation of Revenue Collection Procedures
   - Standardisation of Payment Disbursement Procedures
   - Other Related Measures

Establishment of Treasury Single Account

16. The Ministry of Finance will establish a Treasury Single Account at the People’s Bank of China (central bank). All revenue will enter this account and all expenditures will be paid from this account.
17. Separate bank accounts will be created for each government organisation at commercial banks. Each government organisation will pay its obligations to third parties from these accounts. The accounts will, however, be very different from the accounts that government organisations presently have in commercial banks: First, the Ministry of Finance will have to approve each of the accounts. Second, each transaction from these accounts will be via the Ministry of Finance Payment Center (see below), rather than directly by each organisation. Third, the accounts will be “swept” overnight, i.e. the balance of the accounts at the close of each business day will be zero as any remaining balance will be transferred to the Treasury Single Account at the People’s Bank. As a result, the government will be able to centralise treasury management. In OECD Member countries, overnight balances are regularly invested in commercial banks in order for them to fulfil their overnight reserve (liquidity) requirements.

18. Government organisations will also be permitted to open special accounts for extra-budgetary funds and special purpose funds. These funds can be seen as the equivalent of trust funds and specialized social insurance funds in OECD Member countries. As part of this reform, the number of such funds will be substantially reduced in China. The balances of these accounts will be swept overnight and form part of the central treasury management system.

19. The Ministry of Finance will also permit government organisations to open accounts for small amounts, which will have overnight balances. These are essentially “petty cash” accounts in order for government organisations to pay minor day-to-day expenses.

**Standardisation of Revenue Collection Procedures**

20. The reforms call for all revenue that is collected by government organisations to be deposited (via the commercial banks) into the Treasury Single Account at the People’s Bank immediately as it arrives. In other words, government organisations will no longer be permitted to hold on to the money they collect in order to receive interest income in their own accounts.

21. The above general rule applies to all major categories of revenue. For small sources of revenues, such as proprietary income, government organisations will be permitted to remit that money at the end of each business day rather than immediately as it arrives. This contrast to the practice today whereby, for example, the Foreign Ministry remits all fees for consular and other services that it collects on a quarterly basis.

**Standardisation of Payment Disbursement Procedures**

22. The reforms call for all disbursement to be classified into four categories: (1) Salary, (2) Payments for Purchases of Goods and Services; (3) “Petty Cash” Purchases; and (4) Transfer Payments.

23. There will be two manners in which to effect disbursements: (1) Direct Payment and (2) Authorised Payment.

24. The direct payment approach will be applied for salaries, significant purchases of goods and services (projects), and transfer payments. The authorised payment approach will be applied for lower value purchases of goods and services and “petty cash” purchases. The objective is to concentrate the relatively low number of transactions with high values as direct payments and permit the relatively large number of transactions with low values to be made by authorised payment.
25. The payment disbursement procedures for a direct payment are as follows:

- Each government organisation submits a monthly spending plan to the Ministry of Finance.
- Ministry of Finance approves the monthly spending plans, with amendments if necessary, and returns to the respective government organisations.
- Ministry of Finance sends the approved spending plans for each government organisation to the **Payment Center**, a unit within the Ministry of Finance which will be created as part of the reforms.
- Government organisations submit payment requests to the Payment Center.
- The Payment Center verifies if the payment is in accordance with the monthly spending plans and that the request is signed by a responsible official in the government organisations. If not, the Payment Center will refuse to pay.
- If everything is in order, the Payment Center sends a payment order to the commercial bank where the government organisations has its account. When the nation-wide inter-bank settlement system is established, the payment order will go there directly. This, however, will take some time to be established.
- The commercial bank will pay the amount into the account of the third party recipient.
- The commercial bank will settle with the Ministry of Finance’s Treasury Single Account at the central bank at 4 p.m. each day. If the payment is very large, the settlement with the central bank will take place in real time.
- Concurrently, the commercial bank will send payment information to the payment center and to the government organisation that requested the payment.

26. The payment procedures for an authorized payment are the same as above except for the following:

- The Payment Center will notify each government organisation of the maximum amount it can use each month.
- The Payment Center will also notify this to the commercial bank where the government organisation has its account.
- The government organisations issues a payment order directly to its commercial bank. There is no need to submit payment request to the Payment Center.
- The Payment Center will be notified of this, but only for informational purposes.
- All other aspects are the same as for a direct payment.

**Other Related Measures**

27. Chinese officials noted that seven other reforms, related to the introduction of the new treasury management system, were being implemented.

- A thorough investigation to identify all accounts held by government organisations in commercial banks was being undertaken.
- Further reforms to the budget were being undertaken. These focus on greater itemisation in the budget, both in terms of organisations responsible and for items of expenditure. This is the foundation for improved implementation of the budget.
• A process of amending all related laws and regulations to align them to the new treasury management system. This is principally aimed at ensuring that all government revenue and expenses are part of the government’s treasury management system.

• Creation of a fiscal management information system in order to make policy-relevant information available based on the new treasury management system.

• Creation of an inter-bank settlement system. The large Chinese banks have their own internal settlement systems in place at present, but there is not yet a system of inter-bank settlements in place. This is a huge bottleneck that slows down payment processing.

• Establishment of Payment Center at the Ministry of Finance. This will be the central point for accepting payment orders from government organisations and giving directions to commercial banks to pay moneys. The major difficulty is that government is committed to downsizing the government, but this reform will require additional staff to be hired. The State Council is reviewing how the new reform can be implemented.

• Strengthening the monitoring of budget implementation. Chinese officials noted the abuses taking place in the present system, i.e. money not being remitted to the Ministry of Finance and money being used in non-authorised manners. The focus would especially be on training in this area.

4. Observations and Conclusions of OECD Delegation


29. The Delegation was most impressed by the comprehensive knowledge of treasury management systems in OECD Member countries exhibited by Chinese officials and by the very frank nature of the discussions at the seminar and the free-flowing exchange of ideas.

30. The Delegation emphasised that there were variations in specific institutions and practices across OECD Member countries, but the fundamental principles were the same in all cases.

Treasury Management is Fundamental

31. The Delegation emphasised the importance of treasury management in OECD Member countries. It has three primary objectives. First, to reduce the government’s interest expenditure by investing any idle funds. Second, to prevent abuse from taking place by putting in place effective controls for the receipts and disbursement of funds. Third, to provide immediate information on the government’s financial position. The government’s treasury management system also provides information on the economy. For example, the government’s receipt of taxes is one of the indicators of economic activity in Member countries. Therefore, the treasury management system can alert the government to any actions it may need to take to stimulate or dampen demand in the economy.

32. As noted above, the current treasury management system in China does not provide for any of the above objectives to be accomplished in an effective and efficient manner. The proposed reforms address all of these factors.
Role of Ministry of Finance

33. The Delegation emphasised that the Ministry of Finance is always and inherently in charge of the treasury management function in OECD Member countries; without a central organisation in charge, effective treasury management is not feasible.

34. The Delegation emphasised that all revenues go into the central treasury management system and that all expenditures are paid from the central treasury management system in OECD Member countries, i.e. no transactions whatsoever take place outside the central treasury management system. User charges and other “proprietary” revenue is all deposited into the treasury management system. In cases where separate “off-budget” accounts are held for social insurance programs, these balances are managed as part of the central treasury management system.

35. These features are enshrined in the organic budget laws of OECD Member countries.

36. As noted above, the situation currently diverges from this in important respects in China. The proposed reforms in China address all of these factors.

The Budget

37. The Delegation emphasised that the treasury management function in OECD Member countries was concerned with implementing the budget in the most effective and efficient manner. All decisions on what moneys should be spent on, and what revenues should be collected were taken in the budget. There was no decision-making role in that sense in the treasury management system. The budget therefore needs to be comprehensive and encompass all government revenue and expenditure, and clear lines of accountability need to be in place.

38. China is in the process of updating its budgeting framework by increasing the comprehensiveness of the budget and introducing organisational budgets which clearly define the organisations responsible for revenue and expenditure, and what revenues and expenditures should be collected and disbursed. The Delegation emphasized the importance of this reform; the quality of the budget is a prerequisite for the quality of the treasury management system.

Role of Central Bank

39. The role of the central bank in treasury management varies in OECD Member countries. The Delegation emphasized that regardless of these variations, the monetary policy function of the central bank was clearly distinguished by its role as the fiscal agent of the government. In the United States, for example, the central bank has a very strong role in acting as the government’s fiscal agent. All government payments are settled at the central bank. In New Zealand, the situation is different with the central bank having no role in making payments on behalf of the government.

40. China has opted for a very limited role for the central bank in the proposed reforms to treasury management system. Several reasons were given for this; First, the central bank does not have the capacity to act as the government’s payment agent. The cost of the treasury management system operating through commercial banks is much less. Second, it was believed important to not have this function in the central bank to emphasize that the central bank should be concerned with only monetary policy. Third, the central bank should be monitoring the commercial banks in their function as the government’s payment agent. It could not do so if it was the government’s payment agent.
41. The Delegation noted that the above rationale for a limited role for the central bank was very familiar in OECD Member countries and further noted that the relationship between the finance ministry and the central bank can be challenging because of the dual and sometimes conflicting position of the central bank in serving in the monetary policy and fiscal agent role. The role of the central bank depends on local circumstances; there is no “right” or “wrong” role.

Role of Commercial Bank Accounts

42. The Delegation emphasized that even in cases where government organisations in OECD Member countries have their own bank accounts in commercial banks, these balances were “swept” overnight into the Treasury Single Account in the central bank where it would be managed effectively. In that sense, there is no difference from a treasury management point of view in whether government organisations have accounts in commercial banks or if they have sub-accounts/ledger accounts in the central bank. The existence of accounts in commercial banks does in no way imply that those government organisations have freedom to collect or spend money at will. The existence of such bank accounts does however imply a banking relationship and the Ministry of Finance will need to devote resources to negotiating expected performance levels and monitoring the actual performance of the commercial bank against those expectations.

43. In OECD Member countries where organisations have accounts in commercial banks, they are normally accompanied by a series of incentives (allowing interest to be earned and paid) in order to decentralise cash management procedures. The Delegation stressed that these reforms were considered “leading edge” in OECD Member countries and relied on a very sophisticated banking system in order to be implemented.

Speed of Processing

44. A major concern in China is that a new treasury management system would be cumbersome and there would be significant delays in processing payments. The Delegation emphasised that the treasury management function worked very rapidly in Member countries. Revenues are generally deposited immediately in the single treasury account; expenditures -- even when processed through the central bank -- are generally processed in 2-5 days after the payment order is received. This is irrespective of the geographical location of the place.

45. The Delegation further stressed that payments are now generally being processed by means of electronic fund transfer, rather than by the issuance of physical checks

Large Payments vs. Small Payments

46. The Delegation stressed that differentiation was made between large payments and small payments in OECD Member countries. The Delegation noted that the use of credit cards for small “petty cash” purchases was commonplace in Member countries. This in recognition of the fact that processing payments incurs costs and that those costs may be viewed as unreasonable for small purchases.

47. The Delegation noted that the proposed reforms in China take full account of this, although not by the use of credit cards.
**Reporting**

48. The Delegation noted that extensive reports were made based on the information in the treasury management system. These included reports on the government’s cash balance at the end of each day and monthly reports on the government’s revenue and expenditures by categories of organisations and expenditure. The Delegation emphasised that such reports were publicly available in OECD Member countries.

49. The Delegation also noted that these reports were very sensitive in that financial markets followed them very closely. It was therefore necessary to ensure that the release of the reports was made in a manner that did not advantage or disadvantage any player in the financial markets.

50. Fiscal reporting of this kind is not practiced in China at present and the proposed reforms do not envisage those reports being made publicly available.

**Cash Forecasting**

51. The Delegation also noted that there was no discussion of cash forecasting in the proposed reforms in China. This was a fundamental and inherent part of the treasury management function in OECD Member countries. Cash forecasting is made on the basis of historical patterns for revenue collection and payment disbursement and adjusted for any known special payments. The Delegation noted that such forecasts were made for each day. The Delegation further noted that such forecasts were made public and that financial markets followed any differences between forecasts and actual very carefully; if differences occurred, financial markets “punished” governments in Member countries as this is viewed as evidence of ineffective financial management practices in government.

52. In response, Chinese officials noted that the present reforms focused on establishing a Single Treasury Account and related reforms and that the introduction of cash forecasting techniques would come at a later date.

**Implementing the Reforms**

53. The Delegation endorsed the pilot project approach to implementing the reforms. The reforms are of a fundamental nature and many lessons will be learned from the experience gained in the pilot in order to create an effective and efficient treasury management system. The Delegation further noted that a formal evaluation of the pilot should take place against a pre-determined set of benchmarks. To the extent that such an evaluation indicates that net financial benefits arise, this can be a powerful “marketing” device for both reinforcing and gaining commitment to the change.

54. The Delegation also emphasised that there would be winners and losers in this new system and that the resistance to the reforms experiences in China was to be expected. The Delegation stressed the need to devote resources to communicating the benefits of the new treasury management system and that it was imperative to maintain the level of commitment from senior officials to the reforms.
Appendix

Seminar on Treasury Management

AGENDA

Beijing, 24-25 April 2001 – Xin Da Du Hotel

Co-Chairmen:

Mr. Zhang Tong, Ministry of Finance and Mr. Jon Blondal, OECD Secretariat

Wednesday, 25 April

9:00-9:30 Opening Ceremony
   • Ministry of Finance
   • OECD Delegation

9:30-10:30 Treasury Management in OECD Member countries
   • Mr. Jon Blondal, OECD Secretariat

10:30-12:30 Treasury Management in China
   • Mr. Lou Hong, Chief, Policy and Regulations Division, Treasury Department, Ministry of Finance

12:30-14:00 Luncheon Hosted by Ministry of Finance

14:00-16:30 Institutional Arrangements for Treasury Management
   • Mr. Ken Carfine, United States
   • Mr. Ken Warren, New Zealand

16:30-17:30 Impact of Accrual Accounting / Budgeting on Treasury Management
   • Mr. Ken Carfine, United States
   • Mr. Ken Warren, New Zealand

18:00-20:30 Banquet Hosted by Ministry of Finance
Thursday, 26 April

9:00-12:30 Payment Disbursement and Revenue Collection Procedures
- Mr. Ken Carfine, United States
- Mr. Ken Warren, New Zealand

12:30-14:00 Luncheon Hosted by Finance Bureau of the City of Beijing

14:00-17:00 Cash Forecasting and Reporting Practices
- Mr. Ken Carfine, United States
- Mr. Ken Warren, New Zealand

17:00-17:30 Closing Ceremony
- Ministry of Finance
- OECD Delegation