



CHINA IN THE WAKE OF ASIA'S FINANCIAL CRISIS

Edited by Wang Mengkui

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China in the Wake of Asia's Financial Crisis

Edited by Wang Mengkui

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China in the Wake of Asia's Financial Crisis

This book examines China's response to the Asian financial crisis of 1997, both in its immediate aftermath and in the years since. The crisis caused turmoil throughout Asia's economies, and precipitated wholesale reform of economic and financial policies and institutions across the region. As one of Asia's largest economies, China responded to the crisis more successfully than many others, avoiding devaluation of its currency, whilst undertaking financial reform, restructuring state-owned enterprises, rural development, and social security systems. This book considers all of these issues, showing how the lessons drawn from the crisis have helped shape China's policies of liberalization and market-orientated reform, including its attitude towards globalization and the outside world in general. Based on research conducted by the China Development Research Foundation, one of China's leading think tanks, this book includes contributions from senior policy makers in the Chinese government and from experts participating directly in the government's policy-making process to assess the effects generated by the country's related policies, making it an indispensable account of China's own thinking on its response to the financial crisis.

Wang Mengkui is former President of the Development Research Center of the State Council, and is currently Chairman of the China Development Research Foundation.

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Foreword

A decade ago, when Asia's financial crisis erupted, many people suddenly had doubts about the East Asian economic miracle. Was it the beginning of the end? And could China go unscathed by the crisis, which had a huge negative impact on regions beyond Asia?

Ten years later, the world is witnessing a resumption of Asia's thriving economy, which has not only overcome the consequences of the crisis, but has also managed to put itself back on the path to rapid growth. China weathered the crisis because of proper measures and prudent and stable policies governing the opening of the financial market to the rest of the world. It is reasonable to say that coping with this crisis and learning a lot from the experience enabled China to grasp important opportunities for development and reform, allowing the country to ascend the global economic ladder. As a matter of fact, China's proven accomplishments over the past 10 years in terms of national development and economic reform and in terms of advancing China in the Asian and global economic paradigm have gone far beyond anyone's imagination. China and the rest of Asia are both marching forward along their chosen paths, drawing attention from all parts of the globe.

What has China learned from Asia's financial crisis? How did China fare on the road toward development and reform over the past decade? What will China's socio-economic scene look like in the future? All these questions are of interest to the general public. *China in The Wake of Asia's Financial Crisis* answers most questions about issues such as macroeconomic administration, financial systems, reforms of state-owned enterprises, social construction, and reform of social mechanism management practices in the wake of the crisis. This volume of research presents as detailed a picture as possible of the economic and financial future of China. All the authors are experts in their respective fields, and some are officials who have taken part in the formulation of policies. Readers will not only have access to a convenient interpretation of relevant policies, but will also be presented with an in-depth analysis based on a blend of theories and practice, so as to have a better and more thorough understanding of existing policies and of China's pursuit of development and reform.

History is like a mirror. Without doubt, the circumstances of today are largely different from those of a decade ago. In this era, where a technology-led revolution thrives and where the tide of economic globalization reaches all corners of the

earth, China is poised to comprehensively build a prosperous society. It is time to review China's journey to national development and economic reform to get a clearer picture of where China is heading. The lessons learned from Asia's financial crisis are still of major significance. Finance remains the lifeline of economy in modern times. Some critics say that today's world has seen industrial capitalism give way to financial capitalism. The swift evolution of the financial industry, together with the innovation of financial means, has created great impetus to the development of economic power but has also resulted in new risks. Once the financial system suffers problems, sudden or overall breakdowns will likely occur with dire consequences. Although having positively evolved for 10 years, China's financial industry remains a weak link in the country's economic paradigm. In the scenario of fierce competition in world financial circles, China is still a novice. Thus, it is imperative that China continues to pursue reform and development, carry forward financial reforms, consolidate financial supervision and regulation mechanisms, and prevent financial risks. This is also why we have paid specific attention to financial security when conducting our research.

Wang Mengkui

Former President of the Development Research Center of the State Council of China, and current Chairman for the China Development Research Foundation

September 7, 2007

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Introduction

China in the Wake of Asia's Financial Crisis comprises 14 chapters divided into four parts.

Part I: China's macroeconomic management after the Asian financial crisis

In "From overcoming deflation to preventing inflation," Liu He explains how Asia's financial crisis decrease of the volume of China's international trade and contributed to a decrease in prices of domestic agricultural products, triggering deflation. Fiscal policies based on expansion reforms featuring restructuring enabled China to enter a new era of economic progress and develop an economy that was open to the rest of the world. China made remarkable economic achievements but then also faced a new challenge: the imbalance between internal and external macroeconomic conditions. China's macroeconomic policy makers had to right the imbalance from top to bottom.

"From proactive to sound fiscal policy: an improvement to china's public finance system," by Jia Kang, provides the background, substance, and effects of expansion-based, proactive fiscal policies, which China adopted after Asia's financial crisis erupted in 1997. The chapter also describes China's shift from proactive fiscal policies to sound fiscal policies after 2003 and details the major measures that were taken along the way. Kang also looks into and analyzes "extrusion effects," the effects of "construction funds raised from national bonds," tax reductions, risks related to national bonds, and other important policy-related issues. Kang sums up China's progress in building the public finance system in the past decade.

Yi Gang, in "Fluctuation of the RMB exchange rates and relevant institutional factors," analyzes the reasons for and institutional factors of changes in Renminbi exchange rates. According to Gang, the increasing competitiveness of China's tradable items is a result of enhanced labor productivity and total factor productivity, progress in building the legal system, and the protection of intellectual property rights, as well as the swift increase in the value of China's assets (which are classified as non-tradable items). Such changes were positive but nevertheless led to imbalances. Rectifying the imbalance requires reliance on adjustments to factual

2 Introduction

exchange rates. Meanwhile, nominal exchange rates and commodity prices are both helpful for the adjustment of factual exchange rates.

Long Guoqiang, in “China’s policy of opening up in the decade after the Asian financial crisis,” looks back on and analyzes China’s opening-up policy in the decade after the Asian financial crisis. Guoqiang also looks at future opening-up policies. China adopted proper countermeasures to minimize the impact of the crisis and played an active role in maintaining financial stability and economic cooperation in the region, thus fortifying the country’s influence in the regional economy. In the future, China must meet the needs arising from the country’s scientific concept of development, pursue peaceful development, cling to creeds of “mutual-benefit” and “win-win,” seize new opportunities, overcome new challenges emerging because of globalization, and adjust opening-up strategies and policies.

Part II: China’s financial system and reform of state-owned enterprises after the Asian financial crisis

In “Reform of state-owned commercial banks: from disposing of non-performing assets to institutional reform,” Liu Chunhang maintains that state-owned commercial banks play a principal role in China’s financial system. Since 1998, state-owned commercial banks in China have set out to adopt a series of significant reforms, which focused on addressing their bad assets. Since 2003, the Bank of China, the China Construction Bank, the Bank of Communications, and the Industrial and Commercial Bank of China have all started an orderly restructuring in line with the joint stock system and have become increasingly aware that their common goal of reform is to build up a clarified ownership system and maintain sound corporate governance practices. In fact, today’s banking industry has opened to the outside on a broader scale, and the financial supervision and regulatory mechanism has been constantly developed. The financial environment and infrastructure have improved. Meanwhile, reform and development measures adopted by China’s state-owned commercial banks have yielded impressive results, which have been noticed by the rest of the world. However, these banks have also faced harsh challenges arising from the brand new environment. State-owned commercial banks must still lift themselves up by the bootstraps to improve corporate governance and enhance their competitiveness.

In “System reform of China’s capital market,” Qi Bin and Huang Ming maintain that since the outbreak of Asia’s financial crisis, China’s capital market has evolved, following a largely rectified, standardized and healthy path. Such evolution is manifested principally in institutional changes. Rectification started in 1997 and lasted about two years. It mainly covered illegal transactions in over-the-counter stocks, securities organizations and stock exchanges, the futures market, and investment funds. In July 1999, the “Securities Law” went into force, finally conferring legal status to China’s capital market. Since then, China’s capital market has been further standardized and improved as a result of additional reforms. The State Council issued its “Certain Opinions with Regard to Facilitating the