

How to Sustain China's Growth Miracle?*

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The Chinese economy has delivered a remarkable performance over the last two decades, with annual GDP growth averaging nearly 10 percent. The particular combination of macroeconomic and structural policies that has generated this growth has clearly “worked” well. But rapid growth can hide, or in some cases even exacerbate, a number of deeper problems. For instance, the financial sector is in poor shape and has distorted domestic demand; the patterns of investment financing could lead to a resurgence of non-performing loans (NPLs) in the future and, by fueling a build-up of excess capacity

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in some sectors, could generate deflationary risks in the medium-term. Meanwhile, in the short-term, some of the pressures are becoming evident in other forms such as asset price booms (in the equity markets, in particular).

The sustainability of growth — while an important concern — may not even be the key problem. There are indirect and subtle costs to the current growth model that deserve attention. For instance, tight management of the exchange rate has been facilitated by financial repression and a relatively closed capital account. This has, among other things, meant very low real rates of return for households, who save a lot and have few investment opportunities other than domestic bank deposits. These policies have also curtailed financial sector development, leading to inefficient intermediation of domestic capital. There are clearly large welfare costs associated with these constraints.

The growth strategy has involved a number of policy distortions and constraints that have greatly reduced the room for policy maneuver in case any big shocks should hit. Such shocks could come from internal sources (e.g., loss of confidence in the banking system, social instability generated by rising inequality) or external sources (e.g., international capital market crises, a collapse of external demand, US trade sanctions, flaring-up of tensions over Taiwan, etc.).

Monetary policy is typically the first line of defence against such shocks but, with monetary policy constrained by the objective of maintaining a tightly managed exchange rate, it can at best play a very limited role. There appears to be room for fiscal maneuver since the explicit levels of fiscal deficit and government debt are quite low, but this may be deceptive as there are large contingent liabilities in the state-owned banking system and huge unfunded pension liabilities. The financial system is still dysfunctional in many ways and may not be deep or robust enough to withstand a significant shock.

So what should China do to prepare itself to deal with shocks and make growth more balanced and sustainable? The banking system should be made more robust and driven by market principles, and the

financial system should be broadened to create alternative sources of funding for firms and alternative investment opportunities for households and firms. The state-owned enterprise sector needs to be further corporatized by hardening budget constraints. There is a need for a better social safety net and a better system for delivery of social services.

Many of these reforms are interrelated and trying to implement these reforms in isolation is not an effective way to proceed. For instance, stable macroeconomic policies and a well-developed and efficient financial sector are essential ingredients for balanced and sustainable growth. In turn, these two intermediate objectives would be helped by an effective monetary policy and further capital account liberalization, and with a flexible exchange rate as a prerequisite.

Ignoring these linkages — for instance, trying to push forward with banking reforms while holding monetary policy hostage to an exchange rate objective — makes an already difficult reform process even harder. Similarly, financial repression has kept the real price of capital cheap and, along with subsidized energy and land prices, shifted production towards capital-intensive methods. This works at cross-purposes with the authorities' goal of boosting employment growth and facilitating the transition of rural unemployed and underemployed to employment in manufacturing and services.

Ultimately, the essence of the policy debate can be framed in terms of the pace and sequencing of reforms required to turn these strengths into forces that allow the growth miracle to be sustained and to reduce the risks of its being derailed by shocks.

INVESTMENT-LED GROWTH

One dimension of the Chinese growth story that is of particular relevance in the context of the arguments in this paper is the composition of growth. Investment in physical capital has been a major contributor to growth during this decade, in some recent years accounting for nearly two-thirds of nominal GDP growth. Private

consumption, by contrast, has made a much smaller contribution to growth.¹ One consequence of the investment-heavy expansion has been the relatively slow employment growth.² Indeed, during the period 2000–2005, growth of total non-agricultural employment averaged only 3 percent per annum, compared to average non-agricultural GDP growth of about 9.5 percent.

Why has investment growth been so strong? A substantial fraction of this investment in China has been financed by credit provided by state-owned banks at low interest rates. Indeed, cheap capital has played a big part in skewing the capital:labor ratio and holding down employment growth.³ Recent increases in the base lending rate have been far too small to raise the real price of capital to a meaningful level for an economy that is experiencing annual real growth of over 10 percent (Figure 1.1). In addition, local governments provide subsidized land in order to encourage investment. And energy prices continue to be administered and made available to enterprises at prices below international levels.

A lot of the recent investment has also been financed through retained earnings of profitable firms, which ought to be more defensible on the basis of economic criteria. However, even here the picture is not clear. Profitable state enterprises were not, until very recently, required to pay dividends to the state. This suggests that such investment may have been spurred by the minimal rates of return on bank deposits which made even marginal investment projects seem in the money. The risk, of course, is that such high rates of investment in industries with favorable demand conditions may be leading to a build-up of excess capacity in those very industries; this

¹ For details on the composition of growth, see Aziz, Jahangir, 2006, “Rebalancing China’s Economy: What Does Growth Theory Tell Us?”, *IMF Working Paper 06/291*; and Lardy, Nicholas, 2006, “China: Toward a Consumption-Driven Growth Path”, *Policy Brief 06-6*, Peterson Institute for International Economics (Washington, DC).

² For detailed calculations, see the chapter by Brooks in Prasad, Eswar (editor), 2004, “China’s Growth and Integration into the World Economy”, *IMF Occasional Paper No. 232*.

³ See Aziz (2006).

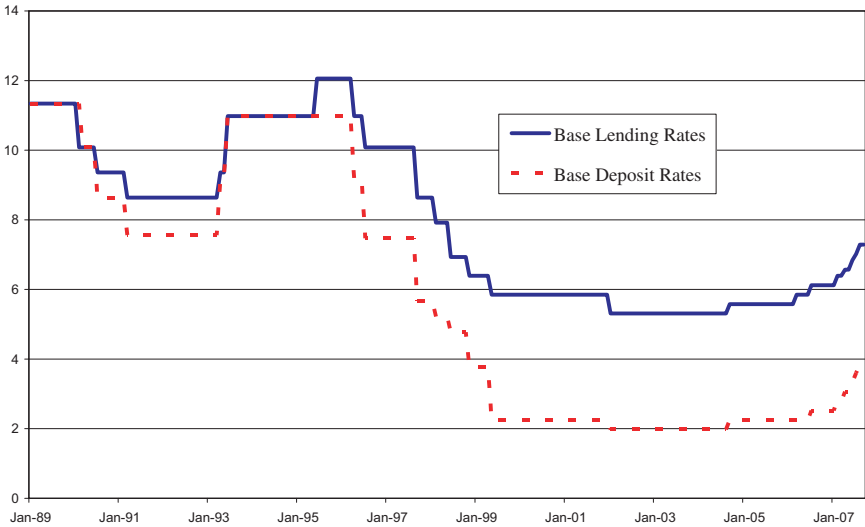


Fig. 1.1 Base Lending and Deposit Rates (1-year rates, in percent)

Source: CEIC.

could become evident if there were adverse demand shocks in the future.⁴

While investment has been high, national savings have been even higher, with both household and corporate savings rising in recent years. The uncertainties engendered by the transition to a market economy, the limited availability of instruments to borrow against future income to finance purchases (major durable goods, housing, etc.), and the lack of international portfolio diversification opportunities have all contributed to high household savings.⁵ Financial system repression has meant that there are few alternatives to funnelling these savings into deposits in the state-owned banking system.

⁴ Goldstein, Morris, and Nicholas R. Lardy, 2004, "What Kind of Landing for the Chinese Economy?", *Policy Brief No. PB04-7*, Institute for International Economics (Washington, DC).

⁵ Chamon, Marcos, and Eswar Prasad, 2008, "Why Are Saving Rates of Urban Households in China Rising?", IMF Working Paper No. 08/145.

Households willingly hold bank deposits despite weaknesses of the banking system because of implicit deposit insurance provided by the government. This provides abundant liquidity for banks to expand credit which, because of the distorted incentives faced by lenders, largely finances investment by state enterprises. State enterprises that do make profits are not required to pay dividends, encouraging them to plough retained earnings (which are counted as enterprise savings) back into investment. Thus, the investment boom in recent years has been fuelled by cheap credit and overoptimistic expectations of future demand growth in sectors that are doing well at present.

MACROECONOMIC POLICIES

China has had a relatively stable exchange rate relative to the US dollar since 1995. Since 2001, the exchange rate has been kept from appreciating only by massive intervention in the exchange market. In tandem with sustained high export growth and a burgeoning current account surplus that is likely to hit 12 percent of GDP in 2007 (Table 1.1), this is indicative of a substantially undervalued currency. Figure 1.2 shows that, despite an appreciation of the renminbi versus the US dollar since June 2005, the real effective exchange rate of the renminbi is now *below* its recent peak in 2002 (largely due to the US dollar's depreciation against other major currencies).

Resisting pressures for exchange rate appreciation has fuelled a surge in the accumulation of international reserves since 2001 (Figure 1.3). Table 1.2 shows that, during the period 2001–2004, inflows of speculative capital (in anticipation of eventual renminbi appreciation) accounted for most of the pick-up in the pace of reserve accumulation relative to the period 1998–2000. During 2005–2006, speculative inflows shrank but the slack was more than taken up by a dramatic surge in the trade balance, which doubled the rate of reserve accumulation that had been seen during 2001–2004. The inflows resulting from these factors have added to the liquidity in the banking system and further complicated the control of credit growth.

Table 1.1 The Balance of Payments (in billions of US dollars)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Gross international reserves	143.4	149.8	158.3	168.9	218.7	295.2	412.2	618.6	825.6	1072.6	1338.7
<i>(in percent of GDP)</i>	15.0	14.7	14.6	14.1	16.5	20.3	25.1	32.0	36.8	40.8	—
Change in international reserves	34.9	6.4	8.5	10.5	49.8	76.5	117.0	206.3	207.0	247.0	266.1
A. Current account balance	37.0	31.5	21.1	20.5	17.4	35.4	45.9	68.7	160.8	249.9	162.9
<i>(in percent of GDP)</i>	3.9	3.1	1.9	1.7	1.3	2.4	2.8	3.6	7.2	9.5	—
Merchandise trade balance	46.2	46.6	36.0	34.5	34.0	44.2	44.7	59.0	134.2	217.7	135.7
<i>(in percent of GDP)</i>	4.9	4.6	3.3	2.9	2.6	3.0	2.7	3.1	6.0	8.3	—
B. Capital account balance	21.0	-6.3	5.2	2.0	34.8	32.3	52.7	110.7	63.0	10.0	90.2
FDI, net	41.7	41.1	37.0	37.5	37.4	46.8	47.2	53.1	67.8	60.3	51.0
C. Errors and omissions, net	-22.3	-18.7	-17.8	-11.9	-4.9	7.8	18.4	27.0	-16.8	-12.9	13.1
<i>Memorandum Items:</i>											
Non-FDI capital account balance											
(including errors and omissions)	-42.9	-66.1	-49.6	-47.4	-7.4	-6.7	23.9	84.6	-21.6	-63.2	52.3
Nominal GDP	953	1019	1083	1198	1325	1454	1641	1932	2244	2626	—

Sources: CEIC, IFS and author's calculations.

Notes: The data for 2007 are end-June data. The non-FDI capital account balance is the capital account balance minus net FDI plus net errors and omissions.

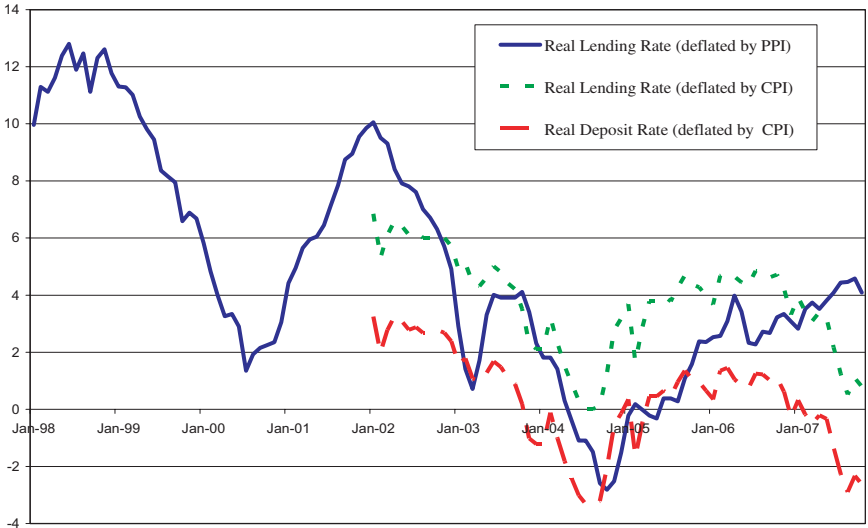


Fig. 1.2 Real Lending and Deposit Rates (1-year rates, in percent)

Source: CEIC and author’s calculations.

Note: Real rates calculated by deflating the nominal rates by twelve-month trailing CPI or PPI inflation.

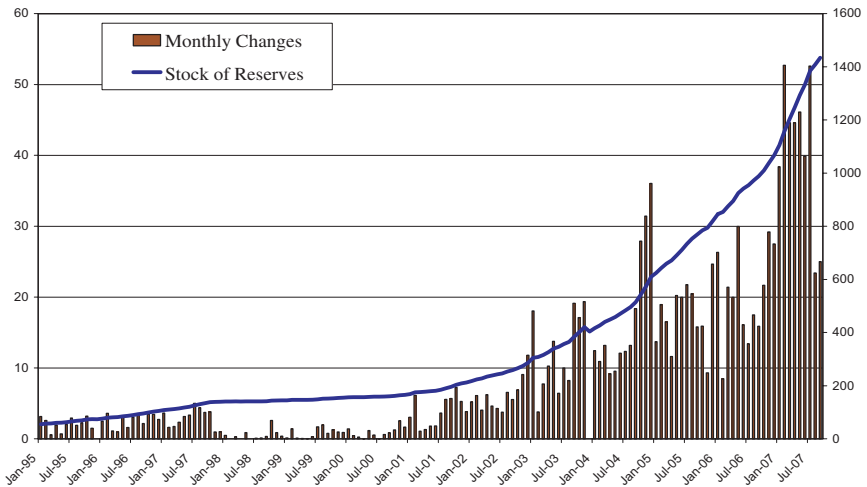


Fig. 1.3 Foreign Exchange Reserves: Flows and Stocks (in billions of USD)

Table 1.2 A Decomposition of the Recent Reserve Build-Up (in billions of US dollars)

	Annual Averages			Changes	
	1998- 2000 (1)	2001- 2004 (2)	2005- 2006 (3)	2001-2004 - 1998-2000 (2) - (1)	2005-2006 - 2001-2004 (3) - (2)
Increase in foreign reserves	8.5	112.4	227.0	103.9	114.6
Current account balance	24.4	41.9	205.4	17.5	163.5
Capital account balance	0.3	57.7	36.5	57.4	-21.2
FDI, net	38.5	46.1	64.1	7.6	17.9
Errors and omissions, net	-16.1	12.1	-14.9	28.2	-26.9
Non-FDI capital account balance (including errors and omissions)	-54.4	23.6	-42.4	78.0	-66.0

Sources: CEIC, IFS and author's calculations.

Notes: The non-FDI capital account balance is the capital account balance minus net FDI plus net errors and omissions.

Why have these inflows not led to rampant inflation? The answer lies in the ability of the People's Bank of China (PBC) to sterilize these inflows. Such sterilization usually quickly runs into limits in most emerging market economies. Government bonds that are used to soak up liquidity have to offer increasingly high yields to convince domestic economic agents to hold them, leading to ever-increasing costs to the budget.

In China, private saving rates (both household and corporate) continue to be very high; most of these savings invariably flow into the banking system since there are few alternatives. This has made the banks flush with liquidity, particularly at a time when they are under pressure to hold down growth in credit. Moreover, banks have an incentive to hold PBC bills rather than increase their lending since corporate lending, for instance, carries a capital

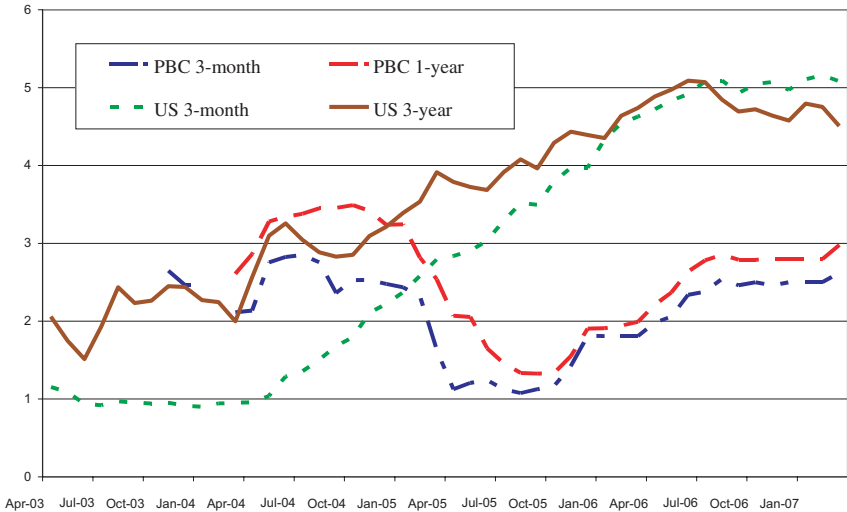


Fig. 1.4 PBC Bill Rates vs. US Treasury Yields (in percent, annualized)

requirement of 100 percent while no capital needs to be put aside for lending to the government. So there is a great deal of demand for PBC bills even at relatively low interest rates. This means that, at the margin, sterilization is essentially a moneymaking operation for the PBC (abstracting from the effects of changes in the exchange rate). Figure 1.4 shows how the present configuration of interest rates in China and the US generates this “profit” from the PBC’s sterilization operations.

But such a cost-benefit calculation can be deceptive. The lack of exchange rate flexibility not only reduces monetary policy independence, it also hampers banking sector reforms. The inability of the PBC to use interest rates as a primary tool of monetary policy implies that credit growth has to be controlled by blunter and non-market-oriented tools, including targets/ceilings for credit growth as well as “non-prudential administrative measures” (which effectively amount to moral suasion). This vitiates the process of banking reform by keeping banks’ lending growth under the administrative guidance of the PBC rather than letting it be guided by market signals. This constraint has also perpetuated large efficiency costs via provision of cheap

credit to inefficient state enterprises.⁶ The incidence of these and other costs of banking system inefficiency are not obvious, but they may ultimately be borne by depositors in the form of low (or negative) real returns on their saving.⁷

The management of capital flows has been another crucial component of macroeconomic policy. Extensive capital controls, along with tax benefits and other incentives, have been used to promote inward FDI, while other forms of inflows, especially portfolio debt, have been discouraged.⁸ Capital controls have also played an important role in protecting the banking system from external competition by restricting the entry of foreign banks and by making it harder to take capital out of the country. The limited development of debt and equity markets means that the state-owned banking system is effectively the only major game in town, for both borrowers and savers.

China's approach to exchange rate policy and capital account liberalization may be indicative of a desire to maintain stability on the domestic and external fronts. And the large stock of foreign exchange reserves resulting from these policies may serve as insurance against vulnerabilities arising from a weak banking system. But the policy distortions needed to maintain this approach could generate imbalances, impose potentially large welfare costs, and become a source of instability.

PATH TO REFORMS

It is not easy to isolate specific policies to deal with particular problems identified aforesaid. Indeed, the reform process appears to have

⁶ Dollar, David, and Shang-Jin Wei, 2007, "Das (Wasted) Kapital: Firm Ownership and Investment Efficiency in China", *IMF Working Paper 07/9*.

⁷ In July 2007, the benchmark one-year deposit rate was raised to 3.33 percent and the tax rate on bank interest income was cut from 20 percent to 5 percent. The effective after-tax deposit rate is now 3.16 percent, which is still below the current rate of CPI inflation.

⁸ Prasad, Eswar, and Shang-Jin Wei, 2007, "China's Approach to Capital Inflows: Patterns and Possible Explanations", in *Capital Controls and Capital Flows in Emerging Economies: Policies, Practices and Consequences*, ed. by Sebastian Edwards (Chicago, IL: University of Chicago Press).

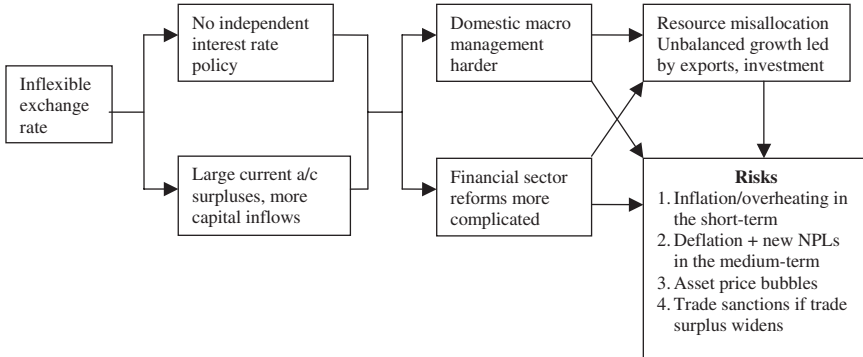


Fig. 1.5 Lack of Exchange Rate Flexibility Complicates Macro Policy and Reforms

reached a stage where the traditional approach of undertaking incremental reforms in isolation from others may not work well anymore.⁹ Given the prominence of China's exchange rate regime in discussions about China-US bilateral relations as well as the issue of global current account imbalances, currency policy provides a good illustration of the interconnectedness of various reforms.

What are the costs of an inflexible exchange rate? Figure 1.5 lays out some of the connections. The main point is that an inflexible exchange rate, while not the root cause of imbalances in the economy, requires a large set of distortionary policies for its maintenance over long periods. It is these distortions that — through multiple channels — hurt economic welfare and could, over time, shift the balance of risks in the economy.

Flipping this around makes it easier to see why exchange rate flexibility matters for China. It is not necessarily because it will directly have a large or lasting impact on problems such as the US-China trade

⁹ For more on this point, see Blanchard, Olivier, and Francesco Giavazzi, 2005, "Rebalancing Growth in China: A Three-Handed Approach", *MIT Department of Economics Working Paper 05/32*; and Prasad, Eswar, and Raghuram Rajan, 2006, "Modernizing China's Growth Paradigm", *American Economic Review*, Vol. 96, No. 2, pp. 331–336.

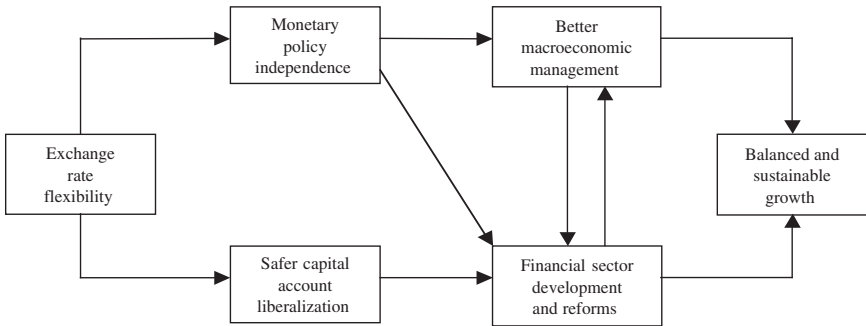


Fig. 1.6 Making the Right Connections

imbalance.¹⁰ Rather, the case for a flexible exchange rate rests on a deeper set of policy priorities, with the ultimate objective being balanced and sustainable growth in the longer term (Figure 1.6).

An independent interest rate policy is the key tool for improving domestic macroeconomic management and promoting stable growth and low inflation. Monetary policy independence is, however, a mirage if the central bank is mandated to attain an exchange rate objective. Capital controls do insulate monetary policy to some extent, but they are notoriously leaky and tend to become increasingly less effective over time.¹¹ Thus, a flexible exchange rate is a prerequisite for an independent monetary policy.

Independent interest rate policy, in turn, is a key input for financial sector reforms. Using interest rate policy, rather than government

¹⁰ While Chinese currency appreciation by itself may not have much of an impact on global current account imbalances, it would be an important step towards resolving those imbalances since other Asian economies may be emboldened to allow their currencies to appreciate as well if China made the first move.

¹¹ A crude way of measuring *net* flows through unofficial channels is to look at the errors and payments category of the balance of payments. Prasad and Wei (2007) document that, during periods of downward (depreciation) pressures on the renminbi — e.g., the Asian financial crisis period — errors and omissions were negative and large, suggesting significant capital flight. During 2003–2005, the errors and omissions turned into large positive numbers, reflecting speculative inflows in anticipation of renminbi appreciation. *Gross* unofficial flows could of course be much larger.

directives, to guide credit expansion is essential to encourage banks to become more robust financial institutions. Fostering the commercial orientation of the banking sector in the absence of monetary policy tools to guide credit and money growth vitiates banking reforms.

The argument that the financial system needs to be fully modernized before allowing currency flexibility therefore has it backwards. Indeed, durable banking reforms are likely to be stymied if the PBC's ability to manage interest rates is constrained by the exchange rate objective. The PBC then has to revert to its old practice of telling state banks how much to lend and to whom, which hardly gives banks the right incentives to assess and price risk carefully in their loan portfolios. This makes banking reforms even more complicated than they already are.

Another requirement for broader financial development is a stable macroeconomic environment, for which, again, good macroeconomic policies, including effective monetary policy, are necessary. On the flip side, the lack of effective macroeconomic management could generate risks via the financial sector. In the absence of room for maneuver on interest rates, liquidity flows into the economy could result in asset price bubbles, including in the real estate and stock markets. These markets could become vulnerable to sudden and unpredictable shifts in investor sentiment that could send them tumbling at the slightest provocation, with broader ripple effects through the economy.

For developing the domestic financial sector, opening up of the capital account — to inflows as well as to outflows — could also serve as an important catalyst.¹² Inflows can bring in technical expertise on developing new financial instruments, creating and managing risk assessment systems, and improving corporate governance. Indeed, using foreign strategic investors to improve the efficiency of domestic banks is a strategy the Chinese authorities see as playing a useful role in their overall reform effort. Allowing outflows would help increase efficiency by creating competition for the domestic banking

¹² See Kose, M. Ayhan, Eswar Prasad, Kenneth Rogoff, and Shang-Jin Wei, 2006, "Financial Globalization: A Reappraisal", *IMF Working Paper 06/189*.

system and limiting the captive source of funds (bank deposits) that now keep domestic banks flush with liquidity. However, opening the capital account ahead of introducing greater flexibility in the exchange rate could pose serious problems in the future.¹³

Ultimately, stable macroeconomic policies and a well-developed and efficient financial sector are crucial ingredients for balanced and sustainable growth. Exchange rate policy is clearly not an end in itself but, as shown by the connections depicted earlier, has an important role to play in achieving these deeper policy reforms and also the ultimate objectives in terms of growth and welfare.

AN ALTERNATIVE MONETARY POLICY FRAMEWORK

What could serve as a suitable alternative anchor for inflation expectations in place of a tightly managed exchange rate? Marvin Goodfriend and I have argued that China should adopt an explicit inflation objective — a long-run range for the inflation rate and an explicit acknowledgment that low inflation is the priority for monetary policy — as a new anchor for monetary policy.¹⁴ An inflation objective, coupled with exchange rate flexibility, would work best to stabilize domestic demand in response to internal and external macroeconomic shocks. Indeed, focusing on inflation stability is the best way for a monetary policy to achieve broader objectives such as financial stability and high employment growth. Over time, the inflation objective would provide a basis for currency flexibility. Thus, exchange rate reform will be seen as a key component of an overall reform strategy that is in China's short- and long-term interests.

¹³ See Eichengreen, Barry, 2004, "Chinese Currency Controversies", *CEPR Discussion Paper 4375* (London, UK); Prasad, Eswar, Thomas Rumbaugh, and Qing Wang, 2005, "Putting the Cart Before the Horse? Capital Account Liberalization and Exchange Rate Flexibility in China", *China and the World Economy*, Vol. 13, No. 4, pp. 3-20; and Yu, Yongding, 2007, "Ten Years After the Asian Financial Crisis: The Fragility and Strength of China's Financial System", manuscript, Chinese Academy of Social Sciences, Beijing.

¹⁴ Goodfriend, Marvin, and Eswar Prasad, 2007, "A Framework for Independent Monetary Policy in China", *CESifo Economic Studies*, Vol. 53, No. 1, pp. 2-41.

The time is right for making the switch — economic growth is strong and headline inflation is low. At the operational level, the PBC could continue its current approach to monetary policy, which includes setting targets for money and credit growth. The crucial difference would be to switch the strategic focus from the exchange rate to the inflation objective, which means that the currency could appreciate or depreciate in response to more fundamental economic forces such as productivity growth. This framework would subsume monitoring of monetary aggregates such as M2 and private credit, but directly targeting these aggregates is increasingly inappropriate for an economy that is undergoing rapid structural transformation and changes in the structure of its financial markets.

A full-fledged inflation-targeting regime could serve as a useful long-term goal, but the approach I have outlined aforesaid is more practical for the foreseeable future and should deliver most of the benefits of formal inflation targeting.

Two related points are worth noting. Independent interest rate policy requires a flexible exchange rate, not a one-off revaluation or a sequence of revaluations. A flexible exchange rate buffers some of the effects of interest rate changes, especially in terms of offsetting the temptation for capital to flow in or out in response to such changes. A one-off revaluation could solve this problem temporarily, but could create even more problems subsequently if interest rate actions in a different direction become necessary, or if investor sentiment and the pressures for capital inflows or outflows shift.

Another crucial point is that exchange rate flexibility should not be confused with full opening of the capital account. An open capital account would allow the currency to float freely and be market-determined. But the exchange rate can be made flexible and the objective of monetary policy independence achieved even if the capital account is not fully open.

A concern often expressed by Chinese policymakers is that, given the fragility of the domestic banking system, exchange rate flexibility could be disastrous. There are two possible factors behind this concern. One is that sharp changes in the value of the currency could destroy bank balance sheets. There is little evidence, however, that

Chinese banks have large exposures to foreign currency assets (and/or external liabilities denominated in renminbi) that would hurt their balance sheets greatly if the renminbi were to appreciate in the short run.

A more serious concern is that outflows of capital could starve the domestic banking system of liquidity by allowing domestic savers to take their money abroad. This is where the difference between exchange rate flexibility and capital account liberalization becomes especially important. There is no reason why, with even the moderately effective capital controls that are in place now, China could not allow for more exchange rate flexibility. A flexible exchange rate, even if it does not yield a "true" market equilibrium rate because capital flows are constrained, can allow for an independent monetary policy. And this flexibility does not by itself generate channels for evading controls on capital flows. In short, as a reason for not moving more quickly towards a flexible exchange rate, banking system weaknesses constitute a red herring.

CONCLUSIONS

China has achieved remarkable economic progress in the last three decades. But a great deal of work remains to be done to make the economy resilient to large shocks, to ensure the sustainability of its growth, and to translate this growth into corresponding improvements in the economic welfare of its citizens. This is a good time for pushing forward with some of those essential reforms.

External pressure can play a helpful role in this reform process, but only if it is placed in the right context. For instance, the debate in the US about the Chinese exchange rate regime has been distorted in some ways and made political rather than substantive when placed in the narrow context of the US-China trade balance. There is an important strategic (and educational) element related to reframing the exchange rate issue in a broader context. This is where external pressure from the international community can be helpful, not in the form of threats but by reorienting the discussion in a fashion that brings into sharper focus the linkages between

currency reform and other core reforms on which there is broad consensus within China.

Furthermore, working with the Chinese to develop deadlines for achieving specific policy goals would be useful if done in a collaborative rather than confrontational manner. These intermediate steps could serve as concrete guideposts for the reform process and help break down internal resistance to the reforms. Commitments that the Chinese made in the context of accession to the World Trade Organization, for instance, have helped to galvanise internal reforms. In China — as in any other country — there are some groups that stand to lose disproportionately from certain reforms, even if those reforms may be hugely beneficial overall. This is precisely where external pressure, if applied judiciously, can be helpful in generating enough momentum to help the forces that are predisposed towards undertaking reforms. A confrontational approach, on the other hand, could well prove counterproductive by bolstering the forces opposed to reform and allowing them to paint certain reforms as being detrimental to China and in the interests only of other countries.

Ultimately, as far as Chinese reforms are concerned, there is a set of shared interests between policymakers in China, the US and elsewhere. For it is deep and enduring reforms that promote sustained and balanced growth in China that are in the best interests of both China and the world economy.