

## **PERSPECTIVES ON PUBLIC POLICY**

### **CHINA'S ECONOMIC POLICY IN THE CONTEXT OF THE CURRENT ASIAN FINANCIAL CRISIS**

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*Abstract.* This paper is based closely on the author's Y. C. Jao lecture presented to the Hong Kong Economic Association in November 1998.

Since economic reform began in China two decades ago, the rate of growth in real output has averaged over 9.5 percent per year. This remarkable achievement has attracted much attention all over the world. Two conclusions can be drawn from this experience. First the change from a centrally planned economy to a more market-oriented economy improves economic efficiency. Almost all other formerly socialist planned economies have since adopted market institutions. Second, well-functioning market economies can take different forms. In many respects China's market economy has its own characteristics. The fact that it has performed well suggests that different forms of market institutions may fit different social and economic environments. Even the developed market economies in different continents are different. By studying the Chinese economy as an important case we can better understand the market economy and formulate economic policy.

As the Chinese economic institutions have been evolving, gradually by the standard of shock therapy but very rapidly as judged by the great adjustments required for the changes made, the study of the Chinese economy has emphasized institutional reform rather than economic policy. As the institutions become more matured and as the financial crisis beginning in Asia creates serious economic problems for China and the rest of the world, the study of economic policy in China receives more attention. From the viewpoints of the Chinese government and observers of China's long-term development, economic reform still takes priority and serves as the basis on which economic policies are formulated. This paper will cover three topics: banking reform and monetary policy; enterprise reform and fiscal policy; and foreign trade and investment. These are important areas for China's economic

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development in general, and in the context of the current Asian economic situation. The Chinese government emphasized these areas before and irrespective of the Asian economic crisis, but has adjusted its policy in the light of the current situation. I will draw two conclusions at the end of this paper.

### 1. BANKING REFORM AND MONETARY POLICY

Before banking reform started in the early 1980s the People's Bank of China served mainly to issue currency, to accept saving deposits from the public and to provide credit to state enterprises under the guidance of central planning. In 1983 the People's Bank was officially changed to a central bank but it did not function as one because commercial banks did not exist. Rather there were four specialized banks: the Industrial and Commercial Bank, the Agricultural Bank, the People's Construction Bank and the Bank of China dealing with foreign transactions. The first three were given some autonomy to extend credit to state enterprises but were also subject to central government direction and under local political pressures to do so. As a result excessive expansion of credit led to inflation in 1985, 1988 and 1993. The chief tool to stop credit expansion was the imposition of credit quotas. In March and May 1995, respectively, the People's Congress passed the Law on the People's Bank of China and the Commercial Bank Law. Both are modern in content, making the People's Bank a modern central bank and the specialized banks modern commercial banks in principle, though not in practice as economic institutions do not change by legislation alone.

To relieve the four state banks from government and political pressure to extend credits, three policy banks were created in 1994 to provide loans to state enterprises. These are the State Development Bank, the Agricultural Development Bank and the Import and Export Bank, which by early 1998 accounted for only about 6 percent of the loans of the big four banks. Since the early 1990s new commercial banks have also appeared on the scene, taking the form of corporations each having its shareholders and board of directors. However, the largest, the Commercial Bank, has only governments at different levels as shareholders while the others have private enterprises but not individuals as shareholders. Currently these banks account for about 15–20 percent of loans and 8–10 percent of deposits. These new banks have more flexibility in decision-making and function more like modern commercial banks.

Modernization of the Chinese banking system takes time. There are still political pressures and economic temptation to extend credits at higher risks than are economically justified. The management and staff still require more training and experience to operate as modern commercial bankers. Furthermore the four state banks have about 20–25 percent nonperforming loans, some US\$200 billion out of a total of nearly US\$1 trillion, as a result of past obligations to finance state enterprises. About 80 percent of the loans of state commercial banks consist of loans to state enterprises. To solve these problems

a number of measures have been taken recently. Local bank managers will be appointed by the banks' headquarters and not subject to approval of the local government, and the four state banks will be free from local government interference in their credit policy. The loan quota system has been abolished but the state banks are still required to make loans to finance government investment. The central bank issued a target in 1997 for the state banks to reduce the percentage of nonperforming loans by 2–3 percent per year in each of the following seven years. A 270 billion RMP bond issue was planned to increase the capital–loan ratios of state banks. The People's Bank is to behave like the US Federal Reserve System, providing closer supervision of the behavior of the commercial banks.

Under current circumstances how likely is it for problems in the Chinese banking system to develop into a full-blown crisis? The answer appears to be very unlikely in spite of the problems and shortcomings of the system just mentioned. In a market economy with a modern banking system a banking crisis occurs when many loans become nonperforming. As a result banks do not have liquidity to pay depositors, and the depositors withdraw their deposits, further aggravating the liquidity problem. Numerous bad loans usually result from unprofitable investment in real estate, construction, infrastructure building, or other major productive activities in an overheated economy. This is an essential element in the countries experiencing the current financial crisis in Asia. The Chinese situation is different. Speculative investments, though existing in real estate markets and in the production of consumer goods, are less serious and subject to government supervision. More important, people have confidence in the value of their deposits in the banks because they believe that the government owns the banks and implicitly guarantees their deposits. The fact that 20–25 percent of total bank loans are bad has not affected this confidence and is not likely to lead to large withdrawals of deposits. Given the high savings rate of the Chinese people and the limited alternatives for their savings, in the last decade the ratio of saving deposits to GDP in China has been rising. Personal bank deposits increased by 23 percent in 1997, though at the lowest rate in a decade partly because other forms of liquid assets have become available. Improvement in liquidity in the banking sector is further evidenced by the reduction of its loans-to-deposits ratio from 200 percent in 1991 to 140 percent in 1998.

Two other elements which have contributed to the financial crisis in South East Asia are absent in China. Much larger percentages of foreign investments in countries like Thailand, Malaysia and Indonesia were portfolio or financial in nature. Foreign investors could, and did, withdraw their money quickly when investment opportunities appeared unfavorable. Most foreign investments in China, on the other hand, take the form of direct investment. Furthermore, capital flows in and out of China are restricted. Secondly governments in Thailand and Indonesia maintained exchange rates which overvalued their own currencies before the crisis occurred. The central bank of Thailand also covered up the loss of a large amount of foreign reserve to support the Thai currency by selling dollars in the futures market. Once the

loss of foreign reserves and overvaluation of the Thai baht were recognized by investors, the risks of their investments became apparent and they withdrew their money swiftly, leading to a sharp devaluation of the Thai baht. I should also mention that China's financial affairs are managed by very able people. The skill and experience of Premier Zhu Rongji and central bank president Dai Xianglong in dealing with a possible financial crisis make it even more unlikely to occur, barring unforeseen developments.

Concerning monetary policy, recall the two major policy objectives announced by Premier Zhu in March when he took office, fully recognizing the "formidable challenges due to the financial crisis in Southeast Asia," namely to maintain a real growth rate at 8 percent or more in 1998 and an inflation rate of not more than 3 percent. As central bank president and Vice Premier, Zhu Rongji deserved much credit in reducing the rate of inflation in China from 24 percent in 1994 to 0.8 percent in 1997 and to almost zero in 1998 by reducing the rate of growth in money supply. Realizing the need to stimulate the economy he is now prepared to raise the inflation rate to 3 percent by adopting a more expansionary monetary policy. By September 1998 currency in circulation in China reached 10 trillion RMB, an increase of 16 percent from a year earlier. Total credit also increased by 17 percent in the same period. Since inflation has slowed down, nominal interest rates have come down. In March 1998 the one-year deposit rate went down to 5.2 percent and the one-year official lending rate to 7.9 percent. Commercial banks are allowed to set their lending rates within a fairly narrow range, which is between 10 percent below and 20 percent above the official lending rate. One problem in monetary policy yet to be resolved is the simultaneous control of interest rates on loans and on deposits, often leading to insufficient profit margins for commercial banks. These rates should be market determined to a larger extent than as practiced in China. This problem is recognized by the People's Bank and the deregulation of interest rates is taking place gradually. As pointed out before, new commercial banks have appeared to compete with the state banks to some extent. This is an encouraging development but the new banks as well as the state banks need to be adequately monitored to prevent them from being financially irresponsible.

## 2. REFORM OF STATE ENTERPRISES AND FISCAL POLICY

In his report to the 15th Congress of the Chinese Communist Party in September 1997, General Secretary Jiang Zemin devoted section V to Economic Restructuring and Economic Development Strategy, stating in part:

The state-owned sector must take up a dominant position in major industries and key areas ... but in other areas, efforts should be made to reorganize assets. We should support, encourage and help diverse forms of collective economy ... in their development .... Public ownership can and should take multiple forms .... Now there have appeared a large number of diverse forms of joint stock cooperative ventures in the urban and rural areas .... Manage well large enterprises while

relaxing control over small ones . . . . We should encourage mergers, standardize bankruptcy procedures, divert laid-off workers, increase efficiency by downsizing staff and encourage reemployment projects . . . . The Party and the government . . . will help them with their welfare, organize job training, open up new avenues of employment . . . . We shall build a social security system, introducing old-age pensions and a medical insurance system . . . and improve the unemployment insurance and social relief systems. Establish public accumulation of funds for urban housing and accelerate the reform of the housing system.

There are four types of enterprises in China: state-owned, collective, individual-owned and overseas-funded. The state-owned sector has declined in importance steadily since the early 1980s. It accounted for only 39 percent of total industrial output in 1998. Inefficiency of state enterprises has been said to be a major problem in the Chinese economy. The seriousness of this problem is exaggerated on two counts. First, productivity of state enterprises has been steadily increasing in the last two decades, although at a slower rate than the collective and private sectors. Second, the relative importance of the state enterprises has been declining and the effect of the performance of the state sector on economic growth is less important than before.

Some of the problems facing the state enterprises are similar to those facing the banking sector. There is a shortage of competent and well-trained managers and staff to operate a modern enterprise. There is a tendency to make management decisions based on personal relations and for personal gain at the expense of the enterprise. The system does not provide the management with appropriate incentives to work for the benefit of the enterprise, including a much lower scale of pay than in similar collective enterprises and the lack of a suitable governance system. Many staff and workers still have the habit of the iron rice bowl, relying on the state to guarantee their job security. In addition, the equipment and technology of many state enterprises are antiquated. One important condition more favorable to the reform of state enterprises than the reform of the banking sector is the high degree of competition from collective and foreign enterprises in both the domestic and foreign markets. Competition has forced the state enterprises to be more efficient, but the banking sector has been opened to competition much more slowly.

The main avenue of continued reform of state enterprises, as stated in the report of General Secretary Jiang Zemin, is to change them to shareholding companies. For the small and medium-sized enterprises, restructuring has taken place whereby managers and workers purchased shares according to their wages and members of a board of directors were elected by the shareholders. For example if the monthly wage of a worker is 600 yuan, he or she may pay 2000 yuan for the shares, while the high-level managers may pay 5000 to 10 000 yuan for the shares. The shares can be traded among shareholders but are not sold to the public. For large state enterprises, restructuring takes a variety of forms but mostly the form of a shareholding corporation. Shares can be purchased by outsiders. The shares of a minority of state enterprises which are qualified according to their financial performance

can be traded in the Shanghai, Shenzhen, Hong Kong, and even the New York Stock Exchanges according to the regulations of the respective exchanges. The State Economic and Trade Commission and its branches at provincial, city and county levels are given the responsibility for restructuring the state enterprises under their jurisdiction. Effective directions on restructuring are given centrally in Beijing at meetings involving party and government leaders of all provinces. These officials in turn transmit the directions to lower levels in all parts of China. As economic adviser to the Shandong Provincial government I met with officials of the Economic and Trade Commission in Shandong on issues of enterprise reform in 1997–1998. The high level of competence of these officials was impressive.

To appraise the prospects of success of the current restructuring of state enterprises in China, the following observations can be made. First, the current effort is a continuation of a series of attempts beginning in 1979 at reforming the state enterprises to make them financially independent, efficient and profitable. It is an evolutionary process and dramatic results should not be expected in a short time. Second, the success of an enterprise depends on many factors of which its ownership and governance structure is only one. Other important factors are the ability and resourcefulness of its managers and workers, the particular industry it is in, the degree of competition, etc. No matter how the corporations of a country are organized, some will make profits while others will lose money. Restructuring cannot make all or almost all Chinese state enterprises profitable as they are subject to competition from collective and foreign companies. Third, on the positive side, the problems with state enterprises are not so serious as to require immediate solution. The government is proceeding at a deliberate speed. It is making sure that not too many workers are laid off in any period and that the workers laid off are given some compensation, usually equal to about one-third of their monthly wage, and are provided with training to re-enter the job market. Fourth, also on the positive side, by allowing foreign capital, management and technology to come in through joint ventures and even buyouts of failing state enterprises, many have been and will be improved in performance. In the later part of 1998 when the Asian economic crisis continued, the privatization of state enterprises was being slowed down for fear that the prices were too low and corrupt officials might benefit from the sales when there was insufficient government supervision. In March 1998, Premier Zhu announced that the problem of state enterprise restructuring should be completed in three years. His main targets were to make profitable the majority of the 50 largest state enterprises which were operating at a loss, and to restructure most small and medium-sized state enterprises into shareholding companies. These targets appear feasible.

Two serious consequences of the failing state enterprises are the bad debts they owe the state banks and the unemployment of laid-off workers due to restructuring. The former problem has been discussed and is unlikely to lead to a banking crisis. Besides the unemployment problem, some workers had their wages reduced, possibly by 50 percent or even more. Some did not receive their regular salaries. These problems are concentrated in provinces with a large

number of state enterprises including the provinces in the north-east. The national unemployment rate (excluding laid-off workers receiving partial compensation) increased from 3.2 percent in 1996 to 4.0 percent in 1997. It was 3.2 percent in October 1998. The unemployment problem in China can be expected to be under control for three reasons. First, as just pointed out, the pace of enterprise restructuring will not be too rapid to create an excessive level of unemployment. Second, the Chinese people are resourceful and the market economy is working so that many laid-off workers have found other jobs in the market, especially in the service sector. Third, the government is stimulating the economy by building infrastructure at a higher rate than was previously planned. This will create employment.

Turning to fiscal policy, Premier Zhu Rongji stated on 19 March at a press conference held by the People's Congress that to achieve an 8 percent growth rate the main means would be to increase domestic demands. He said: "to stimulate domestic demands, we will increase investment in construction of infrastructure, such as railways, highways, agricultural land and water conservancy facilities, municipal facilities and environmental protection facilities. We will also increase investment in hightech industries and in the technical renovation of existing enterprises." A figure quoted in the press is a total of US\$1.2 trillion of investment in the three years 1998 to 2000. If the figure were converted to Chinese RMB by an 8 to 1 ratio, the average of 400 billion dollars per year would become 3200 billion yuan. In 1997 investment in fixed assets increased by 9 percent in real terms to reach 2350 billion yuan. If one allowed for an inflation rate of 3 percent and projected the 2350 figure forward using an annual growth rate of 13 percent in money terms for three years, the amounts of fixed investment in 1998 to 2000 would be 2656, 3000 and 3391 billion yuan, respectively. Therefore, the average of 3200 billion yuan represents a reasonable stimulation program.

Recent economic trends suggest that China's economy continued to grow in 1997 but the rate of growth slowed down in 1998. Industrial output grew by 11.2 percent in real terms in 1997, with the state sector growing at only 5.5 percent but the collective and private-owned sectors growing at 11 percent and 14 percent, respectively. In the first three months of 1998, industrial output in constant prices still increased by 9.7 percent from the same period of 1997, whereas the growth of real GDP during these three months was 7.2 percent, smaller than the target rate of 8 percent for 1998. In the third quarter of 1998, real GDP grew at 7.6 percent, as compared with 6.8 percent in the second quarter. Many infrastructure projects were under way, including the introduction of state-of-the-art technology to agriculture, a new railway linking the north-eastern and southern regions as a part of a planned 245 billion yuan for railway construction in the next five years, among others. China has adopted the Keynesian way to stimulate aggregate demand by increasing government expenditures, especially in infrastructure building. Another component of the increase in government expenditures was due to the severe floods in the summer of 1998 in the central and north-eastern regions for which the government took decisive actions. Retail sales as a

component of aggregate demand grew at an annual rate of 7 percent in the third quarter of 1998. As of early November the government was still expecting to achieve the target growth rate of 8 percent, or something close to it. The growth of over 7 percent during the first three quarters was already a remarkable achievement.

### 3. FOREIGN TRADE AND INVESTMENT

In 1997 total exports of China amounted to 182.7 billion US dollars, about 20 percent of GDP. This figure represents an increase of 21 percent from 1996, as compared with a growth rate of only 1.5 percent from 1995 to 1996. Imports to China totaled 142.4 billion US dollars in 1997, resulting in a trade surplus of 40.3 billion US dollars. Total trade volume was US\$325.6 billion in 1997, about 36 percent of GDP. In March 1998 foreign trade volume was 7.9 percent higher than a year before, with exports increasing 9.24 percent and imports increasing 6.23 percent. However, in May 1998 exports fell by 1.5 percent, falling for the first time in 22 months, and the January–May export growth rate was reduced to only 8.6 percent. By September 1998, exports were reduced by 6.7 percent as compared with a year earlier, although the trade surplus was maintained by the reduction of imports. As a component of aggregate demand, exports seemed to be weakened as a result of the currency devaluation of, and the reduced demand from, several Asian countries in financial crisis, including Japan which is in a recession and has the value of the yen falling. While some of the state-owned companies engaged in foreign trade are not doing well, private and foreign-invested companies are taking an active role in promoting Chinese exports in a variety of consumer goods to the world market. In the first four months of 1998, foreign-invested companies exported some 42 percent of the national total. Even if the rate of increase in the volume of exports was smaller in 1998, the rate of growth in GDP was affected only moderately as exports accounted for only 20 percent of GDP. (Note that in 1996 China's GDP grew by 9.6 percent while its exports grew by only 1.5 percent.) In the meantime the government has adopted a variety of measures to stimulate exports, including the lowering of export duties and the refund of taxes on raw materials used to produce exports.

In 1997 the flow of direct foreign investment continued to be strong, being 10.1 percent higher than 1996. In the first five months of 1998, foreign direct investment fell by 1.49 percent as compared with the same period of 1997. The trade surplus and the surplus in the capital account helped increase the amount of foreign reserves in China by 35 billion US dollars in 1977 to 140 billion by the end of 1997. Since China continued to have a trade surplus during the first few months of 1998, and foreign investment continued to flow in though at a slower rate, foreign exchange reserves should have been accumulating, but remained approximately constant for reasons to be discussed below. At the same time the purchasing power of the Chinese currency is strong as compared with the US dollars at the current [1998] exchange rate of 8.3 Chinese yuan per dollar, and China has a lower inflation rate than the United States, with retail

prices in March 1997 1.2 percent lower than in the same period in 1997 and nearly constant in the middle of 1998. These factors provide strong fundamentals for the value of the Chinese currency and make its devaluation unnecessary. Even if the trade surplus were to fall because of competition in the world markets from Asian countries which have devalued their currencies, the economic fundamentals and the political will of the Chinese leaders appear to be strong enough to make devaluation of the Chinese currency unlikely. When both President Jiang Zemin and Premier Zhu Rongji pronounced in early 1998 that there would not be a devaluation, they intended to have the Chinese economy serve as a stabilizing force in the Asian financial crisis. The Chinese economy is strong enough to play such a role.

Nevertheless, in spite of the strong fundamentals supporting the value of the Chinese currency, many people inside and outside of China are still expecting that the RMB will devalue against the dollar. As some Chinese citizens prefer putting some of their money in US dollars and exporters try to retain their foreign currency earnings abroad, China's foreign reserve increased by only 1 billion from 140 billion dollars in 1998 even when there was a trade surplus of 30 billion and an inflow of foreign investment of 27 billion. The black (free) market rate of the RMB in Hong Kong was about 10 percent lower than the official rate in October 1998. The government decided to impose restrictions on the flow of foreign currency out of China. The restrictions make it more difficult to obtain approval of legal applications for foreign exchange. The Chinese officials claim that such restrictions only mean enforcing existing laws, but in practice delays and inconvenience in obtaining foreign currency make the Chinese currency less convertible and the stable official exchange rate economically less meaningful. For similar reasons, the risks of exposure evident in the current financial crisis would slow down the opening of the Chinese capital account, which usually follows the opening of foreign trade transactions.

For almost two decades continued economic growth and economic reform have been two most important characteristics of the Chinese economy. These characteristics persist during the Asian financial crisis. Reforms of the banking system and of state enterprises remain two of the most important tasks of the Chinese government. As unemployment has increased during the restructuring of state enterprises and as export growth slows down during the financial crisis the Chinese government is attempting to raise aggregate demand by increasing expenditure on infrastructure building. The volume of exports continued to expand early in 1998 but at a slower rate than in 1997, and a trade surplus continued to exist in October 1998. Foreign capital continued to flow in, though at a slower rate. Together with a stable price level these factors provide the fundamentals for a strong Chinese currency. Not only the Chinese yuan is unlikely to devalue as a result of the current Asian financial crisis; in the longer run it may have the tendency to appreciate just as the Japanese yen appreciated in the 1960s to the 1980s during a period of rapid economic growth and export expansion. Combining a fairly robust domestic demand aided by substantial government infrastructure building with a weakened demand for exports,

China's economy was set to grow substantially in 1998 even if it did not quite achieve the 8 percent growth target and can serve as a stabilizing force in the current Asian economic crisis.

#### 4. CONCLUSIONS

For economists who believe in limiting the role of government in a market economy, the experience in China confirms the important role of the government in carrying out economic reform and in implementing economic policies to deal with crisis situations, the latter in developed economies as well. To the extent that government actions are required, the competence of government officials is an extremely important factor determining the success of economic reform and economic policies. China has selected the best talents to serve as government officials, the prevalence of corruption notwithstanding. By contrast, the poor performance of Hong Kong in dealing with the financial crisis is due to the lack of competent economic policymakers and the resulting failure of government policies. Hong Kong has a group of dedicated and competent government administrators headed by a very able Chief Secretary who were reappointed in July 1997. However, top economic officials did not have adequate training and experience in policymaking, especially in a crisis situation, in sharp contrast with the top economic officials on the Chinese mainland and in Taiwan where effective economic measures were taken. Also lacking are their desire and an appropriate institutional setting to seek professional economic advice, also in contrast with the situations on the mainland and in Taiwan.

The Hong Kong media has correctly pointed out three aspects of government failures. First are the unexpected changes in government policies, both from the former nonintervention policies in a free market under colonial rule and in the execution of short-run economic policies. Notice the intervention in housing supply by the announcement of a substantial annual construction of new public housing units and the sale of a large number of existing public housing units at below market prices to specified purchasers. The expected and actual increase in the supply of housing depressed housing prices at an inopportune time. There was also a last-minute cancellation of an announced land auction. Second is the failure to recognize the grave economic situation and to take timely action. The top economic official was forecasting at the end of March 1998 a 3.5 percent annual growth while the first quarter of 1998 had already experienced a negative growth rate of -2.5 percent. The negative growth was probably recognized by ordinary Hong Kong citizens and consumers. Delays in recognition led to delays in taking effective measures.

Third is the failure to stabilize the financial market. To defend the peg of the Hong Kong dollar, a simple and workable means was well known to be for the Monetary Authority to make available options to buy US dollars at the official exchange rate in the future. This would have reduced the uncertainty of people who were concerned about a possible devaluation and decided to sell Hong

Kong dollars. They borrowed Hong Kong dollars to buy US dollars, leading to a significant increase in the interest rate and a reduction in business investment and other productive activities. The reduction of productive activities was also caused by the unpredictability of government economic policies. It contributed to the recession in Hong Kong. A fall in real estate prices resulted from government intervention in the market supply and uncertainties concerning future government policies. The fall in stock prices in the summer 1998, owing to the reduction in economic activities and the lack of business confidence, adversely affected consumption expenditures. To be sure, the severe competition in the export markets and in the domestic tourist industry after the devaluation of the currencies in neighboring Asian countries contributed to the depression in Hong Kong, besides the failure of government policies. On the positive side, Hong Kong economic officials appear to have learned from the experience in 1997–1998. Therefore, we can expect the performance of the officials and of the economy to improve in the future. Perhaps the failures in economic policies were difficult to prevent as Hong Kong was changed from a colonial rule to self government.

The second conclusion to be drawn from the Chinese experience is concerned with the effects of an externally generated economic crisis on the progress of economic reform. There are both positive and negative effects. On the negative side, the speed of reform may be reduced, as evidenced by the introduction of restrictive policies on foreign exchange transactions and on the privatization of state enterprises. On the positive side, the crisis provides new experience to policymakers, and new observations to economists, on the nature of desirable institutional changes. Examples are the need to have transparencies in financial institutions and more effective supervision of commercial banks by the central bank. The appropriate degree to restrict international capital flows and the appropriate speed and sequencing of trade and investment liberation have to be studied carefully. In any case the financial crisis has led to a re-examination of existing economic institutions and will benefit the outcome of economic reform in the long run. When the crisis recedes, economic reform is likely to resume its speed in China if we can judge by the history of the reform process in the last two decades, including the resumption and speeding up of economic reform after the political shock of Tienanmen Square in 1989. Unexpected political and economic disturbances are bound to affect the speed and nature of economic reform and the formulation of economic policies, in China as elsewhere.