

## Xi Jinping's economic dream team must be allowed to succeed

China needs a financial system that allocates resources more productively

**ESWAR PRASAD**



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[Xi Jinping](#) has made opening up, reform and economic liberalisation the guiding slogans for his second term. While the ebb and flow of [China-US trade tension](#) grabs the headlines, these ostensibly ambitious plans for domestic reforms are of far greater significance to China and the world economy.

After locking in his [political dominance](#) at the party congress in March, the Chinese president has taken steps to secure the country's economic future. He has assembled a dream team of competent and reform-minded officials responsible for monetary, exchange rate and financial sector policies. The real test now is whether he uses his vast political capital to support deep-rooted reforms in these and other areas.

Mr Xi seems to understand the importance of fixing [China's financial system](#). Tackling head-on the enormous burden of bad loans in the banking system is essential to avert a disaster down the road. Without changes to their incentives, state-owned banks will continue lending to state enterprises, many of them bloated and unprofitable. This will exacerbate excess capacity in some industries, leaving China no choice but to export its excess supply, fuelling trade tension and putting its own

long-term growth in jeopardy. More investment in heavy industry will worsen environmental degradation — a source of concern not just to China but to the world at large.

China needs a financial system that better allocates resources to more productive uses and to dynamic parts of the economy, especially the services sector and small and medium enterprises. This requires fixing the banking system, improving depth and liquidity in bond markets, and tightening regulation to mitigate risks.

Such reforms will reduce unproductive investment, improve employment and promote more regionally balanced development. Higher employment and income growth, especially in the less-developed interior provinces, would boost household consumption. This in turn would increase imports, making not just President Donald Trump, but all of China's trading partners happier.

This is all easier said than done, but Mr Xi seems to understand the urgency and has the right team in place.

Yi Gang, new governor of the People's Bank of China, has the knowledge and technical skills to modernise China's monetary policy framework. Guo Shuqing, head of the newly merged banking and insurance regulator, is tough-as-nails. In tandem with Liu Shiyu, head of the securities regulator, Mr Guo will bring more discipline to key parts of the financial system. [Liu He](#), the new vice-premier in charge of economic and financial affairs, is a respected reformer and a confidant of Mr Xi. Wang Qishan, another reform-minded official brought back as vice-president, has drawn the short straw, charged with smoothing over trade and other tension with the US. These men have a shared understanding of the need for developing, liberalising and regulating financial markets.

So far, so good. However, Mr Xi's commitment to reforming financial markets is not matched by a similar focus on the reform of state-owned enterprises and upgrading the institutional framework needed to underpin a market economy. Major state enterprises face stricter budget constraints, but party control over them has also been tightened.

With his political power unchallenged, Mr Xi has the opportunity to push aside the reactionary forces that oppose reforms. These typically include powerful provincial governments, large state-owned enterprises, and the major state-owned banks. The president now has enough power that none of these can stand in his way. So he will soon reveal his true self: is he a genuine reformer or does he only tolerate those reforms he regards as essential to economic and social stability?

Mr Xi's team knows what needs to be done, but will be far less effective if he views modest fixes to the financial system as sufficient. He needs to be as bold and ruthless on broad economic reform as he has been in consolidating his political power.

*The writer is a professor at Cornell University and senior fellow at Brookings*

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