

A CONVERSATION WITH ALAN GREENSPAN,  
CHAIRMAN OF THE U.S. FEDERAL RESERVE BOARD<sup>1</sup>

October 24, 1994

ZRJ: I've long wanted to meet you and have often hoped you would come. Now I'm very delighted to meet you. I had hoped to meet you in Madrid.<sup>2</sup> Of course there wasn't time in Madrid to discuss any issues. I had only wanted to invite you to a Chinese meal, but you returned home early. We made extensive preparations for your visit. I know you met today with President Jiang Zemin, and that tomorrow you'll be meeting with Premier Li Peng. Tonight, as a colleague, I just want to invite your delegation to a Chinese dinner. If you have any questions, please do raise them. There are no secrets between us, and even if there were, you'd know about them.

AG: Thank you very much, Mr. Vice Premier. I missed your dinner because I had to leave Madrid early, and I also regret that very much.

Our meetings today have been very meaningful and constructive, and we discussed broad issues that have arisen in the course of your country's reforms. You must have already received a report on those meetings, and I needn't talk about them again in detail.

In our United States, views of China's reforms have also gone through a process of evolution. Shifting from a centrally planned economy that has been in place for many years to a market economy is a complex and difficult process, and China has already achieved tremendous results through a variety of workable methods. In discussions with President Jiang Zemin and with the People's Bank of China, I already pointed out that it's very important to the United States as well as to the whole world that China succeed. Our experience has proven that the development of trade is beneficial to all sides. In particular, its development in China, a country with such an important place in world trade, will be

1. This conversation took place at the Diaoyutai State Guest House in Beijing, where Zhu Rongji met with Chairman Greenspan and hosted a dinner in his honor.

2. In his capacities as Vice Premier and Governor of the People's Bank of China, Zhu Rongji attended the 50th annual joint meeting of the boards of the IMF and World Bank, which was held in Madrid in October 1994.

good for everyone. Therefore we're willing to provide as much assistance as we can to your central bank in those technical areas in which we have many years of experience.

Under a centrally planned economy, the financial system is only used to calculate the nominal values of material resources, whereas a well-rounded financial system like the one we have developed over the last several decades isn't very useful in a planned economy—it can only play a critical role in a market economy. The goal of reform is precisely to establish a more effective competitive market structure, so that China's economy can become a dynamic and competitive economy.

Reforms of China's economic system have already achieved tremendous results, but in order to create a dynamic market mechanism, you still have to focus your attention on resolving certain problems. For example, one of the questions we're concerned about is that China still doesn't have a well-rounded debt market, and the losses of most SOEs are financed by high-powered money from the central bank. If you establish a mechanism that includes a variety of market economy components, the government deficit can be financed through the market, and you wouldn't have to use central bank reserves, which could lead to inflationary pressure and create elements of instability. Even in the market economies of the West, there's an imperfect aspect of their debt markets, but the crucial thing is to eliminate large losses by improving the condition of enterprises or by enabling enterprise bankruptcies. To speed up reforms, the social security system must be independent of the enterprises, so that when they reduce staffing or go bankrupt, there won't be negative consequences for employees.

We also discussed some technical issues, particularly the establishment of a modern payments system. This has great significance for increasing bank reserves and implementing currency policy more effectively.

RTP:<sup>3</sup> We understand that the People's Bank of China already has a series of proposals and plans. How will they affect China's long-term economic development?

EMT:<sup>4</sup> In our meeting with the People's Bank, the question of bank oversight came up. Mr. Vice Premier, could you talk about the handling of bank oversight in the reform of your financial system?

3. Robert T. Parry, then President of the Federal Reserve Bank of San Francisco.

4. Edwin M. Truman, then Director of the Division of International Finance at the Federal Reserve System.

AG: There are many aspects of reform and they touch on the interests of all sides. Many people are already used to the old system, and reforms will make them uncomfortable. The important thing here is to maintain the momentum of reform. If you slow down or stop, the losses will be even greater.

HSC:<sup>5</sup> In the past few meetings, we've heard different views about inflation. Some feel that price increases were caused by the adjustments in the prices of agricultural goods and energy. Mr. Vice Premier, I'd like to hear your thoughts on this.

ZRJ: Chairman Greenspan, I'm very appreciative of the accuracy of your analysis of conditions in China, and I'm also very grateful that you expressed a willingness to give us technical assistance in the area of financial cooperation.

We feel that we will gain many insights in collaborating with the Federal Reserve and with you personally. You're two and a half years older than I am, so you are also 2.5% wiser. You're an economist, while I'm just an electrical engineer. You've worked at the Federal Reserve for 12 years, while I've only been Governor of our central bank for a year. We need your wisdom and experience.

At present, Sino-American relations are at a relatively good stage, and particularly since Presidents Jiang and Clinton met last year, bilateral relations have steadily improved. Ambassador [Stapleton] Roy has also made a contribution to this.

The central banks of our two countries had contacts very early on. The reforms of our financial system that started last year drew on many experiences of the U.S. Federal Reserve. Of course our reforms must move forward on the basis of China's distinctive characteristics, but the initial concepts for the reforms gained many insights from the United States. We attach great importance to this visit by you and your colleagues. I could talk for a very long time about China's reforms, but you don't have the time. Vice Governor [of the People's Bank] Zhou Zhengqing has already introduced a great deal about the People's Bank, and President Jiang has described the problems of the state-owned enterprises. I will speak mainly about inflation problems, which have aroused concern among many people.

First, I don't think China's inflation is as serious as reported in the foreign media. In the past two years, China's GDP growth rate was about 13%, and we expect it to be 10–11% this year. In 1992 the inflation rate was under 6%; it was 13% in 1993 and may exceed 15% this year, possibly even reaching 20%. However, this doesn't tell you exactly how serious China's inflation is, because I think the main reason this year's inflation index is high is that we enacted some reforms

5. Hang-Sheng Cheng, then Vice President of the Federal Reserve Bank of San Francisco.

to the price structure in the course of transitioning to a market economy. This is a period of spasmodic pains that no developing country, especially one that is transitioning from a planned economy to a market economy, can avoid.

The price index was on the high side last year and this year mainly because we deregulated the prices of agricultural goods last November, and those prices have almost doubled since then. If we didn't deregulate them, farmers would not plant crops and would instead flock to the cities in large numbers. Now the prices are determined by the market, and we have benefited considerably. Before last October, nobody would buy chemical fertilizers made in China. Now demand exceeds supply in the markets, and it's fair to say that we could buy up as much as is available in the international markets. This shows that the farmers' enthusiasm for producing is much greater. At the same time, energy and transportation costs, which previously had not been deregulated, have now been deregulated, and the state of the railways is also much improved.

This type of price structure reform will become increasingly rare, and I anticipate that by October or November of this year, [increases in] the price index will also get smaller and smaller. Right now, there are no cases in Chinese markets of supply failing to meet demand; on the contrary, supplies are very abundant. Of course we will still continue to exert macroeconomic controls and promote financial reforms, and keep infrastructure construction and consumer spending at specific levels.

The overall direction of financial reforms is to turn the People's Bank into an agency that can independently implement monetary policy and supervise various types of financial institutions. At the appropriate time, we will change the configuration of the central bank from having branches set up according to provinces to having branches set up according to economic regions. At the same time, we will work toward turning state-owned specialized banks into true commercial banks and will gradually open up the market for financial services. Before meeting you, I met with Mr. John Mack, CEO of Morgan Stanley, and we've already agreed to let him form China's first joint venture investment bank in conjunction with the China Construction Bank. Their signing ceremony will take place this evening.

Recently, we sent a delegation that included several heads of provincial branches of the People's Bank to visit the U.S. Federal Reserve. They went to Washington, D.C., New York, San Francisco, and Los Angeles, and were very warmly received by the Federal Reserve. We will distribute the materials they brought back to all the bank's branches around the country. I would like to express my thanks here to you and your colleagues. We gained many insights, though we cannot simply copy all your experiences. Circumstances in China are much more complicated.

At present we're in the process of gradually passing laws and refining our legal system. We've already submitted draft versions of "Law of the People's Bank of China" and "Commercial Banking Law" to the Standing Committee of the National People's Congress, but they haven't been able to reach a consensus. We'd like to see these laws passed right away.

You have some methods that have been effective in the United States, but that might not be effective in China. For example, you increased the interest rate four times, and so on.

AG: We recently raised rates for the fifth time.

ZRJ: We've carefully observed the reaction each time. You increased rates by 0.25% each time and this was extremely effective, but in China the effect wouldn't be very great. In China perhaps even a 10% increase might not have a great effect because some enterprises have no intention of repaying the money and don't care what the interest rate is, but this situation is gradually changing. Next year the focus of our reforms will be on reforms of the state-owned enterprises. As these succeed, the leveraging effect of financial controls will be even greater. Now we're looking into raising interest rates and hope we can be as successful as you, but the outcome might not be very good.

AG: We still don't know yet what the results will be.

ZRJ: My main goal today is to invite you to have a Chinese dinner, but I don't know if you'll like it or not. We can continue our conversation at the dinner table.

(Dinner conversation)

ZRJ: Mr. Greenspan, I'd like to ask you a question about foreign exchange reserves. Last year we had a trade deficit, but we had a surplus in the first half of this year. At the beginning of the year we had reserves of US\$21.2 billion, but they're now approaching US\$40 billion. IMF head Mr. [Michel] Camdessus says our reserves are too large. We understand that the territory of Taiwan has US\$100 billion in international reserves, Japan has US\$80 billion, and we estimate the United States has over US\$70 billion. Although our reserves have reached US\$40 billion, we still don't have all the conditions needed to allow the renminbi to be totally convertible. What we have right now is convertibility for current accounts.

The U.S. Treasury Department accused the Chinese foreign exchange system of discriminating against foreign enterprises. I think this is because they don't understand the circumstances. At the beginning of this year, before we enacted

convertibility of the renminbi for current accounts, I had sought out the views of foreign-invested institutions. Now this choice is not discrimination—on the contrary, it gives special consideration to foreign-invested enterprises. At the moment we're considering when the renminbi can be made fully convertible.

AG: Right now, the relationship between exports and imports and international reserves isn't as useful a concept as it used to be. In assessing whether or not a country's international reserves are at an appropriate level, the main consideration is how those international reserves will be used. In the United States, the main purpose of international reserves is to support the exchange rate, so the quantity of various currencies (held) is determined by the amount of support the dollar needs to give different currencies. I believe that the forex reserves of the People's Bank also play a role in affecting exchange rates.

JRS:<sup>6</sup> How do you think the exchange rate would change under full convertibility, and what would be an appropriate exchange rate? China's present foreign exchange system isn't an entirely transparent one, and many things are very hard to understand without a detailed explanation, so many foreign enterprises feel that the market is not operating normally. They would certainly be delighted to hear what you just said.

I'm very happy to hear that China's current policy is to allow convertibility of the renminbi for current accounts. Even though we feel the ultimate goal should be full convertibility, this is nevertheless a step forward. We encourage China to continue to deepen its reforms so as to fulfill the commercial conditions for reentry to GATT and for joining the WTO.<sup>7</sup>

ZRJ: If you ask foreign-invested enterprises for their opinions, please tell them this: if they're willing to sell foreign exchange to China's banks, they'll be able to buy foreign exchange at China's banks, but the goods that were contractually committed for export must be exported. Tell them I said so. Also, after you go home, please tell Secretary [Lloyd] Bentsen something that I had already said to him in Madrid. On the issue of China's return to GATT, we've negotiated with the United States for a long time and have made huge concessions. We've basically met the requirements of GATT. Many examples illustrate this. For example, in the first nine months of this year, imports grew by 30%, duties were lower than last year, and duties on several types of products were lowered. I hope the

6. Jeffrey R. Shafer, then Assistant Secretary for International Affairs at the U.S. Department of the Treasury.

7. In 1995 the GATT was replaced by the World Trade Organization (WTO). China's accession to the WTO took place in December 2001.

United States will support our returning to GATT as soon as possible. In Madrid, perhaps out of courtesy, Mr. Bentsen did not express opposition, nor did he express agreement. Please tell him that I hope to get a positive reply from him.

JRS: I'll certainly convey your thoughts to Secretary Bentsen. Mr. Bentsen has always supported improving U.S.-China relations and China's reentry to GATT, but this must be based on commerce, and previous negotiations have always been based on commercial and economic conditions.

ZRJ: After allowing foreign-invested financial institutions to establish operating branches in open coastal cities, China has also opened up 10 large inland cities to them. Today, Morgan Stanley will be signing a contract in Beijing with our China Construction Bank to create a joint venture investment bank. In the future, we'll be allowing even more and varied financial institutions, such as insurance companies, to operate in China. The American International Group has already established a branch company in Shanghai. Considering that the inflation rate in China is rather high, we've already made the greatest possible concessions. I hope that inflation will ease up somewhat next year, and we will then be able to make even greater efforts to return to GATT.

As for foreign-invested banks wanting to engage in renminbi business, there are different views within China on this subject. There's quite a large gap between China's commercial banks and the truly commercial international banks, so they're unable to compete. As China's banking laws become more fully developed, China will take bigger steps to allow foreign-invested banks to start doing renminbi business. Right now, China plans to first start some pilot projects allowing a few foreign-invested banks to engage in renminbi business. We're making selections right now.

AG: In the United States, we don't object to foreign banks starting up businesses in local currency provided that they abide by relevant American banking legislation and meet the requirements of the Federal Reserve. There's no problem for foreign banks to set up representative offices and branches in the United States. Of course there's a question here of competition with local banks. If you were to ask for the opinions of local American banks on this issue, the vast majority of them would oppose foreign banks entering the U.S. market. But as the Federal Reserve, we think in terms of the whole and feel that doing so would be conducive to competition, and competition in turn would promote better efficiency. We welcome foreign banks to start up businesses in local currency in the United States.

I thank you and your colleagues for your frankness in our discussions. Please allow me to give you a little gift on behalf of the U.S. Federal Reserve—it's an

eagle, which is the symbol of the Federal Reserve. You're engaged in a great endeavor, and I sincerely hope that you will succeed. We welcome you to visit the Federal Reserve at any time, and I'll invite you to a Chinese meal, but our chefs may not be as skillful as yours.

ZRJ: I've also prepared a gift for you—a silver panda coin. This doesn't mean that America's central bank is like an eagle and our central bank is like a panda. It means we hope the People's Bank of China can be as dynamic as an eagle and as lovable as a panda. We welcome you to come visit at any time, whether personally or through your representative.