
TESTIMONY of

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before the

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**Public Hearing on China’s Capital Requirements
and U. S. Capital Markets**

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Mr. Chairman and Members of the Commission:

I commend the Commission for its work thus far and am honored to testify on “China’s Capital Requirements and U. S. Capital Markets.” Anyone who has been following China since the economic reform movement began in 1978 recognizes the important strides that country has made in moving toward a market economy and reducing abject poverty. But one also recognizes the institutional incompatibility that still exists between remnants of the old central planning system—especially investment planning—and a free-market system based on private property rights and the rule of law.

With China’s accession to the World Trade Organization (WTO), liberalization will continue. The pace of liberalization, however, will depend on both internal political forces and external influences, particularly U.S. policy. That is why the work of this Committee is so vital.

In thinking about China's capital markets, one must never lose sight of the fact that the Chinese Communist Party (CCP) seeks to use those markets to "revitalize" state-owned enterprises (SOEs). The real question is whether China can overcome the ideological barrier to large-scale privatization when that institutional change would end communism and the CCP's grip on power.

If China is to become a world-class financial center, it must create real—not pseudo—capital markets in which the state protects private property rights and lets market participants, not government officials, determine the best uses of scarce capital. Until that time, China's socialist capital markets will be inefficient and corrupt casinos in which the Chinese people will squander their hard-earned savings.

The list of questions the Commission has proposed addressing deal primarily with China's current and future capital "needs" or "requirements," whether China can meet those needs, and what role U. S. capital markets can play in that process. Those issues are important, but even more important are the questions of what China needs to do to create real capital markets and what the implications of further financial liberalization under the WTO are for U.S.-China relations.

In the following testimony, I shall

- Discuss China's current capital "needs" with regard to funding explicit and implicit government debt.
- Question the usefulness of the capital-requirements approach when thinking about how to facilitate China's future economic growth.
- Take a property rights or institutional approach to analyze China's financial sector and show that all the major problems China is facing—from the high percentage

- of nonperforming loans (NPLs) to the large implicit pension debt (IPD)—stem from the dominance of state ownership and the suppression of the private sector.
- Consider the reforms that need to be taken to “normalize” China’s capital markets by privatizing them and how such reforms would benefit U.S. capital markets and improve U.S.-China relations.

China’s Current Capital Requirements

The Commission poses two major questions with regard to China’s capital requirements: (1) How much capital does China need to meet its *existing* obligations, which stem primarily from the NPLs of the big four state-owned commercial banks and from the large IPD of urban SOEs? (2) How much capital is required “to facilitate future economic growth”? The first question can be answered directly by looking at the existing data; the second question is much more difficult and I will return to it.

Nonperforming Loans

The politicization of investment decisions and the socialization of risk in China under state ownership has led to a massive waste of capital. State-owned banks have lent primarily to SOEs, starving the emerging private sector of capital, and have based their lending decisions on politics, not on sound market criteria. The so-called commercialization of the four major state commercial banks—the Bank of China, the Industrial and Commercial Bank of China, the Construction Bank of China, and the Agriculture Bank of China—is intended to stem the tide of

bad loans, but ownership still remains firmly in the hands of the state, and the bad debts keep piling up.

Estimates of the true size of the NPLs vary. The official estimate is that about 25 percent of outstanding loans from the big four state banks are NPLs, but that figure is almost certainly too low. Nicholas Lardy of the Brookings Institution has estimated that the *cost* of bank recapitalization is at least 40 percent of GDP and may be as high as 75 percent, if international standards are applied. He bases his calculation on the Rmb 270 billion in bonds the government has already issued (in 1998) to increase bank capital; the Rmb 1,400 billion in bonds that the asset management companies (AMCs) have issued (in 1999 and 2000), which have an implicit guarantee by the central government; and the Rmb 2,000 to 5,000 billion in NPLs still on the balance sheets of the big four state banks (Table 1).

Compounding the NPL problem of the four state commercial banks is the dismal condition of the three policy banks, the loans in the financial system that cannot be recovered, the insolvency of the rural credit cooperatives, and the undercapitalization of many of the trust and investment companies. The World Bank estimates (in its September 27, 2001, *East Asia Brief*) that China's contingent liabilities, or "hidden debt" due to the weak condition of the financial sector, are more than 50 percent of GDP. Moreover, those liabilities continue to grow at a rate of at least 2 percent of GDP per year.

Implicit Pension Debt

The figures stated thus far do not include China's IPD, which the World Bank estimates to be nearly 100 percent of GDP (more than US\$1 trillion). That is the amount of money China would need today to pay off current and future promised

TABLE 1	
THE COST OF BANK RECAPITALIZATION IN CHINA	
Policy Action or Condition	Cost (Billions of Rmb)
1. Government bond issue to increase bank capital, 1998	270
2. Implicit guarantee of AMC debt, 1999–2000	1,400
3. NPLs still held by four big state commercial banks	2,000 to 5,000 ^a
Total Cost:	
Rmb (billions)	3,670 to 6,670
US \$ (billions)	443 to 806
Percentage of GDP, 2000	40 to 75
SOURCE: Nicholas Lardy, "China's Worsening Debts," <i>Financial Times</i> , 22 June 2001, p. 13.	
^a The larger figure applies when international accounting practices are used.	

benefits. The existing pension system is clearly not sustainable, and that is why China is moving toward a multi-pillar system with a public PAYGO component and a private fully funded component. Some individual accounts have been established, but they are

“notional” accounts. Funds allocated to them have already been used to help cover the deficit in the PAYGO pillar, which amounted to Rmb 40 billion (US\$ 4.8 billion) in 2000 and will climb steadily in the future.

China’s current pension system covers only urban workers in SOEs. Many of those workers are not receiving their promised pensions. Local governments and the central government are already strapped for revenues and cannot afford to bail out pension funds. Raising payroll taxes from an already high level of 24 percent of wages would serve only to further alienate overtaxed workers and reduce actual taxes collected because of noncompliance. What is required is fundamental reform that will give workers secure property rights to future income.

China’s current capital requirements cannot be met within the present system of widespread state ownership. SOEs are parasites that suck the capital out of state-owned banks and waste it on policy-directed investment rather than market-directed investment. Nearly 80 percent of bank lending goes to the state sector, which produces only about 30 percent of industrial output value. If China continues to adhere to market socialism and fails to institute market liberalism, total government debt will continue to grow. Indeed, Lardy estimates that government debt, excluding IPD, could reach 110 percent of GDP by 2008.¹

How Much “Capital” Does China Need to Facilitate Economic Growth?

The question of how much capital is required for China’s future economic growth is a difficult one to answer. If one were to ask that question at the level of an individual firm, one could construct a capital budget and project capital needs over time to achieve

growth of plant capacity. But one would have to make many assumptions, including that consumers' preferences for the firm's product do not change adversely, that demand grows, and, most important, that there are no unexpected changes in the institutional and policy environment. At the level of the national economy, it is virtually impossible to accurately predict capital needs to fuel future growth. Moreover, such an approach diverts attention from the complex nature of a market economy and the real meaning of capital.

The Market Economy as a Complex System

The market economy is a complex network of trust relations held together by a system of property rights and the rule of law. In contrast to central planning, the market relies on millions of individuals pursuing their own interests to generate a spontaneous order based on freedom of contract and private property rights. Government exists to protect individual rights, including the right to own property and to exchange property rights to increase wealth. Property rights are human rights.

In a market economy, no one plans the total amount of saving and investment. Individuals are free to choose how much to save and to invest, and those individual decisions—not government planning—will determine the rate of capital accumulation and future production and consumption opportunities. The institutional, or property rights, arrangement (including tax and regulatory policies) will shape incentives to save and invest and thereby affect future economic growth. For that reason, I shall focus on China's current institutional arrangement and show that it is the lack of private property

rights and the absence of the rule of law that are at the root of China's financial difficulties.

The Meaning of Capital

The concept of capital cannot be understood in an institutional vacuum. Capital is not merely physical assets (e.g., machines and buildings); it is the *net value* of those assets and ideas to consumers as determined in private markets in which individuals have the right to specialize in ownership and risk bearing, are free to buy and sell capital values—so that future expected profits can be capitalized into their present values—and are able to prevent others from violating their rights. Physical and human capital mean little if the institutional infrastructure permits property to be plundered rather than protected.

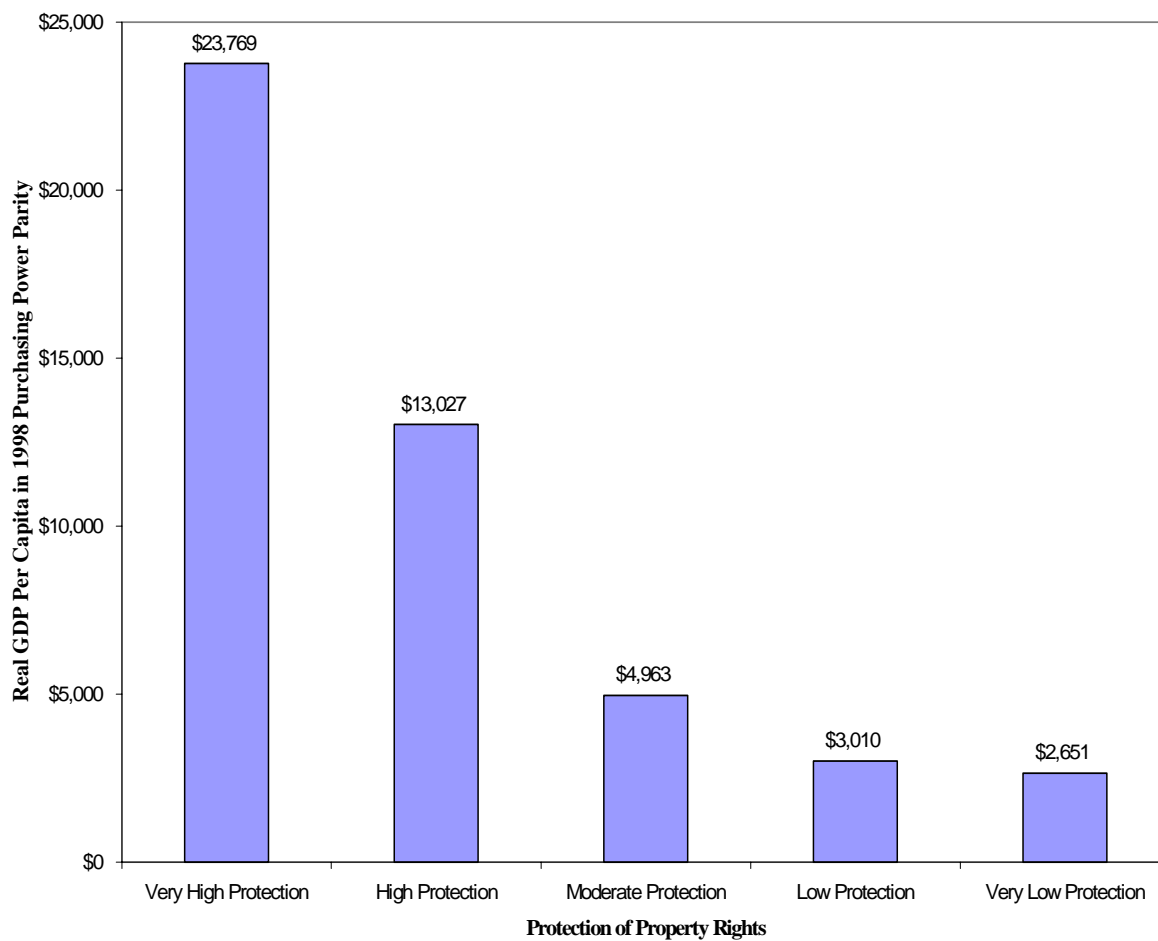
Hernando de Soto, author of *The Mystery of Capital*, is right when he says, “Capital is that value, that additional value, that comes from things that are duly titled;... capital is also law.”² Countries are poor when their leaders prevent privatization and fail to abide by the rule of law. Hong Kong is rich because it adheres to the rule of law and has market-supporting institutions, not because it has abundant physical capital.

The more secure rights to future income streams are, the more confidence individuals will have in the future, the more breadth and depth capital markets will have, and the more liquidity will be created. Likewise, any attenuation or weakening of private property rights—including the rights to use, to sell, and to partition property—will mean less trust, less liquidity, and less wealth. Figure 1 shows that nations with stronger

private property rights have a much higher average level of real GDP per capita than countries with less secure rights.

FIGURE 1

STRONGER PROPERTY RIGHTS EQUAL GREATER WEALTH



SOURCE: Lee Hoskins and Ana I. Eiras, "Property Rights: The Key to Economic Growth," in *2002 Index of Economic Freedom*, ed. G. P. O'Driscoll, Jr., K. R. Holmes, and M. A. O'Grady (Washington and New York: The Heritage Foundation and the Wall Street Journal, 2002), p. 40.

China's physical capital infrastructure is expanding rapidly, but its institutional infrastructure is still weak. If new value and wealth are to be created, China needs real, not pseudo, capital markets.³ People must be free to choose their own investments, including foreign investments, and state ownership must give way to widespread privatization if China is to develop world-class financial markets. Injecting more funds into state-owned banks to lend to state-owned enterprises is a recipe for disaster.

China's Pseudo Capital Markets: The Costs of Capital Repression

China's listing of SOEs on the two major stock exchanges in Shanghai and Shenzhen, as well as listings in Hong Kong, New York, and London, gives the appearance of a vibrant capital market, but the emperor has no clothes. The listed companies are still controlled by the central and local governments. Those companies have no transparent balance sheets or financial reports that inform individual investors about the true profitability of the underlying assets, and the lack of fully transferable shares means that it is impossible to discern real capital values. The stock markets in China are really casinos to raise funds for struggling SOEs, not efficient capital markets.

The CCP's ideological bias against private free capital markets places a heavy burden on the economy in terms of the value lost to society from the misallocation of scarce capital resources. The repression of the private sector means that the savings of the Chinese people are directed into low-interest deposit accounts at state-owned banks or

rural credit cooperatives and then invested in SOEs. The SOEs benefit from the low cost of their funds but have no incentive or flexibility to direct capital to its highest-valued uses.⁴ Since local protectionism is rampant in China, capital is held hostage by local politicians and mostly wasted on nonviable projects. That is why returns to investment are so low in China.

The costs of capital repression in China are evident in (1) the stock market bubble, (2) the heavy reliance on foreign direct investment (FDI), and (3) the fact that China is a net exporter of capital. What appear at first as strengths of the Chinese market socialist system are upon reflection serious defects. Let us see why.

The Stock Market Bubble

The extremely high price/earnings ratios (P/Es) on China's domestic stock exchanges—stocks on average are selling at more than 50 times earnings—reflect the low expected earnings of SOEs, not bullishness about the future of those companies. The quality of information about SOEs is poor, and investors rely mostly on gossip to make their “investment” decisions. The 50 million Chinese who gamble in the stock markets do so only because their investment options are so limited. If they could freely invest in foreign markets, their funds would quickly leave China—*unless ownership reform took place*. Placing SOEs in the hands of private owners would transform those companies and redirect capital to more productive uses. Earnings would rise and P/Es would fall to normal levels. Without ownership reform, share prices are bound to fall to bring about more normal P/Es.⁵

The government has been trying to boost share prices by delaying new listings of SOEs, by injecting capital into dying SOEs, and by trying to talk up the markets. But those are stopgap measures and will only worsen the long-term problems. Delaying fundamental ownership reform will make it more difficult to bring about the institutional changes necessary for long-run stability and growth.

Heavy Reliance on Foreign Direct Investment

China is the second largest recipient of FDI in the world. In 2000, FDI in China amounted to nearly \$41 billion. But instead of reflecting the strength of the Chinese economy, it reflects an inherent weakness—the inability of private firms to acquire the capital necessary to expand their market share. Private entrepreneurs are not allowed to enter the equity markets to raise capital, and they stand at the end of the line when it comes to bank loans, so they must turn to foreign investors. Those investors acquire the assets of private firms and SOEs through joint ventures. The newly created foreign-funded enterprises (FFE) increase allocative efficiency when they take over SOE assets, but private domestic firms are not allowed to bid on those assets, so the prices are less than they would be in a competitive open market. Privatization would allow private entrepreneurs to acquire SOEs and to have greater access to the savings of the Chinese people, so more of China's assets would belong to the Chinese people.

Yasheng Huang of the Harvard Business School has emphasized the above points and concluded that, because of the ideological bias against private enterprise:

There have been huge losers in the Chinese reform process, notably private entrepreneurs who have foregone business growth opportunities [by not being

able to raise capital or to acquire SOE assets] and lost control over their businesses [through joint ventures].... These foregone benefits are financially equivalent to actual losses. Thus, the argument for gradual reform is a political one, not an economic one.⁶

What is needed is to allow private Chinese firms the same rights as foreign firms, but that change will not occur without political reform.

Net Capital Outflows

Although China has attracted large net inflows of FDI, those inflows of private capital have been nearly offset by the outflows of portfolio and other investments (e.g., trade credits and loan repayments). Moreover, when one takes account of China's large accumulation of foreign reserves (now approaching \$200 billion) together with the substantial illegal private capital outflows as seen in the errors and omissions component of the balance of payments (which amounted to nearly \$50 billion over the last three years and more than \$100 billion from 1991 through 1998),⁷ one sees that China's current account surpluses have been financing *net capital outflows*.

In a recent article in the *Cato Journal*, John Greenwood, chief economist at Invesco Asia, Ltd. gives a detailed view of this phenomenon and argues that for a poor country like China, it makes no sense to be a net exporter of capital. Indeed, by holding such large stocks of foreign exchange and using them to acquire foreign assets (e.g., U.S. Treasury securities), China is misallocating capital and denying its citizens the right to earn higher returns overseas. According to Greenwood, "The accumulation of foreign assets by the [Chinese] government in place of the private sector amounts to the backdoor

nationalization of what would otherwise have been potentially profitable overseas investments by private individuals and businesses.”⁸

The fact that China denies its citizens the right to freely invest abroad or at home provides them with a strong incentive to find higher returns illegally. The lack of capital freedom is a major cause of corruption in China.

It is also true, as Huang points out, that foreign exchange reserves are China’s claims on dollar assets. When FDI inflows are financing the growth of China’s foreign exchange reserves, that amount of FDI is not used productively to develop the Chinese economy....This is surely a strange outcome. The Chinese are striving to give up the ownership of their economy only to use the capital surpluses to invest in low-yielding government bonds in America.⁹

The combination of discrimination against the private sector (as evidenced by China’s high dependence on FDI), the ban on full convertibility of the renminbi (which has been maintained by capital controls), and the undervaluation of the renminbi (as evidenced by the large accumulation of foreign reserves) indicates that China cannot get out of its current financial situation without ending its repression of capital and allowing greater capital freedom.

Creating Real Capital Markets in China: The Benefits of Capital Freedom

Piecemeal reform has helped China move slowly toward a more open market. China’s entry to the WTO will help speed the pace of reform and bring about greater liberalization. Foreign banks will have greater market access, and foreign companies will

gain direct distribution rights for the first time. But the real challenge for China will be to allow its own citizens full private property rights, including the right to raise capital in the financial markets, the right to establish fully funded pensions, and the right to full convertibility of the renminbi. Unless there is widespread privatization, China's citizens will remain handicapped in their efforts to improve their lives and futures.

Reform Measures to Increase Capital Freedom

Creating real capital markets in China will require the following measures:

- Removing restrictions on private ownership and on internal and foreign trade;
- Allowing interest rates to be freely set by demand and supply;
- Allowing SOEs to go bankrupt;
- Allowing workers to have private pension accounts that are separately administered by private firms, whether foreign or domestic;
- Allowing full convertibility of the renminbi;
- Allowing full transferability of shares in SOEs so that wealth can be maximized by those individuals who wish to specialize in ownership and risk bearing.

Some of those reform measures have already been initiated and will be advanced by China's accession to the WTO; others, such as privatization, need to be pushed much further.

Selling off SOEs to privatize pensions would be a step in the right direction. Private pensions would create new capital that could help China grow in the future. Moving to a fully funded pension system is economically feasible. According to Peking University economist Zhao Yaohui's estimates, the cost of moving to a fully privatized system—the

transition costs plus the costs of funding individual accounts—would be 15.8 percent of payroll compared to the current 24 percent.¹⁰ Full privatization is gaining support and may become politically feasible in the near future. But the obstacles are still substantial.

Individuals would have a strong incentive to participate in a fully funded system, whereas they have little incentive to participate in the current PAYGO system. As Zhao notes:

The best alternative in solving the financial crisis is to give individuals incentives to participate. The best way to give incentives to individuals is to put all pension contributions (from employer and employee) into individual accounts and make sure that the investment earns competitive returns. This gives individuals the property rights to these accounts. Otherwise, individuals would be better off saving and investing the money on their own.¹¹

If SOEs were transformed into private companies in which individuals held saleable shares, the stock market would reflect more accurately the present values of the listed companies, and P/Es would come back to normal levels. Chen Mingxing, senior researcher with the State Information Centre, recognizes this fact and has recommended more rapid ownership reform. As the *China Daily's Business Weekly* reported, “Chen said that the government should leave the adjustment of share prices to market forces, but put more effort into establishing a marketplace that is ‘just, fair and transparent,’ and reforming the ownership systems at the listed companies.”¹²

By failing to create real capital markets, China is failing to take advantage of the gains to be had from specializing in ownership and risk bearing. The socialization of risk under the current system of state ownership reduces incentives to innovate and create

wealth. The value of Chinese firms is below what it could be if capital were free to flow to its highest-valued uses—and there is no way to discover those uses without competitive markets, which depend on private property rights. That is why China has had to rely so heavily on foreign capital to fuel the growth of the economy.

Benefits of Capital Freedom

Privatizing state-owned banks and allowing interest rates to be set in private capital markets would depoliticize the allocation of bank credit and increase investment returns to the private sector. Allowing both Chinese and foreign investors access to China's capital markets would put China's vast pool of private savings to better use than they are under the current discriminatory system. One of the key lessons from the Asian financial crisis, as Federal Reserve Chairman Alan Greenspan has observed, is that “diversity within the financial sector provides insurance against a financial problem turning into economy-wide distress.” Thus, “the difficult ground work for building the necessary financial infrastructure—improved accounting standards, bankruptcy procedures, legal frameworks [to protect property rights] and disclosure—will pay dividends of their own.”¹³

Privatizing SOEs and state-owned banks and creating private markets for distressed assets would help China solve its NPL problem. Moreover, as Greenwood, emphasizes:

If China's capital markets and its industries were normalized (through deregulation, proper implementation of the rule of law, the encouragement of private markets, and extensive private ownership), then China's balance of

payments would no doubt undergo a major transformation. The balance of payments would witness a switch from current account surplus and capital outflows to current account deficit and capital inflows.¹⁴

He recommends, as a first step in that direction, “the adoption of a progressively more flexible nominal exchange rate regime.” Such liberalization need not create instability provided China continues to liberalize on other fronts and maintains domestic monetary stability. The renminbi would then gradually *appreciate* against the dollar, and the current account would gradually move into a deficit position as exports slowed and imports increased.

The benefits to China and to foreigners from liberalizing the financial sector are great: China would achieve a more efficient use of its capital and attract new investment; the Chinese people would have an important part of their human rights—the right to own property—protected by law; and foreigners would be able to deal with private firms and offer more options to China’s savers.

Implications for U. S.-China Relations

Improving capital freedom in China by securing property rights and liberalizing capital markets and capital flows would increase wealth in China and increase the demand for U.S. goods, services, and investment. As China’s internal markets expand (because of privatization and liberalization), so will U.S.-China trade. Increasing economic freedom is a win-win strategy—both the United States and China can gain.

As economic ties strengthen between China and the United States, as well as China and other nations, the increase in economic interdependence will help lessen the

chance of conflict. Expanding the private sector will help shrink the relative size of the state sector and exert pressure for political liberalization, as has happened in Taiwan.

Empowering China's workers by allowing them to have property rights in their pensions will create a huge positive force in favor of private enterprise and capital freedom, just as happened in Chile.¹⁵ U.S. investment firms and insurance firms would benefit from such a regime change.

China is a rising power that the United States must watch closely. Economic liberalization has not yet had a substantial impact on the political regime. But that can change. China's accession to the WTO will accelerate capital freedom and, with it, political reform. Indeed, leading intellectuals are advocating laws to protect property rights, and one can even read about the importance of property rights in the *China Daily*. For example, that government-backed newspaper recently carried articles that stated:

- What China needs "is a 'rule of law' system to fuel the formation of a freer market, instead of increasing controls."¹⁶
- "The main purpose of the [new] property rights law is to define and specify rights of possession in China, according to Wang Liming, a professor of civil law at Renmin University.... Moreover, it is the basic rule for the regulation of a market economy because the prerequisite for any transaction is the ownership of property and the result of the transaction is the shift of property rights, he added. The lack of basic rules in tangible property rights has hampered the functioning of current legislation such as the Contract Law and the Guarantee Law, Wang said. [The new law] is expected to encourage and stimulate people to create more

wealth for society by giving equal protection to property under different ownership.”¹⁷

China's adoption of a genuine rule of law—protecting life, liberty, and property—would benefit both the Chinese people and the United States. That is why one of China's leading liberal thinkers, Liu Junning, when asked about the future of China, replied, “Whether China will be a constructive partner or an emerging threat will depend, to a very great extent, on the fate of liberalism in China: a liberal China will be a constructive partner; a nationalistic and authoritarian China will be an emerging threat.”¹⁸

Conclusion

Private property makes owners responsible for their actions. What China needs is a system of property rights that assigns liability to individuals, not to the state. That means a system of rights that also allows individual owners to benefit from allocating resources where consumers—rather than CCP officials—want them. The main barrier to large-scale privatization in China has been the fear of the rulers that privatization will mean the end of Party rule, and they are right. They hold on to Marxist ideology in the hope that the people will listen, but more and more people are beginning to see the benefits of private property and free trade. The United States can best help the Chinese people gain political freedom by first supporting economic freedom. Isolating China would only further empower the hardliners.

At base, capital value depends on freedom. By opening markets and sharing ideas (e.g., through student and faculty exchanges, conferences, etc.), and standing by our

founding principles, the United States can help to promote peace and prosperity in China and at home.

Thus, in closing, I recommend that the Commission in its report to Congress:

- Stress the importance of trade liberalization and capital freedom for improving U.S.-China relations.
- Recognize that ultimately the Chinese people must determine their political future and that liberal trade policies will help grow civil society and create incentives for political liberalization.
- Permit more Chinese students and scholars to study in the United States, especially law, economics, and the humanities. Visa procedures should be reexamined. So long as individuals pose no threat to our national security, they should be encouraged to learn about our free society firsthand.

Free trade and privatization can help normalize China and transform it into a modern economy and a civil society under the rule of law. China will then have one country and one system. The United States must be patient and not lose sight of the long-run benefits of a firm commitment to the principles of market liberalism and capital freedom.

Notes

¹ Nicholas Lardy, "Fiscal Sustainability: Between a Rock and a Hard Place," ChinaOnline, 16 June 2000 (<http://www.chinaonline.com>).

² D. Fetting, "An Interview with Hernando de Soto," *The Region*, 15 June, pp. 23, 26. Published by the Federal Reserve Bank of Minneapolis (www.minneapolisfed.org).

³ See James A. Dorn, "Creating Real Capital Markets in China," *Cato Journal* 21 (Spring/Summer 2001): 65-75 (<http://www.cato.org/pubs/journal/cj21n1/cj21n1.html>).

⁴ See David D. Li, "Beating the Trap of Financial Repression in China," *Cato Journal* 21 (Spring/Summer 2001):77-90 (<http://www.cato.org/pubs/journal/cj21n1/cj21n1.html>).

⁵ See Zhang Dingmin, “Ownership Reform to Deflate Stock Bubbles,” *Business Weekly* (Supplement to *China Daily*), 30 October – 5 November 2001, p. 15.

⁶ Yasheng Huang, “Internal and External Reforms: Experiences and Lessons from China,” *Cato Journal* 21 (Spring/Summer 2001): 62 (<http://www.cato.org/pubs/journal/cj21n1/cj21n1.html>). This article is based on his forthcoming book, *Selling China: The Institutional Foundations of Foreign Direct Investment during the Reform Era* (New York: Cambridge University Press, 2002).

⁷ See Dong Fu, “Beyond the Border: Capital In and Out of China” (<http://www.chinaonline.com>) 4 April 2000, and William Dudley, “The Emperor’s New Clothes,” in *The 2001 Guide to Foreign Exchange* (London: Euromoney Institutional Investor PLC, 2001), p. 15. Published with the September 2001 issue of *Euromoney*.

⁸ John Greenwood, “The Impact of China’s WTO Accession on Capital Freedom,” *Cato Journal* 21 (Spring/Summer 2001): 92 (<http://www.cato.org/pubs/journal/cj21n1/cj21n1.html>).

⁹ Huang, p. 51. He notes that about 40 percent of China’s reserves are invested in U.S. Treasury bonds.

¹⁰ Zhao Yaohui, “The Feasibility and Benefits of a Fully Funded Pension System,” paper presented at the Cato/CCER conference on “China’s Pension System: Crisis and Challenge,” Beijing, 8 November 2001, p. 3 (forthcoming in the *Cato Journal*).

¹¹ *Ibid.*, p. 1.

¹² Zhang, p. 15.

¹³ Alan Greenspan, “Lessons from the Global Crises,” remarks before the World Bank Group and the International Monetary Fund Program of Seminars, Washington, D.C., 27 September 1999, p. 10.

¹⁴ Greenwood, p. 93.

¹⁵ For a discussion of the Chilean pension system and its importance for China, see José Piñera, “Empowering People: What China Can Learn from Chile,” in *China in the New Millennium: Market Reforms and Social Development*, ed. J. A. Dorn (Washington, D.C.: Cato Institute, 1998).

¹⁶ Zi Xun, “Nobel Theory No Panacea for China,” *Business Weekly* (Supplement to *China Daily*), 30 October–5 November 2001, p. 15.

¹⁷ Meng Yan, “Draft Law to Protect Property,” *China Daily*, 3 September 2001, p. 1.

¹⁸ Liu Junning, “The Intellectual Turn: The Emergence of Liberalism in Contemporary China,” in *China’s Future: Constructive Partner or Emerging Threat?* ed. T. G. Carpenter and J. A. Dorn (Washington, D.C.: Cato Institute, 2000), p. 60.