



A New US-China Relationship? Part II

Nicholas R. Lardy says the Chinese leadership's stated intention to liberalize the domestic economy could portend important changes sought by the United States.

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Steve Weisman: Nicholas Lardy, senior fellow at the Peterson Institute for International Economics, is here with me, Steve Weisman, talking about the U.S./China relationship and the chances for that relationship improving or evolving, on the eve of the summit meeting between President Obama and President Xi Jinping, near Bob Hope Drive in Sunnylands, California, at the end of the first week of June.

Nick, there have been a lot of news reports that focus on comments by not only President Xi but others, that they're moving more into privatizing the Chinese economy. Is anything changing?

Nicholas Lardy: I think things are changing. I think this new administration has come to the view that the growth model that prevailed for the 10 years that [former President] Hu Jintao and [former Premier] Wen Jiabao, the previous leaders, were in power is no longer effective and that growth is slowing down and that if they don't undertake some fundamental reforms, the likelihood is that growth will slow further. This has, I think, galvanized them to undertake a series of very important reforms in the economic domain.

Steve Weisman: Such as?

Nicholas Lardy: They've now been speaking very openly. Premier Li [Keqiang], who is in charge of the economic portfolio, has given a number of important speeches. The State Council, their cabinet, has followed up with some very specific documents, indicating the kinds of reforms that they will undertake. Li has specifically rejected the modus operandi of the previous regime, that when growth slows down, you flood the economy with credit and you create a new boom. He has specifically said that this is not working and that they have to have more fundamental reform to sustain economic growth. That means some very basic reforms, much greater reliance on the market.

It's not so much privatization as to rely more on the market in resource allocation, less government decision-making, less government approvals for investment projects and other kinds of activities, more price flexibility, an exchange rate that's more determined by the market, more liberalization on the capital accounts so that capital can flow in and out of China somewhat more easily than it currently can, some reforms of prices. Certain price controls are still in effect in China and they've talked for years about lifting those controls and letting the market determine the prices, for example, for energy. Now, they say they're actually going to go ahead and do it. But we'll have to wait and see. So far, it's mostly talk. It's very strong, and it's quite explicit. I think one can be somewhat optimistic that at this very important party meeting in the fall, that we'll see unveiled a series of initiatives in the economic area.

Steve Weisman: What is the growth outlook now for China and how urgent is it that they need to change?

Nicholas Lardy: Growth in the fourth quarter last year, 2012, was very weak. We had a little bit of a pickup in the first quarter, with growth at about 7.7 percent, and many commentators felt that this was the beginning of a strengthening of the economy, that it would strengthen further as we went through the year, and everybody was forecasting that growth would be well above 8 percent in 2013. We don't have second quarter data yet, obviously, but most of the indicators that have come out since the end of the first quarter suggest that the economy continues to be relatively weak. Industrial growth has not picked up. Other indicators are for very modest growth.

It's possible that the second quarter growth will actually be below that of the first quarter. Most investment banks and other people that do forecasting have downgraded their forecasts. Everybody is now below 8 percent. Some are down at 7.5 percent, and a few people have even suggested it's possible that growth for the year as a whole could be under 7.5 percent, which would be quite startling. But, the leadership has signaled, I think, quite clearly, that they are prepared to accept slower growth in a transition as they launch reforms that they think will lead to a stronger period of growth in the future. So, I don't think they're panicking. They have rejected an increase in the stimulus program and said that the real answer is more fundamental economic reform.

Steve Weisman: These policy steps are welcomed by the United States, aren't they?

Nicholas Lardy: Certainly, they are, because they move China much more towards a market economy if they're undertaken. And that would ease some of the frictions in our trade and investment relationship with China.

Steve Weisman: Now, just to close, I must ask about a big issue in the background, the cyber-attacks by maybe the Chinese military on a full range of U.S. institutions, government contractors and defense-related institutions. This has created a furor in the press. How much of a factor do you think it will be in the summit meeting?

Nicholas Lardy: I think the cyber issue has the potential really to derail the whole relationship. It is a massive potential negative that will undo the progress that has been made and potentially could be made in a number of other areas. I think it's a very important issue. It's certainly going to come up. The bad news is the Chinese deny that they're doing this. The good news is that they recognize that they are also subject to cyber-attacks and they do say that there should be a negotiation to set up some international rules governing cyber. So, they've opened the door for a discussion about a set of rules, which I think we should welcome and negotiate and see what could be agreed to.

Steve Weisman: Thank you, Nick.

