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China's Big Chance to Liberalize

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By James A. Dorn

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Charles Wolf Jr. ("A Liberated Yuan Is Likely to Fall," op-ed, April 22) makes the case that further economic liberalization in China, especially internationalizing the yuan by making it fully convertible, would incentivize domestic savers to move their massive deposits to more fertile ground outside the Mainland, thus weakening the yuan against the dollar. Further weakening of the currency would result from China's continuing current account surplus, as funds are invested in foreign assets.

However, if China were to create private capital markets and embrace the rule of law, both domestic and foreign investors would find many attractive investment opportunities in the Middle Kingdom. The real exchange rate would appreciate and the balance of payments would normalize.

The problem is that thus far the Communist Party has not been willing to tolerate a free market in capital or in ideas—both of which are necessary for a robust financial market. Without those reforms, the slightest opening of the capital market risks a large capital outflow, depriving state-owned banks and firms of the funds they need for expansion. Meanwhile, the People's Bank of China continues to accumulate foreign exchange reserves while supplying yuan to peg the exchange rate at a predetermined level, and sterilizing (withdrawing) the excess yuan to prevent runaway inflation.

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