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China's Currency Sterilization and Fiscal Centralization

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Abstract

During the late 1980s and early 1990s, the Chinese economy experienced painful trade-offs between high economic growth and low inflation: stimulating GDP growth would cause severe inflation spikes, while controlling inflation rates would seriously contract GDP growth. In 1994, the Chinese government initiated a series of macroeconomic reforms to revitalize the Chinese economy. After that, the inflation dropped steadily and eventually achieved the “soft landing” in 1996. The high GDP growth rate has also been stabilized. This research elucidates two core components embedded in China's 1994 program: currency sterilization and fiscal (revenue) centralization. The results suggest that classic economic models with nominal rigidity postulation may not be compatible with the Chinese economy.

Key words: economic development, currency intervention