

The Financial Reforms in China



From an Institutional View

ZHAO Yongsheng



China Renmin University Press

The Financial Reforms in China

From an Institutional View

ZHAO Yongsheng

China Renmin University Press

• Beijing •

图书在版编目 (CIP) 数据

中国金融改革 = The Financial Reforms in China: 英文/赵永升著.
—北京: 中国人民大学出版社, 2017. 6
ISBN 978-7-300-24694-9

I. ①中… II. ①赵… III. ①金融改革—研究—中国—英文 IV. ①F832.1

中国版本图书馆 CIP 数据核字 (2017) 第 152035 号

中国金融改革 (英文版)

赵永升 著

Zhongguo Jinrong Gaige

出版发行 中国人民大学出版社

社 址 北京中关村大街 31 号

邮政编码 100080

电 话 010-62511242 (总编室)

010-62511770 (质管部)

010-82501766 (邮购部)

010-62514148 (门市部)

010-62515195 (发行公司)

010-62515275 (盗版举报)

网 址 <http://www.crup.com.cn>

<http://www.ttrnet.com> (人大教研网)

经 销 新华书店

印 刷 北京中印联印务有限公司

规 格 170 mm×230 mm 16 开本

版 次 2017 年 6 月第 1 版

印 张 19.75 插页 2

印 次 2017 年 8 月第 2 次印刷

字 数 175 000

定 价 69.00 元

版权所有 侵权必究 印装差错 负责调换

The Financial
Reforms
in China

Table of Contents

INTRODUCTION / 1

Section 1 Literature / 4

Section 2 Financial Development / 22

PART 1 CHINA'S FINANCE-GROWTH PUZZLE / 43

Section 1 Finance-Growth: from Nexus to Puzzle / 45

Section 2 Financial System's Inefficiency in China / 61

Section 3 Adaptive Efficiency / 127

Section 4 Financial Repression Rate & Its

Liberalization / 142

PART 2 FINANCIAL INSTITUTIONS' REFORMS / 159

Section 1 Banking System Reforms / 161

Section 2 Credit System Reforms / 183

Section 3 WTO-Oriented Reforms / 213

CONCLUSION / 299

BIBLIOGRAPHY / 302

The Financial Reforms in China

INTRODUCTION

This book aims to analyze the financial reforms in China from an institutional view which is in fact a crucial theme to ensure the stability of reforms and growth in this emerging economy.

After the Introduction which will make a brief review of the literature and a presentation of financial development, Part 1 will try to demystify the finance-growth 'puzzle' and the inefficiency of Chinese financial system in setting forth the Adaptive Efficiency and the rate of Financial Repression in China.

Part 2 will analyze the financial institutions' reforms in China, from banking system reforms to credit system reforms in focusing on governmental efforts for the accession to the WTO; the Non-

Performing Loans (NPLs), the State-Owned Enterprises (SOEs) and the State-Owned Banks (SOBs) and the opening-up to foreign competition have also been expatiated.

Finally, this book concludes in advancing policy recommendations without forgetting to mention the further research.

Section 1 Literature

The relationship between finance and growth is in fact a classic theme which has engendered a real controversy during a long period of time, hence, the literature concerned is also numerous. I will just make a brief review as follows.

As a representative figure in the field of finance-growth studies, Ross Levine argued: "Financial development occurs when financial instruments, markets and intermediaries ameliorate... the effects of information, enforcement, and transactions costs and

therefore do a correspondingly better job at providing the five financial functions.” (Ross Levine, 2004) The five functions are producing information about possible investments and allocating capital, monitoring firms and exerting corporate governance, trading, diversification and management of risk, mobilization and pooling of savings, and easing the exchange of goods and services. These functions influence savings and investment decisions, and technological innovations and hence economic growth.

As “Rome was not built in a day”, the pioneering study to assess whether finance exerts a causal influence on growth is Goldsmith (1969) who, in using the data of 35 countries during the period of 1860-1963 (when available), documents (graphically) a positive correlation between financial development and economic development with the finding that the financial intermediary size relative to the size of the economy rises as countries develop.

Nearly a quarter of century later, King and Levine (1993), the second pioneering study, had overcome the weaknesses in the

previous literature by Goldsmith (1969) in adopting 77 country samples this time instead of 35 by Goldsmith and systematically controlling for other factors affecting growth. King and Levine (1993) examined three growth indicators averaged over 1960-1989: real per capita GDP growth, growth in capital stock per person and total productivity growth; they also constructed additional measures of the level of financial development which are DEPTH, BANK and PRIVY in order to measure the size of financial intermediaries, the degree to which the central bank versus commercial banks were allocating credit and the weight of credit to private enterprises respectively.

The definitions for these three variables are as follows: 'DEPTH' equals the value of liquid liabilities divided by the GDP, or $DEPTH = \text{Liquid Liabilities} / \text{GDP}$; 'BANK' is the value of deposit bank domestic credit divided by the sum of this credit plus central bank domestic credit, or $BANK = \text{Deposit bank domestic credit} / [\text{Deposit bank domestic credit} + \text{Central bank domestic credit}]$

credit]; and 'PRIVY' equals the value of gross claims on the private sector divided by the GDP, or $PRIVY = \text{Gross claims on the private sector} / \text{GDP}$. Please see Table 0 - 1 for details.

Table 0 - 1 Growth and Financial Intermediary Development 1960-1989

Dependent Variable	Depth	Bank	Privy
Real per Capita GDP Growth	2.4** (0.007)	3.2** (0.005)	3.2** (0.002)
R ²	0.50	0.50	0.52
Real per Capita Capital Growth	2.2** (0.006)	2.2** (0.008)	2.5** (0.007)
R ²	0.65	0.62	0.64
Productivity Growth	1.8** (0.026)	2.6** (0.010)	2.5** (0.006)
R ²	0.42	0.43	0.44

Source: King and Levine (1993b), Table VII

* significant at the 0.10 level, ** significant at the 0.05 level

(p-values in parentheses)

Observations: 77

Variable definitions:

DEPTH = Liquid Liabilities/GDP

BANK = Deposit bank domestic credit / [deposit bank domestic credit + central bank domestic credit]

PRIVY = Gross claims on the private sector / GDP

Productivity Growth = Real per capita GDP growth - (0.3)*(Real per capita Capital growth)

Other explanatory variables included in each of the nine regression results reported above:

logarithm of initial income, logarithm of initial secondary school enrollment, ratio of government consumption expenditures to GDP, inflation rate, and ratio of exports plus imports to GDP.

Notes: King and Levine (1993b) define 2 percent growth as 0.02. For comparability with subsequent tables, we have redefined 2 percent growth as 2.00 and adjusted the coefficients by a factor of 100.

King and Levine (1993) had found a strong positive relationship between each of the financial development indicators and the three growth indicators, and discovered that the sizes of the coefficients are economically large. \uparrow DEPTH from the mean of the slowest growing quartile (0.2) to the mean of the fastest growing quartile (0.6) of countries \rightarrow per capita growth rate \uparrow by 1% per year; and the rise in DEPTH alone eliminates 20% of the growth difference between the slowest growing and the fastest growing quartile of countries.

Further more, in order to examine whether finance simply follows growth, King and Levine (1993) studied whether the value of financial development in 1960 predicted the three growth indicators over the next 30 years. This predictability has finally been proved with the findings that the financial depth in 1960 is a good predictor of subsequent rates of economic growth, capital accumulation and productivity growth; and that the coefficients are eco-

nomically large. Bolivia: \uparrow DEPTH (1960) from 10% of GDP to 23% (mean for developing countries) \rightarrow per capita GDP 13% larger in 1990. See Table 0 - 2 for details.

Table 0 - 2 Growth and Initial Financial Depth 1960-1989

Dependent Variable	Depth in 1960
Real per Capita GDP Growth, 1960-1989	2.8** (0.001)
R ²	0.61
Real per Capita Capital Growth, 1960-1989	1.9** (0.001)
R ²	0.63
Productivity Growth, 1960-1989	2.2** (0.001)
R ²	0.58

Sources: King and Levine (1993b), Table VIII; and Levine (1997), Table 3

* significant at the 0.10 level, ** significant at the 0.05 level

(p-values in parentheses)

Observations: 57

Variable definitions:

DEPTH=Liquid Liabilities/GDP

Productivity Growth = Real per capita GDP growth - (0.3)*(Real per capita Capital growth)

Other explanatory variables included in each of the regression results reported above:

logarithm of initial income, logarithm of initial secondary school enrollment, ratio of government consumption expenditures to GDP, inflation rate, and ratio of exports plus imports to GDP.

Notes: King and Levine (1993b) and Levine (1997) define 2 percent growth as 0.02. For comparability with subsequent tables, we have redefined 2 percent growth as 2.00 and adjusted the coefficients by a factor of 100.

After King and Levine (1993), Levine and Zervos (1998)

constituted an important cross-country study on stock markets in adopting the data from 42 countries during the period of 1976-1993. They construct numerous measures of stock market development, e. g. the 'Turnover Ratio'^① which reflects trading frictions and information that induces transactions: the USA & Japan: 0.5; Bangladesh, Chile and Egypt: 0.06. Their findings demonstrate that the initial levels of stock market liquidity and banking development are positively and significantly correlated with future rates of economic growth, capital accumulation growth and productivity growth; and that the coefficients are large and economically significant: one-standard-deviation increase in initial stock market liquidity → per capita GDP 15% higher; and the same increase in the bank credit → per capita GDP 14% higher, together, per capita GDP almost 30% higher and productivity almost 25% higher.

Levine and Zervos (1998) also discovered that the link be-

① The Turnover Ratio equals the total value of shares traded on a country's stock exchanges divided by stock market capitalization or value of shares listed.

tween stock markets, banks and growth ran robustly through productivity growth rather than physical capital accumulation; and that the stock market size or market capitalization/GDP was not robustly correlated with growth, capital accumulation and productivity improvements. This demonstrates that simply listing on the stock exchange does not necessarily foster resource allocation. See Table 0 - 3 for details.

Table 0 - 3 Stock Market and Bank Development Predict Growth 1976-1993

Dependent Variable (1976-1993)	Independent Variables (1976)		
	Bank Credit	Turnover	R ²
Real per Capita GDP Growth	1.31** (0.022)	2.69** (0.005)	0.50
Real per Capita Capital Growth	1.48** (0.025)	2.22** (0.024)	0.51
Productivity Growth	1.11** (0.020)	2.01** (0.029)	0.40

Source: Levine and Zervos (1998), Table 3.

* significant at the 0.10 level, * * significant at the 0.05 level. (p-values in parentheses)

Observations: 42 for the real per capita GDP growth regression and 41 for the others.

Variable definitions:

Bank Credit = Bank credit to the private sector/GDP in 1976 or the closest date with data.

Turnover = Value of the trades of domestic shares on domestic exchanges as a share of

market capitalization of domestic shares in 1976 or the closest date with data.

Productivity Growth = Real per capita GDP growth - $(0.3) * (\text{Real per capita Capital growth})$

Other explanatory variables included in each of regression results reported above:

logarithm of initial income, logarithm of initial secondary school enrollment, ratio of government consumption expenditures to GDP, inflation rate, black market exchange rate premium, and frequency of revolutions and coups.

Notes: Levine and Zervos define 2 percent growth as 0.02. For comparability with subsequent tables, we have redefined 2 percent growth as 2.00 and adjusted the coefficient, by a factor of 100.

However, the theme of causality between finance and growth had not yet been well studied till the year 2000. Even Levine and Zervos (1998) think that, the above pioneering literature had some limitations; they did not deal formally with the issue of causality while they showed the prediction, there were difficulties in measuring liquidity, the link between trading and future economic growth might not represent a link between liquidity and growth, they excluded other components of the financial sector while they included measures of the functioning of stock markets and banks, finally, the stock markets may do more than provide liquidity.

To assess whether the finance-growth link is driven by simultaneity bias, one needs instrumental variables that explain cross-country differ-