

Studies on the Chinese
Market Economy Series



Reforming China's Financial System

Chief Editors:
Gao Shangquan
and Chi Fulin

FOREIGN LANGUAGES PRESS BEIJING

Studies on the Chinese Market Economy Series

Reforming China's Financial System

Chief Editors:

Gao Shangquan *and* Chi Fulin

Written by:

Zhu Huayou

FOREIGN LANGUAGES PRESS BEIJING

First Edition 1996

The project is aided by
Hainan (China) Foundation for Reform and Development Research

ISBN 7-119-01341-6

© Foreign Languages Press, Beijing, China, 1996

Published by Foreign Languages Press
24 Baiwanzhuang Road, Beijing 100037, China

Distributed by China International Book Trading Corporation
35 Chegongzhuang Xilu, Beijing 100044, China
P.O. Box 399, Beijing, China

Printed in the People's Republic of China

图书在版编目(CIP)数据

中国金融体制改革:英文/高尚全,迟福林主编;朱华友执笔.

—北京:外文出版社,1996

(中国市场经济研讨/外文出版社主编)

ISBN 7-119-01341-6

I.中… II.①高… ②迟… ③朱… III.金融体制-经济体制改革
—中国-英文 IV.F832.1

中国版本图书馆 CIP 数据核字 (95) 第 09629 号

中国金融体制改革

高尚全 迟福林 主编

朱华友 执笔

*

©外文出版社

外文出版社出版

(中国北京百万庄路 24 号)

邮政编码 100037

北京外文印刷厂印刷

中国国际图书贸易总公司发行

(中国北京车公庄西路 35 号)

北京邮政信箱第 399 号 邮政编码 100044

1996 年(大 32 开)第一版

(英)

ISBN 7-119-01341-6 / F·35(外)

02100

4-E-2937P

Preface

Since the goals of socialist market economy were defined at 14th National Congress of the Communist Party of China in 1992, China has accelerated its reform of economic system and entered a stage of overall deepening of the reform. As a major component of reforming the economic system, reform in financial system has become of key importance, significant in the overall reform of the economic system.

The Academy of China (Hainan) Reform and Development has, in recent years, paid great attention to the study of reforming the financial system, forming special groups to study related subjects and put forward their findings and suggestions.

At the end of 1991, the State Commission for Restructuring the Economy, the People's Bank of China, the World Bank and the UN Development Program jointly convened an international seminar on China's financial reform at the Academy of China (Hainan) Reform and Development. More than 60 senior economic management expert officials and financial experts from China's mainland, Taiwan region, the Republic of South Korea, Japan, Malaysia, Thailand, Britain, the World Bank, the International Monetary Fund and the UN Development Program made a profound study on the subject of how to deepen the reform of China's financial system.

This book collects together these study reports prepared by the Academy of China (Hainan) Reform and Development and the important study results achieved at the international seminar, and incorporates the results of financial studies made by Chinese experts in recent years. Sincere thanks go to both Chinese and foreign experts.

The book explores in depth the contradictions and outstanding questions arising through the reform of financial system and

operation of financial mechanism, and puts forward some specific opinions and programs. It explores and fully discusses many questions, and presents the various ideas, viewpoints and suggestions on these questions held by Chinese and foreign experts to the reader, who can gain greater understanding through comparison and judgment.

Contents

Chapter I

Seize Opportunity and Boldly Promote Financial Reform	1
1. Review and Appraisal of China's Financial Reform	2
2. Sharp Contradictions Between Lagging Financial Reform and Market Economy	7
3. Comparison and Analysis of Programs of Financial System Reform in the 1990s	10
4. Main Aspects of China's Financial Reform	15

Chapter II

Prerequisites for Financial Reform	31
1. Macroeconomic Policy and Financial Development	32
2. Mobilization of Funds	47
3. Effective Allocation of Resources	51
4. Industrial Renovation	57

Chapter III

The Central Bank	61
1. Current Situation of the Central Bank	61
2. On the Relative Independence of the Central Bank	73
3. Some Relationships to Be Properly Handled by the Central Bank	78
4. The Directional Loan	80

Chapter IV

Capital Market	83
1. An Overview of China's Capital Market	83
2. Major Questions in the Development of China's Capital Market	85
3. Steps for the Reform of the Capital Market	94

4. How to Manage and Develop Non-bank Financial Institutions	96
5. China's Urgent Need: Building a Modernized Banking System	98

Chapter V

Monetary Policy	101
1. China's Monetary Policy: Current Situation and Questions	102
2. The Central Bank and Monetary Policy	126
3. The Shift of Monetary Policy to Market Economy	136

Chapter VI

Going to Convertible Currency	146
1. Background of Theory and Positivism	146
2. Requirements of Opening-up Policy for Convertibility of Currency	150
3. Background of China's Reform of Exchange Rate System	153
4. Premises of RMB Becoming a Freely Convertible Currency	158
5. The Supporting Reform and Design of RMB Going to Convertible Currency	160
6. The Influence of Conducting Currency Convertibility	165

Chapter I

Seize Opportunity and Boldly Promote Financial Reform

The 14th National Congress of the Communist Party of China in 1992 clearly stated the goal of China's economic system reform—the establishment of socialist market economic system. This goal is essentially the method of developing a commodity economy by allocating social resources on the basis of market mechanisms and the transformation process of replacing the method of allocating social resources mainly based on the planned economy which is characterized by administrative orders. As the financial mechanism is an organic component of market mechanisms, its structural changes and functional evolution form a major link in this transformation process.

The allocation of resources by market is, first of all, the allocation of monetary capital and the results of financing directly affect the efficiency of resources allocation. Socialist market economy needs a sound and rational financial system; otherwise, the market-based allocation of resources becomes meaningless. To meet the needs of developing a socialist market economy, therefore, it is imperative to accelerate China's financial system reform and establish the financial system that conforms with the operation of a market economy. Guided by Comrade Deng Xiaoping's talks during his inspection tour in the south and the CPC 14th National Congress, China's reform, opening to the outside world and modernization drive have entered a new stage of vigorous development since 1992. The whole nation witnessed an unprecedented high tide of construction and a number of places achieved high-speed or even very high-speed development; the general situation is good. To promote this excellent situation, financial

situation is good. To promote this excellent situation, financial organizations contributed much beneficial work. The main problems at the present time are: the rapid increase of national investment in fixed assets, the rather large amount of money in circulation, the price rises of some means of production by broad margins, and the growing pressure exerted by inflation. There are many causes contributing to this situation, and it is also closely related to finance. The question of general concern is, while promoting economic development, how to strengthen state macro-economic control and establish the new order of a socialist market economy.

The present economic regulation and control by the state mainly encompass the fields of the loan amounts, or the scale of capital construction, interest rates, tax rates, public finance, the volume of foreign debts and foreign exchange rates. Among them, methods of finance become the most important control lever. Deepening reform of financial system is the key to keeping on the present track of steady development in the national economy, preventing the possibility of over-heated economic growth, fulfilling the goal put forward by Comrade Deng Xiaoping of attaining a new step forward every several years.

The State Council recently clarified the goals of reform of the financial system: to establish a financial organization system which separates policy finance from commercial finance, lets state commercial banks for the main body and allows the existence of different kinds of financial institutions; to establish the financial market system of unified opening to the outside world, orderly competition and strict control. Therefore, we should seize the opportunity and boldly promote reform of the financial system.

1. Review and Appraisal of China's Financial Reform

During the financial reform in the past decade or so, China's financial system and its operating mechanism witnessed some fundamental changes. Among them, the multiplying forms of

financial institutions, the innovation of financial tools and the growth of financial market in particular have transformed more savings into investment and provided many enterprises with external financing. This helped realize a large number of investment and profit-making opportunities and promoted economic growth and income rises. It is indisputable that Chinese financial institutions have experienced remarkable changes. As far as the function of the financial system in promoting the allocation of social resources is concerned, China's financial reform has just begun. Reform in the 1990s is as essential as it is more complex and more difficult.

Different kinds of financial institutions have come into being along with the establishment of the central bank. The People's Bank of China exclusively assumed the functions of the central bank in 1984, thereby marking the start of diversification in Chinese financial institutions. Toward the end of 1991, Chinese financial institutions included the central bank, the five state banks (Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, People's Construction Bank of China, and Bank of Communications) and their branches in different places, four regional commercial banks, 377 financial trust and investment companies, 66 securities companies, 19 finance companies, nine financial leasing companies, 58,200 rural credit cooperatives and 3,421 urban credit cooperatives. During this period China generally moved from the old system of unified bank organizations to the existence of diversified financial institutions.

Initial establishment of the financial market has led to a regional inter-bank borrowing market in China, and the amount of inter-bank loans in the nation had reached 200 billion yuan by 1991. But the money market is not very normal. First, the borrowing is over a long period. The financial institutions do not borrow for regulating the money on hand or for making up their legal reserves, instead they borrow for issuing loans. This gives rise to the following phenomena; on one hand, the excessive savings of the specialized banks in the central bank amounted to 12.6 percent of the total deposits, and on the other, inter-bank

borrowing climbed to 100 billion yuan. Second, a unified national market has not taken shape. The regional differences in annual interest rates for the same period may be as large as one percentage point. Third, the benchmark interest rate of the central bank has no power to regulate the borrowing market.

A breakthrough in the past reform is the formation of the Chinese capital market, especially the formation of the securities market. By the end of 1991, the value of securities issued in China totaled 377 billion yuan and their transactions on the market reached 65 billion yuan. The Shanghai and Shenzhen Securities Exchanges started business one after another and the trial stock market made tremendous progress. By the end of June 1992, 40 stocks with a market value of over 60 billion yuan were listed on the two securities exchanges and more than one million people directly invested in stocks. However, the development of Chinese securities market is artificially limited to a considerable extent and has many problems to be solved. The major problems are: the insufficient varieties and small amount of securities and their irrational structure cannot meet public demand; the small and scattered agencies dealing with securities offer inadequate business services; the unsound system of redeeming bonds and guaranteeing their issues affect the credit of bonds; the system of rating bonds has not been established; the interest rates of different bonds are somewhat irrational, all being basically close to the upper limit of state stipulated interest rates, and it is difficult to differentiate the risks involved because the interest rates do not conform to the credit standing of the bond-issuing organizations; the methods of quoting, transaction, delivery and clearance of securities exchange are relatively backward, information is not up-to-date and the unified national market has not been established; the development of the primary market and secondary market is not coordinated and the latter's development falls behind; the management system of the securities market is still imperfect and the laws and regulations governing securities market are inadequate.

Slowness and shortcomings of reform progress have been evidenced in previous financial reform in China, which was a

gradual process starting from the above in a planned way and therefore had always been under government control. Clearly, its progress was slow and inadequate and leant toward the old system. The reasons were the restrictions imposed by the political system and ideologies—especially the worry of whether the reform was capitalist or socialist, the over-emphasis of Chinese characteristics and the negation of successful and advanced Western experiences and international practices; there appeared disputes and reversals in reforming the securities market. Restricted by the lack of deep reform in enterprise, such as the lack of clearly defined property rights of enterprises and an unsound system of internal checking and balancing, the claims and obligations of credit loans could not be fully guaranteed and the bank could proceed with other aspects of its business reforms. Influenced by the guiding idea of macro-policies and restricted by the systems of planning, pricing, investment and public finance, some measures of financial reform could not be put into effect. However, for the purpose of promoting the next step of financial reform, it is beneficial to point out the insufficient efforts in the previous reform.

First, deviation from the guiding idea of the central bank. With the general background of reform toward using the market, an important task of the central bank lies in perfecting the financial market mechanism and the bank should not freely enlarge its power and scope of intervening in the activities of social credit on the pretext of the underdeveloped market. In the 1988-1990 period, the central bank laid enormous stress upon the control of social financial activities by the credit plan, thus preventing to a certain extent the growth of financial market mechanism, especially weakening the main role of specialized banks and other financial institutions in the market. This caused the deviation of social credit from the law of value and produced such strange and distorted credit as issuing loans to lesser institutions with conditions attached, appointed loans and special purpose loans.

Second, China's various kinds of financial institutions have not rid themselves of the status of being completely attached to

the government. A major factor is the appointment of officials under the present personnel system. Thus, the administrative intervention of banks and other financial institutions by the government at different levels, the department in charge and the central bank is justified because of their official positions. This affects the macro-efficiency of capital. Under such a system, the officials play the leading role and "political risks" always exist in the credit activities. To avoid "political risks," the leaders of some financial institutions prefer the increase of economic risks instead.

Third, the financial monopoly has been further reinforced instead of being broken. Therefore, the environment of normal competition has never been created and the efficiency of the financial industry fell.

Fourth, the very insufficient deepening of the financial market, regional blockades, the lack of financial tools and the sluggish development of the securities market caused the financial market to lag behind the commodity market. This affects to a certain extent the future growth of the Chinese commodity economy.

Fifth, the interest rate reform based on market economy remained untouched on the whole. On the contrary, the planned control of interest rate was strengthened tremendously. In the previous stage of reform, the interest rate's function of being the price of capital and allocating resources was suppressed to a certain extent and not demonstrated.

Sixth, the independence of the central bank in monetary policy was not established, a result influenced by the political system.

Seventh, the system of using notes in credit clearance was suspended mid-way through. Intervened by the chain debts in 1989, reform of clearance that had been decided was mistakenly abolished. The method of entrusting the bank to make collections which embodied the planned commodity economy was forcibly restored. A later reform has to be carried out again.

Eighth, the prolonged use of some short-term emergency measures meant the restoration of the old system. For example,

the continued adoption of the Regulations on Cash Management retards the normal progress of commodity transactions. In the management of wage funds, the bank depends on the basic wage fund approved by the labour department to issue cash wages to enterprises and this method is still in force. The control of the amount of loans issued by the urban and rural credit cooperatives seems to remain in place for a long time. All such measures should be abolished in the next stage of reform.

Ninth, the financial supervision has always been exercised mainly by administrative orders and documents issued by the central bank and is not restrained by law. The supervision has not been gradually placed on the legal track. This forms a big hindrance to Chinese financial reform in the 1990s.

Tenth, the reform in the insurance industry has always been a weak link, and it was neglected in the previous reform. Contradictions are outstanding, but their solution takes time.

2. Sharp Contradictions Between Lagging Financial Reform and Market Economy

Judged by financial reform as a whole and the historical process of reform, the Chinese financial industry is still in the infant stage in terms. Many deeply hidden contradictions in the reform are gradually being exposed. The fact that the financial system reform falls behind the economic system reform means it cannot meet the needs for the development of market economy. The following are the outstanding contradictions which call for earnest study and swift solutions.

(1) Replacing reform with improvements does not touch the central issues.

As some experts have pointed out, although the people's bank began assuming the functions of the central bank in 1984, it has never enjoyed the legal guarantee of independently making and implementing a monetary policy. At the same time, it also performs some functions of specialized banks, issuing the special-purpose loans and retaining a portion of its profits. The Chinese central bank is a strange institution compared with the central

banks in developed countries. The reform of specialized banks has different interpretations in recent years—to let them become enterprises, to emphasize their role as policy banks or to introduce enterprise management. These puzzle the public. Talk of turning them into enterprises has lasted for years. Up to now, none of the banks has become a real enterprise. Actually they follow the system of “eating from the same big bowl” and the reform does not touch the central issues.

(2) Weak macro-control and the increasing pressure from inflation.

Some experts hold that China has used finance as an effective method of economic control in recent years, particularly in the three years of rectification and consolidation. The state adopted a policy of austerity, limiting the scale of loans and controlling the amount of credit by strict planned targets. These measures produced some beneficial effects. Owing to the plan based on the actual figure of the previous year, however, every place tried various means to add supplementary requirements or to surpass the limits in the current year so as to raise its target in the next year. At the same time, the vertical distribution of the credit scale and the horizontal allocation of credit capital are often disconnected; the enlarged scale needs more capital while the enlarged capital needs a bigger scale. The plan decided at the start of the year is often changed in the middle of the year and surpassed at the end of the year. The central bank has to make passive readjustments. These contradictions become sharper with the accelerated development of the national economy. In such places where the targets are insufficient, they manage to produce hidden targets beyond the plan. From the reports every place basically has controlled the scale of loans within the plan. The truth is distorted by false reports, altered items and all tricks possible. In such circumstances the central bank, that is, the people's bank, clearly has insufficient power for macro-control and very limited economic means and administrative measures.

(3) Lack of smooth capital flow and seriously lowered quality of credit assets.

The amount of credit in China totals RMB 2,000 billion

yuan. The continuous flow of such a huge amount in economy should produce remarkable results. However, according to the estimates of authoritative departments, 70 percent of the bank's credit is used for the lowest requirements of enterprise working capital, 15 percent is actually bad debt and only 15 percent may be used by the bank. In some places one-third of the credit become stagnant and one-third is lost to bad debt. In the worst places these loans cannot be repaid. This situation seriously weakens the real function of credit capital and enormously reduces the efficiency and earnings of capital flow. As more than one half of China's credit capital comes from savings deposits, its operating risks increase further. The low quality of credit assets and their large amount, slow turnover and low earnings become so serious that changes have to be introduced.

(4) Confused financial order and seriously disordered competition.

Owing to the lack of financial laws and regulations, the mechanism of self-control and unified strong leadership in recent years, confused financial disorder is fairly striking. Despite repeated prohibitions, there exist the following phenomena: the free raising of interest rates on deposits, setting up financial institutions without approval, exceeding the scale of loans, making changes for convenience, contracting false entrustments and making false inter-bank borrowing. In order to increase their strength and obtain capital, clients or areas of operation, the specialized banks blindly compete among themselves. Some set hindrances against others, delay the delivery of bills and even apply pressure on the enterprises which need to open accounts. Some relax their management and supervision. The original relations between banks and enterprises have become distorted. These not only influence the prestige of banks but also adversely affect the entire financial function and the normal operation of enterprises.

(5) "Caged finance" replaces autonomous finance and deprives finance of its subjective initiative and creativeness.

Some experts are of the opinion that China imposes many restraints on finance—restraints on the scale of credit, on operations, on interest rates and on competition. The long-established