IMES DISCUSSION PAPER SERIES

The Challenges Confronting the Banking System Reform in China: An Analysis in Light of Japan's Experience of Financial Liberalization

Kumiko Okazaki, Masazumi Hattori, and Wataru Takahashi

Discussion Paper No. 2011-E-6

IMES

INSTITUTE FOR MONETARY AND ECONOMIC STUDIES

BANK OF JAPAN

2-1-1 NIHONBASHI-HONGOKUCHO
CHUO-KU, TOKYO 103-8660
JAPAN

IMES Discussion Paper Series 2011-E-6
March 2011

The Challenges Confronting the Banking System Reform in China: An Analysis in Light of Japan's Experience of Financial Liberalization

Kumiko Okazaki*, Masazumi Hattori, and Wataru Takahashi*****

Abstract

China's banking system reform has made notable progress since 2002. After restoring their balance sheets, Chinese banks have aggressively increased lending and contributed to supporting the country's economy given the global financial crisis. Thus far, the regulated deposit and lending interest rates, undeveloped capital markets, and restrictions in cross-border capital transactions have given banks an advantage in gaining profits. However, along with the full-blown reform of the economic system toward a market-oriented economy, the conditions protecting banks' profits will change in the future. The experiences of Japanese banks under the financial liberalization that occurred during the 1970s and 1980s indicate how important it is for commercial banks to change their business models in accordance with the fundamental changes in the economy. These experiences may be useful for considering the subsequent reform process of the financial system in China.

Keywords: Banking System Reform; Financial Liberalization; State-owned Commercial Banks; Rent for Banks
JEL classification: G21, O16, O53, P34

*Director and Senior Economist, Institute for Monetary and Economic Studies, Bank of Japan (E-mail: kumiko.okazaki@boj.or.jp)
** Director and Senior Economist, Institute for Monetary and Economic Studies, Bank of Japan (E-mail: masazumi.hattori@boj.or.jp)
***Director-General, Institute for Monetary and Economic Studies, Bank of Japan (E-mail: wataru.takahashi@boj.or.jp)

This paper is a revised version of the draft that was presented at the Symposium on the World Economy and China in the Post Crisis Era, hosted by the China Society of World Economics, at Xiamen University on October 30, 2010. We extend our heartfelt gratitude to Yu Yongding, Ba Shusong, Guo Pei, He Guangwen, Wei Jianing, Wu Qing and several Chinese scholars participating in the symposium and individual meetings in Xiamen and Beijing for their valuable comments and discussions. We are also very grateful to William Overholt and the research staff of the Bank of Japan for their constructive reviews of earlier drafts. Views expressed in this paper are those of the authors and do not necessarily reflect the official views of the Bank of Japan.

Contents

Abbreviations

ABC	Agricultural Bank of China
AMC	asset management company
BOC	Bank of China
BOCOM	Bank of Communications
BOJ	Bank of Japan
CAR	capital adequacy ratio
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
CIRC	China Insurance Regulatory Commission
CPC	Communist Party of China
CSRC	China Security Regulatory Commission
ICBC	Industrial and Commercial Bank of China
IPO	initial public offering
JGB	Japanese government bond
JSCB	joint-stock commercial bank
LIC	local investment company
NPL	nonperforming loan
PBC	People's Bank of China
RCC	rural credit cooperative
RMB	Renminbi
SAFE	State Administrate Foreign Exchange
SASAC	State-owned Assets Supervision and Administration Commission of the State Council
SME	small- and medium-sized enterprises
SOCB	state-owned commercial bank
SOE	state-owned enterprise
WTO	World Trade Organization

1. Introduction

In China, the banking system plays a dominant role in national fund allocation. It handles approximately 70 percent of the external funding for domestic non-financial sectors. Owing to the delayed reform of the financial system, most of the Chinese banks had poor balance sheets in the 1990s. The Asian financial crisis and China's accession to the World Trade Organization (WTO) emphasized the importance of the stability of the financial system. Pursuing the national target of establishing a well-balanced society also required well-balanced fund allocation. Therefore, the Communist Party of China (CPC), the central government, and the banking institutions have accelerated reforms since 2002.

The reform of large commercial banks has shown considerable progress. The five largest commercial banks are now listed at the Stock Exchange of Hong Kong and the Shanghai Stock Exchange. These banks have demonstrated significantly better operational performance than before. Other nationwide joint-stock commercial banks (JSCBs) also promoted organizational reform and are actively expanding their businesses. The restructuring of the local city commercial banks and rural financial institutions has been gathering pace. Further, the relatively stable financial system enabled China to limit the shock of the recent global financial crisis from spreading and to realize strong economic recovery.

However, thus far, the Chinese banking system has not been functioning as an efficient financial intermediary. The loan concentration in the state-owned sectors continues to be significant, and most small- and medium-sized enterprises (SMEs) and individuals continue to rely largely on self-funding and informal finance. Although the regulated interest rates have protected the profits of banks and the state-owned sectors, the government’s artificial control of bank lending rather than the wide use of market tools is increasingly becoming difficult under the diversified and globalized economy.

Considering the challenges of the Chinese banking system, it would be useful to review Japan's experiences under the financial liberalization that occurred during the 1970s and 1980s. In the 1970s, several crucial changes occurred in the Japanese economy. However, the banks, by and large, could not adjust their operational style smoothly to cope with the new economic environment. The banks' mismanagement in terms of making adjustments to their operational style was one of the critical factors that caused the economic bubble in the late 1980s. Moreover, it should be acknowledged that the delayed reform of the regulatory and legal systems surrounding commercial banks was also responsible for distorting banks' incentive to change their business models.

This paper briefly reviews the history of the Chinese banking system reform and especially examines the results of the intensive reform process since 2002. For a further discussion of the challenges that the Chinese financial system may face in the future, this paper also analyzes the behavior of the Japanese banks under the financial liberalization that occurred during the 1970s and 1980s.

2. Outline of the Banking System Reform in China

(1) Gradual Implementation of the Reform

The banking institutions in China currently provide over 70 percent of the external funding sources of domestic non-financial sectors through the financial markets (Table 1)[1]. The deposit accumulated in the banking system amounted to over 180 percent to the country's GDP at the end of 2010. There are more than ten types of financial institutions including policy banks, commercial banks, small- and medium-sized rural financial institutions, a postal savings bank, and several kinds of non-bank financial institutions (Table 2). This is a significant change from the situation in the late 1970s when there was virtually one bank, the People's Bank of China (PBC), which handled small amounts of deposit (approximately 30 percent to the GDP), and basically worked as an accountant and cashier of the state sectors rather than a bank.

Table 1: Proportion of Non-financial Sectors' External Funding Sources in China

(%)

	2007	2008	2009	2010
Bank Loans	78.7	82.4	81.2	75.2
Equities	13.1	5.8	3.0	5.5
Government Securities	3.6	1.7	6.3	8.8
Enterprise Bonds	4.6	10.1	9.5	10.5

Note: The non-financial sectors include the household, corporate, and public sectors.
Sources: PBC China Monetary Policy Report, Quarter Four, 2008, 2009 and 2010

[1] When foreign direct investments are included, the proportion changes in the following manner: bank lending 70 percent, equity issuance 6 percent, government bond issuance 9 percent, corporate bond issuance 5 percent, foreign direct investment 15 percent, and others -5 percent in 2008 (based on the flow of funds statistics).

Table 2: Banking Institutions in China (as of the end of 2009)

	Number of institutions	Market share by assets (%)
Policy Banks & China Development Bank	3	8.8
Policy Banks	(2)	--
China Development Bank	(1)	--
Commercial Banks	238	77.1
Major Commercial Banks	(17)	(65.9)
Large Commercial Banks	(5)	(50.9)
Joint-stock Commercial Banks	(12)	(15.0)
City Commercial Banks	(143)	(7.2)
Rural Commercial Banks	(43)	(2.4)
Foreign Banks (locally incorporated)	(35)	(1.7)
Urban Credit Cooperatives	11	0.0
Rural Cooperative Financial Institutions	3,295	11.0
Rural Credit Cooperatives	(3,056)	(7.0)
Rural Cooperative Banks	(196)	(1.6)
Rural Commercial Banks (duplicated)	(43)	(2.4)
Postal Savings Bank of China	1	3.4
New-type Rural Financial Institutions	172	--
Village or Township Banks	(148)	--
Lending Companies	(8)	--
Rural Mutual Cooperatives	(16)	--
Non-bank Financial Institutions	180	2.0
Banking Asset Management Companies	(4)	--
Trust Companies	(58)	--
Finance Companies of Enterprise Groups	(91)	--
Foreign Finance Companies (locally incorporated)	(2)	
Financial Leasing Companies	(12)	--
Money Brokerage Firms	(3)	--
Auto Financing Companies	(10)	--

Note: The total number of registered banking institutions is 3,857. They possess approximately 193,000 outlets and 2,845 thousand employees.

Source: China Banking Regulatory Commission (CBRC) Annual Report 2009

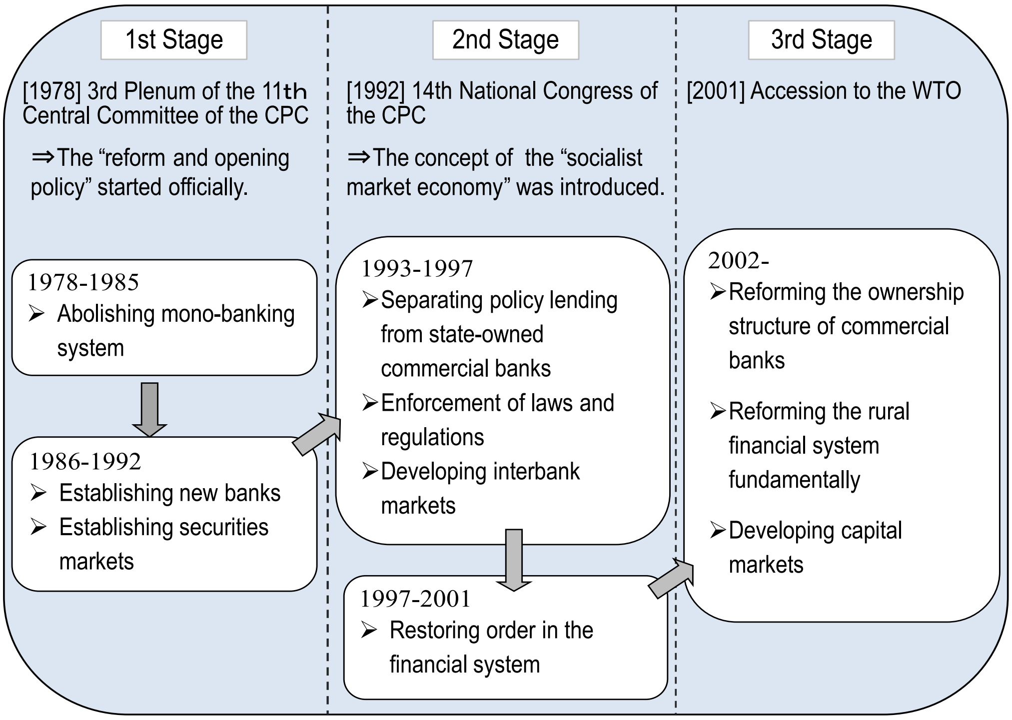
The Chinese economic system reform has been implemented gradually. It did not initially have a clearly defined goal, and the reform objectives have been readjusted cautiously and pragmatically to create a "socialist market economy" from the original objective of creating a "planned economy supplemented with some market elements" (Table 3). As an important part of the reform, the banking system reform also took gradual steps. Nonetheless, the banking institutions were required to carry out several drastic reforms in order to provide enough funds for economic development and social stability of the country (Figure 1).

Table 3: Objectives of the Economic System Reform in China

Time	Key characterizations of reform objectives
1978– Oct. 1984	Planned economy supplemented with some market elements
Oct. 1984– Oct. 1987	Planned commodity economy
Oct. 1987 – June 1989	The state controls the market, and the market guides enterprises
June 1989 – 1991	Organic integration of planned economy and market regulations
1992	Share-holding system and security market can function under socialism
Oct. 1992	Socialist market economy
1994	Corporatization of state-owned enterprises (SOEs) and reform of property rights
1997	Developing the state sector together with all kinds of ownership Grasping the large SOEs while letting small ones go to the market
July 2001	Three representative functions of the Communist Party; permission for owners of private and individual enterprises to be Communist Party members; further development of various ownership forms

Sources: Fan [2002 and 2003]

Figure 1: Outline of the Banking System Reform in China



Sources: Shang [2000], Dai [2001], and Wu [2005]

(2) Reform for Diversifying Banking Institutions (1978–2001)

Abolishment of the Mono-banking System

When China started the "reform and opening policy" in 1978, the CPC and the central government of China decided to abolish the soviet style mono-banking system. Four banks were reestablished or separated from the PBC, and the PBC was clearly defined as the central bank (but a part of the government) in 1984. Since the four banks were initially assigned a special function, they were termed state-owned specialized banks (Table 4).

Table 4: Core Assignments of State-owned Specialized Banks in early1980s

Name	Year of reestablishment/ separation	Assigned Functions
Agricultural Bank of China (ABC)	1979	To manage funds for supporting rural and agriculture sectors. To direct rural credit cooperatives.
Bank of China (BOC)	1979	To finance foreign trade and investment.
China Construction Bank (CCB)	1979	To manage funds for capital construction investment.
Industrial and Commercial Bank of China (ICBC)	1984	To finance business activities of the state-owned enterprises. To collect savings in the urban area.

Note: The China Construction Bank had been named the People's Construction Bank of China until March 1996.
Source: Shang [2000]

In the mid-1980s, the government ordered the state-owned enterprises (SOEs) to shift their funding sources from the direct grants by the central or local governments to interest-bearing bank loans, and the role of the Chinese banks was transformed from that of a government grant distributor to that of a creditor. Simultaneously, the government relaxed the restrictions on the business-areas of the state-owned specialized banks, and permitted the establishment of several new banks in order to ensure that newly developing business sectors and local construction projects could receive financial services more readily.

Reform toward Establishing the "Socialist Market Economy"

The 14th National Congress of the CPC in October 1992 formally approved the concept of the "socialist market economy." Subsequently, the banking system reform set a focus on developing commercial business widely. The government established three policy banks in 1994 (the State Development Bank[2], the Export-Import Bank of China, and the Agricultural

[2] The English name of the bank was subsequently changed to the China Development Bank.

Development Bank of China) in order to separate policy lending from commercial lending. The four state-owned specialized banks were changed to be termed state-owned commercial banks (SOCBs) and were encouraged to develop their commercial business. The Law of the People's Republic of China on Commercial Banks was promulgated in 1995. It aimed to enhance the independence of the commercial banks from the intervention by the government.

However, the Law also required commercial banks to conduct business in accordance with the national industrial policies. In the 1990s, among many economic policy targets, the SOEs' revitalization was given priority in order to secure sufficient employment for social stability. More problematically, the local governments of China were often reported to be neglecting the spirit of the law, and compelled the local branches of the SOCBs to provide as much lending as they required.

From 1992 to 1994, China experienced severe overheating of the economy owing to aggressive investment over the country. The central government had introduced rather strong tightening policies since the middle of 1993, a part of which resulted in suspension of many local construction projects and bankruptcy of enterprises. Under the process, the Chinese banks accumulated large volumes of NPLs. It was widely regarded that most of the NPLs of the SOCBs at that time were a result of the old economic system and political interventions[3].

Trials for SOCBs' Rehabilitation in the late 1990s

When the Asian financial crisis occurred in 1997, the leaders of the CPC and the central government recognized the importance of financial stability. In November 1997, they held the First National Financial Work Conference in order to discuss the policies for restoring order in the financial system in China. Following the conference, a series of policy arrangements were intensively implemented, especially for the purpose of rehabilitating the SOCBs which provided over 70 percent of the total bank loans in the country. The

[3] The PBC Governor Zhou Xiaochuan explained the causes of the SOCBs' NPLs in the following manner: 30 percent of the NPLs were a result of government's economic plans or administrative intervention, another 30 percent were the political requirements for SOCBs to support SOEs, 10 percent were attributed to the SOEs' restructuring processes, 10 percent were the local governments' interventions, and 20 percent were a result of the inner management problems of the SOCBs themselves (Wu [2010]).

abolishment of the credit plan[4], capital injection by the government, change of the loan classification system, and transfer of the NPLs to newly established asset management companies (AMCs) were the new concepts that aimed at recovering the SOCBs' functions[5].

Despite the effort, the balance sheets of the SOCBs remained poor with inadequate capital and significant amounts of NPLs (Table 5). Later, the Chinese government reviewed the situation and found that the government actions in 1998 had been focused on reducing the financial difficulties of banks rather than on solving inherent structural problems, and it had become evident that the banks' financial distress was more serious than had been recognized (Liu [2004]).

Table 5: NPL Ratios and Capital Adequacy Ratios of the SOCBs (1997-2002)

	ICBC	ABC	BOC	CCB
NPL Ratios (%)				
1997	The average of four banks: more than 25%			
2002	25.69	36.63	23.37	16.97
Capital Adequacy Ratios (%)				
1997	4.05	2.93	3.91	3.54
1998	10.40	8.13	11.74	9.31
1999	4.57	1.44	8.50	3.79
2000	5.38	n.a.	9.80	6.51
2001	5.76	1.44	8.30	6.88
2002	5.54	n.a.	8.15	6.91

Sources：CBRC, Cao [2006], and banks' annual reports

Delayed Reform in Rural Financial System

In the late 1990s, the financial system in China's rural area also encountered serious problem. The SOCBs withdrew from the rural area in accordance with the government's guidance for restructuring their branch networks (in order to improve their profitability). The rural credit cooperatives (RCCs) and policy banks were expected to close the gap that

4 The credit plan had been a main measure for the central government (including the PBC) to control fund allocation in China. The State Planning Commission, working with the PBC, imposed an annual credit plan on financial institutions. The national credit plan was broken down into lending quotas for provinces. Simultaneously, the PBC allocated an annual credit quota to each major bank, and it divided the quota into lending quotas for the provincial-level branches. The PBC monitored the usage of the quota (Lardy [1998]).

5 See Okazaki [2007] in detail.

the SOCBs' withdrawal had created. However, they could hardly expand lending. The lack of funding sources and deteriorated balance sheets prevented them from extending loans to new customers. As a result, individuals and enterprises in rural areas had to largely depend on informal finance[6].

In the rural area, it was becoming evident that the postal savings system was not efficient in the allocation of funds across the country. When the Chinese government resumed the postal savings system in 1986[7], the system design was mainly focused on absorbing the retail savings of individuals. All the savings that the system collected were required to be deposited into the PBC's account, and the PBC reallocated the fund, mainly by lending funds to policy banks and RCCs. However, during the late 1990s, the differences in the interest rates of the postal savings system distorted the efficiency of fund allocation, especially in the rural area[8].

(3) Reform after the Accession to the WTO

After China joined the WTO in December 2001, the CPC and the State Council held the Second National Financial Work Conference in February 2002 in order to discuss how to make China's financial system more stable, efficient, and competitive under the intense pressure of further opening the country's economy. The conference paid special attention to several serious issues in the financial sector including the incomplete supervisory system, unsustainable and loose management mechanisms of financial institutions, weak mechanisms for protecting the legal rights and interests of financial institutions, lack of staff with specialized financial knowledge and skills, lack of business innovation by financial

[6] The informal finance generally means unauthorized financing activities, conducted through family and friends, local money houses, or other types of financial associations. There are different versions of the definition of the informal finance in China, and its meaning is partly overlapped with "underground finance" and "illegal finance" (Li [2009]). Jiang [2009] mentions that the PBC estimated the scale of the informal finance in China at around RMB 950 in 2003, accounting for about 7 percent of GDP and 6 percent of total bank loans.

[7] The Chinese government abolished the postal savings system in 1950.

[8] At the end of 1999, although the PBC's deposit rate on postal savings was 4.6008 percent, the PBC's lending rate to financial institutions was 3.78 percent. This implies that the PBC made a loss when it accepted the postal savings system's deposits and lent them to policy banks and RCCs. At the same time, the interest rate on one year term residential deposit of financial institutions including the postal savings system was 2.25 percent. From this, the postal savings system could earn an increased interest of 2.3508 percent per year without any credit risk. Such a situation distorted the fair competition in collecting deposits between the postal savings system and RCCs.

institutions, and disorder in parts of the financial market (People's Daily [2002]). After the conference, several structural reforms were implemented.

Regulatory Framework

The China Banking Regulatory Commission (CBRC), a new regulatory organization officially began its operation in April 2003. The CBRC was created in order to meet the requirement for a specialized regulatory organization for an increasingly complex banking system that was to be completely opened to foreign financial institutions by the end of 2006. Currently, the regulatory and supervisory functions of the financial sector are assigned to the CBRC, China Securities Regulatory Commission (CSRC), and China Insurance Regulatory Commission (CIRC)[9]. The PBC is also responsible for preventing and mitigating systemic financial risks in order to maintain financial stability. The PBC and three regulatory commissions as well as the State Administration of Foreign Exchange (SAFE) have regular meetings for ensuring effective policy coordination (PBC [2010]).

State-owned Commercial Banks

With respect to the banking system reform, the conference focused on the rehabilitation of the SOCBs again. The government finally acknowledged that the unclear ownership system[10], vulnerability to political pressures, and lack of disclosure had made most of the banks and their interested parties reluctant to reform the old business customs. It proposed to convert the SOCBs into joint-stock commercial banks, which would be listed once conditions had improved. In order to promote this reform, a cross-ministries project team, the Central Leading Group on Reforming SOCBs, was established[11]. The team planned to reform the four SOCBs and the Bank of Communications (BOCOM)[12].

---

[9] The PBC initially had supervisory authority in the banking as well as the security and insurance sectors. Along with the development of the financial industries, the CSRC was established in 1992, and the CIRC was established in 1998.

[10] In the 1990s, the meaning of the "state-owned" was ambiguous in China. It was not clearly defined who or which organization was vested with the ownership of the SOCBs, nor what kind of responsibilities that the owners had.

[11] The team was headed by Vice Premier Huang Ju, and managed by PBC Governor Zhou Xiaochuan.

[12] The BOCOM was previously defined as a non-listed JSCB; however at the third stage of the country's banking system reform, it was considered to be a type of SOCB because the Ministry of Finance had been a major shareholder (owning approximately 30 percent of the capital), and the bank had often been expected to provide loans in the same manner as SOCBs.

Owing to the differences in the conditions at these banks, the procedures for their transformations had different courses. However, the basic concept was common across all the banks; the final goal was to transform them into joint-stock commercial banks listed on stock exchanges through initial public offerings (IPOs) and improve their corporate governance and management efficiency. The government prepared the following four measures in order to support this restructuring: capital injection by the government fund, issuance of subordinated bonds (in order to supplement the capital) in the market, disposal of NPLs through AMCs, and introduction of foreign strategic investors (Table 6).

Table 6: Major Arrangements for the Structural Reform of SOCBs since 2002

	ICBC	ABC	BOC	CCB	BOCOM
Month and Year of Reorganization	Oct. 2005	Jan. 2009	Aug. 2004	Sept. 2004	June 2004
Capital Injection by Central Huijin Investment Ltd. (RMB billion)	124.0	130.0	186.4	186.2	3.0
Government's Share in Capital (at the end of Sept.2010)	70.7%	79.2%	67.5%	57.1%	26.5%
Foreign Strategic Investors' Share in Capital (at first)	8.5%	——	16.4%	14.1%	19.9%
(at the end of 2009)	5.3%	——	5.5%	16.6%	19.2%
Fund Raised by IPO (RMB billion)	173.2	162.3	110.0	132.7	43.2
Share Rights Issuance in 2010 (RMB billion)	44.9	——	59.7	61.2	32.7
Outstanding of Issued Subordinated Bonds (at the end of Sept.2010, RMB billion)	75.0	50.0	91.8	80.0	50.0
Capital Adequacy Ratio (at the end of 2009)	12.4%	10.1%	11.1%	11.7%	12.0%
Disposed NPLs Supported by Public Fund (RMB billion)	705.0	815.7	308.1	185.8	53.0
NPL Ratio (at the end of 2009)	1.5%	2.9%	1.5%	1.5%	1.4%
Total Assets (at the end of 2009, RMB trillion)	11.8	8.8	8.7	9.6	3.3
Pre-Tax Profit in 2009 (RMB billion) (Year on Year Change)	167.2 (15.1%)	73.9 (41.2%)	111.4 (27.8%)	138.7 (15.9%)	38.3 (6.5%)

Sources： Web site of each bank

Compared with the rescue arrangements for the SOCBs during the late 1990s, the restructuring scheme since 2002 was more comprehensive and transparent. It employed market-oriented mechanisms for disposing the NPLs and supplementing the banks' capital. The government introduced the auction system partially for inducing the SOCBs to sell NPLs to the AMCs. The subordinated bonds were issued in the inter-bank bond market[13]. The IPOs required a more extensive and comprehensive disclosure of the banks' operating conditions and government's supervisory guidance than before.

Joint-stock Commercial Banks and Policy Banks

A majority of the twelve JSCBs had been relatively market-oriented and free from the historical burden that originated in the planned economy. However, they were not completely free from political intervention (especially from local interest groups). In order to improve corporate governance, the joint stock commercial banks were also required to be publicly listed[14].

The reforms of the three policy banks were implemented under the principal of "differentiated guidance, and one policy package for one bank." It was decided that the China Development Bank would be a commercial bank and the Agricultural Development Bank of China and the Export-Import Bank of China would continue to be a policy bank. All of them received public capital injection in order to improve their balance sheets.

Rural Financial System

The reform in the rural financial sector has made certain progress since 2003. The Ministry of Finance and the PBC provided financial support for conducting the structural reforms of the RCCs. The CBRC, PBC, and the provincial governments cooperated with one another in order to manage the RCCs' ownership structure reforms and the disposal of NPLs. Before the reform, there were approximately 40 thousand RCCs in China, and the structure of their ownership and organization were too vague to ensure the efficient and transparent management. The government encouraged them to be merged in to three types of new

[13] Currently in China, the inter-bank bond market (*yinhangjian zhaiquan shichang* in Chinese) allows the authorized non-bank institutions such as security firms, insurance companies, and enterprises, as well as commercial banks to sell and purchase government bonds and corporate bonds.

[14] In the 1990s, only two banks, the Shenzhen Development Bank and the Shanghai Pudong Development Bank, were listed at the stock exchanges.

institutions (integrated provincial credit cooperatives, rural cooperative banks, and rural commercial banks) in order to improve their corporate governance and, thereby, to utilize limited fund resources. One of the critical points of the reorganization is what "cooperative" means: a majority of the owners of the RCCs must be individual farmers and not local enterprises established by local governments.

Considering the poor network and limited competition among financial services in rural areas, the CBRC relaxed its market-entry policy in December 2006 after the completion of the two-year pilot programs for establishing new types of rural financial institutions. These financial institutions, including village or township banks, lending companies, and rural mutual credit cooperatives, require smaller capital and fewer shareholders for their foundation. The government also had an intention to transform a part of informal financial institutions that had been functioning for the local economic development to the authorized retail financial institutions by relaxing the requirements for market-entry.

The reform of the postal savings system also entered a new stage. In July 2005, the State Council approved the overall reform plan of the postal system of China which included the postal savings system reform. Initially, the postal savings system only absorbed deposits and passed them to the PBC, without extending local lending, and eventually, it became a channel to transfer rural money into urban areas for the construction of cities. In order to use the rural residents' deposits for their own sake, the regulation was changed, and the Postal Savings Bank of China was officially established in March 2007. Today, the bank, which is the fifth largest bank in China in terms of the size of customers' deposits, extends retail loans to individuals and small enterprises both in urban and rural areas.

Accounting System

The accounting system was altered gradually in order to improve the transparency in the management and operation of banks. In January 2002, the Ministry of Finance implemented a new accounting procedure with the guideline "Accounting System for Financial Institutions," which intended to implement the international accounting standards. The global IPOs compelled major Chinese banks to follow the international standards, and most of the SOCBs and JSCBs completed the introduction of the standards by 2006.

(4) Improvement through the Reform since 2002

By the end of 2010, sixteen commercial banks (five large commercial banks[15], eight joint stock commercial banks, and three city banks) were listed at the Shanghai or Shenzhen Stock Exchange, among which eight banks are also listed at the Stock Exchange of Hong Kong. At the end of 2010, the ICBC and CCB ranked as the world's top two banks in terms of market capitalization, and the BOC and ABC held the sixth and eighth position respectively (Table 7). The share prices of these four Chinese banks may be distorted because over 60 percent of the shares are held by either the government or governmental organizations, and are not freely traded on stock exchanges. Nonetheless, this is a symbolic change at Chinese banks.

Table 7: World's Largest 10 Banks in Terms of Market Capitalization (at the end of 2010)

Rank	Name	Country	Market Cap (US$ billion)
1	ICBC	China	233.69
2	CCB	China	225.89
3	HSBC	UK	184.98
4	Wells Fargo	USA	164.84
5	JP Morgan Chase	USA	163.31
6	BOC	China	142.64
7	Citigroup Inc.	USA	140.30
8	ABC	China	135.26
9	Bank of America	USA	133.38
10	Itaú Unibanco	Brazil	94.45

Source: BanksDaily.com

At first glance, the large Chinese commercial banks can compete with the world's top-class banks in terms of the asset and capital sizes. The quality of their assets also improved. The following are the main favorable results of the banking system reform in China since 2002.

Size and Quality of Assets

Table 8 shows the rapid increase of the total assets of major Chinese commercial banks in 2009. At the end of 2004, only five Chinese banks were ranked among the world's 100 largest banks; however, in five years, this number increased to eleven, primarily owing to the increase in the amount of loans that were extended to domestic customers.

15 The CBRC changes the category name of the SOCBs to "large commercial banks," although the government maintains the status of the major share holders of these banks.

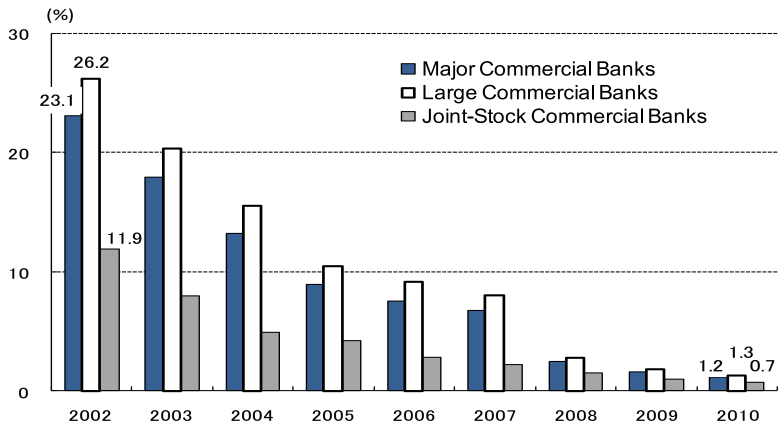
Table 8: Development of Total Assets of Domestic Banks in China (at the end of 2009)

World Ranking	Name	Total Assets (US$ billion)	Year on year Change (%)
11	ICBC	1,726	20.9
18	CCB	1,409	27.5
20	ABC	1,301	26.8
22	BOC	1,281	26.0
46	BOCOM	485	23.7
63	China Merchants Bank	303	31.7
72	China CITIC Bank	260	34.7
81	Shanghai Pudong Development Bank	238	24.0
89	China Minsheng Banking Corp.	209	35.4
93	Industrial Bank	195	30.6
100	China Everbright Bank	175	40.7

Source: *The Banker July 2010*, except that the data of the ABC is based on the bank's annual report, and the world rankings of the ABC and BOC are based on the authors' calculation.

The quality of the assets of Chinese banks has significantly improved owing to the government's support in the disposal of NPLs by the large commercial banks (Figure 2). The NPL ratio of the major commercial banks, which cover over 60 percent of the total assets of the Chinese banking sector, decreased to 1.2 percent at the end of 2010 from 23.1 percent at the end of 2002. The NPL ratio of rural cooperative institutions, which handle approximately 10 percent of the total loans, continued to be high (10.9 percent) even at the end of 2009; however, there was an improvement in this ratio. At the end of 2006, when the new loan classification system was implemented, this ratio was 27.9 percent.

Figure 2: NPL Ratios of Major Commercial Banks (at the yearend)



Source: CBRC

Capital Adequacy

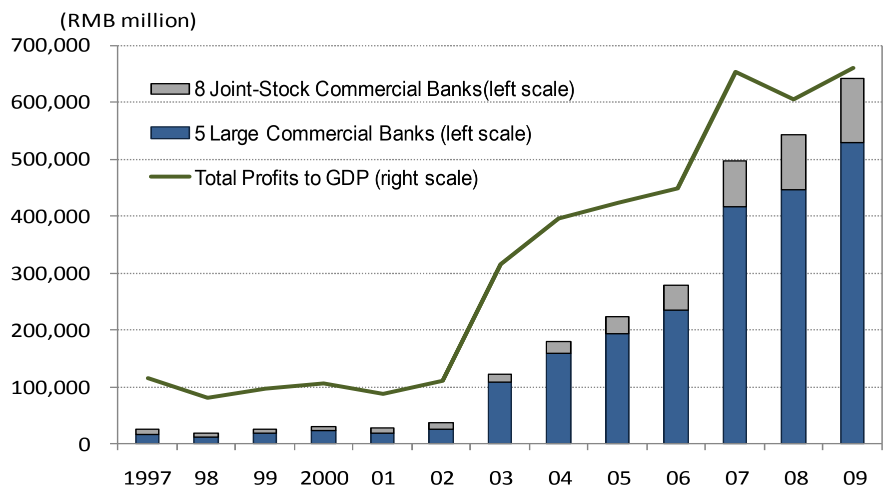
The government's capital injection and banks' fund raising in the markets significantly increased the capital of the banks. By the end of 2009, all the commercial banks cleared the CBRC's requirement of the capital adequacy ratio (CAR, 8 percent or above). This is also a significant change from the end of 2003 when only eight banks, which shared 0.6 percent of the total assets in the banking sector, cleared the target.

The weighted average of the commercial banks' CARs was 11.4 percent at the end of 2009; this was lower than the CAR of 12.0 percent a year ago, reflecting rapid growth in lending. Currently, the CBRC requires the large commercial banks to maintain their CARs at 11.5 percent or above, and the small- and medium-sized commercial banks to maintain their CARs at 10.0 percent or above. Several major commercial banks obtained permission from the CBRC to issue additional shares or subordinated bonds in 2009 and 2010.

Profitability

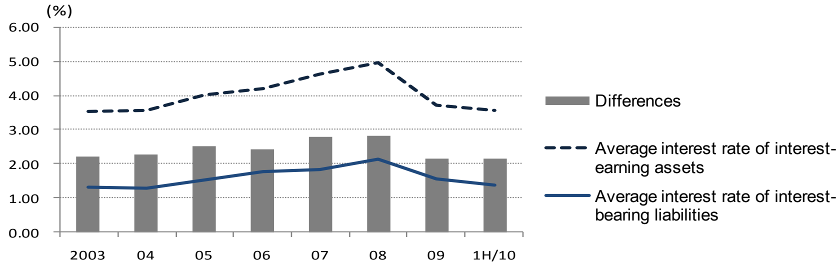
The major listed commercial banks enjoyed favorable operating results over the last three years (Figure 3). On an average, in 2009, 82 percent of the operating profit of these banks came from the net interest income, and 13 percent from the net fee-based income. These favorable operating results were largely a result of the increase of loans. Although the interest rate spread became narrower in 2009, it remained over 2 percent points (Figure 4).

Figure 3: Pre-tax Profit of Listed Major Comeercial Banks



Sources: Banks' annual reports

Figure 4: Interest Rate Differences of 4 Large Commercial Banks



Sources: Annual reports of ICBC, CCB, BOC and BOCOM

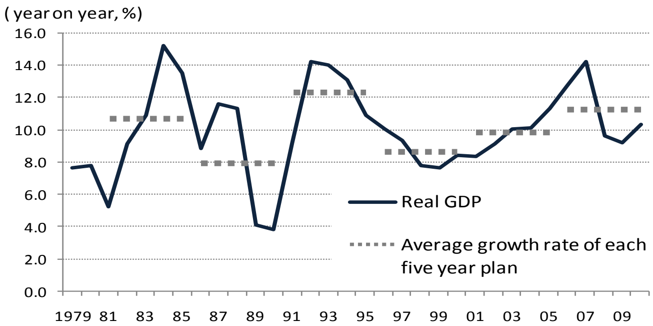
3. Challenges in China's Banking System Reform at Next Stage

(1) China under the Global Financial Crisis

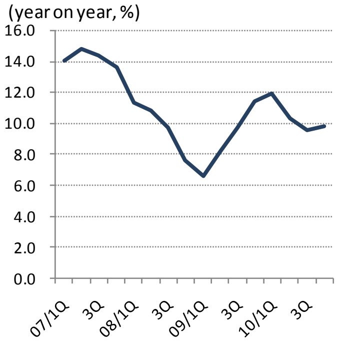
From 2002 to 2007, the Chinese economy had followed a high growth trend boosted by the rapid increase of export and fixed asset investment. In 2007, some signs of economic overheating appeared in the stock market, property market, and a part of commodity markets. The CPI also showed an increasing trend in the year. Under such condition, the central government took tightening policies, and the GDP growth rate started to slow down in the third quarter of 2007. Before the effect of the government policies was fully confirmed, the global financial crisis hit the Chinese economy. The economy displayed a steep fall in the latter half of 2008, owing to a severe decline in the demand from the major international trading partners. However, in the fourth quarter of the year, the Chinese government declared to implement a large scale of stimulus policies so that the economy would escape from falling into a deep recession, and eventually, the economy picked up quickly from the second quarter of 2009 (Figure 5).

Figure 5: Real GDP Growth Rate of China

(Annual Growth)



(Quarterly Growth)



Sources: NBSC

On the recovering process of the economy, the Chinese banks played an important role. Supported by the aforementioned structural reforms and the relatively strict control of the cross-border capital transactions, the Chinese banks did not suffer serious damages from the crisis, and they provided abundant funds for boosting the economy (Table 9). However, the observation on bank lending since 2008 indicates that the Chinese banking system possesses several risks and challenges for it to move to a more market-oriented economy.

Table 9: Amount of Net Increase of RMB Bank Loans in China

(RMB trillion)

	2006	2007	2008	2009	2010
Target of the net increase of bank loans set by the government at the beginning of the year	2.5	2.9	3.6	over 5	7.5
Actual amount of the net increase of bank loans	3.18	3.63	4.91	9.59	7.95

Source: PBC, Xinhua News and People's Daily

(2) Loan Concentration in the State-owned Sectors

SOE's Advantages as a Borrower

When the commercial banks have been extending loans rather actively since the fourth quarter of 2008, the lending for investment projects initiated by the government has been favoring SOEs over private enterprises. Additionally, it has also been favoring large companies over SMEs.

Deng [2010] argues on the situation of the "G*uojin Mintui* (the state sector advances and the private sector retreats)," pointing that bank lending in recent years has been mostly extended to large-sized SOEs[16], because (1) banks regard that the loans to the SOEs are mostly secured by the central and/or local governments[17], (2) the loans to the large-sized SOEs are able to gain the effect of the economies of scale, and (3) commercial banks are paying much more attention to their own profits after being listed.

[16] In 2009, about 50 percent of the SOCBs' loans are extended to large-sized SOEs. On the other hand, the amount of the lending from all banking institutions to private enterprises was only 14 percent of the total lending. If we focused on the short-term lending, the share is lower than 3.4 percent (Deng [2010]).

[17] According to the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), there were 143 thousand SOEs in China at the end of 2008. Currently, about 120 SOEs are termed "Central SOEs", which are supervised by the SASAC directly. Other local SOEs are supervised by the local governments.

The central government does not officially admit the appearance of the "*Guojin Mintui*."[18] However, it recognizes the risks of the loan concentration. The CBRC Chairman Liu Mingkang indicates that the credit risk of commercial banks is increasing; this is because the bank loans that have been extended since 2008 tended to be concentrated in heavy chemical industry and property industry, large corporations and local governments' investment vehicles, and medium- and long-term projects (Liu [2010]).

SMEs' Difficulties in Accessing Bank Loans

In China, the SMEs' difficulty in accessing bank loans has been a serious issue since the 1990s. The private sector, which comprises a number of SMEs, has been largely relying on self-funding and informal finance. When the PBC strictly restrained the increase in bank lending in the fourth quarter of 2007, commercial banks reduced loans to SMEs disproportionately. According to Li Zishan, Chairman of the SMEs Association, the proportion of bank loans for SMEs to the total outstanding of loans dropped from 22.5 percent to 15 percent after the central bank tightened the monetary policy[19]. The Zhejiang Office of the CBRC reported that according to survey results from the Wenzhou enterprises' financing sources, the proportion of bank loans to the SMEs declined from 24 percent in 2006 to 18 percent in 2008[20].

The government has been encouraging banks to extend loans to profitable private enterprises, and the PBC abolished the ceiling of the commercial banks' lending interest rate (leaving the regulation on the floor of the rate) in October 2004. However, thus far, there have been little changes in the loan pricing environment for SMEs. In addition to the above-mentioned factors strengthening the commercial banks' preference for SOEs, it is widely pointed out that the lack of guarantees and unreliable accounting practice of SMEs are the common obstacles for extending bank loans to SMEs.

---

[18] Li Xiaonan, the Chairman of the Board of Supervisors of State-owned Large Enterprises, denies the view that the SOEs' dominance of the markets makes private enterprises difficult to survive (Li [2010]).

[19] http://news.hexun.com.2008-11-21/111513025.html (original news source: an interview at the CCTV program)

[20] According to the PBC, the amount of bank loan to SMEs increased by 31 percent in 2009, led by the government's strong guidance.

Local Investment Companies' Expansion

Since 2009, issues on the bank lending to the so-called local investment companies (LICs[21]) have been attracting strong concerns of the central government. When the Chinese local governments carry out construction projects, they often use the LICs as financing vehicles. Because the local governments are legally prohibited to obtain fund sources from the markets directly[22], they establish the LICs as independent entities for funding of construction projects. There were over 8 thousand LICs in China at the end of 2009. And in recent years, they were aggressively carrying out various kinds of infrastructure projects, being encouraged by the central government's stimulus policies.

The CBRC and PBC found that there were risks behind the extremely rapid increase of bank lending to the LICs, and ordered banks to review the LICs' financial condition in detail. In October 2010, the initial review process was finished, and the banks reported that the bank loans to the LICs amounted to RMB 7.66 trillion (17 percent of the total bank loans in local currency) at the end of June 2010, among which the loans amounting to about RMB 2 trillion (26 percent of the total lending to LICs) might have a problem[23].

(3) Inefficient Fund Management

Limited Usage of Interest Rate Mechanism in the Monetary Policy

Among the major monetary policy tools in China (interest rates, open market operations, reserve requirement ratios, and the window guidance), interest rates have not been flexibly used for adjusting economic conditions. Figure 6 indicates that as compared to the fluctuations in nominal GDP and CPI, changes in the benchmark lending and deposit interest rates were small. Instead, the PBC frequently changed the reserve requirement ratios in recent years (Figure 7), and strengthened the window guidance in order to control the growth of bank loans[24]. It should be noted that the difference between the benchmark

---

21 In Chinese, "*difang rong touzi pingtai* (local financing plat form)."

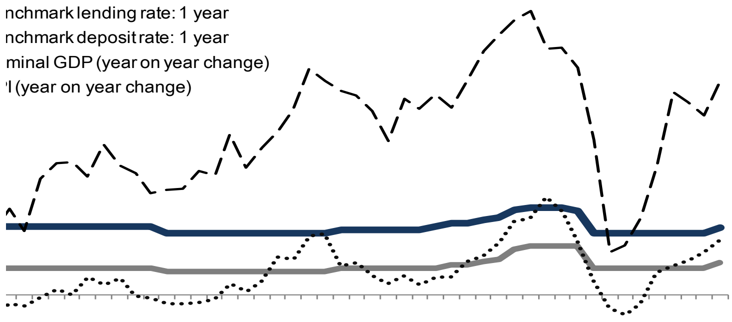
22 The Budget Law prohibits local governments from issuing bonds, the Lending General Provisions prohibits them from receiving a loan, and the Security Law prohibits them from offering anything as collateral.

23 At the end of 2010, most of the bank loans to the LICs had not become NPLs, and in January 2011, the CBRC admitted that banks had demonstrated certain improvements in restraining the risks of those loans. However, the CBRC continues to exercise caution on this issue.

24 For information on the window guidance implementation and its effectiveness in China, see Fukumoto, Higashi, Inamura, and Kimura [2010].

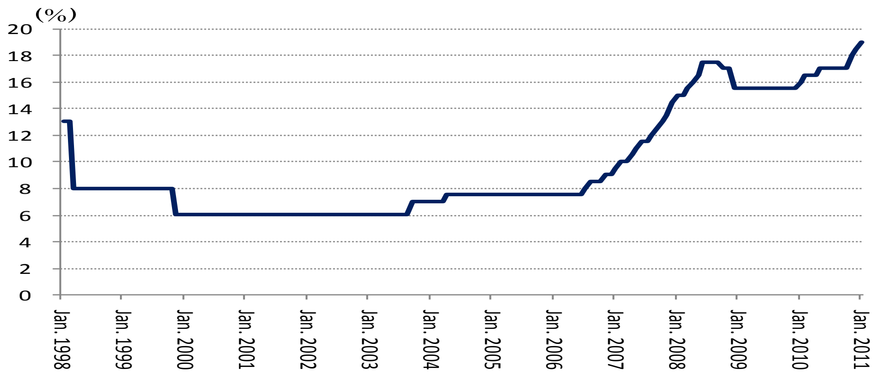
lending interest rate and the benchmark deposit interest rate has not been changed largely since the late 1990s. The government seemed to pay strong attention to the banks' profit when the organizational reforms of major commercial banks were on the process[25].

Figure 6: Trend of Economic Growth and Interest Rates in China



Source: NBSC and PBC

Figure 7: Changes in Reserve Requirement Ratios in China



Source: PBC

---

[25] The former PBC Governor, Dai Xianglong (who held this position from 1995 to 2002), formally explained that the PBC synthetically considered the following factors while determining the interest rates: (1) the condition of general prices, (2) impact to large and medium-sized SOEs' profitability through interest rate payment, (3) impact to banks' profit and tax payment, and (4) national policy and social demand for money. Dai also added that the PBC studied the movement of interest rates in the international markets as a reference (Dai [2001]). It seemed that the Chinese government paid relatively strong attention to the financial results of the SOCBs from 2003 to 2010 in order to complete the IPOs in success. The manner in which the PBC currently considers these factors is not very lucid. However, in recent years, the PBC appears to pay much more attention to the US dollar interest rates in order to maintain the stability of exchange rates and restrain the inflow of speculative money from abroad.

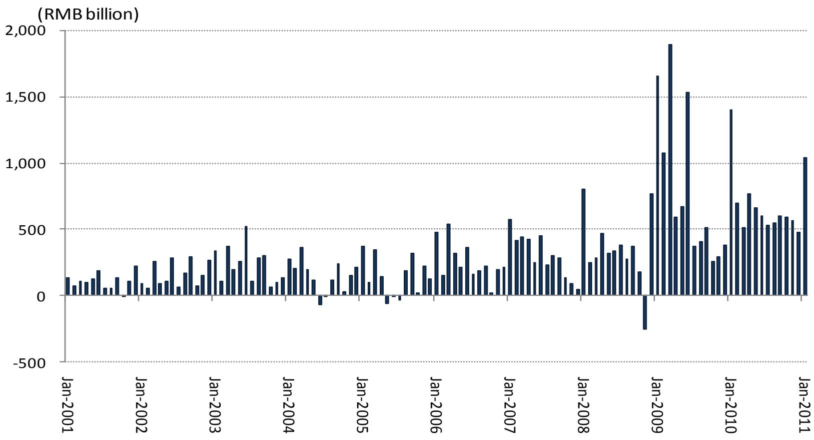
Commercial Banks' Little Attention to Interest Rate Risks

Thus far, the most of Chinese commercial banks do not seem to pay strong attention to the risks of interest rate fluctuation. Although the interest rates in the interbank money markets and bond markets in China had been liberalized by 1999, the impact of the interest rates' movement to the commercial banks' profits has been relatively limited. Because of the strict control of capital transactions and the limited variety of financial products provided to the non-financial corporations and individuals, the large Chinese commercial banks do not face difficulty of gaining deposits[26]. Since the funding cost for lending is relatively low, commercial banks eager to extend loans as much as possible.

Large Fluctuations in Bank Lending

In China, bank loans tend to increase during the first quarter of the year, mainly because of the country's business and social customs[27]. However, the volume of the increase in the loans extended by banks, especially in January, has been remarkably large over the recent years (Figure 8). This is closely related to the targets of the government's economic policy and commercial banks' management of business operation.

Figure 8: Net Increase of RMB Bank Lending in China (Monthly)



Source: PBC

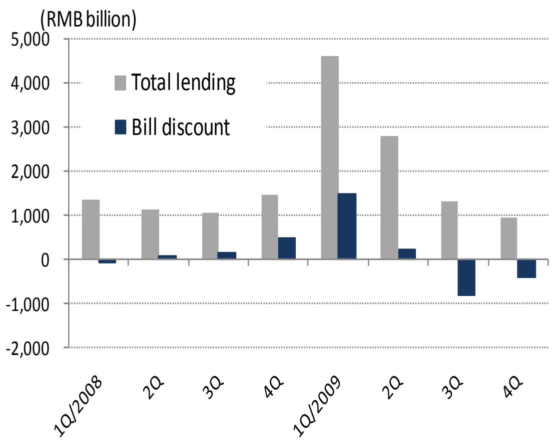
[26] During last 10 years, the local currency deposit has been increasing annually by about 20 percent on average.

[27] Traditionally, the demand for money both in the business sector and the households increases around the new year day of the lunar calendar (in January or February) for the settlement of credit, payout of employee bonuses, purchase of new year gifts, travel, etc. In addition, most of the public construction projects are managed by an annual base and begin in January. Banks are requested to supply loans for project launchings at this time of the year.

At the National People's Congress in March, where the Congress authorizes the government's basic policy for the year, the central government makes commitments to achieve several economic policy targets including the pace of the increase of money supply and the volume of net increase in the total bank loans extended (e.g., RMB 7.5 trillion in 2010, Table 9 above). Before the year-end, the PBC persuades (or orders) commercial banks to adjust the amount of loans in order to achieve the policy target. When the increase in the actual amount of loans is rather large, the PBC guides commercial banks to stop extending new loans or to reduce the amount of loans already extended. Such a situation often occurs in November and December, and owing to the repression of bank loans during these two months, the loans that are extended in January, when a new fiscal year begins, appear as a surge in the supply of new loans. If commercial banks expect a possible change in the funding cost in the future, they would have been more cautious to extend loans.

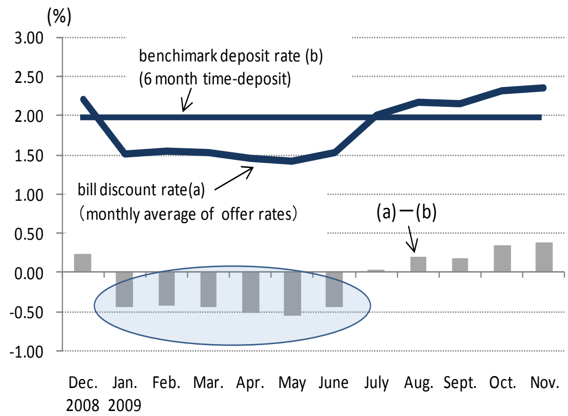
Regarding the fluctuation of the bank lending, it showed an unusual movement in early 2009. When the government encouraged commercial banks to increase lending as early as possible in the late 2008, the commercial banks could not find enough projects in a short time, and extended a short-term lending to the old SOE customers. A sudden increase in the bill discount and a rapid decline of its interest rate in the first quarter of 2009 indicate the commercial banks' aggressiveness in lending through bill discount (Figure 9 and 10).

Figure 9: Net Increase of Bank Lending



Source: PBC

Figure 10: Interest Rates of Bill Discount and Time-Deposit



Sources: PBC and *Zhongguo Piaoju Wang* (http://www.chinacp.com.cn)

The interest rate for bill discount was basically determined in the market, and the competition among commercial banks' lowered the rate quickly in January 2009. According to several news media reports, commercial banks did not change the deposit rate largely, although they could lower the deposit rate (since the central bank abolished the floor of deposit interest rate in 2004)[28]. Since commercial banks in China are required to maintain the ratios of loans to deposits basically at 75 percent or lower, banks usually do not reduce the amount of deposits. Under such situation, many large-sized SOEs increased bill discount borrowing, and deposited the money to another bank so that they could gain profits from the interest differences. Many SOEs were also reported that they did not deposit in the banks, but used the money for investment in property or stock markets.

(4) Development of International Banking Business

Because of the strict control of the cross-border capital transaction, the amount of Chinese portfolio investment abroad and other capital movement through banking accounts (lending and trade finance) is still small. However, since the enterprises' international businesses are expanding, motivated by the government's "go global" policy, some commercial banks have started preparations for expanding business abroad (Table 10).

Table 10: Press Releases on International Businesses of Chinese Banks

Month Year	Announcement
May 2009	CITIC Bank agrees to purchase 70 percent stake in Citic International (in Hong Kong).
June	ICBC agrees to purchase 70 percent stake in the Bank East Asia (Canada) Ltd.
June	CCB opens New York Branch and CCB (London) Ltd.
Sept.	ICBC agrees to purchase stake in ACL Bank Public Company Ltd. (in Thailand).
Jan. 2010	ICBC opens Hanoi Branch
Feb.	BOC opens Perth Branch
Apr.	BOC opens Brisbane Branch and BOC (Brazil).
Apr.	CCB opens Ho Chi Minh City Branch.
Apr.	ICBC opens ICBC (Malaysia) Ltd.
July	BOC opens Kelang Branch (in Malaysia) and three sub-branches in Jakarta
Nov.	ICBC opens Abu Dhabi Branch.
Dec.	CCB opens Sydney Branch
Dec.	BOC opens branches in Penang, Dusseldorf, and Brussels.
Jan. 2011	ICBC opens branches in Paris, Brussels, Amsterdam, Milan and Madrid.
Jan.	ICBC agrees to purchase 80 percent stake in the Bank East Asia (USA) N.A.
Mar.	BOCOM opens Ho Chi Minh City Branch.

Sources: *Zhongguo Hanggye Yanjiu Baogao Wang* (http://www.chinahyyj.com) and press releases of each bank

[28] Since October 2004, the PBC's benchmark interest rates are only implemented for the ceiling of deposit rate, and the floor of lending rate.

In addition, the Chinese government initiated a few pilot projects for the internationalization of the RMB in recent years. The ideas are: the offshore and onshore settlement of RMB payments related to international trade, and an offshore issuance of bonds denominated in RMB. It appears that the Chinese government is still very cautious in relaxing the foreign exchange control regulations. However, the globalization of the Chinese economy would go on further, and banks would be required to support it.

Regarding the international banking business, Hong Kong has played important roles and would continue to do in the future. Norman T. L. Chan, Chief Executive of the Hong Kong Monetary Authority, explains that Hong Kong will contribute to further reform of China's financial system mainly in three aspects. Firstly, Hong Kong commercial banks that have branches in the Mainland will not only bring in capital but also transfer the advanced management skills and experiences. Secondly, the mainland banks will use Hong Kong as the springboard and bridge to "go global". And thirdly, Hong Kong may play a role in promoting RMB as an international currency as well as in promoting the circulation of RMB outside the Mainland (Chan [2010]). Hong Kong seems to be developing as an offshore center of RMB transactions. The pilot schemes of the RMB denominated bond issuance and the RMB trade settlement in Hong Kong may catalyze the deregulation of the financial markets in the Mainland.

Thus far, the executives of major banks seem to be still conservative to promote international businesses. However, some market participants expect that under globalization, if Chinese banks do not offer enterprises financial services offshore, the enterprises may switch to other banks like HSBC that have a presence both in China and the global market[29].

(5)Essential Structural Reform for the Further Development

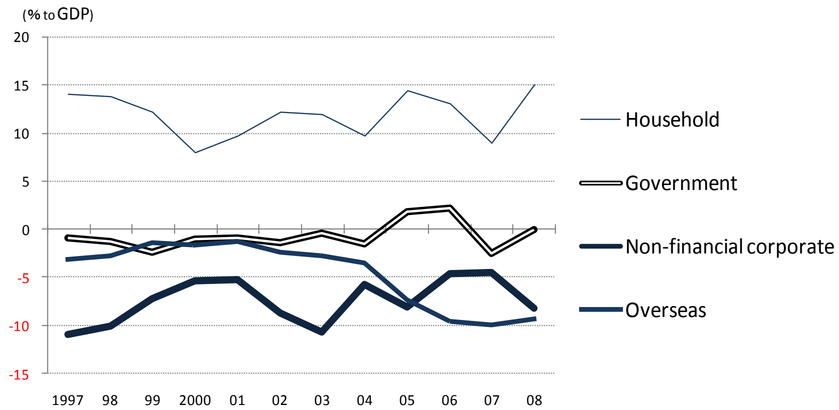
Condition of Corporate Sector's Demand for Funds

In spite of the high pace of the economic growth, China has avoided serious inflation for over ten years. However, the recent rapid growth of money supply, considerable fluctuations in bank loans, and partial overheating of the stock and property markets may imply that macro-economic control by relevant authorities has not worked very effectively.

[29] AFP [2011]

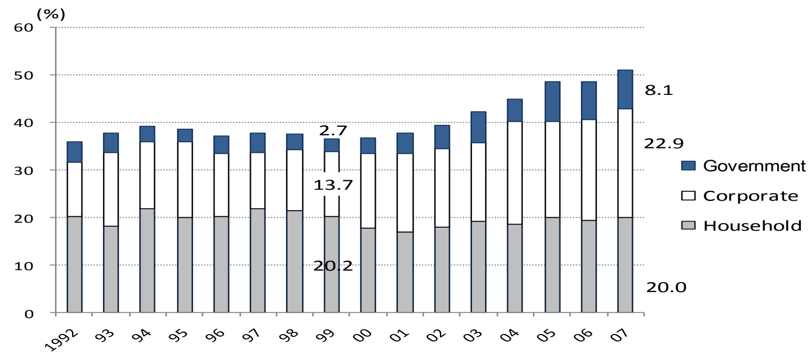
In China, the corporate sector as a whole has been the fund-shortage sector, but simultaneously, the corporate sector's savings rate has been increasing in recent years (Figure 11 and 12). The large-sized SOEs accumulated a considerable amount of reserves throughout 2000s. Kujis [2006] argues that high corporate savings and capital transfers from the government to the large-sized SOEs generally play a much larger role in corporate financing than borrowing from financial institutions.

Figure 11: Trend of the Flow of Funds in China



Source: PBC

Figure 12: China's Saving Ratios to GDP



Source: Zhou [2009]

The central government has been gradually changing the policy related to the corporate finance: it began to require higher dividends from SOEs, to increase the wage standard, and to improve welfare to employees. Along with the changes, the SOEs' demand for external funding would also be changed largely, because they would lose abundant reserves.

Demand for Funds for Urbanization

In the 10th Five-year Plan (2001–2005) of which original plan was announced in October 2000, the CPC proposed to widely implement the strategy for urbanization, and the urban population has increased to 47 percent of the total population in 2009 (it was only 18 percent in 1978). Chen Yuan, Chairman of the China Development Bank, estimates that China needs about RMB 225 trillion of fixed asset investment until the proportion of the urban population reaches to 75 percent (Chen [2010]), the average of the East Asian urbanized countries. Chen also estimates that the urbanization process would be implemented rather gradually. From these points of view, the demand for funds to carry out fixed asset investment would continue to be strong for a long time. It would not difficult for the Chinese banks to find construction projects if they do not care the efficiency.

However, China's investment efficiency is relatively low. For example, among several Asian countries under the high economic growth eras, the marginal capital coefficient, one of the indicators that analyze the efficiency of the investment with respect to the economic growth, is relatively high in China, India, Indonesia and Malaysia (Table 11). The Chinese government is trying to change the mechanism of fund allocation in order to improve the investment efficiency. In this process, the commercial banks are also expected to pay more attention to efficiency of projects when they extend loans[30].

[30] In recent years, the PBC and CBRC often require commercial banks not to extend loans to inefficient fixed asset investments such as: investments in small steel mills, coal mines of low quality, and old factories spreading air, water, and soil pollution etc.

Table 11: Marginal Capital Coefficient of Asian Countries during the High Economic Growth Eras

	Economic growth era (Year)	**Average of real GDP growth rate during the era** (%)	**Average of investment ratio during the era** (% of nominal GDP of fixed asset investment)	**Marginal capital coefficient**
China	1981-1990	9.29	35.19	3.79
	1991-2000	10.42	37.79	3.63
	2001-2005	9.76	39.98	4.10
	2006-2009	11.38	43.79	3.85
India (fiscal year)	1981-1990	5.55	20.78	3.74
	1991-2000	5.46	24.21	4.43
	2001-2005	6.97	29.07	4.17
	2006-2009	7.95	35.78	4.50
Japan	1966-1970	11.09	36.23	3.27
Korea, Rep. of	1986-1990	9.64	32.45	3.37
Indonesia	1989-1993	8.29	30.95	3.73
Malaysia	1992-1996	9.56	40.17	4.20
The Philippines	2003-2007	5.73	15.61	2.72
Thailand	1987-1991	10.93	35.95	3.29

Note: Economic growth era for other than China and India refers to the five-year time during which the average real GDP growth rate marks the highest for the country.

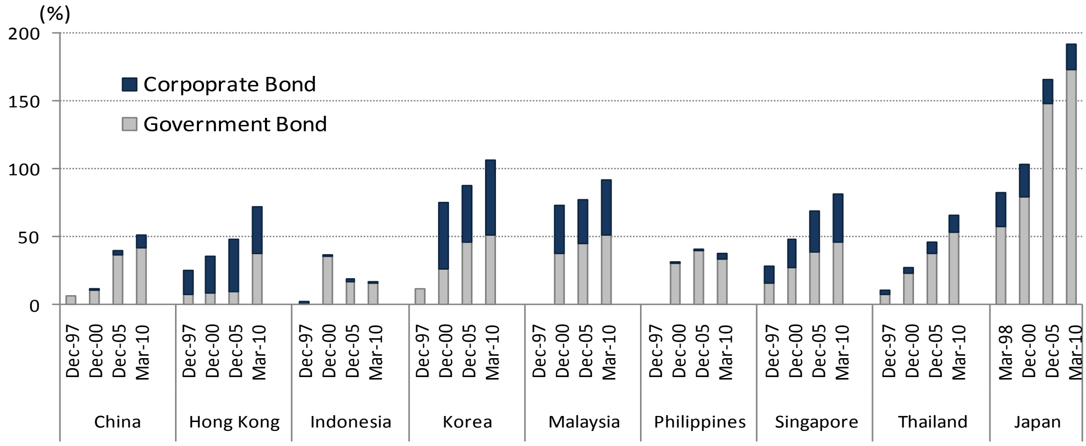
Sources: *China Statistical Yearbook 2010*, *Handbook of Statistics on Indian Economy 2009-2010* (Reserve Bank of India), Cabinet Office of Japan, the World Development Indicators (World Bank), and *White Paper on International Economy and Trade, 2006* (Ministry of Economy, Trade and Industry of Japan)

Capital Markets' Development

In recent years, both the financial authorities and the CCP members have recognized the usefulness of the capital markets. In accordance with the *Opinions of the State Council on Promoting the Reform, Opening and Steady Growth of Capital Markets* issued in 2004, the Chinese government has implemented a wide range of reform. It includes unifying the non-tradable and tradable shares, improving the quality of listed companies, restructuring securities firms, promoting the development of institutional investors, reforming the IPO process, and developing the corporate bond market.

However, the growth of capital markets in China has been relatively subdued. In particular, the Chinese authorities have been rather cautious regarding the repayment ability of enterprises, and the permission for bond issuance continues to be restricted. Most short-term and medium-term corporate bonds are issued in the inter-bank bond market where only the limited investors such as banks and institutional investors can purchase them. As compared to the scale of the economy, the outstanding bond issuance is not large (Figure 13). In order to improve the function of corporate bond markets, it is also imperative to establish a reliable credit rating system and a more transparent accounting system.

Figure 13: Propotion of Outstanding of Bond Issuance to GDP in Asia



Note : In this figure, the "government bond" consists of bonds issued by central government, other government entities, and central bank.
Source: Asian Bonds Online

Though it would take a long time to develop well functioning corporate bond markets in China, Chinese commercial banks should be prepared for the situation that the large-sized leading enterprises may prefer bond issuance to bank loans when bond issuance with more flexible interest rates becomes possible.

Risk Management and Banks' Corporate Governance

Although major commercial banks have been improving their risk management system since 2002 by establishing special committees, strengthening internal audit, and training managers and staff, it is widely regarded that banks do not pay sufficient attention to risk management (especially at the branch level). Only a little effective effort has been made to restrain numerous risk factors before they escalate and become significantly bigger issues.

Through the ownership reform, the listed commercial banks now hold the shareholders' general meetings, board of directors' meetings, and board of supervisors' and senior management meetings when they make an important decision. However, it must be noted that the shareholders of the four largest commercial banks are largely dominated by the government, and the shareholders other than the government have a rather limited say in the decision making process. Most of the non-listed commercial banks have a close relationship with local governments through share holding. Considering the commercial banks' lending activities with large SOEs and local governments, we are still required to place a reservation for evaluating the actual extent of improvement in the banks' corporate governance.

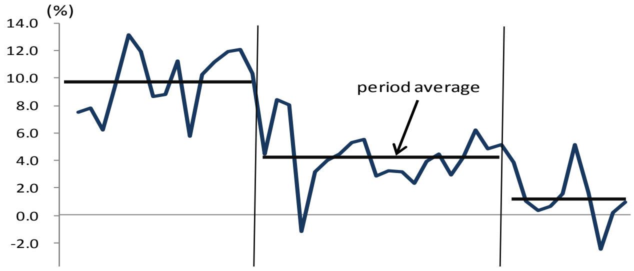
4. Japan's Experiences under Financial Liberalization

China's financial system continues to place various restrictions in order to control capital movement. However, with the further integration of the Chinese economy into the global economy, the demands of domestic enterprises and individuals for global flexible usage of funds would become much stronger. Accordingly, the functioning of the Chinese banks would be required to be more flexible and more market-oriented to fulfill those demands. In order to envision the future design of the banking system reform, it may be useful to review the process of the financial liberalization in Japan as well as the responses of the domestic commercial banks to it in the 1970s and 1980s when Japan faced the problem of excessive savings.

(1) Background of Financial Liberalization

Takahashi and Kobayakawa [2003] summarized the following three changes that brought the Japanese economy to a crucial turning point in the 1970s: (1) the phase of rapid economic growth had come to an end and the growth rate began tracing a downtrend (Figure 14). Among several factors that could explain the decline of the growth rate, the most noteworthy and fundamental factor was the end of the migration of labor from the agricultural to the industrial sectors. (2) The Japanese public began expressing a desire for a shift in the government's growth-oriented policy goals. For example, public demand for reducing environmental pollution, developing social welfare, and more sophisticated management of their financial assets became stronger. (3) The foreign pressure to deregulate and open up Japanese markets was substantially increasing. The relatively good economic performance of Japan aroused the interest of overseas investors in Japanese financial markets.

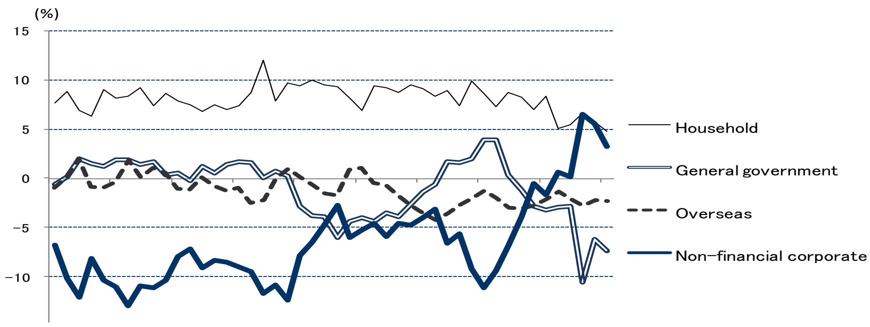
Figure 14： Changes in the Real GDP Growth of Japan



Source: Cabinet Office of Japan

The end of high economic growth effected a significant change in Japan's capital flows. Funding shortfalls in the corporate sector dwindled. A savings surplus continued to accumulate in the household sector. This surplus was absorbed by the public finance and foreign sectors (current account surplus, Figure 15). Since then, Japan has maintained the structure with current account surplus.

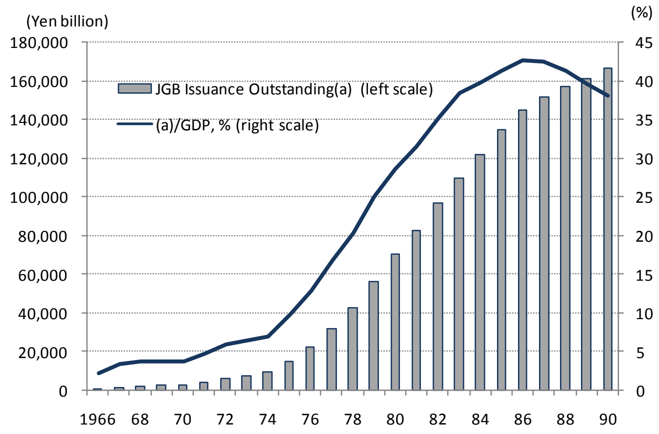
Figure 15: Trend of the Flow of Funds in Japan



Source: Cabinet Office of Japan

The slower economic growth also fundamentally changed the national fiscal balance. The tax revenue growth rate came to be too small to fill fiscal expenditure that started increasing due to social welfare expenditure and economic stimulus plans. In order to offset the fiscal deficit, the Japanese government increased its reliance on government bond issuance (Figure 16). The Japanese government bonds (JGBs) had initially been purchased by banks. However, the expanding volume of the issuance necessitated that the bonds be floated in the financial markets. The interest rates on JGBs were accordingly deregulated in order to improve the appeal of JGBs as investment vehicles.

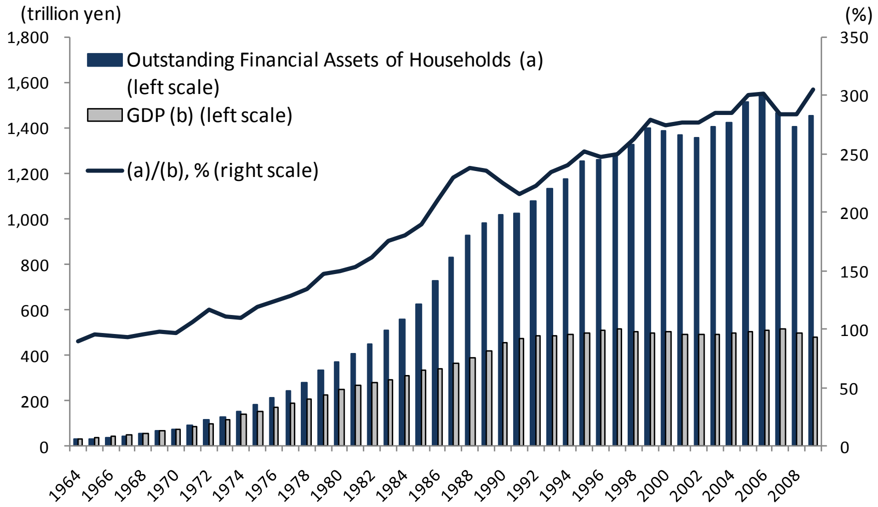
Figure 16: Government Bond Issuance Outstanding in Japan (at the end of fiscal year)



Source: Nakagawa [1992]

The Japanese households' financial assets had been increasing significantly. The outstanding financial assets of households in Japan accounted for 90 percent of the GDP at the end of the fiscal year (FY) 1964, which increased to 117 percent at the end of FY 1972, and to 239 percent at the end of FY 1988 (Figure 17). The households' demand for higher return on investments bearing higher risks was one of the substantial factors that promoted the financial liberalization in the 1970s and 1980s.

Figure 17: Financial Assets of Households in Japan



Sources: Bank of Japan (BOJ) and Cabinet Office of Japan

Although Japan ranked second in the world in terms of its GDP size in 1968, it ranked around 20th in terms of per capita GDP, and the Japanese were confident that there was still prospect for further development. Even the drastic appreciation of the Japanese currency since 1971 and the oil shock in 1974 provided opportunities for the Japanese economy to advance to the new economic structure with a higher level of technology. Under such situation, Japan started the structural reform of the economy and promoted the financial liberalization.

(2) Impact on the Operations and Responses of Commercial Banks

The financial liberalization process in Japan was a phased and gradual approach, although the pace of this process accelerated in the late 1980s. For example, the liberalization of the deposit interest rates took 15 years, and the full scale of liberalization of capital and foreign exchange transactions took 34 years (Annex 1 and 2). However, the regulation of interest rates and separation of financial business were substantially relaxed in the late 1980s.

Substantial Influence on the Fund Management of Non-financial Corporations

Large Japanese enterprises began issuing corporate bonds in the "euro-yen" market and they were mostly purchased by Japanese institutional investors such as life insurance companies, and partially by foreign investors. This was a significant change for both fundraisers and investors. For fundraisers, the process of the issuance of "euro-bond" was easier and more flexible than that of the domestic bond. For investors, the yield of "euro-bonds" was higher than that of the bonds issued by the same Japanese corporations in the Japanese market.

The deregulation of foreign exchange control also promoted the liberalization of interest rates. When a foreign exchange futures market for risk hedging works, interest rates need to be consistent with pricing in the foreign exchange market. In other words, the development of the futures market of foreign exchange would work as a catalyst for interest rate liberalization.

The opening up of market-based funding for non-financial corporations effected a fundamental change in the relationship between the banking sector and the non-financial corporate sectors in the late 1980s. A subset of the non-financial corporations, especially large manufacturing firms, ceased to rely on bank financing and tapped the capital markets instead (Hattori, Shin, and Takahashi [2009]).

Decrease of Rent for Banks

The banks lost the rent that was previously protected by the regulations on interest rates. Table 12 presents the changes in the lending and deposit rates in accordance with financial liberalization. Even in 1985, before the completion of the deposit rate liberalization, the commercial banks had to face rapid narrowing of the lending margin in Japan[31].

Table 12: Interest Rate Differences in Japan and China

	Japan			**China(1)**	
	End of 1970	End of 1985	End of 2010	End of 1991	End of 2010
Long Term Lending	8.50 (prime rate)	7.20 (prime rate)	1.600(2) (prime rate)	9.00 (1-3 years, including 3 years)	5.85 (1-3 years, including 3 years)
Short Term Lending (a)	6.25(3) (prime rate)	5.50(3) (prime rate)	1.475(4) (prime rate)	8.10 (6 months or less)	5.35 (6 months or less)
Short Term Deposit (3 months) (b)	4.00(5)	3.50(5)	0.441(6)	3.24	2.25
(a)-(b)	2.25	2.00	1.034	4.86	3.10

Notes:
(1) The base rates for Renminbi lending and deposit set by the PBC.
(2) The interest rate adopted and released by Mizuho Corporate Bank.
(3) The rate surveyed under the Temporary Interest Rates Adjustment Law.
(4) The lowest interest rate adopted by the six city banks. Since January 23, 1989, these banks have independently set the rate taking into consideration funding costs and other factors.
(5) The BOJ guide-line rate.
(6) The monthly average interest rate on time deposit of less than 3 million yen by 3 months posted at financial institutions.

Sources: BOJ and PBC

On the other hand, the introduction of time deposits with liberalized interest rates enabled the firms to increase funds by tapping the capital market without paying much attention to the timing of the disbursement for fixed asset investments. Before the market-oriented financial product was available, Japanese firms could not hold funds in the deposit accounts yielding competitive market interest revenue. Therefore, the opportunity cost of holding unused liquidity was so high that the firms had to carefully plan fundraisings and disbursements. Competitive market interest rates and flexible term of time deposits with liberalized interest rates compelled non-financial enterprises to resort to exploring various fundraising alternatives.

[31] The liberalization of deposit interest rate was initiated in October 1985 when the restriction on the interest rates on large time deposits of over 1 billion yen was lifted, and gradually progressed until October 1994.

Banks' Responses

Okazaki and Hoshi [2002] summarized that the financial liberalization in Japan during the 1980s was especially slow in terms of the diversification of the investment opportunities for households and the expansion of the business scope for banks. The large enterprises began investing in the securities markets or accumulated their own capital, and reduced their dependency on bank lending. However, the deposits continued to flow into the banking sector. Commercial banks had to cope with the narrowing lending margin rent and reducing traditional customer base. Eventually, in pursuit of higher returns, banks rushed into property-related lending and lending to SMEs.

Delay in Changing the Business Model

In the review of Japan's situation in the 1970s and 1980s, the fundamental structural changes in the financial sector as well as the economic system as a whole are rather evident. An underlying aspect of these changes was that Japan's economy experienced the end of a high growth period and entered an era of lower growth. Nishimura [2003], the former Director-General of the Banking Bureau of Japan's Ministry of Finance, argued that considering the competitiveness of the Japanese financial sector during those days, it was not a realistic choice for them to aggressively expand their business scope by considering global demand in their business. Instead, they should have adjusted the over-capacity of the traditional commercial banking business. However, most of the banks adopted the volume expansion strategy.

In the 1980s, the Japanese commercial banks extended loans virtually only against collateral, mainly in the form of stock and real estate. However, these banks did not carefully evaluate collateral and they relied on the possibility that the prices of stock and real estate would continue to increase, since they had never experienced a prolonged or/and serious decrease in asset prices in the economy. It has often been indicated that banks' risk assessment and management systems were not well designed during the bubble period. In an extreme case, for example, the functions of the loan departments and the risk management departments were merged into one unit for speedy decision-making regarding loans. In retrospect, these kinds of organizational changes compromised the strictness of the loan classification standards.

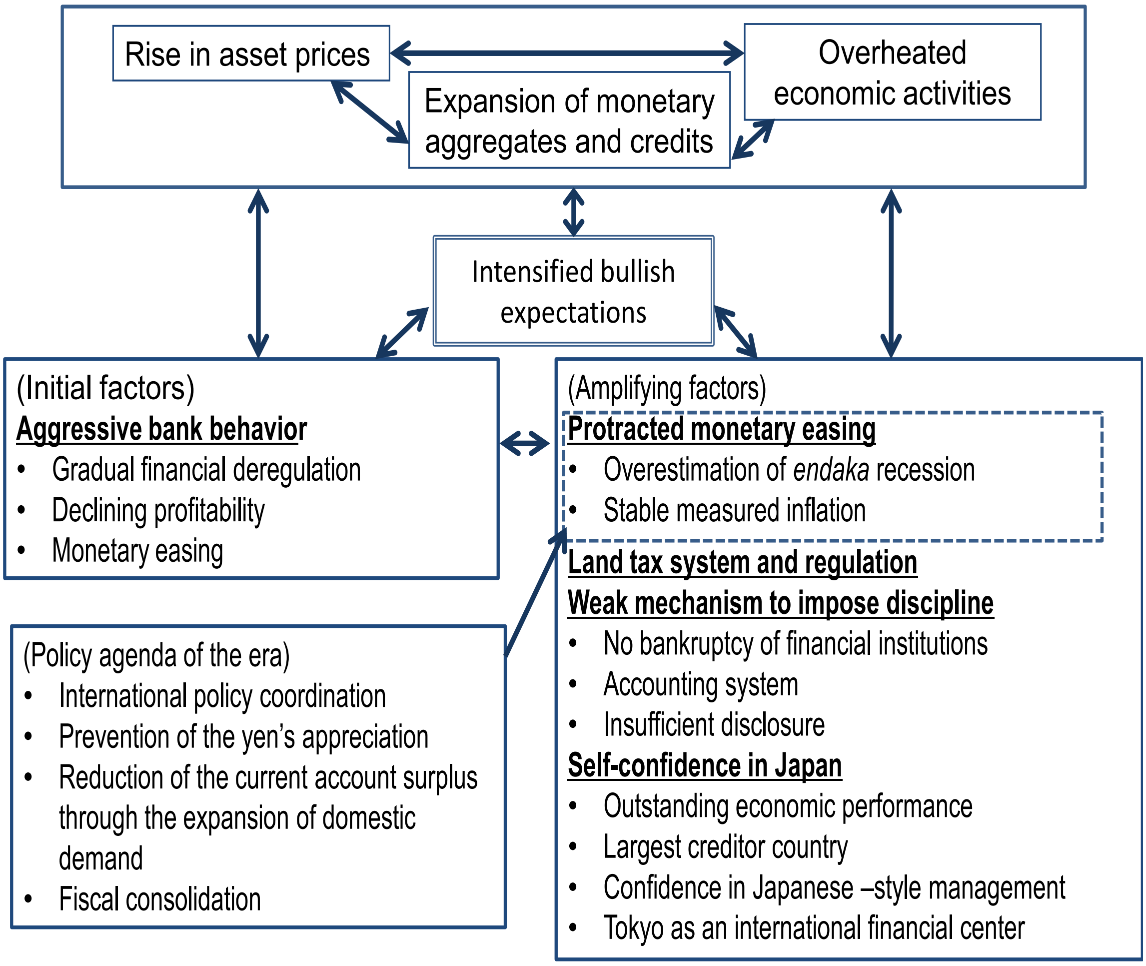
The regulatory changes also required the financial authorities to adapt to a new regime. The so-called "convoy system" that sustained the financial stability with discretionary administration and strict regulations including the one on interest rates came to be obsolete and the financial administration needed to change in line with financial liberalization. However, it also took time to change the manner. The supervisory authorities failed to convince the commercial banks of the need to conduct a rational risk assessment of their loan portfolio since they were also under the influence of the optimistic expectations regarding the Japanese economy in the euphoric atmosphere that existed in the country during the late 1980s. With respect to the related legal infrastructures, the scheme for the disposal of NPLs that would be effective in the case a NPL problem would threaten the solvency of banks had not yet been established.

(3) Lessons

The occurrence and burst of the bubble in Japan during the late 1980s can be attributed to numerous complex factors. Okina, Shirakawa, and Shiratsuka [2001] discussed the following factors with respect to functioning of the bubble economy: bank behavior, monetary policy, land policy, accounting system, and self-confidence in the country, etc. (Figure 18). The commercial banks in Japan delayed the introduction of the necessary corporate governance and risk management reforms. Moreover, they were too slow to change their business model in accordance with changes in their function in the economy from "arbitrage finance" to "value-adding finance."

It should be noted that the supervisory system being called "convoy system," economic rent given to commercial banks accepting various regulations, and insufficient legal system for handling bankruptcy of banks were mutually related and complementary to each other in the 1980s. However, the regulatory framework reform in the 1980s lacked attention to the complementarity between them. For example, comprehensive reform of financial sector did not proceed, while the deregulation of interest rates went forward separately. Moreover, the supervisory authorities abolished restrictions on enterprises' fund-raising in the securities market in the 1980s, but they only allowed banks' phased entry into the securities business. Banks were very concerned that major enterprises would become less dependent on them for funding. This concern was a key factor for the fierce lending competition in the late 1980s. These experiences of Japan point to the importance of comprehensive reform and carefully considered sequence of its process.

Figure 18: Illustration of the Bubble Economy in Japan



Source: Okina, Shirakawa, and Shiratsuka [2001]

Japanese banks took a long time to resolve their NPL problems. Meanwhile, one of the positive outcomes of the Japan's experiences of the bubble burst is the establishment of a legal system for handling the bankruptcy of banks and rules for the injection of public money for overcoming the problems in the banking system. In 2003, the Japanese government established the Financial System Management Council with a legal base, which has the authority to decide the manner in which public fund will be utilized for resolving the issues that led to the bankruptcy of banks. When the recent global financial crisis occurred, such a legal system had not been concretely established even in the most developed countries.

5. Concluding Remarks

Since 2002, the Chinese banking system reform began pursuing the implementation of more market-oriented mechanisms and contributed to the stability of the country's financial system. China successfully prevented the economic shocks due to the global financial crisis from adversely affecting its domestic financial markets, and provided sufficient funds to boost the economy. Thus far, both the quantity and quality of the assets and capital of major commercial banks have improved, and these banks are aggressively increasing their assets in order to gain more profits. Moreover, the large Chinese banks are gradually increasing their presence in the global market.

However, the overall economic system reform toward a market-oriented economy is still underway in China. In recent years, it is becoming much more difficult for the government to control fund allocation by the old style of management. For example, the government's direct guidance and intervention in the decision-making process of commercial banks and enterprises have become less effective. One of the factors that prevent the market mechanisms from functioning effectively is the regulated interest rates. As the draft of the 12th Five Year Plan indicates, the government intends to gradually promote market-based interest rate reform in the coming five years. This reform would not be so fast, because the government would put priority on economic and social stability. Nonetheless, the change of the interest rate mechanism would require commercial banks to change their fund management.

Simultaneously, the Chinese commercial banks should adapt to the trend of globalization in the country's economy. Owing to the strict control of cross-border capital transactions to/from China, thus far, the international businesses of banks are not developed widely. However, the country's "go global" policy requires Chinese banks to support other enterprises' global ventures. In addition, the fact that banks have been permitted to conduct certain experimental operations with trade settlements for expanding the usage of RMB outside the country strongly implies the further development of the international business of Chinese banks.

Considering the diversification of the domestic investment opportunities, development of urbanization, and integration of the Chinese economy with the global one, the Chinese banking system would be required to become more market-oriented and more global. For this purpose, it is critical whether the government allows banks to allocate funds more flexibly and whether banks allocate funds more efficiently on their own responsibility.

In Japan, the main bank system, which supported the customers' finances from a long-term perspective in case they experienced any financial difficulty, contributed to the high growth of the Japanese economy. During the 1980s, some Japanese commercial banks were ranked among the world's top ten banks in terms of asset size and were perceived to be quite successful. However, the relatively large interest rate margins that were protected by government regulation were an important factor for banks to absorb economic shocks. A similar structure wherein the well-protected banks support enterprises also exists in China.

In the 1980s, Japanese banks played an imported role in ensuring economic stability in the country by absorbing various economic shocks. However, they faced serious NPL problems, which affected economic development during the 1990s rather negatively. One of the main causes of the serious NPL problems in Japan was the failure of the banks to reconstruct their business models by adjusting to the liberalization of interest rates under the fundamental structural changes of the economy. In addition, it should be noted that the sequence of the overall financial liberalization had some inconsistency. The delay of changes in the regulatory and legal systems surrounding banks was also responsible for the problems.

Economic history indicates that a financial crisis often happens with deregulations or financial innovations under financial liberalization. The Japan's experiences during the 1980s and 1990s as well as the recent subprime crisis in the US suggest that the aforementioned observation is applicable in these cases. Therefore, from this perspective, what can we say regarding China? Certain similarities between the NPL problems in Japan and China in the late 1990s have often been indicated. However, certain differences should also be noted; the Chinese NPL problem during the 1990s was not caused by the strong effect of financial liberalization, but the general economic reform, particularly that of the SOEs'. Full-blown financial liberalization has not yet begun in China.

Considering the accelerated development and globalization of its economy, the demand for financial liberalization in China will increase. China may face significant challenges with respect to the manner in which financial liberalization must be accompanied by appropriate structural adjustments in the banking sector. The Japanese as well as the US and the European banks have struggled to identify a new and appropriate business model under the rapid developments in financial technology and the fundamental changes of the economic growth model. Considering the large scale of the economy and the high regional disparity in the country, the challenges that China faces in the future may be more complex and diverse.

Annex 1: History of Interest Rate Liberalization in Japan

Year	Month	Changes in the Regulation
1947	Dec.	Temporary Interest Rates Adjustment Law enforced.
1949	Dec.	Foreign Exchange and Foreign Trade Control Law enforced.
1979	Apr.	Call rate liberalized.
	May	Negotiable certificates of deposit introduced.
	Oct.	Trade bill rate liberalized.
1980	Jan.	Medium-term government bond funds introduced.
	Dec.	Foreign Exchange and Foreign Trade Control Law amended.
1982	Apr.	New Banking Law enforced.
1984	Apr.	Sales of foreign CDs and CP permitted.
	Dec.	Interest rates on short-term euro-yen CDs liberalized.
1985	Mar.	Money market certificates introduced.
	July	Interest rates on medium- and long-term euro-yen CDs liberalized.
	Aug.	Large-lot open-end bond investment trusts introduced.
	Oct	Interest rates on large time deposits over 1 billion yen liberalized.
1986	Mar.	Long-term government bond funds introduced.
1989	June	Small-lot money market certificates over 3 million yen introduced.
1991	Nov.	Interest rates on time deposit over 3 million yen liberalized
1992	Mar.	Money management funds introduced.
1993	June	Interest rates on time deposits fully liberalized.
1994	Oct.	Interest rates on demand deposits (excluding current accounts) liberalized.
1998	June	CD issue terms fully liberalized.

Source: Takahashi and Kobayakawa [2003]

Annex 2: History of Capital Account Liberalization in Japan

Year	Month	Changes in the Regulation
1964	Apr.	Japan accepts IMF Article Ⅷ obligations. Japan becomes an OECD member.
1968	Feb.	Yen conversion controls introduced to restrict conversion of foreign currencies into yen and domestic investment in yen.
1971	July	Upper limit on foreign securities purchased by investment trusts and insurance companies abolished.
	Aug.	US suspends dollar conversion to gold (the so-called 'Nixon Shock')
	Dec.	IMF parity changed to ¥308/US$ (Smithsonian rate) and band widened by +/- 2.5%.
1972	Feb.	Purchase of foreign securities by trust banks liberalized.
	Mar.	Purchase of foreign securities by commercial banks liberalized.
	June	Outward foreign direct investment liberalized.
1973	Feb.	Floating exchange rate regime introduced.
	May	Inward direct investment liberalized with exception of five categories of business.
	Dec.	Yen conversion controls on banks partially eased (non-residents permitted to hold yen accounts <except inter-office accounts>).
1974	Jan.	'Voluntary restraint', to balance net foreign securities investments by banks, securities companies, investment trusts and insurance companies introduced.
1976	Nov.	Conditions attaching to outward long-term bank loans are eased.
1977	Mar.	'Voluntary restraint' on foreign securities investments by banks abolished.
	June	Acquisition of foreign equities and bonds by residents belonging to foreign companies permitted. Regulations on net open positions of residents abolished.
1979	Jan.	Regulations on acquisition of yen-denominated bonds excluding those with remaining maturity of more than one year by non-residents relaxed.
	May	Repo transactions by non-residents liberalized (*gensaki* market). CD issuance commenced.
	June	Short-term impact loans introduced and regulations on long-term impact loans lifted.
1980	Dec.	New Foreign Exchange and Foreign Trade Control Law implemented; in-and -out transactions free in principle.
1984	Apr.	Regulations based on the principle of real demand related to forward foreign exchange transactions abolished.
	June	Regulations regarding the conversion of foreign currency-denominated funds into yen abolished. Yen-denominated loans to residents contracted in overseas markets liberalized.
1986	Dec.	Japan Offshore Market (JOM) established.
1995	June	Restriction on number of new branches that a bank can establish removed.
	Aug.	Recycling restrictions on yen-denominated bonds issued by non-residents in overseas markets abolished.
1996	Nov.	'Big-Bang' reform of capital market announced.
1997	Dec.	Ban on financial holding companies lifted.
1998	Apr.	Revised Foreign Exchange and Foreign Trade Law enforced.

Source: Takahashi and Kobayakawa [2003]

References:

Chinese

Cao Fengqi, ed. [2006], *Zhongguo Shangye Yinhang Gaige Yu Chuangxin* (*Commercial Banks' Reform and Innovation in China*), China Financial Publishing House

Chen Yuan [2010], "*Kaifaxing Jinrong Yu Zhongguo Chengshihua Fazhan* (Development Finance and Urbanization Development in China)", *Jingji Yanjiu* (Economics Study), Vol.7 2010

Cheng Siwei, ed. [2006], *Luxian Ji Guanjian: Lun Zhongguo Shangye Yinhang De Gaige* (*Route and Critical Issues in the Reform of China's Commercial Banks*), Economic Science Press

Dai Xianglong, ed. [2001], *Lingdao Ganbu Jinrong Zhishi Duben* (*Textbook on Financial Knowledge for Leading Cadres*), China Financial Publishing House

Deng Wei [2010], *Guojin Mintui De Xueshu Lunzheng ji Qi Xia Yibu* (Academic Argument of "G*uojin Mintui* —the state sector advances and the private sector retreats—"), *Gaige* (Reform), Vol.4 2010.

Kuang Jiazai [2007], "*1978 Nian Yilaide Nongcun Jinrong Tizhi Gaige: Zhengce Yanbian Yu Lujing Fenxi* (Rural Financial System Reform since 1978: An Analysis of the Policy Changes and the Reform History), " *Zhongguo Jingjishi Yanjiu* (*Study of Chinese Economic History*), Vol.1 2007

Li Xiaonan [2010], "Zhengque Fenxi He Renshi Dangqian Guojin Mintui De Taolun (Discussion on the Correct Analysis and Recognition of *Guojin Mintui*)" (http://www.sasac.gov.cn/n1180/n6881559/n6987010/7234618.html)

Liu Minkang [2010], "Mou Yuan Er Bian, Kaichuang Yinhangye Gaige Fazhan Xin Jumian (Change with Gazing away the Future, and Open up a New Stage of Banking Reform)", speech at the Caijing Annual Conference (http://www.cbrc.gov.cn/chinese/home/jsp/docView.jsp?docID=20101217617B0548F94EA8B9FFDD5B2)

People's Bank of China [2010], *Zhongguo Jinrong Wending Baogao* (China Financial Stability Report) 2010, China Financial Publishing House

People's Daily [2002], "*Quanguo Jinrong Gongzuo Huiyi Zaijing Zhaokai* (The National Financial Work Conference was held in Beijing)," February 8, 2002.

Shang Ming, et eds. [2000], *Xin Zhongguo Jinrong 50 Nian* (*50 years of Finance in New China*), China Financial & Economic Publishing House

Wu Jinglian [2010], *Dangdai Zhongguo Jingji Gaige Jiaocheng* (*Understanding and Interpreting China's Economic Reform*), Shanghai Yuandong Press

Wu Xiaoqiu [2005], *Shichang Zhudaoxing Jinrong Tixi: Zhongguo De Zhanlüe Xuanze* (*Market Oriented Financial System: Strategic Choice of China*), China Renmin University Press

Zhang Jie, Xie Xiaoxue and Zhang Shumin [2005], "*Zhongguo Nongcun Jinrong Fuwu: Jinrong Xuqiu Yu Zhidu Gongji* (Rural Financial Service in China: Demand for Finance and Supply of system)," *Huobi Jingrong Pinglun* (Financial Review)

Zhou Xiaochuan [2009], "Zhou Xiaochuan Hangzhang *Zai Quanqiu Zhiku Fenghui Shangde*

Jianghua (Govenor Zhou Xiaochuan's Speech at the Global Think Tank Summit)" (http://www.pbc.gov.cn/publish/hanglingdao/2950/2009/20091126162540414362513/20091126162540414362513_.html)

English

AFP [2011], "ICBC leads charge as Chinese banks go global," 31 January 2011

Chan, Norman T. L. [2010], "Hong Kong's Role in China's Reform and Opening," speech at the 4th Annual China Bankers Forum 2010 "Global Banking: Restructuring and Reform," 17 September 2010

China Banking Regulatory Commission, Annual Report 2006, 2007, 2008 and 2009

China Securities Regulatory Commission ed. [2008], *China Capital Markets Development Report*, China Financial Publishing House

Fan, Gang [2002], "Institutional Reform in a Developing Country: Transition in China," TIGER Working Paper Series No.29, Transformation, Integration and Globalization Economic Research

Fukumoto, Tomoyuki, Masato Higashi, Yasunari Inamura and Takeshi Kimura [2010], "Effectiveness of Window Guidance and Financial Environment: In light of Japan's experience of financial liberalization and a bubble economy," Bank of Japan Review 2010-E-4 (also available in Japanese and Chinese)

Hattori, Masazumi, Hyun Song Shin and Wataru Takahashi [2009], "A Financial System Perspective on Japan's Experience in the Late 1980s," IMES Discussion Paper Series No.2009-E-19

Jiang, Shuxia [2009], "The Evolution of Informal Finance in China and Its Prospects," Jianjun Li and Sara Hsu eds., *Informal Finance in China: American and Chinese Perspectives*, Oxford University Press

Kuijs, Louis [2006], "How will China's Savings-Investment Balance Evolve?" World Bank Policy Research Working Paper No. 3958

Li, Jianjun [2009], "Informal Finance, Underground Finance, Illegal Finance, and Economic Movement: A national Analysis," Jianjun Li and Sara Hsu eds., *Informal Finance in China: American and Chinese Perspectives*, Oxford University Press

Liu, Mingkang [2004], "The State-Owned Banks in China: Reform, Corporate Governance and Prospect," speech at the Beijing International Financial Forum

Okazaki, Kumiko [2007], "Banking System Reform in China: the Challenges of Moving Toward a Market-Oriented Economy," Rand Corporation Occasional Paper 194

Okina, Kunio, Masaaki Shirakawa and Shigenori Shiratsuka [2001], "The Asset Price Bubble and Monetary Policy: Japan's Experience in the Late 1980s and the lessons," Monetary and Economic Studies, (Special Edition) February 2001

Shih, Victor [2005], "China's Uphill Battle for Stronger Banks," *Far Eastern Economic Review*, November 2005

Takahashi, Wataru and Shuji Kobayakawa [2003], "Globalization: Role of Institution Building in the Japanese Financial Sector," Bank of Japan Working Paper Series No.03-E-7

Japanese
Fan Gang [2003], *Chuugoku Mikan no Keizai Kaikaku* (*China Unfinished Economic Reform*), Iwanami Shoten

Okazaki, Tetsuji and Takeo Hoshi [2002], "*Sen Kyuhyaku Hachijuu Nendai no Ginkou Keiei* (Management of Banking Business in the 1980s)," Michio Muramatsu and Masahiro Okuno eds., *Heisei Baburu no Kenkyuu: Baburu no Hassei to Sono Kouzou* (*The Study of the Heisei Bubble: The Outbreak of Bubble Economy and Background Structure*), Toyokeizai Shinposha

Nakagawa, Masaharu, ed. [2002], *Kokusai* (Japanese Government Bond), Okura Zaimu Kyoukai

Nishimura, Yoshimasa [2003], *Nihon no Kinnyuu Seido Kaikaku* (*The Japanese Financial System Reform*), Toyokeizai Shinposha