

Feng Wei

China's Financial Sector Reform in the Transition to a Market Economy

Key issues and policy options

Contents

<i>List of Tables</i>	vi
<i>List of Figures</i>	viii
<i>Abbreviations</i>	ix
<i>Symbols</i>	x
Chapter 1: Introduction	1
1.1 Background	3
1.2 Objectives and Focus	9
1.3 Approach	12
1.4 Structure	16
Part I Assessment on China's Financial Sector Reform To Date	19
Chapter 2: China's Financial System at the Outset of System Transformation in 1978	20
2.1 The Centrally Planned Financial System	20
2.2 Saving-Investment Performance	27
2.3 Implications for Financial Sector Reform	29
Chapter 3: Present State of China's Financial Sector Reform	30
3.1 An Overview of China's Financial Sector Reform	30
3.2 Reforming Investment Finance	34
3.3 Banking System Reform	36
3.3.1 Creating the Central Bank	7
3.3.2 Creating Commercial Banks	45
3.4.4 Final Remarks	56
3.4 Development of Financial Instruments and Markets	57
3.4.1 Money Markets	59
= 3.4.2 Capital Markets	61
3.5 Integration into International Financial System	68
3.6 Summary	70

Chapter 4: Savings, Investment, and Financial Intermediation	72
under Financial Sector Reform in China	
4.1 Measurement of Savings, Investment, and Financial Intermediation	72
4.2 Savings, Investment, and Financial Intermediation under Financial Reform: Theoretic Aspects	75
"1. 4.2.1 The Theory of Financial Liberalization	/ 75
4.2.2 Limitations of the Theory of Financial Liberalization	79
4.3 Savings, Investment, and Financial Intermediation in China	83
4.3.1 Savings Effects	84
4.3.2 Investment Effects	90
4.3.3 Financial Intermediation	95
4.4 Final Remarks	97
Part II Interest Rates Liberalization in China: Key Issues and Policy Options	98
Chapter 5: Necessity of Liberalization of Bank Interest Rates	99
5.1 Definition of Interest Rate Liberalization	100
5.2 Interest Rate Management and Liberalization in China	102
5.2.1 Central Bank Interest Rates	102
5.2.2 Commercial Bank Interest Rates	104
5.2.3 Interbank Interest Rates	105
5.2.4 Securities Interest Rates	106
5.3 Necessity of Liberalization of Bank Interest Rates	107
5.3.1 Inadequacy of Administered Bank Interest-Rates	108
5.3.2 Inconsistency of Administered Interest Rates with Economic Reform	112
5.3.3 Concluding Remarks	115
Chapter 6: Feasibility of Liberalization of Bank Interest Rates in China	116
6.1 Interest Rate Elasticity of Savings	117
6.1.1 Correlation between Household Savings and the Deposit Rate	117
6.1.2 Measurement of the Interest Rate Elasticity of Household Savings	123
6.2 Interest Rate Elasticity of Enterprise Demand for Bank Loans	125

6.2.1	Key Factors Determining the Correlation between Enterprise Demand for Loans and the Loan Rate	125
6.2.2	Statistical Evidence in China	129
6.3	Financial Soundness of Commercial Banks	133
6.3.1	Non-Performing Loans and Adverse Selection by Banks: A Simple Two-Sector and Two-Period Model	134
6.3.2	Implications	138
6.4	Effective Market-Based Monetary Control	138
6.4.1	Open Market Operations	140
6.4.2	Refinancing Policy	142
6.4.3	Legal Reserve Requirements	144
6.5	Prudential Supervision	146
6.5.1	Importance of Prudential Bank Supervision	146
6.5.2	Bank Supervision in China	149
6.6	Conclusions	154

Chapter 7: Sequencing of Liberalization of Bank Interest Rates in China **155**

7.1	Options for Sequencing the Liberalization of Bank Interest Rates	155
7.2	An Analytical Model	159
7.3	Economic Effects of Alternative Sequencing	167
7.3.1	Loan Rate in Advance	167
7.3.2	Deposit Rate in Advance	170
7.4	Final Remarks and Policy Discussions	172

Chapter 8: The Problem of Non-Performing Loans in China's Banking System **173**

8.1	Scale of Non-Performing Loans in China	175
8.1.1	Definition of the Non-Performing Loans in China	175
8.1.2	A Case Study: Non-Performing Loans in the Province Zhejiang	176
8.1.3	Consequence of the Non-Performing Loans: The Insolvency Risks of Banks	181
8.2	Major Reasons for the Problem of Non-performing Bank Loans in China	186
8.2.1	Policy Loans	186

8.2.2	High Enterprise Debt Ratio with Soft Budget Constraints	188
8.2.3	Poor Credit Risk Management of Banks	192
8.3	Resolving the Problem of Non-Performing Loans in China	195
8.3.1	Policy Options: A Theoretic Analysis	196
8.3.2	Lessons from Eastern Europe Countries: A Case Study	202
8.3.3	Conception and Strategy for China	206
8.3.4	Removing the Sources of Non-Performing Loans	212
8.4	Conclusion	215

Part III	Perspectives of China's Financial Sector Reform	216
----------	---	-----

**Chapter 9: Perspectives for China's Financial Sector Reform
in View of The Asian Financial Crisis** 217

9.1	The Nature of Financial Crisis	217
9.2	Effects of the Asian Financial Crisis on China's Financial Sector Reform	220
9.2.1	Banking Insolvency Risk Increases	221
9.2.2	Stock Market Capitalization Stagnant	223
9.2.3	Bank Deposits Tend to Decrease	225
9.2.4	Slower Tempo of Financial Opening	227
9.3	Trends in China's Economic and Reform Policies	228
9.3.1	Accelerating the Speed of Bank Recapitalization	228
9.3.2	Expansive Interest Rate Policy	229
9.3.3	Expansive Fiscal Policy	231
9.3.4	Stable Exchange Rate Policy	233
9.4	Perspectives for China's Financial-Sector Reform	237

Chapter 10: Summaries 241

Annex	257
Annex 1: Financial Services	257
Annex 2: Questions for the Research Tour in China including Hong Kong	259
Annex 3: Main Credit Institutions and Their Services in China	262
Annex 4: Main Points of Decisions on Financial Sector Reforms in December 1997	267
Annex 5: Main Events of China's Financial Sector and Related Reforms 1978-1996	269
Literature	275