

China's Financial Reforms: Why Dysfunctional Banking Survives

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Summary

There is a growing academic consensus critical of the progress of China's banking reforms. This pessimism coincides with official alarm in 2011 about the considerable but unexpected setback to the reform process that has followed the global financial crisis. This paper investigates the mismatch between the ambitious goals set by repeated modernisation programmes for the financial sector since the 1970s and the limited progress in achieving a modern, market-driven, banking sector. The review identifies persistent political intervention in credit management as the fundamental threat to sound banking and investigates why the state has tolerated repeated surges in non-performing loans rather than conceding the autonomy that sound commercial banking requires.

The paper shows that the reform process has been driven very much by the immediate banking requirements of high-speed growth through modernisation and globalisation of the manufacturing sector. This process involved first resurrecting conventional banking facilities abolished under the Soviet-style 'command economy' and then financing the nation's investment drive undertaken by largely autonomous local governments and the burgeoning private sector. International financial services and foreign banking practices were not a priority, unlike former Soviet Bloc and many Third World nations, since China could rely on the major international financial centre provided by Hong Kong.

Subsequently, the state felt unable to free banking from central control and political interference because it was the last government 'paymaster' to survive the retreat from central planning. Credit creation and allocation via the banking system has been the easiest source of funding to finance rural transformation, to counter global crises, to fund major social development projects and to enforce environmental and similar goals on business. Central bankers and financial regulators have lobbied unsuccessfully for competition to prevail. The political convenience of the current arrangements makes state involvement hard to surrender.