The State in Chinese Banking*

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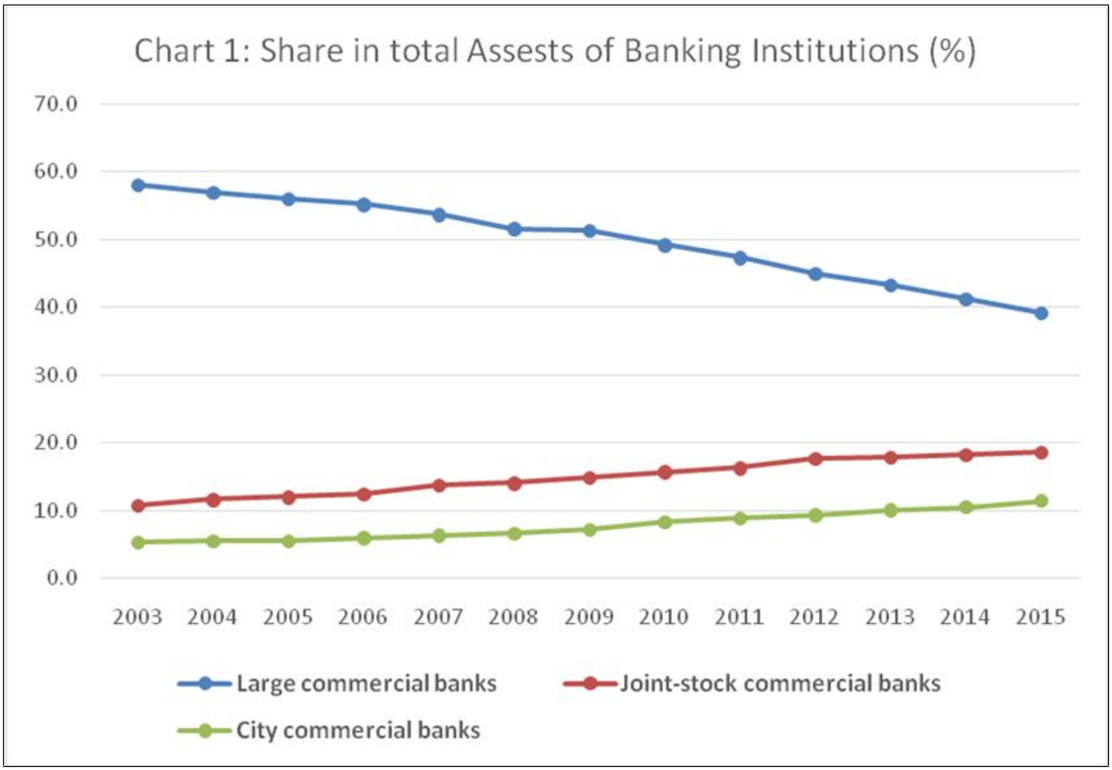
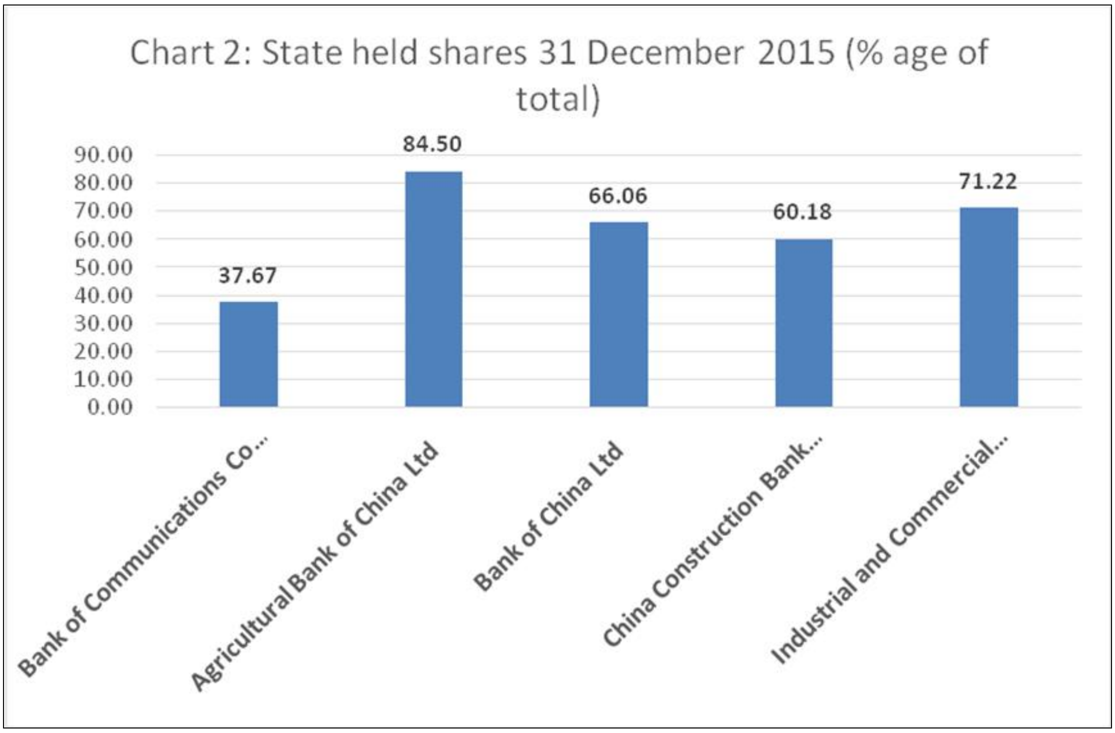
Financial restructuring and liberalisation began in China in the late 1970s, when commercial banking functions were separated from central banking functions. This amounted to moving away from the earlier ‘monobanking’ system in which the People’s Bank of China (PBoC) was almost the sole financial intermediary to one in which it served as the central bank and three independent state-owned institutions were made responsible for undertaking commercial banking functions. These were the Bank of China (BOC), focused on foreign exchange and international transactions, the People’s Construction Bank of China (PCBC) or later the China Construction Bank (CCB), responsible for financing fixed-asset investments in areas outside agriculture, and the Agricultural Bank of China (ABC), entrusted with mobilising savings and financing activities in the rural areas. In 1984, these three banks were supplemented with the Industrial and Commercial Bank of China (ICBC), focused on financing commercial and industrial activities, and these ‘big four’ have constituted the core of the banking business on China. Later, the Bank of Communications, which was re-established in 1987 with a diversified portfolio of activities, joined the big four, to form the big five.

Once this initial break-up of the financial sector was completed, among the main objectives of subsequent financial reform and restructuring were de-concentration and the infusion of competition in banking, greater commercialisation with emphasis on profit generation, and the induction of non-state and private entities into the ownership of banking. To realise these objectives, starting in the late 1980s, a set of 12 joint stock commercial banks and a large number of city commercial banks were created, which together with the large rural credit system, resulted in the proliferation of banking institutions that delivered some competition. Further, as part of the commercialisation of the system, in 1994, three ‘policy banks’ were established, to take over the policy lending functions of the commercial banks, allowing the latter to focus on ‘banking as business’. The policy banks, with special mandates, were either supported with central funds or raised resources through the issue of bonds that were seen as having implicit sovereign guarantees, which reduced the cost of such capital.

The result of all this was a large and diversified financial structure which at the end of 2015 included 3 policy banks, 5 large commercial banks, 12 joint stock commercial banks (JSCBBs) and 133 city commercial banks. By 2003 the share of the large commercial banks in total assets of the banking institutions had come down to 58 per cent, while those of the JSCBs and city banks stood at 10.7 per cent and 5.3 per cent respectively. The growth of the alternatives to the big five continued, enhancing competition, so that by end-2015 the shares in assets of the three sets of commercial banks stood at 39.2 per cent, 18.6 per cent and 11.4 per cent respectively (Chart 1). This amounted to a significant restructuring of the banking industry.



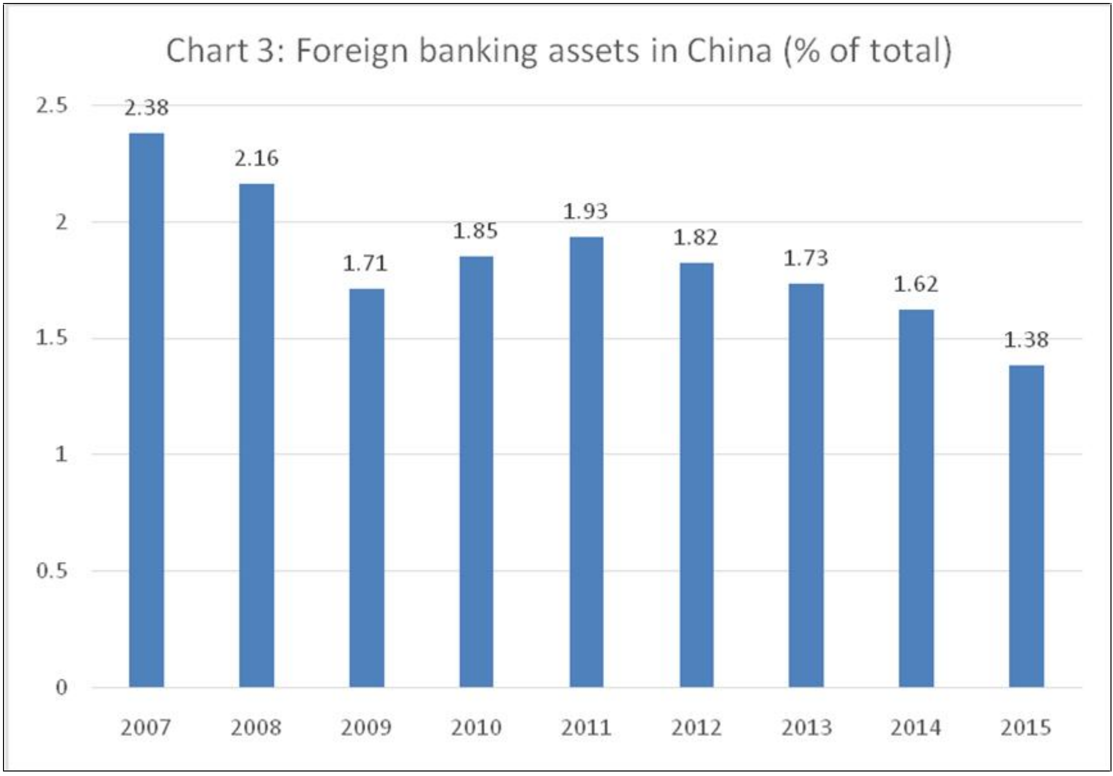


Where the transition has reflected an implicit decision to maintain strong state control over the banking system is in ownership. Private entry though permitted was highly regulated. To start with, the policy banks remained wholly government owned. Second, the entry of non-state entities into banking was confined to the limited purchase of existing or new equity in the banks that were to be "equitized" or in the new joint stock banks and district commercial banks that were to be set up. The creation of purely private banks came much later. The sale of equity was in the form of both A-shares listed in the mainland stock exchanges and priced in RMB, and H-shares listed in the Hongkong stock exchange and priced in HK dollars. The third was when investments by foreign investors were encouraged, ostensibly with the aim of improving governance and business practices in Chinese banks, but caps on ownership applied and permissions were required.

Despite ownership dilution being on the agenda for some time now, the big commercial banks are still largely state owned, with the government stake exceeding 60 per cent in four out of the five big banks (Chart 2) even at the end of 2015. It is only in the Bank of Communications, which joined the big league after being rejuvenated in 1987, had the equity share fallen to 37.7 per cent by December 2015. Moreover, at least a half of the JSCBs have majority ownership by state entities. And even many of the district commercial banks have local and provincial governments being important or dominant stakeholders.

In addition, the entry of foreign players, while significant in terms of the number of financial firms (40 in 2015 as compared with 14 in 2006), is almost negligible in term of relative asset position. Foreign banking assets as a percentage of total banking assets which stood at 2.38 per cent at the end of 2007, was down to a low of 1.38 per cent in 2015 (Chart 3).

All this is indicative of an official decision to retain state control over the banking system. What the Chinese government has done, however, is to 'corporatise' that control. Earlier government ownership was exercised largely through direct investments by the Ministry of Finance. In December 2003 the government established the Central Huijin Investment Ltd, a wholly state-owned company mandated to serve as an investor in financial enterprises on behalf of the state. By mid-2016 Central Huijin, with financial support from the state, held shares in at least 18 firms including China Development Bank, Industrial and Commercial Bank of China Limited, Agricultural Bank of China Limited, Bank of China Limited, China Construction Bank Corporation, and the China Everbright Group.



The result is that, according to one informal estimate relating to 2014, "private investment accounts for less than 12 per cent of the Chinese banking industry's total capital, with the rest controlled by the state" (Financial Times March 11, 2014). In fact, a formal effort to promote purely private backed banks began only in 2014, when a pilot project to allow five private companies, including Alibaba and Telcent, to take sole responsibility for establishing banks was taken up. Since then six more such private banks have been approved. But this seems to be more an effort to rein in and regulate the unofficial banking business that occurs in the "shadow banking sector" and is increasingly operated through the internet.

To many western commentators this is one of the weaknesses of the banking system in China today. Thus, late last year, the Financial Times argued: "China's banks are overwhelmingly state-owned, and small, privately owned businesses have long complained that they struggle to obtain loans. Meanwhile, politically directed lending by state banks has sustained an army of state-owned "zombie enterprises" that are unprofitable but cannot die." This, however, ignores the fact that the structure of lending by China's major banks has changed over time, with profitable retail lending for housing investments and consumption, accounting for a rising share. Combined with the separation of policy lending from commercial bank operations starting from the mid-1990s, this points to a decision to decentralise decisions on credit allocation for commercial purposes, while maintaining a strong public presence in ownership.

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