

PART II

A CHINA SPECIAL REPORT

THE NEW TELEVISION SETS OF CHINA **The Fragility of the PRC's Banking System**

This is the second of a 3-part series about the Government of the People's Republic of China and some of the most pressing problems that the country is facing, today. The third part will be published next Friday.

In 1978, it was determined by the hierarchy of the National People's Congress (NPC) that the economy of the country should be changed, veering away from a centrally planned and centrally controlled economy to that of a market-based economy.

As with all such wide-sweeping recommendations, prior to the votes, being counted at the convening of the 1978 National People's Congress, the outcome of the proposals was well known and accepted by the geriatrics, who marked their votes with the appropriate symbols of submission to their seniors.

Regardless of how this transformation was first promulgated and implemented, the PRC's economy has undergone a radical and surprisingly successful growth since 1978.

The growth of the economy since 1978 has been, in fact, unparalleled in the country's history.

In short, the leadership scored a bulls eye with its move away from the purely Communistic policies, as laid down by the late Chairman Mao Tse Tung (Mao Zedong), to a market-led economy.

High-ranking officials in the Government of the PRC have remarked to TARGET that the country, today, is the closest that it has ever been to a democracy, but that a complete democracy, as practiced in the US and the UK, is too early to introduce: Children should not be given too much freedom in one gulp.

The Key Components

Some of the key components of this economic reform programme were to allow farmers to lease land from collectives and to produce crops for their own benefit.

This has raised agricultural productivity and has given a major push to the PRC economy.

Greed is such a wonderful incentive for man!

Along with this move at agrarian reform, the PRC Government opened its trade doors a mite, reduced some barriers to foreign investment, and facilitated trade development in order to obtain access to new capital and new technology.

By the end of 2001, it is estimated by the Government of the PRC that it had attracted about \$US392 billion in investment inflows.

Since the introduction of the 1978 agrarian reforms to the end of 2001, the economy of the PRC is said to have grown by an average annual rate of about 9.50 percent, according to PRC Government statistics.

During those 23 years, it is estimated that about 350 million residents of the country have been saved from a life of poverty.

That figure is about 27 percent of the total population of the country: The human population of the country, today, said to be about 1.30 billion people.

Also, during those 23 formative years, Real Gross Domestic Product Per Capita has risen from about \$US168 to nearly \$US1,000.

While all this was going on, the country's banking system made significant progress, as did the PRC Government's enterprise system.

Laws, aimed at regulating the banks of the country, were introduced in 1996.

Steps have been taken to sever banks' credit ties with loss-making, State-owned and State-controlled enterprises.

Internal controls and accountability by holding lending officers and management of banks, fully responsible for loans, came into being with the reforms of PRC banking laws.

Those old-time bankers of the PRC, who could not adjust to the new PRC ways of doing things, had to turn in their Communist Party cards.

For the past 5 years or so, the PRC Government has been monitoring State-owned enterprises, closing down those that were hopeless, and putting tens of millions of workers out of jobs.

Even so, it is estimated by the Government of the PRC that, still, about 66 percent of the remaining, State-owned enterprises are not profitable.

This leads to the problem of considering the most efficient use of capital because, while the PRC Government would, gladly, close down the loss-making enterprises, at the same time, it cannot displace the tens of millions of workers, to which such a determination would, ultimately, lead.

So the Government has to continue to plough more and more good money after bad money.

It appears to be the only politically correct thing to do at this juncture – and it is unlikely to irritate the workers of the country.

The accession to the rank of a full member of the World Trade Organisation (WTO) in December 2001, following 15 years of negotiations, has provided the country with a new momentum.

This will lead, no doubt, to further reforms of the economy.

The PRC has guaranteed its WTO trading partners that they will have free access to the PRC insurance industry, to manufacturing, to agriculture, to investment in PRC, State-run enterprises (the profitable ones, of course), and a host of other *'juicy'* investments in the world's most populous country.

The way forward, however, is fraught with 4 pitfalls:

1. The (still) badly managed banking system;
2. The high unemployment rate, which continues to grow;
3. Massive Government debt; and,

4. Corruption.

The Fragility Of The Banking System

During the past 2 decades, the banking system of the PRC has undergone one change after another, the most important of all changes, however, was the scrapping of the single banking system and the introduction of the 2-tiered banking system.

The 2-tiered banking system comprises a Central Bank (The People's Bank of China) and a large number of domestic and foreign-owned and managed banks.

The domestic banks comprise 4, State-owned commercial banks, 12, joint stock banks, and city commercial banks.

The 4, State-owned commercial banks account for about 80 percent of aggregate deposits with all the banks, and more than 70 percent of the aggregate total loans of its banks, operating in the country.

The continuing threat to the economy and the banking system is the directive from Beijing to continue to support State-run enterprises, especially those that are loss making and those, giving considerable employment to workers.

Reforms are one thing, but the eminence gris of Beijing continues to pull the strings on its banking '*puppets*'.

The People's Bank of China, recently, estimated that non-performing loans in 2001 in 4, State-Owned Commercial Banks accounted for about 26 percent of total outstanding loans.

Thus far, bad debts have not unduly hampered the financial sector of the economy, mainly because the economy has been growing at such a pace, plus the immense liquidity at banks, that liquidity, being able to cushion bad debts in the system.

It is said that, when one has a dollar in one's pocket, one does not bother with the one-cent coin, lying in the gutter.

But, when times are tough, one does stoop to collect that one-cent coin with gusto because 100 such coins make one dollar.

Recent banking scandals are starting to take effect in the PRC where the populace is being treated to more and more information about the affairs of the country, something that, in the past, was not considered important and was, certainly, not recommended by the organs of information dissemination.

When foreign banks are fully established and fully operational in the PRC, and when they are permitted to accept renminbi deposits, engage in renminbi-denominated businesses with PRC clients, as well as adopt a more-flexible, foreign-exchange regime, complete with capital account convertibility, it is likely that residents of major cities – Beijing, Shanghai, Guangdong, Harbin, etc – will seek out these foreign banks in order to escape the PRC Government's banking scandals and the many illegal or risky savings schemes at underground banks.

This could lead to a mass exodus of PRC depositors to these foreign banks, thus jeopardising the liquidity of extant PRC banks, operated by PRC banking executives, who take their orders, directly from Beijing.

The Way Forward

Restructuring, once again, of the commercial banks of the PRC is a must; and, such restructuring must be carried out prior to all restrictions, being removed on foreign-owned banks, demanding the right to operate in the country in accordance with the WTO Agreement of December 2001.

The listing of BOC Hongkong (Holdings) Ltd (Code: 2388, Main Board, The Stock Exchange of Hongkong Ltd) on July 15, 2002, was the first commercial bank to be listed on a foreign stock market.

(The Stock Exchange of Hongkong Ltd is considered to be a foreign stock market by Beijing, in accordance with its 1997 promise of: One-country, Two systems)

Other such public listings as BOC Hongkong (Holdings) are sure to follow in the fullness of time.

TARGET notes the many Writs, issued in the High Court of the HKSAR, Writs, issued against former customers of banks, which fall within the ambit of Bank of China, following the listing of BOC Hongkong (Holdings) Ltd.

Pencils have been sharpened because, under the new scheme of things, PRC banks can no longer hide their poor judgments/corruption of the past.

But, it is noted that the banking system of the PRC is still regulated, directly, from Beijing, via The People's Bank of China.

As such, profit and political power may be in conflict, at the end of the business day.

The problem, facing the banking industry of the country, today, appears to be that there are, still, no impartial and objective standards in the PRC to regulate the very important financial system.

The matter of the former Chairman of China Everbright Group Company, Mr Zhu Xiao Hua, is a classic example of the situation, which is continuing to fester.

One is never quite certain whether or not Mr Zhu was guilty of anything, of a criminal nature, or whether he just ran afoul of his immediate superiors in Beijing or elsewhere. (Please see Part I for information on Mr Zhu)

The bigger they come, the harder they fall.

The Chief Executive of the HKSAR, Mr Tung Chee Hwa, is another example of a petty politician of the PRC, who is afraid to do anything without, first, obtaining express orders from Beijing.

In the event that he falls from grace, Beijing would not hesitate to replace him, in a shot, with another '*puppet*', who would most certainly be called: '*A man of the People*'.

However, to find a replacement for Chief Executive Tung Chee Hwa is easier said than done.

This is unlike the situation with Mr Zhu of China Everbright.

Where could Beijing's leadership find a bilingual, ethnically Chinese gentleman, who has been schooled in the political language of modern China?

Where could Beijing's leadership find a Chinese gentleman, one who is fairly rich and who could be assured not to have sticky fingers?

The fact that the '*2002-elections*' of the Chief Executive of the HKSAR was unopposed by any other would-be candidate of the 416 square miles, known as the HKSAR, would indicate to most right-minded people of Beijing's lack of an alternate to the '*old turtle*', as Mr Tung Chee Hwa is known popularly in HKSAR.

In the event that Beijing could find an alternate to Mr Tung Chee Hwa, history would certainly record such an event as merely fine-tuning the PRC economy.

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