Asian Development Outlook 2015
“Financing Asia's Future Growth"

Leo F. Goodstadt, 27 March 2015
Foreigners Get Things Wrong

“Outside predictions about China's economy are never right: Sometimes people criticize it, sometimes people praise it. But always, the predictions are n’t right”.

(Liu Weimin, MFA Spokesman CD 11/07/12)
“Useful lessons can be drawn from the PRC experience”

1. “It is possible to rapidly improve the efficiency of state-owned banks.”

2. “An incremental approach can have unintended consequences … The glacial pace of interest rate liberalization has given rise to an unsustainably large increase in credit and the creation of a large shadow banking system.”

3. “The difficulty of rooting out implicit guarantees and moral hazard in a financial system that is dominated by state-owned actors.”
Economic Revolution

• 1966-76: “Command” economy falters despite robust economic growth:
  – Ideological campaigns’ ability to inspire higher output slumps.
  – State planners lose political credibility.
  – Austerity campaigns provoke growing labour unrest from 1974.

• 1979: Deng Xiaoping’s reforms start the switch to a market economy, at an unexpected gallop.
Economic Reconstruction

1966-76: All conventional legal and financial institutions and systems disappeared.

- By 1978, no lawyers to draft or enforce laws for a market economy. Of PRC’s 2,000 counties, 1,200 had no legal officials (RR 19/12/02)
- No financial supervision, with only 4% of govt agencies audited. ("Report on Auditing Work 1985")
- Banking was reinvented: from cheques and money transfers to L/Cs. Total bank lending rose from RMB210 mn to RMB1.5 bn, 1978-90.
In Place of Planning

- National credit policies by 2000 are replacing fading central plan leverage
  - “OUT”: Bank lending for PRD/YRD (especially for MNCs), plus autos, steel, power, cement, coal; and
  - “IN”: Bank Lending for West/Northeast Regions, plus “strategic industries” IT, advanced equipment m’fctring, new energy/energy saving, new materials
  (NCNA 30/05/12)
Banks Bear the Losses

• 2000: PBOC Governor complained the government took it for granted that “the economic risks of the whole society” could be transferred to his sector. (PBOC Stanford U, 17/10/00)

• 2009: IMF study reported that “the correlation between efficiency and profitability is close to zero for Chinese banks”. (IMF, WP/09/170 (August 2009))

• 2011: IMF said banks’ role as “channel of monetary policy” and “facilitators of fiscal policy” distorted bank “incentives” and increased “contingent liabilities” on “public balance sheet”. (IMF, 2011)
The Costs of State Controls

- 1998-99: US$223 bn bank NPLs refinanced – 70% caused by state intervention. (PBOC, 16/04/04)
- 2009: US$586 bn economic stimulus package, 70% to be funded by LGs
- 2011: US$438 bn LG bank loans “reclassified”.
- 2015: US$160 bn swap funding for LG bonds (mostly bank funded originally) (NCNA, 12/3/15)
An Emerging Financial Market

- 2010: First “clear regulations” for “managing government funds”.
- 2011: “Rudimentary mechanism” to fund LGs at county level.
- 2011-12: NPC rejects law to legalise LG bond issues: LGs “lack transparency and proper monitoring”. (CD 27/06/12)
- 2014: Legislation finally passed with strict controls on bond issues below province level. (NCNA 2/10/14)
Reforms Postponed – By Choice

• 1979: Five Deputy PMs endorsed market-driven interest rates. (*NCNA 8/03/79*)
• 1996: Official pledge of immediate moves towards this goal. (*CNS 25//96*)
• 2002: Pres Jiang promised to leave interest rates “to market forces”. (*NCNA /19/11/02*)
• 2014: PM Li promised measures “granting lenders more control over loans and interest rates”. (*CD 6/03/14*)
Backdoor Reforms

By 2013, an alternative money market was flourishing, linked “informally”, and usually illegally, to the banking system. “About half of all financing activities are conducted through wholesale money and capital markets and at market-determined interest rates”. (HKIMR, WP No.16/2013 (October 2013)
Never Mind the NPLs, Enjoy the GDP Growth

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<tr>
<th></th>
<th>1978</th>
<th>2013</th>
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<tr>
<td>Share of world GDP</td>
<td>2%</td>
<td>12%</td>
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<tr>
<td>World trade ranking</td>
<td>29\textsuperscript{th}</td>
<td>2\textsuperscript{nd}</td>
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<tr>
<td>Total forex reserves</td>
<td>USD1.6bn</td>
<td>USD3.9tn</td>
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<tr>
<td>Total FDI (cumulative)</td>
<td>USD21bn</td>
<td>USD1.9tn</td>
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Legacy of Policies Postponed

- World Bank/PRC Development Research Centre reported in 2014 that China suffered an “infrastructural” deficit. It lacked the fiscal transparency, the financial oversight, the land legislation and the institutional framework to allow the early creation of efficient bond markets and similar funding facilities. (Urban China: Toward Efficient, Inclusive, and Sustainable Urbanization & China 2030)

- Qualified lawyers per 10,000 of population: 2013: PRC: 1.6    USA: 39.6
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3. “The difficulty of rooting out implicit guarantees and moral hazard in a financial system that is dominated by state-owned actors.”
Additional Data and Sources

1. Reluctant Regulators: How the West Created and China Survived the Global Financial Crisis (Hong Kong University Press, 2011)

2. 嚴防金融海嘯重臨: 香港監管文化的啟示 (Hong Kong: Enrich Publishing, 2012)
A Low-income Society

- Total GDP global rankings 2013
  - 1. USA: USD16.8 tn
  - 2. PRC: USD9.2 tn
- GDP per cap global ranking 2013
  - 99. PRC (RR 07/05/14)
- PRC annual income per cap 2013:
  - Urban (disposable) USD4,406
  - Rural (net) USD1,454 (NCNA 24/02/14)
Global Trade, Local Banking

• Foreign banks’ share of total PRC bank assets *(NCNA 13/01/15)*:
  – 2004: 1.84 per cent
  – 2013: 1.73 per cent

• Foreign-financed firms’ share of total PRC foreign trade *(RR 30/04/05, CD 9/09/12)*:
  – 2004: 57 per cent
  – 2011: 50+ per cent