TRANSFORMING CHINA'S TRADITIONAL BANKING SYSTEMS UNDER THE NEW NATIONAL BANKING LAWS

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I. INTRODUCTION

In traditional Chinese, "bank" translates to "qian zhuang", which means a place where money is deposited and lent and a profit is made. However, for three decades under the centrally planned economy in China (1949-1979), the Chinese government owned and controlled banks. Rather than "qian zhuang", a profit-generating body, banks in China had been operated more like a government administrative agency to perform the government's economic and monetary polices. As a result, banks in general were operated in the red with heavy government subsidies.

The economic reforms initiated in late 1978 entailed a significant restructuring of China's unitary and inefficient banking and financial systems. In recent years, banking reform has appeared increasingly important at a time when the central government is combatting double-digit inflation, seeking to attract more foreign trade and investment, and attempting to rescue thousands of ailing state-run enterprises that are mired in operational losses and "triangular debts".[1]

The recently enacted Central Banking Law and the Commercial Banking Law seek to solidify the progress that has been made, and more significantly, provide a framework in which a new banking system will develop. Such a new banking system will make China more closely integrated with international banking and financial systems. As a crucial part of the overall economic reforms, this could help to overhaul China's entire financial

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[1] *See* Tony Walker, *China to Impose Tougher Discipline on Banks*, FIN. TIMES, June 29, 1995, at 6 (noting that among most serious burdens on banking system is that of "triangular debt", which means inability of one enterprise to meet its obligations to another, thus setting off chain reaction that requires infusion of public funds to unblock the system).

system.[2] The banking system could also open up more opportunities for foreign financial institutions that have been trying with fits and starts to access China's banking and financial business, one of the fastest growing yet still rather unstable areas of Chinese business.[3]

This article consists of five parts. After a brief introduction in Part I, Part II reviews China's early banking system in which banks operated strictly under the model of a centrally planned economy. This part also traces the significant changes that occurred in the banking industry since 1979, especially in the early 1990s as broader banking reform was precipitated by an overall economic reform that gained momentum after Deng Xiaoping's southern China tour in January 1992. Part III examines the basic structure and content of the two newly promulgated national banking laws and the Central Bank's Lending Provisions made pursuant to the banking laws. Part IV highlights the progress as well as limits and pressures facing China's transforming banking industry. The article concludes in Part V that China's banking reform will remain gradual and evolutionary.

II. CHINA'S BANKING SYSTEM IN TRANSFORMATION

For a long time, the People's Bank of China ("PBOC") was the only bank in China, performing mixed functions of a sort of central bank and commercial/merchant bank. Founded in December 1948 on the eve of the founding of the People's Republic of China ("PRC"), the PBOC had been a government agency under the State Council with the main responsibilities of stabilizing the value of Renminbi (the official currency) and attracting and allocating funds for "socialist construction." It has traditionally maintained a product-economy management system under highly centralized control, characterized by management in kind and mandatory planning.[4] As a result,

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[2] For a discussion of reforming China's securities industry, see Andrew X. Qian, *Riding Two Horses: Corporatizing Enterprises and the Emerging Securities Regulatory Regime in China*, 12 UCLA PAC. BASIN L.J. 62 (1993); Andrew X. Qian, *Why Does Not the Rising Water Lift the Boat? Internationalization of the Stock Markets and the Securities Regulatory Regime in China*, 29 INT'L LAW. 615 (1995) [hereinafter *The Rising Water*].

[3] *See, e.g., Credit Cards Catch On in China*, WALL ST. J., May 10, 1995, at 10. Credit cards issued in China doubled in 1994 to 8.4 million from a year earlier. Credit charges totalled $6.2 billion, with 135,900 business in more than 30 cities possessing the cards. Credits cards, however, debuted in the China market only 10 years ago. *Id.*

[4] Liu Hongru, *Developments In the Reform of China's Banking and Financial Systems* [hereinafter *Reform of China's Banking and Financial Systems*], 2 J. CHINESE L. 323 (1988).

China's banks traditionally played the passive roles of bookkeepers and cashiers.[5]

In late 1978, China's economic reform and open-door policies were initiated at the Third Plenary Session of the Eleventh Chinese Communist Party Congress.[6] In retrospect, one may briefly divide the past 16-year history of China's banking reform into three stages of development.

The first stage, which dated from 1979 to the mid-1980s, could be characterized as, in a common Chinese saying, "some thunders, but no rains." The drafting of China's banking laws began in 1979 after Deng Xiaoping—China's chief architect of reform and open door policy—remarked in October 1978 that China's banks should be operated like real banks.[7] However, as the overall economic reform had just taken off, the traditional system of a planned economy was not completely dismantled and people had little idea of what a new banking system would look like.

Not surprisingly, some people looked to the west for models. In addition, after the initial years of reform in the rural areas, economic reform programs had expanded into the urban areas in the mid-1980s. The banking reform was placed on the agenda as a part of the urban reform. Around 1983, after the newly created Industrial and Commercial Bank of China took over the commercial-banking functions of PBOC, a group of young PBOC staff members proposed to make PBOC officially a central bank, and moreover, a statutory body answerable only to the National People's Congress ("NPC")[8]—a model similar to the United States' Federal Reserve System. Such a proposal was eventually rejected, because the authorities believed that the stakes were too high for the government to relinquish its control and to have an independent banking system like the United States' Federal Reserve System.[9]

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[5] *Id.*

[6] For an overview of China's economic reform and open-door policy, see generally HARRY HARDING, CHINA'S SECOND REVOLUTION: REFORM AFTER MAO (1987). *See also* RICHARD BAUM, BURYING MAO (1995).

[7] Han Yuting et al., *Ba Yinghang Banchen Zhenzhen de Yinghang - Zhongguo Renmin Yinghang Fa Chutaiji [We Should Operate Banks Like Real Banks - History of the People's Bank of China Law]*, RENMIN RIBAO (overseas ed.), Apr. 21, 1995, at 2.

[8] *See* Joan Zheng, *Battling China's Inflation*, FAR EASTERN ECO. REV., Mar. 30, 1995, at 34.

[9] The U.S. Federal Reserve System was created under the Federal Reserve Act, 38 Stat. 251 (1913). The Act created a seven-member board of governors to supervise the Federal Reserve System. There are 12 reserve districts in the United States, and the Act created a

In January 1986, the Chinese government issued *Provisional Regulations Concerning the Administration of Banks* that symbolized the first step towards banking reform. The commercial-lending business was separated from the PBOC and transferred to newly created "specialized banks."[10] Thus, in the mid-1980s, four "specialized banks" were established, including the Industrial and Commercial Bank of China ("ICBC"),[11] the Agricultural Bank of China ("ABC"),[12] the Bank of China ("BOC")[13] and the People's Construction Bank of China ("PCBC").[14] Several other commercial banks were also set up around this period including the Bank of Communications, Citic Industrial Bank and Everbright Bank. The PBOC had gradually taken

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reserve bank in each district with the power to issue Federal Reserve System notes and to rediscount commercial paper and agricultural obligations. Membership in the Federal Reserve System was made mandatory for national banks and available upon application for qualifying state banks. *See* STEPHEN K. HUBER, BANK OFFICER'S HANDBOOK OF GOVERNMENT REGULATION 1-6, 1-7 (2d ed. 1989). *See generally* MILTON R. SCHROEDER, BANK OFFICER'S HANDBOOK OF COMMERCIAL BANKING LAW 1989 (providing overview of Federal Reserve System in Part I(3)); *cf.* Louis Uchitelle, *At the End, It Looks Like Deja Vu, Again*, N.Y. TIMES, July 2, 1995 at E1, E5 (criticizing Federal Reserve System for being overly cautious, slowing down economy when it is booming, and being reluctant to bring back prosperity).

[10] For a discussion of "specialized banks", see Liu Hongru, *Reform of China's Banking and Financial Systems*, *supra* note 4, at 350-52 (noting specialized banks are not responsible for their own profits and losses, their operating results are not linked to their own profits, and loans are made regardless of risk).

[11] With 500,000 employees and 50,000 branches, ICBC is the largest among the four specialized banks. Many of its clients are among China's top 500 state-owned enterprises, which could hardly be a bonus. *See, e.g.*, Tony Walker, *Slow Winds of Change Blow Among China's Banks - Banks Are Trying to Free Themselves From State Control But Barriers Remain And Progress Has Been Varied*, FIN. TIMES, Dec. 1, 1994, at 32, *available in* LEXIS, News Library, Curnws File [hereinafter *Slow Winds*].

[12] The ABC is in better shape than the ICBC partly because of the success of its township and village enterprises. The ABC has also divested responsibilities for policy lending in agriculture to the newly established Agricultural Development Bank and has transferred one-fifth of its assets to the new policy bank. The ABC has reportedly taken a tougher approach by refusing new lending to the more recalcitrant creditors among state enterprises. *Id.*

[13] Long considered a specialized bank in overseas and foreign exchange business, BOC has 170,000 employees and 8,000 branches in China and 474 overseas offices. *Id.*

[14] With 250,000 employees and 25,000 branches, PCBC is regarded as being in the best position among the three domestic specialized banks to commercialize. Some of its responsibilities have been taken over by the newly established State Development Bank to handle infrastructure lending for big projects such as the Three Gorges Dam. PCBC has formed a joint venture with Morgan Stanley, China International Capital Corp. Ltd., to raise capital abroad to fund China's infrastructure project. *Id.*

on some responsibilities exclusively as a central bank. The following descriptions best summarized China's banking system in the mid-1980s:

> "The organizational principle of the current financial system in China is unified leadership and division of specialism. The overall financial system implements the unified policy, plan and system which are stipulated by the State. Each specialized bank has its special responsibility in its own field. Thus a socialist multi-level financial system with Chinese characteristics has been established, with the central bank as its core and specialized state banks as its main body, and with co-existing diversified forms of financial organization.[15]

The third stage, from the early 1990s until the present, witnessed some significant changes to China's banking system. In 1992, under the general theme of establishing a "socialist market economy with Chinese characteristics," the government issued the *Decision on Financial System Reform* ("*Guanyu Jinrong Tizhi Gaige de Jueding*"), calling for the establishment of a central bank which would be solely responsible for implementing a sound monetary policy, controlling currency and credit supply, and exercising strict supervision over financial institutions. Under the government's new initiatives, a working group for drafting national banking laws was formed in February 1993. Quickly, drafts of the national banking laws were sanctioned in principle at a Communist Party Plenary Session in late 1993.[16]

In 1994-95, China's banking reform took three steps toward building an efficient and autonomous banking system. First, China started reforming its foreign exchange control system. It got rid of the dual exchange rate system for Renminbi yuan that had been in practice for many years. Also, it aims to make Renminbi a fully convertible free currency in the next three to five years. As an initial step, China would permit limited foreign exchange trading in four locations, including Shanghai, Dalian, Shenzhen and eastern

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[15] CHINESE ACADEMY OF SOCIAL SCIENCES, INFORMATION CHINA 633 (1988).

[16] *See* Jeffrey Parker, *China Unveils Sweeping Reforms to Banking System*, REUTERS, Dec. 3, 1993, *available in* LEXIS, News library, Arcnws file.

Jiangsu Province.[17] Second, three policy banks ("*zhengce yinhang*") were formed, including the State Import and Export Bank, the State Development Bank, and the State Agricultural Bank. This to a large extent freed the four specialized banks from making the so-called "policy loans" that are often non-performing and thus are not normally made under a commercial bank's standards. The "big four", after two years of rapid growth, were positioning themselves to become commercial banks. Meanwhile, in order to control inflation and to sustain a reasonable economic growth rate, PBOC, then headed by executive Vice Premier Zhu Rongji,[18] was shifting from using methods of direct control (such as credit freeze and administrative measures) to applying mechanisms of indirect control (e.g. interest rates, reserve funds deposit rates, and open markets).[19] Third, China's banking industry is gradually opening up to foreign participation. China has opened over 20 cities to foreign financial institutions,[20] and has permitted foreign banks to participate in some local banking or non-banking financial business.

As of mid-1995, there are three state policy banks, four state specialized banks, ten commercial banks, over five thousand urban credit co-ops, and some sixty thousand rural credit co-ops.[21] The gradual yet significant banking reform needs national laws to solidify the progress and provide guidance for further (and perhaps bolder) experimentation.

III. A NEW LEGAL FRAMEWORK FOR THE BANKING INDUSTRY

Since 1979, although China has promulgated certain regulations for the banking industry at either administrative or local levels governing banks and

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[17] *See* Tony Walker, *China to Permit Limited Forex Trading*, FIN. TIMES, Mar. 4, 1996, at 4.

[18] *See* Joyce Barnathan and Dexter Roberts, *In China's Shadow Play, The Man To Watch May Be Zhu*, BUS. WEEK, July 17, 1995, at 53 (discussing Zhu's role in running China's economy, including his achievements at Central Bank as he recently stepped down as Governor). *See also WORLD WIRE: Postscripts*, WALL ST. J., July 3, 1995, at A14 (discussing appointment of Dai Xianglong to succeed Zhu Rongji as Central Bank's new Governor).

[19] *See* Ding Jianmin, *Zhongguo Renmin Yinhang Zaici Tigao Daikuan Lilu [PBOC Again Raised Lending Rates]*, RENMIN RIBAO (overseas ed.), July 1, 1995, at 4 (noting that PBOC will raise lending rates 0.24% to financial institutions and raise annual lending rates to commercial banks and other financial institutions 0.96%).

[20] *See* Walker & Peel, *infra* note 64.

[21] *See* Kathy Chen, *China to Create Commercial Banks In 35 Big Cities*, WALL ST. J., June 21, 1995, at A15.

credit unions,[22] international banking,[23] foreign exchanges[24] and insurance,[25] the overall legal regime governing the banking industry is far from adequate. The PRC People's Bank of China Law[26] (hereinafter the "Central Banking Law") and the Commercial Banking Law[27] are the first national laws enacted to govern the banking system.

A. *The Central Banking Law*

The Central Banking Law has eight chapters. It establishes the People's Bank of China as China's central bank,[28] sets up a basic structure under

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[22] *See, e.g.*, Provisional Regulations Concerning the Administration of Banks (1986) [*Yinhang Guanli Zhanxin Tiaoli*], Rules Concerning the Banks Methods of Settlement (1988) [*Yinhang Jiesuan Banfa*], Provisional Regulations Concerning the Municipal Co-operative Credit Unions [*Chengsi Xinyong Hezuoshe Zanxin Tiaoli*] and Provisional Regulations Concerning Administration of Cash (1988) [*Xianjin Guanli Zhanxin Tiaoli*]. The above texts are available in CHINA LAWS FOR FOREIGN BUSINESS: BUSINESS REGULATION, Vol. 1 (CCH Int'l, 1993) [hereinafter CHINA LAWS].

[23] Rules Concerning the Administration of Foreign Invested and China-Foreign Invested Financial Institutions in the Special Economic Zones (1985) [*Zhonghua Renmin Gongheguo Jinji Tequ Waizi Yinhang Zhongwai Hezi Yinhang Guanli Tiaoli*] and Methods Concerning Administration of Overseas Financial Institutions (1990) [*Jinwai Jinrong Jigou Guanli Banfa*]. CHINA LAWS, *supra* note 22.

[24] Provisional Regulations Concerning Administration of Foreign Exchanges (1980) [*Waihui Guanli Zhanxin tiaoli*]; Detailed Rules on Penalizing Violations of Foreign Exchange Regulations (1985) [*Weifan Waihui Guanli Chufa Shixin Xize*] and Methods Concerning Administration of Overseas Investment (1989) [*Jinwai Touzi Waihui Guanli Banfa*]. CHINA LAWS, *supra* note 22.

[25] Provisional Regulations Concerning Administration of Insurance Enterprises (1985) [*Baoxian Qiye Guanli Zhanxin Tiaoli*]. CHINA LAWS, *supra* note 22. The national Insurance Law was approved on the 14th session of the 8th NPC Standing Committee. *See* He Ping, *Bajie Renda Changweihui Shisici Huiyi Bimu [14th Session of the 8th NPC Standing Committee Has Ended]*, RENMIN RIBAO (overseas ed.), July 1, 1995, at 1. The recent NPC Standing Committee session approved Insurance Law, Financial Guaranty Law and Decision to Punish Crimes of Sabotaging Financial Order. *Id.*

[26] Approved on the 3d Session of the 8th National People's Congress ("NPC") on March 18, 1995, the Central Banking Law becomes effective on the day of promulgation. For the text, see RENMIN RIBAO (overseas ed.), Mar. 23, 1995, at 2. For the English translation, see CHINA LAW & PRACTICE, June 27, 1995, at 23-30.

[27] Approved on the 13th Session of the 8th Standing Committee of the 8th NPC on May 10, 1995, it will become effective on July 1, 1995. For the text, see RENMIN RIBAO (overseas ed.), May 13, 1995 at 2. For the English translation, see CHINA LAW & PRACTICE, June 27, 1995, at 32-48.

[28] Central Banking Law, art. 2 (China).

which the central bank will operate, and prescribes two major functions for the central bank.

1. *Nature and Structure*

Owned by the state, the People's Bank of China ("PBOC") was established to formulate and implement the government's monetary policies as well as exercise supervision and administration of the financial industry under the leadership of the State Council.[29] It is not clear whether PBOC as the central bank falls into the same rank as other government ministries such as the Ministry of Finance, or occupies a special position in the State Council (cabinet). As a new method of exercising some kind of supervision by the national legislature, the central bank must report its work to the Standing Committee of the National People's Congress ("NPC").[30]

One of the most unique features about the Central Banking Law is that it forbids any government authorities at any level, any local governments, social organizations or individuals to interfere in the PBOC's lawful and independent implementation of monetary policy, fulfilling its responsibilities, and business operation.[31] Nevertheless, because many of the PBOC provincial branches are under the dual administration of both the PBOC headquarter in Beijing and the local provincial or municipal government, one may hope that in practice as is written in law, such interference will be substantially reduced (if not eliminated).

2. *Major Responsibilities*

The central bank is charged with three major responsibilities: making and implementing national monetary policy,[32] exercising supervision and administration over financial institutions,[33] and maintaining the stability of the official currency—Renminbi yuan. In performing its responsibility as

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[29] *Id.* arts. 2 & 7.

[30] *Id.* art. 6. In addition to NPC's supervisory role, one can argue that NPC also has the right, through some of its special committees (*e.g.*, the Legislative Committee, the Committee of Economy and Finance), to exercise supervision in making sure that the national laws are properly implemented.

[31] *Id.* art. 7.

[32] *Id.* Part One (General Provisions), Part Three (Renminbi) and Part Four (Business Operations).

[33] *Id.* Chapter Five (discussing Financial Supervision and Administration).

monetary policy maker and executor, the Central Banking Law provides the PBOC with economic and market-oriented mechanisms or tools rather than purely administrative measures, including requiring banks to deposit reserves,[34] determining the basic interest rate,[35] operating rediscounts for financial institutions that have accounts with the PBOC,[36] granting loans to commercial banks,[37] and buying and selling treasury bonds and other government securities and foreign exchanges in the open market.[38]

Meanwhile, the Central Banking Law also prohibits the PBOC from engaging in certain activities, such as directly subscribing for or underwriting treasury bonds or other government securities,[39] or providing loan to local government, governmental authorities at any level, non-banking financial institutions, other work units, or individuals.[40] In addition, the central bank may not provide guarantees to any work units or individuals.[41]

The second major responsibility for the PBOC is to supervise and regulate financial institutions.[42] However, there is some ambiguity in some of the provisions (or lack of provisions) in the Central Banking Law that needs future clarification. First, due to the rather vague provisions in the new national securities law, there could be potential (perhaps major) conflicts between the PBOC and the State Council's Securities Commission regarding the jurisdictions of some securities or securities-related institutions (which are considered to be financial institutions). The jurisdiction to regulate these institutions could arguably belong to both or either regulatory bodies. Such jurisdictional problems could also extend to supervision and administration over some non-financial institutions that perform certain financial functions.[43] Second, though not explicit in the language, foreign financial institutions or China-foreign joint ventures in financial industry seem also to

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[34] *Id.* art. 22(1).

[35] *Id.* art. 22(2).

[36] *Id.* art. 22(4).

[37] *Id.* art. 22(4).

[38] *Id.* art. 22(5).

[39] *Id.* art. 28.

[40] *Id.* art. 29.

[41] *Id.* art. 29.

[42] *See Id.* Part 5, arts. 30-36.

[43] *Cf. Fei Yinghang Jinrong Jigou Jiang Jiaqiang Jianguan [PBOC Will Enforce Its Supervision over the Non-Bank Financial Institutions]*, WORLD J. (New York), May 3, 1995, at B15 (noting PBOC plans to issue rules in next two or three years regarding insurance, securities, lottery and investment funds).

be subject to the PBOC's supervision and administration. That means that foreign banks need to obtain approval primarily from the PBOC for establishing branches, representative offices or forming joint ventures in China.

B. The Commercial Banking Law

1. General Principles

The concept of a commercial bank is rather new to China's banking industry, because most of the current candidates yet to be fully transformed into commercial banks in China are labelled as "specialized banks" ("*zhuanye yinhang*"). Today, they are the "big four," the Industrial and Commercial Bank of China, the Agricultural Bank of China, the People's Construction Bank of China and the Bank of China. According to the Commercial Banking Law, commercial banks, under the supervision of the central bank,[44] should be operated under the principles of efficiency, safety and liquidity. The commercial banks should rely on self-operation ("*zizhu jinyin*"), self-risk management ("*zidan fenxian*"), self-responsibility for profits or losses ("*zifu yinkui*"), and self-restraint ("*ziwuo yuesu*").[45] Their operations should be independent and free from any interference of any work units or individuals.[46]

2. Establishment

The Commercial Banking Law contains provisions that explain how commercial banks are to be established and organized. There are different minimum amounts of registered capital requirements for a commercial bank (which shall be RMB 1 billion), an urban co-operative credit union (which shall be RMB 100 million) and a rural co-operative credit union (which shall be RMB 50 million), depending upon the needs of economic development and details of competition within the banking industry.[47] Apart from complying with the PRC Company Law procedures of incorporating a

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[44] Commercial Bank Law, art. 10.
[45] *Id.* art. 4.
[46] *Id.*
[47] *Id.* arts. 12, 13.

company, a new commercial bank incorporator must file an application with and submit certain documents to the central bank for approval.[48]

3. Lending Business and Other Operations

Under the new Commercial Banking Law, a commercial bank must make strict examination of the borrower regarding its borrowing purpose and its ability and method of repayment.[49] It is required that each loan by commercial banks receive guarantees or collateral, and the lending banks should make strict investigations of the guarantors regarding their repayment ability, the ownership and value of their collateral and the feasibility of realizing the mortgage or pledge rights,[50] except that those borrowers with excellent credit could be waived from making such a guarantee.[51]

Once the borrower fails to repay a guaranteed or secured loan upon maturity, the lending bank shall have the lawful right to require the guarantor to repay the principal and interest of such loan, or alternatively have the preemptive right to receive compensation via the collateral.[52] A work unit or individual may not force the bank to make a commercial lending or provide a guarantee.[53] Only a state-owned commercial bank may lend to special projects approved by the State Council and any losses resulting from such lending will get remedies from the State Council.[54] The new law also specifically emphasizes the management of debt-equity ratio.[55]

Furthermore, a commercial bank is forbidden from participating in a number of activities or businesses stipulated in the Commercial Banking Law. For example, commercial banks may not engage in trust investment

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[48] *Id.* art. 14.

[49] *Id.* art. 35.

[50] *Id.* art. 36. It is less clear whether providing guarantee is equivalent to a secured transaction, where the borrower itself and its subsidiaries or affiliates give secured interest in their assets to the lender as is governed by the Uniform Commercial Code (Article 9) in the United States.

[51] *Id.*

[52] *Id.* art. 42.

[53] *Id.* art. 41. *See also Chinese Banks May Say No*, WALL ST. J., May 9, 1995, at A17 (noting that Bank of Communications, Bank of China, People's Construction Bank of China and Industrial and Commercial Bank of China account for 80% of financial transactions and credit in China, and 15% of their loans are bad).

[54] Commercial Banking Law art. 41.

[55] *Id.* art. 39.

or stock business and may not invest in real properties (which are not for its own use) within the PRC.[56] In addition, commercial banks may not normally invest in a non-banking financial institution or enterprise within the PRC.[57]

The new Commercial Banking Law has a separate chapter that addresses the issues of protecting the interests of depositors. The new law affords a commercial bank rights to reject any inquiry, freezing, deduction or garnishing from any work units or individuals on deposits made either by work units or individuals (unless the law provides otherwise).[58] Individual depositors, according to the new law, shall enjoy "voluntariness of depositing, freedom of withdrawal, payment of interest on deposits and maintaining confidentiality". It remains to be seen in practice that depositors' interests would be truly protected by commercial banks under this provision.[59]

4. *Foreign Banks*

The new Commercial Banking Law will also apply to foreign-owned commercial banks, China-foreign joint invested commercial banks and foreign banks' branches. Thus, as the Central Banking Law is rather vague on whether foreign banks or branches and banks of a joint venture type are to be supervised and regulated by the PBOC, the Commercial Banking Law has made clear provisions in this respect.

C. *Lending General Provisions (Trial Implementation)*[60]

Pursuant to the Central Banking Law and the Commercial Banking Law, PBOC sets forth a set of more detailed principles and standards that shall be

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[56] *Id.* art. 43. This provision is similar to the Glass-Steagall Act, which forbids American commercial banks from engaging in the securities underwriting business. *See* STEPHEN K. HUBER, BANK OFFICER'S HANDBOOK OF GOVERNMENT REGULATION § 12.03 1989; *cf. The Future of Banking: A Discussion*, THE NATIONAL L.J., July 17, 1995, at A1, A24 (discussing various proposals to reform Glass-Steagall Act).

[57] Commercial Banking Law art. 43.

[58] Commercial Banking Law arts. 29, 30.

[59] *See* Liu Siyang, *Renda Changweihui Huiyi Fenzu Shenyi Sige Falu he Yige Jueding Chaoan* [*NPC Standing Committee Holds Sessions to Discuss Four Laws and One Decisions*], RENMIN RIBAO (overseas ed.), May 9, 1995, at 1 (noting that when discussing Commercial Banking Law, some NPC members suggested more concrete measures be made to protect depositors' interest).

[60] Promulgated by the PBOC on, and effective as of July 27, 1995; both the text and the English translation are available in CHINA L. & PRACTICE, Nov. 1, 1995, at 35-53.

observed in the domestic lending and borrowing activities. In twelve Parts and eighty-two Articles, the Lending General Provisions (the "Provisions") govern types of loans, loan periods and interest rates, borrowers' rights and obligations, lenders' rights and obligations, lending procedures, administration of loans and protection of loans. Although the trial Provisions contain certain overly rigid[61] or still ambiguous rules, the Provisions represent the Central Bank's comprehensive efforts to restructure and reform the banking business in a systematic, not piecemeal, fashion. The Provisions, however, do not apply to foreign banks or foreign financial institutions and their operations in China.

IV. LIMITS AND PRESSURES IN CHINA'S BANKING REFORM

Shortly after the promulgation of the two national banking laws, new commercial banks have been or are being formed in accordance with the new banking laws.[62] Furthermore, many of the urban and rural co-operative credit unions face opportunities of restructuring and development.[63] Foreign banks may gain a little sense of certainty as the legal framework governing China's banking industry starts to take shape. Their business activities, as well as competition, are expected to increase.[64] China is

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[61] For example, under article 16(1), interest rates on loans must be within the limits set by the PBOC. Under article 25(4), no foreign currency loans may be borrowed by individuals except with PBOC's approval. Nor can the individual borrow the Renminbi funds and convert them into foreign currency funds under article 21(6). Furthermore, article 25(2) prohibits lenders from making a loan for the purpose of earning interest. Disobedience is punishable by confiscation of the interest income and a fine of up to three times its amount. Article 66(2).

[62] *See* Tony Walker, *First Chinese Commercial Bank*, FIN. TIMES, June 27, 1995, at 6 (noting Shenzhen co-operatives commercial bank would be first commercial bank to be set up under new Commercial Bank Law); Dan Lan, *Min Seng Yinghang Niannui Kaiye [The Livelihood Bank Open End of the Year]*, RENMIN RIBAO, May 24, 1995, at 1. The Livelihood Bank will be one of China's first commercial banks formed under the new Commercial Bank Law. It will be in the shareholding form with the National Association of Industry and Commerce as the major shareholder. *Id.*

[63] *See* Chen, *supra* note 21, at A15.

[64] *See* Tony Walker and Quentin Peel, *Way Clear for Five Banks to Open in Beijing*, FIN. TIMES, June 7, 1995, at 4. The five banks that have been approved to have branches in Beijing include the Bank of Tokyo, Citibank, Banque Indosuez, Hongkong and Shanghai Banking Corp. and possibly, the Bank of East Asia. So far, China has opened 23 cities to foreign banks' branches. At the end of 1994, 118 foreign financial institutions had established branches China. *Id. See also Waizi Yinhang Jiang Zai Hu Jinyin Renminbi Yewu [Foreign*

currently campaigning hard to join the World Trade Organization (WTO). It has announced its initial plan to make Renminbi yuan a fully convertible free currency in the next three to five years.[65] Coupled with the efforts toward trade liberalisation and full currency convertibility, China is also beginning to reform thousands of large and medium-sized state-run enterprises. These events and their significant progress—China's prospective entry into the WTO, Renminbi becoming a free currency and the state-run enterprise reform—will hold opportunities as well as challenges for China's banking industry. In light of the progress that has been made in China's banking reform, one should be warned of being overly optimistic in China's banking reform because the verdict for an ultimate success is still out.

First, under the current circumstances, most of the banking institutions, especially those specialized banks and co-operative credit unions, are not up to the standards required by the Commercial Banking Law. As one of the banking law drafters observed, it would take "a period of time for the banking institutions to meet all the new banking laws' requirements."[66]

The undisciplined banking operations are the major source of the "financial disorder" in China. A number of financial scandals (some unreported) have occurred, including the recent bonds trading fiasco in Shanghai.[67] In October of 1995, due to its illegal business, inferior asset quality and undisciplined management, the Shanghai Branch of Zhongyin Trust and Investment Corporation (a non-banking financial institution) was placed under the direct monitoring and supervision of the PBOC Shanghai Branch, in accordance with the national banking law provisions—the first time that a central bank has seized a financial institution in China under the banking laws.[68] Charged with the major responsibility of cleaning up the "banking and financial disorder" at a time of rapid growth of the banking and financial industry, China's Central Bank has a tough task to accomplish ahead.

Banks Will Participate in Renminbi Business in Shanghai], RENMIN RIBAO (overseas ed.), Jan. 16, 1995, at 2.

[65] *See Beijing's Blueprint for Reform*, FIN. TIMES. Nov. 13, 1995, at 19 [hereinafter *Beijing Blueprint*]. During the *Financial Times* interview, Zhu Rongji is reported to have said that China plans to make its currency convertible on the current account "well ahead of schedule." *Id. See also China's Currency 'Convertible Soon'*, FIN. TIMES, Sept. 22, 1995, at 7. Dai Xianglong, Governor of the PBOC, said that China's currency Renminbi yuan should be fully convertible in 1997 or 1998. *Id.*

[66] *See China Passes New Banking Law*, FIN. TIMES, May 12, 1995, at 3.

[67] For discussion, see *The Rising Water*, *supra* note 2, at 628-29.

[68] *See Chinese Financial Firm in Peril*, WALL ST. J., Oct. 16, 1995, at A11.

Second, even if the banking institutions in China are operating under the new banking laws, thus gaining much autonomy in their own operations and management, they are far from being independent and immune from government interference. In fact, the Central Bank is placed directly under the State Council's leadership. The PBOC may decide what means it may use to implement the government's monetary policy, but the decision-making process is still under the tight control of the central government,[69] quite contrary to the Federal Reserve System in the United States which China's new banking system has somehow drawn upon. For commercial banks, likewise, government influence would be strong.

Furthermore, structurally, the PBOC and the big four have thousands of regional and local branch offices that are under dual administration by the headquarters and the regional or local governments. Such an administrative structure could hardly guarantee the full autonomy granted to the banking institutions in the new banking laws.

Third, the success of China's banking reform goes hand-in-hand with that of state enterprise reform. Currently, the number of China's large and medium-sized state enterprises totals fourteen thousand. And nearly one-half of these fourteen hundred state enterprises were debt-ridden in the first half of 1995.[70] Most of these chronically in the red enterprises have had loans from the formerly state banks or from other enterprises which were borrowers from those banks (creating the so-called "triangular debt"). By strict commercial standards, some of China's commercial banks are facing banking insolvency because the bad loans they are unable to recover from thousands of failing state enterprises could amount to one-third of their total commercial loans.[71] For the "big four" commercial banks, the PBOC's new governor estimated that problem loans stand at twenty percent of their total

[69] *Cf. Zhongguo Renmin Yinhang Fu Hangzhang Zhou Zhenqin Jiu Zhongguo Renmin Yinhangfa Da Jizhe Wen [Vice-Governor of PBOC Answered the Press]*, RENMIN RIBAO, Mar. 22, 1995, at 4 (arguing independence for Central Bank means independence from other government agencies and local governments, but the monetary policy is a part of country's macro-economic policy). *See* Henry Sender, *Black-Box Bankers*, FAR EASTERN ECO. REV., Feb. 9, 1995, at 48-49 (noting strange phenomenon in China that central bankers are little known and aspire to obscurity rather than prominence).

[70] *See* Tony Walker, *China to Reform State Companies*, FIN. TIMES, Oct. 6, 1995, at 7 [hereinafter *Reform of State Enterprises*].

[71] According to one estimate, some 45% of China's 11,000 medium to large state companies were in the red in 1994. *See Slow Winds*, *supra* note 11, at 32.

advances, and less than two percent of them are irrecoverable.[72] Unless the enterprise reform takes a dramatic course and these state enterprises are quickly transformed either into profit-making corporations through merger, acquisition, divesture, or management buy-out, or are allowed to go bankrupt, China's banks may have to continue "throwing meat to dogs which can't be retrieved."[73]

To date, Beijing would target one thousand large state enterprises which are key and vital to the national economy for special assistance, which includes continuing bank loans at favorable terms. Enterprise debt would be allowed to be converted to equity as part of the efforts to "corporatize" the state sector and encourage merger.[74] Meanwhile, a large number of state enterprises that are not considered vital to the national economy will become likely candidates for either divesture, management buy-out, merger, or bankruptcy.[75] From the government's current modest plan,[76] the enterprise reform may take longer than expected to come into full swing. One of China's top officials estimated that "if the state banks are to be genuine commercial banks, we have to await the completion of the reform of the state-owned enterprises, and we will try to attain that goal by the end of the Century."[77] Meanwhile, the reform package keeps being revised and has yet to be finalized.

Last but not least, banks in China, especially the Central Bank, are facing mounting pressure and the dilemma between implementing and maintaining tight money policies in order to curb the rampant inflation rate on the one

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[72] *See* Peter Montagnon et al., *Bad Loans at Chinese Banks Total 20%*, FIN. TIMES, Oct. 30, 1995, at 1.

[73] The metaphor was made by Wang Qiren, former chairman of the Bank of China. *See Slow Winds*, *supra* note 11, at 32 (noting that by western measures, non-performing loans may account for up to 30 percent of loan portfolios for those Chinese banks, and these bad loans would render three out of four specialized banks technically insolvent). *See also* Peter Montagnon, *Bad Debts Curb Modernisation Drive*, CHINA SURVEY, Nov. 20, 1995, at 5; Craig Smith, *Chinese Companies Writing Off Old Debts*, WALL ST. J., Dec. 28, 1995, at A4.

[74] *See Reform of State Enterprises*, *supra* note 70.

[75] *Id.*

[76] *See Beijing To Hold Assets Tight*, WALL ST. J., July 3, 1995, at 14 (proposing that reform of China's debt-ridden enterprises won't involve privatization to any significant degree, and these assets will remain in state hands). *See also* Li Andin, *Guojia Jinmaowei Gongbu Gouyou Qiye Jinnian Gaige Yaodian [State's Commission on Economy and Trade Announced This Year's Enterprise Reform Key Points]*, RENMIN RIBAO (overseas ed.), Feb. 8, 1995, at 1.

[77] *See Beijing Blueprint*, *supra* note 65.

hand, and supplying sufficient funds and loosening credit in order to sustain the economic growth at a considerable speed on the other.[78] Maintaining a balance between the above two equally legitimate, yet somewhat contentious concerns would be a tough test for the central and commercial banks in China.

V. CONCLUSION

The enactment of two new banking laws illustrates some progress in reforming China's banking system. China needs to keep working to overcome the above-discussed limits and pressure points. China's banking reform would be gradual and at times frustrating to outsiders (as expectations often exceed reality). Inevitably, China's banking industry faces an uphill battle as it is seeking to gain more autonomy from the central government on the one side and to be freed from making those "policy loans" to the state-run enterprises on the other. Meanwhile, it is facing increasing competition both home and abroad from the foreign counterparts. A new banking system in China would be very different from the old Chinese "qian zhuang" in size and sophistication, but the essence of any banking operations and management, *i.e.* efficiency and independence, should remain basically unchanged.

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[78] *See* Kathy Chen, *China's Central Bank Chief Reaffirms Commitment to Keep Inflation in Check*, AWSJ, Oct. 16, 1995, at 3. *See also Chinese Loans to be Increased*, FIN. TIMES, May 24, 1996, at 7 (ICBC plans to increase lending for working capital this year by some 10 percent, in line with government's decision to ease credit to struggling state enterprises).