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"China's Financial System"

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ABSTRACT

Financial system is a system to financing, can be dividing two ways: one is financial market (direct finance); the other one is financial intermediary (indirect finance). In China, except the banking sector and financial market sector also have the other two sectors. One is Hybrid Sector; it's the kind of privatization. The other is foreign sector, this is important in China's financial system. China has kept a healthy structure of capital inflow since the long term debt accounts for the larger proportion (more than 80%) and Foreign Direct Investment (FDI) plays the major role.

The People's Republic of China (PRC) was established in 1st of Oct. 1949, has been transform from a closed economy dominated by agriculture and central planning system, to a fast-growing, market-oriented, open economy. Since the market-oriented economic reform in 1978, China approaches the issue from the perspective of how best to reform State-Owned Enterprises (SOEs) and State-Owned Banks and makes the transition from an administrative-run, bank-centric system to a broader market-based system.

In this paper, I want to explain that Currently, China is neither Bank-based nor Market-based financial system, or we can say china is adopting both of models. This system has been called "Socialism with Chinese characteristics" and is one type of mixed economy. Also during this transition process, china had been avoided in East Asia Financial crisis in 1997. Because of Chinese capital market has not fully opened. A cautious liberalization policy on the financial market provides a larger room for Chinese government to manage the crisis.

KEY WORDS: Non-performing Loans, developed corporate bond market, Hybrid Sector, Foreign Direct Investment (FDI), why China avoid in East Asia Financial Crisis

SECTION 1

INTRODUCTION

1.1 Aim of study

The aim of this study is to define the concepts of bank-based and market-based financial system and comparative with china to understand the current situation about China's financial system. The reason of China avoid in East Asia Financial Crisis.

1.2 Importance of the study

To understand that China's current Financial System status is the transition process had been encountered some problems and possible solutions and future develop orientation.

1.3 Broad Problem Area

China's financial system is under the inefficient banking sector that have a huge Non-performing Loans and undeveloped financial market that inefficient stock market and tiny proportion in corporate bond market, these prevented china's economy continue grows up.

1.4 Problem Definition

China's banking industry has remained in the government's hands and responsible to support all the State-owned enterprise therefore produces the huge

Non-performing Loans. Because of this the private sector can not easily financing, and china launched stock market that haven't enough experience and a short-term dropped, therefore need to develop the financial market, specially the corporate bond market.

1.5 Methodology

I use some articles to indicate my aim of study. Use the theoretical and some database of China's financial system to prove that current China's financial system is neither bank-based nor market-based; it is unique or Chinese style.

1.6 Limitations and scope of coverage

In this paper I quote the table sources from "China's Financial System: Past, Present, and Future" (Allen, Qian, Qian, 2005) and "The Emerging East Asian Bond Market" (Dalla, Atkhate, 1996). The Figure sources from Chinese Statistical Yearbook 1998-2004; A Statistical Survey of China 1990-2003; People's Bank of China annual report, 2000-2003

1.7 Structure of the study

This paper can be divided into 4 parts. Firstly is Introduction, introduce the aim of study and explain all the structure of this paper. Secondly is Theoretical framework of Financial System, definition of the financial system, and prove that current China's Financial System's neither Bank-based nor Market-based or can say it is unique or undeveloped. Thirdly is Basic Statue of China's Financial System, explain the structure of China's Financial System and choose each part the importance to explain in order to understand the current situation is undeveloped. Finally is Conclusion and Recommendation.

SECTION 2

THEORETICAL FRAMEWORK OF FINANCIAL SYSTEM

2.1 Financial System: Direct Finance and Indirect Finance

Financial system is a system to financing, can be dividing two ways: one is financial market (direct finance); the other one is financial intermediary (indirect finance). Financial markets, markets in which funds are transferred from people who have an excess of available funds to people who have shortage. The process of indirect finance using financial intermediaries, called financial intermediation, is the primary route for moving funds form lenders to borrowers (Mishkin and Eakins, 2006).

Financial systems channel household savings to the corporate sector and allocate investment funds among firms. They allow inter-temporal smoothing of consumption by households and expenditures by firms. They allow both firms and households to share risks. These channels are the sources connecting financial development and financial structure to economic growth. The particular role of the financial system is information acquisition and risk sharing (Allen and Oura, 2004).

At this point to understand is important of financial system in economy is important there functions include facilitating the trading of risk, allocating capital, monitoring managers, mobile savings and earning the trading of goods, services and financial contracts. Growing literature shows that differences in how well financial systems reduce information and transaction costs influence savings rate, investment decisions, technological innovation and long-term growth rates (Levine, 1996).

2.2 Bank-based and Market-based Financial System

Traditionally financial system structure basically can be divided by two categories: Bank-based and market-based, but china's financial system neither bank-based nor market based, it is unique or can say undeveloped.

In bank-based financial systems such as Germany and Japan, banks play a leading role in mobilizing savings, allocating capital, overseeing the investment decisions of corporate managers, and in providing risk management vehicles. In market-based financial systems such as England and the United States, securities markets share center stage with banks in terms of getting society's savings to firms, exerting corporate control, and easing risk management (Demirguc-Kunt and Levine, 2001).

Since the 19th century, many economists have argued that bank-based systems are better at mobilizing savings, identifying good investments, and exerting sound corporate control, particularly during the early stages of economic development and in weak institutional environments. Others, however, emphasize the advantages of markets in allocating capital, providing risk management tools, and mitigating the problems associated with excessively powerful banks. Economists have constructed a vast number of theoretical insights into the comparative advantages of different financial systems (Allen and Gale, 1999).

The bank-based view highlights the positive role of banks in (i) acquiring information about firms and managers and thereby improving capital allocation and corporate governance (Diamond, 1984; Ramakrishnan and Thakor, 1984), (ii) managing cross-sectional, inter-temporal, and liquidity risk and thereby enhancing investment efficiency and economic growth (Allen and Gale, 1999; Bencivenga and Smith, 1991), and (iii) mobilizing capital to exploit economies of scale (Sirri and Tufano, 1995). The bank-based view also stresses the shortcomings of market-based systems. Stiglitz (1985), for instance, argues that well developed markets quickly and publicly reveal information, which reduces the incentives for individual investors to acquire information. Banks, however, mitigate this problem since they form long-run relationships with firms and do not reveal information immediately in public markets (Boot, Greenbaum, and Thakor, 1993). Also, Boot and Thakor (1997) argue that banks – as coordinated coalitions of investors – are better than uncoordinated markets at monitoring firms and reducing post-lending moral hazard (asset substitution). Proponents of the bank-based view also stress that liquid markets create a myopic investor climate (Bhide 1993). In liquid markets, investors can inexpensively sell their shares, so that they have fewer incentives to exert rigorous corporate control. Thus, according to the bank-base view, greater market development may hinder corporate control and economic growth. Furthermore, Gerschenkron (1962) and Rajan and Zingales (1998) stress that powerful banks can more effectively force firms to re-pay their debts than atomistic markets, especially in countries with weak contract enforcement capabilities. Without powerful banks to force repayment, therefore, external investors may be reluctant to finance industrial expansion in countries with underdeveloped institutions. Thus, the bank-based view holds that banks -- unhampered by regulatory restrictions on their activities -- can exploit scale economies in information processing, ameliorate moral hazard through effective monitoring, form long-run relationships with firms to ease asymmetric information distortions, and thereby boost economic growth (Levine, 2002).

The market-based view highlights the growth enhancing role of well-functioning markets in (i) fostering greater incentives to research firms since it is easier to profit from this information by trading in big, liquid markets (Holmstrom and Tirole, 1993), (ii) enhancing corporate governance by easing takeovers and making it easier to tie managerial compensation to firm performance (Jensen and Murphy, 1990), and (iii) facilitating risk management (Levine, 1991; Obstfeld, 1994). Moreover, the market-based view stresses problems with banks. Specifically, powerful banks can stymie innovation by extracting informational rents and protecting established firms with close bank-firm ties from competition (Hellwig, 1991; Rajan, 1992). Furthermore, powerful banks with few regulatory restrictions on their activities may collude with firm managers against other creditors and impede efficient corporate governance (Hellwig, 1998; Wenger and Kaserer, 1998). In contrast, competitive capital markets play a positive role in aggregating diffuse information signals and effectively transmitting this information to investors, with beneficial implications for firm financing and economic performance (Boot and Thakor, 1997; Allen and Gale, 1999). Thus, proponents of the market-based view stress that markets will reduce the inherent inefficiencies associated with banks and enhance economic growth (Levine, 2002).

2.3 Measurement of both Types of Financial System with china

Table 1 A comparison of Financial Systems: Bank-based vs. Market-based measures (value-weighted approach)

panel a) Bank and Market size

Measures	English Origin*	French Origin*	German Origin*	Scandinavian Origin*	Sample Average	China
Bank Credit/GDP	0.62	0.55	0.99	0.49	0.73	1.11 (0.24)[a]
Overhead Cost/Bank Total Assets	0.04	0.05	0.02	0.03	0.03	0.12
Value traded/GDP	0.31	0.07	0.37	0.08	0.27	0.11
Market Cap/GDP	0.58	0.18	0.55	0.25	0.47	0.32

panel b) Structure Indices Markets vs. banks **

Measures	English Origin*	French Origin*	German Origin*	Scandinavian Origin*	Sample Average	China
Structure Activity	-0.76	-2.03	-1.14	-1.83	-1.19	-1.07 (0.46)[a]
Structure Size	-0.10	-1.05	-0.07	-0.69	-0.55	-1.24 (0.29)[a]
Structure Efficiency	-4.69	-6.00	-5.17	-6.17	-5.17	-1.48 (-3.07)[a]
Structure aggregate	1.21	-0.05	0.66	0.13	0.72	N/A
Structure regulatory	7.02	8.21	10.15	7.72	8.95	16.00

panel c) Financial Development (Banking and Market sectors)

Measures	English Origin*	French Origin*	German Origin*	Scandinavian Origin*	Sample Average	China
Finance activity	-1.18	-3.38	-0.84	-2.86	-1.58	-0.85 (-2.38)[a]
Finance Size	5.10	4.29	5.22	4.60	4.95	-1.02 (-2.55)[a]
Finance Efficiency	2.18	0.44	2.85	1.04	2.01	-0.60 (1.14)[a]
Finance aggregate	1.23	0.13	1.47	0.48	1.05	N/A

Notes: *: The numerical result for countries of each legal origin group is calculated based on a value-(GDP of each country) weighted approach; **: Measuring whether a country's financial system is market- or bank-dominated, the higher the measure, the more the system is dominated by markets; [a]: Numbers in brackets indicate bank credit issued to the Hybrid Sector of China (instead of total bank credit)

Sources: Franklin Allen, Jun Qian, And Meijun Qian, "China's Financial System: Past, Present, and Future", July 21, 2005, page 77.

I first compare the size of a country's equity markets and banks relative to that country's gross domestic product (GDP) in the panel a) of Table1. China's stock markets are smaller than most of the other countries, both in terms of market capitalization and the total value traded as fractions of GDP. In order to measure the actual size of the market, "total value traded" is a better measure than "market capitalization," because the latter includes non-tradable shares while the former measures the fraction of total market capitalization traded in the markets, or the "floating supply" of the market. By contrast, China's banking system is much more important in terms of size relative to its stock markets, with its ratio of total bank credit to GDP (1.11) higher than even the German-origin countries (with a weighted average of 0.99). However, when we consider bank credit issued (or loans made) to the Hybrid Sector only, China's ratio drops sharply to 0.24, suggesting that most of the bank credit is issued to companies in the State and Listed Sectors. Moreover, China's banking system is not efficient: its overhead cost to total assets (0.12) is much higher than the average of French-origin countries (0.05), the next highest group of countries.

The panel b) of Table 1 compares the relative importance of financial market vs. banks ("Structure indices"). China has the lowest scores for both Structure Activity and Structure size, suggesting that its banking sector is much larger than its financial markets, and this dominance by the banks over markets is stronger than the average of all LLSV sample countries. In terms of Structure efficiency, which denotes the relative efficiency of markets vs. banks, China has the highest score, suggesting that its stock markets are actually relatively more efficient than banks compared to other countries. This result is mainly driven by the extremely high costs of China's banking system.

I also compare the development of the entire financial system ("Financial Development"), including both banks and markets in the panel c) of Table 3. Given that all other countries' measures were based on private bank credit only, if we only include China's bank credit made to the Hybrid Sector, we find that China's overall financial market size, in terms of both Finance Activity and Finance Size is smaller than the LLSV sample average level, and is only higher than the French-origin countries' average. In terms of Finance Efficiency, China's measure is below all sub-samples of LLSV countries. Based on the above evidence, we can conclude that China's financial system is dominated by a large but inefficient banking sector and undeveloped market sector.

SECTION 3

BASIC STATUE OF CHINA`S FINANCIAL SYSTEM

Since 1978 the People's Republic of China (PRC) government has been reforming its economy from a Soviet-style centrally planned economy to a more market-oriented economy but still within the political framework, provided by the Communist Party of China. This system has been called "Socialism with Chinese characteristics" and is one type of mixed economy.

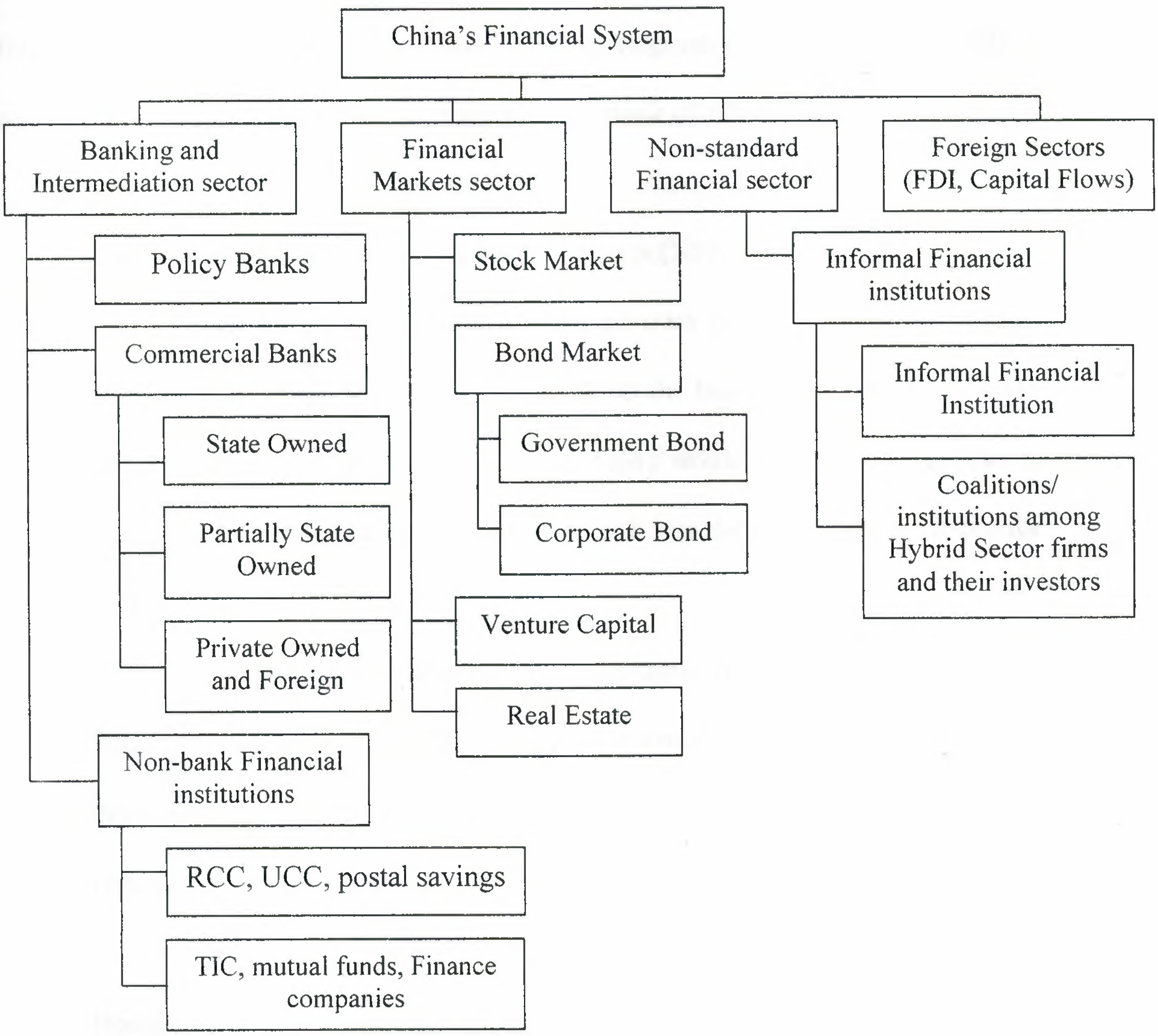

Figure 1 overview of China's Financial System

Source: Franklin Allen, Jun Qian, Meijun Qian, China's Financial System: Past, Present, and Future, July 21, 2005 , page 93

3.1 Research on China's Financial

3.1.1 Banking and Intermediation sector

China's financial system is dominated by a large but under-developed banking system, which is mainly controlled by the four largest state-owned banks (BOC-the bank of china, PCBC-the people's construction bank of china, ICBC-industrial and commercial bank of china, ABC-the agriculture bank of china) with a large amount of Non-performing loans. Supervision Bodies of China's Banking Sector are people's Banking of China (PBOC) and China Banking Regulatory Commission (CBRC). people's Banking of China (PBOC) is the Central Bank of China.

Two reasons that occur Non-performing Loans (NPLs) as following:

1. China's bank hasn't enough data about their own activities and those of their borrowers. In china, loans are often make on the basis of trust; to enquire too aggressively into a borrower's ability to repay would show a lack of respect; and even if a lender desired to enquire, much less data would be available for analysis.
2. Massive level of policy loans that the government over the years required the State-Owned Banks to make to State-Owned Enterprise (SOEs), interest rate is determined by government and without any concern as to the SOEs ability to repay.

Because of these reasons, Companies can borrow at low, government determined interest rates, irrespective of the risk of the loans. The risk is assumed by the government, which must periodically bail out banks by taking over their Non-performing loans. Indeed, companies are further encouraged to seek bank financing by the fact that state controlled banks almost always automatically roll over maturing loans at low rates. This is a classic case of moral hazard. Costs and risks are absorbed by state owned banks, which ultimately pass them to the government. The result is produced a massive deadweight of Non-performing loans.

For now, the burden of debt servicing is manageable. But government bail out can only is a temporary solution for clearing the balance sheets of state owned banks. NPLs are becoming unsustainably large. The national debt as a percentage of Gross Domestic Product (GDP) is estimated to be around 20%. But if you add implicit debts to this figure, it rises to over 130% of GDP, which would likely cause the government to lose its current sovereign risk rating. It is unclear how much longer china can afford to keep bail out its banks.

In the recent years, the Chinese government has taken active measures to reduce the NPLs and improve the efficiency of the banking sector.

- First, four state-owned asset management companies (Dong Fang, Hua Rong, Great Wall, Xin Da) were formed with the goal of assuming the NPLs accumulated in each of the Big Four state banks and liquidating them.
- Second, state-owned banks have diversifies and improved their loan structure by increasing loans made to individual lenders while being more active in risk management and monitoring of loans made to State-Owned Enterprises (SOEs).

- Third, there has been a boom in the entry and growth of non-state financial intermediaries, and this trend is expected to continue with more foreign banks entering the domestic credit markets as a result of china's entrance in to the WTO.

Reforming state-owned banks is solving the problems of NPLs and improving the entire banking sector. A central question in reforming the state-owned banks is the ongoing privatization process. There are two imminent issues: more competition in the banking and intermediation sector; government's dual role as regulator and as majority owner.

3.1.2 China's financial market: Stock Market and Bond Market

The development of China's stock market is one of the most important elements of china's reform in the financial system.

In December 1990 and July 1991, two stock markets, the Shanghai Stock Exchange (SHSE) and the Shenzhen Stock Exchange (SZSE) were established. By the end of 1991, 14 companies were listed on the two stock exchanges. This marked the stock market's entry into the Chinese economic system officially and China's capital market's entrance into its formative stage.

Since China's two stock exchanges were established, two main types of shares are offered by Chinese companies: A shares and B shares. A share is exclusively sold to Chinese nationals. B shares are denominated in RMB but traded and purchased in foreign currency exclusively by foreigners. However, due to the continuous slim trading and small capitalization of the B share market, the China Stock Regulatory Commission (CSRC) decided to open B shares to domestic investors in February. 2001. Besides the two shares, H shares are issued by Chinese companies and traded on the Hong Kong Stock Exchange. N shares-American Depositary Receipts (ADRs) are issued by Chinese companies and traded on the New York Stock Exchange in the form of American Depositary Receipts. S shares are floated by Chinese companies and traded on the Singapore Stock Exchange. The relative sizes of the final two type's shares are small.

After years of inactive transactions during the late 1980s, the stock markets became quite active in Shenzhen and Shanghai in the early 1990s. Because very limited stocks were available on the markets, prices rose very quickly. By August 1993, stock prices in both Shenzhen and Shanghai reached the highest level in terms of the records of past two years and then dropped dramatically. The markets then experienced more than two years stagnation and recovered only after early 1996. From April to mid December 1996, the stock index rose by 120 percent in Shanghai and over three times in Shenzhen. The government then took measures to cool the markets. On December 16, People's daily openly warned the great risk investors were facing with the speculation in the form of the special comments—Understanding correctly of current stock markets. The stock prices fell considerably after that day. But, contrary to some experts' predictions, the market did not stagnate for long and soon recovered and even reached a record high in April 1997, making the government find it necessary to cool it down again. The quota of stock issuance of 30 billion Yuan in 1997 was announced. Then, the market didn't recover from more than two years of bearish behavior until May 19 1999.

In sum, since the stock exchanges were established, the China's stock markets experienced several cycles of boom and bust and turnover levels on the markets also experienced several ups and downs. China's stock market developed quite rapidly. Compared to the initial 8 listed companies on the Shanghai Stock Exchange and 6 on the Shenzhen Stock Exchange in 1991, 1025 companies had been listed on the two stock exchanges by August 13, 2001, with a total market capitalization of 4,357.7 billion Yuan and a tradable market capitalization of 1,413.9 billion Yuan.

It is worth noting that the development of the stock market is accompanied with the reform of state-owned enterprises' ownership and corporate governance structure, namely, the reform of the shareholding system and incorporation of state-owned enterprises. The stock market played a very important role in promoting the reform of state-owned enterprises. At the beginning, due to the stock quota system and a limit of market capacity, many of the listed companies were relatively small. Since 1996, the government expanded the scale of stock issuance so as to support the capital demand of the large-, and medium-sized state-owned enterprises. Since then, a great number of key state-owned enterprises, especially enterprises related to the strategic and pillar industries began to issue their own stocks.

In China, most listed companies are state-owned enterprises. By October 1999, these enterprises have raised more than RMB 400 billion from the stock markets, which has helped them improve their financial condition, promote their technical creation, and expand their profit base.

The development of China's bond market is one of the most important elements of china's reform in the financial system. In china, specially must develop the private bond immediately!

The growth of private bond issues has been stimulated by three main factors. First, most East Asian governments have been cooperating and then privatizing their major state enterprises, notably major public utility companies. Since the intention was not to shed ownership control during the initial phase of privatization, state enterprises were encouraged to meet their financing needs mainly by issuing bonds in the domestic market. Second, the fastest growing firms tend to prefer bond to equity financing, both because bonds allow owners to retain greater control over corporate decisions and because their massive investment requirements cannot be adequately met by bank finance or rights issues. Third, while commercial banks played a vital role initially in financing the needs of public and private enterprises in East Asia, their ability to carry out maturity transformation has been seriously constrained of late by large capital requirements. Too much long-term lending has led to asset and liability maturity mismatches. Moreover, the adoption of risk based capital-adequacy requirements has restricted banks' ability to finance private fixed investments. Three major classes of institutional investors— the contractual saving sector, pension funds, and financial institutions—hold the bulk of East Asian bonds. Bond holdings by individuals are negligible, except in China, where individuals are the major investors in government bonds (Dalla and Atkhate, 1996).

Table 2 China's bond markets: 1990-2002 (Amount in RMB 100 million)

	Treasury Bonds			Policy Financial Bonds			Corporate Bonds		
Year	Amount issued	Redemption Amount	Balance	Amount issued	Redemption Amount	Balance	Amount issued	Redemption Amount	Balance
1990	197.23	76.22	890.34	64.40	50.07	84.88	126.37	77.29	195.44
1991	281.25	111.60	1059.99	66.91	33.67	118.12	249.94	114.31	331.09
1992	460.78	238.05	1282.72	55.00	30.00	143.12	683.71	192.76	822.04
1993	381.31	123.29	1540.74	N/A	34.29	108.83	235.84	255.48	802.40
1994	1137.55	391.89	2286.40	N/A	13.54	95.29	161.75	282.04	682.11
1995	1510.86	496.96	3300.30	N/A	N/A	1708.49	300.80	336.30	646.61
1996	1847.77	786.64	4361.43	1055.60	254.50	2509.59	268.92	317.80	597.73
1997	2411.79	1264.29	5508.93	1431.50	312.30	3628.80	255.23	219.81	521.02
1998	3808.77	2060.86	7765.70	1950.23	320.40	5121.13	149.89	105.25	676.93
1999	4015.00	1238.70	10542.00	1800.89	473.20	6447.48	158.20	56.50	778.63
2000	4657.00	1525.00	13674.00	1645.00	709.20	7383.28	83.00	0.00	861.63
2001	4884.00	2286.00	15618.00	2590.00	1438.80	8534.48	147.00	N/A	1008.63
2002	5934.30	.2261.2	19336.00	3075.00	1555.70	10054.10	325.00	N/A	N/A
Annual growth rate	32.80%	32.60%	29.20%	38.00%	33.20%	48.90%	8.20%	N/A	16.10%

Source: Franklin Allen,Jun Qian,Meijun Qian, China's Financial System: Past, Present, and Future, July 21, 2005 , page 85

Table 2 provides information on the growth of China's bond markets from 1998 to 2002. The government bond market did not grow as fast as the stock market, but did have an annual growth rate of 11.7% during the time period in terms of newly issued bonds, while total outstanding bonds reached RMB 1,933.61 billion (or US$233 billion). The second largest component of the bond market is called policy financial bonds (total outstanding amount RMB 1,005 billion at the end of 2002). These bonds are issued by policy banks, which belong to the Treasury Department, and the proceeds of bond issuance are invested in certain industries (e.g., infrastructure, similar to municipal bonds in the U.S.). Compared to government-issued bonds, the size of the corporate bond market is minuscule: In terms of the amount of outstanding bonds at the end of 2001, the corporate bond market is less than one-fifteenth of the size of the government bond market.

Table 3 comparison with East Asia countries` bond market

	National government	State government	State enterprises	Central bank	Corporate sector	Total
China	24.4	0.0	9.0	0.0	0.0	33.4
Hong Kong	0.1	0.0	0.0	6.8	4.7	11.6
Indonesia	0.0	0.0	1.5	6.8	0.7	9
Korea	27.9	2.7	37.4	32.1	60.8	160.9
Malaysia	29.0	0.0	3.7	2.0	4.9*	39.6
Philippines	24.8	0.0	0.1	0.0	0.0	24.9
Singapore	42.3	0.0	0.0	0.2	2.5	45
Thailand	2.6	0.0	7.6	0.0	3.5	13.7
Total	151.1	2.7	59.3	47.9	77.1	338.1

Source: Ismail Dalla and Deenakh Atkhate, "The Emerging East Asian Bond Market", March 1996, page 11

Bond holdings by individuals are negligible (Dalla and Atkhate, 1996), but Table 3 shows except in China, where individuals are the major investors in government bonds. Now in china the mostly commercial bank to prevent doubtful credit and reduce the risk of credit they don't want offer the loan over one year and prefer to provide the loan to state-owned enterprise. State-owned enterprise is non-corporation economic units; such that the entire assets are owned by the state and which are registered in accordance with the "Regulation of the people's republic of china on the management of registration of corporate enterprises." Excluded from this category are the solely state-funded corporations in the limited liability corporation. The government is the defector owner, and they choose managers to run the firm. Even though these firms do enter the credit plan, this process is constructed and enforced by state banks, which are also under the control of the government.

All of the above makes a convincing argument for the development of a China's corporate bond market. Such a market would serve several functions:

1. It would enable companies to raise funds even if they are not favored customers of the banks. China has one of the world's most entrepreneurial economies, but entrepreneurs aren't usually well connected. So even as new companies are constantly being established, and many succeed and create jobs, they tend to be small and to stay small because they lack access to funding to grow. A corporate bond market could remove this constraint and enable China to create world class companies and even more importantly, jobs for 10 millions people.
2. It allows for fewer systemic risks. Bank loans typically are of short to medium term, and therefore need to be rolled over to cover the life of the project funded. This lends an air of uncertainty to business planning. Worse, loans can be called in before schedule, leaving companies in dire financial predicaments, of the sort that Southeast Asia witnessed during the Asian Crisis. Recourse to bond financing would eliminate any mismatch between the lifetime of assets and the duration of liabilities.
3. As the number of Chinese pension funds, social security funds and insurance funds proliferate, bond markets are keys to ensuring that these funds can match their future payment obligations with assured future income. Without a

long term bond market, such funds, increasingly important to china, will be at risk.

3.1.3 Hybrid Sector

In a comparing China's Financial System this paper (Allen, Qian, Qian, 2002), they find that the most successful part of China`s financial system, in terms of supporting the growth of the overall economy, is not the banking sector or stock market, but rather a sector of alternative financing channels, such as internal financing and trade credits, and coalitions of various forms among firms, investors, and local governments. Many of these financing channels rely on alternative government mechanisms, such as competition in product and input markets, and trust, reputation, and relationships. Together these methods of financing and governance have supported the growth of a "Hybrid Sector" of non-state, non-listed firms with various types of ownership structures. It is important to point out at the outset that our definition of the Hybrid Sector is broader than privately or individually owned firms, which are part of this sector. In particular, firms that are partially owned by local governments (e.g., Township Village Enterprises or TVEs) are also included in the Hybrid Sector, because: first, despite the ownership stake of local governments and the sometimes ambiguous ownership structure and property rights, the operation of these firms resembles more closely that of a for-profit, privately-owned firm than that of a state-owned firm; and second, the ownership stake of local governments in many of these firms has been privatized. The growth of the Hybrid Sector has been much higher than that of the State Sector (state-owned enterprises or SOEs, and all firms where the central government has ultimate control) and the Listed Sector (publicly listed and traded firms with most of them converted from the State Sector), and contributes to most of the economic growth. We believe these alternative channels and mechanisms should be encouraged going forward. They can co-exist with the banks and markets while continuing to fuel the growth of the Hybrid Sector.

Hybrid Sector comprises all the firms that are not state-owned or publicly listed, is the kind of privatization process and includes the following types of firms:

- Privately owned companies but not publicly listed and traded: controlling owners can be Chinese citizens, investors or companies from Taiwan or Hong Kong, or foreign investors or companies.
- Collectively and jointly owned companies, where joint ownership among local government, communities, and institutions is forged.

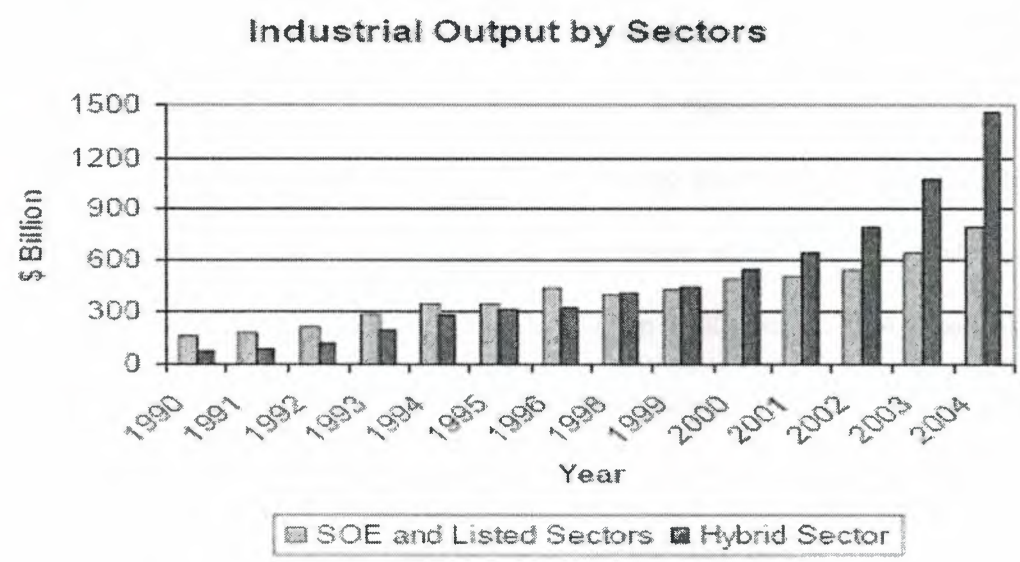

Figure 2 Comparing the Sectors – Industrial Output

In this figure we plot total "industrial output" for State (SOEs) and Listed (publicly listed and traded firms) Sectors combined and for the Hybrid Sector (all the rest of the firms) during 1990 to 2004. Data source for this table is the Chinese Statistical Yearbook 1998 - 2004.

Figure 2 compare the level and growth of industrial output produced in the State and Listed Sectors combined vs. that of the Hybrid Sector from 1990 to 2004.

The output from the Hybrid Sector has been steadily increasing during this period and exceeded that of the other two sectors in 1998. The total output in 2004 is close to US$1500 billion for the Hybrid Sector, while it is around US$800 billion in the State and Listed Sectors combined. The Hybrid Sector grew at an annual rate of over 14% between 1990 and 2004, while the State and Listed Sectors combined grew at around 5% during the same period. In addition, the growth rates for investment in fixed assets of these sectors are comparable (China Statistics Yearbooks; not reported), which implies that the Hybrid Sector is more productive than the State and Listed Sectors. In terms of capital-industrial output ratios, collectively-owned and privately owned firms are on average more than twice as productive (for every $1 invested) as SOEs (Gregory et al. 2000). Moreover, many Hybrid Sector firms do not have easy access to the standard form of financing, namely, bank loans, like SOEs do. As mentioned above, loans made to privately owned firms consist of 1% of all loans made in 1997-98. All of these facts make the growth of the Hybrid Sector even more impressive.

Finally, there has been a fundamental change among the State, Listed, and Hybrid Sectors in terms of their contribution to the entire economy: the State Sector contributed more than two thirds of China's GDP in 1980, but in 2004 it contributed less than one-third of the GDP; in 1980, (nonagricultural) privately owned firms, a type of Hybrid Sector firm, were negligible, but in 2001 they contributed 33% of GDP after growing at an average rate of 20% during this period [China Statistical Yearbooks, 1998-2000]. The above trend of the Hybrid Sector replacing the State Sector will continue in the near future.

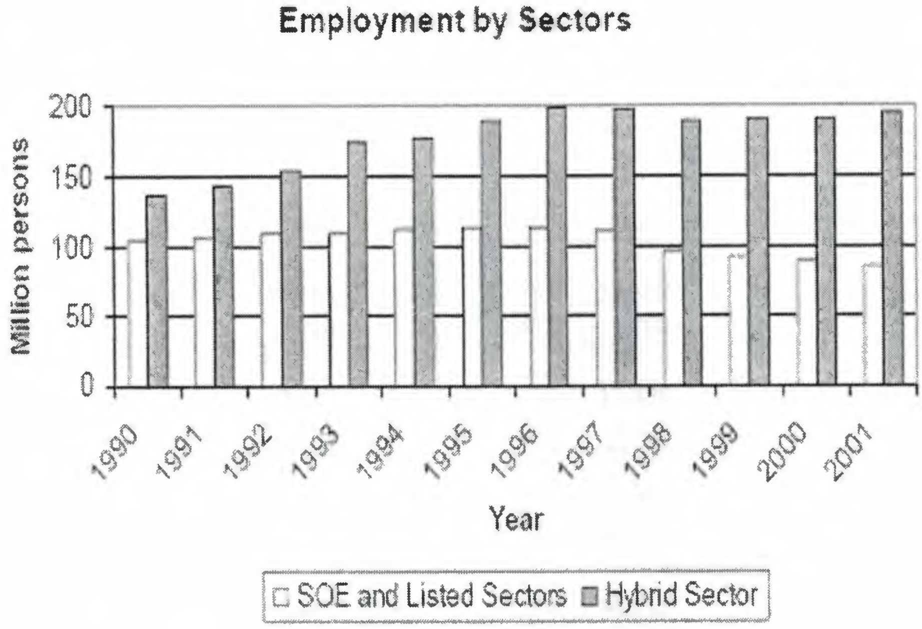

Figure 3 Comparing the Sectors – Employment

In this figure we plot total number of workers employed by the State (SOEs) and Listed (publicly listed and traded firms) Sectors combined and by the Hybrid Sector (all the rest of the firms) during 1990 to 2004. Data source for this table is the Chinese Statistical Yearbook 1998 - 2004.

Figure 3 presents the number and growth of non-agricultural employees in the three sectors. The Hybrid Sector is a much more important source for employment opportunities than the State and Listed Sectors. Over the period from 1990 to 2002, the Hybrid Sector employs an average of over 70% of all non-agricultural workers; the TVEs (part of the Hybrid Sector) have been the most important employers providing (non-agricultural) jobs for residents in the rural areas, while (non-agricultural) privately owned firms employ more than 40% of the workforce in the urban areas. Moreover, the number of employees working in the Hybrid Sector has been growing at 1.5% over this period, while the labor force in the State and Listed Sectors has been shrinking. These patterns are particularly important for China, given its vast population and potential problem of unemployment.

Table 4 Inflows and Outflows of Foreign Direct Investment

Panel a) FDI Inflows and Outflows

	Total amount (in US$ million)						As % of gross fixed capital formation				
	Average 1985-95	1999	2000	2001	2002	2003	Average 1985-95	2000	2001	2002	2003
China											
Inward	11,887	40,319	40,715	46,878	52,743	53,505	6.6	10.3	10.5	11.5	12.4
Outward	1,591	1,775	916	6,884	2,518	1,800	1.0	0.2	1.5	0.5	0.4
Singapore											
Inward	4,512	16,067	17,217	15,038	5,730	11,409	32.0	62.8	60.1	25.6	45.7
Outward	1,518	7,517	5,298	17,063	3,699	5,536	8.5	19.3	68.2	16.5	22.2
United States											
Inward	44,434	283,376	314,007	159,461	62,870	29,772	5.2	15.8	8.1	3.3	1.5
Outward	42,571	209,391	142,626	124,873	115,340	151,884	4.7	7.2	6.4	6.0	7.5
South, East and South-East Asia											
Inward	30,189	109,115	142,683	102,228	86,326	96,915	5.4	15.2	10.8	8.7	9.7
Outward	16,634	39,216	80,031	45,063	34,652	23,487	2.9	8.7	4.8	3.6	2.4
Developing Economies											
Inward	50,773	231,880	252,459	219,721	157,612	172,033	4.5	14.9	13.1	9.9	10.0
Outward	21,620	75,488	98,929	59,861	44,009	35,591	2.0	6.1	3.6	3.0	2.1
World											
Inward	181,704	1,086,750	1,387,953	817,574	678,751	559,576	3.9	19.8	12.0	10.1	7.5
Outward	203,620	1,092,279	1,186,838	721,501	596,487	612,201	4.6	17.1	10.8	9.0	8.4

Panel b) Stocks of FDI

	Total amount (in US$ million)						As % of GDP				
	1980	1990	1995	2000	2002	2003	1980	1990	2000	2002	2003
China											
Inward	1,077	20,694	134,869	348,346	447,966	501,471	0.5	5.8	32.2	35.4	35.6
Outward	N/A	2,489	15,802	25,804	35,206	37,006	N/A	0.7	2.4	2.8	2.6
Singapore											
Inward	6,203	30,468	65,644	112,571	135,890	147,299	52.9	83.1	121.5	153.9	161.3
Outward	3,718	7,808	35,050	56,766	85,374	90,910	31.7	21.3	61.3	96.7	99.5
United States											
Inward	83,046	394,911	535,553	1,214,254	1,505,171	1,553,955	3.0	6.9	12.4	14.4	14.1
Outward	215,375	430,521	699,015	1,293,431	1,839,995	2,069,013	7.8	7.5	13.2	17.6	18.8
South, East and South-East Asia											
Inward	211,039	337,082	581,012	1,195,687	1,259,136	1,352,409	27.4	20.8	36.6	35.6	34.6
Outward	4,515	41,042	181,812	577,763	560,966	607,488	1.0	2.6	18.1	16.2	15.9
Developing Economies											
Inward	301,974	547,965	916,697	1,939,926	2,093,569	2,280,171	12.4	14.7	29.3	31.9	31.4
Outward	60,239	128,561	308,624	793,297	796,503	858,681	3.6	3.8	12.4	12.6	12.2
World											
Inward	692,714	1,950,303	2,992,068	6,089,884	7,371,554	8,245,074	6.6	9.3	19.3	23.0	22.9
Outward	559,629	1,758,216	2,897,574	5,983,342	7,209,582	8,096,863	5.8	8.6	19.1	22.6	23.0

Source: Franklin Allen,Jun Qian,Meijun Qian, China's Financial System: Past, Present, and Future, July 21, 2005 , page78

4. Yuan is stable

3.2.1 The early cooling down

Just like before I explained China's stock market that the government took measures to cool the markets. Chinese economy kept on a high growth since 1980s. The average growth rate is 9.5% in 1980s, 9.5% in the first half of 1990s. However, the growth of the economy in 1990s is not smooth. It was in a recession since 1989, but started to recover from 1991, with the growth rate up from 3.8% in 1990 to 9.2%. Nevertheless, it started to be over heating since 1992, with high inflation and GDP growth rate (14.2%).

Strong measures were adopted by the Chinese government to cool down the economy since 1993 through controlling the bank lending, restructuring the bad loans etc. The economy realized "soft landing" by the end of 1996, fortunately before the South East Asian crisis, with growth rate coming down under 10%, and further down to 8.8% in 1997, inflation dropping out of sight since middle of the year. As commented by Peter Botttelier, now senior advisor to World Bank, "If China had not made the difficult internal policy and institutional adjustments that permitted a "soft landing" in 1996, the Asian financial crisis would probably have dragged the economy in a much serious way".

3.2.2 No debt crisis

China has been benefited largely from her open policy in realizing a long term and stable high economic growth. China is the largest recipient in foreign investment among the developing countries, and the second largest in foreign direct investment (FDI) after the United States in the world. However, China has kept a healthy structure of capital inflow since the long term debt accounts for the larger proportion (more than 80%) and FDI plays the major role. So that, there is no real danger for debt crisis despite China has received increasing amount of foreign capital. Importantly, China has adopted a gradual way in opening her financial market. China had not made her currency convertible. The current account was opened in 1996, but capital market liberalization is still in the process of preparation. This made it impossible for speculators to attack the Chinese Yuan. In considering the case of the Asia financial crisis, it seems that a cautious transition towards a full liberalization of the financial market is necessary, especially for developing countries.

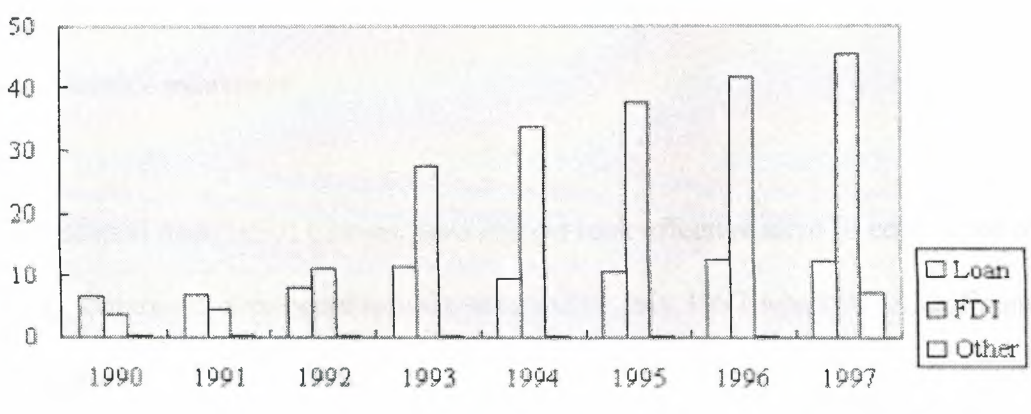

Figure 4 Structure of Foreign Capital Flow (In billion US dollars)

Source: A Statistical Survey of China, 1998

Foreign trade has plaid a very important role in Chinese economy. China is now the 10th largest country in the world. High growth of exports have been an important factor to make Chinese economy dynamic, for example, the contribution from export to GDP is close to 20% in 1997. Especially, increasing trade surplus in 1990s makes China building up a high capacity to pay back the foreign debt with increasing amount of foreign exchange reserve (over 140 billion US dollars by the end of 1997). Comparing the countries suffering from the debt crisis, China had a much better situation in foreign trade balance in mid-1990s (see chart 2).

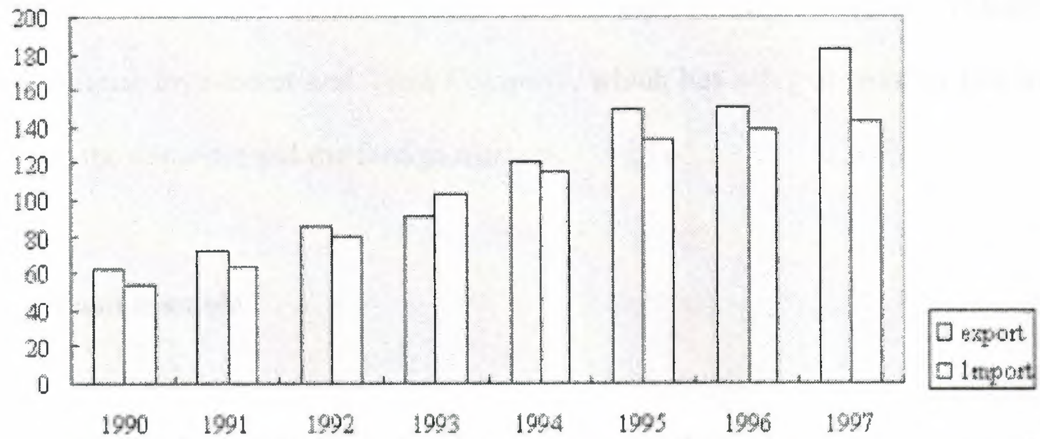

Figure 5 The balance of China's import and export in 1990s (In billion US dollars)

Source: A Statistical survey of China, 1998, p.133

3.2.3 Effective measures

Started from 1993, Chinese government took effective steps to control the over lending. Emergent steps were quickly taken after July 1997 when the Asia financial crisis happened, which include:

- Closing some irresponsible banks and credit units;
- Increasing capital-debt ratio of major state banks (to 8%);
- Re-centralizing the control of foreign borrowing.
- Setting up a special fund for domestic bed loans (30 billion Yuan starting from 1994, with 10 billion added annually);

* Strengthening the evaluation and monitoring on listed companies.

However, to some extent, the debt problem (bed loans) is still worrisome. As a result of the earlier bubble economy, as well as eventual effect of the financial crisis, some problems become apparent. For example, more banks or investment and trust companies are in the trouble. A more recent case is the closure of Guangdong International Investment and Trust Company, which has a big amount of bad loans both on the domestic and the foreign markets.

3.2.4 Yuan is stable

Facing the devaluation of major currencies in the region, the exchange rate of Chinese currency, the Yuan is still stable. Chinese government has stated again and again that it has no intention to devalue the Yuan. Why the exchange rate of Yuan can keep stable?

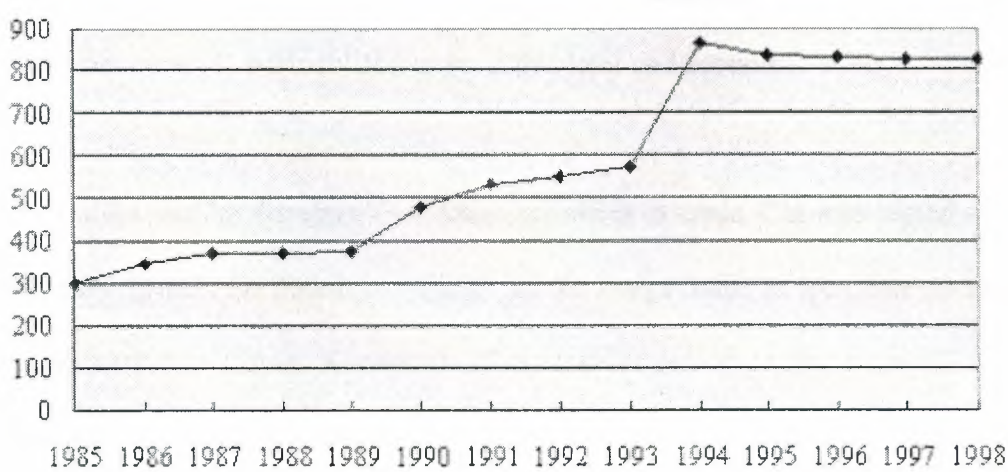

Figure 6 Exchange Rate of Yuan (to US $, yearly based)

Note: For 1998, the rate is mid-August; for the other year, the yearly based middle rate. Source: A Statistical Survey of China, 1998, p.134.

From the trend of the Chinese currency, it has experienced big change and fluctuations in the process of the economic reform and development, but stable after 1994 when it moved to a unified market rate. The current rate is considered to be reasonable.

The fundamentals for the stability of Yuan are there. From the domestic factor, either current account, or foreign debt is in a healthy structure and situation. A high foreign exchange reserve (more than 140 billion US dollars by the end of the third quarter of 1998) and reasonable foreign debt ratio (about 15% of GDP) provide a firm base for the market. Although the export has shown less dynamic, with growth rate only 3.9% in the first 9 months of 1998, but the trade balance is still positive, with 15% increase of trade surplus, to 35.3 billion in the same period. So that, the market confidence for the Chinese currency is still keeping firm.

From the outside factors, a competitive devaluation of the currencies only makes the crisis worse since the major challenge to Chinese export is the declined demand from the trade partners due to their financial and economic crisis.

Besides, unlike the other East Asian countries in crisis, Chinese capital market has not fully opened. So that, it is difficult for the hedge funds to speculate on foreign exchange market in China. A cautious liberalization policy on the financial market provides a larger room for Chinese government to manage the crisis.

Generally speaking, the Chinese economy has been benefited from a stable currency, which can keep the cost low since import parts account for a very high proportion in the export goods. However, it is recognized that the real challenge of the devaluation of other currencies to China is ahead. For many export goods, China may loose the competitive edge if the other currencies are continued to be at the very low rate. It is reasonable to keep Chinese Yuan on a stable base, but not necessary a fixed rate, even though with no pressure for devaluation in the immediate future Chinese economy would continue to grow in a good environment if there were no Asia financial crisis. With successful readjustment of the economy during 1993-1997, the new government headed by Zhu Rongji decided to speed up the reform on State owned enterprises (SOEs) in 1998. Unfortunately, the financial crisis has brought about a negative environment for the reform and economic growth. In face of the financial crisis, the main current concern for Chinese government is how to keep the economy from a big slide. So, the government has made great efforts to keep with her growth target for 1998, i.e. 8%. The significance of it is not the figure itself since it is important to have a high growth rate to keep unemployment from rising. It is a big challenge to make Chinese economy to grow at a rate as high in the situation of a general slow down of the regional economy in the Asia-pacific and the world as a whole. The growth rate is only 7% in the first half of 1998; especially the industrial growth is well below the target, only 7.9%. The major problem is that demand is rather weak due to a slow down of domestic consumption and exports.

Special measures have been taken in order to make the economy to grow at a reasonable rate. The government decided to increase expenditure in the investment of infrastructure. There are as large as 200 billion Yuan investments put into infrastructure projects ranging from high ways, rail ways, to environment protection through issuing special government bonds and corresponding bank credit starting from the third quarter of 1998, which is considered to add 1.5 percentage to 2 percentages of GDP growth.

It is a wise choice to keep the economy growing through the increase of domestic expenditure since the demand of outside market is week. However, what is worrisome is that this government-led expenditure may hide the real structural problems of the economy, for example, inefficiency of the investments, which has existed for quite some time. In fact, the Chinese banking system is still very fragile since there is a high debt to equity ratio of Chinese companies on the one hand, and high ratio of non-performing loans. Fortunately, the Asian crisis has added a new sense of urgency for Chinese leaders to the reform, especially with regard to the reform of SOEs and the financial system. The Chinese economic development can not be sustained without high efficiency of investment and production.

SECTION 4

CONCLUSION AND RECOMMEDIATION

Throughout this paper, we can understand the current situation about china's financial system, has been transform from a closed economy dominated by agriculture and central planning system, to a fast-growing, market-oriented, open economy. During this transform process that each part has the problem and future develop or reform's orientation.

And also explain under this transition process why china avoids in East Asia financial crisis in 1997. Because of Chinese capital market has not fully opened. So that, it is difficult for the hedge funds to speculate on foreign exchange market in China. A cautious liberalization policy on the financial market provides a larger room for Chinese government to manage the crisis.

Even either bank-based Financial System such as Germany, Japan or Market-based Financial System such as Great Britain, United States are successful model countries, but not only adopt one of them will be good for China. We need study these countries's successful experience and find the best way suitable for China's situation.

In fact, the Chinese banking system is still very fragile since there is a high debt to equity ratio of Chinese companies on the one hand, and high ratio of non-performing loans. Accelerate reforming the banking sector, reduce the NPLs is very important elements of china's reform in the financial system. I consider two channels through which the NPLs can be reduced and efficiency of the banking sector improved. First, the entrance and growth of non-state banks and intermediaries should be encouraged. With more domestic and foreign banks and intermediaries, the banking sector becomes more competitive, and competition improves the incentives and efficiency of state-owned banks. Second, the ongoing privatization of state-owned banks will not be completed until the majority of these banks` assets are owned by non-government organizations and investors. With majority state ownership, banks will have perverse incentives in selecting borrowers and borrowers have perverse incentives in selecting investment projects. As a result, a large amount of new NPLs may surface within the network of state-owned banks as the government rids old NPLs from the banks` books.

Also I propose several measures that can increase the size and scope and help to improve the efficiency of the markets. First, the regulatory environment should be improved; for instance, corporate and trading laws and legal protection of investors, as well as institutions governing the enforcement of contracts should be further developed. Second, more professionals such as accountants, investment bankers, and lawyers, should be trained. Third, domestic financial intermediaries that act as institutional investors should be encouraged, as they will play a critical role in improving the efficiency of the markets and strengthening the corporate governance of listed firms. Finally, new financial products and markets should be developed.

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Appendix

The definition of Figure 1

1. Banking and intermediation sector

state-owned banks (big four)	There are four 100% state power banks. The Bank of china (POC), the people's construction bank of china (PCOC), industrial and commercial bank of china (ICBC), the agriculture bank of china (ABC), they carry out commercial banking function. However, they are heavily regulated and interfered with by the people's bank of china (a central government owned and controlled bank under the ministry of finance), such as the imposition on interest rate restrictions and loan allocations
other commercial banks	There are a variety of commercial banks in china with a variety of different types of ownership in addition to the four largest state-owned banks. They can be owned by central government, local government, communities, and individual persons or enterprises. They carry out the functions of commercial banks, and are heavily regulated by the PBOC, mainly on interest rates.
Policy banks	There are three policy banks in china, all created in 1996 and belonging to the treasury department. They are the development bank of china, the import and export bank of china, and the agriculture development bank of china. These banks carry out policy financing roles. For example, issuing bonds or make loans for the development of specifies projects or certain sector of the economy
Rural credit cooperative (RCC)	A credit cooperative is a non-profit organization, providing financial services, such as lending and savings to its members. Rural credit cooperatives are owned and operated by communities in rural areas, and are widespread in china. They started in 1984, and were overseen by the agriculture bank of china until 1996; they were then regionally merged and overseen directly by the People's Bank of China

Urban credit cooperative (UCC)	Urban credit cooperative: this is the counterpart of the rural credit cooperative in the city. In 1996, they were regionally merged and became called city commercial banks
Postal savings	These are deposit-taking institutions run by the bureau of post savings, and regulated by the People's Bank of China. Local branch offices are affiliated with the post offices in the same area, and provide wire transfer distribution of treasury bills, and also act as agencies for insurance or retirement funds
asset management company	The four asset management companies were set up in 1998 to help the financial restructuring of the four major state-owned banks`. They are specialized in managing and recovering the NPLs transferred from the four banks.
Trust and Investment Company (TIC)	In a trust and investment company, In a TIC, a trustee accepts, manages, or uses the trust capital or trust properties in accordance with the special objectives or requests designed by the trust creator. It provides bank (custodial, payment, guarantees) and non-bank (security issuance, financial leasing) financial services. Its loan is restricted to "circulating funds", i.e., working capital (< 3 months). Its sources of funds include: government Treasuries, government departments that administer enterprises, labor protection and welfare institutions, research institutions, academic associations and other foundations.
Non-deposit financial intermediaries (e.g., financial companies)	By law, these companies cannot take deposits. They raise capital from organizations and investors and make loans to individuals or business.
Mutual funds	An open- or close- end fund operated by an investment company which raises money from shareholders and invests in a group of assets, in accordance with a stated set of objectives
2. Financial markets	

Stock market	ShangHai stock exchange and ShenZhen stock exchange (two domestic stock exchange establish in 1990), Hong Kong Stock Exchange.
Bond market	Government bond and Corporate bond.
Venture capital	Money made available for investment in innovative enterprises or research, especially in high technology, in which both the risk of loss and the potential for profit may be considerable. Also called risk capital.
Real state	Land, buildings, and things permanently attached to land and buildings. Also called realty and real property

Supervision Bodies of China`s Banking Sector: PBOC and CBRC

The People's Bank of China (PBOC)	The People's Bank of China (PBOC) is China's central bank, which formulates and implements monetary policy. The PBOC maintains the banking sector's payment, clearing and settlement systems, and manages official foreign exchange and gold reserves. It oversees the State Administration of Foreign Exchange (SAFE) for setting foreign-exchange policies. According to the 1995 Central Bank law, PBOC has full autonomy in applying the monetary instruments, including setting interest rate for commercial banks and trading in government bonds. The State Council maintains oversight of PBOC policies.
China Banking Regulatory Commission (CBRC)	China Banking Regulatory Commission (CBRC) was officially launched on April 28, 2003, to take over the supervisory role of the PBOC. The goal of the landmark reform is to improve the efficiency of bank supervision and to help the PBOC to further focus on the macro economy and currency policy. According to the official Announcement by CBRC posted on its website, the CBRC is responsible for "the regulation and supervision of banks, asset management companies, trust and investment companies as well as other deposit-taking financial institutions. Its mission is to maintain a safe and sound banking system in China."

Domestic Key Player of China's Banking Sector

state-owned banks (big four)	State-Owned Commercial Banks – The 'Big Four': In 1995, the Chinese Government introduced the Commercial Bank Law to commercialize the operations of the four state-owned banks, the Bank of China (BOC), the China Construction Bank (CCB), the Agricultural Bank of China (ABC), and the Industrial and Commercial Bank of China (ICBC).
The Bank of China (BOC)	The Bank of China (BOC) specializes in foreign-exchange transactions and trade finance. In 2002, BOC Hong Kong (Holdings) was successfully listed on the Hong Kong Stock Exchange. The USD2.8 billion offering was over-subscribed by 7.5 times. The deal was a significant move in the reform of China's banking industry.
The China Construction Bank (CCB)	The China Construction Bank (CCB) specializes in medium to long-term credit for long term specialized projects, such as infrastructure projects and urban housing development.
The Agriculture Bank of China (ABC)	The Agriculture Bank of China (ABC) specializes in providing financing to China's agricultural sector and offers wholesale and retail banking services to farmers, township and village enterprises (TVEs) and other rural institutions.
Policy Banks	Three new "policy" banks-the Agricultural Development Bank of China (ADBC), China Development Bank (CDB), and the Export-Import Bank of China (Chexim) - were established in 1994 to take over the government-directed spending functions of the four state-owned commercial banks. These banks are responsible for financing economic and trade development and state-invested projects. CDB specializes in infrastructure financing; ADBC provides funds for agricultural development projects in rural areas; and Chexim specializes in trade financing.

Second Tier Commercial Banks	In addition to the big four state-owned commercial banks, there are smaller commercial banks. The largest ones in this group include the Bank of Communication, CITIC Industrial Bank, China Everbright Bank, Hua Xia Bank, China Minsheng Bank, Guangdong Development Bank, Shenzhen Development Bank, China Merchants Bank, Shanghai Pudong development bank and Fujian Industrial Bank. The second tier banks are generally healthier in terms of asset quality and profitability and have much lower non-performing loan ratios than the big four.
Trust and Investment Corporations	In the midst of the reforms of the 1980s, the government established some new investment banks that engaged in various forms of merchant and investment banking activities. Many of the 240 or so international trust and investment corporations (ITICs) established by government agencies and provincial authorities, however, experienced severe liquidity problems after the bankruptcy of the Guangdong International Trust and Investment Corporation (GITIC) in late 1998. The largest surviving ITIC is China International Trust and Investment Corporation (CITIC), which has a banking subsidiary known as CITIC Industrial Bank.