

Warding off policy-oriented financial risks and promoting effective growth of the national economy

Chen Yuan

Today I am very delighted to give a brief account of the way the State Development Bank (SDB) wards off and mitigates policy-oriented financial risks.

Since last year, in the face of the economic circumstances affected by the Asian financial crisis, the Chinese Government has adopted the policy of stimulating domestic demand in order to sustain a rapid pace of economic growth. The key element of the policy is to expand the investments in infrastructure projects so as to shore up economic growth through the increased investments. Unlike in the past, the increased investments are not directed to industrial projects, neither are they unreasonably spread out on too large a scale. They are mainly channelled to the construction of infrastructure, which is still a bottleneck in the economy. Since the direction of these investments is made clear and the measures are in place on time, substantial effects have been achieved so far. Meanwhile, expanding investment in infrastructure projects constitutes a new challenge to the strengthening of risk management; in particular, we have little experience in how to ward off and mitigate policy-oriented financial risks. Therefore, we are drawing from practical experience and working on how to take effective measures. The focus is on how to subject government behaviour to market rules and help local governments at different levels play positive roles in warding off financial risks while abandoning the usual practice of direct intervention in the specific projects.

Since its establishment in 1994, the SDB has made remarkable progress in funding the construction of key projects in the areas of state basic infrastructures, basic industries and pillar industries. By the end of 1998, the SDB had total assets of more than RMB 500 billion (around US\$ 60 billion), greatly contributing to China's economic reform and

long-term development. In order to ward off and mitigate policy-oriented financial risks, we are taking the following measures:

First, make efforts to establish a market-oriented and independent operating mechanism. The SDB has been working on how to form fund-raising channels with high benefits and low costs, and has adopted a fund-raising method which combines a mandatory subscription mechanism and auctions. Efforts have also been made to improve fund position management and increase the efficiency of funds use, so as to increase the capability to ward off risks at source. Meanwhile, the accounting system reform is being deepened and the branch networking system is being strengthened with a view to gradually exercising credit management on our own.

Second, pay attention to strengthening the analysis of market conditions and boosting the level of decision-making on loan extensions. We have decided to set up the project screening mechanism, under which good projects are chosen and bad ones are rejected, in accordance with the principle of “broad entry, speedy passageway, grabbing good clients and keeping off bad projects”. This mechanism is primarily aimed at increasing our independence in the selection of projects. It is in line with the need to focus project appraisals on the analysis of market conditions and risks that we have instituted the Department of Market and Industry Analysis, which is in charge of the analysis of market conditions and industry developments with the aim of providing appraisal evidence for the loan evaluation departments. In the process of conducting project appraisals, we adhere to the principle of independent appraisal, and combine the role of professionals at the bank with that of the outside experts. As a result, the quality of project appraisals is gradually being boosted. One of the indicators demonstrating the effectiveness of the SDB’s project appraisals is that the ratio of rejected projects to total projects recommended by the government agencies had increased significantly to 46% in 1998, from 13% in 1997.

Third, strengthen credit management and improve the quality of assets. As China Investment Bank was merged into the SDB last December, the strengths of the two banks are now combined, which will strengthen the SDB’s branch networking system and professional expertise to improve credit management. In the process of credit management, great efforts are being made to combine the efficient allocation of new loans with the structural adjustment of outstanding loans, to combine the appraisal of

new projects with the evaluation of the projects under construction, and to combine the loan recovery mechanism with the transfer of non-performing loans. In particular, by making full use of the advantage that the SDB has provided enormous support to infrastructure projects in various regions, we demand that local governments shift the focus of economic coordination to warding off and mitigating risks, and have achieved distinct effects.

Fourth, strive to establish risk management mechanisms throughout the whole process of credit operations. We have set up the Management Committee of Credit Asset Risks, which is in charge of the bank’s credit risk management and monitoring. We have also established the responsibility system for credit risk control, under which the responsibility for risk control has been delegated to each working link and post. Through the establishment of the rules and regulations on the cross-supervision of each post, on the cross-checking of each working link, on the internal control inspection and on the punishment of illegal behaviour, we are striving to improve the internal control system and gradually put in place an effective risk monitoring and control mechanism.

Fifth, actively ward off credit risks. We regard improving the quality of outstanding assets as the key element in warding off credit risks, and have thoroughly checked the loans extended to the coal-related projects. Given that the ratio of non-performing loans in the coal sector to total loans is relatively high, we have put forward a series of counter-measures which are supported and approved by the central government. Special importance is attached to measures aimed at controlling the prices and manufacturing of some coals with high pollution and sulphur and at closing some large state-owned coal mines with exhausted resources in compliance with current adjustments of the state policy on the energy industry. We also have checked the outstanding loans extended to other sectors, and subsequently put forward suggestions and measures on risk control. These suggestions and measures have helped accelerate the structural adjustment and boost the benefits of improved management for the national economy.

Finally, help industrial sectors and local governments to develop a mechanism of investment discipline. In order to effectively ward off financial risks, efforts must be made to subject government behaviour to market rules, and help local governments at different levels actively play their

roles under market conditions. The SDB has signed investment/finance service cooperation agreements with a number of provincial governments, which have helped improve the investment environment and discipline the investment behaviour of relevant industrial sectors and local governments by establishing a unified framework governing who borrows money, who is entitled to use the money and who is also responsible for repaying the money. Meanwhile, we have put in place a system of reporting credit asset quality conditions to relevant industrial sectors and local governments, and impel them to join us in conducting the management and supervision of loan projects through such measures as combining loan recovery with loan extension and linking up loan recovery with project appraisal, so as to invigorate the adjustment of the outstanding loans with the incremental loans of high quality.

While the unusual year 1998 is now behind us, 1999 is going to be another challenging year. As the biggest developing country in the world, China has a vast market and huge potential. This year, the Chinese Government will continue to implement the policy of expanding domestic demand and increasing investment in infrastructure projects in order to promote economic growth, while the steady increases of domestic demand and the stability of the renminbi exchange rate will create favourable conditions for capital inflows. As the biggest policy-oriented bank in China, the SDB is willing to continuously bridge capital inflows, and enhance the communication and cooperation with foreign as well as domestic financial institutions. The SDB will also make great efforts to provide high-quality financial services and play an active role in financial markets both at home and abroad, so as to make a further contribution to China's reform and modernisation of the financial system.