

Zhou Xiaochuan: Speeding up financial reform to support economic development of the west region in China

Speech by Mr Zhou Xiaochuan, Governor of the People's Bank of China, at the High-Level Forum on Economic Development and Financial Services in the Three Gorges Area, Chongqing, China, 15 November 2005.

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Honorable Secretary Huang, Mayor Wang,

Ladies and Gentlemen,

I feel very pleased to participate in this high-level forum. Within a short period of 6 years since the central government took a decision to implement the strategy to develop the west region, tremendous changes have taken place in Chongqing, a city with long history located in Southwest China. Though less developed in terms of economic success, the west region boasts of great potentials for future development. On today's occasion, I would like to share with you my observations on how we could improve financial services to support sustainable economic development in the west region through financial system reform and innovation.

Development of the Three Gorges area plays a special and significant role in the development of the whole west region. Through discussions at this forum, the People's Bank of China and other financial institutions will gain a better understanding of this particular area as well as its financing needs. On the other hand, many issues encountered in the process of economic development in this area are characteristic of the problems found in the development of the whole west region which merit attentive research by the financial sector for good solutions via reform and innovation.

As we can see, there exists a strong demand in the west region for enhanced financial services as many enterprises face difficulties like insufficient capital, difficult access to direct financing and relatively high asset-liability ratio etc. In recent years, despite the fact that both the policy and commercial financial institutions have made great contributions to the economic development of the west region, constrained by natural conditions and other factors such as high cost and long period of investment as well as a relatively large proportion of traditional industries in the GDP, strengthened financial support is needed in this region to modernize the agricultural industry, develop small and medium-sized enterprises and promote economic restructuring. With the national economy increasingly run by the market principles, we shall neither rely on the conventional wisdom of "allocating funds and credit quotas", nor shall we excessively use policy loans to meet financing needs of the west region. But rather we shall forcefully promote financial reform to put in place a financial organization system with good functions and strong competitiveness that can provide quality financial services. At the same time, we shall make efforts to further improve financial eco-system in the west region and cultivate good market environment so as to retain and attract more financial resources and give the market a full play of its fundamental role in financial resource allocation.

Improving financial service in the west region shall be integrated into the overall reform strategy of the Chinese financial system. In 2003, under the steering of the central government, reform of the state-owned commercial banks was officially launched, with important progress already made on various fronts. In particular, the Industrial and Commercial Bank of China, the Bank of China, China Construction Bank and the Bank of Communications have all completed financial restructuring and been transformed into joint-stock companies. The Bank of Communications and China Construction Bank successfully went public. Through the reform measures, financial situation of these banks evidently improved, internal control mechanisms were strengthened and corporate governance started to play its disciplinary roles. These banks each maintain a large branch network in the west region, and these branch offices, as I believe, will persistently improve their business management and adaptability to the market economy with the deepening of financial reform, and thus will provide better financial services to economic development of the west region.

Consistent with steady growth of the Chinese economy, the policy banks also face the problem of business transformation. For a foreseeable long period of time, the policy banks are still needed to strengthen their support to economic development in the west region, however, due to limitations of

these banks in efficient resource allocation and business development, these traditional policy banks face the challenges in the transformation of business mode. From the perspective of international experiences, we can see that starting in 1990s, policy banks in various countries embarked on the journey of business transformation. Generally, these policy banks have transformed themselves into universal development financial institutions. Successful examples include the Korea Development Bank and the German Development Bank (KfW). In line with the inherent requirements of the market economy, policy banks in China shall be transformed into development financial institutions with financial viability and strong competitiveness which mainly engage in providing development financing for the medium and long-term projects while continuing to provide policy financial services subject to the fiscal situation of the state. In this case, the policy banks could serve financing needs of industrial restructuring, infrastructure construction and the implementation of “overseas investment strategy” by enterprises in the west region and the country at large in a more sustainable way.

Though limited in asset size and capital strength, local financial institutions also play an important role in supporting the regional economic development. On this account, we need to make great efforts to promote reform of the local financial institutions and encourage social participation in the restructuring of these institutions so that new mechanisms featuring self-discipline and self-development could be fundamentally established to ensure healthy growth of financial business and strengthened financial services to regional economic development.

In recent years, rural economic development has set higher standards for financial services. In particular in the west region where the agricultural industry accounts for a large proportion of the GDP, there exists an urgent need to improve financial services in the rural areas. The central government has been standing highly attentive to financial work in the rural area and on many different occasions stressed the need to “introduce reform and innovation of the rural financial system”. Financial reform in the rural area shall be carried out in line with the local conditions focusing on exploring a new path for the development of rural finance. Efforts shall be strengthened to construct a rural financial system with improved functions, rationalized division of labor, clear ownership and effective supervision, and to pioneer in developing new cooperative financial institutions in the rural area as well as an effective business model ensuring combined policy and commercial financial support to rural economic development. In 2003, pilot reform program of the Rural Credit Cooperatives (RCCs) was conducted in 8 provinces and municipalities. Chongqing as one of the municipalities participating in the pilot program has so far made good progress in the reform, creating a sound foundation for future endeavors. With support of the government, the RCCs have been released from financial burdens, but this does not mean we have completed the reform. Whether we could make further progress in reforming the RCCs depends critically on the transformation of the operating mechanisms and the financial sustainability of the RCCs. Success in these areas holds great significance not only for the viability and development of the RCCs themselves, but also for the realization of the broad rural economic development strategy.

With regard to supporting economic development in the west region and in the Three Gorges area, we think that financial support should be tilted towards the development of the small and medium-sized enterprises, particularly those non-public SMEs, and to the development of the external sector.

As many have observed, in the government orchestrated reform process of the large commercial banks and the RCCs, the large banks and some medium-sized banks tend to emphasize on their services to the large corporate clients, emphasize on restructuring the used-to-be loose credit management system, and emphasize on strengthening internal control and consolidated management. However, we should not neglect our financial support to the SMEs, especially to the non-public SMEs. I very much appreciate the proposals Mayor Wang just highlighted, and I have more or less some similar viewpoints and would like to summarize as follows:

First, financial institutions should be organized in a way more capable of providing financial services to the SMEs.

Second, while continuing to provide quality service to the big corporate clients, large banks which are taking a high proportion of the financial markets should also strengthen internal research and establish new department units to improve credit services to the SMEs.

Third, large enterprises are more likely to turn to capital market (equity market and bond market) to meet their financing needs in the future and this change will exert greater market pressures on the commercial banks. Therefore, in order to improve business efficiency, the commercial banks should pay more attention to serving the small and medium-sized clients.

Fourth, market-based interest rate reform should be promoted. Under the leadership of the State Council, the People's Bank of China has gained important progress in advancing the market-based interest rate reform in recent years. In the days to come, we will continue to deepen the reform process. Determining interest rate following market principles will enable the lending institutions to better cover their risks and thus to improve their credit services to the small and medium-sized clients.

Fifth, as Mayor Wang just mentioned, great efforts should be made to more effectively promote micro credit business. While the micro credit business has made certain progress in the rural areas, there is still a long way to go before it can meet the financing needs of the rural economy. In recent years, many developing countries in the world have gained useful experiences in growing their micro credit business and some are worth learning. We need to make careful study and research on this matter and advance the micro credit business prudently.

Sixth, financial products innovation should be encouraged. The financial industry is an industry featuring brisk innovation activities. The frequent change and introduction of new products aim to improve allocation of economic resources and better meet the financing needs of the market. In terms of developing new financial products, we have gained in the past some unsuccessful experiences and lessons which we need to draw from to improve the innovation capacity of the financial institutions. Only with improved capability in product innovation, can the financial institutions better serve the financing needs of the SMEs, the non-public enterprises and the economy of the Three Gorges area.

Finally, I would like to stress that the receipt of financial resources in a region is closely associated with the condition of its financial eco-system. Whether it be development or commercial financial business, a sound financial eco-system is the prerequisite to ensure its success. In recent years, with steady improvement of the internal control and risk management systems, some national banks have started to set up internal ratings system in accordance with stipulations of the Basel Capital Accord II, and adopted such an approach to assess the condition of financial eco-systems across various regions, so as to guide their exercise in internal fund allocation, credit planning or the authorization of credit lines. This will to a large extent determine the direction and amount of financial resources movement across the regions. In the west region where the industrial foundation is relatively weak and the economic development is backward, greater efforts should be made to improve the local financial eco-system to attract financial resources. Of course, backwardness in economic development does not necessarily imply a poor financial eco-system. But if the financial eco-system of the west region could be more effectively improved, it would be helpful to quickly develop a comparative advantage in attracting financial resources to provide sustained credit support to the industrial development and restructuring of the region. In terms of building a sound financial eco-system in a region, apart from the efforts by the central government in establishing a good legal and enforcement system, the local governments should also create a favorable platform to ensure justice of the judiciary system so as to provide better protection for the claims of the financial institutions, improve credit environment and foster a mutually beneficial relationship between the banks and the enterprises.

Ladies and gentlemen, many issues remain to be deeply studied and deliberated with regard to accelerating financial system reform and giving the financial industry a greater role in resource allocation to more effectively support economic development of the west region and the Three Gorges area in particular. In this respect, I would like to commend the valuable research and experiments conducted by provinces and municipalities in the Three Gorges area. I have also read some excellent research papers containing good proposals presented at this conference. I think the financial industry should support the favorable policies tailored by the State to facilitate development of the west region and the Three Gorges area in a bid to improve financial services to this end. I also believe that under the leadership of the CPC Central Committee and the State Council and with concerted efforts of all relevant parties, the vast west region including the Three Gorges area will definitely be able to embrace an economic take-off at an early date.

Thank you.