The entry of foreign banks into the Chinese banking sector

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1. The four stages of opening-up the Chinese banking industry

The process of permitting a greater role for foreign banks in the Chinese banking sector has been a gradual one, spread over two decades. Adopting this gradual approach has allowed China to avoid some of the problems observed in other countries, where a rapid entry of foreign banks has been associated with excessively rapid growth in overall bank lending fuelling speculative excesses. The process has comprised four main stages:

- *Stage I: late 1970s to early 1980s.* Foreign banks were allowed to open representative offices.
- *Stage II: 1980s to early 1990s.* Foreign banks were allowed to open operational branches in Special Economic Zones. Early instances included Hong Kong banks operating in nearby Shenzhen. In 1990, arrangements were put in place for them to operate in Shanghai. Later the arrangements were extended to seven other coastal cities.
- *Stage III: Mid 1990s.* Improved regulations on opening up to and supervising foreign banks were formally promulgated, allowing foreign banks to operate in 23 cities.
- *Stage IV: Since 1996*. Foreign banks have been allowed to open branches all across China. A pilot programme was initiated in the Pudong area of Shanghai for foreign banks to undertake local currency business. Foreign banks in Shenzhen and Shanghai have been allowed to undertake a wider range of activities.

2. The role of foreign banks

By the end of October 2000, there were 234 foreign bank representative offices, 157 foreign bank branches and 13 locally registered foreign bank subsidiaries and joint ventures in China. Total assets of foreign banks reached US$ 34 billion. Thirty-two foreign banks have obtained business licences to do renminbi business in Shanghai and Shenzhen.

Foreign banks have played an important role in attracting foreign capital, introducing advanced management experiences and expertise, intensifying competition in the Chinese financial market and promoting the improvement of efficiency and corporate governance of Chinese banks.

3. Further opening-up to foreign banks

Further opening-up of the banking industry is an objective that follows from the requirements of a socialist market economy and economic globalisation. With China’s forthcoming accession to the World Trade Organisation, its financial industry will further open-up to the world in terms of market entrance and national treatment. In time, foreign banks will be able to offer their services to the household sector. Chinese banks will compete with foreign banks in all respects, especially for qualified personnel.

Several factors will become critical for domestic banks to survive and develop in the face of this competition. These include further development of the supervisory system by the central bank. This will involve implementing international standards, such as the Basel Committee’s Core Principles, and moving closer to international best practice. It will also require improvements to the legal framework.

Foreign banks in China are allowed to be fully foreign-owned. However, only large and financially strong banks are allowed to enter the Chinese market. A minimum asset size of US$ 10 billion is required. They must be subject to high quality supervision from the supervisors in their home country. To ensure that foreign banks have the necessary familiarity with the Chinese market before commencing full operations, they are required to have operated a representative office in China for at least two years.

4. Conclusions

The gradual approach to financial opening-up has served China well. Adopting this gradual approach has allowed China to avoid some of the problems observed in other countries, where a rapid entry of foreign banks has been associated with excessively rapid growth in overall bank lending fuelling speculative excesses. Foreign banks have close relations with international financial markets, and there is a risk that their presence could mean international financial disturbances being more readily transmitted to the domestic market. There is also a risk that if foreign banks face difficulties in their home market, they could suddenly withdraw from the Chinese market, causing considerable disruption.