OPENING ADDRESS

Governor Dai Xianglong

First of all, may I on behalf of the People's Bank of China express the warmest welcome to the foreign experts and Chinese participants attending this conference. My sincere gratitude goes to General Manager Crockett of the Bank for International Settlements, Professor Dornbusch from the Massachusetts Institute of Technology and Professor Giavazzi from Bocconi University for their enormous efforts for the successful convening of this conference.

The theme of the conference is experience sharing among the countries represented in the area of financial supervision and the discussion of how to deal with problem banks. The seminar, if well conducted, will be of great significance in strengthening China's financial supervision and promoting international cooperation among central banks and regulatory and supervisory authorities. I hereby wish you a successful conference. In reviewing the experiences and lessons in financial supervision, I believe several issues deserve much attention.

The financial industry can only develop in a healthy macroeconomic environment

The economy sets the tune, whereas financial developments interact with the economy. Although the central bank may adjust the money supply through monetary policy instruments, monetary aggregates eventually reflect the composite fund flows of the households, enterprises, commercial banks and the government agencies. Therefore, sound financial developments call for a healthy macroeconomic environment, in which the behaviour of the households, enterprises, commercial banks and the government is legally defined.

In creating such an environment, it is most important to maintain a reasonable relationship between the growth and structure of the economy and a sustainable level and structure of the external debt. The principle of gradualism should be applied to local currency convertibility.

During 1993–95, China managed to bring the serious inflation under control by tightening monetary policy and increasing effective supply. Since 1 May 1996, the People's Bank of China has cut interest rates on six occasions. Last year, the money supply was increased appropriately while more proactive fiscal policies were adopted. Both helped in fending off severe deflation and maintaining steady growth of the national economy. China encourages foreign direct investment, while striving to control the size and structure of its external debt and to increase its foreign exchange reserves. In 1996, China declared the current account convertibility of the renminbi and adopted the principle of gradualism with regard to capital account convertibility. These measures played an important role in promoting the steady development of the financial sector in China and staving off the direct blast of the Asian financial crisis. On the other hand, the legacy of the overheated real estate markets in 1992 and 1993, the abusive asset stripping and repayment evasion in the recent couple of years, citing enterprise restructuring as an excuse, and the high leverage ratio for state-owned enterprises are major sources of financial risk.

The financial supervision system should be developed in consistency with the specifics of the country in question

In recent years, against the backdrop of innovation and conglomeration in the financial industry, countries such as the United Kingdom, Japan and Korea have unified the various supervisory functions within a single agency. However, China chose a different approach. In a short period after 1987, we allowed securities houses, trust and insurance agencies to be set up within banks, amounting to a comprehensive banking system. Later the rules were revised to allow banks to invest in trust, securities and insurance companies. However, the practice proved to be unfair to smaller financial institutions and resulted in securities markets' risks spreading to the banking business of the same institution. In 1993, the segregation principle for the financial industry was formalised in the "Resolution on Financial System Reform" of the State Council. It was later documented as a legal provision in the Banking Law in 1995. Under the principle of business segregation, and in order to meet demands imposed by the development of the industry, the China Insurance Regulation Commission was established in 1998. At the same time, the

People's Bank of China transferred the duty to supervise the securities companies to the China Securities Regulation Commission. Thus, the three agencies under the State Council carry out their respective regulatory and supervisory responsibilities in the banking, securities and insurance industries.

In addition, the People's Bank of China underwent major reforms in its administrative organisation. At the headquarters, the supervision departments were reorganised so that the supervised are overseen from market entry, through business operation to market exit by the same supervisory group. The 31 provincial branches were replaced by nine regional ones to ensure the independence and fairness of the central bank in executing its duty. In this way, the supervisory resources can be deployed within a larger jurisdiction in a more unified and consolidated manner, with strengthened authority and improved efficiency.

China's financial industry has developed steadily with commensurate reforms

A comprehensive and forward-looking perspective is necessary in analysing the status of the financial industry. It is generally acknowledged that China's financial industry is developing with commensurate reforms. First, the financial system consistent with the socialist market economy has begun to take shape. Second, the financial industry has played an active role in controlling inflation and avoiding deflation. Third, the foreign exchange reserves are sufficient to more than cover one year's import payments. Fourth, public expectations are stable.

However, it should be noted that the financial industry is not at all free of problems and risks, the major ones being the excessively large proportion of savings in the money supply (RMB 5.4 trillion out of RMB 10.5 trillion), the high leverage ratio of the state-owned enterprises, the high ratio of non-performing loans of the state commercial banks and the insolvency of a handful of small- and medium-sized financial institutions.

The resolutions of the State Council lay down that China will adopt a number of measures to address these financial risks. First, the capital market will be developed to increase the capital of the SOEs and improve their creditworthiness and ability to fulfil their civil liabilities. Second, China will forge ahead with the reform of state commercial banks. Supervisory committees will be established to strengthen the external oversight of the state commercial banks. Prudential accounting standards and the five-category asset classification approach will be adopted. A pilot project will be carried out to look into ways to recover non-performing assets through financial asset management companies so as to substantially reduce the ratio of non-performing assets by a large margin. Third, the urban and rural credit cooperatives will be properly managed and serve as cooperative financial institutions with the major equity holders, management team and clients from the local community. They will therefore be better placed to support the private sector and to resolve the financial risks. A deposit insurance scheme for the urban and rural credit cooperatives will be established. Fourth, the trust and investment companies will be rehabilitated under the principle of "trust as the core competence, business segregation, economy of scale and restructuring on a case-by-case basis". Fifth, the market exit mechanism for financial institutions will be improved. For financial institutions with payment difficulties, rehabilitation and rescue should take priority over closure and restructuring over bankruptcy. The closure and liquidation of Guangdong International Trust and Investment Company (GITIC) have evolved into a bankruptcy procedure. At any event, liquidation and repayment will be fair and transparent in compliance with relevant laws and regulations. Finally, international cooperation in financial supervision will be strengthened.

Recently, the East-Asian financial crisis and the consequent financial and economic panic have stimulated a heated discussion in the financial community on the pros and cons of financial globalisation. As a matter of fact, financial globalisation has helped as well as hurt the relevant countries, regions and the international community. The crux of the matter is that we should identify and weigh the pros and cons so as to make full use of the advantages and contain the disadvantages. We believe that facing the challenge of financial globalisation, the international community should join the efforts to build a new mechanism to fend off and address global financial risks, and that countries should strengthen their cooperation in financial supervision.

First, the International Monetary Fund, the World Bank and other international financial organisations should be reformed so that they manifest to a larger extent the principle of transparency and openness. The new system could thus facilitate effective communication, open dialogues and cooperation among the governments, the private sector and international organisations.

Second, in the course of economic and financial globalisation, the specifics of the developing countries should be taken into consideration and gradualism should be applied. On the other hand, the developed countries should, in the interest of the overall and long-term prospects of the world, shoulder more responsibilities in line with their economic strength to fend off the financial risks in the global arena.

Third, the oversight of international capital flows should be strengthened and a monitoring mechanism for short-term cross-border capital movements should be established. Sufficient financial resources should be made available to tackle the tremendous capital movements and short-term liquidity problems.

Fourth, the supervisory system of respective countries should be strengthened, with the Basle Accord at the core. Special attention should be paid to multinational financial institutions and cross-border operations. Not long ago, the Finance Ministers and Central Bank Governors of the G7 countries decided in their Bonn meeting to set up the Financial Stability Forum and the early warning mechanism for financial risks. We hope that this will pave the way for concrete results of international cooperation in financial supervision. Meanwhile, may I congratulate Mr Crockett on his appointment as the Chairman of the Financial Stability Forum. To conclude, I wish you a successful conference.