Wu Xiaoling: Relax control on informal financing to promote resource allocation

Speech by Ms Wu Xiaoling, Deputy Governor of the People's Bank of China, at the "Forum of 50 Chinese Economists", Beijing, 17 February 2005.

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At the end of 2004, outstanding RMB deposits in China's financial institutions amounted to RMB 24.5 trillion yuan, with the ratio of M2 to GDP reaching 189 percent, the highest in the world. However, some enterprises still complain about difficult access to credit and have to resort to informal channels for financing needs. We must admit that the development of China's financial sector is not flexible enough to accommodate the relatively fast and strong growth of China's economy. In my view, the main reason lies in the excessive financial restrictions, which has dampened the development of direct financing, distorted social financing structure, and increased the credit risks of the banking system.

In the transitional period of China's economy, due to factors such as weak self-discipline of market participants, public low awareness of risks and the underdevelopment of social credit culture, it is necessary for a country to strengthen its control on financial sector in a given period of time. However, with the principle of market economy being established, excessive financial control will hinder economic development and distort the normal functioning of financial system.

The rights to own property and freely enter into contract constitute the cornerstone for the market economy. The Constitution amended by the Tenth National People's Congress stipulates that legitimate private property should be protected. An impartial protection of public and private legal properties also serves as a solid foundation for the development of the socialist market economy.

To protect property right, rigorous supervision should be exercised on deposit-taking financial business. For instance, criteria of market entry and risk control are usually applied to all depository institutions, and requirement and regulation of information disclosure are enforced on public placement funds, bond issuers, and listed companies, so as to protect the interests of depositors and investors. Financing activities in violation of laws and regulations should be resolutely cracked down.

To respect property right, fund owners should leave the liberty to use their possessed capital. While strengthening information disclosure and discouraging information misreporting, the sate should at the same time relax control on direct financing and allow the borrowers and investors to make independent decisions. For this purpose, a multi-layer capital market should be developed to facilitate direct financing of various forms. In particular, we should pay attention to the development of the informal financing market.

The informal financing market here refers to financing activities of the individuals and the enterprises. Currently, there is no legal prohibition for financing between individuals, except for usury, which is strictly prohibited in China; as for corporate lending to unspecified customers, such business should be strictly subject to financial supervision as it relates to public interests. However, in my view, we may need to give a second thought to the current strict control over financing activities among the enterprises and those to the individuals.

Nowadays, due to low deposit interest rate, high risks involved in stock market investment, and risks in investing in the much fluctuating mutual fund, trust and other collective investment products, many rich people are willing to lend directly, or through a joint-owned company. As the People's Bank of China has already removed the upper limit of lending rates for financial institutions, this type of financing activities has a greater potential to develop. At present, some small enterprises and individuals often have difficult access to bank loans, but due to some factors such as the regional advantages, some people or their companies are able to control loan risks in a way that could not be done by banks. Why shouldn't we take necessary measures to normalize these financing activities? So long as the sources of funds of these lenders, either individuals or companies, are specified, the existence of these non-deposit taking lending entities should help to standardize the informal financing activities. On such a count, we should newly establish a specific type of financial institutions, which could be either called investment companies if their business are confined to equity investment, credit investment and securities investment, or called loan companies that specialize in micro credit business. Many countries and regions such as the United States, Hongkong and South Africa have established their respective unique supervisory system for these loan institutions. In this regard, we should also promote the legislation of investment company, regulate private fund placement, and advance micro credit business development so as to satisfy the financing needs of the small enterprises and natural persons.

In many countries, rules have been formulated to regulate and supervise the above mentioned lending institutions. These rules allow individuals and companies to issue loans with a license (such as in Hongkong and the NewYork State of the United States), or require the lenders to register every transaction and pay relevant fees (such as in South Africa). Any violations of the supervisory rules will be punished. We should learn from the experience of these market economies in dealing with the informal financing activities, guide commercial banks to establish micro credit business departments or license some micro credit institutions to promote the development of micro credit market.