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“The Contradiction in China’s Gradualist Banking Reforms”
***Brookings Papers on Economic Activity*, Fall 2006, pp. 103-48**

China’s state-owned banks have historically funded money-losing state enterprises as a way of maintaining employment and social stability, but this practice has led to bank insolvency and bailouts. We survey the Chinese banking industry, focusing on the largest banks, which are being reformed to increase their competitiveness following China’s 2001 commitment to open its domestic banking market. We assemble macroeconomic, microeconomic, and anecdotal evidence suggesting that government influence, although less explicit than in the past, continues despite the reforms. Indeed, the reforms thus far do not resolve the tensions between government objectives and the obligation of commercial banks to base their credit decisions on an objective appraisal of ability to repay. We conclude that, when growth slows, this contradiction will become fully apparent, and the government will resolve it by again bailing out the banks. We describe alternative bank reform proposals that would help reconcile the banks’ conflicting objectives.