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CHINESE BANKING SECTOR IN TRANSITION: ANY LESSONS FROM POLAND?

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Abstract

At the end of the twentieth century Asia, and especially China, has rapidly integrated with the world economy. It has been recently confirmed by China's accession to the World Trade Organisation. While this process has been possible due to Chinese fast economic growth, inefficient banking sector appears as a major threat that may shake the stability of the Middle Country in the future. The dissertation focuses on reforms and challenges facing Chinese banking sector, but it also includes other interrelated aspects like privatisation and development of regulatory institutions. This study analyses the experiences of Polish transformation in banking sector and compares it to the situation in China.

This paper investigates the present situation in China in banking sector, the reasons behind it and the correlations that are responsible for shaping it. The comparison with Poland is used here to show which solutions applied in other transformation countries may be helpful in China, but also to claim that their successfulness hinges on internal conditions in China. It is argued that to change the situation in Chinese banking sector the government's engagement in the sector has to be limited and the importance need to be put on regulatory arrangements.

Key words: banking sector, privatisation, state-owned banks, nonperforming loans, economic reforms

Abbreviations

ABC	Agricultural Bank of China
ADBC	Agricultural Development Bank of China
AMCs	Asset Management Companies
BFG	Bank Guarantee Fund
BOC	Bank of China
CBRC	China Banking Regulatory Commission
CDB	China Development Bank
EIBC	Export-Import Bank of China
FDI	Foreign Direct Investments
GINB	General Inspectorate of Banking Supervision
ICBC	Industrial and Commercial Bank of China
IMF	International Monetary Fund
NBP	National Bank of Poland
NPLs	Non-performing loans
PBC	People's Bank of China
PCBC	People's Construction Bank of China
QFII	Qualified Foreign Institutional Investors
ROA	Return on Assets
ROE	Return on Equity
SOBs	State-owned Banks
SOEs	State-owned Enterprises
TVEs	Township and Village Enterprises
WTO	World Trade Organization

Note

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Introduction

I) Research purpose, questions and plan

The reasons and importance of sound financial system has been highlighted by many scholars and international institutions on several occasions, especially after the financial crisis that affected Mexico, the South-East Asia and Russia during 1990's. Greater transparency, better prudential regulations and deliberate credit policy in banking sector have turned out to be crucial to avoid economic contagions. In most countries in the world banks create the core of financial system and act as the intermediaries between small depositors and investment sector.

While we know much about how sound financial system should work, we are less sure how countries in transition should transform its financial systems to make it compatible with constantly changing world economy and in the same time to make it conducive to economic growth. We know less about which steps they should make and when, rather than how desirable financial system and banking sector looks like.

It is a common strategy to make a cross-country study on particular topic and choose the most appropriate or successful model to adopt it later on a domestic ground. It is a good and important way of gaining new information and knowledge. Unfortunately, without reconsidering founding and amending them in relation to particular country, without including inside constraints, limitations and conditions, this simple and rational method has failed to work many times. To show an example, we can relate to a number of prescriptions made by various governments and think tank organisation towards Africa, Latin America and Asia.

From this perspective last International Monetary Fund's (IMF) staff statements suggesting that China should follow Polish model of transformation in financial sector¹ should be analysed carefully. At the beginning of economic reforms Poland has decided not to follow recommendations made by various international financial institutions, claiming that due to internal conditions its final results might be far from desirable one and this choice so far has given good results.

The existing literature varies in its approach about outcomes of Chinese reforms from very optimistic to pessimistic or even catastrophic. The last four years have brought big changes in Chinese banking system. It has been caused by commitments China has agreed to follow when entering the World Trade Organisation (WTO). Most importantly China is lowering its entry barriers and other geographical limitations for international banks. By the end of 2006 all obstacles in financial sector towards foreign investors will be lifted and the process will end. To date however, Chinese financial system is still restricted. There are varieties of restrictions, both regulatory and non regulatory in nature, imposed on clients from accessing financial services in the best possible way and on investors willing to operate in the market.

¹ See: Ingves S. (2002).

The aim of this study is to present and analyse the transformation in the financial sector in Poland and to apply it to reforms in China, in order to compare them, but also to confirm or reject statements suggesting a similar, “Polish” path of reforms for China. The advantages and disadvantages of the Polish banking transformation would be shown and the appropriate changes would be suggested in order to make them more applicable in China. The main research question is: in what degree elements that were successful in the transformation of the Polish banking sector could bring similar results in China? Drawing on this, the main hypothesis of the dissertation would be that *there are elements of the Polish banking transformation that could be applied in China with good results, however, some changes in Chinese banking environment would be necessary to achieve comparable outcomes.*

Secondary questions include:

- How have the reforms in Polish banking sector looked like and what have been the successes and failures?
- What has been changed until now in the Chinese banking sector?
- What are the comparable elements of the transformations in both countries and which elements of the Polish banking transformation should be reconsidered in the course of Chinese transformation?

Following the sub-chapter on methodology, the last part of the introduction presents a theoretical basis for the present study. Chapter 1 contains a general insight about Polish reform period from 1989 onward. Here, special attention is put on transformation of banking system and privatisation process with its results. In Chapter 2 focus is on the point of departure for economic reforms in China and on the transformation in a banking market until now. Possible failures or successes are highlighted. Finally, Chapter 3 provides a comparison between banking reforms in both countries with a special consideration of eventual cross-country solutions or advices. The paper ends with a small forecast on the near future facing Chinese banking sector.

II. Methodology and sources

This dissertation is a case study analysis; as a method, it deals with “a contemporary phenomenon within its real – life context” (Yin 1989: 23). In this project a multiple – case design is used, and two cases are selected and investigated. Following the Yin typology, this research is a theoretical replication – it “predicts contrasting results” for both cases “but for predictable reasons” (Yin 2002: 47), explained also with the support from the theory. The analysed cases are the transformations of financial sectors in Poland and China, where the point of departure for both cases is similar, but the results differ.

There are few delimitations of the present study. Although this paper deals with the financial system, it focuses mainly on banking sector and problems that usually affect it from the perspective of privatisation process. However, reforms in real economy, especially concerning state-owned enterprises and stock exchange, supplement this dissertation. There are also several limitations that usually are perceived as a part of a broad phenomenon of financial system, but because of limited space and scope of this study they have been omitted. Most importantly exchange rate policy and capital account liberalisation, but also financial

intermediaries other than banks, such as investment funds, insurance companies, mutual funds and postal savings are not part of this dissertation. The paper deals only with financial transformations in Poland and China, and, if not related, political reforms are not a part of an analysed issue. The time frame of the study is limited – it starts in 1978 for China and 1989 for Poland and lasts until now but the previous processes are also briefly mentioned.

Various types of source material are used in this thesis. The empirical material consists of a number of primary and secondary sources. The main documents are: the speech by L. Ping on Chinese banking sector and the report by the General Inspectorate of Banking Supervision on the current situation in Poland's financial sector. Moreover, secondary sources, especially academic books and articles, as well as press material are used, with a great number of quantitative data.

III. Theoretical background

According to the World Development Report finances are the key to investments, thus are to the economic growth (World Development Report 1989: 1). Effective financial systems help strengthen economic growth by accumulating capital and later transfer it to the most productive sectors of economy. Following this definition all decisions and actions undertaken to improve situation in financial sector should be welcomed by every country.

In economic theory we can distinguish several links between sound financial system and economic growth. In a study from 2000 three authors found that good level of financial intermediaries development adds to faster rates of economic and total factor productivity growth but weak relations between good financial system and either physical capital accumulation and private savings rate (Beck, Levine, Loayza, 2000: 265-266). Authors acknowledged that although in many instances finance predicts growth it may not be a major cause of it. In the same time financial system development might be a leading indicator of economic growth (Ibidem: 263).

As for the financial sector, economic theory distinguishes two kinds of financial systems: bank-based or market-based, with the difference lying in the institutions that accumulate and channel most of the capital in the society. While the bank-based system is better “at mobilizing savings, identifying good investments, and exerting sound corporate control, particularly during the early stages of economic development and in weak institutional environments”, the market-based system's advantages are “allocating capital, providing risk-management tools, and mitigating the problems associated with excessively powerful banks” (Levine 2002: 398). This distinction provides important information on country's level of development, however, it does not point which of those systems is better in promoting long-term growth. On the contrary, it is more accurate to analyse legal system and enforcement mechanisms in determining financial system since financial development crucially relies on the maturity of the legal system (Ibidem: 402). It does not mean that it comes down to courts' ability in judging and enforcing laws, since the country's financial system depends more on various institutions supervising and regulating the financial market and their enforcement mechanisms (Laporta et. al. 2000: 22). Therefore the development of financial systems relies on the willingness and ability of state's authorities to transfer power and autonomy to those institutions and from legal surrounding in which they operate. In order

to ensure proper functioning of the regulatory institutions, the political influence should be limited to the minimum.

As pointed out by several free-market ideologists, state as the market participant does not perform efficiently and its role should be rather limited to provide framework in which the market will operate.

Chapter 1: The characteristics of banking sector reforms in Poland after 1989

1.1. Initial economic conditions for reforms

From the beginning of transition period Poland has embarked upon a period of fast economic and political reforms that have affected most sectors of economy. Soon, because of its pace and impact those reforms have been called a “shock therapy”. Two most important assumptions envisaging those reforms have been to liberalise and to privatise public life in order to foster economic growth, restore investment efficiency and to make people responsible for their decisions. For the purpose of this paper the focus will be put on banking and financial sector while analysing the last 15 years reforms in Poland

The aftermath of communist system (January 1989) has left Poland in a very bad economic situation. Inflation, comparing to last year reached more than 100 percent and it was further rising up to 1000 percent in October 1989. To curb it down nominal interest rates were set extremely high. As a result banks could only offer short-term credits. To cushion dramatic slow down in economic activities and domestic demand the government decided to boost export competitiveness by devaluing Polish zloty several times. Only in 1989 USD/PL exchange rate grew by 1770% cumulatively (Balcerowicz, Bratkowski 2001: 9). It has improved current account balance only for a moment. Overall between 1990 and 1991 Polish economy shrank by almost 18%.

This situation also affected the banking sector. Due to diminishing revenues from state enterprises government had to finance its expenditures by offering Treasury bonds or taking credits from state-owned banks. This operation focused banks’ activities on public sector fencing out private sector and individuals from access to capital. Big margin difference in interest rates helped to publish good financial statements at the end of 1990 and 1991. Moreover, high inflation at the end of 1980’s depreciated old debts of enterprises and private households.

At the beginning of reforms banks were not prepared to operate on a free market basis. The level of computerisation was low and there were no prudential regulation in relation to banks’ financial positions. Because of the absence of adequate borrowing capacity procedures enterprises could easily receive credits even when they only presented flawed business plans. At that time banks did not have professional, skilled staff to properly assess and supervise risky clients. Those companies who could present property collateral were granted credits almost without any evaluation procedure. It was especially the case with state-owned companies, a traditional sector of banks’ client base. Soon, because of above mentioned activities it turned out that the level of nonperforming loans from moderate level of 15% in 1989 climbed to 31% at the end of 1993.

In addition to banks’ dramatic decrease in solvency, Poland entered the beginning of reforms with a huge level of foreign debt to western countries. Infrastructural and economical

boom of 1970's was fostered by credits from international institutions to the Polish government. During the 1980's nothing was done to pay it back or to reach an agreement that could reduce the overall amount. By the end of 1980's Poland foreign debt reached 42.3 billion US dollars and it was equal to total amount of Poland's 5 year export to western countries.

To improve macroeconomic situation and attract foreign investors Poland signed an agreement with Paris Club in April 1991 and latter in 1994 with London Club. According to first agreement Poland received 50% reduction of its foreign 29.9 billion US dollars liabilities to foreign public creditors. Second agreement set the schedule how Poland will pay back its debt and reduce its foreign debt to foreign private debt-holders.

Here, especially the second settlement has had a significant impact in relation to foreign investors. It has assured them that Poland from now on will be a credible partner that will respect and fulfil its obligations towards private sector.

1.2. Development of the banking sector in Poland

Reforms in banking sector have started before political upheaval, however on a very limited scale. After the political change the new Act on Banking of 1989 introduced some serious changes. New law enabled the establishment of non-state banks (Ibidem: 12). Here there have been no restrictions whether the capital will come from domestic sources or from foreign investors. Almost everyone that possessed the equivalent of 1.5 billion zloty (158 thousands USD as of 1990) could receive a license to open its own bank². In addition there was no requirement that the stakeholders should have any history in banking operations. Moreover, foreign investors could expect tax holidays and other economic incentives to invest in Poland.

In the same time the National Bank of Poland (NBP) has come through significant reforms. From its structure nine commercial banks were created and their legal status was changed from state banks to joint stock companies in order to prepare them to privatisation. From now on NBP has been only responsible for creating money, supervising private banks, facilitate money circulation in the economy and run country's bank account.

After the enactment of new regulations the number of banks operating in Poland has sharply increased, jumping from 18 in 1989 to 87 in 1993, from which 59 banks came from domestic private sources. At this time foreign banks, although present, did not engage in competition with Polish commercial banks. They have operated to provide services for multinational companies making businesses in Poland. On the other hand, a vast majority of newly established domestic banks (except those detached from NBP) had a very limited customer base. Most of them were interrelated with its mother companies and their activities focused mostly on deposit collection and credit expansion for correlated enterprises and influential individuals. Until 1994 only three banks have operated countrywide (that is PKO BP, PKO S.A. and BG_). Due to their branch network, customer base and state involvement their position to date has remained dominant.

Countrywide program to privatise state-owned banks encountered significant problems before the process has even started. Because of too liberal policy at the beginning of bank

² There was no requirement of having the money in cash.

reforms most state-owned commercial banks by the end of 1993 went to financial distress. To prepare them to privatisation and to increase their market value the government decided to recapitalize them and clear their debt portfolios from nonperforming loans (Lachowski 1997: 13). In the same time banks were obliged to separate loans classified by external auditors as doubtful or lost, to not extent new loans to clients possessing those kinds of loans and to create a special department filled with lawyers and economists without working experience in state-owned banks that would deal with non-performing loans (Balcerowicz, Bratkowski 2001: 15). To speed up the recapitalisation process state-owned commercial banks were granted the right to deal directly with their debtors (state-owned companies only) without court settlement procedure. Moreover, to further motivate banks to regain as much as possible from their debtors there was no correlation between the amount of loans recovered by banks and the amount of capital injection from the government. Overall, the costs of privatisation in Poland have reached between 5 and 8 percent of GDP and it has been much less than in Czech Republic (20%) or Hungary (15%). It is worth noting that those solutions have been implemented contrary to prescription of international financial institutions.

In addition to those steps the banking regulatory environment has been further strengthened. The General Inspectorate of Banking Supervision (GINB) was finally established, new accounting principles, conforming to the EU guidelines, and the general prudential requirements, to very big extent following Basle Accord, were introduced. A common deposit insurance scheme with special institution to help troubled banks: the Bank Guarantee Fund (BGF) has started to operate in order to equal guaranty for deposits holders between different kinds of banks. BGF role has been to repay deposits to its holders if a bank will go bankrupt and to help banks in distress to restore their solvency³.

Due to deteriorating situation in banking sector different policy has been also adapted to foreign investors willing to invest in Poland. Because of the big number of small domestic banks in harsh financial situation, foreign investors have been obliged to take over one of those banks when entering the Polish market. Because NBP has been responsible for domestic small banks, it has offered additional incentives. Foreign investors were free from paying mandatory reserve requirement, thus, they could offer 2-3% higher deposit interest rates (Rybiński, Linne 1999: 11). To the rest of the small domestic banks special measures under the NBP's supervision were adopted. Some banks were restructured by NBP and then sold, part of them was merged with other banks, some went bankrupt and one was liquidated. Moreover, to follow European Union regulations the equity requirement for new banks was increased to 5 million ECU.

In the same time competition between banks has started to intensify. More foreign banks have been entering the Polish market, aiming mostly in fast growing segment of individual customers. In April 1993 the European Bank of Reconstruction and Development bought 28.5% stake in Wielkopolski Bank Kredytowy (latter sold to Allied Irish Bank) and ING Bank took over Bank Śląski. In both cases privatisation process was conducted by initial public offering (IPO) and in both banks state treasury has slowly reduced its stake over the period of the next two-three years.

Soon afterwards long-term capital in the form of fixed assets has started to inflow and process of privatization has speeded up. If between 1989 and 1994 only 11 banks decided to invest in Poland, after the agreement with London Club during the next 6 years 36 other

³ Fully for deposits up to 1000ECU and 90% for deposits between 1000 and 3000 ECU.

foreign banks decided to invest in Poland. It is worth underlining here that those banks had been present in Polish banking sector earlier through their representative offices, but had not been engaged much in business operations. What is more important is that new investments have concentrated typically on traditional banking activities such as credit expansion and deposit collection. During this period the remaining seven commercial state-owned banks were privatised by mergers and acquisitions with other Polish banks or taken over by one of foreign strategic investors.

1.3. Successes and failures of transformation in Polish banking sector

Since 1989 the Polish banking sector has faced many changes. Most significantly after 16 years of transition period this sector is owned by private, mostly foreign investors and its effectiveness has greatly improved (see Table 4). It is estimated that in the middle of 2005 around 70% of assets in the banking sector has been controlled by banks with foreign strategic partners (See Table 1). This percentage would be even higher if a share of loan extended by banks with majority of foreign and domestic capital was examined. More specific assessments from the end of 2001 show that among 69 banks operating in Poland 46 have been controlled by foreign investors. Banking sector in Poland has been traditionally perceived as a source of capital for private sector, thus, combined banks' assets are four times higher than stock exchange capitalisation. But, when comparing to the average in European Union the size of Polish banking sector to GDP is still three times smaller.

It is worth noting that privatisation process in Poland has been conducted with the cooperation of stock market. Most banks have been privatised through IPO. Not only has it contributed to faster stock market development, but also to better efficiency of investment opportunities. Banks have further helped to develop capital market by establishing assets management companies and stockbroker offices as part of their departments. These days we can see that banks in Poland want to be truly comprehensive companies in providing financial services to their customers. They offer personal accounts, loans, private banking, insurances, long term investments and pension scheme programmes, not to mention corporate banking. The diversion in bank's operational activities follows an international trend that has started with enactment of Financial Modernisation Act of 1999⁴ (Qing 2000: 830).

When analysing the Polish banking sector after years of reforms few major weaknesses come to the fore. First of all Poland, has failed to create strong universal bank with a majority of Polish capital. There have been several attempts to create a strong domestic financial group around PKO S.A. and lately PKO BP, however, because of lack of political will and clear strategy, those efforts have ended up on nothing. PKO S.A has been taken over by Unicredito Italiano and the future of PKO BP is not clear yet. In the middle of 2005 37.7% of PKO BP shares were sold through public offer on the stock market, but still 51.96% shares remain in the government's hands.

As for the multinational banks, few findings can be distinguished here. Foreign banks usually concentrate their market strategy on the most profitable segments of customers which mean that they offer their services to big domestic and foreign companies and first-tier

⁴ It abolished the Glass-Steagall Act of 1933 which separated the banking, securities and insurance businesses.

individual customers. The economic growth with its ability to create more places to work lies more within small and middle size companies that traditionally find better access to capital in domestic banks. Without strong domestic capital base for small and middle size companies each country unnecessary risks lower economic growth. As pointed out by scholars in relation to Polish economy⁵, reforms in banking sector have outpaced reforms in other sectors of economy, like agriculture, chemical sector and mining. To restructure those branches without any strong domestic bank and access to domestic capital will mean that Poland will face a serious money shortage or will be forced to pay extra costs to utilise capital from foreign sources (Hexter 2001: 29).

Another weakness of reforms is that Poland has failed to create efficient cooperative banks to provide services and capital for less developed parts of country. BG_, the bank that was established to offer services to small farms and family-sized companies in countryside has failed to centralise much smaller cooperative banks in those areas and to finally take them over. Traditionally, this segment of market, although big is not very profitable for banks that want to be competitive, but it is crucial for a country's economy to provide good services there in order to provide equal conditions for development between different regions without any bigger domestic backlash. Moreover, because of inefficient recapitalisation strategy to BG_ its market value has been relatively low. Through out last 16 years the number of cooperative banks has decreased from 1550 to 592 and this tendency should be further sustained.

Thirdly, the very low level of acceptance to economical reforms and especially privatisation process among Polish society can signalise some important changes that should be analysed by other countries in transition. According to one of leading Polish market research companies 90% of population think that Poland has lost because of privatisation and only 7% is convinced that economic reforms have been beneficial (Kornasiewicz, Pugacewicz-Kowalska 2002: 13).

Finally, privatisation process so far has failed to help increase capital managed by Polish banks. Combined Polish capital, around 7 billion USD, is small comparing not only to world first-tier banks, but also when comparing to middle size European banks. From this perspective it can be seen that merger with a strategic foreign partner is essential for Polish bank to have a financial support and growth potential. Banks' consolidation is essential here to provide better services for more demanding customers and to squeeze out inefficient, small banks. Here a further consolidation in banking sector in Poland will depend on mergers and acquisitions between foreign banks that have already invested in Poland (Hexter 2001: 27).

After 16 years of privatisation and economic reforms legal environment in which banks operate has not changed much from unknown reasons. The cost of collateral is still high and any conciliate procedures in court are long and lasting. On the other hand, the state has managed to create responsible and reliable institutions to supervise and control the quality of banks and its solvency. It has been only possible because those institutions have been given a supervisory authority and enforcement power to adopt regulations and intervene in financial institutions, but in the same time they have been accountable for its performance (Ingves 2002). To which extend legal environment and legal enforcements will be used in economy will determine not only development in banking sector, but also in a whole economy.

⁵ For example, see Hexter 2001.

Chapter 2: Chinese financial and banking reforms since 1978

2.1. Point of departure for financial and economic reforms in China

Before 1978 Chinese private sector almost did not exist. Banking sector was operating, but its role was different from banking sectors in market economies. Basically, its role came down to channeling money from the state budget to state-owned enterprises in order to fulfill industrial plans and its responsibilities towards society. In practice there was only one bank that dealt with all kinds of services and customers, fulfilling the role of a commercial and central bank.

The beginning of economic reforms in China has not occurred during one night, like it happened in Poland. It has been a long process to adjust China to new economic environment, started at the Third Plenary Session of the 11th Central Committee of the Communist Party of China in December 1978 and later enforced after Deng Xiaoping South tour in 1992. The reasons behind it have also been different. On the contrary to Poland, China since 1960's has experienced increasing rates of GDP growth (Dutta 2005: 1178) and it has been far from making any political changes.

The onset of reforms has brought new problems and challenges. Most importantly new environment has gradually enforced more competition and financial responsibility for economic decisions, however, because of historic relationships and lack of alternatives companies have remained intertwined with banks. Soon, due to lack of experience and knowledge among managers of state-owned enterprises (SOEs), companies have defaulted to repay their loans and most of banks have gone into financial distress. The number of non-performing loans grew fast during the 80's and 90's. Various sources have presented the entire number to be as high as 30 to 60 per cent of total outstanding loans. This number is expected to be even higher if applying international accounting principles and when including other banking business areas⁶ (He, 2004: 11). Unfortunately, the number of NPLs in four state-owned commercial banks, that create the core of banking sector in China, is also huge in absolute and in percentage terms.

Since 1978 on its road to socialist market economy China has encountered several obstacles. The major one in development of the banking sector has come to correlation between SOEs and SOBs in providing social provisions such as pensions, health care, social insurance and housing (see Table 2). Recently SOEs have provided 40% of jobs for urban population, 57% of pension funds and three quarters of urban housing (Tong 2002: 138). To be able to address those responsibilities, the Chinese state needs to have not only control over capital but also to channel it to SOEs. This situation is expected to spin out in the future since the newly established pension system, due to its costs, is not affordable to whole society and

⁶ Basle Committee for Bank Supervision classified a loan as doubtful or bad when interest payment is overdue at least 180 days when in China the same happens if payment is delayed more than loan maturity or the extended due date (Allen, Qian, Qian 2005: 19).

because drastic approach to reforming SOEs is not feasible and might only cause social unrest.

In addition, from the perspective of more efficient banking system, unfavourable bankruptcy law stresses employee's right, thus, leaving banks at the end of settlement process when particular company goes bankrupt (Ibidem: 160). Some statistics show that from 62,000 firms that have changed their ownership structure more than 50 per cent failed to repay their bank loans (Ping 2003: 7). On the other hand, without successful programme to deal with SOEs the number of credit worth customers among corporate sector will be small, leaving banks without customer base.

2.2. Transformation and problems in Chinese banking market

Before presenting Chinese banking sector it should be mentioned that in China one financial institution cannot provide banking, securities and insurance services; however, is it possible to arrange a co-operation between financial institutions to supplement each offer (He 2004: 9).

Currently banking sector in China consists of seven wholly state-owned banks, around 120 commercial banks, 50,000 credit co-operatives and 211 foreign banks. The first group is later subdivided into state-owned commercial banks and policy banks.

At the beginning of economic reforms three state-owned commercial banks: Agricultural Bank of China (ABC), Bank of China (BOC) and People's Construction Bank of China (PCBC) were separated from the People's Bank of China (PBC), the Chinese Central Bank. Five years later, in 1984 the Industrial and Commercial Bank of China (ICBC) was detached from PBC. Those four banks constitute the core of Chinese banking sector and hold around 60% of total assets in Chinese banking sector (table 3). Additional 10% of banking assets is hold by three policy banks: Agricultural Development Bank of China (ADBC), China Development Bank (CDB) and Export-Import Bank of China (EIBC) that were established in 1994 to relieve four state-owned commercial banks from state-directed lending role. This two-tier banking system is subjected to different regulations. When four SOBs have to follow prudential regulations, three policy banks in their operations are guided by their individual charters (Pei, Shirai 2004: 4).

Commercial banks consist of eleven shareholding or joint-stock commercial banks and around 110 city commercial banks. Their ownership rights are distributed between Chinese state on different levels and private investors. On the contrary to city banks, which have evolved from urban credit co-operatives and operate only in cities, joint-stock banks operate on a national scale and are in the interest of foreign banks willing to invest in China (Hansakul 2004: 4). Those groups of banks focus their business strategy on fast growing segment of small and medium size enterprises and private sector in general.

Credit co-operatives are subdivided to rural and urban credit co-operative to provide services for S&M enterprises and individuals in both areas. Though their number is huge, they hold around 10% of total banking assets. It is estimated that this group of financial intermediaries has the worst record of non-performing loans in the banking sector, reaching 50% in 2003.

Recently, the anxiety of losing market share to foreign banks has pushed domestic financial institutions to enter new business areas, such as consumer loans and personal

payments. The number of personal loans to the total number of outstanding loans in Chinese banks between 1997 and 2003 increased from 0.3 per cent to 10 per cent by Chinese banks (He 2004: 13).

Second problem, closely associated with a high number of NPLs, is low capitalisation of Chinese banks. Most of them have capital ratio well below the requirement of 8 per cent imposed by the Basle Accord in 1988, what exposes them to possible fluctuations caused by market instability. During 1990's Chinese state transferred 270 billion RMB (33.5 billions USD) to four state-owned banks to raise their capital ratio from 4.4 to 8 per cent, however this help did solve the problem only temporarily. Soon after recapitalisation, the bank's capital ratio has lowered to 4.6 with no sign of better financial performance. In the same time capital ratio in joint-stock commercial banks and city commercial banks have ranged between 6 and 7 per cent.

Regulatory setting for banking sector in China is still not efficient however recent changes highlight some major steps toward internationally accepted prudential solutions. From 1998 international accounting standards are in place, however, the problem lies in enforcing those regulations countrywide. To strengthen market-base performance and increase transparency in 2003 the China Banking Regulatory Commission (CBRC) was established. The institution is accountable and supervised by the State Council and China's Central Bank. The CBRC role is to handle and supervise banking sector, but also to enforce compliance with existing regulations.

To further address the problem of NPLs assets management companies (AMCs) have been established. Only in 2000 those companies received the equivalent of 15 per cent of total outstanding loans from Chinese SOBs, but it is expected that this number to date is much higher. How efficiently AMCs are dealing with those loans is a question of bigger debate. It is anticipated that more attractive assets hold by those institutions will be sold to domestic or international investors, but the remaining part is expected to be bared by central government. Evidences from Eastern Europe show that only around 25 per cent of those loans have been recovered (Bonin, Huang 2002: 1088). Most importantly for the sake of Chinese financial system and for improvements in efficiency of the banking sector recapitalisation combined with transfer of bad loans to AMCs hasn't brought desirable results. There are evidences suggesting that after bank's recapitalisation the level of NPLs has been increasing and their capital adequacy ratio has fallen. It would not be a mistake to state that AMCs in their management style and ownership structure are just another kind of SOEs set up to reform other SOEs – banks, thus it is not likely that AMCs will press the state-owned banks to cut capital granting to defaulted borrowers (often SOEs) (Allen, Qian, Qian 2005: 19).

After four years of operations AMCs have recovered 21.9% from total number of NPLs they have received. This level varies significantly between the highest recovery rate 31.47% in Cinda AMC (construction assets from PCBC) and the lowest 10.77% in Greatwall AMC (agricultural assets from ABC). Because AMCs do not have many venues or financial instruments how to recover capital from NPLs, the most commonly used methods have been bidding and auctions (Pei, Shirai 2004: 13). Unfortunately, it implies that only assets that are valuable will be disposed and the rest will remain in AMCs' portfolios.

Because of China's accession to WTO and the incoming full liberalisation of its banking market the role of foreign financial investors in development of the banking sector is expected to rise. At the moment foreign banks are present in China mostly in the form of representative offices. So far only 12 foreign banks have been engaged in joint-ventures with

Chinese commercial banks. Most probably this situation has been caused because of discouraging capital engagement ceiling for foreign investor⁷. According to WTO regulations foreign banks are still not allowed to provide services to Chinese people in RMB but by December 2006 all geographical restrictions will be lifted; however, there are arguments to claim that on everyday basis Most Favourable Nation status granted to every WTO member country will not apply to all financial service providers. The list of restrictions is presented in Appendix.

In addition, on almost every level of banking operations, bank account opening, loans granting or money investing companies operating in China are required to ask for approval from local authorities. Due to above mentioned reasons the number of multinational banks operating in China as well as their market share in 2002 decreased comparing to 2001. In the span of one year the number of foreign banks branches dropped by 12 and their market share decreased from 2% to 1.1% respectively (He 2004: 10). It is worth noting that in China even foreign banks have had non-performing loans ratio of above 20%.

Although stock markets in China (one in Shanghai and one in Shenzhen) exist, their roles differ from the desirable ones, like generating capital for investments, increasing the effectiveness of capital allocation and better valuation of companies. They are tailored in a way that constrains investors from taking control over listed companies through shares acquisition. Moreover, stock markets are subordinated to industrial plan and only companies that are included in it and accepted by the State Council can be listed. A-shares are only available for Chinese citizens and small group of investors under the Qualified Foreign Institutional Investors (QFII) scheme. B-shares are reserved for investors with access to foreign currencies since they are traded in US dollars, but the number of shares offered is significantly low. In addition, Chinese stock exchanges lack institutional investors that could efficiently monitor enterprise performance.

Because of the dominant role of the state as a shareholder (the state holds around two-third of all listed shares that cannot be traded), capital market is not perceived by Chinese entrepreneurs as a good source of capital acquisition. Stock market capitalisation is small and amounts to 17% of China GDP. So far, only a tenth percentage of the capital that banks provide has been acquired from stock exchange (Green 2003: 9). This capital is available mostly for non-privatised former SOEs, but its effectiveness is dramatically low and there are almost no evidences suggesting that when listed, former SOEs are improving their performance.

There might be plenty of reasons to speed up economic reforms and to push China to become more market-base country with growing private sector. One is that Chinese state's total liabilities have already amounted to around 90% of GDP. To sustain and preferably lower the debt level the state soon might be forced to sell out its assets.

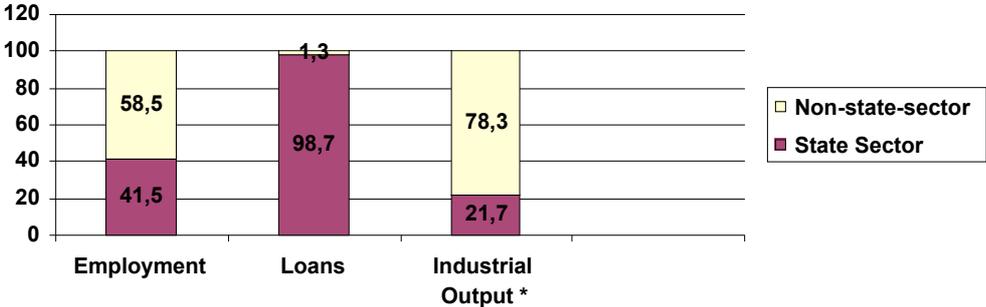
2.3. The results of the transformation

The unprecedented economic growth of the last 25 year has been possible and driven by fast growing private sector. In the same time the sector in China has been almost entirely stripped

⁷ According to Article 8 from the Regulations on Foreign Equity Investments in Chinese Financial Institutions foreign banks' capital engagement should not exceed 20% individually and 25% in total bank's equity.

from access to credits from official sources. It is estimated that only 1.3% of all credits given in 2001 was granted to those companies. Other statistics estimate that even now up to 90% of individually owned companies rely only on self-fundraising channels (Allen, Qian, Qian 2005: 12). In the same time this sector has been responsible for 78.3% of industrial output. This situation relates also to partly state-owned enterprises such as Township Village Enterprises (TVEs). In 2004 privately owned firms contributed 33% of Chinese GDP after growing almost 20% annually since 1980 (Ibidem: 48). To sustain its rate of growth China has to mitigate as many of those obstacles as possible and do it without deeper economic turbulences.

Figure 1. Mismatch between state and non-state sector in terms of productivity, access to capital and employment in China (data for 2001 in %).



*data from: <http://www.china.org.cn/english/2003chinamarket/79519.htm>.

Source: own calculation from Allen, Qian, Qian 2005: 80 and 101⁸.

In the previous sub-chapter it has been mentioned that stock exchanges’ roles so far have not been significant. Nevertheless, between 1996 and 2001 around 420 Chinese companies have changed their controlling shareholders through stock market and about 12,000 have at least diversified their ownership structure. To accelerate this process Chinese state in late 2002 launched a Qualified Foreign Institutional Investors programme to allow top-tier foreign financial institutions to invest in shares, but also in government and enterprise bonds listed on Chinese stock exchanges. Due to various financial and investment requirements QFII programme is tailored only for medium and long-terms investors (MOFCOM, 2004: 361). This process should indicate that stock markets, although cripple in its role, can serve as a mean for privatisation and better firm performance. It is expected that foreign investors’ presence would increase transparency, improve the compliance and corporate governance practices among Chinese enterprises (Yeo 2003: 448).

The recent growth in credit to private sector and individuals is good sign of development in financial services, but as for China the alternative explanation should also be given. Big surge in credits may result in worsening bank’s asset portfolio in the long run. So far, due to excessive lending, Chinese banks have experienced decreasing share of NPLs in the total number of outstanding loans, but if those credits have been granted under the same criteria as in the past, recent developments in the quality of Chinese financial banking market should be questionable.

⁸ For different data see: Tong 2002: 113.

It is well-known that China has a huge level of non-performing loans and that without a money transfer from the state Chinese banks might find themselves in a serious bottleneck. To address this situation at the beginning of 2004 a stringent, based on internationally accepted five-category loans classification system has been adopted. Banks are expected to grade their extended loans as being either Pass, Special-mention, Substandard, Doubtful and Loss (Laurenceson 2004: 8). Weak data collection and inadequate loans valuation may aggravate the final record. In addition, due to taxation policy imposed on banks, only 1 percent from loan-loss provisions can be deductible from taxation, thus discouraging banks from making adequate provisions that are necessary to accelerate loan write-offs and comply with prudential regulations (Ping 2003: 6).

If comparing how SOBs have dealt with NPLs it has to be acknowledged that AMCs at the moment are doing much better job. In the past SOBs did not have separate departments to tackle NPLs, but they also did not have incentives and means to do so. Moreover, the existing regulations have prohibited banks from disposing NPLs at a discount. Since 2003 SOBs can offer NPLs to foreign investors by establishing joint venture entities, instead of direct sell (Pei, Shirai 2004: 14). This way of tackling NPLs is not supported by existing regulations, but it has a tacit acceptance from the officials. On the other hand, during the last 5 years AMCs from small entities with focus on NPLs have transformed themselves into behemoths with the total employment already exceeding 11 millions. Their operational performance and role has been questionable on several occasions but because of their size and importance it is more possible that they will be transformed into more comprehensive financial institutions.

There are more evidences suggesting that the state's influence in banking sector is detrimental for any improvements in their performance. Since 1998, after Chinese government recapitalized state-owned banks with 33 billion USD, the share of risky assets in banks' portfolio has rapidly increased from 11.4% to 24.7% in 2002. Before 1998 the percentage of risky assets was gradually decreasing (Herrero, Santabarbara 2004: 41). In addition, their capital ratio and the percentage of liquid assets have decreased. This situation refers not only to state-owned banks, but also to joint-stock commercial banks and others.

Chapter 3: Comparative analysis and final conclusions

3.1. Comparing transformations in Polish and Chinese banking sectors

So far China has followed a gradualist approach to its reforms in various areas, starting from easiest points and tackling with serious one at the end. Reforms in banking system might be at the end of general macroeconomic reforms in China since they are subjected to transformation of real economy (Ping 2003: 15). In the same time two processes are in progress: restructuring of banking sector and liberalisation of financial system.

If assuming that financial liberalisation can be encouraged through top-down decisions and by enacting new legislations the process of bank restructuring will be more tremendous. Not only ownership structure needs to be changed but first of all the nexus that encourage state-owned banks to selectively choose borrowers (SOEs) needs to be cut. To do this, however, the general plan to thoroughly change SOEs role in the economy has to be implemented. At the moment SOEs are the major providers of pensions for Chinese citizens. Recently, a new kind of pension scheme has been implemented, but because of high costs for Chinese citizens it is expected that only urban dwellers will afford to be covered.

The experiences from Poland suggest that every bank to remain competitive in front of potential consumers should increase its services by adding new or developing existing ones. ATMs, online banking and other services associated with utilization of new technologies will not replace banking services provided through branch network. At the moment the biggest foreign bank in China, the Hong Kong and Shanghai Banking Corporation (HSBC) has about 10 branches. This stays in sharp contrast to ICBC, which manages 8800 branches countrywide (Laurenceson 2004: 8). As long as foreign banks will have difficult access to branch network, their impact on Chinese banks will remain insignificant.

From evidences of the transition countries it is known that foreign banks create more competitive domestic market environment, but only when their market share will reach critical threshold that could threaten domestic banks' position. In general this situation is possible only when financial investors became involved in privatisation process of country domestic banks (Bonin, Huang 2002: 1081). Here, the decisions made by central government are crucial to make it feasible for foreign banks to enter domestic market. To date China has implemented various regulations that rather restrain them from operating.

In addition to those founding, more intense competition starts when foreign banks' loans market share becomes significantly large (Ibidem: 1082). Traditionally, foreign banks' market share in deposits is smaller than in credits. Geographically, competition between domestic and foreign banks focuses mostly in urban areas. It is estimated that currently about

95 per cent profits generated by Chinese domestic banks come from small number of big coastal cities (Ibidem: 1085). This trend will intensify, especially when assuming that in 2010 around 50 per cent of total Chinese population will live in cities (Kedaj 2005: 59).

In China, from the perspective of economic growth, reforms in financial sector have a priority however it does not mean that this process will be short. Drawing from Polish experiences, reforms in banking sector should start from putting more attention on improving corporate governance and internal control. Those objectives should be achieved through strengthening supervision over banks and through stricter execution of regulations concerning prudential standards. It will be the task for independent banking institutions detached from political control or any casual aims. In the same time, it is acknowledged that regulatory structure for banking sector in China reflects a country's economic and political environment with its peculiarities (Ping 2003: 10). For example, implementation of International Accounting Standards in China has been happening without independent accounting professionals that are in other economies. For Chinese authorities, stability in banking sector and especially in the whole economy has to be maintained while reforming banks. Tacitly, it means that there will be no radical changes unless other methods will fail. Stability here is an imperative.

Evidences from the Polish transformation show that, while privatising banks or SOEs, it is more beneficial for the state to sell majority stakes in those enterprises. It not only attracts more investors, but, because control over particular entity is at stake, it can significantly increase bidding price. The last examples with two state-owned banks: BOC and China Construction Bank are in place here. The CRBC announced that after the recapitalisation minority stakes in those banks will be sold to strategic investors, but it didn't significantly increase their prices (Li 2005). Still, those banks have received "BBB-" rating grade from Standards & Poor's indicating that investments in those entities are very risky.

The alternative solution for China is to present and follow a comprehensive privatisation plan that will offer minority stakes in selected enterprises, including banks. The plan should stipulate that investor will have a right to gradually acquire more shares by following the investment schedule signed before the beginning of investment. If it is in place and its assumptions are clear for both sides, the results will be beneficial in three ways. First of all, Chinese state will be in position to expect higher price for selling shares and the bidder will be eager to offer more, if he knows that within the particular span of time he gains more control (Chan, Wong 2005). Secondly, if the process is conducted with a significant involvement of the stock exchanges, it can strengthen control and enforce more market-base performance in other listing companies. Finally, if the pressure is on selling majority stakes faster and ceasing control over companies, the experience of those decisions will be gained sooner and additional amendments could be implemented (Chan 2005).

While it is commonly acknowledged that low entry barriers to the market foster competition, Polish experiences show that financial intermediaries are an exception. It is more likely that lowering entry barriers will lead to more fragile banking system and can significantly impair social confidence to those institutions. Banks need to be financially solvent, have strong capital base and deliberate business strategy when operating. During the first four years of economic reforms in Poland the level of NPLs in Polish banks increased from approximately 12-13% to 31. This surge has been caused by small, undercapitalised domestic banks without good brand and operational history.

Those founding can create a good departure point for changes in China. Just like Poland used to have, China has a huge number of barely solvent banks that do not have any capital base to develop services or remain untouched during economic crisis. Because its banking sector is diversified by geographical or sector hurdles, consolidation process may bring promising outcomes. In addition, it should improve financial soundness and efficiency of better performing banks, but also create new entities for public offering (Herrero, Santabarbara 2004: 29). Consolidation between city commercial banks should not only significantly increase banks' value, but it should also attract attention from foreign investors, since the process will affect the most profitable segment of customers.

To be stronger, banks need to have venues how to augment their capital and invests deposits. At the moment the decreasing level of NPLs in Chinese banks is caused in a greater degree by a surge in their lending activities than because of better supervision since other investment opportunities are not available to banks or are seriously limited. The income structure in Chinese banks confirms that investment venues are limited. Interest incomes generate 95% of revenues and only 5% come from commissions. The latter has doubled in last eight years (Ibidem: 13). On the contrary, in Poland banks' income structure is more diversified. Interest incomes generate only 55%. The rest of revenues come from commissions (23%) and banks' operations on capital and foreign currency market (22%) (GINB 2005: 12).

Although the level of NPLs in Poland is not stable and varies, the Polish approach to bad debts has been different from the one presented by Chinese authorities. In Poland SOBs were granted a right to deal with clients having doubtful loans directly without traditional conciliation procedure in courts. Moreover, there has been no link between record of recovered loans and capital injection from the government. It was supposed to stress bank's efforts in dealing with risky clients. It has not only shortened the time necessary to recover NPL and exert pressure on SOEs to engage in profit-maximising activities, but it has also transferred more responsibility to banks for their future decisions. On the other hand, after 20 years of transformation to market economy, the Chinese state has decided to recapitalise banks to raise their capital ratio to internationally accepted level, but to do it without any conditions imposed on banks. Soon afterwards the capital ratio in Chinese banks has gone down to pre-recapitalisation level with disregard to efforts undertaken by the state. It indicates that after 25 years of economic reforms not only state-owned, but also partly privatized companies rely on the state assistance in the economy. In recent years the number of banks asking Chinese state for capital injection has been growing. Desirable reforms in many instances has brought unwelcome or awkward results and only postponed the problems in time.

Although the thesis focuses on economic issues, the political environment and surrounding in China during the last two decades of twenty century and in Poland at the end of 1980s also have to be taken into account. Political surrounding in both countries has determined the direction and scale of economic transformation. While Poland has quickly transformed its political system to parliamentary democracy and decentralised its decision-making processes, China, to large extend, has remained communist with centrally-commanded economy. Moreover, the size of economy in both countries is different. It is generally easier to adjust financial system to domestic needs in a small country than in a big one. At the beginning of 2005 there were 49 foreign banks operating in Poland. In the same time in China this number reached 244 banks. So far it seems that China is following a

gradual approach, imposing only solutions that have previously worked well in other economies or in China, however, on a limited scale. It is hard to assess if this approach is the most suitable one, but one has to remember that there is relatively much more at stake than it was in Poland. Financial stability has to be ensured on every step, with a banking crisis as the most unwelcome outcome of economic reforms.

3.2. Conclusions and prospects

The aim of the present dissertation has been to assess to which extent reforms and solutions applied in Poland in reforming banking system can bring similar results in China. Both countries and transformations has been analyzed and compared. The major findings indicate that, although the pace of reforms in Poland was too fast and caused some problems, some reforms could successfully be implemented in China.

Since 1978 China has experienced major economic changes, however, they have not affected the banking sector much. Most importantly the focus has been put on private sector as a leading source of economic growth and future prosperity, but the major challenge now is to limit the role of the state in economic life. As for the banking market privatization process has been very slow and opportunistic. Only one bank is in the hands of private investors (Minsheng Bank). While China shares the view that privatization of its banks is essential, I would not recommend entirely China to go the same path as Poland took. Only after 15 years of transformation Polish banking sector resembles those from Western Europe, with similar earnings rates and profitability (see Table 4). In the same time the legal environment in China is too fragile and the temptation for asset stripping is too high. Internal debt in China, although high, is in control and China's huge foreign reserves guarantee that the state can fund its expenditures from other sources, thus fast privatization is not likely to happen.

At the beginning of 1980's and 1990's to increase FDI inflow Chinese state decided to decentralize those parts of its bureaucracy that have been responsible for decision-making process. As a result, local governments received more power and autonomy, but in the same time they have become more responsible financially over the area they wield power. It seems that the same factors that have helped China to grow during the 1990's can improve the current situation and speed up the process of restructuring in the banking sector. Most importantly, China should rethink Polish experiences concerning policies to deal with NPLs and with foreign investors. All decisions leading to increase competition on the Chinese banking market should be welcomed as it is essential for better efficiency, capital allocation as well as for customers.

It is expected and highly recommended that in order to improve Chinese banks' performance, there has to be less government's influence in general. As pointed out by Levine and Laporta, the development and functioning of banking system is determined by autonomy of institutions regulating it. So far in China the degree of this autonomy is still too low. While the political constraints may hamper this process it can be fostered by market participants through better internal controls and diversification of its ownership structures. On the other hand, we have to remember that it is up to the Chinese Party whether to privatize particular bank or not. The same situation refers to appointments for the top positions in those institutions. Ownership change is here the crucial point since it allows an owner to engage in

decision-making process and to play significant management role. It also cuts the link between the state and private sector and leaves latter with no strings attached to make business. Finally, it allows individual shareholders to focus solely on profit-maximizing decisions and effectiveness-seeking solutions.

It is not likely that those changes will happen in the next 10 years. According to WTO documents, China will hold non market economy status until December 11, 2016 (Walton, 2005: 27). While it will trim Chinese export from growing even faster⁹, it will also help China to explain its shortcomings in domestic legal environment, government's control over economy, lack of transparency and adherence to market principles (Ibidem: 34).

It should be mentioned that the role of the state in preserving financial stability is fundamental. In retrospect, before imposing new regulations or transferring money to subordinated entities, the state should clearly spell out the scope, scale and duration of financial guarantees it offers (Ingves 2002). Otherwise, it will only broaden the problem of moral hazard and lead to greater money embezzlement. The expected competition caused by multinational banks will only be beneficial for Chinese banks. To face it Chinese banks will have to learn how to measure risk correctly and operate efficiently in the long run. This will lead them to improvements in their assets quality and financial performance

It is hard to assume that if China would follow the "shock therapy" approach to economic reforms, its rates for growth would be even higher (Laurenceson 2004: 17). If analysing the rates of growth in China and Poland we see that fast and drastic changes are negatively correlated with economic growth and stable economic situation. That is why the IMF's staff advices in relation to China can be questionable and should be reconsidered. Moreover, after 20 years of economic reform China's level of financial depth has more than doubled, while the level in transition countries of Eastern Europe remained on the same level.

It would not be a mistake to state that, in relation to China, reforms in banking system lags behind reforms in the real economy. While there are some advantages of this situation, there are more disadvantages that can seriously affect the transformation. The need for more comprehensive restructuring programme is in place. While it should acknowledge the existing problems, it should also take into account the size, ownership structure and functioning of banking sector in China. The position and the effectiveness of the CBRC will determine the functioning and development of the banking sector.

As for the banking sector, it seems that the role of privatization and independent supervision is recognized by the Chinese government. On the other hand, the prospects for effective privatization program are not clear. The scale and scope will depend on how successfully China will transfer its real sector and on the effectiveness of its crawling pension system So far, for the sake of social stability, the circulation of capital in the economy to large extent will have to remain in the state.

⁹ Because of possible antidumping litigation from other countries

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Annex

Table 1. Various indicators from Polish banking sector.

Specification/Year	1993	1997	2000	2005
Share of NPLs in total outstanding loans (in %)	31,1	10,2	15	13,2
Total number of assets in banking sector to GDP (in %)	59,0	52,8	59,2	59,9
Banking assets with the majority of state capital (in %)	76,1	38,2	21,1	18,1
Banking assets with the majority of foreign capital (in %)	2,6	15,3	69,5	70,0

Source: GINB 2005

Table 2. The role of SOEs in providing social services (data from 1996 in %)

	Social insurance and welfare spending by sector	Share of spending on pension by sector
State sector	84.2	84.6
SOEs	56.8	57.2
Government	27.4	27.4
Non-state sector	15.8	15.4
Urban collective enterprises	11.7	12.7
Private and collective enterprises	4.1	2.7
Total	100	100

Sources: Tong 2002: 130-131

Table 3. Share of assets by type of institution in China (as % of total banking assets).

end-period	State-owned commercial banks	Policy lending banks and other commercial banks	Credit cooperatives	Other institutions	Foreign banks
1995	77	7.2	15.9	-	-
1998	73.6	9.2	16.1	1.0	-
2001	68.4	13.6	16.5	1.4	-
2003	61	21.5	11.4	4.9	1.2

Source: Herrero, Santabarbara 2004: 11

Table 4. Selected indicators on performance of Polish and Chinese banking sector

Year	China		Poland	
	ROA	ROE	ROA	ROE
1995	0.47	10.11	-	-
1998	0.24	4.42	0.7	9.1
2000	0.26	4.67	1.0	14.2
2004	0.22*	4.45*	1.4	17.2

* data for 2002

Sources: (Herrero, Santabarbara 2004: 40), GINB (2005: 49)

Appendix

Restrictions in access and in operation in Chinese banking sector for foreign investors:

- setting working capital requirement on excessively high level between 12 and 72 million € for one branch (15 times higher than in EU countries),
- allowing banks to open only one branch per year,
- treat bank's branches as separate entities, not as parts of a single integrated bank (prudential requirements for capitalisation, liquidity and funding are counted separately for every branch what constrain seriously investment opportunities)
- foreign bank's branch will be allowed to borrow from interbank market only 40% of its total RMB liabilities (it will limit seriously RMB capital base and services to Chinese companies and individuals)
- impose 30% mandatory deposit from working capital
- allowing only banks with commercial status to issue credit cards for individuals
- Companies are allowed to have only one currency current account, cross-city cross-province bank accounts are prohibited.
- Forward contracts for USD/RMB are only offered by Chinese banks
- Central Bank set equal prices for cost of capital and interest rate from deposits for all banks when dealing with foreign currency
- There is no common limited deposit insurance system to cover all banks and depositors, only deposits in state-owned banks are guaranteed (European Union Chamber of Commerce).