A Dilemma of Success: The Reform Path of China’s SOCBs

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Abstract

The reform path of the state-owned commercial banks (SOCBs) of China has already moved beyond the boundary of the Socialist Market Economy (SME). The SME has been a theoretical model that has guided the Reform and Opening for last three decades. The SME is a unique Chinese experiment that attempts to combine socialism and market economy. Theoretically it aims to accomplish a transition from planned economy to market economy (marketization) while maintaining the socialist ownership structure. To put simply, the SME aims not privatization but marketization. However, the reform path of SOCBs since 1990s has gone beyond marketization and moved already toward privatization. The cross-over the SME is not just confined within the reform paths of SOCBs but in those of state-owned enterprises in general. If the reform path of SOCBs or SOEs moves beyond marketization toward privatization, and if the socialist ownership structure is replaced gradually by the capitalist ownership structure, it would raise a critical challenge to the political legitimacy of the Communist Party of China.

Key Words: China’s State-Owned Commercial Banks, Reform Path, Marketization, Privatization, Socialist Market Economy, China Model, Political Legitimacy, Dilemma of Success

1. Introduction

The state-owned commercial banks (SOCBs) assume over 50% of financial transactions in China. Four major SOCBs are Industrial Commercial Bank of China, China Construction Bank, Bank of China, and Agricultural Bank of China. The four SOCBs went through a reform path of specialization, commercialization, and demutualization since 2003. Nevertheless, their asset portfolios are still fragile and their business performances lag behind private or foreign commercial banks. The four SOCBs still face further reform.

The introduction of stock system into the SOCBs since 2003 was to prevent the accumulation of non-performing loans (NPLs) within the SOCBs as well as to modernize their governance system. The accumulation of the NPLs in the SOCBs was inevitable due
to a single ownership structure within a triple linkage among the state, the SOCBs, and the state-owned enterprises (SOEs). To prevent accumulating NPLs in the SOCBs, a stock system was introduced into their ownership structure, by which the reform intended to cut off the triple linkage of a single ownership. In other words, by pluralizing the ownership structure of the triple linkage, the reform intended to prevent further accumulation of NPLs within the SOCBs (Lee Hochul 2006). By introducing a partial privatization in the triple linkage, the reform intended to resolve the problems resulting from a single state ownership structure.

However, even after the introduction of a stock system, the SOCBs still expose fundamental problems in governance system, capital soundness, management supervision, competition with foreign commercial banks, mostly resulting from the fact that the state still exercises strong influences over the SOCBs as the major shareholder (王松濤 2013). After all, without further privatization reform, these problems seem hard to be resolved fundamentally.

The 'socialist market economy' (SME) is the theory and the goal of the reform and opening of China. It is also a key pillar of what is called the 'China Model'. The Chinese experiment combining ‘socialism’ and ‘market economy’ has brought a remarkable economic success so far. For last 35 years, Chinese economy has achieved an average growth rate of 10% and its size has quadrupled. Increasing economic wealth and strengthening military capabilities have been the driving force of ‘rising China’.

What problems does the reform path of the SOCBs raise to the SME and further to the China Model? The reform path of the SOCBs has already moved beyond the boundary of the SME. It has gone beyond marketization and moved already toward privatization. In other words, it is moving into a ‘capitalist market economy’? Although the Communist Party of China (CPC) does not recognize any ‘capitalism’ in its theories and ideologies, the reform path of the SOCBs are already entering into a capitalist area. Such a discrepancy between theory and reality is found not only in the reform path of the SOCBs but also in that of the SOEs in general (李秀峰·金煥允 2011). How would the CPC justify the inevitable evolution of the reform paths of the SOCBs or the SOEs?

First, this study aims to analyze the political economy of the reform path of the SOCBs. Second, through the analysis of the reform path of the SOCBs, it aims to reveal the limit of the SME and an internal incongruity of the China Model. Finally, it aims to raise a dilemma of success of the CPC that results from the limit of the SME and the internal
2. Political Economy of the Socialist Market Economy

How can we understand the socialist market economy? The socialist market economy is simply a combination of socialism and market economy. In terms of property rights, the key element of socialism is a state or public ownership, whereas that of capitalism is a private ownership. In terms of economic operation, market economy is an economy where economic decisions are determined by the autonomous operation of the market, whereas planned economy is an economy where economic decisions are determined by the state. If we combine two types of ownership structure and two types of economic operation, then we have four types of political economy.

<Figure 1> Types of Political Economy

<table>
<thead>
<tr>
<th>Ownership Structure</th>
<th>State Ownership</th>
<th>Private Ownership</th>
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<tbody>
<tr>
<td>Economic Operation</td>
<td>State Plan</td>
<td>State Socialism</td>
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<tr>
<td></td>
<td>Market Operation</td>
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<td>Market Capitalism</td>
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The socialist market economy then implies a combination of a state or public ownership and a market operation. The Reform and Opening, therefore, has been a process of gradually reducing the area of state plan and expanding the area of market operation, while maintaining state or public ownership structure in principle. It has been a gradual transition from a state socialism of Mao Zedong era to a market socialism since Deng Xiaoping. As a result, the reform path has been a process of marketization rather than privatization. In principle, a privatization, i.e., a transition from state ownership to private ownership, was not a goal of the Reform and Opening.
3. The Reform Path of the SOCBs

The reform path of the SOCBs went through several stages: a single bank system, specialization, commercialization, and demutualization. Before the Reform and Opening, the People's Bank of China assumed the role of both central bank and commercial bank, which was a single bank system. In the beginning of the Reform and Opening, while the People's Bank of China was reestablished as the central bank, four specialized banks were established: Bank of China specialized for management of foreign exchanges, Agricultural Bank of China for rural financial business, China Construction Bank for investment of national fixed assets, and Industrial Commercial Bank of China for urban financial business. After the law on commercial bank was enacted in 1994, four specialized banks were transformed into commercial banks by taking policy financing out of them. Even though policy financing was taken away, four commercial banks accumulated NPLs resulting from a single state ownership structure within a triple linkage among the state, the SOEs, and the SOCBs. To tackle with the NPL problem in the SOCBs, four SOCBs were turned into stock companies since 2003. By cutting off a single ownership structure of the triple linkage, the reform intended to prevent accumulating NPLs within the SOCBs.

Even though the four SOCBs were commercialized by taking away policy financing, they were still accumulating the NPLs due to the triple linkage of a single state ownership. Then the introduction of stock system into the SOCBs was to break the single state ownership structure. To list the SOCBs in stock market implies to allow a partial privatization in their ownership structure. However, even with partial privatization, the SOCBs still face serious problems in governance system, asset soundness, management supervision, and competition with foreign commercial banks, mostly resulting from the fact that the state still exercises strong influences over the SOCBs as the major shareholder (王松濤 2013). Without further privatization reform, these problems are not likely to be resolved fundamentally. After all, the reform of marketization inevitably requires the reform of privatization.

4. The Limit of the Socialist Market Economy and the Internal Incongruity of the China Model

The reform path of the SOCBs has already moved beyond the boundary of the SME and
entered into the area of market capitalism (see Figure 1). The SOCBs are still facing serious problems even after partial privatization, which mostly results from strong state influence over the SOCBs as major shareholders. Even though the SOCBs were listed in stock markets, the Ministry of Finance and the Central Huijin Investment Ltd hold 100% of the stock of the Agricultural Bank of China, 71% of the stock of Bank of China and Industrial Commercial Bank of China. In case of China Construction Bank, the Ministry of Finance, the Central Huijin Investment Ltd, and the state corporate bodies hold 57% of the stock. The SOCBs are still under state-dominant governance system. Thus, the reform path of the SOCBs after turning into stock companies cannot but follow further privatization or further pluralization of the ownership structure, which implies that the reform path will enter further into the area of market capitalism as in the figure 1.

In short, the reform path of the SOCBs has moved beyond the boundary of the SME and entered into the area of market capitalism. This indicates the limit of the SME and the internal incongruity of the China Model. Even though the China Model does refuse private ownership and capitalism in its theory and ideology, the reform path of the SOCBs cannot but follow the process of privatization and thus capitalization, though partially.

5. A Dilemma of Success: the Political Legitimacy of the Communist Party of China

The reform path of the SOCBs has accepted partial privatization and demands further privatization. This reform dynamics are found not just in the reforms of the SOCBs but also in those of the SOEs in general. In February 2011, the State-owned Assets Supervision and Administration Commission of the State Council declared that the SOEs of small size did not exist anymore. This implies that the SOEs of small size had been already privatized. Even though the SME aimed at marketization, the reform path could not but accept privatization as the marketization reform deepened. As seen in the reform path of the SOCBs, the privatization reform will expand into the reforms of the SOEs in general.

If the marketization reform reaches the end and the privatization reform expands into the reforms of the SOEs in general, if the socialist ownership structure of state or public ownership contracts and the capitalist ownership structure of private ownership expands, then the CPC will face a dilemma at some time in the future that the CPC is not a communist party anymore. The leaders of the CPC seem to recognize this dilemma. The
theory of ‘three representation’ by Jiang Zemin can be regarded as a response to the dilemma. However, even if the CPC expands its representation from workers and farmers to the whole Chinese people, such a dilemma may not be resolved. It will be difficult for the CPC to maintain political legitimacy without a self-revolution to transform its ideological identity fundamentally.
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