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ESSAY

The Emergence of the New Chinese Banking System: Implications for Global Politics and the Future of Financial Reform

SHRUTI RANA†

INTRODUCTION

As the current financial crisis unfolds around the world, China’s newfound financial and political power is dominating global legal, financial, and political arenas. One recent incident illustrating China’s growing clout occurred in October 2011, when Western media breathlessly reported that many “European countries are looking for a lifeline to extricate themselves from the continent’s severe sovereign debt crisis, which threatens to collapse the continent’s financial system.”¹ The “lifeline” these countries and banks were looking to was China.²

As examples of China’s rapidly expanding financial and political power emerge on a nearly daily basis, it is more critical than ever to

† Associate Professor of Law, University of Maryland Francis King Carey School of Law. These remarks were inspired by my participation in the University of Maryland 2011 International Law Symposium, China, Taiwan, and International Law: A Symposium in Honor of Professor Hungdah Chiu, October 5–6, 2011. I would like to thank the other symposium participants for their thoughtful contributions, especially Daniel C.K. Chow and Andy Y. Sun, my co-panelists on the Contemporary Perspectives on International Private Law Panel. In addition, I would like to thank Professors Carl Minzner, David Super, and David Gamage for their insightful feedback on these remarks, and the editors of the Maryland Journal of International Law, Jennifer Thompson, Emanwel Turnbull, and Catherine Gonzalez for their excellent research assistance. Also, I would like to thank the participants in the New Perspectives on Comparative Law Conference at The George Washington University Law School, on April 20, 2012, who provided invaluable feedback.

1. Barry Hatton, China Charms Europe, but Beijing Has Own Agenda, GUARDIAN, Sept. 18, 2011, http://www.guardian.co.uk/world/feedarticle/9852405. See also Aaron Back & Esther Fung, China’s Wen Vague on Help for Europe, WALL ST. J., Sept. 15, 2011, at A13 (noting that the European debt crisis has put new focus on a potential role for China and other developing economies to come to the aid of Western economies in trouble, but has also underlined the limits to any such scenario, and quoting Premier Wen as stating that “China remains willing to expand its investment in the EU”).

2. See supra note 1.
understand the depth and breadth of the current financial and political
transformations occurring in China, and in particular the rapid
reforms occurring in the Chinese banking system as the country seeks
to assume the mantle of the world’s new banker. Indeed, as one
commentator has recently suggested, perhaps the

most salient feature of the twentieth century so far has been
China’s emergence as a global force . . . . The world is
going through a period of major development, reform and
adjustment. With the growth of multi-polarization, and
economic globalization, China and other emerging
countries are clearly set to play much more important roles
in the second decade of the 21st century. And there have
been many predictions as to what this future world will
look like.3

These remarks, as set forth below, seek to begin a dialogue into
what this new world may look like as global markets rapidly rise, fall,
and transform, focusing on the rise of China in particular and the
political and financial consequences of its recent and unprecedented
path to power. First, these remarks discuss the massive changes that
have transformed the Chinese banking system over the last two
decades from a largely insular, state-run system to one that is moving
to a more market-based economy.4 These remarks then proceed to
elaborate how these changes have accelerated over the last decade,
particularly in the wake of the global financial crisis.5 In analyzing
the history of the Chinese banking transformation, these remarks
discuss how and why China is moving in a direction contrary to that
of most western regimes, as it moves from a more public banking
system to a more privatized one.

Ultimately, these remarks seek to further the global debate over
the lessons that can be learned from the Chinese experience as China
navigates the public/private divide in unique and distinctive ways.
China’s banking system has come to straddle the public/private

3. Zhaoxing Li, Setting the Record Straight on China’s Global Ambitions, EUROPE’S
WORLD, Autumn 2011, http://www.europesworld.org/NewEnglish/Homeold/Article/tabid/
191/ArticleType/ArticleView/ArticleID/21907/language/en-US/Settingtherecordstraighton
Chinasglobalambitions.aspx.

4. See Keith Bradsher, Vows of Support, and Persistent Anxiety: China Links

5. See David Barboza, China’s Treasury Holdings Make U.S. Woes Its Own, N.Y.
TIMES, July 19, 2011, at B1 (describing the measures the Chinese government is taking to
ease structural imbalances in light of the global financial crisis, and in reaction to U.S.
financial problems in particular).
divide in remarkably different ways than the American, European, and other market-based banking regimes it is competing with. In essence, China is charting its own path as it creates a new banking model—that is, developing a new banking model with “Chinese characteristics.”

As part of this examination, these remarks also briefly consider whether China is at the forefront of a new geopolitical development—a development that has been called the rise of new state capitalism. More specifically, one of the key questions facing the geo-political arena is whether a new form of market capitalism is emerging that explicitly embraces a strong state role, with China leading the way in this movement. One author has described this transition, and China’s leading role in this transformation, as follows:

[t]wenty years ago state firms were nothing more than parts of the government machine. Ten years ago, there was widespread doubt about whether they could succeed. Today they include some of the world’s biggest companies, sucking up profits at home and taking on the world market with a will. Between 2005 and 2011, four of the world’s top ten stockmarket flotations involved Chinese state companies (and collectively raised $64.5 billion).

These developments underscore the speed, breadth, and significance of China’s banking reforms for the future of global market capitalism, and the necessity of studying these reforms in depth.

Yet another interesting angle of China’s global impact lies in understanding how China’s banking reforms have shored up its financial and political power, sometimes subtly and sometimes explicitly, at the expense of the United States, Europe, and Japan. Not surprisingly, as China has become the world’s largest export economy, and U.S. dependence on Chinese exports and debt buying has increased dramatically, China’s national pride has surged.

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7. See New Masters of the Universe, How State Enterprise Is Spreading, ECONOMIST, Jan. 21, 2012, at 6, 6–8 (noting that varieties of state capitalism all have something in common: politicians have far more power than they do under liberal capitalism; for example, in authoritarian regimes, politicians can restructure entire industries at the stroke of a pen, although there are nevertheless limits even under these systems to the “Leviathan’s” power).
9. See Barboza, supra note 5.
interesting, yet largely overlooked, strand of China’s rise to greater financial power includes a greater willingness to critique the United States and contrast China’s successes with perceived American weaknesses, as well as compare China’s brand of market capitalism with that of the United States. These remarks therefore analyze several recent examples of how China has been able to use banking reforms to not only achieve greater financial and political power, but also to create a more prominent and confident global voice. Finally, these remarks conclude with a discussion of some of the lessons for the future that can be drawn from China’s recent experiences, both for the current global financial crisis and for how such crises may be moderated in the future.

I. THE FOUNDING OF A BANKING SYSTEM UNDER STRICT CENTRALIZED CONTROL

China’s moves towards market capitalism are relatively recent and remain controversial. These remarks thus begin by examining China’s recent banking reforms with reference to its historical and cultural past, explaining how China developed a uniquely public and private banking system which has in part led China’s fortunes to diverge from those of other major banking regimes during this time of financial crisis.

China’s modern banking system, as with much of its economy after the ascension of the Communist Party, was initially marked by state ownership and central planning. During the first decade of Communist rule, the government gave all control of banking and monetary policy to the People’s Bank of China (PBOC), founded in 1948. Over the next few decades, the Chinese government created three other state-owned commercial banks, the China Construction Bank, the Agricultural Bank of China, and the Industrial and

10. See Bob Davis & Aaron Back, China Slams U.S over Debt, WALL ST. J., July 29, 2011, at C3 (discussing a “sharply-worded commentary from China’s state news agency” regarding a possible downgrade of U.S. debt, and noting that in “some of the strongest language from China’s government on the issue so far, one Xinhua article castigated U.S. leaders for putting the world economy in jeopardy and called on [U.S. leaders] to ‘show some sense of global responsibility’”).

11. See Bradsher, supra note 4 (noting that the European Union feels that China has yet to meet the WTO’s criteria for a market economy and the pace of China’s transition to a more market-oriented one is up to China, and therefore unpredictable).


Commercial Banks of China (these three banks, along with the PBOC, are also known as “The Big Four”).

Unlike banking systems in the United States and Europe, during this time China’s banks did not actually pool savings or act as risk managers. Instead, the banks primarily functioned as state credit-granting agencies, and their principal purpose was to fund the Central Planning Committee’s programs. During this period, the central government controlled the corporate governance of the banks (much as it dominated the corporate governance of all domestic companies at this time).

While this consolidation of power allowed the Central Planning Committee to act quickly and decisively with respect to banking and monetary policies and programs, it also created significant problems that impeded bank efficiency and growth, echoing the experiences of other centrally planned economies during that historical period. Such problems included a lack of discipline with respect to banking policies as well as reduced incentives to maximize economic efficiency.

More specific problems included political pressure on banks, which resulted in bank managers approving highly risky loans in exchange for political favors. Bank managers believed that the government would issue more loans or otherwise bail out the banks if

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15. Id.
16. Id.
17. Id.
18. See, e.g., Peter Ferdinand, Russian and Soviet Shadows over China’s Future?, 68 INT’L AFF. 279, 280 (1992) (noting that when China implemented its first five-year plan between 1953 and 1957 it was consciously following the Soviet model of development and its establishment of a centrally planned economy); Brian Sawers, Reevaluating the Evidence for Anticommons in Transition Russia, 16 COLUM. J. EUR. L. 233, 251 (2010) (recognizing that corruption often arises as a response to the inefficiencies within centrally planned economies); K. Matthew Wong, Securities Regulations in China and their Corporate Finance Implications on State Enterprise Reform, 65 FORDHAM L. REV. 1221, 1224 (1996). Wong notes that:

Viewed broadly, China’s [current] reform movement is a direct response to the gross inefficiency that prevailed within the planned economy. In many ways, China’s current problems with its state sector are similar to those encountered in Russia and Eastern Europe. Years of directives from static state planning and a complete lack of competition have led to bloated bureaucratic management structures and obsolete manufacturing facilities.

Id. (footnotes omitted).
19. See Luehr, supra note 12, at 175.
20. Id.
they ran into any significant economic trouble, creating a structural disincentive for bank employees to maximize economic efficiency, innovation, or profits. Moreover, at the time, corporate management in China was not subject to western-style fiduciary duty rules which impeded efforts against corruption and self-dealing.

As these problems grew, the Chinese government began to rethink its policies, and decided to begin liberalizing its banking system. As a result, in the late 1970s, the Chinese government embarked on a far-reaching set of reforms aimed at moving away from a centrally planned system to one that began to embrace free trade and liberal economic principles. Significantly, China’s reforms were motivated both by a desire to open up its markets as well as an explicit desire to “build a stronger nation.”

II. A Shift Toward Openness in the Chinese Banking System

China began to change its banking and economic systems in 1978 during the “Opening Up” period under Deng Xiaopeng. During this time, China began to gingerly privatize its banking system, allowing banks greater authority to manage their businesses and lending. Between 1978 and 1986, China’s reforms slowly carved out a more limited role for the PBOC, created three additional state banks, and allowed banks more autonomy over their business dealings, enabling them to expand and set up local branches throughout the country. These “incremental reform[s] ushered in the first wave of Chinese economic growth, during which industries and banks flung off the shackles of government control,” at least

21. Id.
23. Luehr, supra note 12, at 175.
24. Id. at 175–76.
25. Id. at 175 (citing NICHOLAS D. KRISTOF & SHERYL WUDUNN, CHINA WAKES: THE STRUGGLE FOR THE SOUL OF A RISING POWER (1994)).
26. Luehr, supra note 12, at 175.
27. Id. at 176.
28. See supra Part I (discussing the formation of the “Big Four” banks).
The Chinese government soon realized, however, that it could not truly move further towards a free (or “free-er”) enterprise system by only tinkering with the existing state-run banking system. Rather, a new banking framework was required.

Consequently, in 1986, the Chinese government took its first steps towards creating a new legal framework for its banking system, issuing “Provisional Regulations on the Control of Banks,” the first comprehensive regulation aimed at the Chinese banking industry. The government intended to develop a framework that would allow the country to move towards a more market-based system which would give businesses more freedom, yet still allow the government to maintain strong control.

During the remainder of the decade and into the 1990s, China grew economically and expanded its political influence. As China began liberalizing and privatizing more rapidly, and China’s banks gained more freedom to lend in furtherance of economic efficiency and productivity (as opposed to serving other political ends), the “Big Four” banks quickly realized that they needed to reform and further modernize their internal banking structures and practices. Reinforcing this push for reform was China’s stated goal of accession to the World Trade Organization (WTO). To aid these goals and reduce the number of nonperforming loans at local branches (primarily due to policy-based lending practices), the government passed another set of banking reforms in the mid-1990s: The Law of the People’s Republic of China on the People’s Bank of China and the Law of the People’s Republic of China on Commercial Banking. These laws successfully addressed agency problems at the local branches, but were otherwise broadly and vaguely drafted and failed to adequately address corporate governance issues at the national banks.

When the Asian Financial Crisis hit in 1997, however, China took heed of the problems its neighbors were facing and decided that it needed to further reform its banking system in order to avoid

29. Luehr, supra note 12, at 176.
30. Id.
31. Id. at 176.
32. Id.
33. Id. at 176–77.
34. Id. at 177.
35. Id.
36. Id.
similarly debilitating crises.\textsuperscript{37} In 1998, China recapitalized the Big Four banks, primarily due to the large amount of nonperforming loans they held.\textsuperscript{38} China created an asset management company for each of the Big Four, which took over the approximately $170 billion in nonperforming loans.\textsuperscript{39} Also in 1998, the government separated the securities, insurance, and banking supervisory structures in the PBOC.\textsuperscript{40} During this period, China’s most successful reform was replacing its old credit-planning system with the asset liability management system as broadly described above.\textsuperscript{41} China also improved its banks’ capital adequacy by complying with the Basel Committee’s International Convergence of Capital Measurement and Capital Standards (Basel II).\textsuperscript{42} In doing so, China was also able to increase its credibility with WTO members, a critical step towards its entry into the WTO.\textsuperscript{43}

III. CHINA LEAPS FORWARD BY ACCEDING TO THE WTO

Although China had first begun to open its banking system to foreign banks in a limited manner in 1991, WTO accession compelled China to further liberalize its banking system.\textsuperscript{44} Essentially, as part of the accession process, China was required to make a broad range of concessions to the other members of the WTO who wanted greater access to the Chinese banking industry, especially the United States, the European Community, Japan, Australia, and Canada.\textsuperscript{45} These reforms are also notable because they were externally, rather than internally driven—during this period, China was essentially forced to enact liberalizing reforms in order to comply with its international obligations.\textsuperscript{46}

When China acceded to the WTO in December 2001, it pledged to fully liberalize foreign access to its domestic banking services

\textsuperscript{37} Id. at 177–78; Alford, supra note 13, at 39.
\textsuperscript{38} Alford, supra note 13, at 39.
\textsuperscript{39} Id.
\textsuperscript{40} Id.
\textsuperscript{41} Luehr, supra note 12, at 178.
\textsuperscript{42} Id.
\textsuperscript{43} Id.
\textsuperscript{44} Ge Jianguo, WTO and Revision of China’s Foreign Banking Regulations, 124 Banking L.J. 536, 536–37 (2007).
\textsuperscript{45} Id.
\textsuperscript{46} See generally Icksoo Kim, Accession into the WTO: External Pressure for Internal Reforms in China, 11 J. Contemp. China 433 (2002).
market over a five-year period. Under the WTO requirements, China was required to allow foreign financial services institutions to supply banking services in accordance with the terms set out in its General Agreement on Trade and Services (GATS) schedule.

China’s GATS schedule stated that with respect to sectors covered by banking commitments, “[w]ithin five years after accession foreign financial institutions will be permitted to provide services to all Chinese clients,” as well as foreign clients, through a “commercial presence” in China. These foreign financial institutions were supposed to be permitted to provide services in the form of, inter alia, bank deposits, various types of lending, and payment and money transmissions. China’s commitment to allow foreign banks to enter the Chinese banking services market through a “commercial presence” included allowing foreign entities to constitute new banks, acquire existing banking institutions, and, importantly, gave foreign entities the ability to maintain establishments in China without limitations on corporate form or foreign capital participation. China was also required to eliminate any “non-prudential measures restricting ownership, operation, and juridical form of foreign financial institutions, including on internal branching and licenses” as well as any remaining geographic restrictions on banking services.

While some of these goals have been met or are in the process of implementation, others remain to be fulfilled despite the completion of China’s five-year transition period. During the transition period, however, the push to comply with the commitments it made to secure WTO accession led China to rapidly accelerate its reforms aimed at liberalization and modernization of the banking system. For example, in 2003, China created the China Banking Regulatory Commission (CBRC), which assumed critical PBOC regulatory functions,
including regulating banks, Asset Management Companies (AMCs), and trust and investment companies, and generally helped maintain a stable financial system. Also in 2003, the Chinese government recapitalized the Bank of China and the China Construction Bank in preparation for listing the banks on the Hong Kong Stock Exchange (the listings were ultimately completed in 2005).\(^5\) In addition, in 2004, China amended its commercial banking laws and allowed London bank HSBC to invest in the Bank of Communications—the “largest equity investment in a Chinese bank since 1949.”\(^6\)

The Bank of China conducted its initial public offering (IPO) on the Hong Kong Stock Exchange in mid-2006. In October of that year (after the government recapitalized it with $50 billion), the Industrial and Commercial Bank of China conducted its IPO on the Hong Kong and Shanghai stock exchanges; at the time, this offering constituted the world’s largest IPO.\(^7\)

On the same day that China’s five-year transitional period ended, China also implemented the Regulations of the People’s Republic of China for the Administration of Foreign Investment Banks (New Regulations) and their implementing rules (New Rules).\(^8\) These rules were aimed at allowing foreign countries or banking entities to enter the Chinese market, though in a highly constrained manner.\(^9\) The

\(^5\) Alford, supra note 13, at 40.

\(^6\) Id. Notably, the Industrial and Commercial Bank of China’s IPO no longer holds the world record for the largest single stock offering—that record was surpassed in 2010, interestingly, by the Agricultural Bank of China, which conducted the world’s largest first-time share sale in 2010 with an initial public offering of $22.1 billion. See Jamil Anderlini, State Share Prop-up Makes AgBank Largest Listing, FIN. TIMES, Aug. 14, 2010, at 9.

\(^7\) Alford, supra note 13, at 41 (citing Keri Greiger, ICBC Makes Strong Debut in Hong Kong, Shanghai, WALL ST. J., Oct. 28, 2006, at B5).

\(^8\) Ge Jianguo, supra note 44, at 536.

\(^9\) A World Bank working paper gives an apt summary of the scope and impact of these changes:

Under the 1994 commitments, foreign banks could only operate in specified regions, accept deposits only from non-residents, and only in foreign currencies (with some exceptions), and make no loans to Chinese citizens. On accession, geographic and client limitations will be eliminated for foreign currency businesses. Even though the schedule states that on accession, local currency businesses will be allowed in four cities, (Shanghai, Shenzhen, Tianjin, and Dalian) there seems to be a binding restriction on clients which will only be relaxed in two years. The entire banking sector [was to have been] fully liberalized by 2006. As in the case of insurance, licenses are to be awarded solely on the basis of prudential criteria with no quantitative limitations or economic needs tests applied.
New Regulations restrict the scope of activities that can be conducted by foreign banks seeking to operate in China through branches instead of through subsidiaries. In particular, foreign bank branches can only take domestic currency deposits of one million renminbi or more from Chinese individuals and cannot make local currency loans to Chinese individuals. Moreover, foreign bank branches cannot issue domestic currency credit cards to Chinese enterprises or Chinese individuals. These restrictions have generated a great deal of concern from other members of the WTO, including the United States, who feel that China has not fulfilled its WTO commitments (a view that continues to this day).

Another significant development occurred in 2007, when the CBRC issued The Guidelines on the Implementation of the New Basel Accord by China’s Banking Sector (Basel II Guidelines). The Basel II Guidelines require full implementation of the entire Basel II


61. See New Regulations, supra note 60, art. 31 (listing the activities that banks may carry out). See also China Opens RMB Retail Business to Foreign Banks from 11 December 2006, KING & WOOD MALLESONS (Nov. 22, 2006), http://www.mallesons.com/publications/marketAlerts/2006/Documents/8696677w.htm.


63. See Friedman, supra note 62 (“The U.S. says the rules contravene a pledge the world’s most populous nation made when it joined the . . . WTO in 2001 to open its debit- and credit-card markets to foreign processors . . . .”). See also Drajem & Eichenbaum, supra note 62 (reporting on the two WTO complaints filed by the United States against China regarding payment-processing and steel duties).

framework by all large banks with operational entities in other countries or regions, or with a large proportion of international business. The Basel II Guidelines warn that State-Owned Commercial Banks (SOCBs) should refrain from “irrationally rushing into the [sic] implementation”65 of Basel II and that “implementation of Basel II... should be [conducted] gradually.”66 Instead of translating the provisions into separate regulations, the Basel II Guidelines encourage SOCBs to implement Basel II as a whole.67

The Basel II Guidelines essentially provided large-scale banks with operational entities in other countries or regions, or with a large proportion of international business, until 2013 to implement Basel II.68 However, China exceeded the expectations of its own guidelines when it announced that Chinese banks were likely to carry out its Basel II obligations by the end of 2010;69 this announcement may be an indication of the strength of China’s economic growth, or simply reflect its ambitions.70

Indeed, the question of why China accelerated implementation of these requirements, particularly during the midst of a global financial crisis, is an interesting one, and it is worth watching how China proceeds in this respect in both the long and short-term.

Around this time the Chinese government also recognized the emergence of a global economic power vacuum, which it sought to fill in order to achieve greater global prominence.71 On a more instrumental level, China was also trying to learn the lessons of the past and create an economic system that could combine the best of both market-based and central control.72 Each of these issues is discussed below.

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65. Id. pt. II.ii.
66. Id.
67. Id. pt. IIIi.
68. Id. pt. V.iii.
69. Luehr, supra note 12, at 193. At the present time, it is unclear whether China has succeeded in fulfilling its Basel II obligations.
70. See supra notes 41–42 and accompanying text.
71. See supra Part II.
72. See supra Part II.
IV. CHINA’S MOVE FROM A PUBLIC TO A PRIVATIZED BANKING MODEL

As country after country felled by the current financial crisis turns towards greater public control over its banking system,73 China seems to be almost unique in moving in the opposite direction. Indeed, China seems to be speeding up the privatization of its banking system in the wake of the global financial crisis.74

As China moves closer to a privatized banking model, its successes and failures are well worth further analysis. First, the speed of China’s recent reforms should not be underestimated. I was able to witness the breathtaking pace of change in China firsthand. In 2010 and 2011, I traveled to China as part of a research team and conducted interviews with banking officials, analyzed data on structural and practical reforms in the banking sector, and observed how China was attempting to transform its banking system from one that suffered from unevenness in practice, liquidity, and loan performance into one that was beginning to implement strong corporate governance principles that echoed, and often matched, those in the United States and Europe.75 For example, in just one year between 2010 and 2011, Chinese banks began to form trade associations and identify best practices, often based on international models, and rapidly changed from a system tentatively moving towards reform to one that appeared to enthusiastically embrace Western-style management and prudential practices.76


74. See Barboza, supra note 5 (describing the measures the Chinese government is taking to ease structural imbalances in light of the global financial crisis and U.S. financial problems).


Another key aspect of China’s recent transformations is that many of China’s recent banking and financial reforms have a Chinese twist—for example, China has imposed higher and more stringent deposit requirements than the United States. In addition, as of January 2011, while China had still not formally implemented a deposit insurance system, it did acknowledge the importance of quickly implementing one, and claims it is “on track” to do so. In lieu of a formal deposit insurance system, “the government acts as a de facto insurer for deposits in China’s domestic banks.” China’s moves towards implementation of a formal deposit insurance system are also significant because deposit insurance is often implemented in response to economic crises or to prepare for or avoid an economic crisis or depression. In this light, it will be important to closely observe how China’s reforms in this area unfold.

Notably, China’s economic reforms have also corresponded with a significant rise in its global power and a resurgence of national pride. China’s growing financial and political might has led global leaders and commentators to ask whether China is on the verge of becoming a global financial leader, and perhaps even the world’s global financial leader. Or is it, like many other countries, in danger of a spectacular economic collapse? Accurately assessing China’s immediate economic future is difficult, not least because China is known for its lack of transparency and operation by government fiat. Nonetheless, many analysts laud China’s gains and predict its impending world dominance. For example, from an outside perspective, China appears to be following an age-old path from financial dominance to political dominance. China is also poised to


79. Id. See also McCullough, *supra* note 77, at 424.


82. Id.

83. See Zhiyong Lan et al., The Growing China and Its Prospective Role in World Affairs, 6 BROWN J. WORLD AFF. 43, 43–44 (1999) (discussing various responses to China’s
surpass Japan as the world’s second largest economy, representing a significant shift in the balance of global economic and political power. 84 Indeed, some have argued that this shift shows that “China’s ascendance is for real, and that the rest of the world will have to reckon with a new economic superpower”—one that is second only to the United States. 85

However, China’s financial picture is not entirely golden. As noted above, China still lacks a secure deposit system—which was a key factor in smoothing some of the wobbles of European and American banking systems. 86 Furthermore, a number of analysts have noted that China’s economic growth is slowing (from 10% in 2010 to 9% in 2012). 87 The International Monetary Fund (IMF) recently concluded a review of the Chinese banking system and reported that Chinese banks were vulnerable to heavy losses due to a rise in off-balance-sheet liabilities and a housing boom. 88 The IMF also pointed out that the Chinese system was becoming more complex, intertwined with other markets, and that informal credit markets and off-balance-sheet activities are on the rise. 89 Moreover, some analysts feel that despite their recent gains and successes, China’s banks are insufficiently capitalized to be able to “move from where they are now to something else.” 90

At the same time, while these issues pose concerns for China’s growth and power, most analysts believe that China has heeded the lessons of the countries whose housing markets have recently collapsed and has begun acting proactively to address the risk of economic bubbles, raising rates and increasing the cost of rapid growth, including speculations that China may be pursuing an imperialistic agenda, and contending that China’s modernization in combination with the size of its economy could have profound historical and global ramifications).

86. McCullough, supra note 77, at 422. See also Xiotlan, supra note 78.
89. Id.
borrowing—the very opposite of what the United States did at the beginning of the recent housing crisis. In other words, thus far China’s credit-tightening efforts may allow it to avoid a hard landing from its housing bubble and other potential economic problems, and thereby prevent China’s economic fortunes from sinking too far.

Nonetheless, there are a number of political and financial concerns which may slow China’s rise. As noted above, the Chinese system suffers from a lack of transparency, making it difficult to gather and analyze hard data. The Chinese judiciary also lacks complete independence, and no express legal or constitutional provisions authorize citizen suits against government entities. It is important to note, however, that China does appear to recognize and is attempting to address some of these issues.

Despite these concerns, overall China still appears to be heading toward global financial and economic leadership, as discussed below.

V. GLOBAL IMPLICATIONS OF CHINA’S BANKING TRANSFORMATION

Joseph Schumpeter once stated that “[t]he monetary system of a people reflects everything that the nation wants, does, suffers, is.” This quote is just as relevant to China now as it was when

91. Id.
92. Afraid of a Bump: China’s Economy is Set to Suffer Hardship But Not the Hard Landing that Many Fear, ECONOMIST, Oct. 22, 2011, at 49 (arguing that despite the existence of bad debts, the central government can afford to bail out the lower tiers of government and the banks they borrowed from, or banks could underpay their depositors).
94. See generally Carl F. Minzer, China’s Turn Against Law, 59 AM. J. COMP. L. 935 (2011).
Schumpeter first stated it in the context of other developing countries. While outwardly China appears to be a largely inflexible authoritarian regime, from the inside the Chinese people appear to be seeking economic progress, power, and a meaningful place on the world stage—efforts which again seem to be tied to resurgence in Chinese national pride.\(^97\) Currently, it looks as though the global financial crisis has provided China with an unprecedented opportunity to muster its strengths—high levels of reserves, high savings rates, and an increasingly educated populace—and parlay them into global strength while the fortunes of the United States and Europe wane.\(^98\)

For instance, while on the surface China appears to be simply satisfying its global commitments and modernizing its banking system to spur growth, a deeper analysis suggests that China is capitalizing on the relative strength of its economy and banking system to further strengthen its global position. Indeed, it is perhaps not entirely coincidental that China is on now track to surpass Japan as the world’s second largest economy, and is rapidly closing in on the United States.\(^99\)

As the Schumpeter quote above highlights, monetary systems and banking reforms can be highly intertwined with a nation’s political and social goals. China currently provides a paradigmatic example of such a situation. For instance, as China attempts to step in to assist other countries suffering financial crises, many have argued that China is actually “increasingly trying to diversify its foreign policy relationships” and “trying to find the right ways to use [and gain from] its new-found influence.”\(^100\) In fact, commentators argue that China’s “strategy” is increasingly becoming clear: “[i]t wants to use its economic leverage to make friends who may be more forgiving in disputes over trade and human rights, and ensure doors are open for its goods and corporate investments” in its main export markets.\(^101\)


\(^99\) Brendon, supra note 81.

\(^100\) Hatton, supra note 1 (quoting Nicholas Consonery, an Asia analyst at Eurasia Group in Washington, D.C.).

\(^101\) Id.
As China steps up its role in the global financial arena, China is gaining not only political and financial power, but an important sense of pride and international confidence. This confidence, in fact, appears to rise in almost direct proportion to the missteps of the United States and other major financial powers. As one commentator put it, “[t]he narrative that China has been financing the United States has taken hold in China . . . . If the U.S. is seen as irresponsibly using that money, that won’t go down well in China.”102 Furthermore, as debates over the most prudent or potentially successful banking and monetary policies intensify in the global arena, “[t]he highly publicized and contentious nature of this debate is an additional nail in the coffin of Chinese perception of the United States as a stabilizing force and responsible actor in global economic affairs.”103 In this light, another fascinating issue to consider is how China will seek to use this moral as well as financial power. Recently, China has begun to use this power to publicly scold the United States for its perceived excesses and profligate spending.104

New examples of China’s rising economic and political influence emerge on nearly a daily basis.105 Again, unraveling the complexities of China’s current policies and actions is vital to understanding both the true nature of the banking reforms currently occurring in China and whether China’s economic power will continue to grow. In particular, understanding the transformations in China’s banking system is imperative for any detailed assessment of their implications both for the global banking system and for China’s prospects for enhancing its financial and political power on the world stage. As many have noted, China is asserting greater political and economic influence in Africa and Latin America106 and has at least the potential to surpass the United States as the world’s largest economy. As the United States increasingly assumes the mantle of the world’s debtor, and China emerges as the world’s creditor, it

102. Davis & Back, supra note 10 (quoting Brookings Institution China scholar Eswar Prasad).
103. Id.
105. See Vardi, supra note 90 (“In February [2012] China’s central bank issued a three-step plan that would tear down the barriers surrounding China’s big banks. Hopes quickly emerged that China’s banks could become international players much like China’s industrial companies, providing capital to a global economy that needs it.”)
106. See Whipp & Anderlini, supra note 84.
appears that the relative futures of U.S. and Chinese dominance, though intertwined, are highly uncertain and unpredictable.

These remarks are intended to set the stage for greater dialogue over China’s recent rise to global political and financial prominence. These remarks intentionally pose provocative questions about the implications of China’s banking transformation for China’s and the world’s geopolitical and financial future. While an in-depth analysis of these issues is beyond the scope of these remarks, I hope that these remarks will provide fodder for future debates, and offer some critical information and background for future research on the implications of China’s rise to power. I plan to address these questions more fully in my future work, and I invite other scholars and commentators to join me in this endeavor. Hopefully, these remarks have identified some of the major questions that are worthy of further study through academic and diplomatic dialogue.

CONCLUSION

Today, many countries, scholars, and key financial and political players are proposing a myriad of “solutions” to the financial problems and crises spreading around the world. These remarks argue for broadening the dialogue over the range of potential solutions to include attention to systems such as China’s, where innovative or unprecedented solutions may ultimately emerge. In addition, these remarks have sought to demonstrate that China is not merely modernizing its banking systems for its own sake or to maximize profits but also is seeking leverage through banking reform to increase its might on the world stage. In essence, what started out as a domestic modernization effort has rapidly become a tool in China’s arsenal as it seeks greater, if not dominant, global financial and political power, with significant implications for the rest of the world.

These remarks have suggested that this happened both because of China’s recent economic successes as it has accelerated its banking reforms, and because these reforms have coincided with the distress of other major financial regimes. In this light, learning as much as possible from China’s successes in moving from a more public, state-controlled system to a more liberalized free market system is vital to understanding the future of global financial reform as well as aiding the task of identifying best practices. The task of unraveling the causalities between China’s reforms, its growing political clout, and the global financial crisis is highly complex, absolutely necessary, and worth a great deal of future study.
In addition, China’s moves towards a “New State Capitalism” could herald the emergence of a new global market system, or they could simply fizzle into simply another historically contingent and brief financial or societal movement. Since China too may soon face some sort of financial crisis, whether China successfully develops a new and vibrant form of state capitalism will be a critical question over the next few years. We must study such developments closely for insights as to how likely China is to weather coming financial storms, and whether it may develop new and innovative solutions to current financial malaises. We also should watch closely to see whether China heeds the recent lessons from other countries currently facing financial crisis and seeks to offer lessons of its own. In this light, observing China’s next steps will be both fascinating and highly instructive as other countries struggle to recover from recent financial crisis. Ultimately, I hope these remarks have set forth interesting and potentially fruitful avenues for further research, as well as provided a taste of the massive changes China is currently pursuing at local, national, and global levels.