China shows signs of opening up its financial system

A series of moves in the last two weeks has raised hopes that financial freedoms could be expanding in the so-called bird cage economy.

By David Pierson, Los Angeles Times

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BEIJING — China may be the world's second-largest economy, but its financial system still answers to strict state controls that critics say hold back the country's development.

The free market plays little role in determining how China's currency is valued, how banks set interest rates or how much capital is allowed to flow in and out of the country.

But in the last two weeks, a series of moves has raised hopes that financial freedoms could be expanding in the so-called bird cage economy.

Chief among them was Chinese Premier Wen Jiabao telling a national radio audience Tuesday that the nation's large state-owned banks were a "monopoly" that profited too easily.

The "big four" banks — Agricultural Bank of China, Bank of China, China Construction Bank and Industrial & Commercial Bank of China — saw earnings rise 26% last year to about $100 billion despite a slowing economy and souring real estate market.

"It's very easy for them to profit," said Yi Xianrong, an economist at the Chinese Academy of Social Sciences, a government think tank.

The banks have also been criticized for lending mainly to large state-owned enterprises and not doing enough to help small and medium-size enterprises.

On the day of Wen's radio address, the China Securities Regulatory Commission loosened restrictions on foreign investors, more than doubling the amount of capital they can invest in China's securities markets to about $80 billion.

A boost in foreign investment could help reduce the volatility of the Shanghai and Shenzhen stock markets, whose roller-coaster swings are often driven by speculators.

"The announcement sends a clear and positive message to international investors that the central government is encouraging further opening up of China's capital markets," wrote Jing Ulrich, JP Morgan's
head of Global Markets, in a research note.

A week earlier, the Wen-led State Council unveiled a pilot program in the entrepreneurial city of Wenzhou to legalize and regulate underground lending as well as broaden access to investments overseas.

Economists say there's growing recognition in Beijing that reforming the nation's financial system is crucial if leaders want to internationalize the country's currency and reduce its dependence on the dollar.

Whether Wen, who will step down later this year, has the political capital to force interest rate or capital account reform remains to be seen. To do so would mean breaking powerful interest groups.

"The longer you wait, the larger the economic stake becomes for those who like the status quo," said Louis Kuijs, an economist formerly at the World Bank and now at the Fung Global Institute in Hong Kong. "Maybe Premier Wen feels like we should really get it going."

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