

Research Series on the Chinese Dream
and China's Development Path

Guogang Wang

A Study on Interest Rate Liberalization in China



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Research Series on the Chinese Dream and China's Development Path

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Drawing on a large body of empirical studies done over the last two decades, this Series provides its readers with in-depth analyses of the past and present and forecasts for the future course of China's development. It contains the latest research results made by members of the Chinese Academy of Social Sciences. This series is an invaluable companion to every researcher who is trying to gain a deeper understanding of the development model, path and experience unique to China. Thanks to the adoption of Socialism with Chinese characteristics, and the implementation of comprehensive reform and opening-up, China has made tremendous achievements in areas such as political reform, economic development, and social construction, and is making great strides towards the realization of the Chinese dream of national rejuvenation. In addition to presenting a detailed account of many of these achievements, the authors also discuss what lessons other countries can learn from China's experience.

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Translated by Sai Pan
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ISSN 2363-6866 ISSN 2363-6874 (electronic)
Research Series on the Chinese Dream and China's Development Path
ISBN 978-981-97-3643-0 ISBN 978-981-97-3644-7 (eBook)
<https://doi.org/10.1007/978-981-97-3644-7>

Jointly published with Social Sciences Academic Press
The print edition is not for sale in China (Mainland). Customers from China (Mainland). Please order the print book from: Social Sciences Academic Press.

Published with financial support of the Innovation Program of the Chinese Academy of Social Sciences.

Translation from the Chinese language edition: “利率市场化改革与利率调控政策研究” by Guogang Wang. © Social Sciences Academic Press 2016. Published by Social Sciences Academic Press. All Rights Reserved.

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Series Preface

Since China's reform and opening began in 1978, the country has come a long way on the path of Socialism with Chinese characteristics, under the leadership of the Communist Party of China. Over 30 years of reform, efforts and sustained spectacular economic growth have turned China into the world's second largest economy, and wrought many profound changes in the Chinese society. These historically significant developments have been garnering increasing attention from scholars, governments, and the general public alike around the world since the 1990s, when the newest wave of China studies began to gather steam. Some of the hottest topics have included the so-called "China miracle", "Chinese phenomenon", "Chinese experience", "Chinese path", and the "Chinese model". Homegrown researchers have soon followed suit. Already hugely productive, this vibrant field is putting out a large number of books each year, with Social Sciences Academic Press alone having published hundreds of titles on a wide range of subjects.

Because most of these books have been written and published in Chinese, however, readership has been limited outside China—even among many who study China—for whom English is still the lingua franca. This language barrier has been an impediment to efforts by academia, business communities, and policy-makers in other countries to form a thorough understanding of contemporary China, of what is distinct about China's past and present may mean not only for her future but also for the future of the world. The need to remove such an impediment is both real and urgent, and the *Research Series on the Chinese Dream and China's Development Path* is my answer to the call.

This series features some of the most notable achievements from the last 20 years by scholars in China in a variety of research topics related to reform and opening. They include both theoretical explorations and empirical studies, and cover economy, society, politics, law, culture, and ecology, the six areas in which reform and opening policies have had the deepest impact and farthest-reaching consequences for the country. Authors for the series have also tried to articulate their visions of the "Chinese Dream" and how the country can realize it in these fields and beyond.

All of the editors and authors for the *Research Series on the Chinese Dream and China's Development Path* are both longtime students of reform and opening and

recognized authorities in their respective academic fields. Their credentials and expertise lend credibility to these books, each of which having been subject to a rigorous peer review process for inclusion in the series. As part of the Reform and Development Program under the State Administration of Press, Publication, Radio, Film, and Television of the People's Republic of China, the series is published by Springer, a Germany-based academic publisher of international repute, and distributed overseas. I am confident that it will help fill a lacuna in studies of China in the era of reform and opening.

Shouguang Xie

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Chapter 1

Deposit and Lending Interest Rate Liberalization Reforms: Challenges, Pathways, and Policy Options



“Steadily advancing interest rate liberalization reforms”¹ is a strategic initiative for adjusting China’s financial system and improving the monetary policy regulation. It is also a priority and challenge in deepening financial reforms. The idea of interest rate liberalization reforms in China was put forth as early as in 1993.² Since 1996, China has implemented interest rate liberalization reforms by following the approach of “taking the first step of reform for foreign currencies before the home currency, loan interest rate before deposit interest rate, long-maturity before short-maturity, and large-sum transactions before small-sum ones.”

By 2004, China had cumulatively deregulated, consolidated, or canceled 118 types of home and foreign interest rate management.³ On October 28, 2004, the People’s Bank of China (hereinafter “PBoC” or the “Central Bank”) released the *Circular on Adjusting Renminbi Benchmark Interest Rates*, which marks the first step of Renminbi deposit and lending interest rate⁴ liberalization reforms. In the following 19 years, however, the Central Bank frequently resorted to administrative interventions to regulate deposit and loan benchmark interest rates, failing to achieve the reform goal of establishing market-based deposit and lending interest rates and market-based allocation of financial resources.

¹ Cited from Outline of the 12th Five-Year Plan for National Economic and Social Development, Chapter 48.

² In 1983, which was prior to this reform, the State Council granted the PBoC the right to adjust the statutory loan interest rate within a $\pm 20\%$ band. However, this right was not exercised until 1987 for working capital loans. Released in 1993, the Decisions of the CPC Central Committee on Matters concerning the Establishment of the Socialist Market Economic System and the Decisions of the State Council on Financial Reforms unequivocally laid out the basic vision for interest rate liberalization reform.

³ See the PBoC’s Report on Monetary Policy Implementation in Q4 2004.

⁴ Unless otherwise specified, “deposit and lending interest rates” in this paper refers to “Renminbi deposit and lending interest rates”, “deposit interest rate” refers to “Renminbi deposit interest rates”, “loan interest rate” refers to “Renminbi loan interest rate”.

The interest rate is the price of capital. It not only sets the basic price for credit and debt financial products but also restrains the price level of equity financial products. Deposit and lending interest rates play a fundamental role in China's interest rate system, and their level of liberalization bears an immediate effect on the market-based pricing of various financial products. Being a complex and arduous systematic project, deposit and lending interest rate liberalization reform is fraught with a host of significant risks. Any misstep may lead to financial and economic turmoil or in the worst case, a financial crisis with inestimable losses. In this sense, deposit and lending interest rate liberalization reform marks a critical stage of China's interest rate liberalization and involves far more stakeholders, difficulties, risks, and complexities than any previous interest rate reforms. All stakeholders must be fully aware of the profundity of this reform, and more cautiously identify solutions and implementation pathways.

1.1 Literature Review on Interest Rate and Interest Rate Liberalization

Interest rate liberalization reform means a process in which the interest rate formation mechanism shifts from administrative regulation to a market-based mechanism and ultimately market-based interest rates. Put simply, interest rate liberalization is the process of realizing or achieving market-based interest rates. That is to say, on the one hand, the shift from regulated to market-based interest rate formation mechanism—irrespective of its stage and pace—is a process of interest rate liberalization. On the other hand, the process of interest rate liberalization will not conclude until market-based interest rates are established.

In the history of monetary economics, numerous studies have been carried out to discuss interest rates and market-based interest rates from different perspectives. Based on the idea of free-market competition, the classical school led by William Petty and Adam Smith underscores the rationality of capital supply and demand in determining interest rates. According to Carl Marx (1894), interest derives from surplus value and is the part of surplus value alienated by industrial capital to bank capital; interest rates are determined by both profitability and factors like intersectoral competition for capital and the supply and demand of capital. John Maynard Keynes (1993) identified differences between the supply and demand relationships of money and capital and introduced the money demand factor, stressing the role of liquidity preference.

Keynes's theory laid the foundation for interest rates to be used as an instrument for economic regulation. Following this approach, John Richard Hicks (1995) introduced interest rate into the IS-LM model as a key factor linking commodity market equilibrium with currency market equilibrium. Since then, the neoclassical school of economics has investigated the formation of interest rate as an economic variable concerning money supply and demand, national income, commodity market, and

currency market equilibrium, and found that interest rate played an important role in regulating the economy.

After the 1970s, Keynesian theories and policies were systematically refuted by Ronald I. McKinnon (1998) and E. S. Shaw (1998). Based on such concepts as “financial repression” and “financial deepening”, they examined government-regulated interest rate policies and consequences in developing countries, proposing that governments should relax interest rate regulation so that interest rates fully reflect capital demand and supply. Their arguments became an important theoretical basis for interest rate liberalization reforms. After the 1980s, Joseph Eugene Stiglitz (2007) et al. performed an analysis of the interest rate determination mechanism under credit rationing. They believed that in a market of information asymmetry, capital transactions might not always follow the auction principle of “whoever bids the highest gets the capital.” As a result, interest rates had lost their function of information transmission. Given the investment risks under credit rationing, an interest rate determined by maximal bank profits does not equal an equilibrium interest rate determined by the supply and demand of capital or money.

Three things can be learned from interest rate theories in Western mainstream economics: First, though Western academics discussed various issues related to interest rates and put forth such concepts as “nominal interest rate”, “real interest rate”, “market-based interest rate” and “natural interest rate”, they seldom performed any systematic analysis of interest rates as an integral system as if only one interest rate existed for various financial products. Second, despite their discussions of interest rate formation mechanisms from different angles and analysis of various interest rate effects, they did not delve further into how each specific interest rate was formed and its associated financial and economic effects from the perspective of an interest rate system. Hence, none of them recognized the uniqueness of deposit and lending interest rates in the market-based interest rates system and their effects, let alone discuss the challenges to deposit and lending interest rate liberalization. Third, the above-mentioned Western interest rate theories offer limited guidance for China’s deposit and lending interest rate liberalization reforms.

As China started to implement interest rate liberalization reforms after the mid-1990s, Chinese scholars have focused their discussions on the following five aspects:

First, the implications of interest rate liberalization. In this respect, a representative view is Li Yang’s (2003), i.e., interest rate liberalization offers two real implications for monetary authorities: 1. Market-based interest rate determination, i.e., the risk structure, maturity structure, and level of interest rates cease to be determined directly by monetary authorities and gradually become determined by sellers and buyers of financial assets independently according to financial market supply and demand. 2. Market-based interest rate management, i.e., instead of resorting to administrative interventions, monetary authorities act as a market participant, using financial resources and monetary policy means at their disposal to alter capital supply and demand in financial markets through currency market transactions and ultimately influence financial market interest rates by regulating benchmark interest rates. The above-mentioned two aspects of interest rate liberalization have been underscored in various studies. According to Wang Guosong (2001), for instance, market-based

interest rates as the goal of interest rate liberalization are achieved when a country's interest rate level and structure are determined by market supply and demand and a combination of market factors such as risk level, inflation, and economic nature. Dai Genyou (2001) believed interest rate liberalization reforms should aim to create an interest rate system and formation mechanism that is underpinned by central bank interest rates, relies on the intermediary effects of currency market interest rates, and determines financial institutions' deposit and lending interest rates according to market supply and demand.

Second, the necessity of interest rate liberalization reforms. In this respect, the literature has focused on the role of interest rate as a macroeconomic policy instrument. As Wang Zhao (2001) noted, regulated interest rates hardly serve as a signal for change in investment in the economy as a whole, which limits their function as monetary policy instruments. Sheng Songcheng and Wu Peixin (2008) also believed that given the absence of market-based transmission between interest rates at various levels, China's monetary policy transmission mainly relied on credit instead of interest rate channels, so that credit scale became the de facto intermediate target of China's monetary policy. This view is supported by empirical studies by Fang Xianming et al. (2005) and Sheng Zhaohui (2006), et al., who found the role of interest rates as a vehicle of China's monetary policy transmission to be impeded and less effective than credit.

Third, conditions for interest rate liberalization. In discussing China's interest rate liberalization reforms, most academics identified the improvement of financial markets as a precondition. For instance, Xu Jian (2003a, b) stressed the importance of financial market fundamentals and financial regulation as the premise for interest rate liberalization. Qian Xiao'an (2003) also identified competitive financial markets, financial institutions' governance, sound corporate operations, and financial regulation as key conditions for interest rate liberalization. Similarly, Zhou Xiaochuan (2011) identified essential conditions for liberalizing interest rates: fair competition among financial institutions, the financial hard constraint for qualified financial institutions, complete monetary policy transmission mechanism, better risk pricing, market-based pricing for a host of financial products, including intermediary business, among others.

Fourth, the relationship between interest rate liberalization and capital account openness. In analyzing China's interest rate liberalization, many academics identified an open economic environment as the external condition, highlighting its coordination with capital account openness. For instance, Wang Xiaoya (2001) identified interest rate liberalization as a basic precondition for opening up the capital account through a combination of interest rate and exchange rate policies. Zhang Zongxin (2006), Wan Xieqiu and Sun Wenji (2004) also stressed the importance of interest rate liberalization reforms from similar perspectives. Yet controversies remain regarding which should be carried out first: interest rate liberalization reforms or capital account openness? A typical view put forth by the Task Force for the International Comparative Research on Interest Rate Liberalization (2002b) holds that the interest rate market must be supported by capital account control. On the contrary, the Task Force of the Survey and Statistics Department of the People's Bank of China (2012)

believed that there was no clear-cut privatization between interest rate liberalization and capital account openness and rules in favor of using the latter to advance interest rate liberalization reforms.

Fifth, risks of interest rate liberalization reforms. Given the pivotal role of interest rates in the financial system, the risks of interest rate reforms have been extensively discussed in the literature. For instance, Wang Guosong (2001) identified three potential risks of interest rate liberalization from restrictive conditions, i.e., fiscal deficit, banking risks, and shrinking demand for investment and consumption. The Task Force of International Comparative Research on Interest Rate Liberalization (2002a) shared similar views but was more concerned with the risk of monetary policy incoherence under imperfect financial markets. Shao Fujun (2004) performed a more detailed analysis of the macro and micro-level risks of interest rate liberalization reforms, highlighting the potential shocks of rising interest rates to the economy. Many other studies such as Huang Jinlao (2001) and Wu Jian (2003a, b) focused on the potential risks of interest rate liberalization reforms to financial institutions, especially commercial banks, and countermeasures.

As can be learned from the above literature, Chinese scholars have discussed a broad range of issues relating to interest rate liberalization reforms extensively and insightfully and reached consensus in many areas. These studies, however, seldom touched upon the role of deposits and loans in China's financial system and the effects of and challenges to deposit and lending interest rate liberalization reforms as part of broader interest rate liberalization reforms.

1.2 Adjusting Resource Allocation in China's Financial System

Difficulties in China's deposit and lending interest rate liberalization reforms are determined by its financial system's traits. In the two-sector model of macroeconomics, the household sector is a surplus sector and the industrial sector is a deficit sector. These two sectors jointly constitute the real-economy sector. In economic operation, surplus capital flows from the household sector to the industrial sector to support wealth creation. Hence, financial activity was originally carried out between the household and industrial sectors (specifically, the household sector supplies capital, and the industrial sector receives capital). That is to say, all financial powers originally rested with the real-economy sector. Specific pathways of capital flow include: First, the household sector provides the industrial sector with equity capital through investment and provides debt capital through such means as bond purchase. Second, within the industrial sector, industrial enterprises provide each other with equity capital in the form of investment and provide debt capital through bond purchase, lending, and financial leasing. Third, the industrial sector returns part of its operating profit to the household sector in the form of dividends and interest. In the process of financial development, financial institutions were separated from

the real-economy sector, becoming specialized in financial services. However, such specialization does not deprive the real-economy sector of its financial powers.

Yet in the decades-long planned economy era, capital supply in China was controlled by the government through fiscal mechanisms. As a result, capital and financial ties between the household and industrial sectors were severed, and so were direct financial ties between household and industrial sectors. Also, their financial powers were deprived. Meanwhile, the role of depository and lending financial institutions came into play: while accepting deposits of surplus funds from the household sector, they issued loans to the industrial sector. Over three decades of reform and opening up, this pattern of financial intermediation has experienced no substantial change despite China's rapid financial development, and showed three distinctive characteristics:

First, the real-economy sector (including industrial and household sectors) lacked basic financial powers. For the household sector, apart from savings, household consumption surplus capital barely had any alternative outlet for financial operation; for the industrial sector, there was little alternative access to capital other than loans from depository and lending financial institutions. Privileges of financial activity became exclusive to depository and lending financial institutions—without their approval, industrial enterprises barely had any access to capital supplied by the household sector.

Second, depository and lending financial institutions became monopolistic seller institutions embedded in the real-economy sector. While receiving capital from the household sector at very low interest rates, they issue expensive loans to the industrial sector, profiteering from a huge interest rate spread.

Third, the shift from direct finance to indirect finance. As a form of direct finance, corporate bonds link capital demand from bond-issuing companies with capital supply from bond-purchasing households. After direct ties of capital supply and demand were severed between the household sector and the industrial sector, depository and lending financial institutions became the dominant buyers of corporate bonds. The household sector deposited funds at depository and lending financial institutions, which then purchased corporate bonds with such depository funds, i.e., capital suppliers are not directly linked with capital users. Having adopted the principle of prudential operation, depository and lending financial institutions are risk-averse and much less tolerant of corporate bond risks than the masses of average people in the household sector. Such risk aversion presents significant barriers to the issuance and sales of corporate bonds from the industrial sector.

Deposits and loans make up a lion's share of all financial products in China's financial system, and depository and lending financial institutions serve as a primary channel for fund allocation in the economy. Consequently, change in the total amount of deposits and loans significantly influences asset allocation and other financial products, money supply, and monetary policy. Moreover, depository and lending financial institutions also exert a significant influence on the financial system and the economy through their business operations. In comparison, the real-economy sector and financial markets are in a weak position in allocating financial resources.

Table 1.1 displays a change in the balance of deposits and loans as a share of assets held by financial institutions in 13 years from 2001 to 2013. First, deposits still represent a key source of operating funds for financial institutions despite a falling share over the period of 13 years (from 93.54% in 2001 to 88.86% in 2013). Compared with 2001, deposits in China had increased by 6.27 times in 2013. Second, loans still represent the most important use of funds for financial institutions despite a falling share over the same 13-year period (from 73.15% in 2001 to 61.12% in 2013). Compared with 2001, loans in China had increased by 5.4 times in 2013. Third, the most important business activity of financial institutions is to accept deposits and issue loans. Changes in deposits and loans, therefore, have a direct influence on the business performance of depository and lending financial institutions and their socio-economic effects.

Since the mid-1990s, China has been calling for vigorously developing direct finance and reversing the dominance of indirect finance. As can be seen from Table 1.2, on the one hand, the balance of each non-depository and non-lending credit financial product such as Treasury bonds and central bank bonds was far smaller than “balance of deposits” or “balance of loans.” The total balance of non-depository and non-lending financial products only stood at 24,900.4 billion yuan in 2013, accounting for 23.85% of “balance of deposits” and 34.63% of “balance of loans.” Deposits and loans, therefore, represent an indisputably dominant share of credit financial products (such dominance could not be fundamentally reversed by annual financing from share issuance and securities investment funds), and indirect finance still holds sway. On the other hand, other credit financial products have been purchased primarily by depository and lending financial institutions with depository funds received from the real-economy sector. They are supplements to rather than replacements of deposits and loans and fall basically into the category of indirect finance. As can be learned from Tables 1.2 and 1.1, various economic entities (such as the household, industrial and government sectors) consume and operate surplus funds that mainly derive from “depository savings” and receive capital from the financial system mainly in the form of “loans.” In China's financial system, deposits and loans are a key mechanism for concentrating and allocating funds while depository and lending financial institutions are the immediate entities for the concentration and allocation of funds.

The dominance of deposits and loans in China's financial system directly influences the quantity of money and monetary policy operations. As can be seen from Table 1.3, in the 12 years from 2001 to 2012, deposits accounted for more than 90% of M2, and this share tends to further increase (from 93.94% in 2001 to 94.19% in 2012); corporate demand deposits as a share of M1 experienced little change, but remained above 60%. When total deposits and corporate demand deposits made up the majorities of M2 and M1, respectively, their growth rates also determine the growth rates of M2 and M1, respectively. Since the increases and decreases of deposits are determined by the income and spending relationships of economic entities, the increase and decrease of corporate demand deposits are determined by the source of funds for real-economy enterprises and how such funds are used. Corporate demand deposits are not primarily restricted by the quantity of money issued by the central bank. In

Table 1.1 Balance of deposits and loans as a share in financial institutions' assets (Unit: 100 million yuan, %)

Year	2001	2003	2005	2007	2009	2011	2012	2013
Total source (or use) of funds	153,539.78	225,313.26	302,042.84	454,267.97	681,874.78	913,226.33	10,24,067.49	1174,666.17
Various deposits	143,617.17	208,055.59	287,169.52	389,371.15	597,741.10	809,368.33	917,554.77	1,043,846.86
Financial bonds	51.38	2226.27	5672.79	11,505.04	16,203.41	10,038.83	8487.57	6681.0
Various loans	112,314.70	158,996.23	194,690.39	261,690.88	399,684.82	547,946.69	629,909.64	718,961.46
Marketable securities and investments	23,112.65	30,259.47	34,942.13	62,789.96	86,643.15	109,304.11	133,313.92	125,399.38
Share of deposits	93.54	92.32	95.08	85.71	87.66	88.63	89.60	88.86
Share of loans	73.15	70.57	64.46	57.61	58.62	60.00	61.51	61.12

Source: *Renminbi Credit Incomes and Expenditures of Financial Institutions*, website of the People's Bank of China

Table 1.2 Amounts of China's credit and debt financial products from 2001 to 2012 (Unit: 100 million yuan)

Year	Balance of various deposits	Balance of various loans	Balance of treasury bonds	Balance of central bank bonds	Balance of financial bonds	Balance of corporate bonds	Balance of enterprise bonds	Balance of short-term financing bonds	Balance of mid-term notes
2001	143,617.17	112,314.70	10,973.18	—	8418.63	—	336.10	—	—
2002	170,917.40	131,293.93	16,326.93	1487.50	9875.14	—	643.00	—	—
2003	208,055.59	158,996.23	21,034.60	3376.80	11,789.69	—	917.00	—	—
2004	240,525.07	177,363.49	24,176.74	11,707.94	14,507.97	—	1232.50	—	—
2005	287,169.52	194,690.39	26,702.57	22,627.84	19,686.44	—	1801.50	1380.50	—
2006	335,434.10	225,285.28	29,048.17	32,299.65	25,387.92	—	2831.50	2667.10	—
2007	389,371.15	261,690.88	46,502.61	36,586.95	32,269.75	52	4422.10	3203.10	—
2008	466,203.32	303,394.64	48,753.36	48,120.95	40,968.34	400	6803.45	4203.10	1672.00
2009	597,741.10	399,684.82	55,411.38	42,326.11	50,952.26	1038.4	10,970.67	4561.05	8634.65
2010	718,237.93	479,195.55	62,628.29	40,908.83	59,355.94	1641.4	14,511.10	6530.35	13,591.12
2011	817,651.51	547,946.69	73,839.07	21,289.72	76,652.55	2896.6	16,799.49	5023.50	19,742.70
2012	943,943.14	629,909.64	80,735.93	13,439.72	95,197.93	5491.4	23,012.23	—	24,922.00
2013	1,043,846.86	718,961.46	91,780.65	5521.72	88,719.58	13,300.00	23,358.65	—	26,323.40

Notes Treasury bonds include book-entry Treasury bonds and (electronic) savings bonds; financial bonds include policy bank bonds, government-backed institutional bonds, commercial bank bonds, and bonds of non-banking financial institutions; corporate bonds include central SOE bonds, local enterprise bonds, and collective bonds

Source Data about various deposit and loan balances is from the PBoC's website; data about treasury bonds, central bank notes, financial bonds, and corporate bonds is from the ChinaBond website; corporate bond data is from Wind information

the currency structure primarily consisted of various deposits, it becomes difficult for the central bank to use monetary policy instruments to influence the increase or decrease in the quantities of such deposits (Wang Guogang, 2011, 2012).

In economic operation, the growth rate of total investment in fixed assets has direct and increasingly strong effects on GDP growth. In 13 years from 2000 to 2012, China's final consumption rate dropped from 62.3% to 49.5%, and the capital formation rate rose from 35.3% to 47.8%.⁵ Table 1.4 lists the source of funds for total investment in fixed assets in 13 years from 2000 to 2012, from which it can be learned that since 2003, the amounts of funds under the three accounts of "domestic loans", "self-raised funds" and "other funds" accounted for over 90% of total investment in fixed assets and tended to keep increasing (up from 88.51% in 2000 to 94.28% in 2012).

Without a doubt, some of "self-raised funds" and "other funds" are the self-owned funds of investment entities (for instance, a real-economy enterprise invests some of its operating profit, and urban and rural residents invest in business undertakings or housing). Judging by annual profits of real-economy enterprises and the amount of personal investments by urban and rural residents, however, most funds under these two accounts still derived from loans from depository and lending financial institutions in various ways. For instance, in the eight years from 2005 to 2012, the total profits of large industrial enterprises in China stood at 1480.254 billion yuan, 1950.444 billion yuan, 2715.518 billion yuan, 3056.237 billion yuan, 3454.222 billion yuan, 5304.966 billion yuan, 6139.6 billion yuan, and 6191 billion yuan, respectively. Rural household fixed asset investment and investment in housing construction amounted to 394.06 billion yuan, 443.62 billion yuan, 512.33 billion yuan, 595.18 billion yuan, 743.45 billion yuan, 788.6 billion yuan, 908.91 billion yuan, and 984.06 billion yuan. During the same period, however, the combined amount of "self-raised funds" and "other funds" reached 7013.875 billion yuan, 8946.02 billion yuan, 11,676.967 billion yuan, 14,320.487 billion yuan, 19,361.742 billion yuan, 22,404.202 billion yuan, 27,973.438 billion yuan, and 33,465.471 billion yuan, respectively, far eclipsing the total profits of industrial enterprises and the total fixed asset investments of rural households. Hence, the status of lending by depository and lending financial institutions is the key determinant of total investment in fixed assets and GDP growth rate.

The Third Plenary Session of the 18th CPC Central Committee called for giving play to the decisive role of the market in allocating resources. As can be learned from the dominance of savings and loans, depository and lending financial institutions play a decisive role in resource allocation under China's financial system. Thus, the following question can be raised: is the allocation of financial resources determined by depository and lending financial institutions or financial markets during China's establishment of a market economic system? Price is a basic mechanism of resource allocation. Deposit and lending interest rate liberalization reforms not only require a shift from administrative control to market-based interest rates but also entail an adjustment of non-market-based financial systems. In China, most financial resources

⁵ China Statistical Yearbook (2013).

Table 1.3 Balance of savings and comparison with M2 and M1 (Unit: 100 million yuan, %)

Year	M2	Various deposits	Various deposits/M2	Growth rate of M 2	Growth rate of various deposits	M 1	Corporate demand deposits	Corporate demand deposits/M1	Growth rate of M 1	Growth rate of corporate demand deposits
2001	152,888.50	143,617.17	93.94	19.98	16.0	59,871.59	37,366.49	62.41	19.86	13.81
2002	183,246.94	170,917.40	93.27	19.86	19.01	70,882.19	45,352.99	63.98	18.39	21.14
2003	214,358.84	208,055.59	97.06	16.98	21.73	80,815.22	53,585.88	66.31	14.01	18.15
2004	250,802.79	240,525.07	95.90	17.0	15.61	95,971.01	61,833.98	64.43	18.75	15.39
2005	296,040.13	287,169.52	97.0	18.04	19.39	107,279.91	66,222.96	61.73	11.78	7.10
2006	345,577.91	335,434.10	97.06	16.73	16.81	126,028.05	77,744.82	61.69	17.48	17.40
2007	403,401.30	389,371.15	96.52	16.73	16.08	152,519.17	95,500.88	62.62	21.02	22.84
2008	475,166.60	466,203.32	98.11	17.79	19.73	166,217.13	101,790.78	61.24	8.98	6.59
2009	610,224.52	597,741.10	97.95	28.42	28.22	221,445.81	139,997.29	63.22	33.23	37.53
2010	725,851.79	718,237.93	98.95	18.95	20.16	266,621.54	164,536.07	61.71	20.40	17.53
2011	851,590.90	809,368.33	95.04	17.32	13.84	289,847.70	191,968.20	66.23	8.71	16.67
2012	974,148.80	917,554.77	94.19	14.39	15.45	308,664.23	203,448.39	65.91	6.49	5.98
2013	1,106,524.98	1,043,846.86	94.34	13.59	10.58	337,291.05	216,591.39	64.22	9.27	6.46

Source: PBoC's website; Data on "corporate demand deposits" in 2001 and 2002 is from *China Financial Statistics (1949-2005)*