

Not Interested: Political Incentives and the Uneven Path Toward Interest Rate Liberalization in China

Victor Shih

Department of Political Science, Northwestern University

Presentation at the Politics of Economic Decline Workshop at Texas A&M University

May 2, 2009

Abstract: Nearly two decades after central bankers began to call for interest rate liberalization, the central bank continues to impose stringent rules on the fluctuation of lending and deposit rates. This seems an unlikely outcome given widespread endorsement of liberalization by technocrats and experts both in and out of the government, China's accession to the WTO, and the technocrats' insulation from popular pressure. Senior Chinese technocrats were motivated to retain control over interest rates by their need to mobilization bank funds to finance massive investment drives. Control over interest rates allowed senior technocrats to do so with ease even during economic downturns because the mandated interest spread guaranteed healthy profits for banks. To maintain that control, technocrats repeatedly suppressed unregulated financial institutions offering higher deposit rates and repeatedly delayed the liberalization of official interest rates.

Interest rate liberalization has been the rallying call of reformers both inside and outside of China for decades. However, despite decades of discussion by the academic community as well as technocrats in the central bank, full liberalization of interest rates remains out of reach. In sharp contrast to the “Chicago Boys” reform carried out in Chile (Silva 1996), this is a case in which insulated technocrats made sure that they retained key macroeconomic levers with which to deal with the main threats of inflation and slow growth and to appease key vested interests. These incentives retarded interest rate liberalization in two ways. On the one hand, high inflation usually led to spontaneous interest rate liberalization as depositors withdrew money from the state banks, which paid negative real interest rates, in favor of underground banks paying market rates. To maintain the state banks’ oligopoly, central technocrats time and again suppressed these unregulated financial institutions. On the other hand, slow growth required technocrats to pump billions to infrastructure projects and to large state owned enterprises (SOEs), and interest rate restrictions, especially on deposit rates, allowed central technocrats to do so while maintaining bank solvency and limiting fiscal deficit. Chinese accession to the World Trade Organization (WTO), ironically, strengthened senior technocrats’ incentive to control deposit interest rates because it presented a way to limit foreign competition while still adhering to the “national treatment” clause.

While the economic rationale for interest rate liberalization is quite clear, the reason why official interest rate liberalization has proceeded at such a slow pace seems puzzling, especially given that it remains incomplete nearly two decades after prices liberalized for nearly every other good or service (Wedeman 2003). The general consensus on interest rate liberalization among both Chinese and Western economists, as

well as among a large contingent in the central bureaucracy, suggests that ideas cannot explain this slow pace of reform (Williamson 1994; Harberger 1993). Politically powerful actors were on both sides of the issues, so a theory of rent-seeking coalition does not fully explain the slow pace of reform. The top leadership has time and again shown its ability to trump the rent-seekers through manipulating the Party *nomenklatura* and by giving out selective incentives (Shirk 1993; Shih 2008). Yet, they were reluctant to do so in this case. Explanations that involve pro-reform technocrats or an insulated elite implementing reform also hold no water here because interest rate liberalization has been repeatedly frustrated by senior technocrats insulated from popular pressure (Nelson 1995; Rodrik 1996). Although there is a dedicated group of technocrats lobbying for reform, they repeatedly failed to carry out full liberalization due to intervention by higher level technocrats.

Rather, the political incentive of the top economic technocrats at the Premier and vice-premier level seems to provide the answer to the puzzle. Because top technocrats are evaluated on the basis of their ability to solve pressing economic issues, control over interest rates allowed them to fulfill a host of objectives, especially their ability to minimize explicit central deficit, pump massive funds to infrastructure projects and large SOEs, and maintain short-term solvency of the banking sector during cyclical downturns. Although senior technocrats have not been removed from power for failing to perform a given task, they have been forced to give up a policy portfolio for perceived failure. When former Premier Zhu Rongji was forced to give up the SOE portfolio after fellow Politburo members charged that his SOE restructuring plan was creating too much unemployment, his prestige suffered a terrible blow (Fewsmith 2001: 213). In similar

ways that Latin American and Former Soviet Union technocrats introduced “political bias” to reform policies that resulted in “partial reform,” Chinese technocrats selectively implemented reform to retain key levers over the economy (Murillo 2002; Kessler 1998; Hellman 1998). The imperative to retain control repeatedly frustrated interest rate liberalization, despite spontaneous episodes of interest rate liberalization at the local level and active lobbying and agenda setting by central bank officials of the People’s Bank of China (PBOC).

Looking comparatively, the slow pace of interest rate liberalization was made possible by the state’s persistent ability to impose financial repression and capital control on the economy (Haggard and Lee 1993). However, Murillo(2002) shows that even when economic reform is imposed by the IMF in the aftermath of financial crises, politicians and technocrats could still implement policies in a way that benefited their own support coalitions. In this light, senior Chinese technocrats behaved no differently. Their actions were constrained by the need to minimize short-term economic pain and to provide financing to various politically powerful interests. In achieving these outcomes, they sought the least costly way, which was the mobilization of a banking sector tightly under their grip. The economy as a whole, however, sacrificed long-run efficiency to allow technocrats to solve these short-term problems.

The discussion below is divided into three major parts. First, the paper will describe the process of setting interest rates in China, shedding light on how politically relevant actors influenced the process of liberalization. It will then fully describe the incentives facing relevant actors in interest rate policies and why they might support or oppose liberalization. The third section will describe the several liberalization cycles and

closely examine the factors that led to local liberalization and the eventual crackdowns from the center, as well as the factors that contributed to the gradualist pattern in interest rate liberalization.

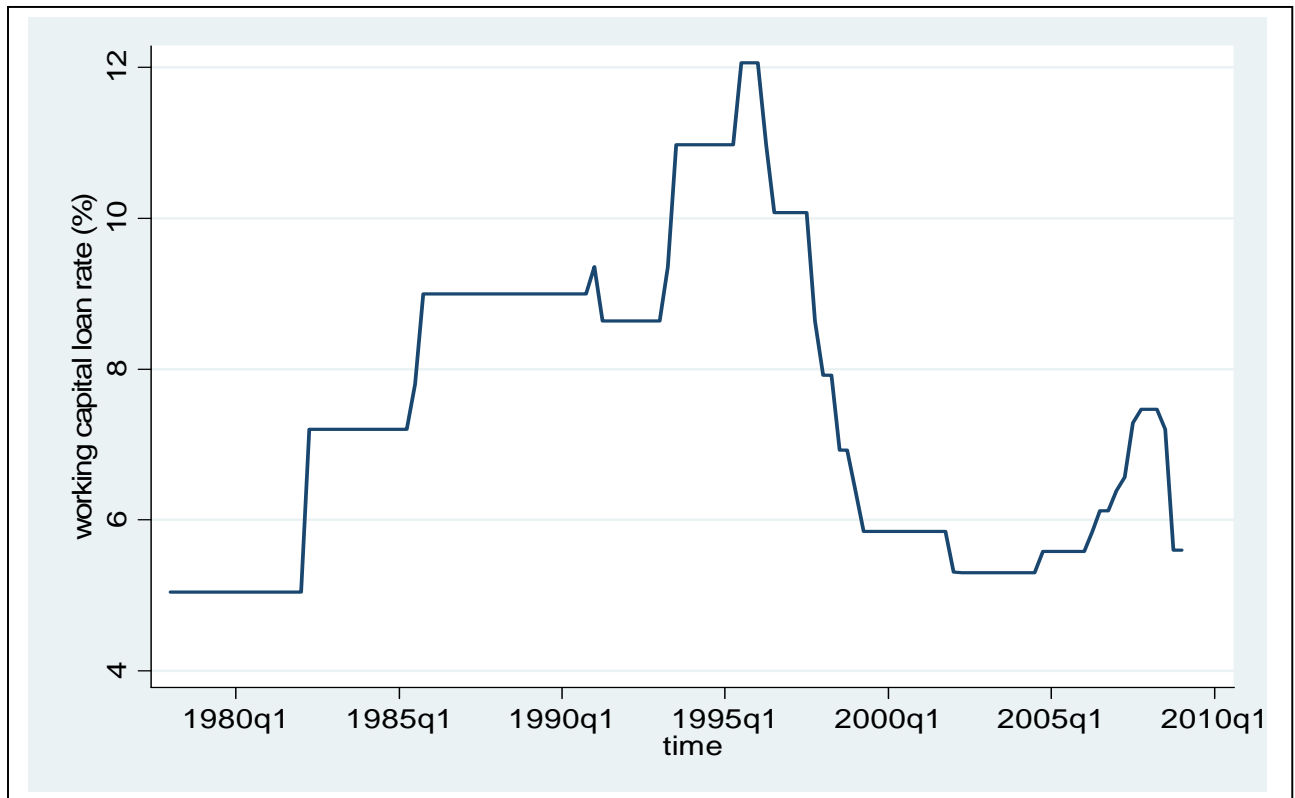
A Passive Interest Rate

Theoretically, interest rate is the equilibrium price of money. It reflects the opportunity cost of spending or investing today rather than tomorrow and the reward that savers reap for forgoing current consumption. As an important market signal, it has a bearing on whether individuals spend or save money, hold cash or deposits, and whether firms invest or not. In China, however, interest rate has not conveyed the equilibrium price of money, but merely served as a pale reflection of the government's monetary policy. The decisions that in a liberalized money market would be determined by interest rates instead have been determined by government administrative policies in China.

Until the mid-90s, the flow of money was determined by the credit plan, which specified the amount of borrowing and lending that each sector, province, and bank could undertake in a given year. This system relegated the other monetary instruments to supplementary roles. Interest rate adjustments were seldom used as a way to affect money supply, and money supply seldom influenced the price of money. At various times, due to high inflation and slow government action, real interest rates in China were negative. The only exception was the adoption of inflation-indexed deposit rate in 1988 and in 1994 to prevent savings from flowing out of the banking system into either underground banks (discussed below) or abroad (Su 1992). Even in those instances, interest rate adjustments only had the limited goal of influencing depositor behavior. As seen in

Figure 1, lending interest rates fluctuated only five times before the mid 1990s, while lending fluctuated wildly during the same period.

Figure 1: 1-Year Working Capital Lending Interest Rate: 1978-2009 (Quarterly)¹



Into the mid 90s, especially after the 1993 inflation, the Chinese government adjusted interest rate more frequently as part of its monetary policy. While interest rate did not reflect the equilibrium price of money, it began to factor into the costs-benefit analysis of the various interest groups in China. In this way, interest rate became a way through which the central government provided subsidies to politically influential groups. Specifically, the PBOC quickly expanded the categories of interest rate beginning in the late 80s and into the 90s such that by the mid 90s, different interest rates applied to

different sectors, types of firms, and types of financial institutions. For example, SOEs enjoyed lower lending interest rate than collectives, which in turn benefited from lower interest rate than private enterprises (Bo et al. 1996). As will be discussed in further details, this allowed SOEs, which received preferential rates, to arbitrage their cheap capital in the underground financial market for a healthy profit.

Because interest rate began to matter to a host of governmental interest groups, they began to actively intervene in interest rate adjustments. According to a central bank researcher, setting interest rate involved the different ministries, the Big Four banks (Bank of China, the Construction Bank, the Agricultural Bank, and the Industrial and Commerce Bank), the Ministry of Finance, the State Council, and the PBOC (Luo 2001). This bargaining process was formalized with the formation of the Monetary Policy Committee (*huobi zhengce weiyuanhui*) in 1997. The members of this Committee, all appointed by the Premier, included the governor of PBOC, two vice governors of the PBOC, two presidents of the Big Four banks, head of the State Administration on Foreign Exchange (SAFE), the head of China Securities Regulatory Commission (CSRC), and 11 representatives from other economic agencies and the academy (Luo 2001). Needless to say, this Committee merely provided suggestions on interest rate adjustments, which needed the approval by the premier.

In this manner, a veteran PBOC researcher describes interest rate adjustment as "a bargaining process between the different interests that produces a political equilibrium, not an economic one " (Xie 1995b). Because of this bargaining process, the PBOC at times set interest rates that were against the monetary target, such as lowering rate for SOEs even though the goal was to reduce money supply. Into the 21st century, money

¹ Quarter-end figures. Source: (Babic 2008)

supply targets were achieved through administrative measures such as relending operations (*zaidaikuan*), reserve requirement adjustment, and minimum lending targets (Ren 2000). When inflation accelerated in late 2007, the central government successively raised interest rates, but soon discovered that a credit ceiling was necessary to control money supply (Jia 2007). The need to re-impose a credit ceiling to control inflation, however, continued to discredit interest rate as an effective tool of monetary policy.

The Main Interests For and Against Liberalization

Given the distributive consequences of interest policies, what were the bureaucratic entities that supported and opposed interest rate liberalization? In brief, large SOEs and the state banks opposed interest rate liberalization because it increased their cost of capital, decreased their profit margin, and, in the case of the SOEs, decreased their ability take advantage of the arbitrage. The Ministry of Finance also fought liberalization because existing interest rate policies decreased the explicit deficit of the central coffer in myriad ways.

The main proponents of liberalization included a subset of technocrats within the PBOC and the local governments, which preferred liberalization for professional reasons and in order to increase local development. Local officials, however, can be compensated by investment projects financed by the state banks. Thus, they were only weakly in favor of interest rate liberalization. Other beneficiaries of interest rate liberalization, namely the depositors and private enterprises, have thus far played little role in the policy process because they were actors outside of the regime. Ultimately, however, interest rate liberalization in China has progressed slowly because the Premier

and other senior leaders in the State Council had a strong disincentive to promote its advancement.

The Large SOEs

The large SOEs in China were against interest rate liberalization for the simple reason that they benefited from the inflexible interest rates. SOEs gained from the status quo in two ways. First, they received explicit subsidies through low or even subsidized lending interest rates. For example, the State Council implemented the policy of providing "closed-ended loans" (*fengbi daikuan*) to distressed SOEs with a potentially profitable production line. Banks were required to provide this loan with a specially low interest rate (Bureau of Economic Prediction of the State Information Center (Guojia Xinxi Zhongxin Jingji Yucebu) 1999). As many SOEs had over due loans and were supposed to pay a stiff penalty for them, the PBOC also drastically lowered the penalty interest rate for overdue loans to relieve their burdens (The People's Bank of China 1999).

Implicitly, however, even without mandatory lending interest rates, the Big Four banks had an incentive to over-lend to large SOEs, especially after 1998. In 1998, Premier Zhu Rongji implemented a system to hold bankers responsible for non-performing loans, but also demanded banks to lend sufficiently to maintain economic growth and to generate a profit. Within a few years, the China Banking Regulatory Commission was formed to monitor banks' non-performance loan (NPL) ratios (Heilmann 2005). Under the crossed pressure to lend massively and to limit NPL ratios, banks fulfilled their lending quota by pouring money into firms that had minimal

bureaucratic risk. In other words, banks sought out firms they knew were protected by government policies or would be bailed out by the government in the event of default.

Their favorite clients included SOEs that had received central government blessings, as well as SOEs and state corporations that had recently offered their shares publicly. Since most publicly traded state firms have also undergone debt-to-equity swaps, their asset-to-liability ratios were likely to be much lower. They were more likely to meet interest payments in the short-run. Moreover, a publicly traded company also signaled to banks that the SOE enjoyed the protection of the government (Chen 2000). Besides publicly traded SOEs, banks also favored large SOEs, especially those that were on the list of "key point enterprises" (*zhongdian qiye*), because, again, lending to them entailed less bureaucratic risk for managers in the event of a default.² Rather than evaluating firms based on their commercial or liquidity risk profiles, bankers lent to firms based on the *bureaucratic* risk profile of these firms.

With cheap and easy access to capital, SOEs set up their own finance companies to lend out capital at the black market rate or to speculate in the real estate or stock markets. While some profit from this arbitrage benefited the SOEs, much of it also went into the pockets of SOE officials (Xie 1995b). In a liberalized financial system with real competition between banks, banks would lend to more profitable private enterprises, depriving SOEs access to cheap capital. While liberalization might force some SOEs to adjust to the new environment, the vast majority of SOEs, which had been kept alive through interest rate subsidies, would make even more losses. As we will discuss later, central technocrats had little interest in this outcome.

The State Banks

The Big Four banks opposed interest rate liberalization because they preferred the existing situation of guaranteed profits. First, the Big Four were strongly in favor of mandatory interest rate on deposits because it prevented banks from engaging in "ruinous competition" with each other to attract deposits, which would increase interest payment to depositors and lower the banks' profitability (Xie et al. 2001: 31).³ Until recently, PBOC set the rates for lending and deposits (Zhou 2002). As seen in Figure 2, the spread between mandatory loan and deposit rates before the mid 1990s guaranteed a modest profit for state banks. The exceptions were periods of high inflation, when deposit rates were boosted to prevent capital flight from the formal banking sector. During these periods, the state banks were under threat from unregulated banks, which paid depositors inflation indexed, market determined rates. To prevent the outflow of funds to these underground institutions, the government has had to repress these institutions while offering higher deposit rates to depositors. Banks thus clearly had an interest in squashing unregulated institutions.

As the Big Four state banks prepared for listings in the Hong Kong and mainland stock markets in the late 1990s, the central bank ensured that there was a healthy spread of at least 3.5% between deposit and loan rates to give banks billions of RMB in guaranteed profit (Dai 2002). As discussed below, the upper bound on loan rates was removed in 2005, but banks still could not charge loan rates lower than the PBOC benchmark rate. Thus, with the continuation of control over deposit rates and a lower bound on loan rate, banks continued to enjoy a nice spread between deposit and loan

² Interview in Beijing: 11/27/00; Shenyang: 12/26/00; Dalian: 5/23/01

³ Interview in Beijing: 6/23/01

rates. As long as banks were held to these bounds and few unofficial banks existed to compete with the official banks, they were still guaranteed a sizable profit.

The Big Four banks were especially weary of the prospect of competing for deposits because they were saddled with large number of NPLs, which required them to use profit to write them off (Shih 2005). If the cost of capital increased, they would be less able to write off these NPLs, which would necessitate a larger bailout of the banks by the treasury. In this respect, banks had an ally in the Ministry of Finance (MOF) and senior technocrats because both had an interest in banks handing in as much net "profit" as possible over to the government.⁴ Moreover, senior technocrats wanted banks' cooperation in massive spending programs during economic downturns. Fixing deposit rates to guarantee a handsome profit to banks when they lend was a powerful motivator to encourage lending.

Instead of facilitating interest rate liberalization, the introduction of foreign banks after China joined the WTO in reality strengthened domestic banks' preference for fixed deposit interest rates. Although all banks benefited from the interest spread, foreign banks were limited in the amount of lending it could conduct by restrictions against cross-border movement of capital and complex procedures on opening new branches to take in deposits (China Banking Regulatory Commission 2006). Thus, the interest spread disproportionately benefited Chinese banks, which already had a large deposit base. Foreign banks mainly competed with Chinese banks in providing new services to depositors and investors (Luo 2007). Deposit rate liberalization would significantly

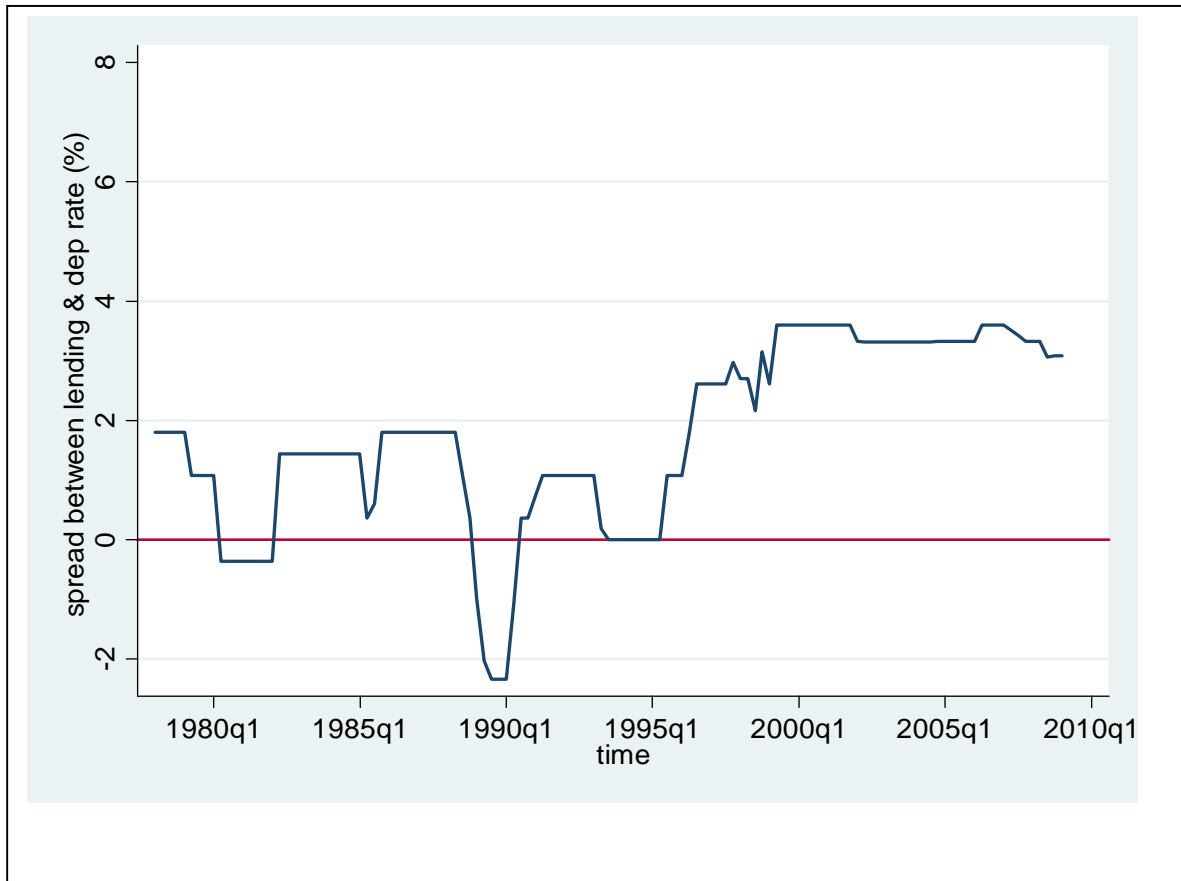
⁴ Every year, the Big Four banks and the MOF fight over how much of bank "profit" would be used toward writing off bad debt and how much would be remitted to the MOF. Both entities, however, preferred a larger size of the "profit." Interview in Beijing: 5/14/01.

decrease the interest spread profit enjoyed by domestic banks, thus making them less competitive vis-à-vis foreign banks.

Besides the fear of deposit competition, the Big Four banks have also acquired large quantity of low yield treasury bonds in recent years in an effort to diversify their portfolio and to lower the NPL ratio. Banks have been able to buy up bonds and still make a slight profit because PBOC rediscounting and bank deposit interest rates cost banks slightly less than what they made from interest paid by bonds.⁵ By March of 2009, the main domestic banks held over 2 trillion RMB (294 billion USD) in government bonds, as well as another 2 trillion RMB in bonds issued by the policy banks, which helped finance government projects (Central Bond Clearance Company 2009). Rather than trading these bonds actively in the repurchasing market, the state banks mostly sit on these bonds and collect the slight profit paid by these papers (Aredy 2002). But this situation further committed the banks and the central government to fixed deposit rates. Banks, which held large quantities of government bonds, would have faced a serious loss if interest rate liberalization led to higher yields on new bonds due to the inverse relationship between the price of existing bonds and the yield of new bonds. The government would then have to engage in costly compensation to the banks and also pay higher yields on newly issued bonds.

⁵ Interest paid by bonds can be slightly lower than deposit interest rate, especially for short-term bonds. Nonetheless, after subtracting deposit tax from the deposit interest payment, deposit rate is lower than interest paid by bonds. While the Ministry of Finance is supposed to collect the deposit tax, it is unclear how much the banks give to the Ministry of Finance and how frequently the tax is collected from the banks. Interview evidence confirms that banks are able to make a profit by buying bonds, which suggests that banks are benefiting from the deposit tax in some manner. Interviews in Beijing: 5/14/01, 6/23/01. Also see (The Monetary Policy Analysis Team of the PBOC 2002)

Figure 2: Interest Spread between 1-Year Deposit and 1-Year Loan Rates, 1978-2009⁶



The Ministry of Finance

The Ministry of Finance also disapproved of interest rate liberalization because it increased the cost of financing the deficit, especially during economic downturns when the need to engage in deficit spending increased. Because a minister of finance was often evaluated by the size of the explicit deficit, the MOF constantly sought to reduce the

⁶ Source: (Babic 2008)

short-term, explicit deficit.⁷ Former Minister of Finance Xiang Huaicheng told Western analysts that "...China's leaders, especially the economic leaders, are very cautious with respect to debt. We shut the doors, and we discuss these issues every day"(Studwell 2002). Again, strict limitation on non-performing loans encouraged banks to lend to "safe" entities related to the state and to purchase low yield assets such as treasury bonds (The Monetary Policy Analysis Team of the PBOC 2002). A fixed deposit interest rate prevented "ruinous competition," thus guaranteeing banks a small profit even if it invested in low yield treasuries. Interest rate liberalization would cause banks to compete for depositors by increasing deposit rates, thus enlarging the cost of capital. This would force banks to deploy capital toward higher yield assets, such as loans and corporate bonds. In the primary market for bonds, the MOF would have to offer higher yields to attract buyers, which would further exacerbate the deficit. Although liberalization of deposit rates would also increase the pool of deposits in banks, China's already high savings rate meant that the marginal increase of deposits from liberalization was likely to be insignificant.

In economic downturns, low borrowing rates constrained the cost of financing SOE losses at a manageable level, which also decreased the explicit budget deficit of the government. Again, this was achieved through explicit preferential treatment of SOEs and banks's bias in favor of lending to firms with bureaucratic connections. The low interest rate also gave banks and other financial institutions an incentive to invest in other low yield instruments that lowered the deficit, such as bonds issued by the policy banks and stocks issued by SOEs. Without mandatory, low interest rates, banks and investors

⁷ This did not mean that the MOF cared about the long-term or latent deficit situation. For example, the MOF did not mind at all that it would have to pay for NPLs not recovered by the AMCs in the future. The

would demand higher yields for bonds issued by policy banks and would, in the case of IPOs for SOEs, offer less money for these loss-making entities. All of this would increase the central treasury's cost of financing state construction projects and of keeping SOEs afloat.

PBOC Technocrats

Despite the wide array of interests that opposed liberalization, a group of technocrats in the PBOC has consistently lobbied for liberalization since the mid-90s. It is difficult to discern why they have so persistently advocated liberalization. Part of it doubtless stemmed from a genuine desire to conform the Chinese banking system to that in the West. These PBOC officials were also frustrated by the constant intervention by the State Council and other ministries in monetary policies. If interest rates liberalized and became strictly a tool for monetary policies rather than a channel for subsidies, PBOC officials hoped that administrative intervention from the other ministries, if not the State Council, would decline.⁸

According to these technocrats, the liberalization of interest rate would give banks, especially joint-stock banks, the incentive to lend to the vibrant private and joint-venture sector, creating jobs, and increasing the efficiency of the financial system (Xie et al. 2001: 29) The inability to change interest rate and the campaign against "financial risk" also compelled banks to put large amount of excess reserve at the PBOC, which increased PBOC interest payments (He 1998).

In making their argument for liberalization, they were helped by the growing consensus in academia and in government think tanks in favor of interest rate

MOF supported the AMCs because it decreased the short-term fiscal pressure on the treasury.

⁸ Interview in Beijing: 5/14/01.

liberalization. By 2001, there were hundreds of articles written by bankers, officials from various ministries, and academics advocating interest rate liberalization each year (Table 1). Of the articles listed in Table 1, the authors are identified in a minority of cases, and they included both government technocrats from various agencies and academics. The barrage of articles on the issue shows that the lack of intellectual support was hardly the main cause of the slow pace of reform in interest rate.

Table 1: The Number of Academic Articles on Interest Rate Liberalization⁹

<i>Year</i>	<i>Articles with Interest Liberalization in Title</i>	<i>Year</i>	<i>Articles with Interest Liberalization in Title</i>
1994	35	2002	280
1995	25	2003	366
1996	60	2004	280
1997	31	2005	229
1998	24	2006	217
1999	25	2007	156
2000	122		
2001	229		

Local Government and Local PBOC

Besides technocrats at the PBOC's headquarters, the other set of relevant actors in favor of interest rate liberalization was the local government and the local PBOC in prosperous regions. While local governments in poorer regions heavily depended on

⁹ The data come from a key word search on the China Academic Journal (CAJ) electronic database of Chinese journals. The search counted the number of articles with titles that include "interest rate" and "reform" (*lilu, gaige*), "interest rate" and "liberalization" (*lilu, ziyouhua*), or "interest rate" and "marketization" (*lilu, shichanghua*).

subsidies, the local governments along the prosperous East Coast had an interest to ensure adequate flow of capital to the private and collective enterprises in their respective jurisdictions. Because their promotions depended on local growth, and local growth increasingly depended on the development of local private and collective enterprises, these officials wanted a free money market to supply adequate capital to these enterprises. As such, local governments have consistently been on the forefront of experimenting with interest rate liberalization and in sheltering underground financial institutions that ignored PBOC interest rate policies. For example, rural credit cooperatives (RCCs) in Wenzhou experimented with charging interest rate that was 100% higher than the mandated rate as early as 1980 (Bo et al. 1996). For the next two decades, RCCs and even branches of the Big Four banks in Wenzhou have pushed the envelope with PBOC policies and were frequently the target of central crackdowns (Bo et al. 1996). In a publicly circulated article, PBOC officials at the Wenzhou branch even boasted about their violation of official PBOC policies and their efforts to "experiment" with interest rate policies (Bo et al. 1996). At the same time, unregulated financial institutions, which provided a substantial part of the financing to the private sector, have long charged market interest rates in these localities (Tsai 2002).

Local PBOC officials had another reason to support liberalization of interest rate: to reduce the monitoring costs of maintaining interest rate policies. In 2002, the PBOC had to monitor over 70 types of interest for commercial banks, 36 types for policy banks, as well as an additional 14 types of subsidized interest. Essentially, because the center manipulated mandatory interest rate to allocate rent to regions, sectors, and policy areas,

the PBOC had to ensure the proper interest rate applied to every major loan (Xie et al. 2001: 28). This caused a regulatory nightmare at every level of the PBOC.

Senior State Council Technocrats

The most decisive actors were the senior State Council bureaucrats at the Premier and vice-premier level. Their command overrode the individual wishes of all the previous interest groups. For the senior technocrats, firm control over deposit and loan rates constituted a powerful tool for the government's effort to boost short-term growth, contain the deficit, and to fulfill a host of policy objectives. With the need to maintain growth through massive investment and the opposite need to constrain deficit at a reasonable level, control over interest rate became crucial in ensuring that both objectives could be achieved. During periods of high inflation, technocrats had to protect the state banking system by squashing episodes of spontaneous interest rate liberalization. During economic downturns, when massive government spending became necessary, the state banking system and low fixed interest rates became handy tools of economic revival. Mandatory deposit rates provided domestic financial institutions a slight profit from buying low yield government securities, thus decreasing the cost of financing deficit. With managed interest rate, high level technocrats could also ensure a healthy profit for the banks. Interest rate policies also allowed the government to "rescue" SOEs and to engage in massive infrastructure spending at relatively low costs.

With strict control over China's vast financial resources, top technocrats could claim credit for "solving" China's myriad problems. In this way, the interest of the Premier and other top-level technocrats were aligned with the interest of the pro-status quo groups. If the banks, the Ministry of Finance, and the large SOEs produced positive

performance indicators due to interest rate policies, the Premier would also be judged in a positive light. Even supposedly pro-market premiers such as Zhu Rongji and Wen Jiabao decided to delay interest rate liberalization in order to achieve these policy objectives.

A Tortuous Path Toward Liberalization

Since the reform, spontaneous episodes of interest rate liberalization have taken place at the local level in periods when the local government had relative autonomy over economic policies. Nonetheless, the central economic bureaucracy, which had the option of endorsing and legitimizing liberalization, consistently brought its full might to quell illegal deposit taking and lending as part of anti-inflation drives. During economic downturns, official interest rate liberalization was stalled in order to provide cheap funds to countercyclical investment drives. Thus, time and again, top bureaucrats of various ideological stripes found interest rate too useful a policy tool to let go. As a result, formal interest rate liberalization has proceeded in fits and starts, never quite reaching the point of full liberalization. To the extent meaningful liberalization occurred, they took place between economic shocks. In the most recent episodes of economic downturns, interest rate control once again showed its full potency, as the government used the interest rate spread to encourage banks to provide massive funds to China's stimulus program.

Policy at the Top and Counter-policies at the Grassroots

The first and perhaps the most far-reaching single step in interest rate liberalization took place in 1981, when the central government allowed banks to fluctuate the rate they charged SOEs for working capital loans to within 20% of the PBOC official

rate (The State Council 1983). Previously, banks had no right to deviate from the official rate set by the PBOC on any loans. At the same time, local level financial institutions had begun to experiment with interest rate liberalization because state policy remained too rigid for the nascent private sector. In Wenzhou, where many of China's nascent private firms were located, rural credit cooperates began charging interest rate that was twice as high as the PBOC mandated rate (Bo et al. 1996). Meanwhile, underground banks, or associations (*hui*), with no ties to the states began to attract deposits by promising illegally high interest rate (Tsai 2002). From the beginning, the local government and the local PBOC in some localities were supportive of or were at least tolerant of these institutions. Rather than trying to extinguish them, they encouraged RCCs to compete with underground banks through further interest rate liberalization such that by 1986, over 78% of the RCCs in Wenzhou charged interest rate significantly higher than the PBOC mandated rate (Bo et al. 1996).

When inflation reached an alarming level in late 1985, the central authorities, then controlled by veteran planner Chen Yun, swooped in to re-impose financial order, but also to investigate cases of "chaos" (*luan*) among local financial institutions. During periods of high inflation, real interest rates paid by the state banks became negative, thus prompting depositors to withdraw large sums of money from the official banking system in favor of underground banks, which paid much higher interest to depositors (Zhou 2000; Huang 2000). To combat such competition, the PBOC issued an edict that forbade all forms of competition for depositors and borrowers through "illegal means" (*feifa shouduan*), namely interest rate adjustments. It also forbade local government from issuing "financial business licenses," which local government had apparently used to

sanction underground banks (The People's Bank of China 1986). 1986 saw the bankruptcy and closure of a string of illegal financial institutions in Wenzhou which had engaged in speculations of various sort (Zhang et al. 2002). It is unclear, however, whether their failure was due to central retrenchment policies, which deflated asset prices, or to fraudulent practices, as the government claimed.

Despite this setback, local PBOC in Wenzhou continued to experiment with greater flexibility with both deposit and lending interest rate for both RCCs and branches of the Big Four banks (Bo et al. 1996). Moreover, underground financial institutions soon reappeared in various coastal cities. The high inflation in 1988 and 1989 once again imposed another round of crackdown on local liberalization initiatives and on underground banks (The People's Bank of China 1989). Rather than allowing interest rate liberalization to spread, as in the case of the household responsibility system, the central technocrats, this time led by Li Peng, chose to squash all "illegal practices."

A new interest rate liberalization cycle began in 1992 after Deng's Tour of the South. Not only did it galvanize local developmental efforts, it also encouraged local government to experiment with interest rate liberalization and to allow the flourishing of underground financial institutions. In Wenzhou, rather than just credit associations, 1992 saw the formation of financial companies, leasing companies, agricultural cooperation societies, and stock ownership transfer consulting services companies (*guquan zhuanrang zixun fuwu suo*), all of which were underground banks implicitly sanctioned by the local authorities (Zhang et al. 2002). While many of these entities were fraudulent schemes, the fact that they consistently provided more capital to the private sector than the state banks indicated that they served an important function in prosperous localities. In a 2001

survey of Fujian farmers in Lianjiang County, legal financial institutions provided merely 10% of farmers' working capital needs, while underground institutions provided 40%. Another study in 2001 reveals that most lending needs in rural Zhejiang, Fujian, and Guangdong were filled by underground banks (Cui et al. 2001). The underground banks' ability to charge market interest rate allowed them to allocate money much more efficiently than the state banks. Despite repeated claims by the PBOC that underground institutions were pyramidal schemes, available evidence suggests that they served a vital function in the local economy. Nonetheless, to maintain the oligopoly of the state banks, these underground banks were repeatedly dismantled by the authorities during periods of high inflation when they took large sums of deposits away from the official banks.

Rise of Pro-Liberalization Technocrats

After the retrenchment in 1993, however, local governments gained a useful ally at the center. A group of pro-market technocrats in the PBOC had been promoted to positions to influence policies. While their efforts still has not brought about liberalization because of the leadership's opposition, their role as agenda setters for the regime's policies brought about important changes on the margin. When the reform-minded Zhu Rongji took charge of the financial portfolio as vice-premier in 1993, their influence on the agenda clearly rose. At the National Finance Conference in July of 1993, Zhu told cadres that "(we should) on the basis of the base interest rate, regulate the scope and level of the financial institutions' flexibility to adjust interest rate"(Zhu 1998). This sentiment was formalized in the December State Council Document "Decision Concerning Financial System Reform," which called for the PBOC to "determine the upper and lower limit for interest rate fluctuation" (The State Council 1998). This

wording implied much more flexibility for banks to set interest rate than the previous system of mandatory rates.

In 1995, Xie Ping, then a rising star in the PBOC, published two articles that provided a blueprint for interest rate liberalization (Xie 1995a, 1995b). According to Xie, the PBOC should first liberalize interbank rate, then allow banks some flexibility with loan rate. The government could then open up the rate for the bond market, which would create a market link between the bond market and the interbank market. Fourth, the PBOC should free up repurchasing rate and stop paying banks interest for reserves to encourage them to participate in the capital market. Fifth, the government should allow banks to float lending interest rate within a certain band. Finally, banks should be allowed to experiment with floating deposit rate within a certain band.

Since the mid-90s, interest rate liberalization has proceeded more or less according to Xie's plan because of the tireless lobbying efforts by PBOC technocrats, but the pace of liberalization has been much slower than what these technocrats had hoped.¹⁰ Attempts to commit to a strict schedule for liberalization were repeatedly frustrated, despite a growing consensus among bankers, academics, and government officials that interest rate liberalization would vastly improve the efficiency of capital allocation in China.¹¹

During Zhu's remaining tenure as vice Premier, the PBOC implemented a series of reform measures in the capital market that were supposed to lay the groundwork for full liberalization. In 1996, the rate in the interbank lending market was liberalized such that participants in the interbank market could determine loan rate depending on the

¹⁰ Interviews in Beijing: 1/3/01, 5/14/01.

¹¹ Interviews in Beijing: 6/23/01, 6/27/01.

demand for money at a particular moment. In the following year, the PBOC liberalized the rate in the interbank bond and note market, which allowed banks to borrow at a market price. However, the equilibrium price at the interbank market, as well as the supply and demand for funds, were still distorted by the mandatory rates for lending and deposits.

The Asian Financial Crisis and Reversals

The Zhu Administration began with a hopeful note for those in favor of interest rate liberalization. The Asian Financial Crisis and the resulting slowing of growth, however, scuttled interest rate liberalization. In early 1998, the PBOC resumed open market operations, which gave the PBOC a powerful tool to control money supply that would one day replace strict interest rate policies. Later in the year, the primary market for policy bank bonds also liberalized, which gave both the PBOC and commercial banks an additional instrument to manage liquidity flow. In the mean time, the PBOC allowed commercial banks to increase deposit rate to 10% above the official rate and loan rate for small and medium enterprises to 30% above the official rate (Bi 2000).

In 2000, the long awaited interest rate liberalization finally seemed reachable. In July, PBOC Governor Dai Xianglong announced a definite plan to liberalize interest rate in three years. Technocrats in the PBOC and others who supported liberalization went on a propaganda blitz in support of the timetable, arguing that the macro conditions for liberalization were finally ripe. Those in favor argued that liberalization could finally take place because the huge size of the banking system would mitigate any harmful effects of the liberalization. Any problem that arose was likely to be small relative to the size of the banking sector (Luo 2001; Zhou 2000). In September of 2000, the PBOC

further announced that interest rate on foreign currency deposit would be set by the China Bank Association, a newly formed government directed association of bankers (The Asian Wall Street Journal 2002). For foreign exchange deposits above 3 million dollars, the banks and the depositors could negotiate an interest rate, subjected to PBOC approval (The People's Bank of China 2000). Full interest rate liberalization seemed within grasp.

However, Premier Zhu Rongji was increasingly under pressure to generate growth in the aftermath of the Asian Financial Crisis. Growth in China fell below 8% in 1998 and 1999 and remained anemic in 2000. In spring of 2001, Zhu ordered Dai to abandon the three-year time table and to change the time frame to a vague "five to ten years" (Gilley and Murphy 2001). While the Big Four banks lobbied for the delay, the ultimately decision was made by Premier Zhu. An informant who worked closely with Zhu on financial policies stated that Zhu intentionally delayed interest rate liberalization in order to deal with a host of other issues, including maintaining growth rate and rescuing SOEs.¹² In late 1999, the Politburo Standing Committee also decided to launch an enormously expensive infrastructure building program for Western China (Zhu 2001). Ultimately, the state banks provided over 600 billion RMB in loans to finance this campaign, and interest rate control, which minimized capital costs for banks and encouraged banks to finance state approved projects, made this drive much less costly than otherwise (Research Team of the CASS Western Development Research Center 2003).

As in previous cases, a reversal did not put liberalization completely on hold because agenda setters within the PBOC continued to propose new reform measures. For example, Dai Xianglong announced at the beginning of 2002 that banks could set interest

rate for loans to small and medium enterprises up to 50% higher than the PBOC rate. Previously, banks could only set this rate at 30% higher than the PBOC rate (People's Daily 2002). In a low interest environment, however, the loosening of interest rate regulation translated into a mere 2% leeway for banks. Later on, the PBOC approved experiments that allowed lending interest rate for RCCs to increase to twice as high as the PBOC rate. Two decades after Wenzhou RCCs instituted the same measure, the PBOC finally gave its seal of approval to *experiment* with this interest rate. As one research report on this reform points out, however, even allowing interest rate to float to twice as high as the official rate still meant that lending and deposit rates were over 10% lower than the black market rate (Research Team of the PBOC Fuzhou Branch 2002). While these reforms were steps toward liberalization, they clearly had little impact on merging the official rate with the market rate.

Win-Win Liberalization

Interest rate liberalization received another boost when Party Secretary General Jiang Zemin remarked at the 2002 16th Party Congress that China should: "cautiously advance the reform of interest rate liberalization..." (Jiang 2002). As before, enthusiasts within the PBOC published several reports in support of liberalization, while representatives from the Big Four banks also provided reasons for slowing down reform. Meanwhile, the PBOC launched another round of crackdowns on illegal interest rate competitions among some local banks (Chan 2002). History seems to repeat itself once more, as the new Premier makes the same vague promise to finally liberalize interest rate.

After China recovered from the Asian Financial Crisis into a period of sustained strong growth, however, interest rate liberalization seemed finally within grasp. On

¹² Interview in Cambridge, MA: 5/2/02

October 29, 2004, the upper limit on lending interest rates was removed, allowing banks to in principle charge as high of an interest rate as they wanted (People's Daily 2005). Moreover, banks could also give depositors rates below the benchmark deposit rates. Similar to Governor Dai Xianlong's time table a few years ago, the PBOC issued a report laying out a concrete plan for full interest rate liberalization.

Despite this liberalization, the underlying logic remained the same. On the deposit front, the removal of lower bound on deposit rates was largely symbolic as banks had few reasons to needlessly decrease rates below those offered by their competitors. Thus, few banks took advantage of the freedom to give less than benchmark deposit rates (Green 2006). On the loan rates liberalization, the central bank reasoned that it would allow banks to “give different loans and rates on the basis of the different risk profiles of the clients”(Research Team on Monetary Policy at the PBOC 2005). While this sounds like a significant gain in efficiency, it in reality was a signal to banks to continue to provide cheap financing to state-sponsored projects and state owned enterprises, which had lower bureaucratic risk profiles. In the mean time, “ruinous competition” between banks was still limited by a strict upper bound on deposit rates and lower bound on loan rates. Thus, banks still could not compete with each other to offer higher deposit rates. Likewise, banks could not compete with each other to offer borrowers low interest because the lowest interest a bank could offer was 90% of the benchmark rate. A PBOC report reveals that a full 27% of all loans made by the state banks were set at the lowest legal rate, suggesting that banks would have competed by offering borrowers low rates had they been allowed to do so (Research Team on Monetary Policy at the PBOC 2005). To give the PBOC credit, the liberalization of loan rates prompted city commercial banks

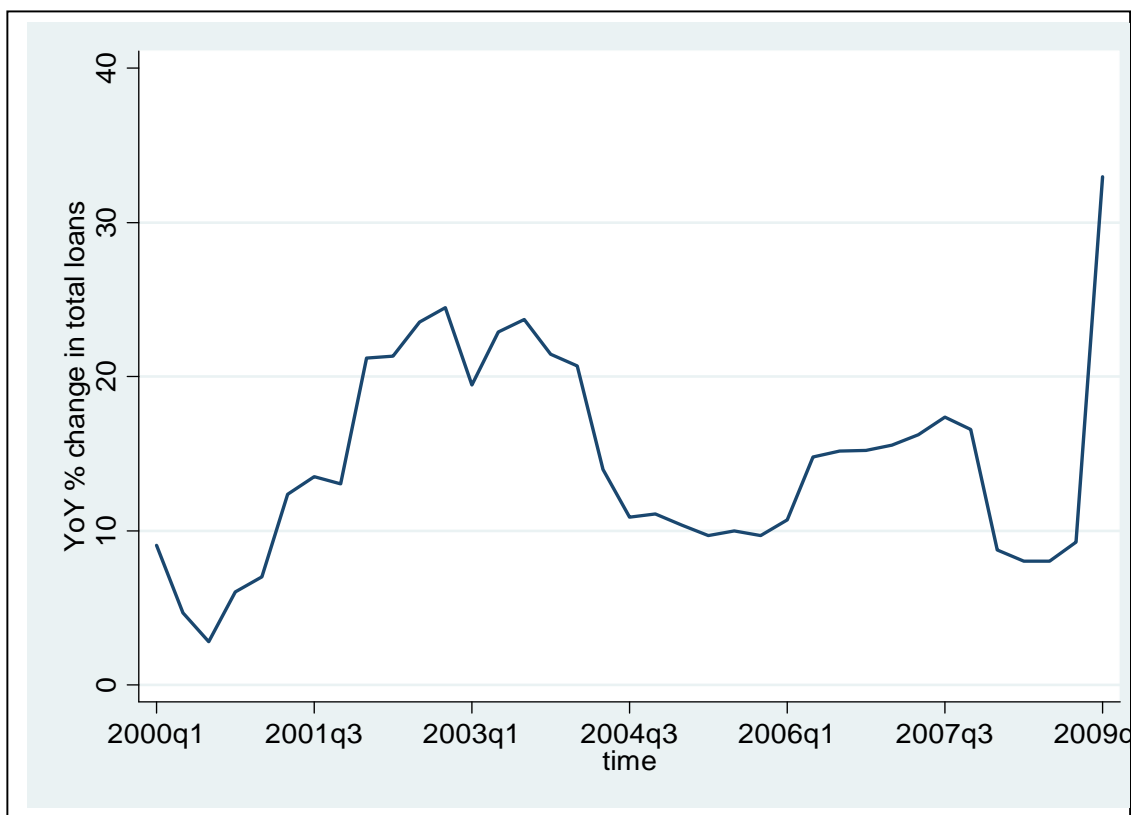
and rural credit cooperatives to offer more loans at high interest rates to riskier borrowers in the private sector, thus providing financing to a segment previously frozen out of the formal banking system (Research Team on Monetary Policy at the PBOC 2005).

Into the current economic downturn, control over interest rates once again facilitated massive countercyclical investment drives. As seen in Figure 2, the PBOC continued to guarantee a healthy interest spread for banks in the current economic downturn. With the upper bound on loan rates removed, banks can earn even more money by lending. Thus, when the central government called on banks to provide financing to the 4 trillion RMB stimulus package in November of 2008, banks responded with great enthusiasm. As seen in Figure 3, lending in China exploded upward in the first quarter of 2009, growing an astonishing 33% from the previous year. The PBOC had originally set credit quota in 2009 at a little over 5 trillion RMB. By the end of first quarter, banks had nearly exhausted that quota by issuing over 4.6 trillion RMB in new loans (Chen 2009). With deposit rates held below benchmark and loan rate above benchmark, banks were actually reaping in healthy profits in the midst of an economic downturn. The first quarter report from domestic banks reflected healthy return from the interest spread, fueled by an unprecedented amount of lending (Han 2009).

Thus, the liberalization of the upper bound in lending interest rate benefited all of the relevant political actors. Senior level technocrats retained the ability to finance the largest countercyclical investment drive in China's history with relative ease. Banks were still protected from "ruinous competition" and continued to enjoy a healthy interest rate spread from lending. Because of banks' willingness to finance the stimulus program, the Ministry of Finance did not have to issue as much debt, thus limiting the size of the

fiscal deficit. Although some large SOEs were probably paying higher borrowing rates due to the lower bound on loan rates, banks were eager to provide massive amount of financing to them, which allowed them to earn a profit by re-lending that money to other entities.

Figure 3: Year-on-Year Change in Total Lending, 2000-2009 (%)¹³



Conclusion

Although China has not faced externally imposed reform policies, it has engaged in significant economic reform on its own. In the cities, many smaller state-owned enterprises were privatized or shuttered, while the private sector was allowed to grow

freely (Naughton 1996). Prices of most goods and services have been liberalized (Wedeman 2003). Despite a giant sea change in the Chinese economy, the state continues to control crucial macroeconomic levers that allow it to affect economic outcomes in important ways. By having control over the flow of money and the direction of investment, central level technocrats can ensure that inflation does not rise beyond control and that growth remains strong. At the same time, these levers also allow them to buy the support of crucial political groups, especially during economic downturns. In order to maintain the effectiveness of these levers, they need to hold depositors in China hostage to the state financial system. If private banks emerge to offer depositors higher interest rates, state banks would have to match those higher rates, thus increasing the cost of financing massive stimulus programs. Thus, without a crisis that forces change, senior level technocrats are unlikely to fully liberalize interest rates, despite strenuous lobbying by some central bankers.

As long as banks are barred from competing for deposits, hundreds of millions of depositors continue to suffer from artificially low deposit rates, which subsidize the profitability of state banks. Although tragic, they are not the only victims of the existing control over interest rates. In the medium and long term, the economy likely suffers from greater inefficiency as easy credit allows inefficient state firms to stay afloat. The state's ability to mobilize large quantities of money at low cost also has negative implications for the world. Most remaining SOEs are concentrated in the heavy industrial and commodities sectors. Thus, as a Chinese government think tank notes, easy credit has allowed them to retain—and in some cases even expand—their capacity in the midst of a serious global downturn (International Financial Research Center 2009). This has

¹³ Source:(China Data Online 2009)

exacerbated global overcapacity and led to the dumping of Chinese goods in certain sectors, especially in steel, on to the world market. Thus, an important victim of the government's continuing effort to manipulate interest rate is global competitors of Chinese state firms.

Bibliography

- Areddy, James. 2002. "China's Bond Market Feels Effects of Split --- Growth in Debt Trading Highlights the Difficulties Of a Two-Tiered System." *The Asian Wall Street Journal*, 11/20/02, M7.
- Babic, Marco. 2008. "People's Bank of China Monetary Policy History Table " *Bloomberg*, 11/26/2008.
- Bi, Jifan. 2000. "Guanyu lilu shichanghua gaige de jidian sikao (Several thoughts concerning interest rate marketization)." *Guoji Jinrong Bao (International Finance News)*, 9/28/00, 7.
- Bo, Zupei, Jun Zhao, and Jin Liu. 1996. "Wenzhou lilu gaige shidian diaocha baogao (Investigation report on the interest rate liberalization experiment in Wenzhou)." *Zhejiang Jinrong (Zhejiang Finance)* 1996 (10):24-8.
- Bureau of Economic Prediction of the State Information Center (Guojia Xinxi Zhongxin Jingji Yucebu). 1999. "Implementing numerous policies can effectively push forth the goal of SOE getting out of difficulties (Duoxiang zhengce chutai youxiao tuidong guoqi tuokun mubiao de shixian)." *Chinese Macroeconomic Signals (Zhongguo Hongguan Jingji Xinxi)*, 1999 (38).
- Central Bond Clearance Company. 2009. "The structure of investors for the main bond categories." In *Monthly Reports*, ed. Central Bond Clearance Company. Beijing.
- Chan, Christine. 2002. "PBOC cracks whip as deposits battle gets out of control." *South China Morning Post*, 11/29/02.
- Chen, Kuncai. 2009. "Daihou guanli: xindai mengtoufanghou de xinkaoyan (Management after lending: new challenges after the explosion in lending)." *Ershiyi Shiji Jingji Baodao (21st Century Business Herald)*, 5/15/2009.
- Chen, Qiang. 2000. "Fei guoyou touzi de xianzhuang, zhangai ji duice jianyi (The current situation and obstacles to non-state investment and suggestions of policy responses)." *Jingji Yuce Fenxi (Economic Prediction and Analysis)* (39):1-12.
- Regulations of the People's Republic of China on Administration of Foreign-funded Banks.*
- China Data Online. 2009. "China Quarterly Economic Statistics." China Data Center.
- Cui, Lijin, Jiang Li, and Liang Wu. 2001. "Understanding the "black box" of underground finance: an investigation of the private capital market in Zhejiang (Puoyi dixia jinrong "heixiangzi": tanfang Zhejiang minjian ziben shichang)." *China Securities News (Zhongguo Zhengquanbao)* 2001 (11/30/01).

- Dai, Genyou. 2002. "Guanyu Lili shichanghua (Concerning Interest rate marketization)." Beijing: Development Research Center of the State Council.
- Fewsmith, Joseph. 2001. *China since Tiananmen : the politics of transition*. Cambridge ; New York: Cambridge University Press.
- Gilley, Bruce, and David Murphy. 2001. "Why China Needs A Real Central Bank." *Far Eastern Economic Review* 2001 (May 24, 2001).
- Green, Stephen. 2006. "China: interest rates, qdii and liquidity challenge." In *On the Ground- Asia*. Shanghai: Standard Chartered Bank.
- Haggard, Stephan, and Chung H. Lee. 1993. "The political dimension of finance in economic development." In *The Politics of Finances in Developing Countries*, ed. S. Haggard, C. H. Lee and S. Maxfield. Ithaca, NY: Cornell University Press.
- Han, Ruiyun. 2009. "Daikuan zengsu tiansi gonghang shouji jingli tongbi zengzhang 6% (The acceleration of lending improved first quarter net profit of ICBC by 6%) " *Ershiyi Shiji Jingji Baodao (21st Century Business Herald)*, 4/28/2009.
- Harberger, Arnold. 1993. "Secrets of Success: A Handful of Heroes." *American Economic Review* 83.
- He, Fangping. 1998. "An analysis on the causes of the 'reluctance to lend' phenomenon and ways to counteract it ("Xidai" xianxiang de cheng'en fenxi ji duice)." *Financial Reference (Jinrong Cankao)* 1998 (3):32-4.
- Heilmann, Sebastian. 2005. "Regulatory innovation by Leninist means: Communist Party supervision in China's financial industry." *China Quarterly* (181).
- Hellman, Joel. 1998. "Winners take all: the politics of partial reform in postcommunist transitions." *World Politics* 50 (2):203-34.
- Huang, Xiangyuan. 2000. "Lili shichanghua shiba shuangbian jian (Interest rate liberalization is a double-edge sword)." ed. Development Research Center of the State Council. Beijing: Development Research Center of the State Council.
- International Financial Research Center. 2009. "Hongguan jingji jidu baogao: 2009nan diyi jidu (Quarterly Report on the Macroeconomy: 1st Quarter of 2009)." In *Quarterly Report on the Macroeconomy*, ed. Institute of World Economy and Politics Chinese Academy of Social Sciences. Beijing: Chinese Academy of Social Sciences.
- Jia, Yubao. 2007. "08nian daikuan zengliang jiangyu jinnian chiping 17hanghangzhang lijun lingzhuang (Lending in 2008 will be the same as this year; 17 bank CEO received their military orders)." *Ershiyi Shiji Jingji Baodao (21st Century Business Herald)*.

- Jiang, Zemin. 2002. "Zai Zhongguo Gongchandang Shiliuci Quanguo daibiao dahui shang de baogao (Report at the Chinese Communist Party 16th National Representative Congress)." *Renmin Ribao (The People's Daily)*, 11/18/02.
- Kessler, Timothy. 1998. "Political Capital: Mexican Financial Policy under Salinas." *World Politics* 51 (1):36-66.
- Luo, Bo. 2001. "Dui Woguo lilu shichanghua wenti de tantao (A discussion on the problems of interest rate marketization in our country)." *Jingji Yanjiu Cankao (The Reference for Economic Research)* 2001 (37).
- Luo, Jun. 2007. "Profit growth triples for foreign banks in China." In *Bloomberg*. New York: Bloomberg.
- Murillo, Victoria. 2002. "Political bias in policy convergence: privatization choices in Latin America." *World Politics* 54 (July 2002):462-93.
- Naughton, Barry. 1996. *Growing Out of the Plan: Chinese Economic Reform 1978-1993*. New York: Cambridge University Press.
- Nelson, Joan. 1995. "Linkages between politics and economics." In *Economic Reform and Democracy*, ed. L. Diamond and M. Plattner. Baltimore: Johns Hopkins University Press.
- People's Daily. 2002. "The Central Bank will put heavy emphasis on bank monitoring (Yanghang jiang ba yinhang jianguan zuowei zhongzhong zhi zhong)." *People's Daily Online (Renmin Ribao Wanyeban)* 2002 (2/11/02).
- . 2005. "Renminbi daikuan lilu guanli kaishi 'shangxian fangkai xiaxian guanli' (Lending rates for RMB loans began 'liberalization at the upper end, management at the lower end')." *Renmin Ribao (People's Daily)*, 2/15/2005.
- Ren, Derong. 2000. "Dangqian huobi zhengce chuandao shouzhu de biaoqian, cheng'en, yu duice (The manifestation, causes, and solution to the blockage to current monetary policies)." *Jinrong Cankao (Financial Reference)* (6):56-60.
- Research Team of the CASS Western Development Research Center. 2003. "Xibu kaifa zongti guihua zhongqi pinggu (A mid-term evaluation of the overall plan to develop the west)." *Jingji Yanjiu Cankao (The Reference for Economic Research)* 2003 (78).
- Research Team of the PBOC Fuzhou Branch. 2002. "Guanyu nongcun xinyongshe lilu gaige shidian de diaocha yu sikao (Investigation and thoughts concerning test points for rural credit cooperative interest rate reform)." *Zhongguo Jinrong (Chinese Finance)* 2002 (12).
- Research Team on Monetary Policy at the PBOC. 2005. "Wenbu tuijin lilu shichanghua baogao (Report on steadily pushing forward interest rate marketization)." In

- Zhongguo huobi zhengce zhixing baogao (Reports on the implementation of monetary policy in China)*, ed. People's Bank of China. Beijing: People's Bank of China.
- Rodrik, Dani. 1996. "Understanding economic policy reform." *Journal of Economic Literature* 34 (March):9-41.
- Shih, Victor. 2005. "Dealing with Non-Performing Loans: Political Constraints and Financial Policies in China." *The China Quarterly* 180 (-1):922-44.
- . 2008. *Factions and Finance in China: Elite Conflicts and Inflation*. New York: Cambridge University Press.
- Shirk, Susan. 1993. *The Political Logic of Economic Reform in China*. Berkeley, CA: The University of California Press.
- Silva, Eduardo. 1996. "From dictatorship to democracy: the business-state nexus in Chile's economic transformation, 1975-1994." *Comparative Politics* 28 (3):299-320.
- Studwell, Joe. 2002. "Macro Economy." *China Economic Quarterly* 2002 (4):18-24.
- Su, Ning. 1992. "1993 nian jingji fazhan yuce ji zhengce jianyi (Predictions on economic development in 1993 and policy recommendations)." In *1993 nian zhongguo: jingji xingshi fenxi yu yuce (China in 1993: analysis and prediction of the economic situation)*, ed. G. Liu. Beijing: Chinese Academy of Social Sciences Press.
- The Asian Wall Street Journal. 2002. "China renews control over setting rates on foreign deposits." *The Asian Wall Street Journal* 2002 (3/8/02).
- The Monetary Policy Analysis Team of the PBOC. 2002. "2002 nian dier jidu huobi zhengce zhixing baogao (The Report on the implementation fo monetary policy during the second quarter of 2002)." Beijing: The PBOC.
- The People's Bank of China. 1986. "Guanyu zhizhi youxie jiceng yinhang zhengqiang xindai yewu, suibian cengshe fenzhi jigou de tongzhi (Notice concerning stopping some basic level banks from fighting for lending and deposit business and from setting up subsidiaries at will)." In *1985 nian Jinrong Guizhang Zhidu Xuanbian (A selection of financial rules and regulations in 1985)*, ed. The Office of the People's Bank of China, THE Office of the Industrial and Commercial Bank of China, The Office of Bank of China and The Office of the Agricultural Bank of China. Beijing: Finance Publisher.
- The People's Bank of China. 1989. "Guanyu jiaqiang lilu guanli gongzuo de zanxing guiding (Temporary regulations concerning strengthening interest management)." In *1988 nian Jinrong Guizhang Zhidu Xuanbian (A selection of Financial Rules and Regulations in 1988)*, ed. The Office of the People's Bank of China, THE

- Office of Bank of China, The Office of the Industrial and Commercial Bank of China, The Office of the Agricultural Bank of China and The Office of the People's Insurance Company. Beijing: Financial Publisher.
- The People's Bank of China. 1999. "Guanyu jiangdi cun, daikuan lilu de tongzhi (Notice concerning decreasing deposit and lending rate)." Beijing: The People's Bank of China.
- . 2000. "Guanyu gaige waibi cundaikuan lilu guanli tizhi de tongzhi (Notice concerning reforming the system managing foreign exchange deposits and lending)." Beijing: The People's Bank of China.
- The State Council. 1983. "Guowuyuan guanyu qieshi jiaqiang xindai guanli, yange kongzhi huobi faxing de jue ding (The State Council's decision concerning strengthening lending management and strictly controlling currency issuance)." In *1981 nian jinrong guizhang zhidu xuanbian (A selection of financial regulations and system in 1981)*, ed. The Office of the People's Bank of China. Beijing: Financial Publisher.
- . 1998. "Guanyu Jinrong Tizhi gaige de jue ding (Decision concerning financial System reform)." In *Xinshiqi jingji tizhi gaige zhongyao wenxian xuanbian (A selection of important documents on economic system reform in the new period)*, ed. Document Research Center of the Chinese Communist Party Central Committee. Beijing: Central Document Publisher.
- Tsai, Kellee S. 2002. *Back-alley banking : private entrepreneurs in China*. Ithaca: Cornell University Press.
- Wedeman, Andrew. 2003. *From Mao to Market*. New York: Cambridge University Press.
- Williamson, John. 1994. "In search of a manual for technopols." In *The Political Economy of Policy Reform*, ed. J. Williamson. Washington, DC: Institute for International Economics.
- Xie, Ping. 1995a. "Lilu shuangguizhi he lilu shichanghua gaige de xuncheng (The process of dual track interest rate and interest rate liberalization reform)." *Hainan Jinrong (Hainan Finance)* 1995 (8):5-9.
- . 1995b. "Zhongguo jingji zhuangui zhong de lilu shichanghua wenti (The question of interest rate liberalization in the midst of economic transition in China)." *Caimao Jingji (Economics of Finance and Trade)* 1995 (8):4-12.
- Xie, Ping, Yiliang Liu, Jiansheng Cheng, and Yin Zeng. 2001. *Cong Tonghuo Pangzhang dao Tonghuo Jinsuo (From Inflation to Deflation)*. Chengdu, Sichuan: Southwest University of Finance and Economics Publisher (Xinan Caijing Daxue Chubanshe).

- Zhang, Zhenyu, Songshan Zhou, Fuguo Sun, and Xiaohui Zhang. 2002. "Fei gongyouzhi jingji xia quyuxing jinrong fengxian ji qi guanli: Wenzhou ge'an yanjiu (The regional financial risk and its management in a non-public economy: the case study of Wenzhou)." *Jinrong Yanjiu (Financial Research)* 2002 (2).
- Zhou, Han. 2002. "Lilu shichanghua: sida yinhang qiefu zhiteng (Interest rate marketization: a greatly felt pain of the Big Four banks)." *Jin Zhoukan (Financial Weekly)* 2002.
- Zhou, Xinhui. 2000. "Lilu shichanghua: Lijiu mixin de huati (Interest rate marketization: a topic that is seemingly new but has a long history)." *Jinrong Shibao (Financial Times)*, 9/23/00.
- Zhu, Rongji. 1998. "Jinyibu tuijin jinrong gaige (Further push forward financial reform)." In *Xinshiqi jingji tizhi gaige zhongyao wenxian xuanbian (A selection of important documents on economic system reform in the new period)*, ed. Document Research Center of CCP Central Committee. Beijing: Central Document Publisher.
- . 2001. "Tongyi sixiang, mingque renwu, bushi shiji shishi xibu diqu dakaifa zhanlue (unite our thinking, clarify our mission, and do not lose the opportunity to implement the strategy of developing the west)." In *Shiwu da yilai zhongyao wenxian xuanbian-zhong (A selection of important documents since the 15th Party Congress- second volume)*, ed. Document Research Center of CCP Central Committee. Beijing: People's Publisher.