



## OXFORD ANALYTICA

CHINA

MONETARY TRANSPARENCY

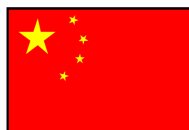
Country Report 2006

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# CHINA



## COMPLIANCE RATINGS

<i>Monetary transparency</i>	2006	2005	2004	2003
Clarity of roles	••	••	••	••
Open decision process	•••	•••	•••	•••
Availability of information	••	••	••	••
Central bank accountability	••	••	••	••
<b>Score</b>	<b>2.25</b>	<b>2.25</b>	<b>2.25</b>	<b>2.25</b>

## OUTLOOK & COMMENTARY

In 2006, China took further steps to improve the transparency of its monetary policy. Since the beginning of the year, the People's Bank of China (PBC) has encouraged market forces to play a greater role in the foreign exchange market, creating increased potential for monetary policy flexibility. Further interest rate liberalisation, which began in 2004, is also expected over the next year. Nevertheless, the pace of currency reform has been very gradual and is expected to remain so over the next year.

The government is likely to establish an overarching regulatory organisation to improve coordination between existing financial regulatory bodies. This would help to clarify the roles and responsibilities of financial regulatory agencies, and enhance supervision of the financial sector.

China could improve its monetary transparency by formalising its policy framework and articulating more clearly its monetary targets and objectives. The central bank is not independent from the government, and does not have final authority over key policy decisions, including interest rate and exchange rate policy.

## EXECUTIVE SUMMARY

### 2.25 Intent declared

During the past year, the credibility of the central bank -- the People's Bank of China (PBC) -- has increased, following a number of steps to improve flexibility and transparency of monetary policy, as well as to set out more clearly the framework for regulating and supervising the financial sector.

A market-maker system in the spot trading of foreign exchange has been in operation since January 2006, as part of a process to allow markets to have greater influence on the currency. This stems from the July 2005 reform of the exchange rate regime, which is beginning to give the PBC potential to conduct a more effective monetary policy. Nevertheless, the pace of currency reform has been very gradual. In August 2006, Fan Gang, a respected economist, was appointed to the central bank's monetary policy committee. He is believed to support the current pace of creeping revaluation, as opposed to his predecessor who favoured a faster pace of liberalisation. There is currently no timetable for further exchange-rate liberalisation, and there are no expectations that the exchange-rate band might be widened in the near term. However, there may be further liberalisation of loan and deposit rates over the next year, continuing on the path of interest rate liberalisation begun in 2004.

Commentators noted that a debate is currently ongoing in closed government circles and among some academics about whether interest rates or inflation should be targeted. For either or both of these to happen, the central bank would need improved communications with the public, greater monetary policy independence and technical expertise. For these reasons, inflation and interest rate targeting are unlikely to be implemented over the next few years and will remain, instead, a long-term goal.

This year, the PBC and senior officials have called for the establishment of an overarching regulatory organisation to improve coordination between existing financial regulatory bodies. The jurisdictional reach of the proposed Financial Regulatory and Supervision Committee will be finalised at a Financial Work meeting at the end of 2006. Given the increasing complexity of the financial market in China and the impending entry of major foreign financial conglomerates from 2007 onwards, the new organisation would help to minimise turf battles between existing regulatory authorities in China.

In 2006, the government indicated its intention to establish a deposit insurance system, covering all deposit financial institutions, in order to enhance protection of depositors. China is in the process of establishing a system of financial soundness indicators. In October 2006, an Anti-Money-Laundering law was adopted that broadens the definition of money-laundering crimes to include acceptance of bribes, violations of financial management regulations and financial fraud. The law is expected to come into effect on 1 January 2007.

China subscribes to the IMF General Data Dissemination System (GDDS). It publishes regular quarterly and annual monetary reports, and in 2006 it published the second Annual Financial Stability Review.

China's overall score is unchanged from last year.

## 1. CLARITY OF ROLES, RESPONSIBILITIES, AND OBJECTIVES OF CENTRAL BANKS

### ●● Intent declared

#### Objectives and institutional framework of monetary policy

##### Central bank objectives and responsibilities

The PBC is the central bank of the People's Republic of China (PRC). The 1995 Law on the PBC mandates the central bank to ensure "the correct formulation and implementation of state monetary policies, instituting and perfecting a macro-control system through the central bank and strengthening supervision and administration of the banking industry."<sup>1</sup> The PBC Law declares that the central bank's responsibilities are to: formulate and implement monetary policies; issue and administer the circulation of the local currency (renminbi); supervise banking institutions and the financial market; manage the foreign exchange and gold reserves, the treasury, and the payment and clearing system; supply banking statistics; and engage in international banking operations.<sup>2</sup> The stated aim of monetary policies is to maintain currency stability and thereby promote economic growth.

In 2003, banking supervision powers, up to then handled by the PBC, were transferred to a new entity, the China Banking Regulatory Commission (CBRC). This separation was implemented at the provincial level in 2004. Although the staff have high technical capacity, the CBRC is relatively small, and in the past there have been concerns about its limited ability to supervise local branch offices. However, in 2005, the CBRC hired more staff and set up several local offices whose officials are familiar with the operations of financial institutions in their respective regions, leading to a corresponding improvement in local supervision capabilities.<sup>3</sup> The Asian Development Bank is helping the CBRC with statistics systems and rating capacity, starting with foreign banks and eventually encompassing all commercial banks. The CBRC conducts regular exchanges with the US Fed and other central banks.<sup>4</sup>

In 2006, the PBC and senior officials called for the establishment of an overarching regulatory organisation to improve coordination between existing financial regulatory bodies; to reduce the increasing complexity of the financial market in China; and to regulate turf battles between different institutions involved in overseeing and regulating the financial sector. In line with WTO commitments, from 1 January 2007 the banking sector will be fully opened to foreign companies. The jurisdictional reach of the proposed Financial Regulatory and Supervision Committee will be finalised at a Financial Work meeting at the end of 2006.<sup>5</sup>

The PBC Law gives the central bank the authority to use monetary policy instruments to achieve its policy objectives, subject to the approval of the State Council. Foreign exchange management is entrusted to the State Administration of Foreign Exchange (SAFE), which operates under the direction of the State Council. SAFE is responsible for the monitoring and control of foreign capital movements, and it ensures that the foreign exchange resources of the country are maintained at an appropriate level. It authorises and registers all public and private entities that engage in foreign exchange and compiles statistics on foreign exchange, public debt and investment flows.<sup>6</sup>

##### Operational autonomy

The PBC is not independent of the government in the administrative or operational sense, although it has gained some autonomy in the use of monetary instruments in recent years. For example, commentators suggest that the

PBC is completely autonomous in its decisions to use open market operations. However, the State Council has authority over interest rate and exchange rate policy.<sup>7</sup> Decisions made by the PBC are generally subject to macroeconomic policies formulated in conjunction with high-level committees of the Communist Party, the Ministry of Finance (MoF), and other powerful government agencies, such as the National Development and Reform Commission (NDRC). The separation of banking supervision and monetary policy functions which followed the creation of the CBRC in 2003 represented a significant change.

The PBC Law states that the premier of the State Council nominates the governor of the PBC, who is confirmed by the National People's Congress (NPC). The premier of the State Council also appoints and removes the central bank's deputy governors. The law vests responsibility for the conduct of monetary policy in the governor and establishes sanctions against abuses of power, conflicts of interest, breaches of secrecy, embezzlement, bribery, and neglect of duties by PBC officials.<sup>8</sup>

## **Institutional relationship between monetary and fiscal operations**

### **Lending to government**

The relationship between the government and the central bank is clearly regulated by the PBC Law. In terms of fiscal autonomy, the PBC Law clearly proscribes the PBC's subscription to primary issues of government debt.<sup>9</sup> This clause was added into the PBC Law to eliminate the automatic monetisation of fiscal deficits by the PBC, which had been carried out prior to 1995. As a result, the PBC has become more autonomous in the use of its instruments in recent years.

The PBC has in the past asked state banks to extend loans to public projects that are partially funded by government bonds. Such policy lending officially ended when the PBC eliminated the annual credit plan for state banks in January 1998. The PBC itself is not permitted to provide loans to governmental bodies or departments, except to those non-bank financial institutions whose borrowing is specifically licensed by the State Council.<sup>10</sup>

The MoF sells government bonds to banking institutions. The PBC issues banking notes and is in charge of the inter-bank market of Treasury bond transactions. The PBC may also open accounts for banking institutions as needed, but it may not overdraw such accounts. It may organise or assist the organisation of banking institutions to settle inter-institutional accounts. It may also determine the amounts, repayment schedules, rates of interest, and forms of loans to commercial banks, although the time limit for such loans cannot exceed one year.<sup>11</sup>

The monetary and banking surveys lack sufficient detail about bank claims on the government, hampering the estimation of the fiscal deficit from monetary balance sheets. The PBC has not reported separate data on central government deposits in its balance sheet since April 2005, because the MoF no longer distinguishes between the central and other government deposit accounts.<sup>12</sup>

### **Central bank involvement in the rest of the economy**

Following a decision by the State Council on 30 December 2003, the PBC announced a 45 billion US dollar (or 4% of GDP) capital injection for two of the four state-owned commercial banks: Bank of China (BOC) and China Construction Bank (CCB). The recapitalisation was conducted by transferring funds from the PBC's international reserves into a new entity called the Central Huijin Investment Company. A similar method of recapitalisation has been formulated for a third state bank, the Industrial and Commercial Bank of China (ICBC). The broad strategy has entailed the bailout of state-owned banks by Huijin, followed by an initial public offering (IPO). This combination is expected to structure management incentives properly. However, the recapitalisation has also increased the risks for the PBC's balance sheet, since reserves were exchanged for an equity investment of uncertain value.

By mid-2005, the authorities had completed financial restructuring of three of the four major commercial banks, including CCB, BOC and ICBC, through capital injections and sales of non-performing loans. By the end of 2005, all three banks announced the selection of major foreign financial institutions as strategic investors with minority ownership stakes, and CCB and BOC completed IPOs. In October 2006, ICBC completed the world's largest ever IPO. The last of the four large state banks is the Agricultural Bank of China (ABC), which is unique as it has been directly involved in policy support to the agricultural sector. The ABC has been slow in restructuring its operations and lacks a concrete reform plan. A restructuring of the bank is currently under consideration in the context of an economy-wide reform of rural financing, but there is no clear time frame for this process.

The Central Huijin Investment Company -- the holding company for the government's share in BOC, CCB, and ICBC -- is characterised by a number of weaknesses. It is thought to have inadequate staff and enforcement authority, is not subject to appropriate accountability requirements, and operates independently of agencies responsible for regulation, supervision or the implementation of monetary policy. The authorities have put an experienced PBC person in charge of Huijin, and most of Huijin's management comes from the PBC and SAFE bureaucracy.<sup>13</sup> Commentators noted that an internal government debate about the future of Huijin and its management is currently taking place.<sup>14</sup>

### **Central bank profit allocation**

Net PBC profits are transferred to the financial department of the State Council after a deduction of expenses and of sufficient funds to maintain PBC general reserves at the level required by the State Council. Losses sustained by the PBC are covered by state allocations. According to the PBC Law, the central bank's capital is owned and allocated by the state.<sup>15</sup> PBC financial liabilities and international reserves are publicly available in the *Quarterly Statistical Bulletin*, although with an inadequate level of detail.

### **Agency roles performed by the central bank on behalf of the government**

Public debt management is carried out by three organisations under the State Council, namely the MoF, the NDRC and SAFE. The MoF plays the lead role in determining, issuing and managing domestic public debt, and it shares responsibility with the NDRC in authorising the issuance of publicly guaranteed debt. The MoF and the PBC coordinate on the amount of domestic debt, whose price is determined by the market. The maturity structure of debt is suggested by the MoF and the NDRC to the State Council.<sup>16</sup>

The NDRC and the MoF jointly authorise new multilateral and bilateral borrowing in line with development objectives.<sup>17</sup> The central bank has the duty to advise the government on its relationship with international organisations, and its governor is part of a government committee that discusses relations with the IMF and the Bank of International Settlements.

The PBC Law mandates the central bank to manage the state treasury and administer the inter-bank payment and settlement system on behalf of the state.<sup>18</sup> Reforms were initiated during the 1990s to establish a modern payments system and develop a national inter-bank money market. The PBC has a national clearing system that provides a local currency payment and settlement service for all banks. It has 1,000 clearing centres covering over 600 cities and towns. The four state banks have their own internal clearing systems that allow intra-city remittances of 500,000 Rmb (64,000 US dollars) or less.

In May 2004, the authorities indicated the start of a three-year period for becoming compliant with the anti-money-laundering (AML) requirements of the multilateral Financial Action Task Force (FATF).<sup>19</sup> In October 2006, an AML law was adopted that broadens the definition of money-laundering crimes to include acceptance of bribes,

violations of financial management regulations and financial fraud. The law is expected to come into effect on 1 January 2007.

Joining the FATF is contingent on having an effective anti-money laundering law.<sup>20</sup> In January 2005, 33 members of the FATF unanimously agreed to accept China as an observer.<sup>21</sup> China will be eligible for FATF membership after the completion of a successful mutual evaluation of its anti-money-laundering and counter-terrorist financing system. The NPC revised the Criminal Law in 1997 to include money laundering as a crime, and in 2003 the PBC issued regulations for financial institutions that included a framework for reporting and monitoring. The central bank is the supervisory authority for anti-money-laundering operations of financial institutions, and has established a stronger AML bureau.<sup>22</sup> The *Rules for Anti-Money Laundering by Financial Institutions* were enacted in 2003, and include a framework for reporting and monitoring. The NPC has ratified the UN Convention Against Transnational Crime.

## 2. OPEN PROCESS FOR FORMULATING AND REPORTING MONETARY POLICY DECISIONS



### The framework, instruments, and targets of monetary policy

#### Framework and monetary targets

The PBC seeks to achieve its monetary objectives by attaining publicly disclosed money supply targets. The monetary base is the operational target, and money supply is the intermediate target. More recently, targets for money and credit growth have become an important device for the PBC to signal its monetary policy intentions.<sup>23</sup> In theory, the state's Five Year Plan is the strategic basis, but in practice its relevance has been decreasing.<sup>24</sup> China moved to a managed-float exchange rate system in July 2005 based on a basket of currencies.<sup>25</sup>

In recent years, the policy framework has involved balancing low inflation with continued strong growth, using monetary aggregates as intermediate targets. However, a conflict in monetary-policy implementation is being created by the tightly managed exchange-rate regime accompanied by strong inflows of foreign currency. Following the July 2005 reform to the exchange rate regime, a number of steps have been taken to deepen the foreign exchange market and allow market forces to potentially have a greater influence on the exchange rate. Since January 2006, a market-maker system in the spot trading of foreign exchange has been in operation. However, given that the PBC is still the largest client in the foreign exchange market, it continues to retain considerable influence over the exchange rate.<sup>26</sup>

According to commentators, in order to achieve more flexibility in monetary policy, China needs banking reforms to enable banks and financial institutions to become more market oriented. It also needs macroeconomic stability and an integrated package of reforms, including fiscal reforms to cushion the negative impact of a potential exchange-rate appreciation. A timetable for further exchange-rate liberalisation is currently not in place, and no widening of the exchange-rate band is expected in the short term, as the process will only be gradual. Commentators also noted that the current monetary framework and aggregate monetary targets are satisfactory for China's current economic situation.<sup>27</sup> According to a recent IMF report, however, "it will be important for the PBC to formalise its policy framework, establishing an appropriate nominal anchor for monetary policy, and more clearly articulating its policy objectives. This would help to underpin market expectations about inflation, interest rates and the exchange rate".<sup>28</sup>

Fan Gang, a respected economist, was appointed to the central bank's Monetary Policy Committee in August 2006. Appointments to the committee can provide some insight into future policy trends. Fan Gang is believed to support the current pace of creeping revaluation and exchange-rate realisation, as opposed to his predecessor who favoured a faster pace of liberalisation.<sup>29</sup>

Commentators noted that a debate is currently ongoing in closed government circles and among some academics about the possibility of targeting inflation. However, three key issues make implementation of these policies unlikely over the next few years: first, there needs to be adequate communication between the government and the public, and this is still limited; second, the central bank needs independence, which it does not yet have; and finally, technical expertise needs to be improved, as the PBC does not yet have the ability to construct and monitor inflation targets. For these reasons, inflation targeting remains a long-term goal. Money supply is likely to be the key monetary target over the next 10 to 20 years.<sup>30</sup>

## **Monetary instruments**

The primary instruments of monetary policy used by the PBC are open-market operations, changes in the discount rate, and reserve requirements, aided and abetted by 'window guidance' to banks on their lending operations. Despite the availability of these instruments, their impact in restraining credit growth has been insufficient in recent months, and in reality a combination of administrative measures, moral suasion, as well as open-market operations were used.<sup>31</sup> Commentators noted that since the widening of the exchange rate band in July 2005, the PBC has gained greater ability to use monetary-policy instruments more effectively. However, while there is potential for a more effective monetary policy, it remains to be seen whether the PBC will take advantage of this in reality.<sup>32</sup>

The PBC Law states that the central bank is the sole body responsible for setting interest rates.<sup>33</sup> However, it requires approval of the State Council to change policy on interest rates. The PBC has stated that its long-term goal is to use interest rates to guide the demand and supply of capital. In recent years, the PBC has liberalised the rates of the inter-bank funding market and foreign-exchange deposits in excess of three million US dollars. In 2004, it liberalised lending rates of commercial banks. The PBC also trades in the domestic bond market to help state banks with liquidity problems, rather than to guide interest rates. On average, it has three to four open-market transactions each month, but the volume involved is not known.

According to commentators, the lack of discretion given to the PBC to set interest rates is an impediment to timely policy action, and there needs to be further interest-rate liberalisation, which has proceeded gradually over the past two years.<sup>34</sup> On 1 January 2004 the PBC increased the flexibility in the rate for loans to the private sector. Financial institutions were also given the freedom to determine lending rates for individual borrowers based on their risk profiles.<sup>35</sup> Commentators noted that there may be more liberalisation of loan and deposit rates over the next year.<sup>36</sup>

## **The monetary policy-making body**

### **Monetary board**

The Monetary Policy Committee of the PBC is responsible for conducting monetary policy. Its functions, composition, and working procedures are set out in the Regulation on the Monetary Policy Committee, issued on 20 June 1999.

The committee is comprised of the governor (who acts as chairman) and two deputy governors of the PBC, a deputy minister of finance, a deputy governor of the NDRC, a member of the Ministry of Commerce, the head of the SAFE, the head of the China Securities Regulatory Commission, a member of the China Insurance Regulatory Commission, three governors of the nine PBC branches representing the different regions of the country, and one economist (at present, Fan Gang). While the PBC nominates, in consultation with other government departments, the committee's members, the State Council is charged with making the formal appointment. The regulations state that committee members should be under 65 years of age, with no criminal convictions, and with over ten years of experience in finance.<sup>37</sup>

The Monetary Policy Committee meets in the second week of the first month of every quarter, and at least two-thirds of its members are needed to reach a quorum. Additional meetings can be called with the approval of at least one-third of the members. The PBC has created a Monetary Affairs Analysis Team that meets on a monthly basis to review the macroeconomic environment underlying monetary policy.

### **Advance meeting schedule**

No advance meeting schedule is published. There is a verbal understanding that meetings are held in the second week of the first month of each quarter.<sup>38</sup>

## **Public statements on monetary policy**

### **Periodic publications**

Decisions taken by the Monetary Policy Committee are published in its official newspaper, the Beijing-based *Financial Times*. Although minutes of policy meetings are not available, a policy statement is released. In addition, the PBC publishes a two-page report every quarter about monetary policy implementation in the *Financial Times* and other leading Chinese newspapers, such as *China Daily*. Annual Monetary Policy reports are also publicly available. Since 2003, the PBC has been publishing its quarterly monetary policy reports in English. The PBC has also begun to use its website to post more timely information about its work, mainly in Chinese, although some information is gradually being posted in English too. Speeches by the PBC governor and deputy governors are being distributed by the Bank for International Settlements on a regular basis and with increasing frequency.

The PBC issues quarterly monetary policy reports. The most recent quarterly monetary policy report -- for the third quarter of 2006 -- was released in November with a lag of two months. The report focuses on monetary and credit performance, monetary policy conduct, financial market performance, and analysis of macroeconomic developments; it also includes a discussion on the monetary policy stance to be adopted in the period ahead.<sup>39</sup> In late 2005 and on 30 October 2006 respectively, the PBC released its first two Financial Stability Reports, which are expected to be annual reports. These reports are not available in English on the PBC's website. Commentators noted that the quality of quarterly and annual reports is satisfactory, and that the information they contain, and their level of analysis, have sufficient depth.<sup>40</sup>

The information contained in the quarterly monetary report has increased over time, and the CBRC is enhancing its reporting of non-performing loans of state-owned banks.<sup>41</sup> Data are more accessible than they used to be, and there is a general perception that both the PBC and the MoF are keeping the media better informed on developments than previously. Credit data have been published by sector since the end of 2004. In January 2005, the Monetary Policy Department issued a *Report on the Promotion of the Liberalisation of Interest Rates*, which commentators found useful in understanding the history of, and policies regarding, interest rates. Commentators also pointed out that the PBC is becoming more open and consistent with regard to its targets.

### **Public hearings**

The PBC submits an *Annual Report* on monetary policies to the Standing Committee of the National People's Congress and issues public statements on its work in the domestic press several times a year. The governor also holds press conferences twice a year. The NDRC, which has responsibility for setting the prices of some key goods in the economy, holds public hearings for groups affected by price rises. These are publicised ten days in advance.

## **Regulations on data reporting by financial institutions to the central bank**

The China Banking Regulatory Commission (CBRC) is charged with the supervision and administration of banking institutions. Its creation, in April 2003, reflected the government's concerns with strengthening the banking sector, in conjunction with the recapitalisation of the four major state banks. The MoF issued 270 billion Rmb (34.5 billion US dollars) in bank-restructuring bonds to recapitalise the four state banks in 1998. The 4.5 billion US dollars

recapitalisation in 2004 repeated this effort, and has been followed by a further capitalisation of the ICBC. The PBC also introduced a five-tier loan classification system in 1999, asking all Chinese banks to adopt this regime as of 1 January 2002.<sup>42</sup> The system requires banks to categorise loans into five grades (pass, special mention, sub-standard, doubtful, and loss) according to the borrowers' repayment ability, credit history and collateral value. Guidelines modelled on international practices for provision against non-performing loans were also drafted in 2002.<sup>43</sup> On 21 May 2002, the PBC issued new rules requiring Chinese banks with assets of more than 1,000 million Rmb, or with deposits of more than 500 million Rmb, to publish detailed annual information about their financial situation. The PBC also requires these banks to provide balance sheets, statements of income, and statements of owner's equity. They also need to provide details of their risk management and corporate governance, as well as details of major events that have taken place in the bank during the accounting year. The banks prepare their annual reports in Chinese and publish them within four months of the end of the accounting year.

The China Securities Regulatory Commission (CSRC) introduced legislation in 2002 requiring listed banks -- and banks seeking to be listed -- to appoint two accounting firms (one domestic and one international) for audits. This legislation builds on China's landmark Code of Corporate Governance for Listed Companies, adopted in January 2001 by the CSRC and the former State Economic and Trade Commission. The code is designed to strengthen the role of shareholders, boards of directors, and boards of supervisors, and to tighten the requirements for information disclosure and transparency in corporate management.<sup>44</sup> In February 2004, the CSRC introduced new rules on capital adequacy and compelled banks for the first time to treat loans to state-owned enterprises and private enterprises equally on their balance sheets. The CBRC has mandated Basel I capital-adequacy requirements of 8% for every bank from January 2007.

According to the IMF, China is in the process of establishing a system of financial soundness indicators and at this stage is soliciting comments on the new system from all relevant agencies.<sup>45</sup>

### 3. PUBLIC AVAILABILITY OF INFORMATION ON MONETARY POLICY

#### ●● Intent declared

#### Release of central bank data

In April 2002, China subscribed to the IMF General Data Dissemination System (GDDS), marking a major step towards increased transparency in the reporting of economic data.<sup>46</sup> In recent years, the PBC has been publishing more financial data on its official website, in its *Annual Report* and *Quarterly Statistical Bulletin*, and in the *Financial Times*. These data, released two to six weeks after the reference period, include broad money and credit aggregates, central bank aggregates, interest rates, stock market indices, international reserves and a depository corporation (banking) survey. Some statistics are already based on the IMF's Balance of Payments Manual and the core principles of the Basel Committee. At present, no information is publicly available regarding the PBC's profit and loss statements. In addition, information on expenses and revenues -- while provided to the National People's Congress -- is not released to the public domain. A balance sheet is published, though it lacks detail. There has been no improvement over the last year in the level of detail or timeliness of the financial statement, which is usually released with a time lag ranging from one to three months.<sup>47</sup>

Since June 2002, the PBC has been publishing more detailed statistics in its *Quarterly Statistical Bulletin*. In line with its participation in the GDDS, the PBC has made a commitment to prepare documentation on the methodology and procedures for compiling monetary and financial statistics, to provide more detailed data and to use more channels to disseminate them. The most notable progress made by the PBC on monetary statistics in recent years has involved expanding the coverage of financial institutions and improving its data dissemination following GDDS recommendations, such as posting advance release calendars on the PBC's websites.<sup>48</sup>

Source data are collected from the PBC's 'All Accounts' financial reporting system. This system electronically collects stock data on monetary statistics and banking supervision indicators in a uniform format from banking institutions which use different accounting procedures. The system allows for the collection of detailed data for classifying bank accounts by economic sector and financial instrument. Data reporting units are periodically inspected to review implementation of reporting instructions and regulations issued by the PBC.

The PBC has enhanced its compliance with GDDS requirements by improving its resources in terms of trained personnel. Specialists in data collection and computerisation are being recruited and transferred from local branches to improve data dissemination. These efforts stem from concerns highlighted by some commentators last year about staff limitations often limiting the capacity to push through reforms effectively.<sup>49</sup>

#### The central bank balance sheet

The PBC's balance sheet is published monthly, 40 days after the reference date, and is available both on the PBC website and in its *Quarterly Statistical Bulletin*. The central bank also reports such details to the IMF.<sup>50</sup>

#### Lender of last resort

The PBC does not disclose information on emergency financial support. The PBC's relationship with state banks and other financial institutions is conducted in an arbitrary and ad hoc manner. State banks look to the central bank

for help and other concessions. In the past, failed financial institutions were either allowed to go bankrupt or were supported by local government and MoF funds.

The creation of the CBRC has improved the lending mechanisms to financial institutions. In the past, requests for funds from commercial banks were automatically granted by the PBC, which retains responsibility for ensuring the overall stability of the financial sector.

The Second Financial Stability Report published in October 2006 states that the government will establish a deposit insurance system, covering all deposit financial institutions to enhance protection of depositors.<sup>51</sup>

## Public information services

Availability of information on the Chinese version of the PBC website has been gradually increasing, and some improvements can also be seen in its English version. Two government-backed websites, run by the China Foreign Exchange Trade System, have articles in English on monetary issues written by top PBC officials, and other useful data on China's money and bond markets.<sup>52</sup> In order to explain the central bank policies to the public, senior PBC officials appear in question-and-answer sessions published in the *Financial Times* and broadcast on the national China Central Television.<sup>53</sup> Figures for monetary surveys, exchange rates, gold and foreign exchange reserves, statistics on foreign exchange and balance sheets of the PBC are also publicly available. Regulations issued by the PBC are available on the website, in major newspapers, and in government gazettes. While a statement accompanies monetary policy decisions, no minutes are released.

The PBC website contains more comprehensive quantity and quality of information regarding monetary policy. It regularly publishes speeches by the chairman. The Bank for International Settlements regularly publishes on its website, and distributes by email, speeches by PBC officials.<sup>54</sup>

The NDRC publishes on its external website a list of the prices it sets. The CBRC website posts quarterly non-performing loans data. The Ministry of Commerce provides a valuable searchable and indexed website in English, and regularly hosts information from other government departments.

#### 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

##### ●● Intent declared

##### **Accountability before a designated public authority**

The PBC Law requires the central bank to submit work reports concerning monetary policies and financial supervision and control to the Standing Committee of the NPC.<sup>55</sup> In addition, summary versions of these reports have to be made available to the general public.

In the past, the NPC was regarded as a rubber stamp of the government. In recent years, it has become more vocal on certain economic issues, although it remains subservient to the Communist Party when it comes to major government decisions. Officials of the PBC are answerable to the State Council and the NPC when called upon to report, normally on a quarterly basis.

##### **Financial statement**

The PBC Law states that the central bank must abide by the state accounting system in managing its revenues and expenditures, and that it is subject to the auditing and supervision of the China National Audit Office (CNAO) and the financial department of the State Council.<sup>56</sup> It must also abide by the Statistical Law of 1996, under which it is illegal to misreport or tamper with data, or release data without approval.

In the absence of detailed information, it seems likely that PBC accounting procedures reflect the drawbacks of China's accounting practices. These are broadly consistent with International Accounting Standards, but still possess several shortcomings in terms of transparency, consistent application, lack of timely public disclosure and accuracy of basic data. The PBC uses a cash-based accounting system, while banking institutions use accrual-based accounting. The latter evaluates fixed assets and other investments at cost, not at market value. Capital is generally inflated by liberal asset revaluations, while provisions made for bad loans are grossly insufficient. The UN System of National Accounts is nominally adhered to, but the continued application of traditional accounting procedures hinders accuracy. There is, however, a willingness within the PBC to improve the quality of statistics, as required by the GDDS.

##### **Audited financial statement**

The PBC publishes its monthly balance sheets, but not its profit-and-loss statements. The central bank is working to remedy this problem, but until staff shortfalls are addressed, no significant improvements can be expected.

The PBC budget is incorporated in the central budget after examination and verification by the financial department of the State Council. The PBC submits information on its expenses and revenues to the MoF and the NPC, but this information is not publicly available. No independently audited PBC financial statement is disclosed. The Audit Bureau of the State Council does, however, publish a report on government agencies, including the PBC, whose results are made available to the public. A recent report on the PBC stated that the PBC had been found to be involved in certain illegal practices. The report was published in the media and was made available online.<sup>57</sup>

### **External and internal audit**

The State Auditor conducts an audit of the PBC each year, but its findings are not publicly available. In addition, the PBC has an Internal Auditing Department that audits the accounts of all PBC departments and the financial institutions under its supervision. Information on the central bank's internal governance procedures is not disclosed publicly. Its accounting policies and internal audit arrangements are based on regulations and guidelines issued by the CNAO.<sup>58</sup> Its Department of Monetary Audit audits the operations of the PBC and banking institutions under its supervision.

### **Conduct of officials**

The PBC Law specifies general standards for the conduct of personal financial affairs by officials and staff of the central bank. In particular, it details measures relating to the wrongful provision of loans, the provision of financial guarantees to a unit or individual, the unauthorised issue of funds, breach of confidentiality, embezzlement, bribery, malpractice for personal gain, abuse of powers and neglect of duties. There is no established legal protection for officials and staff of the PBC in the conduct of their official duties.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to China between 16 and 20 October 2006:

### People's Bank of China, Beijing

We met a central bank official who requested anonymity.

Despite considerable effort to meet someone from the National Development and Reform Commission, *Oxford Analytica* was not granted an interview.

## ADDITIONAL INTERVIEWS

### 16 October 2006

Michael Pettis	Associate Professor of Finance	Guanghua School of Management, Peking University
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### 17 October 2006

Vivek Arora	Senior Resident Representative	IMF
Bert Hofman	Chief, Economics Unit and Lead Economist	World Bank

### 18 October 2006

Su Ge	Partner	Vermilion Partners Limited
Marcus Shadbolt	Partner	Vermilion Partners Limited
Edmund Wang	Associate Director	Vermilion Partners Limited
Arthur Kroeber	Managing Editor	China Economic Quarterly

### 19 October 2006

Min Tang	Deputy Resident Representative	ADB
Xuechun Zhang	Senior Financial Economist	ADB

## NOTES

<sup>1</sup> The Law of the People's Republic of China on the People's Bank of China (PBC Law), 1995, Article 1, is available in English at the PBC website [www.pbc.gov.cn/english/](http://www.pbc.gov.cn/english/)

<sup>2</sup> The PBC Law, Article 4.

<sup>3</sup> Interviews in China, 17-21 November 2005.

<sup>4</sup> Interviews in China, 1-5 November 2004.

<sup>5</sup> “‘Super’ regulator will pose problems”, Oxford Analytica Daily Brief, 21 November 2006; and “Financial watchdog considered for China”, Financial Times, 10 September 2006

<sup>6</sup> “Technical Assistance to the People's Republic of China for Strengthening Public Debt Management”, Asian Development Bank, November 2002, p. 2.

<sup>7</sup> The PBC Law, Article 5.

<sup>8</sup> The PBC Law, Articles 9, 10, 13, 14, 50.

<sup>9</sup> The PBC Law, Articles 5, 28.

<sup>10</sup> The PBC Law, Article 29.

<sup>11</sup> The PBC Law, Article 24-27.

<sup>12</sup> *Staff Report for the 2006 Article IV Consultation*, IMF, July 2006.

<sup>13</sup> See “Beijing's Bailout of Joint-Stock and State-Owned Banks”, Victor Shih, China Brief, The Jamestown Foundation, Vol.5, Issue 18, 16 August 2005 for an account of Huijin's clout and the distribution of staffing in financial supervisory organisations in China.

<sup>14</sup> Interviews in Beijing, 16-20 October 2006.

<sup>15</sup> The PBC Law, Articles 8, 38.

<sup>16</sup> Interviews in China, 1-5 November 2004.

<sup>17</sup> “Technical Assistance to the People's Republic of China for Strengthening Public Debt Management”, Asian Development Bank, November 2002, p. 1.

<sup>18</sup> The PBC Law, Articles 4, 23.

<sup>19</sup> IMF Country Report No. 04/351, November 2004, p. 23.

<sup>20</sup> Interviews in China, 17-21 November 2005.

<sup>21</sup> “Combating Money Laundering and Terrorist Financing in China”, speech by PBC Deputy Governor, Xiang Junbo, at a seminar on ALM and combating terrorist financing on 22 September 2005.

<sup>22</sup> *Rules for Anti-money Laundering by Financial Institutions*, The People's Bank of China, 13 January 2003, [www.pbc.gov.cn/english/detail.asp?col=6800&ID=31](http://www.pbc.gov.cn/english/detail.asp?col=6800&ID=31)

<sup>23</sup> “A Framework for Independent Monetary Policy in China”, IMF Working Paper WP/06/111, May 2006.

<sup>24</sup> Interviews in China, 1-5 November 2004.

<sup>25</sup> Interviews in China, 17-21 November 2005.

<sup>26</sup> *Staff Report for the 2006 Article IV Consultation*, IMF, July 2006.

<sup>27</sup> Interviews in Beijing, 16-20 October 2006.

<sup>28</sup> *Staff Report for the 2006 Article IV Consultation*, IMF, July 2006.

<sup>29</sup> Interviews in Beijing, 16-20 October 2006 and “Policymakers favour continuing caution”, Oxford Analytica Daily Brief, 14 August 2006

<sup>30</sup> Interviews in Beijing, 16-20 October 2006.

<sup>31</sup> *Staff Report for the 2006 Article IV Consultation*, IMF, July 2006.

<sup>32</sup> Interviews in Beijing, 16-20 October 2006.

<sup>33</sup> The PBC Law, Article 4.

<sup>34</sup> Interviews in Beijing, 16-20 October 2006.

<sup>35</sup> “A Framework for Independent Monetary Policy in China”, IMF Working Paper WP/06/111, May 2006.

<sup>36</sup> Interviews in Beijing, 16-20 October 2006.

<sup>37</sup> The regulations are available on website of the People's Bank of China, [www.pbc.gov.cn](http://www.pbc.gov.cn)

<sup>38</sup> Interviews in China, 1-5 November 2004.

<sup>39</sup> *China Monetary Policy Report*, PBC, Quarter Two, 2006 at: [www.pbc.gov.cn/english/detail.asp?col=6400&id=760](http://www.pbc.gov.cn/english/detail.asp?col=6400&id=760)

<sup>40</sup> Interviews in Beijing, 16-20 October 2006.

<sup>41</sup> The CBRC reports regularly on non-performing loans, both of the four largest state-owned banks and of the twelve shareholding banks.

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<sup>42</sup> China adopted Bank of International Settlements standards for the classification of bank loans at the beginning of January 2002. Nevertheless, the banks' reporting and classification of lending behaviour is still perceived as unpredictable and politically motivated.

<sup>43</sup> "Memo on Non-Performing Loans in the People's Republic of China", Asian Development Bank, October 2002, p. 2.

<sup>44</sup> "Code of Corporate Governance for Listed Companies in China", China Securities Regulatory Commission & State Economic and Trade Commission, January 2001.

<sup>45</sup> *Staff Report for the 2006 Article IV Consultation*, IMF, July 2006.

<sup>46</sup> IMF General Data Dissemination System (GDDS) - China, at <http://dsbb.imf.org/Applications/web/gdds/gddscountrycategorylist/?strcode=CHN>

<sup>47</sup> Interviews in Beijing, 16-20 October 2006.

<sup>48</sup> *Staff Report for the 2006 Article IV Consultation*, IMF, July 2006.

<sup>49</sup> Interviews in China, 17-21 November 2005.

<sup>50</sup> Interviews in China, 11-13 November 2002.

<sup>51</sup> "Stabilising China's Finances", Beijing Review, at: [www.bjreview.com.cn/06-46-e/BUS-1.htm](http://www.bjreview.com.cn/06-46-e/BUS-1.htm)

<sup>52</sup> [www.chinabond.com.cn](http://www.chinabond.com.cn); [www.chinamoney.com.cn](http://www.chinamoney.com.cn)

<sup>53</sup> Interviews in China, 11-13 November 2002.

<sup>54</sup> These speeches are available at the following webpage:

[www.bis.org/dcms/fl.jsp?aid=13&pmdid=2&smdid=10&tmdid=0&fmdid=0&dtid=4&y=now](http://www.bis.org/dcms/fl.jsp?aid=13&pmdid=2&smdid=10&tmdid=0&fmdid=0&dtid=4&y=now)

<sup>55</sup> The PBC Law, Article 6.

<sup>56</sup> The PBC Law, Article 39.

<sup>57</sup> Interviews in China, 17-21 November 2005.

<sup>58</sup> Website of China National Audit Office, [www.cnao.gov.cn](http://www.cnao.gov.cn)