70 Years of China's Finance: History, Contributions and Prospects

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Abstract: Over the past 70 years since the founding of the People's Republic of China, great changes have been seen in the financial industry in terms of its nature, function, scale, structure and other features. It has experienced six stages of development, namely, inception and consolidation, arduous growth, exploration and restructuring, segmentation, fictitious economy orientation, and real economy promotion and risk prevention. The tremendous success and useful experience made during this period have largely bolstered the prosperity and stability of the Chinese economy, improved Chinese people's living standards, and exerted a profound impact on China's economy and society. Based on its development pattern, the Chinese financial sector will expect further opening-up at home and abroad and a growing capacity in serving the real economy, while new business forms and models will emerge rapidly and stronger preventive measures against financial risks will be needed. In response to the financial development in the new era, proactive and pragmatic measures need to be in place to safeguard the stable and sound development of the financial industry.

Keywords: 70 years since the founding of the People's Republic of China, financial industry, development path, contribution to the times

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The Chinese economy and society have witnessed amazing changes since the founding of the People's Republic of China. The socialist market economy with Chinese characteristics is constantly evolving and improving through reforms as China has risen from a poverty-stricken country to the world's second largest economy. The economic boom in the nation is inseparable from the strong impetus from its financial industry which has been financing the economic development and boosting the prosperity and stability of China's economy and society. The financial industry in China has emerged as one of the most important industries of the national economy. According to statistics from the website of the National Bureau of Statistics of China, China's financial value-added to Gross Domestic Product (GDP) ratio grew from 1.72 percent in 1952 to 7.68 percent in 2018, and financial institutions reported a surge in loan balance from RMB10.8 billion to RMB136.3 trillion and a sharp increase in deposit balance from RMB3.3 billion to RMB177.5 trillion during the same period. History proves that each and every reform and progress of the financial industry has lent strong momentum to China's economic and social development. The new era calls for building a modern economic system, promoting the overall quality of socio-economic, and leveraging the robust support of modern finance. Under new circumstances, the Chinese economy is faced with mounting pressure of transformation and upgrading domestically and challenges such as trade frictions internationally. The financial industry is also undergoing profound changes in terms of its business forms and structures. Therefore, it is of great theoretical and practical significance to analyze and summarize the development of China's financial industry, identify the development patterns and study and predict the development trends, which will further invigorate the reform and development of the financial industry and support the steady growth of the national economy.

The Founding of the People's Republic of China: Foundation and Consolidation of the Financial Sector (1949–1958)

The founding of the People's Republic of China on October 1, 1949 marked the rise of an independent new country as well as the birth of its financial sector. The government had to resolve issues inherited from the past and set up new economic and financial institutions in place of antiquated ones. In this era the government managed to construct a new financial system through the medium of two steps.

First, a new and improved renminbi system was established and improved. Earlier, the Kuomintang regime had issued massive amount of money which led to severe depreciation of money, inflation and economic collapse and the need of a new renminbi system became urgent. In order to stabilize prices and the economy, the regime abolished the Kuomintang's currency system and banned the circulation of foreign currencies with the aim of precluding them from rigging the money market. Also, the circulation of metal currencies was banned, and gold and silver were abolished as denomination currencies. These measures enabled the renminbi to gradually replace other currencies as the only legal currency in the market. Second, the People's Bank of China (PBOC) centralized the entire financial system. From 1952 onwards, PBOC commenced socialization and centralization of private financial firms by establishing a nationwide banking system of a public-private partnership (PPP) nature. As the banking system became more centralized, PBOC consolidated its power in vertical management in that it worked as the sole banking entity in China. It functioned both as a central bank responsible for currency issuing, economic management and financial management, and as a commercial bank authorized to provide various economic entities with financial services and procedures (Lu & Zhou, 2019, pp. 5-19).

The Chinese financial industry in this period had three characteristics. First, it marked the prominent features of a planned economy. PBOC integrated the control of all financial operations nationwide, including credit budgeting to form a credit administration system. Business credit was abandoned in order for PBOC to control the settlement of accounts among industrial or commercial entities and obtain detailed information on capital flows. Second, the financial market was relatively underdeveloped. In 1952, the financial value-added stood at RMB1.17 billion, yet by the end of the First Five-Year Plan period the figure came to merely RMB1.61 billion, less than 2 percent of the GDP.[①] Third, financial resources were concentrated and channeled to primarily economic revitalization and development. In order to attract funds, the government put a premium on bank savings by encouraging residents to make deposits while using a large portion of retained earnings to fill the gap of bank credit funds and primarily finance the public sector, especially the nationalized secondary industries. The First Five-Year Plan period (1953-1957) saw a 2.3-fold growth in industrial loans, equal to a growth from 9.8 percent to 12 percent in terms of the ratio of industrial loans to total bank loans (PBOC, 2012, p. 160).

The new financial system had great impacts on the Chinese economy. First, it constrained hyperinflation and stabilized prices. Renminbi system as a legal currency served to strengthen cash regulation, crack down on speculation and profiteering, bring down inflation, stabilize prices and create a good climate for economic development. Second, a financial system was introduced to suit the socialist system. It was achieved, step by step, by taking charge of bureaucrat-capital assets, reforming private financial institutions and establishing PBOC to boost the economy. Third, the new financial system laid a foundation for restoring the national economy and carrying on with economic development in the First Five-Year Plan period. In this period the overall industrial output marked a 1.3-fold increase, including a 2.1-fold increase in heavy industries (PBOC, 2012, p. 160) due to the crucial financial support to the heavy industry-centered economy. Fourth, the new financial system, by adopting the socialist transformations (socialist transformation of agriculture, socialist transformation of handicrafts and socialist transformation of capitalist industry and commerce), blazed a way for industrialization. The private finance sector first began socialist transformations in 1952, paving the way for the subsequent socialist reforms in the agricultural, handicraft and capitalist industrial and commercial sectors. Meanwhile, PBOC led other sectors to complete transformations successfully through adjustments of loan interest, credit lines and credit terms for PPP banks.

① Data sourced from the website of the National Bureau of Statistics.

The Great Leap Forward and the Cultural Revolution: Financial Cause Winding Its Way in Difficulty (1958–1978)

The Great Leap Forward (1958-1960), was an indiscreet economic movement driven by unrealistic plans and goals, leading to a poor financial performance and a disrupted financial system. The movement brought the newly revitalized national economy back to the trough again, therefore resulting in serious economic and fiscal difficulties. First, the over-issuance of currency caused hyperinflation during this period. PBOC issued more than RMB4 billion in addition and by the end of 1960, the money supply rocketed by 80 percent relative to that in the end of 1957. Runaway inflation drove up prices by a large margin which negatively affected people's quality of life (PBOC, 2012, p. 160). Second, financial plans were unbalanced and economic figures were wildly falsified on a large scale. Influenced by the thought of "how bold person, and how much production", grassroots financial regulators set unrealistic goals and called on people and enterprises to save huge amounts. Data about loan recovery rates, which failed to be cross-checked, were processed at ease. Third, financial rules and regulations were broken and financial affairs were in a mess. Local financial regulators juggled central government and PBOC financial decrees at the extreme expense of economic and financial systems (Lu & Zhou, 2019, pp. 5-19).

In March 1962, the State Council released the *Decision to Centralize Banking Operations and Tighten Control over Currency Issuance*. PBOC, as the central bank, re-centralized power of local regulatory authorities and tightened control over credit. New credit loans must not be extended without the PBOC's approval and the People's Construction Bank of China (PCBC; the predecessor of China Construction Bank) and Agricultural Bank of China (ABC) were restored. The measures worked to some extent in that they corrected the erroneous ideas of the Great Leap Forward movement and brought economic and financial activities back to normal.

In the Cultural Revolution period (1966-1976), PBOC was integrated into the Ministry of Finance of the People's Republic of China. Although working independently, PBOC had its power significantly weakened and basically lost control of economic regulation nationwide. Besides, the number of financial professionals dropped to a historical low since the founding of the People's Republic of China, while banks basically suspended financial services. The Cultural Revolution resulted in the integration of PCBC and Bank of China (BOC) into PBOC and the end of specialized banks. Political unrest paralyzed the financial industry and wreaked a deadly havoc on the economy until the Cultural Revolution terminated in 1976 when the national economy gradually rebounded. In November 1977, the State Council issued *Several Decrees to Rectify and Strengthen the Power of the Central Bank* in a drive to restore this important part of banking and rectify the financial industry preliminarily. The orders laid a foundation for the advent of the reform and opening up period.

During the two decades from 1958 to 1978, the financial sector underwent multiple stages, setback, restoration, stagnation, and restoration. The sector, on the whole, was underdeveloped. Its annual financial value-added stood at only RMB5.46 billion, accounting for 2.8 percent of the GDP on the average and falling way behind main sectors such as agriculture and industry. Still, the economy achieved success as expected through the goals set for a planned economy. The gross national product (GNP) rebounded from RMB131.23 billion in 1958 to in RMB367.87 billion in 1978 thanks to support from the financial sector.① More loans to industry had such a positive effect that its contribution to the national economy gradually surpassed agriculture (Figure 1). Step by step, China transitioned from a traditional agricultural economy to an industrial economy. By the end of 1978, the industrial output had accounted for more than 40 percent of the GDP and industry rose to become the pillar industry of the national economy.

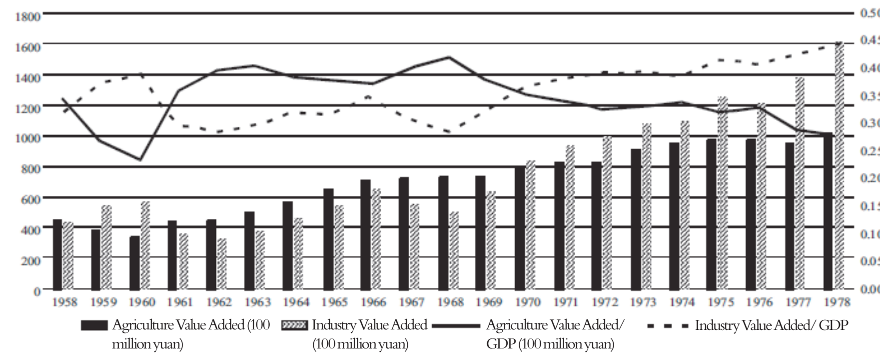

Figure 1 Agriculture vs Industry by Value–Added Contribution to GDP (percent), 1958–1978 (100 million yuan)
Data sourced from the website of the National Bureau of Statistics.

From Rural to Urban: Unprecedented Reform in the Financial System (1978–1992)

The Third Plenary Session of the 11th CPC Central Committee made the strategic resolution to shift the focus to economic development in December 1978, therefore unveiling the economic structural reform in China. As business entities' demand for more financial services increased, the original highly centralized financial system was no longer fit for financial needs in economic development and the financial institutions centered absolutely on PBOC called for immediate reform. The central government adopted the following three measures to promote reform (Jiang, 2019, pp. 21-26).

First, specialized banks were resumed and established. ABC and BOC were separated from PBOC, and PCBC separated from the Ministry of Finance. Also, trust industry and insurance industry recovered gradually (Lu & Zhou, 2019, pp. 5-19; Sun & Zhou, 2018, pp. 15-18). Second, the central bank became independent from the Ministry of Finance in 1983 when the State Council released the *Decision to Empower PBOC as An Independent Central Bank* and trusted it with specific roles. The order marked the birth of a financial system which featured PBOC leadership and coexistence with specialized banks and other types of financial institutions (Jiang, 2019, pp. 21-26; He, 2018, pp. 10-13). Third, credit loans were extended to fuel economic growth. In addition to current capital loans, banks began issuing fixed assets loans and development loans. In 1980, PBOC offered a total of RMB2 billion of medium- and long-term equipment loans to support the light industries

① Data sourced from the website of the National Bureau of Statistics.

(including textiles).

The Third Plenary Session of the 12th CPC Central Committee convened in 1984 and passed the *CPC Central Committee's decision on economic restructuring* directed at the institution of a public sector-dominated "planned commodity economy". Meanwhile, an urban economic reform rolled out with its center on state-owned enterprises and vitality enhancement. In this context, financial institutions increased efforts to reform themselves, achieving unprecedented market breakthroughs. First, bank reform picked up speed while non-bank financial institutions grew stronger. In 1986, the State Council released *Provisional Regulations of the People's Republic of China on the Control of Banks*, stipulating that banks as economically independent entities, should exercise their own power in carrying out financial operations. In order to introduce competition, the government decided to restore or set up a series of joint-stock commercial banks, e.g. Bank of Communications (BOCOM), China Merchants Bank (CMB) and China CITIC Bank (CNCB). Additionally, securities companies, insurance companies and other non-bank financial institutions also developed (Sun & Zhou, 2018, pp. 15-18). Second, significant progress was achieved in the currency and capital markets. The national inter-bank lending market began to develop while negotiable instruments began to take shape as the main instrument of corporate settlement and financing. Government bonds were reissued in the capital market in 1981. In 1990, the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE) came into existence as secondary markets of securities.

The financial sector had comparatively prominent characteristics of its own. Seen from its growth rate, the financial value-added climbed at an annual rate high above agricultural and industrial value-added. As shown in Table 1, the 1978-1992 period highlighted an average annual growth rate (AAGR) of financial value-added at 52.79 percent, high above agriculture and industry and indicative of a fast-growing financial sector contributing increasingly to the national economy.① Two factors were considered responsible for the speedy growth. First, the solely PBOC-controlled financial system transformed into a diverse system where specialized banks, joint-stock commercial banks, securities companies, insurance companies and trust companies ran parallel. Second, loan size quickly grew from RMB325.09 billion in 1983 to RMB2.31321 trillion in 1992, equivalent to a 25 percent AAGR which directly mirrored the relationship between the rocketing finance industry and credit expansion.②

Table 1 Agriculture vs Industry vs Finance by Value-Added Contribution to GDP (percent), 1979-1992

(100 million yuan. Basis Year: 1978)③

	Agriculture Value Added (100 million yuan)	Agriculture Value Added AAGR (percent)	Industry Value Added (100 million yuan)	Industry Value Added AAGR (percent)	Financial Value Added (100 million yuan)	Financial Value Added AAGR (percent)
1979	1,090.2	—	1,762.6	—	75.0	—

① Agriculture here is a reference to farming, forestry, animal husbandry and fishery, same as that in the table.
② CPI is used to gain inflation-adjusted data from nominal loan data.
③ The raw data were processed using indexes for value added by farming, forestry, animal husbandry and fishery, value added by industry and value added by the financial industry to obtain the constant prices of 1978. Same below.

	Agriculture Value Added (100 million yuan)	Agriculture Value Added AAGR (percent)	Industry Value Added (100 million yuan)	Industry Value Added AAGR (percent)	Financial Value Added (100 million yuan)	Financial Value Added AAGR (percent)
1980	1,074.8	-1.41	1,984.7	12.60	80.5	7.35
1981	1,149.8	6.98	2,018.8	1.72	84.3	4.75
1982	1,282.3	11.53	2,135.5	5.78	120.6	43.01
1983	1,388.2	8.25	2,343.1	9.72	152.6	26.59
1984	1,568.0	12.95	2,690.1	14.81	199.5	30.73
1985	1,596.7	1.83	3,174.9	18.02	233.6	17.10
1986	1,649.1	3.28	3,481.4	9.65	304.3	30.26
1987	1,727.2	4.74	3,938.6	13.13	373.0	22.57
1988	1,770.4	2.50	4,532.1	15.07	448.4	20.20
1989	1,824.8	3.08	4,760.7	5.04	564.1	25.81
1990	1,959.4	7.38	4,921.3	3.37	576.3	2.16
1991	2,005.7	2.36	5,625.0	14.30	592.6	2.83
1992	2,100.2	4.71	6,808.7	21.04	630.9	6.47
Average annual amount	1,584.8	6.62	3,584.1	20.45	316.8	52.79

Data sourced from the website of the National Bureau of Statistics.

From the perspective of money issuance, this period featured a massive money supply and high level monetization. Real money supply topped a trillion in 1988; M2 stood at an AAGR of 139.44 percent while the GDP had only an AAGR of 42.62 percent; and the monetization indicator (M2/GDP ratio) nearly tripled, rising from 0.32 to 0.93 (see Figure 2). The figures demonstrated that in the period the commercial economy moved further ahead, money credit had a broader influence and monetization continued to deepen (Li, 2019, pp. 60-61).

From the perspective of investments, residents concentrated on bank savings as a means of wealth management. Bond investments stood at RMB162.92 billion in 1992 when the stock market set sail with an investment of less than RMB30 billion while urban and rural savers totaled a balance up to RMB1.17573 trillion.① During the period, financial products were comparatively few and the general public depended solely on bank savings as an investment vehicle. Only a very few residents had enough money and initiative to invest in bonds and stocks.

From the perspective of financing, banks acted as the main financial intermediary in indirect financing. In spite of the capital market achievements during this period, banks still stood at the core of the financial system where enterprises relied primarily on indirect financial channels. The capital markets, especially the stock market, did not play the part requested of the modern capital markets, such as multi-horizon risk allocation, etc. Instead, they served primarily as a financing instrument oriented to state-owned enterprises. Furthermore, there was a strict approval system on stock issuance, most of which were not exchangeable or tradeable. Heavily characteristic of a planned economy, the

① Data sourced from Wind Economic Database.

Chinese stock market fell far behind those in developed countries.

As a history-making event since the founding of the People's Republic of China, reform and opening up came with far-reaching impacts on the Chinese economy. First of all, explorations of financial system reform laid a foundation for implementing the subsequent series of reform and opening up. The 1978-1992 period which saw the transition from a planned economy to a market economy brought fundamental changes to the financial markets and their structures while generating diversified financial products. The financial market was gradually switching from a planned economy to a market economy, the market entity was becoming more diversified and the structure of financial market was becoming more complex. Second, the successful experience of "wading across the river by feeling for the stones" achieved earlier added to the subsequent faith in financial market expansion. In the transition period China avoided a one-size-fits-all approach by adopting an incremental model of reform which is still a guiding principle for the Chinese economy and the financial markets. Third, financial resources bolstered manufacturing and boosted economic development. In 1979, banks nationwide totaled a real loan balance of only RMB204.66 billion, yet by the end of 1991, the figure had risen to RMB1.87761 trillion, equivalent to an AAGR of more than 60 percent.① The massive amounts of bank credits channeled funds into the industrial sector, especially manufacturing, driving economic structural reform smoothly ahead and adding to the overall strength of China. Fourth, the reconstruction of laws and regulations directed the financial sector to normalization. The 1978-1992 period saw the reconstruction of a body of laws and regulations, including a multitude of organic administrative regulations marking the establishment of a preliminary financial law system (Liu, 2018, pp. 22-25).

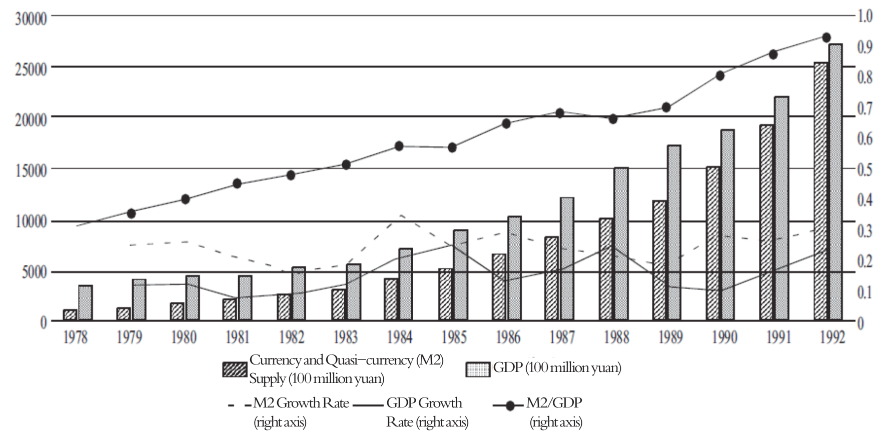

Figure 2 M2, GDP (absolute value) and Increase Ratio, 1978-1992 (100 million yuan; percent)
Data sourced from the website of the National Bureau of Statistics.

The Socialist Market Economy: Advance All-round Financial Reform (1992-2001)

A dozen years of reform brought significant changes to the economic system. To keep up with the times, the 14th CPC National Congress proposed establishing a socialist market economy as the target of economic structural reform in October, 1992. In November 1993, the Third Plenary Session of the 14th CPC Central Committee passed *The Decision of the Central Committee of the Communist*

① Data sourced from the website of the National Bureau of Statistics.

Party of China on Some Issues Concerning the Establishment of a Socialist Market Economy Mechanism. A package of reform plans, including measures on enterprises, markets, regulations and the economy, were specified. In December of the same year, the State Council released *Decision on Reform of the Financial System* and brought out the best in the financial sector in regard to national economy regulations and resource optimizations. It was against this background that China introduced multiple reform plans, e.g. banking, financial markets, financial regulations, etc.

First, state-owned specialized banks underwent commercial reform. The government promulgated the *Law of the People's Republic of China on Banking Regulation and Supervision*, officially determining Industrial and Commercial Bank of China (ICBC), ABC, BOC and China Construction Bank (CCB) as solely state-owned commercial banks against international criteria for operating and management. Three policy banks, i.e., China Development Bank (CDB), The Export-Import Bank of China (EIBC) and Agricultural Development Bank of China (ADBC), were set up to separate non-commercial services from those typical of specialized banks. Policymakers also referred to the practices of Western countries and the related international organizations in adopting the liabilities-assets (L/A) ratio as an indicator by way of strengthened risk management. Also, policy makers set up four financial asset management companies, i.e., Cinda, Orient, Great Wall and Huarong, in order to divest toxic assets from state-owned commercial banks, and improve asset quality to control or mitigate financial risks. As shown by the statistics, the four major asset management companies divested more than RMB4 trillion as nonperforming assets (Lu & Zhou, 2019, pp. 5-19; Chen, 2019, pp. 1-19). Second, financial regulation was reformed and strengthened. In 1992, the State Council decided to establish China Securities Regulatory Commission (CSRC). In 1998, PBOC set up a banking regulatory authority and the State Council set up China Insurance Regulatory Commission (CIRC). From then on, financial regulatory power was decentralized to three separate agencies (He, 2018, pp. 10-13). Third, exchange and interest rates underwent reform, too. In 1994, China introduced important foreign exchange reform to align the official forex rate with the market forex rate, e.g. an integrated, well-managed floating exchange rate based on market supply/demand. Besides, when implementing marketization of interest rates, the *Decision of the State Council on Reform of the Financial System* gave priority to the currency and bond markets in preference to the deposit and loan markets.

The financial industry in this period was characterized by a slow-down in the growth of financial value-added. As indicated in Table 2, the financial value-added dropped prominently behind the industrial value-added in growth and the financial industry growth slowed. Especially noteworthy points in time are 1994 and 1997. In the early 1990s investment overgrowth and total market demand drove banks to make increasing numbers of loans and triggered frequent unreasonable loans and investments. In the second half of 1993, the government took action to regulate the market and restore market order, resulting in a falling financial value-added in 1994. The 1997 Asian financial crisis, which impacted moderately on the Chinese financial markets, came with a sharp dip in real loan growth in 1998 and drove down the financial value-added by nearly 4 percent.

From the perspective of money supply, monetization continued to climb. M2 supply climbed increasingly and by 1998 it topped RMB10 trillion (see Figure 3). The M2/GDP ratio climbed from 0.93 to 1.43, exceeding the critical value of 1. Dang Yin and Wang Yang (2019, pp. 44-57, 124) linked this with several theories, like the monetization and broad monetization hypothesis, the money sediment hypothesis, etc., which more or less associated rising monetization with M2 oversupply.

Table 2 Agriculture vs Industry vs Finance by Value-Added Contribution to GDP (percent), 1992-2001

(100 million yuan. Basis Year: 1978)

	Agriculture Value Added (100 million yuan)	Agriculture Value Added AAGR (percent)	Industry Value Added (100 million yuan)	Industry Value Added AAGR (percent)	Financial Value Added (100 million yuan)	Financial Value Added AAGR (percent)
1992	2,100.2	4.71	6,808.7	21.04	630.9	6.47
1993	2,198.9	4.70	8,167.5	19.96	702.0	11.26
1994	2,287.2	4.02	9,701.4	18.78	770.3	9.73
1995	2,401.3	4.99	11,058.6	13.99	838.3	8.83
1996	2,523.5	5.09	12,440.1	12.49	904.5	7.90
1997	2,611.9	3.50	13,849.2	11.33	986.2	9.03
1998	2,703.4	3.50	15,080.0	8.89	1,036.7	5.11
1999	2,779.4	2.81	16,372.3	8.57	1,092.1	5.35
2000	2,846.2	2.40	17,985.7	9.85	1,168.2	6.96
2001	2,925.3	2.78	19,553.7	8.72	1,250.0	7.01
Average annual amount	2,537.7	3.93	13,101.7	18.72	937.9	9.81

Data sourced from the website of the National Bureau of Statistics.

From the perspective of financing, direct financing became all the more important. In this paper, indirect financing is measured based on loan amount and direct financing is measured based on securitized assets amount. As shown in Figure 4, the percentage of the direct financing amount climbed quickly, reaching 40.58 percent in 2001. The stock financing amount, as a kind of direct financing, climbed to RMB1 trillion in 1996, in excess of the bond financing amount. This proved that the development of the stock market contributed critically to an expanding direct financing market (Wu, 2018). The ratio of indirect financing to direct financing diminished continually from 8.13 in 1992 to 1.46 in 2001, marking a transition in the financial market structure.

From the perspective of preventing risks, the government took multiple measures to respond to the Asian financial crisis which resulted in falling exports and shrinking overseas demand. In order to ease the impact of the crisis and sustain economic growth, PBOC adopted many actions, including cancellation of credit lines, lowering of the required reserve ratio, lowering the deposit and lending rates and issuing RMB260 billion base currency into circulation on the open market. The measures enabled China to respond calmly to the crisis, demonstrating the risk response capability of the financial industry.

The 1992-2001 period, though short, marked the introduction of a socialist market economy as a goal that saw tremendous impacts on the economic and financial fields. First, the market economy increasingly became the megatrend of financial reform. Deng Xiaoping put forward that a socialist economy could also embrace marketization. The idea helped lay a theoretical foundation for in-depth economic and financial reform and provided a way out into the cause of reform and opening up. Specialized bank commercialization, interest rate marketization and other trial reforms helped lay the foundation for future in-depth marketization. Second, the multilevel financial market vigorously boosted the real economic development, hence the change of China into a "global factory". Great developments in the securities markets, especially the stock market, provided direct financing channels for the benefit of the real economy. Manufacturers gained increasing support from the financial industry as they drew motivation from preferential financial policies on loans. Third, improvements in the finance industry laid the foundation for a highly developed economy. Many reform measures not only benefited the financial markets, but also underpinned a sound banking sector. Fourth, a body of economic laws were formed and served to underpin a sustainable, stable financial industry. In 1995 a range of financial laws were passed, so the year is generally considered as the first year of introduction of such laws which marked sweeping progress (Liu, 2018, pp. 22-25).

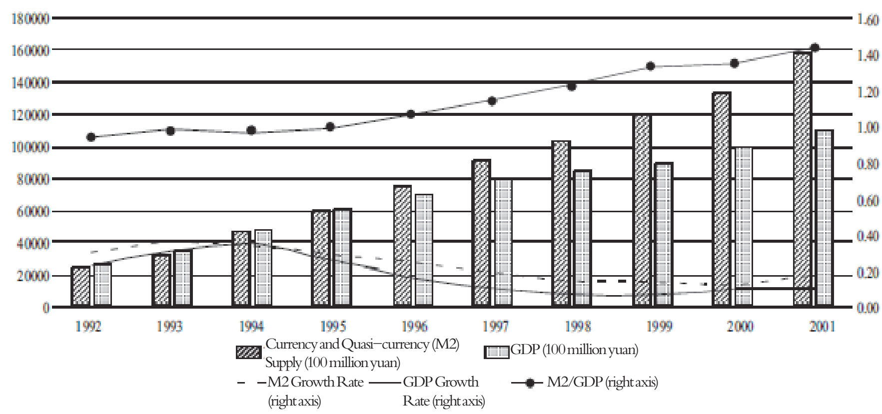

Figure 3 M2, GDP (absolute value) and Increase Ratio, 1992–2001 (100 million yuan; percent)
Data sourced from the website of the National Bureau of Statistics.

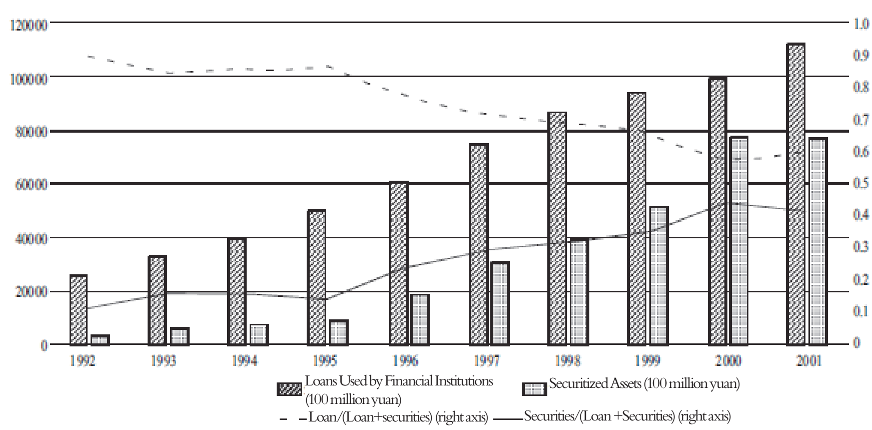

Figure 4 The Ratio of Direct Financing to Indirect Financing, 1992–2001 (100 million yuan; percent)[①]
Data sourced from Wind Economic Database.

① Proportion of indirect financing in total financing = loan/(loan+securities); proportion of direct financing in total financing = securities/(loan+securities)

Entry into the WTO: Acceleration in Financial Reform and Opening up (2001-2012)

China became a member of the World Trade Organization (WTO) in December 2001. In principle, any WTO member must open its financial markets as provided in *The General Agreement on Trade in Services* (GATS) and *Financial Services* which demanded the member open the market gradually or otherwise. A larger international market brought mounting challenges and confronted China with fickle financial uncertainties. The 16th National Congress of the Communist Party of China in 2002 announced that the socialist market economy has taken shape initially. Reform and opening up intensity climbed to a new high. The financial industry needed to accelerate reform and enhance quality at the watershed where huge market transformations occurred domestically and internationally.

The reform package included three measures. First, the share-holding reform of large commercial banks was conducted to provide against heavier financial shocks. From 2005 to 2011, ICBC, ABC, BOC and CCB went public, growing into publicly traded international commercial banks with relatively high competitiveness. That explains why the Chinese banking sector proved to be resilient in hedging crisis and risks during the 2008 global financial crisis (Lu & Zhou, 2019, pp. 5-19; Jiang, 2019, pp. 21-26). Second, the reform measure focused on driving capital market reforms and development. In this regard, split-share was implemented to maximize the constriction of stock market growth and restore the control of the financial system to banks. In April 2005, CSRC released *Notice on Issues Concerning the Pilot Program on the Share–trading Reform of Listed Companies*, signifying an official procedure that significantly stimulated market vitality, enhanced capital allocation efficiency and gave a push to fundamental reform of the financial markets (Wu, 2018). Reform was also introduced to stock issuance policies in 2001 so that instead of being mandated, new issues were applied to ease administrative limits and constrictions while driving information disclosure and marketization. A multi-levelled stock market system was built. SZSE launched the SME board and a second board to provide new financing channels for small-size SMEs and less profitable start-ups. Third, policymakers updated macroeconomic policy which, compared with prudential microeconomic policy centered on single financial institutions, gave more importance to systemic financial risk. In practice, PBOC intensified cooperation with other financial institutions, highlighted endogenous risk and monitored financial risk from more angles.

The financial industry had a few interesting characteristics in this period. A great deal of capital flowed into the real estate market and the financial industry provided less supply to the real economy. Among all RMB-denominated long-term loans in 2006, real estate and manufacturing accounted for 19.7 percent (RMB340.81 billion) and 8.3 percent[①] (RMB143.59 billion) of all newly-made loans respectively, while the figures were 13.9 percent and 7.5 percent[②] in 2007. Prior to the crisis, massive

① Data sourced from *PBC's China Monetary Policy Report 2006.*
② Data sourced from *PBC's China Monetary Policy Report 2007.*

capital flowed into the real estate industry sent prices higher, but comparatively less capital entered real economic sectors such as manufacturing.

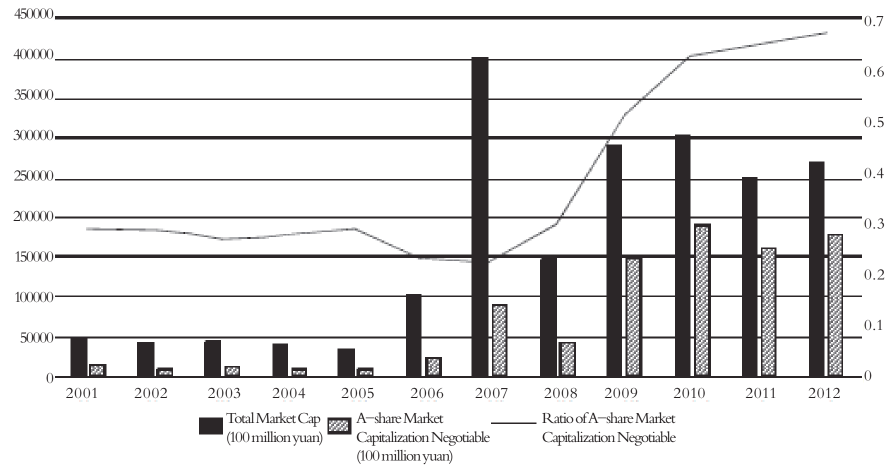

Figure 5 The Ratio of Total Market Cap to Tradable Share Market Cap During the Period 2001–2012 (100 million yuan; percent)
Data sourced from Wind Economic Database.

Seen from the capital markets, significant changes occurred in the stock market. First, the total market cap climbed before the outbreak of the crisis yet with large numbers of asset bubbles. As indicated in Figure 5, the total market cap first topped RMB10 trillion in 2006 and the figure surpassed RMB40 trillion by the end of 2007 until 2008 when the figure shrank sharply during the global financial crisis. The performance of the stock market during the crisis revealed many problems with the Chinese capital markets, including a fragile market system (Wu, 2018). Second, split-share structure reform injected a vital force into the capital markets. As shown in Figure 5, after the split-share structure reform in 2005, the ratio of the tradable share market cap to the total market cap took an uptrend on the whole. By the end of 2012, the ratio rose to around 70 percent. Third, diverse professional institutional investors appeared quickly, leading the stock market in a more reasonable direction.

The asset management market began to germinate. During this period, major commercial banks occupied a dominant portion of the markets, increasing deposit solicitation stress on small and medium-sized banks and driving down their profitability. In this background, China Everbright Bank (CEB) launched the Sunshine B Package in 2004 as China's first wealth management product. By 2005, banks in China issued an approximate total of RMB200 billion worth of individual wealth management products. The figure rocketed to RMB3.7 trillion by 2008 and to RMB17 trillion by the end of 2011 (PBOC, 2012, pp. 160). The development of the asset management market provided more options for individual investors while diversifying investment channels, yet gigantic risks existed because asset management products came under the off-balance sheet (OBS) assets of financial institutions.

From the perspective of opening up to the outside world, the financial industry stepped up efforts to open the doors to global investors. First, the banking sector sped up the opening up on the global level after the publication of the Regulations of the People's Republic of China on the Administration of Foreign-funded Banks in 2006. By the end of 2011, foreign banks in China totaled RMB2.2 trillion in total assets (PBOC, 2012, p. 160). Second, the capital markets stepped up efforts to opening doors to world investors. China kicked off multiple reform programs, including Qualified Foreign

Institutional Investor (QFII), Qualified Domestic Institutional Investor (QDII) and RMB Qualified Foreign Institutional Investor (RQFII), as transitional arrangements for capital markets opening up at a time when capital accounts had not become freely convertible. The programs added to the international financial influence of China and to the development of sound capital markets. Third, the insurance industry also kicked off rapid reforms so that by the end of 2012, expanded openness was basically completed except for a few products.

China's entry into the WTO marked a new starting point for its reform and opening up strategy. Financial reforms increased notably as China faced up to external challenges and strengthened the quality of development, resulting in great impacts on economic growth. Besides, the 2008 global financial crisis gave a tremendous boost to the economy. First, a diverse financial framework laid a foundation for market performance and prosperity. During this period, the capital and money markets ran neck and neck in reform, intensive efforts were directed to capital market reforms and a series of all-important policies were introduced. Banking, securities and insurance combined to contribute to a diverse financial market. Second, intensive opening up injected new vital energy into economic growth. The government expedited share reform for financial institutions, provided foreign financial institutions with more access to new products and continued with capital market opening up in order to assist the Chinese financial sectors to learn management science from its foreign counterparts, establish modern corporate management procedures, break up monopolies and improve the quality of financial products and services. Third, the financial industry diverted more funds from the real economy, compromising the non-real economy. When the global financial crisis started in 2008, problems covered by the apparently booming economy came to the surface and led to stock market bubble bursts, rocketing mortgage crisis and consistent credit fund flow to real estate. These problems blocked readjustments to the economic structure.

New Era: Equal Emphasis on Preventing Financial Risks and Deepening Reform (2012–2019)

Since 2012, the economic growth has weakened with a worsening downturn characterized by a new normal age of economic restructuring and renovation. In 2013, the Third Plenary Session of the 18th CPC Central Committee adopted *The Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform* which highlighted the decisive parts market mechanisms played in resource allocations by defining the importance of economic structural reform as part of an overall reform. The *Decision* also stressed that we should improve the financial market, push ahead with the reform of the financial institutions and open the financial industry wider. During this period, China had to face the pressure of deepening the domestic reform and a fluctuating global economy. That required China to continue with supply-side structural reform programs to upgrade its financial industry.

First, policymakers made every effort to help small and medium-sized enterprises out of financing cost difficulty. In this regard, policymakers put a premium on the development of private banks in order to break up monopolies, encourage competition and expand the range of services. Small and medium-sized banks implemented a targeted reduction of the required reserve ratio so that they could create more lending. In 2019, the government demanded national commercial banks achieve a more than 30 percent increase in loans to small and micro enterprises. Second, direct financing channels were developed to diversify the capital markets. In June 2019, the Sci-Tech Innovation Board began operation to diversify direct financing channels for enterprises (especially high-tech companies), underpin sustainable technological development and inject a vital force into the economy. Third, policymakers carried out financial regulation reforms to hedge risks. A double-pillar regulatory framework was erected as a system to combine two strong points, i.e. a monetary aggregate policy and a custom prudential microeconomic policy, in order for systemic financial risk control and financial stability maintenance. China Banking Regulatory Commission (CBRC) was integrated with CIRC to consolidate regulatory resources. In March 2018, the State Council decided to integrate CBRC and CIRC as China Banking and Insurance Regulatory Commission (CBIRC). Fourth, intensive opening up reform was introduced to lower the entry requirements for foreign financial institutions and allow them to expand operations in China. Also, removing the limit on maximum holdings contributed to expanded financial openness. A bidirectional investment mechanism was introduced to the capital markets, symbolized by the introduction of Shanghai-London Stock Connect in 2019. QDII quotas were cancelled to diversify outward investment channels.

The financial industry exhibited a few new characteristics during this period. From the perspective of growth, the financial industry expanded on a large scale yet provided less support for the real economy. The ratio of manufacturing loans to all loans took a downturn during these years contrary to government policies in support of the real economy (see Table 3). In essence, it resulted from the stress the downturn put on the economy. Non-performing loans resulted primarily from the manufacturing sector, so there was high risk associated with investment in the real economy.

From the perspective of asset management, the capital markets expanded quickly in wild chaos. After 2010, the domestic asset management market expanded quickly. By 2017 the market reached RMB100 trillion in comparison with the total stock market cap of RMB63.2 trillion.[①] Multiple problems existed in the asset management market, e.g. rigid repayments, multi-layered nesting and maturity mismatches. Expansions in asset management signified, to a certain extent, that quite a lot of funds, instead of being directed to the real economy, circulated among many financial institutions. Besides, wealth management products came under the OBS activities free from constraints of (core) capital ratios. Expanding OBS activities raised the leverage ratio of the banks and increased the related risks (He, Qian, & Liu, 2018, pp. 53-70; Ji & Li, 2018, pp. 1-18). For example, ICBC saw its ratio of the OBS to the total assets standing at only 17.70 percent in 2010 and climbing to 27.66 percent by the end of 2017. The asset management sector required urgent rectification and regulation (Wu, 2018).

① Data sourced from *PBOC's China Financial Stability Report 2018.*

Table 3 Manufacturing vs Real Estate vs Finance by Loan, 2010–2017

	Manufacturing Loan Balance (100 million yuan)	Manufacturing Loans/ Loan Balance in Financial Institutions (percent)	Real Estate Loan Balance (100 million yuan)	Real Estate Loans/ Loan Balance in Financial Institutions (percent)	Financial Loan Balance (100 million yuan)	Financial Loan/ Loan Balance in Financial Institutions (percent)
2010	86,474.7	18.05	33,609.4	7.01	1,726.0	0.36
2011	104,844.3	19.13	35,783.0	6.53	1,581.1	0.29
2012	121,934.6	19.36	39,008.6	6.19	2,501.3	0.40
2013	135,948.6	18.91	45,420.9	6.32	3,232.6	0.45
2014	140,615.0	17.22	53,841.4	6.59	3,969.8	0.49
2015	142,987.6	15.22	60,228.1	6.41	31,342.2	3.34
2016	143,822.5	13.49	62,669.3	5.88	37,050.2	3.48
2017	146,939.5	12.23	71,872.5	5.98	35,049.2	2.92

Data sourced from Wind Economic Database.

From the perspective of the development model, potential and risk coexisted in internet finance. Since 2010 the internet finance market has rapidly expanded in China. As shown in Table 4, third-party payment (TPP) amounts grew by RMB183.35 trillion and P2P lending grew six-fold from 2014 to 2018. Microcredit balances have also grown in the past two years. Although internet finance offset the insufficiency of traditional finance and contributed to inclusive finance, countless P2P platforms broke down or fled with investors' money and unlicensed or unauthorized TPP institutions were operated in violation of the law. Poor regulation brought huge risks to internet finance and was apt to divert risks to conventional financial institutions (banks, etc.), resulting in a financial crisis (Qiu, Huang, & Ji, 2018, pp. 17-29).

Table 4 Internet Finance Amounts and Changes, 2014–2018

	TPP Amount (100 million yuan)	P2P Outstanding Balance (100 million yuan)	Microcredit Balance (100 million yuan)
2014	247,200	1,286.69	9,420.38
2015	494,800	3,881.91	9,411.51
2016	992,700	6,795.11	9,272.80
2017	1,432,600	10,417.68	9,799.49
2018	2,080,700	7,889.65	9,950.44

Data sourced from PBOC and WDZJ.com.

From the perspective of risk response, policies inclined primarily to preventing systemic financial risks (He et al., 2018). First, policymakers readjusted financial structures to address mainly local government debts. This kind of debt had two major problems. A large number of unclassified implicit debts caused mismanagement. Debt capital sourced mostly from short-term capital was invested in mid- and long-term programs, hence the risk of maturity mismatches. Faced with this risk, the government took such measures as debt swaps in easing debt stress and inventory risks.

Second, in order to solve problems with the asset management market, PBOC, CBIRC, CSRC and State Administration of Foreign Exchange (SAFE) published *The Guiding Opinions on Regulating Asset Management Business of Financial Institutions*. Third, regulation was consolidated for banks, especially small and medium-sized banks.

Since 2012, the Chinese economy has undergone great challenges as supply-side structural reforms became central to economic structural reforms. It was a period of entering a deep-water zone when policymakers made every effort to drive financial reforms forward against mounting obstacles. Many reform programs are expected to have multiple far-reaching impacts on the Chinese economy. First, protection against systemic financial risk will play a decisive part in a steadily growing economy in a new normal period. At present the Chinese economy has a relatively high overall risk. Although economic growth is slowing, total financial assets continue to climb, indicative of large amounts of hot money in the financial system. This will not only trigger financial risk proliferation, but also intensify the diversion of financial resources from the real economy to the non-real economy. Second, enhanced innovation provides great opportunities for a firmer financial sector. The combination of finance and technology as an irreversible trend has risen as the direction for the future financial sector. Faced with competition, traditional financial institutions have to implement reform by increasing technology spending, developing new products or exploring open banking and smart banking by means of big data or AI technology. Innovation capabilities will become all the more important to the development of financial institutions. Third, the promotion of international financial influence has created conditions for China to further expand its opening up. The RMB became a member of the SDR basket of currencies in 2015, accounting for a 10.92 percent quota, behind only the dollar and the euro. The quota for the RMB as an instrument of international settlement climbed from the 14th place in 2012 to the 5th in 2015, and the currency swap amounts surpassed RMB3 trillion.[①] The statistics are indicative of the huge success China has made in financial reform and opening up and internationalization.

Outlook and Inspirations

When we look back on the 70 years of the Chinese financial industry, we can see how it started and grew into a mainstay of the national economy. However, there are some in-depth economic problems that need to be solved immediately. Economic growth depends overly on real estate and infrastructure investments, manufacturing investments are slowing and economic structural reforms have entered a deep-water zone. Turbulence in the global economy and in international politics are putting pressure on the reform programs. In this special period of transition, the problems with the economy and finance, of a cyclic, structural or institutional nature, become more prominent as they are greater challenges to financial reform and opening up. But we can derive four inspirations from our 70 years of efforts.

① Data sourced from the website of the State Administration of Foreign Exchange.

First, it is very important to adhere to marketization and opening up. The main goal of financial reform is to establish a market-based, modern and international financial system. In practice, the government must press ahead with direct financing by introducing to the capital markets such reform programs as structural adjustment, market tier diversification and improved capital allocation efficiency. The government should give free play to the market in generating the prices for financial products, including marketized instruments which guide the financial industry by reducing administrative regulations. The government should continue with financial opening up, face up to challenges and prevent risks while creating a level playing field for Chinese and foreign financial institutions. Financial market opening up will synchronize the Chinese markets with the global markets while achieving higher economic and financial inclusiveness and internationalization.

Second, policymakers should carry out in-depth supply-side structural reforms and sustain support for the real economy. First of all, inclusive finance was aimed at providing access to financial services for more people and businesses while granting access for those previously excluded from the financial system. Inclusive finance will make the financial system more inclusive (Liang, 2018, pp. 69-72). Second, the government should provide support to the SMEs with lower loan rates, research and innovation resources for core competitiveness. Third, more support should be provided for high-tech industries, especially when the trade disputes with the US escalate and the consolidation of technological strengths becomes imperative. The government should issue relevant financial policies in support for high-tech industries in an effort to transition into smart manufacturing as a long-term dynamic for the economy.

Third, financial regulations should be in line with the stages of financial development and focus on financial risk controls. At present, the Chinese financial industry is at the stage of specialized banking, yet the boundary separating various financial institutions and segments is adding to the characteristic of mixed banking. It is necessary to refer to what the UK and other countries implement as a post-crisis twin-peaks policy which combines prudential regulations with conduct regulations to preclude systemic financial risks. According to the actual situations in China, we should promptly adjust the regulatory system, and the people's Bank of China is responsible for macroprudential supervision, while the CSRC and the CIRC are responsible for microprudential supervision and behavior supervision, so as to prevent systemic financial risks from all aspects. The future financial regulation system must be less rigid, more flexible, and in sync with the development of the financial industry in response to risks and challenges.

Fourth, policymakers should take measures to combine finance and technology for the benefit of innovation. Technological support is very important to the financial infrastructure. Advanced technology bolsters financial infrastructure so that it can meet the actual requirements of the industry. Technology will play an increasingly important part in compliance and regulation. Compliance technology can assist financial institutions to identify suspicious deals and assess client credit scores. Regulatory technology (regtech) can assist the regulatory authorities to monitor corporate risks real-time and issue risk alerts. Financial technology (fintech) is emerging as a new field in finance.

Technology development is bringing transformations to the development models of traditional financial sector. Banks should put a premium on developing high technology, such as AI, to elevate business automation and improve smart business processes (Tang & Zhao, 2018, pp. 74-76). Technology is growing into a key push for financial market development. The government, in this course, should ease policy restrictions and encourage the application of new technology in finance. Meanwhile, close attention should be paid to technology-borne risk so that network security, client privacy and data security will be realized, technology applied in a better regulated manner and the risk spillover effect minimized (Han, 2018, pp. 26-30).

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