GLOBAL TIMES
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Misallocation still an issue for banks

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January 15, 2015

China has made significant progress in liberalizing markets and growing the private sector, but much still needs to be done to shift responsibility from the State to the market - particularly in the financial sector.

The large State-owned banks obey government officials and cannot go bankrupt. The allocation of credit is still heavily politicized, and State-owned enterprises (SOEs) are first in line. Lending rates are set by the People's Bank of China, which is under State control and thus subject to the rule of men, not rule of law.

Recent actions by the central bank have pushed the stock market to new highs and should help the sagging property market, but have done nothing to restructure the financial system or privatize SOEs. The decrease in the benchmark lending rate will help incentivize the mortgage market, but the large excess capacity will persist. Likewise, the injection of about $65 billion into the banking system in the form of short-term loans and another $242 billion from the effective reduction of banks' reserve-requirement ratios - by widening the deposit base and allowing the additional deposits, from asset management funds and securities firms, to be lent out - will help stimulate the stock market and prop up State-owned banks, but do nothing to correct the misallocation of credit and promote "high-quality" growth.

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