

# Contents

	Page
<b>Preface</b>	<b>vii</b>
<b>Glossary Of Abbreviations</b>	<b>ix</b>
<b>I Introduction</b>	<b>I</b>
<b>II China's Financial Reforms Since 1978: An Overview</b>	<b>3</b>
Three Components of Financial Sector Development	3
Institutions	6
Instruments	6
Markets	6
Characteristics of the Overall Reform Process	8
Laboratory Approach and Selectivity	8
Intermediate Control Mechanisms	9
<b>III Financial Sector Development</b>	<b>10</b>
The Role of Banks and Banking Before Economic Reform	10
Re-Establishment of Banking System (1978–84)	10
Diversification and Innovation (1984–88)	11
Rectification and Recentralization (1988–91)	13
Commercialization and Expansion (1992–Present)	14
Present Characteristics	15
<b>IV Legal Underpinning for a Market-Based Financial System</b>	<b>18</b>
Establishment of a Legal Framework for the Central Bank	18
Autonomy of the Central Bank	18
The Central Bank as Legal Entity	19
Primary Objective of the Central Bank	19
Responsibility for Formulating and Implementing Monetary Policy	20
Functions of the Central Bank	20
Instruments of Monetary Policy	21
Regional Participation in Monetary Policy	21
Summary: How Much Autonomy for the PBC?	22
The Commercial Bank Law	22
A Two-Tier Commercial Banking System	22
Reinforcement of the PBC's Authority	23
Separation of Banking and Nonbanking Activities	23
Enhancing Financial Discipline	23
Summary	23

<b>V</b>	<b>Development of Money and Capital Markets</b>	<b>24</b>
	Money Markets	24
	Primary Securities Markets	27
	Government Securities	27
	Nongovernment Securities	31
	Secondary Markets for Securities and Equity	32
	Initial Developments	32
	Building the Infrastructure	32
<b>VI</b>	<b>Payments, Clearing, and Settlement System</b>	<b>37</b>
	Payments System	37
	Clearing and Settlement System	38
<b>VII</b>	<b>Instruments of Monetary Policy and Monetary Developments</b>	<b>40</b>
	The Operating Framework	40
	The Credit Plan	41
	PBC Lending Facilities	42
	Reserve Requirements	43
	Interest Rates	45
	Open Market Operations	47
	Monetary Developments	48
	The First Cycle (1979–82)	48
	The Second Cycle (1984–Early 1986)	48
	The Third Cycle (Mid–1986–Late 1989)	48
	The Fourth Cycle (1992–Present)	52
	Overview: Monetary Developments Versus the Instrument Framework	54
<b>VIII</b>	<b>Developments in the Exchange System</b>	<b>55</b>
	Early Stages: Regulated Exchange Rates and the Foreign Exchange Plan	55
	Swap Centers and Retention Quotas: First Step Toward	
	Market-Determined Rates	55
	Settlement Procedures	58
	Regulation of Swap Center Trading	58
	Reform Plans and Reforms Since 1993	58
	Reform Plans	58
	Implementation	60
	The Present Exchange System	61
	Domestic and Foreign-Funded Enterprises (FFEs)	61
	Domestic and Foreign Banks	61
	Interventions by the PBC	62
	Prudential Regulation	62
<b>IX</b>	<b>The Agenda for Developing a Market-Based Monetary and Exchange System</b>	<b>64</b>
	Assessment of Achievements and Directions for Future Reform	64
	Assessment	64
	Some General Principles	66
	Directions for the Future	66
	Interest Rate Liberalization	67
	Reasons for Liberalizing Interest Rates	67
	Structural Impediments	68
	Plans for Interest Rate Liberalization	69

The Shift to Indirect Monetary Policy	72
The Target-Instrument Framework	73
The Supporting Infrastructure	75
Next Steps in Foreign Exchange Reform	79
Alternatives for Developing Exchange Markets	79
Supervising and Regulating Banks' Foreign Exchange Operations	79
Financial Institutions' Operational and Managerial Capabilities	79
Forward Operations	80
Leveling the Playing Field and Strengthening the Environment for Competition	80
<b>X Assessment and Conclusions</b>	<b>81</b>
Main Characteristics of Financial Sector Development	81
Diversification of Financial Sector	81
Accessibility of Financial Sector	82
Interplay of Government Plans and Market Forces	82
Capital Markets and Money Markets	82
Role of the PBC and Underlying Legal Framework	82
Transition to Indirect Monetary Policy Instruments	83
Interest Rate Liberalization	83
Exchange System	83
The Challenges Ahead	83
Commercialization of State Banks and Level Playing Field	84
Foreign Exchange Market Development	84
Coordination of Monetary and Exchange Rate Policy	84
Real Sector Reform	84
<b>Appendix Chronology of Financial and Exchange System Reforms</b>	<b>85</b>
<b>Bibliography</b>	<b>89</b>
<b>Boxes</b>	
<b>Section</b>	
<b>I</b> 1. Decision of the Third Plenum on Financial Development	2
<b>II</b> 2. China and the Northeast and Southeast Asian "Miracles": Common and Uncommon Features in Financial Sector Development	4
<b>III</b> 3. Policy Lending and Policy Lending Banks	14
<b>V</b> 4. Price Convergence in Secondary Government Securities Markets: The 1990–91 Episode	34
<b>VI</b> 5. The Cash Plan	38
<b>VII</b> 6. The Credit Plan	42
<b>VIII</b> 7. The Retention Quota System	57
8. Trading Arrangements in Swap Centers	59
<b>IX</b> 9. Interest Rate Liberalization and Regional Disparities in China	70
10. Phases in the Formulation of Monetary Policy in Selected Countries	72
11. Monetary Policy Framework Models that Focus on Interest Rates as the Operational Target	75
12. Interbank Market and Financial Reforms	76
<b>Tables</b>	
<b>Section</b>	
<b>II</b> 1. China and the Northeast and Southeast Asian "Miracles": Financial Sector Policies and Development	7