China Banking

20th April 2007 - Issues 3

Perhaps the two domestic industries that have yielded most reluctantly to market oriented reforms in China, the banking and petroleum industry, have recently shown encouraging signs of progress. At the end of last month, and in the first application of China's last, and arguably most important, WTO mandated banking sector reform, four foreign-owed banks were approved as locally incorporated entities. The much-anticipated reforms and their implementation effectively enable the foreign banks to operate freely in the Chinese marketplace and offer a nearly unmitigated range of financial service products without the former geographic, currency and client restrictions. Citigroup, one of the approved foreign lenders, has already announced robust plans to almost double its current number of branch outlets by the end of the year. The laudable reforms and their successful realization should bring significant and tangible benefits to the Chinese banking sector, the average Chinese saver as well as local and foreign enterprises. As foreign banks establish China-based practices, their imported familiarity in developing sound credit cultures in line with international best practices will do far more for China than somewhat appease her foreign trading partners through greater market access and opportunities to rebalance their import/export ratios. Foreign commercial banks that loan and invest prudently, to maximize profit and in accordance with fundamental principles like creditworthiness, will nurture promising domestic enterprises, reward customers with favorable deposit rates and innovative financial options and, lastly, serve as a powerful competitive catalyst for China's massive state-owed banks to relieve themselves of cumbersome, government-informed directives. These banking reforms have further paved the way for China to more sincerely embrace an economic regime fueled by free, uninhibited competition and founded on the voluntary exchange of goods and services—empowering not stymieing the human inclination to create, initiate and invent. Progress on the petroleum front, though present, has been slower and measurably more sheepish. While noting remaining obstacles and obvious contradictions in the market, Chinese media outlets have called the allowance of foreign oil wholesalers in the market de facto market regulation. This seems misleading. Though foreign enterprises may now apply for and putatively attain wholesale licenses, China's tightly controlled pricing mechanism effectively precludes foreign entry. Upstream wholesalers cannot, on market terms, compete with China's two vertically integrated, state-owed, petrol giants (Sinopec and CNPC). If the vast majority of the country's supply is controlled by non-market-oriented firms that can—indeed are instructed—to import and retail petroleum products at losses, this is a marketplace entirely void of market forces. Whereas banking reform initiatives have, since WTO accession, deftly provided foreign operators with, at minimum, a market niche, i.e., foreign currency business, petroleum-related reforms have been continuously structurally beset by the artificial retail pricing mechanism. Foreign competitors, whose operations are naturally dictated by market influences, will have little to no room to maneuver in a market effectively insulated from international prices. New wholesale opportunities and other upstream restructuring, while encouraging

in concept, will likely do little to attract foreign players. The Ministry of Commerce's (MofCom) March issued guidelines additionally requires all wholesaling entities to have a "one-time annual crude processing capacity of over 1 million metric tons" as well as "an oil product depot with a minimum storage capacity of 10,000 cubic meters." The MofCom regulations additionally stipulate that import licenses be applied for and obtained independently of wholesale licenses, further complicating market entry and adding additional variable elements. Requirements of this kind coupled with such highly uncertain profit prospects does little to practically encourage foreign participation and serves to effectively perpetuate SOE predominance. Monopolies, by their nature, obstruct competition. China's petrol monopolies are, if anything, more obstructive in nature than most as Beijing is their majority shareholder. Ostensibly, of course, the new reforms are intended to liberalize what has been a relatively closed and protected industry, though whether these are the necessary first steps to more comprehensive market reforms is unclear. There seems to be an accompanying element of the arbitrary that pervades opening an economic sector that remains so heavy regulated, subsidized and insulated. China's petroleum industry today looks much like her banking industry 10 years ago. Similar institutional interests and obstacles, however, were overcome in the latter's case and it is today positioned for successful international integration. The former is moving frustratingly slowly.