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I. INTRODUCTION

The People’s Republic of China (PRC) has been a military power for the last several decades. Because of the government’s stringent control of virtually every aspect of human rights, politics, and business policies—such as corporate decisions, financial matters, and economic policy—the PRC did not develop like other industrial nations. As a result, the PRC—the world’s most populous nation—lagged behind other developing nations in terms of industrial strength and general economic health. Industries were unable to raise sufficient capital to compete with other global powers; however, in the late 1970s several government officials sought to introduce long-term economic reform to ensure that China would become a global market power. In doing so, China borrowed economic theories from capitalist countries, but incorporated them “on its own terms,” leaving the communist government in control. Accordingly, the government remains the “chief executive officer” and “controlling shareholder” of the economy and its enterprises. The government continues these practices despite its adoption of a “socialist market economy,” in which the state makes economic decisions that drive the economy and businesses respond to market conditions and act accordingly. Basically, the government believes it can

4. See id. at 468 n.36; China’s Economic Reform 16 (Walter Galenson ed., 1993); see also China: A Country Study 165 (Frederica M. Bunge & Rinn-Sup Shinn eds., 3d ed. 1981) (noting that China’s socialist system gives the government control over the financial system and thereby allocates surplus funds to increase the percentage of GNP devoted to investment). This socialist market economy marked an attempted departure from the previous Chinese economic system, characterized by the 13th Congress “as one in which the state regulates the market, and the market guides enterprise.” Williams & Woo, supra note 3, at 468 n.36 (quoting Peter Harrold & Rajiv Lall, China: Reform and Development in 1992–1993, World Bank Discussion Papers No. 215, at 30–31 (1994)).
5. See China: A Nation in Transition 142 (Debra E. Soled ed., 1995) (noting that objective of government reforms was to allow enterprises to respond to “market forces rather than administrative directives issued by government officials”); China’s Economic Reform, supra note 4, at 16 ("The state will
incorporate capitalist functions to allow economic growth while retaining control by implementing underlying social policies.

A. The People’s Republic of China: A Brief History

For thousands of years, China was ruled by dynasty after dynasty. Additionally, foreign invaders including Russia, Japan, and Britain often controlled significant parts of the country. During this period the Chinese were susceptible to internal and external pressures that resulted in a less-than-unified nation. China finally became a republic in 1912 following the Wuchang Uprising. Prior to the uprising and through the end of World War II, the Chinese were constantly involved in territorial disputes with neighboring Asian countries and internal disturbances were common. Ultimately, various factions within the country asserted their right to control, and the Communist faction and its armies emerged as the strongest.

In 1949 the Communist People’s Republic of China was formed after the defeat of the Nationalist forces. The new government modeled itself after that of the former Soviet Union and established communist control at virtually every level. The two institutional pyramids for the PRC are the Chinese Communist Party (CCP) and the all-pervasive government structure. The CCP consists of the Politburo at the highest level, and the party branches at the lowest level.

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regulate the market demand and supply by fiscal, monetary, and legal means, and the market will guide the activities of the enterprises.

7. See id. at 16.
8. See id. at 16–18.
10. See HSÜ, supra note 9, at 34–52 (discussing China’s last dynasty, the Ch’ing dynasty, and imperial China prior to the formation of the Republic in 1949).
11. See id. at 52–54 (discussing China’s civil war from 1945–1949).
12. See id. at 52–55.
13. See id. at 56; THE CURRENT HISTORY ENCYCLOPEDIA OF DEVELOPING NATIONS 229 (Carol L. Thompson et al. eds., 1982) [hereinafter DEVELOPING NATIONS]. The three years after the founding of the PRC marked the first steps in China’s transition to socialism. See Wu Jianfan, Building New China’s Legal System, in CHINA’S LEGAL DEVELOPMENT 1, 6 (John R. Oldham ed., 1986). The government’s three main objectives during this period were to: “1) establish people’s governments at various levels; 2) complete the task of democratic reform; and 3) restore the national economy.” Id. at 6–7.
14. See DEVELOPING NATIONS, supra note 13, at 229.
15. See id.
The top level of the government is the State Council and the bottom level consists of the people’s communes. Although there is a level of decentralization for some actions at the provincial level, the economy is centrally planned and the plans are mandatory. Soon after the People’s Republic was founded in October 1949, the nation progressed rapidly in the areas of manufacturing and industry; however, the disadvantages of Communist economic policies suppressed this growth.

Starting in 1949, the government began a period of reconstruction in which most industrial and commercial property was socialized based largely upon the Soviet model. The first plan implemented was a five-year program to move China towards socialism. In 1958 Chairman Mao Zedong launched his Great Leap Forward, implemented through the mobilization of labor through communes and characterized by a focus on rapid growth to the detriment of quality and technology. Opposition to the Great Leap Forward grew and the country ended the programs; however, the opposition towards forceful tactics still exists today and is a source of great political unrest.

China’s closed economy resulted in stagnant economic conditions until revolutionary economic reforms and an

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16. See id.
17. See id.
18. See id.
20. See generally JEAN CHESNEAUX, CHINA: THE PEOPLE’S REPUBLIC, 1949–1976, at 31–82 (1977) (discussing the Period of Reconstruction from 1949–1952). During the Period of Reconstruction the government instituted New Democracy reforms to foster economic recovery and promote social policies. See id. at 42–43. The PRC’s first Five Year Plan lasted from 1953 until 1957 and formed the economic and political system modeled largely after the former Soviet Union. See id. at 56.
21. See CHINA: A NATION IN TRANSITION, supra note 5, at 56–60 (discussing the first stage of land reform and the effects of the first five-year plan on the economy, community, and industry).
22. See id. at 61.
23. See id. at 63–64. The Great Leap Forward resulted in mass starvation concentrated in rural regions. See id. at 63. Estimated deaths from starvation were approximately 19 million. See id.
24. See, e.g., CHINA: A NATION IN TRANSITION, supra note 5, at 237 (noting that the Great Leap Forward is a pervasive “block of modern China’s chronology and history”); Richard Bernstein, Jiang’s Warning: “No Forgiveness,” N.Y. TIMES, June 30, 1989, at A6 (discussing the Chinese Communist Party’s response to the Tiananmen Square protest of June 4, 1989; noting that there would be no tolerance for those opposed to socialism and for supporters of Western freedoms).
25. See HSÜ, supra note 9, at 842.
open-door policy concerning trade and the economy were adopted in the late 1970s. These far-reaching economic reforms departed from rigid social planning and implemented market-oriented socialism. But even with economic reform, opposition to the communist government is still evident. In 1989, 100,000 students and workers protested against the government and called for democratic reforms in Beijing’s Tiananmen Square. This event, along with other instances of human rights violations, makes foreign investors wary of the PRC’s stability and skeptical of the government’s promise for a stable market system. Only time will tell whether the political unrest within its borders will adversely affect the PRC’s newly reformed markets.

B. Modern Economic Situation

In 1978 Deng Xiaoping ascended to power and began a series of reforms devoted to civil matters and born out of practical necessity. His “open-door policy” centered on utilizing “market mechanisms and foreign resources (including foreign capital and technology) to speed up the growth and modernization of the economy.” His programs, including banking and securities market reforms, strengthened the Chinese economy and provided investment capital to Chinese industries. Today, the PRC must look
beyond self-reliance, egalitarianism, and peasant innovation to develop an industrial economy. To do so, the PRC now emphasizes professional expertise, science and technology, and trade.

Since the inception of these reforms, China’s gross domestic product (GDP) has risen sharply. By 1994 the GDP was over US$500 billion. Between 1978 and 1993, China raised in excess of US$59 billion in capital through foreign direct investment, and by the mid-1990s, China’s economy was growing by at least 12% per year. The GDP real growth rate in 1992, 1993, and 1994, was 13.2%, 13.5%, and 12.6%, respectively; however, this growth was accompanied by high inflation. This high inflation eroded earnings Chinese citizens had previously kept in the form of savings, forcing them to seek other possible investment avenues.

while China had a trade deficit in most years after 1978, this was because of increased domestic demand for imports caused by fast economic growth. See id. at 110. Because of the success of the reforms, China went from 36th in world trade in 1978 to 11th in 1993. See id. at 109.

33. See DEVELOPING NATIONS, supra note 13, at 229.

34. See id.

35. See Yin Xiangshou, supra note 32, at 111 tbl.13.2.

36. See Wei Jia, Tidal Changes in Chinese Foreign Investment Laws and Policies, 2 TUL. J. INT’L & COMP. L. 23, 24 (1994). The country was able to raise this amount through the approval of over 172,000 foreign direct investment contracts. See id.; see also Joel Bergsman & Sanjaya Lall, Personal View: How to Attract Foreign Direct Investment, FIN. TIMES, Apr. 18, 1995, at 19, available in LEXIS, World Library, Fintme File (noting that the majority of the world’s foreign direct investment went to Asian and Latin American countries with China alone receiving more than three times the amounts received by all central and east European countries combined); Record Direct Investment into Developing Countries, XINHUA NEWS AGENCY, Nov. 28, 1984, available in LEXIS, Asiapc Library, Xinhua File (noting that in 1993 developing countries received an estimated US$65 billion of foreign direct investment of which China received approximately US$26 billion).


40. See Kui-Wai Li, supra note 39, at 68–69.
Still, many economists predict that the PRC’s economy will continue to grow.  

Economic growth can be evaluated by many factors, such as the export of manufactured products. In 1978 Chinese exports totaled only US$9.8 billion, as compared to US$121 billion in 1994, making China the eighth largest global exporter of manufactured goods. China’s trading relationship with the United States has grown from near-zero levels during the pre-reform period to approximately US$40 billion during the mid-1990s. Also contributing to economic prosperity is the government’s relatively small consumption of GDP compared to other countries. The governments of both Japan and the United States consume their country’s GDPs at rates over twice the rate of the PRC government.

The Chinese savings rate of 40% of GDP is very high compared to other East Asian countries and the United States. To illustrate, the savings rate of GDP in the United States is approximately 20%. At about twice the U.S. rate, China’s high savings rate gives the Chinese private sector the ability to produce high levels of investment capital. It is this

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41. See China: The Titan Stirs, ECONOMIST, Nov. 28, 1992, at 3, 5. It has been predicted that the PRC’s economy will be the world’s largest by the year 2010. See id. However, the future success of Chinese economic reform is complicated by the need to escape third-world economic conditions and communism. See id. To achieve this, “land reform that sharply raises incomes in the countryside; a transfer of profits and labour from farming to industry; high savings rates, which finance industrial investment; low taxes; vigorous domestic competition; and an openness to foreign influence” are necessary. Id.


44. See China, supra note 42, at 17. In 1995 the PRC government spent just 11.6% of the country’s GDP, compared to approximately 20% for other Asian countries such as Hong Kong, Malaysia, Singapore, South Korea, Taiwan, and Thailand. See id. These countries have been referred to as “economic tigers,” and if China follows suit, “there will be decades more of supercharged growth, probably accompanied by gradual political liberalisation, as the market economy breeds a more pluralistic society.” Id. However, China is different from these economic tigers in that it “faces more uncertainties than other countries in the region that have sheltered under America’s security umbrella.” Id. The Chinese dictatorship and political problems are more severe than those of other Asian nations, and 70% of China’s 1.2 billion population live in rural areas rather than urban centers, as is the case in Hong Kong and Singapore. See id.

45. See id. at 18 & tbl.

46. See id.

47. See id.

48. See id. at 17.
wealth in the form of savings that the government of the PRC wants to fund Chinese industries.\textsuperscript{49}

State-run companies still employ about two-thirds of the urban workforce; however, one of China’s leading economists has noted that nominal employment numbers in the state sector are falling.\textsuperscript{50} Contemporaneous with the decline of employment in the state sector, private employment is continuing to grow,\textsuperscript{51} a possible signal that the PRC is becoming more capitalistic. Continued growth in the private sector should result in increased GDP for the PRC.\textsuperscript{52} This increase is due to greater commercial success on average for private entities than their state-owned counterparts.\textsuperscript{53} In addition, due to the country’s considerable labor force, upward pressure on wages will take longer to occur.\textsuperscript{54} This is beneficial because higher labor prices would decrease the PRC’s GDP.

To continue its economic expansion, over the next decade the PRC is expected to invest over US$1 trillion in transportation and communications infrastructure improvements and energy-related capital equipment investments.\textsuperscript{55} Infrastructure spending is necessary for the PRC to sustain its current level of growth.\textsuperscript{56} Therefore, the PRC will be dependent upon its capital markets to supply the country with the necessary financing.\textsuperscript{57} The New Development Bank was instituted to assist the securities markets in obtaining capital for these projects.\textsuperscript{58} The bank

\textsuperscript{49} Cf. China’s Economic Ascendance: Implications for the United States, Hearing Before the House Comm. on Banking and Fin. Serv., 104th Cong. 99 (1996) [hereinafter Lackritz] (statement of Marc E. Lackritz, President Securities Industry Association) (noting that regulated capital markets are necessary to encourage local investors to invest their savings in the debt/equity markets).

\textsuperscript{50} See China, supra note 42, at 18. Leading Chinese economist Fan Gang notes that the number of citizens employed by state industries has decreased by 10 million people in the past year and that now only 90 million people remain in the state sector. See id.

\textsuperscript{51} See id.

\textsuperscript{52} See id. (noting that shift of resources to private sector promotes economic growth).

\textsuperscript{53} See id.

\textsuperscript{54} See id. at 17.

\textsuperscript{55} See Lackritz, supra note 49, at 95.

\textsuperscript{56} See id. at 95-96. By 1993, China had 3.8 persons per telephone and only one car for every 4,345 persons. See The Pacific Summit; The Pacific Community, L.A. TIMES, Nov. 16, 1993 at 2C. These figures rank far below other developed countries and many other Asian Pacific nations. See id.

\textsuperscript{57} Cf. Lackritz, supra note 49, at 96 (noting that much of this development will be funded through foreign investors, both individual and institutional).

was established through a US$70 billion loan from the World Bank.\textsuperscript{59}

The capital markets, although very young and still experiencing a variety of problems, will be crucial for raising a large amount of investment capital. China’s Minister of Foreign Trade and Economic Cooperation, Wu Yi, has recently stated that the PRC’s stock and bond markets are poised for rapid growth and expansion.\textsuperscript{60} Others agree with his outlook. Among them is the Chinese Academy of Social Sciences, which agreed with Mr. Wu Yi’s analysis and commented that China’s long-term economic development depends heavily upon its investment opportunities.\textsuperscript{61} Foreign direct investment in Chinese industries grew from approximately US$12 billion in 1979–1982 to approximately US$37 billion by the end of 1993.\textsuperscript{62} Additionally, the PRC utilized about 70\% of these funds in 1993.\textsuperscript{63} China is now one of the world’s leading beneficiaries of foreign direct investment.\textsuperscript{64} The recent reacquisition of Hong Kong in 1997 should increase China’s ability to generate foreign investment.\textsuperscript{65}

Investors often worry about strained relations between China and other foreign nations due to political and strategic concerns.\textsuperscript{66} The United States and China were virtually enemies from the 1950s to the 1970s.\textsuperscript{67} The Tiananmen Square massacre of 1989 did not halt economic growth; however, there are continual questions concerning human

\textsuperscript{59} See id.

\textsuperscript{60} See Minister Predicts Rapid Growth and Expansion, INT’L SEC. REG. REP., Nov. 21, 1996, available in LEXIS, News Library, ISRR File. The Chinese government is seeking nationwide economic growth through the capital markets. See id.

\textsuperscript{61} See id.

\textsuperscript{62} See Jia, supra note 36, at 86 tbl.1.

\textsuperscript{63} See id.

\textsuperscript{64} See deLisle, supra note 43, at 516. By the mid-1990s the PRC was attracting US$80–100 billion annually in contracted investment and US$25 billion or more in actual investment. See id. The PRC now rivals the United States in terms of direct foreign investment. See id.

\textsuperscript{65} Cf. id. at 516–17 (noting that Hong Kong is a major contributor to foreign direct investment in China). See generally Edwin L.-C. Lai, The Economic Implications of the Reunification of Hong Kong with China, 30 VAND. J. TRANSNAT’L L. 735 (1997) (discussing potential problems for the Hong Kong economy due to political integration with the PRC and identifying means through which the economy can prosper).

\textsuperscript{66} Cf., e.g., id. at 518 (noting that economic considerations now surpass political, strategic, and international concerns).

\textsuperscript{67} See id.
rights violations in the PRC. Questions still persist concerning China’s status as a Most-Favored Nation. Additionally, there are concerns that China will not gain entry into the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO). Despite these and other questions concerning domestic politics and political stability, the head of the World Bank’s office in Beijing, Pieter Bottelier, predicts that China’s current growth is sustainable for another twenty years. To accomplish this and other goals, the PRC is taking steps outside of the securities and banking arenas to expand its economy. Recently, China promised to take steps to improve the economic environment for foreign companies operating within the PRC. The PRC government may be willing to relax trade restrictions and implement certain commercial reforms to gain entry into the WTO. Still, other reforms are needed, especially those dealing with educational issues. Educational deficiency problems exist in several industries in the PRC. The need for qualified managers is apparent in many industries.

II. ECONOMIC REFORM IN THE PEOPLE’S REPUBLIC OF CHINA

The PRC has developed new economic programs modeled closely after those of the Western capitalistic nations; however, socialist policies still dictate the PRC’s economic policy. Developing countries utilize their securities markets, depending principally upon domestic social conditions and economy. The PRC has certainly adopted its market reforms around the government’s social goals. Despite the foreign and internal investment sources that Chinese industries have

68. See China, supra note 42, at 17.
69. See deLisle, supra note 43, at 518.
70. See id. at 518–19.
71. See China, supra note 42, at 18.
73. See id. However, some believe such reforms would result in “economic dislocation for a huge number of workers employed in inefficient state-run industries.” Id.
75. See Mei Xia et al., The Re-Emerging Securities Market in China 1 (1992). Only five low-income countries have developed securities markets, compared to virtually all high- and middle-income developing countries. See id. Therefore, to promote discretionary investment it is necessary to generate high per capita incomes and savings. See id.
found, it remains imperative to the government to retain control of the corporations within the PRC. In designing new economic programs, the PRC has followed more capitalistic economic reforms adopted by many former communist states. However, the People’s Republic has adopted only limited versions of these capitalistic notions and still maintains staunch support for general social goals.

The PRC model of capitalization is actually a mixture of capitalist notions and social ideals. “Securitization” generally refers to the “process of financial engineering by which an illiquid asset that has no secondary market is converted into a security with an active secondary market.” In the United States, this practice usually results in the holder of a security owning a portion of the corporation. Like many other socialist countries, the PRC initially tried securitization only to finance industries, and therefore generally did not confer ownership rights upon the security holder. As a result, early Chinese corporate securities tended to take the form of American debentures and bonds rather than equity securities; however, as the securitization effort has grown in China, equity securities are now very common.

A. Limited Privatization

To infuse capital into their businesses, the Chinese employ “privatization” in their modern economic practices. Privatization usually entails the sale of state assets to private entities so that the state may use the capital in other areas. Other countries have begun privatization processes; however,
many of these countries have done so wishing to depart from communist philosophy. However, the Chinese practice a derivative of privatization referred to as “limited privatization.” Whereas privatization usually entails selling state assets to private entities to raise capital for use by the state, the PRC retains a controlling interest in its privatized entities. Therefore, by the absorption of private funds into state-controlled businesses, the state is able to accumulate private funds without relinquishing ultimate control of its assets. Under this system of limited privatization an important practical issue arises as to the optimum level of government share necessary to remain within the government’s social objectives while retaining efficient management of the corporation. As a general rule, the controlling share of a large public corporation is well below 51%; however, a socialist government must determine what floor level of ownership it is willing to accept based upon its objectives. Although there is no legal obligation for the PRC government to retain control over most industries, the state has retained a controlling interest in the country’s stock companies due to its socialist policies. The PRC maintains a 51% to 80% interest in enterprises that are now listed on the

85. See id. at 304.
86. See id. at 305.
87. See id. at 303.
88. See id. at 305.
89. See id. Mr. Bersani notes factors that motivated the PRC to proceed with limited privatization. See id. at 304. First, he argues, the PRC government deems its citizens as “collectively too rich.” Id. The government seeks to finance productive industries with the approximately US$310 billion of savings held by Chinese nationals. See id. Second, these massive financial resources in the private sector create a “potential political threat” for the government. Id. Through limited privatization, the PRC hopes to separate government from the day-to-day management of industry while retaining a controlling interest in the enterprise. See id. at 304–05.
90. See Baev, supra note 76, at 17. For example, if the government has profit motives, holding greater equity in the enterprise will be ideal. See id. However, if access to information and the ability to influence and monitor enterprise activities is the motivation, a lower equity stake may be sufficient. See id. at 17–18. This is achieved through the issuance of dual classes of shares with different voting rights. See id. at 18.
91. See id. at 17–18. The governments need to retain a share interest when they begin the process of securitization of state-owned businesses. For example, governments concerned with retaining a “golden share” in a company do so to control: “(i) industries strategic to the national economy, (ii) politically sensitive spheres of the economy, and (iii) industries of symbolic national importance.” Id. at 32 (quotations omitted). The “golden share” refers to an interest allowing the government to outvote all shareholders regardless of the number of shares it holds. See id. at 20.
92. See Bersani, supra note 2, at 310.
stock exchanges. Additionally, the Share Enterprise Trial Measures provide that certain enterprises such as national defense and precious metal mining require the state to maintain a monopoly because of the industry's strategic value. The PRC’s approach to privatization allows the government to raise capital while adhering to its wide ranging social goals. Most importantly, the government is concerned with maintaining ultimate control while allowing enterprises the freedom necessary to capitalize and hopefully prosper.

Recently, the government has been able to change the managerial structure of enterprises without relinquishing ultimate control through this process of limited privatization. The Chinese government has sought to instigate new managerial teams through privatization due to tremendous losses resulting from state-owned operations and believes that these teams can bring profitability to state operations. The government is hoping that managerial freedom and incentives will make these industries more profitable and, as a result, increase government wealth. While the government frees itself of daily decisions, it hopes the changes it is implementing will also result in greater industrial growth.

B. Stock Companies: A Model for Business Capitalization

For the privatization process to work, the PRC had to “corporatize” its state entities to be structured based on a stock ownership system. In the early development of these stock companies, the government sought to motivate management and workers by providing shares of the company solely to company personnel. These shares

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93. See id. at 305–06.
94. See id. at 308. In 1992 the PRC State Economic Commission and other state departments issued the Share Enterprise Trial Measures that contained ownership limitations. See id.
95. See id. at 305. Under limited privatization the state retains a controlling interest in the enterprise. See id. at 306. The government views it as the state’s control of private assets rather than a sale of assets. See id. This allows the political neutralization of the private sector’s vast economic resources. See id. This neutralization is deemed necessary by the government because it believes a great amount of financial resources under private control represents a possible political threat. See id. at 304.
96. See id. at 305 & n.7. Huge losses of state enterprises accounted for a large portion of the 1991 PRC budget deficit of approximately US$3.7 billion. See id.
97. See id. at 306.
98. See id. at 307. Before the issuance of stock was possible, the government tried a responsibility contract system. See id. at 306. Under this
provide the employees with an equity interest in the company; the theory is that this interest should motivate the employee to act in a manner that will make the company more profitable.99 Basically, the government was tying the employees’ income to their job performance.100 In theory, the more the employee performed, the more profitable the company and thus the stock’s value should go up because of the income retained in the enterprise.101 Therefore, the government could seek higher company profits by providing management and employees with performance incentives.

These reorganized companies were considered “internal” stock companies because only those associated with the company and the government owned shares.102 Internal stock companies still operate and are very popular within the PRC.103 By 1993 China’s stock companies were predominantly in the form of internal stock companies.104 Since then, other forms of corporatized entities have appeared and have traded regularly.105 However, one might argue that the PRC has adapted these capitalist notions only to raise the necessary capital to fund its own enterprises, and that the government will not use these capitalist practices at the expense of its underlying social, economic, and political goals.106

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99. See id.
100. See id.
101. Cf. id.
102. See id.
103. See id.
104. See id. at 307 & n.14. Of the approximately 3,700 stock companies in the PRC in 1993, only 69 were listed. See id. n.14. The rest were internal stock companies. See id.
105. See generally Mei Xia et al., supra note 75, at 69–74 (discussing state-owned, collectively owned, private, joint-stock, and foreign investment enterprises).
106. See Bersani, supra note 2, at 327.
III. SECURITIES MARKETS IN THE PEOPLE’S REPUBLIC OF CHINA

A. Development

With the establishment of the movement for economic reform in the late 1970s came the need for capital markets within the PRC. The government laid the foundations for economic reform when it began limited privatization and corporatization of PRC industries. However, the emergence of the country’s securities markets did not occur overnight. It would take many years of practice to develop an efficient market system, something that may still be lacking.

Prior to 1979 and China’s open door policy, China had remained in relative isolation for over thirty years. Although once host of the largest stock market in Asia, the communist government eliminated securities activities shortly after the introduction of communism in 1949. It was not until late 1990 that the PRC government opened its first national stock exchange. The development of the PRC’s capital markets took time and was a gradual formation. The market theories utilized by the new PRC leadership were based upon ideas of Chinese economists that relied on Marxist notions, that is, “that stock companies

107. In January 1992 Xiaoping made the following statement concerning the PRC’s fledgling securities markets:

Are securities and stock markets good or bad? Is there any danger in adopting such things? Do they exist exclusively in capitalism? Can they also be adopted in a socialist system? People are allowed to consider such matters further, but resolute action must be taken to experiment with such things.

Id. at 301.

108. See Mei Xia et al., supra note 75, at 27. After 1979 economic measures designed to liberalize the Chinese external economic sector included the decentralization of the trade system by giving local governments greater autonomy, the encouragement of foreign direct investment through more liberal policies, and the active utilization of external financing to increase domestic savings. See id. “The main thrust of the open-door policy called for vigorous expansion of foreign trade and absorption of foreign capital, advanced technology, and management.” Id. The end result of these reforms was “a marked expansion of external trade, particularly exports; remarkable inflows of foreign investment; and a substantial increase in external borrowing.” Id. From 1978–1989 exports increased by approximately 300% and foreign investment was approximately US$20 billion. See id.


110. See Tarbutton, supra note 37, at 411–12.

111. See id. at 413 n.12.
are a form of capital ownership by the organized working class.”

By 1980 the government allowed employees of collective enterprises to be issued corporate stock. In 1983 the State Council formally acknowledged this practice. This issuance of corporate stock served as the beginning of the implementation of China’s goal to develop capital through internal stock companies. By 1986 the State Council allowed state-owned enterprises to be reorganized into shareholding entities. This led to the first major public issue of shares by state-owned entities. Regional stock exchanges appeared in the Chinese provinces. Soon after the first exchange opened in Shenyang in 1986, over-the-counter markets developed in Shanghai, Tianjin, Chongqing, Beijing, Wuhan, and Guangzhou. However, in March 1987 the State Council restricted this rapid growth by ordering that state-owned enterprises could not offer shares to the general public. This was in response to the rapid trading of company shares to the general public. The measure was taken to ensure that the state retained some manner of organized control over stock issues. However, this directive had little impact on developing modern markets, and prior to the opening of the first two national exchanges, there was evidence of large volume trading involving both publicly issued and internal shares.

B. Securities Reform

To cure the problems with a system of regional exchanges and, additionally, to provide Chinese businesses with desperately needed capital, the government opened the nation’s first national stock exchange on December 19, 1990, in Shanghai. The Shenzhen Stock Exchange was opened

112. Id.
113. See id. at 413.
114. See id. at 413–14.
115. See Bersani, supra note 2, at 307 n.14.
116. See Tarbutton, supra note 37, at 414.
117. See id.
118. See id.
119. See id.
120. See id.
121. See id.
122. See id.
123. See id.
124. See id. at 411–12.
shortly thereafter on July 3, 1991. Smaller regional exchanges are located in Shenyang, Wuhan, Tianjin, and Talian. The scope of the PRCs securities markets is very broad, consisting of a wide variety of financial instruments. Stock issuance is allowed for all collectively owned and private firms and for some selected state-owned businesses.

The Shanghai and Shenzhen stock exchanges operate as nonprofit organizations and employ a membership system in which only exchange members can trade on the exchanges. Any company in the PRC that desires to be listed on either of the two national stock exchanges must adopt the PRC's stock ownership system. In 1992 the PRC State Economic Commission and other state departments issued the Share Enterprise Trial Measures, under which the Opinion on Standards for Companies Limited Shares (hereinafter Opinion) was issued. This Opinion establishes guidelines for the stock companies. Accounting, labor, taxation, and financial management of the country’s stock companies were governed by twelve sets of provisional rules that were issued under national regulations. Because the Opinion does not have the status of a law promulgated by the National People’s Congress, it may be superseded in the future. The Opinion governs the securities markets on the national level; however, some individual securities exchanges have developed their own sets of regulations and guidelines on the regional level, which govern the establishment of stock companies in those particular regions.

On the regional level, the Shenzhen and Shanghai stock exchanges each have developed their own rules and guidelines. The Shenzhen and Shanghai regulations apply

125. See id. at 412.
126. See Lees & Liaw, supra note 109, at 65.
127. See Mei Xia et al., supra note 75, at 58. In addition to equity securities, these instruments include government, index, and municipal bonds, and bonds issued by state-owned specialized banks, non-bank financial institutions, and large industrial enterprises. See id. at 58–59.
128. See id. at 59.
129. See Lees & Liaw, supra note 109, at 65.
130. See Bersani, supra note 2, at 307.
131. See id. at 308.
132. See id.
133. See id.
134. See id.
135. See id. at 308–09.
136. See id. at 308–09 nn.19–20 (referring to the promulgation of the Shenzhen Municipality Provisional Regulations on Companies Limited by
to any company operating in those municipalities; however, the Opinion applies to all companies traded in the PRC.\(^{137}\) Interaction between the Opinion and the municipal provisions is unclear; however, it is evident that these provisions are a step towards developing an “outline” for company law in the PRC.\(^{138}\) A system modeled after the U.S. system would provide a more efficient way to raise capital. In the United States, the Securities and Exchange Commission (SEC) has general oversight powers under the Securities Exchange Act of 1934, but the individual exchanges also share the responsibility as self-regulatory organizations (SROs).\(^{139}\) Self-regulation, rather than a centrally regulated market, provides the system with more flexibility, which can lead to greater efficiency. The PRC may be attempting to suspend trading for some of its listed companies, as evidenced by recent actions in the Shanghai Stock Exchange.\(^{140}\)

The Opinion creates a system of corporate organization that follows the corporate models of the United Kingdom and Hong Kong more so than it follows the U.S. model.\(^{141}\) In China, a stock company divides its capital into shares.\(^{142}\) The companies issue the shares through promoters that establish the company and insure the company if troubled financial conditions occur.\(^{143}\) The promoter’s function is much like that of a typical underwriter in an issue of U.S. securities. There are two main avenues for issuing a company’s shares:\(^{144}\) through a private placement, as long as the sale is not made to any foreign or natural person other than company employees,\(^{145}\) or through public offerings on the

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\(^{137}\) See id. at 309.

\(^{138}\) See id.


\(^{140}\) See Sophie Roell, Survey—China 1996: The Watchdogs Bark, FIN. TIMES, June 27, 1996, at 6, available in 1996 WL 10598248. In April 1996 the exchange suspended trading of six of its companies because of the posting of particularly low annual reports by each company. See id. Although the companies had not violated PRC disclosure requirements, it was a signal that the exchanges are leaning towards making enterprises responsible to their shareholders. See id.

\(^{141}\) See Bersani, supra note 2, at 309.

\(^{142}\) See id. at 311.

\(^{143}\) See id.

\(^{144}\) See id. at 312.

\(^{145}\) See id.
Shenzhen, Shanghai, Hong Kong, or other foreign exchanges.\textsuperscript{146}

A PRC stock company can issue common or preferred shares that are much like those issued in the United States;\textsuperscript{147} however, PRC equity securities must be divided into four categories based on stockholder status.\textsuperscript{148} The first category, “state shares,” are purchased by the government.\textsuperscript{149} “Legal person shares” can be purchased by legal persons of the PRC.\textsuperscript{150} “Foreign investment shares” (B shares) are owned by foreign persons.\textsuperscript{151} Finally, “individual shares” can be purchased by PRC natural persons, including employees of the company.\textsuperscript{152} Categories that are not B shares are usually referred to as “A shares.”\textsuperscript{153} Generally speaking, A shares are for residents and B shares are for foreign investors.\textsuperscript{154} In addition to these classes of equity securities traded in the PRC, the government developed a separate class of shares for Chinese industries called H shares, which are distributed and held in the Hong Kong capital markets.\textsuperscript{155}

B shares are ideal for investors willing to take on higher levels of risk in return for the opportunity of higher returns and participation in the PRC’s growth.\textsuperscript{156} Unfortunately, they are not convertible to A shares.\textsuperscript{157} This feature of B shares represents their great limitation and creates a completely separate market for them as opposed to comparable A shares.\textsuperscript{158} In addition, although B shares were created to attract foreign investment, the stocks “have turned-out to be illiquid.”\textsuperscript{159} Comparable to the securities laws of the United States, the shareholders of PRC stock companies are the

\textsuperscript{146} See id. at 312–13.
\textsuperscript{147} See id. at 314.
\textsuperscript{148} See id.
\textsuperscript{149} See id. & n.43 (outlining the four categories of stockholder status as defined in the Opinion on Standards for Companies Limited by Shares).
\textsuperscript{150} See id
\textsuperscript{151} See id.
\textsuperscript{152} See id.
\textsuperscript{153} See Bersani, supra note 2, at 314–15 n.44.
\textsuperscript{154} See id. at 314–15 & n.44. An individual in the PRC may own no more than 0.5% of a company’s total outstanding shares, but at least 25% of a public company’s outstanding shares must be individually owned. See id. at 315. Company employees may not purchase more than 20% collectively. See id.
\textsuperscript{155} See Lees & Liaw, supra note 109, at 61.
\textsuperscript{156} See id. at 63.
\textsuperscript{157} See id. at 61.
\textsuperscript{158} See id. at 67.
\textsuperscript{159} See id.
\textsuperscript{160} Lackritz, supra note 49, at 5.
“company’s most powerful authority.” 161 The Opinion allows for B shares to be held only by or transferred to foreigners. 162 Likewise, A shares may be held only by Chinese investors. 163

The first national stock exchanges were opened as a result of government efforts to encourage Chinese citizens to invest their estimated US$310 billion in savings into the PRC’s industrial community. 164 The principle reason for the government’s limited privatization of state-owned entities was to tap into this vast wealth of savings. 165 By 1996, a leading Shanghai securities brokerage firm conducted a survey and found that 72% of the respondents favored securities as an investment device over savings accounts. 166 This response may be a result of China’s high inflation rate that hit 24.2% in 1994 before leveling off to 14.8% in 1995. 167 The high inflation resulted in negative real interest rates, forcing investors to find investment vehicles other than savings accounts to retain real wealth. The People’s Bank of China (PBOC), competing directly with the securities markets, saw its deposits “dwindle” in the late 1980s as investors looked to the securities markets for more favorable returns. 168 This phenomenon occurred because people sought higher rates of return instead of the lower interest rates offered on their savings accounts; 169 however, this caused another problem concerning possible conflicts of interest between the PBOC and the securities markets, 170 discussed later in this Comment. 171

Between 1991 and the end of 1993, companies listed on the PRC’s national exchanges grew from approximately 20 to

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161. Bersani, supra note 2, at 316.
162. See id. at 318.
163. See Bersani, supra note 2, at 318–19 (noting that the Opinion does not place restrictions on the number of investors allowed in private companies or the level of sophistication of transferees, but does place restrictions on company employee transfers).
164. See Tarbutton, supra note 37, at 411–12.
165. See Bersani, supra note 2, at 304.
166. See Shanghai Residents Shifting Funds to Securities, INT’L SEC. REG. REP., Aug. 30, 1996, available in LEXIS, News Library, ISRR File. A Shanghai securities brokerage firm reported that “Shanghai residents are shifting their savings from low-interest bank accounts to securities. The survey showed that 72% of the respondents pick securities as their top investment choice, while only 24% picked savings accounts. The survey also revealed that state treasury and enterprise bonds were favored over equities.” Id.
167. See Risk Report, supra note 38, at 3.
168. See Tarbutton, supra note 37, at 415.
169. See id.
170. See id.
171. See infra notes 257–58 and accompanying text.
more than 170.\textsuperscript{172} Capitalization grew from US$12 billion dollars in 1992 to US$40.5 billion by 1993;\textsuperscript{173} however, the Shanghai and Shenzhen Markets generally remained stagnant during 1994.\textsuperscript{174} Thus, while the Chinese economy was growing rapidly as it entered the mid-1990s,\textsuperscript{175} the securities markets were not contributing greatly to this vast growth. On July 29, 1994, the China Securities Regulatory Commission (CSRC) ordered a stop on all new share listings for the remainder of the year based on a sharp decline in the price of shares.\textsuperscript{176} Since then, China’s markets, the number of securities outstanding, and trading volume have grown rapidly, placing the PRC’s national securities markets, in terms of size, among the “middle league of emerging markets.”\textsuperscript{177} By May 1996, 362 companies were listed on China’s national markets, compared to only 14 in 1991.\textsuperscript{178} Market capitalization resulted in US$55 billion by the end of May 1996.\textsuperscript{179} While the markets grew from 1990 to 1994, the growth stalled in 1994, and the government was willing to take action to ensure they would begin rising again. These results also show that China’s reformed securities markets have the ability to raise substantial capital, both foreign and domestic.

C. The Need for Further Securities Reform

Although the Shanghai Securities Exchange and the Shenzhen Stock Exchange have been successful in attracting investment capital to China’s economy, the exchanges remain very risky,\textsuperscript{180} especially for foreign investors. Until recently, Chinese officials admitted openly that the PRC’s securities markets were risky because of fraud and corruption.\textsuperscript{181} However, in November 1996, the China Regulatory Commission issued a new set of rules requiring

\textsuperscript{172} See LEES & LIAW, supra note 109, at 65.
\textsuperscript{173} See id.
\textsuperscript{174} See Xuefeng Qian, supra note 37, at 615.
\textsuperscript{175} See id.
\textsuperscript{176} See LEES & LIAW, supra note 109, at 66.
\textsuperscript{177} China, Reining in the Free Market, EUROMONEY, July 15, 1996, at 146, available in 1996 WL 11120726; see also Lackritz, supra note 49, at 96.
\textsuperscript{178} See Lackritz, supra note 49, at 96.
\textsuperscript{179} See id. This figure was over 25 times higher than in 1992. See id. While China has only recently entered the debt/equity foreign markets as a means to raise capital, from 1991–1995 it was fifth among emerging markets in terms of debt/equity financing (approximately US$14 billion) and was first among developing Asian nations in the international equity markets. See id. at 97.
\textsuperscript{180} See Tarbutton, supra note 37, at 412.
\textsuperscript{181} See id.
brokerage firms to obtain either licenses or certificates to participate in stockbroking activities.\footnote{182} These new regulations concerning broker activities are meant to dissolve the corruption in the securities market and thus alleviate risk for investors, especially concerning investments made by foreign investors.\footnote{183} Corrupt business practices are also having less of an influence on securities markets. In November 1996 the CSRC punished several brokerages for illegal securities transactions.\footnote{184} Analysts perceive this action as a reflection of the government’s resolve to crack down on irregularities in the country’s securities markets.\footnote{185} Foreign investors can greatly enhance the available pool of capital available for Chinese industries if the PRC’s securities markets provide them with greater stability. However, it is questionable whether the Chinese government is willing to accommodate foreign investment concerns considering the government’s strict promotion of socialism.

Another major problem with the PRC’s securities laws is the issue of inadequate disclosure, which particularly affects foreign brokers dealing in Chinese securities.\footnote{186} To issue a security in the United States, the 1933 Securities Act requires that the issuer undertake a timely and expensive commitment to register the security and disclose all material information that an investor might need to make an informed investment decision, unless the security is specifically exempt from those requirements.\footnote{187} In the PRC, the government typically decides what companies should be listed on the exchanges; their true financial situations are concealed from the investor.\footnote{188} Foreign investment bankers are also concerned that the government decides which

\begin{itemize}
\item \footnote{182} See In the Middle of a Boom Market, Securities Firms Face Regulatory Hurdles, INT’L SEC. REG. REP., Nov. 18, 1996, available in LEXIS, News Library, ISRR File. “To obtain the certificate, the firms must have 20 million yuan in net assets as well as 10 million yuan circulating in the market.” \textit{Id}. In addition, “two-thirds of their senior management and dealers must be certified professionals and . . . five percent of their monthly profits must be set aside to cover potential losses.” \textit{Id}.
\item \footnote{183} See Banks and Brokerages Punished for Illegal Stock Dealing, BBC SUMMARY WORLD BROADCASTS, Nov. 18, 1996, available in LEXIS, Asiapc Library, BBCSWB File [hereinafter Banks and Brokerages].
\item \footnote{184} See \textit{id}. The Commission punished 12 bank branches and brokerage firms for illegally bidding for shares on credit. \textit{See id}.
\item \footnote{185} See \textit{id}.
\item \footnote{186} See Roell, \textit{supra} note 140, at 6. In China, annual results are drastically lower than brokers’ expectations, proving that PRC companies are reluctant to provide information containing bad economic news. \textit{See id}.
\item \footnote{188} See Roell, \textit{supra} note 140, at 6.
\end{itemize}
companies should be listed on the national exchanges rather than allowing investors to select the companies. Foreign investors might not desire to speculate in PRC securities unless disclosure requirements are brought up to U.S. standards or the standards of other economic powers.

Another source of dissatisfaction among foreign investors is the membership requirements of the exchanges. All members of the national stock exchanges are Chinese securities houses, which is a disadvantage to foreign investment firms. In July 1994 the CSRC announced it would begin to search for a process by which foreign investors could enter the A share market. The announcement resulted in sharp market increases.

There are several problems that arise out of China’s regulation of the stock markets. One is that listed (public) firms are greatly outnumbered by nonlisted (private) firms, which means that many industries might not be able to raise the amount of capital they desire. If a company is restricted to raising capital from its management and employees (an internal unlisted stock company), it can only tap into the savings of its company personnel. A listed company can seek capital from any investor that is eligible to buy the company’s shares. This is a tremendous advantage because listed companies can be courted by professional or institutional investors that usually have large capital positions. Investors with large amounts of capital may be most useful in financing a company’s capitalization needs. Finally, the PRC’s current system regarding stock companies makes it hard for companies to raise additional capital through new stock issues.

189. See id. The author concludes that the government’s role in the selection process of listing companies is used as much for policy reasons as for commercial reasons. See id. She notes that many “cash-starved state-owned enterprises” with great economic problems “dominate” the exchanges. Id.
190. See LEES & LIAW, supra note 109, at 65. As of March 1994, only 21 foreign securities firms held seats on the Shanghai exchange. See id. These firms are permitted to trade B shares, but because they are not exchange members, they may trade only with the assistance of local brokerages that are members and act as partners. See id. In turn, the local brokerages charge about 20% of the foreign firms’ commissions for such trades. See id.
191. See id. at 66.
192. See id. at 67.
193. See Bersani, supra note 2, at 321.
194. See id. at 322.
The PRC’s current system of market regulation needs to be reformed.\footnote{See generally Jay Zhe Zhang, Comment, Securities Markets and Securities Regulation in China, 22 N.C. J. INT’L L. & COM. REG. 557 (1997) (discussing current PRC securities markets laws, regulations, and practices).} The government needs to free itself of listing and disclosure requirements. However, this approach towards a model more like the United States’ is probably short-lived. In July 1997 China regained control of Hong Kong and its valuable securities markets.\footnote{See Lai, supra note 65, at 736.} It appears that the Hong Kong exchanges are heading for a middle-of-the-road solution.\footnote{See Gareth Hewett, It’s Time to Show Some Faith in HK Blue Chips, S. CHINA MORNING POST, Aug. 13, 1996. Exchange Chief Executive Paul Chow favors a U.S. based system in Hong Kong because he believes it allows investors to make their own decisions if certain risks are properly disclosed. See id. This type of system would place responsibility for complying with disclosure and other requirements on the companies, their banks, and advisors. See id. However, others are skeptical of such a self-certification system for companies. See id. Exchange Deputy Chief Executive Herbert Hui opposes the U.S. model. See id.; see also Ted Hagelin, Reflections on the Economic Future of Hong Kong, 30 VAND. J. TRANSNAT’L L. 701 (1997) (assessing potential problems the reacquisition may have on the Hong Kong economy; noting the Hong Kong markets offer more stable investment markets than other Asian and Latin American countries).}

Foreign investors have two main advantages to purchasing B shares in a stock company.\footnote{See Bersani, supra note 2, at 323.} First, because management and workers can participate in equity ownership, this might provide the motivation to propel the company to profitability.\footnote{See id.} Second, there are fewer restrictions on the sale of shares in a stock company in the PRC as opposed to joint ventures.\footnote{See id. & n.72 (referring to the Regulations for the Implementation of the Law of the People’s Republic of China on Sino-foreign Joint Equity Ventures; noting that the liquidity of stock interests and opportunity for employees to hold equity ownership is an advantage gained by investing in stock companies).}

There are some disadvantages for foreign investors who purchase shares in PRC stock companies.\footnote{See Bersani, supra note 2, at 324.} Under the Opinion, all company and related documents must be prepared in Chinese.\footnote{See id.} This might result in the investor having inadequate disclosure because of language barriers. The market for B shares is also limited because the Chinese are not permitted to own B shares and foreign investors
cannot purchase a company’s A shares. Additionally, brokers selling B shares are concerned with the illiquid nature of these shares. Short-selling of B shares is prohibited and the shares cannot be sold within four days of the original purchase. B shareholders are also usually powerless when companies make decisions that have discriminatory impacts on foreign investors. It has been suggested that the holders of B shares should be given a special veto power to alleviate the risk that a company will make business decisions to the detriment of foreign investors. However, the PRC government does not appear willing to relinquish power to foreign shareholders. The retention of power by the state is of primary importance to socialist goals. It may be noted, however, that the exchanges, with government permission, have been receptive to some investors’ wishes. In October 1996 the Shanghai exchange reduced trading commissions from 0.4% to 0.35% of transactions to stimulate market activity.

Between 1992 and 1993 the trading volume of B shares was far below that of A shares. The average price to earnings ratio of B shares was far lower than that of A shares, and while A shares received positive returns, B shares produced negative returns. By 1994 Shanghai’s

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203. See id. at 325.
204. Cf. id. (noting that joint venture interests provide more liquidity than stock company interests because of the restrictions placed on A and B shares that are not present in the joint venture context).
205. See LEES & LIAW, supra note 109, at 67.
206. Cf. Bersani, supra note 2, at 322 (arguing that “B shareholders, as a class, should have veto power over decisions by the company that would have a discriminatory impact on foreign investors”).
207. See id.
208. See LEES & LIAW, supra note 109, at 70 tbl.4.4. The total trading volume of B shares on the Shanghai exchange in 1992 and 1993 was 16.6% and 8.3%, respectively, which resulted in only 17.1% and 7.6%, respectively, of that exchange’s total market capitalization. See id. The Shenzhen exchange had a total B share market volume of 7.6% and 2.4%, respectively, in those 2 years. See id. The market capitalization from B shares of that exchange in 1992 and 1993 was 6.5% and 8.9%, respectively. See id.
209. Returns for A shares in 1992 on the Shanghai and Shenzhen exchanges were 0.38 and –0.18, respectively. See id. Returns for B Shares were –0.30 and –0.39. See id. During 1993 A share returns on the Shanghai exchange were 0.03 compared to –0.11 for the Shenzhen exchange. See id. In 1992 the average price to earnings ratio (P/E) of A shares was 72.65 for those listed on the Shanghai market while B shares averaged only 17.40. See id. The Shenzhen market fared much better for B shares in 1992 and 1993, as their P/E ratios were 35.56 and 14.45 in those years, respectively. See id. However, B shares were still lower than A shares, which had P/E ratios of 57.52 and 52.19, respectively. See id.
market capitalization for A shares reached US$27 billion and Shenzhen’s market capitalization was US$15 billion.\textsuperscript{210} In contrast, the markets for B shares were US$2.5 billion and US$0.9 billion.\textsuperscript{211}

According to the government, China’s securities markets are “experiments” in capitalism.\textsuperscript{212} Therefore, if the markets present uncontrollable problems, and conflict with general socialist goals, they may be dismantled\textsuperscript{213} and the government may find another avenue to raise capital for its enterprises.

\textbf{IV. THE BANKING INDUSTRY AND FINANCIAL SYSTEM OF THE PEOPLE’S REPUBLIC OF CHINA}

Market function expansion in the economy after 1979 occasioned the necessity for financial system reform.\textsuperscript{214} “Competition, responsibility for profits and losses, incentives for good performance, and rational pricing [interest rates] were basic elements of a more efficient financial system.”\textsuperscript{215} One goal of financial reform was to establish gradually a forceful, yet flexible, banking system.\textsuperscript{216}

Prior to 1979, the PRC’s financial system was composed of a few specialized banks that handled all financial transactions.\textsuperscript{217} Under this system, central planning was used to allocate financial resources and the budget was designed to supply funds and working capital to enterprises.\textsuperscript{218} However, companies usually need more than just operating capital. To grow, sufficient investment capital is needed to improve capital equipment, to supply the necessary labor, and to supply other factors of production.\textsuperscript{219} Prior to the banking reforms, the banking system had a

\textsuperscript{210} See id. at 70. The market capitalization of H shares on the Hong Kong market reached US$2.3 billion. See id. This suggests possible improvements in raising investment capital that the well established capital markets of Hong Kong may bring to China based on Hong Kong’s reversion to Chinese rule in July 1997.

\textsuperscript{211} See id.

\textsuperscript{212} See Roell, supra note 140, at 6.

\textsuperscript{213} See id.

\textsuperscript{214} See Mei Xia ET AL., supra note 75, at 28.

\textsuperscript{215} Id.

\textsuperscript{216} See id.

\textsuperscript{217} See id. at 27.

\textsuperscript{218} See id. at 28.

limited economic role and merely accommodated the economy.\footnote{220}

\textbf{A. Banking Reform}

In 1979 the PRC’s banking system was dramatically transformed through economic reforms,\footnote{221} the objective of which was to establish a socialist market-oriented economy based primarily on public ownership.\footnote{222} Only one year earlier, the PBOC was separated from the Ministry of Finance and given a ministerial rank.\footnote{223} In 1984 the PBOC became the country’s central bank and other specialized banks took over its commercial banking activities.\footnote{224} At that time, there were five main banks in the PRC: the PBOC, the BOC, the Industrial and Commercial Bank of China (ICBC), the People’s Construction Bank of China (PCBC), and the Agricultural Bank of China (ABC).\footnote{225} Currently, the PRC’s

\footnote{220. See Mei Xia et al., supra note 75, at 28.}
\footnote{221. See Yates, supra note 58, at 835. These reforms were designed to ensure the power of the BOC. See id. The reforms were as follows:}

1. The BOC is the only full-service bank allowed for foreign use; other nations are permitted only representative offices.
2. Any group doing business in China must have an account with the BOC.
3. Any individual or enterprise, whether PRC or foreign, wanting foreign exchange must apply for it through the BOC. . . .
4. The above regulations apply also to financial activity in the special economic zones ("SEZs"). In addition, all salaries and profits of non-PRC groups involved in the SEZs must be remitted through the BOC.

\footnote{222. See Gang Yi, Money, Banking, and Financial Markets in China 27 (1994). This socialist-market economy was to be achieved through banking sector reform “aimed at promoting the economic leverage function of the banking system by giving more freedom of operation and profit motives to specialized and other commercial banks, making them independent economic entities while macro monetary policy was controlled by the central bank.” Id.}
\footnote{223. See id.}
\footnote{224. See id.}
\footnote{225. See Lees & Liaw, supra note 109, at 21; see also Yates, supra note 58, at 835. As of 1994, the BOC had 8,000 domestic branches and 474 abroad. See Lees & Liaw, supra note 109, at 24. Areas of specialization include: “[T]he management of foreign-exchange transactions, foreign currency reserves, and lending within the international Eurocredit markets.” Id. Other BOC activities include overseas securities transactions, the issuance of bonds in international markets, and establishing correspondent relations with foreign banks. See id. The duties of the People’s Construction Bank of China (PCBC) include managing budgetary allotments and financing large-scale construction projects. See id. The PCBC has recently entered a joint venture with Morgan Stanley (U.S.) to form the PRC’s first investment bank for the purpose of raising capital abroad for domestic use. See id. at 24–25. The Industrial and Commercial Bank of China (ICBC) was intended to assume the PBOC’s commercial banking
banking community consists essentially of the PBOC and the 4 specialized banks that have a decentralized network of over 120,000 branches.\footnote{See Lees & Liaw, supra note 109, at 21.}

The banking reform began principally with the relinquishment of the PBOC as the sole source for investment capital.\footnote{See Tarbutton, supra note 37, at 413.} The PBOC, which was controlled by the central government, previously was very restrictive in loaning capital to Chinese industries.\footnote{See id.} The State Council directs the PBOC, a government organization.\footnote{See id. at 21.} Therefore, decisions of the PBOC are subject to the wishes of the government.

The four specialized banks generally dominate the banking business, and all of them are owned or controlled by the government.\footnote{See id. at 31.} The specialized banks were given more control of their own operations to promote profit-driven incentives.\footnote{See id. at 30–31.} However, the government could retain significant control of the money supply and credit with the PBOC as the central bank.\footnote{See id. at 31.} The specialized banks were given a more flexible credit and loan policy.\footnote{See id. (discussing data from Good News Yet to Reach Japan, EUROMONEY, Dec. 1994, at 113–18). Together, these banks comprise more than 75% of the banking market share. See id. at 31.} This flexible policy, in turn, would make the banks responsible for their lending decisions in terms of profits and losses.\footnote{See id. at 31.} The government appeared to be relinquishing control of everyday decisions while retaining ultimate control of the economy; however, despite the autonomy these banks have recently received, they do not have complete responsibility for profits activities. See id. at 25. With over 50,000 branches, it is China’s largest commercial bank and is a major provider of working capital loans to state and collective enterprises. See id. The Agricultural Bank of China (ABC) provides banking services to rural areas. See id. In 1994 the BOC, ICBC, PCBC, and ABC were ranked the highest based on shareholders’ equity, assets, and profits. See id. (discussing data from Good News Yet to Reach Japan, EUROMONEY, Dec. 1994, at 113–18). Together, these banks comprise more than 75% of the banking market share. See id. at 31.

\footnote{226. See Lees & Liaw, supra note 109, at 21.}

\footnote{227. See Tarbutton, supra note 37, at 413.}

\footnote{228. See id.}

\footnote{229. See Gang Yi, supra note 222, at 27. The PBOC’s "responsibilities are to make macro monetary policies; control the money supply, interest rates, and exchange rates; serve as the treasury of the central government; regulate financial markets; and formulate the overall credit and loan plan." Id.}

\footnote{230. See id. at 30–31.}

\footnote{231. See id. at 31.}

\footnote{232. See id. Banks dealing with foreign exchange were also subject to the central bank’s approval. See id. Reserve ratios were set by the PBOC at approximately 10% in 1985 and 13% in 1994 to control monetary policy. See id.}

\footnote{233. See id. The specialized banks were given more control of their funds concerning the deposits obtained, capital, and borrowings from the central bank. See id.}

\footnote{234. See id.}
As with other socialist countries, business decisions in the PRC are based on government needs and mandates rather than profit driven motives. Another disadvantage for the specialized banks under the government’s banking reform policies is the limited amount of competition in which they can engage. The specialized banks are limited in the loans they can make, except in some instances in which mutual borrowing between banks is allowed. Although the government still retains a great amount of control over the banking industry, the economic deregulation has allowed Chinese firms to work with cash and credit regulations to obtain what they need from the markets in ways previously unavailable.

The specialized banks’ duties include: loaning to enterprises in accordance with state policies; borrowing and lending at PBOC prescribed interest rates; administering systematic funds transfers; handling credit and settlement transactions; overseeing the cash management of enterprises that have banking relationships with the bank; and handling international financial business, subject to State Council or the PBOC approval. Although these specialized banks do not represent the entire spectrum of the Chinese financial industry, they dominate the PRC’s banking needs.

235. See Mei Xia et al., supra note 75, at 46.
236. See id.
237. See Gang Yi, supra note 222, at 31.
238. See id. at 32. Prior to the economic reforms state firms had to get a physical plan allotment and financing to commence a project. See id. However, as a consequence of the reforms, state firms now have managerial control over market resources. See id. They can sell their products for cash in the market and use the proceeds for their own needs. See id. This has resulted in growth in producer goods markets and increases in the ratio of cash transactions and liquidity of bank transfers. See id.
239. See Lees & Liaw, supra note 109, at 23–24.
240. See id. There are several nonbank financial institutions, such as trust and investment, leasing, and insurance companies. See id. at 28. These institutions serve a role in attracting foreign investment, and the number of such institutions will continue to increase with continued economic reform. See id. at 29. Examples of such institutions include the CITIC (a finance, production, trade, technology, and service conglomerate created in 1979), the CITIC Industrial Bank, the China International Capital Corporation (China’s first international investment bank), The People’s Insurance Company of China (established 1949), China Venturetech Investment Corporation (established 1985), and the Urban and Rural Credit Cooperatives (independent credit unions). See id. at 28–30. Because they are regulated less than banking institutions, nonbank financial institutions are more flexible, efficient, and profit driven. See id. at 31. However, because their resources are shared with bank holding companies, there is the possibility that funds will be diverted to financial institutions affiliated with the banks. See id.
Aside from domestic banks, the open-door policy also allowed foreign banks to enter the PRC’s markets.\textsuperscript{241} These banks were needed to fund economic development\textsuperscript{242} and created competition for the domestic banking industry.\textsuperscript{243} Essentially, in allowing foreign competition, the government made the domestic banking community act in the most economically efficient and profitable manner possible. Additionally, Chinese banks have sought to enter foreign markets;\textsuperscript{244} however, this movement has been met with opposition in the United States.\textsuperscript{245} Domestic Chinese industries have also been able to seek capital in terms of loans from these foreign banks and financial institutions now operating in the PRC.\textsuperscript{246} The Regulations on Foreign and Joint Venture Financial Institutions in Shanghai were promulgated in September of 1990.\textsuperscript{247} This regulation created procedural and other requirements for establishing branches of foreign financial institutions in Shanghai.\textsuperscript{248} By the end of 1993, foreign financial institutions were in Chinese cities by

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241. See id.
242. See id.
243. Cf. id. (noting that foreign banks put “competitive pressure” on the domestic banking industry).
244. See id. at 24.
245. See, e.g., Recent Developments in Banking and Finance in the People’s Republic of China, Hong Kong, and Taiwan, Hearing Before the Comm. on Banking and Fin. Serv., 104th Cong. 66 (1996) (statement of Nicholas R. Lardy, Senior Fellow, Brookings Institution) [hereinafter Lardy] (noting that “[b]anking is the weak link in China’s economic reforms” and that while the purpose of the reforms was to distribute capital more efficiently, the state ownership and influence of the government prolongs the existence of “inefficient, money-losing state-owned manufacturing and commercial enterprises”). Mr. Lardy stated that the Chinese financial system is “extremely fragile.” \textit{Id.} This can be attributed to the reliance of Chinese banks on public savings, the issuance of loans by banks at interest rates lower than the rate of inflation, and the high percentage of nonperforming loans. See \textit{id.} at 66–67. Mr. Lardy believes market fragility will prevent China from allowing foreign banks into the Chinese market because of increased competition. See \textit{id.} at 70. However, continued foreign pressure to enter the Chinese banking markets could provide the impetus for banking reform within the PRC. See \textit{id.} For a concise discussion of Mr. Lardy’s testimony, see Scholar: Bar Chinese Banks from U.S., THOMSON’S INT’L BANKING REG., Mar. 25, 1996, at 1, available in LEXIS, News Library, ABBB File [hereinafter Scholar].
246. See \textit{Gang Yi}, supra note 222, at 33. Although restricted in what types of business they may conduct, foreign banks are gradually being allowed to operate closer to international banking standards. See \textit{id.} The PRC has allowed foreign banks and financial institutions to operate in, “Trade financing, all kinds of deposits and loans in hard currencies, demand deposits and checking services in foreign exchange and bank transfers, consulting, insurance services, underwriting, and corporate finance.” \textit{Id.}
247. See \textit{id.}
248. See \textit{id.}
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the hundreds, as compared to 4 in 1978. Additionally, the prospering securities markets and the absence of legislation like Glass-Steagall make it desirable for foreign banks to enter China’s markets to conduct securities activities.

B. Problems

Banking reforms, and the deregulation under them, while creating greater economic prosperity, are still deficient. State banks are still under pressure to lend to state firms. Almost 70% of bank loans finance the state sector, which produces only approximately 34% of total industrial output. The government continues to finance these state-run companies to avoid creating mass unemployment in industrial centers. However, this short-term goal results in long-term under-performance and inefficiency. Because the financial system has run into these and similar problems, government authorities have proposed several solutions. One of the top priorities is strengthening the PBOC’s role as the central bank. Authorities have suggested making the PBOC responsible for implementing monetary policy without

249. See id. at 32–33. The banks in 1978 were the Hong Kong Shanghai Banking Corp. Ltd. and Standard Chartered Bank PLC, both from the U.K.; from Hong Kong, the Bank of East Asia; and from Singapore, the Overseas-Chinese Banking Corporation. See id. By 1991 additional banks included: from Japan, the Sanwa Bank, the Bank of Tokyo, Dai-Ichi Kangyo Bank, and the Industrial Bank of Japan; from the United States, Citibank, N.A. and the Bank of America; and from France, Banque Indosuez and Credit Lyonnais. See id.

250. See Susan H. MacCormac, Foreign Banking in China: Opportunities for U.S. Investors in the 1990s, 7 J. CHINESE L. 225, 246 (1993). In the United States, the Glass-Steagall Act prohibits commercial banks from entering into certain investment banking and securities transactions. However, Glass-Steagall has been questioned by parties exerting pressure on the U.S. government to allow commercial banks to participate in the capital markets. See, e.g., Prepared Testimony of John D. Hawke, Jr., Treasury Under Secretary for Domestic Finance Before the House Committee on Banking and Financial Services, Fed. News Service, June 3, 1997, available in LEXIS, News Library, Fednews File (urging repeal of sections 20 and 32 of Glass-Steagall, restricting associations between commercial banks and securities firms, and section 4 of the Bank Holding Company Act, limiting bank holding company functions); Steven Lipin & Timothy L. O’Brien, Repeal of Glass-Steagall May Hit Wall Street with Takeover Wave, WALL. ST. J., Mar. 27, 1995, at C1 (noting that 59% of commercial banks larger than US$5 billion indicated the desire to underwrite securities, and that repeal of Glass-Steagall would make securities firms takeover targets).

251. See China, supra note 42, at 18.

252. See id.

253. See id.

254. See LEES & LIAW, supra note 109, at 39.
governmental interference.\textsuperscript{255} Other possible reforms include establishing uniform and competitive financial markets with strong regulation and supervision, reforming the banking system to allow state-owned banks to operate on a commercial basis, and delegating policy-based lending from commercial to newly established policy banks.\textsuperscript{256}

Under Article 5, section 11 of the Interim Regulations of Banks passed in 1986, the PBOC was delegated authority to regulate the regional stock exchanges.\textsuperscript{257} However, allowing the country’s largest bank and lending institution to regulate the markets created a major conflict of interest.\textsuperscript{258} The possibility of mismanagement was shown by the fact that PBOC deposits decreased, due in part to negative real interest rates and the attractive terms offered in the securities markets.\textsuperscript{259} Another problem with the PBOC was that it regulated the regional exchanges through its regional offices, which led to a variety of regulatory rules across various markets naturally resulting in inconsistencies.\textsuperscript{260} Further evidence of the central bank’s inability to manage its regional offices was presented to the House Banking Committee of the United States in 1996 when Congress considered the requests of Chinese banks to open branches in the United States.\textsuperscript{261} In particular, the Shaghai branch of

\begin{footnotesize}
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\item See id.
\item See id.
\item See Tarbutton, supra note 37, at 414–15 n.26. The PBOC is authorized to regulate stocks, bonds, and negotiable instruments, and to administer financial markets. See id.
\item See id. at 415.
\item See id.
\item See id. at 415–16.
\item See, e.g., Lardy, supra note 245, at 70; Scholar, supra note 245, at 1. Mr. Lardy noted that while Chinese banking authorities have not adequately assessed bank asset quality:

Several authoritative Chinese sources have suggested that as much as a third of the outstanding loans of banks and other financial institutions are non-performing. Even if one assumes both that banks discontinue extending loans to bad credit risks immediately and that banks ultimately recover as much as half of their existing nonperforming loans from the proceeds of the liquidation of enterprises unable to amortize their debt, total financial losses would be 15 percent of GDP and more than three times bank capital.

Lardy, supra note 245, at 68. However, another commentator was more optimistic about the progress of China’s economic reforms. See Recent Developments in the People’s Republic of China, Hong Kong, and Taiwan, Hearing Before the House Comm. on Banking and Fin. Servs., Banking and Finance, 104th Cong. 3 (1996) (testimony of David A. Lipton, Assistant Secretary, Treasury for International Affairs). David Lipton noted that “China is
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the PBOC regulated the Shanghai Exchange and the Shenzhen branch regulated that province’s market. This resulted in two major securities regulatory provisions: the Shenzhen Provisional Regulations on Companies Limited by Shares (Shenzhen Regulations) and the Shanghai Municipality Provisional Regulations on Companies Limited by Shares (Shanghai Regulations). Each were developed with distinctive regional characteristics. Even after the PRC formed a national market system, these measures existed largely unreformed until 1993. This decentralized regulation by the PBOC has also contributed to the potential for abuses and the possibility of fraud and corruption in the markets.

Although the government intends to give the banking industry more managerial freedom in its commercial activities, there remains one major problem: the PRC has an abundance of inexpensive labor, but a shortage of professionals. This shortage includes qualified managers, salespersons, quality control personnel, and marketers, all of which are needed to run an efficient financial system. Educational reforms need to be included in the government’s plans to make up for this loss; currently, the mainland produces only a few hundred MBA graduates per year from making incremental progress in its effort to reform and modernize its domestic banking sector.”

262. See Tarbutton, supra note 37, at 415.
263. See supra note 136 and accompanying text.
264. See id.
265. See Tarbutton, supra note 37, at 415–16.
266. See id.
267. See id. at 420. An example of such abuses was the riots in Shenzhen in August of 1992 resulting from a defective group of share application forms. See id. Consequently, the State Council assumed greater control of the markets and the PBOC was removed from its regulatory capacity and replaced by the newly formed State Council Securities Committee (SCSC) and the China Securities Regulatory Commission (CSRC). See id. The State Council designed these two institutions to formulate a regulatory policy for the Shanghai and Shenzhen national markets, as well as for other “informal” PRC exchanges. See id.
269. See id.
accredited programs. More educated personnel are needed to efficiently run the PRC’s financial community.

V. HONG KONG’S POTENTIAL EFFECT ON ECONOMIC MARKETS IN THE PEOPLE’S REPUBLIC OF CHINA

Another interesting situation concerning Chinese markets arose recently as the PRC assumed sovereignty over Hong Kong on July 1, 1997. Until 1985, the world believed Hong Kong would remain indefinitely a British Crown Colony. Hong Kong’s securities markets grew as the economy progressed following World War II, and a regulated system was developed in the early 1970s. This mature market system allowed Hong Kong to grow financially like other major financial centers such as New York, London, and Tokyo. Today, Hong Kong is an important international financial center, having over 150 licensed banks, over 75% of which are among the top 100 banks in the world. In 1995 the total market capitalization for the 542 public companies listed on the Hong Kong Stock Exchange was over US$300 billion. Additionally, the Hong Kong banking industry had total assets and liabilities estimated at over US$1 trillion. By 1996 Hong Kong’s per capita GDP was only slightly lower than that of the United States while its annual GDP growth was more than double that of the United States. In 1997, after 155 years of British laws and rule, Hong Kong had to adjust to the wishes and laws of the PRC; however, China’s leaders have stated that Hong Kong will remain under its current legal structure in an effort to preserve its status as

270. See id.
271. See Lai, supra note 65, at 736.
274. See Neoh, supra note 272, at 310; see also Hagelin, supra note 708 (noting that Hong Kong is home to 85 of the world’s top 100 banks and 750 corporate regional headquarters, and that 540 companies are listed on the Hong Kong stock exchange).
275. See Hagelin, supra note 197, at 708.
276. See id.
277. See id. at 707. The per capita GDP was US$25,300 while the economy recorded an average GDP growth rate of 6% from 1985 to 1995. See id. The unemployment rate has also averaged under 2% per year, well below U.S. standards. See id.
278. See Neoh, supra note 272, at 310.
an international economic power. The chairman of the CSRC recently denied merger allegations concerning the Shenzhen and Hong Kong stock exchanges. Perhaps the PRC’s leadership realizes that Hong Kong industries can provide financial growth and that socialization of those industries might hamper this economic jewel. However, investors are not sure about this notion and the skeptics are withdrawing from Hong Kong’s markets.

Some investors welcome enthusiastically the United Kingdom’s relinquishment of Hong Kong to the PRC, and believe Hong Kong will be a gateway to the Chinese markets for American and other foreign investors. Before July 1997, China already utilized greatly the developed Hong Kong markets. In 1995 over 90% of Chinese funds were raised through syndicated loans through Hong Kong. Approximately US$64 billion has been invested in nearly 1,000 projects in the PRC by over 40% of the companies in the Hong Kong market. Chinese companies represent nearly “5% of the market value of the Hong Kong stock market.” The PRC’s investment of more than US$20 billion in Hong Kong’s office buildings, airport, and harbor is further evidence that China intends to continue utilizing Hong Kong’s markets in this way.

Another situation that concerns Hong Kong, the PRC, and other Asian countries is the capital markets crisis in Asia in late 1997 and early 1998. In fact, over the past 2 1/2

279. See Lai, supra note 65, at 736–37 (discussing reunification under the concept of “one country, two systems”). While Hong Kong will maintain its British-style legal system and will be an independent economic entity, it will not be an independent legal entity and will be subject to China’s control. See id.
280. See Merger Called Off Between Shenzhen, Hong Kong Bourses, INT’L SEC. REG. REP., Nov. 21, 1996, available in LEXIS, News Library, ISRR File (noting that rumors concerning a possible merger were exaggerated, but the Shenzhen and Hong Kong exchanges would establish a cooperative arrangement).
281. See generally Marcus Gleisser, Hong Kong Called Key to China Market, Plain Dealer, May 31, 1996, at 3C (noting that Hong Kong would retain its autonomy and social and economic systems despite its merger with China’s state-control economy, and that China would use Hong Kong as a means for reform within its own country and a link to international trade).
282. See Mark O’Neill, Hong Kong “Irreplaceable” Finance Centre, China, REUTER EUR. BUS. REP., Oct. 26, 1995. In 1995 it was predicted that Hong Kong would become China’s “international financial center” and source of capital. See id.
283. See id.
284. Id.
285. See Gleisser, supra note 281, at 3C.
years, Hong Kong’s stock market dropped by 47%.\textsuperscript{286} However, some investors believe this represents only a temporary setback and the Asian economies will return to rapid and stable rates of growth.\textsuperscript{287} A return to a stable, growing economy would benefit Hong Kong and the PRC in the future. It is too soon to tell whether the PRC will be able to utilize the Hong Kong markets to finance Chinese industries or whether Hong Kong will become more like its socialist parent country.

\textbf{VI. Conclusion}

The Chinese claim to be communist/socialist while embracing capitalist ideas to further economic expansion. Two of the most important routes the PRC has sought for this growth have been securities and banking reforms. Although the securities and banking industries have recently provided investment financing for thousands of PRC enterprises, only further improvements will maintain the tide of capital inflow. However, the PRC is dedicated to socialist ideals and does not appear willing to further economic prosperity at the expense of its political philosophies.

\textbf{A. Securities Markets}

The securities markets in the PRC have developed rapidly. Quick transitions have brought a steady influx of investment capital from both PRC nationals and foreign investors; however, its rapid formation has led to a variety of problems. Some of these problems are a result of the government’s staunch support of socialism. The illiquid B share market discourages foreign investment. Listing requirements, derived from the promotion of socialism, present an additional problem. The PRC government should not use the Chinese securities exchanges to market non-profitable state-owned enterprises. The government should

\textsuperscript{286} See Robert Lenzner & Justin Doebele, \textit{Here Come the Bottom-Fishers}, FORBES, Feb. 9, 1998, at 45 (noting that many Asian markets are experiencing similar market declines, such as Taiwan (down 37%), Singapore (down 62%), and Korea (down 83%)).

\textsuperscript{287} See \textit{id}. Goldman Sachs recommends investing in Asian economies and predicts a market turnaround or upswing. See \textit{id}. \textit{But cf.} Paul Abrahams & Gillian Tett, \textit{Capital Inadequacy}, FIN. TIMES, Jan. 28, 1998 at 13 (exploring the crisis and its relation to the Japanese economy and, more specifically, its banking industry; noting that if the Nikkei 225 index closes below 15,000 on March 31, 1998, many top Japanese banks will have unrealized gains “wiped out” due to heavy securities speculation). Such a result could prove disastrous, and there always is a risk of systemic failure in the global financial markets.
adopt a system more like that of the United States, in which companies wishing to be listed on major exchanges need only pass minimal requirements and complete a comprehensive registration and disclosure process. Investors should be able to decide in which companies to invest.

Additionally, the markets themselves pose problems for investors. Problems with disclosure requirements remain. The PBOC should not be able to exert as much control over the capital markets as it does. The government should eliminate the central bank’s conflicts of interest with the securities exchanges by removing the central bank from its position of oversight and placing the CSRC in ultimate regulatory control of the exchanges. The markets would also benefit from a national system of securities regulation instead of different provincial systems that promulgate individual rules and regulations.

Regardless of the present problems, the PRC’s securities markets have been somewhat successful in attracting necessary foreign investment capital, and have done an excellent job of obtaining domestic resources. The government also seems to be adopting regulations favoring foreign investors. However, foreign investors should observe the markets closely over the next few years to see if the PRC will allow its markets to depart from socialism enough to obtain necessary investment capital. If the government does, then the PRC should present an excellent opportunity to invest in a growing economy.

B. Banking Industry

The financial system in the PRC has been reformed to bring it up to the standards of the modern commercial banking industry; however, problems in several areas must be corrected to make this system more efficient and profitable. The PBOC’s role as the economy’s central bank needs to be separated completely from the capital markets. Even the hint of impropriety concerning conflicts of interest between its accounts and the securities markets is enough to make some investors think twice about investing in PRC industries. Additionally, outside the area of economic reforms, the PRC government must dedicate itself to

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288. See I.A. Tokley, Step By Step: Introducing the Latest Chinese Securities Regulation, 25 HONG KONG L.J. 98, 100 (1995). However, some perceive the new laws as an attempt to maintain state control over the issuance of shares to foreign investors. See id.
reforming its educational system to supply its industries with qualified managers. The system will only be as efficient as those directing it.

Finally, the government should allow capitalist values to govern loan decisions by banks. One principle of capitalism is that failure is allowed, and may even be more efficient in some instances. The government could maintain control of most industries; however, it should not direct banks to loan their limited resources to state-owned enterprises on the verge of failure. Banks should be able to provide funds to enterprises that have a chance to profit, allowing the employment of more citizens and significant contributions to a growing economy. Although the financial system is plagued by these problems, the banking reforms have significantly improved economic growth and should continue to do so in the future.

C. Overall Picture

The People’s Republic of China has allowed its economy to elevate itself and sustain a high level of growth, due in tremendous part to its willingness to embrace capitalist principles concerning investment vehicles. By opening a national securities network, the government receives investment capital from nationals and foreigners needed by country industries. However, the country needs additional infrastructure improvements and industries need additional capital for growth; therefore, the government must find a way to attract more investment. This investment could be supplied through foreign investors and banks; however, these individuals and corporations need further assurances from the government that the Chinese economy will remain stable and secure in the future. Additionally, the PRC should seek to improve its capital inflow by utilizing Hong Kong’s markets. The question investors and banks must ask before making further investments in the PRC is: Just how much will the government embrace capitalist theories to induce investment in PRC industries?

Todd Kenneth Ramey