

Securities Markets and the People's Republic of China

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The Chinese government is currently reviewing the cost, benefits, and implications of establishing a securities market in China. The authors discuss the historical development of the securities markets, China's current institutional structure, contemporary problems and issues, and the outlook for the development of the securities markets in the PRC.

This research has found that the necessary environment for the development of an equity market in China is continuing to evolve. Many important actions necessary for the development of the market have been or are now occurring. However, recent actions which have curtailed the issuance of stocks and bonds appears to be a step in the wrong direction.

I. Introduction

One of the major goals of the Chinese government has been to mobilize domestic financial resources and to improve the allocative efficiency of funds. They have drawn on the expertise of a variety of advisors, the available empirical literature¹ as well as the experience of many nations and investment bankers to deter-

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¹ For a discussion of the major empirical literature in this area, see the forthcoming book by Sudweeks, *Equity Market Development in Developing Countries*, Praeger, 1988.

mine how securities markets aid in both these areas.² The Chinese government is still reviewing the costs, benefits, and implications of establishing a securities market in China, and has previously allowed "experiments" in different provinces.³ Between 1981 and December 1986, some 7,000 enterprises had issued shares, and stock and bond markets had opened in several major cities.

With a great deal of fanfare, the Beijing Stock Exchange opened in January 1987. The first issue traded by the Exchange was the sale of 1,200 shares of the Tiangiao Department Store, which was purchased by eager investors within a few days. Since the Exchange was authorized to both sell and buy stocks, it was expected that this part of the financial market would be very active and prosperous. However, in an about-face, China unveiled regulations in early April designed to curtail the issuance of stocks and bonds.⁴

Under the new rules issued by the State Council, state enterprises will no longer be able to issue stock to the public, although certain collectives may do so under tighter control. These restrictions are the latest example of China's recent drift toward socialist orthodoxy, and a setback for the proponents of financial system reform in China.⁵

Many China experts consider securities markets an anathema to the Chinese way of doing things. They consider securities markets not suited to the current economic and political system in China. Although in the past they may have been right, the events of the past eight years has shown an initial development of an environment suited to the encouragement of securities markets in China.

² For example, see Antoine van Agtmael, *Emerging Securities Markets*, Euromoney Publications, 1984.

³ For example, Shenyang and Shanghai have bond and stock trading centers, with other major economic centers, including Canton, Wuhan and Chongqing also planning similar centers. See Fung, "China's Economic Stock Market Expands," *The Wall Street Journal*, Nov. 12, 1986, p. 36. Moreover, the Chinese have also established links with the New York Stock Exchange for an exchange of financial professionals, academics, and students, see Rustin, "Big Board Plans To Set Up Link with Chinese," *The Wall Street Journal*, Nov. 13, 1986, p. 26.

⁴ Schiffman, "China Clamps Down on Securities Issues," *The Asian Wall Street Journal*, Apr. 8, 1987, p. 3.

⁵ Although this may be the case, many Chinese experts see this latest episode as only a minor setback, and expect that share trading will be allowed in the near future.

In order to improve the allocative efficiency of resources (and also promote savings), there have been major changes in the economic and financial systems in China relating to securities markets. In this article, the authors provide a review of the historical development of the securities markets in China. Attention is then focused on China's current institutional structure, contemporary problems and issues, and the outlook for the development of the securities market in People's Republic of China.

II. Historical Development

A. Early Infant Stage (1919-1949)

Securities markets are not a new occurrence in the PRC. Prior to the revolution, Shanghai was considered the international financial center of the Far East, the "Paris of Asia."⁶ Shanghai had a functioning stock exchange from 1919 to 1949 and served as one of Asia's major money centers during that period. Most major international banks had a branch office located there.

However, the new Chinese government that came to power in 1949 viewed the stock exchange as one of the most oppressive symbols of capitalism and closed it after the revolution.⁷ In addition to the closing of the stock exchange, all but four foreign banks left China, with these four banks being stripped of their prior status and prestige.⁸

B. Restricted Stage (1949-1978)

After the revolution, banks became the sole members of the financial sector in China. Operations changed from one of intermediation of funds to one of fulfilling directives of the Chinese government. Banks became passive players in the economy.⁹ The Ministry of Finance provided all the fixed capital funds needed by

⁶ "The Four Who Stayed — And Cashed In," *Institutional Investor*, Feb. 1986, p. 139.

⁷ "China's Stock Market — Born Again?" *The China Business Review*, Jan./Feb. 1986, p. 37.

⁸ These four banks were all from Hong Kong.

⁹ Rafferty, "China's Banking Revolution," *Institutional Investor*, Feb. 1986, p. 134.

government-owned enterprises. It operated through the People's Construction Bank of China, which operated more like an appropriations branch of the Ministry of Finance than a true bank.

Banks did not provide working capital. Working capital for enterprises came from the Ministry of Finance and was allocated according to planned production quotas. Banks were confined to extending credit to cover unexpected or temporary "above quota" needs for working capital. Banks essentially performed as cashiers and fiscal agents, and did not evaluate the credit risk associated with the extension of funds. Under such circumstances it is not surprising that some Chinese were thought to have developed a "casual attitude toward money," according to Jing Shuping, Executive Director of the China International Trust and Investment Company.¹⁰

C. Later Infant Stage (1979-1985)

In 1979 the government set in motion a process of economic reforms aimed at decentralizing production and investment decisions and subjecting these increasingly to market influences. Authority has been gradually shifting from the planning authorities to lower levels. This has led to greater autonomy at the enterprise level, including retention of a portion of earnings, thus reducing dependence on the government for investment financing.

In addition, where previously supplemental funding came free of charge from the budget, some new funding must be borrowed from the banks at specific interest rates for both working capital and fixed investment. Profit taxation in many instances has replaced remittance of profits to the government. Enterprises are becoming accountable for profits in what is gradually becoming an increasingly competitive market for goods and services.¹¹ There have been some increases in wage differentiation, in addition to some enterprises being allowed to fire, hire and give bonuses.

During the late 1970s, the institutional structure of the banking system was changed to meet the needs of the growing economy.

¹⁰ Jing Shuping, Executive Director of the China International Trust and Investment Company, as quoted in Rafferty, p. 134.

¹¹ Phillip D. Grub, "A Yen for Yuan: Trading and Investing in the China Market," *Business Horizons*, 30, 4, July/Aug. 1987.

The People's Bank of China (PBOC) regained some of its powers, and the Agriculture Bank of China was reestablished. The China International Trust and Investment Company (CITIC) was set up under the State Council, a cabinet-like body run by the prime minister. In addition, in 1981 the China Investment Bank was established to channel World Bank funds into domestic investment projects.

Before 1979, the activities of the PBOC were restricted to short-term financing of temporary and seasonal credit needs, mostly for "non-quota" working capital financing. However, in 1979 the State Council authorized the purchase of RMB2 billion in equipment loans for enterprise modernization, which broadened the scope of lending by the PBOC in China.

Other changes occurred in 1983, including the introduction by the PBOC of "floating" interest rates for working capital. This was a new concept whereby companies were charged higher rates when needs for working capital exceeded the planning target, and lower rate when needs were lower than the target (i.e. the interest rate charged was more closely related to risk).

Other institutional changes followed in 1983 and 1984. The People's Insurance Company of China was established to handle domestic and international insurance. In addition, the commercial activities of the PBOC were spun off to the newly created Industrial and Commercial Bank of China. This latter action left the PBOC as the central bank, responsible for monetary policy and for supervising the entire banking system, similar to other western central banks.

In 1981, Treasury bonds were floated for the first time, paying 8 percent annual coupon to individual bond holders, increased to 9 percent in 1985.¹² In 1985, two major specialized banks (ICBC and ABC) also issued bonds for the first time to depositors, at the same yield as Treasury Bonds. Shares, or essentially non-voting participatory certificates, were issued first by private companies in 1982, and then by state-owned enterprises in 1985.

In 1985, a growing economy with rapid extension of domestic lending and injudicious use of national foreign-exchange reserves created a situation which prompted tough restrictions on China's

¹² As a point of reference, inflation in 1985 was about 10 percent.

bankers.¹³ This tightening of credit was an important incentive to the encouragement of some companies to raise funds through selling bonds and shares, although statistical information on the amount of shares and bonds sold is not available.

In the Seventh Five-year plan, the government confirmed its intention to promote separation between ownership and management of public activities.¹⁴ Public ownership will continue to dominate, but management will be with the enterprise itself. Major government action will be reserved for the overall management of the economy, rather than direct enterprise management.

In early 1987 student demonstrations prompted a conservative clampdown and a campaign against bourgeois liberalization, or Western ideas. Afterward, Communist Party Secretary-General Hu Yaobang was dismissed and blamed for being soft on Western ideas. Orthodox socialists began making inroads, and current policies reflect the uneasy balance between conservatives and reformers in the leadership.

III. Current Institutional Structure

The banking sector is the focus of the financial sector in almost all countries. However, in China, banks are even more important, especially in regards to securities markets. Although many aspects have changed during the last few years, there is still little competition, and interest rates still play only a limited role in the mobilization and allocation of resources.

A. Regulatory Structure

The regulatory framework in China is primarily composed of the People's Bank of China (PBOC). It was formally transformed into a central bank on January 1984 and is directly subordinate to the State Council. The PBOC supervises the activities of all banks and quasi-banking institutions, as well as those of non-bank

¹³ "Coming of Age Amid a Flurry of Setbacks," *Far Eastern Economic Review*, Mar. 1986, p. 94.

¹⁴ Zhao, "Report on the Seventh Five-Year Plan," (delivered at the fourth Session of the Sixth National People's Congress, Mar. 25, 1986), *Beijing Review*, Apr. 1986, 29, 16. p. 12.

financial institutions, such as the People's Insurance Company. The major functions of the PBOC include:

- studying, formulating and reviewing monetary policy guidelines and regulations on national monetary affairs;
- exercising unified control over currency issuance and circulation on the market;
- working out nationwide credit and cash plans; organizing, carrying out and balancing nationwide credit funds;
- examining and approving the establishment, merger and dissolution of monetary organizations;
- exercising unified control over credit and deposit interest rates on renminbi (RMB), foreign exchange rates and foreign exchange reserves;
- acting as the state treasury, handling treasury receipts and expenditures;
- coordinating and examining the operation of all other expenditures;
- regulating the issue of negotiable securities by enterprises and supervising money markets; and
- coordinating and operating in the international monetary system on behalf of the Chinese government.

After the reform, the PBOC's responsibility of accepting deposits and providing commercial loans was transferred to the Industrial and Commercial Bank of China (ICBOC).

B. Institutional Framework

The institutional framework in China is mainly composed of specialized banks, foreign banks, and non-bank financial intermediaries.

1. Specialized Banks

Specialized banks in China include the Agricultural Bank of China (ABC), the Bank of China (BOC), the China International Trust and Investment Company (CITIC), and the Industrial and Commercial Bank of China (ICBC).

The ABC, reestablished in 1979, is directly subordinate to the State Council with supervision entrusted to the PBOC. Its role is to function as a commercial bank, providing credit to agricultural

and supply marketing establishments and also to collectively owned rural industry and commerce. It also is responsible for the supervision of the rural credit cooperatives spread throughout the country. Most of the reserves of the ABC are from reserves of the rural credit cooperative (RCC). The RCC are major vehicles for bringing into the financial system the rapidly growing savings of China's rural population.

The BOC is China's foreign exchange bank. It handles foreign exchange transactions, issues foreign currency, issues bonds in international capital markets, takes foreign exchange deposits and makes foreign exchange loans.¹⁵

The CITIC, established in 1979, is directly under the leadership of the State Council. CITIC has also received a license to handle foreign exchange, thus breaking the Bank of China's monopoly over foreign exchange. Its major function is to absorb foreign investment to facilitate the introduction of advanced technology.

Provincial Investment and Trust Companies, similar to the CITIC, have also been established. These are set up as domestic trust corporations, replacing budgetary investment grants by loans.

The ICB, spun off from the PBOC in 1984, handles the commercial banking operations in urban areas. The ICB has a large deposit base and branches all over China.

2. Foreign Banks

There are only four non-Chinese banks in China outside the special economic zones, and all are holdovers from the pre-revolution period. These banks are allowed to deal with Chinese corporations as well as with foreign customers, but still may not do renminbi business. Other foreign banks have set up representative offices in China, with money-making activities limited to securities trading and consulting.¹⁶

3. Non-bank Financial Intermediaries

¹⁵ Wilson, "China's Banks Learn a New Game," *The Bankers*, Aug. 1986, p. 15.

¹⁶ "How the Foreigners are Coping," *Institutional Investor*, International Edition, Feb. 1986, p. 141.

Currently there are many institutional innovations occurring in China. Trust and investment companies, commercial paper, leasing operations, and insurance companies have been established and are growing at a rapid pace.

C. Primary Securities Markets

As part of the continuing reforms, the Chinese government has allowed experiments of a small nature in different parts of the country. Some private companies and enterprises have been allowed to sell shares since 1981. For the first time since 1949, China's state-owned companies and factories have been allowed to issue stock.¹⁷ As noted earlier, more than 7,000 firms have issued shares since 1981.

Some cities, notably Guangzhou, have issued detailed regulations regarding stock and bond issues,¹⁸ although no overall guidelines have yet been issued by the PBOC. Some Chinese economists are concerned about speculation and many Chinese leaders have said that speculation cannot be tolerated. There is also the question of transferring state-owned property into private hands.

The primary market in China consists of issues of Treasury bonds, corporate bonds, and enterprise bonds or "shares."

1. Treasury Bonds

Treasury bonds were first issued starting in 1981, mostly as a type of forced investment with purchasers determined by administrative allocation, as rates were very low (about 5 percent). Since 1982 these bonds also have been purchased on a voluntary basis by individuals as the rates became competitive and even more attractive than deposit rates. Some liquidity has been provided for the bonds purchased by enterprises since they can be

¹⁷ Restrictions have been established to prevent shareholders gaining control of state-owned companies. Seventy percent of the ownership was retained by the state, an employee's stock purchase cannot exceed 50,000 yuan (\$12,625), and annual dividend cannot exceed 12 percent of the share capital. Caution seems to be the watchword as this experiment could have a big impact on the economy in China. See Fung, "China's State-Owned Firms Issuing Stock: 'Experimental' Move Splits Economic Reformists and Conservatives," *The Asian Wall Street Journal*, Mar. 18, 1986, pp. 1, 10.

¹⁸ Wilson, p. 24.

used as collateral for borrowing from banks. Of RMB100 billion of Government revenue in 1984, RMB4 billion was from Treasury bonds.¹⁹ About RMB23 billion has been raised in Treasury bond sales from 1981-85.²⁰

2. Bond Issues

Bond issues grew rapidly in 1985, particularly among rural enterprises, as Peking tightened bank loans to enterprises and factories in order to moderate an overheated economy. Between 1984 and 1985 in Canton alone, enterprises raised RMB200 million between stock and bond issues.²¹

Many bonds offer interest rates at twice that offered by banks, causing many to withdraw their savings and invest in bonds. Chinese bankers estimate that one third of the money used for such purposes came from savings accounts.²² A drop in bank savings can hamper the states' financial plans by undermining the banks' function of controlling the flow of funds. Consequently, Canton issued regulations in January 1986 that regulated interest rates for bond issues a maximum of 20 percent above bank interest rates, and that bond issuers must obtain prior approval from the PBOC before making an offer.

Bank bonds were issued for the first time in 1985 by the ABC and the ICBC. In 1985 some RMB1.5 billion was issued by the ABC with another issue of RMB1 billion announced in 1987.²³ These new bonds will be sold only to individuals, and will have an interest rate of 9 percent.

3. Corporate or Enterprise Bonds ("Shares")

Corporate or enterprise bonds are often called shares in China. The term "shares" in China refers to enterprise bonds with a participatory feature, a minimum interest rate and a possible

19 "Share and Share Unalike," *Euromoney*, April 1985, p. 63.

20 "The Once and Future Financial Centre?" *Euromoney*, June 1986, pp. 51-53.

21 A comparative figure for country isn't available, see Fung, p. 10.

22 It is interesting to note that the bond issues which took place in 1985 and the first half of 1986 in Shen Yang did not influence the stable increase of deposits in that city. As reported by Zhang, Correspondent with World Economic Herald, People's Republic of China, from a discussion with the President of the Shen Yang Branch of the People's Bank of China.

23 "Chinese Bank Plans Bond Issue," *Asian Wall Street Journal*, Jan. 1, 1987, p. 19.

dividend to be paid if the enterprise profits allow.²⁴ They contain elements of what are termed "non-voting, redeemable participating preferred stock" in Western companies, and "participation" or "investment certificates" in others.

The rationale for issuing shares is the need for firms to gain increased funding necessary for operations or plant expansion. The amount they can borrow from State Banks is limited; also, existing regulations may impose conditions or restrictions on the use of borrowed funds. As firms modernize and expand, the need for funds often exceeds supply.

A primary feature of these "shares" is that they typically come in small denominations of RMB50 or 100 for individuals and RMB100,000 for institutions. They are usually short term, usually one to five years.²⁵ Early redemption may or may not be allowed, and some enterprises allow their shares to be inherited. Redemption is usually guaranteed, but not always. In addition, there may be privileges attached, such as gaining priority in renting offices of a building being constructed by the enterprise, or to nominate a relative to join its payroll.²⁶

Return is composed of two portions, interest and dividend. The rate of interest is fixed at the time of issue, or it may be pegged to the rate of interest on PBOC deposit rates. Dividends are distributed according to profits after payment of interest, taxes, and employee bonuses. Interest to individuals may be higher than interest paid to institutions. Since the return on stocks are higher than on deposits, and the issues are usually guaranteed officially,²⁷ it is an attractive investment and many individuals have transferred their money from banks to stock-issuing enterprises. However, there is as yet no secondary market and there exists high costs for transferring shares.

²⁴ Dividends were paid by a company to stockholders for the first time since the revolution in 1949. Rate of return on "shares" of the Yanzhong Industrial Co. of Shanghai was 15 percent, see "Dividends Will be Paid by a Chinese Company to Stockholders," *The Asian Wall Street Journal*, Mar. 3, 1986.

²⁵ Although a 12 year term has been reported, see Wilson, p. 24.

²⁶ "Suddenly the Stock Market is OK," *Euromoney*, June 1986, p. 49.

²⁷ When the government guarantees stock issues, it accepts the burden of paying for an enterprise's wrong decisions. It appears to be an attempt to develop the market by ensuring that no shareholder loses money. However, it continues to reinforce the concept that there is no downside risk in shares.

"Shares" are typically sold to enterprise workers, most in the form of depository receipts for the workers account, although some are sold to the public. Cost to the issuing company tends to be high compared to other alternatives, if available. The use of high returns on shares may be an attempt to evade restrictions on wage and bonus payments, particularly where they may be seen as a worker profit-participation scheme.

A reversal of the April decree on the non-issuance of stocks occurred in August 1987. Hiway Electrical Company, a smaller Beijing-based computer systems firm, quietly began selling shares to the public to raise needed funds. This may be an indication that the leadership has decided to permit a controlled loosening of the Chinese Councils stringent policies.

D. Secondary Securities Markets

There has been much discussion about the establishment of a secondary market or stock exchange for trading of securities. Since "shares" are really time deposit substitutes whose prices cannot fluctuate, and as many other preconditions such as an adequate supply of securities are not fulfilled, the formal establishment of an exchange may not yet make economic sense while the experiments are still under observation. Experimental stock exchanges have been established in Shenyang and Shanghai, while three other cities have plans to establish centers for trading stocks and bonds.²⁸

Theoretically, the role of banks, the PBOC and the ICB is to issue shares and bonds on behalf of enterprises, pay them the proceeds and pass on to shareholders the interest or dividends. The banks' role is equivalent to a stock exchange,²⁹ although transfer fees make this prohibitively expensive.

Present Chinese law prevents dealings between individuals or enterprises in shares and bonds. Banks are authorized to act as dealers and to make a market as well as to discount such securities.³⁰

28 Fung, "China's Embryonic Stock Market Expands," *The Wall Street Journal*, Nov. 12, 1986.

29 Wilson, "China's Bankers Learn a New Game," *The Banker*, Aug. 1986, p. 23.

30 "Suddenly the Stock Market is OK," *Euro money*, June 1986, p. 51.

Overall, from discussions with international organizations and government officials regarding the current institutional framework in China, it appears the initial framework for a securities market is being established at a rapid rate.

IV. Contemporary Problems and Issues

Although the economic and political reforms are progressing, they are not complete. There is still much to be done to aid in greater mobilization and allocation of domestic financial resources. Government intervention is still great through the influence of central, provincial and local planning officials; and their remaining authority over banks, in addition to their influence over taxes, input allocation, pricing decisions, and the appointment of the managers themselves. Although the problems do indeed exist, the authors maintain that many of the issues thought to be most damaging to the development of a securities market in China may have been exaggerated.

A. Contemporary Problems

There are many problems which exist regarding the formal establishment of securities markets in China. One of the most critical is the continuing removal of barriers to competition and the continued reduction of the government controlled allocation system. Other problems also exist.

Price controls and segmentation continue to distort market signals, and the tax system is used as a means to correct the distortions in an ad hoc manner. Work bonuses tend to be distributed in an egalitarian manner, with pressure for managers to divert profits to worker welfare problems. Price reforms, to include the removal of administratively set prices, will need to be made in light of important inflationary pressures.³¹ Default risk, the possibility of firms going bankrupt, still must be addressed as there is no current legally accepted concept of a firm going bankrupt in China.³²

³¹ For example, despite rapid growth in urban household real incomes, personal incomes are not taxed, and housing rents have not been adjusted, in some cases for 30 or more years.

³² The Chinese government is currently considering the formulation of a bankruptcy law. From an interview with Yang, Lecturer in International Business, University of International Business and Economics, Peking, China.

The question of whether enterprises will be able to continue to carry the heavy burden of social overhead and worker welfare must also be addressed. Finally, many government bureaus still hold to the desirability of provincial authority, fully integrated vertical production processes, and their own narrow personal interests which threaten the reforms and changes.

Another shortfall of current policy is that share cannot be sold for foreigners. This presents a problem in encouraging foreign investment, particularly joint ventures. Until shares can be traded freely, China will not see a major increase in foreign investment, as most foreign investors would prefer to issue stocks and then be able to sell them to either a Chinese firm or other foreign investor should their investment objective change.

Interest rate structure is also another problem which China has yet to resolve. Interest rates for deposits and loans are set by the central bank. Interest rates have not played the role in allocating resources and mobilizing savings that has occurred in other countries. However, in a series of steps, interest rates have been raised to levels closer to market rates, given the low inflation in the past and inflation in 1985 of around ten percent. However, a major problem in the interest rate structure is the low rate paid on enterprise time deposits and on Treasury bonds held by enterprises (5 percent). Enterprises are required to purchase these bills at below-market rates. This causes enterprises to use available funds for internal investments or inventory accumulation rather than savings. In addition, despite higher interest rates by banks, neither enterprises nor financial institutions perceive the borrowing to be especially risky due to the experience that the budget will cover any eventual losses. The result is an excessive demand for credit which is hard to control.

B. Major Issues

The establishment of a formal stock exchange will have a great impact on the economic and social systems in China. Major issues will need to be addressed. However, the impact may not be as great as was first considered. These issues include shareholder influence in the decision making process, structuring ownership characteristics possibilities of firms losing money, implications for privatization, "exploitation of the workers" rhetoric, changes in the

state-owned nature of the enterprise, and political repercussions should the experiments fail.

Once workers become shareholders, they are bound to have an influence in enterprise decision-making processes which may effect local and national productivity. As workers begin making decisions regarding the firm, this limits the amount of top-down direction from the planning committees, limiting government control and planning. This may be true; however, but with the development of specific non-voting financial instruments and institutions, this problem may be alleviated to a large degree.

Many consider that the issuance of equity shares may seem to be at odds with a basic tenet of public ownership. However, there are many different ways of structuring institutions, mechanisms and the legal and regulatory framework which are perfectly compatible with a socialist system, assuming there exists a fundamental desire to move towards a system which incorporates some of the more important elements of a market economy.³³

Another impact of the stock exchange is the possibility of losing money. Losing money is not a concept that Chinese institutions are familiar with, given the past system of government covering the shortfalls of the enterprises. However, this is a possibility in light of domestic and international competition, and may be beneficial in the long run if it helps the firms become more competitive.

Some consider that the development of individual shareholders could precipitate privatization of the Chinese economy. This need not be the case as alternative methods of ownership can be established consistent with a "Chinese" method of ownership which takes advantage of China's many unique social and economic traditions.

Others argue that an individual who owns shares in a state-owned factory is exploiting the workers because he shares in the profits but not the labor. This argument maintains that labor is the only important input to the success of an organization, laying aside the necessity for capital equipment and working capital.

Many officials are worried that the sale of shares will change

³³ The Scandinavian nations are clear examples of successful and harmonious integration of basic elements of both socialist and market economic institutions and principles.

the state-owned enterprise nature if people are allowed to share the profits. To them stock issues should be limited to collective and private enterprises. This may be a preferred alternative, although other alternatives should be explored.

Finally, one of the more dangerous effects of stock issues among state-owned companies is the possibility for political repercussions. The Chinese enterprises lack experience in running companies, in addition to issuing stock. Should the experiment flounder, conservative officials could use it as a weapon against the reformist leaders and ideology, hence the need to proceed in a cautious and incremental manner.

V. Conclusion

There is no "right" way to organize a financial system, as imperfections exist in all systems. However, it has been observed that successful system must be consistent with each countries differing social and economic systems and traditions. There are probably "better" ways, depending on the country circumstances and the evolution of the development of the financial sector. Likewise, there is no "right" way to establish a securities market, only a "better" way which may differ for each country.

Many experiments taking place in the field of non-bank financial intermediation in China are a very positive development. The growing range and volume of financial institutions and instruments should contribute to the efficiency of financial intermediation and the effective allocation of resources. This process should be encouraged and should continue to bring about an increase in the size and diversity of institutions, in addition to decreasing the segmentation in the markets.

The recent restrictions on securities markets in China are indeed regrettable. Recent articles regarding China's borrowing needs show the great need for funds.³⁴ Some of those funds that may have been raised through the proper functioning of the securities markets must now be raised through funds borrowed in

³⁴ See, for example, Cheah, "China Emerges as Big Borrower With New Loan," *The Asian Wall Street Journal*, Apr. 12, 1987, p. 1.

international markets or through commercial banks. The major problem is that these funds, both principal and interest, will have to be repaid. This would not be the case with shares. Moreover, the possibility exists that the government could have raised funds more cheaply through the domestic, rather than international capital markets.

In summary, this research has found that the necessary environment for the development of an equity market in China is continuing to evolve. Many important actions necessary for the development of the market have been or are now occurring. However, recent actions which have curtailed the issuance of stocks and bonds appears to be a step in the wrong direction.

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