

## PROBLEMS OF CHINA'S BANKING SECTOR DEVELOPMENT

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*The article focuses on the theoretical aspects of the problems of China's banking sector development. The strengths and weaknesses of the Chinese banking sector in the context of the global macroeconomic crisis are characterized. The existing problems affecting not only the further development of the banking system, but also the economy and sustainable development of China as a whole are highlighted*

**Keywords:** *banking sector, illegal financial transactions, overdue loans, deposits, reserve funds.*

The pandemic and the global crisis create an extremely unfavorable macroeconomic background for the functioning of the national economy. Economic activity continues to weaken, aggregate demand and real incomes of the population continue to fall. The deterioration of economic dynamics is observed to one degree or another in all sectors and spheres. So the banking sector, being the most important institutional component of the Chinese economy, is experiencing considerable difficulties. As the banking sector is one of the most important subsystems of China's economy, we conducted a comprehensive analysis and identified its weaknesses and strengths. The analysis of existing problems is useful and significant for strategic planning and management, both by an individual bank and by the monetary policy of the state.

Firstly, let's review the strengths of the Chinese banking system. There is no secret that for five years the banking system of the People's Republic of China has been a leader in the global market. The State government controls and regulates all types of banks, ranging from large financial institutions to small branches of cooperatives. The main bank has a huge impact on the entire banking system, as it contains more than 70% of the total assets of the state. Each financial institution has its own banking function and is responsible for certain monetary transactions. The government is able to stop, cancel or change any banking transaction that is aimed at state needs. The government does not control and does not make changes to the policy of the stock market, where 80% of funds are deposits of the population.

The country has most of the legal obligations on all existing banks of the People's Republic of China. China is characterized by the rigidity of the banking system with minimizing the existence of shadow financing. Such a type as the distribution system of banks absolutely satisfies the total control of the state of all major financial transactions in the territory of the People's Republic of China.

The presence of shortcomings does not yet indicate the imperfection of the banking system of the People's Republic of China, since the state is characterized by a large-scale area and a large number of the population. A rapidly growing economy requires an increasing number of financial transactions that will ensure the further development of industry and the service sector. China's banking system can be safely called stable and stable. The organization of financial transactions is carried out competently, in order to increase assets and liabilities. The only obvious disadvantage that China has been trying to prevent for 3 years is the predominance of loans over deposits.

As we can see, China's banking system is quite strong, but in recent years certain problems have appeared, some of which are caused by the global economic crisis. Let's consider some of them.

1. The first problem is the growth of overdue loans. Overdue loans continued to grow in the period from 2019-2021. The volume of overdue loans of subsidiary banks of China at the end of 2021 amounted to 2.7 billion yuan, a year earlier — 780.5 million yuan. The share of delinquency from the loan portfolio decreased from 2.1% to 1.2%. The volume of loans with overdue payments over 90 days amounted to 1.5 billion yuan, a year earlier — 770.9 million yuan; the share of «long» delinquency from the loan portfolio decreased from 2% to 0.6% [1].

By 2021 the level of overdue loans of individuals decreased to 5.8%, while at the beginning of the study period it was 7.9%. However, the dynamics of overdue loans of legal entities is completely different: in 2016 the level was 6.3%, while in 2021 it was 7.3%[1].

Many Chinese state-owned banks have actively invested in the economies of Russia, Ukraine and Belarus: since 2000, China has provided more than \$125 billion in loans to Russia (mainly to state-owned companies in the energy sector), Ukrainian projects – primarily agricultural and infrastructure - have received \$7 billion in loans from China, a portfolio of loans from Chinese state organizations, provided to Belarus, estimated at \$8 billion, Reinhart and co-authors calculated. The three countries together account for almost 20% of China's loans to sovereign borrowers since 2000 [1].

Now this means that a significant share of China's sovereign loan portfolio falls on borrowers with a sharply increased risk of default. The share of problem loans issued by China has been growing rapidly since the mid-2010s, when Venezuela defaulted, and the coronavirus pandemic further intensified this trend: if in 2010 potentially overdue loans accounted for 5% of the Chinese portfolio of sovereign loans, then in 2022 their share reached 60% [2]. The Russian-Ukrainian political conflict, which directly affects only three borrowers of China, may trigger a sudden stop of lending by China not only to the economies associated with the parties to the conflict, but also dozens of other developing countries in almost all regions of the world.

The researchers come to the conclusion about the probability of a sudden stop of lending from China due to three main reasons they found:

- a sharp increase in the share of «bad» loans in China's sovereign portfolio,
- a sharp increase in the number of restructuring of borrowers' obligations,
- a sharp reduction in the issuance of new loans by China.

The problem of a sharp increase in potentially problematic loans in China's portfolio is exacerbated by the fact that for many developing countries, China has become a key creditor in recent decades. At the same time, Chinese loans are often characterized by large volumes, short terms and high interest rates, which makes it difficult to pay them in crisis situations.

So, the main cause of overdue loans nowadays is pandemic and international political conflicts.

2. The next problem is related to the previous problem - this is the excess of credit operations over deposit operations. The imbalance between loans and deposits in China's banking system entails certain risks. If a bank has provided more loans to its customers than deposits, then the bank becomes insolvent, that is, the lack of deposits does not allow the bank to repay its loans to other banks or the National bank of China in a timely manner.

3. The next problems - inefficient corporate governance in Chinese banks which leads to corruption and «shadow» transactions. There are fraud, «shadow» transactions and corruption in

the Chinese banking system despite the great control over banking activities by the main State Bank and the authorities, There are several reasons that caused this problem.

Firstly, many Chinese banks always have a main shareholder who dominates and manipulates other shareholders. The main shareholder interferes in the daily activities of the bank and makes a fortune with the help of shady machinations.

Having a monopoly block of shares, the main shareholder of the bank can legally manipulate the shareholders' meeting of the bank in accordance with the rules «one share — one vote» and «majority dominates». In the end, joint-stock meetings provide for the needs of the holder of a controlling stake, and do not implement the supervisory activities of the functioning of the bank.

For example, from 2005 to 2019, Tomorrow Holding, the holder of the main stake, illegally borrowed 156 billion yuan (\$22.4 billion) from Baoshang Bank through 209 shell companies in the form of 347 loans, which eventually turned out to be invalid [3]. Such operations lead to serious financial and operational risks and violate the interests of other shareholders and all depositors.

Secondly, sometimes in banks the board of directors exists only nominally. The Chairman of the Management Board has a dominant voting right, which leads to ineffective risk control.

For example, the Board of Directors of Baoshang Bank has been an empty shell for a long time. Among the 13 directors in 2015, a significant part did not participate in decision-making and did not object to illegal decisions. Some were willing to take bribes, shirk their duties, or even approve of the actions of others.

Thirdly, the supervisory board does not function, demonstrating weak independence and professionalism. For example, the supervisory board of Baoshang Bank attracts attention. Of the seven managers, four also worked at the bank as employees subordinate to the board of directors or the management team. In addition, some lacked the necessary professional knowledge to perform their duties well. As a result, the supervisory board was not responsible for the entire company or for all shareholders, especially small and medium-sized ones, but was subordinate to the main shareholder of Tomorrow Holding and the Board of Directors.

Fourth, the management team ignored the rules and regulations. Due to the lack of effective supervision, the management of Baoshang Bank not only illegally helped Tomorrow Holding to seize huge amounts of money, but also fraudulently obtained loans through transactions with third parties associated with the bank.

Most of the related transactions have not been approved by the Board of directors. Some of them were solved collectively by a group of senior managers or even by a single member. Many loans previously issued as part of transactions with related parties were invalid at the time of the takeover. Due to the lack of effective supervision, the management of Baoshang Bank not only illegally helped Tomorrow Holding to seize huge amounts of money, but also fraudulently obtained loans through transactions with third parties associated with the bank.

So, the main problem is that the bank can be completely controlled by the main shareholder and insiders who have taken over local regulators, which lead to failures in corporate governance and turn all activities into corruption and violation of the law. Having a monopoly stake, the main shareholder manipulates the shareholders' meeting of the bank, interferes in the daily activities of the bank and makes fortunes with the help of shady machinations. Sometimes in some banks the board of directors is just a formality, since a significant part of the directors do not participate in decision-making and do not object to illegal decisions, and the supervisory board has weak independence. Sometimes the management team ignored the rules and regulations. Thus, mistakes in corporate governance lead to financial corruption and misconduct.

Currently, corporate governance is one of the most discussed issues in China's banks, scientific meetings and political circles around the world as it plays an increasingly important role in the development of the economy.

4. The following problem in the banking system – insufficient number of reserves in China's banks [4]. In order to regulate China's monetary policy, banks are required to form a reserve fund in case of crisis situations when there is an urgent need to repay deposits of the population and organizations. China's banks faced the problem of early repayment of deposits during the economic crisis caused by the pandemic in 2019-2021. During this period, the Chinese population and organizations applied for early repayment of deposits, but the applications were not satisfied. Since the overdue loans were not repaid during the crisis, Chinese banks were unable to form reserves in a timely manner intended for the payment of deposits urgently

The strengths and weaknesses of the Chinese banking system are presented in Table.

Table. – Strengths and weaknesses of the Chinese banking sector

Strength sides	Weak sides
The state government controls and regulates all types of banks, from large financial institutions to small branches of cooperatives	«Shadow» operations, corruption and a lack of qualified specialists for control a large number of daily financial transactions
The main bank has a huge influence on the entire banking system, since it contains more than 70% of the total assets of the state	Insufficient number of reserves in China's banks
Each financial institution has its own banking function and is responsible for certain monetary transactions	The growing number of «bad» (overdue) loans
The government is able to stop, cancel or change any banking transaction that is aimed at public needs. The government does not control and does not make changes to the policy of the stock market, where 80% of the funds are deposits of the population	
The country has the most legal obligations on all existing banks in China	Predominance of loans over deposits

Source: own development based on economic literature.

So, as we can see there are many strengths in China's banking system. For example, the government can stop, cancel or modify any banking transaction in order to prevent fraud and violation of the law. The government does not control and does not make changes to the policy of the stock market, where the main share of funds are deposits of the population. China's banking system is quite strong, but in recent years certain problems have appeared, some of which are caused by the global economic, political problems and conflicts. Some of the following problems in the banking system of the People's Republic of China: «Shadow» operations, corruption and a lack of qualified specialists for control a large number of daily financial transactions; growing number of overdue loans and predominance of loans over deposits; insufficient reserve funds.

These problems are urgent and require certain solutions, as they significantly hinder the development of not only the banking sector, but also the entire financial system and economy of China.

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### ПРОБЛЕМЫ РАЗВИТИЯ БАНКОВСКОГО СЕКТОРА В КИТАЕ

*В статье представлены теоретические аспекты существующих проблем в развитии банковского сектора Китая. Охарактеризованы сильные и слабые стороны банковской системы Китая в контексте глобального макроэкономического кризиса. Выделены проблемы, влияющие не только на дальнейшее развитие банковского сектора, но и в целом на экономику и устойчивое развитие Китая.*

**Ключевые слова:** *банковский сектор, незаконные финансовые операции, просроченные кредиты, депозиты, резервные фонды.*