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A paradigm shift for China's central banking system

Abstract: *This paper recognizes the challenges faced by the People's Bank of China in its central banking endeavor. The fundamental problem lies with the entrenchment of party politics within the government, which compromises its operations. We conclude that it needs to make a paradigm shift from its current controlled disposition to one that calls the shots in all central banking decisions, especially now that more is expected of it with China becoming a member of the World Trade Organization. However, the relationship between the government and the party has to be changed before it can enjoy the manifestations of a truly independent central bank.*

Key words: *central banking, independence, monetary policy, People's Bank of China, World Trade Organization.*

The paper focuses on the administrative and operational structure of the Chinese central bank, the People's Bank of China (PBC), with the authors' advocating the central bank's full independence as the main thrust of the paper. We attempt to analyze if the PBC is indeed an independent institution as promulgated by the "Law of the People's Republic of China on the People's Bank of China" (henceforth "Law of the PBC"), and describe how some of the manifestations of a truly independent PBC can overcome the impediments that it currently faces. A conscious effort is made to highlight the legal structure of the monetary system with the objective of illuminating its shortcomings and, in particular, the illusion of independence that the central bank law gives.

We recognize that the problems the PBC faces do not just lie with the central bank financing bankrupted enterprises, local governments ignoring the monetary directives of the PBC, or the latter having to fulfill

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fiscal obligations. The fundamental problem lies with the relationship between the government, at both the central and local levels, and the Chinese Communist Party (CCP). The former is entrenched with party politics involving party coalitions and communist elites representing various interest groups. They play important roles in influencing policy changes in China's economic transitional process.

We note that the infiltration of party politics of the one-party state has challenged the relationships between the PBC and the other players, such as the banking system, the local governments, and the state-owned enterprises (SOEs). The pervasive stronghold that the party has over the PBC negates the many efforts made in changing the rules of operation for effective central bank management, which, the authors believe, are only cosmetic in nature. This poses the biggest bottleneck to the PBC's performance as a genuine central banker.

We therefore conclude that the crucial ingredient to effective central banking is true independence, whether politically, legally, or financially. We note that even the promulgation of the "Law of the PBC" does not guarantee giving the PBC "autonomy" or "discretionary autonomy" due to party interferences. And we advocate that the PBC needs to undergo a paradigm shift in order to succeed in effective central bank management so as to serve its roles well as a monetary policy manager as well as a financial regulator and supervisor, and in particular to handle the needs of the "new" monetary and financial environment in a post–World Trade Organization (WTO) China.[1] However, we qualify that some conditions need to be fulfilled in order for the PBC to make a successful paradigm shift. Of paramount importance is the fundamental issue on the entrenchment of party politics in the workings of the PBC. We endorse nonparty intervention in the workings of the PBC and all other government institutions as well, such as the Ministry of Finance (MOF), where party sentiments often juxtapose the policy-making decisions of these institutions with that of the central bank's for vested interests. All these conditions may be easier said than done. Ultimately, it requires the will and clout of the upper echelons to push the recommended resolutions through, and the latter do not work effectively if there is still a lack of transparency in governance and disclosure. Therefore, the legal system and enforcement agencies need to be well developed to handle the checks and balances of "nonconformists," which also include the local governments

[1] China became a member of the WTO on December 11, 2001.

and financial institutions. Otherwise, the PBC may buckle under the weight of a complex and challenging post-WTO China environment where there will be increased monetization and financial depth.

Is the PBC an independent central bank?

The PBC was established on December 1, 1948, as the only required state-owned "monobank" deemed necessary for socialism to be achieved. It adopted a fairly similar Soviet-style banking operations. It was the only bank in China performing the functions of both a central bank and one of general banking from 1949 to 1979. It was formed through the merger of three banks—the Bank of Northern China, the Bank of North Sea, and the Northwest Peasant Bank (Wan, 1999). On September 17, 1983, the PBC was ordered to perform exclusively the functions of a national central bank. It was to be relieved of its duties of performing the functions of industrial, commercial, and savings banking businesses. The "Law of the PBC" was passed in 1995, putting the PBC in charge of monetary policy and banking supervision. It is to "independently implement monetary policies" under the "leadership of the State Council" ("Law of the PBC," Article 7).[2] This was a landmark recognition by the authorities that the rule of law or having a legal framework is critical in financial supervision and regulation. Moreover, the strengthening of the roles of the central bank was deemed necessary, particularly as a financial supervisor and regulator, especially after a spate of bankruptcies that occurred as a result of increasing nonperforming loans and unhealthy banking practices. The functions of handling insurance and securities sectors were hived off into separate bodies; that is, the Insurance Supervision Commission of China (ISCC) and the China Securities Regulatory Commission (CSRC), respectively.

The journey to achieving full independence by the PBC has been thwarted with obstacles, some of which are "deliberately positioned." These are demonstrated by its organizational structure, operational and decision-making process, and credibility with financial institutions and local governments and the public at large. Xu makes a distinction between the PBC's independence "from government" and "within government"; that is, autonomy; and factually states that the PBC's independence "from the government" may not be "very relevant" as it

[2] Refer to Tokley and Ravn (1997) for a review of the various Articles that are included in the "Law of the PBC," as highlighted in this paper.

functions as a government organ and it is "well known" that the PBC has "limited autonomy or independence in both formulating and implementing monetary policy" (1998, pp. 144–145). This known fact is enough to give room for a debate on the issue as to how "relevant" the PBC's current setup is, as its central banking role increases over time with the evolving real and financial sectors. And, in our opinion, such a "time" has arrived and the PBC needs to stay "relevant," especially now that China has become a member of the WTO, and is fulfilling the membership requirements but has yet to experience the full impact of what membership brings on its macroeconomy in general, and central banking in particular.

To understand how independence can enhance the PBC's capacity to perform its central banking functions, we first discuss and address the issues arising from the PBC's lack of independence, and in the process, we also uncover the legal intricacies of the central bank. These issues are mainly related to the PBC's lack of political and policy independence, and financial independence. We then seek to understand the fundamental problem that gives rise to these issues; that is, the relationship between the government and the party.

Political and policy independence

There are four areas of concern regarding the PBC's lack of political and policy independence. At the highest administrative level, the issue deals with the PBC's leadership appointments and boardroom decision-making process, which have implications on its central banking operations. These relate to the highly politicized appointment process as well as the pervasive arm of the CCP machinery, which seemingly runs the operations at the central bank. The other concerns relate to the resistance at the grassroots level and the PBC's role in policy lending.

Leadership appointments

The "Law of the PBC" abolished the board of directors, whose previous representation had caused many conflicts of interest that made the PBC vulnerable to the MOF. The new law called for a governor to take over the helm, being nominated by the Premier of the State Council and approved by the National People's Congress (NPC) or its Standing Committee, and subjected to appointment and removal by the president of the country ("Law of the PBC," Article 9). Deputy governors whose appointments and removals are within the powers of the Premier support the governor in his or her work (Article 10). The provisions contained in the central bank law allow for "loopholes" in the hiring and

firing process. There are no specifications on the type of desired qualifications and terms of service for both the governor and deputy governors, and this gives way to strong hints on the political background and the CCP's membership as some of the major criteria for selecting the PBC leadership. The State Council is thereby in a strong position to nominate or appoint persons who are "loyal" to the government and easily dismiss nonconformists when necessary. Further, the office-bearers may give in under pressures from the government on monetary matters, as they are afraid of losing their positions and powers. Also, the absence of explicit restrictions on central bank officials after they leave office makes them susceptible to "private" incentives and political influence during their tenure with the PBC (Lou, 2001).

Boardroom decision-making process

The PBC was separated from the MOF in 1984, and took on a status and role equivalent to a ministerial organization ("Law of the PBC," Article 2). While the "Law of the PBC" states clearly that the central bank shall "independently implement monetary policies" (Article 7), it operates under the "leadership of the State Council" (Article 7) and needs to seek "the State Council for approval prior to implementation" (Article 5). By simply not reporting to a finance minister or some other minister demonstrates the legal independence of the PBC, which will influence its standing and prestige within the government apparatus. However, before the official demise of the annual credit-quota plan at the end of 1997 (Lu and Yu, 1999), the PBC seemed to work in subordination to other central agencies, such as the State Planning Commission (SPC), as an instrument in carrying out the direct monetary policy tool.

And although it is to "independently implement monetary policies" ("Law of the PBC," Article 7) through the establishment of the Monetary Policy Committee (MPC) (Article 11), the latter's role has been said to be undermined by another vehicle of the government, the 15-member Central Financial Work Committee (CFWC), a CCP cell that possesses the real decision-making power behind the policies advocated (Gilley and Murphy, 2001). The CFWC's very existence and clout (such as setting interest rates, closing down banks, deciding the amount of loans state-owned commercial banks [SOCBs][3] should give to loss-making SOEs to prevent layoffs and social unrests) makes the PBC a hollow

[3] These are the Agricultural Bank of China (ABC), Bank of China (BOC), China Construction Bank (CCB), and the Industrial and Commercial Bank of China (ICBC).

institution. This simply highlights the party's desire to maintain full control. The 12-member MPC comprises ministerial officials, regulators, and economists "whose functions, compositions, and duties shall be prescribed by the State Council" (Article 11). It was created as an establishment within the PBC and was understood to play a similar role as the U.S. Federal Open Market Committee (FOMC). In fact, it plays only a "consultative" role (Article 11) and is not a policy-making institution. These provisions on the creation of the MPC obviously indicate that there are problems with the PBC institutional structure under the central banking law. It also demonstrates the permeating influence of the political party within the government stronghold.

Resistance at the grassroots level

The PBC faces the dilemma of reducing administrative intervention by local governments and relying on them to organize the implementation of monetary policy and the realization of macroeconomic goals and objectives. It exercises centralized and unified leadership and control over its branches (Article 12). However, being "free from any intervention by local governments or government departments at all levels, by public organizations or individuals" (Article 7) proves not to be so. The PBC faces challenges and resistance from the local leadership and financial institutions. The latter ignored directives on the dangers of excess credit (Dipchand et al., 1994) and it faces circumventions in many situations (Holz, 1992; Naughton, 1993). Its branches' lending decisions are being put under the unduly influence of the local governments (Lardy, 1998; Lu and Yu, 1999; Mo, 1999) to fund their pet projects or entities that they have with local businessmen. The PBC branch staff faces conflicts between monitoring the implementation of monetary policy directives by the local governments and branches of state banks, and keeping their "iron rice-bowl"; that is, their jobs, housing, medical, and other welfare benefits, as these are provided by the local governments. Such scenarios have hurt the image of the PBC and hence its credibility as a central bank.

It would not have been an easy task to rein in the substantial powers of the local governments, financial institutions, and enterprises since the time that administrative and economic decentralization (Chen, 1995) was endorsed by the central government as part of the reform process. The reorganization of the PBC in November 1998 (ACFB, 1999) was intended, among other reasons, to reduce administrative intervention by the localities, thereby increasing the PBC's power in pursuing monetary policies and financial supervision. Previously, the regional branches were established in parallel with the setup of the 31 administrative divisions.

The new organizational structure involves the establishment of trans-provincial branches in nine major regions, and supported by 20 financial supervisory offices. It is somewhat similar to the structure of the U.S. Federal Reserve System (FRS) although we admit, unreservedly, that the FRS is not totally faultless. Like each Federal Reserve district, which covers a number of states, each transprovincial branch covers a number of provinces under its jurisdiction. And being the regional arms of the PBC, they perform defined central bank functions in their respective regions (People's Bank of China, 1999). However, we question the impact that the new structure has on monetary policy management as party politics, such as those involving the CFWC, continue to undermine the influence of the PBC over the localities in the new setup. We will delve more into this issue below.

Role in policy lending

Article 3 of the "Law of the PBC" clearly states that the aim of monetary policy is "to maintain the stability of the value of currency" and "thereby promote economic growth." However, issues arise as these two principle objectives are always in conflict, as there are other aims that monetary policy is targeted to achieve. Xu (1998) notes that the government managed to make the PBC subordinate to its development tasks and high growth policy. As it was before the promulgation of the "Law of the PBC" in 1995, the conflict between these two objectives accounted for the macroeconomic instabilities in the periods from late 1984 to 1985, from late 1987 to early 1989, and in the first half of 1993 while the country embarked on its modernization program. The conflict was exacerbated as the objective of promoting growth brought about demands for financial resources from both the central and local governments for various "top priority" development projects.

When the PBC was instituted as a central bank in September 1983, and was supposed to gain "autonomy," moving away from fiscal responsibilities to monetary ones, policy lending was still mainly skewed toward government priority projects that had economic development and growth as the main objectives. Fiscal authorities through budgetary appropriations should normally support these requests for funds. There was also no law to limit the government's discretionary access to the PBC's coffers to offset its budget deficits. While the PBC had to support both fiscal and industrial policies, it went "overboard" in fulfilling its obligations and the dissemination of funds. As illustrated in Table 1, between 1991 and 1996, the policy loans accounted for about a third of the total state banks' loans. There was, however, no denial that the PBC

Table 1
Policy loans (RMB billion)

	1991	1992	1993	1994	1995	1996
Policy loans total	6,781.7	7,410.9	9,322.6	11,485.2	14,159.7	16,440.1
Total loans by state banks	18,044.1	21,615.5	26,461.1	32,441.3	39,393.6	47,434.7
Proportion of policy loans (percent)	37.58	34.29	35.23	35.40	35.94	34.66

Source: Institute of Economics, Chinese Academy of Social Sciences, "Aggregate Trend, Financial Risk and External Shocks: Analyses of the Current Chinese Macroeconomic Situation," *Jingji Yanjiu,* (Economic Research), March 1998, *3,* 3–14.

was instrumental in financing the growth of the Chinese economy, as evident by its continuous excessive lending.

Although the PBC was finally released from lending funds to the MOF for funding government deficits as promulgated in the "Law of the PBC" in 1995, so that the budgetary grants be replaced by loans (Dipchand et al., 1994), it still indirectly fulfills this request by delegating the fiscal obligations to the SOCBs. This not only conflicted with the SOCBs' performance-oriented business goals but also defeated the government's purpose of creating three policy banks[4] to fulfill these fiscal duties. These loans were refinanced at subsidized interest rates, which were usually set below the deposit rates of the same maturity paid to households (Hofman, 1998), and were in fact subsidies for loss-making SOEs disguised as or "disbursed in the form of bank loans" (Lau, 1999).

The SOCBs continued to be the main sources of credit, as the capital market was still not well developed. The inabilities of the inefficient and loss-making SOEs to repay their loans have resulted in ballooning non-performing loans for these banks (Dornbusch and Giavazzi, 1999; Lardy, 1999; Lau, 1999). This has serious implications on the financial sector in general, and the banking industry in particular. However, to stop financing, the SOEs would result in potentially serious social problems as massive unemployment would be the outcome. Hence it has been debated in many quarters that monetary policy accommodate the fiscal policy (Xu, 1998). And until the reforms in the social security system, the enterprise as well as the government budgetary sectors, happen on a positive note, the PBC's independence is compromised when it has to support both monetary and other government economic policies and, in particular, the fiscal and industrial policies.

Financial independence

The PBC also demonstrates a lack of financial independence. The ability of central banks, as practiced in the rest of the world, to keep a small fraction of the money they make to finance themselves, provides a certain degree of independence and authority (Volcker, 1991). The PBC is financially dependent on the State Council's budget appropriations. The "Law of the PBC" stipulates that "a budget of the People's Bank of China shall be incorporated in the central budget after it has been examined and verified by the financial department of the State Council and shall be

[4] These are the Agricultural Development Bank (ADB), the Export-Import Bank of China (Eximbank), and the State Development Bank (SDB).

subject to budget implementation supervision by the finance department of the State Council" (Article 37). Moreover, the PBC has to "turn over to the State Treasury the entire net profit from its income for each fiscal accounting year minus annual expenditures after withdrawing funds for its general reserve at a proportion determined by the financial department of the State Council" (Article 38). This financial dependency characteristic in no small way makes the central bank beholden to political interferences.

The relationship between the government and the party

Up to this point, we have drawn attention to the PBC's lack of clout in monetary policy management by highlighting several examples including that of being a reluctant vehicle for funding both fiscal and budgetary needs. It has also been taken to task to financing the decaying SOEs to prevent bankruptcies. The latter would not only have implications on unemployment and social unrests but also on the stronghold one-party system. The central bank has to participate actively in such industrial or social policies, though the literature on macropolicy coordination does not deal with such intervention. We realize that even the promulgation of the "Law of the PBC" does not guarantee giving the PBC "autonomy" or "discretionary autonomy."

We believe that the fundamental problem lies with the relationship between the government, at both the central and local levels, and the incumbent party. The former is deeply entrenched with party politics. These involve party coalitions and communist elites representing competing group and institutional interests, and whose responses and actions have a definite impact on policy changes in the country's economic transitional process. Among the party coalitions, the "reformers" embrace market-oriented reforms with or without a need to change its basic institution and political features, whereas the "conservatives" oppose both market-oriented economic and political reforms for fear of losing their powers and privileges. Some of the conservatives, though, are "willing to improve central planning and control by reducing the detail and scope of plans and directives" (Chen, 1995, p. 78). Their primary concern is whether market-driven reforms, such as in central banking, would be compatible with a "socialist" system.

The question on the PBC's autonomy, let alone independence, is not an easy matter to resolve, as this involves powerful forces at work, at both the center and the localities, and in both the government and the enterprises. The "competing interests of the center and the localities" (White and Bowles, 1996, p. 163) continue to generate institutional

changes in the financial system, such as those in the central bank, making enforcement of financial discipline by the center even more difficult. One such example is the localities' use of nonbank financial institutions (NBFIs) to evade controls exerted through the banking system. Thus the political tug-of-war between competing groups and the interplay of such political forces at all levels has challenged the PBC in its role as the country's central banker.

It becomes obvious that the PBC's authority is emasculated by party politics. Such infiltration of party sentiments in most, if not all, government institutions take over policy-making decisions, making the latter hollow institutions. It challenges the relationships between the PBC and the other players, such as the banking system, the local governments, and the enterprises. The various government ministries are under the control of the party, such as the party's Central Financial and Economic Leading Group being put in charge of financial and monetary affairs, including the PBC, before 1998. The real supervisory power later moved to the more conservative CFWC in 1998. It is thus not uncommon that bureaucratic and legislative decisions have to adhere to "the party's line, principles and policies as well as relevant instructions and decisions of the party Central Committee and State Council" (Gilley and Murphy, 2001, p. 50), many of which run counter to the principles of monetary policy management as practiced in a market-driven economy, which the PBC aspires to acquire. The PBC merely serves as an administrative organ for carrying out decisions made by the CFWC. The fact that the latter makes no qualms about its control over the country's monetary and banking policies on a day-to-day basis, with the MPC playing only a consultative role, gives weight to the strong party sentiments in monetary policy affairs.

While the central bank demonstrates a forthcoming attitude toward key issues, such as interest rate liberalization, local currency convertibility, liberalization of the banking sector, or SOCBs' banking reforms, the CFWC displays a relatively dissembled one. Apparently, a competitive and vibrant banking sector and prudent monetary policy do not rank high on its agenda as compared to social and political stability. Again, the main issue is the PBC's lack of independence, where it is key not only in promoting monetary stability but also in ensuring its effectiveness and efficiency and therefore establishing its credibility (Xu, 1998).

Indeed the pervasive stronghold of the party over the PBC poses the greatest bottleneck to the central bank's performance as a genuine central banker. It negates the many efforts made in changing the rules of operation for effective central bank management, such as those as demonstrated by the "Law of the PBC" and the restructuring of the PBC in

1998. We therefore question the authenticity of these rules and believe that they provide only a cosmetic layer over the skin-deep party-determined policies. We believe that such changes in the rules of operation of the PBC or any other government institution are of secondary importance, and could even be ineffective, if the relationship between the government and the party is not changed first.

A paradigm shift for the PBC

In this section, we address some areas where independence can enhance the PBC's capacity to perform its central banking functions by demonstrating some of the manifestations of an independent PBC. However, we also recognize that some conditions need to be fulfilled in order for the PBC to improve its performance in central banking. We see a strong need for the PBC to succeed in effective central bank management so as to serve its roles well as a monetary policy manager as well as a financial regulator and supervisor. It needs to experience the progression to a central banker that is empowered and market-driven so as to handle the needs of the "new" monetary and financial environment in a post-WTO China, where there will be increased financial deepening brought about by the influx of new financial instruments and foreign financial institutions, and increased growths in both the domestic banking sector and financial markets. Hence, we strongly advocate that the PBC undergo a paradigm shift in central bank management.

We believe that the most crucial ingredient the PBC needs is independence. Independence will allow the PBC to exercise its task as a genuine central banker, emulating other central banks in market economies. From our discussions in the section "Is the PBC an independent central bank?" we note that even the promulgation of the "Law of the PBC" does not guarantee giving the central bank "autonomy" or "discretionary autonomy," the latter as recommended by White and Bowles (1996), mainly due to interferences from party coalitions and communist elites representing competing group and institutional interests. Independence should be the foundation of the PBC's effectiveness. Operating the central bank with only "Chinese characteristics" can create loopholes for the infiltration of party politics. A "market-driven" monetary and financial environment in the twenty-first century information age would not operate effectively under the umbrella of a party-controlled PBC. This would have adverse implications for the macroeconomy at large. As it is, there is the possibility of the PBC's managing one of the world's largest reserve currencies and banking system, and having a voice in regional and

international monetary affairs. An independent, enabled, and empowered PBC is needed to realize this Chinese vision.

The PBC must have the will and power to make radical changes. We address the question of how independence can enhance the PBC's capacity to perform its central banking functions by demonstrating some of the manifestations of an independent PBC. This includes the MPC having a direct role in policy-making instead of being a vehicle for consultation to the CFWC. The PBC's political independence would allow it to manage the country's monetary and banking system without any interference. It would have the authority to set interest rates, end "perpetual" funding to the loss-making SOEs, liquidate shaky and nonperforming financial institutions that pose a threat to the banking system, and allow competition to drive the financial sector. The PBC would also not be directly involved in credit allocation. And it would ensure that credit is not provided to a particular sector through the process of money creation; it should be provided via the budget.

The PBC would demonstrate power as an independent central bank. A powerful PBC would also be able to push through important policy reforms needed for a new post-WTO banking environment. These policies include the continual disposal of nonperforming loans of the troubled SOCBs to debt-salvage companies, and the flotation of the domestic banks (in particular, the SOCBs) to transform the banking sector into a competitive and independent industry. They will also serve as part of the development of the capital market. The "corporatization" of these banks would also help ensure transparencies, accountability to shareholders, profit management, and professional management of the SOCBs.

An empowered PBC would have the ability to ensure the full compliance of its monetary directives by local governments and financial institutions, and hence money supply would be manageable and predictable. It would also prevent macroeconomic instabilities like those experienced in the 1980s and early 1990s. Likewise, the PBC would see to it that the actual implementation of severe penalties be imposed on local governments and financial institutions that do not adhere to the PBC's regulatory and supervisory directives.

However, some conditions need to be fulfilled in order for the PBC to improve its performance in central banking functions, as those described above. These conditions include that the appointments to the PBC need to be based on technical competence and it must be seen to be "objective and nonpartisan." The people holding top management positions should not be political appointees. The PBC must "be close to the political process but not part of it" (Godeaux, 1991, p. 77). The PBC should also

exercise financial independence, reducing its reliance on funds from the state budget to run its operations.

A powerful central bank also needs to be well informed. A lack of prior knowledge is making supervision of the country's banks increasingly difficult to deal with. The PBC should be given access to the books of banks on a frequent basis within a year, just like those practiced elsewhere in market economies. Otherwise, the authorities would never be aware of any banking problems until it is too late. This has major implications, especially when dealing with the 40,000 Rural Credit Cooperatives, which holds about 12 percent of the country's total deposits (Gilley and Murphy, 2001).

For the PBC to demonstrate influence and autonomy, public opinion also plays an important role. However, to garner such public support, it has to be earned. And this has to be done through its demonstration of expertise, professionalism, and accountability. This relies on the quality of the research that is performed at the PBC, a high-quality professional staff and a decision-making body that has the ability to communicate effectively. The PBC will have to build an infrastructure that can attract and keep the best people with a career-based organization and a reasonably competitive salary structure, and provide an environment for open discussion of issues within the bank. Currently, the PBC is losing its best staff to the financial sector, which is exacerbated by the WTO-led entry of foreign financial institutions, with unattractive compensation as the main push factor. And in order to regulate foreign banks, the PBC needs people who are highly skilled, such as in international finance and capital flows. Although the PBC runs "20 banking universities and another 15 general finance universities to train future staff for the country's financial system" (ibid., p. 52), the quality of the staff is still questionable.

The PBC needs to demonstrate a strong sense of accountability by being transparent in its doings, make public disclosure a way of life, and articulate policies to the rest of the government and the general public. In particular, its role as an independent monetary policy manager has to be articulated to the nine regional centers, which were created in 1998 to reduce the interferences from the local governments. These regions can be instrumental in providing information about regional developments and in communicating with the public.

Of paramount importance is the issue of the entrenchment of party politics in the workings of the PBC. Although we recognize the efforts made by the PBC in its 1998 restructuring endeavor to improve its central banking performance with new rules of operation, new processes,

and reorganization, these changes are, however, nullified by the omnipresent CFWC, which has been positioned to "counter" the PBC's desire for independent central bank management. The PBC should be freed from the institutional grip of the party. It should not merely serve as the administrative organ responsible for implementing the monetary and banking policies as directed by the pervasive and powerful CFWC. The higher authorities should not only recognize that the existence of party politics within the government puts brakes to desired market-driven economic advancement, but they should also act on the dichotomy between country interests and party interests.

The solution does not merely involve stripping local governments of their power, as recommended by Wong (1992). Instead, at the highest administrative level, until and unless factions within the party converge to a common understanding of an effective market-driven and independent central bank management, and even if the "Law of the PBC" is further amended (such as in the pertinent areas as highlighted in the section "Is the PBC an independent central bank?") to give the central bank more independence, the PBC will continue to experience hurdles in its central banking role. Likewise, at the lower local government level, with the central government eradicating the root problem of any party interferences to the PBC branch operations, such issues as local governments' unreasonable demands for funds to implement their pet projects would be unheard of. While we note that the fulfillment of these conditions does require the will and clout of the upper echelons of the Chinese administration to push these resolutions through, it is also equally important that this is backed by a well-developed legal system that can ensure the enforcement of a higher standard of transparency in governance and disclosure. Such an undertaking would help discourage the "nonconforming" behaviors of the local government and financial institutions.

We believe that the above observations are necessary for the PBC in making a successful paradigm shift from its current position. Otherwise, a post-WTO China environment that manifests attributes of increased monetization and financial depth, may prove too complex and challenging for the PBC to fulfill is roles as the country's central banker.

Conclusion

This paper recognizes the challenges faced by the PBC in its central banking endeavor. It notes that the chief impediment to the PBC serving its roles as both monetary policy manager and financial regulator and

supervisor is its lack of independence. Even the promulgation of the "Law of the PBC" does not guarantee giving the PBC "autonomy" or "discretionary autonomy." This leads us to believe that the fundamental problem lies with the entrenchment of party politics within the government, which compromises the sound and effective operations of the PBC. We conclude that any efforts made in changing the rules of operation for effective central bank management are only cosmetic in nature and of secondary importance if the relationship between the government and party is not changed first.

Although we recognize that it is not an easy task, reining in the substantial powers of party politics is the desired solution, which would translate to more independence for the PBC. This would give the PBC considerable autonomy vis-à-vis other ministries under the State Council and above that of local governments to exercise effective monetary policy management and prudential supervision of the financial institutions, to back down on demands to extend loans to unviable projects, and to ensure that any subsidies for policy lending are financed through the budget rather than borne by the banking system.

The PBC needs to make a paradigm shift from its current inhibited and controlled disposition to one that calls the "shots" in all central banking decisions. As China progressively opens to the rest of the world, it is timely that the PBC revisits its roles and functions and makes a quantum leap to genuine central bank management, as practiced in market economies. This is a critical move, as the possibility of the PBC's managing one of the world's largest reserve currencies and banking system, and having a voice in regional and international monetary affairs is no more than a distant dream.

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