

RINCO

...dinamandi
...nani ehlile!

...KON



TIPS

TRADE & INDUSTRIAL POLICY STRATEGIES



Towards a New Partnership: China in the SADC Banking Sector

Memory Dube

December 2008



indigenous **growth**

Towards a New Partnership: China in the SADC Banking Sector

Author: Dube, Memory

Institution: TIPS

Date: December 2008

Contents

Contents.....	2
List of Tables.....	3
Abbreviations	3
Executive Summary	4
1. Introduction.....	6
2. Banking Sector Liberalisation and Reforms in SADC.....	7
3. The Growth of the Chinese Banking Sector	11
4. Current State of the Chinese Banking Sector and Level of Integration in Global Financial Sector.....	15
5. China’s Experience in Investing in the International Banking Market	18
6. China’s Banks in SADC.....	20
7. What does the Chinese penetration mean for SADC?.....	21
7.1 Domestic Reform	22
7.2 Bank recapitalisation and expansion.....	22
7.3 New markets and customers.....	23
7.4 Protection from shocks	23
7.5 New Chinese ventures.....	23
7.6 Political implications	23
8. Conclusion.....	24
9. Recommendations.....	25
References.....	27
10. Appendix.....	30

List of Tables

Appendix Table 1. Foreign Investments in Chinese Banks	30
Appendix Table 2. Presence of Chinese banks in foreign markets.....	32

Abbreviations

ATM	Automatic Teller Machine
CDB	China Development Bank
CIC	China Investment Corporation
CRBC	China Bank Regulation Commission
EU	European Union
GATS	General Agreement on Trade in Services
ICBC	Industrial and Commercial Bank of China
IFSC	International Financial Services Centre
PBC	(The) People's Bank of China
SADC	Southern African Development Community
SME	Small and Medium Enterprises
WTO	World Trade Organisation

Executive Summary

Sino-African relations have long been defined by projects and infrastructure development in sectors that are of strategic importance to the growth of the Chinese economy. These are projects that have typically ensured a steady supply of much needed resources and raw materials to Chinese industries. Chinese banks have, in turn, been involved in the financing of such projects. This pattern has evolved and Chinese banks are currently also involved with investing in the banking sector overseas. This new investment direction has been initiated by the Industrial and Commercial Bank of China which has invested in Standard Bank South Africa to the value of US\$5.5 billion - acquiring a 20% stake in Standard Bank. Standard Bank is one of the largest banks in South Africa and has a significant presence in the Southern African Development Community (SADC) as well as the rest of Africa and in 21 other countries in the world.

The establishment of the China – Africa Development Fund will see Chinese entrepreneurs embarking on low cost projects that are funded by Chinese banks with the further support of the low-cost labour provided by Chinese immigrants who follow Chinese companies abroad. Such low-cost projects with significant returns potential are likely to attract other commercial banks through the provision of banking services. This would entail investing in the SADC banking sector possibly along the lines adopted by the Industrial and Commercial Bank of China.

The global financial crisis, whose effects have been most severe on the world's largest banks, has created a vacuum in the SADC banking sector by stalling investment from the traditional investor. The world's largest banks, brought to their knees by the crisis, and having had to be bailed out, are in no position to continue investing in the SADC banking sector. China, less severely affected by the crisis, with a burgeoning economy, and with banks that are awash with cash, is, in contrast, able to fill in the vacuum left by the western banks in the SADC region.

With the exception of South Africa and Mauritius the SADC banking sector itself is not well-developed. Regionally, the banking sector cannot even sustain the domestic banking activities and has to import some of the required services. There are also some barriers to banking services in the SADC region that need to be attended to if the sector is to grow and benefit from investments. The SADC banking sector does have a huge potential for growth though: several countries have strong commercial banks that can be strengthened enough to feed the regional growth of the retail banking sector.

The advent of China in the SADC banking sector could be used as an opportunity to reform the SADC banking sector so as to create an enabling environment for investment and to reap the full benefits of such investments. SADC banks can consider investing Chinese banks to acquire new skills, products and technologies to improve their sector. The lack of extensive external investment experience on the part of Chinese banks is compensated by the fact that China has in the past two decades embarked on an

aggressive modernisation drive of its banking sector. Moreover, this drive, associated with a strong liberalisation process, saw western institutions invest in Chinese banks. Chinese financial institutions used this opportunity to gain skills and expertise as well as modern banking methods. This background has ensured that China has not been radical and overambitious in the investment method used in SADC. Instead, China has adopted a cautious investment strategy that currently concentrates on partnerships rather than on establishing local branches forthright. The selection of banks with which to partner with - as seen with Standard Bank, a bank with a huge SADC presence - appears to be aimed at getting in-house knowledge and information on the local SADC banking terrain. Such partnering will make up for lack of investment experience when Chinese banks eventually establish local branches and subsidiaries.

Properly managed and with the adequate reforms and systems in place within the SADC banking sector, the new investment interest of China should be one that spins benefits for both China and SADC while redefining the financial terrain in SADC.

1. Introduction

This paper uses as its point of departure the recent demise of the world's largest financial institutions that set in motion the current global financial crisis. These financial institutions look set to re-evaluate their model of global finance and it is anticipated that western finance will be dramatically transformed in the near future (Meyer, 2008). The void created by the fall of these financial powerhouses is expected to be filled in by private financial institutions from China and Japan. The focus in this paper is on China, however, because of its aggressive drive to acquire markets as well as resources from Africa. Over the years, China has come to be touted as the new economic powerhouse on account of its economic growth and its share in world trade, despite its developing country status. China's emergence in the global economy is also linked to enhanced Sino-African relations, particularly in the context of political and economic links. These relations have been underpinned by China's need to access key raw materials that are abundant in Africa. As of 2005, China has been said to be the world's biggest consumer of raw materials, overtaking the US (BBC News, 2005; Bleischwitz, 2006). These raw materials feed the growth of China's manufacturing industries which are also supported by cheap labour. As they grow, these industries need to find markets for their products and Africa is an ideal market for Chinese low-cost manufactured products. Lastly, China is seeking a more significant role in international politics and through its intensified presence in Africa. Through various investment drives, the Chinese government seeks to achieve African support globally (Le Pere and Shelton, 2007:121). The Chinese venture into Africa has not been without controversy, however, and it has generated many debates. The principal question raised however, relates to the implications for Africa of this Chinese penetration.

China can take advantage of the void created by western banks in Africa as a consequence of the global financial crisis and, possibly, create a new banking era for Africa. This is the position of Meyer (2008). Through the chronicles of Sino-African relations in the financial sector and an analysis of other extraneous factors that impact on such Chinese investments in the banking sector in Africa, this paper will assess the implications of the Chinese penetration of the banking sector in the Southern African Development Community (SADC). Investments will be assessed against the background of a SADC region that is faced with the challenge of developing a competitive services industry, especially in the context of the recently launched SADC Free Trade Area.

This paper looks at the banking sector as it is at the core of many other service industries and could possibly be referred to as one of the drivers of the establishment and/or development of other economic sectors. Also, a strong financial services sector with adequate support systems is one of the critical elements of a conducive and sustained economic growth. As one of the key drivers of economic growth and a determinant of a country's trade capacity, especially in sectors such as transport and distribution, it is essential that services trade be managed with great vigilance. While the level and depth of trade liberalisation in the services sector certainly impacts on Chinese investments in SADC banks, this paper is not concerned with, and will not debate the merits or demerits of liberalisation in the banking sector. Rather, it will deal with the facts on the status of liberalisation in the banking sector in SADC as they are presented

vis-à-vis the benefits or otherwise of the Chinese penetration in both, the sector and the region. From this analysis of the possibly re-structured financial world and China's place within it, as well as an assessment of the possible impact on the SADC banking sector, it is hoped that this paper will raise a few issues that will help put the Chinese issue into perspective.

The paper is structured as follows: the first part of this paper determines the state of liberalisation in the banking sector within SADC as one of the possible determinants of the reaction of SADC to China getting a stake in the SADC banking sector. The second part of the paper focuses on the growth of the Chinese banking sector from the moment it was decentralised. Given the lack of experience on the part of Chinese banks in entering foreign markets, the state of the banking sector in China will be considered in the third part of the paper. As a relatively new arena for China, instinct prescribes that the state of its banks as well as the extent of Chinese liberalisation in the banking sector be scrutinised to assess the sustainability of Chinese investment in the SADC banking sector. In the fourth part, China's experience in investing in the international banking market is considered, where the Chinese banks have sought to invest and how much inroads they have made in that aspect. This then leads us to the SADC banks and we look at the level and extent of Chinese penetration in the SADC banks. This is covered in the fifth part. All the above will help measure the overall impact of Chinese investments in the SADC banking sector which are covered in the sixth part of the paper. The seventh and eighth parts set out the conclusion and some policy considerations.

2. Banking Sector Liberalisation and Reforms in SADC

In anticipation of increased and possibly deepening relations between China and SADC in the financial services sector, it is necessary to look at the state of and reforms that have been undertaken to date in the banking sector in the SADC region. The nature, extent and depth of Chinese investments in the SADC banking sector will depend to a certain extent on the commitments made by the SADC countries in this sector. This section analyses SADC members' General Agreement on Trade in Services (GATS) commitments to determine the level of openness in the banking sector. This analysis of the state of the banking sector in SADC is used to assist in determining the impact and/or implications of the Chinese penetration in the banking sector. It would then be easier to assess the advantages /disadvantages that Chinese banks could bring.

South Africa and Mauritius are the only two SADC countries with a banking system that is sophisticated enough to offer international services through the operation of international offshore accounts (Murinde and Ryan, 2003:193). South Africa's banking sector is not just limited to South Africa but extends to the region – for instance Standard Bank South Africa offers services to 14 other African countries, eight of which are SADC countries (Kumalo, 2006:28). Other South African banks that have entered the regional market include ABSA, Nedcor, Investec and First National Bank (Mowatt, 2008:15). In other words, South Africa has managed to export its banking services to the rest of the region. This achievement by South African

banks is, however, marred by the lack of robust and effective regulation in the sector which has resulted in high Automatic Teller Machine (ATM) prices and handling fees (Khumalo, 2006). The Competition Commission of South Africa held an enquiry on banking between August 2006 and June 2008 to examine the high transaction fees charged by South African banks as well as access to the retail banking sector. The enquiry focused on personal transaction costs and the findings indicate that bank charges in South Africa are significantly higher than they would be at competitive levels and the market structure as it currently stands ensures the ability of banks to abuse their market power if they so wish (Competition Commission, 2008a and 2008b). Such situation as painted by the enquiry effectively reduces access to banking services for the poor, and worsens the access barriers to the formal banking system.

Mauritian banks have also expanded into other SADC countries such as Malawi, Madagascar, Mozambique and Seychelles. Internationally, Mauritian banks are present in India and France, which illustrates the level of sophistication of the Mauritian banking sector (Jansen, 2006:12). The financial services sector in Mauritius is highly liberalised, with the most open banking sector in Africa and with government having ceased direct control of bank credit and started utilising monetary policies to control inflation (see Murinde & Ryan, 2003 and Khumalo, 2006:28).

The other country with a strong export potential in the banking sector, albeit not having yet ventured outside of its borders, is Botswana. Botswana has concentrated mainly on building the financial services sector as an area of growth for the Botswana economy. Its efforts are concentrated in the International Financial Services Centre (IFSC), a government agency which is supposed to mobilise funds and investments from South Africa and the rest of the world into other parts of Africa. The main objective of this project is to make Botswana the hub of all financial services activities in Sub-Saharan Africa by encouraging companies and institutions falling under the IFSC to provide financial services to clients outside of Botswana (Jansen, 2006). Substantial effort and progress has been made to improve and develop Botswana's financial sector further through the abolition of exchange controls and introduction of foreign exchange bureaux as well as foreign accounts (Khumalo, 2006:28).

In the case of Zimbabwe, Zambia, Malawi and the Democratic Republic of Congo, the financial sector is identified by a hybrid of both state and private sector participation, with a significant effort being made towards "stimulating competition, developing money markets, making interests rates more flexible, and moving towards indirect money control" (Khumalo, 2006:28). Malawi, Zambia and Zimbabwe were, in 2003, reported to boast commercial banks of international standing, taking into consideration the capital strength and asset size of the relevant banks (Murinde & Ryan, 2003:193).¹

¹ It is highly unlikely that Zimbabwe's commercial banks can still be classified as internationally competitive. Nevertheless, its banking system is significantly developed and might do well without the current political and economic meltdown that the country is experiencing.

As for the members of the Common Monetary Area,² Lesotho, Swaziland and Namibia, their financial systems - and that would refer to these countries' banking systems as well -, are reported to be less sophisticated than and much smaller versions of the South African financial services system. These countries' banks do not seem to have any significant standing in the region moreover. Having integrated their currency systems, these banks are likely to be represented by South African banks in the region and are only adequate for the needs of the small populations of the country in which they emanate. In any case, South African banks are very active in these countries (Jansen, 2006:15).

The remaining three SADC members, Angola, Mozambique and Tanzania, all have a financial services sector that was for a long time defined by socialist economic policies but has undergone and is still undergoing reforms that embrace market principles in monetary policies. Progress in reforming these countries' banking sector has been slow though and the services offered by the banks are still limited to short-term, trade related finance (Khumalo, 2006:28). Also, whereas Mozambique has commercial banks of international standing, in Tanzania, only 6% of the population has access to formal banking facilities according to Jansen (2006:13). Moreover, according to Napier (2008:366), the majority of the Tanzanian population uses informal products rather than the formal banking system. Lack of access to banking services and facilities has encouraged the growth of micro-finance and miscellaneous related issues.³ Dealing with these would require the absorption of the populace into the formal banking system and the further development of the banking sector so as to enable it to accommodate the masses. Also, failure to resolve the low levels of access to banking services and products results in a huge amount of cash circulating outside the formal banking system which in turn keeps bank charges at a high level. High bank charges would work to restrict access to the formal banking system by the lower income level groups and, ultimately, would not augur well for the development of the banking sector and the economy.

In terms of the GATS only seven SADC countries have made commitments in the banking sector. This suggests that the sector is sensitive although the absence of commitment under GATS is not indicative of the actual state of liberalisation in the financial services sector.⁴ Nonetheless, it can be said that financial services in SADC are generally weak and inadequate to support domestic banking activities, with most members importing their financial services (Mowatt, 2008). According to Napier (2008), the barriers to trade in financial services include:

² This is a monetary union or single monetary area where there are no exchange controls between the members of the monetary union and they apply the same exchange control policies on third countries.

³ Informal micro-financing systems have the attendant problem of unregulated interest rates that accumulate at considerable proportions. Such informal credit – lending systems perpetuate the cycle of poverty as poor people rely on them and also spend more than twice the borrowed amounts in interest payments. The other challenge attached to this development is with the integration of such micro-finance into the formal system (see Jansen, 2006:13).

⁴ Also, under the International Monetary Fund and World Bank programmes, some reforms have taken place outside of the GATS framework. (Khumalo, 2006:29). These reforms, undertaken under the auspices of economic structural adjustment programmes, generally involved increasing real interest rates to positive levels, the use of commercial criteria to allocate credit, the strengthening of prudential regulation, and supervision and the restructuring of state-owned banks (see Mowatt, 2000:12).

- Inadequate information infrastructure; The financial sector is highly dependent on information and lack of or incorrect information would damage the financial market considerably. Some of the information imbalances may stem from the lack of local knowledge whereby solutions are imported from western financial experts, which solutions are sometimes inappropriate for the African banking terrain.
- Regulatory barriers; Such barriers arise from either inappropriate/absent regulation or regulatory stasis.
- Lack of physical access to banks; Research shows, for instance, that as of April 2005, there were only 63 ATMs in Tanzania, while only 45% of Botswana's population lives in areas where there is a permanent banking presence.
- Affordability of banking services; For example, an estimated 2.5 million out of 6 million Zambian adults' access to banking is restricted by the high minimum balance requirements set by the banks. These 2.5 million adults simply cannot afford to bank.
- State intervention in the banking sector; State intervention results in market distortion through inefficient and subsidised institutions.⁵ State ownership of banks also results in political interference in bank management. Such state intervention or ownership in banks is especially risky for the continued stability and development of the financial services sector when there is no transparent and independent monitoring mechanism.
- Financial illiteracy; Lack of financial literacy is one of the constraints to financial market development in the region. The fact that 60% of South African adults are not familiar with the term "interest rates" illustrates this point. Also, a staggering 77% of Zambians do not understand the term "ATM card" while 21% of Tanzanians do not utilize banks for the simple fact that they do not know how to operate an account.
- Khumalo (2008:30) adds blurred divisions between commercial and central banking functions, government interference in central banks as well as uncontrolled fiscal functions of central banks that detract them from their monetary roles.

While perhaps the above can be used to describe the SADC banking sector in general, the fact is that the peculiarity of these countries is the extreme heterogenic nature of the banking systems, of regulatory frameworks as well as of the performance of banks (see Murinde & Ryan, 2003:192). That is, there is not one SADC banking sector. Although not totally irreconcilable, SADC countries have widely divergent banking systems. The reference to a SADC banking sector is for the sake of argument and simplicity and would be based on the general commonalities as defined by the SADC economic and infrastructural geography. The commonalities that would define the banking sector in SADC would include factors such as how the banking sector is composed of commercial banks, savings banks and post office savings banks as well as that the fact that the regulatory framework governing these banks is the sole responsibility of the central banks which are under government control for most countries.

⁵ This is not to underestimate the importance and the value of subsidies in the banking sector. Subsidies have played a prominent role in bringing access to banking services to people in remote areas such as rural areas through postal and savings banks. (On this point see Napier, 2008: 374).

There remains a large challenge in curing the ills mentioned earlier in the SADC banking sector. The disparity in terms of development of the banking sector in the different countries of the region is not conducive to entry by foreign banks. Further structural changes to the banking sector are needed before the full benefits of foreign investment in the banking sector can be realised. As it stands, the above points to a region where countries like South Africa and Mauritius could strengthen their banking systems through foreign bank entry. Yet, other countries, such as Zambia and Tanzania might see their local banks decimated by increased competition.

In view of the SADC movement towards full economic integration, efforts should be made to action the SADC Finance and Investment Protocol which seeks the integration and harmonisation of financial and investment policies and regulations of SADC states. The content of this Protocol is commendable but, like most Protocols signed by SADC States, it is hampered by institutional weaknesses which can only be remedied by SADC states committing themselves to the achievement of the Protocol's objectives. Properly implemented, the Finance and Investment Protocol should help reform the banking sector and facilitate the receipt of foreign investments so that these take on a regional dimension. In turn, it might also help the process of reform of the banking sector if the Chinese entry into the SADC banking system is accompanied by reforms being undertaken in individual SADC countries to bring their banking systems at least on par with that of South Africa. It would be easier to implement and conform to international norms in the banking sector once the region has uniformly reached the standard of South Africa. As stated above, South Africa's banking sector can compete internationally and it is also identified by extensive electronic banking facilities as well as a comprehensive distribution of automated teller machines. Reforming and modernising the banking sector would assist in managing foreign bank entry.

3. The Growth of the Chinese Banking Sector

The state of the banking sector in SADC points to a requirement for the foreign banks that seek to invest in the SADC banking market to be strong and stable. It is expected that such a foreign bank be more efficient and have superior skills and technologies in place so as to effect an improvement of the SADC banking system. It is from this standpoint that an analysis of the state of the Chinese banking sector is warranted. Even though it has limited expertise in penetrating foreign markets in the banking sector,⁶ the demise of the

⁶ On this, Meyers (2008) points to the fact that the presence of foreign banks in emerging markets, which would include SADC, is founded in colonial ties and how, cultural, linguistic and economic proximity brought about by colonialism has played an influential role for western countries. The fact that China lacks such proximity would likely place it at a disadvantage in entering the SADC markets as it would be less familiar territory than for banks from the former colonisers.

world's most prominent financial institutions effectively puts their investment drives in Africa and elsewhere on hold until the financial crisis has been resolved.⁷

Such investment would also tie in with China's objective to deepen the Chinese footprint in Africa and strengthen political and economic ties. It also goes without saying that SADC countries, troubled by weak domestic savings and investment, would welcome any foreign capital and China is in a position to provide such capital. Such external financing from China's banks would alleviate balance of payment constraints, assist with debt repayment, boost domestic savings and improve economic growth (see for instance Wang (2007)). Nonetheless, such benefits of China's investment in the banking sector should not detract from the fact that China does not have the same amount of experience or expertise in entering foreign markets in the banking sector that western banks have. Of interest in this regard is that China has been aggressively working towards garnering as much expertise as it can in the banking industry. It has done so by liberalising its banking sector and opening itself up to foreign investments in the sector. In other words, the liberalisation of China's banking sector has gone a long way towards increasing China's know-how and competitive edge in the banking industry; and the experience that China has gained from foreign investors in its banks could be all that it needs to be able to invest in the region's banks more extensively. This section traces the reform, growth and development of China's banking system to its current state.⁸

The Chinese banking sector is represented by some of the largest banks in the world by capitalisation and the size of the banks' balance sheets. The process towards such a position has been long and intensive.

The transformation of the banking sector was, historically, based on a conscious movement away from centrally planned policies to a market and risk based sector. Until 1979, and as typical of a centrally planned economy, the People's Bank of China (PBC) was the only bank in China and was responsible for all issues related to banking. The first steps in the restructuring process involved breaking up the centralised banking system and introducing a two-tier system.

Between 1979 and 1986 the reform of the Chinese system was characterised by the dismantling of the mono-bank system to usher a multi-tiered banking system. During this period four state owned commercial banks were created - the Agricultural Bank of China, the Bank of China, the China Construction Bank, and the Industrial and Commercial Bank of China. The approach taken by China in restructuring the banking system was to introduce competition before privatising the state-owned banks.

In the period between 1987 and 1991, domestic competition was being consolidated and a joint stock universal bank was created, the Bank of Communications. This period also saw the emergence of Credit Cooperatives which provide basic banking services (Dobson, 2008:327).

⁷ The current financial crisis means that the Western banks cannot aggressively pursue their African interests but are rather focused on resolving the financial crisis and getting back on their feet. As mentioned in the introduction, the financial crisis leaves room for the emerging economic powerhouses such as China to invest in the African banking sector.

⁸ This and the next section rely extensively on information drawn from Herrero and Santabarbara (2004).

The period between 1991 and 1996 saw the creation of three policy-lending banks. Created in 1994, the Agricultural Development Bank, the China Development Bank, and the Export-Import Bank of China were to carry out the development policies previously the responsibility of the four state-owned commercial banks and their main objectives were, respectively, agricultural development, national infrastructure and foreign trade. During that period, in 1992, the China Everbright Bank and Hua Xia Bank were set up by the Chinese government as a means of stimulating competition in the commercial banking sector. In 1996, the People's Bank of China licensed nine foreign banks to conduct business in the Pudong Development Zone in Shanghai. China's only fully private bank, China Minsheng Bank, which is focused on lending the private sector, was also formed in 1996.

State intervention and ownership of banks has been listed in the above section as one of the barriers to the development of a financial sector. It should be noted that the aggressive modernisation drive in the Chinese banking sector did not completely eradicate all of the pre-1997 elements of the Chinese banking system. This is especially true of state ownership of banks and this should have consequences for the current pattern of investments in the banking sector. The fact that nearly all of China's banks still have public ownership is an issue of concern considering that public ownership of banks is higher in countries with underdeveloped financial systems, low levels of per capita income as well as interventionist and inefficient governments (La Porta, Lopez-De-Silanes & and Shleifer, 2002). On the other hand, arguments in favour of government ownership of banks are in terms of the need to maintain the sound functioning of the banking system, the need to mitigate market failures which arise from information asymmetries, as well as the need to fund social development projects and to promote financial development – including enhanced access to banking services to the poor and people staying in remote areas.⁹ It remains however, that state owned banks are highly susceptible and vulnerable to political manipulation which could be detrimental to their continued sustainability. Also, state owned banks are essentially crisis resolution vehicles used to bail out banks in distress. When such state owned banks venture out to invest in the international arena, they should be considered with caution. Thorough research should be conducted into the feasibility and benefits of such investment and weigh them against the possible risks such banks carry. Also, there are political implications involved when state owned banks venture into other markets across the world. That is, China would have, in essence, a direct say in the direction of other countries' banks and indirectly determines the direction of countries' finance.

Between 1997 and 2001, China was preparing for accession to the World Trade Organisation (WTO). Reforms were initiated to strengthen state-owned banks. Moreover, a number of foreign banks were given permission to operate in a few cities. Foreign banks' business with Chinese citizens and corporations was generally limited to foreign currency dealings though their main clients were foreign residents and foreign and joint-venture enterprises (Dobson, 2008:327).

⁹ Yeyati, E. L., Micco, A. & Panizza, U. (2004) "Should the Government be in the Banking Business?" http://www.iadb.org/res/publications/pubfiles/pubB-2005E_4836.pdf (accessed 11 January 2009).

China eventually acceded to the WTO in 2001 and the Chinese banking sector underwent further reforms as a consequence of this accession to the WTO. The reform and restructuring steps post-WTO were, according to Chan-Fishel (2007:5) premised on three policy objectives:

- “Bank restructuring: purging non-performing loans and injecting public capital, particularly in the “Big Four” state-owned commercial banks;
- Financial liberalization: gradually letting the markets determine prices, introducing quality controls and opening the sector greater foreign competition;
- Strengthened financial regulation and supervision, including introducing better risk management, corporate governance, and disclosure; and adopting international standards.”

In line with the WTO accession process, China made some commitments and, according to Mattoo (2004) “China’s GATS commitments represents the most radical services reform program negotiated in the WTO. China promised to eliminate in a few years most restrictions on foreign entry and ownership, as well as most forms of discrimination against foreign firms” (Dobson, 2008:327) . These commitments included those in the financial services sector and thus concretised the restructuring of the banking sector. Efforts were made to improve the laws and regulations in the banking sector. Accordingly, a regulation was passed in 2001 to enable the People’s Bank of China to revoke troubled institutions. This culminated in the liquidation of Everbright International Trust and Investment Corporation in 2002. Further regulations led to the improvement of the information disclosure system for banks. A body was created, the China Bank Regulation Commission (CBRC), to control bank regulation. This was followed by amendments to the People’s Bank Law and the Commercial Banks Law and the enactment of the Bank Supervisory Law that gave effect to the China Bank Regulation Law, in 2004. The China Bank Regulation Law also governs mergers and acquisitions between foreign and Chinese banks. The China Bank Regulation Commission is one of the most positive developments made in the banking sector as it ensured a significant degree of transparency in the sector.

One of the biggest shortfalls of Chinese banks is their non-performing loans and this has become one of the priority areas for the CBRC (Chan-Fishel, 2007:12). One of CBRC’s main efforts is in reducing the non-performing loans of Chinese banks and in ensuring that Chinese banks conform to international standards. A new set of loan classification procedures has been created for all banks to follow - loan classifications are now based on risk-profiles rather than length of maturity.

An overhaul of the retail banking sector was announced in 2003. This overhaul was aimed at balance sheet restructuring and recapitalisation, improving governance and stimulating competition by bringing in foreign banks and thus simultaneously stimulating efficiency in the Chinese banking sector. For its part, the Chinese government injected capital into the Bank of China, the China Construction Bank and the Industrial and Commercial Bank of China in 2004 and 2005. Funds drawn from the nation’s foreign exchange reserves improved these banks’ capital strength, resulting in very successful initial public offerings for each of the aforementioned banks. Incidentally, these banks are among the strongest banks in the world in terms

of market capitalisation. In anticipation of the penetration of foreign banks that was to come with the liberalisation of the banking sector, the People's Bank of China published the Regulations on the Administration of Foreign Financial Institutions in 2002 and unified the regulations on deposit and loan interest rates for both domestic and foreign banks. The percentage of foreign ownership in domestic banks was, in 2003, increased from 15% to 20% for single shareholders and to 25% overall.

When the Regulations on Administration of Foreign-Funded Banks came into effect in 2006, constraints on foreign banks in terms of ownership, operation, establishment and geographical restrictions were lifted. Instead, foreign banks now have to 'qualify' by meeting minimum capital requirements, having a consecutive earnings record and being incorporated in China (Dobson, 2008:330). By so doing, China is screening foreign banks to ensure that stable foreign banks with a strong capital base invest and that the banks can be closely and better monitored if they are a Chinese registered legal entity. The quality of banks then allowed to operate in China can be assessed from Appendix Table 1, p. 30; most of the banks that have invested in China's banking sector are well-known banks of international standing. These banks have asset up as China opened up its the banking sector to foreign investors.

Opening up the banking sector to China's investing public – the domestic investors – has, in contrast, been rather stunted. As previously mentioned, there is only one fully private bank in China, China Minsheng Bank. The new banking laws were also in anticipation of new share-holding banks with private shares and, in 2003, Bohai Bank, China's first national joint-stock commercial bank, was approved, paving the way for other banks of such nature to emerge in the future. It is nonetheless difficult to consolidate private ownership of banks by domestic investors when government is the biggest shareholder in these banks such that there is no independent management (Dobson, 2008:329).

China has put into place some very drastic reforms in order to modernise its banking system and to introduce international banking norms and standards. China has not pursued a single policy designed to cure all of its deficiencies but has employed a trial and error method. The process of reform has, however, been guided by the three objectives of restructuring, liberalisation and regulation. Milestones have been achieved in each of these three objectives and have removed the Chinese banking system so far from the centralised banking system to a market determined one.

4. Current State of the Chinese Banking Sector and Level of Integration in Global Financial Sector

Since the commencement of the restructuring of the Chinese financial sector in 1979, China's financial sector has become more bank-dominated. Banks currently drive the financial services industry. Long strides have been covered since the initial steps towards decentralising the Chinese banking sector. The emphasis has mostly been on bringing the domestic sector in line with other international banking sector, improving and modernising it, making it more competitive.

Despite having some of the world's biggest banks in its domestic sector, China is not really integrated into the global banking or financial system. China's currency is virtually unused outside of China and its capital market is not yet a financier for foreign borrowers. Declaring that China's stock market is not yet a financier is based on the presumption that, in the near future, given China's recent buoyant economic growth and the aggressive efforts at reforming and strengthening the domestic financial system, China might be able to penetrate the global financial markets. Its banks could then possibly influence the direction of global finance.

China's accession to the WTO and the trade liberalisation that it entailed, as well as China's insistent attempts to modernise its industries and move away from centrism, has resulted in a positive influx of foreign direct investment into China. Coupled with China's phenomenal growth, this investment has given the country access to international capital markets. The financial services sector being bank dominated, the domestic savings rate in China is very high: 70% of the country's savings are held in banks rather than stock markets or other investments in the financial market. This has resulted in a substantial current account surplus and massive official reserves (see Herrero & Santabarbara, 2004: 19, 22). This free-flow of cash has a downside to it though; coupled with government capital injections into the banks, it has resulted in excessive bank lending, creating a runaway economy. This, which has triggered the issuing of non-performing loans, is now posing a problem in a context on the Chinese economy curbed growth (Chan-Fishel, 2007:5).

Non-performing loans pose a serious problem for the future sustainability of Chinese banks. Chinese estimates - as according to the CBRC - that non-performing loans stand at 9% of the total loans in 2007 but independent analysts put the figures at a much higher level - at 20-25% of total loans (*Ibid.*). Viewed from the perspective of the global financial crisis, the seriousness of the non-performing loan problem is quite serious. Outstanding non-performing loans held by Chinese banks were US\$ 540 billion at the end of 2007 and this amount is quite comparable to the US\$ 588 billion that had been written off by global financial institutions between 2007 through to September 2008 in the current global financial crisis (*Ibid.*). If the savings and loan crisis of the USA that caused around 4000 banks to crumble only resulted in losses of US\$ 400 billion, the question then focuses on the resilience of Chinese banks. Are these banks strong enough to withstand the loss of non-performing loans to the above mentioned values without causing financial instability? (*Ibid.*)

The issue of non-performing loans in China is one to be wary of and one that would likely impact Chinese investments in the banking sector. In order to address the problem of non-performing loans, banks need to build up their capital base by making themselves more profitable. The problem also rests partly with the Chinese legacy of a centralised economy where there was pressure on the banks to sustain poorly-performing and non-profitable state owned enterprises. In spite of an attempt to cut off lending to non-profitable state owned enterprises, the reality is that China's state owned enterprises receive more than half of the total bank loans but contribute to less than 25% of China's GDP (Chan-Fishel, 2007:3-5). Also, the banks are heavily reliant on these state owned enterprises as borrowers.

China's banks are yet to be tested by the economic downturn, particularly if the state owned enterprises were to fail to perform. The recent high economic growth of China has lured banks into lending rather

recklessly, with lax evaluation and monitoring mechanism for new loans. This would have increased the level of non-performing loans in an economic downturn situation. The current global crisis will most likely not affect China as extensively as elsewhere - especially as China's GDP is driven by domestic investment - but the crisis will, most likely, curb China's growth (Biacuana, 2008).. During the third quarter of 2008, China only recorded a growth rate of 9%, 2% less than the 11% growth rate that was recorded for 2007 and this is likely to decrease further as the global financial crisis forces a decline in the demand for China's manufactured products (Press TV, 2008). The World bank has projected a 7.5% growth rate for 2009 while the International Monetary Fund insists on 5% (Cutler, 2009). The slowed down growth should also affect the banking sector. Continued government injections of capital into the banks also worsen the problem of non-performing loans as banks take more risks in their lending in the comfort of future capital injections should the risky loans fail to perform.

The other factor that exacerbates the problem of nonperforming loans is the lack of solid laws and regulations governing nonperforming loans (Chan-Fishel, 2007:6). This is particularly in reference to bankruptcy laws which do not allow banks to file bankruptcy against public utilities or companies and firms deemed important to the national interest. This is possibly a remnant of the previously centralised economy. Nonetheless, bankruptcy laws only apply to state owned enterprises and even then, when creditors are being paid out, banks do not get first priority. A Liquidation Committee, for whom there are no guidelines on the liquidation process, decides who gets what in the liquidation process and this Committee's decisions are usually shaped by other loyalties such as party politics (*Ibid.*).

In lending recklessly, the banks could be reliant on the large spreads that they are afforded by the government. Loan and deposit rates in China are not determined by market forces. These are, instead, specified by the central bank, which always sets high lending rates and very low savings returns, thereby generating high returns for the banks (Herrero & Santabarbara, 2004:25). The principles driving how the central bank determine interest rates have worked in part to reduce the banks' penchant for risky lending as they can rely on their traditional borrowers (state-owned enterprises) and the generous margin between deposit and interest rates (Herrero & Santabarbara, 2004:23). Although the government has kept the exchange rate flexible enough to allow integration into the global financial system, it has kept reign on the fluctuating exchange rate by acquiring large foreign exchange earnings from exports and FDI inflows, in the process sterilising the resulting liquidity. Although this limits the independence of monetary policy, it must be borne in mind that China has an investment-led export oriented growth strategy that relies significantly on stable exchange and interest rates. The latter is one of the paradoxes of the Chinese banking system. While such prudential measures on the part of government and of the central bank inhibit the independent administration of banks, their efficiency and competitiveness, these measures also contribute to a certain degree to the development of the banks efficiency by improving bank oversight and ensuring the adherence to prudential measures.

Lending to state owned enterprises has helped sustain jobs in the Chinese market. With new efforts at cutting back on non-performing loans, banks have now curtailed lending to ailing state owned enterprises, forcing them to become either more profitable or to close. Cutting off the traditional life-line of such firms has

resulted in job losses but this has been partially remedied by the banks issuing micro-loans to the laid-off workers to assist them in starting their own businesses. Micro-loans together with the new emphasis on funding small and medium enterprises, has helped, at least until recently, to sustain the social safety net in China (Chan-Fishel, 2007:3). However, despite these efforts, China, like the SADC states, is bedevilled with the problem of lack of access to credit by the poor and regional economic disparities. Lack of access to credit by the poor is caused by the cutting back on easy-lending by the banks and the withdrawal of banks from the poor regions, with those banks that are resident in these poor regions becoming a channel for the flow of capital from these regions to the more affluent ones (Dobson, 2008: 332 – 333). Geographical restrictions in the liberalisation of banking services have resulted in the agglomeration of benefits in those regions initially liberalised to such an extent that the other regions - liberalised late in the process - will struggle to catch up. To remedy this situation, the Chinese government has resolved to reform the rural financial system and to encourage the establishment of micro-lending institutions as well as approving the launch of a China Postal Saving Bank. The above measures are expected to improve the access to financial services of the rural poor.

Other issues that the Chinese banking sector needs to deal with, although effort is being made to reform banking laws, are the fragmented laws and regulations on banking which result in simple banking transactions becoming complicated. Unconsolidated laws and regulations result in several different licences from different government agencies being needed for one single banking transaction (Chan-Fishel, 2007:6). This creates unnecessary hassles in the banking process.

China has made some very significant inroads in transforming its banking sector. The institutional structure still inhibits the efficiency of the banking sector and the Chinese banking sector is yet to achieve international standards but the strides made so far are impressive. Current reforms have met with approval from foreign investors who have demonstrated their confidence in the Chinese banking sector by investing in droves, showing that they are confident of China's economic growth prospects over the medium and long time horizon (Chan-Fishel, 2007:8). By turning potential competitors into partners in the banking sector, China has ensured the import of international standards into their banking sector. The only point of caution is that Chinese banks have so far ridden on the high level of economic growth being experienced by China; they are yet to be assessed against adverse economic conditions. Long term growth would propel China into further integration in the global financial system. Further integration will contribute substantially into the further development of the Chinese banking sector.

5. China's Experience in Investing in the International Banking Market

China's 10th 5 Year Plan (2001 – 2005) included the 'Go Out' strategy where the banking sector was encouraged to 'go out' and "play a key role in facilitating international capital flows, mergers and acquisitions and in the country's efforts to seek resources" (Chan-Fishel, 2007:1). Recently, China's financial efforts have been aimed at overseas investments to establish and consolidate the Chinese presence and influence

in the global financial system. This is particularly important when one considers the concern on the lack of experience that China has in investing in international banks which would be a cause for concern if China expands its investments in the SADC banking sector. From the analysis of the Chinese banking sector, it appears that China's banking sector has recently started modernising. There are a few organisational and institutional issues that still need serious attention, especially the government influence over these banks which deprives the banks of administrative autonomy. One has to ask what kind of administrative culture these banks will import into SADC. In answering that question, however, one needs to consider the other investments in the banking sector that Chinese banks have made elsewhere on the international area.

CITIC Securities, a Chinese financial institution was towards the end of 2007, poised to acquire 6% of Bear Stearns, a United States' investment bank that was then struggling with its mortgage business. Bear Stearns was supposed to provide a 2% stake in CITIC in return but the deal fell through when Bear Stearns became insolvent in March 2008 and was then acquired by JP Morgan Chase (Herrero & Santabarbara, 2004:25). Chinese financial institutions have acquired large stakes in Asian banks, a familiar territory compared to western countries and Africa with, moreover, lesser political implications. Most significantly, the Industrial and Commercial Bank of China (ICBC), has acquired a 20% stake in South Africa's Standard Bank as will be discussed below.

In addition to the above, Chinese banks have also acquired stakes in United Kingdom and United States banks, albeit to a lesser extent. China Investment Corporation (CIC) managed to buy stakes when Blackstone, a US financial institution dealing in private equity, got listed in 2007. China Development Bank acquired shares in Barclays Bank and the agreement made provision for the Chinese bank to invest further if Barclays' bid for ABN-Amro succeeded, which it did not. It is, however, China Minsheng Bank's stake in UCBH Holdings that is fully geared for the transfer of skills, technology and expertise. UCBH Holdings is a US bank that has a majority ethnic Chinese clientele. The deal is structured in such a way that each bank has right of board representation in the other, and, pending US regulatory approval, Minsheng Bank is at liberty to increase its stake in the bank.

Appendix Table 2, p. 32 shows the disparity between Chinese investment in banks in Europe and US and Chinese investment in Asia and Africa. The table also shows that the stakes acquired in Asian and African banks are significantly high.

It is apparent from the above discussion on China's experience in investing in the international banking market that China has made a concerted effort to gain expertise. Through inviting international investors into its banking sector and partnering up with them, China is ensuring that skill and expertise are imported and transferred to the Chinese people. In the same vein, venturing out into international banks is also in preparation of positioning Chinese banks as influential global players.

The rigorous efforts at restructuring and reforming its banking sector are confirmation of China's interest in investing in the banking sector in SADC more broadly.

6. China's Banks in SADC

This section looks at the inroads that China has made so far in gaining a foothold in the SADC banking sector and/or the extent of Chinese bank presence in SADC. I will look at the choice of banks penetrated by China and the extent of such banks' presence in the region to determine the strategic importance of the banks for China's expansion.

Finance has long played a role in China's endeavours in Africa. The China Export – Import Bank is tasked with the objective of dealing with international trade and it is China's major export credit agency and the primary financier of infrastructure projects in Africa (Bosshard, 2007).¹⁰ In that role, China ExIm Bank has extended unconditional loans to African governments and financed projects for infrastructural development. Although most of the infrastructural projects are based primarily in sectors of strategic importance to China's economy as it races to secure resources from Africa, they serve to strengthen political and economic relations between Africa and China and contribute to Africa's development. World Bank estimates put the level of aid through loans to sub-Saharan Africa at over \$12.5 billion in mid-2006 (*Ibid.*). More than 80% of these loans are concentrated in Angola, Nigeria, Mozambique, Sudan and Zimbabwe. China ExIm Bank has financed the building of hydropower dams in Mozambique and Zambia as well as railway lines in Angola, DRC and Zambia. Already, Chinese finance has had a significant presence in SADC. If Chinese banks invest in the SADC banking sector then it would simply be a case of Chinese financial institutions operating from within SADC and offering other banking services.

The China Development Bank, a primary lender to the domestic market in China, is also set to increase its involvement in Africa through the US\$5bn China – Africa Development Fund which it administers in partnership with the China ExIm Bank (Meyer & Alden, 2008). The Fund's objective is to financially support Chinese enterprises that invest in projects in Africa. Such investment projects should be focused on agriculture and manufacturing industries, infrastructure and underlying industries, natural resources and industrial parks set up by Chinese enterprises (China Development Bank, undated). Four funding deals have already taken place. The funding of the involved Chinese companies was described in the Chinese press as a private equity fund that is more concerned with social development than with returns (Meyer & Alden, 2008). Yet, bearing in mind that Chinese companies usually bring in their workforce from China, if the companies funded by the China - Africa Development Fund bring their own labour it would significantly reduce the costs of the project, reduce the financial risks for any investor and generate high financial returns. Low cost and high returns should be an attractive incentive for Chinese commercial banks to invest in Chinese enterprises in Africa and SADC (*Ibid.*).

The above is however overshadowed by the largest yet investment made in Africa – the acquisition of a 20% stake in Standard Bank South Africa by the Industrial and Commercial Bank of China for US\$5.5 billion is the first stepping stone of Chinese banks in gaining a foothold in the SADC banking sector. This was a

¹⁰ The rest of the paragraph on the financing of development projects in the SADC region relies on Bosshard (2007) as well.

very strategic move on the part of ICBC as Standard Bank is Africa's biggest bank and possibly one of the most advanced in terms of skills and expertise. Standard Bank's presence in Africa cuts across 18 countries and it has a presence in 21 other countries outside of Africa. The bank has 713 branches in South Africa and 240 branches across Africa according to Pesek (2007).

Standard Bank is connected to eight other SADC banks through Stanbic Africa. This means that China now has an automatic foothold in these other SADC countries where Standard Bank South Africa has stakes. By so investing, ICBC will be able to open its own legal entities in the future. There are in-house learning effects from one of the best banks in Africa. Acquiring stakes in a bank with a large international presence (e.g. Standard Bank), will help ease the apprehension associated with Chinese banks entering other banking markets in the rest of SADC.

This new partnership between Standard Bank and ICBC is a marriage of giants that should produce benefits for both banks. These two banks will now have access to each other's territories. Standard Bank now has access to the market of one of the world's fastest growing economies and to increase its capital base while China is gaining a very strong foothold on the banking sector in the region. Most importantly, Standard Bank will use the capital raised from selling its shares to ICBC to expand its sphere of influence in Africa and the rest of the developing world. The most unique aspect of this investment, outside of the fact that this deal is the largest investment deal in Africa, is that China is engaging with Africa on Africa's terms and this deal does not appear to have been made with conditions attached (Georgy, 2007). The buying of shares does seem to have involved control or financial change requirements (see Pesek, 2007).

The investment deal between Standard bank and ICBC represents an opportunity for ICBC to establish its presence in South Africa, and, given the vast presence of South African banks in the region, in the region as well. Its choice of partner indicated a commitment to expand its banking sector and Standard bank is the appropriate leverage that it needs to enter other banks in the region.

7. What does the Chinese penetration mean for SADC?

Western institutions have declared their faith and confidence in the Chinese banking sector by investing in it. By so doing they are transferring vital skills and expertise to the Chinese banking sector and equipping it for expansion across the globe. China itself has been proactive in the process and has already embarked on investment drives in the banking sector, investing in banks in Asia, Africa, the UK and the USA. Chinese investment is often fraught with controversy, especially when it comes to governance issues and politics, and thus it has not been able to gain a significant foothold in strategic international financial institutions in Europe and the USA. In contrast, it appears that the Chinese liberalisation of the banking sector has been aimed significantly at modernising its banking sector using the expertise brought in by investors and

becoming more competitive. International banks of repute have partnered with Chinese banks and have significant input in these banks' operations.¹¹

7.1 Domestic Reform

The accession of China to the WTO has ensured that China pursues policies that are in line with international standards and the reforms in the banking sector as per the accession requirements has been very radical, proof of China's determination to improve and develop its banking sector. Given its technological advancement and phenomenal economic growth, China's banks would improve the efficiency of SADC banks. With regard to strong prudential supervision that China's banks are supposed to import into SADC, China is still struggling with the regulatory mechanisms for its banking sector. However, given the political dispensation in China, it is highly likely that the banks that venture out will be put under scrutiny so as not to jeopardise political relations. Also, the development of China's banking sector is continuing and China is further enhancing its competitive capabilities. China's technological advancements far outweigh those of SADC and therefore Chinese banks would import technological know-how that should improve the domestic banking sector.

There is also the issue of skills. Such expansions through investments need a different set of skills. Bad management can negate all the benefits of China's entry into the SADC banking sector. The professional and administrative capacity of banks in SADC would need to be boosted. China's banks are expected to bring in some new service channels, diversified banking products as well as introduce new banking portfolios. The challenge is to ensure that the skills and capacity that China brings is transferred to the local banks' workforce. This will improve bank management as well the professional capacity of the workforce, in addition to improving the SADC banking system.

7.2 Bank recapitalisation and expansion

China is awash in cash. Investing in SADC banks would provide Chinese banks with an outlet for their excessive cash reserves and would also provide a solution to the reckless lending that results in non-performing loans. The cash invested by China can be used by the SADC banks to expand their operations and in their recapitalisation drives. Standard Bank has indicated that it will use part of the capital raised from its partnership with ICBC for further expansion. \$450 million will be used in Africa, \$400 million will be used for growth in South Africa, \$350 million for international activities, \$200 million will be used to establish and fund a global resources fund that will be managed in partnership with ICBC, \$200 million for private equity investments and, lastly, \$900 million for Standard Bank's strategic capital reserves (Meyer and Alden, 2008:10).

¹¹ This section was compiled in part from the information on the benefits of liberalisation of the banking sector, drawn from Dobson (2008:297).

7.3 New markets and customers

Local markets in SADC, through partnering with Chinese banks, could get a ready market of Chinese migrant workers who follow the Chinese corporations into Africa. The Chinese banks themselves would also find a ready market in the local Chinese small and medium enterprises (SMEs) and get an opportunity to expand their product offering to include Chinese language client-servicing, local and hard currency working capital facilities to SMEs as well as deposit taking services and electronic transfers to China. Seeing that the Chinese investment strategy is partnering up with the dominant banks, these clients will be absorbed into these banks that China invests in.

7.4 Protection from shocks

The ICBC is in a position to provide a stable source of credit that can help shield the SADC banks from adverse economic shocks. One key aspect of the ICBC is that it is a publicly-owned bank, that is directly under the control of the Chinese government. As the Chinese government is keen to consolidate relations with Africa, SADC would have some assurance of funding from China as it is seeking strategic political and economic relationships. The government – backed nature of the Chinese investment in this sector gives the Chinese banks an advantage over other investors in terms of consistency and it reduces the risk of the Chinese banks pulling out in the event of financial distress.

7.5 New Chinese ventures

In investing in the banking sector, China is moving away from a pattern of funding projects that narrowly serve the country's own economic interests. China has a history of funding projects that are of strategic importance to its quest for resources only. Entry into the banking sector is a signal that China might be shifting to more commercial/business investments.

If the pattern of penetration is the same as that adopted with Standard Bank, then the benefits are two-way: China consolidates its foothold in the banking sector and learns about the local operations of SADC banks; in parallel SADC benefits from a diversification from China's narrow focus on only developing sectors that are of strategic importance to its quest for resources. If the Chinese keep up the strategy of partnering with the region's big banks, banking services might expand but in line with the parent bank's activities.

7.6 Political implications

The issue of cultural, linguistic and economic remoteness has long been dampened by the closer ties being experience between Africa and China. China was, for instance, quite instrumental in supporting the liberation movements of certain African countries. The ties go back to the pre-independence period however.

China has been interpreted by the ruling class of some African countries as a saviour and an alternative to imperialist and colonial powers, a point raised by Meyer & Alden (2008). The problem that arises from such vision is that, apart from the practical economic implications, be they negative or positive, China's infiltration of the African economy in all aspects, banking sector included, has implications on democracy and good governance. This is especially so when one considers the policy on non-intervention and the aid packages that do not have any conditions on democracy, human rights and good governance. By ignoring such factors as corrupt governments and human rights abuses and not imposing conditions of good governance, China is exacerbating deteriorating conditions in Africa and, in the long run, it will come back to haunt China when they fail to reap benefits on their investments because of their support of corrupt governments.

Masson *et al.* (2008) and Herrero & Santabarbara (2004:19) contend that the situation with regards to the Chinese stance on corrupt governance and human rights abuses is changing however. China recently condemned the Sudanese government on human rights abuses in the Darfur region. It also recently contributed to the cost of the African Union peacekeeping force. China is also reportedly distancing itself from the government of Zimbabwe. It could be that China is realising that it is in its own best interests that Africa enjoys stability and development – a point raised by Bosshard (2007) - and that it is best to steer clear of political controversy.

8. Conclusion

In the wake of the global financial crisis, the traditional investors in Africa's banking sector are seen concentrating on healing their financial institutions and trying to keep them afloat. The financial crisis has created a vacuum in the banking sector and which vacuum China looks set to fill. As a rising economic powerhouse and long-time investor in Africa, China has used this opportunity to consolidate its relations with Africa. There are concerns though, including those related to the fact that China has little experience in investing in the banking sector and none at all in investing in the former colonies of the West. However, China has been, for a period of more than two decades, been working aggressively at modernising its banking sector to rank with the international best.

Although China's banks have not yet reached their optimum in terms of skills and technology, ICBC ranks as the biggest bank in the world in terms of its capitalisation. The strength of China's banks is expected to grow hand in hand with China's economic growth. Also, China's banks have also become a prime investment destination for western banks and China has used this opportunity to gain skills and expertise as well as keep abreast of modern trends. The environment in the financial world currently permits the dawn of a new era in the banking sector for SADC with Chinese investments. Perhaps as testimony of its lack of experience, China has adopted a cautious approach in its investments that is focused on linking up with the bigger local banks and get in-house learning on the domestic banking environment first. This move could culminate in competitive Chinese banking institutions when they finally open local branches or subsidiaries in the SADC region. The new partnership between China and SADC in the banking sector finally sees China moving away from its stereotype of an investor that is primarily focused on projects of strategic

importance to its own economic interests. SADC would benefit from Chinese trade and investment that will grow the regional economy and encourage regional integration.

SADC's banking is generally weak and inadequate for its domestic needs, let alone to compete at the international level. China presents an opportunity for reform that can be locked at GATS level if such reform works. This partnership presents learning opportunities for SADC as well as China is a developing country that probably understands the constraints facing the SADC banking sector better than the traditional investors. The political ties between China and SADC should also work towards consolidating this new partnership to make it beneficial for both China and SADC countries. If SADC could remedy the shortcomings of their banking sector, the gains and opportunities presented by China far outweigh the disadvantages.

9. Recommendations

China has come a long way in its modernisation drive. At the moment China stands as one of the emerging economic powers and yet it is a developing country. Any partnerships that SADC makes with China should also be focused on learning from China's economic reform. China embarked on a very radical reform of its banking sector and, as the Chinese banking sector grows from strength to strength, this reform drive is showing benefits. The entry of China in the SADC banking sector could also be seen as an opportunity to reform the SADC banking sector and bring it in line with international standards and norms. The capital invested by in these banks should be used for such reform initiatives.

China has made the initial investment in South Africa. This investment should not be considered outside of the context of regional integration in SADC. In that sense, other SADC countries need to restructure their banking systems in order to attract investment, including those from China, in their banks. However, the current financial crisis suggests that they are to be careful in doing so and in selecting the right partner. At least, regionally, there is a significant risk of capital "polarisation" if numerous SADC banks remain inadequately developed to handle foreign investment as all the capital could move to the better developed South African bank. This situation would not be conducive for SADC and its integration efforts as it will further uneven the economic geography of the region.

With regard to some of the barriers to banking in the region, the capital raised from Chinese investment should also be used for expansion that involves reaching into the remote areas without banking services and to give access to the poor. While the partnership of ICBC with Standard Bank appears positive for the development of the banking sector in South Africa, it should be borne in mind that Standard Bank is one of the four banks that control 84% of the industry's assets in South Africa (Napier, 2008). Such strong position is problematic if it keeps the sector stagnant. If foreign investment is not checked, it will serve to consolidate such monopolies at the expense of creating a competitive domestic banking industry. Also, banks such as the top four banks in South Africa could see little incentives to improve their services. It is important that the process of opening up to foreign banks be managed carefully in such a way that it is not to the detriment of the banking sector in SADC.

In the same vein, research should be carried out on how to effectively reform the banking sector in SADC to receive foreign investment. Not all the SADC countries have committed to trade liberalisation in the banking sector under the GATS framework and the question is whether such commitments are wise in the face of underdeveloped banking sectors. Research should be towards an identification of the correct sequencing of reforms, that is whether the approach should be liberalisation first or privatisation and competitiveness first.

It is expected that after the initial investment that is founded on partnerships, China will venture out to establish their own independent banking entities after acquiring adequate information on the local banking environment and how it operates. In the current environment of weak, inadequate regulation with insufficient human resource capacity, such a development would be to the detriment of the banking sector. What such a development would entail is that there will be an increased number of banks needing supervision, with the newly established foreign owned banks requiring substantially more supervision, and no domestic capacity to supervise or regulate (as raised by Mowatt, 2000:14). The risks associated with foreign bank entry should not be disregarded in the face of stronger enhanced relations with China as such risks are very real. In significantly weak banking sectors such as is prevalent in the SADC region, competition from foreign banks may serve to push the domestic banks out of the more profitable market segment and increase the risks of bank failure (*Ibid.*). Domestic banks will be incentivised to take on greater and more reckless risk in trying to stay afloat (as raised by Wang, 2003). There is also the threat of domestic banks engaging in more strict credit-rationing, an approach that will serve to close out a majority of the population and further worsen the bank access problem, making banking only exclusively for the wealthier section of the population (*Ibid.*).

Overall, this new Chinese interest in the banking sector should be used to occasion positive reform in the banking sector. Although convention calls for the reduction and elimination of state intervention in the banking sector, such withdrawal of the state is partly dependent on the strength of the financial system. Domestic regulation in the banking sector should therefore be aimed at more than just keeping an eye on the new foreign entrants to the sector but also to encourage and ensure a strong and sustainable financial system that is not easily vulnerable to shocks. Regulation in the wake of foreign entrants in the markets should be over-arching and cover the sector from angles. China presents an opportunity for the overhaul of the financial system and the banking sector in SADC. SADC should initiate a reform process whilst accommodating China and then lock in these reforms using the GATS framework.

References

- BBC News (2005) "China emerges as global consumer", BBC News 17 February 2005, available from: <http://news.bbc.co.uk/2/hi/asia-pacific/4272577.stm> (Accessed 1 March 2009).
- Biacuana, G. (2008) "China-Africa Trade and the Global Financial Crisis", 17 October 2008, South African Institute of International Affairs, available from: http://www.saiia.org.za/index.php?option=com_content&view=article&id=867:china-africa-trade-and-the-global-financial-crisis&catid=78:diplomatic-pouch&itemid=230 (Accessed 22 November 2008).
- Bleischwitz, R. (2006) "International Raw Materials Markets: Rising Prices and Growing Conflict Potential" in T. Debiel *et al.* (eds) *Global Trends 2007*, pp. 65 - 78.
- Bosshard, P. (2007) "China's Role in Financing African Infrastructure", International Rivers Report. available from: <http://internationalrivers.org/files/ChinaEximBankAfrica.pdf> (Accessed 01 March 2009)
- Chan-Fishel, M. (2007) "Time to Go Green: Environmental Responsibility in the Chinese Banking Sector", Friends of the Earth United States Research Report. Bank Track, available from: http://www.foe.org/pdf/Chinese_Bank_Report_5-9-07.pdf (Accessed November 2008).
- China Development Bank (undated) "CAD – Fund", available from: <http://www.cdb.com.cn/english/Column.asp?ColumnId=176> (Accessed 11 January 2009).
- Competition Commission (2008a) "Press Statement", 25 June 2008 (Press Release), available from: http://www.compcom.co.za/banking/documents/sum%20docs/PR11_2008.doc (Accessed 25 June 2008).
- Competition Commission (2008b) "Technical Report on the Banking Enquiry", June 2008 (Press Release), available from: http://www.compcom.co.za/banking/documents/PR19_2008.doc (Accessed 7 March 2009).
- Cutler, R.M. (2009) "Asia turns blind eye to facts", *Asia Times Online*, 23 January 2009, available from: http://www.atimes.com/atimes/China_Business/KA23Cb01.html (Accessed 14 March 2009).
- Dobson, W. (2008) "Financial Services and International Trade Agreements: The Development Dimension" Chapter 7 pp. 289 - 337 in A. Mattoo, R. M. Stern and G. Zanini, *A Handbook of International Trade in Services*, Oxford University Press, Oxford.
- Georgy, M. (2007) "China digs deeper into Africa with bank deal", *Mail and Guardian Online*, 26 October 2007, Available from: <http://www.mg.co.za/article/2007-10-26-china-digs-deeper-into-africa-with-bank-deal> (Accessed 9 January 2009).
- Herrero, A. G. and Santabarbara D. (2004) "Where is the Chinese Banking System Going with the Ongoing Reform?" Banco de España, EconWPA Research Paper, Macroeconomics Series No. 0408001, Available from: <http://ideas.repec.org/p/wpa/wuwpma/0408001.html#provider> (Accessed 9 January 2009).
- Jansen, M. (2006) "Services Trade Liberalisation at the Regional Level: Does Southern and Eastern Africa Stand to Gain from the EPA Negotiations?", Staff Working Paper ERSD-2006-06, Geneva, World Trade Organisation, Economic Research and Statistics Division.

Khumalo, N. (2006) "Services Trade in Southern Africa. A Literature Survey and Overview", *Trade Policy Report 10*, The South African Institute of International Affairs, Braamfontein.

La Porta R., Lopez-De-Silanes, F. and Shleifer A. (2002) "Government Ownership of Banks", National Bureau of Economic Research Working Papers No. 7620, available from: <http://mba.tuck.dartmouth.edu/pages/faculty/rafael.laporta/publications/LaPorta%20PDF%20Papers-ALL/Govt%20Ownershi-Banks-All/Govt%20Ownership%20of%20Banks.pdf> (Accessed 9 January 2009).

Le Pere, G. and Shelton, G. (2007) "China, Africa and South Africa: South – South Co-operation in a Global Era", Institute for Global Dialogue, Midrand.

Li, T. (2008) "China's Non-performing Loans: A US\$ 540 billion problem unsolved" Working Paper, available from: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1278235 (Accessed 7 March 2009).

Masson, P.; Dobson W. and Lafrance, R. (2008) "China's Integration into the Global Financial System", *Bank of Canada Review*, pp. 19 - 31.

Meyer, R. (2008) "China Could Usher in a New Era of Banking in Africa", 6 October 2008, available from: http://www.saiia.org.za/index.php?option=com_content&view=article&id=844 (Accessed 15 October 2008)

Meyer, R. and Alden, C. (2008) "Banking on Africa: Chinese Financial Institutions and Africa", China – Africa Policy Report No 5, South African Institute of International Affairs, Braamfontein. available from: http://www.saiia.org.za/images/stories/pubs/occasional_papers/saia_sop_14_meyer_alden_20081201.pdf (Accessed 15 October 2008)

Mowatt, R. (2000) "Prospects for Financial Sector Reform in the Context of Regional Integration in SADC", *Southern African Update*, Trade and Industrial Policy Strategies, available from: <http://www.tips.org.za/files/422.pdf> (Accessed November 2008)

Murinde, V. and Ryan, C. (2003) "The Implications of WTO and GATS for the Banking Sector in Africa", *World Economy*, Vol. 26, No. 2, pp. 181-207.

Napier, M. (2008) "Africa's Financial Sector: Barriers to Access and Recommendations for Donors", in H. B. Hansen, G. Mills and G. Wahlers (eds.) *Africa Beyond Aid*, Brenthurst Foundation, Johannesburg.

Pesek, W. (2007) "Standard Bank Deal Signals China's Changing Approach", *Business Report*, 5 November 2007, available from: <http://www.busrep.co.za/index.php?fSectionId=553&fArticleId=4113970> (Accessed 11 January 2009).

PressTV (2008) "China Ready for Global Financial Crisis", 26 October 2008, available from: <http://www.presstv.ir/Detail.aspx?id=73294§ionid=351020404> (Accessed 11 January 2009).

Wang, Y. (2003) "Services, GATS and Key Issues in Financial Sector", Paper prepared for the Senior Policy Seminar on "The Integrated Framework and WTO Accession", Phnom Penh, Cambodia May 1st-3rd, 2003.

Wang, Y. J. (2007) "What Drives China's Growing Role in Africa", IMF Working Paper WP/07/211, Washington D.C., the IMF.

Yeyati, E. L., Micco, A. & Panizza, U. (2004) "Should the Government be in the Banking Business? The Role of State-Owned and Development Banks" Inter-American Development Bank, Research Department RES Working Papers No. 4379, available from: http://www.iadb.org/res/publications/pubfiles/pubB-2005E_4836.pdf (Accessed 11 January 2009).

10. Appendix

Appendix Table 1. Foreign Investments in Chinese Banks

Date	Chinese bank	Foreign investor	Equity share (%)	US\$ millions
2002	Shanghai Pudong Dev Bank	Citigroup	15	73
2002	Bank of Shanghai	IFC/HSBC	15	145
2002	China Everbright Bank	IFC	5	19
2002–05	Bank of Nanjing Paribas	IFC/BNP	25	114
2004	Industrial Bank	Hang Seng/ IFC/GIC	25	326
2004	China Minsheng Banking Corp.	IFC/Temasek	6	125
2004	Shenzhen Development Bank	Newbridge	18	150
2004	Xi'an City Commercial Bank	IFC/Scotiabank	25	40
2005	Jinan City Commercial Bank	Commonwealth Bank	11	17
2005	Bank of Beijing	IFC/ING	25	270
2005	Hangzhou City Commercial Bank	Commonwealth Bank/ADB	25	110
2005	Huaxia Bank	Deutsche/ Sal Oppenheim	13	325
2005	Bohai Bank	Standard Chartered	20	125
2005	Bank of Communications	HSBC	20	1,750
2005	China Construction Bank	Bank of America/ Temasek	14	4,000
2005	Bank of China	RBS/UBS/ Temasek/ADB	17	5,175

2005	Tianjin City Commercial Bank	ANZ	20	110
2005	Industrial and Commercial Bank of China	Goldman/Allianz	10	3,700
2006	Ningbo Commercial Bank	OCBC	12	70
2006	Shanghai Rural Commercial Bank	ANZ	20	252
2006	United Rural Cooperative Bank of Hangzhou	Rabobank/IFC	15	30
2006	Chongqing City Commercial Bank	Dah Sing/Carlyle	25	130
2006	Guangdong Development Bank	Citigroup/IBM	25	760
2007	CITIC Industrial Bank	BBVA	5	650
2007	Dalian City Commercial Bank	Scotiabank/IFC	25	320
Total				18,786

Source: Masson, Dobson & Lafrance (2008:23, Table 3).

Appendix Table 2. Presence of Chinese banks in foreign markets

Date	Chinese bank	Target	Equity stake (%)	Estimated value (US\$ mil)
December 2006	Bank of China	Singapore Aircraft Leasing	100.0	965
December 2006	Industrial and Commercial Bank of China	Bank Halim Indonesia	90.0	10
May 2007	China Investment Corporation	Blackstone	9.9	3,000
May 2007	CDB	China-Africa Development Fund	100.0	1,000
July 2007	CDB	Barclays	3.1	3,100
August 2007	Industrial and Commercial Bank of China	Seng Hang Bank (Macau)	79.9	583
October 2007	CITIC Securities	Bear Stearns*	6.0	1,000
October 2007	China Minsheng Banking Corp.	UCBH (San Francisco)	9.9	317
October 2007	Industrial and Commercial Bank of China	Standard Bank of South Africa	20.0	5,600

Source: Masson, Dobson & Lafrance (2008:24, Table 4).