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The Foreign Banks' Influence in Information Technology Adoption in the Chinese Banking System

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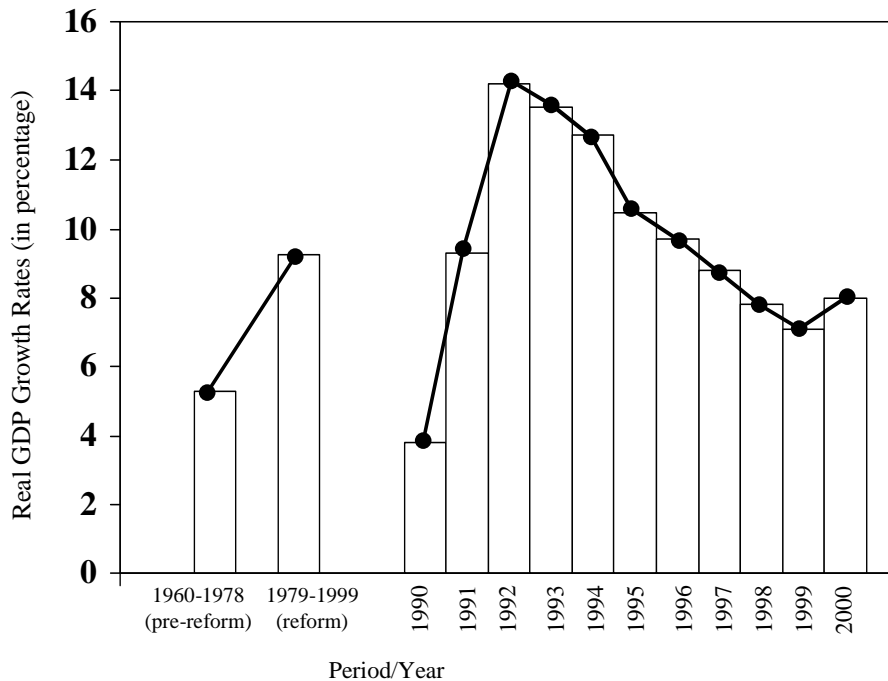
EXECUTIVE SUMMARY

Foreign direct investment has been a common conduit of technology transfer for the locally funded enterprises in the host country to adopt foreign technology. In addition, it could be a powerful agent in affecting technology adoption within a technologically backward host country. By contrast, foreign direct investment has not been a significant source of information technology transfer into the Chinese banking system. Neither has it been an effective agent in affecting technology adoption in this system. The priority and concern of the Chinese government in protecting, and retaining control of, its domestic banks and financial market have kept foreign direct investment in the banking industry at a relatively modest level. The controlled industry, the long wait for full market competition, and the inadequate infrastructure and operating framework have inhibited the foreign banks from adopting highly sophisticated information technology for their restricted business operations and from being an effective conduit in technology transfer.

BACKGROUND

The Chinese Economy

The Chinese economy's GDP (Gross Domestic Product) has been riding on a positive growth phenomenon, since the initiation of its economic reform program and its transition from a command to a market-based economy in 1979. The new direction undertaken by the Chinese government has definitely propelled the growth of the economy between the pre-reform and reform periods, as shown in Graph 1. The real GDP growth between 1979 and 2000 (in the reform period) was at an average annual rate of 9.25%, superseding the average annual growth of 5.3% experienced between 1960 and 1978 (in the pre-reform period). Although the growth had lost its vigor between 1992 and 1999, many economists and observers remained optimistic in the potential of this emerging market economy.

Graph 1: China's Real GDP Growth Rates: Pre-reform and Reform Periods and Annual

Source: *The World Bank, 1980-1999; China Statistical Yearbook, 1989-1999; National Bureau of Statistics People's Republic of China, 2001.*

The Chinese Banking System

Prior to 1979, the financial flows in the Chinese socialist economy were largely governed by the predetermined central plan. Under this system, the state-owned banks were the most active and important financial agents in the economy. They provided the amount of money required to produce the predetermined amount of output and supervised the utilization of funds in accordance with the requirements of the central plan. The banks virtually had no independent role in the creation of either money or credit from the funds deposited by the households and the state-owned enterprises. They merely acted as financial agents of the Ministry of Finance, and the inflow and outflow of money effectively belonged to the latter. The banking system at that time was a monobank system in which a single bank, the People's Bank of China (refer to Appendix 1 for a brief history of this bank), undertook the roles of central and commercial banking. As compared to the capitalist system, the financial intermediary activity level and role of the Chinese socialist banking system was very limited and noncompetitive, and deliberately simple and passive. In terms of information technology adoption, there was less demand and incentive for banking technology applications.

The decision made by the Eleventh Central Committee of the Chinese Communist Party in 1978 to transform the socialist country to a market economy has resulted in the implementation of the economic reform program. Since then, the economic reform program has been conducted on a gradual and experimental basis, with emphasis on opening economic sectors (at varying degrees) to market forces, trade and foreign investment. The Chinese government recognized that the support of a well-developed and active financial industry is one of the requisite conditions for the full operation of a market economy. Hence, the financial sector became one of the initial sectors selected for reform and for eventual full foreign participation. The ultimate aim of the reform of this sector is to achieve a sound financial system that is capable of deploying scarce capital resources in the most efficient way that

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