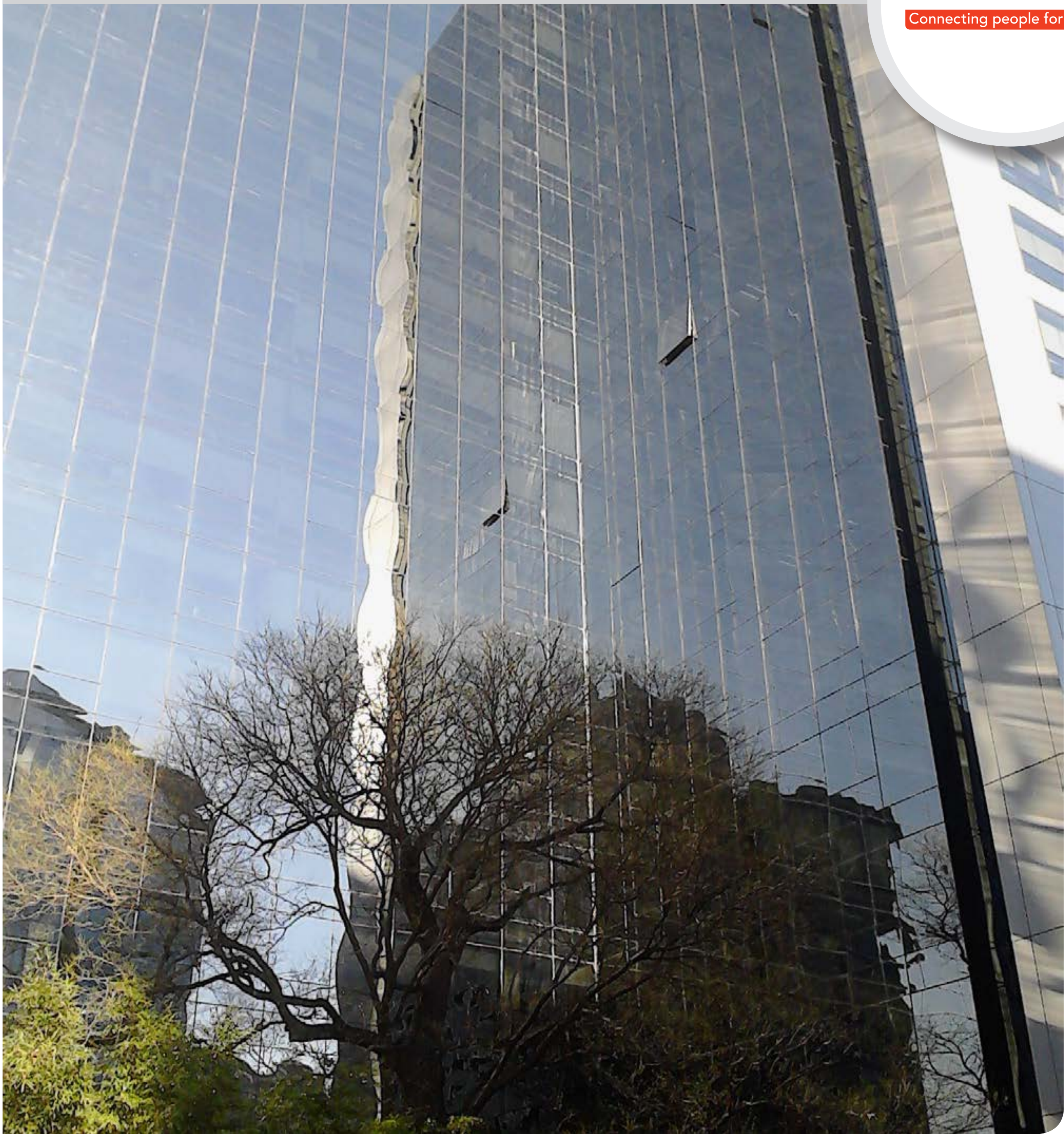
CHINESE BANKS
CONTROLLING POLITICS WITH MONEY

Both ENDS
Connecting people for change

Stiftung Asienhaus

CONTENTS



Bank building Beijing

INTRODUCTION

Chinese banks do not only invest heavily in China, but also increasingly beyond national borders, especially in developing countries. The manner in which this takes place is not only of importance to the Chinese, but also to the citizens of these developing countries. How Chinese banks conduct themselves is also important to civil society organisations and international banks that are concerned with issues related to sustainability, poverty reduction and corporate social responsibility. The regulations that apply to Chinese banks and international banking regulations influence one another. This publication attempts to clarify why this is happening and what the consequences are.

Since 2008, Chinese banks have been forced to invest in sustainable companies and not in companies that violate the law and pollute the environment. These regulations are laid out in the Chinese government's so-called Green Credit Policy. Both ENDS' Chinese partner organisation, Green Watershed has been keeping a watchful eye to see if Chinese banks follow these regulations. Monitoring these banks is challenging, because they seldom release information. However, in its recently published sixth[1] report in English, Green Watershed concluded that the extent to which Chinese banks honour the rules of the Green Credit Policy differs strongly from bank to bank. In order to better monitor and report on these practices in the future, Green Watershed wants to gain more insight into the investments and policies of Chinese banks.

What role can Chinese civil society organisations play in monitoring banks and which possibilities are open to them? And will their activities generate useful insights for the people and organisations committed to creating a sustainable and fair world? Usually, the legislator of a country is responsible for making social and environmental laws. The monitoring of compliance with those laws, by banks, for instance, is a governmental task. Banks, however, develop their own regulations and standards for socially responsible investing, and handle the monitoring of compliance themselves.

In undemocratic countries, it is difficult for citizens and civil society organisations to exert influence via the government over the manner in which banks invest. In such countries, it may be easier to influence the banks themselves, by monitoring whether the banks heed their own regulations.

But why would banks impose social and environmental regulations on themselves in the first place? The reality is that these rules are primarily motivated by business – they increase profitability. These regulations are therefore seldom motivated by ideology and ideas about how money should be spent in the fairest and most sustainable way. Much stronger motives for corporate social responsibility include fear of compensation claims and image damage. Therefore, such selfimposed social and environmental regulations are very different to rules and regulations imposed by governments. Moreover, by their very definition, they are not created as a result of public decisionmaking. Citizens and civil society organisations can do nothing more than monitor compliance and push towards improved behaviour; they have no participation in shaping the content of the rules themselves.

This publication attempts to find out what the effects of a democratic deficit are on the roles of and task allocation between the government, banks and civil society organisations. We further show that where it comes to running a bank, Chinese banks and international banks face similar challenges and choices. With this document, Both ENDS hopes to initiate a debate that until now has hardly been held. We also hope that more information will become available in the future, in order to sharpen the discussion.

1 The latest 7th. report is in Chinese only.

Why and how is Both ENDS involved with Chinese banks?

Both ENDS has been watching international banks outside of China for years - organisations such as the World Bank and the European Investment Bank (EIB). These banks' investments often cause damage to the environment and the livelihoods of people in developing countries. The banks recognise this problem and have drawn up so-called safeguard policies: requirements that projects must meet to be eligible for funding, in order to limit the damage to people and their environment.

The World Bank plays a leading role in setting the standard for safeguards: banks around the world traditionally look to the World Bank for social and environmental banking standards. And this is one of the reasons why Both ENDS has spent years advocating that the World Bank improve its social and environmental safeguards. We monitor whether the World Bank and other international multilateral banks comply with their own safeguards and talk to the banks' policymakers to further refine these rules. Together with our partner organisations in developing countries, we also enter talks with the governments of the countries that control these public banks.

We now hope to enter into conversation with Chinese banks about their investments in countries outside China. According to Article 21 of China's Green Credit Policy, such investments must comply with the laws of the host country and with the relevant international standards.

Both ENDS has become involved with Chinese banks for several reasons. Firstly, our partners in developing countries have asked us to intervene. They want to get in touch with fellow organisations in China, in order to collaborate and exchange information about such things as whether or not there are complaints procedures at Chinese banks. If, for example, the World Bank does not adhere to its own rules, a complaints procedure may be initiated. But where does one lodge a complaint if a Chinese bank fails to comply with international rules?

Secondly, the number of Chinese investments in developing countries has increased significantly. Both ENDS looks at international financial flows in terms of sustainability and fairness, and naturally China should be included. The world's countries and economies are becoming increasingly entwined. Therefore, it should no longer be surprising that a Dutch organisation takes an interest in the policies of Chinese banks, or that our former Prime Minister Kok serves as a board member of a Chinese bank.

Thirdly, it is often thought that Chinese banks are not bound by social- and environmental regulations, but there is a policy that governs Chinese investors: the Chinese Green Credit Policy. It consists of a clear set of rules and related guidelines for implementation and compliance. Chinese investors must also comply with international standards. The only question is whether this policy is actually implemented. Both ENDS wants to avoid the pitfall of thinking that "China will just do what it wants anyway," which can be abused to get out of adhering to the World Bank's safeguards. The World Bank, in turn, sees Chinese investment as competition; developing countries may choose a Chinese bank instead of the World Bank, because Chinese banks have less stringent social and environmental conditions for investment. The World Bank is currently conducting a review of its safeguards, and may use this argument to make its own regulations more flexible. It goes without saying that we want to prevent this, and therefore we are in talks with policy makers from the World Bank.

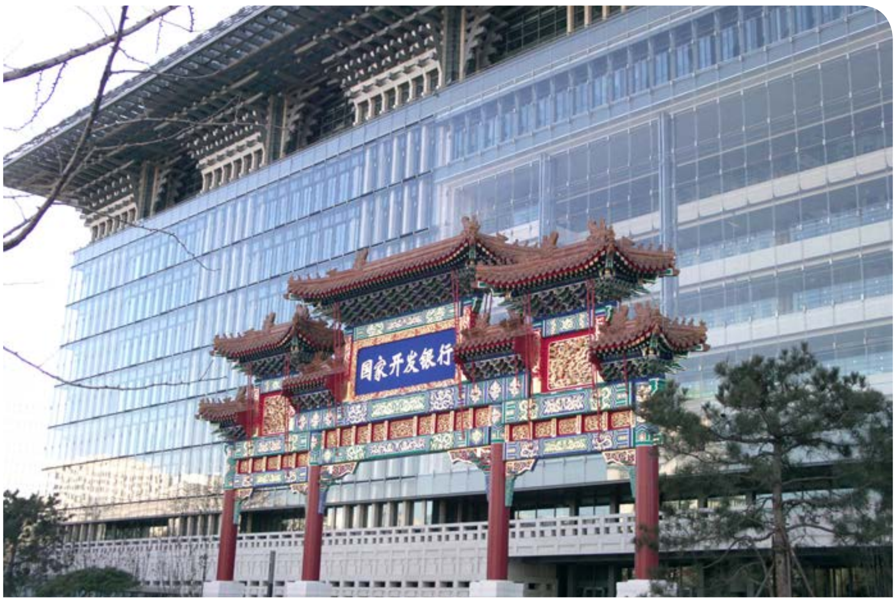
The final reason for Both ENDS to focus on Chinese banks is that our Chinese partner organisations want to know with which international standards Chinese banks must comply. As mentioned previously, these standards are determined partly by the safeguard policies of the World Bank, and therefore it is important for our partners in China that the World Bank will continue to use strict international social and environmental standards, so that Chinese banks are also encouraged to do so. To ensure that their voice is heard, Both ENDS also involves Chinese organisations in its discussions with the World Bank on the establishment of the new safeguards.

Green Watershed, Chinese Banks and corporate social responsibility

Green Watershed monitors whether Chinese banks comply with social- and environmental regulations and publishes an annual report in which the social responsibility performance of Chinese banks is assessed, measured and ranked. The report also looks at the public availability of data, and environmental, social and personnel policies. It looks at the organisational structure of banks (do they have environmental experts or environmental departments?) and at banks' public relations activities and investment portfolios (does a bank invest in green sectors of the economy, and if so, how much?).

It is a challenge for Green Watershed to find all of the information it needs for this comparison study. For a comparison study like this it is essential to find a partner organisation in order to obtain access to all the information needed. As part of an NGO-twinning project organised by the German NGO 'Stiftung Asienhaus' with funding from the Robert Bosch Foundation, Pieter Jansen of Both ENDS worked at Green Watershed for several weeks, researching the policies of Chinese banks. He contributed to the publication of Green Watershed's penultimate report, which provided an overview of the last five years of Green Policy and compliance by Chinese banks. The idea was to discuss the findings of the investigation with bank employees, but that was an unworkable plan.

So, for example, it was not possible to get information from the three major 'policy banks': China Development Bank[2], China Exim Bank and the Agricultural Development Bank of China. These fully state-owned banks invest in economic development and international trade. All information about these banks is labelled as 'politically sensitive', and it is not allowed to criticise these banks – that would be viewed as a direct attack on the state. In addition to the three policy banks, the Chinese state administers a number of commercial banks, some of which are in the hands of the central government, while the others are controlled by local authorities. These commercial banks make it a little easier to access information; some have even joined international initiatives for socially responsible banking. However, this does not mean that they are completely transparent or that they only invest in green economy or social sectors.



China Development Bank

2 CDB formally is not a policy bank any longer; it has been changed to be a commercial one since 2008. CDB is not in the stock market however, so is not a listed bank and its business is state interest related. Green Watershed's report only covers listed banks because there is relatively easier access to information about them according to law and regulations.

The history of Chinese banks in a nutshell

The combination of a communist system and a banking sector is strange in itself. What kinds of banks are these? Are they similar to banks in the Western world? And how do politics and commerce coexist in China? If social organisations want to exercise influence over the policy of Chinese banks, they must first understand how the banks work. In a communist state, do you approach the banks directly or do you address the government? Is openness actually appreciated? On the one hand, information about the China Development Bank is almost treated as a state secret, and on the other hand, Chinese banks appear eager to meet international corporate social responsibility standards.

China has a long history of banking. The oldest local banks date back to the Song Dynasty (960-1279 AD) and were - as in Europe - associated with trading houses of rich families. In the course of history, Chinese banks have therefore had to adapt to totally new realities. In the nineteenth century, the Chinese economy was 'opened up' by Western powers, who injected foreign capital. Subsequently, under the communist regime, the economy – and therefore the Chinese banking sector – became fully shielded and insulated from abroad. A period followed in which some foreign capital was allowed, provided that it was strictly controlled by the state. Today, Chinese banks have become major players in the international markets, and therefore it is important for them to meet international standards of corporate social responsibility.

The Imperial Bank was founded in 1897. This was the first modern development bank in China. The Chinese empire required a state bank to build a modern economy. By creating money and concentrating it in banks, capital became available for investment to exponentially grow the economy. The profits generated could fund further development. The Imperial Court attracted bankers from HSBC to teach Chinese bankers the tricks of the modern banking trade. The Imperial Bank faced much competition from local banks, which until then had always generated state revenues for the Chinese empire. Therefore, the Daqing Bank, the successor of the Imperial Bank, was better protected by the state, and grew to become the first central bank of China, under the name Bank of China.

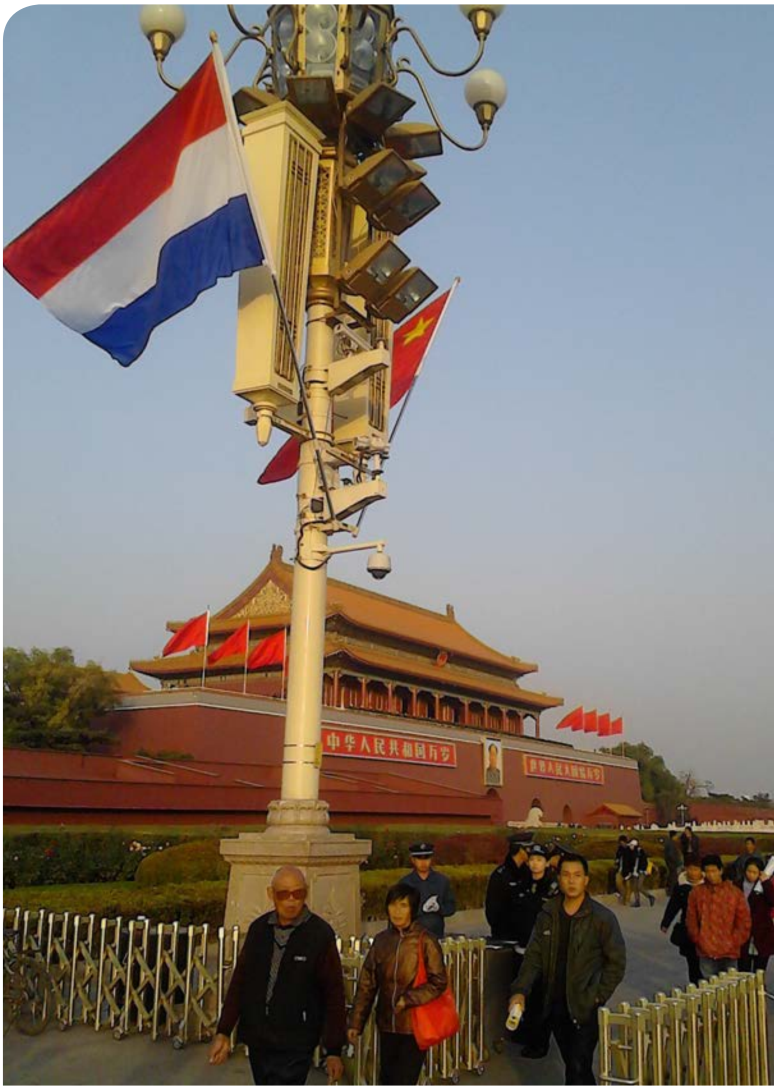
The Chinese empire required an injection of capital to build its own infrastructure and a national industry, and to be able to compete with the colonial powers. There were also war debts, imposed by the same colonial powers after the Opium Wars and the failed Boxer Rebellion. As a result, China had to borrow from Western banks, and pay interest on its loans. You can still see the old buildings where these foreign banks settled in the city of Guangzhou. It was probably this unequal colonial treatment that led Mao Zedong to declare in his publication *The Chinese Revolution and the Chinese Communist Party* (1939) that China's financial sector was monopolised by the colonial powers with their banks and loans. During the Mao-era China hardly borrowed from foreign banks or powers, and largely closed itself off from the international capital markets. After the death of Mao, successor Deng Xiaoping created

Chinese Central Bank

the so-called 'Go global' campaign. In 1980, he invited economist Milton Friedman to teach the Communist party about neoliberal market thinking. After China became a member of the WTO in 2000, the financial sector very slowly opened itself up to foreign banks. Since 2003, some foreign commercial banks even have a minority share in a number of Chinese banks.

In 2014 the Chinese government launched a pilot project to deregulate the banking sector: some more private Chinese banks were allowed under the supervision of the China Banking Regulatory Commission. This Commission advises the People's Bank of China and the Ministry in charge of macroeconomic policies, national annual budget, fiscal policy, government expenditure[3] on the content of the Green Credit Policy and compliance with it. When banks do not comply, the People's Bank of China and the Ministry are expected to take action. It is expected that commercial banks will be given more freedom to act in accordance with international corporate social responsibility regulations. But, to date, according to the Financial Times, almost all Chinese banks that are registered on the stock market are still state-instruments[4]. Directors of large banks are selected by the Communist Party and appointed as senior officials within the government.

Ever since the Friedman lessons, the Communist Party's policy seems to be to profit from the investment of Western multinationals - with China as the world's production centre - without losing control of Chinese banks. With the profits, more and more Chinese banks are now 'going global' with their investments.



Dutch flags near the Gate of Heavenly Peace

3 Basically, it is People's Bank of China and CBRC who are regulating Chinese banks, the former focusing on financial and monetary policy making, the latter regulating banking operation. The former is powerful, while the latter has no real authority of 'execution' of punishment.

4 http://www.ft.com/intl/cms/s/0/f2c76852-d015-11df-bb9e-00144feab49a.html#axzz3RWraymF1.

BOX 1: BANKS

Under the current political system, the Chinese government controls the banking sector. Keep in mind, however, that Western economies were also built using state banks, which created money in order to invest. In China, the Daqing bank was established expressly for that reason. Today, there are a whole range of state-controlled banks in China to fulfil this political and economic function. The Chinese government also uses its Green Credit Policy as a mechanism to push the economy into a greener and more social direction, creating money and investing it in green sectors of the economy instead of polluting industries.

The principle of borrowing money from banks at interest is not only a mechanism for money creation, but also for debt creation. In order to repay the loan and the interest, the lender must generate income from economic activity. This necessitates investment, for which more money must be borrowed. This principle applies to both private customers and governments that borrow from a bank. Debts sets a mechanism in motion in society that necessitates growth. The economy of a country must increasingly invest more and ensure productivity in order to pay back the banks with interest. This mechanism leads to a concentration of assets at banks. The same mechanism was at work during the colonial era, when China repeatedly built up debt at foreign banks in order to invest in the development of its national economy, the profits of which would be used to pay off the foreign debt.

Green investments are not immune to the debt mechanism, because even loans for wind energy, for example, have to generate profits. Green investments do not stop the need for economic growth to pay off debt. More and more economic activity is required to repay debts with interest, resulting in an accumulation of wealth at the banks. With deregulation, the state monopoly on money is (partly) outsourced to privately-held banks, and part of the wealth is distributed to the shareholders. If private banks gain a monopoly on the creation of money, the debt mechanism works in favour of the banks' shareholders.

In China, as elsewhere, this has led to the rise of a super-wealthy segment of the population, while exponentially increasing economic inequality. Deregulation has also led to the formation of cartels. The cost of money (interest) is not determined by a free market of supply and demand, but is determined by the banks that have a monopoly over the creation of money in the form of debt.

Rural women

The role of civil society organisations in China

Xiaogang Yu, Director of our partner organisation Green Watershed, expects that the gradual deregulation of the banking sector will give civil society organisations more room to monitor banks' social responsibility – governmental supervision could then be taken over, in part, by civil society organisations. Both ENDS hopes that also international civil society organisations that monitor banks, will be given access to China in order to do their jobs.

The argument that civil society organisations may have more room to monitor commercial banks, would not apply in Europe. There, commercial banks are primarily interested in the profitability of an investment, not the social responsibility side. European banks only conduct business in a socially responsible manner to prevent damage to their image and minimise risks, such as the payment of compensation for environmental damages. Moreover, civil society organisations know from experience with international commercial banks, that privately-held banks do not easily share information and often hide behind the excuse of business confidentiality.

Commercial banks are only accountable to their shareholders, while public banks have to be more open, because they manage public money. In China, however, it is not possible to monitor the public banks, which makes it all the more challenging for Both ENDS and our partner organisations to do our work, because the Exim Bank and the China Development Bank are the very banks that invest the most in developing countries. How these banks conduct themselves is therefore very relevant to our partners in these countries. In many countries outside China, civil society organisations can remind public multilateral banks, such as the World Bank, that they should heed their own rules. Moreover, they can approach their governments, who not only have a share in these multilateral banks, but also have a say in the management of the banks about how money is spent. The monitoring function in such cases is performed by countries' parliaments. In China, the reality is quite different for CSOs; it is therefore important to examine how they can still exert influence within the Chinese political context.

Bridge in the Guangzhou city centre

BOX 2: GOVERNING EN GOVERNANCE

Public control of banking policy, or coresponsibility for such policy, is known as 'governing'. When governing, the government takes responsibility for the spending of public money and citizens (generally speaking) have an indirect say and a certain level of control over that spend. Governance is a technical implementation instrument used by banks to measure their results, via performance indicators. Corporate social responsibility, of which the costs and benefits can be measured, falls under governance.

Banks - Western or Chinese - tend to prefer governance to governing, because it fits better within the prevailing banking culture to be as efficient as possible, particularly by spending as much money in the shortest possible time as possible. Efficiency is good for profits, and thus for shareholders. With governance, it's all about business models, indicators, targets, procedures and auditing. Societal choices, which in a democratic system would be up for discussion between citizens and stakeholders, can be reduced to a technical management question: Does the governance of the bank meet the minimum social and environmental standards? The World Bank, which is currently reviewing its social and environmental safeguards, also prefers to reduce its social and environmental policies to a technical governance issue. Moreover, the World Bank advises countries to deregulate their banking sector: something that the new leadership in China would gladly take over in its policy. The technique of governance could easily be incorporated into the Chinese political and financial system because there is no public control over the spending of money.

The governance model therefore fits with the desire of the Chinese political leaders to retain its control over money and investments, without requiring much public participation. According to Green Watershed it is therefore increasingly important that NGOs exist in China to monitor banks on their social and environmental policies.

The former bank building of City Bank on Shamina Island in Guangzhou

The future

Civil society organisations such as Green Watershed monitor banks' compliance with the Green Credit Policy. The Chinese government uses its banks' money creation steering mechanism to steer its economy in a green and social direction. Simultaneously, the Chinese government is moving towards the deregulation of the banking sector. Chinese banks are taking over the policy instruments of safeguards and/or corporate social responsibility from international banks.

CSOs hope that the deregulation of the banking sector will provide more room to monitor the banks' environmental and social policies, in much the same way that they've been monitoring the safeguards of the World Bank and other banks. Until now, there was little room to do so in China, and to make banks really 'green', supervision and control are required. The Green Credit policy may be obligatory, but there is way too little control by the Banking Regulatory Commission.

In addition to governance, Both ENDS would also like to see NGOs keep the governing aspects of banks top of mind. We will actively publish about this in the coming years and continue to exchange information about the banks and their investments. We will also keep trying to get in touch with the Chinese government and policy makers, along with our partner organisations in China and the rest of the world.

Both ENDS will also investigate Chinese banks' complaints procedures, to see whether partner organisations in developing countries can use these procedures when Chinese investments cause harm to their habitat. We will also look into the role that a public regulator could play in China, and would be happy to advise the Chinese government, if necessary.

Finally, we will continue to engage our Chinese partner organisations in our international work related to the World Bank and other multilateral institutions. Our Chinese partners want to make clear to the World Bank that Chinese international investments cannot serve as a reason for the Bank to change its own social and environmental safeguards.

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