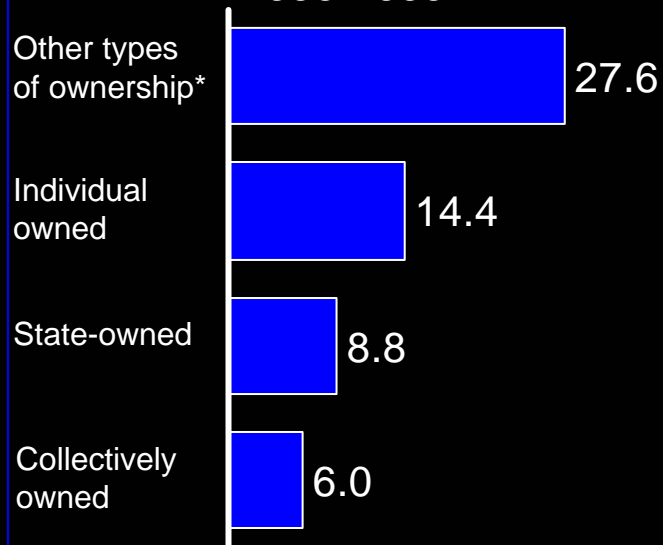


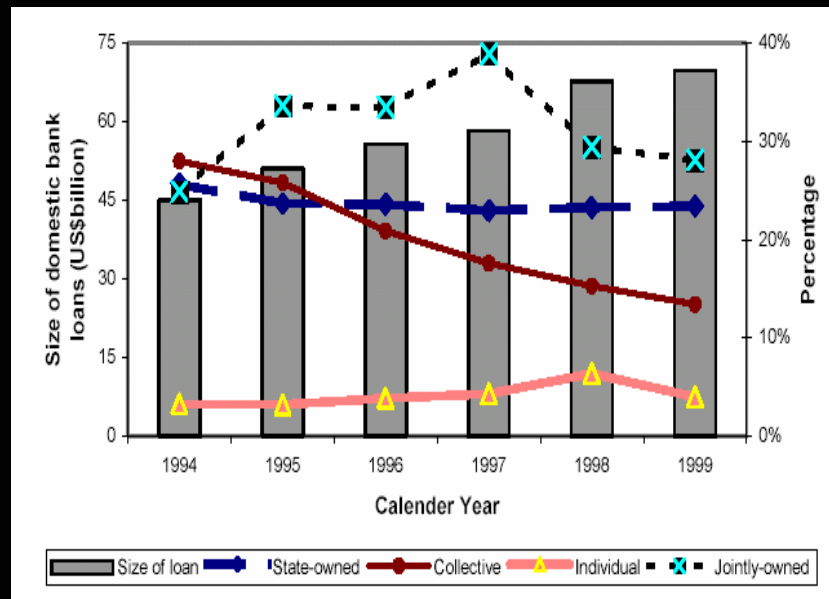
PUZZLE RAISED IN ALLEN ET AL (2002) ABOUT CHINESE ECONOMY – THE IRRELEVANCE OF FINANCE IN CHINA?

Growth rate of industrial output, %, 1998-1999



Informal sector (non- SOEs) provides most of the economy's growth

Domestic bank loan: size and firms' financing sources



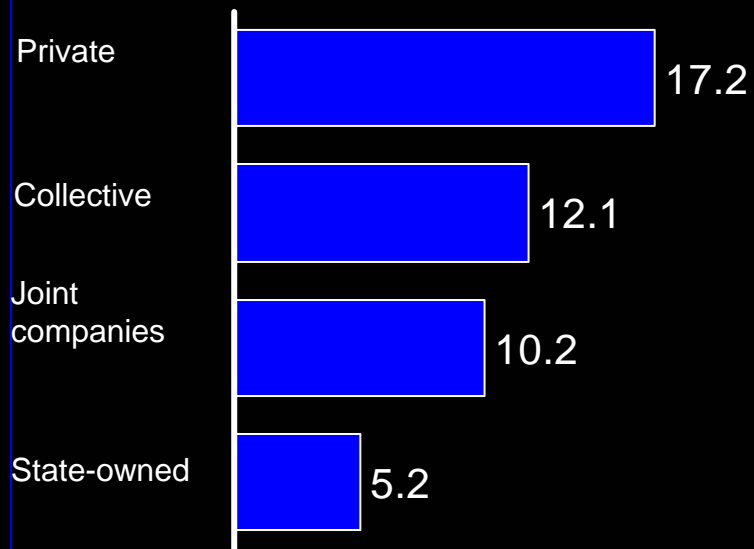
Bank loans only account for a very small part of informal sector's fundraising

* includes foreign owned companies, companies owned by investors from Taiwan, Hong Kong and TVEs

A VALID QUESTION: HOW DOES INFORMAL SECTOR GET CAPITAL? (ARE THERE ANY INFORMAL FINANCING CHANNELS IN CHINA?)

Preliminary results from Liu & Xiao 2003*

Chinese firms' unreported profits as percentage of total assets, 1995-2002



Why do firms with greater external financing constraints tend to hide more?

Implications

- There are some informal financing channels for Chinese firms with external financing constraints, e.g., under-reporting profits?
- Profit under-reporting is an illegitimate (or legitimate) response to an extremely inefficient financial system?
- Surfacing the under-reported profits may be a stimulus to further develop China's financial markets?

* based on data about 4,000 Chinese manufacturing firms during the period from 1995 to 2002

Source: Liu, Qiao and Geng Xiao, 2003, Profit reporting and finance, University of Hong Kong working paper

Questions For Debate and Brainstorming:

- Majority of Chinese SMEs face financing constrains. Is it challenging the future of the Chinese economy and the reforms of China's financial systems?
- Is developing bond market and securitizing assets a viable option for SMEs to relieve their financing constraints? If so, how?

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