

Abstract

Abstract of thesis entitled "Soft-budget constraints, ownership structure and banking in China", submitted by Wang Jue (M-A4-6806-2) for the degree of master of Social Science at the University of Macau in June 2006.

Since János Kornai published his seminal work on shortage economy in 1979, soft-budget constraints have been widely recognized as one of the most fundamental problems in socialist economies. Recently economists have started to build an equilibrium theory of soft-budget constraints. The objective of my research is to analyze the soft-budget constraint problem among stated-owned commercial banks and the central bank based on the Dewatripont and Maskin (1995) framework. In my study, I analyze economic factors behind bad debts incurred by state banks in China in particular and to study the financial transformation in China in general.

By following closely the D-M model, and by adding the liquidation choice made by state-owned enterprises (SOEs) which face soft-budget constraints, I find that the bailout process of commercial banks does harm to the hardening of budget constraints of SOEs. Furthermore, I extend the model to include state-owned and privately owned commercial banks and to explain why the Chinese government recapitalized state-owned commercial banks in 2002 when they were planning to list in the stock market. I show that, as recapitalization costs on state-owned commercial banks are less than that of privately owned banks under soft-budget constraints, the central government is more willing to recapitalize state-owned commercial banks than privately owned banks. This finding provides supports for the presence of soft-budget constraints in Chinese banking sector.

Key words: Soft-Budget Constraints, Commercial Banks in China, Banking Transformation, Ownership Structure, State Ownership