

Bank Productivity in China 1997-2007: An Exercise in Measurement

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Summary

The theory of contestability suggests that the threat of entry in the banking market will improve its general efficiency and productivity, as incumbent banks gear up to deal with potential competition. It is generally accepted that the opening up of the Chinese banking market with respect to WTO and the entry of foreign banks to RMB business will improve the efficiency and productivity of Chinese banks. This study examines the productivity growth of the nationwide banks of China and a sample of city commercial, banks for the eleven years to 2007. The study uses a number of models to measure productivity growth and utilises a bootstrap methodology to minimise the bias in measurement and provide a statistical inference capability that enables us to pose the question, has there been a significant improvement in Chinese banking productivity (measured in different ways) in the run up to WTO? The study is innovative in treating non-performing loans as a 'bad' output, in the same way as pollution would be treated as a negative but unavoidable output in manufacturing. The study separates the productivity growth of banks in general into state-owned banks, joint-stock banks and city commercial banks. Total factor productivity growth is decomposed into improvements in technical efficiency, representing shifts in the production frontier, from efficiency gains, representing movements towards the frontier. The results show that average total factor productivity for the joint-stock banks was better than that of the state-owned banks for some models of measurement but not others. But the average city commercial banks improved its productivity growth both in terms of frontier shift and efficiency gain throughout the whole period. The study also shows that individual state-owned and joint-stock banks did improve their productivity growth and defined an improving production frontier. Most other banks lagged behind so that the gap between the inefficient banks and the most efficient banks widened. While individual banks improved their productivity growth there is no evidence that the average productivity growth of Chinese banks as a whole improved in the run-up to WTO.