Communists Constructing Capitalism

Socio-Economic Uncertainty, Communist Party Rule, and China's Financial Development, 1990-2008

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To what extent does China's experience of economic reform since 1989 compel a reconsideration of the ontological foundations of contemporary capitalist development? China's political economy remains characterized by a unique and resilient political structure (the Chinese Communist Party) that penetrates both 'private' (market) and 'public' (state) organizations. The conceptual rootedness of contemporary theories of comparative and international political economy in a distinctly Western historical experience of capitalist development hinders their ability to understand Chinese capitalism on its own terms—as historically, culturally, and globally embedded. To generate greater analytic traction in understanding China's otherwise paradoxical constellation of actors and dynamics, I argue that contemporary capitalism should be studied as a set of mechanisms for managing and exploiting socio-economic *uncertainty*, rather than according to the binary logics of state regulation and market competition. These mechanisms can be conceptualized as an overarching *risk environment.* On this basis, I trace how the cognitive frames, social institutions, and relational networks that emerged within the 'socialist market economy' [社会主义市场经济] in China's post-Tiananmen financial system have placed the Chinese Communist Party at the nexus of the state and the market. I argue that specific ideas emerged about how to manage the flow of capital, playing a significant role in underpinning expectations of financial growth and stability. During this period the financial system underpinned the CCP's capacity to both manage *and* exploit socio-economic uncertainty through the path of reform, forming a central explanatory factor in a developmental trajectory marked by a trifecta of rapid economic growth, macroeconomic stability, and deepening socio-economic imbalances. Rather than viewing the path of financial reform in China solely in terms of 'partial' or 'failed' free-market reform, it thus becomes possible to cast China's development in a new light as the product of a more concerted vision of how the financial system would enable a mode of economic development that combined the drive for capital accumulation with the distinctive socio-political circumstances of post-1989 China.

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It goes without saying that this thesis could not have been completed without the help and support of a great many people. First and foremost, Andy Hurrell has been utterly steadfast and truly exceptional in his feedback, guidance, and encouragement throughout the project, even at the number of points when the direction and objectives of my research were less than crystal clear. Not only a wonderful scholar but also a tremendous teacher and mentor, his mark upon the thesis is clearly apparent, even as he urged me to follow my own instincts, ideas, and impulses at every opportunity. At Oxford, I have been the beneficiary of an incredibly deep and diverse intellectual community, stretching across the fields of international relations and Chinese studies. Many have read and commented on parts of it, but in particular, Sarah Eaton and Kalypso Nicolaïdis provided insightful and invaluable feedback, improving the thesis considerably. Quentin Bruneau has been a part of this from the beginning, and I have been lucky to have Bilal Baloch's friendship and advice in the latter stages of my time in Oxford. My collegaues and classmates at DPIR have been constant sources of both intellectual inspiration and social diversion in equally important ways. And to all those across the university with whom I have had the opportunity to discuss the thesis and the bigger questions in which it is embedded, I am extremely grateful.

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List of Acronyms

ABC	Agricultural Bank of China
ADBC	Agricultural Development Bank of China
AFC	Asian Financial Crisis
AMC	Asset management company
BOCOM	Bank of Communications
BIS	Bank for International Settlements
BOC	Bank of China
CASS	Chinese Academy of Social Sciences
CBA	Commonwealth Bank of Australia
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
CCBs	City commercial banks
CCP	Communist Party of China
CDB	China Development Bank
CDIC	Central Discipline and Inspection Commission
CFDIWC	Central Financial Discipline and Inspection Work Commission
CFELSG	Central Finance and Economic Leading Small Group
CFRLSG	Central Financial Reform Leading Small Group
CFSLSG	Central Financial Safety Leading Small Group
CLSGSRSB	Central Leading Small Group on Shareholding Reform of the State Banks
CFWC	Central Financial Work Commission
CIRC	China Insurance Regulatory Commission
CITIC	China International Trust and Investment Corporation
CMB	China Merchants Bank
COD	Central Organization Department
CSRC	China Securities Regulatory Commission
DRC	Development Research Center of the State Council
EIBC	Export-Import Bank of China
FDI	Foreign Direct Investment
FSI	Foreign Strategic Investor
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GITIC	Guangdong International Trust and Investment Company

ICBC	Industrial and Commercial Bank of China
IFC	International Finance Corporation
IMF	International Monetary Fund
ITIC	International Trust and Investment Company
IPO	Initial public offering
HKSE	Hong Kong Stock Exchange
JSCB	Joint-stock commercial bank
LBRS	Law on Banking Regulation and Supervision
MOF	Ministry of Finance
MOCOM	Ministry of Commerce
NBFI	Non-bank financial institution
NCSSF	National Council for Social Security Fund
NDRC	National Development and Reform Commission
NPC	National People's Congress
NPL	Non-performing loan
OMO	Open market operations
PBOC	People's Bank of China
PRC	People's Republic of China
PSC	Politburo Standing Committee
RCC	Rural credit cooperative
RMB	Chinese Renminbi
ROA	Return on assets
ROE	Return on equity
RRR	Reserve ratio requirement
SASAC	State-owned Assets Supervision and Administrative Commission
SME	Small and medium enterprise
SOCB	State-owned commercial bank
SOE	State-owned enterprise
SHSE	Shanghai Stock Exchange
SZSE	Shenzhen Stock Exchange
TIC	Trust and investment corporation
TVE	Township and village enterprise
WTO	World Trade Organization

I Introduction

> My question is simply this: if China's historical practice of socialism is the major characteristic of Chinese modernity, why have the New Enlightenment intellectuals who have borrowed from Weber and other theorists to critique socialism not been logically led to a critical reflection on the question of modernity itself? [1]
>
> — Wang Hui

> 亚当·斯密实际上讲过两只看不见的手，一只是讲市场，一只是讲道德。
>
> Adam Smith in fact spoke of two 'invisible hands', one of the market, the other of morality.[2]
>
> — Wen Jiabao

On 8 November 2008 in the heart of Beijing's financial street, an executive at one of China's 'big five' state-owned commercial banks (SOCBs) rxeceived a phone call from the head of one of the bank's offices in a city in Shandong province. The provincial bank head had dined the night before with a local party official, and one topic dominated discussion: how they could maintain confidence in the financial system, free up liquidity and investment capital, and stimulate domestic demand. Three days previously, the Central Committee of the Communist Party of China (CCP) had issued Document No. 18, laying out 10 policies to "further expand domestic demand and assure stable rapid growth" in the midst of global economic downturn, and cadres across the country were tripping over themselves to gear up plans and projects for investment.[3] One dilemma presented itself however: since its establishment in 2003 the China Banking

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[1] Wang Hui, "Contemporary Chinese Thought and the Question of the Modern [当代中国的思想状况与现代性问题]," in *China's New Order: Society, Politics, and Economy in Transition*, ed. Wang Hui (Cambridge, MA: Harvard University Press, 2003 [1998]), 147.

[2] Wen Jiabao, "温家宝总理在线交流 [Premier Wen Jiabao Communicates Online]," *中国政府网，新华网联合专访 [Chinese Government and Xinhua Combined Exclusive Interviews]*, 28 February 2009.

[3] Liu Zebang, "关于中共中央 18 号文件 [On the Central Committee's Document No. 18]," <http://liuzebang.2000.blog.163.com/blog/static/4224889200810264456842/>, accessed on 8 July 2013.

Regulatory Commission (CBRC) had also been leading the 'modernization' of China's banking sector in macro-prudential regulation, corporate governance, and financial supervision, aspects of which were at risk being ridden roughshod over in the frenetic drive to shore up growth. The Beijing executive's opinion was clear: the Party centre was under no allusions as to the need for clear macroeconomic direction, and if those at lower levels started second-guessing, "no-one would know what to do and economic disorder would ensue." Unity [团结] was the order of the day, and the CBRC would also do what the Party required of it.[4]

When I sat down with this executive in late-2012, sipping green tea in a corner office in the heart of Beijing's 'financial street' [金融街], financial crisis had brought Western economies to their knees, and the triumphalism that had accompanied China's much-feted stimulus package and 8.7 percent GDP growth in 2009 had begun to fade amidst growing awareness of wasteful investment projects, a further consolidation of economic power within the largest state-owned enterprises (SOEs), and a perception that ordinary households were amongst the last beneficiaries of the stimulus spending. We talked about this concept of economic disorder [*jingji hunluan* 经济混乱]—what it means, what causes it, and its implications. I asked about what lessons he drew from the global financial crisis, and he said interesting but not entirely unexpected things about reducing inefficient state bureaucracy, about managing moral hazard, about limiting the innovation of complex financial products, but then he surprised me. He mentioned a different word for disorder [*dongluan* - 动乱], and said that neither the state nor the market were capable of managing this kind of disorder. It is a political word, not an economic one, and it connotes turmoil, unrest, *upheaval.* As China was accelerating financial reform, as the 'transformation of the state' was gathering pace, the lesson that this banker took from the crisis

[4] BJ:2012.12.14. Interview, Beijing.

was that it was neither the regulatory state nor the free market that prevented *dongluan.* It was the Party.

Deng Xiaoping, the initial progenitor of China's economic reforms, emerged from the economic distress of Maoist collectivization during the Great Leap Forward and the social turbulence of the Cultural Revolution with a firm belief in the possibility of reconfiguring the social and economic institutions of Chinese society to fulfill the pragmatic needs of the Chinese nation. The transformation of China's society and economy since the 1978 Third Plenum[5] has taken place along numerous and varied dimensions, involving far-reaching changes in economic structure, the reinvigoration of education systems, science and technology, and a fundamental revision of how China views itself in relation to the rest of the world. But the defining feature of Deng's vision of a distinctly 'modern' China was the recognition that the forces of commerce were not to be resisted and shied away from. The reform and reconstruction of a system of financial intermediation would constitute a core feature of this endeavour. China now possesses virtually all of the institutions of a modern financial system.[6] Its banks are amongst the largest in the world,[7] and they continue to play a critically important role in determining the extent and nature of the growth of the Chinese economy. Yet, since Deng spoke at the outset of the reform era of the construction of 'real' banks,[8] the ongoing reform of the financial sector has left it unclear to many—observers of and participants in the economic system alike—exactly what this role is, and what it should be.

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[5] The Third Plenum of the Communist Party Central Committee is generally held approximately one year after the National Party Congress, and traditionally serves as a platform for the announcement of major new shifts in economic policy.

[6] Barry Naughton, *The Chinese Economy: Transitions and Growth* (Cambridge, MA: Harvard University Press, 2007), 451.

[7] Of China's 'Big Five' state-owned commercial banks (SOCBs), four are included within the top fifteen largest banks globally by asset holdings, with the largest, Industrial & Commercial Bank of China (ICBC), at #1. When ranked by market capitalization, China's banks are positioned even higher, with four within the top ten.

[8] Deng Xiaoping, quoted in Han Yuting, "把银行变成真正的银行 [We Should Transform the Banks into Real Banks] " *人民日报 [People's Daily]*, 21 April 1995.

Implicit in any attempt to understand how China constructed a modern financial system, the role that this system has played in China's post-Mao economic development, and its implications for the evolution of Chinese society more broadly, is the challenge of understanding the sources and drivers of change in China's political economy. 1978 marked a watershed moment in the relationship between Chinese and Western political philosophies, modes of social organization, and economic ideas. It is now axiomatic that China's contemporary political economy is the product of a coalescence of a civilization possessive of unique and deeply entrenched norms, traditions, and ideologies, and the increasingly transnational influence of a capitalist mode of economic organization throughout the world. Their interaction has filtered through contingencies of history that have not only constituted critical junctures in and of themselves, but also have given rise to historical legacies that would continue to play a role in the course of social development. And yet, whilst we know that capitalism—as discourse and as ideology—is now linked inextricably to China's future development, do we yet have an adequate understanding of how China, in having been reshaped by capitalism, is itself coming to reshape the concept and practice of capitalism?

The central argument that I develop in this thesis is that an adequate understanding of China's reform-era path of capitalist development requires us to look beyond the concepts of the state and the market, and instead theorize and detail the politico-economic agency of the CCP itself, and in particular the ideas and conceptions of order that underpin its role within the broader political economy. Such factors have been largely neglected in existing accounts of China's financial development and reform, which remain focused on the more micro-level dynamics of political contestation *within* the state and market environments, without pausing to consider more broadly how these political and economic logics interacted so as to produce a remarkably stable, if unbalanced and potentially unsustainable, set of mechanisms for economic growth and accumulation of capital. As I argue in this thesis, without accounting for the ideational cohesion that generated a powerful basis for CCP authority and control over the flow of capital throughout the economy, it becomes difficult to explain how the trajectory of reform embodied simultaneously (1) an embrace of the market, (2) the rationalization of the state, and (3) the preservation and deepening of the role of the CCP within the financial system. Although Chinese financial policy-making and development since the early 1990s has embodied a capitalist logic of economic growth and accumulation, the manifestation of this logic elides the traditional analytical dichotomy between the state and the market. Rather, this logic manifests in the CCP constituting the central feature of a system of financial 'risk' management that has functioned both to support economic growth, and at the same time as a mechanism of political control. That is to say, the process of financial reform involved the construction of a system that would enable state-regulated and market-based economic growth at the same time as preserve CCP authority over the nature and structure of that growth.

I examine how this process of 'communists constructing capitalism' has been underpinned by a specific set of cognitive frames and ideas concerning the relationship between financial capital and the real political economy. These frames are a product of deeply embedded social norms and structures coalescing with the opportunities and constraints—both discursive and material—generated through China's interaction with the global political economy. Accordingly, the financial system continuously occupied a unique position at the centre of the broader political economy. Through analysis of the path of financial reform since the early 1990s, I trace the implications of the duality of the role that it fulfilled under the aegis of CCP control, firstly as an economically effective mechanism for financial intermediation within the real economy, and secondly as a politically effective mechanism for preserving centralized power and authority over the benefits of that financial intermediation. The institutional and regulatory reforms that did take place during the 1990s and 2000s do not overshadow the continuity of this function, and, as will be discussed in later chapters, the way in which those reforms in fact were in many ways structured specifically around the need to preserve the integrity of this duality.

The story of the development of the banking system is accordingly less one of obstructed or stalled reform, but more one of a commitment to pressing against the limits of the growth model, and engaging in a form of brinksmanship with financial crisis in an effort to secure enough material wealth in order to ameliorate the effects of capitalist accumulation. This effort to 'buy time' through accumulation, and to 'do enough' to address social conflict and preserve social stability, is what distinguishes the modern epoch of capitalist accumulation from either a traditional conception of free market laissez-faire capitalism, or of the true ideal of the developmental state. This was the guiding principle that has accompanied 'reform' since the early 1990s, and it can still be witnessed today as the CCP continues to actively engineer the process of growth in a way that ameliorates the worst excesses of capitalist development. As I argue in this thesis, it serves ultimately as a demonstration of just how antithetical capitalism can be to the principles of democracy. The role of the CCP in straddling the private and public institutional divide illuminates not just how the development of capitalism affected China, but how China affects our conceptions of capitalism.

Capitalism: East and West, National and Global

This overarching question of how to understand capitalist development in China is directly related to the linkages between those disciplines with a stake in the question 'what is China', either as a case unto itself (Chinese politics), a vehicle of comparison (CPE), or as a second image (IPE). These linkages hinge upon the modes in which ideas, interests, and institutions coalesce between different actors at different levels of analysis. In drawing these connections, two fractures emerge within the current lines of analytical distinction that continue to animate much discussion of China's place in the global political economy. The first concerns the question of the domestic (or the local) and its relationship to the international (or the global), the second the question of the political logics of the state and its relationship to the economic logics of the market. Both of these questions are examined in greater depth in Chapter Two and returned to in the concluding chapter; here I delve briefly into how they relate to each other, and how they animate and contextualize the current study.

As this thesis seeks to shed light on, how the political problem is resolved in China via the economic, and moreover how the economic solution is in turn underpinned through the political, is one of the most intriguing aspects of China's path of reform and opening.[9] How this process unfolds is connected intimately to the evolution of the global political economy. Recognizing the extent of the interpenetration of the political and the economic transforms the question of how China 'affects' this process from one of the exercise of state economic power and the political agency of private economic actors, into one of how structurally entrenched imperatives—both domestic and international—are constraining certain individuals, networks, and institutions, whilst generating political resources for others within an increasingly interdependent global system. This focus upon how the dynamics of economic development can simultaneously constrain and empower actors forms one of the core themes of the thesis.

I therefore address these fractures between the universal and the local, and the political and the economic, by approaching the 'China question' from an alternative perspective—one that de-emphasizes the 'state vs market' dichotomy and instead focuses on the socio-economic foundations of power and authority that manifest through the financial system. At the core of a global political economy that gives rise to these analytical fractures and yet seemingly operates in a way that denies their empirical and historical salience reside multiple systems for mediating the flow of capital and resources necessary for modern economic activity and production. Finance—and more specifically financial capital—penetrates the political realm as well as the economic,

[9] This interpenetration of the political and the economic is addressed admirably by Greta Krippner, who details how 'financialization' in the United States offered a 'solution' to the socio-political crises of the 1970s. Likewise, I seek to understand how a particular mode of economic growth 'solved' the socio-political dilemmas faced by the CCP. Further, and in contrast to a Marxist world-systems theoretical perspective, we both seek to "scale back the analysis to more manageable proportions where precise mechanisms and specific social actors are more visible." See Greta Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Cambridge, MA: Harvard University Press, 2011), 15.

whilst also forming a critical set of linkages between the domestic and the international within the global political economy. This leads to the 'double paradox' of China's trajectory of economic development, which I explicate further in the next section, but further it also leads to the question of finance and its 'duality of purpose'—as a system of financial intermediation as well as political control. It further points towards how the role of China's financial system is crucial to seeing China's emergence into the global political economy as breaking down barriers between not only the political and the economic, but also between the local and the universal. This thesis speaks thus not only to the study of China's political economy and the theoretical and conceptual debates that surround this endeavour, but also to more fundamental questions in IR/IPE, concerning how the universal coalesces with the local at the point of what remains fundamentally but not exclusively the international.

In this manner the thesis seeks to answer Kellee Tsai's call for scholarship to better "show what China can do for political science, both empirically and analytically."[10] It firstly provides an insight into the paradoxical path of China's financial development as a largely non-liberalized set of institutions that nonetheless underpinned stable, rapid, yet unsustainable economic growth. This is an empirical paradox that has not yet been adequately addressed, and I place the role of the CCP at the heart of this examination. The role of the financial system in China's development has, as for all other financial systems in the world, been underpinned by a set of ideas, institutions, and networks that enable socio-political uncertainty to be evaluated, financial risk to be managed, and economic activity to take place. I show how this process in China has revolved not around an equilibrium reached between 'state regulation' and 'market freedom', but around the role of the CCP as the source of confidence and faith in financial stability and economic growth.

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[10] For a recent exploration, see Kellee Tsai, "China's Political Economy and Political Science," *Perspectives on Politics* 11:3 (2013): 860-71.

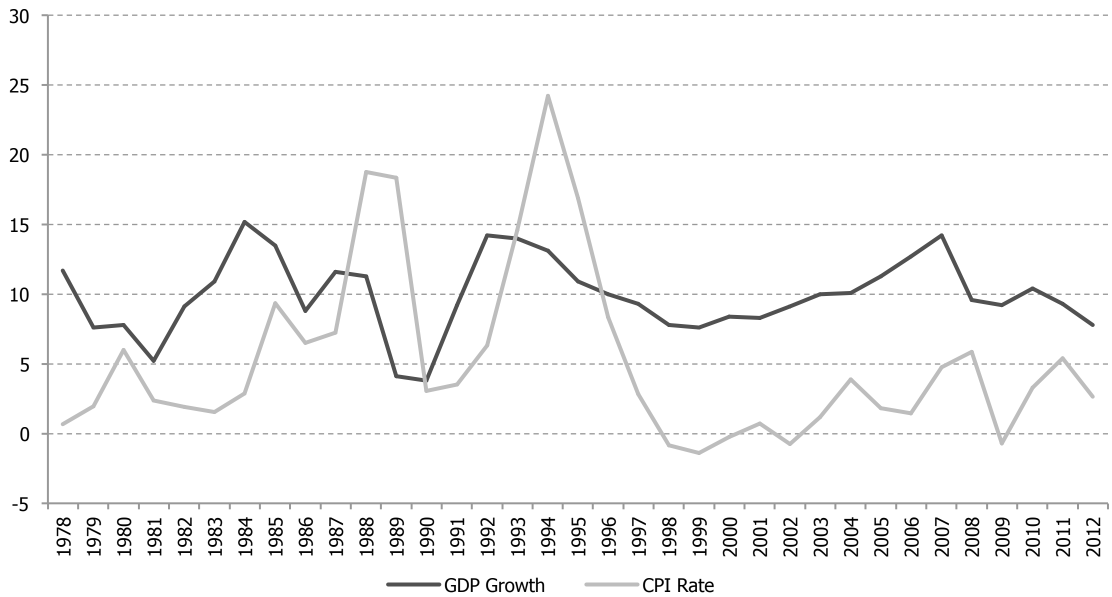
This gives rise to the second objective of this thesis, which is to explore how such a perspective overcomes some of the limitations of studying the political economy of financial capitalism that arise through a focus upon the distinct institutional categories of 'the state' and 'the market'. The role of the CCP as I conceptualize and analyze in this thesis illustrates the difficulties of relying upon these categories to understand the intersection of universal logics of economic development and the particular social institutions through which these logics manifest. The study represents an attempt to overcome these conceptual limitations, and accordingly provide a means of grappling with the empirical problem of explaining paradoxical trends in China's politico-economic development at the same time as generating insight into what the past twenty-odd years of financial development in China can tell us about the nature of contemporary political economy as contemporary *capitalist* political economy.

The third focus of the thesis is accordingly upon placing these investigations in the context of the long-run evolution of the global political economy, and destabilizing conceptions of China as 'just another actor' that is coming to participate in a global order whose dynamics can be comprehended on the basis of concepts and theories of socio-economic action rooted in 'Western political economy'. China's paradoxical experience of financial reform and economic growth demonstrates that there exists significant scope for reconfiguring understandings of how financial systems affect the course of socio-economic development within contemporary global capitalism. The distinctiveness of the mode of interaction between political authority and financial capital in China has the potential to profoundly disrupt the otherwise presumed linearity of evolution in the global order, even as capitalism itself as a mode of social organization comes to be increasingly entrenched within this global order.

A Troubled Nexus: Economic Growth, Stability, and Communist Party Rule

The overarching motivation for this study thus arises from the question of how capitalism as a quintessentially modern mode of social organization is capable of adapting to, co-opting, and reshaping social structures and norms in ways that defy the traditional analytic categories of Western political economy. A question central to understanding the current and future dynamics of the global political economy, it resolves into focus through a basic paradox residing at the heart of China's development during the reform period. As Figure 1.1 shows, China has experienced highly rapid growth, and has done so without precipitating either severe macroeconomic instability or financial crisis.[11]

Figure 1.1: Economic growth and inflation, 1978-2012



Source: CEIC

[11] One of the more remarkable aspects of China's growth story has been that it has been accompanied by low levels of price volatility. Headline growth has averaged 9.92 percent between 1978 and 2012, whilst consumer price inflation averaged only 5.27 percent over the same period, a remarkable achievement for a 'transitional' middle-income economy.

Yet the benefits of this minor economic miracle have not accrued equally, as the politicization of economic success in a rapidly commercializing society has become increasingly clear. As the role of markets across different sectors of the real economy has increased, the trajectory of economic development has grown increasingly skewed. At the microeconomic level, those firms and individuals who are able to gain access to credit finance have predictably been better positioned to take advantage of opportunities for economic expansion and market-based growth. This further translates into cleavages at the macroeconomic level, as specific industrial sectors and geographic regions have benefited disproportionately from increasing levels of financial capital within the economy. These outcomes might not be so surprising but for the fact that discrimination in credit allocation has occurred through a banking system dominated by SOCBs. There accordingly resides a 'double paradox' at the heart of the story of Chinese economic development. The first is that, contrary to standard conceptions of financial reform, the banking system lagged significantly behind the real economy in market-oriented liberalization, yet was still capable of supporting stable and rapid economic growth. The second is that when the sustainability of this function began to demonstrate its limits by producing increasing and highly visible levels of imbalance at both the micro- and macro-levels, it did not experience significant change. Rather, policies to preserve macroeconomic growth and stability continued to be prioritized over those to produce a more sustainable and balanced trajectory of development.

Three recent studies have examined the political economy of China's financial development. How well do they explain the dynamics of both continuity and change in China's financial sector? They each emphasize different means of exploring these questions within the theoretical 'troika' of political economy, highlighting interests, institutions, and ideas as different analytic foci.[12] Yasheng Huang focuses on the urban/rural divide, painting the picture in terms of a "political balance between two Chinas – the entrepreneurial, market-driven rural China vis-à-vis the state-led urban China."[13] He argues that the shift towards a Shanghai-centered 'crony capitalism' under the tenure of Jiang Zemin and Zhu Rongji, as opposed to rural private entrepreneurship, had significant deleterious consequences for broader social welfare. Victor Shih emphasizes the policymaking struggles between political factions rooted in the central and provincial government hierarchies, arguing that their priorities in dispensing political patronage and accumulating bureaucratic power respectively drive inflationary cycles at the same time as hindering financial reform and efficiency.[14] Carl Walter and Fraser Howie adopt a simple state-market binary, arguing that the process of debt restructuring and banking reform in the late 1990s and 2000s has both concealed and contributed to the fundamental weakness of China's financial system.[15]

Each of these studies is an empirically rich and sophisticated account of financial reform in the 1980s and 1990s, however none provides a satisfying means for understanding where these institutionally rooted interests and preferences derive from. Huang's analysis has little definitive to say beyond the observation that Jiang Zemin and Zhu Rongji both hailed from Shanghai, and thus the 'great reversal'[16] was due to a shift in power to Shanghai-based technocrats who emphasized state-led development. Shih's argument rests upon the internal logic of bureaucratic power maximization, arguing that major decisions to enact reform in the

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[12] Mark Blyth, "Political Economy: An Approach to Comparative Analysis or a Subfield within a Subfield? ," in *Comparative Politics: Rationality, Culture, and Structure*, ed. Mark Irving Lichbach and Alan Zuckerman (Cambridge, UK: Cambridge University Press, 2009).

[13] Yasheng Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State* (New York, NY: Cambridge University Press, 2008).

[14] Victor Shih, *Factions and Finance in China: Elite Conflict and Inflation* (Cambridge, UK: Cambridge University Press, 2008).

[15] Carl Walter and Fraser Howie, *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise* (Singapore, SG: Wiley & Sons, 2011).

[16] Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State*, 109.

financial system are to be explained by the desire of elites to enhance their factional standing and strengthen their power base. Yet it remains unexplained why the goal of economic growth, and the use of the financial system in order to achieve it, continued to constitute the means of securing legitimacy, authority, and power within the policy-making process and the political economy more broadly. Shih's account provides a partial explanation of the political elites using the financial system to gain and preserve political power, however not why it might be necessary for political power to remain premised on the ability to maintain headline economic growth, and to preserve the politico-economic institutions that would enable it. Indeed, "even if we choose to believe that the power struggle in China is more a political game than an ideological debate it is worth noting that the widely accepted way to exercise power in this political game is through ideological debate."[17] Accordingly, one must turn to a deeper stratum of analysis in order to understand the social, discursive, and ideological foundations of China's economic development.[18] Particularly, the question of whether the logic of bureaucratic power maximization could suffice to obstruct the re-orientation of financial policy towards a more sustainable path of development remains open,[19] however the analysis developed in the current

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[17] Tu Weiming, *Way, Learning and Politics: Essays on the Confucian Intellectual* (Albany, NY: State University of New York Press, 1993), 175. As Misra argues, "the interaction between ideas, ideology, power conflicts, and policy formation is much more complex than is conceded by the power-interest and bureaucratic politics approaches." Kalpana Misra, *From Post-Maosim to Post-Marxism: The Erosion of Official Ideology in Deng's China* (London, UK: Routledge, 1998), 8.

[18] The role of factions in the development of economic policy is one revolving around debates and tensions that are in fact only sub-debates: hidden below the surface level of these power struggles in fact resides a larger debate, the resolution of which has provided the foundation for 'stable reciprocal expectations' and understandings that have given rise to the unique brand of capitalism in China whose origins and consequences we are only now beginning to more fully understand. Accordingly, this study seeks to probe not just the differences but more importantly the *similarities* between factions, personalities, perspectives on reform, rather than characterizing the policy debates as involving fundamentally opposed notions of reform and development against each other.

[19] As Chin has argued, the factional politics model is much less convincing in explaining economic policymaking from the late 1990s onwards than it was in the era of the dominance of the revolutionary old guard generation that lasted until the death of Deng Xiaoping in 1997. Gregory Chin, "Understanding Currency Policy and Central Banking in China," *The Journal of Asian Studies* 72:3 (2013): 519-38, 525.

study casts doubt on the plausibility of it comprising the sole or even primary basis for the continued logic of economic growth maximization.[20]

Beyond these two studies, the most comprehensive account of financial development in the 2000s that draws a connection between the path of reform and its underlying political rationale does not attempt to do so in a rigorously academic manner. Walter and Howie argue that the process of debt restructuring and banking reform both conceals and betrays the fundamental weakness of China's financial system.[21] Yet it remains trapped within the assumption that the transition to a liberalized, commercialized, market-oriented financial system is the only means by which to assure both a sustainable and equitable path of financial development. The failure of China's leaders to undertake such reforms is ascribed neatly to ministerial turf-wars and bureaucratic stalemate, thereby providing a rather inadequate analysis of the political economy of China's financial reform. These accounts do not provide adequate explanations of why significant reform and rapid economic growth did in fact take place, but was neither the product of an effective depoliticized technocratic state, nor the smooth operation of free liberal markets. It is increasingly clear that change in China's political economy, and *especially* within China's financial sector, is not predicated on a teleological conception of a system that resembles a liberal market democracy.[22] As I emphasize throughout this thesis, a near-exclusive focus on the net losers and the net winners in the political economy of reform has deflected attention from considered analysis of what kind of market economy that reform is directed towards.

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[20] As I discuss in the final chapter, the ways in which we are just now beginning to see evidence of a reorientation of this discourse of economic growth maximization is an important topic for future research.

[21] Walter and Howie, *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise.*

[22] As this thesis illustrates, commencing any analysis of Chinese political economy with the World Bank's nine components of what is "generally considered to constitute a comprehensive reform program" is bound to lead one in a problematic direction from the outset. See Joel Hellman, "Winners Take All: The Politics of Partial Reform in Postcommunist Transitions," *World Politics* 50:2 (1998): 203-34.

Re-assessing The Political Economy of Finance in China: Three Themes

We thus remain confronted by the challenge of understanding why rapid and stable economic growth coincided with the concentration of politico-economic power and therefore access to credit finance. This produced cleavages both in socio-economic opportunities at the micro-level, as well as related imbalances in the macro-level trajectory of economic growth. Further, we are faced with the question of how the financial system, as the sector most critical to determining the overall path of economic development, was utilized as a basis for orienting China's socio-economic development in this manner and not towards sustainable and broad-based growth. Not only are these two questions—that of why economic growth crowded out every other objective, but that of how the financial system enabled this to happen—fundamentally intertwined, but they demand a reconfiguration of our understandings of the factors driving a particular path of socio-economic development in China, and how the role of the financial sector is central to this developmental trajectory.

In this section I address three central issues: first, *why* China's reform experience provokes us to reassess the roles of state and market in the process of capitalist development. Second, *how* this re-assessment may be undertaken by probing the economic sociology of financial intermediation as a mechanism of determining the quantity and direction of capital flows. Third, it presents a theory of *what* this mechanism looks like in reform-era China, bringing into play the role of the CCP not just as a formal organization, but as a cognitively framed, institutionally sophisticated, and highly networked set of mechanisms for coordinating and controlling the flow of capital throughout the political economy.

Why: Beyond States and Markets

The majority of existing analyses of China's financial system view the Chinese political economy as embodying a state of mutual antimony between an interventionist state and a competitive market.[23] State intervention is either praised as an effective developmental mechanism, or it is condemned as a harmful obstacle to an efficient set of market mechanisms. Yet these categories of analysis are an unsatisfying basis for understanding any particular given process of development as embedded within a historically contingent social order.[24] One of the central objectives of this thesis is to provide an alternative to this conceptual antimony, by pointing to the way in which *capitalist* economic development—as distinct from some timeless and ahistorical conception of either *state-led* or *market-led* development—rests upon contingent foundations that are both socially embedded and historically situated. Such social embeddedness enables actors straddling 'the public' and 'the private'—thus fusing together the state and the market—to coordinate social action in ways that can produce dynamic economic growth, yet also produce a concentration of power over how that growth takes place, and whom it benefits. This social embeddedness can be seen reflected in the role of the CCP in China's political economy.

An orthodox 'competitive markets perspective' account of China's banking reform generally traces the gradual uncoupling of the banking sector from direct state control, arguing for the incompleteness of this process of graduating from state-directed lending to profit-driven capital allocation.[25] Rooted in a linear and unidirectional market transition theory,[26] the competitive markets perspective assumes that increasing marketization, consolidation of

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[23] Giving rise to such concepts such as a 'partial reform equilibrium' that have underscored studies discussed above such as those by Huang, Shih, and Walter and Howie. ———, "Winners Take All: The Politics of Partial Reform in Postcommunist Transitions".

[24] As Streeck asserts, "capitalism must be studied, not as a static and timeless ideal type of an economic system that exists outside of or apart from society, but as an historical social order that is precisely about the relationship between the social and the economic—a social order that came into its own in Western Europe in the early nineteenth century and has been continuously evolving since." Wolfgang Streeck, "How to Study Contemporary Capitalism?," *European Journal of Sociology* 53:1 (2012): 1-28, 3.

[25] Charles Kwong, "China's Banking Reform: The Remaining Agenda," *Global Economic Review* 40:2 (2011): 161-78; Nicholas Lardy, *China's Unfinished Economic Revolution* (Washington, DC: Brookings Institution, 1998); Minxin Pei, "The Political Economy of Banking Reforms in China, 1993-1997," *Journal of Contemporary China* 7:18 (1998): 321-50; ———, *China's Trapped Transition: The Limits of Developmental Autocracy* (Cambridge, MA: Harvard University Press, 2006); Walter and Howie, *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise.*

[26] Victor Nee, "A Theory of Market Transition: From Redistribution to Markets in State Socialism," *American Sociological Review* 54:5 (1989): 663-81.

property rights, and the assumption of financial risk by private actors within the financial sector will deliver greater economic efficiency and greater social equality.[27] Much of this literature on the role of the financial system in affecting the path of socio-economic development focuses upon the relationship between financial liberalization and economic growth,[28] and evidence of the positive correlation between the two.[29] However as a result of this focus, such approaches approach the paradox of China's development by addressing only two cells of Table 1.1: growth-generating competition on the part of private actors, and growth-retarding corruption or monopoly on the part of public actors.[30] The existence of effective state capacity, and the financial elites that underpin it, are regarded as epiphenomenal at best, and as accentuating corruption and vested interests at worst.

Table 1.1: Conceptions of Chinese economic development

	Driver of Growth	**Driver of financial discrimination**
Economic Entrepreneurship (Competitive Markets)	Competition	Rent-seeking / Corporate Monopoly
Bureaucratic Technocracy (Developmental State)	Developmentalism	Corruption / State Monopoly

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[27] These perspectives rely upon the McKinnon-Shaw Hypothesis which held that common instances of government intervention in the financial sector, such as interest rate control and directed credit, generated financial repression that constituted a fundamental obstacle to economic growth in developing countries. For notable and influential examples, see Lardy, *China's Unfinished Economic Revolution*; K W Li, *Financial Repression and Economic Reform in China* (Westport, CT: Praeger, 1994); Xiaoping Xu, *China's Financial System under Transition* (Basingstoke, UK: MacMillan, 1998).

[28] Edward Shaw, *Financial Deepening in Economic Development* (New York, NY: Oxford University Press, 1973); Ronald McKinnon, *Money and Capital in Economic Development* (Washington, DC: The Brookings Institution, 1973).

[29] Ross Levine, "Finance and Growth: Theory, Mechanisms, and Evidence," in *Handbook of Economic Growth*, ed. Philippe Aghion and Steven Durlauf (London, UK: Elsevier, 2005); Noriel Roubini and Xavier Sala-i-Martin, "Financial Repression and Economic Growth," *Journal of Development Economics* 39(1992): 5-30.

[30] Thomas Bernstein and Lü Xiaobo, *Taxation without Representation in Contemporary Rural China* (Cambridge, UK: Cambridge University Press, 2003); Lü Xiaobo, *Cadres and Corruption* (Stanford, CA: Stanford University Press, 2000).

Alternative accounts of China's banking and financial reforms, under the label of the 'developmental state perspective', dispute that China's financial sector has necessarily performed in such a sub-optimal manner as is commonly argued. The developmental state perspective also places analytical emphasis upon only two of the cells of the table, however conversely this time it is active state developmentalism that is viewed as largely responsible for facilitating such rapid economic growth.[31] These perspectives are problematic because they are each characterized by the assumption that the institutions of the market and the state are inherently driven by distinct logics of action, leading them to unjustified predilections for either emphasizing the negative (the competitive markets perspective) or the positive (the developmental state perspective) outcomes of a state-controlled and financially repressed banking sector. The analytic paradox that emerges at the nexus of financial reform, social inequality, and economic growth is that these accounts leave untouched the question of why political actors are presumed to play two roles simultaneously: that of pragmatic and disciplined developmental authority as well as rent-seeking and power-maximizing profit-seeker.

Jettisoning these assumptions involves a recognition that even as the integration of global production and the transnationalization of financial activity has brought 'transitional' and 'developing' countries firmly within the realm of the global capitalist system, the experience of reform-era China serves as a clear reminder that the processes of capitalist production can take place through socio-culturally variegated and historically contingent institutional structures. As Breslin observes, financial systems and their impact upon economic development cannot be assessed as objectively given and structurally homogeneous, but rather reflect not only the interests of their creators as well as the social understandings that surround them:

[31] John Knight, "China as a Developmental State," *The World Economy* 37:10 (2014): 1335-447.

> Financial systems and structures do not just emerge. They are constructed to serve specific ends. … [F]inancial reform in China is a study of an attempt to build a new financial system to serve new ends, … shaped by and contingent on how the leadership manoeuvres between conflicting demands, and conflicting imperatives.[32]

As such, capitalism is a constellation of logics of action and cognitive dispositions, not a set of pre-ordained economic arrangements that may be deductively conceived and assessed in a reductionist manner.[33] Consequently, whilst the ideas and practices of capitalism transform those societies with which they come into contact, the historical lineages and cultural norms of societies in turn have profound consequences for the basis upon which capitalist ideas and practices become manifest in social and productive arrangements.

This opens up the possibility of exploring an alternative perspective that recasts the political economy as displaying significant functional similarities between the institutions of the state and the market.[34] On this view, China's banking sector constitutes a set of both discursive and structural institutions that fuse together state and market actors, embodying a substantially different confluence of rationalities than either that of a commercially-oriented system of intermediation premised on the underlying stability and efficiency of profit-seeking market actors, or of a banking sector rationally engineered by a group of wise and visionary bureaucrats. As observed by one prominent private sector commentator,

> There are two clearly opposing camps in China's economic circle regarding the role of government. The first objects to government intervention and stresses the role of free-market mechanisms. The second believes in the unique advantage of a strong government in driving growth. … What is strange, however, is that the two don't actually fiercely disagree but, rather, appear to be in remarkable accord over long-term economic issues.

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[32] Shaun Breslin, "Paradigm Shifts and Time-lags? The Politics of Financial Reform in the People's Republic of China " *Asian Business & Management* 2:1 (2003): 2003.

[33] As Streeck points out, "attempts to theorize capitalism as a social formation tend to suffer from an unfortunate legacy of economic reductionism." Wolfgang Streeck. "Taking Capitalism Seriously: Toward an Institutionalist Approach to Contemporary Political Economy". *MPIfG Discussion Paper Series 10/15*. Cologne, DE: Max Planck Institute for the Study of Societies, 2010.

[34] The way in which state and market are fused together under different forms of authority in capitalist political economy is explored further in Chapter Two.

> Both adopt the same language; such as 'adjust the structure' and 'change the economic growth model'.[35]

In circumstances where such ambiguity exists as to the role of a state-controlled banking sector, it is not enough to re-tell the story of banking reform in China as simply one of state-rooted bureaucratic politics, or of the inexorable pull of market forces. Rather, one must question the timeless quality of these concepts and the largely reified analytic weight that is placed upon them. As the second chapter of this thesis makes clear, this begins with placing the current dynamics of Chinese financial reform in the context of a historical process of economic development in which the relationship the state, the market, and their relationship to patterns of power and authority held different meanings, which were utilized for different purposes. Only upon this basis, does it become feasible to undertake a more fundamental *conceptual re-description* of the financial landscape of contemporary Chinese capitalism and its role within the broader transnational political economy, an objective that resides at the heart of this study.

How: Reconceiving Financial Governance

The political economy of financial governance in circumstances where the dividing lines between state and market are blurred challenges us to grapple more concretely with the question of how logics of economic growth and activity are generated, implemented, and reinforced. Rather than attempting to describe these logics with reference to the 'rationality' underpinning the 'institutions' of the state or the market, it becomes necessary to analyze them in terms of their particularly capitalist nature.[36] They are both historically contingent and socially variegated, and accordingly must be theorized as such: as dynamic and constantly in flux. In this way, it becomes

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[35] Edward Ding, *South China Morning Post*, 28 January 2012.
[36] Streeck, "Taking Capitalism Seriously: Toward an Institutionalist Approach to Contemporary Political Economy," 30.

possible to begin to develop the micro-foundations of an institutionalist approach to the study of financial governance through the reconceptualization of the role and structure of the financial system in China, and its theoretical reconstruction around the concept of a financial risk environment.

In China's case, the concentration of assets within the banking system means that credit intermediated through banks, and financial institutions associated with the banks, plays an integral role in determining the rate of economic growth. The implications of this 'deep but narrow'[37] financial profile are reflected in the observation that "China is an extremely credit-dependent economy. Without the role of credit finance, the China growth story would not have been possible."[38] This growth has been dependent upon investor confidence—the belief that investments can be made and financial risks assumed with the expectation of making sufficient profit to offset that risk. As Akerlof and Shiller point out:

> The very meaning of trust is that we go beyond the rational. Indeed the truly trusting person often discards or discounts certain information. She may not even process the information that is available to her rationally; even if she has processed it rationally, she still may not act on it. She acts according to what she trusts to be true.
>
> If this is what we mean by confidence, then we see immediately why, if it varies over time, it should play a major role in the business cycle. Why? In good times, people trust. They make decisions spontaneously. They know instinctively that they will be successful. They suspend their suspicions. Asset values will be high and perhaps also increasing. As long as people remain trusting, their impulsiveness will not be evident.[39]

Providing a financial risk-minimal environment is thus critical for economic growth and the level of financial risk is a significant determinant of economic activity. As risk increases, activity decreases, and vice-versa. This risk can be managed within the financial system either through

[37] Naughton, *The Chinese Economy: Transitions and Growth.*

[38] BJ:2012.12.14. Interview, Beijing.

[39] George Akerlof and Robert Shiller, *Animal Spirits: How Human Psychology Drives the Economy, and Why it Matters for Global Capitalism* (Princeton, NJ: Princeton University Press, 2009), 12-13.

the use of hedging and diversification (ie. securitization) within financial markets,[40] or through the use of implicit or explicit guarantees. The use of government guarantees of loans and credit is an effective method of managing uncertainty when financial market freedom either fails or is not permitted. This model of risk management has underpinned growth in China to the extent that one banker summarized pithily, "moral hazard is state policy."[41]

This role of the financial system as a tool for economic growth dovetails with its role as a tool for political authority. Under a system of central planning, the dependence of individuals and organizations upon the central government for all of their financial and material needs deprives them of political influence, however it eliminates risk and thus generates security.[42] With the assumption of risk however also comes influence. When an actor is exposed to risk through their investment in a particular project or enterprise, they demand an opportunity to have some voice in how the material dividends of that project will be distributed. By assuming the ultimate financial risk of its development strategy, the CCP maintains the ability to centralize control and authority over how the benefits, and the costs, of growth are distributed. This retention of power within the networks and institutional structures of the CCP itself has generated its capacity to remain the indispensable political core of an expanding, vibrant, and increasingly commercialized market economy.

The institutional reorientation of China's financial system towards the prioritization of economic growth over social egalitarianism therefore cannot be understood exclusively as the commercialization of lending practices, and/or as a process of structural liberalization to open

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[40] For an exploration of how markets themselves can offer investors and entrepreneurs the necessary relative security in which to conduct economic exchange under conditions of risk uncertainty, see Harrison White, *Markets from Networks: Socioeconomic Models of Production* (Princeton, NJ: Princeton University Press, 2002).

[41] BJ:2012.11.29 #5. Interview, Beijing.

[42] Bruce Dickson, *Red Capitalists in China: The Party, Private Entrepreneurs, and Prospects for Political Change* (Cambridge, UK: Cambridge University Press, 2003).

up the system to private capital. Nor should it be understood exclusively as retrenching state-controlled entities as the beneficiaries of directly political exchanges. Rather, the economic and political functions of the financial system conjoin such that the increasingly commercialized structure of the financial system, and the increasingly rationalized activities of financial institutions are directed towards strengthening not just the market economy, but a market economy over which the CCP ultimately remained 'paramount leader', with the ability to 'bang the table' [拍桌][43] and end the discussion. Reconceiving the financial system in this way obviates the debate as to the link between financial liberalization and economic growth, concerning the question of whether economic growth occurs because of state control or despite it. The specific issue of state control does not necessarily have such a decisive influence upon economic growth, since if the conditions exist that motivate a society to prioritize economic growth, then it can take place with an emphasis upon deploying capital via socio-economic institutions that may be oriented towards either private or public ownership and control. The desire of the CCP leadership to prioritize economic growth whilst maintaining political control prompted the attempt to manage risk and support growth through paths of reform other than financial market liberalization.

What: A Theory of the Party

As the preceding two sections have detailed, the state and the market are concepts that each take on different meanings and roles within any given historical social order. In the context of financial governance, they each play a role in determining the dynamics of macroeconomic

[43] This derives from the traditional characterisation of China's 'paramount leader' as the 'core' of the CCP, willing to enter into discussions with others, but ultimately wielding the prerogative of final, and sometimes arbitrary, decision-making power.

stability and microeconomic efficiency, but they are not determinative. Rather, it is authority over how socio-economic uncertainty is assessed, and financial risk managed, that produces these socio-economic outcomes, and these patterns of authority are historically contingent and socially embedded constructs. In this light, the CCP can be theorized as the response to a universal imperative for generating socio-economic order in a uniquely Chinese socio-economic context. The conception of the CCP that I develop and utilize throughout this thesis is comprised of an array of frames, institutions, and networks that address this imperative. It can be distinguished accordingly from either the state or the market *per se*, since the CCP corresponds neatly to neither of these, but rather is to be conceived as one unique case of *governance*—the use of different social mechanisms to manage economic and political forces such that they neither overwhelm nor dominate one another.[44] At the core of these economic and political forces resides the problem of uncertainty, and it is the challenge of confronting and managing this uncertainty—of generating and modulating the social structures that enable decision-making under conditions of uncertainty—that the CCP provides a means of addressing. Far from remaining institutionally static and ideologically inert,[45] the CCP has formed an institutionally sophisticated, ideologically robust, and highly networked structure located at the nexus of state governance and regulation, and the market-active institutions of finance and capital. At different levels of analysis, I identify how the historical and cultural factors specific to the Chinese experience of socio-economic development have contributed to the characteristics and function of this risk environment, and how it provides a mechanism capable of fulfilling the otherwise potentially competing objectives of the CCP: legitimacy and control.

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[44] For a critique of the concept, discourse, and practice of 'governance', see Claus Offe, "Governance: An Empty Signifier?," *Constellations* 16:4 (2009): 550-62, 550.

[45] Many scholars and commentators presumed that institutional change in the CCP was inevitable during the 1990s, however the presumed inevitability was that of a more 'democratic and pluralistic' form of government, rather than a series of institutional innovations that would at once preserve CCP rule as well as avoid provoking further social turmoil. See Frank Pieke, *The Ordinary and the Extraordinary: An Anthropological Study of Chinese Reform and the 1989 People's Movement in Beijing* (London, UK: Kegan Paul International, 1996), 3.

Approaching the study of China's political economy in this manner therefore does not directly challenge other theories of behavioural decision-making in contemporary China. Accounts of China's reform trajectory derived from concepts of the developmental state, models of bureaucratic power politics, complementarities of institutional design, or bargaining dynamics of central-local relations each offer useful insights into China's historical and current path of development. However, if the goal is instead to explain not just economic growth and macroeconomic stability, but also the broader question of how these dynamics are embedded in a longer-run trajectory of socio-cultural and politico-economic evolution, then it is necessary to develop a dynamic theory that could "capture the forces producing change in the system."[46] In his attempt to do more than simply provide a static description of that system, Oksenberg could do little more than point to idiosyncratic and ad hoc factors that were "generating an evolution of the system, but in an incoherent and uncoordinated fashion," concluding that "increasingly, the system has a disjointed, byzantine quality to it."[47] In developing a theory of the CCP, the goal is therefore not to supplant entirely other frameworks of Chinese political economy, but to generate a greater analytic coherence to the diverse multitude of factors that are driving China's political economy.

As I explore in the second chapter, the role of the CCP emerges out of a historical social order, the 'rationality' of which has been largely occluded in both the historiography of economic development, as well as the theoretical architecture of contemporary political economy. Zheng Yongnian has labelled the CCP the 'organizational emperor', the nature of which as *socio-culturally embedded* has been downplayed as either epiphenomenal or analytically residual in the study of the

[46] Michel Oksenberg, "China's Political System: Challenges of the Twenty-First Century," *The China Journal* 45(2001): 21-35, 28.

[47] ———, "China's Political System: Challenges of the Twenty-First Century", 28.

state and the market from a Western politico-economic perspective.[48] I disclaim that China's contemporary socialism is essentially just the most recent incarnation of the country's age-old tradition of absolutist state power,[49] but argue for the need to adopt a dialectical approach to the rise of the CCP and the patterns of political authority it has come to exist at the centre of. That is to say, neither the cultural-philosophical foundations of Confucianism that had underpinned imperial rule since 221 BC,[50] nor a transplanted system of political thought giving rise to a largely endogenous organizational dynamic of CCP rule, should be seen as exclusively responsible for the structuring of contemporary Chinese politics.[51] Rather, the CCP reflects the deep rootedness of *Chinese* modernity within the enduring social orders that have and continue to characterize Chinese society and culture.

Out of this conception of the CCP emerges an alternative means of telling the story of China's financial reform. Rather than pitting mutually opposed logics of the state and market against each other, this thesis offers an account of economic growth, of financial stability, and of the concentration of political power as the product of what makes society and the political economy hang together, even if only in temporary and unstable constellations of interests and power. In this narrative, reform-era China has been marked by a series of socio-historically contingent critical junctures that instilled and then retrenched economic growth as a fundamental policy priority, and precipitated the construction of a risk environment that would not only enable economic growth and political authority to co-exist, but would in fact produce a self-reinforcing relationship between a discourse of economic growth and a discourse of stable social

48 Zheng points towards the rootedness in Chinese culture of the CCP's functional characteristics. Yongnian Zheng, *The Chinese Communist Party as Organizational Emperor: Culture, Reproduction and Transformation* (Abingdon, UK: Routledge, 2010).

49 See Marc Blecher, *China Against the Tides: Restructuring Through Revolution, Radicalism, and Reform* (London, UK: Continuum, 2003), 1.

50 John K Fairbank and Merle Goldman, *China: A New History* (Cambridge, MA: Belknap Press of Harvard University Press, 2006), 51-53.

51 A similar argument is made by Arif Dirlik with respect to the dialectical interplay of ideology and organization in the formation of the CCP's formation in 1921, following the Russian Revolution of 1917 and the May Fourth Movement of 1919. Arif Dirlik, *The Origins of Chinese Communism* (New York, NY: Oxford University Press, 1989).

development and progress under the political leadership and authority of the CCP. In the aftermath of the political and ideological turmoil of both the Cultural Revolution and the societally traumatic repression of the 1989 protest movements, economic growth came to be viewed as the primary, if not sole, basis for legitimacy. The opening of China's economy during the 1990s, combined with the 1997 Asian Financial Crisis (AFC) came to reinforce this particular political logic of economic reform,[52] and despite the deepening of fundamental imbalances within China's economy during the 2000s, the intertwining of political and economic objectives further propelled efforts to 'build' [建设], 'strengthen' [加强], and 'perfect' [完善] this CCP-centered risk environment, even as economic and financial reform proceeded apace.[53] Accordingly, economic activity has flourished but at the heart of this growth has been the deployment of capital in a particular manner, one that enfolds the power of capital within the political structure.

Reflections on the Research Agenda

As the foregoing sections seek to make clear, the transformation of China's financial sector provides an opportunity for the re-examination of a number of theoretical issues concerning the political economy of capitalism, and particularly, the manner by which the imperatives of political, social, and economic reproduction in the realm of transnational capital are arranged in malleable institutional configurations and dynamics. The motivation for probing the sociological role of the CCP arose inductively from early discussions in the field amongst academics and bankers in Beijing, when it rapidly became apparent that in order to understand the role of the

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[52] Cf. Susan Shirk, *The Political Logic of Economic Reform in China* (Berkeley, CA: University of California Press, 1993).

[53] As Walter and Howie state, "with all aspects of banking under the Party's control, risk is thought to be manageable." Walter and Howie, *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise*, 25.

financial system in China, one must look beyond traditional notions of financial markets and state regulation, for the idea of finance in China is a much larger one, intimately tied to the broader dynamics of politics and power of China's development. Significant theoretical and empirical challenges consequently arose. It became necessary to develop an analytical framework that would remain faithful to the socio-cultural factors underpinning institutional development, whilst still enabling the specific features of the CCP role in China's political economy to be contextualized within broader theoretical debates concerning logics of rational action. Empirically, targeting the CCP as a subject of analysis, rather than problematically relying upon the 'state' and official organs of government as proxies for policymaking, political authority, and the exercise of power, would unsurprisingly generate further hurdles in terms of gaining access to empirical data, and eliciting information and insights from interview subjects. Nevertheless, it remained the case that I found considerable support—sufficient to encourage me to pursue such line of inquiry—in China amongst both research colleagues and interview subjects for an approach that sought to understood how members of the CCP, residing as they do now very much at the interstices of the state and the market, have been driven at once by the imperatives of maintaining national development, of preserving organizational integrity of the CCP itself, and their own personal interests.

Given the paucity of research on the sociological role of the CCP in China's political economy, the thesis undertakes exploratory research objectives, combining elements of theory building and theory testing.[54] In order to achieve such objectives, I adopt a reiterative inductive and deductive approach, identifying how particular features and dynamics of China's politico-economic development provide a basis for drawing conceptual conclusions regarding the drivers and causes of particular socio-economic outcomes. The objective of such analyses, as Lai

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[54] Alexander George and Andrew Bennett, *Case Studies and Theory Development in the Social Sciences* (Cambridge, MA: MIT Press, 2005), 75.

observes, "is not to extrapolate representations to a larger population, but to use these cases to demonstrate the conceptual underpinnings of [the] study."[55] This allows for a much closer and detailed recognition of the interdependence of subject and object in social systems,[56] reflecting how "the idea of isolating factors as independent variables may be an ontological fallacy."[57] The disclaiming of an analytical method identifying strict causal mechanisms based on specific independent and dependent variables does not preclude an empirically grounded and rigorous explanation of the dynamics of the global political economy. Wendt has disputed that explanatory power is monopolized by those engaged in strict causal analysis, arguing instead for the potential of constitutive analysis, involving the asking of 'how' and 'what' questions, rather than 'why' questions.[58] This approach involves a rejection of methodological reductionism. Accordingly, the research involved in this thesis is highly inductive, and regards theory as fulfilling two functions. Firstly, it aids in the development of a heuristic framework that guides the conduct of empirical investigation. Secondly, it offers the promise of a conceptual vocabulary with which to describe the results of this empirical investigation. The model is intended to be explanatory, but not in a sense of identifying the strict causal logics of social reproduction. Rather, it is an attempt to provide an outline of the 'mechanisms'[59] through which social contextual factors affect the micro-level exercise of rationality, and vice-versa.

This emphasis upon description of the mechanisms of social development, rather than the identification of cause and effect in the process of social development, derives from the

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55 Karen Lai, *Approaches to 'Markets': The Development of Shanghai as an International Financial Centre* (Doctoral Dissertation, University of Nottingham, 2007), 117.

56 Mark Blyth, "Ideas, Uncertainty, and Evolution," in *Ideas and Politics in Social Science Research*, ed. Daniel Béland and Robert Henry Cox (Oxford, UK: Oxford University Press, 2011), 100.

57 Orion Lewis and Sven Steinmo, "Taking Evolution Seriously in Political Science," *Theory in Biosciences* 129:2-3 (2010): 235-45, 240.

58 Alexander Wendt, "On Constitution and Causation in International Relations," *Review of International Studies* 24:5 (1998): 101-18.

59 For a description of mechanisms as the "nuts, bolts, cogs and wheels" of social scientific inquiry, see Jon Elster, *Nuts and Bolts for the Social Sciences* (New York, NY: Cambridge University Press, 1989), 3. See also Peter Hedström, *Dissecting the Social: On the Principles of Analytical Sociology* (Cambridge, UK: Cambridge University Press, 2005).

inherent intersubjectivity of social action. An actor's behaviour—whether individual or another social entity—is not exclusively attributed to its inherent characteristics or motives, but to its interaction with social context of which their individual presence forms one part. Thus, as Schneiberg and Clemens note, "individual action derives from scripts or schemas drawn from shared cultural systems."[60] Sociological institutionalism holds that both individual actors and collectivities are "as much the embodiment of the prescriptions of the available cultural forms as they are the aggregation of lower-level units and interests."[61] However, if causal mechanisms are at work within intersubjectively generated institutional settings, with effects discernible not only laterally at the same level of collective organization, but also generating both 'trickle-up' and 'trickle-down'[62] effects upon higher-order social structures and individual human agents respectively, the difficulties posed for the possibility of identifying clear causal mechanisms are significant and not easily ignored. Agency and structure are mutually re-iterative. This call for a holistic perspective in the description and analysis of the Chinese political economy is however not easily satisfied. Given the heterogeneity of scholarly views as to the nature of Chinese economic and financial development, all of which possess some degree of empirical support, one consequence, as Fligstein and Zhang note, is "the lack of systematic, overarching theoretical thinking about what is happening."[63] Ultimately, through the development of such a systematic, overarching conceptual heuristic framework, this thesis seeks to capture, even in general terms, aspects of rationality that are unduly silenced within orthodox accounts of rational action in the political economy.

[60] Marc Schneiberg and Elisabeth Clemens, "The Typical Tools for the Job: Research Strategies in Institutional Analysis," *Sociological Theory* 24:3 (2006): 195-227, 195.

[61] John Meyer, George Boli, and Francisco Thomas, "Ontology and Rationalization in the Western Cultural Account," in *Institutional Environments and Organizations: Structural Complexity and Individualism*, ed. W. Richard Schott and John Meyer (Thousand Oaks, CA: Sage, 1994), 15.

[62] See Marie-Laure Djelic and Sigrid Quack, eds., *Globalization and Institutions: Redefining the Rules of the Economic Game* (Cheltenham, UK: Edward Elgar, 2003).

[63] Neil Fligstein and Jianjun Zhang, "A New Agenda for Research on the Trajectory of Chinese Capitalism," *Management and Organization Review* 7:1 (2011): 39-62, 41.

In undertaking this task, it is necessary to remain mindful of the distinction between model and reality. Models are not the reality, but rather, one of the main tools by which it is possible to identify the interesting questions in a particular context. Bourdieu's distinction between "the things of logic," and the "logic of things" informs this view.[64] Models are logical constructions about how 'things' fit together; our research is about how things actually do or do not fit together in a messy empirical reality. By exploring the gap, the logic of systems is left behind, and the realm of action as played out in history with all its elements of contingency, indeterminacy, and unpredictability is entered.[65] Kristensen summarizes the potential of the modeling process, stating that,

> This style of doing research might come to play a significant role if, in the future, social sciences begin to aspire more to understand how societies construct themselves as complex, systemic worlds, to integrate micro observations with macro-synthesis, and to a more cumulative view of knowledge formation based on induction, rather than simply wanting to deconstruct and tear apart universalistic prejudices or deductively reinforce them with poor reference to what is going on in the world.[66]

In seeking to do this, analysts of the institutional settings of capitalist activity must avoid dogmatism in attempts at synthesis, modeling or typologizing. Kristensen warns against a belief that "there are only a few (ideal typical) models of capitalism that are viable in practice, and that this viability is dependent on the internal coherence of these capitalisms as 'real-type' systems."[67] An emphasis upon dissolving the analytical reification, on one hand, of the territorial and social boundaries of the nation-state, and on the other, of the politico-economic categories of the state and market, whilst still retaining consideration of their empirical salience, provides an

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[64] Pierre Bourdieu, *Practical Reason: On the Theory of Action* (Cambridge, UK: Polity Press, 1998). Cited in Peer Hull Kristensen, "Modelling Business Systems and the Civilizing Process," in *Changing Capitalisms? Internationalization, Institutional Change, and Systems of Economic Organization*, ed. Glenn Morgan, Richard Whitley, and Eli Moen (Oxford, UK: Oxford University Press, 2005).

[65] Glenn Morgan, "Introduction: Changing Capitalisms? Internationalization, Institutional Change, and Systems of Economic Organization," ibid., 4-5.

[66] Peer Hull Kristensen, "Modelling Business Systems and the Civilizing Process," ibid., 385.

[67] ———, "Modelling Business Systems and the Civilizing Process," 386.

opportunity to avoid this false reinforcement of the ideal-typical notion of capitalism as a system of markets set within a system of states.

Given the ontological perspective in which the study is grounded, it is a challenge to connect individual and micro-level social phenomena, such as the development of particular attitudes and normative worldviews, to macrohistorical phenomena such as the development and impact of China's banking sector. It recognizes that "to identify the process, one must perform the difficult cognitive feat of figuring out which aspects of the initial conditions observed, in conjunction with which simple principles of the many that may be at work, would have combined to generate the observed sequence of events."[68] Process-tracing through an in-depth exploratory case study is therefore the most adequate tool for providing an overarching framework[69] for describing and explaining the way in which the empirical elements of social action within the case at hand, perceived through the theoretical heuristics, are linked together.[70]

The process of fieldwork and data collection took place over a period of the two years from April 2012 to April 2014. Firstly, I gathered interview data during an extended period of advanced language study and fieldwork from April 2012 to September 2013. As a visiting researcher at the School of Government at Peking University, and a visiting fellow at the Institute of World Economics and Politics at the Chinese Academy of Social Sciences in Beijing, I was able to use a 'snow-balling' method to conduct over 60 interviews with members of the Chinese financial elite. These interviews were conducted in both Chinese and English with

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[68] Jack Goldstone, *Revolution and Rebellion in the Early Modern World* (Berkeley, CA: University of California Press, 1991), 50.

[69] Charles Ragin, *The Comparative Method: Moving Beyond Qualitative and Quantitative Strategies* (Berkeley, CA: University of California Press, 1987).

[70] Previous studies of the political economy of China's development have involved the use of such qualitative fieldwork strategies in order to understand how and with what meaning political and economic actors are constructing modes of governance in China. Yuenyuen An, *State, Market, and Bureau-Contracting in Reform China* (Doctoral Dissertation, Stanford University, 2009); Lai, "Approaches to 'Markets': The Development of Shanghai as an International Financial Centre; Maria Edin, *Market Forces and Communist Power: Local Political Institutions and Economic Development in China* (Doctoral Dissertation, Uppsala University, 2000).

individuals both working in and retired from the central ministries and regulatory agencies, the central bank, commercial banks including all of the 'big five' state-owned commercial banks, and a number of government think-tanks and universities. These semi-structured interviews lasted on average one hour, and generated direct insights and information as to the process of financial policy-making, the role of the CCP networks in the financial system, and the function of the legal and social institutions underpinning financial and economic activity in China. I returned to Beijing for a further period of four weeks in April 2014 in order to conduct further and follow-up interviews with a number of key individuals.

The interviews also provided a rich source of contextual information as to interpretations of concepts such as 'market freedom', 'socialist market economy', and 'financialization' in the context of China's modern financial system. In short, these interviews were undertaken in order to gain greater insight into how financial elites and policy-makers in China 'think' about the role of the financial system and of financial capital in socio-economic development. Accordingly, the interview process is intended to access the in-depth and interpretative views and experiences of individuals and institutions involved in Chinese banking practices and the process of banking reform within the broader process of economic development. This is particularly so in terms of the changing structure, purpose, and activities of the banking sector as integral to the efforts of Chinese policy-makers in securing their dual interests in retaining authority and control over the process of broader economic growth and development.

In addition to the data generated through these interviews, I rely upon a variety of primary and secondary materials as key sources of evidence for this thesis. These can be divided into three categories. First, economic and financial data collected from collections such as *CEIC China Economic Premium* and the *China Statistical Yearbook* [中国统计年鉴] (economic data at the national, provincial, and city-level) and the *Almanac of China's Finance and Banking* [中国金融年鉴] (financial sector data). Regulations, policies and decrees are found in sources such as *A Collection* *of Financial Regulations and Systems* [金融规章制度选编]. Second, the research is strengthened by consulting the Chinese secondary literature as well as media coverage of financial reform. This secondary literature includes a number of internal government journals that I was able to access whilst at the Universities Service Centre for Chinese Studies at the Chinese University of Hong Kong. These include *Financial Reference* [金融参考], *Financial Statistics and Analysis* [金融统计与分析], *Financial Research Report* [金融研究报告], *Internal Reference of Reform* [改革内参], and *Leader's Policy-Making Information* [领导决策信息]. The thesis also draws upon academic journal articles and monographs written by financial elites and policymakers. Finally, I make use of archival materials that include records of key thinkers and decision-makers such Wu Jinglian 吴敬琏, Xue Muqiao 薛暮桥, Chen Jinhua 陈锦华, Zhu Rongji 朱镕基, Dai Xianglong 戴相龙, Zhou Xiaochuan 周小川, and Yi Gang 易纲. These records provide significant assistance with tracing the path of reform within the financial sector and connecting ideas and discourses to policies and outcomes.

Synopsis of the Thesis

The thesis unfolds over six chapters. Chapter Two positions the current study of China's evolving capitalism in the broader context of China's historical politico-economic evolution, and the significance of the Braudelian distinction between a 'market economy' and a 'capitalist economy' for the study of contemporary political economy.[71] Underlying the current debate as to the nature of China's 'state capitalism' both in comparative and global context remains the

[71] See Giovanni Arrighi, *Adam Smith in Beijing: Lineages of the Twenty-First Century* (London; New York: Verso, 2008); R Bin Wong, *China Transformed: Historical Change and the Limits of European Experience* (Ithaca, NY: Cornell University Press, 1997).

challenge of better understanding the role of socio-political authority in underpinning different modes of economic development. I reassess the concept of rational action and argue that the Eurocentrism that dominated debates as to why China 'failed' to develop capitalism is the same Eurocentrism that has reified the conceptual state and market as the definitive analytic categories of Western political economy. This connects with the concerns outlined above as to the difficulties of reconciling China's contemporary economic transformation with the fact of its political system remaining firmly rooted in what some still conceive of as the 'pre-modern',[72] as well as retaining lineages of a decidedly modern socialist era. Thus, it is only by way of understanding contemporary capitalism as more than the various configurations of state and market institutions—as the broad literature surrounding varieties of capitalism would reduce it to—that China's otherwise highly paradoxical path of development can begin to be made sense of. More specifically, it opens up the theoretical space for conceptualizing the role of the CCP as an integral element of this evolving capitalist enterprise, a task that is undertaken in Chapter Three.

Chapter Three accordingly develops an analytic framework for understanding how the financial system underpins a particular path of politico-economic development. It first examines how the concept of uncertainty and its relationship to financial risk is fundamental to making socio-economic action possible, a process with both economic and political implications. The management of risk and uncertainty not only generates the potential for economic growth, but also contains the mechanisms for structuring that growth in particular ways. The chapter thus develops the concept of a 'risk environment', exploring how a particular risk environment has emerged out of the socio-cultural and historical resources available to Chinese actors. As a dynamic model of change and stability, the concept of the risk environment provides a

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[72] For example, Jonathan Spence, *The Search for Modern China* (New York, NY: Norton, 2013); Gilbert Rozman, ed. *The Modernization of China* (New York, NY: Free Press, 1981).

framework for tracing over time the underlying forces driving the reinforcement of dominant ideas, institutions, and networks, and also their disruption and evolution.

Chapters Four and Five trace the role of the financial sector in China's broader strategy and path of economic growth and development form 1990-2008. Chapter Four focuses on the period 1990-1997. The politico-economic retrenchment following the social protest movement and events in Tiananmen Square that unfolded in June 1989 would lay the basis for economic revitalization, but along lines very different from a liberal free-market ideal.[73] The chapter examines this legacy of neoconservative ascendancy in the aftermath of 1989, combined with Deng Xiaoping's successful reassertion of economic growth and development as the foremost economic, political, and social priority. Together, these laid the basis for a path of reform that combined an effort to increase the commercial effectiveness and rationality of the financial system with the reconsolidation of centralized political authority, and an upgrading of the political and ideological cohesion of the most significant and critical sectors of the political economy at the time; the banks and the state-owned industrial firms.

Chapter Five examines the process of financial reform and restructuring following the 1997 Asian Financial Crisis, during the process of WTO accession, and through to the unfolding of the 2008 global financial crisis. As China transitioned from what had been a position still of (relative) international isolation to (partial) integration with the global economy, it was necessary to develop a set of financial and macroeconomic policies that would support trade and attract investment. China's leaders therefore sought to construct an internationally oriented modern financial system, which for all appearances was now increasingly geared for competition with foreign banks both at home and eventually abroad. Yet, as would become apparent when

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[73] As is belatedly being more broadly recognized, 1989 was not just about Tiananmen—the social movement was nationwide and the events of 1989 were critical to reshaping the social identity and political milieu of the entire nation. See Louisa Lim, *The People's Republic of Amnesia: Tiananmen Revisited* (Oxford, UK: Oxford University Press, 2014).

financial crisis emanated from the US in 2008, the premise of reform during the 2000s had not been to replicate a Western financial system, but to transform the banking system into a more effective tool for achieving the broader politico-economic goals of the CCP. Reform was intensified, not in order to create more independent market forces, but rather to improve the market as a tool for the CCP.

The concluding Chapter Six returns to some of the questions raised in this introduction. It considers why, in the study of the intertwined processes of evolution in the global order and China's ongoing socio-economic transformation, it is both useful and necessary to study the role of the financial system in China's economic development, and in turn to study the role of the CCP in China's financial system. It points to some of the ways in which the arguments developed in this thesis will be important to future research into the reshaping of China's political economy and the global political economy in the aftermath of the global financial crisis. Finally, it draws out some of the implications of this thesis for the conceptual, theoretical, and methodological ways in which we approach the 'China question' in an era of flux and change in the global capitalist order.

II Ancient Markets, Modern Capitalism: The Political Economy of China's Financial Development in Historical Perspective

> [N]one of the standard models of economic and political theory can explain China. ... China still does not have well-specified property rights, town-village enterprises hardly resembled the standard firm of economics, and it remains to this day a communist dictatorship.[1]
>
> — Douglass North

> It is merely in the night of our ignorance that all alien shapes take on the same hue.[2]
>
> — Perry Anderson

Introduction: China and the Problem of the Longue Durée

The period of historical development that China experienced from the early nineteenth through the mid-twentieth centuries, in which domestic upheavals intertwined with foreign subjugation, occupies an outsized position in the social imaginary of contemporary China.[3] Particularly, these developments gave rise to the question as to why Chinese society 'failed' to develop 'modern' institutions and capabilities such as were emerging in 'the West'.[4] This framing of the question reflects an emphasis placed upon the assumed positive impact of Western influence upon a traditional system characterized by stagnation. In Sinology, as Fairbank wrote,

> China of the early nineteenth century had a circular flow economy in which production was absorbed in consumption, with very little if any net saving, so that the economy merely reproduced itself without advancing … While there was some commercialization

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[1] Douglass North, "The Chinese Menu (For Development)," *The Wall Street Journal*, 7 April 2005.

[2] Perry Anderson, *Lineages of the Absolutist State* (London, UK: New Left Books, 1974), 549.

[3] See Orville Schell and John Delury, *Wealth and Power: China's Long March to the Twenty-First Century* (London, UK: Little, Brown, 2013).

[4] From a classical Marxist perspective (as was the case in the PRC itself), the question is framed as one of why China 'failed' to progress historically from feudalism to capitalism.

> of the economy [in the late Ming and early Qing], it was not a major or disequilibriating change.[5]

Even the master economic historian of the longue durée, Fernand Braudel, who argued that the Chinese case highlighted the need to distinguish between market economy and capitalism,[6] was unable to develop an accurate and balanced assessment of the course of Chinese economic history. He would claim that,

> China's economic achievements were modest and, to be frank, backward compared with those of the West. … Her inferiority lay in her economic structure [that was] less developed than that of Islam or the West. … The Chinese economy was not yet mature. … Nor was there any credit system until the eighteenth (and in some places) until the nineteenth century.[7]

Most importantly for our purposes, the field of political economy was that which most deeply reified a Eurocentric rationality, and which has been the most reluctant to relinquish it. The classic theory of the emergence of Western capitalism largely emerges from the comparative sociology of Sombart and Weber, who argued that,

> Economic growth and development in the West over the long term has been due to the institutionalized separation of business and household capital, the widespread adoption of rational book-keeping and accounting techniques; the creation of a formally free labor force; … the development of rational structures of law and administration; of industrial processes and technology; and importantly, of a business orientation that valued the accumulation of capital as an end in itself.[8]

These conclusions led to the corollary development of the classic theory of the 'failure' of capitalism in China as being centered on the weakness of separation between firms and their owners and thus the lack of institutions to define the relationship between capital and owners, a cultural and spiritual environment resistant to capital accumulation, and the crushing presence of

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[5] John K Fairbank, Alexander Eckstein, and LS Yang, "Economic Change in Early Modern China: An Analytic Framework," *Economic Development and Cultural Change* 9:1 (1960): 1-26, 4-5.

[6] Original emphasis. Fernand Braudel, *Civilization and Capitalism, 15th - 18th Century, Vol. 2: The Wheels of Commerce* (Berkeley, CA: University of California Press, 1982), 588.

[7] ———, *A History of Civilizations* (London, UK: Penguin, 1995), 194-5, 285.

[8] Gordon Marshall, *In Search of the Spirit of Capitalism: An Essay on Max Weber's Protestant Ethic Thesis* (New York, NY: Columbia University Press, 1982), 64.

the imperial state. On this reading, firms lacked official legal status per se, which exposed them to 'grasping officials'[9] and the greater prestige of officialdom and land ownership meant that the large fortunes of the gentry class, even if they had their origins in commerce,[10] did not prioritize the building of commercial empires. Accordingly, there was an absence in China of those commercial dynasties that gradually accumulated a stock of capital independent of other loci of power, and which gradually became sufficiently powerful social forces to promote capitalist expansion.[11]

Accordingly, as Blue and Brook have observed, this question of why China 'failed' has continued to serve both in East and West as "the basic intellectual horizon for scholarly research and practical planning with regard to Chinese society and China's place in the world."[12] This has largely been the case seemingly regardless of where Chinese eyes themselves would turn, as the Japanese experience seemed to point towards how "a combination of 'self-Orientalizing' and extensive learning from the West" could enhance the effectiveness of both state and economy in the face of competition with 'modern' Western powers.[13] Nowhere has this become more evident than in the discourse surrounding China's economic reforms, in which the idea of 'the modern' is conceived of as a set of institutions underpinning a market-based economic system that over the course of its development had eluded China. This chapter positions the current study of China's evolving capitalism in the context of China's historical politico-economic

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[9] Kenneth Pomeranz, "'Traditional' Chinese Business Forms Revisited: Family, Firm, and Financing in the History of the Yutang Company of Jining, 1779-1956," *Late Imperial China* 18:1 (1997): 1-38, 3.

[10] He Bingdi, *The Ladder of Success in Imperial China: Aspects of Social Mobility, 1368-1911* (New York, NY: Columbia University Press, 1962), 77-8.

[11] Fernand Braudel, *Afterthoughts on Material Civilization and Capitalism* (Baltimore, MD: Johns Hopkins University Press, 1977), 68-71; K.N. Chaudhuri, *Asia Before Europe* (Cambridge, UK: Cambridge University Press, 1990), 384-6; Albert Feuerwerker, "The State and the Economy in Late Imperial China," *Theory and Society* 13:3 (1984): 297-326, 319-20.

[12] Gregory Blue and Timothy Brook, "Introduction," in *China and Historical Capitalism: Genealogies of Sinological Knowledge*, ed. Gregory Blue and Timothy Brook (Cambridge, UK: Cambridge University Press, 1999), 2. This was a symptom of a commitment to modernity, rather than a reflection of the desirability of capitalist development. For a good example of how Marxist scholarship within the PRC internalized this frame of reference, see Fang Xing, "The Retarded Development of Capitalism," in *Chinese Capitalism, 1522-1840*, ed. Xu Dixin and Wu Chengming (Houndmills, UK: Macmillan, 2000 [1985]).

[13] Blue and Brook, "Introduction," 3.

evolution, and the significance of the Braudelian distinction between a 'market economy' and a 'capitalist economy' for the study of contemporary political economy.[14] I argue that it is necessary to critically scrutinize how modern social theory has linked Europe's historical experience of market and state formation with the development of capitalism. The influence of this experience upon the reification of the state and market as the analytic categories of contemporary political economy occludes a more salient focus upon the variegated potentials of the capitalism that characterizes China's contemporary development.

This connects with the concerns outlined above as to the difficulties of reconciling China's current economic transformation with the fact of its political system remaining firmly rooted in what some still conceive of as the 'pre-modern',[15] as well as retaining lineages of a decidedly modern socialist era. Thus, it is only by way of understanding contemporary capitalism as more than the various configurations of state and market institutions—as the broad literature surrounding varieties of capitalism would have it—that China's otherwise highly paradoxical path of development can begin to be made sense of. Such analytical frameworks, borne out of the Western historical experience as they are, deprive non-Western modes of politico-economic organization of a place within the historical development of variegated potential modernities. In other words, the treatment of contemporary capitalism as the exclusive product or feature of a modernity that has its roots only in Western historical experience, unduly excludes the possibility of features of non-Western political economies playing not just a sociologically significant but in some cases an integral and foundational role within capitalist society. This chapter, then, takes the first steps toward a historically contextualized economic sociology of China's politico-

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[14] See Arrighi, *Adam Smith in Beijing: Lineages of the Twenty-First Century*; Wong, *China Transformed: Historical Change and the Limits of European Experience*. This further follows the lead of Wolfgang Streeck in adopting as its subject not the *institutions* of China's political economy but its *capitalism*. Wolfgang Streeck, *Reforming Capitalism: Institutional Change in the German Political Economy* (Oxford, UK: Oxford University Press, 2009), 3.

[15] For example, Spence, *The Search for Modern China*.

economic development, and thus opens up the theoretical space for conceptualizing the role of the CCP as an integral element of this evolving capitalist enterprise, a task that is undertaken in Chapter Three.

In the next section I place the distinction between a free market and capitalism in historical context, arguing that this enables us to see how China's experience and practice of markets was, and remains different to the Western historical experience, but this by no means demands the conclusion that China's experience of market-based economy was not amenable to capitalism. Rather, it simply was not amenable to European-style capitalism. A fuller comparative historiography of China's and Europe's development compels us to grapple with the full implications of the recognition that there is more than one potential institutional configuration of capitalist society. Not only might capitalisms 'vary', but they might also disrupt the shape and function of what have been regarded as foundational dimensions of capitalism—state and market. I hone in on the role of the financial system and the management of capital flows through the economy in this distinctive historical experience of market development in China. Just as the European experience of state building was intertwined with the role of finance in its capitalist development, the relationship between political authority and financial capital in China played an important role in the developmental trajectory of its non-capitalist political economy. By framing the comparison of China's contemporary experience of financial development with that which unfolded during the imperial era within the distinction between a Smithian market economy and a Marxian capitalist economy, and also between Braudel's conception of the middle 'competitive market' stratum of the economy and the higher 'profit-seeking' capitalist stratum, we begin to gain a better understanding of how China's independent and distinctive experience of pre-capitalist 'economic rationality' compels us to investigate the socio-institutional underpinnings of China's contemporary development as a positive rather than negative question.

The following section then examines how the social theory that emerged out of the study of these experiences embodies an assumption of Western state-market relations constituting the foundation of a linear process of capitalist modernization. This section unfolds as a critical review of the various potential conceptual frameworks for understanding the role of China's financial system in comparative and historical perspective. It examines several perspectives that each claim to generate analytic purchase on the study of China's political economy, beginning with the varieties of capitalism approach, the developmental state literature, theories of international political economy, and the organizational institutionalist literature. The conclusion of this chapter is that the possibilities for understanding China's current dynamics of political authority and financial capital are limited to the extent that logics of action underpinning the categories of state and market as universal categories of politico-economic analysis are presumed to be borne out of Western European historical experience. By assessing the development of China's financial system in historical and comparative perspective, and elucidating the similarities and differences of how the dynamics of financial activity played different micro-level roles in the paths of economic development, it becomes possible to render more clear Braudel's distinction between market-based economic development and capitalist economic development, and therefore how both market and state can be embedded in socio-historically contingent and thus varied processes of capitalist development.

Markets, States, and the Variegated Origins of Capitalism

We begin therefore to see the potential difficulties in assuming, as European social theorists have since the 19th century, that modern economic progress involves one inevitable and natural path of development that has emerged out of the European socio-historical experience. This assumption had two elements. The first was conceptual, and involved an assumed link between a modern capitalist rationality as distinct from a traditionalism that was assumed to characterize those societies that did not develop the same institutions as Western Europe did. This then produced and was in turn compounded by a second, empirical, assumption that this particular kind of rationalism was to be found in the particular form of market competition that emerged in Europe. In this formulation, capitalism was erroneously assumed to be the (uniquely European) market competition that was erroneously assumed to be a (uniquely European) rationalism that in turn was the foundation for economic growth. These assumptions entail the logical conclusions that China 'failed' to develop capitalism because it lacked the requisite rationalism that was to be found only in Western Europe. The embeddedness of these assumptions within many traditions of social thought, and the permeation of that conclusion into our ensuing frameworks for analysis, leads then to a final, equally problematic conclusion, namely that now China is becoming increasingly capitalist, there is only one real trajectory of development upon which it might do so. As I will below explore further in the context of contemporary theories of political economy, the model of development that these assumptions place at the centre of modern economic history is premised on one particular configuration of government regulation and market competition, one that arises directly from the process of state making and market formation in the European experience of economic development. The respective roles of the bureaucracy and the market reflect this both in theory and in practice. Yet, if we suspend those assumptions upon which this model is founded, and postulate that this itself was the particular manifestation of a rationalism that is neither exclusive nor universal, then on what basis do we begin to understand the rationalism that was present in China prior to 1820 and of which we find evidence in the political economy of contemporary China?

In order to address this question, this section examines the lineages of the state and market-based economic development in imperial China, arguing that (1) these two processes constituted a rational and sophisticated economic sociology of market behaviour and economic development; (2) this economic sociology was distinct from that which led to European-style capitalism, but was not necessarily incompatible with it; and (3) accordingly, the construction of a capitalist system in contemporary China—one that is deeply embedded in the competitive dynamics of an integrated global economy—represents potentially the coalescence of logics of politico-economic organization that are as equally rational as they are qualitatively distinct. These arguments dovetail with conceptual possibilities opened up by Giovanni Arrighi thus:

> The bifurcation [of Europe and China] resulted in a strengthening of the capacity and disposition of Western states to pursue the subordinate incorporation of East Asian states within the structures of their own system on the one side, and in a decreasing capacity of East Asian states to prevent such an incorporation on the other. But once the incorporation actually occurred, as it did in the wake of the Opium Wars, the historical heritage of the East Asian system did not vanish in a generalized convergence toward Western practices and patterns of political and economic interaction. There was convergence but through a process of hybridization that preserved and eventually revived important features of the East Asian system.[16]

And yet, as is so often the case, the writing of history and the construction of knowledge have been subject to a greater path-dependency than the empirical reality whence they arise. The challenge is to delve deeper into the historical sociology of China's long-run trajectory of economic development, at which point it may become more feasible to assess the issue that is oft-discussed yet little understood: whether in the world only China has been exceptional in successfully resisting being "reshaped by the pressures of capitalism originating in western Europe …[and] to have survived the Western imperialist remaking of the world in the past few centuries."[17] As Rowe has observed,

> Whatever the reason, the divergences between Chinese and Western social histories since 1500 are not due to the fact that the progressive West discovered capitalism and the modern state and China did not, but rather to the fact that the two civilizations developed these institutions in somewhat different fashions, conditioned by the distinctiveness of their two respective cultures.[18]

But where Rowe speaks here of capitalism, it is necessary to distinguish between the process of creating markets and that of industrialization and the development of capitalist modes of

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[16] Giovanni Arrighi et al., "Historical Capitalism, East and West," in *The Resurgence of East Asia: 500, 150, and 50 Year Perspectives*, ed. Giovanni Arrighi, Takeshi Hamashita, and Mark Selden (Oxford, UK: Routledge, 2003), 318.

[17] Hill Gates, *China's Motor: A Thousand Years of Petty Capitalism* (Ithaca, NY: Cornell University Press, 1996), 6.

[18] William Rowe, "Modern Chinese Social History in Comparative Perspective," in *Heritage of China: Contemporary Perspectives on Chinese Civilization*, ed. P S Ropp (Berkeley, CA: University of California Press, 1990), 262.

production, distribution, and consumption. Accordingly, the processes of market and state formation constituted the historical experiences for both China and Europe between 1500 and 1820. Yet these were to occur on different bases, with disparate results, and accordingly with potentially different implications for the features and dynamics of their respective systems of contemporary capitalism.

The Emergence of Markets

A number of significant interventions have been made in recent years challenging the historiography underpinning orthodox conceptions of politico-economic development in Western Europe and China.[19] These comparative historical analyses provide a wealth of evidence of how China's imperial economy from at least the Song dynasty (960-1280 AD) had established deep and broad market relations in a range of commodities, a wide variety of credit/debt relationships, along with the first national issuance of banknotes and paper money. Economic (along with political) integration is not a novel theme in Chinese economic history, as "national markets and interregional financial links between major commercial centers" were in continual existence and operation for many centuries before the Opium Wars.[20] Chinese markets in grain and other commodities were highly developed and efficient even across long distances, constituting a much more unified market structure than had ever or would exist in Europe for many more centuries.[21] Trade between different provinces easily eclipsed 'international' trade in

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[19] The most important of these for the purposes of direct comaprison between China and Western Europe are Arrighi, *Adam Smith in Beijing: Lineages of the Twenty-First Century*; Kenneth Pomeranz, *The Great Divergence: China, Europe, and the Making of the Modern World Economy* (Princeton, NJ: Princeton University Press, 2000); Wong, *China Transformed: Historical Change and the Limits of European Experience.*

[20] Thomas Rawski, *Economic Growth in Prewar China* (Berkeley, CA: University of California Press, 1989), 146.

[21] Yeh-chien Wang, "Secular Trends of Rice Prices in the Yangzi Delta, 1638-1935," in *Chinese History in Economic Perspective*, ed. Thomas Rawski and Lillian Li (Berkeley, CA: University of California Press, 1992).

Europe.[22] By the time of the late Ming and early Qing dynasties, China was far less mercantilist than Western Europe was at the same time.[23]

Property rights and their protection have formed a core aspect of the liberal canon of Western social theory.[24] In China, by the seventeenth century at the latest, a largely unconstrained market existed in land, underpinned by "recognized rights of private ownership [that] included those of utilization, inheritance and alienability."[25] The concept of real property much more closely resembled that of the modern West than those of any other imperial states, and arguably than that of early modern Europe itself.[26] Likely no more than 3 percent of total arable land belonged to the state,[27] and in any event, its hereditary tenants sold and mortgaged it as if their tenure treated much of this as private property in which their tenure was wholly secure.[28] There was accordingly a

> constant, complex, and extremely dynamic process of change taking place [in the late Ming and early Qing], involving production, circulation, exchange and distribution, in the land system, in tenancy and wage labour relations, and the emergence of other new social relations.[29]

As Bramall and Nolan point out, this "casts serious doubt on the idea that private property in land was a uniquely European phenomenon which formed the basis of wider concepts of private

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[22] ———, "Secular Trends of Rice Prices in the Yangzi Delta, 1638-1935," 38; Pomeranz, *The Great Divergence: China, Europe, and the Making of the Modern World Economy*, 34-35.

[23] Gang Deng, *Maritime Sector, Institutions, and Sea Power of Premodern China* (Westport, CN: Greenwood Press, 1999), 201-20.

[24] See Douglass North and Robert Thomas, *The Rise of the Western World: A New Economic History* (Cambridge, UK: Cambridge University Press, 1973).

[25] Rowe, "Modern Chinese Social History in Comparative Perspective," 242.

[26] Pomeranz, *The Great Divergence: China, Europe, and the Making of the Modern World Economy*, 71-73.

[27] Philip Huang, *The Peasant Economy and Social Change in North China* (Stanford, CA: Stanford University Press, 1985), 87.

[28] Pomeranz, *The Great Divergence: China, Europe, and the Making of the Modern World Economy*, 71.

[29] Wu Chengming, "Introduction: On Embryonic Capitalism " in *Chinese Capitalism, 1522-1840*, ed. Xu Dixin and Wu Chengming (Houndmills, UK: Macmillan, 2000 [1985]), 17.

property, which in turn facilitated capitalist investment and innovation, which in short was responsible for 'the rise of the West'."[30]

This was not necessarily evidence of capitalism per se; rather it was evidence of a sophisticated market economy, in which large-scale production was based on simple division of labour, and unified movement of commodity prices was the result of supply and demand across relatively unified yet localized markets.[31] The state actively promoted the unification of national markets and was engaged in the construction of both institutions and the physical infrastructure necessary for this to take place. This delivered significant benefits for the many peasants who bought and sold goods, however it did not translate into the concentration of wealth amongst particular actors on the basis of market manipulation. As Wong argues, "official support for commerce did not mean promotion of commercial capitalism as it developed in Europe."[32] It is here that the importance becomes clear of Arrighi's distinction between a 'Smithian' mode of market development[33] and the Marxian accumulation of capital that prompted the rise of capitalist financial systems in Europe.[34] The unification and highly competitive nature of China's markets were what led Smith himself to praise the Chinese political economy, and which distinguished it from the European configuration of small and politically vulnerable states aligned with large corporate interests, a crucial distinction the significance of which will be highlighted in the next section.

The Chinese financial system played not only a significant role in underpinning the dynamics of this Smithian market economy, but further (and perhaps more importantly)

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[30] Chris Bramall and Peter Nolan, "Introduction: Embryonic Capitalism in East Asia," ibid. (2000), xxiii; cf. North and Thomas, *The Rise of the Western World: A New Economic History.*

[31] Wu Chengming, "Introduction: On Embryonic Capitalism ".

[32] Wong, *China Transformed: Historical Change and the Limits of European Experience*, 138.

[33] In which money was regarded as a means of transformation of a set of commodities into another set of commodities of greater use value (Marx's classic formulation of C-M-C').

[34] Arrighi, *Adam Smith in Beijing: Lineages of the Twenty-First Century*, Chapters 2 & 3.

reflected the broader nature of the relationship between people, capital, and the state. Just as was the case in Europe, the initial development of banking in China was the "progressive centralization of clearance," a process in which credit was extended within an increasing geographical area, for a greater variety of socio-economic activities, and for a longer temporal duration.[35] Although there remain only limited analyses and sources of data on the nature of systems of credit and finance in the late-imperial period, we can nonetheless reach several conclusions. Firstly the system of credit and finance was well developed, with a variety of different institutions fulfilling different roles. Secondly this system was intimately connected to the real economy, servicing the merchant class and the trade of commodities with no evidence of the financial accumulation that played such a central role in the emergence of European financial systems.[36] By the late imperial period, China's indigenous financial system had come to represent

> a complex and sophisticated adaptation to the requirements of an agrarian economy with substantial and interregional trade. … China's financial system paralleled that of preindustrial Europe in its complexity and sophistication. There were numerous intermediaries, from local moneychangers and pawnshops to large institutions with far-flung networks of branches or correspondents.[37]

These institutions for allocating the investment, fixed, and working capital necessary for carrying out commercial business therefore provided the requisite stability for the smooth functioning of markets in the real economy, but not necessarily for the 'endless accumulation' of capital that was so essential for the development and survival of European political economies that eventually coalesced around the nation-state. The utilization of capital had sociological foundations that were rooted in the historical experience of constructing the Chinese state,

[35] Abbott Usher, *The Early History of Deposit Banking in Mediterranean Europe* (Cambridge, MA: Harvard University Press, 1943), 4.

[36] See Giovanni Arrighi, *The Long Twentieth Century: Money, Power, and the Origins of Our Times* (London, UK: Verso, 2009 [1994]).

[37] Rawski, *Economic Growth in Prewar China*, 125-6.

which was itself closely related to the structural features of Chinese society and its economy, and thus hewn out of a very different social setting than that of the modern European state.

The structure of social relations that underpinned the interplay of commerce and capital in imperial China was fluid and complex, but not unsystematic. As Pomeranz has argued, it is necessary to "avoid treating labels such as 'merchant' and 'official' as excessively rigid categories, ignoring the extent to which single families straddled these categories, rather than engaging in 'social mobility' and moving cleanly from one category to another."[38] There was a logic of capital accumulation and reinvestment that operated through a rational and sophisticated relationship between the gentile and commercial components not just of a sole family lineage but also within the broader fabric of elite society. Family firms embedded within these financial structures were able to finance a significant part of the commercial agenda that in the West has been attributed to managerial firms and Western corporate forms linked to independent capital markets.[39] Pomeranz argues that indeed they "may even have become more capable of financing these changes by moving in the direction of greater identification with one family. … [such firms] seem as well organized and situated in society for rational management, expansion, and capital accumulation as their counterparts elsewhere."[40] Considerable evidence thus exists that different forms of Chinese partnership allowed entrepreneurs to organize investment capital and

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[38] Pomeranz, "'Traditional' Chinese Business Forms Revisited: Family, Firm, and Financing in the History of the Yutang Company of Jining, 1779-1956", 29-30.

[39] Although family firms were also core features of early European capitalism, it was their transmutation into capital structures legally independent of other elite social formations that is the important aspect of their distinctly capitalist nature.

[40] Pomeranz, "'Traditional' Chinese Business Forms Revisited: Family, Firm, and Financing in the History of the Yutang Company of Jining, 1779-1956", 27-8.

re-invest profits for the long term in ways similar to those made possible by Western joint-stock companies.[41]

These lineage-based firms both hired professional managers but also had interlocking arrangements with each other for the raising of investment capital.[42] Some of them lasted for over 300 years, such as the Ruifuxiang Company,[43] and several in Tianjin that existed from the late seventeenth century into the twentieth.[44] In the absence of "any compelling evidence for the supposed historical necessity of making clear separations between business and household activities,"[45] the organizational character of the family in late imperial China was productively and securely able to function "as much as an enterprise as a domestic group."[46] Through the Ming and the Qing dynasties, this pattern of corporate investment continued to evolve in conjunction with the rise of the *qianzhuang*, which "held the ganglions of the financial lines of the country."[47] The *qianzhuang* were financial firms organized around either a single proprietorship, or more commonly through a partnership rooted in members of a family, clan, or close circle of friends. They handled deposits, lent capital, facilitated remittances and the exchange of money, with unlimited financial liability guaranteed by all resources of the proprietor or partnership.[48] The interlocking partnership structures across the family lineages of the urban elite of both urban commercial firms and these native banks therefore facilitated the raising of long-term capital and

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[41] Madeleine Zelin, "Capital Accumulation and Investment Strategies in Early Modern China: The Case of the Furong Salt Yard," ibid. 9 (1988): 79-122; Kenneth Pomeranz, "'Traditional' Chinese Business Forms Revisited: Family, Firm, and Financing in the History of the Yutang Company of Jining, 1779-1956," ibid. 18 (1997): 1-38.

[42] Wellington Chan, "The Organizational Structure of the Traditional Chinese Firm and Its Modern Reform," *Business History Review* 56:2 (1982): 218-35, 219-22.

[43] ———, "The Organizational Structure of the Traditional Chinese Firm and Its Modern Reform".

[44] Man-bun Kwan, *The Merchant World of Tianjin: Society and Economy of a Chinese City* (Doctoral Dissertation, Stanford University, 1990), 260-72.

[45] Robert Gardella, "Squaring Accounts: Commercial Bookkeeping and Capitalist Rationalism in Late Qing and Republican China," *The Journal of Asian Studies* 51:2 (1992): 317-39, 322.

[46] Myron Cohen, "Being Chinese: The Peripheralization of Traditional Identity," *Daedalus* 120:2 (1991): 113-34, 116.

[47] Frank Tamagna, *Banking and Finance in China* (New York: Institute of Pacific Relations, 1942), 47.

[48] ———, *Banking and Finance in China*, 57.

financing in innovative ways during this period.[49] Rowe has described this process of development accordingly:

> By the late Ming dynasty partnerships had become very sophisticated: the numerous gradients between managing and silent partners each bore specified limits of financial liability that were respected in legal proceedings. Although that great Western capitalist breakthrough, double-entry bookkeeping, apparently had not been achieved, accounting techniques adequate to measure such items as profit margins, assets, and liability were in general use. The banking institutions that had developed by the late eighteenth century offered a sophisticated range of credit instruments, and the joint-stock company, with its capacity for growth-oriented refinancing, had appeared even earlier. The technology of mobilizing and managing had also reached an impressively high level. Moreover, China developed systems of agency, brokering, and factoring arguably much more refined than those of the early modern West. They gave China the unique ability to develop a powerful and efficient commercial capitalism without the large-scale individual firms that had been necessary in Europe.[50]

This relationship between finance capital and the real market economy within Braudel's middle 'Smithian' stratum of the economy however lays the basis for but does not actually itself constitute a capitalist dynamic of financial accumulation as a mechanism of pursuing market power. The Chinese case indicates how the emergence of a capitalist economic structure is not the natural and inevitable result of a market economy. Even as Smith's analysis of the growth of European market economies would still stress the importance of agriculture, assume the finite nature of economic growth, and predict real wages to ultimately fall to subsistence levels, China had long been constructing an economy that was similarly advanced in its market dynamics and vibrancy. The distinction that would produce divergence in the European and Chinese trajectories would be found not in the process of market development, but in the process of state formation.

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[49] Gardella, "Squaring Accounts: Commercial Bookkeeping and Capitalist Rationalism in Late Qing and Republican China", 318.

[50] Rowe, "Modern Chinese Social History in Comparative Perspective," 252.

The Emergence of Capitalism

Whereas Europe's experience of economic and political development produced the modern nation-state, China's did not. As Tilly sums up pithily, "within their own space, Europeans farmed, manufactured, traded and, especially, fought each other. Almost inadvertently, they thereby created national states."[51] In contrast, the distinctive rationalism underpinning the process of market-formation and state-building in imperial China would translate into a different form of political economy from that which developed as a product of economic development and state-making in Europe. If capitalist transformation in Europe was not a naturally endogenous product of the spread of European markets, then we ought to consider the possibility that it was the emergence in Europe of a particular variety of state that was the source of this transformation. This in turn could either be driven by endogenous or exogenous factors. The endogenous explanation centres on the development of a Weberian bureaucratic rational state that remains the conceptual baseline for much analysis of political economy around the world:

1. A 'rational-legal' centralized bureaucracy which operates according to impersonal (rather than arbitrary) norms and presupposes a clear separation of the public and private realms;
2. A 'minimalist' or laissez-faire posture in relation to the economy (i.e. where the state does not interfere in the 'natural' operation of the free market). This simultaneously goes to the heart of the claim that the economy is rational in the sense that it operates optimally in the absence of political interventions and distortions;
3. A democratic propensity where political citizenship rights are granted so as to empower individuals.[52]

Hobson deconstructs the 'mythical' tenets of the uniquely Western origins of rationality in political economy.[53] How these characteristics came to be ideal-typicalised within modern social theory is explored below in the next section, however what is emphasized here is how the politico-economic configurations contained within and between European states were not the

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[51] Charles Tilly, *Coercion, Capital, and European States, AD 990-1992* (Oxford, UK: Blackwell Publishing, 1992), 16.
[52] John Hobson, *The Eastern Origins of Western Civilisation* (Cambridge, UK: Cambridge University Press, 2004), 283-84.
[53] ———, *The Eastern Origins of Western Civilisation*, 283-84.

driver of the path of capitalist development in Western Europe but rather were the *vehicle*—and but one of potentially several—for the mobilization of capital in order to secure the interests of the dominant political forces within Western European society. If such a nation-state was not inevitable, then there must have been some other factor that precipitated its emergence. It is this exogenous explanation that we are accordingly concerned with here. The Western European nation-state that in the study of political economy has come to dominate conceptions of how authority and regulation is structured in society was the effect rather than the cause of the capitalist imperative that arose from the political circumstances and fortunes of the various socio-cultural groupings—church, state, and nation—that were vying for supremacy at the time.

Capitalism emerged in Western Europe as a result of the existential conflict that unfolded between these different socio-cultural groupings. Interstate competition in early modern Europe became "literally murderous."[54] Financing past, present, and future wars was by far the greatest expenditure of European states,[55] a phenomenon that Sombart argued was the foundation for Europe's wealth.[56] As Vries has argued,

> For [European states] it often was easier to cut a deal with a small group of big "capitalists," who were given wide-ranging economic powers (and, sometimes, in so-called chartered companies, even powers we would now regard as inalienable parts of sovereignty), than to try and increase their income by taxing the populace more effectively.[57]

In contrast, there never existed an incentive for the imperial Chinese state to embark upon this form of commercialized accumulation of capital. This was not the result of China lacking socio-cultural features conducive to capitalist development. Rather, China possessed deep structural

[54] Peer Vries, "Governing Growth: A Comparative Analysis of the Role of the State in the Rise of the West," *Journal of World History* 13:1 (2002): 67-138, 76.

[55] Richard Bonney, ed. *The Rise of the Fiscal State in Europe* (Oxford, UK: Oxford University Press, 1999).

[56] Werner Sombart, *Krieg und Kapitalismus* (Munich, DE: Duncker & Humblot, 1913); Vries, "Governing Growth: A Comparative Analysis of the Role of the State in the Rise of the West", 77.

[57] ———, "Governing Growth: A Comparative Analysis of the Role of the State in the Rise of the West", 71.

conditions for the ongoing development of a Smithian mode of market exchange.[58] Tilly's structural logic of 'capital and coercion' provides also an explanation for the availability of an alternative trajectory of development in China. The city in imperial China was also located at the nexus of two overlapping hierarchies: as economic centres embedded in a national market, and also as political centres embedded within the imperial regime.[59] Just as in Europe, there existed all the potential elements for what Skinner refers to as 'macroregions' to form into competitive warring states, by concentrating capital within urban centres and mobilization of resources for waging war and preparation thereto, precipitating the development of attendant social and political institutions that would come to form the modern bureaucratic state. Both Europe and China as continental landmasses each contained the necessary endogenous ingredients for the development of capitalism. However it was an exogenous factor—existential competition—that spurred European national societies as embryonic states to in turn give birth to capitalism. The absence of such inter-state competition for mobile capital therefore goes a long way in explaining why capitalism did not "spread like an epidemic"[60] in East Asia as it did in the European world. Snooks describes it such that "ultimately, China's misfortune was a lack of serious competition."[61] Looking at the other side of the coin, Pomeranz is inclined instead to label Europe a 'fortunate freak' whose capital-intensive, energy-intensive, and land-consuming path of development was a product of projecting the competitive state making process out into the

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[58] Arrighi et al., "Historical Capitalism, East and West," 265.

[59] William Skinner, "Cities and the Hierarchy of Local Systems," in *The City in Late Imperial China*, ed. William Skinner (Stanford, CA: Stanford University Press, 1977), 275-352.

[60] Arrighi et al., "Historical Capitalism, East and West," 280.

[61] Graeme Snooks, *The Dynamic Society: Exploring the Sources of Global Change* (London, UK: Routledge, 1996), 323. The economic dynamism and innovative capacity of the Song dynasty was related to the fact that it was much smaller than the Ming or Qing empires, and only one state amongst several. Accordingly it was compelled to wage numerous wars, taxation was higher than in later eras, and a greater proportion of it was spent by the state on industry. China during this period therefore resembled Europe more than was the case under with Ming or Qing. See Vries, "Governing Growth: A Comparative Analysis of the Role of the State in the Rise of the West", 90.

world—generating a confluence of resource and energy flows, and both the domestic and colonial institutions to take advantage of them.[62]

Again, it is crucial to examine the way in which this process of forming states was linked to the financial underpinnings of economic growth, which would manifest in the various different forms of the relationship between the state and capital. By the sixteenth century China's financial system had developed a considerable efficiency in facilitating the long-distance grain trade across the empire.[63] Accordingly, as Pomeranz has suggested, the way in which

> Chinese credit institutions might have done more to help sustain needed flows of primary products from afar does help focus our attention on where Europe's financial institutions—in fact the political economy of capitalism (in Braudel's sense) and military fiscalism in general—were probably more important: namely in organizing western Europe's trade with remote peripheries.[64]

The guildhalls that arose during the early Qing period were active promoters of a rapidly expanding national market, were imbued with a spirit of egalitarianism, and thus regulated production in order to eliminate competition between their members. The *huiguan* were regional-specific organizations that provided association and networks amongst merchants from a shared hometown or province, whilst the *gongsuo* were industry-oriented and devoted to fostering connections between those involved in the trade of a particular commodity.[65] In these ways they resembled the medieval guilds of Europe, but with one crucial distinction. They remained always subordinate to the imperial government, for the reason that the cities in which they were based, and which formed the locus of the long-distance trade that expanded rapidly in the eighteenth century, were always first and foremost centers of commerce, rather than of politics. European

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62 Pomeranz, *The Great Divergence: China, Europe, and the Making of the Modern World Economy*, 207.

63 R Bin Wong, "The Political Economy of Agrarian Empire and its Modern Legacy," in *China and Historical Capitalism: Genealogies of Sinological Knowledge*, ed. Timothy Brook and Gregory Blue (Cambridge, UK: Cambridge University Press, 1999), 217.

64 Pomeranz, *The Great Divergence: China, Europe, and the Making of the Modern World Economy*, 185.

65 Fang Xing et al., "The Growth of Commodity Circulation and the Rise of Merchant Organisations," in *Chinese Capitalism, 1522-1840*, ed. Xu Dixin and Wu Chengming (Houndmills, UK: Macmilland, 2000), 179-83.

guilds became intimately connected to the political fortunes of the urban centres in which they were embedded: ongoing warfare secured not just property rights writ large, which were also highly secure in imperial China, but "property in privileges," which extended through the contracting out of tax collection through tax farming ventures, the establishment of highly venal offices, a broad range of state-granted monopolies, and confirmation of guild privileges.[66] Seen in this perspective, capitalist development is not the product of property rights and free markets, but rather the effective accumulation and mobilization of resources for market domination and monopoly.

This was in direct contrast to the Chinese situation, with its widespread guilds and regulatory frameworks for merchant activity designed to regulate markets, rather than to raise revenue.[67] China was simply more unified and coherent than Europe could ever hope to be. It "had no corporate groups, no elites, with their own bases of power and authority, either in the cities or in the countryside. … The state's commitment to social order was shared by elites. This kind of state making did not encounter many of the challenges faced by Europe."[68] The economic sociology of the process by which firms in imperial China raised capital for large-scale commercial activities has implications for how we conceive of the relationship between individual firms' behaviour, the broader political economy in which they were embedded, and thus the institutional foundations for the imperial state to take a particular form. Land, labour, and capital were treated differently. The former were no less secure in China than in Europe. But the capital of merchant firms remained insecure, attached as it was to the individual. Whereas the concept of private property in land was not restricted either through scale or on the basis of its

[66] Pomeranz, *The Great Divergence: China, Europe, and the Making of the Modern World Economy*, 196.

[67] Susan Mann, *Local Merchants and the Chinese Bureaucracy, 1750-1950* (Stanford, CA: Stanford University Press, 1987), 42; ———, "Household Handicrafts and State Policy in Qing Times," in *To Achieve Security and Wealth: The Qing State and the Economy*, ed. Jane Leonard and John Watt (Ithaca, NY: Cornell University Press, 1992), 76-79.

[68] Wong, *China Transformed: Historical Change and the Limits of European Experience*, 198-99.

owner, this was never the case with trading capital, and "the merchant and his working stock remained indivisible."[69] Other factors of production—land and labour—were socially divisible, as they were openly available on the open market to anyone who possessed sufficient purchasing power. However the working capital necessary for trade and industry remained closely tied to mercantile groups, and "the notion that the possession of title to commercial investments yielding permanent income might be better than the direct taxation of merchants does not seem to have suggested itself to Asian rulers."[70] This is not to say that merchants were therefore vulnerable and suffered more expropriations than was the case elsewhere.[71] But they operated within tight constraints that arose out of the contentedness of the state to rely upon fiscal, rather than financial sources of spending power. Monetary issues were not of central importance in imperial China, since the majority of state revenues were derived from the land tax, rather than through debt or commercial activities.[72] Accordingly, "capital always was the junior partner, at best, and closely guarded." [73] Chinese society possessed no particular social grouping comparable to 'the capitalists' or the bourgeoisie of Europe. Trading or banking often was not so much in the hands of members of a specific social group, but of people from specific regions, each with their own specialty.[74]

The comparative historiography of China's economic development points to one overriding conclusion. The organization of the factors of production in China was no less

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[69] K.N. Chaudhuri, *Trade and Civilisation in the Indian Ocean: An Economic History from the Rise of Islam to 1750* (Cambridge, UK: Cambridge University Press, 1985), 210.

[70] ———, *Trade and Civilisation in the Indian Ocean: An Economic History from the Rise of Islam to 1750*, 228.

[71] Pomeranz, *The Great Divergence: China, Europe, and the Making of the Modern World Economy*, 170.

[72] The full quote is that, "The livelihood of the scholar-official class was not greatly threatened by monetary depreciation. The foundation of their livelihood lay in the land, and the greater part of the gain from land was not in money. Capitalist society replaces landlords with capitalists as the rulers. The income of capitalists is entirely in money, and monetary problems therefore come to be seen as the central economic problems." Peng Xinwei, *A Monetary History of China, Vol. 2 [中国货币史, 第二卷]* (Bellingham, WA: Center for East Asian Studies, 1994), 792.

[73] Vries, "Governing Growth: A Comparative Analysis of the Role of the State in the Rise of the West", 87.

[74] ———, "Governing Growth: A Comparative Analysis of the Role of the State in the Rise of the West", 87.

rationally effective than those in Europe, however they were organized in different ways, and for a different purpose. Whereas the symbiotic relationship between merchant capital and the state in Europe came to be premised on the need to accumulate capital in the hands of the state thus enabling the waging of war, the relationship between merchant capital and the state in China was always premised on the desire to construct and improve a unified national market. Both qualitative innovation in financial organization and the quantitative scale of merchant loans were absent, in the absence of existential threats and thus the financial imperatives that confronted European states between the sixteenth and eighteenth centuries. Competition was greater, prices more responsive, and productivity greater in China than in Europe. However given the rootedness of both production and trade in landed property rather than working capital, and the corresponding reliance of the imperial state upon direct taxation rather than the raising of capital, the power of merchants remained subordinated to the state.

Those methods of accounting, firm management, and capital raising practiced by merchants and bankers that constituted the economic sociology of a non-capitalist yet market-oriented imperial state were "not only historically significant in [their] own right, but could serve as a bridge rather than a barrier to the cosmopolitan world of modern business management."[75] Hamilton and Chang have argued that,

> There are significant parallels between the organization of the late imperial economy and the organization of the modern capitalist economies in Taiwan and Mainland China. This parallel cannot be explained as a function of some linear sequence of events … [but] instead as having emerged from similar (but by no means identical) shared understandings of social organization and from similar (but by no means identical) structural conditions confronted by economically active participants, such as relations of power and authority.[76]

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[75] Gardella, "Squaring Accounts: Commercial Bookkeeping and Capitalist Rationalism in Late Qing and Republican China", 334.

[76] Gary Hamilton and Wei-An Chang, "The Importance of Commerce in the Organization of China's Late Imperial Economy," in *The Resurgence of East Asia: 500, 150 and 50 Year Perspectives*, ed. Giovanni Arrighi, Takeshi Hamashita, and Mark Selden (Abingdon, UK: Routledge, 2003), 176.

This provides us an entrée into the comparative question of how the structures and logics of market-based economic exchange that characterized imperial China, having underpinned the emergence of a large and stable imperial state, would come to underpin capitalist forms of economic exchange in contemporary China. Not only this, it connects us to the related question of why this transformation is taking place now, rather than in the eighteenth or nineteenth centuries as a product of the developmental trajectory that stretches all the way back to the economic dynamism of the Song dynasty.

If the emergence of capitalism is symbiotically connected to the emergence of a state in economic competition with other states, then it is possible to hypothesize that a likely driver of capitalist development in reform-era China is that of its self-perception of having entered into a set of competitive relationships with other major economies of the world. The desires for reclamation of national pride and the absolution of its historical humiliation have been powerful motivations for the accumulation of wealth and capital in the modern era.[77] The contrast with the absence of competitive transnational pressures facing China during the period of its greatest centrality to the world economy, from the 15th-18th century is instructive. But the fact that China was again catapulted into the global economy in a competitive fashion, thus placing itself in a position to be enclosed within the global capitalist economy, is not to say that it was to adopt the same kind of capitalism as had arisen out of Western Europe and that had been developing along its own historical trajectory. Even as it was to become capitalist, it was to do this according to a very different institutional logic, and one that is embedded deeply within and displays strong continuity with its own historical experience of market-based economic activity upon which a profit-driven capitalist system is built.

[77] Schell and Delury, *Wealth and Power: China's Long March to the Twenty-First Century.*

Seen from this perspective, the Chinese constellation of economic institutions, susceptible though it was to change and in some cases, destruction, following European contact, would lay the basis for a distinctive mode of capitalist development that reflected fundamental features of its non-capitalist but pro-market origins: a unified imperial political structure that monopolized influence upon the state's capacity to collect and utilize financial capital. The state would constitute the organizational apparatus for interacting and controlling the market, but the real source of power resided not within the abstract constitutional rights of an institutionalized bureaucracy, but in the deep-seated legitimacy of a national imperial structure that itself commanded authority over both the state and the market in equal measure. As I argue in later chapters, China's post-1978 process of reform and opening has witnessed this power coming to reside with the CCP. Before doing so however, in the next section of this chapter I explore how the Eurocentric foundations of modern theories of political economy limit their ability to adequately theorize and comprehend China's contemporary path of capitalist development.

The Eurocentric Rationality of Political Economy

How did the experience of state and market formation in Europe lay the theoretical basis for contemporary theories of political economy and capitalism? The idea of the state and the market as the foundational categories for politico-economic analysis are borne out of the Western experience, as the writing of global economic history continues to revolve around the two historical processes of state and market building that took place in Western Europe, and which have thus come to constitute the benchmarks against which the historical development of other societies and regions are compared and evaluated. I earlier detailed the ways in which those social and political formations were specific to the Western European experience, and how China's own historical experience of market and state formation presents an alternative pathway to the construction of a modern capitalist society. As China's contemporary capitalist development continues along its own unique path, it is becoming increasingly apparent that,

> Academic theories of market development [in China] have frequently been based on the Western European and American experiences. This is in spite of the fact that the Chinese experience seems to deny the basic principles of many of those theories.[78]

In this section and the next I therefore scrutinize how the social theory underpinning the concepts and frameworks of contemporary political economy generates obstacles to understanding China's contemporary experience of development. My intention in so doing is to draw connections between how the writing of history and the formulation of theory that accompanied 'the great divergence' embodied a pronounced Eurocentrism, and our conceptual and theoretical difficulties in making adequate sense of China's current trajectories of political and economic development. That is to say, our previous errors in attempting to understand historical divergence are proving a serious limitation in our current efforts to come to terms with contemporary convergence.

Political economy is now conceived of as the study of the interrelations between, on one hand, collective action in general and collective rule-making in particular, and on the other, 'the economy', which extends from economic and social policy-making to the way in which economic interests and constraints influence policy, politics, and social life as a whole.[79] Classical political economy, as practiced by Smith, Marx, Durkheim, Weber, and Polanyi, was concerned with understanding not only how processes of economic development transformed society, but also with how certain social and political formations affected the development of capitalism as a mode of production.[80] Max Weber was the first in a line of historical sociologists to make a

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[78] Fligstein and Zhang, "A New Agenda for Research on the Trajectory of Chinese Capitalism", 39.

[79] Streeck, "Taking Capitalism Seriously: Toward an Institutionalist Approach to Contemporary Political Economy," 6.

[80] See Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Oxford, UK: Oxford University Press, 1993 [1776]); Max Weber, *General Economic History* (New Brunswick, NJ: Transaction, 1995 [1927]); Karl Marx, *Capital, Vol I*, trans. Ben Fowkes (New York: Vintage Books, 1977); Émile Durkheim, *The Division of Labor in Society*, trans. W.D. Halls (New York, NY: The Free Press, 1984 [1893]); Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Boston, MA: Beacon Press, 1957).

determined effort to view 'capitalism' in a worldwide context.[81] Yet his theorization of the rational state and its relationship to modern capitalism as a uniquely European phenomenon drew upon a comparative framework that treated the West and the 'non-West' very differently. Given his ultimate aim of identifying those features of Western civilization and capitalism in particular "that were responsible for the emergence, in the West alone, of cultural phenomena he thought of as having universal validity,"[82] the ideal-typical characterizations of Western rationality that emerged from his analyses would therefore, when combined with the notion that social progress was a linear trajectory of development, come to be regarded as the inevitable and sole manifestation of a capitalist rationality. Weber would ultimately view this process of bureaucratic rationalization in Europe with great pessimism, and thus the capacity of European modernity to ultimately resist the threat of the 'enslavement of the individual' can be seen as rooted in the non-totalizing nature of the development of that rational state. And yet, even as naïve conceptions of the possibility of perfecting within Western society a rationality fulfilling enlightenment ideals are now all but non-existent, the shadow of Weber's ideal-typical rationality remains in evidence throughout attempts to understand the cultures, economies, and politics of the non-West. This raises the question of why it was—and why it remains so for many—the case that "the intrinsic (that is, not merely contingent) relationship between Modernity and what [Weber] called 'Occidental rationalism' was still self-evident."[83] The manner in which a Weberian conception of rationality thus underpinned—to varying extents—modernization theory and world-systems theory[84] has thus generated deep contradictions in the theoretical benchmark of

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[81] Jack Goody, *The Theft of History* (Cambridge, UK: Cambridge University Press, 2006), 180.

[82] Gregory Blue, "China and Western Social Thought in the Modern Period," in *China and Historical Capitalism: Genealogies of Sinological Knowledge*, ed. Timothy Brook and Gregory Blue (Cambridge, UK: Cambridge University Press, 1999), 95.

[83] Jürgen Habermas, *The Philosophical Discourse of Modernity: Twelve Lectures* (Cambridge, MA: MIT Press, 1987), 1.

[84] Wang Hui, "Weber and the Question of Chinese Modernity," in *The Politics of Imagining Asia*, ed. Wang Hui and Theodore Hunter (Cambridge, MA: Harvard University Press, 2011), 293-98.

'rational' socio-political and economic organization against which China has been compared by those within and outside China alike, and by liberals and Marxists alike.

One of the results of this grounding of political economy in the assumed universality of the Western European experience of the allied yet antagonistic relationship between capital and political authority is the construction of the state and market as largely discrete analytic categories. From its roots in the thought of these classical political economists, the analysis of the relationship between society and the economy thus became subject to a tendency towards an economistic reductionism, in which social relations and order are functionally derived from the 'laws' of economic activity. The discipline of sociology, in resistance to this economic determinism, came to emphasize the role of social agency and choice, but in doing so, relinquished any claim to analytical purchase upon 'the economy', the study of which in turn became further entrenched in its discharge of social contingency from any substantive theoretical role. The tension between the political and the economic was apparent in the treatment of "'the economy' … as 'nature': as an exogenous complex of fixed relations of cause and effect that political actors had to take into account so they could use them to their advantage."[85] The separation of the economic from the political or social has today progressed to a problematic degree. As Underhill notes, the manner by which orthodox political economy "starkly contrasts the dynamics of free markets with the 'political' dynamics of regulation and governance … yields a distorted view of how real-world economic agents compete with each other and what we should do in terms of policy."[86]

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[85] Jens Beckert and Wolfgang Streeck. "Economic Sociology and Political Economy: A Programmatic Perspective". *MPIfG Working Paper 08/04*. Köln, DE: Max-Planck-Institut für Gesellschaftsforschung, 2008.

[86] Geoffrey Underhill, "Theory and the Market after the Crisis: The Endogeneity of Financial Governance," *Working Paper* (Amsterdam, NL: Amsterdam Institute for Social Science Research, 2010), 2.

The gradual yet seemingly inexorable encroachment of the economy and its 'laws' upon 'the polity' beginning in the 1980s rendered this conceptual dichotomy between the ideal-types of the freely competitive market and social and political institutions increasingly doubtful. Political economy reacted by incorporating the analysis of the social as a functionally driven product of economic action. Exemplifying this approach, Weingast and Wittman state that "in our view, political economy is the methodology of economics applied to the analysis of political behavior and institutions."[87] Rational actor models on which both mainstream and new institutional economics are founded, and which also take prominence in social network analysis and orthodox political economy

> proceed from definitions of rationality that are independent of the cultural interpretation of the relevant situation by the actors. This tactic, however, can be justified not by its empirical validity, but only because of the usefulness of generalized assumptions of rational action for formal modeling.[88]

The limitations of a political economy approach founded on an atomistic methodological individualism prompted a turn in attention towards the study of social institutions, and their effect upon economic growth and social development. North and Thomas argued that the key to effective development was the establishment of sound institutions that equated the private to the social rate of return, setting in place incentives that would deter rational individuals from taking actions that were privately profitable but socially harmful and encourage them to engage in behaviour that was privately costly but socially beneficial.[89] Nevertheless, in many ways the emphasis upon the formality of institutions and their consequent materiality meant that the 'new

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[87] The implications of this is that, "The unit of analysis is typically the individual. The individual is motivated to achieve goals (usually preference maximization but in evolutionary games, maximization of surviving offspring), the theory is based in mathematics (often game theoretic), and the empirics either use sophisticated statistical techniques or involve experiments where money is used as a motivating force in the experiment." Barry Weingast and Donald Wittman, "Introduction: The Reach of Political Economy," in *The Oxford Handbook of Political Economy*, ed. Donald Wittman and Barry Weingast (Oxford, UK: Oxford University Press, 2008), 3.

[88] Beckert and Streeck, "Economic Sociology and Political Economy: A Programmatic Perspective," 18.

[89] North and Thomas, *The Rise of the Western World: A New Economic History*.

institutional economics' came largely to be premised upon methodological principles similar to the neoclassical theories of political economy whose limitations it had originally sought to ameliorate.

The result was that property rights as a condition of economic change became fundamental to the conceptual apparatus of the neoclassical economic theory that underpins modern institutional economics.[90] The ability to freely contract for the sale of land was a fundamental component of the lowering of transaction costs and ensuing efficiency gains. It further was the basis for the distinction drawn by classical political economists between the different forms of income: wages for workers, profits for capitalists, and rents for landlords. As Sugihara has noted, on this yardstick East Asia was always going to fare poorly.[91] These boundaries between merchants, families, and elites as different economic and political groupings had simply never operated in the same way as in Europe. Even as institutional theory has taken (thus far limited) steps towards ameliorating misconceptions of actual political economy in the West, it has achieved virtually no progress whatsoever in ameliorating the Eurocentrism of mainstream conceptions of political economy. Underhill has argued, "if we really do have a political economy, we must demonstrate, empirically and conceptually, how the whole is greater than the sum of its parts, how states and markets are integral to each other in the process of governance."[92] Indeed, the effort to look beyond states and markets for the sources of continuity and change in comparative political economy is rooted in identifying that 'how' noted by Underhill; a priori there is something other than states and markets themselves that binds them together in variegated institutional configurations. He urges the reconceptualization of the state-

[90] Marx, *Capital, Vol I*; North and Thomas, *The Rise of the Western World: A New Economic History*.

[91] Kaoru Sugihara, "The East Asian Path of Economic Development: A Long-Term Perspective," in *The Resurgence of East Asia: 500, 150, and 50 Year Perspectives*, ed. Giovanni Arrighi, Takeshi Hamashita, and Mark Selden (Abingdon, UK: Routledge, 2003), 87.

[92] Geoffrey Underhill, "State, Market, and Global Political Economy: Genealogy of an (Inter-?) Discipline," *International Affairs* 76:4 (2000): 805-24, 820.

market relationship from that of an interdependent dichotomy to one of a state-market condominium, but the conceptual foundations of that condominium are sadly lacking. It is one thing to argue that politics and economics cannot be separated, but another entirely to be reflexive about how our conceptions of political and economic rationality are constrained by a conceptual genealogy that is contained within a horizon of theoretic possibilities rooted in the Western historical experience. Accordingly, Underhill writes that,

> [Its] diversity of origin and of analytical approach militates strongly towards interpreting IPE not as an offshoot of traditional International Relations, but as rooted in the broad tradition of political economy which emerged in the European Enlightenment.[93]

The difficulty with this exhortation is immediately plain to see. The "tradition of political economy which emerged in the European Enlightenment" can only go so far in explaining or understanding political economies that developed in conditions far removed from those of the European historical experience. The limits of this tradition have been examined in some depth by André Gunder Frank, who argues that,

> this Eurocentrism had nineteenth-century sociological great-grandfathers in the 'father of sociology' August Comte and in Sir Henry Maine, who distinguished between supposedly new forms of thinking and of social organization based on 'science' and 'contract', which allegedly replaced age-old 'traditional' ones. One grandfather was Émile Durkheim, who idealized 'organic' vs. 'mechanical' forms of social organization; another was Ferdinand Tönnis, ho alleged a transition from traditional Gemeinschaft' to modern 'Gesellschaft'.[94]

The list could be continued: Parsons, Habermas, Redfield, Giddens, and even Toynbee, who in his study of other civilizations continued to herald the uniqueness of the 'Western'. The same applies to critics of capitalism: Marx proposed the notion of the 'Asiatic Mode of Production', and Polanyi claimed that no market relations, or division of labour or trade over long distances, existed on any significant scale prior to the 'Great Transformation' that unfolded in Europe

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[93] ———, "State, Market, and Global Political Economy: Genealogy of an (Inter-?) Discipline", 807.

[94] André Gunder Frank, *ReOrient: Global Economy in the Asian Age* (Berkeley, CA: University of California Press, 1998), 18.

during the nineteenth century. The difficulties encountered even now in attempting to make sense of China's politico-economic development have deep historically embedded roots. As Frank puts it,

> Received classical social theory from "Marx Weber" and their disciples is vitiated by its ingrained Eurocentrism, a bias that is not usually admitted or, perhaps, self-perceived. That bias distorts perception of, indeed blinds us from seeing, the reality of the world outside the West. Moreover, the same Eurocentrism also prevents or distorts any realistic perception even of Europe and the West itself.[95]

In this way, we begin to see the implications of writing the historiography of economic development *as it took place in Western Europe,* and positioning it as the root theoretical foundation of contemporary political economy, and the concepts and analytical constructs that are used to operationalize it.

This Eurocentrism has manifested across various literatures in political economy that each have provided specific concepts and frameworks for understanding and analyzing capitalism in comparative context, and has limited their capacity to genuinely transcend the limits of European historical experience, and understand political economy and capitalism in different places, and at different times, on their own terms. Although the acknowledgment of the relevance of institutions for the coordination of politico-economic activity remained largely captured within the confines of a monodimensional rational-egoistic assumption, it nonetheless catalyzed the resurgence of a Weberian perspective that focuses upon the state-as-agent, seeking a more plausible approach to accommodating different models of state/economy relations across socio-cultural contexts. As Stepan has formulated it,

> the state must be considered as more than the 'government.' It is the continuous administrative, legal, bureaucratic and coercive systems that attempt not only to structure

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[95] ———, *ReOrient: Global Economy in the Asian Age*, 28.

> relationships between civil society and public authority in a polity but also to structure many crucial relationships within civil society as well.[96]

This prompted the development of the notion of 'divergent capitalisms',[97] 'models of capitalism',[98] or 'varieties of capitalism' (VoC).[99] These different attempts to typologize contemporary capitalism remain rooted in the assumptions of the homogeneity of institutions considered essential for capitalism.

These conceptions of political economy thus tend to attempt to pigeonhole diverse economic forms into discrete and largely static categories of state involvement in a market economy that were premised on the analysis of advanced Western economies.[100] Yet underpinning the focus upon the state as a social institution, the nature and composition of which determines the evolution of politico-economic processes, rationality remains trapped within a bifurcation, the causes and normative implications of which remain unaddressed. As Streeck explains, the underlying fundamentals of the VoC approach are that

> social systems are politically structured to compete with each other economically; that competitive institutional arrangements tend to move and settle into a self-stabilizing equilibrium; that politics is about designing institutions that enable an efficient deployment of economic resources; that today there exist basically two variants of capitalism that are in principle equally competitive and therefore unlikely to converge; that especially employers and their firms, interested as they are in their own competitiveness, can and do instruct states and government on how optimally to organize a society as an efficient production regime; and that social systems are kept together by pressures for institutional complementarity in the service of competitive production.[101]

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[96] Alfred Stepan, *The State and Society: Peru in Comparative Perspective* (Princeton, NJ: Princeton University Press, 1978), xii.

[97] Richard Whitley, *Divergent Capitalisms: The Social Structuring and Change of Business Systems* (Oxford, UK: Oxford University Press, 1999).

[98] Bruno Amable, *The Diversity of Modern Capitalism* (Oxford, UK: Oxford University Press, 2003).

[99] Peter A. Hall and David Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford, UK: Oxford University Press, 2001).

[100] See Joachim Ahrens and Patrick Jünemann, "Transitional Institutions, Institutional Complementarities and Economic Performance in China: A 'Varieties of Capitalism' Approach" (Presented at *Workshop Series on the Role of Institutions in East Asian Development: Institutional Foundations of Innovation and Competitiveness in East Asia*, Duisburg, DE, 2007).

[101] Streeck, *Reforming Capitalism: Institutional Change in the German Political Economy*, 20.

Whilst as a descriptive exercise, the distinction between social institutions (systems of public governance, ie. the state) and firms (market actors) is entirely valid,[102] this approach fails to ask how individuals imbued with power and agency, come not only to recognize, but also to internalize and implement the complementarities between modes of action that transgress this dividing line between public institutions and private firms.[103] China may well be undergoing a process of capitalist development, however the VoC approach assumes a very limited range of complementarities between state and market, and accordingly of the potential institutional mechanisms for achieving those complementarities.

Inspired by Gerschenkron's classic consideration of the role of the state in hindering or fostering economic development,[104] a related Weberian strand of literature focused on the concept of the developmental state, which emerged out of inquiries into how neoliberal policy prescriptions calling for the minimization of state influence upon and intervention into industrializing economies had been challenged by the developmental experience of countries such as Japan, South Korea, and Taiwan.[105] According to Walder, the existence of clear incentives and organizational capacity for government principals to monitor agents and enforce

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102 For an example of the conceptual division between the structure of public institutions, and the agency of private firms, see Morgan, "Introduction: Changing Capitalisms? Internationalization, Institutional Change, and Systems of Economic Organization."

103 This is evident in accounts of China's economic reform process such as that of McNally in referring to the emergence of "a realm of the 'economy' separate and distinct from the 'state'". See Christopher McNally, "Reflections on Capitalism and China's Emerging Poltical Economy," in *China's Emergent Political Economy: Capitalism in the Dragon's Lair*, ed. Christopher McNally (Oxford, UK: Routledge, 2008).

104 Alexander Gerschenkron, *Economic Backwardness in Historical Perspective: A Book of Essays* (Cambridge, MA: Belknap Press of Harvard University Press, 1962).

105 Ronald Dore, *Flexible Rigidities: Industrial Policy and Structural Adjustment in the Japanese Economy, 1970-1980* (Stanford, CA: Stanford University Press, 1986); Alice Amsden, *Asia's Next Giant: South Korea and Late Industrialization* (New York, NY: Oxford University Press, 1989); Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton, NJ: Princeton University Press, 2004); Peter Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton: Princeton University Press, 1995); Chalmers Johnston, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975* (Stanford, CA: Stanford University Press, 1982).

their interests as owners of capital, can lead to public officials replacing the private entrepreneur as the primary mechanism driving productivity gains and market-oriented economic growth.[106]

Despite the recognition of the variability of state action that extends institutional political economy beyond advanced democratic capitalist societies, the developmental state literature has not entirely escaped the assumptions of an effective bureaucratic rationality counterposed to the rational-egoistic action of the individual economic agent. It continues to largely reflect the original emphasis exemplified by Skocpol in recognizing that,

> Doubts about the superior rationality of state actions deserve respectful attention; yet we need not entirely dismiss the possibility that partially or fully autonomous state actions may be able to address problems and even find 'solutions' beyond the reach of societal actors and those parts of government closely constrained by them.[107]

Skocpol's description of this latter issue—the generation and appropriate use of 'sound ideas'—leaves out important dimensions such as the cognitive development of substantive worldviews and their impact on how ideas will be processed, accepted and/or internalized. The turn towards the developmental state as an institution capable of actively promoting and achieving economic growth begins to capture the functional characteristics of the bureaucratic state, but nonetheless leaves unaddressed the issue of the purposive ends to which those social actors 'constituting' the state mobilize the institutional capability of the state as an entity embedded within society, but simultaneously imbued with a distinct agency. The state in this conception still remains a discrete and autonomous actor, capable itself of acting upon social stimuli as a coherent entity. Whilst Skocpol's acknowledgment that "policies different from those demanded by societal actors will be produced" by the state,[108] remains salient, the turn towards the serious study of social

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[106] Andrew Walder, "Local Governments as Industrial Firms: An Organizational Analysis of China's Transitional Economy," *American Journal of Sociology* 101:2 (1995): 263-301.

[107] Theda Skocpol, "Bringing the State Back In: Strategies of Analysis in Current Research," in *Bringing the State Back In*, ed. Peter Evans, Dietrich Rueschemeyer, and Theda Skocpol (New York: Cambridge University Press, 1985), 15.

[108] ———, "Bringing the State Back In: Strategies of Analysis in Current Research," 15.

institutions provides avenues for problematizing an essentialized conception of the state as a social institution that wields social agency in its own right, as well as providing an arena for the interactions of other social actors. The necessity of a similar conceptual move away from the state as a unitary actor has been identified in the context of analyzing state/society relations in modern China. As Gries and Rosen have argued,

> speaking in the plural of 'states' and 'societies' liberates us from the beguiling but decidedly Liberal notion of a David society fighting valiantly against a Goliath state. State and social actors in China, we find, are not always unitary and antagonistic; they can and often do form alliances with each other and against other political groups.[109]

The question is not whether the bureaucratic state is rational or not, but rather, one of how rationality is produced through actors embedded in different institutions, in different socio-cultural contexts, and at different historical junctures.

This being the case, then what kind of ontology could open up scope for understanding how socialized and discursively competent agents—active at all levels of the global political economy—come to develop the cognitive perspectives (or 'interested' framings of issues) with which they make real-world decisions? An institutionalist perspective commences with an acknowledgment that the economic activities of humans are embedded and framed within larger institutional schemes—"the building blocks of social order"[110]—that tend to be more or less stable.[111] From the 1950s onwards, social scientists have been concerned with the spread of capitalist practices and institutions across the world, from the perspective both of

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[109] Peter Hayes Gries and Stanley Rosen, "Introduction: Popular Protest and State Legitimation in 21st-century China," in *State and Society in 21st-century China*, ed. Peter Hayes Gries and Stanley Rosen (New York, NY: Routledge Curzon, 2004).

[110] Wolfgang Streeck and Kathleen Thelen, "Introduction: Institutional Change in Advanced Political Economies," in *Beyond Continuity: Institutional Change in Advanced Political Economies*, ed. Wolfgang Streeck and Kathleen Thelen (Oxford, UK: Oxford University Press, 2005), 9.

[111] Max Weber, *Economy and Society* (Berkeley, CA: University of California Press, 1978 [1922]); Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*; Thorstein Veblen, *The Theory of Business Enterprise* (New York, NY: Mentor Books, 1904); Douglass North, *Institutions, Institutional Change and Economic Performance* (Cambridge, UK: Cambridge University Press, 1990).

modernization[112] and neo-Marxist[113] theory. From these origins in a profoundly ideological struggle between competing visions of global economic development, both of which were largely discredited by world events,[114] the study of social institutions as means of organizing capitalist political economies came to be couched within a recognition that capitalism as a politico-economic system seemed likely neither to collapse within itself, nor come to be adopted homogeneously across the world.[115] Scholars thus began to demand greater attention to the conditions under which institutional variations within capitalism arose and evolved historically.[116] In doing so however, institutionalist political economy arguably came to become overly abstracted from "particular properties of the capitalist social configuration,"[117] taking 'capitalism' for granted and thereby downplaying the contradictions and tensions generated in a distinctly 'capitalist' era of global and national politico-economic evolution. As Streeck argues,

> While recent analyses of institutional change had made progress in classifying certain formal properties of the processes found to be at work in the real world of contemporary capitalism in general terms, they were unable to speak to the underlying causes of such processes. They also remained unconnected to a growing literature that had become dissatisfied with universalistic representations of 'the economy' as nature, or as a black box, returning for remedy to the concept of capitalism as a historically specific socio-economic order.[118]

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112 Walt Rostow, *The Stages of Economic Growth: A Non-Communist Manifesto* (New York, NY: Cambridge University Press, 1960).

113 James O'Connor, *The Fiscal Crisis of the State* (New York, NY: St Martin's Press, 1973); Nicos Poulantzas, *Political Power and Social Class* (London, UK: New Left Books, 1974).

114 John Campbell, "Institutional Reproduction and Change," in *The Oxford Handbook of Comparative Institutional Analysis*, ed. Glenn Morgan, et al. (Oxford, UK: Oxford University Press, 2010).

115 The three primary strands of institutional analysis are now generally characterized as rational choice institutionalism, historical institutionalism, and sociological (or organizational) institutionalism.

116 John Campbell, J Rogers Hollingsworth, and Leon Lindberg, eds., *Governance of the American Economy* (New York, NY: Cambridge University Press, 1991); Kathleen Thelen, Sven Steinmo, and Frank Longstreth, eds., *Structuring Politics: Historical Institutionalism in Comparative Perspective* (New York, NY: Cambridge University Press, 1992).

117 Streeck, "Taking Capitalism Seriously: Toward an Institutionalist Approach to Contemporary Political Economy," 7.

118 ———, "Taking Capitalism Seriously: Toward an Institutionalist Approach to Contemporary Political Economy; This literature includes Jamie Peck and Nik Theodore, "Variegated Capitalism," *Human Geography* 31(2007): 731-72; William Sewell, "The Temporalities of Capitalism," *Socio-Economic Review* 6(2008): 517-37; Dorothee Bohle and Bela Greskovits, "Varieties of Capitalism and Capitalism 'tout court'," *European Journal of Sociology* 50:355-368 (2009).

A central question of political economy therefore demands a specification of how institutional regimes are generated, maintained, and changed, not merely as distinctively capitalist social formations, but which can be conceived of beyond the confines of the European historical experience.

There exists little scholarly consensus on what constitutes a social institution.[119] Underpinning the rational choice institutionalist perspective, North states that "[i]nstitutions provide the framework within which human beings interact. They establish the cooperative and competitive relationships which constitute a society and more specifically an economic order."[120] Over time, institutional constraints accumulate and the culture of a society is nothing else than the "cumulative structure of rules, norms and beliefs that we inherit from the past, that shape our present and that influence our future".[121] In this view, social institutions are purely devoted to the reduction of uncertainty in a complex social world, and as "humanly devised constraints imposed on human interaction"[122] relegate cultural and historical factors, insofar as they complicate the "ideal conditions for maximal efficiency"[123] and economic performance, to the category of obstacles to be overcome through cognitive learning and social evolution. Highly functionalist in nature, explanations of institutional emergence and change rooted in this conception of institutions not only neglect the role of *politics*, but also more problematically, deny

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[119] See Marie-Laure Djelic, "Institutional Perspectives - Working Towards Coherence or Irreconcilable Diversity?," in *The Oxford Handbook of Comparative Institutional Analysis*, ed. Glenn Morgan, et al. (Oxford, UK: Oxford University Press, 2010).

[120] Douglass North, *Structure and Change in Economic History* (New York, NY: Norton, 1981), 201.

[121] ———, *Understanding the Process of Economic Change* (Princeton, NJ: Princeton University Press, 2005), 6.

[122] ———, *Institutions, Institutional Change and Economic Performance*, 3.

[123] Beckert and Streeck, "Economic Sociology and Political Economy: A Programmatic Perspective," 21.

the potential for different modes of *political relationship* to play a substantive role in explaining institutional change.[124]

In contrast to the conception of institutions as functionally driven efficiency-maximizing coordination mechanisms, social institutions may also be conceived of as structured by collectively enforced rules of obligatory behaviour.[125] Rules and expectations however cannot always be assumed to be perfectly internalized by actors, nor will they always be obeyed out of the self-interest of those actors.[126] Actors interpret institutional rules and engage in creative attempts to subsume the unique specificities of the current circumstances within a general understanding of what the rule is supposed to mean. This emphasis upon the point at which the ontological gaps between the general and the specific as well as between the normative and the factual is what largely defines the perspective of 'actor-centered institutionalism'.[127] Given the flexibility and freedom of this creative interpretative process,[128] the institutional ethos of action, as well as the expected ethos of action amongst institutionally situated actors is a critical factor in explaining the nature of institutional change. Institutions can therefore include informal and common cultural frameworks, symbolism, and taken-for-granted cognitive schema as well as formal rule systems, as well as the routines and processes that sustain and reproduce them.[129] Isomorphism takes place as organizations of a common type, due to their common institutional environment, adopt similar structures and practices over time, not on the basis of a universally

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[124] John Campbell and Leon Lindberg, "Property Rights and the Organization of Economic Activity by the State " *American Sociological Review* 55(1990): 634-47; Neil Fligstein, *The Transformation of Corporate Control* (Cambridge, MA: Harvard University Press, 1990).

[125] Streeck, "Taking Capitalism Seriously: Toward an Institutionalist Approach to Contemporary Political Economy," 6.

[126] In other words, actors are not presupposed to be either 'over-socialized' or 'over-rationalized'. See Dennis Wrong, "The Oversocialized Conception of Man in Modern Sociology," *American Sociological Review* 26(1961): 183-93.

[127] Renate Mayntz and Fritz Scharpf, "Der Ansatz des akteurzentrierten Institutionalismus," in *Gesellschaftliche Selbstregulierung und politische Steuerung*, ed. Renate Mayntz and Fritz Scharpf (Frankfurt am Main, DE: Campus, 1995).

[128] What Hans Joas has labelled the 'creativity of action'. Hans Joas, *The Creativity of Action* (Cambridge, UK: Polity Press, 2005).

[129] Ronald Jepperson, "Institutions, Institutional Effects, and Institutionalism," in *The New Institutionalism in Organizational Analysis*, ed. Walter Powell and Paul DiMaggio (Chicago, IL: Chicago University Press, 1991), 145.

applicable instrumental cost-benefit calculation, but on the basis of a desire for conformity to the culturally appropriate scripts, schema, and organizational models within their environment.[130]

But what are these models of conformity, and whence do they emerge? The extent to which these different institutional traditions accommodate a shared understanding of social institutions is contested across the different traditions and in different disciplines.[131] Nevertheless, given the shared historical linkages of each of the three traditions to Weber's thought,[132] it can perhaps be viewed as a progressive development that attempts are being made to incorporate both structural and ideational factors, by understanding an institution as (for example) "a system of rules, beliefs, norms and organizations that together generate a regularity of social behaviour."[133] It is only recently that the historical disregard for agency in institutional analysis, largely borne out of a Durkheimian or Parsonian functionalism began to be ameliorated.[134] At the very least, there is an increasing level of consensus that however broadly institutions are to be defined, they ought to be understood as being simultaneously products of human action and powerful influences upon human action.[135] The majority of efforts to integrate a theory of agency into the institutionalist perspective took as their point of departure the acknowledgment that the complexity, heterogeneity, and partial incoherence of institutional frames allowed individuals to utilize and recombine various institutional elements at their disposal to devise new

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[130] John Campbell, *Institutional Change and Globalization* (Princeton, NJ: Princeton University Press, 2004), 19.

[131] Djelic, "Institutional Perspectives - Working Towards Coherence or Irreconcilable Diversity?," 26.

[132] Walter Powell and Paul DiMaggio, eds., *The New Institutionalism in Organizational Analysis* (Chicago, IL: University of Chicago Press, 1991).

[133] Avner Greif, *Institutions and the Path to the Modern Economy* (Cambridge, UK: Cambridge University Press, 2006), 30.

[134] Rationalists denied implicitly the emergence of the social agent in their full complexity, historical institutionalists underscored the path-dependency of institutional frames, whilst sociological institutionalists emphasized the difficulty of escaping from the 'weight' of institutions as broad cultural and symbolic patterns. See Meyer, Boli, and Thomas, "Ontology and Rationalization in the Western Cultural Account," 18.

[135] Djelic, "Institutional Perspectives - Working Towards Coherence or Irreconcilable Diversity?," 26.

or partially reinvented solutions to their problems.[136] Yet pursuing the notion of the 'institutional entrepreneur' through to its logical conclusion as yet provided no satisfactory resolution of the ontological contradiction between a conception of institutions as deeply constitutive of actors, their expectations, and their interests on one hand, and a conception of actors as strategic, disembedded, and resource-utilizing.[137] For all its emphasis upon the institutional embeddedness of social action, neo-institutionalist theory has (perhaps understandably) made little headway in delineating the institutional manifestation of the dialectical relationship between social structure and individual agency. Most theories of action rely upon a largely teleological means-end schema for understanding human intentionality, in which an actor's perception of the world is regarded as essentially 'given', stable from context to context, and separate from action itself.[138] A course of action is then 'chosen' on the basis of anticipated consequences; what might be termed a 'portfolio' model of the actor.[139]

Yet without going beyond this view, the social environment from which the resources for the exercise of action vis-à-vis institutions are drawn still remains dominated by institutions themselves. Rather, institutions ought to be understood as forming part of an environment in which substantial indeterminacy and situational ambiguity nonetheless remain, generating gaps in which the development of worldviews, perceptions, and preferences becomes not only important, but highly contingent and context-specific. In this conception, the institution becomes just one element of a situation—a 'social fact' within the situational horizon.[140]

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[136] Jens Beckert, "Agency, Entrepreneurs, and Institutional Change: The Role of Strategic Choice and Institutionalized Practices in Organizations," *Organization Studies* 20:5 (1999): 777-99; Wolfgang Streeck and Kathleen Thelen, eds., *Beyond Continuity: Institutional Change in Advanced Political Economies* (Oxford, UK: Oxford University Press, 2005).

[137] Marie-Laure Djelic and Kerstin Sahlin-Andersson, eds., *Transnational Governance* (Cambridge, UK: Cambridge University Press, 2006).

[138] Gregory Jackson, "Actors and Institutions," in *The Oxford Handbook of Comparative Institutional Analysis*, ed. Glenn Morgan, et al. (Oxford, UK: Oxford University Press, 2010), 77.

[139] Josh Whitford, "Pragmatism and the Untenable Dualism of Means and Ends: Why Rational Choice Theory Doe Not Deserve Paradigmatic Privilege," *Theory and Society* 31:3 (2002): 325-63.

[140] Jackson, "Actors and Institutions," 77.

Accordingly, since the institution does not impose a monopoly upon the intersubjective process by which an actor develops a worldview and derivative preferences, the meaning of an institution in particular historical circumstances becomes contingent. No one-to-one relationship between institutions and their context-specific meaning exists.[141] Particular behaviours, patterns, or relationships may be more or less institutionalized, but institutions cannot be considered a fixed, exogenous, objective reality. Rather, their meaning exists both exogenously and endogenously to the actor, as a 'matter of degree'.[142] Jackson sums it up rather neatly in stating that,

> Institutions may be understood as a non-deterministic context for action. These contexts are inhabited by multiple actors with different skills and capacities. Actors may see and interpret the same institution in different ways. Such differences may give rise to contention or conflict over those meanings, and lead to the incremental modification of those institutions over time.[143]

By providing a means of understanding similarities across different socio-cultural contexts that are not explained by such a functionalist rationality,[144] institutionalism seeks to fill in the social constructivist paradigm with substantive content, generating claims as to what social structure is, rather than simply why it matters. It seeks to understand in empirical and practically relevant ways how a particular set of cultural norms comes to affect behaviour and decision-making across different institutional contexts.

Nevertheless, we can see some of the ways in which institutionalism comes to betray a variety of concerns that remain central to a truly constructivist account of political economy. It is evident that there are significant shortcomings in the institutionalist approach that become

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[141] Roger Friedland and Robert Alford, "Bringing Society Back In: Symbols, Practices, and Institutional Contradictions," in *The New Institutionalism in Organizational Analysis*, ed. Walter Powell and Paul DiMaggio (Chicago, IL: University of Chicago Press, 1991), 255.

[142] Ronald Jepperson, "Institutions, Institutional Effects, and Institutionalism," ibid. (Chicago University Press).

[143] Jackson, "Actors and Institutions," 80.

[144] Martha Finnemore, "Norms, Culture, and World Politics: Insights from Sociology's Institutionalism," *International Organization* 50:2 (1996): 325-47.

apparent when attempting to mobilize it in the study of political economy.[145] First, the underlying commitment to structuralism within its theoretical models crowd out culturally embedded agency and dynamism that could motivate a departure from instrumental rationality. Second, it sometimes problematically assumes Western rationality (embodied in law, bureaucracy and markets) as the means to achieve progress (wealth accumulation) and justice (equality). Third, it suffers from a deficit of attention paid to the impact of power relations, and the contestation and conflict that ensues. The institutionalist perspective brings a number of theoretical and analytical opportunities to the question of how practices and institutions of capitalist economic production may come to be realized as a particular arrangement of mechanisms for social coordination through vertical hierarchy and horizontal competition. Nevertheless, despite its growing recognition of the mutual constitution of institutions and actors, the current state of theory within the institutionalist perspective remains challenged by such a question due to its bias towards either institutional stasis, or convergence towards a particular conception of social order that largely mirrors those that have evolved incrementally within the advanced political economies of the Western world.

Conclusion

In this chapter I have sought to provide a foundation for the reconceptualization of China's contemporary political economy that begins in the next chapter. I argued that the limitations of current concepts and frameworks in theorizing the interplay of the political, economic, and social logics of contemporary capitalism, both East and West, have deep roots that can be traced back

[145] Strenuous efforts within more recent literature have not yet fully overcome many of the issues identified almost twenty years ago. Peter A. Hall and Rosemary C. R. Taylor, "Political Science and the Three New Institutionalisms," *Political Studies* XLIV(1996): 936-57.

to historical differences in how this interplay produced divergent trajectories of development in Europe and China. This can be read as a critique of mainstream political economy on two levels. Firstly of the still-visible limitations of current frameworks for understanding the distinctly capitalist dynamics of the global political economy, and secondly, of a deeper inability to develop analytic frameworks for a capitalism that is the product not exclusively of historical trajectories rooted in the Western experience. As Anderson emphasized in the same passage as the epigraph at the commencement of this chapter,

> Asian development cannot in any way be reduced to a uniform residual category, left over after the canons of European revolution have been established. Any serious theoretical exploration of the historical field outside … Europe will have to supersede traditional and generic contrasts with it, and proceed to a concrete and accurate typology of social formations and state systems in their own right, which respects their very great differences of structure and development.[146]

Conceptualizing the capitalism that has emerged in China demands a perspective that takes the concepts of rationality and interests seriously, but recognizes that these cannot be assumed to be embodied in ideal-typical fashion to be attached to the institutional forms of corporate firms, bureaucratic actors, and overarching structures of political authority that have emerged as a result of Western historical experience. Furthermore, it is crucial to recognize that the historical contingency of capitalism as a particular social formation renders it necessary to understand institutional change as located within broader trajectories of development that are neither immutable nor inevitable. Just as China's experience involves reconfiguring some of the socio-institutional underpinnings of capitalist political economy, so too do we need to reconfigure the theoretical frameworks that we deploy to assess and analyze it.

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[146] Anderson, *Lineages of the Absolutist State*, 549.

III Financial Development Under Conditions of Uncertainty: Conceptualizing a Risk Environment

> Assuming that we are facing a choice under uncertainty, what does rational-choice theory tell us about what we ought to do? The answer is: very little.[1]
>
> — Jon Elster

> There are two kinds of risk assessment. The first is based on numbers. The second is based on belief.[2]
>
> — Risk assessment manager, Agricultural Bank of China

Introduction

In the previous chapter I sought to place contemporary Chinese political economy in historical and comparative perspective, arguing that when viewed in the longue durée it becomes necessary to introduce a Braudelian conceptual distinction between forms of market exchange and forms of capitalist exchange.[3] I return to the question of the nature of contemporary capitalism in the conclusion of this chapter, adopting the 'minimal formula' of Boltanski and Chiapello, who characterize capitalism as

> an imperative to unlimited accumulation of capital by formally peaceful means. The constant reintroduction of capital into the economic circuit with a view to deriving its profit—that is to say, increasing the capital, which will in turn be reinvested—is the basic mark of capitalism.[4]

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[1] Jon Elster, *Rational Choice* (New York, NY: New York University Press, 1986), 6.

[2] BJ:2012.11.09. Interview, Beijing.

[3] See Fernand Braudel, *Civilization and Capitalism, 15th - 18th Century, Vol. 1: The Structure of Everyday Life* (New York, NY: Harper & Row, 1981); Arrighi, *Adam Smith in Beijing: Lineages of the Twenty-First Century*; Wong, *China Transformed: Historical Change and the Limits of European Experience.*

[4] Original emphasis. Luc Boltanski and Eve Chiapello, *The New Spirit of Capitalism* (London, UK: Verso, 2007 [1999]), 4-5. Several characteristics of a political economy constitute a common ground for different definitions. Capital is considered the central requirement and necessary for economic activity, 'free' workers are contained within a system of wage labour, and the accumulation of money and wealth is a common objective amongst economic actors.

The desires for commercial modernization and global economic integration that China has embraced since the beginning of the reform era have coalesced with the domestic imperatives of Chinese society and culture in ways that represent novel yet distinctly capitalist modes of mediating between different sources of power and authority. Accordingly, as I argued in the previous chapter, an adequate understanding of the transformation of the Chinese financial system since 1978 cannot be assumed to rest upon the discrete institutional categories of the state, the market, and civil society as they are traditionally understood in Western social theory. An attempt to analyze the development of China's financial system and the role that it has played within China's development thus demands a reappraisal of the nature of these institutional categories of 'rational' socio-economic action in modern capitalist society. This chapter develops a framework for this analysis, in which the flow of capital throughout the political economy is modulated not as a product of market liberalization or state planning, but in terms of its relation to the socio-political authority of the CCP. Through the exercise of such authority, an ideologically robust, institutionally sophisticated, and highly networked organizational structure at the nexus of state governance and market-active financial institutions is capable of enabling both economic activity whilst also preserving political control. This framework generates the analytical space for conceiving of the CCP as residing at the core of a coherent and institutionally flexible system of capitalist accumulation,[5] rather than as either a rigid and ossified authoritarian organization encircled by capitalist market forces, or as a committed adherent to the financial and economic liberalization that is often assumed to inevitably accompany the process of economic commercialization and growth.

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[5] I deal with the question of socio-economic change and stability later in this chapter, as a product of the interaction of the 'dimensions of embeddedness'—frames, institutions, and networks—that underpin the analytical framework. Continuity has been preserved in the underlying *logics* of capitalist development in China, even as dramatic *institutional* change has unfolded through the reform process. It is understanding this distinction that propels the effort to move beyond existing categories of 'state' and 'market'.

Contrary to both conventional micro-economic assessments of financial efficiency and macro-economic assessments of its presumed teleological transformation from a relic of the planned economy into a 'modern' financial system, I thus approach the study of the Chinese banking system as a system of risk management that has been actively constructed and reinforced by financial elites committed to the CCP's goal of realizing economic growth without relinquishing political control. In this sense, China's approach to financial reform has been deliberate, and Chinese policy-makers' conception of the role of the financial system has not in fact been predicated on the financial system operating as just another 'economic sector' that was either suitable for 'privatization' or 'marketization' based on current circumstances and other factors related to comparative advantage, vested interests, and endowments of factors of production. Rather, Chinese financial elites have had a distinct vision of how the financial system is to exist as an economic sector supportive of and ancillary to the real economy. China's conceptions of finance, what it represents within society, and how it is to relate to political authority are distinct. In later chapters I trace how these conceptions of finance and its relationship to the socio-political have informed China's path of development as a domestically oriented yet globally emerging political economy. Through this examination it becomes possible to begin to understand China's position within the broader evolution of modern global capitalism in more nuanced and accurate ways.

In the second section I examine the social foundations and significance of politico-economic risk and uncertainty, arguing that interpretations of and resultant responses to risk and uncertainty are highly influential factors in the construction of actors' preferences, as well as the means by which they pursue those preferences. The third section outlines the concept of the 'risk environment' as a holistic social basis upon which these interpretations and responses are formed, doing so with reference to the particularities of the Chinese politico-economic context. The fourth section traces out the ways in which the construction of a risk environment produces socio-economic outcomes that can be assessed in terms of growth, stability, and broader socio-economic balance. The fifth section turns to the issue of stability and change in the risk environment, detailing the mechanisms by which different components of the risk environment interact, variously reinforcing and undermining each other. Finally, the sixth section draws out the implications of the analytical framework for the understanding of China's development trajectory as *distinctive* yet *distinctly capitalist* in nature.

The Socio-Economic Significance of Risk and Uncertainty

Before detailing in the next section the characteristics of the risk environment that has emerged in China during the reform era, it is necessary to explore the relevance of risk and uncertainty for the analysis of the drivers of socio-economic action. In developing an analytical framework around the concept of a risk environment, I place it in opposition to the reduction of rationality to an under-socialised conception of an individual's utility-maximizing calculus of either economic wealth or political power. At the same time I retain an emphasis upon the intentional agency of the social actor, seeking to avoid an over-socialized view of institutional constraints and macro-structures. Rather, as Beckert explains,

> Thinking about economic rationality does not focus on the identification and realization of an optimal strategy but, instead, on the construction of the meaning of intentionally rational economic action. If an optimal strategy cannot be deduced mathematically from existing preferences and conditions, decisions depend on actors' definitions of the situation. Such definitions constitute the intelligibility of the complex environment and are reached through contingent interpretations that are based on judgments about material conditions, causal relations, the future actions of relevant others, and assumptions about changes in technology or markets. In this process means and ends are intertwined and formed in the situation itself; they become more pronounced and undergo continuous revision as action proceeds, and as actors learn new things through further experiences,

> disappointments, and encouragements. The definition of the situation is seen as the result of contingent reflections of actors in a social process.[6]

Previous treatments of the political economy of China's reform have addressed the question of the motives for economic activity. As Gore observes,

> economic dynamism is defined as the dominant pattern of interactions among the main actors of an economy. It is associated with or characterized by the main actors, their utility functions, and the structural features of an economy; it is sustained by the incentive structure of a given institutional context, and is the primary driving force in the economy that ultimately determines the outcome.[7]

Yet in such formulations, there remains an under-specification of how such utility functions emerge and evolve, how different factors modulate incentive structures, and how the structural features of an economy will be interpreted and responded to on the basis of intersubjective understandings between actors. A focus upon the significance of risk and uncertainty provides a powerful conceptual basis upon which to identify and come to terms with both the ends to which social action is directed, as well as the means by which that social action takes place. By differentiating between the sociological management of broader uncertainty in order to address immediate politico-economic risk, we can see more clearly how means and ends coalesced in the reconfiguration of the post-Tiananmen political economy.

Conceptualizing a risk environment as a socially constructed set of institutional mechanisms residing at the heart of economic growth in China enables one to begin to understand how, having embraced the idea that stable economic growth was essential above all else to securing the social and political goals of the CCP, China's policy-makers and financial elites were able to orient the banking system and the allocation of capital towards a particular set of economic goals and priorities in the absence of sophisticated market mechanisms and in the

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[6] Jens Beckert, *Beyond the Market: The Social Foundations of Economic Efficiency* (Princeton, NJ: Princeton University Press, 2002), 290.

[7] Lance Gore, *Market Communism: The Institutional Foundation of China's Post-Mao Hyper-Growth* (Oxford, UK: Oxford University Press, 1998), 36.

face of increasing market-competition in the real economy. This conception of the risk environment that enabled the fulfillment of these goals approaches the financial system as a set of social resources—a tool of macroeconomic and political policy. In this light, it becomes both possible and necessary to base the analysis of the foundations of economic growth on a sociological analysis of the financial system as constitutively embedded within the broader economy. Whilst there is a developed literature on the sociology of financial markets, there is somewhat of an odd dearth of adequate treatment of the sociological role of the financial system in economic growth. This demands addressing not only the way in which the financial system directs capital in a particular set of patterns according to economic and political interests, but also the way in which discourses and ideas about the financial system itself affect the path of economic growth. Firstly it will affect the internal structure and dynamics of the financial system, but it will also affect the way in which non-financial markets and broader economic systems come to structure themselves vis-à-vis the financial system. Addressing the financial system as a complex of distinctively sociological institutions recognizes that,

> Although economic action is conditioned by the social contexts in which it takes place, it is not determined by these contexts but rather depends on how they are interpreted by economic actors … understanding economic action requires that the responses of actors and their assessment of the risks and opportunities inherent in a given situation be explained with reference to the meaning that the situation has for them.[8]

The deployment of financial capital and its investment into production thus stimulating employment, economic activity, and the resulting accumulation of greater capital is a process that demands intersubjectively shared understandings amongst a wide variety of actors throughout the political economy. The flow of capital throughout the real economy as financial capital rests upon sociological foundations, and it is thus socio-economic features that both demand and are reflective of capitalism's systemic dynamism and individual innovativeness.

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[8] Beckert and Streeck, "Economic Sociology and Political Economy: A Programmatic Perspective," 17-18.

The ways in which social actors interpret and respond to risk and uncertainty are significant factors in shaping the outcomes of decision-making in terms of institutional stability, social equality, and material economic growth. One of the fundamental obstacles confronted by social actors is that of the uncertainty that arises out of an actor's embeddedness within a social environment.[9] For a rational institutionalist like Douglass North, uncertainty is a product of the complexity of the problems to be solved, the limitations of the problem-solving software possessed by an actors, and incomplete information between social agents.[10] In contrast, for an economic sociologist like Jens Beckert uncertainty must be regarded as qualitatively different from situations of risk, since the problem of risk is commonly understood to be one that is to be measured, evaluated, and responded to on a quantitative basis.[11] In situations of risk, "the distribution of the outcome in a group of instances is known … while in the case of uncertainty … it is impossible to form a group of instances because the situation dealt with is to a high degree unique."[12] Uncertainty is thus much more than the probability distribution problem that arises out of the 'complexity' emphasized by rationalist institutional analysis.

The significance of the uncertainty inherent in action as social action arises not just in commercial exchange relations between individuals or private legal bodies, but more broadly across a range of actors with interests in the economic reproduction of society. Decision-making under conditions of uncertainty demands that a variety of complex and inter-related social conditions be interpreted and then managed in order for any form of agency to be exercised in a coherent manner. In this sense, the reproduction of society involves two processes. The first process is a matter of how social actors construct the ends of action, whereas the second

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[9] Frank Knight, *Risk, Uncertainty, and Profit* (Chicago, IL: Chicago University Press, 1985 [1921]).

[10] North, *Institutions, Institutional Change and Economic Performance*, 25.

[11] Jens Beckert, "What is Sociological about Economic Sociology? Uncertainty and the Embeddedness of Economic Action," *Theory and Society* 25(1996): 803-40, 804.

[12] Knight, *Risk, Uncertainty, and Profit*, 229.

involves the construction of means by which to achieve those ends. This gives rise to the two inter-related problems of action: (1) assigning preferences, and (2) navigating between competition and cooperation. These dilemmas can only be resolved via a system of more or less 'stable reciprocal expectations'[13] on the part of actors that enable them to manage the uncertainty and risk that arises not just within market-settings, but which also afflicts action within the political economy more broadly. The basis upon which these expectations emerge and evolve in order to enable not just economic action, but a particular form of economic action, is at the heart of the concept of a risk environment. Being socially embedded, these expectations are thus each reliant for their institutional integrity upon a base level of intersubjective understanding. Identifying the variegated nature of this intersubjective understanding, and how this understanding evolves and manifests for different actors in different areas, is the necessary step in understanding the distinctive nature of Chinese capitalism as well as the reasons for China's distinctive and paradoxical path of economic growth.

The social construction of a modern business system is therefore not just a matter of shaping patterns of trust and expectation, but shaping them in a particular way. As Redding and Witt observe,

> Being modern is in essence having a society in which the problem of mistrust has been solved sufficiently well to allow most people to take the risk of transacting business (at least potentially) with most other people, even if they are strangers.[14]

These structures of expectation are sources of social power and authority, becoming laden thus not just with neutral 'steering capacity', but also with the potentials for realizing profoundly normative visions and agendas for the nature of social action.

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[13] Jens Beckert, "The Social Order of Markets," *Theory and Society* 38(2009): 245-69, 245.

[14] S. Gordon Redding and Michael Witt, *The Future of Chinese Capitalism: Choices and Chances* (Oxford, UK: Oxford University Press, 2007), 3-4.

These 'fictional expectations'[15] are buttressed by both rational means-end calculations and social macrostructures, but the decision-making process is reducible to neither. The importance of approaching the issue of risk and uncertainty intersubjectively is borne out through field research. Actors within the Chinese political economy and particularly the financial sector refer frequently to 'expectations' [预期 or 期待] in how they dealt with not only government and party officials but also, if they are bankers, with their clients and creditors. The basis of these expectations is rooted in their interpretation of a broad variety of factors and variables stretching across the directly political (elite party politics as well as localized political dynamics), the socio-cultural (shifting patterns of demand and consumption and the evolution of social values), and the directly economic (production efficiency, earnings records, and investment prospectuses). In this way, financial elites refer to 'structures of expectation' in their decision-making processes, and the manner in which they do so then reinforces certain patterns of expectation and intersubjective acceptance such that they also emerge as social rigidities capable of structuring individual agency. As Beckert argues,

> The dynamics of capitalism depend on the creation of expectations that make promises appear credible, goods desirable, imaginaries worth pursuing, and strategies plausible. By influencing macroeconomic outcomes, expectations provide a link between micro and macro levels of analysis. To enable the expansion in scope and complexity that has been characteristic of contemporary capitalist economies, societies needed to develop the cultural, political, and institutional prerequisites that allowed for highly unlikely behavior based on expectations of perceived opportunities in uncertain situations. … [They] are shaped communicatively by actors—firms, the state, market intermediaries, advocacy groups, etc.—and are based on institutional, cultural, and network structures.[16]

At the same time, these structures of expectations are manipulable by actors in order to achieve particular objectives and interests. This 'management of expectations' has the result that,

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[15] Jens Beckert, "Imagined Futures: Fictional Expectations in the Economy," *Theory and Society* 42:3 (2013): 219-40.

[16] ———, "Capitalism as a System of Expectations: Toward a Sociological Microfoundation of Political Economy," *Politics and Society* 41:3 (2013): 323-50, 341-42.

> Motivating the decisions of actors by shaping their expectations, including the shaping of the social and political structures underlying these expectations, becomes one of the main tasks of political regulators and a major goal of speech acts uttered in the field of the economy.[17]

Heilmann and Perry have argued that one of the central elements of the style of 'adaptive governance' practiced by the CCP is that of 'guerilla-style policymaking' in which secrecy, versatility, speed, and surprise enable the CCP and its leaders to "embrace uncertainty in order to benefit from it."[18] Although Heilmann and Perry limit themselves to assessing the mechanisms by which individual elites and policymakers 'push and seize' policy innovations, this deliberate embrace of ambiguity and uncertainty generates a broader phenomenon of 'multivocality' as a distinctive mechanism of control and authority. The multivocality of interpretation is "the fact that single actions can be interpreted coherently from multiple perspectives simultaneously, the fact that single actions can be moves in many games at once, and the fact that public and private motivations cannot be parsed."[19] In their illuminating study of Florentine state-building in the 15th century, Padgett and Ansell argue that this is the key to understanding how the 'sphinxlike character' of Cosimo de Medici was paradoxically capable of founding a dynasty that dominated Florence for three centuries, even as he appeared to possess no formal institutional authority within the political economy. All others around him were compelled to construct their own distinctive attributions of his identity, something crucial to his ability to maintain discretion and

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17 ———, "Capitalism as a System of Expectations: Toward a Sociological Microfoundation of Political Economy", 326.

18 Sebastian Heilmann and Elizabeth Perry, "Embracing Uncertainty: Guerrilla Policy Style and Adaptive Governance in China," in *Mao's Invisible Hand: The Political Foundations of Adaptive Governance in China*, ed. Sebastian Heilmann and Elizabeth Perry (Cambridge, MA: Harvard University Press, 2011), 8.

19 John Padgett and Christopher Ansell, "Robust Action and the Rise of the Medici, 1400-1434," *American Journal of Sociology* 98:6 (1993): 1259-319, 1263.

remain at the indispensable center of a 'positional play' game.[20] Accordingly, "control was diffused throughout the structure of others' self-fashionings,"[21] such that,

> One needs to penetrate beneath the veneer of formal institutions and apparently clear goals, down to the relational substratum of people's actual lives. Studying "social embeddedness," we claim, means not the denial of agency, or even groups, but rather an appreciation for the localized, ambiguous, and contradictory character of these lives. Heterogeneity of localized actions, networks, and identities explains both why aggregation is predictable only in hindsight and how political power is born.[22]

However, Heilmann and Perry come close to excessively downplaying the role of institutions in reducing uncertainty in the Chinese political economy, especially as rationalization and institutionalization of the dynamic processes has become increasingly seen as an important priority of politico-economic reform. What is evident is the extent to which both of these styles of governance have been integral and central to the path of market-led economic reform under the authoritative control and guidance of the CCP. Institutions have emerged that reduce uncertainty and permit the expectations necessary for successful and dynamic socio-economic reproduction, yet the CCP has thus far retained its capacity to manipulate these institutions and manage expectations such that its ultimate capacity to control and rule has remained intact.

In sum, the uncertainty of socio-economic action has enabled the CCP to maintain control, even when circumstances undermine its legitimacy. Entrenched and resilient CCP control has arisen out of the CCP's ability to exploit the functional necessity of constructing cognitive frames, institutions, and networks to manage uncertainty, such that the capacity to manage uncertainty becomes concentrated within the CCP as a particular social grouping. This need for cognitive, institutional, and networked mechanisms for reducing uncertainty and mediating (and thus translating) the social world into a comprehensible environment for action

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[20] A positional play game involves the maneuvering of opponents into the forced clarification of their (but not one's own) tactical lines of action. See ———, "Robust Action and the Rise of the Medici, 1400-1434", 1264.

[21] ———, "Robust Action and the Rise of the Medici, 1400-1434", 1264.

[22] ———, "Robust Action and the Rise of the Medici, 1400-1434", 1310.

has historically been conceived of as being satisfied either by the structures of state governance or structures of market exchange. In China's emergence as a capitalist political economy, the role of the CCP disturbs these traditional categories of state and market, not because the functional characteristics of hierarchical control or contractual exchange as a means of organizing socio-economic reproduction have been modified, but rather because the imperatives of capitalism find clear expression in how the CCP constructs frames, institutions, and networks as mechanisms for orienting action towards economic growth as a basis for satisfying the priorities of social stability and order.

A risk environment is therefore a specific configuration of socially constructed and culturally mediated institutional structures that renders it rational for certain actors to undertake certain economic activities. It operates as a bridging concept between an actor's micro-social circumstances, and actual social outcomes, by detailing the social theoretic dimensions across which logics of action will play out so as to produce particular outcomes. As such, a risk environment of some form or another underpins all socio-economic activity. It is neither a set of structural social institutions nor a deliberate product of specific agents. Rather, it is the encompassing array of intersubjectively generated capacities to act within the embedded context of an uncertain and inherently 'risky' social environment. It takes its form by concentrating the attentions of different actors within the political economy upon a particular set of problems involved in formulating paths of action in pursuit of socio-economic development. Accordingly, a financial risk environment will assume a particular institutional configuration that permits and encourages a particular form of economic growth and development. Changes in a risk environment's institutional configuration will produce corresponding change in the nature of economic growth and societal development.

Importantly, the framework developed here to delineate the contours of a risk environment is not one to explain the behaviour of market-situated actors acting and making decisions under conditions of market uncertainty, nor is it a framework to comprehend bureaucratic or political decision-making. It is dedicated to comprehending the evolution and impact of a particular set of actors: those who arise from a context of social embeddedness in which they not only constitute the political sphere, but also simultaneously determine the parameters and shape of the market. The conceptual difficulty encountered in both outlining and applying such a framework for stability and change in relation to a case such as China's, is that it represents an attempt to study the political and the economic dimensions of the CCP within a single analytical framework. That is to say, the heuristic of the risk environment as I develop it within this thesis is directed towards both the dynamics of making policy as well as economic decisions. Once presumptions of the analytical significance of public or private ownership for the dynamics of economic reproduction are discarded, the significance of the CCP's role at the heart of both of these processes in China's transition to an authoritarian capitalist society becomes not only apparent, but also inescapable.

In this sense, certain elements of the concept of the risk environment are applicable to the analysis of market- and bureaucracy-centric actors respectively, but it is necessary to recognize that China's uniqueness emerges from the way in which continuity has been preserved so effectively and so deliberately in the path of development and reform. This point assumes particular significance when it is accepted of the current study privileging this set of actors over other possible sources of action and agency that have played a role in China's economic development. The significance of the particular risk environment that evolved around the central role of the CCP in structuring the course of development in China lies in its status as a necessary but insufficient condition for China's development. A focus upon the role of the CCP does not exclude the role played by other factors, but is rather to highlight the central and distinctive nature of that role, and its implications for how we conceptualize development as a product of socially embedded action capable of being undertaken by a variety of actors independently of a preconceived role within either bureaucratic or market structures.

As is clear from the above statements, the insights of economic sociology provide the necessary point of entry into an exploration of the sociological foundations of the role of China's banking and financial system in underpinning China's socio-economic development. The recognition that a risk environment is socially constructed and pre-conditional for economic activity allows one to pose not the question of how effectively a financial risk environment manages risk, but how the effective management of financial risk itself has been defined through the construction of a particular politico-economic discourse. Thus the risk environment, and in particular the socially constructed foundations of the risk environment, plays a profoundly important role in shaping the path of socio-economic development. Yet in what exactly is a risk environment embedded, and how does this embeddedness affect the nature of the risk environment that has emerged in China? The next section turns to these questions, investigating the social foundations of the CCP's management of risk and uncertainty in the reform era.

Constructing a Risk Environment

I utilize dimensions of embeddedness "as variables to explain economic processes and structures."[23] In the present case they are the variables that assist in comprehending the role of the CCP in constructing a 'space of power' through which both the forces of capital and of politics are capable of transmission. The exercise of power within this social space is what enables actors to engage in sense making of the social world, to develop interests and preferences, and to coordinate meaningful social action. The question thus arises of the substantive bases upon which this risk environment is constructed, and the logics of action that derive from this risk environment. This section first argues that notwithstanding the 'pragmatism'

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[23] Beckert, "The Social Order of Markets", 292.

of China's approach to economic and financial reform, it is both necessary and possible to delineate the contours of Chinese social relations in a way that is analytically useful for understanding the role of the CCP in the course of financial reform. It introduces the categories and concepts developed by Chinese sociologist Fei Xiaotong, developing these as the substantive basis for an analytical framework centered around three dimensions of embeddedness: cognitive frames, institutional structures, and social networks.

A number of prominent Chinese intellectuals have taken steps to attempt to construct a Chinese social science that is "both informed by Western social science and at the same time critical of mainstream Western thinking."[24] Central amongst these are Wang Hui and Cui Zhiyuan, who have argued that China should avoid the single-minded pursuit of the Western neoliberal economic model, not only because the validity of that model has been rendered highly doubtful in recent decades and years, but also because they argue that China has the intellectual resources and legacies that will enable it to avoid some of the problems that afflict the West.[25] The arguments developed by such intellectuals during the reform era and their influence will come into play in later chapters. However their thought functions most effectively as a method of critique and for framing the theoretical endeavour at hand, rather than the basis for a positive conception of social order in modern China. For the purposes of developing such an analytical framework with which to outline the contours of a risk environment, the most useful set of concepts are those of Fei Xiaotong, who was the first Chinese sociologist to attempt to develop an indigenous theory of Chinese society that was intelligible through the conceptual and

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[24] Joseph Fewsmith, *China Since Tiananmen: From Deng Xiaoping to Hu Jintao* (Cambridge, UK: Cambridge University Press, 2008), 129.

[25] See Wang Hui, *现代中国思想的兴起 (全四册) [The Rise of Modern Chinese Thought (Four Volumes)]* (Beijing, CN: 新知三联书店 [New Knowledge Joint Publishing], 2004-09); ———, "Contemporary Chinese Thought and the Question of the Modern [当代中国的思想状况与现代性问题]; Cui Zhiyuan, *第二次思想解放与制度创新 [The Second Thought Liberation and Institutional Innovation]* (Hong Kong, CN: Oxford University Press, 1997).

linguistic idioms of Western social science and which thus enabled a comparative reference.[26] Fei's sociology assists in developing a framework for analyzing a structure that does not abide by traditional categories of institutional design dominated by the state/market dichotomy.[27] The 'culture' question is not one that should be resolved here through epistemological debate. Rather it can and must be approached empirically as a relevant and influential factor in the process of social evolution; a 'practical sociology'[28] that, in its due attentiveness to the practice of socio-economic evolution and transformation, embeds its theory and analysis in the social reality undergirding and surrounding this process.

Fei's theory draws clear conceptual distinctions between the social structure of Western (presumably the Anglo-Saxon western world) and Chinese society. He argues that whereas Western society is characterized by an 'organizational mode of association' (*tuantigeju* 团体格局), Chinese society is characterized by a 'differential mode of association' (*chaxugeju* 差序格局). Fei's conception of the Western mode of association as a distinct social formation is thus described:

> Western societies are somewhat like the way we collect rice straw to use to cook our food. After harvest, the rice straw is bound into bundles; several bundles are bound into larger bundles; and these are then stacked together so that they can be carried on shoulder poles. Each piece of straw belongs in a small bundle, which in turn belongs in a larger bundle, which in turn makes up a stack. The separate straws, the separate bundles, and finally the separate stacks all fit together to make up the whole haystack. In this way, the separately bound bundles can be stacked in an orderly way.
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> In Western society, these separate units are organizations. By making an analogy between organizations in Western societies and the composition of haystacks, I want to indicate

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[26] See Yang Yabin, *近代中国社会学 [Modern Chinese Sociology]* (Beijing, CN: Chinese Social Sciences Press, 2001), 665.

[27] It is important here to stress that this does not constitute the beginnings of a culturalist argument concerning the construction of a 'Chinese capitalism' as the key factor in explaining China's path of economic development (whether regarded as successful or otherwise). This is to emphasise that capitalism in China cannot be comprehended absent reference to "the structure of a Global Capitalism that is its condition", and vice-versa. And yet culture matters; there exists more than one pathway to capitalist modernity, and the cultural and historical lineages of Chinese society constitute part of the 'Chineseness' of a form of capitalism that has emerged by virtue of its position within global capitalism. See Arif Dirlik, "Critical Reflections on 'Chinese Capitalism' as Paradigm," *Identities* 3:3 (1997): 303-30, 323.

[28] Sun Liping, "On the Practice of Market Transition," in *Sociology and Anthropology in Twentieth-Century China: Between Universalism and Indigenism*, ed. Arif Dirlik (Hong Kong, CN: The Chinese University Press 2012).

> that in Western society individuals form organizations. Each organization has its own boundaries, which clearly define those people who are members and those who are not. That much is always clear. The people in an organization form a group, and their relationship to the organization is usually the same. If there are differences among group members or distinctions among ranks within the organization, these would have been agree upon earlier as part of the rules of the organization.
>
> […] My purpose in making the analogy […] is to help us see more concretely the pattern of personal relationships in social life, what I will henceforth call the 'organizational mode of association'.[29]

In contrast to the organizational mode, the concept of *chaxugeju* represents an attempt to describe analytically the patterning of Chinese society through nonequivalent ranked categories of social relationships. These social relationships have four key features. Firstly, networks are discontinuous, in that they centre on individuals and are composed differently for each person. This means that egocentrism and an a priori social embeddedness can coexist. They are egocentric since each person is at the centre of their own social network.[30] Yet simultaneously the Chinese mode of association presupposes multiple linkages of self with others and a categorization of those linkages in sets of 'consanguineous coordinates' such as the 'socialized space' of geography, close family, or broader lineages.[31] Secondly, each link in a Chinese person's network is defined in terms of a dyadic social tie (*guanxi* 关系). Each tie is simultaneously both normatively defined and strictly personal.[32] They are normative in the sense that they consist of an explicit category of social relationship that demands specific, prescribed

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[29] Fei Xiaotong, *乡土中国 [From the Soil]* (Shanghai, CN: Shanghai People's Press, 2006 [1948]), 61-62.

[30] Stephan Feuchtwang, "Social Egoism and Individualism: Surprises and Questions that Arise from Reading Fei Xiaotong's Idea of 'The Opposition' between East and West'," in *Fei Xiaotong and Sociology-Anthropology in China*, ed. Ro Ma (Beijing, CN: Beijing Social Science Academic Press, 2009).

[31] Fei Xiaotong, *乡土中国 [From the Soil]*, 121.

[32] For an examination and update of the interactional aspects of Fei concepts of *chaxugeju* and *tuantigeju*, see Chang Xiangqun, *Guanxi or Li Shang-Wanglai? Social Support, Reciprocity, and Social Creativity in a Chinese Village* (Taipei, TW: Airiti Press, 2010).

'ritual' (礼) behaviour.[33] Personal in the sense that the specific prescribed actions necessary to maintain the link are rooted in norms of reciprocity and are defined as personal obligations on the part of each individual, particularly the subordinate in the dyadic relationship: obligations of the child to the parent, the wife to the husband, the official to the ruler, and the younger to the older. Thirdly, networks have no explicit boundaries, since they are not created on a jurisdictional basis—'signed up for'—as is the case the case for Western organizational forms, but rather are preset. Whether someone in fact conforms to the obligations and expectations of the relationships, and thus is 'moral and upright', is another matter. Although the relationship pre-exists, a person is called upon to 'achieve' the relationship by rising to the normative standard demanded by that specific tie. A society thus comprised contains no sharp boundary lines, but only ambiguous zones of more or less dense and more or less institutionalized network configurations that impose normative demands upon the individuals within them. Finally, the normative content of behaviour in society is context-specific. Embedded in a world of differentially categorized social relationships, people evaluate ongoing action by considering the specific relations among actors. What is considered moral behaviour depends on the situation and social categories of the actors, rather than on abstract standards pertaining to autonomous individuals.

In sum, it is a profoundly personal, relational, normative, and egocentric system of social networks linking people together in multiple ways and placing different, though clear-cut, moral demands on each person in each specific context. The Confucian state was seen by its members as an enormous, but nevertheless united group, whilst the western version is doctrinally at least an abstraction, a universal or absolute idea. Thus the Chinese state is in essence the "super-family

[33] See Gary Hamilton, "World Images, Authority, and Institutions A Comparison of China and the West," *European Journal of Social Theory* 13:1 (2010): 31-48.

of Chinese people."[34] Yet it is not that Chinese society is group-oriented; the popular notion of Chinese society as oriented towards the 'collective' and thus disinclined to prioritize self-interest is a fallacy.[35] Rather, Chinese society is indeed centered on the individual, but as the basis of social egoism, not social individualism. Social structure emerges from networks created through relational ties linking the self with discrete categories of other individuals. It is a society in which considerations of order, not laws, predominate. In this context, social order rests not upon the adherence of individuals to norms whose universal legitimacy is defined procedurally and thus in the abstract, but rather on the ability of individuals to uphold the normative obligations inherent in their network of concentrically expanding social relations. Fei's conception of this social egoism identifies clearly the paradox of Confucian normative theory: why Confucius himself was never capable of identifying a universal definition of 'benevolence' [仁], always relying upon discrete examples to identify what would not be 'benevolent' in the context of a particular dyadic tie or personal relationship.[36] That Confucian political philosophy remains rooted in practical circumstances—in simple terms lacking a universal theory of justice—is intimately related to how it both emerged out of and shaped fundamental characteristics of Chinese social structure itself.[37]

The organizational mode of Chinese commerce thus stands in contradistinction to the Western model of economic organization that revolved around those who controlled access to economic sectors and who had jurisdiction of economic institutions. It was with the

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34 S. Gordon Redding, *The Spirit of Chinese Capitalism* (Berlin, DE: Walter de Gruyter, 1990), 44.

35 The idea of the 'collectivist' nature of East Asian society is one that has been propagated and entrenched by proponents of the 'Asian Values' argument, both academically in order to attempt to explain economic success, but also by governments in order to make a culturally relativist argument for authoritarianism.

36 Zhao Tingyang, "身与身外- 儒家的一个未决问题 [Self and Other: An Unresolved Issue in Confucian Theory]," *中国人民大学学报 [Journal of Renmin University of China]* 21:1 (2007): 15-21.

37 The extent to which Confucian philosophy merely reflected, or itself actively constructed this social structure is a complex debate which shall be left alone here.

development of constitutional government that citizens emerged with the right to unfettered access to the economy, where their profitmaking was unrestricted, and only the law limited control. Rather, in the Chinese mode of economic organization, the emphasis has always been upon harmony, upon a relational order that solicits obedience to the relationships that will ostensibly generate that harmony. As Needham states,

> The Chinese notion of order positively excluded the [Western] notion of law … The Chinese world-view depended on a totally different line of thought [from the law-based world-view developed in the West]. The harmonious cooperation of all beings arose, not from the orders of a superior authority external to themselves, but from the fact that [the Chinese] were all parts in a hierarchy of wholes forming a cosmic pattern, and what they obeyed were the internal dictates of their own natures.[38]

As Hamilton points out, the Chinese emphasis upon ordered relationships and on the achievement of harmony in those relationships generated a powerful foundation for the establishment of social and political institutions.[39] Over the course of the Ming and Qing dynasties, market-based institutions were developed on the basis of regional and kinship relationships. These relationships were ordered on the basis of collegiality and kinship. They were individually created and guaranteed through state-sponsored groups, that is, through various kinds of self-regulating kinship and commercial associations.

This ideal-typical characterization of the uniquely patterned structure of 'traditional' Chinese society provides us with a basis for further developing analytical tools that integrate the substantive features of Chinese social relations with the conceptual labels and apparatus that have developed in Western social science, which constitute the idioms in which existing scholarship and analysis of Chinese social phenomena have been undertaken, and which form a more familiar methodological basis upon which our empirical analysis of evolution of China's

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[38] Joseph Needham, *Science and Civilisation in China, Vol 2: History of Scientific Thought* (Cambridge, UK: Cambridge University Press, 1956), 582.

[39] Gary Hamilton, "The Organizational Foundations of Western and Chinese Commerce: A Historical and Comparative Analysis," in *Asian Business Networks*, ed. Gary Hamilton (Berlin, DE: Walter de Gruyter, 1996).

financial system in the reform-era can take place. These concepts I develop in the next sections, being (1) cognitive frames; (2) social institutions; (3) and relational networks.

Cognitive Frames

Frames are 'schemata of interpretation',[40] comprising "narratives that guide both analysis and action in practical situations".[41] They function heuristically, contributing to the normative and mental organization of a social environment, and thereby to the organization of the risk environment. As Blyth argues,

> Economic ideas make it possible for agents to reduce uncertainty by acting as interpretive frameworks that describe and systematically account for the workings of the economy by defining its constitutive elements and providing a general understanding of their 'proper' (and therefore improper) interrelations.[42]

Given the uncertainty of outcomes that afflicts all social action, such frames assist in reducing such uncertainty and generating stability in two ways: firstly as lenses through which interpretations of institutions and social networks are refracted,[43] and secondly as social structures in their own right that both catalyze the formation and legitimize the perpetuation of such institutions and networks.[44] As Fligstein observes, such cognitive models are not typically included in conceptualizations of social organization, since actors' common understandings are

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[40] Erving Goffman, *Frame Analysis: An Essay on the Organization of Experience* (London, UK: Northeastern University Press, 1986).

[41] Martin Rein and Donald Schon, "Frame Critical Policy Analysis and Frame Reflective Policy Practice," *Knowledge and Policy: The International Journal of Knowledge Transfer and Utilization* 9(1996): 85-104, 89.

[42] Mark Blyth, *Great Transformations: Economic Ideas and Institutional Change in the Twentieth Century* (Cambridge, UK: Cambridge University Press, 2002), 37.

[43] At a fundamental level, modes of cognition shape social reality. For example, one particular aspect of Chinese language is significant in this regard. The creation of a graphical language as opposed to a phonetic one relies upon the medium of the senses, the notion of a tangibility that permits it in some way to be 'seen'. This requirement thus hinders the emergence of purely abstract and non-tangible notions and concepts, and goes some way in further explaining the emphasis placed upon developing both social philosophy and political practice through practical and tangible examples, rather than as a deductively abstract exercize. See Redding, *The Spirit of Chinese Capitalism*, 75.

[44] Jens Beckert, "How Do Fields Change? The Interrelations of Institutions, Networks, and Cognition in the Dynamics of Markets," *Organization Studies* 31:5 (2010): 605-27, 610.

not assumed to be consequential to explaining their actions.[45] But such shared understandings are essential to assessing the skill of actors in interpreting their situations, constructing viable courses of action, and innovating upon existing routines and practices.[46]

The relevance of cognitive frames for the structuring of Chinese financial relations arises out of the deeply rooted lineages of cultural heritage and historical trajectories of politico-economic development. This reflects the extent to which, contrary to the ahistorical and paradoxically culturally barren depictions of Chinese society and economy amongst the foundational theorists of political economy, we should recognize how,

> Economic action, like social action in general, takes place and is bound to take place within collectively constituted social macrostructures of social order, and it depends on their integrity. The interests that economic actors pursue and the rules that they follow must be culturally sanctioned; not being naturally given, they are also in need of discursive reflection whenever they become problematic.[47]

It is therefore appropriate to view the cultural resources of Chinese society as a basis for framing socio-economic action in the context of contemporary China. In his classic study of the 'overseas Chinese', Redding sought to develop an understanding of the 'spirit of Chinese capitalism',[48] identifying three sets of concepts that have and continue to frame action embedded within a Chinese socio-cultural context. Even though Redding did not draw upon Fei's social theory in his study, his framing categories reflect closely Fei's conception of Chinese social structure and relations. The three socio-cultural legacies Redding identifies are paternalism, personalism, and insecurity (Figure 3.1).

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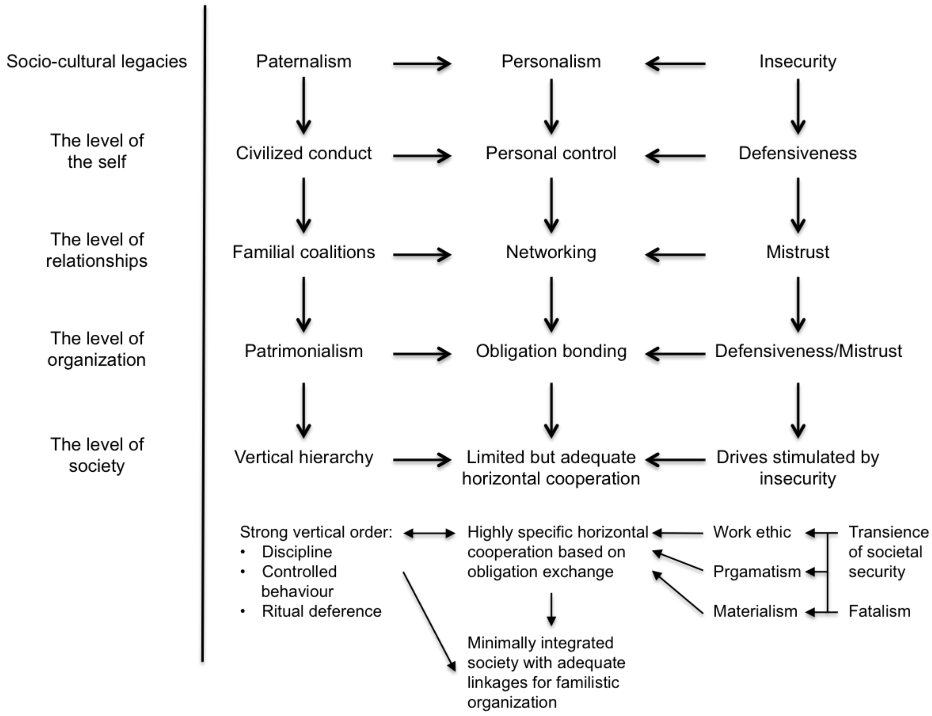
[45] Neil Fligstein, *The Architecture of Markets: An Economic Sociology of Twenty-First Century Capitalist Societies* (Princeton, NJ: Princeton University Press, 2001), 30.

[46] Daniel Béland and Robert Henry Cox, eds., *Ideas and Politics in Social Science Research* (Oxford, UK: Oxford University Press, 2011); Pierre Bourdieu and Loïc Wacquant, *An Invitation to Reflexive Sociology* (Cambridge, UK: Cambridge University Press, 1992).

[47] Beckert and Streeck, "Economic Sociology and Political Economy: A Programmatic Perspective," 13.

[48] As I argue in the final section of this chapter, what Redding described is not so much the 'spirit of Chinese capitalism', but a set of social relations more appropriately described as a 'market economy with Chinese characteristics', even accepting that this itself is something of a problematic term.

Figure 3.1: Cognitive frames in China



Source: Redding (1990)

The emphasis upon paternalism, personalism, and insecurity means that decision-making will never take place out of the context of concrete social circumstances, as officials, executives, and entrepreneurs will absorb information immediately at hand and use their intuition to process it, rather than looking for abstract theoretical explanations removed from the complex social context in which such decisions are always embedded.[49] Understanding frames in this light draws attention to the multivocality of CCP authority in China, in which the ambiguity surrounding the nature of CCP rule is at once a producer of socio-economic uncertainty within broader society,

[49] Redding, *The Spirit of Chinese Capitalism*, 77.

as well as a solution for coping with that uncertainty. Nonetheless, the underlying socio-cultural basis for the CCP's paradoxical embrace of uncertainty is not solely to be derived from Mao's revolutionary experiences, as Heilmann and Perry argue,[50] but derives also from more fundamental structures of Chinese social relations, many of which came to be embodied in the CCP itself through the revolutionary period. Yet as I argued in the previous chapter, the cultural-historic rootedness of social relations by no means is incompatible with processes of institutionalization, rationalization, and systematization of social structures and decision-making mechanisms. The nature of the intersubjectivity of social relations in Chinese society raises the issue of institutions and the role that they play in the rational organization of social order.

Social Institutions

Institutions and the norms underpinning them create mutual expectations for interactions and limit the choice set of actors.[51] They reduce contingency in action situations by generating sanctions for norm transgression and providing credibility to decision-making processes.[52] Yet at the same time what is distinctive about social institutions is their need to be legitimated within a given social order and thus integrated into a specific social, political, and cultural context.[53] Further, how an institution, and the rules and norms underpinning it, is mentally perceived and

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[50] Heilmann and Perry, "Embracing Uncertainty: Guerrilla Policy Style and Adaptive Governance in China."

[51] An institution is any collectively accepted system of rules (procedures, practices) that enable us to create institutional facts. These rules typically have the form *X counts as Y in C*, where an object, persona, or state of affairs *X* is assigned a special status, the *Y* status, such that the new status enables the person or object to perform functions that it could not perform solely in virtue of its physical structure, but requires as a necessary condition the assignment of the status. See John Searle, "What is an Institution?," *Journal of Institutional Economics* 1:1 (2005): 1-22.

[52] Beckert, *Beyond the Market: The Social Foundations of Economic Efficiency*, 291; Geoffrey Hodgson, "What are Institutions?," *Journal of Economic Issues* 40:1 (2006): 1-25; ———, *Economics and Institutions* (Oxford, UK: Oxford University Press, 1988).

[53] Beckert, *Beyond the Market: The Social Foundations of Economic Efficiency*, 291.

self-represented by an individual is constitutive of that institution,[54] for in their peculiarly social nature institutions are dependent for their existence upon the supporting beliefs and mental attitudes of those individuals that both 'make' and 'take' the relevant rules and norms.[55]

The implications of Fei's conception of the differential mode of association for the institutions of social control and social order are profound. The logic and actual unit of control (the relationship between individuals versus the individual person) differ between Chinese and Western society. In the West, individuals are presumed to be autonomous, and thus subject to the rule of law as individuals. Individual rights, as identified and secured through a constitution, specify the basis for individual autonomy. Laws itemize those actions that would unduly infringe upon these rights. In China, society is regulated and order generated more through rituals, which means that order depends upon peoples' obedience to their social obligations. Accordingly, the obligations for each relationship must be identified, people must learn those obligations, and be corrected when they fail to fulfill them. The entire network of people joined through a set of relationships is implicated when one person fails to perform appropriately.[56]

Significant differences begin to emerge between the West and China in terms of conceptualizing the role of the state in society, and the nature of state authority. The state is the highest organization in Western society. As Nettl once classically stated with reference to the state, "the thing exists and no amount of conceptual restructuring can dissolve it."[57] It has historically been extremely difficult for the Chinese state to maintain order and rule by jurisdiction, since ruling elites were inevitably faced with a disparity between their direct and

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[54] John Searle, *The Construction of Social Reality* (Cambridge, UK: Cambridge University Press, 1995); ———, "What is an Institution?".

[55] See Streeck, "Taking Capitalism Seriously: Toward an Institutionalist Approach to Contemporary Political Economy; ———, *Reforming Capitalism: Institutional Change in the German Political Economy.*

[56] Gary Hamilton and Wang Zheng, "Introduction," in *乡土中国 [From the Soil: The Foundations of Chinese Society]*, ed. Fei Xiaotong (Los Angeles, CA: University of California Press, 1992).

[57] J P Nettl, "The State as a Conceptual Variable," *World Politics* 20:4 (1968): 559-92, 559.

formal tools of power, and the scale and diversity of the country.[58] As Redding has observed, in such circumstances it was role compliance, rather than formal legal structures that protected social order,[59] and this was thus a social order that "could operate by itself, with the minimum of assistance from the formal political structure."[60] Given the nature of Chinese society, such a formal political structure, with the rigidity and constitutionalizing nature of 'rationalized' laws and codified norms, was fundamentally impractical and undesirable. In this sense, Chinese social structure developed on the basis that 'reasonableness' is superior to 'reason'.[61]

This formed the basis for the distinctly social role of the state as it has existed historically in China. The CCP was already 28 years old when it forged the Chinese state and thus, "to the revolutionaries, a state constitution surely did not mean something like a contract that a democratic government makes with society or an agreement on how political power should be divided and shared."[62] It is the CCP that provides coherence and consistency across a fragmented and decentralized state, as its institutional presence extends across all branches and levels of the bureaucracy.[63] The fundamental nexus of authority and control is not a jurisdictional top-down system that controls the actions of every individual through the imposition of legal rules through a transparent bureaucratic state structure. Rather, the means of control is located in the institutionalized networks of relationships, and power holders' authority derives from their 'educational' function. Conceiving the role of the CCP in this manner casts in a different light the well-known aphorism 'heaven is high and the emperor is far away'. This means that

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58 Arthur Wright, "Values, Roles, and Personalities," in *Confucian Personalities*, ed. Arthur Wright and Denis Twitchett (Stanford, CA: Stanford University Press, 1962), 11.

59 Redding, *The Spirit of Chinese Capitalism*, 46.

60 C K Yang, "Some Characteristics of Chinese Bureaucratic Behaviour," in *Confucianism in Action*, ed. David Nivison and Arthur Wright (Stanford, CA: Stanford University Press, 1959), 164.

61 Yutang Lin, *My Country, My People* (London, UK: Heinemann, 1941), 86.

62 Shiping Zheng, *Party vs. State in Post-1949 China : the Institutional Dilemma* (Cambridge, UK: Cambridge University Press, 1997), 47.

63 Ann Florini, Hairong Lai, and Yeling Tan, *China Experiments: From Local Innovations to National Reform* (Washington, DC: Brookings Institution Press, 2012), 11.

officialdom is removed from local society, and whilst they are in principle responsible for managing the whole, they do not intervene in the parts. It is only when disorder arises that they must ensure that all involved in the network work within their own successive circles of relationships to ensure that order is restored. The logic is that if everyone is attentive to the normative expectations of his or her close relations, then the whole world is at peace and the people can prosper.[64]

The role of the CCP thus begins to come into focus. The CCP remains the one indispensable institution of Chinese political economy. As McGregor has concluded, even if it were disbanded or fell apart, it would have to be put back together again, because its members alone have the skills, experience and networks to run the country.[65] These networks extend from the highest echelons of central party rule, through to the local level in which Party committees are established and embedded within organizations across state, society, and market.[66] However the relationship between the state and the CCP is a difficult one to unpack. As Heilmann points out,

> In Western scholarship, there appears to be a strong tendency in many studies of the Chinese economy to treat Party bodies as something irregular and exogenous to state bureaucracies. In fact, Communist Party organs such as the CFWC [Central Financial Work Commission] whose organizational set-up and functions are formally regulated by a series of lengthy (although not easily obtainable) Party documents cannot be seen as irregular. Instead they must be recognized as part of the core institutions of policy-making and supervision in China's present political economy.[67]

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[64] Hamilton and Zheng, "Introduction."

[65] Richard McGregor, *The Party: The Secret World of China's Communist Rulers* (New York, NY: Harper Collins, 2010), xiv.

[66] The role of local levels of CCP administration in contributing to broader macroeconomic and political dynamics is difficult to analyze systematically largely for reasons of access to adequate empirical data. This thesis therefore places greater emphasis on the capacity of the central party apparatus to diffuse and consolidate authority and power through such 'local' organizations as the party committees of major financial institutions, regulatory agencies, and other administrative organs.

[67] Sebastian Heilmann, "Regulatory Innovation by Leninist Means: Community Party Supervision in China's Financial Industry," *The China Quarterly* 181(2005): 1-21, 4.

Yet even as it is essential to recognize the interpenetration of the CCP with the Chinese state, the categories through which we ordinarily seek to describe this interpenetration remain tied to inherently Western concepts of formal authority and regulation. The CCP, having itself adopted many of the organizational norms of a classic Leninist bureaucratic machine, has relied upon and produced innumerable decrees, directives, and other documents through which it governs itself and the country as a whole. However, insofar as the 'sinews of governance'[68] embodied in the CCP cannot be assumed a priori to be commensurate to the institutions of the state, the broad sociological parameters of the CCP as an institution of governance must be appreciated and reckoned with.

The question thus arises of how the institutionalization of governance in China has coincided with its legalization and its rationalization. In its interpenetration of the bureaucratic state, the CCP disrupts the coherency of these concepts as they are ordinarily understood. As it has presided over an increasing institutionalization of the various structures of governance, the CCP has sought to "maintain its real authority by working within the framework of the new constitutionalist rules."[69] This process becomes apparent through the evolution in China of a fundamental institution of a capitalist market society: property rights and their protection. In classic economic terms, ownership implies de facto property rights, including (1) a claim to the residual surplus produced by an asset, (2) control over the asset, (3) the right to exclude others from using it, and (4) the right to sell it. Although these rights may be co-extensive with de jure rights conferred by a legal registration document, legal title is ultimately irrelevant from an

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[68] Dali Yang, "Economic Transformation and State Rebuilding in China," in *Holding China Together: Diversity and National Integration in the Post-Deng Era*, ed. Barry Naughton and Dali Yang (Cambridge, UK: Cambridge University Press, 2004), 121.

[69] Zhiyue Bo, "The Institutionalization of Elite Management in China," ibid., 74.

economic perspective.[70] Under this definition, ownership implies risk.[71] One's status as residual claimant of profits, also implies that one will bear losses if no such residual surplus eventuates. The ideal liberal model highlights the importance of clearly demarcating where property rights and thus associated returns and risk reside. The political power of the state renders it an unreliable bearer of these rights, since it ostensibly retains the authority to disrupt the legal institutional framework that underpins these property rights. Many Chinese officials implicitly adopt this uni-dimensional perspective of the markets vs. hierarchies approach—albeit at a macroeconomic level—when they explain the economic reforms they have undertaken since 1978, in institutional terms, as a restructuring of the system from bureaucratic to market governance.[72] However, when questioned further on the nature of the CCP and its role in mediating between these bureaucratic and market logics, officials give indications of the distinct political logic that provides the CCP with its institutional relevance within China's contemporary political economy. As a governmental advisor expressed it, "the question of ultimate ownership is not the most important one, but rather whether or not cadres can be trusted to be commercially focused."[73] This reflects a comment made by Premier Wen Jiabao that "it does not matter so much if some firms are losing money and some are making money, it is all within the same country and within the same system."[74]

The same assessment can be made of the CCP's mode of governance over the financial system: as it has embraced the conceptual framework and institutional architectures of a 'socialist market economy', it has nevertheless adapted itself and its relations to other governance

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[70] Mark DeWeaver, *Animal Spirits with Chinese Characteristics: Investment Booms and Busts in the World's Emerging Economic Giant* (New York, NY: Palgrave MacMillan, 2012), 16.

[71] ———, *Animal Spirits with Chinese Characteristics: Investment Booms and Busts in the World's Emerging Economic Giant*, 16.

[72] Max Boisot and John Child, "From Fiefs to Clans and Network Capitalism: Explaining China's Emerging Economic Order," *Administrative Science Quarterly* 41:4 (1996): 600-28, 605.

[73] BJ:2012.06.16. Interview, Beijing.

[74] Internal meeting of the State Council, 2004. BJ:2012.09.07. Interview, Beijing.

structures in order to preserve its real authority over the evolving political economy. Reconceptualizing the relationship between the CCP, the state, and the market, has significant implications for our understanding of the rationalization of the financial sector. As the process of marketization unfolded, the need to establish modern institutions of finance have come to clash and then be resolved with the system of 'parallel rule' that had been adopted from the Soviet model of 'police-patrol' oversight.[75] Parallel rule continues to dictate that the party-dominated institutions of governance be responsible for all important appointments of officials within the financial system.[76] Alongside this, modes of technical management through Western concepts of banking supervision and regulation are established, but Chinese institutions and principles distinctively influence the manner in which they work.[77]

China's banking system has increasingly come to resemble the institutional configuration of any other modern system of financial intermediation, and yet the core feature of financial institutions in China remains their duality. This duality in turn transforms the nature of financial markets and the broader institutional fabric of capital in China. Capital is transformed from a tool for the exercise of ostensibly market power, into a tool for the market-situated exercise not of state power, but the power of a group of actors whose role is inextricably bound up with both the productive functions of the market but also the governance functions of the state. These functions are not objectively assigned to financial institutions, nor are they structurally immutable. Rather, it is the social acceptance of these institutions and, crucially, the terms of that acceptance that are of analytical import in identifying the significance of China's banking system

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[75] Shirk, *The Political Logic of Economic Reform in China*, 57-8.

[76] Katharina Pistor, "The Governance of China's Finance," in *Capitalizing China*, ed. Joseph Fan and Randall Morck (Chicago, IL: Chicago University Press, 2013); see also Lingling Wei and Bob Davis, "For a Top Chinese Banker, Profits Hinder Political Rise," *The Wall Street Journal*, 19 February 2012.

[77] For a discussion of institutional bricolage in the context of Chinese banking regulation, see Violaine Cousin. "中监为体, 西监为用: On the Specifics of Chinese Bank Regulation". *MPRA Working Paper 36040*. Munich, DE: University Library of Munich, 2011.

for the nature of economic growth. The core actors involved in constructing and then assigning a 'status function' to the institutions of Chinese finance undertake this process on the basis of formal rules and informal norms. The institutional foundations of CCP authority and control thus remain rooted—rationally—in ideological norms and cultural framings, rather than legal-rationality[78] As socio-economic transformation has proceeded apace, and the CCP itself has adapted in order to retain authority, ideology was transformed from a deductive source of policy, into an inductive mechanism for justifying, rationalizing, and validating the empirical realities brought about through policy experimentation and implementation.[79]

Relational Networks

The decisions of politico-economic actors can be understood from their specific position within a network of market participants. Arenas for social action embedded constitutively within social networks further reduce uncertainty by diffusing information, generating potential courses of action, and facilitating collective action. In China, the typology of social ties is complex and distinctive. *Guanxi* [关系] embodies both an instrumental exchange element, as well as emotional involvement, in such a way that it is usual for friendship to be indistinguishable from rational exchanges aimed at achieving personal objectives.[80] Depending on the weighting accorded to the instrumental versus the emotional element of the relationship, it is possible to distinguish between acquaintance and familial ties at either end of the spectrum, with familiar ties resting in between. For instrumental exchange relationships, the norm of fair and equitable exchange [*bao*

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78 As Wang Xuedong, director of the CCP Central Committee's Institute of World Socialism observed, "we know there are those abroad who think we have a 'crisis of ideology', but we do not agree." Quoted in David Shambaugh, *China's Communist Party: Atrophy and Adaptation* (Washington, DC: Woodrow Wilson Center Press, 2008), 104.

79 ———, *China's Communist Party: Atrophy and Adaptation*, 105.

80 C.C. Chen, Y.R. Chen, and K. Xin, "Guanxi Practices and Trust in Management: A Procedural Justice Perspective," *Organization Science* 15:2 (2004): 200-09.

报] provides the moral and behavioural norms for stranger and acquaintance ties.[81] In such relationships, people are highly individualistic and operate on the basis of a self-interested rational calculation, but are guided by the 'rule of equity' in such dealings.[82] The concept of the 'rule of need' [*lun* 伦] is that which guides the familial relationships of Chinese society.[83] Within the limited circle of *guanxi*, individuals operate on the basis of principles of benevolence and obligation. Self-interested behaviour in such relationships is considered immoral.[84] Accordingly, Hwang refers to the 'rule of need' operating such that each individual is accordingly obliged to satisfy the needs of his or her familial ties. Familial ties are characterized by a moderation and integration of both of these sets of behavioural principles. Within groups constituted on such a form of quasi-collective basis, individuals tend to imitate familial ties, by meeting each other's needs without requesting anything in return. However, in contrast to familial ties, it is mutually understood that repayment is in fact necessary. Luo has characterised this dynamic as driven by the 'ethic of brotherhood' (*yi* 义).[85] Thus the 'rule of need' demands that assistance or favour be granted where necessary without expectation of recompense, whilst the 'norm of equity' demands that the recipient of the favour never forget it. Once the favour-giver clearly asks for the favour to be returned, his or her help is no longer a favour, but one side of an instrumental transaction.

How does such a conception of social structure and social networks in Chinese society assist in analyzing the institutional form and function of China's financial system? The establishment of trust is a necessary element for economic activity, whether it be hierarchically

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[81] Jar-Der Luo, "Guanxi Revisited: An Exploratory Study of Familiar Ties in a Chinese Workplace," *Management and Organization Review* 7:2 (2011): 329-51.

[82] K.K. Hwang, *The Chinese Power Game* (Taipei, TW: Chi-Liu Press, 1988).

[83] X.W. Zhai, *The Logic of Chinese Actions* (Beijing, CN: Social Science Documentation Publishers, 2001).

[84] Luo, "Guanxi Revisited: An Exploratory Study of Familiar Ties in a Chinese Workplace".

[85] ———, "Guanxi Revisited: An Exploratory Study of Familiar Ties in a Chinese Workplace", 332.

organized or market-based.[86] Generalized trust, in Williamson's formulation, is rooted in a faith in governance mechanisms, and permits complex transactions based on abstract and unfamiliar relationships.[87] This form of trust is less prominent in Chinese society, as individuals tend to distrust strangers and outsiders, and tend to be willing to conduct complex transactions only with friends and family.[88] The remarks by Redding and Witt above concerning the role of generalized trust as a distinctly modern phenomenon, allude to the connection between the socio-cultural lineages of paternalism, personalism, and mistrust on one hand, and the potential for network relationships to resolve the problems of trust and cooperation through the construction of institutional forms that both leverage upon and reinforce existing network structures.

The principles through which the CCP underpins Chinese society thus have a systemic quality; they permeate the institutions of the political economy and its governance, such that the operation of these formal institutions is infused and overlaid with what amounts to a non-state and non-market set of institutional dynamics. Institutions that operate accordingly are intimately connected to social networks, both in order to diffuse the cognitive frames and ideas that underpin institutions, but also to actively reproduce the socio-economic reality latent within cognitive frames and institutional development. This is evident throughout China's financial elites who constitute a dense and overlapping network of party cadres that connect all of the important entities in the financial system, and which comprise the core of China's governance

86 Mark Granovetter, "Economic Action and Social Structure: The Problem of Embeddedness," *American Journal of Sociology* 19:3 (1985): 481-510.

87 Oliver Williamson, *The Mechanisms of Governance* (Oxford, UK: Oxford University Press, 1996).

88 S K Wang and X Liu, "The Foundation of Trust: An Explanation of Rationality," in *Trust in Chinese Society*, ed. Y F Zhang and S C Peng (Beijing, CN: Chinese City Press, 2003).

regime for finance.[89] As Katharina Pistor has argued in relation to the control over appointment of financial elites by the CCP,

> [Human resources management] has become a substitute to direct state control, which was still pervasive in China until the end of the 1990s, and a complement to the new rule-based formal mechanisms of control. The CCP's control over [HRM] intensified as the state apparatus loosened its direct control over the financial system.[90]

The para-institutional network that is the CCP cadre system is rooted in the party's 'position-list' [职务名称表] system,[91] at its core a list of positions for approximately 5,000 party officials [中共中央管理干部职务名称表]. Within this there exists a more select 1,000 strong 'elite within the elite' list known as the Central Cadres List [中央干部目录], as well as a longer list of 39,000 official positions whose appointment must be reported to the Central Committee [向中央备案的干部职务名单]. It is administered by the Organization Department of the CCP, a highly secretive yet incredibly influential party organ.[92] As one Ministry of Finance official stated in relation to the contemporary role of financial elites, "the chairmen of the large banks cannot be said to be real bankers. They are politicians."[93] At the heart of this remains a focus on the incentive structure for banking management and behaviour. The social responsibility of senior banking management must be achieved, whether through informal moral persuasion or through overt material measures, and constitutes a fundamental component in achieving a balance between profit and responsibility. As Liu Mingkang, then head of the China Banking Regulatory Commission pointed out in 2008, "whether the incentives for increased performance are sourced

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[89] This is apparent even amongst the most notionally 'private' of the joint-stock commercial banks, such as Minsheng Bank. See Bloomberg News, "Minsheng Sinks as President Resigns After Probe Report," *Bloomberg Business*, 2 February 2015.

[90] Pistor, "The Governance of China's Finance," 3.

[91] Often referred to as the *nomenklatura,* having been modelled upon the Soviet methods of Party control over the bureaucracy.

[92] As Hamrin and Zhao have described it, ""Economic units are afraid of the [NDRC] and all units fear the Organization Department." See Carol Lee Hamrin and Suisheng Zhao, "Introduction: Core Issues in Understanding the Decision Process," in *Decision-Making in Deng's China: Perspectives from Insiders*, ed. Carol Lee Hamrin and Suisheng Zhao (Armonk, NY: M.E. Sharpe, 1995), xxxvii.

[93] BJ:2012.06.06. Interview, Beijing.

in market profits or social [ie. political] advancement, regulatory and governance structures must be capable of achieving this balance."[94]

Networks do not operate just as mechanisms for transmission of information, but play also a significant structural role in economic action. Whilst the impact of non-economic factors such as social ties upon economic processes has traditionally been conceived of in negative terms, such as corruption and rent-seeking, the pursuit of economic goals through non-economic institutions, the cost of which one cannot generally contribute to (such as employer networks based on trust and friendship), can also have positive impacts upon outcomes.[95] That the density of such a social network is directly and positively correlated with the coherence and durability of norms spread throughout and held within that network is one of the oldest and most axiomatic findings in social psychology.[96] This economically significant role of networks has manifested in China via networks of economic interdependency that generate the requisite levels of certainty and stability of expectations necessary for economic decision-making. CCP membership has a positive effect on firm performance, and party membership assists private entrepreneurs in obtaining loans from banks or other financial institutions, and affords them greater confidence in the legal system.[97] This builds upon the empirical investigations of Allen et al, who find that rather than ownership, it is connections that provide the best explanation for the capacity of a financial system lacking strong legal and institutional foundations to generate growth-supporting

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[94] Mingkang Liu, "全球金融稳定与全球文明 [Global Financial Stability and Global Civilization]," in *Speech at the Annual Conference on 'World Civilization', 2 May* (British Museum, London2008).

[95] Mark Granovetter, "The Impact of Social Structure on Economic Outcomes," *Journal of Economic Perspectives* 19:1 (2005): 33-50, 35; Wolfgang Streeck, "Beneficial Constraints: On the Economic Limits of Rational Voluntarism," in *Contemporary Capitalism: The Embeddedness of Institutions*, ed. J Rogers Hollingsworth and Robert Boyer (Cambridge: Cambridge University Press, 1997).

[96] See Leon Festinger, Stanley Schachter, and Kurt Back, *Social Pressures in Informal Groups* (Cambridge, MA: MIT Press, 1948).

[97] Hongbin Li et al., "Political Connections, Financing and Firm Performance: Evidence from Chinese Private Firms," *Journal of Development Economics* 87(2008): 283-99.

financing channels.[98] This dovetails with the use of unofficial lending criteria that are closely tied to the diffusion of CCP priorities.[99] As Poisot and Child explain,

> What appears to be happening in many parts of China's economic sphere is that the system continues to reproduce a model of organization specific to the relations between the governmental authorities and the enterprises within their hegemony. The authorities concerned are industrial ministries, provincial government, and (more often) local governments. Inter-organizational relations between government bodies and the enterprises within their purview, relations that in other industrial economics would be conducted at arm's length through markets, are managed through personal interactions. The impersonal abstract order associated with decentralization to markets has yet to replace the much more concrete personalized order that delegation within a patrimonial system can allow.[100]

Although bureaucracy, market, and party are all discursively separated, they are structurally strongly integrated. The market and the CCP are not simply alternatives to the bureaucracy but intimately connected with it. The market provides cadres and work units with new opportunities. Similarly, entrepreneurs in the market sphere have found ways to tap the resources, power, and privileges of the bureaucratic sphere. Phenomena such as corruption, gift giving, and patron-client relationships, which are part of the sphere of personal transactions, play a pivotal role in mediating the transactions between market and bureaucracy and in integrating society at the level of social action.[101]

In these sections I have begun to sketch out the contours of embeddedness in which Chinese financial elites have constructed a socio-economic risk environment. Yet it remains necessary to explore how these dimensions of embeddedness affect socio-economic action and thus socio-economic outcomes. The next section identifies the mechanisms of stability and

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[98] Franklin Allen, Jun Qian, and Meijun Qian, "Law, Finance, and Economic Growth in China," *Journal of Financial Economics* 77:1 (2005): 57-116.

[99] Geoffrey Yeung, "How Banks in China Make Lending Decisions," *Journal of Contemporary China* 18:59 (2009): 285-302.

[100] Boisot and Child, "From Fiefs to Clans and Network Capitalism: Explaining China's Emerging Economic Order", 605.

[101] Frank Pieke, "Bureaucracy, Friends, and Money: The Growth of Capital Socialism in China," *Comparative Studies in Society and History* 37:3 (1995): 494-518, 496; Andrew Wedeman, *Double Paradox: Rapid Growth and Rising Corruption in China* (Ithaca, NY: Cornell University Press, 2012).

change in the political economy, providing a means of understanding the role that a particular risk environment plays in shaping broader socio-economic outcomes.

Uncertainty and Socio-economic Outcomes

These dimensions of embeddedness constitute a description of mechanisms for reducing uncertainty so as to render socio-economic action possible. They also provide a means of making sense of how particular socio-economic outcomes derive from decision-making within this continuously evolving environment. These dimensions of embeddedness will affect perceptions of the implications of extending trust, making economic investments, and using financial tools in order to reap a profit. The economic implications of a risk environment can be identified across three different functions of a 'commercially efficient' banking and financial system. The first role is that of allocating funds to projects with the highest rate of return, thus increasing the marginal productivity of capital.[102] Second, financial development can also allocate resources at lower costs, if it causes the financial system to be subject to lower taxation and regulatory burdens.[103] Finally, financial systems have an effect upon the rate of private savings.[104] In addition to such immediate micro-economic impacts, as a set of social institutions that cause certain forms of financial market dynamics such as perpetual crisis,[105] or financial bubbles,[106] the risk environment might be said to matter first and foremost either as a force for pro-cyclicality, or as a tool conversely for moderating the business cycle. Even as the structural and material foundations for economic growth may experience continuity, it is the socially constructed risk environment that

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[102] Robert King and Ross Levine, "Finance and Growth: Schumpeter Might be Right," *Quarterly Journal of Economics* 53 (1993): 715-37.

[103] Lardy, *China's Unfinished Economic Revolution*, 129.

[104] Marco Pagano, "Financial Markets and Growth: An Overview," *European Economic Review* 37 (1993): 613-22.

[105] Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance.*

[106] Ackerlof and Shilling, *Animal Spirits: How Human Psychology Drives the Economy, and Why it Matters for Global Capitalism.*

modulates the deployment of these economic resources, the allocation of capital, and thus the long-term trajectory of economic growth so as to produce socio-economic outcomes both in terms of productive efficiency and social sustainability.

However, to take seriously the status of financial systems as social systems further involves recognizing that the economic outcomes produced by a risk environment will have socio-political implications. From such a perspective the overall outcome of any particular risk environment as conceived thus is to make it easier and cheaper for one set of actors in the economy to access capital than others.[107] As one leading academic stated in relation to China's financial development,

> There is a serious inequality in the distribution of wealth and capital resources. … This is directly connected to the way in which interest rates and financial markets must be managed in order keep China's economy on an even footing as it speeds forward like a high-speed train from Shanghai to Beijing and back again.[108]

It is possible to assess the socio-political significance of each of the dimensions of embeddedness (cognitive, institutional, and networked) through their role in mediating financial capital by shaping actors' expectations of what particular pathways of action will result in. For example, cognitive frames emerged that fundamentally disrupted expectations for the extension of credit. Expectations for the use of capital shifted from underpinning egalitarian social policies through the all-encompassing firms of a command economy to a mechanism for capital accumulation.[109] The ways in which this capital would be accumulated however was to remain

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[107] Anders Johansson, "Financial Repression and China's Economic Imbalances," in *Rebalancing and Sustaining Growth in China*, ed. Huw McKay and Ligang Song (Canberra, AU: ANU E-Press, 2012).

[108] BJ:2012.11.24. Interview, Beijing.

[109] As Deng Xiaoping stated at the crucial Central Work Conference of 1978, in a speech that would become official policy of the Communist Party in December 1978,

> We should allow some areas, enterprises, and workers and farmers to earn more and live a better life earlier than others through diligence and hard work. When some people become better off ahead of others, they are bound to have a tremendous demonstrative impact on their neighbours and will prompt them to follow their examples. In this way, the national economy as a whole will keep advancing wave upon wave, enabling people of all ethnic backgrounds throughout the country to become rich at a relatively faster rate.

firmly within the control of the CCP. Implementing this notion of development would thus lead to an institutional framework that fostered growth and retrenched control at the same time:

> On the one end, the financial framework has arranged a forced marriage between the deposits of the masses and state-owned commercial banks. On the other end, the illegal fundraising law has served as a means to keep public deposits from running away from their arranged marriage. This in effect serves as an official announcement that financial independence is forbidden.[110]

Finally, actors' positions within CCP-dominated network structures meant that an actor's role in this process of economic growth and accumulation of capital has come to be rooted in their relationship to the institutionally mediated networks of the financial system and the ease with which they are therefore able to access capital, rather than in any innate capacity to more productively use this capital on the basis of being owned either privately or by the state.

Understanding the structure, and more importantly, the function of the financial system in these terms sheds further light on China's financial development. Conventional wisdom holds that financial liberalization and economic growth are positively correlated.[111] Financial repression in China can be considered to have taken six forms:

1. Repression of the real deposit interest rate
2. Aggregate degree of control over interest rates
3. Capital account control
4. Statutory reserve requirements
5. Share of state-owned banks in total bank loans
6. Share of state-owned firms in total outstanding loans[112]

There is a growing literature on how repressive financial policies foster a number of specific politico-economic imbalances, including inequality,[113] sectoral transformation,[114] and an

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Li Lanqing, *Breaking Through: The Birth of China's Opening-Up Policy* (Oxford, UK: Oxford University Press, 2009), 69.

110 Wang Yong, "Courting Financial Innovation," *Caixin*, 9 December 2013.

111 Shaw, *Financial Deepening in Economic Development*; McKinnon, *Money and Capital in Economic Development*; Levine, "Finance and Growth: Theory, Mechanisms, and Evidence; Roubini and Sala-i-Martin, "Financial Repression and Economic Growth".

112 Yiping Huang and Xun Wang, "Does Financial Repression Inhibit or Facilitate Economic Growth? A Case Study of Chinese Reform Experience," *Oxford Bulletin of Economics and Statistics* 73:6 (2011): 833-55.

economy's external position.[115] However China's experience has also led many to question this line of argument, and re-examine the role of financial repression in development. Arguments have therefore also been made in favour of the need for developing countries to manage money supply and financial stability through repressive domestic financial policies,[116] and limits upon the extent and pace of external liberalization.[117]

The relationship between financial repression and growth however is not necessarily linear,[118] and thus these two views are not necessarily incompatible. Huang and Wang have argued that financial repression was beneficial to China's overall economic growth during the 1980s and 1990s, however after 2000 it had a negative impact upon headline GDP growth.[119] Of all of these measures of financial repression, the one form of financial repression that did not have a negative impact upon growth was that of the share of state-owned banks in total bank loans. Their speculative hypothesis is that the capital allocation of the state banks is not significantly different from that of the other banks.[120] Accordingly, under certain conditions financially repressive policies of interest rate regulation and directed-credit allocation may be

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113 Anders Johansson and Xun Wang. "Financial Sector Policies, Poverty and Inequality". *Working Paper No. 2012-24*. Beijing, CN: China Economic Research Center, 2012.

114 ———. "Financial Repression and Structural Imbalances". *Working Paper No. 2011-19*. Beijing, CN: China Economic Research Center 2011.

115 ———. "Financial Repression and External Imbalances". *Working Paper No. 2012-20*. Beijing, CN: China Economic Research Center, 2012.

116 T Hellmann, K Murdock, and J Stiglitz, "Financial Restraint: Towards a New Paradigm," in *The Role of Government in East Asian Economic Development: Comparative Institutional Analysis*, ed. M Aoki, H-K Kim, and M Okuno-Fujuwara (Oxford, UK: Clarendon Press, 1997); Joseph Stiglitz, "The Role of the State in Financial Markets," in *Proceeding of the World Bank Annual Conference on Development Economics, 1993: Supplement to the World Bank Economic Review and the World Bank Research Observer*, ed. Michael Bruno and Boris Pleskovic (Washington, DC: World Bank, 1994).

117 Eswar Prasad et al., "Effects of Financial Globalization on Developing Countries: Some Empirical Evidence," in *Ocassional Paper* (Washington, DC: International Monetary Fund, 2003); Joseph Stiglitz, "Capital Market Liberalization, Economic Growth, and Instability," *World Development* 28 (2000): 1075-1086.

118 Johansson, "Financial Repression and China's Economic Imbalances."

119 Huang and Wang, "Does Financial Repression Inhibit or Facilitate Economic Growth? A Case Study of Chinese Reform Experience".

120 ———, "Does Financial Repression Inhibit or Facilitate Economic Growth? A Case Study of Chinese Reform Experience", 847.

beneficial for economic growth.[121] Such repression can generate an 'adaptive efficiency' at the expense of 'allocative efficiency',[122] by carving out the policy space for fostering rapid development in the real economy through a state-led growth strategy.[123] Financial repression may thus be beneficial for economic growth under certain conditions, but it will nonetheless generate economic dynamics that threaten the balanced nature of that growth.

That financial repression has lain at the heart of the relationship between the financial system and the real economy in China is universally accepted. However there remains very little understanding of the root causes of financial repression in China and why it has persisted for so long when the underlying financial dynamics that it produces have had regressive impacts upon the broader sustainability of China's socio-economic development. This reflects the paradox identified in the introduction to this study, in which the emergence of contradictions and the intensification of socio-economic pressures in the 2000s beg the question of why Zhu Rongji, a politician with a limited factional power base was capable of substantially reconfiguring the existing conceptual relationship between the 'plan' and the 'market', whereas despite their ostensible intentions of doing so, the administration of Hu Jintao and Wen Jiabao was unable to address the tensions posed by the intensifying socio-economic inequality created by China's path of economic development. The challenge is to understand not only why a particular set of cognitive dispositions, institutions, and networks combined to generate this financial repression and the social instabilities that have accompanied it, but also to shed light on both the resilience

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121 ———, "Does Financial Repression Inhibit or Facilitate Economic Growth? A Case Study of Chinese Reform Experience".

122 David Li, "Beating the Trap of Financial Repression in China," *Cato Journal* 21:1 (2001): 77-90; Jean-Claude Maswana, "China's Financial Development and Economic Growth: Exploring the Contradictions," *Journal of Chinese Economics and Finance* 3(2011): 15-27.

123 Ricardo Hausmann and Dani Rodrik, "Economic Development as Self-Discovery," *Journal of Development Economics* 72:2 (2003): 603-33.

and malleability of the factors underlying financial repression. The next section accordingly examines the question of stability and change in the risk environment.

Stability and Change in the Risk Environment

As dimensions of social embeddedness, actors draw upon cognitive frames, social institutions, and relational networks in order to manage the uncertainty that would otherwise prevent the development of a coherent basis for social action. This applies not only to the development of patterned expectations in the risk environment and thus an element of intersubjectively generated stability, but also importantly the development of accepted contingency that imbues actors with a capacity for cognitive flexibility and thus permits the possibility of change and transformation. Making the conceptual link from the nature of socio-economic embeddedness to socio-economic outcomes involves identifying the mechanisms by which social actors are both conditioned by and elect to shape that embeddedness.

Approaching the analysis of change and stability demands that these three dimensions of embeddedness be considered simultaneously and in light of one another. Actors can deploy the social resources generated through one of them in order to influence another.[124] As Beckert has argued, mechanisms of change and continuity such as path dependence, critical junctures, mimicry, and structural holes are all predominantly oriented to one of the dimensions of embeddedness, thereby inhibiting a comprehensive understanding the processes of stability and change as a function of the reciprocal influence of forces arising out of actors' embeddedness.[125]

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[124] Beckert, "How Do Fields Change? The Interrelations of Institutions, Networks, and Cognition in the Dynamics of Markets", 611.

[125] ———, "How Do Fields Change? The Interrelations of Institutions, Networks, and Cognition in the Dynamics of Markets", 611.

Potential mechanisms by which these dimensions of embeddedness form conditions and restraints on each other for social reproduction and change are elaborated in Table 3.1.

Table 3.1: Stability and change in the risk environment

Subject	**Object**	**Action**	**Effect**
Institutions	Networks	Stability	Institutionalize networks
		Change	Reconfigure and influence the structure of networks
	Frames	Stability	Institutionalize frames
		Change	Demonstrate suitability/appropriateness of frames
Networks	Institutions	Stability	Complement and buttress institutions
		Change	Generate collective power to change and shape institutions
	Frames	Stability	Diffuse and entrench frames
		Change	Provide pathways for adaptation and evolution of frames
Frames	Institutions	Stability	Legitimize institutions
		Change	De-legitimize institutions
	Networks	Stability	Legitimize power relations within networks
		Change	Alter perceptions of networks

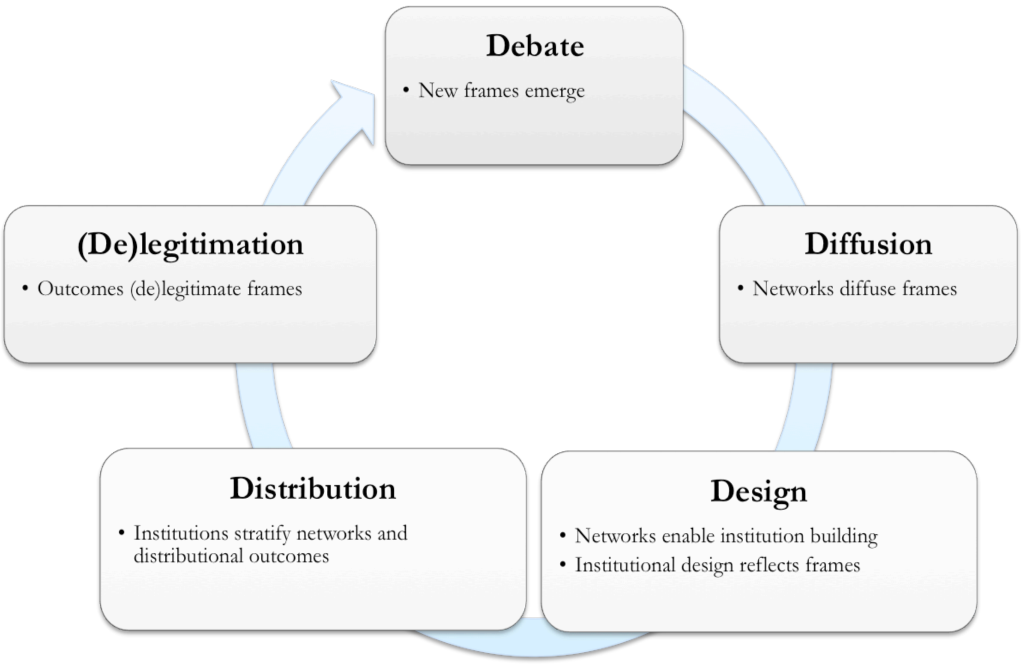
Source: Author, Beckert (2010)

This typology of inter-dimensional effects has a number of implications for examining the nature and evolution of the Chinese banking sector as a lynchpin of responses to both the endogenous and exogenous demands of economic development. Frames, institutions, and networks do not simply function as 'neutral' devices to resolve coordination problems,[126] but shape patterns of competition, mediate the exercise of power, and thus make a deep contribution to socio-economic stratification. A focus on these dimensions of embeddedness and the mechanisms

[126] ———, "How Do Fields Change? The Interrelations of Institutions, Networks, and Cognition in the Dynamics of Markets", 611.

through which they both reinforce and reconfigure the social world is thus not to deny the role and significance of interests, but rather to emphasize the extent to which these interests are shaped and modulated by a pervasive social embeddedness. It permits the development of a dynamic theory of the role of ideas in cognitively framing the process of institutional change, the stratification of networks, and the production of socio-economic outcomes that in turn precipitate the renegotiation of dominant ideas and thus new cognitive frames.

Figure 3.2: A model of frames, institutions, and networks



Source: Author

Debate: Cognitive frames are necessary for managing Knightian socio-economic uncertainty. The development, contestation, and agreement of such frames enable actors to coalesce around shared interpretations and understandings of social reality. The ideas that emerge in the aftermath of uncertainty-inducing junctures—either in the form of macroeconomic instability or deepening social inequality—provide the foundational elements of a risk environment that gives shape to a particular conception of how that uncertainty can be managed through network-formation and institution-building. The cognitive frames that have underpinned Chinese political economy both in modern and pre-modern eras have permitted the construction of a risk environment that allows the CCP to act simultaneously as the guarantor of economic control, and that of economic growth. They generate a means of controlling uncertainty, by way of embracing uncertainty.[127]

Diffusion: Social networks diffuse cognitive frames and enable coalition-building and collective action, and thus influence the process of institutional design and construction. To be influential, cognitive frames must be "well understood, expressed, advocated (including tactical and strategic aspects), and legitimized".[128] This entails that they be diffused in some way, and social networks play an integral role in this process of frame diffusion. The formation of particular networks around existing individuals, ideologies, and institutions, have played a significant role in the path of China's economic development, as dominant framings prevail and become entrenched by virtue of their adoption and promulgation through these networks.

Design: Institutional design reflects the shared understandings of how frames are to be interpreted. As cognitive frames are mediated through policy-relevant social networks, the actors involved in the process of institutional construction draw upon these frames as resources and tools for catalyzing institutional change. In the realm of financial and monetary policy, this change involves regulating and modulating the flow of capital. An array of institutions embody particular conceptions of how to manage the social relations that constitute financial networks,

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[127] As discussed above. See Heilmann and Perry, "Embracing Uncertainty: Guerrilla Policy Style and Adaptive Governance in China."

[128] Dieter Plehwe, *The Making of a Comprehensive Transnational Discourse Community: The Mont Pèlerin Society of Neoliberal Intellectuals* (Berlin, DE: WZB, 2007), 5.

including those that affect the quantity and value of capital (central banking), the allocation of capital (financial intermediaries), and the dynamics of financial markets (financial regulation).

Distribution: Institutional change reconfigures economic-relevant network positions, leading to structural stratification in socio-economic outcomes. Socio-economic reproduction through the allocation of capital and resulting economic activity rests upon networked dynamics, both in political and in market-structural terms. These networks are structured by a variety of different political and economic factors. The ways in which institutional structures affect the supply, demand, and cost of capital have varying impacts upon the extent to which an economic actor is positioned to access and then utilize capital. Depending on the nature of that actor, that capital will be deployed to different uses, and thus an institutionally modulated allocation of capital will lead to a stratified accumulation of capital within the political economy.

(De)legitimation: Endogenously, such stratification has the potential to disturb the intellectual coherency of cognitive frames, generating impetus to challenge existing institutions and networks. Whether or not the actual social outcomes produced by this process—in terms of stability, aggregate material wealth, social equality etc.—coincide with the still-salient cognitive premises upon which networks were utilized and institutions constructed has an effect upon the evaluative interpretation of those cognitive frames as fundamentally normative socio-economic discourses. Exogenously, shocks and events further have the potential to disturb the coherency of cognitive frames as new interpretations and understandings disrupt the continuity and harmony between still-salient cognitive framings and actual socio-economic outcomes. These endogenous and exogenous trends and disruptions thus in turn produce 'cognitive evolution', as this diffusion reconfigures interpretations of actual social outcomes, and reflects back upon the salience or acceptability of the original cognitive frames.[129]

This allows us to begin to make sense not only of the politico-economic roles that the financial system and the CCP have played in the course of China's development since 1978, but also a social-theoretic understanding of why certain features of these roles have displayed resilience at the same time as others have undergone radical transformation. These dimensions of embeddedness and the mechanisms by which they both reproduce and reconfigure the rationality of socio-economic action provide the foundations of the empirical analysis undertaken in this thesis. Ideas concerning the relationship between 'socialist' ideology and the market economy gave rise to cognitive frames that guided debates within the CCP over institutional design, providing the motivation and generating the normative resources for certain actors to stabilize particular institutional forms and to de-legitimize others. The resulting evolution of legal-bureaucratic and market institutions reconfigured the relative positions of individuals and groups within the social networks underpinning the CCP and its relation to the real economy, and enabled certain actors to reinforce their position within a stratified political economy, even as others' positions were weakened and subordinated through newly emergent institutions of reform and development. These networks were furthermore critical in mobilizing sources of support for particular ideas concerning the role of financial capital within the reform and development of China's political economy, as well as comprising critically important 'social glue' for the buttressing of the social institutions that were playing an increasingly significant role in the legal-rationalization of Chinese society and political economy. The confluence of intellectual and political networks within the CCP provided mechanisms of cognitive diffusion

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129 Emmanuel Adler, *Communitarian International Relations: The Epistemic Foundations of International Relations* (London, UK: Routledge, 2005), 17.

amongst party elites and policy-makers. The resulting changes in the real economy and the ever-present prospects of financial crisis continually catalyzed these processes of social change.

The interplay of these mechanisms and the unfolding resulting social processes however should not be permitted to cloud over the potential latency of ideas, frames, and the shared understandings that emerge in the interpretation of and response to uncertainty. In seeking to explain social change and social stability, it is as important to delve into those areas of unspoken and taken-for-granted agreement and consensus as it is to examine the political contestation and bargaining that accompanies institutional change. Although the influence of broader 'meta-contexts' has been recognized as one means of understanding more adequately how institutional structure can empower as well as constrain agents,[130] the potential for discursive meta-contexts to both give rise to and be underpinned by the reification of ideas and frames is often neglected. It is this series of meta-frames and meta-contexts that is crucial in developing a more complete picture of why discrepancies exist between social reality and social cognition. The problem of socio-economic uncertainty, beyond its conception as either probabilistic risk or even as Knightian uncertainty, also has roots in the ideas that are latently shared by actors, such that they fall away from actors' cognitive horizons and thus the realm of contestation, and instead come to structure behaviour and action implicitly. The reification of these ideas and frames forms an important component in understanding the development of what can be termed the 'spirit of Chinese capitalism',[131] a concept that will be explored below.

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[130] Stephen Bell and Hui Feng, "How Proximate and 'Meta-institutional' Contexts Shape Institutional Change: Explaining the Rise of the People's Bank of China," *Political Studies* (2013): 1-19.

[131] cf. Redding, *The Spirit of Chinese Capitalism*.

Conclusion: The New Spirit of Chinese Capitalism

In the above sections I have explored the significance of a risk environment, its peculiar mechanisms of change and continuity in China's political economy, and the way in which it is capable of producing particular socio-economic outcomes by mediating the flow of financial capital. These indicate how the roles of different actors in influencing social action have the capacity to reflect a specific and inherently normative vision of political economy that emerges out of particular ideas about the relationship between financial capital and political authority. The analytical implications of this framework can be seen in the process by which financial reform has unfolded since 1978, and critically since 1992, forming the basis for the empirical analysis undertaken in the following chapters. The CCP recognized that it needed to embrace an 'interest-based' society, but it was clearly apparent that interests and ideology were closely interlinked, and that concepts of credit and finance also involved notions of risk and return that had implications for the wielding of social power, as creditors can leverage their expectations so as to compel a debtor to act in confidence-preserving ways.[132] The outcome of appealing to economic interests in the use of investment capital is that the necessity of maintaining such confidence, and thus loyalty, "gives to the capitalists a powerful indirect control over government policy: everything which may shake the state of confidence must be carefully avoided because it would cause economic crisis."[133] And yet this confidence and game of expectations remains a mutual one. The establishment of market-oriented institutions was necessary not just for being rational and efficient, but also for being rational and efficient for specific and socially constructed purposes.

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[132] Beckert, "Capitalism as a System of Expectations: Toward a Sociological Microfoundation of Political Economy", 334.
[133] Michael Kalecki, "Political Aspects of Full Employment," *Political Quarterly* 14:4 (1943): 322-30.

Conventional narratives of the expansion of markets throughout different economic sectors in China too often fail to pursue the implications of how particular markets are constructed in particular ways. The construction of a capitalist economy is not a matter simply of guaranteeing market exchange, but rather one of accounting for the assumption of risk, and the distribution of the profits of that market exchange. This reflects Braudel's characterization of the system of capitalist exchange as distinguished by the existence of a layer of systematic appropriation of profit, an activity that presupposes but is not necessarily directly attached to a lower stratum of participants in trade and exchange whose rewards are more or less proportionate to the costs and risks involved in such activities.[134] As Wong argues, for Braudel market economies can exist wherever buyers and sellers convene to exchange goods at prices considered sensible by both parties.[135] In historical comparative context, as explored in Chapter Two, the construction by the CCP of particular markets for capital in China has not been neutral, but rather has been directed towards a particular vision of national growth and development.

The significance of the concept of a risk environment thus lies not only in explaining micro- and macro-level economic outcomes, but also to take the description and analysis of a specific kind of embeddedness that generates these particular outcomes and relate it to a macro-level view of broader societal development. In short, the embeddedness of socio-economic action is imbricated with the development of capitalist modernity as it is unfolding and evolving in China. The emergence and evolution of this risk environment also raises questions of how risk and uncertainty are related to the emergence, development, and spread of capitalist modes of social organization. Through its construction of a risk environment, the development of ideas around an authoritarian market economy, the deployment of relational networks, and the

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[134] Braudel, *Civilization and Capitalism, 15th - 18th Century, Vol. 1: The Structure of Everyday Life*, 23-25. See also Arrighi et al., "Historical Capitalism, East and West," 262-64.

[135] Wong, *China Transformed: Historical Change and the Limits of European Experience*, 51.

building of rationalized institutions have all been part of the CCP's efforts to govern a rapidly emerging capitalist political economy. Addressing this issue in the context of China's experience of reform and opening revolves around the question of the extent to which particular interpretations and responses underpin a specific socio-economic formation that we can identify as constituting contemporary capitalism, centered around the "imperative to unlimited accumulation of capital by formally peaceful means."[136] This brings to the fore the illusion of a distinction between a liberal and illiberal politics in the structuring of capitalist society. What Redding sought to identify in his *Spirit of Chinese Capitalism* was less the spirit of capitalism, and more the sociological foundations of 'market exchange with Chinese characteristics'. Capitalism as a mode of social organization is rooted firmly in discrete socio-historical circumstances, and it is only possible to identify something akin to its 'spirit' by examining the macro-social processes through which it emerges, develops, and becomes entrenched within the cognitive, institutional, and structural matrices of social relations. The spirit of capitalism is the "set of beliefs associated with the capitalist order that helps to justify this order and, by legitimating them, to sustain the forms of action and predispositions compatible with it."[137] Such a perspective is intent not on "explaining the genesis of capitalism but on understanding the conditions in which it can once again secure for itself the actors required for profit creation."[138]

The uniqueness of China's new capitalist society resides in the determination of the CCP to maintain the explicitness of its role as custodian of the power of capital. As Walter and Howie observe,

> Risk, in market terms, means price; like everything else, capital has a price attached to it. In China, however, the Party has made sure that it alone, and not a market-driven yield

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[136] Original emphasis. Boltanski and Chiapello, *The New Spirit of Capitalism*, 4-5.
[137] ———, *The New Spirit of Capitalism*, 10-11.
[138] ———, *The New Spirit of Capitalism*, 11.

> curve, provides the definitive measure of risk-free cost of capital, and this measure is based ultimately on the funding cost for bank loans, the one-year deposit rate.[139]

This interpenetration of the market and the state in the pursuit of capital accumulation is thus unfolding in a direction distinct from that of Western conceptions of free-market, individualistic, and bottom-up capitalist development. Even as the CCP embraces the discourse of an antagonism between the state and the market and seeks publically to parse out the functions of the bureaucratic and economic systems respectively as mainstream economic theory would dictate, the underlying array of cognitive, institutional, and structural features of the risk environment remains focused upon the capacity of the CCP keep the market alive, rather than the capacity of the market to keep the state afloat.

[139] Walter and Howie, *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise*, 85.

IV Constructing a 'Modern' Financial System: 1991-1997

计划多一点还是市场多一点，不是社会主义与资本主义的本源区别，计划和市场都是经济手段。

Whether a little more plan, or a little more market; this is not the fundamental difference between socialism and capitalism. The plan and the market are both economic tools.[1]

— Deng Xiaoping

The Party is everywhere, in all institutions, and [with] influence over all people. But the way it works is invisible, like in that American movie, Fight Club. The first rule is that you don't talk about it.[2]

— Beijing Investment Banker

Introduction

One of the seminal works on the evolution of China's financial sector in the early 1990s is Nicholas Lardy's China's *Unfinished Economic Revolution*, published in 1998. Chapter Four is entitled 'Creating a Modern Financial System', in which he argued that,

> If China is to successfully complete its transition to a market economy and sustain a reasonably high rate of economic growth in the future, it must create a modern banking system, one that will meet accepted international accounting standards. The failure to do so will not only mean that the allocation of capital by banks will continue to be inefficient. It will also constrain the development of capital markets, limit the growth of the new domestic banks created since the mid-1980s, require continued indefinite severe limitations on the scope of business of foreign banks operating in China, limit the ability of the government to relax its heavy controls on interest rates, and make it more difficult to adopt monetary policy instruments that might moderate the large macroeconomic fluctuations experienced in the last two decades.[3]

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[1] Deng Xiaoping, *邓小平文选第三卷 [Selected Works of Deng Xiaoping, Volume 3]* (Beijing, CN: Renmin Press, 1993), 373; See further, Hu Shuli, Huo Kan, and Yang Zheyu, "[改革是怎样重启的一社会主义市场经济体制的由来] How is Reform to be Restarted? The Origins of the Socialist Market Economy," *中国改革 [China Reform]* 12 (2012).

[2] BJ:2012.11.28 #2. Interview, Beijing.

[3] Lardy, *China's Unfinished Economic Revolution*, 129.

Lardy was correct that the changes necessary for China to transform its financial system into one that resembled those of liberal market economic financial sectors had not transpired in the years since 1993. However as this chapter argues, the underlying reason for the unique and peculiar path of financial reform during the early and mid-1990s was the CCP's active and deliberate construction of a financial system that would serve both the economic function of economic growth and accumulation as well as the political function of continued CCP control. There exist several orthodox accounts that continue to conflate 'reform' with 'market liberalization'. It was not that of factional stalemate between Jiang Zemin and Zhu Rongji,[4] simply the urban biases of the new technocratic leadership,[5] or the vested interests entrenched in the under-performing state-owned sector,[6] that should be considered the root cause of 'illiberal' financial reform. Huang's proffered "conjecture" for the lack of liberalization is that Jiang Zemin and Zhu Rongji were both Shanghai-sourced technocrats, and that the experiences of Tiananmen were deeply felt by the top leadership.[7] Furthermore, his argument is at odds with that proposed by Shih, in which Jiang Zemin and Zhu Rongji emerge as the heads of rival factions committed respectively to decentralizing and centralizing financial power.[8] These existing narratives each miss crucial elements of the overall trajectory of reform and more importantly, miss the profound implications of what was in fact a much more concerted intersubjective understanding of the bases for growth, reform, and development that were embodied within the financial system as it actually existed and operated within the economy. At the start of a volume detailing the myriad problems of the Chinese financial system Huang appears at pains to admit, "the basic fact is clear: China has experienced phenomenal

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[4] Shih, *Factions and Finance in China: Elite Conflict and Inflation*.
[5] Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State*.
[6] Lardy, *China's Unfinished Economic Revolution*.
[7] Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State*, 111.
[8] Shih, *Factions and Finance in China: Elite Conflict and Inflation*, 154.

growth in conjunction with a dysfunctional financial system."[9] Yet they unfortunately provide very little in the way of a satisfying answer for how this came to be so.

Shih's factional account of elite politics in the 1990s rests upon the observation that, "unlike the usual portrayal of technocrats who were either agents to political principals or 'insulated' technocrats operating beyond the pull of politics, technocrats in China were highly politicized."[10] However, the political and economic demands upon the top leadership came to produce as much a cohesiveness of perspective as much as factional infighting, and which led to the creation of cognitive frames, institutions, and networks capable of mitigating the tension embodied within the financial system between the politics of growth, and the politics of stability. Shih's factional model generates a degree of insight into how personal political priorities sewed discord between members of the CCP elite in the waning years of Deng Xiaoping's authority, however it provides very little sense of how the CCP was capable of so effectively mitigating the excesses of these inflationary cycles, the extent to which its approach to reform of the financial system itself was crucial to this success, and why this would ultimately produce a political economy that bound together the interests of both state, market, and society in the uninterrupted pursuit of economic growth.

Although reform and opening commenced in the late 1970s, the Party-line that has undergirded economic policy-making in the reform era emerged with the conceptual and ideological development of the socialist market economy (社会主义市场经济) in 1992.[11] What has been labeled the 'neoconservative legacy'[12] was a catalyst for the reassessment of the path of reform that had been adopted during the 1980s prior to the Tiananmen Square protests of 1989. During

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[9] Yasheng Huang, Tony Saich, and Edward Steinfeld, eds., *Financial Sector Reform in China* (Cambridge, MA: Harvard University Asia Center, 2005), 12.

[10] Shih, *Factions and Finance in China: Elite Conflict and Inflation*, 160.

[11] See Kokubun Ryosei, "Explaining the Rise of China" (Presented at *Explaining the Rise of China: A Challenge to Western Social Science Theories?*, Harvard University, MA, 2010).

[12] Sarah Eaton, *China's State Capitalist Turn: Political Economy of the Advancing State* (Doctoral Dissertation, University of Toronto, 2011).

the 1990s, rather than the CCP becoming detached from administrative hierarchies and institutions of state, the party was even more tightly integrated into other chains of command. The hierarchical relationships in the government and CCP were "more clearly specified, monitored more effectively, and tied more closely to material rewards".[13] It was thus in the period 1991-1997 that the duality of the financial system began to emerge clearly as a critical feature of China's political economy. It was the product of a commitment to the active construction of a capitalist political economy under the continued authoritarian rule of the CCP, and thus constituted the roots of a discourse and logic of economic growth as the means by which the goals of governance by the CCP could be achieved. The financial system's utility for commercialization of real economic sectors began to be better understood and appreciated. At the same time however the financial sector remained closely bound to the administrative and political demands of restructuring centre-local relations.

This chapter thus traces the re-invigoration of the discourse of economic growth and its manifestation in the drive to establish a distinctly 'modern' financial system that satisfied the increasingly commercial imperatives of economic development, the evolution of a rationalized bureaucratic structure, and the need to retain authority over capital within the existing CCP-dominated political structure. Cognitive frames were constructed around the financial system as the backbone of growth in the economy, the 'infrastructure of the infrastructure,' and the necessity of rationalizing, institutionalizing, and commercializing the financial system in ways that would allow it to fulfill this role. Yet at the same time these frames emphasized the extent to which the financial system was critical to the CCP's maintenance of control and stability in the political economy. The layering of these cognitive framings was influenced not only by the existing institutions of the party-state, but was also shaped through the development of these frames within networks of intellectuals and officials who were seeking to reconstruct a theoretical and analytical basis for

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[13] Barry Naughton and Dali Yang, "Holding China Together: Introduction," in *Holding China Together: Diversity and National Integration in the Post-Deng Era*, ed. Barry Naughton and Dali Yang (Cambridge, UK: Cambridge University Press, 2004), 8.

socio-economic progress in a society desperately in need of intellectual leadership. Institution building took place along both of these dimensions, as the commercially driven institutionalization of finance coincided with the rationalization of party control. These institutions were framed within the intellectual and political debates concerning the 'socialist market economy', and were also shaped by the networks of economic and political influence that ran through the echelons of the top leadership at the time. Further, networks were used both in order to reinforce discipline and embed the flow of capital within broader socio-political objectives, even as they were simultaneously deployed instrumentally in order to channel funds in a competitive process of wealth accumulation and individual advancement.

The banking sector lay at the heart of this rationalization and reconsolidation of the CCP role within the economy. From the point of his elevation to the Politburo Standing Committee, Zhu Rongji was determined to assert macreconomic control, and consolidated personal and party control over the financial system in order to restrain lending and reduce inflation, whilst taking steps to elevate savings and provide a source of capital. This was achieved through institutional reform, but in no way did this actually create 'market competition' within the financial system, but rather simply a much more effective system of state control. He developed and pushed through SOE reform, but the savings that accumulated at the same time as he worked to deflate the monetary base were channeled not towards making sure that laid off workers were supported, but that large SOEs were bolstered and were given further growth opportunities. Thus we see how the CCP mechanisms of control were essential to the duality of the financial system, even as it began to assume a modern institutional form.

The Fallout from Tiananmen: Doubling down on Development

In the aftermath of Tiananmen, neoconservative concepts came to take a powerful hold on politico-economic thought. However this was not simply a matter of reform-averse conservatives holding sway over liberal-minded reformers. Rather, the neoconservative vision was as much characterized by a drive for reform as the liberal vision, but one that insisted upon maintaining a concerted and realistic appraisal of what development-oriented reform necessitated in a new environment where it was clear that China's future lay equally with global integration and economic development, but also with CCP-led authoritarianism. For many intellectuals, Tiananmen came to be seen "not so much as a case of repression as another instance of romantic radicalism bringing about its own defeat."[14] What goes more unnoticed is the extent to which the events of June 1989, as much a product of economic instability and loss of price control as it was concerned with direct political liberalization, came to place the CCP leadership in a position whereby not only was its political legitimacy increasingly dependent upon its managerial capacity, but its margin for error in terms of economic governance was increasingly thin. The CCP needed to produce rapid economic growth, and it needed to make sure that this growth was stable and under control at all times. It is this feature of the path of reform in the early 1990s that sets it apart from that of the 1980s. In contrast to the loss of macroeconomic control during the 1980s and the austerity drive of 1989-1990[15] that catalyzed a sharp decrease in growth, the bid to control inflation in 1993 through party discipline and financial repression was achieved without a corresponding drop in growth. The soft landing following the macroeconomic instability of the mid-1990s was so effectively achieved because the financial repression that was necessary in order to reconcile economic and political priorities in the post-1989 environment involved the strengthening of control over the financial system even as it was subjected to increasing commercialization and rationalization. It was the development of a growth strategy rooted in financial repression that formed the basis for this achievement. In this section I detail how this financially repressive growth strategy reflected the distinctly socio-political significance of the post-Tiananmen neoconservative legacy.

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[14] Fewsmith, *China Since Tiananmen: From Deng Xiaoping to Hu Jintao*, 102.

[15] See Central Committee of the Communist Party of China. 中共中央关于进一步治理整顿和深化改革的决定 [Decision of the Central Committee on Steps to Re-establish Order and to Deepen Reform]. (Beijing. CN: Central Committee of the Communist Party of China, 1990).

In the post-Tiananmen period, the Chinese Party leadership was confronted with a pressing need to reconstruct its interpretation and understanding of 'reform'. The validity and appropriateness of Deng Xiaoping's vision of China's reform path—particularly as it had manifested in Zhao Ziyang's leadership of the Party—was contested by conservatives in terms of it rendering the CCP vulnerable to a diminishment of control over a process of socio-economic change that was clearly in motion throughout China.[16] The issue was as deep as having to determine whether the socialist orientation itself would be upheld.[17] These questions would be intensely debated and contested for the next two years, revolving around the fundamental issue of whether a market economy was fundamentally capitalist in nature or if it could potentially exist in a socialist economy [市场姓社还是姓资]. The process of renegotiation of the ideological and politico-economic foundations of China's now suddenly uncertain development trajectory necessarily addressed two forms of challenge: the political challenge of defining the foundation for the Party's ruling legitimacy, and the economic challenge of shaping policies and institutions that would enable this foundation to be consolidated and built upon. The financial system resided at the core of both of these issues, as loss of control over the money supply was regarded as one of the greatest risks for social stability,[18] whilst the provision of bank credit constituted a crucial component of fuelling the necessary high-speed growth. Following the blow to the CCP's socialist legitimacy dealt by 1989, the issue of how to engineer the growth necessary for political survival came to be in direct tension with the need to maintain economic stability as a matter of political survival.

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[16] Fewsmith, *China Since Tiananmen: From Deng Xiaoping to Hu Jintao*, 21-22.

[17] Central Committee of the Communist Party of China, "中共中央关于成立财经, 政法, 外事, 科学文教各小组的通知 (CPC Central Committee Notice on the Establishment of the Finance and Economy, Politics and Law, Foreign Affairs, Science, and Culture and Education Small Groups)," in *中国共产党组织史资料 (Materials on the Organizational History of the Communist Party of China), Vol 9.*, ed. CPC Party History Research Office, CPC Organization Department, and Central Archives (Beijing, PRC: CPC Party History Publishers, 1998), 618.

[18] As Zhu Rongji unambiguously stated it in 1994 in an address to a symposium of central bank branch presidents in 1994, "If prices aren't stable, people's hearts won't be stable, and we won't be politically stable." Zhu Rongji, "跨出金融改革关键性的一步 [Taking a Critical Step Forward in Financial Reforms]," in *朱镕基讲话实录 (全四卷) [Zhu Rongji on the Record (Four Volumes)]*, ed. Zhu Rongji (Beijing, CN: People's Press, 2011 [1994]).

The search for legitimacy in the post-Tiananmen era thus produced a reconsolidation of economic growth and development as the new raison d'être for the CCP. The interregnum in reform and opening following 1989 had given rise to a fierce debate over the future direction of Chinese economic development. Anti-reform conservatism was seemingly entrenched in Beijing, as conservatives led by Chen Yun took a series of steps to charge Deng's rapid economic reform efforts with having precipitated the inflationary pressures of the late 1980s. This manifested in two ways. First, that a reconsolidation of central planning capacity was necessary for the ongoing sustainability of China's economic growth,[19] and second that party discipline had to be re-established on traditional terms of Marxist thought.[20] It was imperative thus in 1991 and 1992 that Deng Xiaoping take drastic measures prior to the Fourteenth Party Congress. Deng's offensive was a critical point in the ideological re-orientation of Chinese society.[21] Whilst engaged in the Southern tour, Deng's first priority thus was to end the prolonged ideological and policy debate that had constrained his efforts to accelerate economic growth and development.[22] However this resolution derived from fundamentally different sources from those underlying the liberalizing reforms of the 1980s, and sought to separate the economic from the political in a way that had been anathema to Hu Yaobang and Zhao Ziyang. In targeting the 'leftist' tendency to hold fast to orthodox Marxist ideology, he argued that "describing reform and opening as the importation and development of

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[19] This produced the notably unsuccessful period of austerity of late 1989 and 1990. See Barry Naughton, *Growing Out of the Plan: Chinese Economic Reform, 1978-1993* (Cambridge, UK: Cambridge University Press, 1995), 273-83.

[20] In the aftermath of 1989, Song Ping, along with Yao Yilin one of the most conservative members of the Politburo Standing Committee, had promulgated a set of criteria for the career advancement of CCP cadres that stressed ideological purity, contending, "in assessing the performance of officials, Marxist morality should come before ability … cadres should have both ability and political integrity with [the latter] being more important]." Political integrity was further defined by Song as a cadre's behaviour during the "political disturbance of 1989." Song Ping, "加强党的建设，提高党的战斗力 [Strengthen the Party's Construction, Elevate the Party's Fighting Ability]," *党建研究 [Party Construction Studies]* 4(1991).

[21] Hu Shuli, Huo Kan, and Yang Zheyu, "[改革是怎样重启的一社会主义市场经济体制的由来] How is Reform to be Restarted? The Origins of the Socialist Market Economy".

[22] Suisheng Zhao, "Deng Xiaoping's Southern Tour: Elite Politics in Post-Tiananmen China," *Asian Survey* 33:8 (1993): 739-56, 746.

capitalism and viewing the main danger of 'peaceful evolution'[23] as coming from the economic field are leftist manifestations."[24] He further emphasized the party line of 'one centre and two basic points' [一中心两基点].[25] The centre was that economic growth and development of the forces of production was the central task of the Chinese state, whilst the two basic points were the means by which this was to be achieved: (1) centralized political control and the upholding of the 'Four Cardinal Principles',[26] and (2) insisting upon reform and openness to the outside world.[27]

The repercussions to Deng's preemptive attack in the south indicate that no side had decisively won the struggle prior to the Fourteenth Party Congress in October 1992.[28] However by the close of the conference what was evident was that Dengist policy circles had thoroughly marginalized the voices of intellectuals from across the political spectrum, insisting that GDP growth was the fundamental means of ameliorating the potential risk of social discontent.[29] This reflected the demise of what remained of a true egalitarian streak within the leadership, as central planners such as Chen Yun who believed rapid economic growth was inherently destabilizing lost influence, and those younger conservatives including Li Peng and Yao Yilin adopted an 'indicative planning' perspective, rooted in the experience of Japan and the newly industrializing economies of

[23] 'Peaceful evolution' was regarded as a process by which subversive elements of bourgeois liberalization and capitalism would gradually and innocuously permeate society, politics and the economy.

[24] *Beijing Review* 35:15 (1992), 5.

[25] Tang Tsou, "Further thoughts on chinese politics at the top: the past, the present, and the future " *Journal of Contemporary China* 7:17 (1998): 167-99.

[26] The four cardinal principles [四项基本原则] are (1) the principle of upholding the socialist path; (2) the principle of upholding the people's democratic dictatorship; (3) the principle of upholding the leadership of the Communist Party of China; and (4) the principle of upholding Mao Zedong thought and Marxism-Leninism.

[27] Deng had first announced this signature epithet in June 1989, only five days after having cleared Tiananmen Square. See Deng Xiaoping, "在接见首都戒严部队军以上干部时的讲话 [Speech Made While Receiving Cadres of the Martial Law Units in the Capital at and Above the Army Level]," (June 9, 1989).

[28] Zhao, "Deng Xiaoping's Southern Tour: Elite Politics in Post-Tiananmen China", 755.

[29] Hui Qin, "共识破裂：改革争论的激化 [Rupturing Consensus: The Intensification of the Reform Debate]," *南方周末 [Southern Weekend]*, 21 February 2008.

East Asia.[30] As Jiang Zemin gradually sought to establish himself as the 'core' of the third generation of leadership, he sought to articulate a coherent vision of socio-economic development, one which would come to revolve around strengthening CCP authority on three bases: development, stability, and national unity.[31] Zhu Rongji was elevated to the Standing Committee of the Politburo in 1992 by Deng Xiaoping with the implicit support of Chen Yun, and tasked with the responsibility of bringing his technocratic style to bear on macroeconomic management.[32] Each of these leaders recognized the imperative of economic growth, and the fact that the CCP's political future was tied inextricably to it.

The political turmoil of 1989 had precipitated a renewed emphasis upon economic growth, and the economic dimensions of the challenge now confronting the CCP in the early 1990s were numerous and varied in nature. Under the conditions of extreme uncertainty that faced CCP policymakers, financial elites, entrepreneurs, and the managers of SOEs, it was virtually impossible for any of these actors to accurately gauge the levels of risk that were attached to financial decisions. Rather, it was necessary to draw upon existing social resources and structures in order to manage this uncertainty in the process of reconstructing social order in the aftermath of an existential crisis in 1989. The following sections detail how this management of uncertainty unfolded through the evolution of specific cognitive frames, institutional structures, and relational networks in relation to the flow of capital through the financial system, and accordingly lay at the heart of the restructuring of China's mode of economic development during the course of the mid-1990s. The frames, institutions, and networks that arose and evolved in the early 1990s profoundly influenced the path of socio-economic development, underpinning the duality of the banking and financial system as a

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[30] Sebastian Heilmann and Lea Shih. "The Rise of Industrial Policy in China, 1978-2012". *Harvard-Yenching Institute Working Paper Series*. Cambridge, MA: Harvard-Yenching Institute, 2012; See also Xue Muqiao, *薛暮桥回忆录 [Memoir of Xue Muqiao]* (Tianjin, CN: Tianjin People's Publisher, 1996), 440.

[31] Yongnian Zheng, "Ideological Decline, The Rise of an Interest-based social order, and the demise of communism in China " in *The Nanxun Legacy and China's Development in the Post-Deng Era*, ed. John Wong and Yongnian Zheng (Singapore, SG: Singapore University Press, 2001).

[32] Shih, *Factions and Finance in China: Elite Conflict and Inflation*, 151.

means of generating economic growth without endangering political authority. This duality of the role of the financial system enabled these tensions to be resolved. I argue that the course of reform would build upon these dimensions of embeddedness in a way that reconciled the compromises demanded between the adoption of economic policies for purely economic purposes, and the adoption of economic policies for extra-economic purposes. What emerges from this process is a clear sense of demarcation between these two realms, and the manner in which their reconciliation was a fundamental necessity for maintaining the social foundations not only of economic activity, but also for maintaining the coherence and integrity of the broader social compact that has characterized social, political, and economic relations in China since 1989.

Cognitive Frames: 正名市场经济

These pressures confronting the CCP during the years following 1989 precipitated a deep-seated reconsideration of the bases for the party's legitimacy and policy-making mandate. The attitudes, principles, and ideas that would guide financial reform in the years following did not emerge from an ideological and intellectual vacuum. The 'rectification' of the 'market economy' [正名市场经济][33] was a process that generated the space for developing positive plans for subsequent reform; it lay the basis for the 'socialist market economy', and thus as a conceptual heuristic it provided the cognitive frame that would enable actors to reorient their behaviour and action within the political economy towards a different conception of the relationship between the state and the market. It was the CCP that would guide and engineer the evolution of this relationship, by taking this

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[33] 正名 [*zhengming* - The rectification of names] is a concept deployed in Confucian philosophy, rooted in the principle that order, harmony, and justice in the world are contingent upon social and physical objects being 'labelled' and 'designated' correctly, such that they exist and function in their normatively appropriate position. For example Xunzi, a later Confucian scholar, exemplified its application to the political realm, arguing for the importance of the maxim "Let the ruler be ruler, the subject subject; let the father be father, and the son son." See Frits Staal, "Oriental Ideas on the Origin of Language," *Journal of the American Oriental Society* 99:1 (1979): 1, 8.

cognitive frame of a 'socialist market economy' and diffusing it through the party networks that spanned both market and state, whilst consolidating it through the establishment of institutions that embodied the dualism inherent in the reconciliation of the economic growth priority and the political authority of the CCP. Furthermore, the existing institutional landscape and the nature of social networks had a significant impact upon the development of cognitive frames. It was not simply a matter that 'institutions' such as universities, think tanks, or professional associations had an effect upon the 'socialization' of discourse and actors within new and evolving cognitive frameworks.[34] Rather, the very foundational institutions of the economy and the socio-economic outcomes that these had produced (economic instability and the imperiling of the CCP's political and ideological legitimacy) served to motivate a shift in the framing of potential reform trajectories, but also firmly anchored and stabilized cognitive frames and their associated normative orientations.

This concept and label of the 'socialist market economy' embodied the cognitive building blocks of paternalism, personalism, and insecurity that characterize the intersubjective dimensions of social interaction in Chinese society. It came to be an actual social structure that catalyzed the process of creating a non-independent central bank that was infused with dense party networks and to the passing of legislation that codified a degree of ambiguity and retained a significant degree of space for arbitrary and highly personal authority. It further enabled the establishment of financial markets that genuinely rationalized the flow of capital in the economy, but rationalized it according to a deeply embedded logic of state and party-led economic development. As a common reference point and a set of shared understandings, it enabled the development of consensus around the need for this particular path of financial reform. But further, it generated faith and credibility in the ability of the CCP to secure economic growth without losing control of the economy.

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[34] See Beckert, "How Do Fields Change? The Interrelations of Institutions, Networks, and Cognition in the Dynamics of Markets", 618.

The entrenchment of the discourse of economic development in the post-Tiananmen era had particular ramifications for the financial system. 'Doubling down on development' also meant doubling down on capital, and it meant that the CCP was compelled to begin to confront the question of how to construct a modern financial system that would not disembed itself from either the real economy or society, and especially not the CCP itself that mediated between the two. The real dimensions of the conundrum facing the party in the ideological and theoretical debates of the early 1990s is apparent in the following statement by a retired official:

> You [the author] ask about the question "does the market have a socialist or capitalist surname?" [市场姓社还是姓资], but I think that in those days, the question was not just about the market. The market was already a reality for China.[35] The question for me at the time [the mid-1990s] was really "does capital itself have to be capitalist?" [是否资本一定要属于资本主义]. Deng Xiaoping seemed to believe that the answer was no, and Zhu Rongji seemed to agree with him.[36]

Deng Xiaoping identified the purpose of reform as being to maintain and strengthen, rather than weaken and relax, CCP leadership.[37] In this way, the consequence of Deng's successful drive to embed the CCP's legitimacy within its capacity to generate economic development was to generate a need for transformation of the financial system. Furthermore, it became necessary to do it in a way that ensured that not only the market, but capital itself retained an allegiance to socialist ideology.

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[35] This dovetails with Wu Jinglian's observations at the 1990 conference on economic issues convened by the central party leadership on 5 July, where he argued that "the slogan 'planned economy should be merged together with the market' was inappropriate, and rather what should be promoted is the concept of the 12th 3rd plenum 'socialist commodity economy', which in reality is the same thing as a 'socialist market economy'. See Jinglian Wu, "1993 年：经济改革进入"整体推进"的新阶段 [1993: Economic Reform Enters a New Period of "Comprehensive Reform"," in *中国经济改革：二十讲 [Chinese Economic Reform: Twenty Essays]* (Beijing, CN: Sanlian Publishers 2012), 120-21.

[36] BJ:2013.04.07. Interview, Beijing.

[37] Wang Qinghua, "The "State of the State" in Reform-Era China " *Asian Perspective* 35 (2011): 89-110, 94.

Socialism and the Market: 社会主义市场经济

The foundation for this was the theoretical development of the 'socialist market economy' [社会主义市场经济]. The State Commission on Economic System Reform (SCESR) (国家体改委), had been established in 1982 as a top-level body under the State Council to lead thinking on economic reform. From 1990 until 1993 it was headed by Chen Jinhua, who brought forth the line of reasoning that was to find favour amongst Deng Xiaoping and the highest leadership of the CCP at the 14th Party Congress. Chen argued that combining the 'visible hand' with the 'invisible hand' had begun to become a universal trend for managing and optimizing the global economic system. If capitalist countries were to draw upon planning mechanisms to overcome the drawbacks of the market, it only stood to reason that socialism could also utilize markets in order to raise efficiency and overcome the deficiencies of planning.[38] It was a matter of embedding the market within a socio-cultural context that would retain its socialist ideological values notwithstanding the newfound significance of monetary exchange relations. During his 1992 Southern tour, Deng had declared that,

> Setbacks have befallen socialism in some countries and regions, and may appear a diminishing force. However, the experiences we gain and the lessons learnt will propel the development of socialism in more healthy directions. Therefore do not panic, thinking Marxism is going to disappear, become redundant, or is destined for failure. It is no such thing![39]

Stripping away the ideological hyperbole, this meant that, "in Deng's grand game plan, the predicate 'socialist' in China's 'socialist market economy' remained largely a strategic capability to be carefully preserved under the continued rule of the communist party."[40] As one retired academic stated it,

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[38] Chen Jinhua, *国事忆述 [Remembering State Affairs]* (Beijing, CN: CCP Party History Publisher, 2005), 216.

[39] Deng Xiaoping, *邓小平文选第三卷 [Selected Works of Deng Xiaoping, Volume 3]*, 382-3.

[40] Lance Gore, "Dream On: Communists of the Dengist Brand in Capitalistic China," in *The Nanxun Legacy and China's Development in the Post-Deng Era*, ed. John Wong and Yongnian Zheng (Singapore, SG: Singapore University Press, 2001), 202.

> In today's China the idea of 'socialism' is not taken very seriously, but in the 1990s when Deng Xiaoping was in charge, there was still a commitment to the socialist identity. Of course this meant the Party, but isn't this what socialism has always been about?[41]

He characterized the implications of the idea of the socialist market economy for economic thinking at the time in the following terms,

> Yes, of course there were lots of politics involved; Deng Xiaoping was fighting for his legacy. But it was also something more. It was recognition that both the market and the party were essential for China's future. The challenge was to make them fit together.[42]

In November 1993 at the 3rd plenum of the Fourteenth Party Congress, the Central Committee adopted the 50-point 'Decision on Some Issues Concerning the Establishment of a Socialist Market Economic System'.[43] This decision would come to have profound effects upon the understandings of institutional change in the financial sector.

After Deng had 'rectified' understandings of what a market economy was and was not for, the next task was to determine how the concept that underpinned the necessary regulation of such a market economy was to be understood, interpreted, and implemented in the context of the newly developed concept of the socialist market economy itself. In his promulgation and support for Deng's formulation of the socialist market economy Zhu Rongji was profoundly antithetical to the ideological debates surrounding the role of the market. As a task-oriented problem-solver, Zhu interpreted Deng's southern talks not in terms of the ideological status of the market, but rather purely as a call to "seize the moment … and not let it slip by."[44] Zhu has been accurately portrayed as a centralizing figure in the course of economic reform, a reformist technocrat who dominated

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[41] BJ:2013.07.13. Interview, Beijing.

[42] ———. Interview, Beijing.

[43] Central Committee of the Communist Party of China. 中共中央关于建立社会主义市场经济体制若干问题的决定 [Decision of the Central Committee of the CCP on Issues Concerning the Establishment of a Socialist Market Economic System]. (Beijing, CN: Central Committee of the Communist Party of China, 14 November, 1993).

[44] Zhu Rongji, *Zhu Rongji on the Record* (Beijing, CN: Foreign Languages Press, 2013), 54.

financial policymaking from when Document No.6[45] was promulgated in 1993 until the end of his tenure as Premier in 2003. Yet this is not to imply that he was in any way apolitical. As a member of the Standing Committee, he not only unsurprisingly played a role in the deal making and power dynamics that characterize Chinese elite politics,[46] but he was firmly committed to a political vision that conceived of economic growth as both the product and the guarantor of financial stability and social order. As a senior banking executive described it,

> Zhu Rongji's financial and commercial knowledge meant that he understood how signals worked in the financial system. He saw how Deng Xiaoping's Southern tour was interpreted as a sign that it was now politically acceptable again to embrace the market, but he also saw how that led to inflation and a loss of economic control. But he knew the solution to this was not to return to central planning like some wanted. For him the solution was to signal that markets were good, but that they needed rules and he would be the one setting and enforcing the rules.[47]

Zhu Rongji's personal and political style was reflected throughout his tenure. His authority over the government apparatus was characterized by a significant personalization and de-institutionalization of the policy development process.[48]

Jiang Zemin's interpretation of the socialist market economy was that macroeconomic tools, rather than administrative means, should be the main instruments of control; the plan should

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[45] A seminal decision of the CCP dedicated to bringing under control the macroeconomic instability that had developed in the aftermath of Deng's Southern tour and the 14th Party Congress. See Central Committee of the Communist Party of China. 中共中央和国务院关于当前经济情况和加强宏观经济调控的意见 [Proposal of the CPC Central Committee and State Council on the Current Economic Situation and the Strengthening of Macroeconomic Control]. (Beijing, CN: Central Committee of the Communist Party of China, 1993).

[46] The extent to which this deal making provides the basis for identifying factions as a coherent model for bureaucratic politics is however questionable. The primary difficulty for the factional account of elite politics in this period is that of reconciling the images of Deng Xiaoping as the archetype of the decentralizing reformer and Zhu Rongji as the archetype of the centralizing reformer, with the fact that it was Deng Xiaoping who identified Zhu's technocratic acumen and elevated him directly from Shanghai provincial politics into the very highest echelons of CCP leadership. At this point, the factional model devolves back into one relying simply upon political expediency, as Deng seeks a provincial ally in the face of entrenched opopsition in Beijing, and Zhu henceafter elects to side with Chen Yun in order to advance his own career. Furthermore, whilst proponents of the factional model such as Victor Shih correctly portray the path of reform during this period as a highly contested one in which power dynamics were crucial, his factional politics model provides no explanation as to why the absence of reform was not to produce widespread disillusionment with the stability and integrity of the banking system. See Shih, *Factions and Finance in China: Elite Conflict and Inflation*, 151-59.

[47] BJ:2012.06.08 #1. Interview, Beijing.

[48] Barry Naughton, "China's Economic Think Tanks: Their Changing Role in the 1990s," *The China Quarterly* 171(2002): 625-35, 630-31.

be confined to 'strategic targets'; and the state should endeavor to remove local barriers to an 'integrated national economy'.[49] However where Zhu Rongji was the technocratic reformer, Jiang Zemin was the consummate politician. Following the 1994 fourth plenum, Jiang Zemin begin to firmly consolidate his position as the 'core' of the party and instigated a movement away from the position held by Deng that economics was to constitute the politics of reform-era China, towards an increasing emphasis upon the ideological requirements of reform and governance. He asserted that the 'unification of understanding' between all cadres was essential, above and beyond economic development, and pointedly criticized those cadres who would "bury their heads in the sands of economic reform and ignore the work of ideological education."[50] However, as Wu Guoguang has highlighted, the fundamental cause of the return of ideology in the mid-1990s was rooted in the absence of institutional rebuilding in the political domain that would reflect and be in accordance with China's socio-economic evolution.[51] Thus, rather than viewing the re-ideologization of the Chinese political system and broader society in general as conflicting with Deng's previous emphasis upon matters of practice rather than ideology, the dedication to party-work and strengthening in the post-Deng era should be seen as the entrenchment and reinforcement of Deng's maxim that the prioritization of the economic should be foremost for the CCP. Further, in this way it constituted a reorientation of CCP ideology itself towards the economic, and an exhortation to carve out moral precepts and norms with which to guide the CCP's pursuit of economic development. This reflected not only a morally charged approach to the establishment and regulation of markets, but one that began to catalyze and in fact itself constitute "the cultural and technical work necessary to produce, to sustain, or—conversely—to constrain the

[49] "什么是社会主义市场经济？主要内容与编写特点 [What is the Socialist Market Economy? Primary Content and Characteristics]," *人民日报 [People's Daily]*, 19 November 1993.

[50] Jiang Zemin, *领导干部一定要讲政治 [Leading Cadres Must Emphasize Politics]* (Beijing, CN: People's Press, 1996).

[51] Guoguang Wu, "The Return of Ideology? Struggling to Organize Politics during Socio-Economic Transitions," in *The Nanxun Legacy and China's Development in the Post-Deng Era*, ed. John Wong and Yongnian Zheng (Singapore, SG: Singapore University Press, 2001), 238.

market."[52] For Jiang, the socialism underlying the establishment of a 'socialist market economy' was thus about 'public ownership',[53] and public ownership was about control and party leadership.[54]

Commercialized Control: 宏观调控

The two main policy priorities in 1992 and 1993 were 'rectification' [整顿] and 'reform' [改革]. Zhu Rongji conceived of these as separate but mutually reiterative: "The first thing is to rectify and the second is to reform. We use reform as a means to rectify and to speed up reforms on the foundation of rectification."[55] Addressing the weaknesses that had emerged in the fiscal and tax systems were part of this effort, building upon the influential arguments of Wang Shaoguang and Hu Angang, who argued that the decline in the central government's 'financial extractive capacity' since the beginning of the reform era was a substantial cause of China's macroeconomic instability.[56] In late June 1993, when the debate concerning the assertion of macroeconomic control over the overheated economy was at its fiercest, Hu Angang and Wang Shaoguang met with the Minister of Finance and were informed that "the line of thought relating to the reform of the fiscal system that you propose in the report comes very close to the way of thinking on the part of the central leaders."[57] This extended not only to Zhu Rongji, who was the lead architect of the fiscal

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52 Marion Fourcade and Kieran Healy, "Moral Views of Market Society," *Annual Review of Sociology* 33(2007): 285-311, 305.

53 Communist Party of China Research Department, *江泽民论有中国特色社会主义 [Jiang Zemin: On Socialism with Chinese Characteristics]* (Beijing, CN: Communist Party of China Research Department, 2002), 45.

54 See Dai Xianglong, "回顾 1997 全国金融工作会议 [Looking back on 1997's Financial Work Conference]," *中国金融 [China Finance]* 55 (2010): 19-20.

55 Zhu Rongji, "整顿财税接续，严肃财经纪律，强化税收征管，加快财税改革 [Rectify the Fiscal and Tax Order, Restore Strict Budgetary Discipline, Strengthen Taxation Collection, Speed up Fiscal and Tax Reform] " in *十四大以来重要文献选编 (上) [Selection of Important Documents Since the 14th Party Congress]* ed. Document Research Center of the Chinese Communist Party Central Committee (Beijing, CN: Central Document Press, 2011 [1993]).

56 Wang Shaoguang and Hu Angang. "加强中央政府在市场经济转型中的主导作用：关于中国国家能力的研究报告 [Strengthening the Guiding Role of the Central Government During the Transition to a Market Economy: A Research Report on China's State Capacity]". New Haven, CT & Beijing, CN: Yale University & Chinese Academy of Sciences, 1993.

57 Hu Angang, "Background to Writing the Report on State Capacity," *Chinese Economy* 31:4 (1998): 5-29, 17.

and financial reforms in the early 1990s, but was "entirely in line with General Secretary Jiang Zemin's line of thinking".[58] Wang and Hu's arguments for the strengthening of the state's financial capacity espoused by Wang and Hu formed the basis for the 1994 reforms towards a unified taxation system.

Zhu Rongji had the same desire to consolidate control over and resurrect the financial system as an effective tool for macroeconomic stability.[59] In contrast to the fiscal reform that was a "way to dig the government out of [its] hole," the financial reforms were "a way of advancing reform through the whole economy and generating future growth."[60] Concomitant with the decline in the central government's fiscal capacity, monetary policy arose as the necessary basis for macroeconomic control. As Naughton observed,

> Previously, only fiscal policy was important; since reform, fiscal policy has been rendered impotent. By contrast, whereas monetary policy used to be fairly trivial, today only monetary policy can really matter for macroeconomic stability.[61]

The loss of monetary control in 1993 precipitated the drive for configuring systems of economic control that preserved the political compromises and understandings that existed as between society and party.[62] This was one of the primary motivations of Zhu Rongji's drive to establish the central bank as a credible institution that could both implement decisive monetary policy as well as control the banks.

In 1993, despite the fervor of a reignited emphasis on economic development and growth, Zhu Rongji still highlighted the numerous problems associated with ill-discipline within the banking system, and the volatility of credit growth. As he announced in a March speech,

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[58] Official in the Central Policy Research Office, cited in ———, "Background to Writing the Report on State Capacity", 18.

[59] BJ:2014.04.14 #2. Interview, Beijing.

[60] BJ:2012.05.14. Interview, Beijing.

[61] Barry Naughton, "China's Macroeconomy in Transition," in *China's Transitional Economy*, ed. Andrew Walder (Oxford, UK: Oxford University Press, 1996), 125.

[62] Jinglian Wu, "重建金融系统 [Reconstruct the Financial System]," in *中国经济改革：二十讲 [Chinese Economic Reform: Twenty Essays]* (Beijing, CN: Sanlian Publishers, 2012).

> [M]ost provinces and municipalities don't have the money, they have red-ink finances, and when they have shortfalls they borrow from the banks. Last year, just to make up for losses in edible grains, they borrowed almost RMB 30 billion from the banks, and in the first quarter of this year they added another RMB 3 billion in loans. That's why 'do it big and do it fast' relies on nothing but an expansion of bank credit, on printing more money.[63]

This exemplifies the shift in policy-making priorities. 'Do it big, and do it fast' was originally a positive slogan popularized in the 1980s so as to exhort officials and entrepreneurs to maximize every possible opportunity to undertake new business and public projects. However Zhu came to associate it with carelessness in economic decision-making that endangered the sustainability of economic growth and reform of the enterprise structure and financial system.[64] Although structural reform of the SOE sector was a pressing challenge facing the CCP in 1992, the immediate concern was to reign in those projects and activities that were fuelling the demand for working capital loans from the banking system. The level of triangular debt swelled to 380 billion RMB by 1991.[65] It is common to assign cause for this build-up to competition with the newly emerging township-village enterprises, high interest rates and their own inherent inefficiency.[66] Zhu's conclusion in 1991 was however that these may be exacerbating factors, but the primary cause of the triangular debt was that departments, local governments, and enterprises were blindly starting up projects in pursuit of production value and speed.[67]

In late 1992, the Party Central Committee sought to consolidate control over the loss of macroeconomic control, by issuing 'Party Central Committee Document No. 8'.[68] This document

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[63] Zhu Rongji, "On Comprehensively and Correctly Understanding the Spirit of Deng Xiaoping's Talks in Southern China," in *Zhu Rongji on the Record: The Road to Reform, 1991-1997*, ed. Zhu Rongji (Beijing, CN: Foreign Languages Press, 2013 [1992]), 66.

[64] ———, "On Comprehensively and Correctly Understanding the Spirit of Deng Xiaoping's Talks in Southern China," 61.

[65] Triangular debt was inter-firm indebtedness within the SOE sector and a consequent reliance upon extensive working capital loans from the banking sector in order to overcome constant cash and liquidity shortages.

[66] Fewsmith, *China Since Tiananmen: From Deng Xiaoping to Hu Jintao.*

[67] Zhu Rongji, "Clearing up Triangular Debt Must Start with the Source: Fixed-Asset Investments," in *Zhu Rongji on the Record: The Road to Reform: 1991-1997* (Beijing, CN: Foreign Languages Press 2013 [1991]).

[68] State Council of the People's Republic of China. 国务院关于加强对固定资产投资和信用配额宏观调控的通知 [Notice on Strengthening Macroeconomic Control over Fixed-Asset Investments and Credit Quotas]. (Beijing, CN: State Council of the People's Republic of China, 1992).

emphasized four macroeconomic control measures. Firstly it placed priority on strengthening control over the scale of fixed-asset investment, and accordingly strengthening the management of social fundraising for such investment. All forms of securities were to be issued in accordance with the national plan, whilst it was forbidden to raise money outside the plan by arbitrarily issuing bonds and stocks, or forcing enterprises to pay mandatory contributions. Secondly, control over credit quotas was to be strengthened. As Zhu Rongji stressed in October 1992, Document No. 8 was strict in stipulating, "if any bank exceeds [its proportion of the overall RMB 350 billion in credit to be issued nationally], it will be held responsible; if any region exceeds [such a limit], the principal leaders of that region's Party committee and people's government will be held responsible."[69] Thirdly, it was considered necessary to actively organize the 'recapture' of money and the placement of funds, by strictly enforcing a system of responsibility for government agencies at all levels. Fourthly, increasing the level of forex reserves was regarded as a priority, maintaining reserves at no less than USD 20 billion was seen as a minimum benchmark. The document focused on administrative measures, rather than market-based measures secured through economic principles, in part because the problems of lax macroeconomic controls were largely a product of government maladministration, but more importantly there was a belief that a socialist market economy was always necessarily to retain a strong element of administrative planning and government control over macroeconomic trends and dynamics.[70]

The extent of overheating in the financial sector by mid-1993 resulted in the Party Central Committee and State Council issuing the 'Proposal on the Current Economic Situation and on Strengthening Macro-Economic Control' ('Document No. 6') [国务院关于当前经济情况和加强

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[69] Zhu Rongji, "Some Comments on the Current Economic Situation and Macroeconomic Controls," in *Zhu Rongji on the Record: The Road to Reform, 1991-1997*, ed. Zhu Rongji (Beijing, CN: Foreign Languages Press, 2013 [1993]), 119-20.

[70] ———, "Some Comments on the Current Economic Situation and Macroeconomic Controls," 121.

宏观调控的意见].[71] Its implementation was the most pressing issue confronting the leadership at the time.[72] Zhu emphasized three principles that were essential for cadres to heed in approaching the implementation of Document No. 6. The first and most important was to 'unify thinking':

> We must align our thinking and see the entire country as a single chessboard. Because they're not in the same place, localities may feel differently from the central government, and feelings may differ from one locality to another, or between the coastal areas and the interior. But no matter how you feel, we must all align our thinking; otherwise we won't be able to solve the present problems.[73]

Second, Zhu called for measures "not to manage and rectify but to further deepen the reforms. … We must turn the resolution of the most pressing current programs into a force for accelerating the reforms and for building a socialist market economy."[74] Third, he argued,

> Without powerful organizational tools, without steely disciplinary tools, and without impartial legal tools to complement them, it will be hard even for correct economic tools to be effective. It's very harmful to view all of these as administrative tools.[75]

In order to effectively deploy market forces as a mechanism for economic growth and development, it was necessary to develop guidance on the nature of a concept that resided at the core of the debate as to the appropriate relationship between the plan and the market, and socialism and

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[71] This involved: (1) Maintaining control of the monetary base; (2) Restrain banks from lending in violation of the rules; (3) Put an end to chaotic fund-raising; (4) Strictly control the scale of lending; (5) Be prepared to raise interest rates, or to implement value-guaranteed savings accounts; (6) Step up central bank reform; (7) Call on specialized banks to guarantee payments; (8) Integrate reform of the investment system with the reform of the specialized banks; (9) Ensure that the sale of treasury bonds is completed with the designated time frame; (10) Implement the existing plan for issuing stocks and for listing abroad; (11) Step up studies of the forex market and to stabilize the foreign exchange rate; (12) Step up studies on methods and policies to rectify the real estate market; (13) Strengthen the levying and collection of taxes; (14) Undertake a comprehensive audit of construction projects, and strictly control the establishment of new factories; (15) Actively undertake reform of commodity prices, in order to inhibit their rapid rise; (16) Strictly control increases in social group purchasing power. See Central Committee of the Communist Party of China, "中共中央和国务院关于当前经济情况和加强宏观经济调控的意见 [Proposal of the CPC Central Committee and State Council on the Current Economic Situation and the Strengthening of Macroeconomic Control]."

[72] Chen, *国事忆述 [Remembering State Affairs]*, 272.

[73] Zhu Rongji, "Thirteen Measures for Strengthening Macroeconomic Controls," in *Zhu Rongji on the Record: The Road to Reform, 1991-1997*, ed. Rongji Zhu (Beijing, CN: Foreign Languages Press, 2013 [1993]), 134-35.

[74] ———, "Thirteen Measures for Strengthening Macroeconomic Controls," 135.

[75] ———, "Thirteen Measures for Strengthening Macroeconomic Controls," 136.

capitalism: "macro-level control and adjustment" [宏观调控], reflected in Zhu Rongji's assertion that,

> As a socialist country, only with reliable macroeconomic control is it possible for China to effectively guide the direction of a market economy, and to realize the superiority of a socialist system. Accordingly, the construction and development of a socialist market economy must rely upon macroeconomic control; the spontaneous development of the market economy is not capable of bringing about a socialist market economy.[76]

In the post-Tiananmen reassessment of China's path of socio-economic development, there was one constant: the CCP would remain at the heart of the political system. In order to generate the economic development that now more than ever constituted the Party's basis for socio-political legitimacy, commercialized control and guidance under the leadership of the CCP would come to be regarded as the key to the realization of a socialist market economy and thus the reinvigoration of China's development. This concept of the 'socialist market economy' was not simply the oxymoronic manifestation of the ideological desperation of China's political elite, but rather has come to serve as a subtle yet crucial cognitive frame that takes the necessarily authoritarian basis for CCP rule and combines it with the belief that the market is a tool for realizing economic aims, rather than a politically significant institution that constitutes a normative end in and of itself. These ideas have played a crucial role in framing the construction and evolution of the institutions and networks that underpinned the particular path of economic development in the 1990s, and this role is the subject of the next sections.

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[76] Guangdi Liu, Genyou Dai, and Jian Li, eds., *中国经济体制转轨时期的货币政策研究 [Research on Monetary Policy during China's Period of Economic Transition]* (Beijing, CN: China Finance Publishing House 1997), 2.

Institution-Building: (In)Formalizing Ambiguity

The reforms of the 1980s had maintained an "administrative regulatory system that imposed state supervision over virtually all economic transactions,"[77] a characteristic of economic relations that was evident nowhere more clearly than in the financial system. This changed following the reinvigoration of reform in 1992. Establishing the institutions of a 'modern' financial system was recognized as an essential component in the construction of a 'socialist market economy', yet many of the specifics of the necessary reform were not spelled out within the broader ideological debate concerning the 'market' and 'plan' that was unfolding at the time.[78] In this section I trace the process of institutional development in the financial sector in the early and mid-1990s, with the intention of contextualizing this path of institutional reform within two broader trends: firstly a process of economic growth in which the financial sector played an important role, and secondly a process of reconsolidation of CCP control and authority over the political economy. Through this path of institutional development it is possible to discern how priorities revolving around CCP control and economic growth acted as a set of cognitive frames for policy decisions, and that relational networks played a significant role in the transmission and reinforcement of these framings. Furthermore, these institutional changes produced real impacts upon the networks that underpinned access to credit and finance, such that the resulting stratification of the political economy distributed resources, and concentrated economic growth in a way that reflected the path of financial institutional development, and the cognitive framings that underpinned it.

The development of the financially repressive urban-biased path of development was a reflection of how the implementation of the concept of macroeconomic control and adjustment

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[77] Pitman Potter, "Liberation and Control: Deng Xiaoping's Nanxun Legacy and the Chinese Legal System," in *The Nanxun Legacy and China's Development in the Post-Deng Era*, ed. John Wong and Yongnian Zheng (Singapore, SG: Singapore University Press, 2001), 250.

[78] Wu, "1993 年：经济改革进入"整体推进"的新阶段 [1993: Economic Reform Enters a New Period of "Comprehensive Reform"."

was a response to the twin political and economic exigencies of the post-Tiananmen neoconservative era. The banking system channeled savings from the household to the enterprise sector. Between late-1989 and mid-1993 the overall economic policy priority of the leadership evolved from one of controlling inflation to reigniting growth. However by the early 1990s the strategy of 'growing out of the plan' via dual-track price reform and the transformation of rural enterprise had reached its logical conclusion.[79] This meant that the preferential credit policies for state firms, originally designed to shield SOEs from the austerity imposed from 1989-1991, quickly turned into conduits for channeling large amounts of bank credit to state firms. In contrast to the 1980s in which the immediate efficiency gains of price reform had propelled growth, China's rapid economic growth in the 1990s would be based on the rapid accumulation of capital, and particularly physical investment.[80] Rapid capital accumulation was the critical component of China's economic growth, and was the result of "economic reform policies making and keeping enterprise investment highly profitable, and of powerful incentives for households, enterprises, and government to save; and that the extremely inefficient financial system did not prove to be a serious obstacle."[81] The rate of return on capital was high throughout the decade, and despite the rapid rate of capital accumulation, expected profitability was sufficiently high to induce high investment levels. Entrepreneurial expectations of rapid economic growth were crucial for this high investment rate.[82]

I examine how mechanisms of party control and commercialization emerged and developed in tandem across the institutions necessary for supporting economic activity. China's policy-makers were seeking to accommodate the needs of an increasingly market-oriented and

[79] Naughton, *Growing Out of the Plan: Chinese Economic Reform, 1978-1993*, 274.

[80] One comprehensive study of China's growth examines also the contribution of the accumulation of human capital, which arose out of the liberalization of the labour market. See John Knight and Sai Ding, *China's Remarkable Economic Growth* (Oxford, UK: Oxford University Press, 2012).

[81] ———, *China's Remarkable Economic Growth*, 124.

[82] ———, *China's Remarkable Economic Growth*, 315.

internationally integrated production system by commercializing the financial system. The development of a legal and institutional framework for banking and finance in the early 1990s was thus integral to the national effort to transform and commercialize the financial system. However, neither in conception nor in practice was it part of a strategy to promote the development of financial relationships that would rely upon either a legal-rational state bureaucracy or a secular market in order to maintain their integrity. In other words, financial relationships were placed on a more commercial footing, yet the efficacy of this commercialism remained highly dependent upon the role and utility of the CCP itself.

Through this process, institutional ambiguity constituted the means by which the CCP exercised instrumental control through 'multi-vocality', but at the same time this was incompatible with an internally contradictory normative framework. Achieving some degree of ideational (and thus ideological) coherency in this template for action therefore was a necessary prerequisite for preserving an intersubjective faith and confidence in the 'vision' of the CCP. The cognitive frames that emerged out of the intense struggle over the meaning of the market [姓社还是姓资] generated this latent basis for reducing uncertainty. Whilst the 'guerilla policy style'[83] certainly provided a crucial underlying basis for the resilience and policymaking versatility of the leadership during this period, just as the revolutionary CCP was itself founded upon the shared ideological foundations of socialist struggle as the path towards rejuvenation of the Chinese nation, China's capacity to construct a market-led economy came to be underpinned by an ongoing transformation of the shared ideological basis for an ambiguous but essential role for CCP leadership in the flow and management of capital.

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83 Heilmann and Perry, "Embracing Uncertainty: Guerrilla Policy Style and Adaptive Governance in China," 12-13.

Policymaking Institutions

Institutional change in the central financial policymaking apparatus was built upon the ideas that framed policy debates during and following the 1992 decision to establish a socialist market economy. Both Jiang Zemin and Zhu Rongji (although for different reasons) recognized that a centralization of political power was necessary in order to realize this objective. Relational networks played a role in this process of institutional change, as well as serving to reinforce and buttress institutional structures and functions. The interpenetration of party and state functions and organizations is reinforced through the relationships between think tank researchers and policymakers. As Zhu has argued, "because of China's special administrative system, its think tanks have relationships that Western think tanks lack, namely, the institutionalized networks attached to the Chinese administrative system."[84] The position-list system serves not only as an institutionalized mechanism of party control, but also embodies sets of informal networks that diffuse ideas generated through government think tanks such as the Chinese Academy of Social Sciences and the Development Research Center of the State Council.[85] Accordingly, this enables one to view the role of social networks in China's political economy not as extra-institutional or supplementary, but as integral social structures that integrate the formal institutions of governance with processes of socio-economic reproduction.[86]

In the aftermath of Tiananmen, reconfigured networks of intellectuals and scholar-officials emerged who drew upon Western academic theories as well as their direct experiences of the West in order to advocate for a rational and systematic approach to the reform and liberalization of the economy. This reconfiguration of intellectual and party networks involved two trends that would guide policymaking. Firstly, they became more closely integrated with the formal policymaking

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[84] Xufeng Zhu, *The Rise of Think Tanks in China* (London, UK: Routledge, 2013), 40.
[85] ———, *The Rise of Think Tanks in China*, 42.
[86] See Sebastian Heilmann, "Explaining the Rise of China" (Presented at *Explaining the Rise of China: A Challenge to Western Social Science Theories?*, Harvard University, MA, 2010).

process, and although in practice this meant seeking an audience with and persuading Zhu Rongji, this was increasingly taking place within the institutional structures of the party-state. Secondly, the ideological divisions in these networks became less acute, as there was a greater coalescence around the intellectual challenge of conceptualizing and advocating market reforms. The areas of institutional reforms seen as necessary in the early-1990s concerned the financial, enterprise, and fiscal systems. The 'comprehensive reform group' [整体改革派], led by Wu Jinglian, had argued that the intertwining of all of these broad areas meant that it was necessary to undertake reforms concurrently rather than seeking problems in the different areas sequentially.[87] This group included young officials such as Zhou Xiaochuan, Guo Shuqing, and Lou Jiwei. These thinkers would come to represent a network of economic thinkers who would later rise to prominence in leading government positions.[88] Wu Jinglian had already been an influential advisor to Zhao Ziyang during the 1980s, but nonetheless his views have always been highly mindful of the destabilizing and regressive effects of inflation.[89]

Another influential voice was that of Chen Yuan, the son of party elder Chen Yun. The younger Chen had become a Vice-Governor of the PBOC in 1988, and would later take over the helm of China Development Bank in 1998. In 1991 he published an article that emphatically argued for the strengthening of macroeconomic control over the economy.[90] Despite emphasizing the fundamental prerequisite nature of applying market pressure for the reform of the enterprise system, he differentiated at a basic level such market pressure from the principles and institutions of macro-economic control, which constituted a market-active paradigm but one that prevented

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[87] Wu Jinglian, Zhou Xiaochuan, and Rong Jingben, *建设市场经济的总体构想与方案设计 [The Road to a Market Economy: A Comprehensive Framework and Working Proposals]* (Beijing, CN: Central Compilation & Translation Press, 1995).

[88] Just these three officials would count between them leading positions at the CBRC, CSRC, BOC, CCB, PBOC, MOF, SAFE, NDRC, CIC, and the Shandong Provincial Government, amongst a plethora of other party-related positions.

[89] Xiao Zhengqin, "朱镕基运用智囊团知会的技巧 [Zhu Employs the Wisdom of his Think Tanks]," *新报 [HK Daily News]*, 25 January 1999.

[90] Chen Yuan, "我国经济的深层问题和选择 [Deep-Seated Issues and Choices of China's Economy]," *经济研究 [Economic Research]* March(1991): 18-26.

any separation of growth imperatives from social imperatives. Warning against the 'hollowing out' [掏空] of party control over the economy, Chen advocated the consolidation of market forces under political control, and the adoption of a 'new centralization'.[91] This would involve harnessing the power of the state, even as markets were permitted to break through local protectionism and micro-level distortions of enterprise efficiency.[92] A year later Chen published another article, in which he assessed the thought of both John Maynard Keynes and Milton Friedman. Regarding the former, he approved of the role of government in achieving quantitative 'macroeconomic regulation and control' [宏观调控], but rejected the methods of expansionary fiscal policy in order to achieve it. He also rejected Friedman's laissez-faire philosophy but approved of setting monetary policy goals. From such writings, it is clear that he was disinclined to develop an ideological preference for emphasizing either government or market, but rather was insistent that "western economics can be turned to serve our socialist revolution."[93]

These intellectual networks however were dually enmeshed; in addition to advancing their own ideas through intellectual debates, they were deeply embedded in the party networks that not only secured their careers and provided them with a policy audience, but impressed upon them also the significance of the 'national conditions'[94] in which China, and the CCP, found itself increasingly alone in the post-Soviet liberal global order of the 1990s. As Bell and Feng have observed, the "vagueness in interpreting the incentives and preferences of senior bureaucrats is also due to their

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[91] ———, "我国经济的深层问题和选择 [Deep-Seated Issues and Choices of China's Economy]", 19.

[92] ———, "我国经济的深层问题和选择 [Deep-Seated Issues and Choices of China's Economy]", 19-20.

[93] ———, "我国经济运行研究的几个方法和理论问题 [Several Methodological and Theoretical Questions on Research into China's Economic Operations," *经济研究 [Economic Research]* 2(1992).

[94] See Wang Shaoguang and Hu Angang, "加强中央政府在市场经济转型中的主导作用: 关于中国国家能力的研究报告 [Strengthening the Guiding Role of the Central Government During the Transition to a Market Economy: A Research Report on China's State Capacity]."

dual identities as government officials as well as party cadres."[95] As these intellectuals-cum-officials-cum-cadres rose to leadership positions in the late 1990s and 2000s, the contradictions between their Western-informed economic training and the demands of CCP authority and control would become increasingly apparent. However, in the early 1990s, their role within the policymaking process was to encourage the increasing expertise and concomitant rationalization of economic thinking,[96] coalescing around the idea of 'macroeconomic control' [宏观调控] as the fundamental basis upon which to realize a 'socialist market economy'. At the same time, since Zhu Rongji was emerging as the lynchpin of economic policy, the process of financial restructuring became increasingly dependent upon the personalization of the policy process, and accordingly the personalization of policy credibility.[97]

One institutional lynchpin that re-emerged for linking financial and economic policy to the political imperatives of the CCP is the Central Finance and Economics Leading Group (CFELG) [中央财经领导小组]. The CFELG is an extra-constitutional policymaking body that links together the highest echelons of the CCP and the formal state bureaucracy. As a leading small group, it possesses tremendous influence,[98] and moves "back and forth between government and party depending on which leader is taking charge of economic work."[99] However all members are party cadres and one of its primary functions, as with other leading small groups, is to provide a mechanism for the CCP General Secretary to re-assert authority over economic policymaking whenever it is deemed necessary. The Staff Office of the CFELG is a crucial source of intellectual policy proposals, as it works directly for the highest leadership and draws upon a flexible and wide-

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[95] Stephen Bell and Hui Feng, *The Rise of the People's Bank of China: The Politics of Institutional Change* (Cambridge, MA: Harvard University Press, 2013), 126.

[96] Naughton, "China's Economic Think Tanks: Their Changing Role in the 1990s".

[97] BJ:2012.05.27. Interview, Beijing; BJ:2012.12.12. Interview, Beijing.

[98] Yang Shengchun, *中国最高领导班子的左右手：中共中央直属机构档案 1949-1998 [The Assistants of the Top Leadership Groups of the CCP: A Record of Directly Subordinate Institutions, 1949-1998]* (Taipei, TW: Yongye Publishers, 2000).

[99] Shirk, *The Political Logic of Economic Reform in China*, 61-62.

ranging network of officials and researchers for 'document-drafting groups' [起草组] that frame financial and economic policy.[100]

During the 1980s Zhao Ziyang had relied upon it heavily as a means of resisting the pressure for centralization mounted by the State Planning Commission. Following 4 June 1989 and Zhao's downfall the CFELG became practically dormant. It existed merely as a shadowy advisory organ and had no role in day-to-day policy-making until 1993.[101] Under Jiang's stewardship however, it underwent major expansion and was transformed into a policy-setting, and in many ways, a policy-implementing and supervisory body.[102] This was emblematic of the way in which Jiang Zemin expanded the functions of a number of the leading groups within the Central Committee in the early 1990s. This was a series of moves that ran counter to the principle of increasing separation of the party and government, and a streamlining of the party bureaucracy.[103] However Jiang largely deferred to Zhu Rongji on financial policymaking, and Zhu's guiding hand would be highly evident throughout the path of financial policymaking until 2003. He formed the Central Financial Reform Leading Group (CFRLG) in early 1993.[104] This then led to the national conference on financial work that was convened by the State Council in July 1993. Zhu Rongji established party organizations directed towards reforming the shareholding structure of the

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[100] Wu Guoguang, "Documentary Politics: Hypotheses, Process, and Case Studies," in *Decision-Making in Deng's China: Perspectives from Insiders*, ed. Carol Lee Hamrin and Suisheng Zhao (Armonk, NY: M.E. Sharpe, 1995).

[101] Party source, quoted in Willy Wo-Lap Lam, "Jiang's Men Clash with Top Officials," *South China Morning Post*, 9 February 1995.

[102] Departments for macro-economic analysis, industry, and agriculture were added to the CFELG in the mid-1990s, and Jiang further installed a large number of Shanghai Clique-associated protégés within key leadership positions, such as Zeng Peiyan and Hua Jianmin.

[103] Willy Wo-Lap Lam, *The Era of Jiang Zemin* (Singapore, SG: Prentice Hall, 1999), 87.

[104] Zhu Rongji, "整顿财税接续，严肃财经纪律，强化税收征管，加快财税改革 [Rectify the Fiscal and Tax Order, Restore Strict Budgetary Discipline, Strengthen Taxation Collection, Speed up Fiscal and Tax Reform] ".

banks[105] in the mid 1990s, however they were significantly less powerful and were headed only by the Governor of the PBOC, Dai Xianglong.[106]

Central Banking

In December 1993 the State Council promulgated the Decision on Reform of the Financial System, identifying the following objectives of financial reform:

1. Establishment of an independent macro economic control mechanism by the PBOC (independent from local governments, but under the control of the SC);
2. Establishment of policy banks;
3. Transformation of SOCBs into commercial banks;
4. Establishment of unified, open, well-ordered, competitive, and well-managed financial markets,
5. Reform of foreign exchange controls, by unifying rates, and moving towards current account convertibility;
6. Issuance of guidance for the development of non-bank financial institutions (NBFIs);
7. Development of a financial services infrastructure and modern financial management system.[107]

The decision on financial reform was intended to transform the system, providing the basis for substantive and far-reaching changes in the institutional structure of the financial sector. The document emerged out of the State Commission on Economic System Reform, in the context of the debates of 1993 surrounding the centralization of macroeconomic control.[108] It reflected a recognition that market-oriented reforms were necessary, yet preserved the ambiguity of implementation of process that has remained a hallmark characteristic of the financial system ever since in several key aspects: lines of regulatory authority and control, delineation of property and

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[105] These were similar to the Central Leading Group on Shareholding Reform of the State Banks [中央国有商业银行股份制改革领导小组] that would be created in 2003 by Wen Jiabao.

[106] Wang Chenbo, "国有银行上市：一场艰难的体制告别 [Public Listing of the SOCBs: A Difficult Farewell to the System]," *新闻周刊 [News Weekly]*, 28 November 2003.

[107] State Council of the People's Republic of China. 国务院关于金融体制改革的决定 [Decision of the State Council Concerning Reform of the Financial System]. (Beijing, CN: State Council of the People's Republic of China, 1993).

[108] Chen, *国事忆述 [Remembering State Affairs]*.

ownership rights, and the allocation of both risk and return.[109] Nevertheless, it marked the beginnings of systemic 'modernization' of the financial system as one that would successfully support capital accumulation. The most important component of the round of reform that arose out of the 1993 decision was the establishment of the PBOC as a fully functioning central bank at the heart of a modern central banking system.[110] Establishing the goal of central banking as that of ensuring price stability for growth was an essential element in creating expectations of a favourable investment climate. High inflation depresses savings as the real interest rate decreases, and interest rate repression was necessary in order to ensure a flow of cheap capital and spur investment. SOEs were growth-oriented rather than profit-oriented per se, which is what Zhu Rongji desired. Given the necessity and success of price reform, he knew that the CCP needed market forces to drive the real economy, and that it needed to establish a modern central bank in order to allow it to do so.[111]

The most striking feature of the reforms of the central banking system was centralization without independence.[112] Zhu Rongji argued that his governorship of the PBOC was irrelevant:

> It doesn't matter whether I'm the governor of the Central Bank. I'm already responsible for finance and for the banking sector. […] In the case of China, no matter how independent the Central Bank is, it can't be independent of the State Council. The independence of the China's central bank refers to its independence from local governments and other ministries and commissions under the State Council.[113]

This reflects the fact the PBOC "is not a puppet agency, nor is it independent of the central state leadership".[114] Its establishment was a deliberate rationalization of central banking but a rationalization according to the logic of financial and monetary policy serving a development strategy rather than being committed to a deductive application of market principles. A

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[109] Wu Xiaoqiu, *市场主导型金融体系：中国的战略选择 [Market-Oriented Financial System: China's Strategic Choice]* (Beijing, CN: China Renmin University Press, 2005).

[110] Wu, "重建金融系统 [Reconstruct the Financial System]," 147.

[111] BJ:2014.04.14 #1. Interview, Beijing.

[112] Pei, "The Political Economy of Banking Reforms in China, 1993-1997", 341.

[113] Zhu Rongji, *Zhu Rongji Meets the Press* (Oxford, UK: Oxford University Press, 2011), 25.

[114] Bell and Feng, *The Rise of the People's Bank of China: The Politics of Institutional Change*, 11.

relationship of 'mutual dependency'[115] evolved between the PBOC and the party-state following 1993.[116] Zhu Rongji replaced Li Guixian as governor of the PBOC in July 1993 in the context of a significant decline in bank deposits in early 1993. His efforts thereafter to reverse that decline were due to his determination to launch a capital-intensive growth strategy based on the intermediation of household savings through the banking sector.[117]

The focus of analysis has often been on the capacity of central authorities to maintain macroeconomic stability and achieving a soft landing to the overheated economy and inflation spike of the mid-1990s. Yet during the 1980s the PBOC developed another fundamental function and practice, that of re-lending (再贷款), a role that was contradictory to that of providing macroeconomic stability. Re-lending was a practice by which the central bank would redistribute financial resources through the imposition of high reserve ratio requirements. These funds that were deposited with the central bank could then be re-lent as earmarked policy loans.[118] Under the credit plan this practice of re-lending continued to constitute a primary basis for the ongoing viability of the specialized banks, as they were enfolded within Zhu's strategy for resolving triangular debt, managing inflationary pressures, and maintaining contributions to SOE working capital needs.[119]

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115 ———, *The Rise of the People's Bank of China: The Politics of Institutional Change.*

116 This arose out of Zhu's consolidation of control over the central economic bureaucracy, reflected in the appointment of his protégés Dai Xianglong in 1995, and then Zhou Xiaochuan in 2003 to the position of PBOC Governor.

117 BJ:2012.10.21. Interview, Beijing.

118 World Bank. "China: Macroeconomic Stability in a Decentralized Economy". Washington, DC: World Bank, 1995.

119 Lardy, *China's Unfinished Economic Revolution*, 110.

On March 18, 1995, the Law of the People's Republic of China on the People's Bank of China (*Central Bank Law*) was passed by the National People's Congress.[120] One senior official has stated,

> The law was passed so that everyone knew that the drive to commercialize was serious. Zhu Rongji had become governor of the PBOC already, but what were people to make of that other than that he was becoming more powerful? The inflation and economic instability of the early 1990s meant that there was no other option but to create a real central bank.[121]

Legally the central bank formulates an 'independent monetary policy' under the leadership of the State Council.[122] Article 2 of the *Central Bank Law* explicitly places the identification of policy objectives and goals under the purview of the State Council.[123] The law formally confirmed the PBOC's status as a central bank, and mandated that it 'formulate and implement' monetary policy. This remit was defined in Article 3 as: "the aim of monetary policies is to maintain the stability of the value of the currency and thereby promote economic growth."[124] Although the article's phrasing indicates that price stability is viewed as a necessary if insufficient condition for economic growth, there is an inherent ambiguity as to the extent to which economic growth is the ultimate objective of central bank policy.[125] In reality, the PBOC was expected to pursue a comprehensive policy objective, "aiming to balance inflation, employment, growth, and balance of payments concerns."[126] Although as Bell and Feng argue, the consensus view within the PBOC is that price stability remains the bank's core contribution to the pursuit of economic growth, its leaders

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[120] National People's Congress of the People's Republic of China. 中华人民共和国中国人民银行法 [Law of the People's Republic of China on the People's Bank of China]. (Beijing, CN: 中国民主法制出版社 [China Demcoracy and Legal System Publishers], 1995).

[121] BJ:2012.10.21. Interview, Beijing.

[122] Xianglong Dai, *领导干部金融知识读本 [Instructional Reader in Finance for Leadership Cadres]* (Beijing, CN: China Financial Publishing House, 2001), 4.

[123] *中华人民共和国中国人民银行法 [Law of the People's Republic of China on the People's Bank of China]*.

[124] Article 3, *中华人民共和国中国人民银行法 [Law of the People's Republic of China on the People's Bank of China]*.

[125] He Guoqian, *中国经济市场化进程中的货币政策 [China's Monetary Policy in the Midst of Economic Liberalization]* (Doctoral Dissertation, Peking University, 1998). Wu, "重建金融系统 [Reconstruct the Financial System]," 145.

[126] Bell and Feng, *The Rise of the People's Bank of China: The Politics of Institutional Change*, 141.

acknowledge the institutional realities that arise out of the tension between the PBOC's formal status and the reality of is role in China's political economy. Firstly, they understand the difficulty of pursuing multiple goals simultaneously. Secondly, they accept the extent to which their responsibilities are embedded within a wider set of political and economic priorities, and that their performance is assessed not by reference to fulfilling a formal mandate but by how well they negotiate these priorities.[127]

Financial Institutions: Specialized, Commercialized, Policy, or Other?

There was little indication within the pre-1992 banking system that it had undergone significant change from the pre-1978 centrally planned model in terms of how the process of credit allocation was to relate to the broader sphere of production. It remained institutionally incapable of performing the ideal liberal role of financial intermediation in an increasingly market-oriented economy.[128] Two broad analytical responses emerge in response to this. Firstly, orthodox explanations for this absence of behavioural change center on the role of factional politics or vested interests in obstructing the course of reform. As Victor Shih argues, during this period, "although elite factions fought over monetary control, there were no elite defenders of banking autonomy from administrative intervention."[129] Such accounts of the banking system during the 1990s were technically accurate, however their assessment criteria were deductively premised upon their functioning as commercial banks, with an objective function being that of maximizing expected profits subject to a risk constraint.[130] However as the second perspective stresses, this assumption is questionable, as there was always considerable evidence that a range of other objectives and

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[127] BJ:2012.10.10. Interview, Beijing.

[128] See Cecil Dipchand, Yichun Zhang, and Mingjia Ma, *The Chinese Financial System* (Westport, CT: Greenwood Press, 1994); Lardy, *China's Unfinished Economic Revolution*; On Kit Tam, ed. *Financial Reform in China* (London, UK: Routledge, 1995).

[129] Shih, *Factions and Finance in China: Elite Conflict and Inflation*, 125.

[130] See Anthony Santomero, "Modelling the Banking Firm," *Journal of Money, Credit and Banking* 16:4 (1984): 576-616, 580.

priorities underpinned both bank lending behaviour as well as the policy motivations behind institutional reform. Such analyses have focused on the 'social objectives' of the banks; the developmental role of the banks warrants different criteria with which to empirically test their performance.[131]

China's overall growth rate averaged 11.5 percent between 1991-1997. As recent studies of the impact of China's financial repression have argued, whilst it is possible that deeper reform and a more liberalized financial sector would have increased this growth rate, it is improbable.[132] This challenges the conclusions drawn by those who focus upon the banking system's allocative efficiency. Conversely, the second perspective argues that it was precisely because of the banking system's unreformed and developmental nature that growth was so high. I argue however that the ability of an institutionally underdeveloped banking system to underpin these rates of growth was less the product of a developmental technocratic leadership led by far-sighted pragmatists, but rather emerged as an ad hoc and internally inconsistent product of the conflicting imperatives to secure economic growth at the same time as guaranteeing the primacy of CCP political authority.

The December 1993 'Decision on Reform of the Financial System'[133] provided the basis for the transformation of the specialized banks [专业银行] into commercial banks [商业银行]. The reforms in the institutional structure and role of the banking system over the next several years were substantive, yet they did not have the effect that market-oriented liberal reformists would have desired. Rather, they effected an enhancement and realignment of the existing role that the banks had played in the reform process thus far; there was recognition that reform was necessary in order to support a rapidly developing market economy, but this was not necessarily commensurate with

[131] See James Laurenceson and JCH Chai, "State Banks and Economic Development in China," *Journal of International Development* 13:2 (2001): 211-25.

[132] Huang and Wang, "Does Financial Repression Inhibit or Facilitate Economic Growth? A Case Study of Chinese Reform Experience".

[133] State Council of the People's Republic of China, "国务院关于金融体制改革的决定 [Decision of the State Council Concerning Reform of the Financial System]."

reform that would improve commercial allocative efficiency. Rather, the path of reform was consistent with the construction of a commercial environment that prioritized growth and stability over efficiency, in circumstances where both of these priorities were dependent upon satisfying both investors (household depositors) and consumers (enterprise borrowers) that the institutional structure of financial intermediation remained intact and viable.

The process of banking reform thus cannot be understood except in the context of reform of both the fiscal system and the situation confronting SOEs at the time. Furthermore, even though as Naughton admits, it is easier (if not impermissible) to identify ex-post coherence to the reform process,[134] it is necessary to assess the path of reform as part of the broader and significantly contiguous development of the economic and industrial capacity of the Chinese economy since the post-1989 interregnum.[135] In the early 1990s Premier Li Peng was in the midst of implementing the 'Large Enterprise Strategy' [大企业集团战略], which arose out of a deep concern on the part of the central government at the time that the decrease in the state's share of industrial production to 59 percent was "not only an economic but a major political problem."[136] The 'grasping the large and letting go of the small' [抓大放小] policy of consolidating and rationalizing state ownership was at the same time being developed by Zhu Rongji and first presented at the 1993 Third Plenum of the Fourteenth Central Committee, before being adopted officially in 1995 at the Fifth

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[134] Naughton, *Growing Out of the Plan: Chinese Economic Reform, 1978-1993*, 309.

[135] For excellent overviews, see Heilmann and Shih, "The Rise of Industrial Policy in China, 1978-2012; Eaton, "China's State Capitalist Turn: Political Economy of the Advancing State."

[136] Willy Wo-Lap Lam, *China After Deng Xiaoping: The Power Struggle in Beijing since Tiananmen* (Armonk, NY: M.E. Sharpe, 1995), 55.

Plenum.[137] This programme built up the capital of large SOEs at the expense of those loss-making SOEs that were privatized.[138]

The premise of these strategies for reform of SOEs was not to seek to improve enterprise efficiency, but rather to strengthen them as pillars of China's national industrial capacity. The legacy of this line of thought that took shape in the post-1989 period has been clearly discernible in the evolution of central government policy ever since.[139] They reflected the fact that the incentives facing enterprise managers at the time were oriented towards growth, rather than towards profitability.[140] This consolidation of the state-owned sector was underpinned by a commensurate centralization in financial control and repression. The pattern of bank lending was structured around this industrial policy, rather than as a matter of transferring funds to those SOEs and regions which had the largest number of workers made vulnerable as a consequence of the drive towards SOE privatization.[141] A similar logic was evident in Zhu's solution to the SOE's triangular debt crisis. He compelled the banks to disburse loans of 80 billion RMB to the most heavily indebted enterprises who were in turn ordered to resolve their outstanding debts to other SOEs. This had the effect of eliminating 380 billion RMB in inter-firm debt, but simultaneously created a further raft of bad debt on the balance sheets of the SOCBs.[142]

The institutional evolution of the state-banking sector also involved the establishment of three policy banks in 1993 to take up the policy-directed lending activities of the state commercial

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[137] Kun-Chin Lin, "Macroeconomic Disequilibria and Enterprise Reform: Restructuring the Chinese Oil and Petrochemical Industries in the 1990s," *The China Journal* 60(2008): 49-79, 61.

[138] Institute for Industrial Economics. "中国工业发展报告 1997 [Chinese Industrial Development Report 1997]". Beijing, CN: 北京经济管理出版社 [Beijing Economic Management Press], 1998.

[139] Eaton, "China's State Capitalist Turn: Political Economy of the Advancing State."

[140] Knight and Ding, *China's Remarkable Economic Growth*; Edward Steinfeld, *Forging Reform in China: The Fate of State-Owned Industry* (Cambridge, UK: Cambridge University Press, 1998).

[141] Cf. Shih, *Factions and Finance in China: Elite Conflict and Inflation*, 73; Lardy, *China's Unfinished Economic Revolution*.

[142] Shih, *Factions and Finance in China: Elite Conflict and Inflation*, 146.

banks. These were the China Development Bank (CDB),[143] the Export-Import Bank of China (EIBC), and the Agricultural Development Bank of China (ADBC). Each of these policy banks were intended to serve a particular function within a financial landscape that was being reconfigured in accordance with the newfound commitment to a 'socialist market economy'.[144] The CDB is ostensibly responsible for the financing of major infrastructural projects; the EIBC is to promote foreign trade; and the ADBC finances agricultural and rural development projects. The rationale for their establishment was that economic areas existed in which the commercial banks were either unwilling or unable to extend finance.[145] Upon establishing the CDB the bank was therefore immediately authorized to issue 'financial guarantee construction bonds' [财政担保建设债券].[146]

In the debate surrounding the establishment of the policy banks, it was widely recognized that policy banks would only work if the core functions of the banking system were transformed.[147] Zhu Mingchun argued at the time that once policy banks were established, the government would be able to desist from having to assume complete responsibility for enterprise and industry.[148] This would have necessitated the transfer of significant quantities of policy loans from the specialized banks to the policy banks. The decision to retain these non-performing loans on the balance sheets of the existing banks was made on the basis of the absence of a sound plan for recapitalization of

143 As a matter of translation, the official name of the bank should be rendered in English as the 'National Development Bank', however since the CDB itself, for reasons unknown, adopts 'China' rather than 'National', I do the same.

144 The initial first governor of the CDB was Yao Zhenyen, who was entirely unconcerned with the source of funds of CDB projects. BJ:2012.05.30. Interview, Beijing.

145 Chen Jiagui, ed. *中国金融改革开放 30 年研究 [Research on 30 Years of China's Financial Reform and Opening-Up]* (Beijing, CN: Economy & Management Publishing House, 2008), 141.

146 State Council of the People's Republic of China. 国务院关于组建国家开发银行的通知 [Notice of the State Council on the Establishment of the State Development Bank]. (Beijing, CN: State Council of the People's Republic of China, 1994).

147 Zi Huang, "是否需要设立政策性银行 [Whether There is a Need to Establish Policy Banks]," *经济体制改革内参 [Internal Reference of Economic System Reform]* 3 (1992): 35-37, 36.

148 Zhu Mingchun, "加快金融体制改革，建立竞争性金融制度 [Accelerate Reform of the Financial System, Establish a Competitive Financial System]," ibid.4(1993): 13-16.

the still-not yet 'commercial' banks.[149] This was the case prior to the acceptance of the socialist market economy at the Third Plenum of the 14th Party Congress, and it was argued that unless the government was prepared to solely utilize interest rates, re-lending, and open market operations to regulate commercial banks, it made little sense to establish separate policy banks.[150] Following the acceptance and diffusion of the frame of a socialist market economy, attitudes towards policy banks shifted.[151] One interviewee described it in the following terms,

> The banking system was such a mess at the time, because there was no real banking system. The idea of the 'specialized' banks was one that didn't make much sense, especially to reformers such as Wu Jinglian. But he would have been disappointed I think, because the policy banks clearly fit into the strategy of industrial development, but left the other banks behind with a lot of problems.[152]

Following the establishment of the policy banks, there was little indication that SOCBs began operating on commercial terms. The conventional view of the commercialization of the big four banks in this period was that it was a crucial but partial and failed series of steps on the way to the establishment of a 'modern enterprise system' [现代企业制度].[153] As Kwong has observed, the role of the big four as government policy agents to finance state projects and SOEs involved processes of capital allocation "on the basis of social and political consideration instead of profitability and business criteria."[154] Throughout the process of financial reform during the 1980s and well into the 1990s, policy lending remained a defining characteristic of the Chinese banking system. One-third of total loans outstanding in 1985 were policy loans, and one fifth in 1995.[155] It is commonly assumed that this was the product of the governmental constraints placed upon SOCBs

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149 BJ:2012.10.21. Interview, Beijing.

150 Huang, "是否需要设立政策性银行 [Whether There is a Need to Establish Policy Banks]".

151 Zhu Mingchun, "加快金融体制改革，建立竞争性金融制度 [Accelerate Reform of the Financial System, Establish a Competitive Financial System]," 13-16.

152 BJ:2013.04.07. Interview, Beijing.

153 Jing Leng, *Corporate Governance and Financial Reform in China's Transition Economy* (Hong Kong, HK: Hong Kong University Press, 2009), 2.

154 Kwong, "China's Banking Reform: The Remaining Agenda", 164.

155 See Lardy, *China's Unfinished Economic Revolution*, 83-92.

at the time. As Blanchard stated in 1997, "as long as the central government provides the guarantee that it will stand behind commercial banks in the event of a financial crisis, SOCBs are unable to refuse to renew non-performing loans." [156]

In 1995 the *Law of the People's Republic of China on Commercial Banking*[157] (*Commercial Banking Law*) officially reclassified the existing big four banks as commercial banks, in an effort to increase their independence from the state. Notwithstanding the formal change in naming the SOCBs, the law made it clear that lending behaviour was not to be guided purely by commercial considerations of profit. Article 34 of the *Commercial Banking Law* stated that, "A commercial bank shall conduct its loan business in accordance with the need for the development of the national economy and social progress and under the guidance of state industrial policy."[158] Further, Article 41 continues, "A commercial bank owned solely by the state should provide loans for special projects approved by the state council."[159] This closely reflects the process—paradoxical from a Western perspective—of legal rationalization around the prerogatives of national development as they are determined contextually by the CCP. One member of a central government think-tank provided the following frank opinion:

> Some say that there needs to be responsiveness to 'market needs'. In corporate governance this means transparency and clear lines of loyalty. But since 1993 the banks are at the center of China's economic development, and if there is a conflict between what the government needs from the banks, and what the market wants from the banks, why should the market always be right?[160]

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[156] RJ Blanchard, "The Heart of Economic Reform: China's banks struggle under the weight of State-owned enterprise debt," *China Business Review* 24(1997): 16-24.

[157] Standing Committee of the National People's Congress of the People's Republic of China. 中华人民共和国商业银行法 [Law of the People's Republic of China on Commercial Banks]. (Beijing, CN: 中国民主法制出版社 [China Demcoracy and Legal System Publishers].

[158] ———, "中华人民共和国商业银行法 [Law of the People's Republic of China on Commercial Banks]."

[159] ———, "中华人民共和国商业银行法 [Law of the People's Republic of China on Commercial Banks]."

[160] BJ:2012.06.05 #2. Interview, Beijing.

The law stipulated that the banks' business operations were to be governed by principles of efficiency, safety, and liquidity, and they were to make their own decisions regarding business operations, take responsibility for their own risks, profits, and losses, and exercise appropriate self-restraint in their operations. The banks took a number of immediate steps to reform their organizational structures and behaviour, including the establishment of asset/liability management committees, credit committees, closure of loss-incurring branches, major investments in IT, and staff training. However as one former bank-employee stated, "these things were basically 'window-dressing' [装装门面的] that did not change the basic facts of the banks' existences".[161] Yet the drive to commercialize and rationalize the banks between 1993 and 1996 did have an effect upon the banks; as the same interviewee somewhat later observed, "it seemed like the changes to the banks made them more effective at what they were doing."[162]

Notwithstanding the shifting legal status of the banks following the passage of the Commercial Bank Law, credit remained controlled almost exclusively through the state credit plan [信用计划], under which the PBOC set credit limits on the state commercial banks, thereby controlling the volume of fresh credit. This was gradually phased out and abolished in January 1998, as credit ceilings on financial institutions other than the specialized state-owned banks were eliminated and replaced with regulations regarding assets and liability and risk management. Whilst the credit plan was still in operation, the central bank had, until 1994, permitted local PBOC branches to adjust their credit ceiling by seven percent on either side of this limit. This flexibility in setting credit ceilings was removed in 1994, although local branches were able still to determine the distribution of credit quotas. Although these policies provided the central government with significant and close control over the amount of credit in circulation, local governments and the SOEs associated with them for the purposes of taxation and revenue came to accumulate debt that

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[161] BJ:2012.06.10. Interview, Beijing.
[162] ———. Interview, Beijing.

had very little likelihood of being repaid in full. Acceptance of this situation by the banks generated a self-replicating system, deriving from the ongoing lack of commercial experience on the part of the commercial banks and the familiarity of local government officials with state-planned credit.

Non-bank financial institutions (NBFIs) played an important and often under-appreciated role in the financial landscape of post-Tiananmen China (Table 4.1). Rural credit cooperatives (RCCs) had existed as deposit-taking institutions since the pre-reform era, and continued to be the largest set of NBFIs during the 1990s. RCCs were always conceived of as independent financial institutions that operated according to principles of democratic collective management.[163] However RCCs have historically possessed very little operational autonomy but rather have been run as the lowest rung of the state financial administration, executing much of state policy across rural areas and sectors.[164] The close connection between RCCs and the state financial system meant that government officials considered their loans to be 'from the public, to the public'.[165] The non-bank financial sector would evolve to split in two directions during the 1990s, with RCCs playing a crucial role in the broader intermediation system, whilst trust and investment companies (TICs) were engaged in highly speculative and risky investments with a low level of allocative efficiency.[166] After having had their activities curtailed dramatically in the late 1980s, during the early 1990s as the central government's fiscal capacity declined, and restrictions upon SOCB lending were implemented through the credit plan, TICs again proliferated until in 1997 there were more than 600 in existence.[167] During the 1980s TICs were largely established by SOCBs in order to promote

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[163] China Finance and Banking Society, *中国金融年鉴 1990 [Almanac of China's Finance and Banking 1990]* (Beijing, CN: China Financial Publishing House, 1991), 80.

[164] On Kit Tam, "Rural Finance in China," *China Quarterly* 113:60-76 (1988), 71.

[165] See Zhu Ling, Jiang Zhongyi, and J. von Braun, *Credit Systems for the Rural Poor in China* (New York, NY: Nova Science Publishers, 1997), 80.

[166] James Laurenceson and Joseph Chai, *Financial Reform and Economic Development in China* (Cheltenham, UK: Edward Elgar, 2003), 76-77.

[167] Five firms in particular were notable for the scale and rapidity of their demise: China Rural Trust and Investment Corp in January 1997; Hainan Development Bank on 21 May 1998; China New Technology Venture Capital Corp on 22 June 1998; Pudong United Trust and Investment Corporation in October 1998; and Guangdong International Trust and Investment Company in 1999.

more horizontal flows of funds between financial institutions even though local governments possessed a high degree of direct and indirect control, whereas in the 1990s TICs became very closely associated with local governments and their development objectives.[168]

Table 4.1: Assets, loans, and deposits, by financial institution in 1997 (%)

Type of Institution	Assets	Loans	Deposits
Banks	84.6	80.7	76.5
State-owned banks	82.1	77.5	72.3
Other banks	2.5	3.2	4.2
Non-banks	15.4	19.3	23.5
Urban Credit Cooperatives	3.2	4.0	5.8
Rural Credit Cooperatives	8.2	10.4	12.8
Trust and Finance Companies	3.0	3.9	4.9
Total	**100**	**100**	**100**
(Billion RMB)	**7,697.1**	**6,115.3**	**6,857.1**

Source: Almanac of China's Finance and Banking 1997

Money Markets

From the beginning of reform the question of interest rate adjustment as a mechanism for the efficient allocation of capital had been present. Prior to 1978, the PBOC had directly controlled and targeted more than 100 different rates. The prevailing view had been that maintaining these controls would allow the PBOC to control and reduce any potential volatility in interest rates and thus liquidity during the price-setting experiments of the 1980s.[169] The administrative regulation and

[168] Dipchand, Zhang, and Ma, *The Chinese Financial System*, 110.

[169] BJ:2012.10.10. Interview, Beijing. The first sign of interest rates becoming more directly responsive to market conditions was the *Provisional Regulation on Strengthening Interest Rate Administration,* a planning document issued by the PBOC in 1988. However the basis for this responsiveness was a strengthening of the authority and mediating capacity of the central bank, rather than any reliniquishing of authority or influence over the determination of specific interest rates. People's Bank of China. 关于加强利率管理工作的暂行规定 [Provisional Regulation on Strengthening Interest Rate Management]. People's Bank of China, (Beijing, CN: People's Bank of China, 1988).

management of interest rates was a critical institutional foundation for stable investment-led growth. Financial repression was the basis for guaranteeing a cheap and stable source of capital for the fixed-capital investment that was the primary contributor to aggregate output growth from 1990-1998.[170] This degree of investment was feasible only with a commensurately high level of savings, and as the World Bank noted in 1996, China's growth-engendering capital accumulation "was supported by an extraordinarily high savings rate that has come to depend increasingly on China's thrifty households."[171] The importance of financial repression raised the question of how faith in the banking system was to be maintained so as to avoid large-scale deposit withdrawals. In contrast to other transition economies in which households hold most of their hard currency in cash, China's households were willing to retain vast sums of hard currency in state banks.[172]

This issue of how to prevent disintermediation of capital in periods of high inflationary pressures had been faced in the late 1980s and arose again in late 1992 and 1993 when inflation peaked again at 24.3 percent. The interest rates on sight deposits had been fixed at 2.88 percent since the mid-1980s, and were raised only to a maximum of 3.15 percent in July 1993 when inflationary pressure was at its highest.[173] Thus the real deposit rate was significantly negative. In order to stem deposit leakage from the banking system, when Zhu Rongji assumed the governorship of the PBOC in 1993, he indexed long-term interest rates to inflation, encouraging the public to hold more illiquid savings deposits (Table 4.2).

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170 Of the 9.5 percent total output growth over this period, capital accumulation accounted for 6.4 percent, labor force growth accounted for 0.5 percent, and total factor productivity (TFP) growth accounted for 2.6 percent. See Paul Heytens and Harm Zebregs, "How Fast Can China Grow? ," in *China: Competing in the Global Economy*, ed. Wanda Tseng and Markus Rodlauer (Washington, DC: International Monetary Fund, 2003).

171 World Bank. "The Chinese Economy: Fighting Inflation, Deepening Reform". *World Bank Country Study* Washington, DC: World Bank, 1996.

172 Lardy, *China's Unfinished Economic Revolution*, 131.

173 China Finance and Banking Society, *中国金融年鉴 1993 [Almanac of China's Finance and Banking 1993]* (Beijing, CN: China Financial Publishing House, 1994), 492-94.

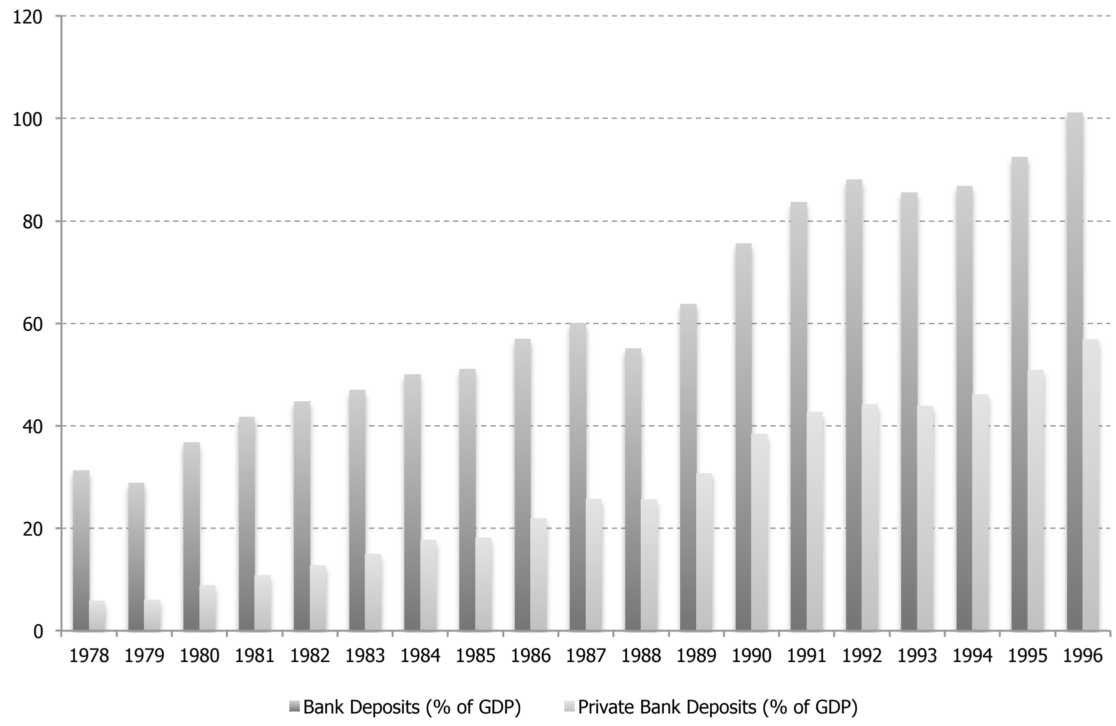
Table 4.2: Long-term interest rates, 1994-1995[174]

	March 1994	March 1995	September 1995
Indexed Deposit Rate			
Three-year	13.43	24.11	24.88
Five-year	16.13	26.81	27.58
Eight-year	18.83	29.51	30.28
Loan rate for fixed-asset investment			
Three- to five-year	13.86	14.58	15.12
Five- to ten-year	14.04	14.78	15.30

These moves had the effect at least of stemming the withdrawal in 1992 and 1993 of capital from the banks in the face of inflationary pressures. However, interest rates on sight deposits remained highly negative during the years of high inflation from 1993-1995, with real interest rates averaging approximately –16 percent across these three years. The need to maintain liquidity meant that households continued to hold as much as 35 percent of their savings in sight deposits, such that the proceeds of this de facto tax on liquidity provided an implicit subsidy to borrowers who benefitted from interest rate repression. Nevertheless, despite this financial repression, by 1997, bank deposits had exceeded GDP, overwhelmingly underpinned by household savings (Figure 4.1).

[174] Wei Feng, *China's Transition to a Market Economy* (Hamburg, DE: Lit Verlag, 1999).

Figure 4.1: Savings levels, 1978-1996



Source: Almanac of China's Finance and Banking 1996

The efforts by the central government to prevent disintermediation of both household and enterprise savings were underpinned by controlling interest rates. This remained a form of control that mediated between the needs of households and enterprises by subjecting the banking system to significant financial pressure. It was only by entrenching the relationship of mutual dependency between the PBOC and the banks that it was possible to avoid both a banking crisis and a ratcheting up of pressure upon financially fragile SOEs, without producing further inflationary pressure. What liberals had hailed as a milestone in 1993 for financial reform in fact was at the same time being actively undermined by the utilization of the banking system as a system for the PBOC to implement monetary policy as well as retain control over industrial policy and financial intermediation.[175] The underlying dynamics of the relationship between households, enterprises and China's rapid industrial development were thus established, with the banking system residing at its core.

Capital Markets

Since the commencement of reform, the fundamental channel for the flow of capital throughout the Chinese economy has remained one of bank credit.[176] It was nevertheless inevitable that the prospect of establishing financial exchanges as mechanisms for the allocation of capital was one that would have to be grappled with, as the CCP sought to reduce the degree of direct political intervention in the financial system. Deng Xiaoping had resolutely answered the question of the relationship between the market economy and socialism. Financial markets embody acutely its logical extension, "does capital itself have to be capitalist?"[177] During his Southern Tour, Deng had the following to say on the topic of financial markets:

> Securities, stock markets, are they good or evil? Are they dangerous or safe? Are they unique to capitalism or also suitable to socialism? Let's try and see. Let's try for one or two years; if it goes well we can relax controls, and if it goes badly we can correct or close it. Even if we have to close it, we may do it quickly, or slowly, or partly. What are we afraid of? If we maintain this attitude, then we will not make big mistakes.[178]

The Shanghai (SHSE) and the Shenzhen (SZSE) Stock Exchanges were established in December 1990. By the end of the 1991, the SHSE had eight listed stocks and 25 members, whilst the SZSE

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[175] BJ:2014.04.15 #1. Interview, Beijing.

[176] Wu, "重建金融系统 [Reconstruct the Financial System]," 146.

[177] BJ:2013.04.07. Interview, Beijing.

[178] Deng Xiaoping, *邓小平文选第三卷 [Selected Works of Deng Xiaoping, Volume 3]*, 373.

had six listed stocks and 15 members.[179] Following the 'August 10' incident in 1992, the central government recognized the need to bring the emerging capital markets under a systematic framework of control.[180] The China Securities Regulatory Commission (CSRC) [中国证券监督管理委员会] was established in October 1992. This further led to the State Council in December 1992 promulgating the first set of comprehensive regulations for capital markets.[181] One of the designers of the CSRC was Gao Xiqing, who has described himself as a "Lei Feng[182] type—a small cog in a huge Party machine, and wherever they put me I'm happily there."[183] When drafting the initial regulations for the capital markets, Gao says that,

> [my colleagues and I] tried to copy [the American securities system] in many ways, we also borrowed rules from the British, Taiwanese, Japanese, and German systems, because the American rules of laissez faire just wouldn't work in China. People wouldn't agree to it. Even after all these years, we have a system that looks on the surface like others, but when you talk about the enforcement level, and the actual details of the laws, it's very different.[184]

Although the CSRC would emerge during the 1997 National Financial Work Conference as the preeminent regulator over the financial markets, the State Council Securities Commission (SCSC) [国务院证券委员会] was established at the same time in October 1992 in order to provide overall

179 China Securities Regulatory Commission. "China Capital Markets Development Report". Beijing, CN: China Securities Regulatory Commission, 2008.

180 On 10 August 1992, upwards of half a million individuals waited for a share subscription that was to be issued by the Shenzhen branch of the People's Bank of China. When the number of subscription forms distributed was obviously less than what had been promised, enraged prospective investors rioted in the streets.

181 State Council of the People's Republic of China. 国务院关于进一步加强证券市场宏观管理的通知 [Notice of the State Council Concerning Further Strengthening Macroeconomic Management of the Financial Markets] (Beijing, CN: State Council of the People's Republic of China, 1992).

182 Lei Feng (1940-1962) was a soldier of the People's Liberation Army, who was characterized by the CCP and China's leaders as a selfless model citizen devoted to the CCP, Mao Zedong, and the people of China. Following his accidental death he became the subject of a posthumous national propaganda campaign "Follow the example of Comrade Lei Feng" [向雷锋同志学习].

183 Gao Xiqing's remarks are further interesting for the fact that as one of the early 'returnees' [海龟] he is one of the more 'Westernized' financial policymakers and regulators. Duke Law School, "Gao Xiqing '86: Reformer and Optimist," *Duke Law Magazine* 23:2 (2005): 22-23, 22.

184 ———, "Gao Xiqing '86: Reformer and Optimist", 23.

macroeconomic management of the emerging securities markets. Further, the Securities Supervision Office of the PBOC had already been established in May 1992.[185]

The scope for the development of capital markets that operated according to the ideals of Western principles was limited due to the weaknesses of the banking system, and the fact that unfettered competition for the banking system was not a prospect that the CCP was willing to countenance.[186] The fate of the capital markets remained intimately connected to that of the SOCBs. However this was not of material concern for those policymakers who had provided the original impetus and sanction for the formalization of these markets to begin with, as the objective of establishing and formalizing capital markets was to facilitate the raising of capital, rather than achieve more efficient financial intermediation and risk management. As one government report phrased it at the time, "the purpose of the share system is the share system and not to issue shares to the public."[187] Some accounts portray the emergence of stock markets as a product of the economic liberalism of the 1980s, an embrace of the concept of private ownership, and an increasing preference for free market thinking.[188] However notwithstanding the entrepreneurial spirit pervading Shenzhen throughout the decade, the efforts of the 'comprehensive reform group' along with other well-connected princelings such as Wang Qishan to advocate for the establishment of stock exchanges crystalized in Yao Yilin's support of experimenting with such markets as new channels for the raising of capital for SOEs.[189] Zhu Rongji, at the time Mayor of Shanghai, also viewed the establishment of formal stock exchanges as a useful means of retaining

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[185] China Securities Regulatory Commission, "China Capital Markets Development Report."

[186] Xie Ping, "关于国有企业的改革 [On the Reform of State-owned Enterprises]," *经济研究 [Economic Research]* 2(1994): 25-33.

[187] Gao Shangqun and Ye Sen. "China Economic Systems Reform Yearbook". 1990. Quoted in Carl Walter and Fraser Howie, *Privatizing China: Inside China's Stock Markets* (Singapore, SG: Wiley, 2003), 21.

[188] ———, *Privatizing China: Inside China's Stock Markets.*

[189] Li Kehua, "十年股市他们这样富起来 [Stock Markets: Rising to Riches This Way in Ten Years]" *中国证券报 [China Securities Report]* (2000).

control and majority ownership whilst alleviating the financing burden upon the central government to maintain the investment and working capital of SOEs.

As conceived in the early 1990s, the premise of financial commercialization was to achieve a greater concordance between the flow of capital and the needs of economic development, and one mechanism with which to achieve this would be competition. The experimentation with futures markets in 1993 further embodied the difficult trajectory of market development in the nascent stages of China's acceptance of markets for capital. It is well-known the extent to which policy-makers were concerned with the impact of such markets upon 'stability', yet the contours of how this tension played out through the reform process remain obscure. The experiments with shareholding reform of medium-size SOEs in the 1980s had prompted the nascent but rapid emergence of a market for equity shares. Yet market-led competitive rationalization was not to be the premise for growth-supporting rationalization. Rather, it was the ambiguity embodied and uncertainty embodied within the CCP itself in terms of its role in underpinning competitive economic activity that enabled it not only to remain at the centre of the financial system, but also to remain indispensable. Speaking of the relationship between capital markets and the CCP, one interviewee stated,

> Adam Smith wrote about the invisible hand, and Americans all treat this as the most fundamental part of capitalism. But the CCP does not want an invisible hand. The CCP wants to be the invisible hand itself.[190]

This was reflected in the identification of the state's priorities for commercialization and the role of capital markets:

> Because the government controls the development of China's stock markets, the guiding ideology is very important. I want to emphasize that up until today the guiding ideology in developing the stock markets is still to "help state enterprises resolve their problems."[191]

[190] BJ:2012.06.04. Interview, Beijing.

The next chapter will explore in greater detail how the accelerating process of institutional commercialization in the banking sector after the Asian Financial Crisis would display a deepening of this relationship between the state-owned sector and China's capital markets. The stock markets would come to function as a crucial source of capital for the banks themselves, and the impact of their public listing would have an impact upon corporate governance. Nevertheless it was in the early 1990s that the initial dynamics of the relationship between the banking system and financial markets were established. This was one of the instrumental establishment and utilization of interbank, bond, equity, and foreign exchange markets, all of which were not only minor relative to the banking system in quantitative terms, but also subordinated in role and function to the major financial institutions.

Relational Networks: Party-State-Market Autonomy

The role of relational networks—and especially those that emerge out of the CCP—in underpinning the Chinese political economy is widely recognized. In the 1990s they played a significant role in influencing the path of economic development, both by diffusing the cognitive frames that underpinned an institutional fusion of CCP control and economic growth, but further by positioning enterprises to each other in terms of access to finance. The structure of the political and business networks that underpinned economic activity and growth were affected by the cognitive frames and associated institutions that emerged in the early 1990s. They were more commercially rationalized and subjected economic actors to increasingly stringent economic performance standards, yet they simultaneously relied heavily upon and retrenched existing networks of political ties centered on the CCP.

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[191] Zhang Weiying, quoted in Wang An, *股爷您上座 [Mister Share: To the Head of the Table]* (Beijing, CN: Huayi Publishing House, 2000), 364-65.

Party Discipline and Revolving Doors

The drive to consolidate control over the banking system as a mechanism for macroeconomic policy and financial intermediation relied heavily upon the ability of the leadership to diffuse its policy preferences and signal the way in which institutional evolution was expected to impact upon economic behaviour. Party discipline was at the core of Zhu Rongji's emphasis upon the 'unification of thinking'[192] and reconciling the disparate elements of the newly emerging institutional function of the banking system. Although the state apparatus continued to fulfill its functional role in crafting industrial policy, drawing up the credit plan, and issuing guidance to bank managers, party networks were relied upon to set the priorities and parameters of these functions.

Party networks operate both horizontally and vertically to diffuse cognitive frames and to buttress institutions. Horizontally, they function by virtue of overlapping networked bonds of loyalty, guanxi, and mutual obligation. During the 1990s, the appointment of all leading financial cadres was overseen by the Central Organization Department under the 1990 position-list.[193] The capacity of the Party to control the transfer and promotion of these cadres was strengthened,[194] as now-prominent cadres such as Zhou Xiaochuan, Wang Qishan, Dai Xianglong, Liu Mingkang, Guo Shuqing, and Shang Fulin were rotated progressively through the primary financial institutions that were emerging in the early 1990s: the five SOCBs, three policy banks, the PBOC, the CSRC, and SAFE. One former member of the monetary policy committee describes this process of rotation and placement in the following terms:

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[192] Zhu Rongji, "Thirteen Measures for Strengthening Macroeconomic Controls," 134.

[193] The 1990 position-list was published on 10 May 1990, particularly as one of the measures to reassert party discipline in the aftermath of 4 June 1989.

[194] John Burns, "Strengthening Central CCP Control of Leadership Selection: The 1990 Nomenklatura," *The China Quarterly* 138(1994): 458-91.

> They don't think the same way, but all of the top financial guys have spent their careers being moved around by the party, through the central bank, the state banks, the regulators. They have different ideas about how to do it, but they all know that their careers depend on protecting the party. And the ones who are at the top now, they were groomed beginning in the early 1990s.[195]

Vertically, they functioned through hierarchical injunctions and the instillation of party discipline amongst cadres. After every major party meeting or financial work conference, comprehensive party-led study meetings were convened in order to determine how to implement the objectives and realize the intentions of central leaders. This has continued through the reform era. For example, in 1993 following the 14th Party Congress at which the goal of constructing a socialist market economy was proclaimed, the Bank of Communications organized meetings for all branch managers to meet together, at which the Bank President Dai Xianglong, who would later be appointed Governor of the PBOC in 1995 gave a speech, laying out his vision of a 'socialist commercial bank'.[196] The role and duty of cadres within state-owned firms is thus to provide moral and political leadership, frequently through political and ideological study sessions, a role that has retained its salience through the reform era.[197] One retired banker who was a CCP-Committee member within his state-owned commercial bank recalls the manner in which they were compelled to read, study, and then debate Dai Xianglong's 'instructional handbook'[198] for leading cadres involved in financial work.[199]

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[195] BJ:2014.04.15 #1. Interview, Beijing.

[196] Dai Xianglong, "把交通银行办成社会主义商业银行 [Transform the Bank of Communications into a Socialist Commercial Bank] " in *戴相龙金融文选 [Dai Xianglong: Collections on Banking and Monetary Policy]*, ed. Dai Xianglong (Beijing, CN: China Financial Publishing House 1993).

[197] Margaret Pearson, *China's New Business Elite: The Political Consequences of Economic Reform* (Berkeley: University of California Press, 1997), 68.

[198] Dai, *领导干部金融知识读本 [Instructional Reader in Finance for Leadership Cadres]*.

[199] BJ:2013.08.09. Interview, Beijing.

Networks, Growth, and the Origins of the Investment Binge

Changes in the institutional framework underpinning the relationship between the banking sector and the real economy precipitated a change in the structure of networks that influenced lending decisions in the 1990s. These institutional developments structured the incentives and reconfigured the structural positions of creditors, intermediaries, and debtors within the political economy so as to produce a system of allocation of capital that heavily prioritized the urban over the rural, the coastal over the interior, and produced significant intra-regional income inequality. As savers were incentivized to provide the banking system with a large supply of cheap capital, these funds were channeled across the industrial landscape in such a way as to preserve the twin compacts that existed as between the CCP leadership and its major constituencies. Not only the networks of political support that pervaded the basic functional components of the political economy, but also the broader population needed to be reassured that the path of development generated an environment in which continued economic growth was sustainable.

Although the passage of the *Commercial Banking Law* in 1995 and the establishment of the policy banks was a clear indication to banking cadres that changes were afoot in the role of the newly created 'commercial' banks, this was by no means interpreted as commensurate with a wholesale transformation of the relationship between the state-owned industrial sector and the state-owned banking sector.[200] Rather, there was a shift towards commercialization, with loan officers beginning to favour lending to more profitable SOEs over less-productive ones.[201] During the 1990s, Chinese SOCBs discriminated positively in favour of SOEs, such that those cities with

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[200] BJ:2012.06.14. Interview, Beijing; BJ:2012.10.10. Interview, Beijing.

[201] Robert Cull and Colin Xu, "Bureaucrats, State Banks, and the Efficiency of Credit Allocation: The Experience of Chinese State-owned Enterprises," *Journal of Comparative Economics* 28(2000): 1-31, 9; BJ:2012.10.10. Interview, Beijing. Robert Cull and Colin Xu, "Who Gets Credit? The Behaviour of Bureaucrats and State Banks in Allocating Credit to Chinese State-owned Enterprises," *Journal of Development Economics* 71:2 (2003): 533-59.

higher SOE shares in total output enjoyed greater access to bank loans.[202] In 1997, privately owned companies received only 5.7 percent of total loans from SOCBs, notwithstanding their contribution of over 20 percent to overall industrial output.[203]

These lending patterns were heavily concentrated through political networks that permeated all levels of the CCP. It is widely documented that in the mid 1990s, it was still the case that commercial banks were disbursing loans based purely on political considerations, with no prerogative to act on the basis of commercial considerations in 90 percent of loan decisions.[204] A variety of problematic loan relationships remained common. 'Hatted loans' [带帽下贷], 'designated loans' [点贷], and 'special project loans' [专项贷款] were all means by which party officials were able to secure finance for projects both beyond the original credit plan and in order to satisfy growth targets.[205] This would have an adverse impact upon the credibility and viability of the credit plan, however the abolition of the credit plan was a development that was acceptable to cadres both within the bureaucracy and industry as long as they retained confidence in the underlying support of the central government and their ability to obtain the necessary finance.[206] It was growth rather than profit that remained the underlying rationale for industrial policy.

This hinged upon maintaining the expectations of a large number of bureaucrats, loan officers, and managers. As Steinfeld has observed, just because there was a shift to the market away

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[202] Shang-Jin Wei and Tao Wang, "The Siamese Twins: Do State-owned Banks Favor State-owned Enterprises in China?," *China Economic Review* 8:1 (1997): 19-29.

[203] People's Bank of China, *China Financial Outlook 1997* (Beijing, CN: China Financial Publishing House, 1998), 91.

[204] Jiangxi Provincial Branch Office People's Bank of China, "转制中的国有企业银行债券问题的调查报告 [Research Report on the Issues of Bank Loans to State-Owned Enterprises during Transition] " *经济研究参考 [Economic Research Reference]* 63(1996): 33-38, 34.

[205] Tao Li, "分析专业银行的点贷做法 [Analysis of the Specialized Banks' Practice of Designated Loans]," *经济日报 [Economic Daily]*, 16 September 1994.

[206] BJ:2012.11.24. Interview, Beijing.

from central planning, did not mean that the bureaucratic apparatus of the old system would simply disappear.[207] As one veteran banker stated,

> This was highly problematic of course, but at the same time it was just one of many problems. Zhu Rongji was trying to deal with inflation and inefficiency without destroying growth. But this is not easy.[208]

It was not easy because the only way to control inflation without destroying growth was to rely upon the existing and highly inefficient networks of lending and borrowing, rather than compelling banks to forge genuinely new and effective networks of credit flow to more commercially viable and efficient enterprises. The goals of simultaneously preserving macroeconomic stability and growth at the same time were prioritized over increasing efficiency, even as the commercialization and rationalization of the political economy were proceeding apace.[209]

The divergence began to emerge between the ideal of the envisaged allocation of resources [理想资源配置] and the reality of the 'socialist market economy' as the effects of reform began to take hold. The reforms of the 1980s had left much of the urban economic structure virtually untouched. China's labour structure was thus shifting from an emphasis upon entrepreneurs to one upon labourers as capital-intensive growth came to rapidly increase in significance and prominence. In contrast to the rural reforms of the 1980s, in which local markets and rural entrepreneurship flourished, paid employment came increasingly to be the predominant option for transitioning out of agricultural production.[210] Whilst GDP growth remained high during the 1990s, it was unsustainable, concentrated upon heavy urban development, and reliant upon foreign direct investment and the extraction of resources from rural areas, rather than indigenously sourced finance and capital. According to Huang, Chinese development in the 1980s was a rags-to-riches

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[207] Steinfeld, *Forging Reform in China: The Fate of State-Owned Industry*, 60.

[208] BJ:2014.04.15 #2. Interview, Beijing.

[209] ———. Interview, Beijing. BJ:2012.06.20. Interview, Beijing.

[210] The drive for capital-intensive growth thus precipitated a profound transformation in the income sources and profiles of rural residents. Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State*, 118.

growth story, whilst the growth of the 1990s led to sharp income inequalities, a reduction of social opportunities available to the working population, slower income growth, and an investment-heavy growth pattern.[211] The consequence of reliance upon party-dominated networks for financial intermediation was to generate modes of exclusion from economic and financial opportunity. In contrast to the reforms of the 1980s, in which "rationalizing reforms had consistently failed",[212] China supposedly demonstrated in the early and mid 1990s that it would "not be perpetually stuck in a phase of half-reformed institutions and coexisting incompatible instruments of plan and market."[213] Naughton was correct that fundamentally significant reform was achieved during this period, but the rationalization of the institutions and networks of economic activity that emerged through these reforms did not unfold in the manner for which Naughton was expectantly hoping. Rather they were rationalized so as to consolidate the effectiveness of the state-owned networks of capital within an increasingly market-driven economic environment. Direct planning was replaced by indirect control, and the *formal diktats* of a Leninist command system were replaced by the *networked edicts* of an organization capable of binding together the institutions of state and market in order to generate the immediate incentives underpinning both political order and economic dynamism.

Conclusion

As developed in Chapter Three, the guiding framework for analyzing the role of the CCP within the political economy of China's economic and financial reform can be summarized thus: cognitive frames guide policy objectives, producing the policy decisions that establish or modify institutions, shaping the networks that constitute economic exchange, and altering the social and material

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211 ———, *Capitalism with Chinese Characteristics: Entrepreneurship and the State*, 112.
212 Naughton, *Growing Out of the Plan: Chinese Economic Reform, 1978-1993*, 307.
213 ———, *Growing Out of the Plan: Chinese Economic Reform, 1978-1993*, 307.

outcomes that entrench or disrupt cognitive frames. In this chapter I have traced how the concept of a 'socialist market economy' provided a broad contextual frame for the development of a macroeconomic and financial policy revolving around the accumulation and investment of capital as a means of securing economic growth without the CCP being compelled to endanger its control over these sources of growth and development. This precipitated institutional redesign in order to both stimulate and control economic growth. The institutions to thus emerge out of and around these policies were central to the stabilizing of expectations, but given their deliberate non-independence from the CCP, the networks between industry, finance, and party evolved as the foundation of economic growth in the 1990s, even as the institutional framework increasingly resembled a modern financial structure. The combination of framing China's path of development in terms of realizing a 'socialist market economy', and the reform and establishment of institutions that emerged as a product of this cognitive orientation produced a financial environment that structurally produced both high rates of growth, and high degrees of inefficiency, but preserved the locus of socio-political control with the CCP. The institutional transformation of the financial sector under Zhu Rongji made possible the financial repression that both assured macroeconomic stability as well as a source of capital for industrial restructuring and an investment-biased growth strategy.

It is for this reason that the 'comprehensive reform' strategy championed by Wu Jinglian was not realized in the way that models and expectations of liberal market-oriented reform would have expected. Reviewing the turning points of 1993 in the process of reform, it is possible to identify a number of areas in which the 'new era of comprehensive reform' [政体改革的新阶段] had arrived, yet financial reform was conspicuous in its absence from this list.[214] The imperative to maintain control over the flow of capital reflected the limits of the notion that a market economy

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[214] BJ:2012.12.12. Interview, Beijing; Wu, "1993 年：经济改革进入"整体推进"的新阶段 [1993: Economic Reform Enters a New Period of "Comprehensive Reform"."

understood through the lens of liberal Western economic theory was compatible with the continued existence of an authoritarian political system. Minxin Pei has argued that the reforms of the mid-1990s were characterized by a strong and negative influence of the political system: "as long as the state remains the owner of China's largest banks, political decision-making will unavoidably prevail over commercial considerations."[215] However when examined in the broader context of the challenges created by risk and uncertainty facing the CCP coming out of the post-1989 interregnum, and the institutional and socio-economic tools available to the CCP's leaders, the course of reform more clearly indicates that it was not so much the case that political decision-making was unavoidable, but rather that it was essential and deliberate.

Yet this is not to assert that this consolidation of control over capital effectively rendered it a neutral force for economic and social development. The approach to the role of the market that Deng Xiaoping had framed through the concept of the 'socialist market economy' can be understood as one in which the underlying socio-political foundations of modern Chinese society (ie. a socialism embodied within CCP authority and rule) would be able to absorb, integrate, and utilize the market without being fundamentally threatened. The premise of Deng's 'socialist market economy' was that markets are neutral economic tools,[216] capable of being deployed and manipulated in order to advance broader social goals under the direction of an ideologically cohesive party apparatus. The separation of state and market was only ever conceived of as possible in circumstances where the party was capable of mediating between administrative and market mechanisms of politico-economic control. However, the cognitive frames that emerged in the aftermath of Tiananmen were not limited to 'how-to' rules, but had also profound implications on distributional outcomes and 'orders of worth'.[217] What Deng Xiaoping however failed to appreciate

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[215] Pei, "The Political Economy of Banking Reforms in China, 1993-1997", 349.

[216] Wei-Wei Zhang, *Ideology and Economic Reform Under Deng Xiaoping: 1978-1993* (London, UK: Kegan Paul, 1996), 214.

[217] Luc Boltanski and Laurent Thévenot, *On Justification: Economic Ideas and Political Change in the Twentieth Century* (Princeton, NJ: Princeton University Press, 2006).

was the way in which markets are "explicitly moral projects, saturated with normativity."[218] As Beckert notes, "ideological innovations might also have unintended side effects that prevent the control of their consequences even by powerful actors."[219]

The path of reform set in motion during the post-Tiananmen neoconservative interregnum was successful in neutralizing the volatility of capital, however it served merely to ameliorate, rather than eliminate the pressures that accrued from the concentration of profit-making (ie. rent-seeking) opportunities within a network of firms and individuals that was simultaneously indispensable for securing the stability of the system.[220] This would come to manifest in two primary ways in 1997. The scale and severity of the issue of non-performing domestic loans to SOEs became increasingly apparent in 1997, and the quantity of toxic debt weighing upon their balance sheets was perceived as hindering their prospects of being able to attract capital and compete with foreign banks both domestically and internationally following China's anticipated accession to the WTO in 2001. Also among the developments that would usher in a new wave of reform in 1998 was the buildup of unsustainable foreign debt. The collapse and aftermath of the Guangdong International Trust and Investment Company, and the onset of the Asian Financial Crisis would have profound impacts upon the future evolution of the financial system's role in China's path of development through the late 1990s and 2000s.

China's CCP leadership was beginning to grapple with the inevitable challenge of integrating China's financial institutions into the global financial order. Having built what appeared to be an institutionally complete and thus 'modern' financial system, its potential to raise and then allocate capital for China's ongoing CCP-led growth strategy was to become increasingly reliant

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218 Fourcade and Healy, "Moral Views of Market Society", 299-300.

219 Beckert, "How Do Fields Change? The Interrelations of Institutions, Networks, and Cognition in the Dynamics of Markets", 617.

220 As Riedel et al have argued, "repairing a repressed financial system necessarily involves more than changing financial policy. It requires nothing less than a fundamental reorientation of development strategy, which inevitably entails heavy economic, political, and social costs." James Riedel, Jing Jin, and Jian Gao, *How China Grows: Investment, Finance, and Reform* (Princeton, NJ: Princeton University Press, 2007), 73.

upon new stakeholders. As the next chapter details, they would increasingly recognize that along with the reliance upon capital holders, and especially foreign capital holders, would come an ever-more acute need to manage expectations and maintain broad faith and confidence. The path of reform would involve the increasing commercialization of financial institutions and the rationalization of state administrative functions. Yet the ongoing pursuit and accelleration of economic growth was possible only through a concomitant deepening of the role of the CCP at the heart of a risk environment that managed uncertainty, even as the CCP and those connected to it exploited that uncertainty to preserve political and economic control.

V Entering the World, Consolidating at Home: 1998-2007

> At every phase of history, China has had to face other people and their cultures. Numerous contacts and exchanges, whether positive or negative, have brought about changes in the cultures of China and its neighbors. [D]uring this process the "us" and "them" have merged into a new "us."
>
> — *A Long River of History* by Cho-Yun Hsu

> Foreigners wanted it both ways. They wanted the Chinese market to develop, but they wanted the Chinese state to step in to make it safe too. Why should the Party do this? Foreigners are not the concern of the Party.[1]
>
> — Retired financial cadre, Beijing

Introduction

The period 1998-2007 saw China entering the WTO and deeply embedding itself within the global economy even as it came to grapple with the international discrediting of the East Asian growth model following the Asian Financial Crisis and the debt burdens brought about by its own unbalanced growth trajectory that had emerged over the preceding seven years. By the eve of the 2008 financial crisis, it was clear that China's financial sector had experienced sweeping institutional change over the preceding ten years. Now spearheaded by publically listed banking titans and a central bank with an emerging international reputation for effective and technocratic macroeconomic management, the financial system appeared to have served effectively as a lynchpin of China's years of heady rates of economic growth that peaked at 14.2 percent in 2007. Yet, despite the extent of financial reform between 1998 and 2008, it is also clear that the reorganization of state and market within the financial sector had resulted in the predominance

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[1] BJ:2013.08.09. Interview, Beijing.

of neither.[2] As would become clear in the final months of 2008 when China's economic stimulus package came into effect, the banking system that had been such an area of concerted focus by both Zhu Rongji and Wen Jiabao, in only very limited ways bore a functional resemblance to the liberal financial systems that had supposedly been the model for China's own path of financial reform, but which were now embroiled in existential crisis themselves.

From a standard liberal perspective, this process of financial reform was thus a 'failure'; the market-based elements of the system were immature according to the standards of orthodox financial theory, and the financial sector remained a long way from playing the full-fledged 'mature' role of financial systems in more 'advanced' economies. Although a broad sweep of changes took place within the financial sector during Zhu Rongji's tenure as Premier, as Shih has observed,

> It is evident that the financial sector was little more market-oriented than when he had first taken office. Although some of his efforts furthered market allocation of capital, other policies pulled China back to the planned economy. Thus, explanations that rely on his reform orientation, the capability of technocrats, or the diffusion of market-oriented ideas cannot satisfactorily account for the lack of significant financial sector reform during his administration; those conditions were all present at the beginning of his administration.[3]

This is only paradoxical if it is assumed that the ultimate objective of financial reform was in fact to institute a fully market-oriented and liberalized financial sector. Such a paradox arises from a long-held analytic assumption that along with the rationalization and downsizing of the Chinese *state* in the process of economic reform, so too would the role of the *party* be diminished and even eliminated, presumably even more rapidly and deeply than the state itself. This chapter demonstrates how this misplaced assumption obstructs an accurate assessment of how state and

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[2] Albert Keidel, "China's Financial Sector: Contributions to Growth and Downside Risks," in *China's Emerging Financial Markets: Challenges and Opportunities*, ed. James Barth, John Tatom, and Glenn Yago (Santa Monica, CA: Milken Institute, 2009).

[3] Shih, *Factions and Finance in China: Elite Conflict and Inflation.*

party interacted during this period. It argues that the key to explaining these developments is to focus upon the way that the CCP was able to reduce the uncertainty inherent in this path of reform, but also to reduce it in a *particular way,* such that trajectories of growth and development, even whilst highly rapid and stable, were simultaneously highly unbalanced and unsustainable. I therefore trace the process by which these trends unfolded. Unless we account for the role that the management of uncertainty played as a key driver of the evolution of the financial sector during this era, it becomes difficult to plausibly make sense of why both the market and the CCP enhanced their ability to influence not only the rate but also the structure of economic growth.

As China developed from what had been a position still of (relative) international isolation to (partial) integration with the global economy, it was necessary to develop a set of financial and macroeconomic policies that would support trade and attract investment.[4] China's leaders sought to construct an internationally oriented modern financial system, which for all appearances was now geared towards competition with foreign banks both at home and eventually abroad. This process of institutional rationalization within the financial system was not a chimera; policymakers, banks, and regulators each conceived of their role within the financial system in terms substantively different from those of the mid-1990s. Yet, as would become apparent when financial crisis emanated from the US in 2008, the premise of reform during the 2000s had not been to replicate a Western financial system, but to transform the banking system into a more effective tool for achieving the broader politico-economic goals of the CCP.

[4] Breslin, "Paradigm Shifts and Time-lags? The Politics of Financial Reform in the People's Republic of China ".

Rather than the path of reform being one of failure or as settling into a partial reform equilibrium as a result of bureaucratic or elite politics,[5] the ways in which the CCP was negotiating a number of risks and uncertainties by way of instituting its own distinctive mode of economic development meant that reform was less about either pursuing market-led liberalization or state-led planning, but rather maintaining capital-led economic growth and accumulation. As this chapter argues, the duality of the financial sector's role that emerged in the process of reform in the mid-1990s continued to be reflected in the frames, institutions, and networks that evolved between 1998 and 2007. It was only by retaining the foundational role of the financial sector as a centrally controlled lynchpin of an increasingly marketized and globally integrated economy that the CCP was capable of achieving economic growth whilst guarding against the destabilizing implications of relinquishing control over capital flows.

Mounting Pressures, International and Domestic

As Zhu Rongji ascended to the pinnacle of economic leadership of the CCP in late 1997, the potential for 'crisis' was supposedly pervasive. Although in 1997-98 the economy was in a relatively healthy condition as a result of Zhu's fiscal recentralization, and contractionary monetary policy from 1994-1996,[6] this balancing act also heightened policymakers' sensitivity to possible threats to economic growth and stability. At the macroeconomic level, economic growth slid downwards, dipping below eight percent in 1998-1999, whilst China experienced deflation for the first time in the reform era. The drivers of financial policymaking in this period reflected a number of both domestic and international concerns. China experienced its first

[5] As Chin has argued, the factional politics model is much less convincing in explaining economic policymaking from the late 1990s onwards than it was in the era of the dominance of the revolutionary old guard generation that lasted until the death of Deng Xiaoping in 1997. Chin, "Understanding Currency Policy and Central Banking in China", 525.

[6] Chris Bramall, *Chinese Economic Development* (Abingdon, UK: Routledge, 2009), 490.

modern-era failures of financial firms, each of which had connections to international sources of capital, and the Asian Financial Crisis represented a salutary warning of the possible effects upon domestic monetary policy and currency stability of the broad-based relaxation of control over transnational capital flows. As Breslin has argued, despite China's reform experience having had shown itself more successful than the 'shock therapy' liberalization deployed elsewhere, China was

> now facing the task of paying for its relative success in three ways – paying in financial terms in the guise of an insolvent banking system; paying in terms of increased obligation, duties to and pressures from the international system; and paying in terms of the (delayed) growth in unemployment.[7]

The reforms of the 1990s had provided a path of navigation through the risk and uncertainty to emerge in the immediate post-1989 political economy by framing the financial system in terms of a combination of CCP authority over an expanding market economy. Yet these reforms had themselves given rise to new financial risks, which were now further entwined with the dimensions of China's deepening international integration. Not merely unquantifiable in purely economic and financial terms, these risks and the uncertainty whence they emerged were deeply embroiled in a continuing set of debates as to how China's society and politics were going to confront a critical new phase in the country's contemporary development. This uncertainty surrounded the fundamental questions of who or what was responsible for maintaining the integrity of the financial system, and how they were going to achieve this as China's domestic economy and its position within the global economy continued to evolve. Accordingly, there were two broad interrelated strands of uncertainty that needed to be addressed at this time. Firstly, that of a concern that the banking system was unable to maintain its own internal integrity, and that accordingly at some point existing domestic stakeholders in the banking

[7] Breslin, "Paradigm Shifts and Time-lags? The Politics of Financial Reform in the People's Republic of China ".

system—ordinary household and corporate depositors—would lose confidence in the financial system. Secondly, that the financial system was precariously exposed to destabilizing external competition, and that WTO entry and China's need to attract foreign capital would be a catalyzing factor in bringing about financial instability and crisis.

Crisis and the Domestic

Although the Asian financial crisis influenced China in real economic terms, its greater significance was at the discursive level. It had a deep impact upon perceptions of and attitudes towards the nature and dynamics of the global financial system, and the interpretation of specific aspects of China's integration into this system. As I explore further below, this would have tangible effects on how debates unfolded and discourses emerged around the challenges of pursuing financial reform, the cognitive frames that emerged out of those debates, and the actual policy measures that accordingly eventuated. In immediate terms however, the crisis gave rise to two potential risks within the Chinese economy: firstly a currency crisis, resulting from balance of payment problems or heavy capital outflows, and secondly, a banking crisis caused by loss of depositor confidence and banks' insolvency.[8] However, the AFC was not immediately viewed as a threat with existential ramifications by the Chinese leadership.[9] As Yu Yongding observed at the time,

> For many years, observers have criticized China's slowness in developing financial markets and liberalizing its capital account. The Chinese government itself was also worried by the slow progress. Rather theatrically, the disadvantage has turned into advantage. Owing to capital controls and the underdevelopment of financial markets and

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[8] Huang Yiping, *China's Last Steps Across the River: Enterprise and Banking Reforms* (Canberra, AU: Asia Pacific Press, 2001).
[9] BJ:2014.04.18. Interview, Beijing; BJ:2013.08.21. Interview, Beijing.

> the lack of sophisticated financial instruments, such as stock futures and foreign exchange forwards, RMB escaped the attack by international speculators.[10]

However the AFC nonetheless revealed the depth of a potential conflict between the risks posed by China's economic opening and the ability of the financial system to contain and manage those risks. Immediately following the Fifteenth Party Congress in September 1997, Jiang Zemin stressed the importance of drawing the correct lessons from the AFC and ensuring that the risk of financial instability was comprehensively managed by the CCP.[11] He drew the link explicitly between the financial system and broader social stability, stating that, "if the financial system is unstable, then it will also affect economic and social stability."[12] The financial sector had to prove capable of withstanding integration with foreign capital, but it had to do so in a way that would safeguard the stability of the financial system in ways that had clearly been lacking in other East Asian economies. Capital controls and a tightly regulated financial sector had prevented the transnational flow of destabilizing capital. From the earliest days of reform, foreign direct investment (FDI) had played a central role in the Chinese growth story, and despite the experience of the AFC, there was widespread recognition amongst the leadership of the "increasing indispensability of FDI to China's future economic growth."[13] In practice, financial reform and internationalization following the AFC would therefore maintain a sharp distinction between speculative portfolio and fixed investment capital.

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[10] Yu Yongding, "China's Macroeconomic Situation and Future Prospects," *World Economy and China* 3 (1999), 15.

[11] Zhu Rongji, "深化金融改；防范金融风险；开创金融工作新局面 [Deepen Financial Reform; Guard Against Financial Risks; Create a New Phase for Financial Work]," in *新时期经济体制改革重要文献选编 [A Selection of Important Documents on Structural Economic Reform in the New Period]*, ed. Document Research Center of the Chinese Communist Party Central Committee (Beijing, CN: Central Document Publisher, 1998), 422.

[12] Jiang Zemin, "深化金融改革; 防范金融风险 [Deepen Financial Reform; Guard Against Financial Risks]," in *江泽民文选 [Collected Works of Jiang Zemin]*, ed. Editorial Committee of the Central Document Bureau (Beijing, CN: Central Document Publisher, 2006 [1997]).

[13] BJ:2012.06.06. Interview, Beijing; BJ:2012.10.12. Interview, Beijing; Chang Ta-kuang, "SAFE and Sound," *China Business Review* 25:4 (1998): 31-35.

Against this backdrop of the crisis, from 17-19 November 1997, the Central Committee of the CPC and the State Council convened an emergency National Financial Work Conference in Beijing.[14] It called for the establishment of a financial system compatible with the socialist market economy and for the strengthening of the risk management capacity of financial institutions over the next three years.[15] Zhu Rongji saw the AFC as demanding a redoubling of efforts to deepen financial reform, stating that it "has caused us to be determined to solve these problems at the most fundamental level—we can hesitate no longer."[16] The AFC precipitated a vigorous discussion amongst economic policymakers and researchers as to the nature of these problems. The two views of the causes of the crisis fell into two broad camps, one stressing the destructive power of international speculative capital,[17] the other emphasizing the weaknesses of the financial systems in those countries most heavily affected by the crisis.[18] Yet insofar as the ultimate direction of post-crisis policy development was influenced by these debates, it was to adopt both messages as mutually compatible.[19] Foreign and transnational capital *was* a potentially destructive and destabilizing force for China, and the financial foundations of a number of the countries *were* weak. However they were weak not because they departed from the strictures of

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[14] This meeting was notable for the presence all of Jiang Zemin, Li Peng, and Zhu Rongji. Participants also included not only central bank officials at the national and provincial level, officials from the headquarters and major provincial branches of the state owned banks, insurance companies, and many NBFIs, but also provincial governors and provincial level finance officials.

[15] Historical Research Unit of the Central Committee of the Communist Party of China, *中共十一届三中全会以来大事记 - 下 [Major Events after the Third Session of the Eleventh Central Committee of the Communist Party of China (III)]* (Beijing, CN: Central Document Press, 1999).

[16] Zhu Rongji, "深化金融改革，防范金融风险，开创金融工作新局面 [Deepen Financial Reforms, Guard Against Financial Risks, and Open Up a New Phase of Financial Work]," in *十五大以来重要文献选编 [Selection of Important Documents Since the 15th Party Congress]*, ed. Document Research Center of the Chinese Communist Party Central Committee (Beijing, CN: Central Document Press, 2000 [1997]).

[17] Pang Zhongying, "国际金融体系酝酿改革 [International Financial System Deliberates Reform] " *人民日报 [People's Daily]*, 9 April 1998.

[18] Ding Jianming and Li Jianxin, "东南亚金融危机的启示 [Revelations of the Southeast Asian Financial Crisis]," ibid., 5 January; Zhu Min, "东亚金融动荡引发的思考 [Reflections Provoked by the Asian Financial Upheaval]," ibid., 26 January.

[19] The cognitive framings that would guide the path of institutional change are discussed below.

the 'Washington Consensus', but because of the weakness of mechanisms in place for managing both the domestic and international financial demands of economic development.

It was in this context that China was progressing steadily towards WTO accession. Accession and the consequent opening up of financial services under the GATS agreement was considered an important step in the overall reform process, principally in terms of gaining greater exposure to foreign expertise, but also for its potential to foster greater commercial discipline upon the sector.[20] The idea that the CCP has used global economic integration in order to apply pressure for domestic economic and financial reform is not new.[21] However the course of financial reform in the years from 1998-2007 demonstrate the extent to which global economic integration precipitated a *particular kind* of reform, one which utilized significant elements of 'modern finance' but utilized them in substantively very different ways. Although the circumstances in which the Chinese economy was operating were no longer the same as those of the early 1990s, the risk environment remained functionally highly similar. The banking and financial system was still fundamentally there to provide certainty to domestic financial actors, a function that continued to be reflected in the course of its reform.

In the face of 'inevitable globalization' a number of questions were being asked of the Chinese economy and financial system in 1998. What was the appropriate relationship between domestic and foreign capital? How did the political implications of international as opposed to domestic financial liberalization differ? What did it mean for the 'socialist market economy', or for 'socialism with Chinese characteristics' itself? The debates amongst China's policymakers and intellectuals that took place precipitated the development of cognitive framings surrounding the

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[20] Allen, Qian, and Qian, "Law, Finance, and Economic Growth in China"; Lamin Leigh and Richard Podpiera. "The Rise of Foreign Investment in China's Banks - Taking Stock". *IMF Working Papers*. Washington, DC: International Monetary Fund, 2006.

[21] Shaun Breslin, "Reforming China's Embedded Socialist Compromise: China and the WTO " *Global Change, Peace & Security* 15:3 (2003): 213-29.

role of the CCP within the financial system, influenced the path of financial institutional design and restructuring, and reconfigured the relational networks through which financial capital flowed throughout the economy. The AFC was an exogenous juncture that, whilst not illuminating any direct link between China's path of reform thus far in the 1990s and the potential for financial crisis, certainly both reflected back on the frames that had guided financial reform earlier in the decade, and in doing so provoked further reflection amongst the Chinese policymaking elite as to the future path of reform. It reinforced two messages: firstly that the East Asian developmental state was by no means immune to financial crisis precipitated by external actors and factors, and secondly that accordingly, devising ways to generate economic growth whilst maintaining those institutions and characteristics that preserved China's financial stability was crucial to China's management of the 'inevitable' fact of economic integration and globalization. These challenges were intimately bound up with the condition of domestic financial institutions, and as circumstances simultaneously evolved within this domestic sector, the extent to which the realms of foreign and domestic capital were in fact intertwined became increasingly apparent.

Debt and the International

After having 'tamed' inflation through 1995-96 by coupling financial restructuring to a financially repressive and investment-oriented growth strategy, the domestic financial challenges that emerged in the late 1990s were significant. Prominent amongst these was the accumulation of debt relationships that linked together financial institutions of three kinds: state-owned commercial banks, China's international trust and investment companies (ITICSs), and the foreign creditors of those ITICs. Amidst the macroeconomic slowdown, a number of financial institutions experienced distress and failure.[22] Principal amongst these was the Guangdong Trust and Investment Company (GITIC), which after having accumulated over USD 3.7 billion in liabilities to foreign financial institutions, in October 1998 became subject to a central government inquiry headed by Wang Qishan, and entered bankruptcy in January 1999.[23] Trust and investment companies, both domestic and international, had always occupied an ambiguous position within the financial ecosystem, and had accordingly been subject to a constantly changing regulatory environment.[24] The industry had experienced a number of 'rectifications' [整顿] since the beginning of the reform period in 1978. The latest of these had begun in 1995 and was still unfolding throughout 1996.[25]

These internationally exposed financial failures were themselves an indirect product of Zhu Rongji's recentralization of fiscal relations, as provincial governments found themselves deprived of funds that they had come to take for granted after years of progressive decentralization. Instead they turned to foreign financial institutions in order to source capital for development-oriented investment. Foreign investors were assuaged by the presence of implicit guarantees from provincial governments, and such 'comfort letters' predictably undermined the rigour and strictness of credit risk analysis undertaken by foreign financial institutions in their purchase of ITIC-issued corporate debt.[26] Following the Asian Financial Crisis, these foreign sources of capital had begun to dry up due to concerns both about the integrity of China's financial institutions themselves and the prospects for economic growth amidst a difficult

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[22] Five firms in particular were notable for the scale and rapidity of their demise: China Rural Trust and Investment Corp in January 1997; Hainan Development Bank on 21 May 1998; China New Technology Venture Capital Corp on 22 June 1998; Pudong United Trust and Investment Corporation in October 1998; and Guangdong International Trust and Investment Company in October 1998.

[23] Mark Landler, "Bankruptcy the Chinese Way: Foreign Bankers are Shown to the End of the Line," *New York Times*, 22 January 1999.

[24] These clampdowns on TIC activities unfolded in 1982, 1985, 1990, and 1995. See Anjali Kumar et al. "China's Non-Bank Financial Institutions". *World Bank Discussion Paper No. 358*. Washington, DC: The World Bank, 1997.

[25] ———, "China's Non-Bank Financial Institutions."

[26] Chang Ta-kuang, "The East is in the Red," *International Financial Law Review* 18 (1999).

international economic environment. Foreign lending to China's financial system had already in fact declined prior to the GITIC bankruptcy, registering declines in the second and third quarters of 1998,[27] in a sharp reversal of a USD 5.2 billion increase in 1997.[28]

The international reaction to the GITIC closure was "swift and unforgiving."[29] Following the GITIC episode, a number of banks suffered ratings downgrades.[30] Both Moody's and Standard & Poors had assumed that the creditworthiness of both GITIC and the China International Trust and Investment Company (CITIC) was synonymous with that of the central government, and assigned them both investment grade ratings.[31] PBOC Governor Dai Xianglong attempted to reassure investors and creditors in the aftermath of the GITIC collapse.[32] One of the legal counsel assisting in the drafting of the 1986 bankruptcy law itself believed that the handling of GITIC heralded far-reaching advances in the Chinese business environment:

> In the long term, China has established clearly that it will not fall into the moral hazard trap of rescuing badly run companies just because they are too big to fail. In the future, Chinese companies will no longer be able to obtain easy credit on the basis of opaque financial statements, personal connections (*guanxi*) and vague comfort letters from their parent governmental authorities.[33]

The crisis prompted Zhu Rongji to state rather truculently that contrary to the beliefs of international financial investors that "China is already in the midst of a financial crisis and does not have the capacity to support its payments and is not creditworthy, … we are completely able

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[27] USD 3.3 billion and 6.3 billion in the second and third quarters respectively.

[28] Bank for International Settlements. "Consolidated International Banking Statistics ". *Consolidated Statistics*. Basel, CH: Bank for International Settlements, 1999.

[29] Chang Ta-kuang, "The East is in the Red".

[30] James Harding, "Downgrade for Five Financial Institutions," *Financial Times*, 2 March 1999; Moody's Investor Service. "Banking System Outlook: China". Singapore, SG: Moody's 1999.

[31] Nicholas Lardy, "The Role of Foreign Trade and Investment in China's Economic Transformation," *The China Quarterly* 144(1995): 1065-82, 1068.

[32] "China Central Banker Tries to Assure Hong Kong Bankers on ITICs ", *China Securities Bulletin*, 5 November 1998.

[33] Chang Ta-kuang, "The East is in the Red"; ———, "The Making of the Chinese Bankruptcy Law: A Study in the Chinese Legislative Process," *Harvard International Law Journal* 28:2 (1987): 333-72.

to repay our debt."[34] For Zhu the question was one of moral hazard: "The issue is whether or not the government should repay this kind of debt."[35] Yet Zhu's distinction between the central and local government is crucial, and points to how the GITIC episode represented very different things to foreigners than it did to domestic financial elites. The crucial element of his statement was that,

> This affair sends a message to the world: the Chinese government shall not repay the debt of any particular financial sector, if responsibility for those debts is not accepted by every level of government. This is to say, if foreign banks and financial institutions wish to invest in these financial industries, then they should undertake risk analysis and 'steer a careful course'.[36]

Through such comments, Zhu was making the point to foreign capital-holders that the central government was willing to assume the role of guarantor where it saw fit. This was in contrast to the message sent to creditors within the domestic system, which was that there would be political consequences if they failed to generate greater financial profit through their activities. A marked cleavage therefore opened up between how domestic and foreign creditors conceived of the role of the market in underpinning financial stability. The experience of GITIC led policymakers to a greater appreciation of the need to find more effective ways to mediate the relationship between domestic and foreign capital:

> They [central policymakers] realized that the [trust and] investment companies were a clumsy and difficult to manage way of accessing foreign capital. Zhu Rongji was outraged that the local cadres in Guangdong had been so foolish to make these kinds of guarantees. If they wanted foreign capital and foreign investors, then they would have to do it the proper correct way.[37]

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[34] Li Liming and Zeng Renxiong, *1979-2006: 中国金融大变革 [1979-2006: China's Financial Transformation]* (Shanghai, CN: Shanghai People's Publishing House, 2007), 474.

[35] ———, *1979-2006: 中国金融大变革 [1979-2006: China's Financial Transformation]*, 474.

[36] ———, *1979-2006: 中国金融大变革 [1979-2006: China's Financial Transformation]*, 474.

[37] BJ:2012.11.17 #1. Interview, Beijing.

Following GITIC, the nature of the relationship between state-owned financial institutions and the funding needs of both local governments and SOEs in this management of the relationship between domestic and foreign capital would increasingly come to depend on central government attitudes towards debt and the threat that it posed to broader financial stability. The failures of government- and bank-owned TICs were closely linked to the emergence of large numbers of non-performing loans in the Chinese banking system following the rapid investment-led growth of the early 1990s. The scale of these NPLs was significant, with most Chinese analysts calculating it at between 20 and 40 percent.[38] Zhu Rongji's administration was therefore caught between the real economic needs for capital to maintain an investment-led trajectory of growth, and the imperatives of maintaining the market-situated integrity of the financial system as these sources of capital became increasingly internationalized. The policy basis for addressing these challenges would be laid by constructing cognitive frames that emphasized both the rationalization of the state and the enhancement of distinctively Chinese structures of authority and power that would anchor and stabilize this process of reform and rationalization.

Cognitive Frames: 做大做强

The increasing diversity of actors and the interests that they had in the ongoing evolution of the Chinese financial sector meant that the process of managing uncertainty therefore was now significantly more complex than it had been during the earlier years of reform. This section explores the cognitive frames that addressed this uncertainty, and thereby would come to anchor the process of dramatic institutional change that unfolded within the financial sector between

[38] Yi Gang, "中国金融机构的资产结构和政策含义 [Asset Structure of Chinese Financial Institutions and its Policy Significance]," *经济研究 [Economic Research]* 12(1996); Li Xinning, "从东亚金融危机看我国的金融隐患：对啊国有肚子商业银行资产运营现状的分析," *改革 [Reform]* 3(1998): 31-40.

1998 and 2007. The international economic environment and the domestic pressures of growth and reform precipitated a deepening of reform guided by a set of frames that served to maintain stability as well as enable growth without derogating from CCP power.

These cognitive frames were not just rhetoric of convenience, nor were they purely instrumental tools to be deployed within a broader game of bureaucratic power plays. The frames that emerged were not just significant in providing guidance to policymakers and CCP leaders in determining the path of institutional change. They were also central to the process of interpreting institutional change, thus generating expectations of how China's political economy was to further evolve and develop in the years following. They accordingly played a deeper and more fundamental role in generating the stable reciprocal expectations that were essential for three purposes. They first underpinned the political process of reshaping the institutional landscape of China's political economy by shaping the policy parameters of institutional change. Second, they further served a microeconomic function by enabling the continued intermediation of investment capital throughout the economy by providing the reference point for investors, shareholders, and corporate decision makers to construct mutual understandings of the politicized and hierarchical power over risk management. Finally they acted as mechanisms for broader macroeconomic stability within the financial system by anchoring expectations of policy and regulation in the underlying political objectives of the CCP.

The overarching frame that guided the leadership was that of economic growth. Yet such growth narratives were themselves further conditional upon particular discourses that rendered them feasible. These underlying discourses revolved around the preservation of the socio-political structures of the CCP in parallel with the construction of new market and state structure. Financial pressures were mounting within the domestic political economy of troubled relationships between SOCBs, local government authorities, and SOEs that continued to serve as the largest underlying source of GDP growth. They were intensifying internationally as the financial system began to play a significant role in the internationalization of China's economy, and the private manufacturing sector came increasingly to contribute to overall GDP growth and balance of payments pressures. In this context a broader discourse of economic growth resolved into two frames concerning two interrelated imperatives in the process of reform and opening; that of confronting globalization, and that of transforming and rationalizing the state-market relationship itself. As the following sections trace, these frames operated at different levels, but each revolved around the central role of the CCP as a means of managing uncertainty, in the process opening up opportunities for the simultaneous exploitation of that uncertainty. The first focused attention on the need to retain authority over the power of capital within China, whilst the second honed in on the consequent need to preserve the locus of that authority within the CCP itself. In this way they respectively honed in on the capacity to 'capitalize' upon foreign opening and thus foreign capital, and domestic wealth, without ceding control over the institutions and networks of growth. They were clearly intertwined. The potential challenges posed by 'entering the world' [入世] could only be met through the transformation of the state. In order to confront the challenge of globalization, the state was to be transformed into an internationally 'palatable' as well as functionally effective set of institutions, but power was to remain firmly embedded within the CCP. The separated yet codependent roles of state, market, and party thus were central to achieving these equally codependent economic and political objectives.

In broader context, the role of the CCP as a functional bedrock of society was not withering in the face of the increased commercialization of economy and society of the 1990s, but rather both evolved naturally and was actively enhanced through the eras of Jiang Zemin and Hu Jintao.[39] Following Deng Xiaoping's death in 1997, there was a brief interlude in which Jiang

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[39] See Jia Heping, "The Three Represents Campaign: Reform the Party or Indoctrinate the Capitalists?," *The Cato Journal* 24:3 (2004): 261-75.

looked to be emerging from Deng's shadow and embracing a more liberal political and economic perspective.[40] The discursive demolition of the 'East Asian Miracle'[41] in the aftermath of the AFC and what appeared as ominous signs of the potential ramifications of allowing 'crony capitalism' to spread in the absence of democratic checks and balances[42] led many intellectuals to anticipate an opening up of discourse not just in the economic but also political realm. Jiang adopted for the first time the phrase 'rule of law' 依法制国 rather than the previous 'rule by law' 依法治国 at the 15th Party Congress in 1997,[43] and following a lengthy debate he proclaimed in 2000 that the CCP itself should open itself to private entrepreneurs and permit them membership.[44] Yet at the same time he instituted the 'Three Emphases' or 'Three Talks' [三讲] movement at the beginning of 1999, which deepened and hardened the ideological foundations of Jiang's authority.[45] As Gore has observed, it seemed to many as if the "forces of the communist polity and forces of the capitalist economy were pulling the country in opposing directions."[46] But this was to misperceive the way in which the economic fortunes of China's expanding private sector and the 'shadow' finance that fuelled it were not only compatible with the political fortunes of the CCP, but in many ways were entirely dependent on them.[47] Not so much the exposure of an entrenched political system to liberal currents of thought, let alone the

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[40] Fewsmith, *China Since Tiananmen: From Deng Xiaoping to Hu Jintao*, 198-201.

[41] World Bank. "The East Asian Miracle: Economic Growth and Public Policy". *World Bank Policy Research Report*. Washington, DC: World Bank, 1993.

[42] Li Zhenzhi, "也要推动政治改革 [It is Necessary Also to Push Forward Political Reform]," *改革 [Reform]* 1(1998).

[43] One must be extremely wary of the act of translation: the two are phonetically the same—*yifa zhiguo*—however the *'zhi'* is a different character. That used in the formulation 'rule of law' is the character for 'system', and in Chinese the more appropriate meaning for the concept 'rule of law' is accordingly one of the rationalization, regularization, or *systematization* of the legal system. That the concept of the 'rule of law' as and when used in Chinese political discourse means some form of 'Western' constitutionalism is ultimately little more than an orientalizing asusmption.

[44] Jiang Zemin, "Speech at the Gathering to Celebrate the 80th Anniversary of the Founding of the Chinese Communist Party [在庆祝中国共产党成立八十周年大会上的讲话]," *Renmin Ribao [人民日报]*, 2 July 2001 2001.

[45] These are to place emphasis on 'politics, study, and moral integrity' [讲政治，讲学习，讲正气].

[46] Gore, "Dream On: Communists of the Dengist Brand in Capitalistic China," 197.

[47] This is especially evident in the way that private entrepreneurs navigated around the formal strictures of SOE-centric financing channels in ways that relied upon their ability to gain access to and favour with party officials. See Kellee Tsai, *Back-Alley Banking: Private Entrepreneurs in China* (Ithaca, NY: Cornell University Press, 2002).

potential transformation of existing institutional structures of one-party rule, Jiang's steps in 'opening the Party' were in hindsight a concerted attempt to ensure that the development of the private sector and the forces of commercial enterprise remained under the close authority of the CCP.[48]

The ideologically infused frames and policies that emerged in this period of great uncertainty provide indications of how the political and the economic were thus to be reconciled. Those who advocated reform, liberalization, and receptiveness to globalization did so more on the basis of their perceived utility as rational tools for pursuing national economic strength than any committed fundamental belief in the freedom of the market, wealth maximization, or the value of liberal individualism.[49] It was the pursuit of efficiency, rather than justice, that motivated the leaders at this time.[50] The detachment of these two aspects of political economy provided scope for developing and implementing novel and sometimes inadvertently innovative conceptions of the market as well as conceptions of the state. As becomes clear through the rest of this chapter, this novelty can be traced back to the distinctive position of the CCP at the nexus of this state/market complex, a position that had profound influence upon the path and nature of China's socio-economic development.

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[48] Kellee Tsai, *Capitalism Without Democracy: The Private Sector in Contemporary China* (Ithaca, NY: Cornell University Press, 2007); Dickson, *Red Capitalists in China: The Party, Private Entrepreneurs, and Prospects for Political Change.*

[49] Wang Bingcai, *与狼共舞：中国加入 [Dancing with Wolves: China Enters the World]* (Beijing, CN: China Literary Publishing House 中国书籍出版社, 1998); Chen Yuming, ed. *中国加入 WTO 各行业前景分析 [An Analysis of Each Industry's Prospects as China Enters the WTO]* (Beijing, CN: Economics Press [经济出版社], 2000).

[50] Zhang Gaoling, *中国领导人与中国现代化 [China's Leaders and China's Modernization]* (Beijing, CN: Central Documents Press [中央文献出版社], 2004).

Confronting Globalization: 中体西用

China's deepening integration within the global economy and the experience of the AFC brought both positive economic benefits but also awareness of the attendant risks of diminishing economic sovereignty. The challenge of managing this process had a profound effect upon the orientation towards economic and political reform. The lesson drawn by the CCP from this period of financial instability was not that China must make its financial system more like those of Western countries. Rather, it should appropriate those aspects of Western financial institutional form and practice that would aid it in its pursuit of broader national objectives. These ideas provided the reference points for actors straddling both the market and the state to orient themselves towards. In so doing they further lay at the heart of the construction of an increasingly capitalist political economy whose integrity continued to center around the CCP's control and authority over capital.

China's leaders thus were began to articulate more determinedly how the increasingly inevitable process of coalescence with the global economy might be reconciled with domestic challenges and priorities at the time. On 10 March 1998, Jiang Zemin stated that,

> The Asian Financial Crisis has proven to be both a revelation and a lesson for a number of Asian countries. We have to recognize and treat properly the issue of economic 'globalization'. Economic globalization is an objective trend of world economic development, from which no one can escape and in which everyone has to participate. The key point is to see 'globalization' dialectically; ie., to see both its positive aspects and its negative aspects. This issue is particularly important for developing countries. We must therefore have both the courage and the virtue to participate in this process of globalization by both cooperating and competing.[51]

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[51] People's Daily, "江泽民主席参加香港代表团审议时强调坚定不移贯彻 "一国两制" 方针继续保持香港繁荣稳定 [Whilst Participating in a Delegation to Hong Kong, General Secretary Jiang Zemin Emphasizes the Unswerving Implementation of the 'One Country, Two Systems' Policy to Continue Protecting Hong Kong's Prosperity and Stability," *人民日报 [People's Daily]*, 10 March 1998.

The AFC in particular gave rise to a vigorous debate within the Chinese intellectual community as to the nature of 'globalization' in the late 1990s and what it meant for China. As will be explored below in the process of institutional change within the financial sector, this 'dialecticism' would come to manifest in a more fluid perspective of 'Chinese learning for its essence, Western learning for its utility' [中学为体，西学为用]. Zhu Rongji saw the reform of the economy in "the same way that the self-strengtheners of the previous century had—as selectively borrowing Western methods and techniques in pursuit of wealth and power but on Chinese terms."[52]

In the midst of a series of episodes during the 1990s through which many Chinese intellectuals felt as if China was being increasingly ostracized and discriminated against by Western countries,[53] many Chinese intellectuals, especially those who had been educated in the West, began to believe that the faith of 1980s China in the universal validity of liberal ideals had been at best naïve, and at worst had themselves been partially responsible for deepening China's social and ideological fissures.[54] However it was in the economic realm especially that signs of the discrediting of the 'Western liberal model' were even more apparent, and more specific than the rise of popular nationalism. In the aftermath of Deng's Southern Tour, Chicago-trained economist Lin Yifu had proposed a free market theory of comparative advantage,[55] and this

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[52] Schell and Delury, *Wealth and Power: China's Long March to the Twenty-First Century*, 348-49.

[53] These included the defeat in 1993 of China's bid to host the 2000 Olympic Games, the action of the US during the 1995-6 Taiwan Straits Crisis, NATO intervention in Kosovo, and particularly the 1999 bombing of the Chinese embassy in Belgrade.

[54] As Rana Mitter has described it, a "shimmering time of political and cultural promise whose attraction lay in its instability." Rana Mitter, *A Bitter Revoution: China's Struggle with the Modern World* (Oxford, UK: Oxford University Press, 2004), 245.

[55] Lin Yifu, Cai Fang, and Li Zhou, *中国的奇迹: 发展战略葛经济改革 [China's Miracle: Development Strategy and Economic Reform]* (Shanghai, CN: Sanlian Publishers [三联书店], 1994).

acted as a lightning rod for a strong critical backlash from prominent 'New Left' intellectuals.[56] As Gao Debu emphasized,

> It is impossible to think sensibly about how to open to the global economy without paying attention to how we protect our national economy. It is a basic principle to develop our national economy, and in doing so we can ensure that the globalization has positive benefits for us.[57]

More importantly, it precipitated new thinking on the institutional development of China's 'socialist market economy' in an era of globalization. In 1997 Cui Zhiyuan published his theory of the 'second thought liberation', which sought to break down the false dichotomies of the market and the state that saw the former as the embodiment of justice through individual liberty and the latter as the guardian of a socialist egalitarianism.[58] Rather, he argued that 'institutional innovation' was dependent upon strengthening both the market and the state, and doing so under the "guiding principle of economic and political democracy."[59] Modern capitalism from this perspective was regarded as both liberating and oppressive, the challenge being to unpack its complexity and cut through reified institutions and ideologies. According to Cui, none of the received categories of 'Western' thought were guarantors of either economic prosperity or political democracy, but rather had to be re-assessed and re-implemented in light of China's historical experience and circumstances.

1997 was also the year of Deng Xiaoping's death. Jiang Zemin had already given some indication of his neoauthoritarian perspective, and his ability to operate in a highly instrumental

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[56] Hu Wei, "中国发展的比较优势何在? 超越纯经济观点的分析 [Where does China's Comparative Advantage Lie for its Development? An Analysis Beyond a Pure Economic Point of View]," *战略与管理 [Strategy and Management]* 5(1995): 69-78; Cheng Ming, "东亚模式的美丽 [The Glamour of the East Asian Model]," ibid.2(1994): 18-27.

[57] Gao Debu, "全球化还是民族化？ [Globalization or Nationalization?]," *中国党政干部论坛 [Chinese Cadres' Forum]* 5(1997): 44.

[58] Cui Zhiyuan, *第二次思想解放与制度创新 [The Second Thought Liberaliation and Institutional Innovation]*.

[59] ———, *第二次思想解放与制度创新 [The Second Thought Liberaliation and Institutional Innovation]*, 13.

manner when it came to the relationship between political and economic reform: economic reform was not just to be permitted but actively fostered in circumstances where it contributed to the political structure that supported him. In Jiang therefore could be seen the most overt manifestation of the 'paradoxical' evolution of Chinese political economy—a desire to be a part of the 'modern' world that was matched equally strongly by an insistence that the construction of that modernity within China could only possibly take place under the socio-political auspices of an organization such as the CCP. The death of Deng Xiaoping removed the last check on Jiang's neoauthoritarian instincts.[60]

Globalization as 'an objective trend of world economic development'[61] was a matter therefore for both economic and political reform. The experiences with GITIC, the onset of the AFC, and the change in leadership provoked new consideration within policymaking and intellectual circles as to where new sources of economic growth were to be found and the political mechanisms through which they could be managed. One of the most critical factors in mediating this relationship between the political and the economic in the process of international economic integration was the question of the management of capital. Both the domestic and the transnational dimensions of the financial uncertainty that had emerged in the late 1990s cohered in a hardening of an instrumental attitude towards the relationship between foreign and domestic capital. For Chinese policymakers, the presence of foreign institutional capital in China was linked closely to the process of domestic financial restructuring. Confronted with a need to carve out non-performing loans and debt restructuring, key officials within both the PBOC and the

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[60] Bramall, *Chinese Economic Development*, 475.

[61] People's Daily, "江泽民主席参加香港代表团审议时强调坚定不移贯彻 "一国两制" 方针继续保持香港繁荣稳定 [Whilst Participating in a Delegation to Hong Kong, General Secretary Jiang Zemin Emphasizes the Unswerving Implementation of the 'One Country, Two Systems' Policy to Continue Protecting Hong Kong's Prosperity and Stability."

MOF believed that there were great risks involved in allowing foreign financial institutions to acquire either loan portfolios or take ownership stakes themselves.[62]

An example of the contingency of China's policymakers' responses to China's emergence into the international monetary system can be seen in the evolution of China's exchange rate regime.[63] Even in 2005, when ideas of the market-led commercialisation of China's financial sector were at the height of their intellectual and policy discursive acceptance,[64] China's experience of financial reform and opening was contrary to the conventional wisdom of China inevitably if gradually progressing toward some ideal-type of a globally integrated capitalist economy. As Logan Wright detailed in his study of the 2005 decision to de-peg the RMB from the USD,

> [The] attempt to introduce additional market influence into China's exchange rate policy was not necessarily consistent with the broader objective of the liberalization of China's economy and increasing openness to the global financial system. Just as the reform of China's exchange rate was a contingent phenomenon, … the prospects for long-term economic integration are similarly contingent.[65]

As was the case for outward-oriented and inward-focused reform alike, maintaining domestic financial stability, and preserving centralized macroeconomic control over the flow of capital were to remain the most fundamental policy priorities for China's leadership. Just as perceptions and understandings of the broader global economic order were in flux, China's institutional response reflected significant contingency in how state, market, and party would evolve in tandem to meet these challenges.

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[62] BJ:2012.05.23. Interview, Beijing; BJ:2012.06.06. Interview, Beijing.

[63] The institutional development of the exchange rate regime is explored in greater detail later in this chapter.

[64] BJ:2012.05.23. Interview, Beijing.

[65] Logan Wright, *The Elusive Price of Stability: Ideas and Interests in the Reform of China's Exchange Rate Regime* (Doctoral Dissertation, George Washington University 2009), 305.

Transforming the State: 政企分开

Following the recognition of the scale of NPLs and the shock of the Asian Financial Crisis, calls for a deepening and acceleration of reform resonated throughout the economics profession and policymaking circles.[66] The policy to 'grasp the large and release the small' [抓大放小] remained the basic guiding line of enterprise reform, and formed in turn the strategic pathway towards the 'going forth' [走出去] objective. As explored in Chapter Four, the 'large enterprise strategy' [大企业集团战略] and other industrial sector reforms of the 1990s, had taken cues from the South Korean *chaebol* model.[67] The AFC cast doubt upon the soundness of this strategy, however the reaction amongst economic policymakers was not to reject its overall salience, but rather to take steps to ensure that China's 'National Team' would not be vulnerable to the same financial pressures that had so affected South Korea's large enterprises. The link between the real economy and the financial remained the focal point of attention, and in this respect it was the role of the state that was mediating this relationship. The 'separation of government and business' [政企分开] was therefore central to the ongoing problem of reform of the state-owned sector. As acceptance of the utility of market forces in determining an increasing range of prices grew, there was a commensurate sense of urgency in the necessity of reducing administrative interference in the market.

The two broad frames were fundamentally intertwined. As Liu Xirui argued in an influential 2002 article in *Chinese Administration and Management,*

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[66] Wu Jinglian. "China's Transition to a Market Economy: How Far Across the River?". *Working Paper No. 69*. Center for Research on Economic Development and Policy Reform: Stanford University, 2000.

[67] Heilmann and Shih, "The Rise of Industrial Policy in China, 1978-2012."

> In the context of economic globalization, it is inevitable that the government will have to become a more service-oriented economy. … and the most critical aspect of that transformation is the separation of government from business.[68]

As Chapter Four detailed, the origins of this guiding line were clearly to be found earlier in the 1990s, as Zhu Rongji had sought to begin to introduce more modern forms of macroeconomic control [宏观调控] into the financial system.[69] The discourse of regulatory reform and the separation of government and business deepened markedly in 1997 with the change in CCP leadership, and terms such as 'corporate governance' began to appear for the first time in CCP documents.[70] However, just as in the earlier period, it did not produce a linear and unambiguous movement towards a liberal financial system. As Opper has observed, the "official policy line was indeed to encourage a separation of government and business to support a rationalization of the economic sphere. In retrospect, however, reforms revealed a high degree of ambivalence and inconsistency."[71] Rather than being the product of 'partial' or 'failed' reform though, this inconsistency and ambivalence arises from the fact that even as the state administrative apparatus was rationalized and downsized in order to interfere less with economic processes, the role of the CCP within the broader political economy was preserved, and even bolstered. As I examine in greater detail below, this took place via a sophisticated system of party committees as "control mechanisms with government agencies, military units, and state-owned enterprises."[72] They were

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[68] Liu Xirui, "服务型政府: 经济全球化背景下中国政府改革的目标选择 [Service-Style Government: China's Choice of Reform Goal Under Conditions of Globalization] " *中国行政管理 [Chinese Administration and Management]*:7 (2002): 5-8.

[69] Deng Xiaoping had himself alluded to this line of thinking much earlier in the reform process: "It is time for us to distinguish the responsibilities of the Party and those of the government and to stop substituting the former for the latter." Deng Xiaoping, *Selected works of Deng Xiaoping (1975-1982)*, ed. Chung-kuo Kung, 1st ed. (Beijing: Foreign Languages Press, 1984), 303.

[70] Liu Xirui, "服务型政府: 经济全球化背景下中国政府改革的目标选择 [Service-Style Government: China's Choice of Reform Goal Under Conditions of Globalization] ".

[71] Sonja Opper, "Going Public Without the Public: Between Political Governance and Corporate Governance," in *The Chinese Economy in the 21st Century: Enterprise and Business Behaviour*, ed. Barbara Krug and Hans Hendrischke (Cheltenham, UK: Edward Elgar, 2007), 10.

[72] John Dotson. "The China Rising Leaders Project, Part 1: The Chinese Communist Party and its Emerging Next-Generation Leaders". *Staff Research Report*. Washington, DC: US-China Economic and Security Review Commission 2012.

buttressed by cadre performance benchmarks and evaluation criteria, and the enfolding of career advancement not just into networks or patronage, but further and more fundamentally into broader imperatives of party building and progress. In the financial sector, it was the Central Financial Work Commission (CFWC), established in 1998, which stood at the apex of this system. Government [政] is not synonymous with the Party [党] in either institutional, ideological, or functional terms, and accordingly, "the Party [was] not willing to allow the creation of a leaner and more efficient public sector at the expense of Party control."[73] As Wu Bangguo, then Vice-Premier of the State Council and Politburo member, stated explicitly in 1997:

> Even if the government administration does not interfere with the enterprises, the Party must absolutely not lose its political leadership powers with regard to the enterprises. … The Party should take part in the decision-making in the enterprise with regard to major issues.[74]

The result was that even as the state infrastructure was streamlined and rationalized, this simply meant that it became a more effective 'host organism' for the CCP.[75] The desire for China to build up its national economic strength and power was related to the process of ensuring that those big firms that would lead the vanguard of China's economic rationalization and globalization were not only represented within the political system, but were symbiotically connected to it.[76]

The Central Financial Work Conference of November 1997 was therefore not merely concerned with the threat of the AFC, but pointed to the need to address the NPL problem.[77] In

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[73] Kjeld Erik Brødsgaard, "Institutional Reform and the *Bianzhi* System in China " *China Quarterly* 170(2002): 361-86, 386.

[74] "副总理吴邦国强调党在改革过程中的领导地位 [Vice-Premier Wu Bangguo Stresses the Party's Leadership Position in Reform]," *Xinhua*, 14 December 1997.

[75] Dotson, "The China Rising Leaders Project, Part 1: The Chinese Communist Party and its Emerging Next-Generation Leaders."

[76] Barry Naughton, "Government Reorganization: Liu Mingkang and Financial Restructuring," *Chinese Leadership Monitor* 7(2003): 1-10.

[77] Yi Gang, *中国金融改革思考录 [Reflections on the Financial Reform of China]* (Beijing, CN: Commercial Press, 2011), 293.

his address to Conference, Zhu Rongji had stressed the opportuneness of deepening reform following the Asian Financial Crisis. The failure of GITIC and other TICs provided significant impetus for increasing the stability, transparency and commercial footing of the banking sector.[78] Although he argued that great successes had been achieved in the years following the 14th Party Congress in 1992, he also argued that,

> We must recognize that deep problems in the financial sector have not yet been touched upon, and that serious historical problems that have built up over many years have not yet been resolved.[79]

The first of the problems identified by Zhu was that "government is not separate from banking, nor is government separate from enterprises."[80] This was seen as central to a variety of issues afflicting the stability and effectiveness of the financial system, including overheating in real estate and development zones, capital shortage and excessive debt amongst SOEs, redundant investment construction, and inappropriate practices in the process of bank credit appropriation.[81] Accordingly, Zhu saw the separation of government and banking as a core component in the 'streamlining' and 'modernization' of the financial system. Nonetheless, he went to great lengths to emphasize that this streamlining was possible only with the reconsolidation of CCP authority within the financial sector, and that the establishment of the Central Financial Work Commission and the Central Financial Disciplinary and Inspection Commission, as well as the concomitant revamping and restructuring of the party committee system within the PBOC and SOCBs, were all to serve as 'the backbone' [骨干][82] for the

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[78] Jianbo Lou, *China's Troubled Bank Loans: Workout and Prevention* (London, UK: Kluwer Law International, 2001).

[79] Zhu Rongji, "深化金融改革，防范金融风险，开创金融工作新局面 [Deepen Financial Reforms, Guard Against Financial Risks, and Open Up a New Phase of Financial Work]."

[80] ———, "深化金融改革，防范金融风险，开创金融工作新局面 [Deepen Financial Reforms, Guard Against Financial Risks, and Open Up a New Phase of Financial Work]."

[81] ———, "深化金融改革，防范金融风险，开创金融工作新局面 [Deepen Financial Reforms, Guard Against Financial Risks, and Open Up a New Phase of Financial Work]."

[82] BJ:2012.06.05 #1. Interview, Beijing.

rationalization of the state's role in the allocation of financial capital.[83] Most accounts of financial reform perceive the CCP as a constant source of interference either in the smooth operation of free markets or the technocratic developmentalism of the state bureaucracy. What is clear however, is that even amongst the most pragmatic and rationalist of the economic policymaking elite, it was precisely the converse: it was excessive *state* interference that was obstructing "the centralized and unified leadership of the Party over financial work, … the Party's strength in political ideology, and … the Party Central Committee's line, programs, and policies."[84] It was therefore at the nexus of the two trends that the organizational role of the CCP in underpinning the risk environment became increasingly apparent, as a functionally crucial structure for maintaining faith in the viability of economic growth in changing circumstances, as well as a pathway to reconciling the increased role of the market with the continued resilience of a one-party state. This role was to be embodied within the capacity of the CCP to both *manage* and *exploit* uncertainty through the course of institutional change in the financial sector.

Institutional Change: Competitiveness over Competition

The range of challenges that characterized the policymaking environment in the late 1990s came to influence the priorities of China's leaders as well as conceptions of how those objectives might be achieved. The Beijing economic policymaking community was deeply affected by the experience of the AFC, and the need to confront the challenges of financial globalization through the centralization of political authority over a process of commercialization of the banking sector was reflected across policymaking institutions and networks. The group of

[83] Zhu Rongji, "深化金融改革，防范金融风险，开创金融工作新局面 [Deepen Financial Reforms, Guard Against Financial Risks, and Open Up a New Phase of Financial Work]."

[84] ———, "深化金融改革，防范金融风险，开创金融工作新局面 [Deepen Financial Reforms, Guard Against Financial Risks, and Open Up a New Phase of Financial Work]."

'comprehensive reformers' [整体改革派] led by Wu Jinglian continued to rise within policymaking circles, and the foremost members of this school, including Zhou Xiaochuan, Guo Shuqing, Wang Qishan, and Lou Jiwei would come to occupy some of the highest executive positions within the financial system during the early and mid-2000s. Their ideas and attitudes concerning the goals necessary for the rationalization of the financial sector in the face of increasing globalization were embedded within the broader cognitive frames that placed the CCP at the center of what otherwise was still seen as an antagonistic relationship between the 'state' and the 'market'—one which all agreed needed to be addressed.[85] Reform embodied movement towards greater international financial integration, a deepening of market-oriented reforms in the ownership, regulation, and organizational behaviour of the state-owned banking sector, and yet also significant bolstering of mechanisms of Communist Party control over how both of these processes would unfold.

Throughout this process, the ability to control uncertainty was critical. Cognitive frames had enabled the development of broad and reciprocal expectations amongst key actors as to the nature of reform and evolution itself. These expectations were an essential element in the process of institutional change. As the following sections detail, these functions were reflected through the course of institutional change across the realms of central banking, the commercial banking sector, the structure of regulatory oversight, and markets for capital and foreign exchange. The development of these frames was also a source of power. The capacity to control uncertainty was also an opportunity to exploit uncertainty, and as the section below on the networked CCP supervision and oversight in the financial system details, framing the path of financial reform in terms of deepening and bolstering CCP authority in the face of socio-

[85] As Bell and Feng have aptly stated (yet underappreciate the significance of), these individuals can be characterized neither as Weberian bureaucrats nor Machiavellian politicians. Bell and Feng, *The Rise of the People's Bank of China: The Politics of Institutional Change*, 126.

economic uncertainty was central to the concentration of power over how economic growth would unfold, and who would benefit from it.

Central Banking: The Growth of Mutual Dependency

The PBOC underwent significant institutional change in the years following the Asian Financial Crisis. Its increasingly evident role as lynchpin of macroeconomic coordination was reflected in the bolstering of its independence from both local provincial actors and the SOCBs. This however did not produce an increase in the overall independence of monetary policy, exchange rate policy, or the practice of banking supervision. These reforms were part of a process of commercializing state-enterprise relationships, but they did not reduce the nature of interdependence between the core wielders of political authority within the CCP and the key holders of technical financial expertise within the financial bureaucracy. It was thus a transformation that rendered the PBOC more entrenched in a state of mutual dependency with the CCP. Its status within both the bureaucracy and the broader financial community as the deepest repository of technical financial expertise[86] rendered it indispensable in the policymaking process, and lent credibility to the decisions of the State Council.[87] Conversely, the credibility of this status as technocratic macroeconomic manager became closely tied to the positions occupied by the PBOC's leaders within the political hierarchies of the Central Committee and the CCP. This was a product not just of the rational interplay of bureaucratic interests within either a 'fragmented' post-socialist system,[88] but emerged out of their joint embeddedness as

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[86] For an account of the professionalization of the PBOC, see ———, *The Rise of the People's Bank of China: The Politics of Institutional Change*, 120-25.

[87] BJ:2012.05.23. Interview, Beijing; BJ:2012.05.30. Interview, Beijing; BJ:2012.06.05 #2. Interview, Beijing.

[88] David Lampton and Kenneth Lieberthal, eds., *Bureaucracy, Politics, and Decision-Making in Post-Mao China* (Berkeley, CA: University of California Press, 1992).

party elites within a shared understanding of the functional imperatives of the CCP's role as the ultimate authority with responsibility for preserving financial and macroeconomic stability. Even as the deepening reform was viewed as a necessary and inevitable process, China's top financial officials continued to stress the importance of accepting the differences of not only the goals but also the mechanisms of China's monetary policy.[89] These dynamics of mutual political dependency remained in place throughout the deepening of reform across the Jiang/Zhu and Hu/Wen regimes, as the institutional framework within which the PBOC operated was seen as highly successful in both managing the expectations of party elites and stimulating an increasingly active array of financial market actors.

The November 1997 Financial Work Conference produced a wholesale restructuring of branch network of the PBOC along macro-regional rather than provincial administrative lines.[90] Until 1998, the PBOC branch network was based on the administrative system, with 31 offices located at the provincial level, a situation that provided provincial party officials with significant leverage to influence local bank branches' decision-making processes. This negatively impacted the allocative efficiency of capital as provinces duplicated investments and pet projects of local administrators were more easily able to attract bank credit.[91] The reform merged or closed 148 city-level PBOC branches, and replaced the provincial offices with nine regional branches that were better placed for financial supervision, and which were to later become the architecture of the China Banking Regulatory Commission.[92] This institutional restructuring came into force in 1999, and was accompanied by the formation in 1997 of the Monetary Policy Committee. This

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[89] Zhou Xiaochuan, "中国货币政策的特点和挑战 [The Characteristics and Challenges of China's Monetary Policy]," *Caijing* 175:26 (2006).
[90] Lou, *China's Troubled Bank Loans: Workout and Prevention.*
[91] Laurenceson and Chai, *Financial Reform and Economic Development in China*, 19.
[92] People's Bank of China, *China Financial Outlook 1998* (Beijing, CN: China Financial Publishing House, 1999), 53.

enhanced the monetary policy-making effectiveness of the PBOC, as the monetary policy target began shifted towards overall money supply rather than the scale of credit finance.[93]

In 1998 the PBOC abolished the system of directly controlling credit quotas [信贷规模计划].[94] The transformation of the credit plan from compulsory [控制性] to a consultative target [参考指标] within an overall 'guidance plan' [信贷规划] reflected an intention to move away from direct [直接跳空] to indirect regulation [间接调控].[95] These were all seen as efforts to stymie local provincial officials' efforts to exploit their political superiority over the local branch offices of SOCBs, a dynamic that had produced both non-performing loans and inflationary pressure.[96] Yet this notion of 'indirect regulation' was and remains a complex one. It refers to the replacement of the administrative structures of pre-reform central planning with more flexible systems of management more responsive to the exigencies of macroeconomic conditions.[97] This meant also being more attuned to the overall political priorities underpinning monetary policy, and resulted in a much more effective 'crisis management' [危机处理][98] capacity than either the unwieldy strictures of comprehensive credit plans or the unpredictable volatility of market-led corrections.[99] Not merely a matter of controlling lending practices through the promulgation and

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[93] Wu, "重建金融系统 [Reconstruct the Financial System]."

[94] Luo Dezhi, *1949-2002: 中国银行制度变迁研究 [1949-2002: Research on Changes in China's Banking System]* (Doctoral Dissertation, Fudan University, 2003), 70; People's Bank of China. 中国人民银行关于该经过有商业银行贷款规模规例的通知 [Notice on improving the Managmeent of Loan Size for State-Owned Commercial Banks]. (Beijing, CN: People's Bank of China, 1998).

[95] BJ:2012.10.10. Interview, Beijing.

[96] Tong Shiqing. "The Vissicitudes and Logic of Change in China's Credit System". *Shanghai University of Finance Working Paper* Shanghai, CN: Shanghai University of Finance, 2007.

[97] BJ:2012.10.10. Interview, Beijing; BJ:2012.11.16 #3. Interview, Beijing.

[98] This is reminiscient of Susan Shirk's notion of leadership and regulatory authority being intertwined together in a system of 'management by exception'. Susan Shirk, "The Chinese Political System and the Political Strategy of Economic Reform," in *Bureaucracy, Politics, and Decision Making in Post-Mao China*, ed. Kenneth Lieberthal and David Lampton (Berkeley, CA: University of California Press, 1992), 76.

[99] BJ:2012.10.21. Interview, Beijing.

enforcement of clear legal guidelines, 'indirect regulation' thus manifested in the use of these consultative targets within a broader framework of indirect guidance.

The role of the PBOC thus in mediating between its political embeddedness and its role in guiding financial markets thus developed into a particular form of 'window guidance',[100] through which the evolving tools of monetary and macroeconomic policy such as open market operations (OMOs) and the frequent adjustment of reserve ratio requirements (RRRs) have been enclosed within a network of officials (including the heads of SOCBs, JSCBs, and regulatory officials) who meet regularly in order to develop consistency in the interpretation of policy and manage shared expectations of the macroeconomic and monetary environment.[101] The PBOC began to intervene in the interbank market for government bonds in May 1998,[102] and began to issue its own PBOC bills in 2002. By mid-2008 the PBOC had issued RMB 14.8 trillion of such securities, a forty-fold increase over that at end-2002.[103] As China's current account imbalance deepened after 2003, the capacity of the central bank to credibly sterilize inflows of foreign capital increasingly depended upon a combination of these market operations with the ability of the PBOC to compel SOCBs and other state-owned financial institutions to maintain their holdings of PBOC bills.

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[100] Although different forms of 'forward guidance' have emerged as a widely recognized and important dimension of central banking internationally (such as Mario Draghi's famous pledge in July 2012 to 'do whatever it takes' to save the Euro), the nature of 'moral suasion' or 'jawboning' in China remains of a qualitatively distinct dynamic between a central bank and financial institutions. BJ:2012.06.20. Interview, Beijing.

[101] BJ:2012.10.10. Interview, Beijing.

[102] This interbank bond market itself was only initiated in June 1997.

[103] People's Bank of China. "China Monetary Policy Report Quarter Two, 2008". Beijing, CN: People's Bank of China, 2008.

Financial Institutions: Reform and 'Public' Listing

The banking system also underwent radical institutional change between 1998 and 2007. At the end of a long and complex process, the banking system looked a lot more like commercialized, rationalized, and internationally confident financial institutions. Yet even as they were increasingly all of these things, they were nonetheless rationalized tools of the CCP whose key position in supporting the broader macroeconomic demands of reform and development was clear to all stakeholders in this process. The institutional forms that emerged from both the process of disposal of non-performing loans and the course of 'share reform' [股改] were strongly hierarchical in nature, reflecting the continued paramountcy of the political system, but the containment of this hierarchy in modern institutional forms.

The dire state of the balance sheets of the SOCBs was viewed as a significant impediment to China's credibility on the international economic stage just as China was preparing for a significant increase in its interaction with the global economy.[104] The AFC further underscored the extent to which a robust financial system was essential for managing this process of globalization, but it further reinforced—to Zhu Rongji especially—the extent to which this 'immunity from the Asian bug' was premised upon a deepening of the 'rectification' [整顿] that had guided financial reform and policymaking since 1993. In this context, a number of research reports emerged that argued for the combination of political retrenchment and greater rationalization of linkages between the state authorities and financial institutions in order to address the problem of debt within the banking sector.[105] The dissemination of these findings

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[104] Zhan Xiangyang, *论中国不良债权债务的化解 [On the Dissolution of Bad Debt and Obligations in China]* (Beijing, CN: China Financial Publisher [中国金融出版社], 2000).

[105] State Economic and Trade Commission and People's Bank of China. 关于下达核销贷坏账准备金分配规模和编制企业兼并破产和职工再就业工作计划的通知 [Notice Concerning the Scale of Distribution of Bad-Loan Reserves and

and arguments was encouraged by Hua Jianmin, who was Chief of the Office of the Central Financial and Economic Leading Small Group from 1996 until 2003,[106] as well as a variety of Zhu's protégés within the comprehensive reform group.[107]

Through this process of institutional change the SOCBs were recapitalized, large tranches of non-performing loans were cleaved off from their official balance sheets, and they all began—and in some cases completed—the process of listing publically on the Shanghai and Hong Kong stock exchanges. Mainstream liberal perspectives on this course of banking reform have remained premised on a linear teleological notion of financial reform. Walter and Howie's effort to trace the strategies adopted through the PBOC and the MOF for disposal of toxic assets, recapitalization, and finally public listing, produced an ultimate conclusion that the dependence of China's banking system on opaque transfers of capital through complex channels of ownership, debt, and fiat meant that the artifice was likely to come tumbling down at any moment.[108] Yet a more nuanced analysis of these developments within the institutional sphere of China's banking sector reveals a logic at play that is occluded by Walter and Howie's assumption that the only 'logical' route to an effective role for the financial system is one of unadulterated market liberalization. This underlying presumption of a unidirectional process of transition to a liberal market financial system is problematic. Cai Esheng, then Deputy Governor of the PBOC, made the point clearly in 1999 when stating that the concept of reform in the financial sector is "different and more profound" than that used ordinarily by many of those interested in China's 'reform', and that "the issues … today will not be solved simply by principles of market

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the Drafting of Plans for Enterprise Bankruptcy and Reemployment of Workers] (Beijing, CN: People's Bank of China, , 1997).

[106] Upon Wen Jiabao's asumption of the Premiership in 2003, Hua was appointed Head of the State Council itself.

[107] BJ:2014.04.14 #2. Interview, Beijing.

[108] Walter and Howie, *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise.*

economies."[109] At the end of this process, "like the People's Liberation Army, the banking apparatus would remain a preserve of the party and subject only to its control."[110] The principal reason for this was not that conservatives had prevailed in a pitched bureaucratic battle with pro-market reformers, but rather the simple fact that neither a model of free market competition nor one of arms-length administrative regulation was considered capable of generating the incentives for rapid economic growth whilst also preserving centralized political control. Rather, CCP ideology, organizations, and networks were harnessed for the purposes of keeping the state bureaucracy and financial institutions functionally and formally separate, but linked politically under the aegis of CCP control. Accordingly, from this perspective it becomes possible to shed deeper light on an otherwise paradoxical trajectory of economic commercialization and political retrenchment. One real motivation *was* to change corporate culture and to modernize the banks themselves in organizational and operational terms. A further real motivation was to draw upon international capital. Both of these were in order to foster economic growth. What made this economic growth *possible*—and therefore was the most important determinant of 'partial' marketization—was the strengthening of the CCP's capacity to undergird macroeconomic management in the face of greater international market forces and the increasing rationalization of the state. Given the CCP's performance legitimacy, and the growing inevitability of global integration, economic growth was thus only possible through partial marketization.

The restructuring process commenced in 1998. The PBOC reduced the required reserve ratio from 13 to 9 percent, freeing up RMB 270 billion in spare deposits within the SOCBs. These funds were used to purchase RMB 270 billion of special government bonds issued by the

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[109] Cai Esheng, "Financial Supervision in China: Framework, Methods, and Current Issues," in *Strengthening the Banking System in China: Issues and Experience*, ed. Bank for International Settlements (Basel, CH: Bank for International Settlements, 1999).

[110] Economic cadre, quoted in Lam, *The Era of Jiang Zemin*, 384.

MOF. The MOF then recapitalized the SOCBs directly with these funds.[111] Four asset management companies (AMCs)[112] were established in 1999 between April (Cinda AMC) and October (Huarong AMC, Orient AMC, and Great Wall AMC). They remain 'solely state-owned non-bank financial institutions'[113] whose operations are opaque and financial situations largely undisclosed. These AMCs were capitalized themselves with 40 billion RMB from the MOF, but in order to purchase the troubled assets from BOC, ICBC, and CCB, issued bonds worth 811 billion RMB to each of the banks (Table 5.1). With a further 604 billion RMB of credit extended from the PBOC, in 2000 they purchased RMB 1.415 trillion of the NPLs held by the SOCBs. This process enabled the SOCBs to replace RMB 1.4 trillion in non-performing debt with an equivalent amount in sound and secure assets ostensibly backed by the Ministry of Finance.[114] That the MOF stands behind the repayment of these bonds, even as they were evergreened and extended in 2009 for another ten years, has been an open secret within the financial system since the plan was first implemented in the aftermath of the AFC.[115] As one interviewee from a SOCB stated,

> The debt was still there, and of course someone was going to have pay for it, but it made sense to place the debt somewhere between the MOF and the banks themselves whilst it was being worked out. The banks needed it off their books, and the MOF didn't want to

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111 RMB 93 billion of this went to BOC and CCB, ICBC received RMB 85 billion, whilst ABC received RMB 92 billion.

112 China Cinda Asset Management Company (Cinda AMC) [中国信达资产管理公司] was closely aligned to CCB; China Huarong Asset Management Company (Huarong AMC) [中国华融资产管理公司] was aligned to ICBC; China Orient Asset Management Company (Orient AMC) [中国东方资产管理公司] was aligned with BOC; China Great Wall Asset Management Company (Great Wall AMC) [中国长城资产管理公司] was aligned with ABC.

113 State Council of the People's Republic of China. 金融资产管理公司条例 [Regulation on Financial Asset Management Companies]. (Beijing, CN: State Council of the People's Republic of China, 2000).

114 The CCB listing prospectus stated that "in the event that Cinda is unable to pay any interest on the bond in full, the MOF will provide financial support, … when necessary, the MOF will provide support with respect to Cinda's repayment of the principal of the bond." Whether this extends to all of the AMCs or just Cinda AMC is unclear. China Construction Bank. "Global Offering Prospectus". Hong Kong, CN: Hong Kong Exchanges and Clearing Limited, 2005.

115 BJ:2012.09.12. Interview, Beijing.

> write it all down immediately and leave a huge hole on their books, so it was convenient for everyone to put it somewhere else and pretend that it didn't really exist.[116]

Over the course of the ten-year maturation of the bonds issued by the AMCS, the recovery rate was estimated at averaging 20 percent.[117] However this was of little consequence; as one interviewee pithily but rather cryptically expressed it, "the AMCs served their purpose which was to make everything else possible."[118] One interviewee queried the seemingly insistent focus of some commentators on the desirability of dealing with bad loans through the 'chaos of transparency':

> What would be the preferable option? To abide by abstract principles, or to make sure that there are funds when and where they are needed?[119]

From this perspective, it was the very lack of transparency around the AMCs and the nature of their operations and relationships to other financial institutions that was crucial for generating the conditions necessary for Chinese state officials, domestic depositors, and foreign investors, to each in their own way interpret the process of banking reform as conducive to financial stability. In this way, the use of the AMCs to support the banking sector itself would come to reflect the dependence of financial stability upon the *liquidity* of financial institutions, rather than their technical *solvency* per se.[120]

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[116] BJ:2012.09.17. Interview, Beijing.

[117] China Banking Regulatory Commission. "2009 年鉴 [2009 Annual Report] ". Beijing, CN: China Banking Regulatory Commission, 2010.

[118] BJ:2013.08.26. Interview, Beijing.

[119] BJ:2013.08.21. Interview, Beijing.

[120] Jonathan Anderson. "Which Way Out for the Banking System". *Asian Economic Perspectives Research Report*. Hong Kong, CN: UBS Global Economic & Strategy Research Institute 2006.

Table 5.1: Sources of funds for AMC purchase of NPLs, 1999 (RMB billions)

	PBOC Credit	**AMC Bonds**	**Purchase of NPLs**
Cinda	48	347	395
Great Wall	346	0	346
Huarong	95	313	408
Orient	116	151	267
Total	**605**	**811**	**1,416**

Source: BJ:2012.06.05 #2. Interview, Beijing

This first round of recapitalization and NPL disposal left the SOCBs with a remaining RMB 2.2 trillion of NPLs still on their books. The terms of China's WTO accession in 2001 included a five-year window until 2006 for the granting to foreign financial institutions of full access to China's financial sector. The PBOC was seen as the clear candidate to assume primary responsibility for further reform of the SOCBs, given the technocratic expertise at its disposal and the rising status of its newly appointed governor Zhou Xiaochuan. The MOF-led recapitalization and NPL disposal of 1998-99 had been achieved by drawing upon fiscal resources; these were now overstretched, and it was therefore seen as necessary to either draw upon domestic or foreign private capital. Either option involved change in the ownership structure of the banks, and the PBOC was accordingly caught in between the expectations of an evolving market environment and an imperative that notwithstanding the status of either foreign or domestic private actors in the process of shareholding reform, the banking system would remain subject to ultimate authority vested in the CCP. In this respect, despite greater receptiveness to the utility of markets in the financial sector on the part of the PBOC,[121] the perceptions of MOF and PBOC officials towards the rationale for banking reform were both

[121] Bell and Feng, *The Rise of the People's Bank of China: The Politics of Institutional Change.*

rooted in Zhu Rongji's plans for rationalization and streamlining of the state, and thus evinced a continuity from the late 1990s through the 2000s following Zhu's retirement. Some sense of this can be seen how in response to a question about China's 'privatization' process, a "taken aback" Zhu Rongji remarked to former US President George HW Bush in 1998 that,

> Mr Bush, China isn't privatizing. We're creating a shareholding system, and a shareholding system is only one of many forms of public ownership.[122]

As Schell and Delury have argued, "Zhu was categorical on this point. … The ultimate goal of these reforms … was not to dismantle the state sector, but to streamline it and thereby make it a stronger element of Deng's new form of marketized socialism."[123]

The goal of transforming the banking system from a scattered assortment of liabilities into a source of national economic strength was thus closely bound up with the 'public' listing of the SOCBs. Liu Mingkang, chairman of the newly established China Banking Regulatory Commission, argued in 2004 that the government actions in 1998-99 had been focused on reducing the financial difficulties of banks rather than on overhauling inherent structural problems, and it had become clear that the banks should do more to streamline and rationalize their organizational structures.[124] The policymaking process was underpinned within the Party through the Central Leading Group on Shareholding Reform of the State Banks [CLGSRSB] [中央国有商业银行股份制改革领导小组], which was established by Wen Jiabao in January 2003. This brought together all of the senior financial figures CCP authority and was chaired by Vice-Premier and Politburo Standing Committee Huang Ju. Zhou Xiaochuan enjoyed Huang's

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[122] Zhu Rongji, *Zhu Rongji Meets the Press*, 248.

[123] Schell and Delury, *Wealth and Power: China's Long March to the Twenty-First Century*, 342.

[124] Liu Mingkang, "The State-Owned Banks in China: Reform, Corporate Governance, and Prospects," (Speech at the Beijing International Financial Forum: China Banking Regulatory Commission, 2004).

support,[125] and this further bolstered the ability of the PBOC to enact its vision of banking restructuring reform from 2003 onwards.[126]

Central Huijin Investment Ltd [中央汇金投资有限责任公司] was established as a subsidiary of the State Administration for Foreign Exchange (SAFE), which in turn is an agency subordinate to the PBOC. Guo Shuqing, then also director of SAFE at the time, was therefore its first administrator. It was created in order to bypass the prohibition upon the PBOC from taking a direct ownership stake in any commercial bank.[127] Huijin was authorized by the State Council to make "equity investments in major state-owned financial enterprises, and … to the extent of its capital contribution, [to] exercise the rights and perform the obligations as an investor on behalf of the State in accordance with applicable laws."[128] Thus in 2003 when the PBOC determined that BOC and CCB were financially sound enough to write down further capital losses, China's rapidly increasing foreign exchange reserves were utilized through SAFE in order to provide USD 22.5 billion to BOC and CCB for these purposes. In May 2004, RMB 475 billion in NPLs were transferred to the AMCs from these two banks, for consideration from the AMCs of RMB 145 billion. The PBOC then extended direct credit of RMB 700 billion to fund a second tranche of NPL disposal from ICBC, which transferred RMB 705 billion of NPLs to the AMCs. Finally, in 2004 the PBOC extended Special Bills totaling RMB 567 billion to BOC, CCB, and ICBC, which were due to mature in 2009. In 2005, Bank of Communications auctioned off RMB 64 billion in NPLs, for which the bidding AMCs paid RMB 32 billion. On 22 April 2005, following the State Council's approval of the joint-stock reform plan, ICBC was

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125 Bob Davis, "Political Overlords Shackle China's Monetary Mandarins," *The Wall Street Journal*, 15 April 2011.

126 BJ:2012.05.27. Interview, Beijing.

127 National People's Congress of the People's Republic of China, "中华人民共和国中国人民银行法 [Law of the People's Republic of China on the People's Bank of China]."

128 Central Huijin Investment Ltd., "About Us," <http://www.huijin-inv.cn/hjen/aboutus/aboutus_2008.html?var1=About>, accessed on 21 August 2013.

again recapitalized, but this time followed the course of BOC and CCB in drawing USD 15 billion from the foreign exchange reserves through SAFE. One month later on 27 May 2005, ICBC then transferred RMB 246 billion of NPLs to Huarong AMC at book value, before signing further agreements on 27 June 2005 with all four AMCs to sell RMB 459 billion in NPLs also at book value.

This second round of recapitalization and NPL disposal was closely oriented towards the goal of attracting foreign capital. Foreign strategic investors (FSIs) were actively encouraged to take direct equity stakes in Chinese banks (see Table 5.2). The courting of FSIs eventuated neither in serious competition from foreign financial institutions within the domestic Chinese market nor in dramatic shifts in the patterns of authority within the banking sector. The dual rationale for reform and internationalization—tapping foreign capital and improving the organizational efficiency of the banking sector—was pursued within the encompassing frames of state rationalization, global integration, and continued supervision and control by the CCP.

Table 5.2: Foreign investment in Chinese banks since 2002

Date	Chinese Bank	FSI	Nationality	USD Million	Share (%)
11/2001	Nanjing City Commercial Bank	IFC	International	27	5.0
01/2006		BNP Paribas	France	87	19.2
06/2002	Everbright Bank	IFC	International	19	4.9
09/2002	Xi'an City Commercial Bank	Bank of Nova Scotia	Canada	7	5.0
09/2002		IFC	International	20	12.5
05/2003	Minsheng Bank	IFC	International	24	1.2
11/2004		Temasek	Singapore	106	4.6
09/2003	Shanghai Pudong Development Bank	Citigroup	USA	72	4.6
12/2003	Industrial Bank	Hang Seng Bank	Hong Kong	208	16.2
12/2003		GIC	Singapore	50	4.0
12/2003		IFC	International	70	5.0
06/2004	Shenzhen Development Bank	New Bridge Capital	USA	149	17.9
10/2005		GE Finance	USA	100	7.0
08/2004	BOCOM	HSBC	UK	1,747	19.9
11/2004	Jinan City Commercial Bank	CBA	Australia	11	11.0

03/2005	Bank of Beijing	ING Group	Netherlands	215	19.9
03/2005		IFC	International	50	5.0
04/2005	Hangzhou City Commercial Bank	CBA	Australia	76	19.9
06/2005	CCB	Bank of America	USA	2,500	9.1
07/2005		Temasek	Singapore	1,466	5.1
08/2005	Nanchong City Commercial Bank	GIDB	Germany	5	13.3
08/2005	BOC	RBS/Merrill Lynch/Li Ka Shing Foundation	UK/USA/Hong Kong	3,048	10.0
09/2005		Temasek	Singapore	1,524	5.0
09/2005		UBS	Switzerland	500	1.6
10/2005		Asian Development Bank	International	75	0.2
06/2006		Mitsubishi UFJ	Japan	180	0.2
09/2005	Bohai Bank	Standard Chartered Bank	UK	123	19.9
10/2005	Huaxia Bank	Deutsche Bank	Germany	325	14.0
10/2005		Pangaea Capital Management	Singapore	125	6.9
12/2005	Tianjin City Commercial Bank	ANZ Group	Australia	120	19.9
01/2006	Ningbo City Commercial Bank	OCBC Bank	Singapore	71	12.2
01/2006	ICBC	Goldman Sachs/Amex/Allianz	USA/Germany	3,780	10.0
07/2006	United Rural Cooperative Banks of Hangzhou	Rabobank Group	Netherlands	20	10.0
		IFC	International	10	5.0
11/2006	Guangdong Development Bank	Citigroup	USA	723	20.0

Source: Author-collected Data

Through this process, the most financially distressed of the SOCBs—ABC—had been largely uninvolved in the recapitalization process. However this changed in January 2007 when the National Financial Work Conference determined that ABC would aim for the "Three rurals: overall transformation, commercial operationalization, targeted listing [三农：整体改制，商业运作，择机上市]".[129] On 31 December 2007, ABC then transferred RMB 816 billion of NPLs in return for an MOF receivable worth 665 billion and RMB 151 billion in borrowed funds from

[129] "农行整体改制上市方案敲定面向三农 择机上市 [Plan for ABC's Overall Transformation and Public Listing Concluded: Directed Towards the Three Rurals and Targeted Listing]," *Xinhua*, January 20 2007.

PBOC. In November 2008, following the determination of the 'Regulations on ABC Restructuring' on 21 October, Huijin injected USD 19 billion into ABC, again from the foreign exchange reserves. As of ABC's record-breaking USD 22.1 billion IPO in August 2010,[130] all of China's seven largest banks came to be listed on the Hong Kong and Shanghai stock exchanges (see Table 5.3).

Table 5.3: Public listing of China's largest banks

Bank	Date of H-Share Listing	Final Price (HK$)	Proceeds of HK IPO	Date of A-Share Listing	Final Price (RMB)	Proceeds of Shanghai IPO
BOCOM	23/06/2005	2.50	16.8 billion	15/05/2007	7.90	25.2 billion
CCB	27/10/2005	2.35	71.6 billion	25/09/2007	6.45	58.1 billion
BOC	01/06/2006	2.95	86.7 billion	05/07/2006	3.08	20.0 billion
CMB	22/09/2006	8.55	20.7 billion	09/04/2002	7.30	11.0 billion
ICBC	27/10/2006	3.07	123.9 billion	27/10/2006	3.12	46.6 billion
CITIC Bank	27/04/2007	5.86	32.9 billion	27/04/2007	5.80	13.4 billion
ABC	16/07/2010	3.20	92.6 billion	15/07/2010	2.68	68.5 billion

Source: Annual Reports, Various

Currently, the most significant holders of equity in China's banking system are Huijin and the MOF (see Table 5.4). Other state entities that possess major ownership stakes include the National Council of the Social Security Fund (NCSSF), and a Hong Kong-incorporated entity, Hong Kong Securities Clearing Company Ltd, which is 50 percent owned by the HKSE and 50 percent owned by the five largest banks operating in Hong Kong.[131] These changes in the institutional and asset structure of the banking sector following WTO entry were, from one perspective, merely 'symbolic'.[132] Although now listed 'publicly' on the HKSE and SHSE, these

[130] Jamil Anderlini, "AgBank IPO Officially the World's Biggest," *Financial Times*, 13 August 2010.

[131] Each of the following holds a 10 percent stake in HKSCC Nominees Ltd: HSBC, Standard Chartered Bank, Hang Seng Bank, Bank of East Asia, and Bank of China. See Bank for International Settlements. "Securities Settlement System Disclosure Statement: HKSSC Ltd". Basel: Bank for International Settlements.

[132] Chen Aiming, "China One Year After WTO Entry," in *The Chinese Economy After WTO Accession*, ed. Bao Shuming, Lin Shuanglin, and Zhao Changwen (Abingdon, UK: Ashgate, 2002).

steps reflected an instrumental attitude to the public listing of the institutions, rather than regarding it as an end in itself.[133] Whereas the conventional rationale for public listing includes the improvement of corporate governance and transparency in addition to the raising of capital, the non-market tradability of two-thirds of the shares of the state-owned banks and the retention of state control over both traded and non-traded stocks means that market price signals and market-actor oversight still play a highly limited role in determining the market capitalization of the banks.[134]

Table 5.4 Equity structure of China's largest banks, 2010[135]

	Five Largest Shareholders by Stake				
	#1	#2	#3	#4	#5
Agricultural Bank of China	Huijin (40.12%)	Ministry of Finance (39.21%)	HKSCC Nominees Lts (8.99%)	SSF (3.02%)	Ping An Life Insurance Company of China, Ltd (0.97)
Bank of China	Huijin (67.60%)	HKSCC Nominees Ltd (29.13%)	Bank of Tokyo-Mitubishi UFJ Ltd (0.19%)	China Life Insurance Co Ltd (0.15%)	Asian Development Bank (0.11%)
China Construction Bank	Huijin (57.03%)	HKSCC Nominees Ltd (19.79%)	Bank of America (10.23%)	Fullerton Financial (5.65%)	Baosteel Group (1.41%)
Industrial and Commercial Bank of China	Huijin (35.4%)	Ministry of Finance (35.3%)	HKSCC Nominees Ltd (24.5%)	ICBC Credit Suisse Asset Management Co Ltd (0.3%)	Ping An Insurances (Group) Company of China (0.3%)
Bank of Communications	Ministry of Finance (26.52%)	HKSCC Nominees Ltd (21.93%)	HSBC (18.63%)	Capital Airports Holding Company (2.01%)	State Grid Asset Management Co. Ltd. (0.92%)
China Minsheng Bank	HKSCC Nominees Ltd (15.44%)	New Hope Investment Co Ltd (4.99%)	China Life Insurance Company (4.31%)	China Shipowners Mutual Assurance Association (3.39%)	Orient Group Co Ltd (3.32%)
Industrial Bank	Financial Bureau of Fujian Province (21.03%)	Hang Seng Bank Ltd (12.80%)	Tetrad Ventures Pty Ltd (3.07%)	Fujian Tobacco Haisheng Investment Management Co. Ltd. (2.73%)	COFCO Ltd. (1.78%)

133 Bell and Feng, *The Rise of the People's Bank of China: The Politics of Institutional Change*, 281.
134 BJ:2012.06.04. Interview, Beijing; BJ:2012.06.05 #2. Interview, Beijing.
135 This date was selected in order to be able to incorporate ABC, which listed publically in 2010.

Huaxia Bank	Shougang Corporation (13.98%)	State Grid Corporation of China (11.94%)	Deutsche Bank (11.27%)	Hongta Tobacco Group Co Ltd (6.00%)	Runhua Group Co Ltd (4.88%)
China Merchants Bank	HKSCC Nominees Ltd (17.86%)	China Merchants Steam Navigation Co Ltd (12.40%)	China Ocean Shipping Co (6.22%)	Shenzhen Yan Qing Investment and Development Co (2.95%)	Guangzhou Maritime Transport Company (2.93%)

Source: Annual Reports, various years

Following the combination of domestic restructuring and public listing, the core of the banking sector came to resemble an internationally competitive set of institutions dedicated to international best practice. However lines of ownership and the lines of control within the banking sector are not coterminous. The formal ceiling of 25 percent for foreign ownership in a single domestic bank and that of 20 percent for any single foreign investor preserved the ongoing paramountcy of formal state ownership. Reflecting the continued paramountcy of the political system to emerge from 'share reform' [股改], the shareholding structure of the SOCBs therefore introduced a new legal entity into the Chinese corporate landscape; that of 'large and small non-[traders]' [大小非].[136] The distinction between these categories is closely related to the nature of the stock market as a 'policy market' [政策市场] in which the hierarchy of political control over the banking sector—and thus their role within the implementation of macroeconomic and monetary policy and a national scale—comes to enter into a symbiotic relationship with the *market* value of the banks themselves. Strict ownership is thus not conclusive in determining how control rights are actually exercised over a state-owned entity, even one that has been legally incorporated for the purposes of operating within a competitive

[136] A 'large non-trader' [大非] is a large-scale holder of non-tradeable R-shares, whilst a 'small non-trader' [小非] is a holder of a smaller quantity of such R-shares (typically regarded as less than 5 percent of the whole stock of the company). China Securities Depository and Clearing Commission. 中国证券登记结算统计年鉴 [China Securities and Settlement Statistical Yearbook]. (Shanghai, CN: China Securities Depository and Clearing Commission, 2008).

market environment.[137] The CCP's powers are not mentioned in the charters of any of the SOCBs, however neither would it be appropriate to relegate this influence to 'informal' means of control and governance.

The structural embeddedness of the state within the capital markets in this manner, and the concomitant awareness on the part of market participants that these enterprises are in turn embedded within a political hierarchy with the CCP at its apex, is what enables the CCP to act simultaneously as "the most important controller of risk as well as the largest source of uncertainty."[138] Thus, not only are ownership structures characterized by retention of predominant state ownership, it has been precisely *because* those state institutions are embedded in an institutional hierarchy whose coherence depends upon the CCP that they are able to function effectively as mechanisms for corporate governance acceptable to the political elite. The continued role of the CCP anchored the expectations both of domestic and foreign investors alike:

> Whilst it is generally acknowledged that privatization goes hand-in-hand with improved efficiency, this might not be the case in China because the very fact that the banks are owned by the state reassures the depositors.[139]

Despite the presence of independent directors, foreign strategic investors, and mechanisms for corporate accountability, the most important source of faith and confidence in the banking system remains the simple fact of CCP control over the actions and practices of the biggest

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[137] In functional terms, the similarity between the ownership structures of the publicly listed commercial banks and a non-commercial, non-publicly listed bank such as the China Development Bank is instructive. See Li Xia, "实施债转股企业的防卫与条件 [The Parameters and Circumstances for Enterprises in the Debt-Equity Swap Swap] " *金融时报 [Financial News]*, 15 September 2000.. The CDB has three shareholders: MOF (50.18 percent), Huijin (47.63 percent), and the NCSSF (2.19 percent). China Development Bank. "Annual Report 2011". Beijing: China Development Bank, 2011.

[138] BJ:2013.04.07. Interview, Beijing.

[139] Xie Ping, "Options for China's Financial System," in *Strengthening the Banking System in China: Issues and Experience*, ed. Bank for International Settlements (Basel, CH: Bank for International Settlements, 1999), 329.

banks.[140] As Keith et al emphasize, in terms of the emergent Chinese 'risk culture', what is most important is not whether such a state of affairs is actually always true,[141] but that investors, shareholders, and corporate decision makers alike construct mutual understandings on the basis of the ultimate repository of power over market risk and uncertainty being retained within political hierarchies that extend from the implementation by banks of regulations on loan classification,[142] to decisions made at the highest levels of the CCP on the impact of interest rate movements.[143]

Banking Regulation: Vertical Supervision

The problems of the banking sector and the threat it posed to the deepening internationalization of the Chinese economy were seen by Zhu Rongji in the aftermath of the AFC as equally a problem of personnel as of institutional structure. The Central Committee and the State Council issued a notice following the November 1997 conference, identifying the following problems as central to the financial situation at the time:

> In the process of transformation from a planned economy towards a socialist market economy, the organization of the financial system has not been appropriate to the needs of reform and development, laws have been incomplete, financial supervision has been weak, management has been disorderly, discipline has been lax, and a small number of employees have demonstrated their inferior quality.[144]

According to Liu Mingkang, in 1998 Zhu told the bank presidents,

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[140] BJ:2012.09.07. Interview, Beijing; BJ:2012.10.21. Interview, Beijing.

[141] Michael Keith et al., *China Constructing Capitalism: Economic Life and Urban Change* (Abingdon, UK: Routledge, 2014), 211.

[142] BJ:2013.08.09. Interview, Beijing.

[143] BJ:2013.08.26. Interview, Beijing.

[144] State Council of the People's Republic of China. 中共中央国务院关于深化金融改革，整顿金融秩序，防范金融风险的通知 [Notice of the State Council Concerning Deepening Financial Reform, Rectifying Financial Order, and Guarding Against Financial Risk]. (Beijing, CN: State Council of the People's Republic of China, 1997).

> Let's say goodbye to all these excuses. No more government-dictated loans. I'll give you money in one shot. Carve off all your existing non-performing loans—I don't care where they came from, but I do care about your future behavior. I'll get proper benchmarks to measure your performance from here on. [For new bad loans] I will hold accountable those who are responsible.[145]

There was clear recognition within China's regulatory apparatus of the challenges faced by China's banks by WTO accession, however the CCP sought the pursuit of increased commercial competitiveness through a deepening of the existing macro-framework of centralized supervision.[146] Zhu's vision of increasing accountability therefore involved the centralization of control and supervision over the banking sector, even as the state bureaucracy was being rationalized and streamlined. This challenge was met through the establishment of the Central Financial Work Commission, and the 'correspondingly' established Central Financial Disciplinary and Inspection Work Committee (CFDIWC) [中央金融纪律检查工作委员会].[147] The CFDIWC was designed to provide far greater capacity for the active monitoring of those engaged in 'financial work' [金融工作], so as to "strengthen the unified leadership of the Party in financial work."[148] This also coincided with a restructuring of the party organization in all of the major financial institutions, as emphasis was placed upon the construction of stronger

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145 Quoted in Robert Kuhn, *What China's Leaders Think: The Inside Story of China's Reform and What This Means for the Future* (Singpore, SG: John Wiley, 2010), 266.

146 Whilst the State Council formally controlled the PBOC, which in turn controlled the SOCBs, the CCP further imposed parallel methods of control through the Central Discipline and Inspection Commission (CDIC), which was subordinate to the Central Committee of the CPC and which exercised control over staffing the party committees present within all SOEs. Tang Shuangning, "应对 WTO 挑战 加快中国银行业改革开放步伐 "Coping with WTO Challenges by Accelerating the Pace of China's Banking Sector Reform and Opening Up"," in *Speech by CBRC Vice-Chairman Tang Shuangning, China Banking Regulatory Commission* (Beijing, PRC2003).

147 This took place in December 1997, following the November convening of the Central Financial Work Conference. State Council of the People's Republic of China, "中共中央国务院关于深化金融改革，整顿金融秩序，防范金融风险的通知 [Notice of the State Council Concerning Deepening Financial Reform, Rectifying Financial Order, and Guarding Against Financial Risk]."

148 ———, "中共中央国务院关于深化金融改革，整顿金融秩序，防范金融风险的通知 [Notice of the State Council Concerning Deepening Financial Reform, Rectifying Financial Order, and Guarding Against Financial Risk]."

systems of 'vertical leadership', in order that all of the necessary duties and functions were carried out according to law.

In 2003 Wen Jiabao's assumption of leadership over the Central Finance Leading Small Group coincided with a concerted refocusing of attention to the banking sector. Further, his establishment of a new leading small group (the Central Finance Safety Leading Small Group (CFSLSG) [中央金融安全领导小组]) was not merely a rebranding of the CFWC.[149] Some also saw the CBRC as something of a successor to the CFWC.[150] However, the CFWC, having served its function of reasserting centralized control over personnel and financial leadership following the shock of the GITIC bankruptcy and AFC, saw many of its core functions of cadre appointment transferred to the CCP Organization Department,[151] and thus retrenched within the Party apparatus itself, rather than dispersed through the channels of the governmental bureaucracy ministries.[152] Until the CBRC came into being in 2003, the PBOC retained jurisdiction over supervision of the banking sector. The macro-regional restructuring of 1998 produced the regulatory architecture that would become the institutional foundation for the CBRC, the establishment of which was delayed beyond that of other regulatory bodies[153] due not only to the reluctance of the PBOC to relinquish jurisdictional turf, but more fundamentally because of broader concerns (both within and beyond the PBOC) that it would usher in instability at a crucial moment in China's financial reform, when the current PBOC-rooted supervisory system was itself being fundamentally restructured.[154]

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[149] There was in fact very little continuity in staffing between the two groups. Barry Naughton, "The Emergence of Wen Jiabao," *Chinese Leadership Monitor* 6(2003): 36-47, 43-44.

[150] ———, "Government Reorganization: Liu Mingkang and Financial Restructuring", 3.

[151] The CFWC's role in 'horizontal' rather than 'vertical' financial supervision will be explored below.

[152] Heilmann, "Regulatory Innovation by Leninist Means: Community Party Supervision in China's Financial Industry", 17.

[153] The CSRC and CIRC were both established in 1998.

[154] BJ:2012.06.14. Interview, Beijing; BJ:2012.11.28 #3. Interview, Beijing.

The formal regulatory structure of China's financial sector now resembles in institutional terms that which can be found in all developed Western market economies. Introducing the concept of 'corporate governance' into official policymaking discourse in 1999, the 15th Central Committee announced a policy to establish new mechanisms for developing systems of holding corporate decision-makers to account for their managerial performance.[155] At the heart of this policy was a reassertion of the principle of the "Party controlling personnel", even as the document stated that systems of corporate governance constituted the heart of the enterprise system. Although there arose conflicts within the incentive structure of this interlocking system whereby senior managers would continue to be appointed through party-controlled procedures, it was the *nature* of the 'control' that was more important. Establishing clear guidelines and regulations under the 'leadership' of the CCP for managerial performance, did not threaten the power of the Party, as long as the mechanisms for enforcing compliance with such expectations remained under Party control. As Wu Jinglian has observed in broader context, the concept of the rule of law does not pose a threat in the eyes of the CCP in the way that democracy does.[156]

> The tension between the formal distribution of power at the micro and the macro level can thus trigger a 'voluntary' acceptance or even the request for political involvement at the firm level as long as the enterprise decision-making elite believes that cooperation will actually yield positive economic returns for either the insiders and/or the firm.[157]

Upon its establishment, it became increasingly clear that even as the CBRC was intended to assume the regulatory functions of the PBOC and thus present a 'modern' institutional structure for financial regulation, the functional nature of state regulation was to take on a distinctive form that continued to reflect a CCP-dominated political hierarchy. The Chinese notion of regulation

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[155] Central Committee of the Communist Party of China. 中共中央关于国有企业改革和发展若干重大问题的决定 [Decision of the Central Committee on Major Issues Concerning the Reform and Development of State-Owned Enterprises]. (Beijing, CN: Central Committee of the Communist Party of China, 1999).

[156] Wu Jinglian, "China's Transition to a Market Economy: How Far Across the River?."

[157] Opper, "Going Public Without the Public: Between Political Governance and Corporate Governance," 12.

embodies the notion that the CCP is both umpire and player, reflected in regulatory authorities asserting a sense of ownership over the banks and their overall regulatory approach.[158] The ambiguity of objective legal standards is intentionally designed to provide space for normative moral standards to be provided by leaders; the CCP therefore commands arbitrary and decisive power. The CBRC is subject to an ostensible tension between its roles as both supervisor and CCP agent.[159] The regulatory goal of financial stability coexists with the political interpretation of economic needs,[160] providing the legal basis for the CBRC to act within the context of political objectives.[161] This reflects the fact that personal statements by political leaders have institutionalized norm-setting character in China, and are not just individual personal opinions.[162] That is to say, they do not reflect simply upon the individual and their position within political structures and discourse, but rather upon the nature of those structures and discourses themselves.

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158 The term for 'regulation' [监督管理] is the conjunction of two different words: *jiandu* [监督]means that of supervision or oversight, whilst *guanli* [管理] refers to management. See He Weiping, *Banking Regulation in China: The Role of Public and Private Sectors* (New York, NY: Palgrave Macmillan, 2014), 3.

159 Stefan Brehm, "Risk Management in China's State Banks - International Best Practice and the Political Economy of Regulation," *Business and Politics* 10:1 (2008): 1-29, 6.

160 Article 15 of the 2003 *Law on Banking Regulation and Supervision* (*LBRS*) stipulates that "the banking regulatory authority under the State Council shall, in accordance with applicable laws and administrative regulations, formulate and promulgate supervisory rules and regulations for banking institutions."

161 This tension is apparent between Article 3 of the *LBRS* which identifies the CBRC's objective as to "promote safety and soundness of the banking industry" and Articles 2 and 5 of the Guidelines on Banks' Lending to Small Enterprises (SELG), promulgated by the CBRC, which demands that all banks (policy banks, commercial banks, and rural credit cooperatives) establish specialized departments that will undertake small enterprise lending activities. Other laws to embody this tension include the *Guidelines on Improving Financial Services of Commercial Banks to High-Tech Enterprises* enacted by the CBRC in December 2006, Article 4 of which directs commercial banks to promote the National Medium and Long-Term Strategy for the Development of Science and Technology (2006-2020) and provide loans for innovative activities. Brehm, "Risk Management in China's State Banks - International Best Practice and the Political Economy of Regulation".

162 Fewsmith, *China Since Tiananmen: From Deng Xiaoping to Hu Jintao.*

Money Markets

Commencing in 1997, a policy of gradual interest rate liberalization was instituted, when a ten per cent band of flexibility was initially introduced for loans to small and medium enterprises. In 1998 this relaxation was extended to all borrowers, before being increased to 20 per cent above the benchmark rate set by the PBOC. This liberalization coincided with the onset of the NPLs crisis in 1997, and represented a concerted effort by the Zhu Rongji administration to instill greater capacity for the pricing of risk within the commercial banks, the previous absence of which had undoubtedly been a significant factor in the build up of an enormous stock of toxic debt within the banking system. However, the cap on deposit rates was maintained, and the floor upon lending rates was maintained at ten per cent below the benchmark rate, thus guaranteeing that a highly profitable interest rate spread remained at the disposal of the banks. The specific management of deposit rates became especially pronounced after 2003. Prior to this, the PBOC would make rapid adjustments to nominal deposit rates to reflect increases and decreases in consumer price inflation. However, beginning in 2004, the PBOC responded to inflation increases with a lag, whilst reducing nominal deposit rates rapidly in line with decreases in inflation.[163] With the band of flexibility within which commercial banks were free to deviate from the PBOC-set benchmark rates maintaining a rate floor of 90 percent of the benchmark, competition amongst the major banks virtually guaranteed the uniformity of lending rates at the lowest level sanctioned by the PBOC.

Deepening economic integration presented clear challenges for the management of China's exchange rate, as reforms were undertaken in a number of domestic manufacturing

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[163] Nicholas Lardy, *Sustaining China's Economic Growth After the Global Financial Crisis* (Washington, DC: Peterson Institute for International Economics, 2012).

sectors in order to pave the way for WTO accession.[164] As with the institutional change in the banking sector itself, the CCP leadership approached the management of the currency as a further tool with which to pursue economic growth in tandem with the preservation of political control. The confrontation of economic globalization unfolded through the construction of an increasingly rationalized set of relationships between the state and market, yet one that was coordinated and underpinned by the continuing authority of the CCP. From 1998 onwards, monetary policy was subordinated to exchange rate policy.[165] In turn, exchange rate policy was subordinated to preserving internal stability, which demanded the retention of ultimate regulatory authority over capital.

The domestic politico-economic roots of this policy are generally considered to reside in the desire of the CCP elite to monopolise export sector-generated private profits whilst deflecting the concomitant costs of foreign reserve sterilisation and financial repression onto the broader public.[166] This view however fails to capture the full extent of the political economic factors underpinning China's exchange rate and capital controls regime. Although the powerful export lobby remains influential,[167] assuming its decisive influence nevertheless underdetermines the foreign economic policy-making process, and places too great a weight on the capacity of particular interest groups to affect policy decisions that implicate the fundamental interests of the CCP in legitimacy and stability.[168] The active management of the exchange rate regime has played a central role in China's growth and development strategy, but was not exclusively due to the

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[164] See ———, *Integrating China into the Global Economy* (Washington, DC: Brookings Institution Press, 2002).

[165] Wright, "The Elusive Price of Stability: Ideas and Interests in the Reform of China's Exchange Rate Regime," 297.

[166] Herman Schwartz, *Subprime Nation: American Power, Global Capital, and the Housing Bubble* (Ithaca, NY: Cornell University Press, 2009), 164-71.

[167] Ho-fung Hung, "Rise of China and the Global Accumulation Crisis," *Review of International Political Economy* 15:2 (2008): 149-79.

[168] Wright, "The Elusive Price of Stability: Ideas and Interests in the Reform of China's Exchange Rate Regime."

prioritisation of export-oriented growth and the state-owned sector,[169] and nor did it necessarily translate into an export-dominated overall growth strategy. China structured its financial system in a way that prevents it from achieving internal balance at the same time as external balance due to Chinese policymakers' emphasis upon preserving socio-economic stability, an economic outcome that is explored further later in this chapter. The ideational basis upon which this exchange rate regime developed was one that revolved fundamentally around the maintenance of CCP legitimacy and ruling authority. Crucial therefore to understanding China's macroeconomic policy is its construction around a particular conception of the relationship between the policy-making authority of the CCP and that of capital, rather than simply the identification of a singular monetary target, be it either an emphasis upon price stability or full employment.

As China acceded to the WTO in the aftermath of the AFC, a 'mercantilist objective'[170] became evident in the drive to accumulate foreign reserves as a 'foreign-exchange-creating economy' (创汇经济). During this period the exchange rate thus was not viewed as "a price to be determined by the market but rather as a tool in China's broader development strategy."[171] The banking sector formed a central component in implementing this policy of exchange rate undervaluation. Beginning in 1998, the PBOC was tasked with two potentially conflicting policy objectives: maintaining export competitiveness through currency devaluation at the same time as ensuring monetary stability. An export-driven current account surplus will have an inflationary effect upon the domestic money supply in the absence of central bank intervention to prevent the capital it expends on accumulation of foreign exchange reserves from entering the domestic money supply. Since 2003, the PBOC has sterilized this surplus capital through two methods.

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169 Cf. Mattias Vermeiren, "Foreign Exchange Accumulation and the Entrapment of Chinese Monetary Power: Towards a Balanced Growth Regime?," *New Political Economy* 18:5 (2013): 680-714.

170 Yu Yongding, "Rebalancing the Chinese Economy," *Oxford Review of Economic Policy* 29:3 (2012): 551-68.

171 Arthur Kroeber, "The Renminbi: The Political Economy of a Currency," *Foreign Policy*, 7 September 2011; Christopher McNally, "Sino-Capitalism," *World Politics* 64:4 (2012): 741-76, 758-9.

Firstly, it has directly imposed bond quotas upon the SOCBs which require them to hold a certain amount of interest-bearing bills issued by the central bank, thus reducing the money supply.[172] Secondly, it has increased the required reserve ratio, forcing banks to deposit greater shares of their capital with the central bank and thus curtailing their lending operations. The effect of these sterilization methods was to reduce the portion of the total money supply in circulation and reduce inflationary pressure.[173]

The ongoing viability of both of these sterilization methods depended on the maintenance of low interest rates.[174] Since the intervention in the foreign exchange markets from 2003-2007 was continuous, large-scale, and unidirectional, investors in central bank bonds would bet that the sterilization efforts cannot remain sustainable and viable in the long-run. If interest rates were flexible, this calculation would force up interest rates upon the PBOC bonds, and thus significantly increase the costs of sterilization borne by the central bank, since a difference between the interest earned on foreign currency-denominated debt instruments that comprise official reserves, and the interest paid on the bonds issued to the SOCBs, would emerge and continuously increase. Thus by setting interest rates at a low rate, the PBOC avoided these increased sterilization costs, but in doing so, implicitly taxed the banks that held these bonds rather than other, more lucrative investments.[175] The PBOC then offset this tax by reducing the costs of capital for the banks; it shifted the burden onto household depositors by depressing the benchmark deposit rate. In this manner, the preservation of an exchange rate regime with highly limited flexibility for the purposes of domestic stability within a weak institutional and regulatory

[172] By the end of 2010, commercial banks had acquired approximately 4 trillion RMB of central bank bills at 1.692 percent for three-month maturity, and 2.126 percent for one-year maturity. The discrepancy between these returns and the average lending rate of 6.11 percent constitutes an implicit tax upon commercial banks. Carlo Milana and Harry Wu, "Growth, Institutions, and Entrepreneurial Finance in China: A Survey," *Strategic Change* 21(2012): 83-106.

[173] Fan Gang, "China's Monetary Sterilization," <http://www.project-syndicate.org/commentary/china-s-monetary-sterilization>, accessed on 15 July 2011.

[174] Zhang Ming, "Chinese Stylized Sterilization: The Cost-sharing Mechanism and Financial Repression," *China & World Economy* 20:2 (2012): 41-58.

[175] ———, "Chinese Stylized Sterilization: The Cost-sharing Mechanism and Financial Repression".

environment was symbiotically connected to the broader and deeper repression of the financial system.

Relational Networks: Making Institutions Work for the CCP

The Nexus of Party Networks and Economic Growth

In the post-AFC policymaking environment, Zhu Rongji's economic policymaking was framed within the dual challenges of managing the risks of global financial integration, as well as a determination to improve the operational effectiveness of the banking sector. The entire process of banking and regulatory restructuring was underpinned by the essential guiding principle of 'leadership of the Party' through the party committees within financial institutions that were each linked vertically to the CFELSG.[176] As a policymaking and policy coordinating body, the CFELSG was functionally separate from these horizontal and vertical mechanisms of governance, although it exercised ultimate responsibility and control over them as well. The processes of institutional change traced in the previous section were themselves underpinned by an increase in CCP oversight in order to manage uncertainty. As Heilmann observes,

> As soon as China's top leaders had agreed [in 1997] on the need for centralization to counter financial risk, they were able to achieve comprehensive regulatory reform by leaving state institutions intact on the surface for the time being while swiftly changing the internal rules governing Communist Party-appointed 'leadership cadres' and creating a powerful, yet mostly invisible Party body for monitoring financial executives.[177]

Although Zhu Rongji introduced plans to reform the party structure where organizational overlap existed amongst different parts of the Central Committee, these were not intended to

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[176] BJ:2012.06.04. Interview, Beijing; Dai Xianglong, "回顾 1997 全国金融工作会议 [Looking back on 1997's Financial Work Conference]".

[177] Heilmann, "Regulatory Innovation by Leninist Means: Community Party Supervision in China's Financial Industry".

weaken the party apparatus, but rather to streamline it and increase its efficiency.[178] Where it mattered most to Zhu—the economic realm—the organizational depth and authority of CCP regulatory oversight and capacity for intervention were enhanced. Zhu's response to the problem of reform both in the financial system and SOEs thus emphasized much more strongly the management of *people* and *ideas,* rather than *institutions* and *structures.* As a senior academic observed in 1998, Zhu did "not think there [was] anything particularly wrong with the existing structure. He [had] been telling managers that the problem [was] more themselves—sloth, inefficiency, and corruption—than the system."[179] This meant that, "improving the moral quality of cadres was a prerequisite to solving problems ranging from corruption to SOE efficiency."[180] Just as the evolution of cognitive frames and the path of institutional change reflected the importance of continued CCP control to managing the uncertainty of deepening reform, the most effective mechanism available to Zhu Rongji—and Wen Jiabao after him—for achieving economic growth without permitting the establishment of alternative bases of financial and political power was the control exercised by the CCP over the networks of financial relations.

Following the institutional reforms of the mid 1990s, the supervisory role of the CCP accordingly remained the foundation of both horizontal and vertical governance mechanisms, and was enhanced in a number of different ways. In an effort to bolster its legitimacy in China's evolving governance structure, the CCP made some of its operations more transparent, promulgating a set of 'Regulations on the Work of Selection and Appointment of Leading Party and Government Cadres' [党政领导干部选发任用工作条例]. These built upon provisional regulations that had first been promulgated in 1995,[181] and which although not published

[178] "Scheme to Trim Fat from Party Structure," *South China Morning Post*, 12 March 1998.

[179] Yang Zhongmei, 朱镕基传 *[A Biography of Zhu Rongji]* (Taipei, TW: China Times Press, 1998), 236.

[180] Lam, *The Era of Jiang Zemin*, 371fn.

[181] Zhiyue Bo, "Selection and Appointment of Leading Cadres in Post-Deng China," *Chinese Law and Government* 32(1999).

publicly, had been widely circulated among administrators and managers and already were in practical operation as binding rules. The new regulations now encompassed the appointment procedures for over 400,000 cadres ranked at deputy county head (division chief) and above.[182]

The primary mechanism for the CCP's tightening of the means of policy diffusion through the financial sector was the Central Financial Work Commission, a body established in 1997 and directly and exclusively answerable to the Central Committee.[183] In contrast to the agenda setting and decision-making functions of the Leading Small Groups,[184] it was the primary organization devoted to supervision and management of cadres, as the overseer of horizontal networks linking the executive ranks of China's key financial institutions both amongst themselves and to the Central Committee itself. It was mandated explicitly to "implement the Party line, guidelines, policies, and lead the work of party-construction throughout the financial system, but not to engage in financial business or provide financial services."[185] It complemented the Central Organization Department, which in 1998 refocused significant attention on the work of cadres within the financial system.[186] Wen Jiabao, at that stage a Vice Premier and member of the PSC, served as chair of the CFWC. It effectively leapfrogged the PBOC, the MOF, and subsidiaries such as CIC and Huijin in enabling direct CCP appointment of senior management

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182 ———, "Selection and Appointment of Leading Cadres in Post-Deng China".

183 State Council of the People's Republic of China, "中共中央国务院关于深化金融改革，整顿金融秩序，防范金融风险的通知 [Notice of the State Council Concerning Deepening Financial Reform, Rectifying Financial Order, and Guarding Against Financial Risk]."

184 Wen Jiabao, as the head of the CFWC, clearly saw its role as one of implementation rather than formulation of CCP policy. Heilmann, "Regulatory Innovation by Leninist Means: Community Party Supervision in China's Financial Industry", 8.

185 State Council of the People's Republic of China, "中共中央国务院关于深化金融改革，整顿金融秩序，防范金融风险的通知 [Notice of the State Council Concerning Deepening Financial Reform, Rectifying Financial Order, and Guarding Against Financial Risk]."

186 Central Organization Department of the Chinese Communist Party. 中央金融工委组织部关于金融系统党的领导体制调整后金融系统转移党员组织关系等有股烟问题的通知 [Notice of the Organization Department of the Central Financial Work Commssion on Issues Related to the Transformation of Relations Between Party Personnel Organizations in the Financial System Following the Restructuring of the Party Leadership System of the Financial System]. Central Organization Department of the Chinese Communist Party, (Beijing, CN: Central Organization Department of the Chinese Communist Party, 1998).

throughout the banking sector.[187] It worked closely in tandem with the Central Organization Department that already shouldered responsibility for the 'position-list' system of leading cadre appointment.[188] Thus, between 1998 and 2003 the CFWC controlled the appointment of senior executives across all key institutions in finance, including regulators, administrative agencies and banks.

Growth and Deepening Imbalances

These institutional transformations and the ideas and networks that underpinned them laid foundations for the deepening of a highly unbalanced growth trajectory. As Figure 5.1 indicates, the year 2000 marked a major inflection point in the development of serious imbalances in the composition of GDP growth, when the share of consumption commenced a decrease from 47 percent to reach 34 percent, and investment rose from 35 to reach 43 percent by 2006. Two primary trends therefore emerge from the trajectory of growth between 1998 and 2007: firstly the significant increase in investment between 2000 and 2004, and secondly the significant increase in net exports between 2005 and 2008. Following the AFC, it was accordingly first investment, and then exports, that led to a final headline rate of over 14 percent in 2007.

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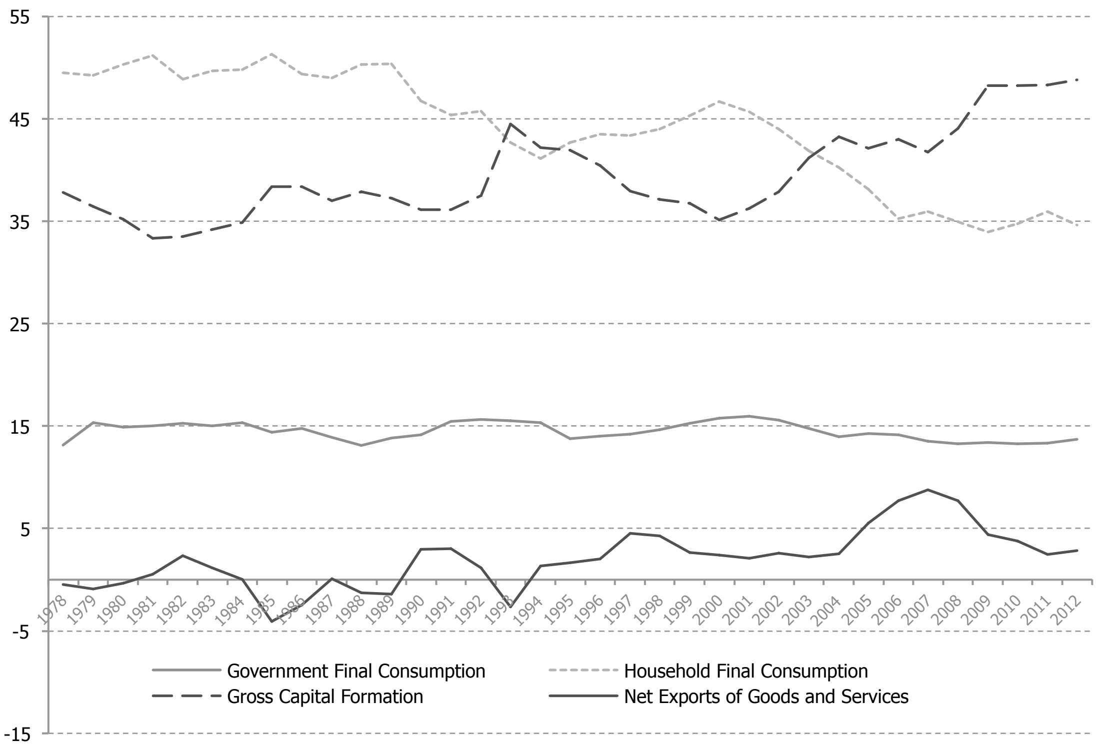
[187] Heilmann, "Regulatory Innovation by Leninist Means: Community Party Supervision in China's Financial Industry".

[188] Central Organization Department of the Chinese Communist Party. 中共中央金融工作委员会关于中央各金融机构党组改为党委有关问题的通知 [Notice of the Central Financial Work Conference on Issues Related to the Transformation of Central Financial Institutions' Party Organizations into Party Committees]. Central Organization Department of the Chinese Communist Party, (Beijing, CN: Central Organization Department of the Chinese Communist Party, 1998).

Figure 5.1: Shares of investment, consumption, and exports in GDP, 1978-2012



Source: World Bank, CEIC

Following the AFC, the CCP prioritized the stimulation of domestic demand through expansion in investment projects in order to sustain a rapid pace of economic growth.[189] Rather than industrial projects, capital was channeled towards infrastructure, which was perceived as still constituting a fundamental bottleneck in the economy. Knight and Ding have found that from 1998 onwards the return on capital in industry rose substantially across both the state and non-state sectors:

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[189] Chen Yuan, "Warding off Policy-Oriented Financial Risks and Promoting Effective Growth of the National Economy," in *Strengthening the Banking System in China: Issues and Experience*, ed. Bank for International Settlements (Basel, CH: Bank for International Settlements, 1999).

> Enterprise reform and marketization achieved efficiency gains through the reallocation of resources toward more productive uses—from the state sector to the private sector, from agriculture to industry, and from domestic to foreign markets. Entrepreneurial expectations of rapid economic growth were crucial for high investment and the resultant path of economic growth.[190]

The immediate impact of the post-AFC financial restructuring was to produce more effective mechanisms of capital allocation, even if levels of gross capital formation increased relative to other drivers of growth. This is to draw attention to the *qualitative nature* of that investment in contrast to that of either the investment that produced inflationary pressures in the mid 1990s or the increase in investment that followed the 2008 financial crisis. The newly restructured banking system continued to provide significant loans to enterprises whose loans had been the target of the debt restructuring efforts beginning in 1998. Financial statements indicate that corporate clients still accounted for over three-quarters of total lending by the four SOCBs that had listed publically by the end of 2007: BOCOM (81 percent),[191] ICBC (75 percent),[192] BOC (76 percent),[193] and CCB (75 percent).[194] Of these loans to the corporate sector, loans to SOEs still weighed heavily, with loans to non-state-owned enterprises comprising 34 percent in the case of ICBC,[195] and 36 percent in the case of CCB.[196]

Figure 5.2 demonstrates how, following the rapid reduction in reliance upon government budgetary outlays for the financing of investment, enterprises came increasingly and steadily to rely upon their own savings for their capital outlays. This reflects the fact that China's investment-led growth has been driven by endogenous factors; even as FDI increased, this was

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[190] Knight and Ding, *China's Remarkable Economic Growth*, 177.

[191] Bank of Communications. "Annual Report". Shanghai, CN: Bank of Communications, 2007.

[192] Industrial and Commercial Bank of China. "Annual Report". Beijing, CN: Industrial and Commercial Bank of China, 2007.

[193] Bank of China. "Annual Report". Beijing, CN: Bank of China, 2007.

[194] China Construction Bank. "Annual Report". Beijing, CN: China Construction Bank, 2007.

[195] Industrial and Commercial Bank of China, "Annual Report," 167.

[196] China Construction Bank, "Annual Report," 197.

directed primarily towards the manufacturing sector, a phenomenon that was increasingly prioritized by the Chinese government as the country's integration proceeded apace following WTO accession.[197] These investment levels and the entrepreneurial expectations underpinning them were highly dependent on the financial repression engineered through the SOCBs and the interest rate regulation that was a central element in these policies. The direct effect of these negative real interest rates was to repress growth in household disposable income relative to a less repressed financial environment. Two further indirect effects began to emerge. The first was that the savings rate as a portion of household disposable income increased,[198] since the objective of savings in a society without a strong social safety net is to reach a target level of financial assets.[199] The second was that this financial security-motivated increase in savings, the unattractiveness of depositing these savings with commercial banks, and the limited range of other attractive consumer investment options, produced a heightened demand for residential property. As wealthy urban households began to attempt to capitalize upon a speculative real-estate bubble, a further transfer of household wealth into the construction and infrastructure sectors began to take hold, accentuating the divergence between consumption and investment.

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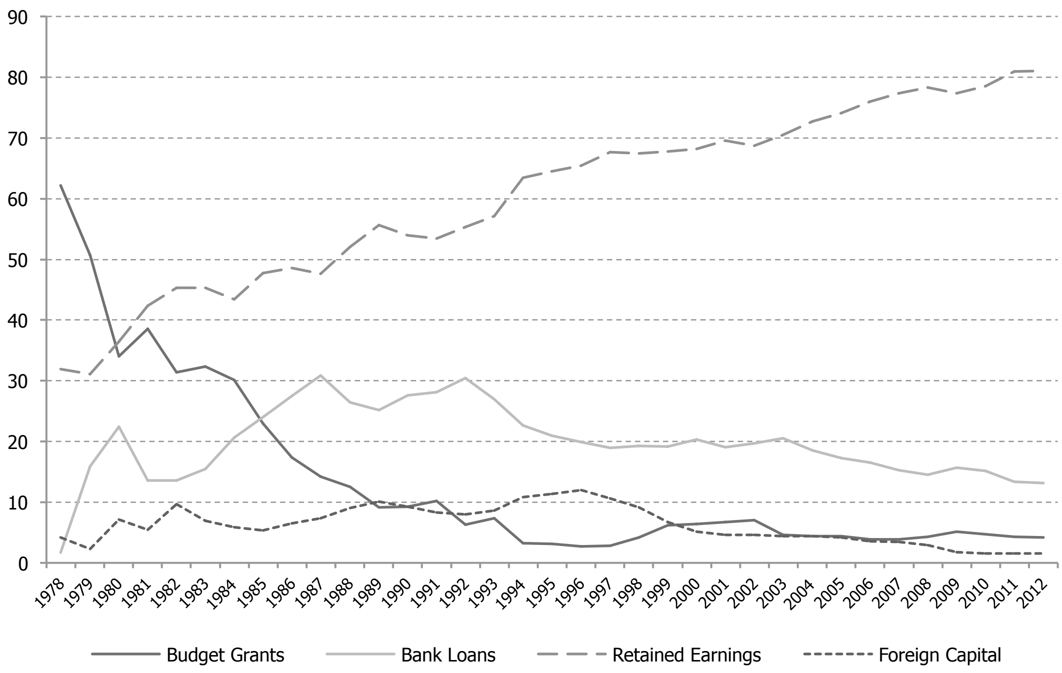
[197] Yasheng Huang, *Selling China: Foreign Direct Investment During the Reform Era* (Cambridge, UK: Cambridge University Press, 2003).

[198] Thus China's high savings rate reached an unprecedented level of more than 50 per cent of GDP in the period 2006-2010. Guonan Ma and Wang Yi. "China's High Savings Rate: Myth and Reality". *BIS Working Paper No. 312*. Basel, CH: Bank for International Settlements, 2010.

[199] Marcos Chamon and Eswar Prasad, "Why are Savings Rates of Urban Households in China Rising? ," *American Economic Journal: Macroeconomics* 2:1 (2010): 93-130.

Figure 5.2: Sources of funds for fixed-asset investment, 1978-2012



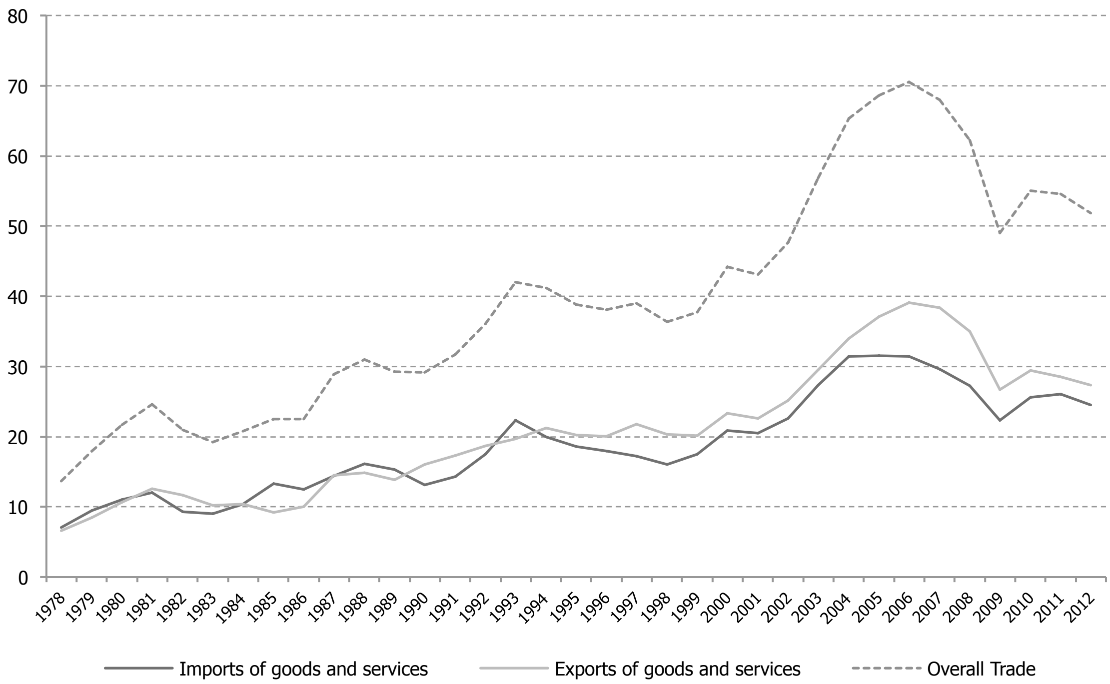
Source: CEIC

The roles of both investment and exports (as well as both the public and private sectors) in China's growth were thus both linked closely to the institutional structure and macroeconomic role of the state-dominated financial sector. The overinvestment complex was related to the unbalanced external nature of the growth trajectory, as the relationship between the path of institutional reform in the banking sector and the emergence of overinvestment arose on the basis of policymakers' insistence upon targeting internal balance at the expense of external balance.[200] This reflects the fact that China's growth story has been one of domestic demand. Figure 5.1 above illustrates the minor role that net exports have played in contributing to overall

[200] Yu, "Rebalancing the Chinese Economy".

GDP growth, only coming to provide a significant contribution to GDP growth after 2005, the point at which China's current account surplus experienced a significant concomitant increase to reach over 10 percent in 2007. Yet overall trade as a share of GDP increased since 1978 (Figure 5.3). Although a significant contribution economic growth eventuated from exports directly as well as domestic industries connected through supply-chain and infrastructure needs, this overall investment- and export-dominated growth model remained premised on the ongoing role of the financial system to manage the macroeconomic pressures that resulted from both.

Figure 5.3: Exports and imports in GDP, 1978-2012



Source: World Bank

When in 2005 China's GDP growth did come to reflect increasingly large shares of exports of goods and services, this did not coincide with a depreciation of the RMB in either real or trade-weighted terms. For this reason, it is not possible to neatly depict the Chinese exchange rate regime as part of a coherent international monetary system in the form of a Bretton Woods II system. Such a system has been characterised by the emergence of a 'fixed exchange rate periphery' in Asia, with China at its core and motivated by an export-led growth strategy.[201] From this perspective, given high savings and policy-driven lending practices, it was purely by virtue of an undervalued exchange rate and the consequent opportunities for export to the US market that China was able to prevent the severe misallocation of capital.[202] This argument focuses on the real effective exchange rate ("REER") of the RMB vis-à-vis the USD. The exchange rate regime was fixed rigidly at RMB 8.27 = USD 1 from 1994 until July 2005 when it was reformed into a managed floating rate. However, although the change in exchange rate policy had an effect upon the exchange rate itself in marginal terms (and actually declined in real, trade-weighted value during 2006 and 2007),[203] the current account surplus continued to rise dramatically before peaking in 2008 at 10 percent of GDP (Figure 5.4).[204] Were Chinese policy-makers genuinely formulating exchange rate policy on the basis of the interests of export-oriented manufacturers, and concerned fundamentally with preserving employment in those export sectors, then it would not have been logical to focus on the REER at the expense of the trade-weighted real exchange rate, for a majority of China's exports did and continue to flow to markets whose currencies float against the dollar.[205] This trade-weighted exchange rate in fact appreciated by nearly 30 percent between 1994 and 2002 (Figure 5.4).

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[201] Michael Dooley, David Folkerts-Landau, and Peter Garber. "An Essay on the Revived Bretton Woods System". *NBER Working Paper 9971*. Cambridge MA: National Bureau of Economic Research, 2003; ———. "The Revived Bretton Woods System: The Effects of Periphery Intervention and Reserve Management on Interest Rates and Exchange Rates in Center Countries". *NBER Working Paper 10332*. Cambridge, MA: National Bureau of Economic Research, 2004; ———. "Direct Investment, Rising Real Wages and the Absorption of Excess Labor in the Periphery". *NBER Working Paper 10626*. Cambridge, MA: National Bureau of Economic Research, 2004.

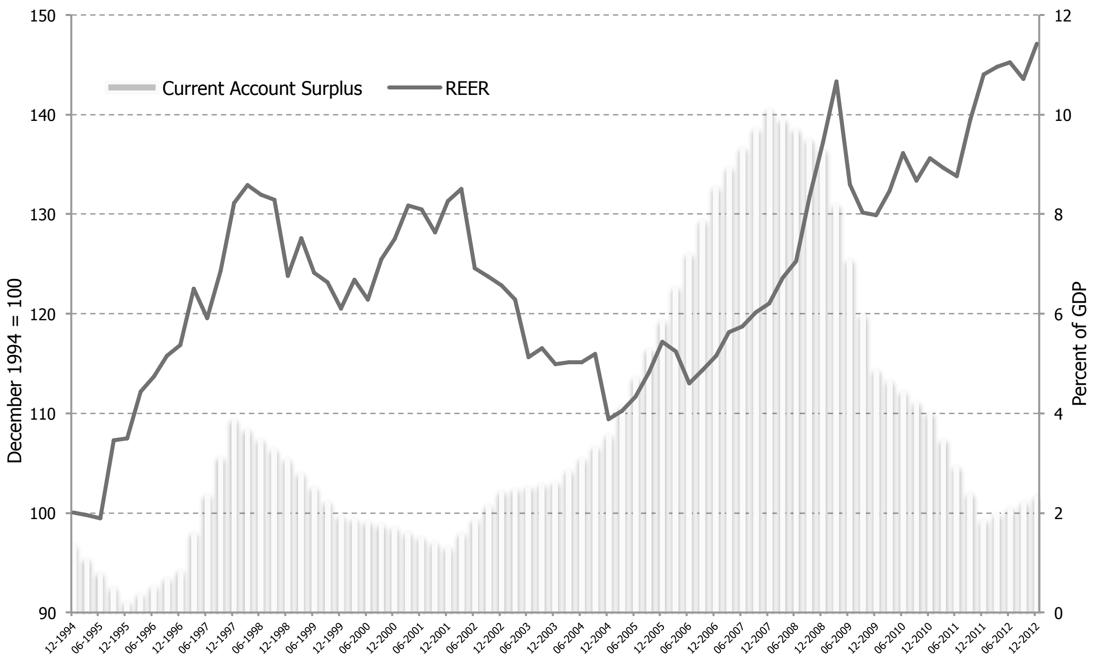
[202] Luigi Bonatti and Andrea Fracasso, 'Global Rebalancing and the Future of the Sino–US Codependency' (2010) 18(4) *China & World Economy* 70-87, p.71.

[203] Lardy, *Sustaining China's Economic Growth After the Global Financial Crisis* 104.

[204] Yuning Gao and D'Maris Coffman, "Renminbi Internationalization as a Response to the Global Imbalance," *Journal of Chinese Economic and Business Studies* 11:2 (2013): 139-51, 140.

[205] Morris Goldstein and Nicholas Lardy, *The Future of China's Exchange Rate Policy* (Washington, DC: Peterson Institute for International Economics, 2009).

Figure 5.4: Real effective exchange rate and current account, 1994 - 2012



Source: National Bureau of Statistics, China Statistical Yearbook; CEIC

Thus the notion that the bilateral USD-RMB was targeted out of consideration for maintaining export-sector employment is ultimately somewhat unconvincing. Rather, it was focused inwards so as to promote faith and confidence in what Alvo and Mishkin have labelled the 'key to macroeconomic success',[206] the economy's fundamental macroeconomic institutions of fiscal, monetary, and financial stability. In this sense, it is reflective of the need to construct a particular financial regime around the CCP's broader and deeper emphasis on a particular mode of control over the flow of capital within the domestic political economy. Policymakers

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[206] Guillermo Calvo and Frederic Mishkin, "The Mirage of Exchange Rate Regimes for Emerging Market Countries," *The Journal of Economic Perspectives* 17:4 (2003): 99-118.

neglected external macroeconomic balance, focusing instead upon policies beneficial to internal macroeconomic balance. Indeed, as Yu Yongding has observed, the "fiscal and monetary blend" of monetary policy to control overheating and fiscal policy to avert downturn had been quite successful in maintaining simultaneously low unemployment and low inflation.[207] China's economic policy making can be seen as directed towards maintaining domestic financial stability within a weak regulatory and institutional financial environment.[208] In this sense, the peg to the USD was viewed as valuable for reasons of maintaining domestic financial stability and as an anchor for monetary policy.[209]

Conclusion

Zhu Rongji continues to be viewed generally by Western viewers (and to a lesser extent amongst Chinese financial analysts)[210] as the consummate economic reformer and financial architect concerned with enacting a vision of market-oriented efficiency through economic competition. But what Zhu in fact achieved was the construction of a Chinese capitalism that was at its zenith from 2005-2008, as growth surged on the back of an increasingly unbalanced economic growth model. Western bankers, advisors, and commentators who looked to this period of economic opening and integration as commensurate with the diminishment of Party influence within the financial system were mistaken. They saw the growth of market forces and the establishment of modern institutional forms as evidence of the CCP's need to remove itself from the financial system in order to permit continued transformation of the Chinese political economy, and yet it

[207] Yu, "Rebalancing the Chinese Economy", 558.

[208] Morris Goldstein and Nicholas Lardy. "China's Role in the Revived Bretton Woods System: A Case of Mistaken Identity". *Working Paper No. WP05-02*. Washington, DC: Institute for International Economics, 2005.

[209] BJ:2012.06.16. Interview, Beijing; BJ:2012.06.08 #1. Interview, Beijing.

[210] BJ:2012.11.21. Interview, Beijing.

was precisely the opposite; the CCP's continued salience as a crux of reform was exactly what *enabled* such changes to unfold. Through this system of risk management, the CCP was able to achieve its goals of stability through growth despite the socially regressive effects that this had because it was capable of constructing a system that was both market- and state-led; it was the CCP that crossed the institutional divide between state and market. In this sense, by strengthening the role of the CCP, it thereby strengthened both the market and the state. The course of reform and the resulting growth during this period thereby reflected a fundamental continuity in the economic sociology of China's mode of economic and financial governance. As Schell and Delury have observed,

> It was an old story, but with a new ending. The party-state's ultimate ownership rights of the national economy and the total monopoly of political power were no more to be changed, or even tinkered with, than the basic tenets of the Confucian construct were to be altered by the early self-strengtheners a century ago.[211]

In such a vein, this chapter has traced the evolution of the banking sector and its role at the institutional core of this retention of authority over an increasingly capitalist authoritarian political economy as it mediated the relationship between different social groupings both domestic and foreign. The eruption of the global financial crisis in 2008 has ushered in a new chapter in the development of China's financial capitalism, one that continues to unfold around us now and whose dynamics and implications for the longer-run evolution of global capitalism we are only just now beginning to more adequately and rigorously grasp.

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[211] Schell and Delury, *Wealth and Power: China's Long March to the Twenty-First Century*, 349.

VI The Future of Chinese Capitalism

The jury is very much out on how epiphenomenal the West's post-1800 advantage will be.[1]

— Kenneth Pomeranz

国家负亏，银行负债，老板负赢

The nation takes care of losses, the bank takes care of debt, and the boss takes care of profits.[2]

— Satirical aphorism

The Evolution of China's Financial Capitalism

Since China's leaders first began to construct a 'modern' financial system following Deng's Southern Tour and the 1993 Third Plenum, economic growth has been not only highly rapid and stable, but also has become increasingly imbalanced. The deepening of the market's role in financial intermediation and the bureaucratization of the state have been accompanied by the rationalization of the CCP's role as authority over both. This thesis has argued that China's paradoxical path of development is largely a consequence of conceptions of reform that saw the harnessing of capital as both a means of fostering economic growth, as well as of shaping the political dynamics of society. These conceptions revolved around the idea of capital and the markets through which it could be allocated as tools, rather than as normative ends and objectives in themselves. Thus even as the financial system has become increasingly commercialized and devoted to supporting economic growth, it has simultaneously lain at the

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[1] Kenneth Pomeranz, "Putting Modernity in its Place(s): Reflections on Jack Goody's *The Theft of History*," *Theory, Culture & Society* 26:7 (2009): 32-51, 36.

[2] BJ:2012.11.28 #4. Interview, Beijing.

heart of the ability of the CCP to ensure that this economic growth continuously supported the political needs of the Party.

This thesis has traced how particular conceptions of how political authority and economic power are to be exercised through the financial system have influenced the path of politico-economic development in China since the 1989 social protest movement. The significance of the 'neoconservative legacy' of 1989 for the evolution of Chinese capitalism is difficult to overstate. It precipitated a turn towards economic growth as a means of ameliorating the political and social pressures that had been steadily building up not just since 1978 and the birth of 'reform', but had arguably been fomenting equally throughout China's socialist era. The deeply political and ideational contestation that took place in the aftermath of 1989, and which culminated in Deng Xiaoping's Southern Tour and the 1993 Third Plenum decision to establish a 'socialist market economy' [社会主义市场经济], gave rise to a mode of development that combined an expansion of the *economic role of markets* and a contraction of the *political role of the state*, with the deepening of the *sociological role of the CCP* as a means of organizing the rapidly reforming political economy of Chinese capitalism.

This took place through the development of cognitive frames anchoring actors' expectations, the establishment of new institutional configurations embodying these expectations, and the deployment of relational networks to act upon these expectations. Zhu Rongji's commitment to the technocratic deployment of market efficiency within the parameters of a deeply conservative role for the CCP to play in maintaining overarching authority over the flow of capital throughout the economy was clearly visible in the interpretation amongst financial elites of the concept of the social market economy and the policies of 'macroeconomic control' [宏观调控]. The establishment of legal and regulatory institutions such as the *Commercial Banking Law* and the *Law of the People's Bank of China* reflected these priorities, all of which served to stratify the economic connections and networks that underlay an investment-oriented and financially repressive political economy. It was this combination of the increasing scope of market opportunity alongside the role of the CCP that was responsible for the rapid and stable economic growth that fulfilled crucial political functions for the CCP, but which would also lay the basis for the concentration of politico-economic power amongst those actors positioned favourably within this risk environment.

The Asian financial crisis was another crucial inflection point in the ideational evolution of China's political economy and the role of the financial system. Even as it reinforced the wisdom of maintaining a sharp distinction between foreign and domestic capital and strong barriers to the transnational flow of capital, it also compelled a recognition that China's continued economic development was inextricably linked to global economic currents and those same transnational capital flows that it was assiduously guarding itself against. This precipitated the emergence of a different set of cognitive frames, which focused on how the roles of the market and the state could possibly evolve within a 'socialist market economy' that was becoming increasingly transnational in nature. Although it was broadly recognized that excessive government interference in the banking system was problematic and a hindrance to the efficient use of capital at the micro-level, this did not mean that the market was perceived as capable of generating either optimal macroeconomic outcomes within the financial sector, or safeguarding the foundational political imperatives of continued CCP control.

What instead emerged in order to harness both the economic and the political demands of the post-AFC financial system was the same one that had managed expectations of deepening reform and transformation in the early and mid-1990s. The continued substantive role of the CCP was critical both to maintaining overall confidence in the stability of the financial system, even as the substantive role of the state itself was reduced along formal measures of ownership and regulatory power. This was a risk environment that was accordingly dominated by the CCP, in which cognitive frames revolved around the use of 'Western' macroeconomic management techniques and institutions as tools for the construction of a system that remained highly 'Chinese' in its core essence and function [中体西用]. The multivocality of CCP power throughout this system was not merely the manifestation of efforts to preserve an opaque and predatory one-party state. This multivocality was an essential element in the preservation of the integrity of a precariously balanced broader system dependent upon rapid and stable economic growth, but which was constitutionally incapable of achieving both through a reliance upon either unadulterated market forces in the allocation of capital, or the technocratic forces of bureaucratic planning and administration.

This role was hence reflected in the ongoing institutional change throughout this period, as NPLs within the core of the banking system were worked out neither through the explicit assumption of financial responsibility by the government, nor via the liquidation of those financial institutions that had been central to their accumulation. The separation of business and government [政企分开] lay at the heart of the public listing of these institutions, but was accompanied by a bolstering of mechanisms for deeper Party authority over the operations of the banks, through the operations of the Central Financial Work Commission. Institutionally the banking sector thus remained at the heart of a system in which state and market had been separated formally, but nonetheless remained deeply embedded in the *political* imperatives of both, in terms of their natural and ongoing subordination to the CCP as the highest source of authority over the course of economic development. The development of increasingly market-oriented institutions both of financial intermediation and of financial regulation enabled the attraction of foreign strategic investors on the basis of the banking system's dedication to international best practice in terms of prudential regulation and corporate governance. The substantive operation of the banks however remained rooted in a set of mutual shared understandings amongst financial elites as to the ultimately political role of the banks and their position at the centre of the financial repression that supported investment-led growth following the AFC, and which then deepened from 2000 to peak in 2007.

It is commonplace to hear claims that the global financial crisis that began to unfold in 2008 changed everything. It is still too early to draw firm conclusions as to how the crisis and the processes that it set in motion have affected the long-term stability of China's economy, and the long-term sustainability of its political system. Only now can we begin to see signs of how the investment-biased and imbalanced political economy that had its roots in the post-Tiananmen socio-political environment is now reaching its limits, and starting to precipitate a further transmutation of the Chinese political economy as the deeper consequences of debt accumulation become increasingly apparent. A detailed examination of this process of stability and change since the crisis is accordingly a task for future research.

The argument developed in this thesis however points to some of the ways in which the trajectory of economic growth and the role of the financial system has continued to play a central role both in China's response to the crisis, as well as the ways in which the CCP is now seeking to deal with the implications of this response. The supposed success of China's developmental model in propelling economic growth was seemingly confirmed in 2008 as China's banking and financial sector was structurally insulated from the financial contagion emanating from the US. The crisis had two main effects: it firstly presented an immediate economic challenge for China's banking system, as the precipitous fall in global demand called for economic stimulus in which the banks, given their extant position within China's political economy, would inevitably play a central role. The second impact was at the ideational level. The crisis has had a major impact upon the financial deregulatory paradigm that had underpinned the Anglo-American financial world prior to the crisis. Yet the discursive setbacks to this paradigm masked the deeper underlying reality of crisis capitalism that is now reconstituting itself in China just as it likewise continues to across the global economy. The discrediting of this deregulatory paradigm in the Western world led to a renewed and concerted focus upon more stringent and targeted prudential regulation to combat both institutional and systemic risk, yet it remains an open question as to whether the crisis has precipitated a more fundamental reconsideration of the balance of power between financial markets, capital, and institutions on one hand, and the sources of political authority and legitimacy on the other.

Following the crisis, it was on this level that the implications of the crisis were interpreted by Chinese financial policymakers and elites—as a reflection of limitations in Western politico-economic *process,* rather than merely in the *outcome*. In the aftermath of the crisis, immediate economic imperatives combined with the ideational interpretation of the crisis, producing a stimulus package that reflected an emphasis upon mechanisms of control and authority more fundamental than arm's length regulation and standard setting. The crisis thus precipitated in China a response that approached the role of the banking sector in ways starkly different to Western political economies. Rather than seeking to insulate the real economy and public finances from the private financial sector, the Chinese crisis response directly enmeshed financial institutions ever-closer to the heart of the Chinese political economy. Whereas Western conceptions of the relationship between the financial sector, the real economy, and the political system experienced a shift from a belief in the self-regulating capacity of the market, to the (re-) regulatory role of the state, the Chinese response has exhibited significant continuity in the nature of these relationships. Progress towards developing technocratic and rationalised financial regulatory institutions has unfolded under the auspices of continued overarching CCP authority. Financial markets had never been regarded by Chinese policymakers as self-regulating, and thus the central locus of capacity to manage uncertainty and thus not only maintain economic growth as well as financial stability has continued to revolve around the CCP itself, and not a nascent regime of technocratic liberal regulation.

This returns us to the banker mentioned in the opening passage of this thesis, who despite holding a position at the very center of an increasingly modern, commercial, and international Chinese banking sector, remains firmly entrenched in the broader political system of control and authority over the flow of capital. As China's new leadership under Xi Jinping have taken the reins of power, it has become ever clearer that the dynamics of continuous capitalist transformation and authoritarian 'governance' are two sides of the same Chinese coin. That the CCP continues to pursue the 'rejuvenation of the great Chinese nation' without seemingly any indication of loosening its grip on the levers of political power, yet is now firmly committed to deepening and enhancing the role of the market is testament to the need for more nuanced and reflective appraisals of the relationship between the market, the state, and society. China's experience of financial development has brought it once again to the question of how to utilize the market, as Deng Xiaoping envisaged all along, as an 'economic tool' [经济手段] that has little bearing on the fact of a society's socialism or capitalism. As the Chinese developmental experience increasingly intensifies divisions in both economic opportunity and outcome, it remains to be seen whether China's distinctive politics can prove capable of ameliorating the excesses of capitalist development.

Reevaluating Chinese Financial and Economic Reform

The way in which ideas, interests, and institutions have emerged and evolved in China's political economy is the product of the emergence and evolution of Chinese capitalist modernity. Just as the experience of modernity in the West is a process of historical change that has roots extending far beyond the contemporary era of global capital, contemporary China can only be understood as the latest iteration of the deeply historical interplay of political, economic, and social forces, steadily accumulating through lineages and junctures that serve to both reinforce and disrupt ideational paradigms, institutional configurations, and networked topographies. To argue that the features of 'premodern' China remain analytically salient in the study of 'modern' China is not to mount a culturalist argument, but rather to decenter the Western experience of modernity as the only available theoretical and conceptual lens through which to study modern Chinese development. As we saw in Chapter Two, the Chinese experience of economic development in imperial China constituted a rational and sophisticated economic sociology of market behaviour and economic development that was distinct from that which led to European-style capitalism, but was not necessarily incompatible with it. Accordingly, the construction of a capitalist system in contemporary China—one that is now deeply embedded in the competitive dynamics of an integrated global economy—represents potentially the coalescence of logics of politico-economic organization that are as equally rational as they are qualitatively distinct.

Decentering the universality of the Western historical experience places one then in a difficult position. Compelled to undertake a reflexive reappraisal of those concepts that have underlain the study of Western political economy but which may prove inadequate for the study of Chinese political economy, one must search for alternative conceptual foundations for the analysis of rational social action that provide useful insight into the construction of *modernity,* without assuming that actors embedded in such modernities abide by the same conception of rationality. This means also being ecumenical about the study of *capitalism,* and to this end the analytic framework developed in this thesis has revolved around the role of *uncertainty* as one core conceptual feature of social action that enables one to marshal together theories of economic development and theories of political power. It does do however without ascribing a priori to a sociological or politico-economic ontology that focuses deterministically on concepts such as the Weberian bureaucratic state or Marxian creative destruction that may have been prominent in the experience of Western capitalism, but which cannot be assumed to be central to the story of Chinese capitalism. Rather, the concept of uncertainty, and the cognitive frames, social institutions, and networked relations that enable us to manage it, can be deployed in order not only to develop better explanations of empirical phenomena such as the patterns of authority and power exercised by the CCP in the construction of a capitalist political economy, but also to place those explanations in the broader comparative context of global capitalist development and evolution.

What has been central to the story of Chinese capitalism is the economic role and political implications of capital itself. Harnessing the flow of capital throughout the economy can be conceived as a process of managing the uncertainty inherent in financial decision-making, one that has been underpinned in China through the role of the CCP at the nexus of the state and the market. Control over the flow of financial capital is a source of both the power to incentivize economic growth, as well as the power to distribute the benefits of this growth in uneven ways. Yet as I have sought to demonstrate, the ways in which these flows of capital are managed and controlled are not deterministically reducible to either 'the market' or 'the state'; rather, they must be assessed on the basis of a broader array of mechanisms that allow actors to generate stable reciprocal expectations, and thereby to manage the fundamental uncertainty that afflicts all social action. In China the CCP itself comprises a large and fundamental element in this array, and the reason that China's path of development is too often mischaracterized and misinterpreted is due to an assumption that the institutions of capitalist modernity must all somehow be pressed out of the same mould. As we have seen, China presents many reasons to recognize that perhaps this is not in fact the case.

Accordingly, this thesis has highlighted the complex, obscure, but critically important role of the CCP in underpinning China's path of financial reform and economic development more broadly. It has argued that the CCP's role is both the reflection as well as the source of particular *ideas* about how to manage the flow of capital that are reducible neither to the endogenous self-interested rationality of bureaucratic *institutions* (as scholars such as Victor Shih would posit) nor to relapses into a 'premodern'—and thus exogenous—set of interests that manifest in parochial personal *networks* or local biases (such as Yasheng Huang would argue). By placing specific ideas at the center of the analysis and the role that they played in underpinning expectations of financial growth and stability, it becomes possible to cast China's development in a new light by refracting it through the socio-economic foundations of capitalist development, rather than as a process of transition from a centrally planned economy to a market-oriented one.

Jettisoning such assumptions opens up space for deeper analytic appreciation of the role of different factors and variables in the study of China's economic reform. The interests of financial elites within the Chinese political economy could not be determined *ex ante* in an environment characterized by extreme uncertainty, and there is no *a priori* reason to presume that the immediate institutional or networked positions or identities of particular actors would be determinative in shaping material interests over and above the ideas and frames to emerge out of a significantly broader social context comprised of multiple and overlapping institutional contexts, the historical lineages of Chinese political and economic development, and the deeply rooted hierarchies and structures that continue to reside at the heart of Chinese society. The story of how these interests come into existence, and the effect that they had on the path of institutional change and the production of real socio-economic outcomes therefore cannot be told in ignorance of particular ideas about the relationship between financial capital and political authority. Yet this is not just to say that *ideas mattered;* this thesis has been concerned with developing a broader and more holistic understanding of *how these ideas mattered,* and in order to do this, it has been necessary to displace analytic perspectives that locate China's experience of modernity squarely within the parameters of the Western experience of modernity—assuming that as China embraces modernity, it relinquishes and severs its ties to an equally *modern* historical experience of social, political, and economic development. The ideas that have guided intellectual debate, the politics policymaking and economic behaviour are firmly rooted in *this* historical experience, and accordingly this experience and its impact upon China's contemporary development must be assessed on its own terms and in its own light.

Such a perspective compels us to rethink our analyses of a number of issues and areas within China's financial system and its role in the country's developmental trajectory. Increasing liberalization in the financial sector will not necessarily produce a more ecumenical and broad-based path of growth—as this thesis has argued, the process of marketization is itself contingent upon the continued role of the CCP as the guardian of financial stability. The nature of this role is changing along with the constitutive foundations of the CCP itself, as the institutions and networks of power that in aggregate comprise the CCP increasingly straddle the expanding private sector. As a result, the deepening contradictions and tensions of capitalist development will be reflected less in the evolving balance between 'state intervention' and 'market autonomy', and more in the variegated distribution of power and agency amongst actors according to their ideational, institutional, and relational connections to existing structures of authority and control. The development of China's financial system and its capacity to support broad-based and sustainable real economic growth is therefore tied closely to the ways in which the CCP manages and adapts to this process of constitutive change in the foundations of its ruling mandate and authority. As the market plays an increasingly significant role in allocating the flow of financial capital throughout the real economy, stability within the financial sector will be generated through its continued embeddedness in the political system, rather than as a product of unfettered market forces or an independent and technocratic regulatory regime.

A Global Capitalist Order in Flux

The implications of the reconceptualization undertaken in this thesis extend beyond the study of Chinese 'domestic' political economy. Reevaluating China's development in historical comparative context challenges existing ways of thinking about the dynamics of global order and China's place within it. This global order is in flux, yet translation of the debates that emerge out of that flux into a set of questions oriented towards China's place within the global order occludes the possibility that China is at once constructing its own version of modernity, one that intersects, reinforces, and simultaneously dislodges the very premises of some of these questions. In other words, the ontological incoherency of the modern capitalist order—the as yet unresolved crises and tensions that reside at the nexus of an imperative of unceasing economic growth and the social demands of the polity, and the efforts that are expended in order to resolve and mitigate these crises—demands more concerted efforts to study China's transformation on its own terms, and thus to reconceptualize many of the received categories underpinning the current study of international political economy itself. That is to say, it challenges us to understand China's development as a distinctive, unique, yet nonetheless thoroughly modern process of confronting those same questions that reside at the core of contemporary capitalist development, elsewhere and globally.

In taking up this challenge, this thesis has asked how capitalism in China disrupts conventional understandings of a linear continuum between the logic of state regulation, and that of market freedom. It explores how the process of constructing a particular capitalism in China has been possible across time, across territorial boundaries, and through politics itself. As Wolfgang Streeck observes,

> Capitalism must be studied, not as a static and timeless ideal type of an economic system that exists outside of or apart from society, but as an historical social order that is precisely about the relationship between the social and the economic – a social order that came into its own in Western Europe in the early nineteenth century and has been continuously evolving since. Seen this way, what is represented by economic theory as a technical arrangement for economic convenience, or as a causal structure of variable properties more or less suitable for expert control, can be recognized as a socially and historically constructed dynamic complex of institutional constraints and opportunities, expectations, rights, resources and power, with far-reaching ramifications into the surrounding society: its distribution of power, status and life chances, its action dispositions and capacities, and its social identities and ways of life.[3]

This necessity of studying capitalism as, in Streeck's terms, an 'historical social order' gave rise to the second chapter of this thesis, in which the development and legacies of earlier Chinese development were analyzed as the contextual foundation out of which contemporary capitalist development in China has emerged. By interrogating this process, it becomes possible to gain a more complete picture of how particular modes of regulating, ameliorating, and contesting the dynamics of capitalist development are at once a product of global modernity, even as they simultaneously reshape that modernity.

This means that the study of China's place and behaviour in the global order, and the objectives, policies, and strategies that are developed within China must be understood neither as

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[3] Streeck, "How to Study Contemporary Capitalism?", 3-4.

the products of endogenous socio-cultural or political dynamics, nor as any form of automated response to exogenous change in the global political economy. This thesis has shown how a number of decisions and dynamics of China's financial reform have been driven by particular ideas about how the global and the local are to coalesce together. At critical junctures in this reform process, the need for global economic integration was perceived as a challenge of reconciling a variety of different constraints and making use of a number of different opportunities both internationally and domestically. The inevitable and universal reality of interstate competition was recognized, as were the opportunities afforded by an increasingly efficient and sophisticated system of global trade and communication. The institutional circumstances of China's political system were a major factor in determining the extent and nature of China's variegated and experimental policies of international openness, as was the recognition of the social interests that would be affected by these policies. But for all of these factors, the *raw material* of social agency in the policymaking process remained *ideas* about how different social, political, and economic forces would be arranged together. As Wong has encapsulated it,

> Most commentaries on the Chinese role in the international economy view matters from the perspective of actors already in the institutional order of the international economy and ponder how the Chinese might fit in. … [T]he challenge … is how to understand the ways that domestic, regional, and global concerns intersect and mutually affect the policy choices toward the international economy that actors in any particular country make.[4]

As this thesis has argued, studying one particular actor or social grouping's position in the world remains a question of understanding the intersection of these various 'domestic, regional, and global concerns' as part of a 'capitalist historical social order', and therefore doing so in ways that reflect the contingency of structures and dynamics that are often regarded as part of the very

[4] R Bin Wong, "Chinese Political Economy and the International Economy: Linking Global, Regional and Domestic Possibilities," in *Aftermath: A New Global Economic Order?*, ed. Craig Calhoun and Georgi Derlugian (New York, NY: New York University Press, 2011), 150.

fabric of international society or the international system. Recognizing that contingency is not to deny the socially constructed material force of those structures and dynamics, but rather to accept that some of their most fundamental aspects are mutable, and further that this mutability is a product not of universal political or economic laws, but of the flow of specific ideas that both emerge out of a social space even as they also act upon that social space. As China comes to occupy an increasingly central position in the global political economy, the study of international political economy must be open and alive to patterns of continuity *and* change not just in the balance of power within the international system, but potentially also in the very means through which power is constructed in that international system.

Placing this in the context of how to modulate the flow of capital throughout national and global economies has implications for our understanding of global change and continuity in a number of domains that are each characterized by the socio-politically embedded interplay of market and state institutions. These feed into the ways that we seek to understand the evolution of global finance with reference to China itself. How do we understand and explain policy choices concerning the internationalization of the RMB and the evolution of the international monetary system? Further, as China's transnational corporations and sovereign wealth funds (SWFs) become an increasingly active presence in overseas markets, how is their rootedness in China's domestic political economy to be understood and factored into analyses of their decisions and behaviour? These implications also extend beyond a focus exclusively upon China, as the role of the CCP within a risk environment that has underpinned growth and development in China can be seen as one manifestation of deeper and more general processes of organizing political and economic responses to the fundamental uncertainty inherent in the financial relationships and systems of contemporary capitalism. How do we understand the development of the American financial system in the years leading up to the 2008 crisis as the outcome of a particular risk environment that was rooted in normative paradigms of socio-political thought? To what extent is the evolution of global financial hubs and the financial markets that they regulate influenced by their embeddedness in cognitive framings of who and what is to exercise authority over the flow of capital? The arguments of this thesis point to the need to place these questions and developments in greater historical and social context, as part of an ongoing process of change that involves the reshaping, and in some areas, the active reconstruction of the global political economy in ways that potentially reflect differing interpretations and ideas of how political authority can and should underpin the productive use of financial capital.

Appendix: Institutional Affiliations of Interviewees

Academic Research Institutions

Beijing Normal University

Boyuan Foundation

Conference Board China Center

Development Research Center of the State Council

East China University of Political Science and Law

Hong Kong University of Science and Technology

Institute of World Economics and Politics, Chinese Academy of Social Sciences

Institute of Finance and Banking, Chinese Academy of Social Sciences

Peking University

Tsinghua University

University of Hong Kong

Government Bodies

Central Leading Group for Finance and Economics

China Investment Corporation

China Banking Regulatory Commission

China Securities Regulatory Commission

Counsellor's Office of the State Council

Financial and Economics Committee, National People's Congress

Ministry of Finance

National Development and Reform Commission

People's Bank of China

Shenzhen Stock Exchange

Shanghai Stock Exchange

Standing Committee of the National People's Congress

State Administration of Foreign Exchange

Tianjin Municipal Government

Banks

Agricultural Bank of China

Bank of China

Baoshang Bank

China Construction Bank

China Development Bank

CITIC Bank

Export-Import Bank of China

Industrial and Commercial Bank of China

Minsheng Bank

Private Sector

China International Capital Corporation

Deutsche Bank Greater China

Hong Kong Exchanges and Clearing Limited

Primavera Capital Group

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BJ:2012.05.30. Interview, Beijing.

BJ:2012.06.04. Interview, Beijing.

BJ:2012.06.05 #1. Interview, Beijing.

BJ:2012.06.05 #2. Interview, Beijing.

BJ:2012.06.06. Interview, Beijing.

BJ:2012.06.08 #1. Interview, Beijing.

BJ:2012.06.10. Interview, Beijing.

BJ:2012.06.14. Interview, Beijing.

BJ:2012.06.16. Interview, Beijing.

BJ:2012.06.20. Interview, Beijing.

BJ:2012.09.07. Interview, Beijing.

BJ:2012.09.12. Interview, Beijing.

BJ:2012.09.17. Interview, Beijing.

BJ:2012.10.10. Interview, Beijing.

BJ:2012.10.12. Interview, Beijing.

BJ:2012.10.21. Interview, Beijing.

BJ:2012.11.09. Interview, Beijing.

BJ:2012.11.16 #3. Interview, Beijing.

BJ:2012.11.17 #1. Interview, Beijing.

BJ:2012.11.21. Interview, Beijing.

BJ:2012.11.24. Interview, Beijing.

BJ:2012.11.28 #2. Interview, Beijing.

BJ:2012.11.28 #3. Interview, Beijing.

BJ:2012.11.28 #4. Interview, Beijing.

BJ:2012.11.29 #5. Interview, Beijing.

BJ:2012.12.12. Interview, Beijing.

BJ:2012.12.14. Interview, Beijing.

BJ:2013.04.07. Interview, Beijing.

BJ:2013.07.13. Interview, Beijing.

BJ:2013.08.09. Interview, Beijing.

BJ:2013.08.21. Interview, Beijing.

BJ:2013.08.26. Interview, Beijing.

BJ:2014.04.14 #1. Interview, Beijing.

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