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Shi, Yuning (2024) Has the Chinese economy been financialised? An

analysis focusing on the state sector.

PhD thesis. SOAS University of London.

https://doi.org/10.25501/SOAS.00041989

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Has the Chinese economy been financialised? An analysis focusing on the state sector

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Thesis submitted for the degree of PhD

2023

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For Lezhi

Declaration for SOAS PhD thesis

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Abbreviations

ABC - Agricultural Bank of China
ARI - Account-receivable investment
BoC - Bank of China Limited
BOCOM - Bank of Communication
CBIRC - China Banking and Insurance Regulatory Commission
CBRC - China Banking Regulatory Commission
CCB - China Construction Bank
CCP - Chinese Communist Party
CIRC- China Insurance Regulatory Commission
CNOOC - China National Offshore Oil Corporation
CNPC- China National Petroleum Corporation
CPF - China Petroleum Finance Co.
CSRC - China Securities Regulatory Commission
DAMP - Direct asset management product
FDI - Foreign Direct Investment
GFC - Global financial crisis
ICBC - Industrial and Commercial Bank of China
IMF - International Monetary Fund
IPO - Initial Public Offering
LGFV - Local government financing vehicles
LTD - Loan-to-deposit
MCB - municipal corporate bonds
MOF - Ministry of Finance
NDRC - National Development and Reform Commission
NPL - Non-performing loan
PBOC - People's Bank of China
PRC - People's Republic of China
PSBC - Postal Saving Bank of China
PSC - Standing Committee of the Politburo
QDII - Qualified Domestic Institutional Investor
QFII - Qualified Foreign Institutional Investor
ROA - Return on Assets
RQFII - Renminbi Qualified Financial Institutional Investor
SASAC - State-Owned Assets Supervision and Administration Commission of the State Council
SAFE - State Administration of Foreign Exchange
SCIOs - State-owned capital investment and operation companies
SDR - Special Drawing Rights
Sinopec - China Petrochemical Corporation
SME - Small- and medium-sized enterprises
SOE - State-owned enterprises
SOCB – State-owned commercial banks
TBR - Trust beneficiary right
TFS - Total social financing
TVE - Township and village enterprises

WMP - Wealth management products

Abstract

This dissertation analyses the financialisation of the Chinese economy by considering the transformation of the state sector, including state-owned enterprises (SOEs), the financial system (especially banks) and local governments. After surveying the theoretical and empirical literature, I illustrate that neither the framework of financialisation of core capitalist countries nor that of subordinate financialisation of peripheral countries fully fits the development in China. To facilitate the analysis of the transformation of China's state sector, I develop a political economy framework that departs from the conduct of three fundamental economic agents in the state sector. Specifically, the framework focuses on the altered mix of financial and non-financial activities of SOEs, the changing role of the banking sector, the shifting sources of revenue and the altered financing behaviour of local governments.

I then show that the three agents in the state sector, namely, SOEs, the financial sector and the local governments experienced great changes with the rise of finance in China, particularly in the twenty-first century. But in essence, they possess the same characteristics as in the early reform era of the 1980s and 1990s.

Specifically, I show that central SOEs are turning into "small kingdoms[1]" that are more financially sophisticated, have skills in undertaking market finance transactions, and earn financial profits. The banking sector has developed a domain of "shadow banking" and local governments have adopted the practices of corporations. Moreover, the state governs SOEs

[1] This term is used to describe the large SOE groups which are considered to possess large economic and political clout in the existing literature, see Brødsgaard, 2012. I am aware that this term may carry orientalist and feudalist implication, but that is not at all what is meant in this thesis. Rather, the gist of it is to show the enormous economic, social, and political power that the large SOE groups have accumulated.

and the financial sector increasingly through financial methods. However, the financing of SOEs continues to rely heavily on banks, and SOEs have even formed tighter relations with banks through shadow banking practices. The banking sector remains centred on the provision of finance to enterprises and operates under a strong state presence, especially regarding interest rates and international capital flows. Moreover, relational and government-controlled structures in finance have not been replaced by arm's length and private mechanisms.

The analysis is supported empirically – thus placing the work more firmly in the literature – by constructing a dataset comprising 362 non-financial central SOEs that are publicly listed in Chinese mainland in Shenzhen and Shanghai Stock Exchange over the period of 2000 – 2019. Drawing on the theoretical discussion and using a range of statistical measures, the dissertation concludes that there is no sufficient ground to claim that the Chinese economy is becoming financialised. The complex interplay between SOEs, the financial system, and the local governments in China are more likely to be credit expansion. Further transformations towards these directions might still result in the financialisation of the Chinese economy, but it seems not yet.

Acknowledgement

First and foremost, I would like to express my sincerest gratitude and heartfelt appreciation to my supervisor Professor Costas Lapavitsas, to whom I owe huge intellectual debts. My doctoral research would have been impossible without his relentless support and generous encouragement. His line-by-line critical reading, incisive comments, as well as his commitment to the highest standards and the infinite patience have pushed me to bring out my best work and profoundly shaped my academic development. He guided me to explore many other possibilities in my time at SOAS, such as writing book chapters, publishing articles, teaching and consulting, which made my PhD journey tremendously rewarding and enjoyable. Along the way that I was working with him, Professor Lapavitsas always had faith in me, which energised me to constantly strive for improvements. He has been an empowering mentor both academically and in life, whose wisdom, optimism, charisma and caringness not only inspired me to become a rigorous scholar but also made him a lifelong dependable friend.

My gratitude also extends to Dr. Dic Lo, who is my second supervisor, co-author and mentor. I am deeply grateful for his guidance and trust in co-authoring a paper with me at the early stage of my PhD. His consistent support and insightful suggestions on my doctoral research and future career have made my way forward clearer. I could not have wished for a better second supervisor.

My deepest gratitude goes to my beloved husband, Dr. Yunyi Zhang, for his unwavering love and unconditional support. It is him that firmly encouraged me to pursue this PhD and walked me through the long way. He is always there by my side cheering me up through difficulties

and celebrating every accomplishment. He is also the most supportive and inspiring study partner--we spent so much time together at different libraries, at doctoral school, at his working space in Warwick, and at our home office. Beyond that, he is also my best friend who always knows how to make me laugh, and my life partner who I love with all my heart.

My sincere thanks of course go out to my parents, grandparents and parents-in-law, who are the best support system that one could ever ask for. Their emotional and financial support ensured that I had the privilege to study abroad and to live a colourful life here in London. At the final year of my PhD, I was pregnant and had my little baby Lezhi, to whom this thesis is dedicated. I hope he likes this first gift that came from mommy.

I also would like to thank the wonderful friends I have made throughout my time at SOAS, including Xinwen Zhang, Weiwei Chen, Xuetong Wang, Shehryar Qazi, Thanos Moraitis, and Juan J Duque. I enjoyed reading and working with Shehryar, Thanos and Juan, who have deeply inspired me and completely changed my way of learning and questioning. I also have been extremely fortunate to have had the company of my friends outside SOAS, including Yayi Zhao, Yuan Lv, Xueer Zou, Miaolei Wu, Hairuo Yang, and Jieren Ke, with whom I spent most of my spare time and created so many precious memories.

Finally, thanks also to the PhD cohorts and academic staff at the Economics department who also provided valuable comments on my research throughout the years. It has been a privilege to spend these past years focused on my research and I am truly grateful to everyone who has offered their help. Thank you.

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Chapter 1. Introduction

Looking back over the past four decades, it is astonishing to find how rapid that Chinese economy has evolved. The economy transformed from a backward agrarian economy to the second largest economy in the world, only next to the leading hegemon, the US, and achieved an unprecedented industrialisation in human history—China "is the only country whose economy registers all the industrial categories contained in the United Nations Industrial Classification" (Lapavitsas and the EReNSEP Writing Collective, 2023, p. 275). It has created its own unique development path and political economic system where capitalist elements have sprung up but remain a so-called socialist system. The economic and institutional reform in China allowed the state successfully establishing and managing the large industrial and financial capitals which further became "national champions" dominating the "commanding heights" of the economy as monopolistic enterprises and also competing with other capitalist multinational companies in the global market.

China's rapid economic catching up would not have been possible without the rise of finance. Finance has grown significantly, playing a crucial role in the transformation of the Chinese economy. With the commencement of the Opening and Reform (the Reform hereafter) in the late 1970s, the mono-bank system of finance shifted quickly in the direction of liberalisation and the introduction of markets, a process that accelerated in the 1990s. Specifically, state-owned banks adopted commercial practices and were encouraged to adopt a corporate outlook. Moreover, the state control of the interest rate was increasingly relaxed, with market-based finance emerging and flourishing. Now, after more than forty years of such

financial reforms, China possesses an enormous financial system, which has also been profoundly transformed.

However, Chinese economy stepped into a so-called "New Normal" in the early 2010s, and it has witnessed the slowdown of the GDP growth rate, stagnated investment-to-GDP ratio and dropping rate of profitability. Although investment has remained at a high level comparing with other countries, the sluggish increase rate of both GDP and investment seemed to indicate a weakening accumulation in China. At the same time, finance has risen, and penetrated to every corner of the economy, and it led to the transformation of the basic economic agents' conducts as well as the way that the state governs the economy. But the interest rate has not fully liberalised. Yet, the significance of China in the international monetary system is disproportionately low with the capital account being not fully convertible.

Based on the trajectory of China's development in the recent four decades, the term "financialisation" was brought to my attention as it seems an appealing concept to analyse the transformation of the Chinese economy. Financialisation emerged in the 1970s to capture the feature of the US economy which has been increasingly dominated by large corporations. It was inspired by the work of the *Monthly Review* School, particularly the study of Harry Magdoff and Paul Sweezy, who systematically explore the shifted gravity from production to finance in capitalism since the 1960s, which was caused by the transition from competitive capitalism to monopoly capitalism. Sweezy (1997) observes and summarises three interrelated underlying trends of monopoly capitalism from the 1974-5 recession onwards: 1) slowdown of the overall growth rate; 2) worldwide proliferation of monopolistic (or oligopolistic) multinational corporations; and 3) financialisation of capital accumulation

process. That is to say, stagnation and financialisation go hand in hand in the monopolistic capitalism. I have found this insight to be very useful and relied on it throughout the thesis, even though I have not adopted the theoretical framework of Monthly Review.

This dissertation begins with a quest for financialisation as a potential parameter for the transformation of the Chinese economy. It seems that China has stepped into the old road of financialisation considering its stagnation and monopolisation. But in certain ways, it looks not like it because of the relatively closed and strongly state-presented financial system, as well as the non-changed core of the large state-owned enterprises (SOEs) [2] and governments. This dissertation is about to explore the conduct of the fundamental agents to map the transformation of the Chinese economy and to specify whether or not financialisation is a relevant concept to understand these transformations.

By looking into the conduct of SOEs, banks and governments, this dissertation argues that there are no sufficient grounds to identify financialisation in China currently. Indeed, China has experienced a massive growth in finance and the conduct of the fundamental agents have changed in certain ways, but the core of them has not altered. The seemingly transformations of each economic agent actually display great continuity. Moreover, it did not bring any further institutional change, i.e., the whole economic system remains a relational and government-controlled structure.

[2] SOE refers to the enterprises where the state has a controlling stake in this thesis. This has been elaborated in full in Section 4.3.

This chapter, as the introduction of the whole dissertation will first outline the motivations of carrying out this research, which demands a brief discussion of the landscape of the development of Chinese economy in the past twenty years. The second section then presents the research question, the precis of the approach and methodology. Finally, the contributions and the structure of the whole dissertation follows one another.

1.1 Motivations: some stylised facts and literature gaps

The Chinese economy is unique, complicated and multi-faceted. Thus, its transformation is expected to be qualitatively different from that in other economies. By reviewing the literature, it finds that the existing literature did not provide much reference on mapping or interpreting its transformation, and the literature on financialisation also lacks Chinese evidence. Therefore, a systemic study examining Chinese economy's transformation from the lens of financialisation is necessary. This section shows why this dissertation is necessary and significant from both the economic realities and existing studies.

1.1.1 Chinese economic reality

According to Marxist political economy, the periodic crisis is the result of "the pathology of capitalist production, not of commodity circulation and money" (Lapavitsas, 2013, p. 268). The primary aspect of the capitalist accumulation is always the production. However, monetary aspects hold great importance and are integral to the production process. Thus, some selected Chinese economic realities will be presented from both the production side and the financial side in this section.

To look at China through the aforementioned "three interrelated underlying trends", it is surprising that China has been going through a similar route in the recent twenty years as the mature capitalist economies have gone through in the 1970s onwards. Chinese GDP had kept two-digit annual growth rate at roughly 10% during 1978-2008, but the economy started to grow at a slower speed after the 2008 Global Financial Crisis, as shown in Figure 1. The growth rate collapsed in 2008, and it bounced back a little in 2010 under the impact of the stimulus package, but it once again dropped in the following year, and kept at a rather stable level at around 7% in the first half of the first decade of the new century. The GDP growth rate dropped below 7% in 2016, and stabilised at the level until the pandemic broke out in 2020. The slowdown of economic growth was referred to as 'New Normal' by Chinese leadership in circa 2013, implying that the already large economy will enter into a new stage where the growth rate would be more moderate. The slowdown of the economic growth exhibits symptoms of weakness in accumulation. The most straightforward evidence is the decline of the rate of profit since 2010s, as shown in Figure 2. [3]

[3] The calculation of rate of profit draws on the method proposed by Li (2017), that is, r = (GDP – labour cost – taxation cost – depreciation of fixed capital) / capital stock. However, despite following the spirit of Li's method, it does not deploy exactly the same procedures and nor does it use the same data sources. To be more specific, the measure of the capital stock used by Li was calculated by him, whereas I used secondary data that was retrieved from Federal Reserve in St. Louis, originally published in the work of Feenstra et al. (2015) in *American Economic Review*. Thus, the rates calculated in this thesis is considerably lower than Li's estimates. For the same reason, it is also lower than the estimates that has been done in Li and Li (2015) and Marquetti et al. (2021). However, the general trends are consistent throughout-- the rate of profit of Chinese economy reached a mini peak around the Great Crisis of 2007-9, and then went down after 2011.

Figure 1 Annual growth rate of GDP. China, 1978-2021

Source: World Bank Data.

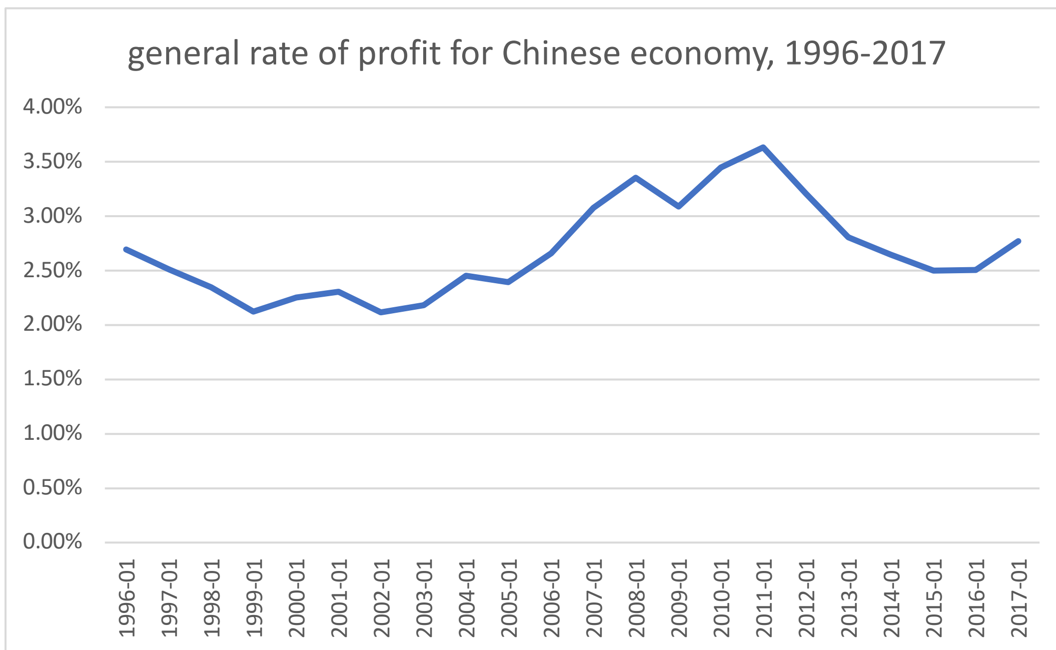

Figure 2 China's general rate of profit, percentage, 1996-2017.

Source: Author's own calculation based on data from *Wind*, China National Statistics Yearbook and Fred St. Louis.

Like the developed countries, weak productivity growth is connected to weak investment. Figure 3 shows a relative weakening of aggregate investment in China after the Great Crisis of 2007-9. It is to note that although the investment kept increasing in the past two decades, its relative level to GDP has stagnated since the GFC. So far, China has had a tendency of stagnation if the GDP and investment growth rate continue to go down.

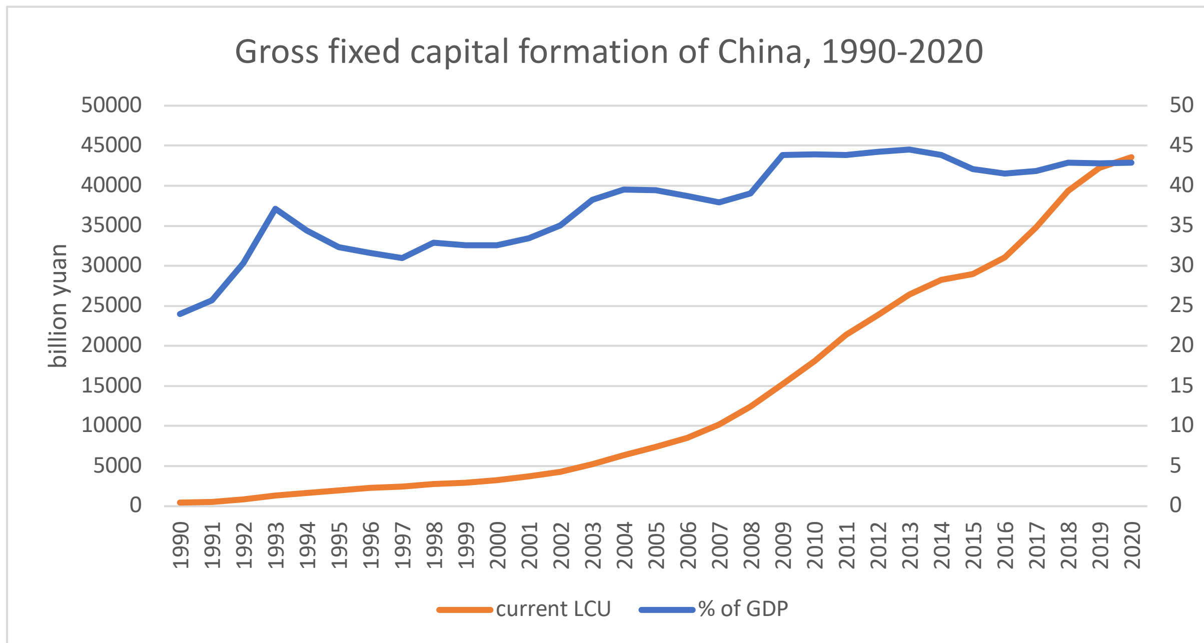

Figure 3 Gross fixed capital formation, China, 1990-2020.

Source: The World Bank.

At the same time, monopolistic enterprises grew faster in China. The state created large enterprises— "national champions" deliberately to compete with other multinational companies in the global market. SOEs took advantage of this opportunity, developing into conglomerates which stand at the pinnacle of the Chinese economy. The non-state enterprises imitated the business structure and their way of expansion. The companies which top at their own industries were inclined to expand into a conglomerate by either horizontally merging smaller companies in the same industry or vertically merging and acquiring

companies in the related industries. Or they simply developed the related business realm from scratch by taking advantage of their abundant capital. As a result, China became the late comer on the list of the world largest or the most profitable companies.

Meanwhile, finance has experienced dramatic expansion. The state-owned commercial banks have been possessing the absolutely dominating power in the banking sector and have become also well-known in the global financial market. Three of the Big Five [4] were on the list of top ten largest companies in the world in 2023. Market finance has seen a quick growth since its establishment in the 1980s. China's bond market stood at 140.26 trillion renminbi (circa 19.7 trillion USD) in 2021, making it the second largest bond market in the world, only second to the US bond market (Lotay and Chong, 2022). Its market size was even larger than the combined size of that of the UK and Japan (ibid). In terms of the market capitalisation of the stock market, China was ranked the fourth as of January of 2023, accounting for 3.7% of global equity market value. [5] The money market was relatively young compared with its capital market, but the rise of shadow banking filled the gap that left by the underdeveloped money market. Estimates of the scale of China's shadow banking by researchers vary greatly – from 8 to 80 per of GDP (Ehlers et al., 2018; Elliott, et al., 2015; Tsai, 2015), whereas Chinese official estimates the shadow banking in both broader and narrow sense, accounting for a large range of national GDP. It was up to 121 per cent of the national

[4] The Big Five used to be Big Four before Bank of Communication was included. It now refers to the five state-owned commercial banks in China, namely, China Construction Bank, Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, Bank of Communication. The first three are on the top 10 of the list of Global 2000 in 2023, which can be retrieved from https://www.forbes.com/lists/global2000/?sh=25b19eb25ac0, last access on 26 July 2023.

[5] The data was retrieved from https://www.statista.com/statistics/710680/global-stock-markets-by-country/ , last access on 26 July 2023.

GDP in 2017 when the shadow banking was at its peak, and it gradually went down in the following years (CBIRC, 2020). It accounted 86% of national GDP in 2019 (ibid).

Hugely inflated debts have haunted China with the rise of finance, especially the exceedingly high corporate debt. According to the data by Bank of International Settlements (BIS), China's total non-financial debt reached 254% of GDP in 2018, a drastic increase from 142% in 2008. Of these non-financial debts, 60% are corporate debts, while government and households account respectively for 20%, as shown in Figure 4.[6] This is a very different composition of aggregate debt from the USA, whose total non-financial debt stabilised at roughly 250% of GDP in the pre-pandemic time. Of the US non-financial debt in the same period, it almost averaged out in each sector, with the household sector and corporate sector each accounting roughly for 80% of its GDP, whereas China's household debt was only slightly more than 40%, but the corporate debt was much higher. [7]

[6] The debt level of non-financial sector is the sum of that of general government, households and non-financial corporations.

[7] All figures from China and the USA taken from Bank of International Settlement (2022), Statistics of Credit to the non-financial sector, available at https://www.bis.org/statistics/totcredit.htm, accessed on 5 Apr. 2022.

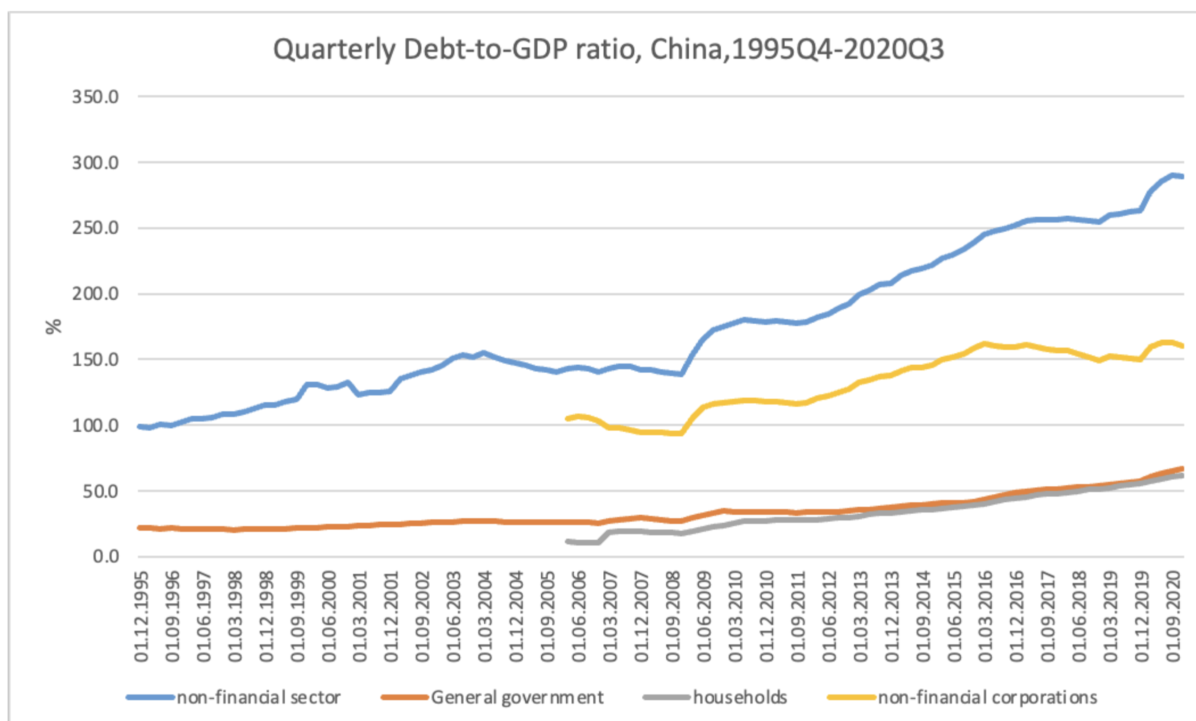

Figure 4 Debt-to-GDP ratio for different sectors, percentage, 1995-2020

Source: Bank for International Settlement

1.1.2 Literature gap

The stylised facts indicate the transformation of the Chinese economy. To make sense of the transformation from the perspective of financialisation, it is necessary to have a clear understanding of the role and content of financialisation. As an emerging topic, financialisation draws the attention of scholars from all disciplines in social sciences, including in economics, sociology, political science, geography, and interdisciplinary research. However, scholars have not yet agreed on its definition, nor the paradigm of analysing financialisation of an economy. Thus, financialisation can be understood from different schools of thoughts, such as Marxist political economy, Post-Keynesianism, French Regulation Schools, and others; or it can be examined from different perspectives, or through various approaches or themes. For example, financialisation can be used to describe a systemic transformation of capitalism, or to be associated with the secular stagnation, and thus, perpetual crisis, or the emergence

of the new management priority in firms (shareholder value), or individuals' increasing participate in the financial market and financial activities (financialisation of everyday life or households), or the growing dominance of market-based financial system over the bank-based system, and many more others (Lapavitsas, 2013; Powell, 2013; van der Zwan, 2014). However, the difference of each theme or approach can be very subtle at most of the time.

Financialisation is originated from the debate of the rise of finance of the US economy, and it then expanded to assess the similar tendency in developed countries, such as the UK, France and Japan. Recently, a growing body of literature started to examine financialisation in developing countries, namely, Latin American, East and Southeast Asian, and East European countries. These empirical studies display various forms of financialisation, but they convey the same message that the manifestation of financialisation is contingent upon country-specific institutional, political, economic and historical backgrounds.

Specifically, financialisation in developed countries is normally an *internal* process that rises from within its domestic economy, manifested alongside the deregulation of their financial systems that peaked in the 1990s and 2000s, especially in the US and the UK where it was underscored by the sophisticated and rapidly growing financial innovations, typically securitisation, respectively (Karwowski and Stockhammer, 2017; Krippner, 2012). Analytically, financialisation in developed countries is often approached by examining the changing conduct of behaviours of basic economic agents, as well as their altered interactions with one another, namely, non-financial enterprises, the financial sector and households (Karwowski et al., 2020; Lapavitsas, 2013).

Financialisation in developing countries is channelled from *external* through financial liberalisation in the recent three decades, marked by the shift of financial systems in a market-based direction, increased inflows of portfolio and bank lending, accumulating debts for enterprises and households as well as entry of foreign banks in the national economy, from which aspects that the financialisation in developing countries is examined (Becker et al., 2010; Bonizzi, 2013; Cho, 2010; Dos Santos, 2011; Kaltenbrunner and Painceira, 2018; Karwowski and Stockhammer, 2017; Lapavitsas, 2009, 2013; Rethel, 2010). In these respects, financialisation in developing countries can be referred to as 'subordinate' or 'dependent' financialisation (Lapavitsas, 2013; Lapavitsas and Soydan, 2022; Powell, 2013).

It is not difficult to find out that China was left out of the crucial academic debate of financialisation in both theoretical and empirical dimension by reviewing the literature. Theoretically, there is no appropriate analytical framework for China's financialisation; and empirically, it lacks the systematic evidence of financialisation of China. Among the limited literature on China's financialisation, some of them oversimplified financialisation to the over development of finance (see, for example, Zhang, 2019; Zhang and Zhuge, 2013; Zhao and Tian, 2015), and some of them excessively narrowly focused on the transformation of the government, believing that increasingly financial tools that have been utilised in state's governance imply financialisation (see, for example, Feng et al., 2022; He et al., 2020; Jiang and Waley, 2021; Naughton, 2019; Petry, 2020; Wang, 2015; Wu et al., 2022). Both of the ideas are reasonable in certain ways, but too thin for the meaning of financialisation.

Thus, a systemic study of financialisation on China's context will be a valuable addition for the academic debate of the meaning and variegated forms of financialisation. It will also close the literature gap by begetting an appropriate analytical framework for it.

1.2 Research questions, approaches and methodology

The declining rate of profit in the aggregate economy, stagnated investment, the emergence of monopolistic enterprises in both state and non-state sector, the ever-increasing debts, the rising shadow banking and its penetration to other walks of life, as well as the government-controlled financial system in part mirror financialisation in developed countries, and also shares similarities with 'subordinate' or 'dependent' financialisation in developing countries, but with considerable differences with both of them. Nevertheless, the Chinese economic realities reflect a qualitatively different structure of capitalism in China than in elsewhere. Financialisation itself is contingent on the country-specific historical, political and institutional background as will be fully elaborated in Chapter 2 and 3. Financialisation in China, thus, is expected to be fundamentally different from any existing forms if at all. To answer the research question of *whether the Chinese economy has become financialised* needs to clarify the definition of financialisation first, and an appropriate analytical framework is required to operationalise the research question.

Financialisation can represent an epochal transformation of capitalism (broadly along the lines of Arrighi, 1994; Harvey, 1989; Lapavitsas, 2013) which stems in the perspective of Marxist political economy, and this has been adopted as the definition of financialisation in this dissertation. After reviewing the literature of financialisation, I came to the conclusion

that the framework proposed by Costas Lapavitsas is the most relevant for examining of the Chinese case. The fundamental reason is that his approach, too, treats financialisation as an epochal transformation, and builds upon the division between financial and real accumulation from the standpoint of Marxist political economy. In this light, financialisation rests on the altered conduct of the fundamental agents of the economy, namely, non-financial enterprises, financial enterprises and workers/households in the capitalist countries (Lapavitsas, 2013). Consequently, to establish whether financialisation has taken place it is imperative empirically to consider the conduct of these agents in each case. It is emphasised in this dissertation that financialisation is by no means an escape of productive capital into the financial realm seeking for higher profits, or production is being crowded out by the finance (ibid, c.f. Lo, 2018; Orhangazi, 2008; Stockhammer, 2008).

The transformation of the Chinese economy shall be approached through an analytical framework that is developed by extending and adjusting Lapavitsas' analytical framework. The analytical framework is built upon the basic economic agent's conducts in the state sector, namely SOEs, banks and governments. The reason why this analytical framework focuses only on the state sector is that there exists huge discrepancy between the state sector and the non-state sector within Chinese economy. The operating mechanism of the state capital is not necessarily the same as the non-state one. In this light, financialisation cannot be explored as an integral phenomenon of Chinese economy. Thus, this dissertation focuses on the state sector which owns major monopolistic enterprises in the commanding height of Chinese economy. Financialisation is such a concept that holds for the monopolistic capital (Lapavitsas, 2013). Hence, the state sector is more appropriate to be treated as objective of this research. The main research question, thus, can be operationalised as *1) how is the conduct of each of*

the economic actor within the state sector (i.e., SOEs, banks and governments) transformed with the rise of finance in the past twenty years? 2) Do the transformations represent financialisation?

It is also to note that financialisation has to be made a clear-cut conceptually with financial development as well as financial liberalisation and financial deepening despite the inherent differences among these notions. If financial development does not result in wider changes in the conduct of the economy and the institutions of both economy and society, it lames little sense to talk of financialisation.

To be a complement to the conduct of basic economic agents, this dissertation also takes consideration of their altered relations with the rise of finance and the institutional settings. Thus, a mixture of qualitative and quantitative methods is deployed to cater the different needs of this multifaceted issue. Quantitatively, this dissertation uses quantitative method on landscaping the full pictures of the behaviours of publicly listed central SOEs. It is done by collecting, cleaning and constructing the data set for the publicly listed central SOEs, and then pulling out the stylised facts that drawn from this original dataset. The empirical findings are then interpreted through the lens of Marxist political economy.

The institutional analysis is employed throughout the whole thesis to demonstrate Chinese political economic structures and the mechanism of Chinese economy, equipping the reader with the basic knowledge of the intertwined relations of the basic economic agents (namely, SOEs, financial sector and governments) that will be immediately relevant to the analysis of financialisation. The institutional analysis will also help to understand how each of their

transformations would lead to a further transformation of others and possibly the change of the political economic system of China.

Additionally, I had several inform talks with the same private concrete factory owner and its chief accountant in Shanxi Province, China, during my doctoral research from 2018 to 2023. This open-ended interview is more conversational than the traditional interview, which could best accommodate the interviewees' feeling and expertise, letting the interviewees to take more control of the conversation in order to compensate interviewer's insufficient knowledge in a particular area, and to get more useful information out of the conservations.

1.3 Contributions

This dissertation has contributed to the following four aspects. First, this dissertation is a piece of fresh systemic research on financialisation in the context of China. A growing body of scholars have put their fingers on financialisation on Chinese economy, but it seems that they are too ambitious as they attempt to illustrate this profoundly compounding and broad issue in just one paper's length. Consequently, they either oversimplified financialisation to several quantifiable metrics without considering the political economy side of the concept, or they noticed the Chinese specificities but did not provide enough empirical evidence to support their arguments. This dissertation chimes in attempting to fix these problems by providing systemic empirical evidence and a thorough political economy discussion of these findings in book-length research on financialisation of Chinese economy with a primary focus on the state sector, which add weights to the existing literature that it lacks the evidence from China.

Moreover, this dissertation offers an innovative perspective of comprehending China's market reform and the structure of Chinese economy. By looking into the changed conducts of basic economic agents as well as their altered relations under the rise of finance, it is found that they have been transformed in certain ways, but the core has not changed yet. Specifically, SOEs have acquired more financial skills, but the close tie between SOEs and banks, especially state-owned banks have not been cut loose, and they have not been as sophisticated in the arena in market finance. Banks have had the tendency to become shadow banking, but the core remains credit-centric, partially-liberalised and state-influenced. Governments have used increasingly financial tools in their governance in both the central and local level. The local governments have been transforming into corporations with the facilitation of local government financing vehicles (LGFVs), indicating that the relational and government-controlled structure prevails in the Chinese economy.

No previous studies have ever isolated the state sector from the non-state sector when discussing the financialisation of the Chinese economy. Although certain pieces have focused on financialisation of the state (Naughton, 2019a; Wang, 2015), they only broadly articulate the role of the state in Chinese economy without differentiating the specificity of that of the government and the Party, let alone the role of the local government. And they tend to treat the state as one exogenous high power which is parallel to the enterprises and the financial system. This dissertation precisely identifies the state sector of Chinese economy, which consists of non-financial SOEs, financial system, in particular state-owned commercial banks as well as the government. Such identification allows the state is treated as an endogenous player in the Chinese economy. Unexpectedly, in some cases, it could be the exogenous high power and the endogenous player at the same time, such as the hybrid role of State-owned

Asset Supervision and Administration Commission of the State sector (SASAC) which will be discussed in Chapter 4. The role of the Communist Party has also been discussed throughout this dissertation. Besides, other relevant government bodies are introduced whenever it is necessary. By considering various actors, this thesis breaks the wrong perception that the Chinese state sector is a seamless entirety. Rather, each of the actor has its own interest and incentive under the unanimous national goal and policy, therefore, they transformed differently. Also, these actors in the state sector are interrelated in various ways as they are elements inside one relatively closed system, resulting that the transformation becomes even more complex.

The fourth is an innovative use of data. This dissertation constructs a mini dataset that comprises 362 non-financial central SOEs which are publicly listed in mainland China in Shenzhen and Shanghai Stock Exchange over the period of 2000 – 2019. The dataset is constructed by estimating flow of investments and flow of funds based on companies' consolidated balance sheet data that drawn from *Wind*. Only a few studies have focused on central SOEs, and fewer of them have their focus on publicly listed central SOEs. The firm-level balance sheet data of this particular sample will be of great value in the future empirical works for China's SOEs.

1.4 Dissertation structure

The dissertation has a total of eight chapters whose body parts can be divided into two parts. The introduction primarily shows the motivation of carrying out this research and formulates the research question. This dissertation is dedicated to answering the question that whether

or not Chinese economy has been financialised by focusing the transformations of economic agents in the state sector. The first part is composed of Chapter 2 and 3 that explore financialisation theoretically and conceptually, as well as attempt to develop an analytical framework that could help to answer the research questions. The second part makes up of four core empirical chapters which provide rich empirical evidence and in-depth political economy analysis of the transformation and financialisation of the economic agents of the state sector. Precisely, Chapter 4 and 5 are about the SOEs, Chapter 6 is on the banking sector and Chapter 7 is on the transformation of banks and local governments. Finally, Chapter 8 concludes the dissertation by summing up the contributions and primary findings, also pointing out the possibilities for further research. The rest of this dissertation is structured as follows.

Body part of the dissertation starts from Chapter 2 where extensive scholarly works of financialisation are surveyed. Theoretically, it reviews, compares and contrasts the literature from the perspective of different schools of thoughts, typically, Marxist political economy, Post-Keynesianism, French Regulation School, and other strands or interdisciplinary works in social sciences. Empirically, this chapter reviews, compares and contrasts the key tendencies of financialisation in mature capitalist countries and in developing countries, respectively. It is made clear that financialisation is manifested in different forms given different historic, institutional and political backgrounds. Thus, it is expected that China's financialisation would be different if at all. Thus, it follows a survey on the existing literature of financialisation on China. It is found that current studies on financialisation of Chinese economy lacks the conceptual depth of the analysis, and often use financialisation interchangeably with financial liberalisation, financial development, financial globalisation or financial deepening, despite

the difference in these concepts. Hence, a section is dedicated to differentiating financialisation from financial liberalisation/development/globalisation/deepening, building the conceptual foundation for the analytical framework that is proposed in Chapter 3.

Nevertheless, it seems that none of the existing framework could perfectly fit the Chinese context as China shares the similarities with financialisation of both developed and developing countries, but also have strong Chinese specificities that are dissimilar to either of them. In this light, Chapter 3 aims to construct an analytical framework that could incorporate the specificities of Chinese state sector to help understand its financialisation. To achieve this goal, Chapter 3 begins with an introduction of the Marxist political economy approach that the analytical framework is built upon, following a thorough elaboration of the original analytical framework that is used to analyse financialisation, and how it is developed according to China's context. Lastly, this chapter also introduces the methodologies that are employed in this dissertation, namely, the quantitative methods and qualitative methods, including institutional analysis and informal talks.

Part II shifts the focus from the conceptualisation of financialisation to the analysis of the transformation of Chinese economy with a specific concentration on the state sector from perspective of financialisation. This part provides rich empirical evidence and in-depth political economy analysis of the transformation of the state sector and the discussion on whether or not it is financialisation. Thus, this part is dedicated to three basic agents of the state sector, namely, SOEs, banks and governments, aiming to see how exactly they regulate (performing as the exogenous high power) and participate (being the endogenous player), and how these conducts change with the rise of finance in China during the last two decades.

Chapter 4 concentrates on the institutional analysis of the nature of large enterprises in the state sector, i.e., the centrally managed SOEs. It starts with a brief introduction of China's hierarchical political-economic framework where the role of the Communist Party and different levels of governments are explained, as well as the differences between central SOEs and local SOEs, along with the relation between the Party, the government, and the SOEs. The basic economic agents in the state sector, thus, will be better positioned in the particular political-economic system, which will be useful when understanding their collusions in the shadow banking activities. It then turns to Central SOEs, the monopoly capital in Chinese economy as they effectively monopolise the natural resources, hold tightly the price-setting power and achieve the asset concentration. This chapter argues that despite the state ownership and the *nomenklatura* system, central SOEs have created their own 'small kingdoms' by exploiting their accumulated economic and political power to pursue their own interest, but not in the context of a planned economy. The state's governance over these 'small kingdoms' has increasingly relied on financialised means, effectively facilitating their transformations to be financially sophisticated non-financial enterprises. However, the non-separable ownership and control of the state over the SOEs make the shareholder value difficult to be identified. These compounding changes keep these 'small kingdoms' the core of Chinese economy, and also make financialisation impossible for Chinese SOEs.

Chapter 5 is one of the core chapters of empirical evidence, presenting the altered financing behaviour of central SOEs by using a self-constructed mini dataset on central SOE. The original data is collected from the consolidated balance sheet of 362 non-financial central SOEs which are publicly listed in mainland China in Shenzhen and Shanghai Stock Exchange over the

period of 2000 – 2019. And the dataset is constructed by estimating annual flow of investments and flow of funds based on this data that is drawn from *Wind*. The empirical evidence showcases that central SOEs still borrowed heavily from banks, and at the same time, they had been increasingly dependent on trade credit, which was in similar size as the bank borrowing during the selected period, with them substituting each other in most years. Strikingly, central SOEs have been net trade credit recipients instead of trade creditors, while borrowing heavily from banks and sitting on enormous amount of retained earnings. These financing behaviours shed light on the monopoly power of these state-owned giants as well as the undeveloped nature of Chinese financial system, and the relational and government-controlled structures of credits. The empirical evidence implies that the central SOEs have been acquiring more financial skills, but they have not seen fundamental change of their financing patterns nor their relations with the financial sector, thus, it is premature to speak of financialisation of China's monopolies in the state sector. The evidence of financing patterns is also confirmed by the evidence from the cash flows.

Chapter 6 approaches financialisation of China's financial sector from its trajectory of liberalisation and its relationship with the state. By looking back at the reform of the banking sector as well as the establishment and development of market finance in China, the transformations in fact conceals great continuity. Precisely, China's first transformation of the financial sector commenced at the Opening and Reform and ended before the global crisis. The first transformation reintroduced the market in China's financial system with a powerful banking system and a full set of money market and capital market. The second transformation happened in the post-GFC period with the growth of shadow banking. Specifically, banks are performing increasingly like "banks in the shadow", i.e., to undertaking off-balance-sheet

businesses to bypass the regulation and performing as middlemen in between financial markets and non-financial enterprises and creating tight links between the banking sector and various different submarkets in financial markets, in particular, the bond market. Despite the two transformations, China's financial system remains bank-based, partially liberalised and state-controlled. And the relational and government-controlled structure prevails. The continued characteristics of China's financial sector make it impossible for the arm's length and private mechanism of finance to grow. Under such conditions, financialistion is impossible to be identified.

Chapter 7 explains how local governments are transformed with the penetration of finance. It argues that local governments are behaving like corporations with the facilitation of local government financial vehicles under the mechanism of "land finance". However, the core of the conduct of local governments has remained unchanged. The increasingly business-like local governments remained their developmental characteristics—to raise more funds through innovatively financialised way for local infrastructure development. Additionally, the financial skills that exercised by the local governments are also bank-based and credit centric, not so much related to the securitisation. Last but not least, the close relation between LGFVs, local governments and the banks reinforce the relational and government-controlled structure of finance. The arm's length and private mechanism have not grown in the financial sector. Therefore, the increasingly used financial means of local governments in obtaining more fiscal revenue does not imply financialisation.

Chapter 8 first recaps the research questions and summarises the analytical framework and the main empirical findings. It then answers the two operationalised question that have been

raised in the first chapter in order to reach to the answer to the research question-- *whether or not Chinese economy has been financialised*. In section 8.2, it provides an in-depth political economy discussion of the transformation of each actor in the state sector, and illustrates why these transformations are not financialisation, but more like the credit expansion. This chapter then concludes by stating the caveats of this research and pointing out a few further research possibilities. In sum, my conclusion of this dissertation is that there are insufficient grounds yet that there is financialisation in Chinese economy.

Chapter 2. Approaching Financialisation: Theory and Literature

2.1 Introduction

The first step in exploring financialisation of the Chinese economy is to understand the concept of financialisation. However, it is not easy as there is yet common agreement on the definition of financialisation. For more than three decades after the emergence of the term "financialisation", a wide range of scholars in all disciplines in social sciences have focused on researching the concept and its applications, including in economics, sociology, political science, geography, and interdisciplinary research. Even it seems that everybody in the social sciences has been discussing this buzzword, the understanding of financialisation has not increased proportionally with the number of works on the topic. This chapter, thus, dedicates itself to the theoretical and empirical works on financialisation, attempting to lay out an appropriate theoretical foundation for understanding the epochal change of China's national economy, and to situate the Chinese financialisation in the broader academic conversation of financialisation.

The literature review of this thesis will be undertaken in the following three levels. First, reviewing the work of financialisation from a theoretical perspective as it is written in section 2.2 allows a comprehensive understanding of the theories on the topic of financialisation, which will be helpful for developing an analytical tool for China's case. The existing theories on financialisation will be surveyed from different schools of thoughts. They apparently cannot be exhausted as the literature on financialisation grows faster and larger over time, only several most influential of them could be surveyed in this research, namely, Marxists political economy, French Regulationism, Post-Keynesianism and some works in socio-

economic path. Various schools of thoughts share common grounds in comprehending financialisation, but they also concentrate on different aspects or processes of this multifaceted economic and social phenomenon.

Based on their own theoretical underpinnings, various approaches or themes are employed to understand financialisation. For example, financialisation is used to describe a systemic transformation of capitalism, or to be associated with the secular stagnation, and thus, perpetual crisis, or the emergence of the new management priority in firms (shareholder value), or individuals' increasing participate in the financial market and financial activities (financialisation of everyday life or households), or the growing dominance of market-based financial system over the bank-based system, and many more others (Lapavitsas, 2013; Powell, 2013; van der Zwan, 2014). However, the difference of each theme or approach can be very subtle at most of the time, thus, there is no clear-cut differentiation of these themes or approaches. In this sense, to look at financialisation from the standpoint of different schools of thought, rather than from the themes would be more consistent in terms of the theoretical foundation.

Second, empirical works on financialisation will be examined as a benchmark for China's financialisation in section 2.3. It is found that the course of financialisation varies greatly in different countries, but they also share commonalities inside the group of core capitalist countries / developed countries and the periphery capitalist countries / developing countries. Specifically, financialisation in developed countries is normally an *internal* process that rises from within its domestic economy, which is then called an "epochal transformation" by Marxist political economists, whereas financialisation of developing countries mostly

happened under the *external* influence, i.e., developing countries are brought to the orbit of developed countries due to their subordinate role in the international system. Therefore, financialisation of developed countries focuses primarily on the *domestic* dimension and that of developing countries on *international* dimension.

China possesses both the characteristics of developed countries and developing countries when it comes to its recent-decade political economic changes. The domestic economy has changed fundamentally from a planned economy to a quasi-capitalist system under its Opening and Reform, while the change has been further enhanced by its active pursue in the participation of the global economy. Empirical works on financialisation in both developed and developing countries, therefore, become crucially important for China's case.

Third, the studies on financialisation in China's context will be reviewed in section 2.4. section 2.4.1 attempts to distinguish financialisation with financial liberalisation, or financial development or financial deepening [8] as a preparation because it is found that 'financialisation' is always used interchangeably with financial development, financial liberalisation, or, in some cases, financial deepening. Even though there is no consensus on the definition and the clear scope of the term 'financialisation', it is by no means the same as financial development, financial liberalisation, financial deepening or financial globalisation. It argues that financialisation must have a certain level of financial development as prerequisite condition, whereas the latter does not necessarily lead to the former. And financialisation belongs to political economy realm, stressing the altered accumulation

[8] I am aware that financial development, financial liberalisation, financial globalisation and financial deepening are not exactly the same concept, but it beyond the scale and scope of this chapter to differentiate the nuance of these concepts. Rather, they are regarded as the synonym as opposed to 'financialisation'.

regime and social relation that embedded in the economy, whereas financial development and the others aforementioned are mainstream economic and finance concepts which pay more attention to the relations between finance and economic growth.

Based on this conceptual differentiation, section 2.4.1 and 2.4.2 systemically surveys the existing Chinese-language research and English-language of financialisation in China's context, respectively. Shockingly, Chinese-language literature, compared with English-language ones, pays less attention to China's uniqueness, namely, the state's role in the economy and its transformation in the ongoing reform. Also, Chinese-language scholarly works tend to obfuscate financialisation with the aforementioned mainstream financial-development-related concepts. The English-language existing works have corrected these flaws, putting their fingers on transformation of the state's sector, but unfortunately, they omitted the intertwined relations between different actors of the state. This survey makes the literature gap clear, which this thesis aims to fill. Finally, section 2.5 concludes the whole chapter.

2.2 Financialisation in different schools of thoughts

The concept of financialisation is closely associated with Marxist political economy, while many other schools of thoughts also approach it from their own perspectives, such as Post-Keynesianism and the French Regulation School. The term "financialisation" was first brought to the attention of the left by Harry Magdoff and Paul Sweezy (1987), who were the earliest to systematically explore the shifted gravity from production to finance in capitalism since the 1980s. They two also took editorship in the 1960s' *Monthly Review* and have written for the journal constantly since the 1990s. Since then, *Monthly Review* has become an important outlet for the left to discuss financialisation, both theoretically and empirically. This section

will theoretically compare and contrast financialisation in different schools of thoughts, namely, Marxists political economy, French Regulationism, Post-Keynesianism.

2.1.1 Marxist Political Economy

The discussion of financialisation from Marxist political economy goes back to the *Monthly Review* school, which was largely based on Paul Baran and Paul Sweezy's (1966) *Monopoly Capital*. The basic logic of their arguments starts from the historical analysis that they believe capitalism went into the monopolistic stage where the economy is dominated by monopolistic multinational corporations. The growing monopolisation in turn caused the fall of investment as the rate of return to capital (profit rate) declined, which further led to the slowdown of capital accumulation, and therefore the slowdown of the economic growth rate. Sweezy (1997) has observed and summarised three underlying trends of monopoly capitalism since the recession of 1974-5: 1) slowdown of the overall growth rate; 2) worldwide proliferation of monopolistic (or oligopolistic) multinational corporations; and 3) financialisation of capital accumulation process.

The three trends are interrelated. Stagnation and financialisation in the mature capitalist economies since the mid-1970s were regarded as the contradictory consequences of internationalisation of monopoly capital (Foster et al., 2011; Sweezy, 1997). Monopoly capital, on the one hand, generates enormous profits, but on the other hand, makes the enterprises unable to find sufficient investment opportunities in the increasingly controlled market as the rate of profit (or, more accurately, the absorption of the surplus) declined (Sweezy, 1997). Therefore, the capital accumulation slows, so was the economic growth which is powered by the capital accumulation (ibid). As a result, monopolisation not only spread the stagnation to

the wider world through its internationalisation, but also gave rise to financialisation to many of the capitalist countries (Foster et al., 2011). Other scholars of *Monthly Review* School have inherited this analysis, especially John Bellamy Foster, Fred Magdoff and Robert W. McChesney, see, for example, Foster, 2010, 2007; Foster and Magdoff, 2009; Foster and McChesney, 2009.

The transition from competitive capitalism to monopoly capitalism is a natural outcome as Foster et al., (2011) states that "accumulation naturally goes hand in hand with the concentration and centralisation of capital and the monopolisation of the main means of production in a few hands", which is in line with the argument of Baran and Sweezy (1966) that the existence of monopolistic enterprises is the result of centralisation and concentration of contemporary capitalism. The concentration and centralisation of capital means that the small family firms were replaced by large industrial corporations because the big capital always beats and absorbs small ones (Foster et al., 2011). Therefore, the global production in each industry is increasingly dominated by a very few multinational companies.

With the help of finance, the concentration and centralisation of capital accelerate, making the modern corporation possible (Foster et al., 2011). The latter was regarded as the "culmination of the process of concentration and internationalisation [of capital]" (Barnet and Müller, 1974, pp. 213–4). They normally have a headquarter in its home country-- in most cases, a rich developed country, and operate in many others, especially in developing countries according to their comparative advantages, making the latter subordinate to their global production and market, which then helps them become the only few survivors in the industries through the merge and acquisition of the small local businesses. The global

economy, therefore, was under the control of hundreds of enterprises which monopolise their industries and did not compete with the traditional rule of the classic market (ibid), which led to unexpected consequences--"the more monopolistic the economy, the stronger the tendency of stagnation" (Sweezy, 1980, in Magdoff and Foster, 2014).

The problem in the centre of the monopolistic capitalism is the surplus absorption. Specifically, as profitable investment opportunities declined, capitalists had to find a way to consume their surpluses (Sweezy, 1997). Baran and Sweezy (1966) observed this in the 1960s, the consumption, second wave of automobilisation and even state spending, including civilian and military spending, among other factors could not fully absorb the surplus or lift the system out of stagnation.

It is to be noted that this thesis does not fully accept the theoretical approach of the *Monthly Review* School, nor does it seek to apply its approach to China. Rather, I have merely deployed the School's broad insights as a launching pad for the detailed analysis of the thesis. Above all, the term "monopolistic enterprises", used frequently in this thesis, does not mean the same as for the *Monthly Review* School, that is, monopolistic enterprises that generate an enormous economic surplus (not profit) which cannot be absorbed through investment. Rather, I have used the term in the more classic Marxist sense of referring to enterprises which are large in size and possess certain monopoly power over markets and entire sectors, as will be stated further in Section 4.4.2. There is also no doubt that Chinese large SOEs function in different ways from private monopolistic enterprises and to an extent follow different motivations and mechanisms. Thus, the transformation of Chinese large enterprises

in a monopolistic direction would not necessarily lead to financialisation along the lines suggested by the *Monthly Review* School.

Monthly Review School also argues that financialisation represents an epochal transformation of capitalism from production to finance. This point has also been developed by Giovanni Arrighi (1994) in his famous book *Long Twentieth Century.* Arrighi (1994, p.3) agrees with David Harvey (1989, p.145), who believe that capitalism may be in the middle of a historical transition that is turning away from Fordism and Keynesianism. This transition has turned towards the empowerment of finance, leading to the ever-expanding and ever-sophisticated financial market as well as financial instruments. Harvey's insights on the shift of regime of accumulation shares a common ground with Regulationists, which will be presented in the following sections.

Arrighi (1994) uses Karl Marx's general formula of capital – MCM' – to interpret the logic of the recurrence pattern of capitalism in his famous work *The Long Twenties Century*, which is built on Fernand Braudel's (1982) idea of *long durée* of capitalism, arguing that the way that the capitalism works has been indeed different since the 1970s, while it looks unprecedented at the first glance, but in fact not so much if looking back to the long capitalist history. This formula describes two phases: MC phase of capital accumulation and CM' phases of financial rebirth and expansion. The two phases make up a complete "systemic cycle of accumulation" (Arrighi, 1994, p.6). In the MC phase, money capital is activated through increasing of commodities, while in CM' phase, money capital is set free "from its commodity form, and accumulation proceeds through financial deals" (ibid). In this sense, capitalism just entered

another cycle of recurrent cycle of accumulation, where financialisation is the second phase of this cycle that finance waws expanding.

To prove his point of the recurrence pattern of capitalism, Arrighi (1994) summarises empirically that in the history of capitalism, Genoese switched from commodities to banking in 15th century's Italy; One century later, Spanish did the same again; in the mid-18th century, Dutch became the "bankers of Europe" after withdrawing from commerce; and in the 19th century, English welcomed an "oversupply of money capital" by ending the "fantastic venture of industrial revolution". Currently, it is the US capital that started in the industrialisation in the late 19th century, went through the so-called Fordism-Keynesianism in the first half of 20th century, now has entered to a round of financial explosion since the 1970s (Arrighi, 1994, p.5-6).

Costas Lapavitsas, an internationally well-known Marxist political economist, offered a path-breaking contribution on financialisation, whose approach is rooted in Marxist political economy, especially the Marxist theory of finance, and is greatly inspired by *Monthly Review* School and the debate of imperialism, specifically that of Hilferding and Lenin, believing that the financialisation represents a structural transformation of capitalism with the emergence of finance capital (ibid). Distinguished from other Marxists and scholars in other schools of thoughts, Lapavitsas argues that financial system is not a shelter for capital to seek higher profits when the profitability in production sector is low (Lapavitsas, 2013). Financial system is rather integrally connected to production, but the financial system has its own fundamental economic relations and profit-making motives that are different from production realm

(Lapavitsas, 2013, 2011; Lapavitsas and Powell, 2013), by which the approach to this thesis is greatly inspired.

Lapavitsas also focuses on the gap that has been left by the *Monthly Review* school and Marxists in other streams by focusing on the altered conduct of agents in mature capitalist economy, namely, non-financial enterprises, financial system, specifically banks, as well as workers and households to account financialisation from a holistic view (see, for example, (Lapavitsas, 2013, 2011; Lapavitsas and Powell, 2013). This analytical approach has set the tone for the research on domestic dimension of financialisation of an economy, including both the core and periphery capitalist countries, as well as this particular dissertation on China's financialisation. Based on this point, Lapavitsas has summarised three tendencies of financialisation in mature capitalist countries, on which the theoretical framework of this thesis is built. More will be elaborated in length in later sections and next chapter.

However, his standings have discrepancies with a few other Marxists political economists, in particular, Ben Fine, one of the leading Marxist political economists in the UK, who has openly criticised Lapavitsas systematically during circa 2009-2011 on several publications. Their major differences concentrate primarily on two aspects: 1) the relation of interest-bearing capital and fictitious capital and 2) if the tendency of rate of profit to fall is the cause of financialisation. These two aspects are also the primary debating points for many other Marxists.

On the first aspect, Fine (2010) claims that "the value of the loan (and the interest payments due) can itself be bought and sold at a monetary value that may or may not correspond to

the potential to realise that value in the application of the money advanced as capital by whoever took the loan" (Fine, 2013, p. 50). Such independent circulation of interest-bearing capital in paper form is termed as fictitious capital according to Marx as Fine (2010, p.20) interpreted that "whose pricing is distinct from the value of the real assets on which they ultimately depend". On the opposite, Lapavitsas (2013) disagrees with Fine, believing that loanable capital or interest-bearing capital itself is not fictitious, rather, the loanable capital is integrally connected to the circuit of production, although the trading of it could give rise to the fictitious capital.

The tendency of the rate of profit to fall is associated with a type of Marxism which believes capital seeks for higher profits in financial realm as the profitability in production sector had been low and unstable for the past decades for various reasons. However, the higher profitability in the realm of finance is non-sustainable. In this sense, the economic crisis will be recurrent. The most sophisticated account is offered by Brenner (see, for example, 2002, 2006). Brenner's theory is not on the same page as Marxist tendency of the rate of profit to fall as Brenner believes the linkage of the fall in profitability and the fall in real wage whereas other Marxists believe the rise of real wage squeezes the rate of profit, see, for example, the special issues of *Historical Materialism* —vol. 4 issue 1, 1999 and vol. 5 issue 1, 1999.

In summary, the Marxist approaches should be of interest for contemporary China, especially in the dawn of China's financialisation. First of all, the "three trends" prevails in China--- the monopolistic corporations in both the state and non-state sector dominate industries and the national economy. Meanwhile, stagnation and internationalisation of large capitals have been observed, especially in the state sector. Hence, financialisation is the right direction to go

when exploring this change that has newly emerged in China. Secondly, as China's transition from a socialist system to a quasi-capitalist system, the structure of enterprises has been going through huge changes as well, which in turn led to altered relationship between different economic agents, namely, non-financial enterprises, financial enterprises and the households, which constitutes the fundamental transformation of the Chinese economy. To explore whether China is going through an epochal transformation, a perspective on financialisation from Marxist political economy, especially the theoretical framework that proposed by Costas Lapavitsas is suitable. In this sense, the perspective of financialisation from Marxist political economy is particularly important and useful for contemporary China under the "New Normal".

2.1.2 French Regulation School

French Regulationists consider financialisation as an alternative regime of accumulation to Fordism which came to an end in the 1970s in their perspectives (see, for example, Boyer, 2008; Grahl and Teague, 2000). However, the primary concerns of French Regulation School's research is not necessarily financialisation *per se*, rather, it is more about if finance-led accumulation is an alternative regime of growth to sustain capitalism (Erturk et al., 2008). Within the framework of French Regulation School, it is of vital importance to assess the transformation of institutional forms vis-à-vis the rise of alternative growth regimes as oppose to Fordism with a certain mode of regulation in order to answer the general question of "how capitalism could achieve long periods of stability and growth that could be sustained for ten years or more" (Erturk et al., 2008, p. 175). The question is posted by the slowdown productivity and the accelerating inflation in the US at the end of the 1960s (ibid). The scope of focus of French Regulationists does not restrict by a technical understanding of regulation,

rather, it incorporates state intervention, social norms, collective beliefs, and the labour process, among others (Aglietta, 2008; Becker et al., 2010; Jessop, 2005).

Robert Boyer, one of the founders of the French Regulation School, believes several factors, including the large mergers, capital flows among countries, new forms of corporate governance and the individual access to the equity market, have suggested the transformation to a "financial-led accumulation regime" (Boyer, 2008, p. 180). He was inspired by Aglietta (1998, cited in Boyer 2008), who saw the emergence of a finance-led regime as a potential successful successor to Fordism, not only within nation states but also across the border as a global accumulation regime. Becker et al. (2010) pick up on the finance-led growth model proposed by Boyer (2000) to provide several concrete perspectives to address financialisation by elaborating with the case of Brazil, Chile, Serbia, and Slovakia.

French Regulationists regard the shareholder value as a key aspect of the transformation of corporate behaviour and the development of globalised financial regime, the emphasis on shareholder value, hence on the conduct of enterprises, is very important, see, for example, Aglietta, 2000; Aglietta and Breton, 2001; Jessop, 1990; Lazonick and O'Sullivan, 2000. They observe that the capital market has been shaping the transformation of US corporations' behaviour since the 1970s. Corporations used to retain part of their earnings and to reinvest in the corporate growth prior to the 1970s, whereas after the 1970s, they tended to buy back shares to push up their own equity prices, meanwhile, they had higher indebtedness. The orientation to the financial return creates financial instability which are detrimental to the economic prosperity (see the *Economy and Society* Vol. 29 Issue 1, 2000, particularly Aglietta, 2000; Lazonick and O'Sullivan, 2000). For the Regulationists, the shareholder value is

perceived as a new form of competition and governance mode under the globalised financial regime, which is of crucial importance to their attention on the mechanism and institutional conditions of the possible growth regime for the modern capitalism after the 1960s (Boyer, 2010).

2.1.3 Post-Keynesianism

Post-Keynesianism shares an affinity with Marxism on the analysis of financialisation from the perspective of rentier class, although their theoretical inspiration primarily comes from Keynes rather than from Marx. Post-Keynesians particularly regard moneylenders as rentiers as Keynes himself particularly regards the rentier as financial rentier whereas Marx associated rentier with the ownership of land. Marx's counterpart notion to Keynes's rentier is monied capitalist. Post-Keynesians consider the emergence of rentier is due to the financial expansion, which is at the expense of industrial profits, resulting in the poor performance of investments, outputs and growth in developed countries.

Post-Keynesians identify the analytical connection between the declining production and the booming in finance during the period of financialisation by doing extensive empirical work, showing the deleterious impact of financial activities on the economy as the investment has been diverted to finance rather than production (see, for example, Epstein and Jayadev, 2005; Orhangazi, 2008; Stockhammer, 2004, 2008). Methodologically, Post-Keynesians are good at reconciling economic models and econometric techniques with the heterodox economic concepts, in order to find empirical evidence (see, for example, Stockhammer, 2004; Orhangazi, 2008; Onaran et al., 2011). Some of the scholars focus more on the aggregate macroeconomy, and others focus more on only one sector, typically, non-financial enterprises.

On a macro level, Post-Keynesians point out the centrality of the financial sector in the mature capitalist economy, namely, the US, the UK and several core European countries, such as Germany and France (see, for example, Stockhammer, 2004, 2008; Orhangazi, 2008; Onaran et al., 2011). Unlike French Regulationists, Post-Keynesians believe that the change of macroeconomy is shaped by the financial sector, and financialisation could potentially explain "an economically significant part of the slowdown in accumulation", but the macroeconomy is not yet finance-led (Onaran et al., 2011; Stockhammer, 2004, p.739). Their underpinning logic is that the rentier incomes, namely, dividends and interest payments, decreases the investment. Consequently, rentier imposes a depressing effect on the real sector, and further on the economy as a whole (see, for example, Onaran et al., 2011; Skott and Ryoo 2008).

On the micro level, Post-Keynesians are the first to bring the micro foundation to the macroeconomy–employing the micro firm-level data to see the altered corporate governance and the changed investments and financial profits of non-financial firms over time and then move to macro-level to look at the non-financial enterprise's role as an integration in the national economy (see, for example, Orhangazi, 2008; Stockhammer, 2004). In this sense, Post-Keynesians share similarities with the "shareholder value" approach as many of Post-Keynesian works also stress the power of shareholders and thus the altered management priority—shifted towards the owners or shareholders' priority. They argue that the increasing financial incentives and financial investment would crowd out the real investment in the productive sector, resulting the slowdown of the capitalist accumulation (Stockhammer, 2008) Orhangazi (2008) also point out that the non-financial firms not only gain more from the financial market, but also pay more to financial market in the form of interest payments,

dividend pay-outs or share buybacks. This finding is summarised as “dual movement” by Van der Zwan (2014), which has been confirmed by many other scholarly works beyond Post-Keynesian school, such as Duménil and Lévy, 2005; Akkemik and Özen, 2014.

Besides, Post-Keynesians have a decisive difference with Marxists, and especially with Lapavitsas, a Marxist who explains that the financial system is integrally connected to production, and it is “a set of markets and institutions that mobilises loanable capital and supports capitalist accumulation” (Lapavitsas, 2013, p. 31), in which sense that financialisation is not seen as a “triumph of rentier over productive capitalists” from Marxist point of view. In contrast, post-Keynesians tend to believe that capital was crowded out from the production as finance rises, which presumably isolates the role of finance from production, lying under the argument of the rise of rentier.

Rentier, like financialisation, has no commonly agreed definition. The concept of “rent” itself is debatable, so is the concept of “rentier”. Rent is defined differently in heterodox and mainstream economics. In orthodox or mainstream economics tradition, rent is no longer necessarily associated with the assets, but still closely related to the idea of “control”—the monopoly power. Rent represents the abnormal profits occasioned by the capitalist power to monopolise a market (Tollison, 1982).

In heterodox tradition, rent is generally represented as “payment for monopoly control of an asset”, regardless the asset has to be land, as Adam Smith, David Ricardo and Karl Marx advocate, or any crucial assets, as Harvey suggests (Christophers, 2020, p. 20). However, John Maynard Keynes is at the opposite to Marx and Harvey and their predecessors. Keynes

precisely refers to rentier as financial rentier, which he calls 'functionless investors' in *General Theory*, i.e., people who generate income via their ownership of capital, thus exploit its 'scarcity-value' (Epstein and Jayadev, 2005, p. 48). Inheriting from both of their definitions, workings these days within heterodox traditions conceptualise rent and rentier in a much more expansive manner. The foundation for them is still the "monopoly control of an asset", but the asset can be anything, including financial assets. For example, Thomas Piketty (2014, p.422) believes that rent is "remuneration for ownership of [an] asset, independent of any labour"; Guy Standing (2017, p.2) shares the similar idea that it is the income generated "from ownership, possession or control of assets that are scarce or artificially made scarce". Epstein and Jayadev (2005) adopt another definition which better reflects financialisation. They believe rentier is "an active class that is fostering and profiting from the process of financialisation", including "profits from financial market activities of financial industry", including banks, stockholders, and insurance companies (Epstein and Jayadev, 2005, p. 49).

This point is relevant for the case of China in this dissertation as the Chinese state can be regarded as rentier by any definition because, on the one hand, the state owns the crucial and scarce assets, including but not limiting to, land, financial assets and natural resources; on the other hand, the Chinese state also monopolise the most strategic markets via SOEs, including the energy market, financial market and transportations, among many others. The idea of rentier is relevant to the state's role in China's financialisation, which is to be entangled in the coming chapters of this dissertation.

2.3 Defining Characters of Financialisation

Financialisation is first emerged to characterise the US economy since the late 1960s, and more scholars have come into this academic conversation to describe the similar change in other developed capitalist countries, such as in the UK, Germany, France and Japan (see, for example, Lapavitsas, 2013; Stockhammer, 2004). However, financialisation does not necessarily take the exact same form in every country as the form of financialisation is contingent on specific institutional, political and historical relations even though there are certain common trends (Lapavitsas, 2013; Lapavitsas and Powell, 2013; Powell, 2013). Thus, it is expected that the financialisation in mature capitalist countries is vastly different from that of developing countries. With the expanding of the literature, financialisation indeed has seen increasing applications in developing countries, which is often referred to as "subordinate financialisation" as it is shaped by imperial relations between states (Powell, 2013). The first two subsections below will summarise the trends and characterisations of financialisation in developed and developing countries, respectively.

Different forms of financialisation are relevant to the case of China as the Chinese case is quite complicated and hybrid, which will be elaborated in-depth in next chapter. To just give it a flavour, in terms of the size of the economy, including that of the financial market, China is even economically stronger than most of the developed countries, namely, the UK, Germany, France and Japan. However, China still possesses enormous underdevelopment elements as developing countries do, including its financial system as well as the way that the large enterprises, particularly large SOEs, finance themselves. These two features compound the financialisation in China. The typical forms of financialisation of developed and developing

countries must be clearly and correctly understood as a foundation for the analytical tool for China's case.

2.3.1 Financialisation of Mature Capitalist Countries

Financialisation necessarily varies across countries over time, the aim of the theoretical framework is, therefore, not to come up with a one-size-fits-all model that could be applied to any country, rather, the aim is to abstract the similar tendencies for certain countries around the same time. As mentioned in section 2.2, scholars approach financialisation either from macro level, i.e. the whole economy (see, for example, Davis and Kim, 2015; Dore, 2008; Krippner, 2005) or from micro level, i.e. the behaviour of enterprises, financial institutions or households (see, for example, Mertens, 2017; Orhangazi, 2008; Rabinovich, 2019). And an increasing number of works now focus on financialisation of various kinds of public provisions, such as housing, pension and natural resources (see, for example, Aalbers, 2016; Bayliss, 2014; Mabbett, 2020). Nevertheless, financialisation of the developed countries focuses primarily on *domestic* dimensions as financialisation emerged from within their economies. However, it does not imply that the international dimension is not important for financialisation of developed countries, it is only because that developed countries stay in dominant positions of the world system where they, especially the US, have the full control of the world money, and developing countries are merely subordinate to it. Hence, the international dimension is more critical for developing countries than it is for the developed countries. Thus, more of the international dimension will be unfolded later for developing countries.

Costas Lapavitsas is among the first scholars who has come up with a rather comprehensive and generic theoretical framework for the analysis of financialisation of the core capitalist

countries. To bring it forth briefly, Lapavitsas has summarised three tendencies of financialisation in mature capitalist countries, which has solid theoretical foundations that built on Marxist political economy. Lapavitsas (2011, 2013) treats financialisation as a systemic transformation of mature capitalist countries, featuring the change of a set of relations between different agents in mature capitalist economies. His framework comprises the key elements of the altered conducts of behaviour of the fundamental agent of the economy, namely, non-financial enterprises, banks and households/workers as well as their changing relations in the course of financialisation. The framework will be fully illustrated in section 3.3 in next chapter as it serves the foundation of the analytical tool of this thesis.

2.3.2 Financialisation of Developing Countries

Financialisation is originated from the debate of the rise of finance of the US economy, and it then expanded to assess the similar tendency in developed countries, such as the UK, France and Japan. Recently, a growing body of literature started to examine financialisation in developing countries, namely, Latin American, East and Southeast Asian, and East European countries. Different schools of thought address the specificity of financialisation of developing countries from different theoretical underpinnings. French Regulation school's central focus is on the specificity of finance-led regimes in various developing countries, which is along the same logic line of its discussion of the developed economies (Becker et al., 2010). They argue that that the regime is built upon a set of institutions and policies, which is the Washington Consensus in the case of developing countries' financialisation since the 1970s. Marxists look at financialisation from the lens of imperialism, such as Foster and Magdoff (2009), Lapavitsas (2009, 2013) and Powell (2013); or similar as French Regulationists, from the lens of shift of

neoliberalism, but focus more on the power balance between capital and labour such as Ashman, Fine, and Newman (2011).

Financialisation of developing countries have more sophisticated fronts and country-specific characteristics than that of the developed countries. The reason is that the force pushing financialisation comes from both internal and external. Similar as that of developed countries, financialisation in developing countries represents a structural change of their domestic economy, but more than that, it also represents the changing interaction of domestic economy with the global system in both production and finance (Lapavitsas, 2013), i.e., financialisation in developing countries does not rule out the crucial role played by domestic entities in promoting the growth of finance, but puts great emphasis on the changing relations between domestic economy and the international financial system, with the latter in a driving position. Financialisation of developing countries reflects the weaker ability of "individual countries to regulate their macroeconomies through the demand and exchange rate management" (Glyn, 2007, pp. 87–8) as well as the subordinate role of developing countries' to the world market and international monetary system (Lapavitsas, 2013), which is shaped by imperial relations in the hierarchical international system (Lapavitsas, 2013; Powell, 2013). In this sense, the financialisation of developing/emerging countries is sometimes referred to as "subordinate financialisation", which was first developed by Jeff Powell in his PhD thesis (Powell, 2013). Financialisation in developing countries are also referred to as 'dependent financialisation' by French Regulationists, who see financialisation in periphery, particularly, Latin America, as a new form of dependency, see, for example, Becker et. al., 2010; Becker and Jäger, 2010. This section will summarise the specific features of financialisation of

developing countries with respect to foreign reserve holdings, capital flows, and foreign bank entries.

Financialisation of developing countries started together with the financial liberalisation and globalisation in the 1970s. The rise of international aspects of financialisation is the outcome of this institutional change. With the breakdown of Bretton Wood system, the erosion of Golden Age, and the rise of the Washington Consensus, World Bank and International Monetary Fund (IMF) began to be the dominant power of the international financial and monetary system (Ashman et al., 2011; Bonizzi, 2013; Lapavitsas, 2013). The Washington Consensus has promoted the domestic transformation of financial systems of developing countries from bank-based to market-based, and the relational and the government-controlled structure are gradually replaced by arm's length and private mechanism (Lapavitsas, 2009a, 2013). Internationally, they have created a supranational power but without base in society. Effectively, however, these international institutions are under the control of the US, the leading imperial power, and represents the interests of the US, which in turn reinforce the imperial power by making other countries, especially emerging countries, hoard large amount of US Dollar as foreign reserve, equivalent to recognising its quasi-world money status (Foster and Magdoff, 2009).

Supplementary to the theoretical discussion of variegated form of financialisation in developing countries, scholars also provide rich empirical evidence from various aspects. Financialisation of developing countries have both domestic and international dimension, the empirical evidence, thus, can be grouped into two main categories, namely, domestic and international. On domestic dimension, it is similar as the evidence for developed countries,

i.e., the financialisation are primarily examined from the altered conduct of non-financial enterprises, financial systems and households, see, for example, Demir (2007) for the evidence of Argentina, Mexico and Turkey; Kalinowski and Cho (2009) for South Korea; and Karwowski (2012) and Sampaio (2012) for South Africa. To note that the financial system in the domestic dimension primarily refers to the changing conduct of banks and the expansion of the financial markets, and the transformation from bank-based system to market-based system, but it inevitably has overlap with the international dimension as the transformation comes along with the entry of foreign capital and foreign banks.

For the international dimension, scholars primarily focus on two prominent features of financialisation-- capital inflow to developing countries and the entry of foreign banks, see, for instance, Cho (2010) for South Korea, Dos Santos (2011) for Brazil and Mexico, Lapavitsas (2013) for periphery countries as a whole. Karwowski and Stockhammer (2017) systemically compare financialisation of the emerging countries with that of the two Anglo-Saxon typical cases—the UK and the US from six different aspects ranging from domestic to international dimensions: 1) financial deregulations; 2) foreign financial flows; 3) asset price volatility; 4) the shift from bank-based to market-based finance; 5) business debt; 6) household indebtedness.

One of the most important aspects of international dimension is the capital flow. Washington Consensus is to require the openness of capital account of developing countries to allow the capital inflow from developed countries, which were supposed to promote the domestic development of developing countries. However, near the turn of the century (circa 1997-1999), the pattern of capital flows reversed, i.e., capital began to flow from the developing

countries to the developed countries. Given the subordinate role of the developing countries, the global capital flow greatly narrowed the policy space for the nation states in influencing domestic economies (Helleiner, 2002), and increased the vulnerability and the cost of the developing countries in the international financial system (Lapavitsas, 2013). Additionally, developing countries began to hold large amount of US Dollars as foreign reserve to increase their abilities against the risk (Glyn, 2007), both of which are because the US Dollar has served the role of the quasi-world money. The reversed capital flow effectively becomes the tool of poor developing countries subsidising rich developed countries, which goes against the original intention that the developed countries help to promote the domestic development.

Lapavitsas (2013, p.249) reveals the relation between foreign reserve holdings and capital flows as "accumulation of reserves is ultimately the reason why the net global flow of capital has been reversed leading to capital flowing from poor to rich countries". Financialisation in emerging countries can be characterised by "dependency on inflows of capital" (Becker et al., 2010, p. 230). They suggest that building up large foreign reserves by devaluating their currencies to achieve trade surplus is one way to shield from the crisis in the future.

There are two routes to accumulate foreign reserve as Lapavitsas (2013) suggested. One is the export-oriented countries earned trade surplus by exporting an enormous amount of goods and services, such as China and other East Asians countries did before crisis; or the natural resources net exporting countries, such as Russia and Middle East countries, which earn a large amount of foreign currencies, in particular, the US Dollars. And the second and also the cheapest way is to buy US Treasuries. Reserve pays no interests to the holders, and holding reserve by purchasing US public debt is essentially holders subsidising the US—in

most cases, developing countries subsidising the most powerful hegemon in the international system.

The accumulation of a large amount of foreign reserves for emerging countries finally leads to the reverse of capital flows, i.e., capital flows from the poor to the rich, which is costly for the developing states, such as central bank sterilisation, opportunity cost and the shrinking in value with respect to the exchange rate. This deviates from the intention of Washington Consensus that the liberalisation of the capital account is aiming at allowing the inflow of foreign currencies to solve the domestic shortage of credits for the sake of developing countries' development. However, in reality, it is the developing countries that subsidise the developed countries by providing both cheap good and credits for them, all of which built on the fact that the US Dollar possesses a quasi-world money status in the international monetary system.

Another feature of financialisation is the encouragement of the entry of foreign banks into the territory of developing countries. Under the neoliberal policy push of financial liberalisation, foreign banks, on the one hand, had played substantial role in developing countries, but on the other hand, the entry of foreign banks have channelled the risks to emerging countries, resulting in more vulnerable and more instable domestic financial system in these countries (Bonizzi, 2013; Dos Santos, 2011). Bringing foreign banks was supposed to improve the efficiency of the domestic financial markets in the emerging countries, and help to solve the credit shortage problem (Lapavitsas, 2013). However, the entry of foreign banks reduced the financing opportunities of domestic small-and-medium-size enterprises, facilitated the "retail-lending-orientation", i.e., lending to households for consumption and

mortgages, triggering the involvement of domestic banks' in this profitable market (Dos Santos, 2011; Lapavitsas, 2013).

Empirical wise, South Korea went from financial protectionism to pro-foreign entry in the aftermath of the 1997 Asian Financial crisis by following the IMF proposal (Cho, 2010). It went farther and swifter than the IMF requested. As a result, the foreign holding of bank assets in South Korea increased sixfold in 2008 to 23.9%, compared with 4% in 1997. It is similar in Latin American and Southeast Asian countries. The market share of foreign banks went from 6% in 1995 to 28.3% in 2005 in Brazil, from 10% to 15.5% in Philippines (Dos Santos, 2011). The reorientation of lending is most prominent in Eastern European countries, namely Estonia, Hungary, Romania and Poland. The share of loans to individuals in these countries rose up to more or less 50% by 2008 (ibid).

2.4 Bank-based VS. market-based system in an era of financialisation

As was discussed in the previous section, the financialisation of the core and the developing countries was manifested differently as financialisation varies according to different institutional and historical background, and so does the financial system itself. The ascendancy of finance was already stressed by Lenin (1917) in his *Imperialism*. He argued that finance capital took different forms depending on different economic structures, political systems and the institutional mechanisms in various countries (Lapavitsas, 2013). Along similar lines, financialisation would be expected to be different in countries with different financial systems. Crucial in this respect is the difference between bank-based and market-based financial systems.

The typology of bank-based (German-Japan) and market-based (Anglo-Saxon) financial systems is a long-standing debate in the course of capitalist development. This section will revisit the distinction between the two in the era of financialisation and draw conclusions about its relevance to China.

The dichotomy between the bank-based and market-based financial system was usefully formalised by John Zysman (1983) who examined how the capacities of the government to selectively intervene the economy could shape different industrial outcomes. He distinctly focused on one element—the different financial structures, which he assumed to explain the difference in government capacities for industrial leadership. Zysman (1983, pp.7) argued that a particular arrangement of national financial systems determines how the private sector and the state could interreact by “limiting both the marketplace options of firms and the administrative choices of governments”.

His analysis departed from the belief that “market positions are a source of political power and government choices shape the operations of the market” (Zysman, 1983, pp.17). Therefore, he posited three different types of financial systems. The first is a capital market-based financial system where the competitive price determines resource allocation. And the relation between government and the industry is reinforced by arm’s length supervision. A company’s strategy on investment and production is self-led and government policies are not consciously influencing the business development. The typical example of this type is the United States. The second type is a credit-based financial system where prices are administered by the government, thus facilitating intervention in industrial affairs (Zysman, 1983, pp.18). The government can consciously influence business strategies so that it could

further shape certain industrial sectors. France and Japan fit in this category. The third type is also a credit-based one, but this system is dominated by the financial institutions which possess enough market power to influence industry. West Germany is an example of this type.

Both the second and the third type are credit-based systems, but the second has a component of state-led adjustment strategy whereas the third is dominated by the market power of the financial institutions. With the development and further application of this typology, the latter two different credit-based system could be lumped together as one model. There are no analytical problems resulting from this step, as long as it is clearly understood that major differences remain among systems, especially in the aspect of corporate governance.

The dichotomy between bank-based and mark-based financial system has similarities with the variety of capitalism (VoC) approach that was proposed by Peter A. Hall and David Soskice (2001). VoC is a firm-centred political economy approach that considers enterprises as the crucial actors of adjustment in capitalist economy, whose activities could affect the overall economic performance. It believes that a firm's capacities are ultimately relational, thus, firms may encounter coordination problems (Hall and Soskice, 2001). Five spheres are mentioned in which firms must develop relationships to resolve coordination problems, namely, industrial relations, vocational training and education, corporate governance, inter-firm relations and employees (Hall and Soskice, 2001, p. 7).

From this perspective, a distinction can be drawn between liberal market economies (LMEs) and coordinated market economy (CME). They are the two poles of a spectrum on which many countries can be arrayed, exemplified by the USA for LMEs and Germany for CMEs.

Specifically, LME's market relationships rest on arm's-length exchanges of goods and services, whereas CMEs rely heavily on non-market relationships (Hall and Soskice, 2001). The foundation for this distinction is the different market environment in which LMEs fosters competition and formal contracting whereas CMEs adopt non-market modes of coordination that entail relational and incomplete contracting and collaboration within the networks. As a result, economic equilibrium in LMEs is achieved by the firm's spontaneous reaction to the demand and supply whereas that of CMEs is the consequence of "strategic interaction among forms and other actors" (Hall and Soskice, 2001, p. 8). Regarding provision of finance, LMEs are characterised by short-term finance provided in open markets, whereas CMEs are characterised by long-term finance primarily from banks. Thus, in certain way, the classification of LMEs and CMEs is similar to that of market-based and bank-based financial systems.

Michel Albert (1993) also describes this differentiation by using the term "Rhine model of capitalism" and "neo-American model", with the former exemplified by Germany and the latter by the US as it is explicitly suggested by the names. The two different models represent different finance structures and methods of social control (Albert, 1993). In the Rhine model, finance pivots on banks and serves the need of industries. Also, it is non-speculative, whereas in the neo-American model, financial speculation has the upper hand over finance for industry, and short-term profit undermines long-term investment. In similar spirit, Dore (2000) refers to the difference as 'stock market capitalism' and 'welfare capitalism'.

These analyses are all based on the assumption that the financial system plays *a* central role - if not *the* central role - in determining the nature of capitalist economy, and different financial systems reflect different relations between the financial system, enterprises and the state. Moreover, these studies also correspond to the distinction found in the literature between the Anglo-Saxon financial system as capital market-based or securitisation-based compared to the Japanese-German model, which is bank-based or credit-based (see, for example, Aoki, 1994; Dore, 2000; Suzuki, 2011). The Anglo-Saxon model is competitive and rules-based, thus, it is a much less protective framework than the Japanese-German model, which is claimed to be a 'relational-based' structure (Suzuki, 2011, p. 60).

These two systems work fundamentally differently. The bank-based systems often "identify a 'relational' or 'commitment' aspect" (Aoki and Patrick, 1994, p. xxi; Lapavitsas, 2013, p. 182). Thus, the bank-based system allows for more state intervention, and long-term investment planning, which are presumably more conducive to growth (Lapavitsas, 2013). The best example is the Japanese "main bank" system which is defined as "a long-term relationship between a firm and a particular bank from which the firm obtains its largest share of borrowings" (Aoki et al., 1994, p. 3). What makes the Japanese main bank system special is that the main bank not only plays the role of the provider of the bank loans but also monitors the firm and intervenes when things go wrong (Aoki et al., 1994; Suzuki, 2011).

In comparison, the arm's length mechanisms of market-based system might offer a better evaluation of the risks and costs of capital. Bank financing only plays a limited role in the Anglo-Saxon model, and various long-term financing needs are met through the securities market which contains a diversified base of investors with a range of animal spirits (Suzuki,

2011). But it also claimed that this model provides relatively shorter-term relationships between banks and enterprises, which are not as beneficial as the bank-based system for long-run growth in the early stages of a country's industrial and economic development (Aoki and Patrick, 1994).

For our purposes, by no means is it implied that bank-based systems are superior to market-based systems. The point is, rather, that "no system develops in a vacuum", i.e., any financial system in any country is the result of a combination of certain political, historical and institutional forces (Aoki and Patrick, 1994, p. xxi). There is no such thing as one financial system that is absolutely better than the other. It is also possible that for a certain development stage, a bank-based model would perform better, but for another stage, a market-based system would generate better economic outcomes. Particularly as both the financial system and the economy evolve over time (Aoki and Patrick, 1994). Additionally, it is to note that despite the fierce debate of the dichotomy between bank-based and market-based system in academia, the difference in theory is much more extreme than it is in practice as most countries possess elements from both the systems.

Given the distinction between bank-based and market-based financial systems, it is to be expected that financialisation in countries with different financial systems would be different. The empirical evidence provided by the existing literature already bears that point out. Financialisation of the core countries are not identical despite some common trends. For instance, banks in the UK, US, Germany and Japan are turning away from non-financial enterprises, but lend more to households and financial corporations (Lapavitsas, 2013). This tendency can be found in all four countries, but the conduct of banks is not necessarily the

same in Germany and Japan as in the UK and the USA. German banks have a stronger tendency to transact with other financial institutions, whereas in the USA and the UK banks implicate households deeply in the operations of the financial system. Thus, household indebtedness in Germany is relatively low compared to the UK and the USA.

Financialisation can be considered as the historical advance of Anglo-Saxon market-based finance (Lapavitsas, 2013). However, the character of the financial system cannot be fully captured by the distinction between market-based and bank-based financial system as the financial system are too complicated to perfectly fit into this classification. Thus, financialisation provides a more comprehensive framework to consider the relation between the financial system, enterprises and the state, especially in the course of economic transition.

For developing countries, it is typically found that financialisation has two distinctive features. First, the financial system shifts in a market-based direction (Karwowski and Stockhammer, 2017; Lapavitsas, 2009a; Rethel, 2010); and second, the relational and government-controlled character of the financial system shift toward arm's-length and private mechanisms of finance (Lapavitsas, 2009a, 2013). This strand of empirical evidence and theoretical debates provide invaluable insights for the Chinese case.

To be brief, the Chinese financial system resembles the Japanese "main bank" system, especially within the state sector, but with major differences. Although the elements of market-based finance have been growing extensively, including the expansion of shadow banking, these elements have always been finally connected to the banking sector (He and Wei, 2022; Shi, 2023). The potential shift of the Chinese economy toward a more clearly

recognised market-based financial system is not only important for understanding the transformation and potentially financialisation of the Chinese economy, but also crucial for the further reform of the Chinese economy. In this light, the empirical parts of this thesis will first examine the transformation of the financial system, and then tackle the question of how the relations between the financial system, the enterprises, and the state are changing. These topics will be mainly examined in Chapter 6 and 7.

2.5 Financialisation in the context of China

This dissertation targets on unfolding the tale of financialisation of the Chinese economy, which has drawn increasing attention among scholars in various disciplines. This section, thus, will systemically survey the academic works on financialisation in the context of China. Unfortunately, because of the language barrier, the discussion in Chinese language and in English have only very limited interactions. Perhaps because of the lack of interactions as well as the lack of universally 'correct' meaning of the term of financialisation, plus China was a late comer in the global financial system, scholars sometimes conflate the term of financialisation with financial liberalisation, financial deepening, financial globalisation or financial development. To cast light on this, the rest of this section will proceed as follow: section 2.4.1 attempts to distinguish financialisation from other orthodox financial-development-related concepts. Section 2.4.2 surveys the Chinese-language works on financialisation in the context of China by pegging on the conceptual distinctions, and section 2.4.3 surveys the English-language scholarly works on financialisation in the context of China.

2.5.1 Distinction with financial development/liberalisation/deepening

Because of the inconsistent and non-universally agreed definition of it, financialisation is sometimes obfuscated with the idea of financial development, financial deepening, financial liberalisation, financial globalisation or even the plain expansion of the financial system, especially in the context of developing countries, despite the nuance of these notions. Financial development is the most frequent appearance in any narratives, namely, academic works, policy briefs, news and commentaries. Financial development is a paradigmatic neoclassical approach to discuss the relationship between finance and economic development by assessing the financial market in terms of its efficiency in allocation of resources (Bonizzi, 2013). The US-led international financial institutions, namely, IMF and the World Bank are the biggest advocates of financial development. According to the explanation provided by the World Bank, financial development, fundamentally, is about "overcoming costs incurred in the financial system". [9] Precisely, the process is aiming to reduce the costs of acquiring information, enforcing contracts, and making transactions to foster the emergence of financial contracts, markets and intermediates, which consist of the financial system. On this purpose, the World Bank is in favour of foreign bank's entry to the developing countries with biasedly publishing research reports on the benefits of its entry and deliberately dismissing the potential risks that might have transmitted to these countries (Dos Santos, 2011).

Financial liberalisation and financial deepening are concepts advocated by neoliberal orthodoxy to developing countries, associated with international capital flows, with the

[9] Citation can be retrieved from World Bank: http://www.worldbank.org/en/publication/gfdr/gfdr-2016/background/financial-development [last access on 08/05/2019]

former more attached to the context of developing countries. Put it differently, financial development in developing countries is mostly manifested in the form of financial deepening and financial liberalisation. These concepts dominate the mainstreams economics and finance studies where scholars generally discuss their relations with economic growth.

The argument that financial development can boost economic development can at least date back to Schumpeter (1911, translated in 1934), who stressed the importance of bank loans in helping invest enterprises' innovations. Scholars in next few generations have constantly confirmed Schumpeter's point through theoretical analysis and empirical evidence. King and Levine (1993) draw a consistent conclusion with Schumpeter's by measuring the level of financial development and various indicators on economic development, such as the physical capital accumulation, real GDP growth per capita, etc. The data consists of 80 countries over 29 years (from 1960-1989). In addition, Levine (1997) and Porta et al. (1997, 1998) draw a similar conclusion. Gurley and Shaw (1960) expand the institutions in financial system to non-monetary intermediaries, which could have similar functions as banks: transforming saving to investments to boost economic development. It is notable that these works showcase the positive relationship between financial development and economic growth, but they do not indicate any causalities between these two.

However, in recent decades, mainstream economic researchers began to realise the non-linear relationship between financial development and economic growth. It is found out that financial development does not necessarily always come with a positive impact on economic growth. Additionally, different impacts of financial development on economic growth depend on the development level of the country as well as many other factors, including the political

institutions. Mainstream studies have already revealed its doubts on whether foreign bank's entry would be as effective as it was expected because the financial development and more specifically, foreign bank's operation is built on 'hard' information, such as accounting information and collateral values, whereas the developing countries with less developed financial system have long relied on 'soft' information, such as entrepreneurial ability and trustworthiness (Detragiache et al., 2006).

Cecchetti and Kharroubi (2015) argue that the need for deepening financial system in the emerging economies and that in the advanced economies have different roles in thriving economic growth. Finance can be a two-edged sword. It contributes to economic growth when the credit is relatively low, or the employment in the financial sector is modest. But when it is above the threshold, for example, the debt of the government, corporate or households are beyond 100%, the financial system can become a drag to the whole economy. They also argue that for advanced economies, "a fast-growing financial sector can be detrimental to aggregate productivity growth" (Cecchetti and Kharroubi, 2012, p.1). Similarly, Law and Singh (2014) find an inverted U-shape relation between financial development and economic growth. They argue that financial development is only beneficial for economic development when it below a certain level, otherwise, too much finance could harm economic growth, and low- and middle-income countries tend to have less advanced financial development level than the high-income countries. De Gregorio and Guidotti (1995), Huang and Lin (2009) and Rioja and Valev (2004) find out that the positive relationship of financial development and economic development is more significant in low-and-middle-income countries than that of high-income countries.

Both the theoretical and empirical evidence suggests that financial development is not always helpful for the growth of the economy. Many scholars mistakenly believe that too much finance that caused the stagnation of economy is financialisation. In fact, financialisation has nothing to do with the level of economic development. Indeed, a sufficient degree of financial development is a prerequisite condition for financialisation, but it is possible that financialisation symptoms can exhibit in developing countries which lack significant financial deepening or financial innovations (Lapavitsas and Soydan, 2022). Within the expanding body of literature discussing financialisation of developing countries, South Africa is almost the only African countries that appears in the financialisation narrative as the most of other African countries are not easy to fit in this academic conversation with a rudimentary financial sector and underdeveloped financial instruments. For South Africa and the most discussed emerging countries in Latin American countries and East Asian countries, they followed the neoliberal prescription aggressively by liberalising their financial systems in the 1980s. Even so, they are still quite premature in financial development, but it does not prevent the financialisation tendency happening in these countries. In this sense, the level of financial development and financialisation are neither sufficient nor adequate conditions for each other.

To summarise, the concept of financialisation belongs to the realm of political economy. Rather than simply focusing on the volume and quantity of all kinds of financial activities, financialisation departs from the growing financial motives and activities in different sectors in the economy, namely, the non-financial sectors, financial sectors, and households, and then put much emphasis on the underlying transformation of the altered behaviours of them and the changing relations between them. Financialisation also pays attention to the sum of these micro-entities, i.e., the fundamental change of the pattern of accumulation, even the

epochal transformation of capitalism itself, with the certain class change and social structure movement. Thus, in the scholarly work, financialisation offers more broader social perspectives than the mainstream financial development related concepts do. Particularly, financialisation always comes along with stagnation, weak investment, social inequalities, and the underneath imperial relations. It is, therefore, distinct from the concept of financial development, financial deepening, financial liberalisation or financial globalisation, even though it covers certain similar terrains with the latter concepts, such as capital flows, fluctuation of asset prices and instabilities and risks (Lapavitsas and Soydan, 2022).

2.5.2 Chinese-language literature

It has seen the Chinese-language literature on financialisation expanding dramatically since the 2010s. By searching the key word “financialisation” (金融化) on Chinese largest online database, CNKI.net (中国知网), it not only shows thousands of periodicals, but also hundreds of postgraduate dissertations that published in the recent decade. Financialisation first appear in Chinese-language research in 1987, discussing the financialisation of medical and healthcare industry in China (Ginzberg and Guo, 1987). However, the term of ‘financialisation’ are not necessarily defined the same as it was in English literature at that time as it did not cite any of the standard references, rather, it was treated as a newly created term to describe the penetration of finance to the health and medical system and happened to be coincides with ‘financialisation’. The research on financialisation saw a slow increase in the 1990s and the 2000s. After the 2008 Global Financial Crisis, financialisation in Chinese literature experienced a balloon, and keep rising up until today.

However, it remains a great pity that quality of these research has not improved proportionately. By reviewing large number of Chinese-language literature on financialisation, three fundamental flaws are found. First and foremost, the concept of financialisation has been mistakenly treated as synonym of financial development, financial globalisation, financial deepening or financial liberalisation, despite the nuance between the latter. It is understandable, in some sense, in the context of China because it only takes less than half century for China transforming from a country with a Soviet-type mono-bank system to a gigantic system where the full set of western financial instruments were established and has become the world leading financial market. Given that financialisation must have a certain degree of financial development as a prerequisite condition, it is quite easy to get them mixed with one another in the case of China.

It is often seen the neoclassic financial and economic theory mixed with heterodox economic theory without any conceptual and theoretical differentiation. For instance, Zhang Chengsi (2019) reviews the macro-level financialisation research, claiming that there are two different strands based on different value and research paradigms, one is neoclassic financial deepening, financial development and financial growth, and the other is western Marxism, Post-Keynesianism and radical political economy. He argues that the former is the prologue of financialisation, stressing the positive impact of finance on the economic growth whereas the latter views financialisation with 'tinted glass', and constantly connects financialisation with the negative narrative such as 'fragility' and 'financial crisis'.

This is a typical misunderstanding of financialisation, which can also be found in many other Chinese-language works, such as Zhao and Tian (2015), Zhang and Zhuge (2013), and many

more others. The departure of this type of misunderstanding is the relation between financial development and economic growth, which they tend to believe is a reversed U curve—a certain level of financial development is beneficial for economic growth and beyond a certain level, the over development of finance is detrimental to the economic growth. And the phase where finance has over developed is considered as financialisation in their views. This idea is not entirely wrong because indeed financialisation should build on a certain level of financial development, but what they are wrong about is that financialisation will not necessarily happen in every country where it has adequate financial development (Karwowski and Stockhammer, 2017). By the same logic, financialisation is also possible in developing countries where lack significant financial deepening or innovation (Lapavitsas and Soydan, 2022). Indeed, financialisation is always observed together with stagnation, inequality and many other economic and social problems, but to only verdict financialisation by the impact of financial development on economic growth is neither sufficient nor adequate.

Additionally, it is not fair to say that heterodox theories look financialisation through "tinted glass". Indeed, heterodox theories do usually take a critical stand on the role of finance, but this is for sure not biased or discriminated against finance. Rather, heterodox theories recognise the crucial role of finance in capitalist economy and attempt to situate it in a bigger picture—the altered behaviour of economic agents and thus, the altered accumulation regime and the epochal transformation of capitalism. Similarly, it is not true that neoclassic financial development theories are all in favour with the view that finance can boost economic growth as reviewed in the section 2.4.1. In fact, they are two completely different set of theories that concentrates on similar objectives. In essence, financial development and financial liberalisation are embedded in the neoliberal hierarchical world system, seducing

the late developers to follow their proposed policies that fundamentally beneficial to the core countries, whereas the research on financialisation, especially those on the developing countries are highly sceptical and critical about this idea. So, these two sets of completely different concepts cannot be used interchangeably despite there is no universally agreed definition of financialisation.

The second problem in the existing Chinese-language research on financialisation of Chinese economy is embedded in the first one, but on the realm of methodology. Specifically, Chinese scholars tend to oversimplify the financialisation to certain measurements, relying on standard metrics without adopting a clear theoretical framework, completely overlooking the mechanism of how exactly the Chinese economy is working. There is no doubt about the necessity of developing finance- and economic-related metrics when doing empirical works, such as the bank profitability, fixed investments of the economy relative to GDP, the debt level of enterprises, and such. However, as mentioned before, financialisation is rooted in a nation's historical, institutional, political and economic background, and closely related to the changing conduct of basic economic agents and their changing relations, namely, non-financial enterprises, financial institutions and households (Lapavitsas and Soydan, 2022). Without recognising the defining features that set Chinese economy apart from others and the altered behaviours of the basic economic agents in Chinese economy, the metrics could never demonstrate financialisation in China.

For instance, Zhang Chengsi (2019) published on Economic Research (《经济研究》), one of the top peer-reviewed Economics journal in China, that the logic of financialisation includes three dimensions: macro, micro and meso level, the first two of which are borrowed from the

West, and the last of which is embedded in Chinese reality. Zhang interprets that the macro level of financialisation in western academia is essentially represented by the increase of proportion of financial output and financial profits in national economy and the micro level is reflected by the increase of financial investments and financial profits of non-financial enterprises (Chengsi Zhang, 2019). He believes that the meso level is unique for Chinese context, which includes commodity securitisation and goods financialisation (ibid). Others do not necessarily utilise the same measurements, but they use the similar three-level or two-level (micro and macro) framework, such as Zhang and Zhuge (2013), Chen and Guo (2016). Without a proper theoretical recognition, the increasing financial profit in the economy is not evident of financialisation but simply a natural outcome of an expansive financial sector. For the similar logic, the so-called “unique” meso level of Chinese economy only indicate a growing financial system but nothing more than that. Last but not the least, these metrics are isolated in certain ways, so they cannot reflect the changing relations between the basic agents of the economy, which lies at the core of financialisation. Let alone none of them have ever included the households or individuals into their considerations.

And the last common problem is that Chinese-language scholarly works have not captured the specificity of the Chinese economy, nor do they recognise the root in China’s unique economic political system, which the English-language works are doing much better, surprisingly. Chinese scholars tend to regard the Chinese economy as another entity that not dissimilar with any other capitalist countries, which is not true. The biggest difference between the Chinese economy and the other economy is the role of the state, and the way that the state intervenes its economy. Without including the Chinese specificities, the

measurements certainly would not be able to capture the precise features of Chinese financialisation.

2.5.3 English-language literature

In neoliberal capitalist economy, the role of the state is diminishing but the role of the financial market is enhancing. For this reason, financialisation of the state has been rarely discussed. Karwowski (2019) offers a structured overview of the financialisation of the state in capitalist countries. She defines financialisation of the state broadly as "the increasing influence of financial logics, instruments, markets and accumulation strategies in the state activities in a way potentially detrimental to the state's accountability towards its citizens" (Karwowski, 2019, p. 1002).

In the context of China, the research agenda on financialisation of the state is more obvious than that in the western context. A growing body of English-language literature has put their fingers on the specificity of Chinese economic and political system, especially the role of the state. Many scholars refer to China's financialisation as 'state-led' financailisation (Naughton, 2019b; Pan et al., 2021; Wang, 2020, 2015). It is well-nigh impossible to only look at the economy side when the economic growth has been accompanied by profound political and institutional reform. The changing role of the state in the economy in the past few decades is essentially a changing relation between the state and the market. Naughton (2019), Pan et al. (2021) and Wang (2015) resonate with Karwowski (2019) on the connotation of financialisation of the state, despite their differences of focus. Karwowski (2019) looks financialisation through the lens of two main policy fields: fiscal and monetary policy, and her focus is the transformation of the state itself, whereas Naughton (2019), Pan et al. (2021) and

Wang (2015) primarily concentrate on the changing mechanism of state's direct intervention in the economy, such as the way the state managed and governed SOEs and financial institutions, especially state-owned banks, or the financial means that has been increasingly used in industrial policies, whose focus is the transformation of the economy that is led by the government with the financialised tools.

As will be mentioned in the in Chapter 4, the "state" in Chinese context can have fairly broad meaning. It can include the Communist Party, State Council, i.e., the central government, or all different central authorities, such as the Central Bank, as well as the local government and local authorities, depending on the context. When referring to the 'state sector' in Chinese context, it usually means SOEs, and/or the state-owned financial institutions. Among the works of financialisation of China's state sector, most of them focus on either the central-level government bodies, including the central government, the National Development and Reform Commission (NDRC), State-owned Asset Supervision and Administration Commission of the State sector (SASAC), among others, or the local government. Typically, those which focus on the local government are less likely to focus on local branches of other government bodies as they do not have as much authority compared with the local governments. Nevertheless, none of the existing works does have systemically examined the transformation of the state sector, including both the central level and the local level across different actors, against the backdrop of the rise of finance.

Plenty of the works that have explored the transformation of the central-level government's governance by explicitly using the term 'financialisation', such as Naughton (2019), Pan et. al., (2021), Petry (2020), Wang (2015). These works neither specifically differentiate the central-

level and the local-level government, nor do they differentiate between different government organs, such as government bodies or Party organs. Rather, they treat the state as a non-splitable entity. Naughton (2019) uses financialisation to describe two broad transformations of the state, one is that the state pursues national goals mainly through financial means and the second is more precise, that state's control over SOEs is increasingly depending on financial instruments. Wang (2015, p.603) is along the same lines, arguing that Chinese state has been increasingly dependent on financial means to manage its ownership, assets and public investments, and refashioned itself as "a shareholder and institutional investor in the economy". In this sense, Wang (2015) claims that Chinese state transformed to a 'shareholding state', and its economic management is financialisation.

Many other scholars have worked on multiple topics on financialisation of China's context, focusing primarily on financialisation of city and urban development, as well as housing and land financialisation, all of which are closely associated with the role that the local governments play in China's massive scale of public investments. By financialisation, they do not necessarily mean the same as financialisation originally does in theory, but represents the way that the local government's collusion with the "urban investment and development companies that fund, construct and then often operate and manage new projects on behalf of local governments" (Jiang and Waley, 2021). Similarly, Wu et. al., (2022) and the rest four papers of the special issue of *Regional Studies* (2022, April) reveals that the increasing financial approaches are deployed in China's urban and regional development, including various types of debt-financing (Feng et al., 2022; Li et al., 2022), contributing to China's financialisation. They have also found that the financialisation process is not a unidirectional

process, rather, the state sometimes reinforces financialisation and sometimes constrains it (Feng et al., 2022; Wu et al., 2022).

Among the works of financialisation on Chinese economy, Pan et al., (2021) offers a more comprehensive studies where they explore the behaviour and interaction between different actors of the state sector in the purpose of uncovering how they altogether shape the state-led financialisation in China. They define the "state-led financialisation" as "state's growing use of financialised policies" (Pan et al., 2021, p. 750). They use the government-guided investment fund (GGIF) as a cutting point to China's state-led financialisation, claiming that the spread of GGIF is an outcome of state's policy goal which is achieved by the state's planning and the involvement of financialised tools. In this process, the state and the process of financialisation have mutual forces on each other, i.e., the state shapes the process of financialisation in China and in turn financialisation transforms the state as well (Pan et al., 2021, p. 751).

2.6 The costs and disadvantages of financialisation

As will be elaborated more fully in the next chapter, financialisation indeed reflects the acceleration of circulation, and it is facilitated by the deregulation of the financial sector and the promotion of the neoliberalism. Financialisation, therefore, is associated with the rapid growth of the financial sector, the expansion of the financial profits, and the increasing holding of financial assets for households. However, financialisation is more than that as it is regarded as the root cause of a series of problems in capitalist economies. This section will summarise the costs and disadvantages of financialisation from the domestic and

international dimension, aiming to specify the possible merits of the Chinese state-led model and to help avoid these potential costs.

Financialisation is found to have a profound and largely negative impact on the operations of non-financial companies (NFCs) (Crotty, 2005; Epstein, 2005). Neoliberalism has prevailed and created a so-called “neoliberal paradox”, which summarises precisely the problem that is faced by the NFCs, and also indicates more negative outcomes for workers and for the economy as a whole. The “neoliberal paradox” refers to the situation where “intense product market competition made it possible for most NFC to achieve high earnings most of the time, but financial markets demanded that NFCs generate ever-increasing earnings or face falling stock prices and the threat of hostile takeover” (Crotty, 2005, p. 79).

NFCs adopted the destructive competition strategy in the market by cutting-throat pricing and over-investment relative to demand, creating chronic excess capacity (Crotty, 2005). To survive under such a ‘coercive competition’ market environment, NFCs were forced to adopt shorter planning horizons, at the expense of long-term sustainable growth for non-financial enterprises which is rooted in the increasing involvement in financial activities (Crotty, 2005, 1993). On the bright side, non-financial enterprises gain more from the financial market, but on the downside, these profits are not reinvested into the firm’s production facilities, but are distributed to shareholders in the form of dividends and share buybacks, which is beneficial for their immediate return (Crotty, 2005; Epstein, 2005). The pressure for immediate returns can result in decisions that prioritise shareholder value maximisation over investments in research and development, employee training, or long-term strategic planning.

This also contributes to a significant macroeconomic problem, especially the increase of zombie firms, whose profits are so low that they cannot even pay the interest on their debts, which is often found to be one of the reasons of weak accumulation in the core capitalist counties, especially the USA (Águila and Graña, 2023). And it further leads to the deviation between stock market performance and macroeconomic indicators.

Short-termism also causes a change in labour relations. Specifically, in order to survive beyond the short run, firms had to lower labour costs through downsizing as well as through wage and benefit cutting (Crotty, 2005; Epstein, 2005; Lazonick and O'Sullivan, 2000), leading to "conflict-driven" labour relations (Crotty, 2005, p. 79). The cost of job losses to displaced workers has been substantial since wages and salaries tend to be significantly lower than in the previous jobs. More prominently, job insecurity has grown (Lazonick, 2015; Lazonick and O'Sullivan, 2000) and the intensification of labour as well as the extension of unpaid labour became a significant problem under financialisation (Lapavitsas, 2013, p. 174). This has weakened labour unions and reduced the influence of workers in economic decision-making. While laying off skilled workers, NFCs focused on distributing corporate revenues to support the price of their stocks (Lazonick and O'Sullivan, 2000). Labour lost against capital (Lapavitsas, 2013).

The loss of employment and prioritising the financial returns led to a change in social structures. Large numbers of well-paid blue-collar workers lost their jobs in the 1980s and 1990s in the US, which permanently eliminated middle-class jobs (Lazonick, 2015). The workers who remained at their jobs faced wage and welfare cutting, whereas managers who were renumerated through financial assets gained substantial financial returns, enlarging the

income gap with those who earn wages. Financial profits have been the major lever of the enrichment of the top layers of income distribution (Lapavitsas, 2013). As a result, the middle class tended to shrink, and social wealth became increasingly concentrated in the hands of a small elite class (Lazonick, 2015). Consequently, social inequality has grown, mostly in Anglo-Saxon countries – precisely where financialisation has been at its most forceful (Lapavitsas, 2013).

Financialisation began in full earnest in the 1970s when Regan in the USA and Thatcher in the UK promoted neoliberalism and open the way toward large-scale privatisations. Thus, financialisation is found to have been associated with the retreat of public provision across a range of services, including housing, pension, education, health, transport, and so on (Lapavitsas, 2013a). This has given space for private provision where private finance emerged as a mediator across these fields, even though its performance has often been predatory and crisis-prone. For the same reason, households were forced into the financial realm with the facilitation of banks and other financial institutions. To pay for more privatised consumption, households were burdened with increasing debt for mortgages, general consumption, education, and health. At the same time, the savings of households were also channelled to banks thus supporting financial profits (Lapavitsas, 2013).

Financialisation was facilitated by the deregulation of the domestic financial systems in terms of interest rates as well as the practices and activities of financial institutions (Lapavitsas, 2013a). The central problems created by financialisation are "speculative and excessively liquid financial flows that create debt-laden balance sheets, overly short-term perspectives, volatility and mispricing of important asset prices, including exchange rates, and subsequent

misallocation of resources and unstable economic growth rate” (Epstein, 2005, pp.12). This has made the current capitalism even more prone to crisis. Crises are particularly costly socially because the households and individuals have been dragged into the financial system in different ways, they became more vulnerable, and the destructive power of financial crises became even greater.

On the international level, financialisation is facilitated by the lifting of international money and financial controls (Lapavitsas, 2013). Exchange rates among major economies have become more flexible since the collapse of the Bretton Woods Agreement in 1973, and the cross-border capital flows have been deregulated (ibid). A huge cost for developing countries but a benefit for the developed countries, especially the USA, is the reversed capital flow - capital has been exported from the poor developing countries to the rich developed countries, i.e. the poor are subsidising the rich. This has already been thoroughly discussed in Section 2.3.

Putting the Chinese model against this background, it is found that the state-led model has already helped China to at least alleviate the impact of global financialisation. First and foremost, the state has not fully liberalised interest rates, exchange rates and the capital account, which affords the state greater policy room in the economy. Second, state ownership of large SOEs and financial institutions, especially banks, has prevented the emergence of the deeply problematic practice in contemporary capitalist economies of intervening publicly to deal with bank losses and prevent collapse merely to return the banks to private hands. State ownership allows the state to intervene in the economy decisively and effectively by allocating resources to industries, especially during a crisis, as will be elaborated fully in

Chapter 6. Additionally, public ownership of both banks and large enterprises ensures the implementation of long-term investment that is beneficial for both real accumulation and social welfare.

2.7 Conclusion

This chapter surveys extensive literature on financialisation from both theoretical analysis and empirical evidence. Theoretically, works are reviewed by different schools of thoughts, namely, Marxist political economy, post-Keynesianism and French Regulation Schools. They share commonalities on certain aspects, but also contrast each other on other issues. Because of the different theoretical foundations, the definition of financialisation has not yet reached an agreement. Empirically, the existing literature is categorised by different characteristics of developed countries and developing countries, where the financialisation emerged from the national economy from within and channelled from external influences, respectively, providing useful benchmark for China's economic, financial and societal evolution.

Among various definition of financialisation, Epstein's (2005, p.3) description is the most widely accepted one: "financialisation means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies". However, this definition is rather broad and vague, and oversimplifies financialisation and the change that it has brought to both the economy and society. If Epstein's description were to be employed to recognise financialisation in a certain economy, it would be easily mixed with the general rise and growth of finance in recent decades, which has been discussed fuller in section 2.4, and used as a peg for the existing literature on financialisation in the context of China.

The rest of section 2.4 surveyed the Chinese-language and English-language works on financialisation of Chinese economy. It finds that Chinese-language studies have conflated financialisation with orthodox finance concepts, namely, financial deepening, financial liberalisation, financial globalisation and financial development, despite the nuance of the latter. The Chinese-language works failed to recognise the specificity of Chinese economy, especially the role of the state. Thus, their conclusion that Chinese economy has been financialised is not evident. English-language literature has put their fingers on the role of state but not properly situates the Chinese case in the academic conversation of financialisation, i.e., lack of theoretical underpinning and analytical tool. To fill the research gap, next chapter will start to tackle these unsolved problems by employing the appropriate approach and developing a useful analytical framework.

Chapter 3. Marxist Political Economy Approach, Analytical Framework and Methodology

3.1 Introduction

This chapter is in the quest for an appropriate theoretical approach and an analytical framework for financialisation of Chinese state sector. Section 3.2 elaborates a Marxist political economy approach that departs from Marxist theory of finance, which is mainly developed and advocated by Costas Lapavitsas. This approach believes that finance is integrally connected to the circuit of productive capital, in which sense financialisation neither represents the capital's escape from productive sector to the financial sector in search of higher profits, nor the consequence that capital being crowded out from production (Lapavitsas, 2013). This approach is built on a dichotomy of finance and real accumulation, which he inherits the Uno tradition, claiming that finance and real accumulation is a two-way relationship. Precisely, Lapavitsas summarises this relationship via a pyramid-like credit system, where the pyramid rises from the simplest trade credit to the most complex central bank credit, with different social foundations for each type of credit.

To apply the theory into an analytical framework, Lapavitsas believes that financialisation represents an epochal transformation of capitalist economies, whose foundation is the altered conduct of behaviours of the basic agents of the economy, namely, non-financial enterprises, financial enterprises and workers/households, as well as their changing relations (Lapavitsas, 2013). His analytical framework is more appropriate for the financialisation of the core capitalist countries whose financialisation was originated from their domestic economies *internally.* The basic agents of the economy provide a sufficient and suitable framework for domestic dimension of financialisation.

In essence, the transformation of Chinese economy bears similarities with both financialisation of core and periphery countries. On the one hand, the transformation of Chinese economy was primarily originated from its domestic institutional, political and economic changes that started from the Opening and Reform since the late 1970s. In this sense, it is very much alike the core countries whose transformation emerged from within their economy. However, they are qualitatively different because the Chinese transformation was directly intervened and participated by the state during the course whereas the state has rather limited roles, despite the state indeed facilitated financialisation by deregulating the financial system. On the other hand, China's transformation shares some commonalities with the financialisation of the periphery countries as China was a late comer in the world market and in global financial system as most of them do. But the Chinese case does not resemble the subordinate nature of the latter because of China's rather controlled and closed financial system, especially the non-convertible capital account, which makes the external impact of the global finance limited. Thus, the international dimension of financialisation in China is not as obvious as it is in other developing countries whose financialisation was channelled from outside via capital flows and the entry of foreign banks. This is also one of the reasons why this thesis chooses to solely focus on the domestic dimension.

In this sense, none of the existing framework would perfectly fit the Chinese situation, so it desperately calls for a suitable analytical framework. To approach financialisation of Chinese economy from the perspective of the transformation of the state sector, the analytical framework will, thus, mainly serve the need of the internal/domestic dimension. Hence, an analytical framework is proposed by building on Lapavitsas' analytical framework and taking

the Chinese specificities into consideration. The framework will depart from the altered conduct of basic agents in the state sector, namely, SOEs, financial system, especially SOCBs, and local governments, as well as their changing relationship with one another.

This chapter also introduces the methodologies that have been employed in this thesis. The transformation of Chinese economy, especially that of the state sector surely belongs to the realm of political economy. Hence, a mixed method of quantitative and qualitative methods is required. Quantitative methods that will be utilised in the following chapters are briefly introduced in Section 3.5.1. Qualitative methods include institutional analysis and informal talks. The institutional analysis depicts the landscape of the Chinese institutional settings and mechanisms to lay out the foundation for better understanding the transformation. Informal talks provide supporting evidence for the quantitative findings, leading to a more convincing conclusion. Finally, Section 3.6 concludes this chapter.

3.2 An Approach based on Marxist Political Economy

The analytical instrument of this dissertation is based on Marxist political economy, particularly on Marxist theory of finance, which is well articulated and developed by modern Marxists, such as Itoh and Lapavitsas (1999), Lapavitsas (2003) and Lapavitsas (2013). Fundamentally, Lapavistsas and his co-authors recognise that there is a difference between productive capital and interest-bearing loanable capital, which brings the difference between financial operation and non-financial operation. However, based on this point, they believe that money and finance are integral parts of the production. Specifically, it needs money and finance to start the circuit of production—purchasing the initial investment, including paying for the labour cost, as well as accelerating the trading and commercial activities that attached

to the production. Money and finance are involved in each step of the circuit, including the sales, the financing and the profiting, as well as the reinvestment once profiting.

Indeed, the circulation has seen an acceleration in the era of financialisation in many economies, and the volume has been growing fast. But it is by no means an escape of productive capital into the financial realm seeking for higher profits, or production is being crowded out by the finance (ibid, c.f. Lo, 2018; Orhangazi, 2008; Stockhammer, 2008). In fact, the accelerated circulation is way more complex than the capital simply escaping production to make the circulation faster. Because, first of all, finance has its own logic and "financial system is a set of ordered economic relations" with its own markets and institutions, rather than simply being a shelter for capital when it seeks for higher profits (Lapavitsas, 2013, p. 37). Finance can make profits by supporting the accumulation, such as the most straightforward way of earning interest margins in the form of bank credits. Meanwhile, finance could also make profits without production being part of it by speculating, whose profitability is incomparable with that of production. Secondly, the fast-growing circulation has to do with the changing relations between the financial enterprises and non-financial enterprises as well as households/individuals in the new era of the rise of finance. The balance between financial and non-financial operations in the circuit of productive capital has changed because of these changing relations, which marks financialisation.

Financialisation is built on the bedrock of the relation between finance and real accumulation, which have a two-way relationship. On this matter, Uno tradition of Marxist theory of finance is typically useful and made a path-breaking contribution. Makoto Itoh is a prominent scholar of Uno School, by which Lapavitsas' works are heavily influenced. Precisely, Uno School argues

that “finance comprises an integral whole of relations ordered in interconnected layers emerging spontaneously out of real accumulation”, which is then summarised by Lapavitsas via a pyramid-like credit system, as Figure 5 shows (Lapavitsas, 2003, pp. 122–3).

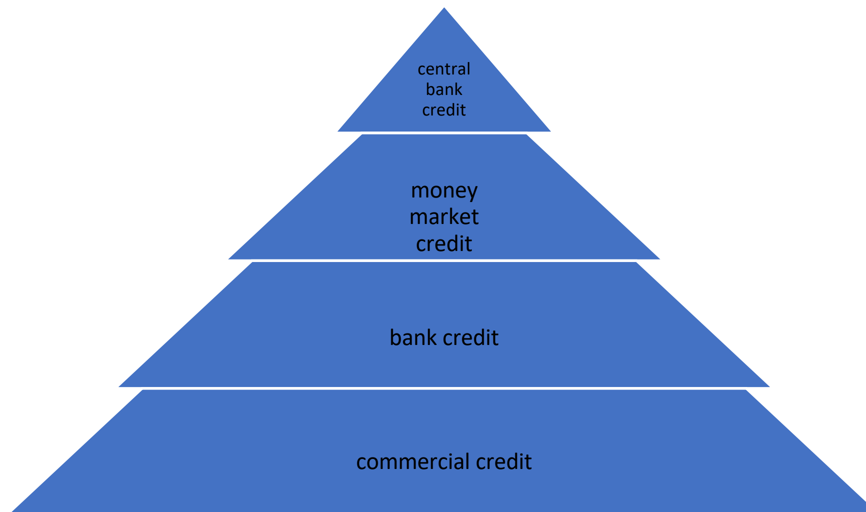

Figure 5 Credit system pyramid

Source: Lapavitsas, 2003, pp. 122–3

Lapavitsas argues that the credit system is “a mechanism for the concentration and allocation of loanable capital among industrial and commercial capitals” (Itoh and Lapavitsas, 1999, p.151). Further in his later work, Lapavitsas (2003) elaborates on the pyramid-shape credit system where the commercial credit or trade credit is at the fundamental level and central bank credit is at the top of the pyramid. Money market credit and bank credit stay in between them with bank credit next to commercial credits and the money market credit at the higher level next to the central bank credit, as shown in Figure 5. The pyramid rises from the simple to the complex where they “mutually sustain each other, thus generating social trust and validity in the system of credit as a whole” (Lapavitsas, 2013, p. 123). Overall, the credit

pyramid vividly illustrates the chain of interconnected promises to pay of the credit in capitalist economies.

It is to be noted that the financial market is not necessarily equivalent to the credit system as the latter does not include the capital (stock) market, which exists alongside credit system by connecting to it through value flows and price determination (Lapavitsas, 2013, p. 123). Money market is included in the credit system but the stock market is not because Uno tradition believes that money is traded 'as funds' in the money market whereas money is traded 'as capital' in the capital market (Lapavitsas, 2013). However, they are still connected with one another primarily through two links. The first is that they both provide options for holders of idle money who could make their fund available either within the credit system or in the capital market; secondly, prices in the capital market are determined by the credit system (Lapavitsas, 2013). Typically, the rate of interest of the money market sets the benchmark for all other rates of interests within the credit system, and it also decides the rate of return in the capital market (ibid).

Departing from these particular Marxist Political Economy approach, financialisation is regarded as a historical structural transformation of an economy in terms of the interactions between finance and the rest of the economy, particularly, the production (Lapavitsas, 2013). Hence, financialisation represents a fundamental transformation of financial operations as well as the "balance between financial and non-financial activities that are integral to the circuit of productive capital" (Lapavitsas, 2013, p.217). To apply the approach into an analytical framework, Lapavitsas believes the foundation of financialisation as the structural

transformation is the conduct of behaviours of the basic agents of the economy, namely, non-financial enterprises, financial enterprises and workers/households (Lapavitsas, 2013).

The altered conduct of behaviours of these economic agents as well as their changing relations comprise the core of financialisation. Thus, to understand financialisation, it must start from the financial operation that are intrinsic to the circulation of the productive capital. Different types of credits represent different promise to pay, and have different trust requirements (Lapavitsas, 2003, p. 70), and the changing conduct of basic economic agents and their altered relations are embedded in the social foundations of each type of credits. Thus, it is important and necessary to first know who gives what credits and why when understanding the changing behaviours of the basic agents of the economy, as well as the changing relations between them. Each type of credits will be carefully introduced later in this section.

Trade credit

Trade/commercial credits emerge spontaneously amongst capitalist enterprises in the normal course of operations and provide a link between the credit system and capitalist accumulation, which fundamentally rest on a field of trust and power (Lapavitsas, 2003, p. 71). It does not involve either loanable capital or financial institutions to emerge "as it is simply the advance of finished output against promises to pay among enterprises" (Lapavitsas, 2013, p. 123).

Unlike the bank creditor and debtor are in the essentially equal position, trade creditor and debtor are clearly in an unequal position in this borrowing-lending relation. The inherent asymmetry in operations of the trade credit is clearly beneficial to the recipients more than it

is to the trade creditor. The trade credit debtor could purchase production inputs at no immediate money cost, as such, they could expand their production, and further increase the profitability (Itoh and Lapavitsas, 1999, p. 149). However, for the creditor, they face the delayed or cancelled payment even though they could economise on the cost of storing finished goods and mitigate the sudden price fluctuation of selling these outputs (ibid). Empirical evidence has proved this point that the late payment of the trade credit has already become a contributor of Chinese small and medium sized firms' distress and failure (Wu, 2017). Additionally, trade creditor lengthens the turnover time of their capital, thus, lowering its profitability in the long run (Lapavitsas, 2003). In this light, a capitalist would benefit if they sell for cash and buy on credit (Lapavitsas, 2003).

Whether a capitalist enterprise can finally sell for cash or not depends on its market power (Fabbri and Klapper, 2008). Capitalist enterprises with greater market power, i.e., less competitive pressure, such as having a dominant market share, or providing differentiated products, among others, might be under less pressure of offering trade credit (Fabbri and Klapper, 2008; Lapavitsas, 2003). Enterprises, thus, will be on larger competitive pressure if it refuses or unable to provide trade credit (ibid). On the other side of the same token, the commercial trust between two parties determines if the creditor is willing to advance trade credit to the debtor. The commercial trust is built upon two factors—profit generation and access to money (Lapavitsas, 2003).

Bank credit

Bank credit represents a more developed and social form of credit, compared with commercial credit because it partially built on the trade credit relations, but more than merely

the trust between two known capitalists (Lapavitsas, 2003, p. 71). The power imbalance between the creditor and borrower is minimised by involving in the professional intermediator—the banking institution. Similar as the trade credit, bank credits also arise spontaneously, but they do not have to be in between two capitalist enterprises which have business relations with one another. It could arise between any two capitalists under the intermediation of a bank.

The emergence of banking credit was partially built upon the trade credit relation (Lapavitsas, 2003). Given trade credit is significantly disadvantageous for creditor, it would be beneficial for creditors if the return of their capital can be obtained within the agreed timeframe. By relying on the trade credit instruments such as commercial bills, the trade creditor can either use the bill to pay their input purchase or sell the bill to other capitalist who possesses the idle money to achieve their goals of getting the return of their capital in a shorter period of time (ibid). For the first option, it depends on if the supplier is willing to accept the bill, and the bill could be passed to others for several times. The bill effectively works as a credit money in every exchange, and the original debtor becomes increasingly remote in this prolonged creditor-debtor relations (ibid). For the second option, the bill will be discounted—a sum that is smaller than that due on repayment because the interest is included in (ibid). Because the interest it accrues, the second option is qualitatively different from the first option being the banking/ monetary credit (Lapavitsas, 2003, p. 77).

In this sense, banking credit emerged when money-dealing capitalists regularly dealt with the commercial bills by exchanging one type of promise to pay (between enterprises) for another (bank to enterprises), and these money-dealing capitalists became banks, “though the

possibility is open to capitalists who hold sums of idle money" (Lapavitsas, 2003, p. 78,79). Specifically, banks collect idle money from one capitalist enterprises, transform it into capital that available for lending, i.e., loanable money capital, and direct it to another capitalist enterprises for its production and profit generation (Lapavitsas, 2003).

Money market credit

Money market credit arises spontaneously among banks when they attempt to secure reserves under the uneven access to it, i.e. banks have difficulty securing reserves borrow from those have abundant reserves (Lapavitsas, 2003). Thus, money market credit does not always involve industrial capitalists because the transaction among banks is the transaction of loanable money market among financial institutions (ibid). In this light, the trade of market loanable capital is traded in large sums for a short period of time (ibid). Also, money market breaks the geographical and economic boundaries for the idle money funds to flow across the society, with the interest rate reflecting its price and acceptability within the society. In this sense, money market credit represents an even higher level of credit, compared with bank credit and commercial credit.

3.3 Conduct of behaviours of fundamental economic agents

Scholars may or may not explicitly stress the analytical framework that comprises the conduct of behaviours of the fundamental economic agents, they more or less focus at least one of them, namely, non-financial enterprises/corporations, [10] financial sectors and households or workers. Costas Lapavitsas is the first to analyse financialisation from the perspective of the

[10] Enterprises and corporations are interchangeable in most cases, but some scholars distinct them from one another.

conduct of behaviours of the fundamental economic agents as well as their altered relations. This section will follow his framework to summarise the common tendencies of the fundamental agents of the economy in the course of financialisation, aiming to using it as a benchmark when developing a suitable framework for China's state sector.

3.3.1 Non-financial Enterprises

Scholars look at financialisations of non-financial enterprises mostly through the following three lens: 1) dual movements of non-financial enterprises, i.e., increasing financial profits and financial costs (see, for example, Crotty, 2005; Epstein and Jayadev, 2005; Krippner, 2005; Orhangazi, 2008); 2) non-financial enterprises' orientation towards shareholder value (see, for example, Lazonick and O'Sullivan, 2000; Stockhammer, 2008); and 3) how non-financial enterprises finance themselves . These three aspects seem isolated at the first glance, but in fact, they are intertwined with one another, which will be elaborated in full in this section.

There is a tendency that large enterprises not only derive more profits from the financial market but also pay more to the financial market in the form of dividends, interests and share buybacks. Van der Zwan's (2014, p.104) creatively combines the simultaneously increasing financial profits and financial costs to name it as "dual movement" of enterprises, which, in her opinion, laying out the foundation for the slowing down of accumulation in her renowned survey paper on financialisation. Orhangazi (2008) utilises the firm-level data in the US from 1973 to 2003 empirically prove that the dual movement is more obvious in large corporations than in small ones as the large corporations have more capability, such as funds, access and information, than small ones.

Rabinovich (2019, p.738) summarises the findings that non-financial corporations "increasingly engaged in financial accumulation from which they derive a growing proportion of financial income" as "financial turn of accumulation hypothesis". But on a different note, he argues that the observations have oversimplified when they are used to convict financialisation of an economy by merely looking at the increasing proportion of financial profits of non-financial corporations. To scrutinise this hypothesis, he provides more empirical evidence beyond financial profits of non-financial corporations in the United States, namely, the structure of assets and flow of funds. Additionally, he utilises size analysis to ensure the empirical findings are consistent in non-financial corporations of different sizes. Finally, he rejects the hypothesis of the "financial turn of accumulation" as the interest income of non-financial corporations in the US had been low (less than 1%) in the observed period from 1969 to 2016.

To summarise, the dual movement is observed and recognised by most of the scholars, but whether or not they perceive this as evidence of financialisation is debatable. It is obvious that only the fact of the dual movement cannot be the sufficient nor adequate conditions for financialisation of non-financial enterprises because more related elements need to be considered.

On this front, the increasing financial expenses derives the shareholder values in a certain way --- high financial costs make the non-financial enterprises have no enough capital for the real investment, which is also known as "squeezing out" or "crowding out" theme (Van der Zwan, 2014, p. 104). Post-Keynesians link the increasing financial expenses and shareholder value through the emergence and rise of rentier in a way that the increasing power of the

rentier leads to the change to corporate governance, which is captured by the term "shareholder value orientation" (Powell, 2013).

Specifically, non-financial firms pay an increasing amount of expenses to the financial market in the form of dividends, share-buybacks, interest payments, among others because of the changed corporate governance that was caused by severe international competition (see, for example, Crotty, 2005; Krippner, 2005; Orhangazi, 2008.), and hostile takeovers and increasing number of mergers and acquisition (Davis and Thompson, 1994; Fligstein, 1990; Lowenstein, 2004). The change of governance shifts the incentive of top managers, who pay more attention to the short-term financial market return, leading to drastically shortened horizon of decision-making (Crotty, 2005; Orhangazi, 2008). What made the non-financial firms fundamentally different from those in the industrial ages is that the firm now distributes the productivity gains to the shareholders, rather than reinvests to the firms further productive development as they did in the industrial ages (Baud and Durand, 2012; Lazonick and O'Sullivan, 2000; Milberg, 2008).

The change of corporate governance naturally leads to the second theme for financialisation of non-financial enterprises--the shift of management priority towards the "shareholder value", which is developed by a group of scholar who initially focus the research on corporate management and governance (Fligstein, 1990; Froud et al., 2000; Lazonick and O'Sullivan, 2000). Post-Keynesians interpret this shift from their standpoint on rentier. Epstein and Jayadev (2005) provide a macro-level empirical evidence to indicate the increasing share of rentier income in the national income throughout the 1980s and 1990s by using significantly

increasing profits of financial firms and total interest income as percentage of gross national products (GNP) in most OECD countries increased significantly in this period.

Non-financial firms have been pressured by the financial market under the shareholder value, and at the same time, the pressure is diverted to employees. It signals the "distributional effect of financialisation, perceived as a worsening balance for labour versus capital" (Lapavitsas, 2013, p. 32). The empirical evidence gives it confirmation. Lazonick and O'Sullivan (2000, p.5) argue that the shareholder value orientation made the non-financial firms shift from "retain and reinvest" to "downsize and redistribution", resulting in job losses. Stockhammer (2012) observes households' stagnated real wages and the default on their loans, as well as the general income inequality in society. Overall, the shareholder value orientation and the rise of rentier signify the win of capital over labours in the era of financialisation.

The third way of examining financialisation of non-financial enterprises is to look at how exactly the non-financial enterprises finance themselves, which is mostly developed by Lapavitsas (2013) in his book *Profiting without Producing*. Lapavitsas (2011, 2013) has observed that the large multinational corporations in the mature core capitalist countries, such as the US and the UK, began to finance their investments through retained earning instead of mostly relying on bank credits. And when they turned to external finance, they have become more dependent on financial markets, and have developed strong skills in financial operations, such as the bond and equity trading in the open market.

This idea is not isolated from the aforementioned two themes, rather, Lapavitsas has gone one step further to the roots to find out how non-financial enterprises finance themselves. In fact, Lapavitsas recognises these changes without explicitly spelling out the increasing financial profits and costs, or the rebalance of the shareholders' and the managers' power. However, because the change of the financing pattern naturally leads to the change of composition of profits and costs, the strategy of the enterprises, as well as the relative power balance between capital and workers, Lapavitsas' claim is more to the core of the fundamental relations of financialisation. Specifically, Lapavitsas points out that shareholder value might partially explain some of the differences of the US enterprises, which are notorious for its share buybacks and dividends pay-outs, "but financialisation has to do with systemic access to funds and acquisitions of financial assets, both of which are more fundamental process than shareholder value" (Lapavitsas, 2013, p. 35).

However, Lapavitsas (2013) disagrees the logic of increasing financial activities of non-financial firms at the expense of productive investments because he believes that finance has always been integrally connected with the circuit of productive capital. The production and commerce are not possible without finance as finance is integral to each and every process of production—from the initial investment to the expansion of the production, either purchasing inputs through commercial credits or expanding business through bank credit borrowing. Thus, to Lapavitsas, the core relation of financialisation lies in the "financial operation of non-financial enterprises" (Lapavitsas, 2013, p. 217). In this sense, financialisation is neither the escape of capital from productive sector to financial realm in the hope of higher profits nor the increasing financial activities squeezing the productive

capital out of the production (ibid), which is exactly the application of the approach and analytical framework of this thesis.

3.3.2 The financial sector

As mentioned in section 3.2 that the credit system and the stock/capital market consist of the financial market (Lapavitsas, 2013, p. 123). The balance between credit system and the capital market is quite complex theoretically, but it determines the distinction between market-based financial system, such as the US and the UK—Anglo-Saxon type, and the bank-based ones, such as the Germany or the Japanese type (Lapavitsas, 2013). In the existing literature, a transition from a bank-based financial system to a market-based one in developing countries is a theme for financialisation, which has been discussed in Chapter 2 (see, for example, Bonizzi, 2013; Karwowski and Stockhammer, 2017; Lapavitsas, 2013). This institutional transition and the conduct of behaviours of banks and capital markets reinforce each other in the course of financialisation.

Financialisation is found closely related to the expansion of the financial sector. Because only few Marxists political economists have distinguished the credit system and the capital market, the 'expansion of the financial market' in the existing literature normally refers to the growth of capital market or the financial system as a whole (see, for example, Becker et al., 2010; Petry, 2020; Rethel, 2010). Scholars developed various metrics to capture the rise of financial market, some of them are from a relatively micro level, such as the changing volume and composition of capital flows, or the increasing scale of bank assets or larger stock market capitalisation relative to GDP (see, for example, Lapavitsas and Soydan, 2022; Stockhammer, 2008). And some from a more broader perspective to look at the increasing financial profits

in the economy, or even the change of regime of accumulation, such as Regulationists' works, see, for example, Becker et al. (2010), Boyer (2008, 2000), as well as Krippner (2005).

Krippner (2005, p.174) believes that the regime of accumulation is decided by the source of the profit, and thus she innovatively concentrates on the financial profits of the US economy as the evidence of the rise of finance to characterise the "long-term structural change of the US economy". Krippner (2005, p.174-5), therefore, defines financialisation as "a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production" in search of the structural change of the US economy in the post-1970s. She particularly explains that "financial" refers to "activities relating to the provision (or transfer) of liquid in expectation of future interest, dividends, or capital gains". Along the same lines, increasing profits from financial markets is named as the "portfolio income" (comprising income from interest payment, dividends, and capital gains on investments) (ibid). She uses the aggregate economic data to reveal the rise of finance of the US economy, i.e., how the relative shares of each sector (including manufacturing, services, and FIRE--- finance, insurance and real estate) in the US economy has changed in the period between 1950 and 2001, which is quite different from other literature that focuses narrowly on the micro aspect of non-financial enterprises (Krippner, 2011, 2005). She also proposes a series of "accumulation-based" measures, as opposed to the existing "activity-based" measures, to capture the shift of structure of the US economy– the dominance of income sources in the US economy shifted towards the FIRE sector, while faced the decline of the manufacturing and growth of services.

The expansion of capital market is also organically linked with the rise of shareholder values which has been summarised previously. However, scholars who research on financialisation have not given enough emphasis of the relative fall of banks, which are the foundation of any type of financial system, including the market-based ones. Costas Lapavitsas has put much of his attention on the commercial banks as they remain the hub of financial system and are crucial intermediary in between the basic agents in the economy, namely, in between the production and finance as well as in between the households and finance. Additionally, banks also play a decisive role in determining the rate of interest as well as the money supply. When bank's conduct of behaviours has changed, that of households, of enterprises and of other financial institutions change at the same time, and vice versa.

Lapavitsas summarises three ways that commercial banks have been transforming themselves since the 1970s in the core capitalist countries. First, the lending of commercial banks to non-financial enterprises has declined since the early 1990s, when the financialisation reached full swing in the core capitalist countries, reflecting the relative detachment of banks from productive accumulation in the course of financialisation. Second, commercial banks have been increasingly drawing their profits from households and individuals through lending, mostly from providing mortgages to households, as well as through handling their savings and financial assets. Third, commercial banks have been transforming themselves towards the investment banking by mitigating in open markets to draw profits increasingly from commissions and fees, and capital gains from trading (Lapavitsas, 2013, 2011, 2009b). The stylised facts of the US, the UK, Germany, and Japan between circa 1980s to the 2010s confirm his argument.

3.3.3 Households

A great number of scholars have touched upon the financialisation of households, ranging from their wage bills to their everyday life. Among them, a group of scholars intertwin financialisation with everyday international political economy (EIPE), a bifurcation of International Political Economy (IPE), which promotes the inclusion of attention on non-elite actors and everyday objectives (Elias, 2010; Hobson and Seabrooke, 2009a, 2009b). In this strand of literature, finance is treated as "a decentralised form of power" through "individual's own interactions with new financial technologies and systems of financial knowledge" (Van der Zwan, 2014, p. 102). This group of scholars, such as Erturk et al. (2007), Aitken (2007), Langley (2009, 2007), among others departure from the "democratisation of finance" or "popular finance", "whereby financial products and services have been made available to large parts of the population", as opposed to the rise of rentier, an elite class (Van der Zwan, 2014, p. 111). They also recognise the link between the prevailing pension funds in Anglo-American economies and financialisation (see, for example, Dixon, 2008; Langley, 2004).

Another group of scholars seems more radical, and they stand opposite to the idea of "decentralised form of finance'. Along the lines of imperial relations that embedded in finance, they argue households and individuals are expropriated by finance (see for example, Lapavitsas, 2009, 2013; Lapavitsas and Dos Santos, 2013) (cf. Fine 2010, 2013). They have noticed that the real wage of workers has been stagnated since the 1970s. With the retreat of public provision, individuals and households have been dragged into the financial system and involuntarily holding increasing amount of financial assets, such as pensions, insurance, among others (Lapavitsas, 2013, 2011). And at the same time, households also involuntarily

bear more financial debts in the form of consumer finance, such as credit cards, or loans of people’s basic needs, such as student loans and mortgage, among many more others (ibid).

Observations of the two groups of scholars share some commonalities but they perceive these observations massively different. They both have noticed that the provision of people’s basic needs is shifted to the financial market, including the pension, the housing, the healthcare, and the education. Van der Zwan (2014, p.111) regards these services which should have been provided by welfare states as an “increased convergence of finance and life cycle” because people now need to turn to financial products to hedge the risks and uncertainties they might face in their future lives. Similarly, Lapavitsas (2009, 2011, 2013) and other radical political economists think the increasing involvement of individuals in the mechanism of finance to meet their basic needs is resulted from the retreat of public provisions by the state. And Lapavitsas (2009, 2011, 2013) also connects it with the transformation of banks—banks and other financial institutions have facilitated financialisation of households as intermediaries and operators through assisting their consumptions and savings in the financial market. So, he believes it is a new way for banks to make profits, and it is also the basis for financial expropriation.

Compared with the scholars of EIPE, the tendencies that are summarised by Lapavitsas (2009, 2011 and 2013) is more comprehensive and more to the core of financialisation because he looks both sides of the balance sheet of households, i.e., households have been involved in the financial system either forcibly or voluntarily with respect to both assets and liabilities. Assets include pensions, insurance and houses, among others, while at the same time, liabilities increased, i.e., the level of indebtedness of households rise, as the consumptions,

assets and some basic needs are financed by credit cards, mortgages, as well as student loans, and many other types of credits. Thus, it reveals not only the benefits that brought by finance, but also the potentially detrimental consequences that finance has brought to everyday life of each household and individuals.

Financailisation of households also leads to the polarisation of incomes and then increases the inequality of income and wealth (Becker et al., 2010; Lin and Tomaskovic-Devey, 2013; Stockhammer, 2012). It is because the capital owner earns increasing financial profits from the financial operations, and they wish to do so to sustain the earning, whereas the wage earner incurs debts in order to maintain the consumption and meet the basic needs in the financialised era (Becker et al., 2010). For the same idea, Duménil and Lévy (2004) propose the concept of "two-tier capitalism", where they argue that not only the capitalist class but also the broader salaried class gained access to financial market through pension funds. However, the capital ownership of the latter is passive and subordinate, and then, they form a 'two-tier capitalism' altogether. Scholars believe that "finance cannot nurture a [large middle] class" because only a small group of elites can profit from finance, and "with the division of capital, skills, and education, great middle-class societies lose something vital and unique" (Phillips, 1993, p.197, cited in Arrighi, 1994: 325), which finally will erode the social basis of democracy (Phillips, 2002).

3.3.4 State's role in financialisation

The state has not been included as a parameter in any of the analytical framework of financialisation. However, the state indeed has been playing a crucial role in financialisation, and its importance is escalating when the recurrent crisis strikes. The state used to be treated

as an *exogenous* player in financialisation when scholars primarily focus on the economy, the individuals, or society or capitalism as a whole, to name only a few highly cited works, Davis and Kim, 2015; Krippner, 2005; Stockhammer, 2004, and the list goes on. Financialisation goes hand in hand with neoliberalism, which perceives the market as the perfect mechanism for the economy (Fine, 2009; Lapavitsas, 2013), the state, under the view of neoliberalism, is regarded as "corrupt, rent-seeking and inefficient" (Fine, 2009, p. 11). Thus, deregulation, privatisation and liberalisation become the dominating trends in capitalist countries across the globe, as it is considered that less state intervention would have less deleterious impact on capitalist accumulation (Lapavitsas, 2013).

In recent decade, an increasing number of scholars started to notice the role of the state in financialisation and have argued that finance is strategically influenced by the state. The state's governance towards its objectives, in turn, is influenced by finance. As has been discussed in Chapter 4 that Chinese state has adopted more financial mechanisms when managing its SOEs, including both financial institutions and non-financial enterprises, and the state has utilised increasing financial means when pursuing its industrial policies and urban development, such as setting up government-guided investment funds (GGIF) and bringing the public-private projects (see, for example, Feng et al., 2022; Jiang and Waley, 2021; Naughton, 2019; Pan et al., 2021). Lagna (2016) observes the similar situation in Italy. Precisely, he suggests that the Italian government implements statecraft strategies by exploiting the market-based methods and technologies of financial innovation, which is a key aspect of the financialisation of the state.

In this view, the state is treated as an *endogenous* element of financialisation. In fact, the above two different arguments are essentially the two sides of the same coin. Because it is the state's deregulation that eventually made the privatisation and liberalisation possible. So, suffice it to say that financialisation would have been impossible without the state's facilitation and enabling (Lapavitsas, 2013). And because of the rise of finance, state itself uses more financial means to achieve its own policy goals and governance. Therefore, the state intervention has never been eliminated, and it is the state that plays the crucial role in allowing the rise of finance and the finance in turn reinforce the role of financialisation, or to say the least, the role of finance in the economy.

Other than the facilitating role, the state has been increasingly participated in the financial market. Karwowski (2019) has provided a comprehensive overview of the literature on the role of the state in financialisation, defining financialisation of the state as the changed relationship between the state and financial market and practices, where this relation is understood as sovereign duties and accountabilities towards its citizens, arguing that financialisation of the state could diminish these duties and reduce these accountabilities. She identifies four ways in which it works through public institutions and policies, namely, adoption of financial logics, advancing financial innovation, embracing financial accumulation strategies, and directly financialising the lives of citizens. This piece has covered most of the themes in the existing literature of financialisation of the state.

By allowing the unfettered financialisation, the state also plays the role to prevent the worst that caused by financialisation. The US state led the way in the 2007-9 Global financial crisis, and the European Union countries followed. It is more so in the economic turmoil aftermath

the Global Pandemic in the early 2020s. The state policies primarily focused on three aspects to tackle the weakness of the economy, namely, liquidity shortage, financial institutions' bad assets and recapitalisation of institutions which had insufficient own capital (Lapavitsas, 2013a; Lapavitsas and the EReNSEP Writing Collective, 2023).

3.4 Analytical Framework

Financialisation of the core capitalist countries originate from within its domestic economy, and these core countries are at the high level of the hierarchical world system and world market. On the contrary, financialisation of the developing and emerging countries are mainly channelled from the core countries through the flow of capital, entry of foreign banks and financial institutions, and other neoliberal policies and institutions. They position in a subordinate place in the world market and world system, thus, financialisation of developing countries are normally called 'subordinate financialisation' or ''dependent financialisation' (Lapavitsas and Powell, 2013; Lapavitsas and Soydan, 2022; Powell, 2013). It is to note that the subordinate financialialisation is much more than any simple measures of capital flows, but rooted in the imperialism and is reflected in the "subjugation of domestic monetary policies to the imperatives of international capital and the relationship of the domestic currency with the world money" (Powell, 2013, p. 302).

Neither of the two types of financialisation does perfectly fit in China's reality, hence, it requires a theoretical framework that could incorporate Chinese specificities and could help to understands China's financialisation, especially its state sector. Having stated in the introduction that, on the one hand, China's transformation was originated from its domestic reform, so the domestic dimension of financialisation comprises the meat of China's

financialisation like that of the core capitalist countries. However, the state plays a decisive yet unique role in China's financialisation, which distinguish it from that of the core countries. On the other hand, China's case shares similarities with subordinate financialisation as China also integrated itself to the world market by embracing the neoliberalism. But China's case is qualitatively different from other periphery countries as China chooses neoliberalism as a policy choice while maintain its relatively high independence from this doctrine. Rather than completely subordinate to the world market, China kept its economy relatively close and opened it up gradually from the beginning. Up until now, its capital account remains relatively closed compared with other emerging countries. So, subordination financialisation does not necessarily speak for China's situation, either. Therefore, the analytical framework will be mainly focusing on domestic dimensions of China's economy and leaving the international dimension for the future research.

Just to recap, the domestic dimension of financialisation is examined through the lens of different sectors in the economy, namely, non-financial enterprises, financial system and the households, plus the underlying facilitation of the state. As China's financialisation will be approached from the state sector, the analytical framework that built on Lapavitsas' analytical framework of domestic dimension of financialisation should include the following aspects: SOEs, financial sector, typically the banking sector, and the local government. Individuals are not directly relevant, so it is excluded from this analytical framework for China. This choice is a strategic one, thus, it is not exhaustive apparently. For example, the focus of the financial sector is put on to banks primarily. It does not imply other financial institutions had not changed when finance rises in China, but this is just to reflect the absolutely central role of the banks in China and its unique way of transformation that easily set itself apart from banks

in other countries. Other than the framework itself, the innovation also lies at the analysis of the altered behaviour of conducts of each actor within the state sector as well as their intertwined relations, which is inherited from Lapavitsas' analysis of the core of financialisation.

Such division could avoid the problem of equalling the state sector with the government bodies. The state sector is quite a broad existence in China's context, and this framework incorporate different state's role under one single roof, i.e., both of the government bodies and the economies will be examined under this framework, but the meaning of financialisation does not necessarily hold the same when describing SOEs and (local) governments. Financialisation of the SOEs is reflected by their increasing financial operations whereas that of the government is reflected by their adoptions of financial logics in governing the economy. For the latter, 'transformation' is constantly used interchangeably with financialisation, as, to some extent, 'financialisation' lacks theoretical underpinning in this context. Nevertheless, financialisation of the state sector requires a thorough look at the changing conduct of basic economic agents of the productive and the financial sector within the state sector, as well as the increasing financial means in state's management, as well as the closer tie between any two of the actors.

Inherited the idea of *Monthly Review School* and rooted in the imperialism that advocate by Lenin and Hilferding, the underlying assumption of Lapavitsas' analytical framework of financialisation is based on monopoly capital, so, the non-financial enterprises in his framework refer to large enterprise, in many cases, large multinational corporations. Publicly listed central SOEs as an integral, therefore, is the best proxy for the monopolies in the state

sector. In the era of the rise of finance, state’s increasing reliance on financial means in managing SOEs seems to unexpectedly promote financialisation of SOEs. And SOEs' transformation into financial operators, in turn, has changed its relations with the local governments and banks.

The financial sector, especially the state-owned bank, is an equally important actor in the state sector, if it is not more important. Unfortunately, current research on financialisation in the Chinese context has not put enough weight on it. This thesis will fill in this gap by looking at the transformation of the banking sector itself, especially its transformation when shadow banking started to rise after the 2008 Global Financial Crisis. Also, the changing relations of banking sector and other actors will be examined because the banking sector as a crucial intermediary in between the government and SOEs have also facilitated the transformation of other actors, particularly the SOEs and local governments.

Chinese local government has drawn increasing attention in recent decades because of the rapid urban development and its massive amount of accumulated debts through the most innovative ways. Yet, only very few of these works have explored the transformation of local governments from its changing behaviour of conducts. This thesis, hence, will engulf this literature gap by looking into the increasing financial motives and financial logics of local governments in financing local development, and examining its transformation from the perspective of financialisation, as well as how the transformation of other sectors, especially the banking sector, facilitate the transformation of the local government.

3.5 Methodology

Financialisation of Chinese state sector is a complicated political economy issue that requires a mixed method of both qualitative and quantitative. This thesis utilises three methods to cater different needs of this multifaceted issue. Specifically, the institutional analysis is employed throughout the whole thesis to demonstrate the political economic structures and mechanism of China, equipping the reader with the basic knowledge of the intertwined historic relation of the basic economic agents that will be involved in the analysis of financialisation, namely, SOEs, financial sector and local governments so as to understand how each of their transformation would lead to a further transformation of others and possibly the whole state sector. The quantitative method is used to landscape the full pictures of the behaviours of publicly listed central SOEs and the banking sectors, with some of them confirmed by qualitative research findings.

3.5.1 Quantitative methods

This thesis relies primarily on interpreting the stylised facts that drawn from an original dataset. The first step of the quantitative analysis in this thesis is to collect, clean and construct the data set. Then the data needs to be consolidated or estimated for different purpose of use. This section will elaborate the datasets that have been used in this thesis. More about the data cleaning, construction and the exact way of estimating will be shown in the corresponding empirical chapters where they will be employed and analysed.

<u>The financial sector</u>

Chapter 6 uses the data of China's state-owned commercial banks (SOCBs), and also compares and contrasts some of them with the US counterparts in order to easily put it against a familiar

background. The SOCBs refer the "Big Four" plus the other two large SOCBs that were established later. Specifically, the "Big Four" are Agriculture Bank of China (ABC), Bank of China (BoC), China Construction Bank (CCB) and Industrial and Commercial Bank of China (ICBC), and Bank of Communications (BOCOM) as well as Postal Saving Bank of China.

The data of SOCBs is primarily from Wind, the Chinese equivalent of Bloomberg. Some of the rests are retrieved from the database of Federal Reserve Bank of St. Louis where it records the same series for both China and the US. For only handful of data, they come from China Bank and Insurance Regulatory Commission or Financial Statistic Yearbooks.

The SOEs

To uncover the core of financialisation and to comprehend the financing decision, it is necessary to look at the trajectory of the balance between 'internal' and 'external' finance for productive capital (Lapavitsas, 2013, p. 217). The quantitative methods will be mainly applied in Chapter 5 to demonstrate the changing patterns of the external and internal finance of 362 publicly listed central SOEs.

The data of SOEs is trickier than that of the SOCBs because SOEs do not have as clear definition as that of SOCBs. For instance, to indicate the SOE's transformation towards financially sophisticated enterprises, the financing behaviours of SOEs will be analysed, along with some other stylised facts, such as the level of investments, operating profits, among others. Hence, the firm-level data will be needed. However, SOEs can be quite different from one kind and another in the Chinese context. For instance, there are at least differences between central SOEs and local SOEs, which will be elaborated fully in Chapter 4. The accessibilities of these

data are not the same. So, choosing the sample of SOEs affects the final conclusion. As mentioned before, financialisation is about the monopolised capital, thus, the publicly listed central SOEs as an integral is a good proxy. Hence, in the empirical chapters of SOEs, the firm-level data for publicly listed central SOEs are used. Other than they are the best proxy for large enterprises in China's state sector, they also have the most accessible and comprehensive firm-level data about SOEs that one can obtain.

The dataset that used for publicly listed central SOEs is based on the raw data of enterprise's flow of investments and flow of funds which are collectively drawn from their balance sheets that are available on Wind from their annual financial reports. I use these data to construct a mini dataset that comprises 362 non-financial central SOEs which are publicly listed in mainland China in Shenzhen and Shanghai Stock Exchange over the period of 2000 – 2019.

3.5.2 Qualitative methods

Institutional analysis and informal talks are the main tools used as qualitative methods in this thesis. The recent decades have seen significant expansion in research examining how institutional context affect the nature and the behaviour of firms, the operation of markets, and economic outcomes. Financialisation as a structural transformation of capitalist economy is contingent on specific institutional and historical backgrounds. Thus, institutional analysis is a must in this thesis. Additionally, for the case of China in particular, understanding institutional settings and mechanism has its own imperative because nothing can be simply economic in this system where the politics, Party and economics are highly intertwined with one another. One can never discuss the economy without taking the state into consideration in China (Lan, 2021).

Institutional analysis is applied throughout the whole thesis, and Chapter 4 is primarily devoted to the introduction of the institutional settings of China's unique political economic system. The Chapter will set out the basic political and economic hierarchy in China, define the term that constantly used in this thesis, such as the "state" and "government", and introduce the basic actors inside the system, namely, SOEs and SOCBs, aiming to prepare the readers with the proper foundation of China's institutional settings in order to better understand the altered conduct of each basic agents in the state sector and further to better understand the transformations of them.

Informal talks also named as informal conversations (Swain and King, 2022) or informal conversational interview (Patton, 2014, p. 642), a most open-ended approach to interviewing that relying on "the spontaneous generation of questions in the natural flow of an interaction, often as part of ongoing research" (Patton, 2014, p. 642). There are very few applications of this type of research methods in economics research as economics does not normally rely on ethnographic methodology. However, this method does have its unique advantages compared with the structured or semi-structured interviews.

First of all, this method could generate greater ease of communication with its maximum flexibility about time and questions (Patton, 2014; Swain and King, 2022). This approach works particularly well when researchers have enough time to stay in the setting or to have more than one interview opportunities with the interviewees (Patton, 2014). By doing so, researchers have the chance to adjust the direction and deepen the conversation as it goes (ibid). Secondly, this method could potentially produce "more realistic and naturalistic data

with less performativity" from both sides of the interview because both sides can be less distracted by the formality of interviews such as switching on and off the recording devices (Swain and King, 2022, p. 2). The maximum flexibility allows the interviewees to open up and to express themselves "in their own terms and at their own space" without any deception (Bernard, 2017, p. 164).

I had several informal talks with the same private concrete factory owner and its chief accountant in Shanxi Province, China, during my PhD research from 2018 to 2023. The interviewees have been operating the business in concrete industry in Shanxi Province for more than ten years and happen to be my acquaintance. I asked their oral permissions on using these talks as the evidence of this research. Semi-structured interviews were planned originally. But soon after the start of the talk, I found the interviewees were holding back something as they were not comfortable about the recording and notes-taking while talking according to their off-record conversations. The interviewees also provided feedback to me that some of the questions, they thought, were not in the core of the problem. And they offered more information that they regarded critical afterwards. Thus, I decided to change the semi-structured interview to a more open-ended one to best accommodate the interviewees, letting the interviewees to take more control of the conversation in order to get more useful information out of the conservations.

I had the opportunity to have several conversations with them at different times during the five-year time span. We first interacted in 2018, when the factory was profiting. The owner told me that the norm of this industry is to sell on credit, and it took long to get the payment. Or in many occasions, instead of receiving the cash payment, he received commercial papers,

all kinds of financial derivatives or even houses as payments. But he was not very much concerned about it because no matter how long it would take, he finally got paid in one way or another most of the time. However, when COVID-19 stroke China in 2020, the economy deteriorated quickly, so did his situation. He became angrier and more anxious about his own situation, the whole industry and even the Chinese economy as he still sale on credit but could not get paid as before. For those small number of companies which would be able to repay his trade credits, they paid with different kinds of financial derivatives, instead of the cash that his business craved the most. Even for these financial derivatives, he constantly had difficulties to cash in. The in-depth interpretation and analysis will be presented in Chapter 5.

Overall, the method of informal talk creates a comfortable, secure and genuine environment for conversations. It could best accommodate the interviewee's needs, and also keeps the collected data and information less artificial and more naturalistic than a formal interview, providing a great supplementary for the empirical evidence pulled from secondary data.

3.6 Conclusion

This chapter first introduces a Marxist Political Economy approach, which departs from the Marxist theory of finance and Uno tradition, attempting to set the ground for the analytical instruments. It claims that financialisation in the core capitalist countries is represented by an altered relation between the fundamental actors of the economy, namely, non-financial enterprises, financial enterprises and individuals/households, which is rooted in the changing conduct of behaviours of each of them in the era of the rise of finance. In this sense, financialisation is by no means an escape of productive capital to the financial sector or productive capital being crowded out from the productive sector by high-profit financial

activities. The pyramid-shape credit system will be of great use in the interpretation of the changing financing patterns in Chapter 5.

After summarising the characteristics of financialisation in the core capitalist countries and combining it with that of the periphery capitalist countries in the previous chapter, it is found that Chinese case shares some commonalities with them both but at the same time, none of the analytical framework could work perfectly to incorporate Chinese specificities. To fill this research gaps, an analytical framework is proposed for better understanding the transformation of Chinese economy from the perspective of the state sector. Specifically, the framework is built upon Lapavitsas' framework for financialisation of the core capitalist countries, where the altered conduct of behaviours of fundamental economic agents as well as their changing relations are analysed, namely, non-financial enterprises, financial enterprises, and households or individuals. To adjust it to fit for the Chinese state sector, SOEs, SOCBs and the local governments are included in this newly proposed analytical framework. The empirical chapters in Part II of this thesis will be analysed each of them in-depth.

Finally, the methodology that has been used to conduct this research is carefully documented. This thesis innovatively uses the informal talk and institutional analysis to support and enrich the empirical evidence. A mixture of qualitative and quantitative methods and a dialogical method of data and theory are employed to present and to analyse the transformation and potentially financialisation of China's state sector.

Chapter 4. The Nature of Large Enterprises in China's State Sector

4.1 Introduction

The analytical framework in Chapter 3 proposes that the altered conduct of the basic agents of the state sector as well the changing relations between them are required to explore financialisation for Chinese economy. Non-financial SOEs are one of the basic agents, which play crucial roles in China's political-economic system. This chapter and the next focus on SOEs. Specifically, this chapter equips the reader with the necessary background of Chinese political economic framework, the position of SOEs and large central SOEs in this framework, as well as the characteristics of the large SOEs, serving as the institutional analysis for understanding the altered conducts of large central SOEs. This chapter argues that large SOEs possess enormous political and economic clout that are large enough to form their own small kingdoms, which are easy for them to transform into the business operators who are more financially sophisticated. State's role in this transformation is compounding. For one thing, it is the exogenous high power by being the regulator of the SOEs, but the state is not strong enough to put the "small kingdoms" under full control. The state has increasingly relied on financialised means in the governance over SOEs, which effectively accelerates their transformation. For another, the state is also an endogenous market player. But the state has not been caught shifting to shareholder values. Overall, financialisation of SOEs has no sufficient grounds to be identified.

The most prominent transformation of SOEs is the change of business structure for the large ones-- business groups were intentionally created by the state for large SOE to make them

“national champions” in order to compete with other large multinational companies in the global market. They have gone through profound changes throughout the Reform and have transformed from independent units of the planned economy to “small kingdoms” which possess enormous political and economic clouts, and some even truly become “national champions”. These business groups are formed by either vertically integrating businesses from upstream to downstream within one industry, such as CNPC and Sinopec, or horizontally integrating businesses across industries into one huge group to expand the scale and scope of the core businesses. Either way, they have become the monopolistic enterprises in the most profitable industries and have extracted substantial profits. With the pyramidal structure of these business groups, most of the profits are siphoned into parent companies, which always have incentives to allocate the funds to the most profitable firms to generate more profits, as well as to impress the shareholders. The financial arms of these business groups empower themselves to involve in various financial activities, acquiring strong financial skills and financial assets. The changed business structure has become the institutional foundation for central SOE’s transformation.

The way that the central SOEs were governed also facilitates its transformation. The state governance over some central SOEs have shifted from the hands of various ministries to the hand of State-owned Asset Supervision and Administration Commission of the State sector (SASAC) since its establishment in 2003, which performs as both the investor and the regulator of central SOEs. With the rise of finance in China, SASAC’s governance mode is changing from the old “managing personnel, managing affairs and managing assets” to the new mode of “managing capital”. The change of the governance signals the state’s control over central SOE is exercised increasingly by financial means, which allows central SOEs to acquire increasingly

sophisticated financial skills, and effectively accelerates their transformations.

This chapter reveals that SOEs exploit the imbalanced power and interest of owners and regulators, also take advantage of the *nomenklatura* system which ironically designed to hopefully keep the cadre under the Party's control, consequently, gaining immense power to transform into "small kingdoms", which are more financially sophisticated and could also form their own interest groups to further influence the policy making. However, the fact that they are the basic units of the Chinese economy which have to be compatible in the grand national goals has not changed. Thus, they do not necessarily imply the state's transformation towards financialisation overall.

The rest of this chapter proceeds as follows. Section 4.2 pictures the landscape of China's political and economic hierarchy as a necessary institutional background. Section 4.3 first clarifies the definition of SOEs and central SOEs in China before it is extensively used later in this dissertation. Then, SOEs are situated in this unique political-economic system, in order to better understand SOE's role in the Chinese state system as well as how they are managed and governed by the state. Because financialisation is about large enterprises, the focus then narrows down to the central SOEs with three monopolistic powers being elaborated in Section 4.4. Finally, Section 4.5 concludes.

4.2 China's political-economic framework

To understand the transformation of the conduct of agents within the state sector under the rise of finance in China, one must first comprehend the composition of the state sector, as well as the power and resource distribution within the political-economic system. This section

will primarily introduce China's unique political-economic system where the agents are operating within. Subsequent chapters will specifically discuss the position of each agent of the state sector within this distinctive system, so that they can be placed in an appropriate context to understand the significance of their transformations.

4.2.1 China’s political hierarchy

The Party and Nomenklatura system

Upon the establishment of People’s Republic of China (PRC), a centralised system had been formed where the Chinese Communist Party (CCP) oversees the bureaucratic apparatus and integrates the military and business into the system with its tight discipline. China has a Party-State system, where the Party and the government are deeply intertwined. The centralised one-party system blurs the boundary of “state”, “government”, and “Party”. This section will attempt to differentiate these interrelated terms, which are relevant to understand the Chinese economy and its transformation.

The Communist Party is the apex of Chinese political system. Party leaders always hold the highest power in their equivalent level, allowing the Communist Party to control and to mobilise personnel and resources when necessary. The top official of CCP is the General Secretary, whoever holds this position also serves as the head of the state, i.e., President of China and head of the armed forces, i.e., Chairman of Central Military Commission. The General Secretary of the Communist Party, together with another four to eight officials, forms the Standing Committee of the Politburo (PSC), the highest echelon of China’s collective leadership. Communist Party branch (*dangzhibu* 党支部) exists in every organisations where

there are more than three people,[11] and the party branches are even introduced to the China's office of foreign companies.

The Communist Party exerts control over both central and regional governments and permeates various aspects of the state system. The deeply intertwined Party and government is glued primarily through the *nomenklatura* system, putting into practice Stalin's dictum "cadre decides everything"(Manion, 1985, p. 203). Senior officials normally hold positions in both Party and the government. Being a Communist Party member becomes an unwritten requirement for holding some key positions in the state system, including governments, SOEs and other institutions, i.e., universities, public research institutions, among others (Sandalow, 2019).

Nomenklatura originates from a Russian term "nomenclature", meaning "a list of positions , arranged in order of seniority, including a description of the duties of each office" (Harasymiw, 1969, p. 494). It had been used in the Soviet Union to recruit and to regulate main leading cadres of Party and of the state, including "most important leading positions in all organised activities of social life" (Harasymiw, 1969, p. 494; Manion, 1985). For those intermediate positions that are subject to Party's recommendations for appointment, release or transfer, it is required to get Party's approval no matter the recommendations were made by party or non-party bodies (Harasymiw, 1969). *Nomenklatura*, in the present purpose, means Party *nomenklatura* if not specifically stated (ibid).

[11] This can be found in the recent government release *The Central Committee of the Communist Party of China issued the "Regulations on the Work of the Grassroots Organizations of State-owned Enterprises of the Communist Party of China (for Trial Implementation)" [中共中央印发《中国共产党国有企业基层组织工作条例（试行）》].* Available at http://www.gov.cn/zhengce/2020-01/05/content_5466687.htm, last access on 13 March 2022.

In the Chinese context, *nomenklatura* is regarded as a key instrument of Party control of leadership selection and appointment within CCP and government bureaucracies and other state institutions, including central SOE, universities, and so on (Chan, 2004; Leutert, 2018; Manion, 1985). *Nomenklatura* in China uses as an instrument to appoint, to promote, to remove, to transfer and to evaluate bureaucracies (Manion, 1985).

It is unique in China that top executives of SOEs are business leaders as well as Party and state cadres at the same time (Brødsgaard, 2012), they are also referred to as "cadre-entrepreneurs" (Nee, 1992, p. 7). Either way, they are not capitalists. The top managers of large central SOEs are subject to the management of both the Party and government system due to their dual roles -- as business managers or entrepreneurs, they are subject to the management of SASAC whereas as cadre, they are subject to the management of the Party, which is covered by the *nomenklatura* system. This is an extraordinary arrangement in the Chinese context where the planned economy has been abandoned and capitalist elements grow. Being a Party cadre, he/she is under rigid Party organisational frameworks, and the political power is gained through being a Party member, unlike it in the west where the political power is acquired through the donor model. Being an entrepreneur, he/she enjoys great autonomy as the enterprises are no longer operated in the Soviet-type planned economy where the input and output were planned. This extraordinary arrangement makes China stand out and determines the out-of-ordinary transformation of SOEs.

Under *nomenklatura* system, officials can move between positions of business leaders and government officials in this system (Duan and Saich, 2014), which is known as the "revolving

door" between positions of businesses leader and government posts (Zhang, 2015, p. 96). A recent survey shows that nearly 30% of 183 government officials above vice-ministerial level have used to hold positions in SOEs, and 115 senior executives who are working in SOEs have previously worked in the government (ibid). The move among different state institutions is guaranteed by the cadre transfer system which requires the top leaders in the state sector, including the government officials and business top leaders, to be transferred after a certain period of time (Duan and Saich, 2014). For leading cadres below the vice-ministerial level, they are allowed to stay in the same position for a maximum of two terms (ten years). The higher the cadre's ranking is, the stricter the observation would be and more frequently the transfer would occur (ibid).

Take Guo Shengkun *(郭声琨)* as an example. He used to be a vice-administerial official at The Board of Supervisors of the Key Large State-owned Enterprises (*guoyou zhongdian daxingqiye jianshihui 国有重点企业监事会*) before he became the first CEO of China Aluminium Corporation, which is a SOE at vice-ministerial level. After five years at the position as CEO, he was promoted to Secretary of Communist Party Committee of Guangxi Autonomous Region (ministerial level), then to Minister of Public Security and finally to Secretary of the Central Political and Legal Committee, a vice-national level official (c.f. Leutert, 2018)[12]. There are countless similar examples in Chinese cadre teams.

[12] Leutert (2018, p.16) does not recognise Guo's pathway as one example of "revolving door", instead, it was claimed to be "one-way exit" because he was promoted to provincial equivalent government officials from his position as business leader, and then further promoted to the Party organ in the central level, without coming back to SOEs ever since. In Leutert's (2018) definition, a "revolving door" means the individuals move back and forth from SOEs and government/Party positions. Nevertheless, whether it is "revolving door" or "one-way exit" is beyond the scope of this research. Either way, it is enough to cast light on the "cadre-entrepreneurs" system.

The government

The Central government is appointed by National Congress of the Communist Party every five years. In a similar manner, regional governments are also controlled by the Communist Party. Within the Government, the top officials are President and Premier. The Premier is the chair of the State Council, who is responsible for coordinating China's national and international policies. It is also the second-ranking member of the PSC. The Premier, four vice Premiers and five State Councillors serve on State Council together with twenty-five ministers, commissioners, and other heads of government offices, who are supported by a large bureaucracy. The State Council is sometimes used interchangeably with the central government, that is equivalent to the cabinet in the UK or the Administration in the US.

The government itself has its hierarchical structure, which consists of five levels: central, provincial, prefectural, county, and township, and the lower subordinate to the higher. For instance, several townships consist of a county. County government oversees the township government within the country's territory. Except the central level, all of the lower levels can be referred to as local level. Each of the 31 provincial-level regions in Chinese mainland[13] has a full set of Party and government settings mirroring that of central level, but with a lower political rank. Governor of Province ranks equal to that of central government ministers. The central and the local are connected and coordinated by the same chain of command, which is guaranteed by upward accountability (Zhou, 2020a). The same as the central level, it is still the case that the Party branch in equivalent level is on the top of the local power pyramid.

[13] Macau, Hong Kong and Taiwan are not included.

However, the reality is much more complicated than the designed structure itself. For instance, the political status and economic resources of provincial capital cities can be completely different from those of ordinary cities, although both are prefecture-level cities (*dijishi* 地级市) (Lan, 2021). Another example is that there are significant differences among county-level cities (*xianjishi* 县级市), counties (*xian* 县), and districts under the jurisdiction of cities (*shixiaqu* 市辖区) although all are county-level units (ibid). In terms of land and economic affairs, the power of county-level cities is greater than that of counties, and the power of counties is greater than that of ordinary districts under the jurisdiction of cities (ibid).

4.2.2 China's economic hierarchy

Less apparent than the political hierarchy, scholars' views on China's economic hierarchy have not reached a consensus. To just name a few influential ones, Qian and Xu (1993, p. 542) argue that China has had a "multi-layer-multi-regional" type economy based on geographic principle, which they call M-economy, as opposed to Eastern European and USSR's U-Economy where the economy is based on the functional or specialisation principle. Qian and Xu (1993) believe that the M-economy in China facilitates the sustained entry and expansion of the non-state economy, which later, as they reckon, becomes China's growth engine (see, for example, Lardy, 2014; Qian and Xu, 1993). They regard Chinese M-economy as six administrative layers: central, provincial, prefecture, county, township (previously commune), and village (previously, brigade), which correspond precisely with the aforementioned five-level government administration system, except that the latter does not include the village which is normally regarded as autonomous unit in China's political system.

In this M-economy, government at each level controls the enterprises that affiliated to them, and also oversees the enterprises at the immediate lower level. For instance, township government controls the enterprises that affiliated to itself as well as oversees the village (Qian and Xu, 1993). Even though part of this framework has lost its context due to the rapid reform of SOEs--the collective township enterprises and village enterprises did not exist anymore as they went through the *de facto* privatisation in the 1990s (Pearson, 2015), it could still by and large describe China's economic regional hierarchy as it is embedded in the same political hierarchy. However, during the time they developed this framework, there was not much of the non-state sector, so they omitted it from their model, which then becomes the largest shortcoming. Plus, the mixed ownership reform further blurs the division of SOEs and non-SOEs, and the national economy were more integrated now, so it is not the best framework today to describe China's economic hierarchy. However, the gist of multi-layer economy has not changed.

Margaret Pearson viewed Chinese economy from three different tiers according to their strategic importance, i.e. "how tightly the party-state leader wish to hold onto"(Pearson, 2015, p. 32). This view makes more sense than viewing it as several segments providing China has gone far in integrating the national economy as a result of market creation. The top tier is primarily made up by central SOEs, consisting of most of the large business groups in the strategic industries, such as energy, telecommunication, transportation, aviation, and constructions, among others (Pearson, 2015), thus, the first-tier enterprises are also considered strategic in terms of national and economic security (Lin et al., 2020; Pearson, 2015). More than 2/3 of SASAC's assets were in four industries which belong to the first tier: oil and petrochemicals; electricity; telecommunications; and military industry on its

establishment in 2003 (Tsai and Naughton, 2015). They are "too big to fail" because the massive asset size, large employment, and their support to ancillary industries in the lower tiers (Pearson, 2015; Sutherland, 2003). Most of the "national champions" which will be discussed in subsequent sections and the next chapter are also first-tier companies.

The middle tier comprises enterprises "that are considered important but in which the state asserts less central oversight compared to top-tier industries"(Pearson, 2015, p. 34), such as automobiles, large pharmaceuticals, chemicals, etc. SOEs still dominate in the middle tier, but they are mostly local or regional SOEs instead of central SOEs. There are several competitive non-state firms in the middle tier, too, such as Huawei, the top telecommunications equipment and consumer electronics provider, and Geely, a multinational automotive company, among others. The non-state firms on the list of Fortune 500 are all covered in the middle tier. The bottom tier of the economy is made up of non-state small and medium companies, personal services and retailers, accounting over 99% of enterprises in China by the end of 2018.

The line between tiers can be fluid, and when firms pursue vertical integration, the industry can straddle tiers (Pearson, 2015). For instance, there are companies in telecommunications industries in each tier. The telecom service providers are national monopolistic enterprises, belonging to the first tier. The key equipment providers, such as Huawei, are in the middle tier. Other handset factories fall into the bottom tier (ibid).

Very similar to Pearson's three-tier economy, Zheng and Huang (2018) have noticed that the state and the economy in China are inseparable, arguing that China has a three-layer market

hierarchy from the relation of the state and the market. The three-layer market comprises the national market at the top, market-state interactions in the middle, and regional and local grassroots markets at the bottom. Specifically, on the top layer, the state sector occupies the commanding heights, i.e., exercising a monopoly at only a few selected important industries. This is in line with Pearson's top-tier economy, where large central SOEs dominates the most strategic industries in the national economy. By doing so, the state acquires the dominance over society, and also allows the interaction between the state and social forces, resulting the growth of the market, which then leads to the emergence of the second layer—state-private partnership.

On this second layer, the state retains the structural domination of the market and private sector but opens to strategy of cooperation and co-optation with them, i.e., this is not a pair of equal relations because the state keeps the dominant place. Typically, this partnership forms in two different ways. One is that the state initiate the economic projects and the private sector is responsible for fulfilling the task, and the other is the opposite that the private sector initiates and the state sector make it a national institution by taking over the tasks (Zheng and Huang, 2018).

Last but not the least, the market also exists at the local level where the state has not insert much of its intervention or not much of private-public partnership exists, which is called the "grassroots markets". In these markets, individuals are the main market participants and organisers. Put it differently, no major market players or the state are required in these markets. This is also in line with Pearson's bottom-tier economy where the large part of the economy is made up of the non-state small and medium sized businesses. Nevertheless,

scholars have all agreed that the large central SOEs have always maintained their strong presence in the Chinese economic "commanding height". In this sense, central SOEs are perfect objectives for the study of financialisation.

4.3 SOEs and central SOEs in China's political economic hierarchy

As have been mentioned above that SOEs play important roles in China's political-economic system. Specifically, they are never purely economic actors, rather, SOEs are "political and organisational centres" even up until today (Zheng and Huang, 2018, p. 119). However, SOEs have huge discrepancies among themselves. As has briefly mentioned in section 4.2.2, there are central SOEs and local SOEs, and they position differently in China's hierarchical political economic system. By and large, the most important enterprises – veritable giants on a global scale – were under the control of the central government and they are larger in size, while thousands of others were controlled by regional governments and other parts of the state, and they are relatively smaller in size. This section introduces different types of SOEs and to elaborate their different roles in China's political-economic system so as to build a foundation for further understanding their transformations with the rise of finance. The emphasis lies in the central SOEs-- those larger ones that matter for financialisation.

4.3.1 What are SOEs and central SOEs?

SOEs has been formalised as crucially important elements of Chinese political and economic system by 1982, when 39 ministries were dissolved and SOEs were created to take over the commercial functions of these ministries (Brødsgaard, 2012). In the post-reform era, SOEs provided the economic foundation for the state to catch up with the advanced economy, and allow the Party-State to (in)directly control the national economy through interventions on

themselves, and eventually support the goal of building “comprehensive national power” (Pearson, 2015, p. 2). Two decades later since the reform, there were more than 150,000 SOEs in operation in Chinese economy and varying greatly among themselves (Lin et al., 2020).

SOEs are not as easy to be classified as it would seem to be due to the significant ownership change during the Reform. The concept of SOE has not been clearly defined, so it could vary in different contexts. In a narrow sense, only the state wholly-owned companies and enterprises can be classified as SOEs. However, the boundary of SOE and private enterprises are becoming increasingly blurry because of the mixed ownership reform which allows the “bi-directional flow of stake-acquiring investment” between the state-owned and non-state-owned enterprises, i.e., SOEs are allowed to acquire the stakes of non-SOEs, and reverse is also allowed (Lo et al., 2022, p. 303). About 65% of China’s top thousand private companies had equity investment from the state owners in 2019 (Bai et al., 2021). The private owners with direct investment from the state tripled in 2019 compared with that in 2000, and the number of indirect investments increased 50 times during the same period (ibid). In this light, to recognise a SOE from the point of this narrow sense becomes unrealistic. Such that, in a broader sense, the enterprises whose state-owned shares are exceeding 50%, i.e. the state is in the controlling position, can be classified as SOEs (Cui and Zhang, 2021; Liu, 2013). The inconsistent definition of SOE explains the inconsistency of the data of SOEs, further explains the contradictory conclusions in the ocean of literature on SOEs. The broader sense is adopted in this dissertation, otherwise, it will be specifically stated. Additionally, this research will also try to avoid the term of “private enterprises” for the above stated reason. Instead, non-SOEs will be used as a replacement.

Central SOEs is a sub-category of SOEs. Specifically, central SOE is short for centrally managed state-owned enterprises, referring to those enterprises in which State Council (i.e., the Central Government) or the designated agencies on behalf of the State Council, namely, Ministry of Finance (MoF), SASAC, among others perform their responsibilities as shareholders. They can be grouped into three different categories according to whom that they are under control of: 1) Enterprises that are under the control of SASAC are normally those providing public goods, and those in natural monopoly industries, as well as some which providing competitive goods. 2) Enterprises that are under the control of Banking and Insurance Regulatory Commission (BIRC), China Security Regulatory Commission (CSRC) and MoF are mostly financial institutions, including policy banks, state-owned commercial banks, state-owned insurance companies, state-owned asset management companies and the likes. 3) Enterprises that are under the control of other departments of State Council or other ministries, such as China Tobacco, and industries such as broadcast, publication, so on and so forth (SASAC, 2017).

In this dissertation, central SOE only refers to non-financial central SOEs which are covered by the aforementioned classification 1) and 3). The financial central SOEs will be referred in a more precise manner when necessary in the subsequent chapters. Publicly listed non-financial central SOEs are part and parcel of non-financial central SOEs, specifically referring to those which are publicly listed in the Chinese stock market, and whose controlling shareholder is SASAC or other ministries. A mini dataset consisting of all 362 publicly listed non-financial central SOEs is constructed and will be introduced and utilised in the next chapter.

4.3.2 How are SOEs governed?

The way that SOEs are regulated and operated is embedded in the specific Chinese political

institutions. The tightness of state control spans a wide range of spectrum according to different closeness between the government and the SOEs. Some of them are under full control of the administrative department and some of them are managed in a less intensive way by SASAC (Duan and Saich, 2014). The clearest example of the full control is the tobacco industry. China Tobacco Corporation (*guojia yancao zonggongsi* 国家烟草总公司) was established in 1982, and two years later in 1984, State Tobacco Monopoly Bureau (*guojia yancao zhuanmaiju* 国家烟草专卖局) was set up. In fact, they were the "same institution with two different brands" (*yigejigou, liangkuaipaizi* 一个机构，两块牌子) (China Tobacco). The business entity and the government body are operated as a unified system to practice the management principle of "unified leadership with vertical management and monopoly" (*tongyilingdao, chuizhiguanli, zhuanyingzhuanmai*. 统一领导，垂直管理，专营专卖) (ibid). This institution monopolises the entire tobacco industry in China, including personnel, finances and goods, production, supply, and sale, as well as trade, export and import (*rencaiwu, changongxiao, neiwaimao* 人财物，产供销，内外贸) (ibid).

However, in most cases, SOEs are run by the state through the hand of SASAC, the designated authority to exercise government ownership and also to regulate and to supervise central SOEs on behalf of the State Council (SASAC, 2018). SASAC was established in March 2003 in the hope to alter the situation where various ministries and bureaus regulated and administrated SOEs on different issues causing overlapping, resulting in chaotic management. SASAC also aims to facilitate the reform of transforming SOEs to corporations where the management logic is shifted from managerialism to following the market mechanism. SASAC's duties range from human resources management to making major business decisions, most

importantly, to preserving and to increasing the value of the state assets. This management pattern is known as the mode of "managing personnel, managing affairs and managing assets" (*guanren, guanshi, guanzichan* 管人，管事，管资产). However, with majority of large SOEs establishing their own business groups and actively acquiring stakes of other companies through its holding shells, SASAC's governance pattern has to keep up with this change. Hence, the focus of governance started to shift towards "managing capital" (*guanziben* 管资本) in the mid-2010s.

The old governance pattern: Managing personnel, managing affairs and managing assets

Top leaders in SOEs are filled by Party appointees (Brødsgaard, 2012), that is the reason why the management of top executives of central SOEs are in hands of Organisation Department of CCP (Organisation Department hereafter). The management of SOEs have been gradually shifted to SASAC since its establishment, forming a system to manage SOE's business leaders, which are dominated by SASAC and supplemented by Organisation Department (Yang et al., 2013). The top executive of vice-administerial Central SOEs are appointed and managed by Organisation Department and SASAC, whereas those of the departmental central SOEs are mainly appointed and managed by SASAC with the approval from Organisation Department (Leutert, 2018, p. 5).

SASAC's decision on promoting a cadre is primarily based on their performance. SASAC signs a performance contract with the person who is in charge of the enterprise. The remuneration of the person in charge of a wholly state-owned enterprise in the enterprise shall be paid according to the performance contract, and the reward or penalty will be given to the person based on the result of annual and term assessments (Yang et al., 2013). Political promotion is

one of the rewards (ibid). Therefore, these top executives have great incentive to improve their performance in order to prolong their political life and to climb up the ladder of political rank (ibid).

In terms of managing affairs, SASAC does not involve in day-to-day business operations, but it does have a strong say on management and decisions on significant events, including split, merge, bankruptcy, or dissolution, among others. Additionally, SASACs at all levels have the right to decide the transfer of state-owned equity in the enterprises. If the transfer of equity results in the state losing the controlling shareholder position, it shall be reported to the government at the corresponding level for approval.

In terms of managing assets, SASACs in all levels are in charge of the basic management of property right's recognition, property right's registration, asset evaluation and supervision, asset clearance and verification, among others. When it comes to the major investment and financing plans and development strategies of the enterprises in which it invests, SASAC should perform the responsibilities of investors in accordance with national development plans and industrial policies. The wholly state-owned enterprises and companies are required to report their financial, production and operation conditions, as well as the maintenance and appreciation of state-owned assets to SASAC on a regular basis.

The new governance pattern: Managing capital

The governance pattern of SASAC has been gradually changing from the old pattern of "manage personnel, manage affairs and manage assets" to a new pattern of "managing capital" with the new round of SOE reform. State-owned capital investment and operation companies

(SCIOs) were established as the professional platforms for the operation of state-owned capital under the current stage of reform (Naughton, 2019). They were also inserted as an additional layer between SASAC and the SOE business groups with professional financial expertise to assist SOEs in obtaining higher financial returns (Naughton, 2019). Furthermore, SCIOs also have developmental functions—they should "push state capital into important industries and key sectors that affect national security, the commanding heights of national economy and the people's livelihoods… and fully bring into play the core and exemplary function of SOEs in realising the strategy of innovation-driven development and become a manufacturing power" (Naughton, 2019, p. 51).

Transferring its governance focus from "managing assets" to "managing capital" means that SASAC will 1) shift from direct intervention to the supervision as an investor so as to ensure the autonomy of enterprises; 2) shift from focusing on the development of individual enterprises to focusing on the overall function of state-owned capital; 3) shift the way of regulation from the administrative mandate to marketised legal management in order to avoid the outdated administrative and bureaucratic style of management.

SOEs themselves hold enormous profits without remitting to the state, so they have increasingly large power to influence the policy making. This was because of the historical reasons which was embedded on the SOE and tax reform in the 1980s (Kuijs et al., 2005). During the early reform era, SOEs were not able to make profits, so they were fed by substantial government subsidies every year (ibid). As such, the SOEs handed over a proportion of their profits to the state, which then were included as part and parcel of the fiscal revenue by the state (ibid). In 1978, the "revenue from enterprises" was the largest

source of fiscal budget revenue, accounting for more than half of the total (China Statistical Yearbook 2004 p.291 in Kuijs et al., 2005, p. 2). When SOEs were asked to be responsible for their own losses and profits (zifuyingkui 自负盈亏) in the 1980s, the profit retention was implemented in the same time to incentivise the enterprises and their managers (Kuijs et al., 2005). However, the profit retention made "revenue from enterprises" drop, further leading to a sharp decline of fiscal revenues. The tax reform started in 1994, deciding that the revenue of SOEs' should be submitted to the government in the form of tax at a unified rate (ibid). Together with this change, a decision was made by the state that it would not collect the after-tax profit for an unspecific period of time from SOEs, which started the power shifting from the state to the SOEs (Kuijs et al., 2005; Naughton, 2008).

Until mid-2007, SASAC has started the reform aiming to collect a proportion of the after-tax profits or dividends from the central SOEs to expand the budget for the central government (Ministry of Finance, 2007). Most central SOEs (99) are subject to 5% of profit remittance, with only very few of them (17 + State Tobacco Monopoly) having to remit 10% and another 17 of central SOEs, mostly military industrial SOEs and research institutes, being exempt from remitting the profit for three years (Brødsgaard, 2012; Naughton, 2008, p. 6). However, an offsetting tax reform was implemented a while later—the corporate tax was lowered from 33% to 25% for SOEs, made it the same with that of the foreign firms (ibid). As a result, the businesses were still in control of their vast profits, fuelling their enlarging economic and political bargaining power. On the other side of the same coin, it shows that SASAC, as the owner of the large SOEs, does not have the full control over these large SOEs because it does not have the right of revenue collection (Naughton, 2008).

A peculiar phenomenon has been observed in China's state sector that, on the one hand, the state has been increasingly relying on financial means to manage and to govern the SOEs, which seems to shift towards shareholder value, but on the other hand, the SOEs only pay little dividends back to their largest owners (i.e., the state) every year. Additionally, the state does not manipulate the stock price as the multinational corporations in capitalist countries do, such as buy back shares or others. On top of this, the SOEs do not seem to always have the consistent interest with their owners, not to mention prioritising the shareholder's value. As an important element of financialisation, it is necessary to interpret the transformation of the state sector from the perspective of shareholder's value orientation.

The ownership and the control are usually separated in different hands for the large companies in the western capitalist countries. Ownership is exercised by a group with major *interest* in an enterprise whereas the control is exercised with a separate group by having sufficient *power* over it (Means, 1931). Owners are in a position "both to manage an enterprises or delegate its management and to receive any profits or benefits which might accrue" (Means, 1931, p. 69). The separation of ownership and control requires that managers operate the enterprises in the *interest* of the owner (ibid). However, in many cases, the manager is not willing to fully represent the interest of the owner because managers could utilise their *power* to meet their own interests. This problem is often called "principal-agent problem" in mainstream economics.

To solve this "principal-agent problem", agent theorists argue that to reunite the ownership and the control could also unite the interests of them, i.e., introducing the performance-based executive compensation to create a community of interest of owners and managers (Van der

Zwan, 2014). Such theory suggests that manager's performance should be linked with the rate of return on the company's stock. The manager, thus, shares the same interest with the owners -- maximising the stock price. This belief had quickly wiped out the US economy and spread to other core countries, such as Germany, the UK and Japan (Lazonick and O'Sullivan, 2000).

In the case of China's non-financial SOEs, the ownership and control are unified. Because SASAC, on the one hand, is the *de facto* owner of central SOEs that performs as investors and centrally-owned non-financial SOEs on behalf of the state; and on the other hand, SASAC is also the manager or the regulator of central SOEs as it is in charge of the management of personnel, assets and important decisions such as merge and acquisition, dissolutions and the likes. In this sense, SASAC is a hybrid agency that holds both the ownership and control, i.e., has both owner's *interest* and manager's *power*. However, as the "owner", SASAC is a designated agency of the state, whose *interests* might not necessarily the same, which should have been the same in principle. To make things more complicated, the ultimate owner of SOEs is the people in the socialist China. The unification of ownership and control does not really solve the "principal-agent" problem. Since SOEs are subject to economic planning, whether it is forced or not, they will be more or less obliged to operate in compliance with domestic industrial policies and national development goals. Thus, they are not as short-sighted as many of the multinationals in capitalist countries which spend a great fortune to buy back their own stock to push up their own stock prices. In this sense, Chinese central SOEs has not witnessed any signals of shifting to the shareholder value's orientation.

There are several explanations. First, under the *nomenklatura* system, managers of SOEs are

business leaders and bureaucrats at the same time. So, their compensations are not necessarily monied income, the political promotion matters. Because the compensation is not always associated with the performance of the business, the top priority of the managers of SOEs is not necessarily maximising the profits. They would rather to follow the state's direction to show their loyalty and obedience to the state's policy in order to gain political promotion. That is why SOEs always take on projects that are critical to the government's interests regardless of profits. Under such situation, stock price is the least thing that these business leaders could worry about.

Secondly, only a small proportion of SOEs are publicly listed, and for those SOEs which are publicly listed, only a small fraction of their capital has been listed. Thus, the stock price of the enterprises has only very limited impact in the context of China's SOEs. On top of that, because the stock is not always part of the top executive's compensation, the business leaders of SOEs care less about their market performances and care more about prolonging their political careers.

Last but not the least, whoever the shareholder might be for the SOEs, they are not capitalists after all. Thus, their top priorities are not necessarily the same as those under the logic of private capital in the capitalist countries. Rather, the top priorities for the state and the state entities that perform the role of the shareholder are always to achieve the national goals, which is not equal to profit maximisation or high stock prices. Additionally, the unclearly defined "shareholder" in this context makes it difficult to even clarify the shareholder value. Therefore, there is no adequate reason to conclude that the shareholder value orientation has dominated the China's state sector.

4.3.3 The position of SOEs and central SOEs in China’s political-economic system

SOEs in the political system

Anything has its political ranking in China’s political-economic system, so there is no exception for SOEs. For central SOEs, there are 53 of them are at the vice-ministerial level (*fubuji 副部级*) which is half level lower than the ministries, and the rest of central SOEs are at departmental level (*zhengtingji 正厅级*), half level lower than the vice-ministerial level (Leutert, 2016). With exception of it, there are also limited of central SOEs are at the ministerial level (*zhengbuji 正部级*), such as China Railway Corporation, CITIC Group and China Investment Group (ibid). The ranking for local SOEs is much more complicated as the ranking of local governments that they are affiliated to are much more complicated than the central level, as it has been mentioned in Section 4.2.1 in the five-level government administration level.

The political ranking of a SOE determines the political ranking of its top executives, who are certainly covered by *nomenklatura* system. SOE’s top executives particularly refer to the following posts of a SOE holding company: general manager (*zongjingli 总经理*), president (*zongcai 总裁*) or Party Committee Secretary (*dangwei shuji 党委书记*) (Leutert, 2018, p. 5). And in some cases where the position exists, it also includes the chair of the board of directors (*dongshizhang 董事长*) (ibid). As mentioned in Section 4.2.1 that the top managers of the large central SOEs are cadre and business leader at the same time. Endowing two different roles for them seems a smart way to keep them under the radar of Party’s *nomenklatura* system, but at the same time, it also empowered them to form their interest groups, making

the power balance leaning towards the large SOEs, and effectively facilitated their formation of “small kingdoms” and their transformations towards financially sophisticated enterprises.

As mentioned earlier that executive managers of SOEs are referred to as “cadre-entrepreneurs” (Nee, 1992, p.7). Cadre-entrepreneurs and local officials share a common “neolocalist orientation” (Nee, 1992, p. 11). Local authorities (e.g. the Party sectary of a township government) are not directly engaged in the management of local SOEs but play a role that are “analogous to the chairman of the board of a conglomerate firm” (Nee, 1992, p. 13). In this sense, local government and the SOEs in its jurisdiction could easily form of partnership where the local government assists SOEs gaining resources such as capital, raw materials, labours and so on, and in return, SOEs growth and profitability have great impact on maximising the revenue streams of local governments. This is also true for central SOEs and central government that they are in a partnership and have a shared interest.

People who have backgrounds working in the SOE business groups or in the industrial sectors that the SOE business groups belongs to will have an opportunities to advance the interest of their (former) employers if they hold a higher position in the government or the Party (Brødsgaard, 2012). Through the *nomenklatura* system, they also have the chance to promote and protect their associates or subordinates in the former workplace, and they together form an interest group to pursue the interest which are beneficial to themselves (ibid). Even though there is no lobbying tradition in China, the interest group has an even larger power to influence the policy making.

However, inside the interest group, other than the shared interests, they also have different

individual interests. On the one hand, as the business leader who is evaluated by their performance, they would strive to maximise the profits in order to get reward or at least not get punished. To note that the reward does not necessarily lead to great personal wealth, unless through illicit means, except for some bonus (Nee, 1992). Rather, the rewards are mostly political, such as expanding the organisation power, or the promotion of themselves to a higher political hierarchy, among others (ibid). On the other hand, as state's cadre, they seek to maintain a tight and close relation with its higher authorities for further advancing their career as well as to increase their bargaining powers on certain issues. To achieve the latter purpose, the top executives might have to take on projects that are critical to the government's interests but not necessarily critical to their own interests or the interest of the business. Regardless of the fact that there are policy burdens on large SOEs, they are still amongst the most profitable corporations in the country.

SOEs in the economic system

SOEs have always been critical to Chinese economy no matter when it was a planned economy, or later when it is a so-called "socialist market economy" or "state capitalism" (see, for example, Huang, 2008; Lin, 2010; Naughton, 2017). The state ownership accounted for 80% of GDP in 1978 before the reform started (Sutherland, 2003, p. 22). Notwithstanding the number has been dropping ever since because of market reform and privatisation, the state sector still represents more than 1/3 of Chinese GDP up until 2015 (Holz, 2018).

However, SOE's role in China's economic development is always under a fierce debate. Conventional insights have accused SOEs of being a drag of the economic development due to its low profitability and the private firms were regarded as the engine of China's growth

miracle (Allen et al., 2005; Bai et al., 2006; World Bank, 1996). They primarily come from the point of unclearly defined property rights, believing that undefined property rights caused chaotic management and low productive efficiency of SOEs (Djankov et al., 2003; Kornai, 1990) or at least, they believe that it remains a big puzzle that how come China could achieve a specular economic growth without the clearly defined property rights (Hsieh and Song, 2015; Lin et al., 2020). The alternative view is gaining grounds recently that China's large SOEs are representing the core of the economy and plays important role in the China's economic take-off including the innovation (see, for example, Lo, 1999; Lo et al., 2022; Sutherland, 2003). And it also has functioned countercyclically as a stabiliser during 2008 financial crisis (Pearson, 2015).

In fact, SOEs position in China's economic system depends on different time frame, different types of SOEs or different industries. Regardless, existing studies did not differentiate the SOEs in anyways, namely, they did not differentiate central SOEs and regional SOEs, or SOEs in the strategic sector or not when they consider SOE's position in China's economic system. This could be misleading because various types of SOEs in variegate industries play different roles in the economy. This section will briefly look back the reform of SOEs and specify its changing role in the national economy.

Chinese state had never relinquished the idea of state ownership no matter it was a planned economy or market economy. Modern enterprise system did not exist in the pre-reformed China, instead, enterprises were part of the centralised economic planning system where they were not independent production units (Brødsgaard, 2012). At that time, 65 out of 100 ministries or equivalent departments in the central government were responsible for

economic management (ibid). In order to be compatible with the market creation, SOEs were born in the 1980s by taking over the commercial functions of these ministries and the administrative functions were merged into other ministries (ibid). For instance, China National Petroleum Corporation (CNPC), China National Offshore Oil Corporation (CNOOC) and China Petrochemical Corporation (Sinopec) were the businesses that were separated out from Ministry of Petroleum Industry in the 1980s. And the big four state-owned banks were also born out of the People's Bank of China in the same reform period.

In the 1990s, the focus of the reform of SOEs was "grasp the large and let go of the small" (*zhuada fangxiao* 抓大放小), meaning privatising the loss-making small SOEs, primarily collective township enterprises, whereas consolidating the profit-making enterprises to enable them to develop in a large scale and scope so as to be able to compete internationally (Huang, 2008; Sutherland, 2003). The enterprises in the most strategic industries were still kept under state ownership and state control (Huang, 2008; Pearson, 2015; Sutherland, 2003). Later, the trend of "the state sector advances while the private sector retreat" (*guojin mintui* 国进民退) was featured in the Chinese economy. Soon afterwards, the large SOEs were fostered to be the "national champions" (see, for example, Huang, 2008; Lin and Milhaupt, 2013; Sutherland, 2003).

The disproportionally high percentage of assets is the best evidence for SOE's asset concentration and its dominant position in Chinese economy. The asset of SOEs under the control of SASAC accounts for more or less half of the state's total non-financial assets (see Figure 6), whereas the number of SOEs only accounts for less than 0.5% of total number of

enterprises by the end of 2019. [14] Additionally, more than two third of SASAC's assets were in four industries which obviously belong to the first-tier companies according to Pearson's classification: oil and petrochemicals; electricity; telecommunications (Tsai and Naughton, 2015, p. 4). With the corporatisation of SOEs, the changing governance mode of SASAC, and the formation of the business groups, SOEs, especially the large central SOEs, have become internationally competitive. 135 Chinese firms (including Hong Kong, Macau, but no Taiwan) [15] made it to the list of Fortune Global 500 in 2021, overtaking the US for the second time. 82 of them (60%) were SOEs, and 49 of them (36.3%) were central SOEs and their subsidiaries (SASAC, 2021).

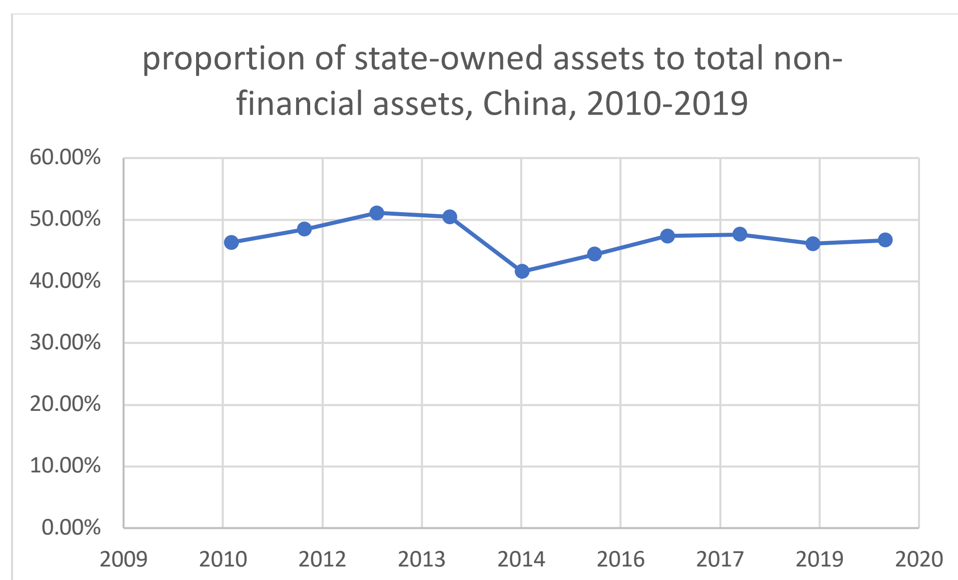

Figure 6 State-owned assets as a percentage of the total non-financial assets, 2010-2019

Source: author's calculation based on data from *Wind*.

With such great power in the market, these large central SOEs have accumulated enormous

[14] According to 2020 China Statistical Yearbook Table 1-8, there were 21 million enterprises in China (China Statistical Yearbook 2020), and 74,547 SOEs by 2019.

[15] Chinese Mainland and Hong Kong have 135 firms in total on the list.

corporate wealth. However, SASAC as the *de facto* owners and regulators of large SOEs, they have inadequate control over these large central SOEs, and effectively help them keep the majority profits to themselves. Plus the political clout that grow out of their interest groups, large central SOEs have become the “small kingdoms” (Brødsgaard, 2012, p. 630). Consequently, their political and economic influence are great enough to disobey and even to challenge the state’s decision.

The oil giants purposedly cut the domestic supply to force the government to increase the price in 2015 is the best example. As will be explained in section 4.4.2 that the price of refined oil is partially set by the market based on the government-guided price. Market of the refined oil is dominated by two companies—Sinopec and CNPC, accounting for 90% of China’s refined capacity (Downs, 2010). In 2005, the international oil price overgrew by 50%, whereas the price of diesel and gasoline in China only increased by 20% under the government guide (Downs, 2010; IEA, 2006). This was meant to ease the public panic and to stabilise the economy by capping the price, but the two oil giants exported the refined products instead of supplying to the domestic market, resulting a severe oil shortage in China, especially in southern area (ibid). Plenty of oil stations were forced to close, causing long queues outside of those which were still open (ibid). The government did not subsidise the refined oil in this crisis, instead, the oil giants were mandated by the government to cap the increase of the price to 20%. Therefore, the oil companies had to lobby the price administration to ask for a greater price liberalisation to somewhat cover their losses (ibid). Finally, the price of diesel and gasoline increased by 3% and 5%, respectively, in March 2006, and they were raised again by another 11.1% and 9.6%, respectively, by National Development and Reform Commission (IEA, 2006). The agent eventually made the principal surrender.

Oil giants uses their market power to make the policy shifted towards their benefits, but the monopolies in the airline industry managed to override the state's interest by taking advantage of the *nomenklatura* system to achieve its own interest. The people who have backgrounds working in the central SOE business groups or in the industrial sectors that the central SOE business groups belongs to will have an opportunities to advance the interest of their (former) employers if they hold a higher position in the government or the Party (Brødsgaard, 2012). Through the *nomenklatura* system, they also have the chance to promote and protect their associates or subordinates in the former workplace, and they together form an interest group to pursue the interest which are beneficial to themselves (ibid). Even though there is no lobbying tradition in China, the interest group has a large power to influence the policy making and the business deal.

An obvious example is how Air China sabotaged the business deal between China Eastern Airline and Singapore Airline in 2007 under the situation where China Eastern Airline and Singapore Airline had been in talks for two years, plus China Eastern Airline had received all the necessary approvals from five different administrative bodies, including that from the State Council (Naughton, 2008). Because Air China, one of the two strong "national champions" in the industry, did not want Singapore Airline, a true world-class competitor, to cooperate with another slightly weaker rivalry in the home market because Air China was eager to keep its dominance unchallenged (ibid). While SASAC repeatedly affirmed that it supported the idea that "foreign strategic investors" tie up with central SOEs, Li Jiaxing, China Air's then head, argued that Air China and China Eastern Airline could form an even stronger national champion to keep the foreign investor out of their domestic market (ibid). Later that year in

December, Li Jiaxing was promoted to the position of acting minister of the Civil Aviation Administration of China, the nominally independent airline regulatory commission (ibid). His or Air China's ambition of acquiring China Eastern Airline's share was revealed completely, and Air China finally voted against the deal in China Eastern Airline's outside shareholder's meeting. Because it was originally holding a substantial share of China Eastern Airline, it had enough power to make this deal abort. SASAC's vision of creating an internationally competitive industry eventually did not work out.

4.4 Forming business groups and acquiring monopoly power

Large central SOEs monopolistic position is not always gained naturally through market competition. Rather, it is gained by design as the state restricted the competition in certain industries in order to deliberately keep SOE's dominate position. It is clearly stated by SASAC that the state sector should remain the absolute controlling power over seven industries that are critical to national security and economic commanding height, including military industry, electricity and grid, petroleum and petrochemical, coal, telecommunications, aviation and shipping. The late 1990s reform made only two to three large companies left in each of these industries, wiping out most of the local private small businesses, helping SOEs grow large and gain the absolute monopolistic position in those industries (Brødsgaard, 2012). This section will primarily focus on the large central SOEs and elaborate their monopolistic powers in Chinese economy.

4.4.1 Business group

Forming business group is one of the defining characteristics of China's large central SOEs, and

the "national champions" were created by the state deliberately instead of naturally grown into such monopolistic enterprises. Forming large business was the industrial policy at the 1990s to foster Chinese "national team" to compete with the world's leading companies (Huang, 2008; Nolan, 2001).

Business groups first emerged as contract-based business alliances in the 1980s. The business alliances were then taken place by business groups in the second half of 1980s when SOE were corporatised (Lin and Milhaupt, 2013). At this stage, SOEs restructured mostly through horizontal integration aiming at deepening the specialisation of each business group and separating the commercial activities of SOEs from the regulatory role of the government (Lin and Milhaupt, 2013, p. 714). It sparked the fever of SOE restructure on the local level but lacked "economic coherence and functional governance mechanism" (ibid). Meanwhile, more ministries were downgraded to bureaus, placed under the newly created State Economic and Trade Commission, which did not have much say on SOE's business decisions (Brødsgaard, 2012). This is the time when SOEs started to obtain momentum because they no longer needed to constantly juggle between their own business decisions and their ministerial counterparts' (ibid).

Business groups were first formally established in 1991 in a situation where the government chose 55 enterprises for experimentation (Huang, 2008). The list kept expanding in the following years, and it reached 120 by 1997 (ibid). The newly established business groups were in the industries such as automobiles, machinery, electronics, steel, transportation, among others (ibid). And they entitled a range of preferential policies from taxation to government contracts.

Together with the formation of business groups, the reform of establishing a modern enterprises system followed fairly quickly in the second stage (1993-2003) of SOE reform, in order to create large internationally competitive Chinese companies (Brødsgaard, 2012; Sutherland, 2003). In this stage of the reform, a great number of them were restructured to two separate entities: one is a solely state-owned parent company, and the other is an operating subsidiary which is open to non-state investors, including accepting investors in stock market by Initial Public Offering (IPO) (Brødsgaard, 2012; Sutherland, 2003). By the end of 1990s, almost all of these business groups went public in at least one mainland Chinese stock market—Shanghai or Shenzhen, and about half of them had publicly listed companies outside mainland China, mostly in Hong Kong or the US (Brødsgaard, 2012; Huang, 2008).

A state-owned business group is, by and large, comprised by the following four components: (1) a core holding company, also known as the parent company, whose shares are entirely owned by SASAC; (2) one or more publicly traded subsidiaries, whose majority shares are owned by the parent company; (3) a financial company that serves the financial needs of the group; (4) a research institute that coordinates the group's innovation process (Lin and Milhaupt, 2013). To be qualified as a business group, a holding (parent) company and its controlled subsidiaries are required, non-controlled subsidiaries and other affiliated companies are optional (ibid). Figure 7 shows the management hierarchy of a business group with the required components highlighted by an amber rectangular.

The in-house finance company is not an essential, but all business groups crave for it. As a result, finance company almost became a must for each business group. Some even have

more than one financial company in one business group. The financial companies are designed to help member companies save working capital for the whole group and reduce the financial frictions in the market by making in-house borrowing available. They have made great achievements in this regard. The finance companies were supposed to be non-bank financial institutions. However, in practice, they operate with no difference from banks. Under the current legal system, these financial companies are exempt from the general prohibition on intercompany lending, so they may engage in a wide range of activities, including taking deposits from group members, advancing loans to them, providing payment, insurance and foreign exchange services to members, as well as underwriting securities. Additionally, they also engage in consumer finance related to the products of group members and invest in securities issued by financial institutions.

The financial companies also grew rapidly in asset size, range of businesses and profits, gaining increasing importance in the operation of business groups. The best example is financial companies of CNPC. There are two different financial companies within the gigantic CNPC business group, one is CNPC capital co. *(zhongyou ziben 中油资本),* a subsidiary of CNPC, as well as a publicly listed financial central SOE, and the other is China Petroleum Finance Co. (CPF hereafter) *(zhongyou caiwu 中油财务)*, a non-bank financial institution jointly owned by CNPC (40% of its total shares) and some member companies, including the CNPC capital co. (28% of its total shares). The complex cross shareholding inside this group is shown in Figure 8.

It is astonishing how huge the asset size of these financial arms. CNPC Capital Co. is one of the top 5 listed company in Shenzhen Stock Exchange in terms of its market value. As for CPF, it is

a financial company with four branches and eighteen business handling offices in various cities in mainland China where CNPC member companies are located. It also has three overseas branches in Hong Kong, Dubai and Singapore to provide cross-border financial services in support of CNPC's overseas operations (China Petroleum Finance Co., 2020). CPF alone is larger than many of the rural commercial banks in terms of the number of branches and the spectrum of businesses. [16] CPF is also large in terms of its size of assets and profits. Total assets of the CPF was 600 billion yuan in 2019, which was more than double of the average of city commercial banks in the same year (China Petroleum Finance Co., 2020). [17] The net profit of CPF in 2019 was 9.95 billion yuan, which was nearly six times of average net profit of city commercial bank in the same year (1.87 billion yuan) (ibid). CPF has already been larger than majority of commercial banking institutions in the city and rural level in terms of net profits.

Once the parent company becomes a holding company, they began to acquire equity of other companies (Bai et al., 2021). SOEs acquire stakes of other SOEs and private companies, making a complex shareholding structure (Bai et al., 2021; Lo et al., 2022). And the holding company perform primarily as an equity investor, creating large business group through the cross shareholding. Figure 8 showcases the complex shareholding structure by taking CNPC as an example. Bai et al. (2021) have done the same exercise for every Chinese firm by peeling off the ownership layer until the ultimate owners are found, revealing that the state owners had equity investment in hundred thousand private owners in China in 2009, 65% of which were

[16] Data source: *Balance Sheet of Banking Sector in 2019*, published by China Banking and Insurance Regulatory Commission, available from http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=890465&itemId=954&generaltype=0

[17] According to 2019 data published by China Banking and Insurance Regulatory Commission, total assets of all 134 city commercial banks in 2019 were 37,275 billion yuan. On average, the total asset of each of them was 278 billion yuan, which was smaller than the size of asset of CPF.

the largest 1000 private owners. The cross shareholding also stimulates the transition of SASAC' governance pattern as well as the transformation of these large central SOEs.

The pyramidal structure of the business group and their special bond with the state guarantees them to keep most of their profits. Within the business group, the profits move upward to the parent company. The parent companies are listed companies for most of the central SOE business groups, and they often perform as a holding company in the group, so they could enjoy the dividend from other listed subsidiaries. However, the parent company holds and utilises the cash without further forwarding it to the state (Kuijs et al., 2005).

The parent company could also weigh in the redistribution of the assets and revenues in order to impress the shareholders. They manipulate the assets and revenue amongst member companies by dividing "their assets into profitable and non-profitable firms in order to list the most profitable on the stock market" with the redistribution of revenues among its subsidiaries, which often have been done "with enormous discretion" (Naughton, 2015, p. 60). This is also called "packaging for listing" (Kuijs et al., 2005, p. 10). In this way, the profits also move upwards from lower-level subsidiaries to the top-level parent company, where the profits are retained (Naughton, 2015). As a result, these publicly listed firms earned a great fortune from the stock market with only listing a tiny proportion of their shares. At the same time, it also created a mess. For instance, the parent company invest in the non-core businesses, such as speculative commercial real estates (Kuijs et al., 2005, p. 10). What is worse is that the parent company often extract cash from its subsidiaries through various means, such as borrowing and fees (ibid). It often takes more than 2-3 years to repay, and in most case, they did not plan to pay with cash (ibid).

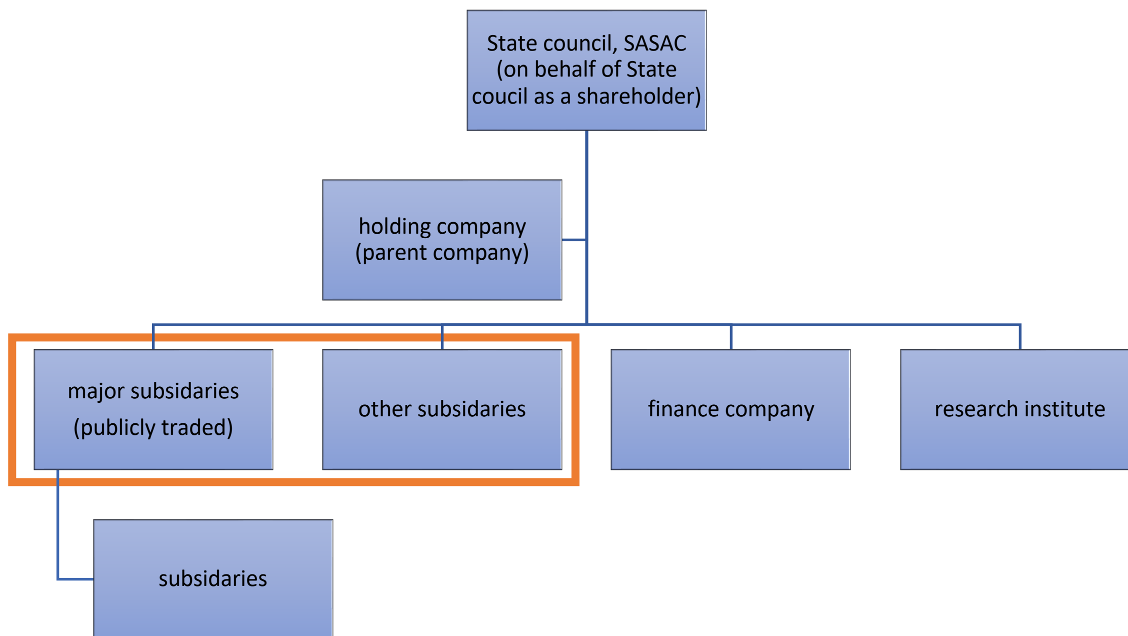

Figure 7 Management Hierarchy of a Business Group

Source: Lin and Milhaupt (2013).

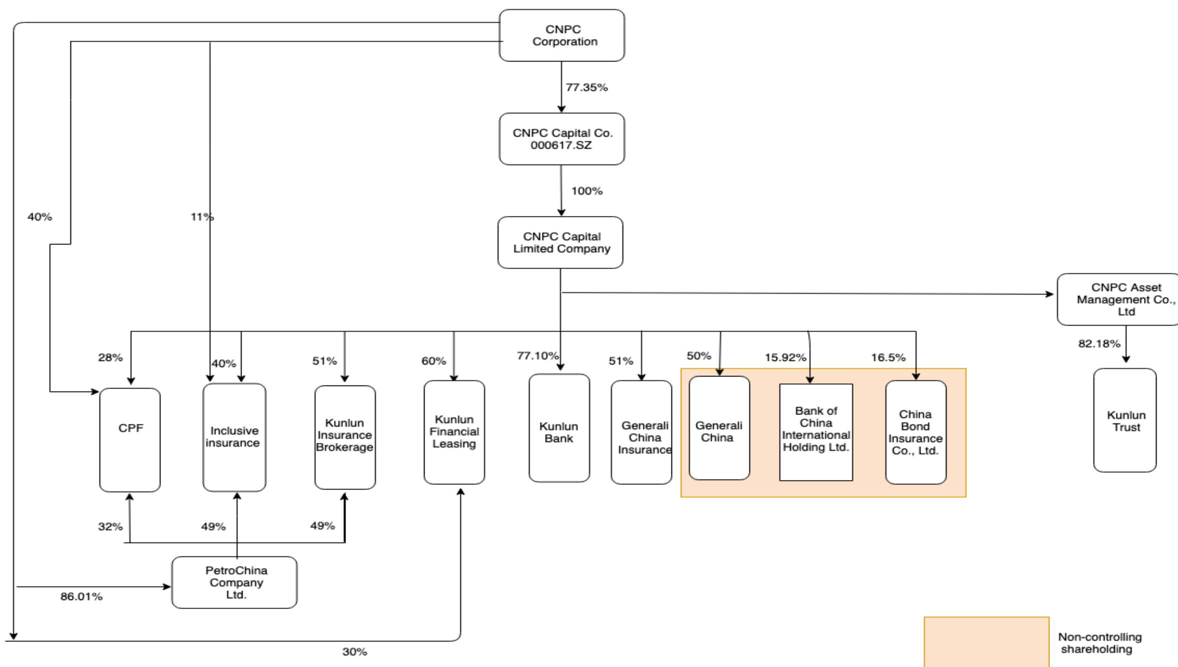

Figure 8 Shareholding Structure of CNPC Capital Co.

Source: CNPC Capital Co. official website, available at:

http://www.cnpccapital.cn/cnpccapital/gqjg/common_common_tzzgx.shtml [Accessed 27 Nov. 2020].

4.4.2 Acquiring the monopoly power

Resource monopoly

Central SOEs dominate the key elements of natural resources, especially the mineral resources and some other energy resources. The monopoly is firstly ensured by the franchise that granted by the government to a handful central SOEs, secondly by limiting the entry to these industries and thirdly by limiting competition in these industries (Duan and Saich, 2014). SOEs were also accused of consuming a large amount of resources at discounted prices, or even at no charge (Duan and Saich, 2014, p. 11)

State's monopoly of mineral resources is the best example to illustrate the resource monopoly. *Special Administrative Measures (Negative list) for the Access of Foreign Investment (Waishangtouzi zhunru tebie guanli cuoshi fumianqingdan 外商投资准入特别管理措施负面清单)* regulates that mineral exploitation is banned for foreign investors. It guarantees the mineral resources in the hand of domestic firms. Moreover, *Mineral Resources Law* articulates the state ownership of mineral resources and regulated the right to mineral resources exploration and exploitation (Ministry of Commerce, 1986). The private firms were completely ruled out of the resource's exploration and exploitation, and further guarantees the state monopoly in this area.

The way to guarantee the state monopoly is to grant the licence to a handful SOEs. To use the oil industry as a specific example. The franchise of allowing the exploration of the onshore

and offshore oil and gas only extends to three large SOEs: China's National Petroleum Corporation (CNPC), China Petrochemical Corporation (Sinopec) and China National Offshore Oil Corporation (CNOOC). Specifically, CNPC and Sinopec have exclusive rights in exploration, development and production of oil in cooperation with foreign investors within the regions for cooperative development of continental petroleum resources (State Council, 1993). And CNOOC is in full charge of the Sino-foreign partnership in the offshore oil exploration, production, exploitation and sales (State Council, 1982).

As mentioned before, foreign investors are not allowed to operate in mineral exploitation on their own. They can only do so by cooperating with the three franchised SOEs in this industry. But they also face restrictions in the procedural processes related to the contract during the cooperation (Duan and Saich, 2014, p. 5). As per regulated by the State Council, a foreign company must conclude contractual relations with a company authorised by Chinese government, and in the case of onshore petroleum resources, the only authorised companies are CNPC and Sinopec, which means that any foreign companies wishing to enter China's oil industry have to negotiate, conclude and execute all contracts with CNPC or Sinopec upon Ministry of Commerce's approval (Duan and Saich, 2014, pp. 5–6).

In recent years, the resource monopoly seems to be eased slightly and gradually by allowing private and foreign capital in certain monopolised industries. In 2005, *Thirty-six Guidelines on the non-public economy (Feigong jingji 36 tiao 非公经济 36 条)* states that non-state capital can be allowed in monopolistic industries including electricity, telecommunications, railway, aviation, oil and others in order to further introduce market competition in these areas (State Council, 2005). Moreover, the industries which are allowed foreign capitals should also allow

private capitals, and the restriction on the proportion of equity should be relaxed (ibid). Allowing foreign and non-state capital in the strategic industries does not contradictory with the fact that the state has to be the controlling power in order to keep the monopolistic position.

Price setting power

After nearly 50 years of price liberalisation, Chinese state still maintains control over certain prices through the mechanism of government pricing and government guided pricing (Duan and Saich, 2014). *Price Law of People's Republic China (zhonghua renmin gongheguo jiagefa 中华人民共和国价格法)* regulates that the prices shall be set by the government or guided by government for the following five cases: 1) the commodities that are of great importance to the development of the national economy or people's livelihood; 2) scarce resources and the commodities made out of scare resources; 3) commodities of natural monopoly; 4) important public utilities; 5) and important services of public welfare (State Administration for Market Regulation, 1997).

The price setting power is monopolised by the central government as the *Price Law* regulates that the scope of specific items and uses for government-set or government guided price shall depend on the pricing catalogues issued by the central and local governments (State Administration for Market Regulation, 1997). The *Central Pricing Catalogue (Zhongyang dingjia mulu 中央定价目录)* are issued by the Price Administration Department upon State Council's approval (ibid). And provincial-level pricing catalogues should be in accordance with the central pricing catalogues and should be publicised upon the approval of both local governments at the same level and of the State Council (ibid). There are 16 items of 7

categories in the current *Central Pricing Catalogue*, including electricity transmission and distribution, oil and gas pipeline transportation, basic public transportation, important postal services, special medicine, blood among others (The National Development and Reform Commission, 2020).

In several other industries, although the price is not directly set by the government, the mechanism of government guided pricing is prevailing. By 2004, only less than 10% prices of retail products are government-set or government-guided, and this number is slightly lower for prices of agricultural products and slightly higher for prices of production materials (Weber, 2021, pp. 8–9). Government guided price occurs when the benchmark price is set by the government in accordance with the domestic and international prices and the enterprises set the market price accordingly. The refined oil price is set by the government guided price whereas the crude oil price is set by the market completely (The National Development and Reform Commission, 2009). It is regulated by *Petroleum Price Management Measures (shiyoujiage guanlibanfa 石油价格管理办法)* that the retail price and wholesale price of gasoline and diesel, as well as the supply price of gasoline and diesel for wholesale enterprises, railways, transportation and other special users, implement government guided prices; and the supply prices of gasoline and diesel used by the State Reserve and Xinjiang Production and Construction Corps, as well as the ex-factory prices of aviation gasoline and aviation kerosene, are subject to government pricing (ibid). The retail price ceiling of gasoline and diesel are also set by National Development and Reform Commission for the province and province-equivalent regions, as well as for several central cities where the retail price is unified in the whole region (ibid). In those provinces where the retail price of gasoline and diesel is not unified, the price difference between region is also restricted by National Development and

Reform Commission (NDRC) (ibid).

4.5 Conclusion

This chapter introduces China's hierarchical political-economic system, which serves the institutional background for understanding SOEs and their transformation. SOEs can be different from one kind to another by their ownerships, scales, and relations with the government, thus, only the large SOEs which are the main players in the most strategic industries in Chinese economy are the objectives for the discussion of financialisation. Thus, this chapter spends more time on elaborating the characteristics of them, i.e., large central SOEs, as well as their relations with the state. One of the defining characteristics is that SOEs integrated vertically or horizontally into state-owned business groups which has a parent company on the top as a shareholding shell, several subsidiaries and at least one financial company at the lower level. With the pyramidal structure of these business groups and cross shareholding, most of the profits siphoned into parent companies, making them stand out internationally. Plus, the financial arms of these business groups empowered them involving in various financial activities and acquiring large financial assets and strong financial skills, resulting in their transformation towards financially sophisticated business entities.

Other than its favourable business structure, it has been found that large central SOEs are also good at exploiting the political-economic system by taking advantage of the *nonmenklatura* system and forming interest groups, resulting in them transforming from independent units of the planned economy to "small kingdoms" which possess enormous political and economic clouts that are great enough to influence the industrial policies and national goals. On top of that, the state's control over these large central SOEs is not powerful enough, and the financial

means have been increasingly used, effectively accelerating their transformation towards financially sophisticated business.

In a nutshell, SOEs are in monopolistic positions in China's commanding height. By taking advantage of the market reforms, the large SOEs formed the business groups that has pyramidal structures that are beneficial for their profit retaining. Moreover, the special "cadre-entrepreneur" status of SOEs' business leaders facilitates the formation of the interest group and in turn, facilitates the accumulation of their political clouts. The great corporate wealth and political influence turn the large SOEs into "small kingdoms". The state, at the same time, has increasingly relied on financialised means to govern the SOE, which effectively promote the process of the transformation of the SOEs towards financially sophisticated business. However, because of the unclearly defined shareholder and manager as well as the dual role of SOE's business leader, the shift to shareholder value orientation is difficult to be captured at the current stage. Next chapter will look into a selected sample of large central SOEs from their changing conduct of behaviours to figure out the changing financing patterns, their profits compositions and cash flow, which help to identify the core relations of financialisation in order to explore the answer of large SOE's financialisation.

Chapter 5. Publicly Listed Central SOEs: The Nature of Their Financial Activities

5.1 Introduction

Chapter 4 has thoroughly introduced the position of SOEs and central SOEs in China's political economic system, as well as the characteristics of central SOE's business group. It argues in that the state created large productive capitals intentionally and managed them increasingly through financialised means, but the state could not have full control over the large SOE business groups. The large SOEs have developed into "small kingdoms" that could command large proportion of their profits and enormous political power to form their own interest group and to insert influence on the policy making. By restructuring into business groups with in-house financial arms, the large SOEs are involved in various financial activities.

Productive capital has its internal characteristics and can also engage in various external relations. To put it precisely, financial operations are intrinsic to the productive capital, which exhibits productive capital's *internal* character. Sufficient money is needed to commence the circuit of productive capital, such as purchasing the initial investment and paying for the labour cost. The continuity of the circuit relies on the regular return of money capital. In this sense, productive capital is self-financing as the revenue from a sufficient amount of output sale could cover the initial cost (Lapavitsas, 2013). At the same time, productive capital is also frequently financed by other types of finance through the engagement in the *external* relations, namely, commercial credits, loanable capital from banks or equities. In this sense, financialisation reflects the change of composition of external finance, particularly, funds obtained in the open market are gaining more relative importance than the funds from banks.

This change also brings along the changing balance between the internal and external finance (Lapavitsas, 2013). Thus, the analysis of financialisation of the non-financial enterprises should depart from the changing balance between the internal and external finance as well as the changing composition of external finance.

It has been repeatedly stressed in Chapter 3 that financialisation neither represents the escape of productive capital to the realm of finance for higher profits, nor does it represent the productive capital being crowded out by the increasing financial activities. Rather, it represents an epochal transformation of capitalism which can be reflected by "a transformation of the mix of financial and non-financial activities that are integral to the circuit of productive capital" (Lapavitsas, 2013, p. 217).

In this sense, this chapter will further demonstrate what financial activities that central SOEs have been involved in, and how. To answer these two questions, the changing financing patterns of external finance, as well as the changing balance between internal and external finance of 362 publicly listed central SOEs will be displayed and interpreted as the revelation of the core relations of financialisation of non-financial enterprises in the context of China.

This chapter follows the method that has been initially used by Corbett and Jenkinson (1996) when constructing a comparative dataset on the source of finance for the investment in the UK, the US, Germany and Japan to challenge some of the conventional views of international differences, which was then further extended by Lapavitsas (2013) to uncover the core of financialisation in several mature capitalist countries, such as the UK, the US, Germany and Japan. Methodologically, this chapter creates a dataset that consists of 362 publicly listed

central SOEs in China during the period between 2000 and 2019. The dataset is drawn from the balance sheet information, as well as the statements of income and the statements of cash flows. The data is deployed in its net basis, i.e., after balancing out the sources and uses of funds of the sample enterprises. The net value can be misleading in some ways because cancelling out the sources and uses can lead to certain information loss, but it did not prevent the net value casts a revealing light on the funding practices of the publicly listed central SOEs (Lapavitsas, 2013).

It finds that external finance depicts a different picture from that of the core capitalist countries. The bank and market finance had strong cyclical features in the US and the UK by moving in opposite directions, and they were close in volume (Lapavitsas, 2013). For the publicly listed central SOEs in China, bank and market finance moved oppositely as well, but they were not comparable in volume as market finance only accounted for a trivial proportion of total external finance. Moreover, bank credits and trade credits are the most important external finance. The publicly listed central SOEs have been borrowing heavily from banks, and at the same time, they use increasing amount of trade credits, which also includes the in-house borrowings between the member companies within the same business group. It points to SOE's participation in shadow banking activities, and also indicates the underdeveloped nature of the state monopolies and of China financial system. The heavy reliance on the trade credit also implies the significant monopolistic powers of these state-owned monopolistic enterprises, which is found true in last chapter that these large central SOEs have already transformed into "small kingdoms" with enormous economic and political clouts.

Internal financing wise, the empirical findings show that the retained earnings were much smaller than the external finance, and it was even smaller than the trade credit for most of the years in between 2001 and 2019. Bank borrowing first overtook retained earnings in 2008 and almost kept this this trend in the following ten years except a few. The biggest component of the rather insignificant amount of retained earnings is undistributed profits. This aligns with the previous chapter's findings that large central SOEs held onto a significant portion of their profits instead of returning them to the state.

To better identify financialisation in China's publicly listed central SOEs, empirical findings of interest income as well as that of cash flow are presented in Section 5.5 and 5.6. The income composition indicates a rising interest incomes for the publicly listed central SOEs in the observed period, but the proportion of the interest incomes in the total operating incomes was only slightly higher than 4% for the historical highest, and it was normally between 1.5%-3.5% during the period, which is roughly in line with the case of US non-financial corporations in the same period (Rabinovich, 2019), implying a moderate financial income for China's state monopolistic enterprises. The cash flows of operating activities were much higher than that of the financing activities, partially explaining the rising trade credits as well as the increasing operating incomes and profits.

By and large, the empirical findings indeed showcase large central SOEs' transformation towards financially sophisticated enterprises, but they do not support their financialisation. Despite the increasing involvement in shadow banking activities, China's large central SOEs have not fundamentally altered their financing patterns—they have not been distant from banks, and they have not turned to retained earnings for their investments. Their financial

skills that occurred in dealing with bank credits did not extend to financial markets, and their profiting-making operations have not been completely rebalanced. The subsequent chapters will further explain that the increasing shadow activities are still credit-centric and bank-based, which is more of the credit expansion instead of financialisation.

Remainder of this chapter will proceed as follows. Section 5.2 introduces the data, the estimation and the methodology for calculating each type of finance. From Section 5.3 onwards, each section will present one part of empirical findings of how publicly listed central SOEs have been financing themselves. Precisely, Section 5.3 will focus on the external finance, namely, bank credits, trade credits, including the receivables, and market finance. Section 5.4 will present and analyse the findings on the retained earnings. Section 5.5 will use data from the statement of income to analyse the interest incomes. Section 5.6 follows by providing evidence from cash flow (gross value) to double check the evidence that drawn from balance sheet data (next value). Section 5.7 attempts to answer the important questions that have been revealed from the stylised facts—why the publicly listed central SOEs still rely heavily on trade credits given the easy access to more advanced types of credits and the fact that they sat on large liquidities? And what does that mean for the transformation of large central SOEs? And finally, it concludes the whole chapter.

5.2 Data and Methods

5.2.1 Data construction

The dataset is constructed by estimating flow of investments and flow of funds based on raw data drawn from *Wind*. The sample comprises 362 non-financial central SOEs which are publicly listed in Chinese mainland in Shenzhen and Shanghai Stock Exchange over the period

of 2000 – 2019. For the business groups, the parent company and its subsidiaries can be listed separately. That is the reason why the number of publicly listed central SOEs is significantly larger than the number of central SOE business groups.[18] For instance, China National Offshore Oil Corporation (CNOOC) is a centrally-owned business group that is included in the SASAC's list of central SOE business groups. Three of its subsidiaries are also centrally-owned SOEs that are separately listed in China's stock market, namely, China Oilfield Service Limited (COSL), Offshore Oil Engineering Co. Ltd (COOEC), and CNOOC Energy Technology & Service Limited. These three subsidiaries as well as the parent company are all included in this dataset.

Publicly listed central SOEs in this sample have both consolidated balance sheets and (parent) company balance sheets. This chapter utilises consolidated balance sheets extracted from the annual financial reports, which are prepared in accordance with China Accounting Standards. Consolidated balance sheets are used for the following reasons. First, consolidated balance sheets could reflect the financial conditions of the whole business group. As mentioned previously, each of the 362 publicly listed central SOEs belongs to a large business group, and some of them also have their own subsidiaries. Borrowing and lending between the subsidiaries or between parent company and a subsidiary within the same business group will be cancelled out in the consolidated balance sheet. After cancelling out, the borrowing and lending between subsidiaries or between a subsidiary and parent company will be noted under account payable or deposits received, and account receivable or advance payments, respectively, which are classified as trade credit. This could also partially explain why the trade credit has been exceedingly high for these publicly listed central SOEs. In this sense, compared

[18] There are 98 of central SOE groups in total on the list of SASAC by June 2023. The full list is available at http://www.sasac.gov.cn/n2588045/n27271785/n27271792/c14159097/content.html, last accessed on 30 Aug. 2023.

with the company balance sheets, consolidated balance sheets have reported the information that have counterbalance part of the within-group transactions, better reflecting the net financing from outside the business group, even though it cannot be certain how much of the trade credit were generated by the in-house finance and how much from the non-affiliated companies.

Second, the data from consolidated balance sheets are more convenient for international comparison because publicly listed companies in some countries and regions, such as in the US and in Hong Kong, are only required the exposure of the consolidated balance sheets, whereas in other places, such as in Chinese mainland, double exposure is required, i.e., to expose the information on both consolidated and company balance sheets.

However, this dataset could lead to three potential issues. The first issue is about the different sizes of publicly listed central SOEs in the sample. Companies in this sample are grouped by their ownerships, instead of their sizes. So, they vary significantly in terms of size of assets. There are internationally gigantic enterprises such as Sinopec, and smaller ones whose asset sizes are incomparable. Also, some of the large and important central SOEs have not been included in this dataset. Because they have not been publicly listed, such as China Tobacco, or they have been publicly listed somewhere else outside the Chinese mainland, for instance, CNOOC, one of the three oil giants in China is publicly listed in Hong Kong. To summarise, the dataset does not include all the monopolistic enterprises in the state sector, and for those which are included, they are not differentiated by size. However, this has already been the best proxy for the large monopolistic enterprises in the state sector as illustrated in last chapter. The findings should be interpreted with caution.

The second caveat is that the annual financial reports of these firms do not always provide the fullest information because of the different listing time and the inconsistent quality of the data collecting and auditing. There were huge missing values for majority of the series in the early years before 2008, so were the case for few others in the later years. Comparatively, the large central SOEs, especially those "national champions" with global reach, have better data quality, i.e., fewer missing values and better data consistency. However, this dataset has already been the best available data that can be constructed and utilised on this purpose.

Thirdly, the aforementioned two issues have decided that the analysis has to be done in an aggregate level. The indicators are constructed by taking the sum value, instead of taking the average. The reason is that the data large number of missing values are from smaller SOEs, and the data for large central SOEs are more systematically presented. For those which only have random missing values, the missing values are regarded as zero when doing the calculation and estimation. For those more than half of which were missing in the observed period, the whole series of this company will be dropped out. This won't have an impact on the final results since the smaller companies are the ones being dropped, and the focus of financialisation is on larger enterprises anyway. The sum can provide a more accurate representation of financial information for larger central SOEs.

5.2.2 Estimation

This chapter will be exploring how the investment has been financed and how the retained earnings have been used in China's publicly listed Chinese central SOEs in the first twenty years of the 21st century. As the investment as well as internal and external finance are flow

concepts, the data can be either obtained from flow of funds in national account, or estimated from the balance sheet information (Corbett and Jenkinson, 1997; Gilina Hale and Long, 2011). For this particular sample, it is reasonable to collect the raw data from the consolidated banlance sheets from their annual financial reports and estimate the annual flow of investment.

Precisely, the balance sheet information indicates the 'balance' of each item after all the operation within a fiscal year. In other words, it is a concept of stock. In order to match the investment, the flow of finance must be estimated from the balance sheet data. Thus, the indicators whose raw data are from balance sheets should be estimated by taking year-on-year difference to obtain the annual flow of each of them, as shown in equation (1). Specifically, the flow for company i at the time t is calculated by using the stock at time t minus the stock at time $t-1$ for the ith company, noted as

$$flow_{i,t} = stock_{i,t} - stock_{i,t-1} \quad (1)$$

Then sum up the value of flow for all companies at time t to get the flow of this indicator at time t on the aggregate level, noted as

$$flow_t = \sum_{i=1}^{362} flow_{i,t} \quad (2)$$

It is to note that the time range of the raw data (i.e., the balance sheets themselves) is from 2000 to 2019, so that of the estimated external and internal finance (i.e., the flows) is from 2001 to 2019.

For some of the indicators, they themselves are obtained by summing up the sub-components. In this case, it needs iterative use of equation (3) and equation (4) until all subcomponents

have been grouped into the three main financing ways, namely, bank borrowings, trade credits and market finance.

$$A_{i,t} = \sum_{j=1}^{n} a_{i,j,t} \quad (3)$$

where $a_{i,j,t}$ represents the component j for the company i at the time t. For instance, in the case of bank borrowing, $a_{i,1,t}$ is short-term borrowing for company i at year t and $a_{i,2,t}$ is long-term borrowing for company i at year t. $A_{i,t}$ thus, represents the total value of indicator A for company i at time t. In the case of bank borrowing, it represents bank borrowing for company i at year t.

$$F_t = \sum_{i=1}^{362} A_{i,t} \quad (4)$$

where F_t represents the sum of total value of item A for all companies. In the case of the bank borrowing, it represents the total bank borrowing for all 362 publicly listed central SOEs at the time t.

For the purpose of comparison or standardisation, the proportion and the proportionate change should be estimated. This method makes sense in the aggregate level, but it also has limitation that the percentage in aggregate level covers up the heterogeneity of individual firms. So, the interpretation of the results should be done with cautions. The proportion is calculated as equation (5).

$$percentage_{j,t} = \sum_{i=1}^{362} a_{i,j,t} \div F_t \quad (5)$$

where $\sum_{i=1}^{362} a_{i,j,t}$ represents the value of component j for all companies at time t. And this percentage represents the percentage of one subcomponent to the total value of the indicator. In the case of bank borrowing, $percentage_{1,t}$ represents the percentage of short-

term borrowing for all companies at time t to the total bank borrowing for all companies at time t.

Net value is a common choice by scholars who are examining the financing behaviour of non-financial enterprises, (see for example Corbett & Jenkinson , 1997, Lapavitsas, 2013). However, only looking at net values could be misleading in certain ways. For example, in Corbett and Jenkinson's work (1997), they claim that they find it hard to justify the characterisation of Germany being a "bank-based" financial system because the bank finance only accounts for less than 12% of funds for investments. It is likely that the sources and uses of bank loans were large in their gross terms, but they were close in volumn. So once the net value is taken, they offset a large proportion making the net value small. To support their arguments, Corbett and Jenkinson also considered the norm and function of German financial system. Scholars including themselves have noticed that the relative weak bank representatives on the supervisory board of German companies could help to confirm the minor role that banks play in financing investments (Corbett and Jenkinson, 1997).

I am fully aware the weakness of using the net value, but it still cast important lights with the best possible data. In this chapter, two different methods are utilised to overcome the possible shortcomings casued by net values. First, both asset and liability side of gross trade credits are presented in section 5.3.2 and 5.3.3; secondly, more stylised facts on the composition of the assets, cash flows and the income as well as the expenses will be presented as supportive evidence, which are all shown in gross terms.

5.3 Empirical findings of publicly listed central SOE's external financing

As elaborated in the introduction, to uncover the core of financialisation, it is necessary to look at the trajectory of the balance between 'internal' and 'external' finance for productive capital (Lapavitsas, 2013, p. 217). External finance can be divided into three groups: bank borrowing, trade credits and market finance. Each of the subsections will be dedicated to one particular external finance.

The sum of the external finance for China's publicly listed central SOEs was exceedingly high in the period of 2000-2019. In most of the time between 2007 and 2017, the total external financing was no less than two-fold of the total investment of these companies in the same year (Figure 9 and 10).

The most striking feature of the sample in the selected period is that trade credits are no less than the bank borrowing for publicly listed central SOEs in the first two decades of the 2000s, even during the period of the credit boom right after the 2008 global financial crisis. Instead, trade credits and bank borrowings substituted each other by and large over the observed period, as shown in Figure 12. It argues that these publicly listed central SOEs require their suppliers to extend the trade credit to them by exercising their monopoly power in the market, also with the help of the in-house financial arms, the within-group borrowing and lending mushroomed, contributing to the increase of trade credit.

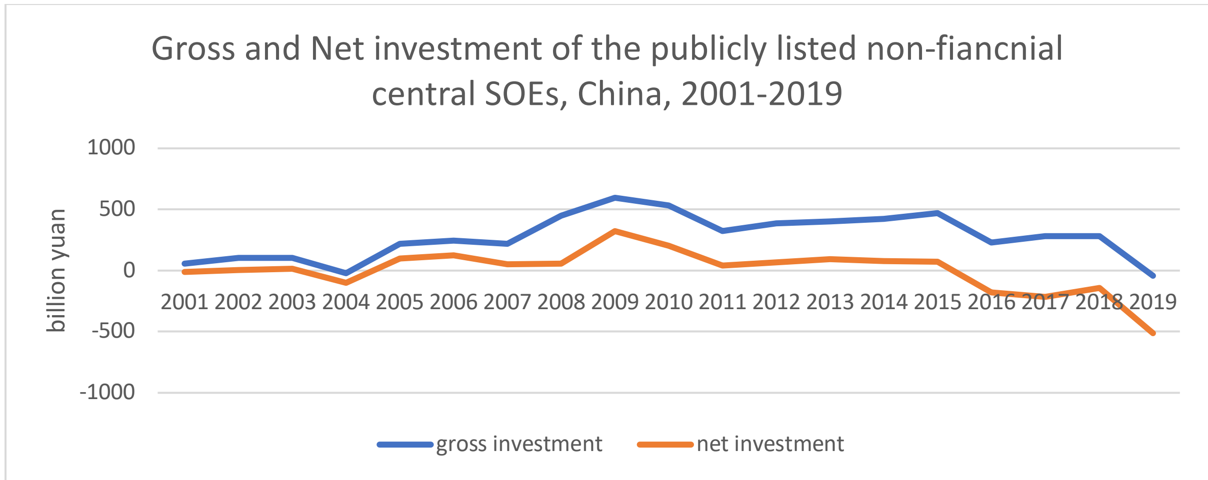

Figure 9 The gross and net investment of publicly listed central SOEs in China, 2001-2019.

Source: author's calculation based on data from *Wind*.

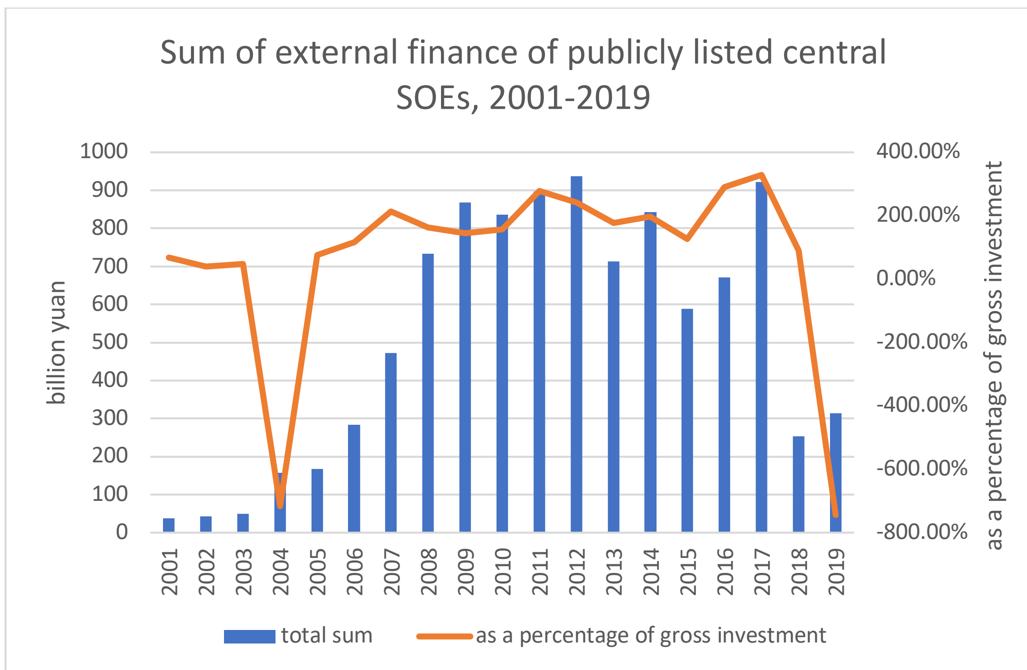

Figure 10 Sum of total external finance of publicly listed central SOEs in China, 2001-2019.

Source: author's calculation based on data from *Wind*.

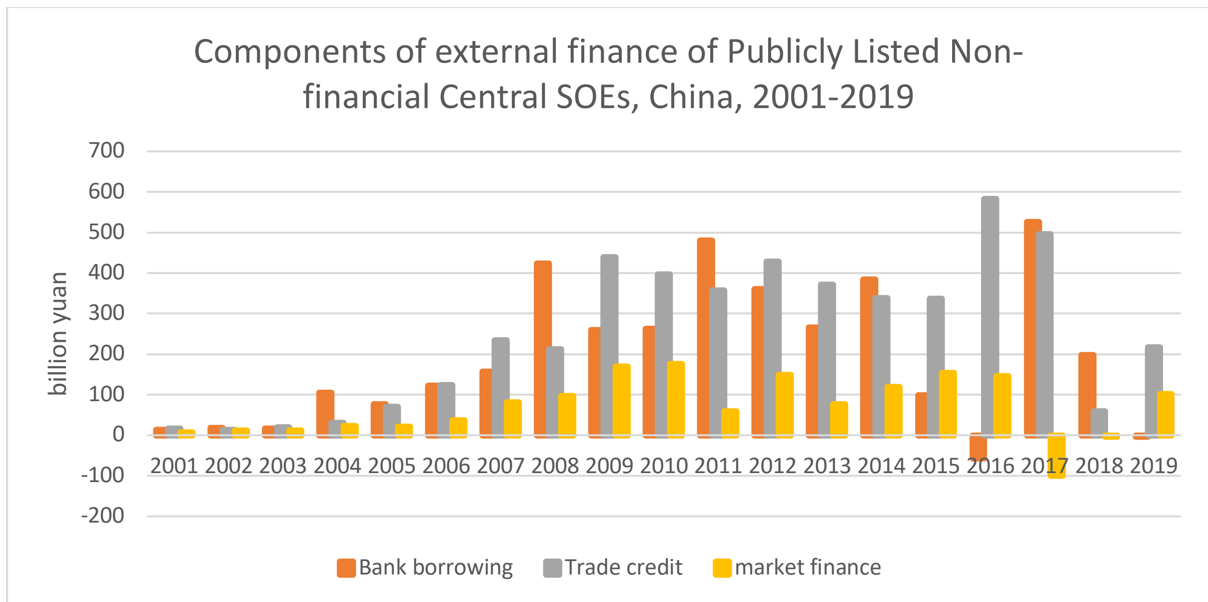

Figure 11 Components of external finance of publicly listed central SOEs in China, 2001-2019.

Source: author's calculation based on data from *Wind*.

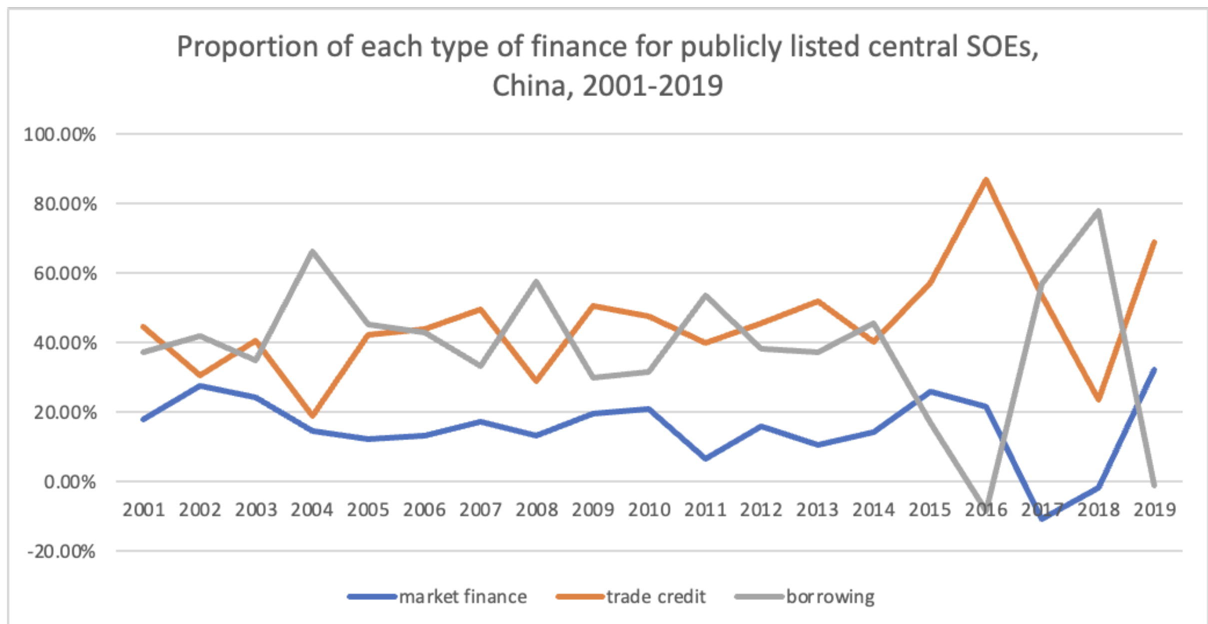

Figure 12 Proportion of each type of external finance for publicly listed central SOEs in China, 2001-2019.

Source: author's calculation based on data from *Wind*.

5.3.1 Empirical findings regarding bank borrowing

Bank borrowing is constructed as the sum of short-term and long-term borrowing. Short-term borrowings are those with a borrowing period of one year or less, while long-term borrowings are those with a borrowing period of more than one year. Non-financial firms are prohibited to borrow from each other directly, except for the borrowing-lending between non-financial members within the same business group, which is recorded under the trade credit instead of under the category of bank borrowing. Thus, the long-term and short-term borrowing in the balance sheets can be regarded as formal borrowing from banks or from other financial institutions. However, no available data does allow the distinction between borrowing from banks and borrowing from other channels. So, the sum of long-term and short-term borrowing are named collectively as “bank borrowing” in this chapter.

Short-term borrowings were more volatile than long-term borrowings over the entire period between 2001 and 2019, as shown in Figure 13. Short-term borrowings were larger or at least not much less than long-term borrowings before the global financial crisis, whereas after the crisis, the size of long-term borrowing was systemically larger than that of short-term borrowings. The reason for the increase in long-term borrowing can be attributed to the injection of a 4-trillion RMB stimulus package into the market in 2009 (Chen et al., 2020). This stimulus plan was centred on infrastructure and funded mostly (2/3 of the stimulus package) by commercial bank loans, with local governments being the primary borrowers (Chen et al., 2020; The Treasury of Australia, 2012; Wong, 2011). The borrowed funds were predominantly long-term loans, maturing in three to five years, and were utilised to finance long-term local infrastructure projects (Chen et al., 2020). Central SOEs as the companies with the easiest access to bank credits as well as the main contractors undertaking the investment projects,

they obtained tremendous long-term bank credits during this period. By and large, bank borrowing peaked in 2011, and kept at a relatively high level roughly between 2008 and 2014 when the global financial crisis stroke and stimulus plan was in place.

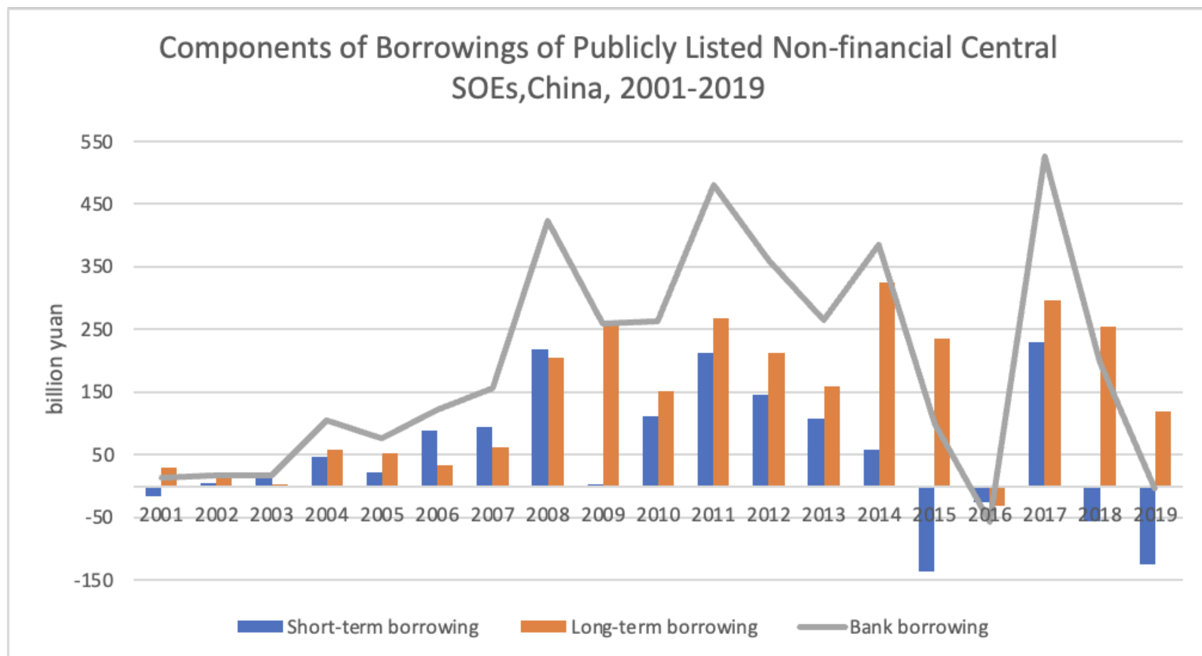

Figure 13 Components of borrowings of publicly listed non-financial central SOEs, China, 2001-2019.

Source: author's calculation based on data from *Wind*.

5.3.2 Empirical findings regarding trade credit

Trade credit is constructed as the sum of notes payable and accounts payable, long-term payables, advances from customers, and contract liabilities. Contract liability is dropped in the estimation due to the large amount of missing value. Evidence in Figure 14 shows that the trade credit grew continuously before the global financial crisis, and it declined slightly in 2008. It then reached a high level in 2009 and kept at a relatively stable level from 2009 to 2017 with it peaking in 2016. Among its four components, notes and accounts payable makes up the largest proportion of the total trade credits. It peaked in 2009 when the stimulus package was first in place and kept at a relatively high level up until 2019. The advances from

customers were gradually gaining more importance since 2016 but collapsed in 2018. Long-term payables kept the smallest components of total payables throughout the whole observed period.

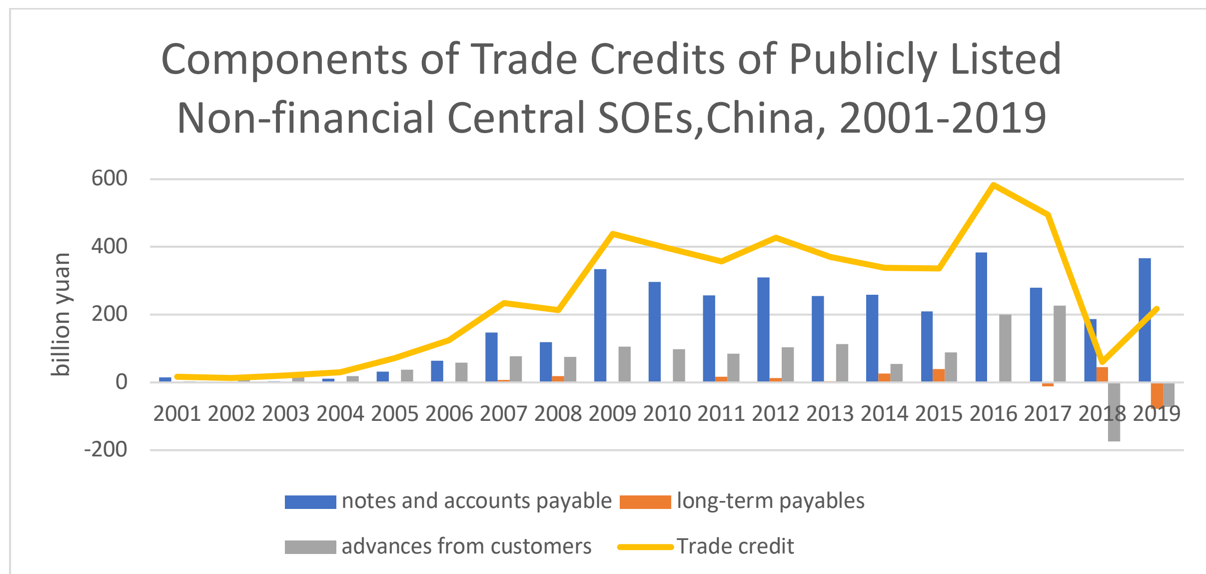

Figure 14 Components of trade credits of publicly listed non-financial central SOEs, China, 2001-2019.

Source: author's calculation based on data from *Wind*.

Total trade credit was in a similar size to bank borrowing during most of the years in the observed period, and the trade credit was larger than bank borrowing in 2009-2013, as shown in Figure 11 and 12. This not only happened in publicly listed central SOEs, but also true to the Chinese firms as an entirety during the period of 2004-2013 (Wu, 2017). Wu has found that the value of trade credits and bank loans were rising for Chinese corporate sector during 2003-2014, with the trade credit taking over bank credits at the end of the ten-year period (ibid).

Total trade credit has the substitute effect with the total bank borrowing in terms of the proportion in the total external finance for China's publicly listed central SOEs in the recent

two decades. It is shown in Figure 12 that when the bank borrowing was low, normally the trade credit was high, and vice versa, and their proportion in the total external finance roughly substituted each other by a similar amount. For example, when the trade credit peaked in 2009, the borrowing was down to the lowest level in that period. It then repeated in 2011, 2016, 2017 and 2019.

To figure out the relative size of trade credit and bank borrowing of publicly listed central SOEs, a comparison has been made and it is visualised in Figure 15. The blue bar shows the proportion of total companies having larger bank borrowings and the orange bar shows the proportion of total companies having larger trade credits. It is evident that the proportion of companies having larger trade credits has been steadily increasing over the period of 2001-2019. The proportion of total companies having large bank borrowings was larger than that of having large trade credits by and large in between 2001 and 2008, whereas after the implementation of the 4-trillion stimulus package in 2009, the proportion of having larger trade credit were constantly higher than that of having larger bank borrowings, and the difference between the two numbers was increasing. The proportion of having larger bank borrowings kept at a relative stable level at around 40%, indicating that it is not the case that they were turning away from banks, but more publicly listed central SOEs use increasingly amount of trade credits over the years.

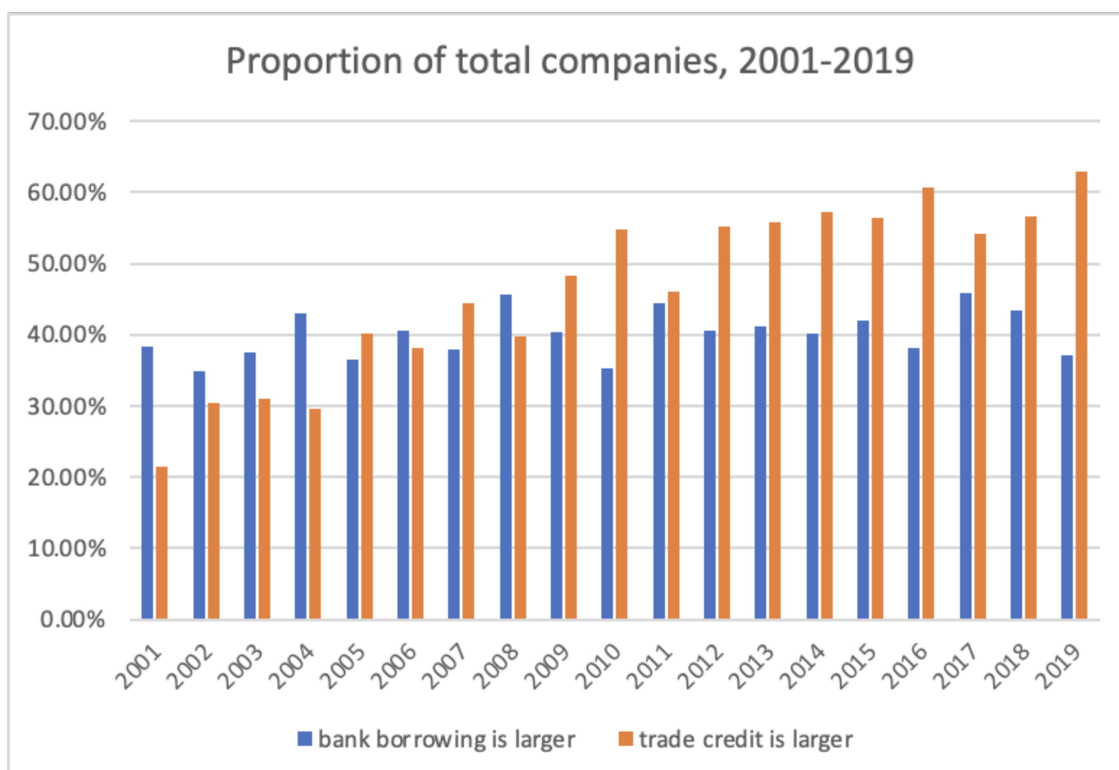

Figure 15 The proportion of total companies having larger bank borrowings or having larger trade credits, 2001-2019.

Source: author's calculation based on data from *Wind*.

Combining all the information together, it could prove that the publicly listed central SOEs have been involved in shadow banking activities. To recap, within-group borrowing between member companies is recorded as notes and accounts payable under the umbrella of trade credits. The data itself does not allow the differentiation between the future promise to pay and the in-house borrowing, nevertheless, it does not prevent to cast light on the increasing use of trade credits. The in-house borrowing is essentially a type of affiliated entrusted loan, a typical shadow borrowing product that will be introduced in-depth in Chapter 6. Inside the same business group, the prohibited borrowing between two non-financial enterprises is allowed with the help of the in-house financial arms. To borrow inside the business group instead of outside from banks or the market contributed to the increase of trade credits. The stylised facts in Figure 12 and 15 have proved this point because the amount of notes and

accounts payable as well as total amount of the trade credit have started to roar since 2009, when the shadow banking was quickly taking ground. More evidence on cash flow in Section 5.6 will also confirm this argument.

Existing literature provides explanations for the rising trade credits. Literature reveals that the US firms used trade credit as one of their most important short-term external sources of finance (Fabbri and Klapper, 2008; Petersen and Rajan, 1997), and it is quite common that firms use the short-term account and notes payable to replace the short-term borrowing to reduce the finance cost (Kling et al., 2014). This could also make sense in interpreting the increasing use of trade credits for China's publicly listed central SOEs. To borrow inside the business group instead of outside from banks could dramatically reduce the expense as they save up on the interest payment. On the other side of the same token, the exchange of resources inside the same group accrues higher profits for the whole group at the lowest costs. Thus, members have incentives to borrow inside the same group, resulting in the rising use of trade credits on the book.

Having stated earlier in several different chapters that central SOEs clearly possess sufficient economic, social and political clout that could insert its influence on plenty of aspects, including the policy making. And they enjoy the implicit central government guarantee as they are owned and managed by the agents of the central government. In this sense, they have sufficient power to attract the trade creditor. Additionally, as customers, central SOEs are in favourable positions of requiring trade credit. In certain industries, suppliers selling their products on credit to the customer becomes a norm. This has been confirmed by the informal talks with the private business owner of a concrete industry in Shanxi Province. His business

is the material supplier for the real estate development or infrastructure investments, most of which are constructed by central SOEs or large regional SOEs. The business owner told me that the private businesses like his must sell to their customers on credit, which, in most cases, are central SOEs or large regional SOEs or the well-known large non-state real estate developers. If the cash flow is not sufficient for the material supplier to sell on credit, the customer, i.e., the monopolistic enterprises would immediately switch to others who would be able to and be willing to do so.

On the other side of the same token, central SOEs are in monopolistic positions in the Chinese economy, these smaller-sized non-state enterprises are in a naturally disadvantageous position where they have less market power and face larger competitive pressure. They have to sell on credits when dealing with large central SOEs as there are more than enough enterprises that are able and willing to offer trade credit to them which could always buy on credit anyway.

5.3.3 Additional empirical evidence on receivables

To better understand the funding behaviours of publicly listed central SOEs, total receivables are also worth an examination. The trade credits of publicly listed central SOEs are under researched in the existing literature, let alone the political economy of how and why they rely on trade credits while they have multiple formal financing channels. To cast light on this, more evidence on receivables of the publicly listed central SOEs will be outlined below for a fuller picture of trade credit.

Receivables are calculated as the sum of note and account receivables, long-term receivables, and advance payments. It is to be noted that the time scale of receivables is from 2007 to 2017 because of the large missing values before 2007. The visualisation of the components of the receivables is shown in Figure 16. It is clear that the note and account receivables are the largest component of total receivables. They increased rapidly in 2009 and kept at a high level during 2009 – 2014 and became highly volatile since 2015.

Contrary to the intuition, the publicly listed central SOEs were net recipients of the trade credit instead of net suppliers in the observed period, i.e., their total payables were systemically higher than the total receivables, as is shown in Figure 17. This has challenged the findings in some existing literature, such as the finding of Ge and Qiu (2007) and Hale and Long (2011) that Chinese SOEs on overage were net suppliers (creditors) of trade credit in 1994-1999 and in 1997-2006, respectively, and private firms were net recipients (debtors) of trade credits. It is claimed in the existing literature that enterprises which extend trade credits to their customers will be more likely to demand the trade credits from their suppliers (Fabbri and Klapper, 2008). Because, firstly, total receivables could be used to finance total payables; secondly, the maturity has to be matched between liabilities and assets as a risk management tool, i.e., to hedge their short-term receivable risks (ibid). This could help to explain part of the reason why the financially unconstraint firms, such as publicly listed central SOEs in this sample, offer and receive trade credit simultaneously (ibid).

Fabbri and Klapper (2008) revealed that suppliers with weaker market power are more likely to extend trade credits to their customers and sell products or services on credit, and this is in line with Lapavistsas' arguments (2003). That is to say that the customers buy on credits

due to the larger market power. So they will have larger payables. This has also been confirmed by informal talks with the concrete factory owner who has close business relations with large SOEs. As one of the upper-stream suppliers to the large SOEs which are developers in the real estate industry or in the local investment products, the private concrete factory owner was in a competitive market with only very limited market power compared with the latter. Thus, the large SOEs could leverage their market power to buy products on credit from the private businesses. Thus, the large SOEs are expected to have larger payables than receivables, which has been confirmed by Figure 18. This offers an explanation on why central SOEs still use such a large amount of trade credit while they have multiple channels of formal finance.

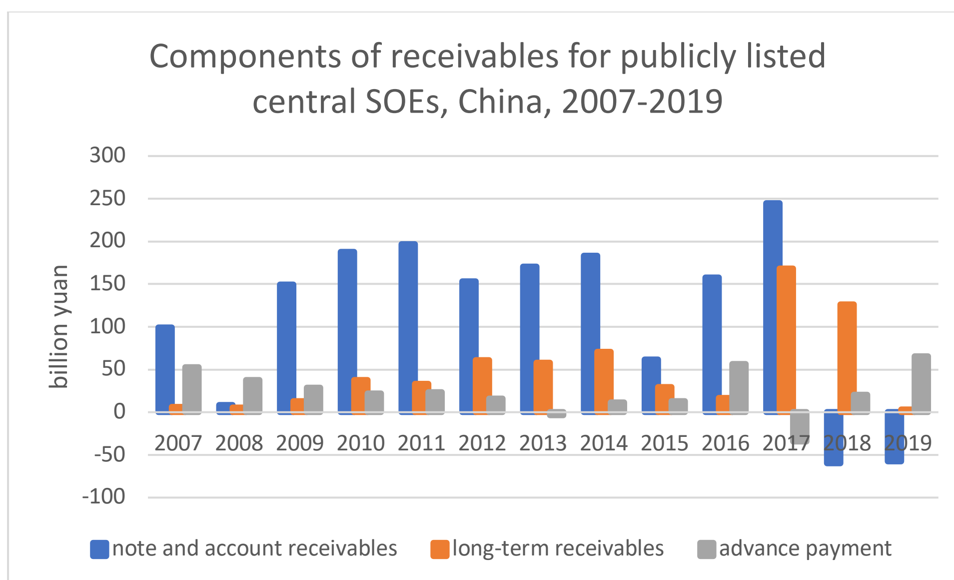

Figure 16 Components of total receivables for publicly listed central SOEs in China, 2007-2019.

Source: author's calculation based on data from *Wind*.

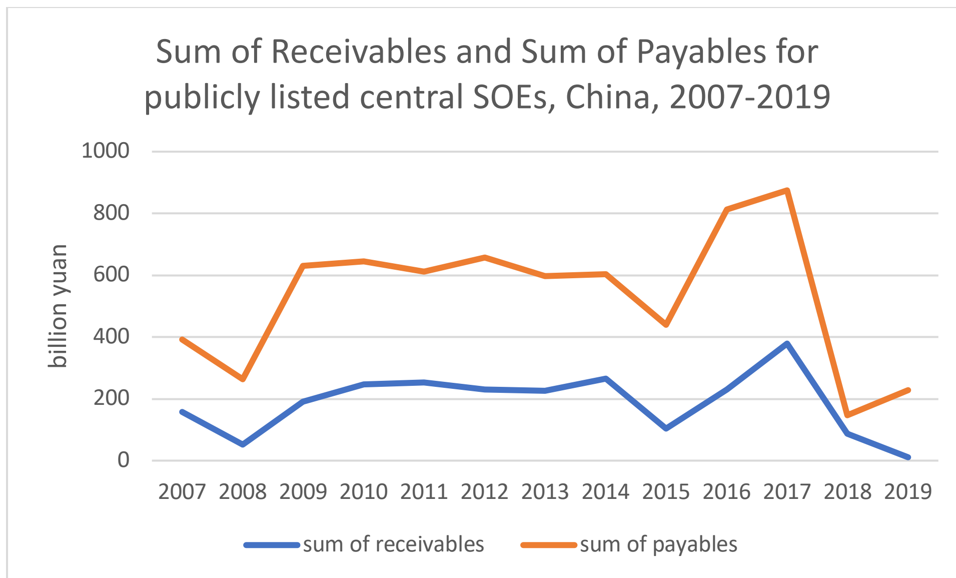

Figure 17 Total receivables and total payables for publicly listed central SOEs in China, 2007-2019.

Source: author's calculation based on data from *Wind*.

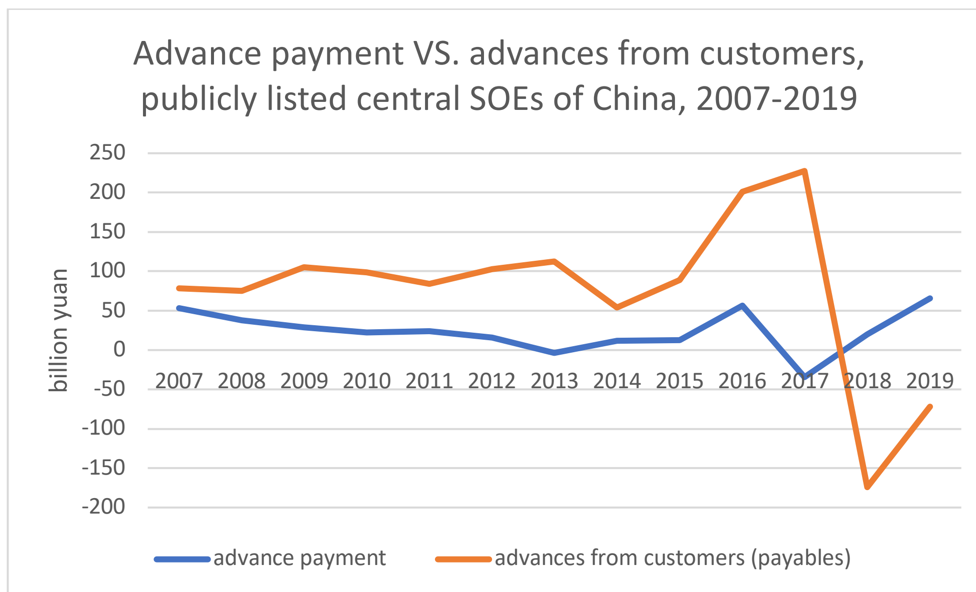

Figure 18 Advance payments and advances from customers for publicly listed central SOEs in China, 2007-2019.

Source: author's calculation based on data from *Wind*.

5.3.4 Empirical findings regarding market finance

Market finance is constructed as the sum of share capital, debentures payable, short-term debentures payable, other equity instruments, financial derivative liabilities, and transactional financial liabilities. Because of the large amount of missing value for short-term debentures payable, other equity instruments and financial derivative liabilities, market finance is estimated as the sum of share capital, debentures payable and transactional financial liabilities. The visualisation in Figure 19 illustrates that share capital makes the foundation of the market finance. Share capital has remained stable before 2013 when it saw a significant rise. The transactional liabilities were rather insignificant as a component of market finance, whereas the debentures payable volatiles heavily and it drove the total market finance up and down.

Debenture payable is one type of corporate bond whose maturity is one year or above. It was only trivial before 2007. It increased significantly in 2007 to a similar size with share capital, and soon ballooned in 2009-10 to about triple the size of 2007-8. In the next ten years after the Global Financial Crisis, the debenture payable was extremely volatile and drove the change of market finance providing the other two relatively stable components.

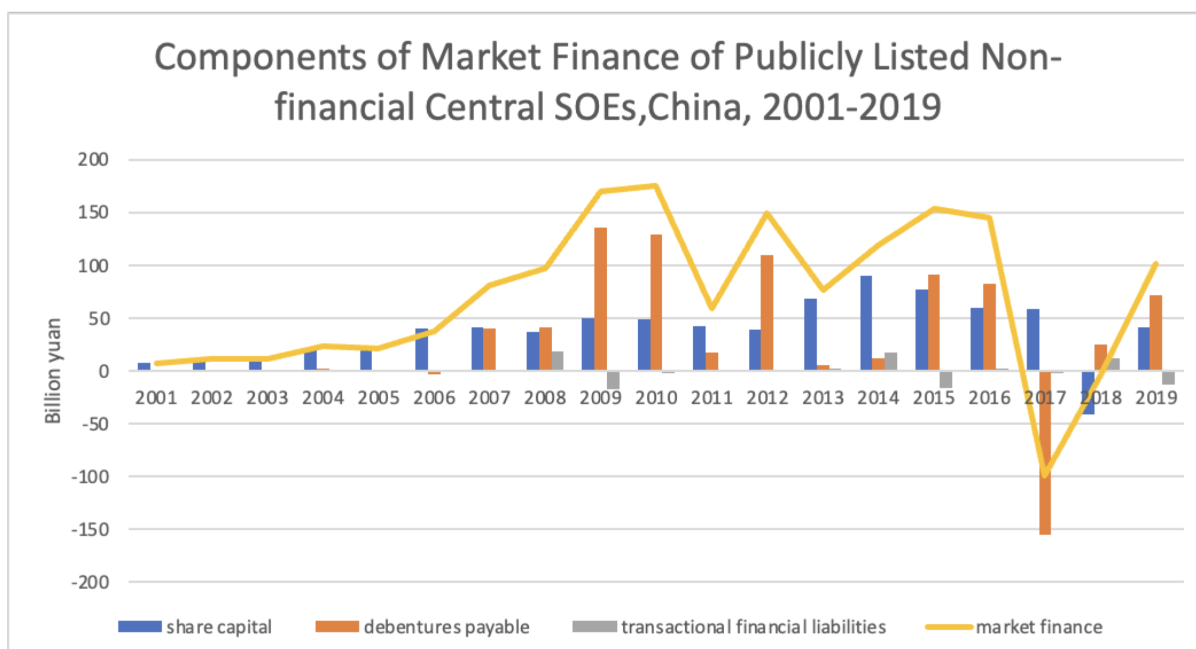

Figure 19 Components of market finance of publicly listed non-financial central SOEs, China, 2001-2019.

Source: author's calculation based on data from *Wind*.

5.4 Empirical finding of retained earnings

Retained earnings refers to the net earnings or profits of a company after accounting for dividend payments, which is usually reported in the balance sheets under the category of shareholder values. However, many publicly listed central SOEs did not report it directly. According to the definition on *Wind*, the retained earning is the sum of statutory surplus reserve and undistributed profits where the statutory surplus reserve is a compulsory surplus reserve that the enterprises must extract from after-tax profits (10% of it) according to China's state stipulation. In this light, the essence of retained earnings in China is undistributed profits. The undistributed profit is reported in the balance sheet at end of the period, which equals undistributed profits at beginning of the period + net profits attributable to equity holders of the company - appropriation to statutory surplus reserves - dividends payable to ordinary shares. Thus, the retained earnings in this chapter will be estimated by summing up the statutory surplus reserves and undistributed profits.

Figure 20 shows the trajectory of retained earnings and its components in the past two decades. The undistributed profit has remained the largest component of the retained earnings, and the statutory surplus reserve was trivial compared to it. Total retained earnings increased steadily in the period from 2001 to 2010 and reached a historically high level. Then, the retained earnings dropped significantly from 2011 to 2016 and finally bounced back to the 2010 level. As a percentage of gross investment, the retained earnings became volatile and unstable during the global financial crisis between 2007 and 2011, the percentage then decreased in the following four years, and then started to rise since 2016, when it accounted for nearly the whole of investment. [19] Overall, it was quite small compared with the core capitalist countries, such as that in the UK, the US, Germany or Japan (see, for example, Lapavitsas, 2013).

The undistributed profits as the largest component of retained earnings carry much more weights than the retained earnings. In previous chapters, it argues that the central SOEs acquired great economic clouts by accumulating enormous profits on their own hands. This can be confirmed by the large amount of undistributed profits. These undistributed profits are also highly likely to be the evidence of central SOE's participation in the shadow banking businesses. It is claimed in existing literature that the expansive SOEs have ventured into the real estate sector-- most large SOEs have the ability to provide funding for real estate companies using their own profits (Zheng and Huang, 2018, p. 415).

[19] The gross investment in 2004 and 2019 were negative, thus, the percentage for these two years were negative as well. If these two numbers were not dropped, the percentage would look like a straight line, which would mislead the audience. Therefore, I have removed the two negative number from the data series.

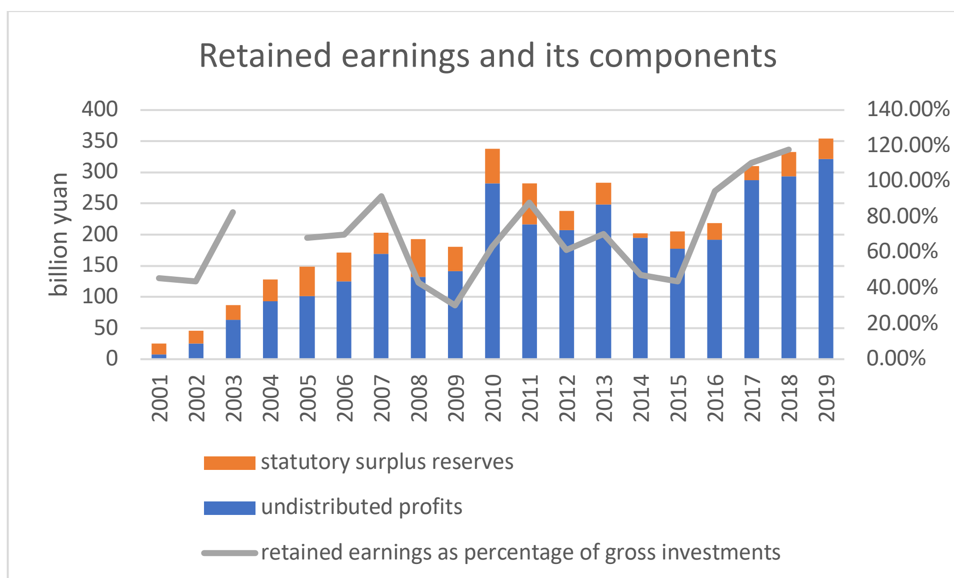

Figure 20 Total retained earnings and as a percentage of gross investments of publicly listed central SOEs, China, 2001-2019.

Source: author's calculation based on data from *Wind*.

5.5 Empirical findings of interest incomes

Existing studies of the financialisation of non-financial enterprises have noticed a simultaneous increase in earnings and expenses from and to the financial market since the late 1980s (see, for example, Aglietta, 2000; Orhangazi, 2008; Stockhammer, 2004). Non-financial enterprises deriving more financial incomes is related to the increased acquisition of financial assets. The increasing financial expenses are associated with the increased transfer of earnings from non-financial enterprises to financial markets in the form of interest payments, dividend payments and stock buybacks (Orhangazi, 2008; Rabinovich, 2019). This tendency has been summarised as "dual movement" by Van der Zwan (2014). Rabinovich (2019, p.738) summarises their findings that non-financial corporations "increasingly engaged in financial accumulation from which they derive a growing proportion of financial income" as "financial turn of accumulation hypothesis". He rejects this hypothesis by providing empirical evidence beyond the financial profits of non-financial enterprises in the United

States from 1950 to 2016, including the structure of assets and flow of funds. This section and the next will deploy his method by using the data of China's publicly listed central SOEs in the period of 2000 – 2018 to identify the changing income composition of these state monopolies.

For the analysis of income composition, financial incomes lie at the heart. Financial incomes for these companies are supposed to include interest income, insurance premiums, and commissions and fees. However, most of these companies do not have or do not report insurance premiums or commissions and fees. So, the interest income is used as the proxy for the financial income. As for the financial expense, it is recorded in the income sheets of company's annual financial reports. Weirdly, it includes the difference between interest expenses and interest incomes, instead of interest expense itself. So, the interest expense is estimated by summing the interest incomes and the difference between interest expenses and interest incomes. The raw data are extracted from income sheets of the publicly listed central SOEs from *Wind*.

Figure 21 shows the interest incomes and expenses for China's publicly listed central SOEs increased steadily during the observed time period, and the growth rate slowed down since 2013. Interest incomes were significantly smaller than the interest expenses in the first two decades of the 21st century. Interest incomes only accounted for roughly 2%-3.5% of total operating incomes, which increased to 4.06% in 2018--the highest level in the twenty-year period. This indicates these SOEs' modest participation in financial activities.

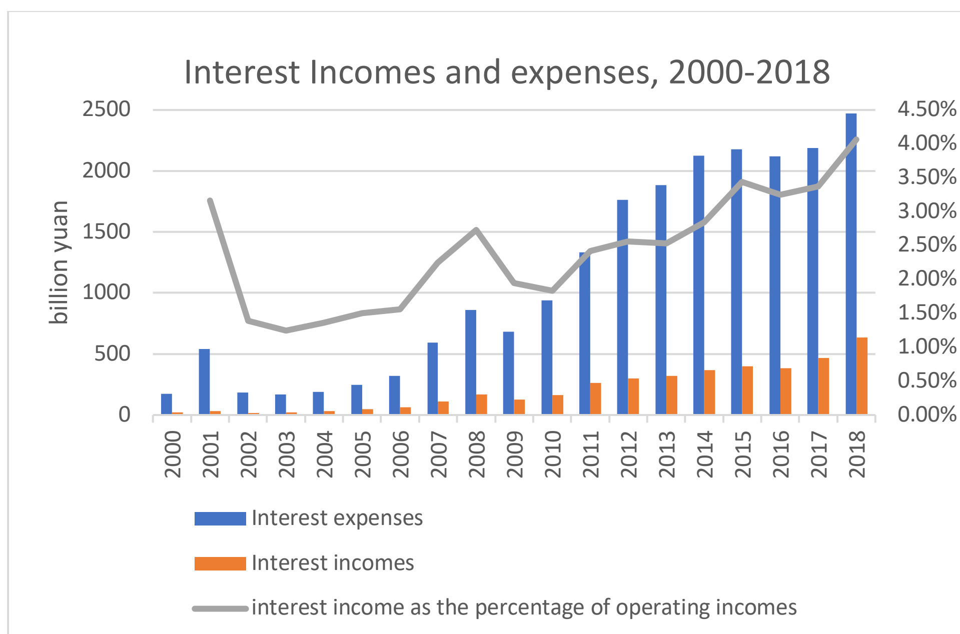

Figure 20 Interest incomes and expenses of publicly listed central SOEs, China, 2000-2018.

Source: author's calculation based on data from *Wind*.

5.6 Reconsidering the empirical results in light of cash flows

As discussed previously, the data that is on net basis can be misleading if the gross uses and gross sources are close in size because the net value can be very small after balancing out each other, which could potentially lead to information loss. In this case, the use of cash flow could remedy this situation. Thus, the data from statements of cash flow for China's publicly listed central SOEs is needed. Specifically, bank borrowing is recorded in the cash flow of financing activities whereas trade credit is not directly reported, but this piece of information is included in the cash flow of operational activities. The data prior to 2005 was dropped because of the large missing values, thus, the series for cash flow started from 2006. This sub-section will first present the cash flow of financing activities and that of operating activities from both uses and sources and then compare and contrast the conclusions that are made by using the balance-sheet data which is on the net-basis. It turns out that the gross terms

roughly confirm those conclusions. Specifically, these central SOEs have not been found distant from banks. Although they have been involved in more financial activities, they still focus on their core businesses as the cash flow from operational activities was significantly higher than that from financial activities. These findings do not support financialisation of these central SOEs.

5.6.1 Cash flow of financing activities

There are four sources of financing activities: cash flow from borrowing, including short-term and long-term borrowing from banks or other financial institutions; cash flow from financial investments, including the capital that the company raised through their investors; cash flow from bond issuing and cash flow from other financing activities, including interest incomes, borrowing from non-financial enterprises and individuals, gaining government subsidies, amongst others. Figure 22 shows the composition of sources of financing activities for China's publicly listed central SOEs in the years between 2006 and 2019. It is clear that bank borrowing accounted for more than 80% of total sources of financing in the years between 2006 and 2019, confirming the argument that these central SOEs borrows heavily from banks, which is different from the common trend that has been observed in the core capitalist countries where the non-financial enterprises were found to be distant from banks. This finding also confirms bank's critical role in SOE's operating and financing behaviours.

There are three main ways of using funds in financing activities: cash flow used for debt repayment, including repayment for bank borrowings and bonds; cash flow used for dividend distribution, profit distribution and interest expenses; and cash flow used for other financing activities, including commission payment for financial institutions, shares, bonds, and

securities buybacks, amongst others. Figure 23 shows that the debt repayment accounted for more than 80% of total uses in financing activities between 2008 and 2019. The debt repayment includes both the repayment for bank borrowings and for bonds, but from the information of the sources, it could be seen that the bank borrowing was significantly larger than bond issuing, so, the largest proportion of debt repayment should be contributed by repaying the bank loans. Another important finding is that the uses in dividends and profit distributes stabilised at the level of around 10% of total uses for financing activities, providing additional support for rejecting the hypothesis of China's central SOE's shift to the "shareholder values".

To put the uses and sources together in Figure 24, it looks more evident that the "dual movement" happens in China's central SOEs have not been distant from banks--- bank borrowing accounts for more than 80% of the total sources of financing activities, and the debt repayment accounts for pretty much the same of the total uses of financing activities. It is also in line with the increasing interest incomes and expenses which is shown in section 5.5. However, considering the small proportion that the interest income is in the operating income, as well as the central role that played by the bank credit, the dual movement does not imply the emergence of financialisation. It only reflects something no more than the credit expansion.

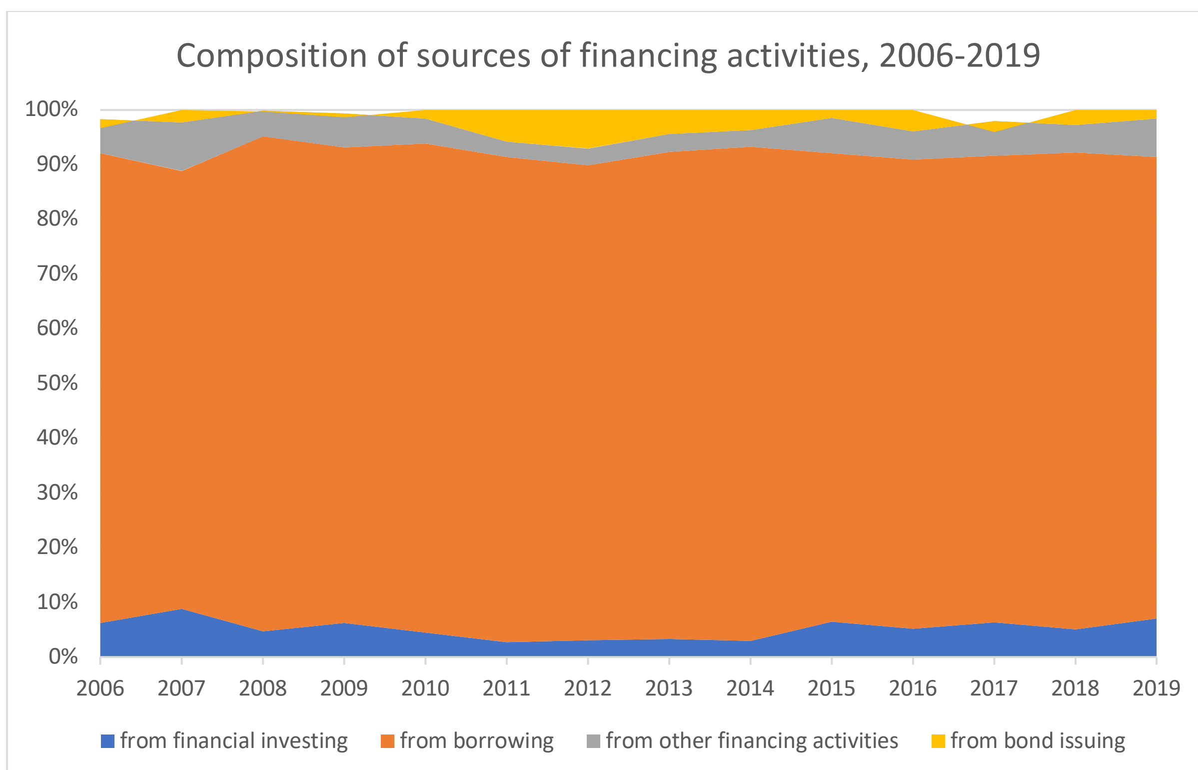

Figure 21 Composition of sources of financing activities, 2006-2019.

Source: author's calculation based on data from *Wind*.

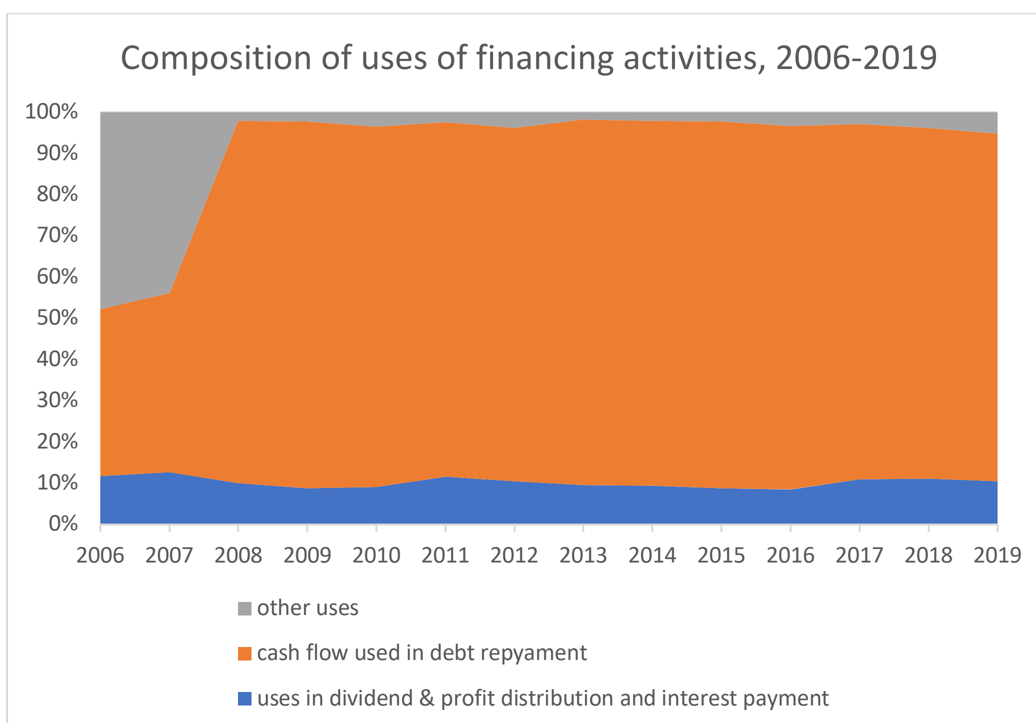

Figure 22 Composition of uses of financing activities, 2006-2019

Source: author's calculation based on data from *Wind*.

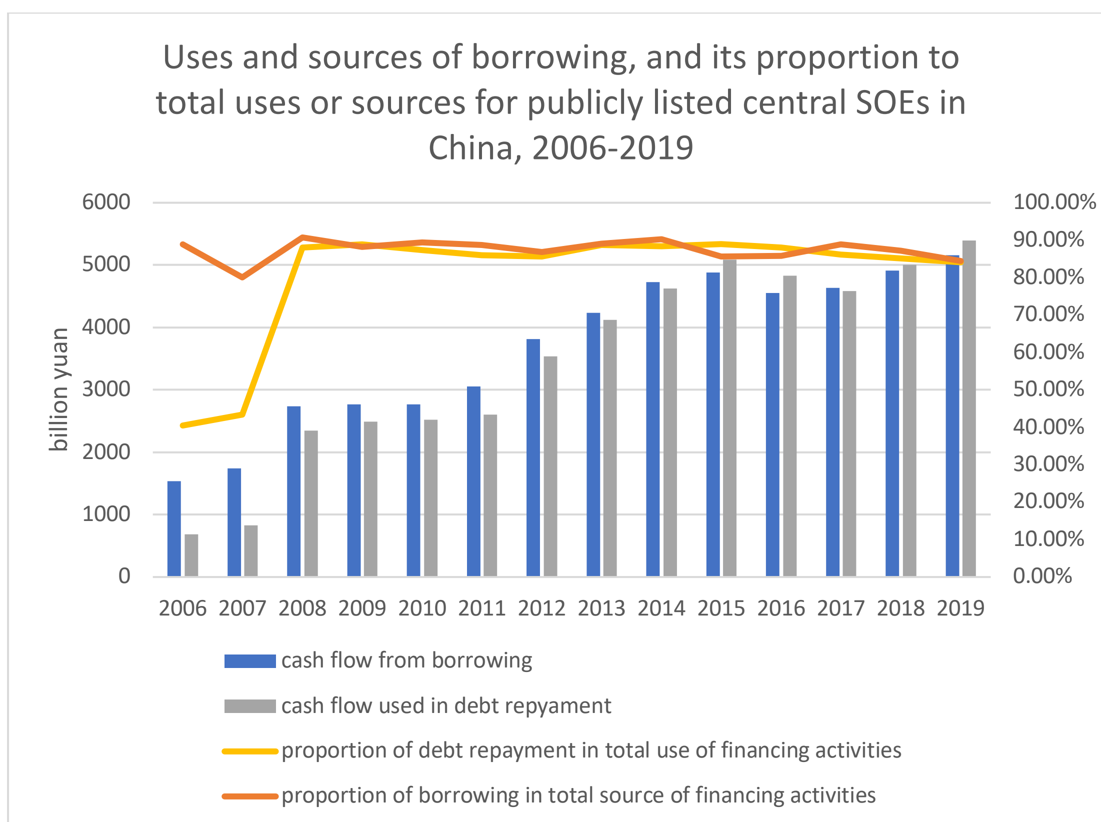

Figure 23 Uses and sources of borrowing and its proportion to total uses or sources for China's publicly listed non-financial central SOEs, 2006-2019.

Source: author's calculation based on data from *Wind*.

5.6.2 Cash flow of operating activities

The largest component of the sources and uses of operating activities is the product sales and services, and the sources of operational activities were always larger than the uses, as it is shown in Figure 25. The comparison between the cash flow of financing activities and operating activities shed light on the uses of cash of these central SOEs, as shown in Figure 26 and 27.

It is evident that cash flow from operating activities was much higher than that from financing activities, and it was also the case in terms of the uses as shown in Figure 26 and 27. They also

indicate that the cash flow that generated from the central SOEs' daily operation was significantly larger than that of financing activities, reflecting the non-existence of the excessive financial operations, and further implying the non-existence of financialisation of central SOEs at the current stage.

Although there is no way that the amount of trade credit could be isolated from this cash flow information, the exact amount of the trade credit cannot be worked out. There must be some that is used for the repayment of the trade credits in the cash that used for operational activities, and similarly, there must be a proportion that comes as other's repayment of these central SOEs receivables in the cash flow from operational activities. The overall large amount of cash flow uses and sources of operating activities were consistently larger than that of the financing activities, which could roughly confirm the evidence that the publicly listed central SOEs had used large amount of trade credits while had easy access to bank credits in the first twenty years of 21st century.

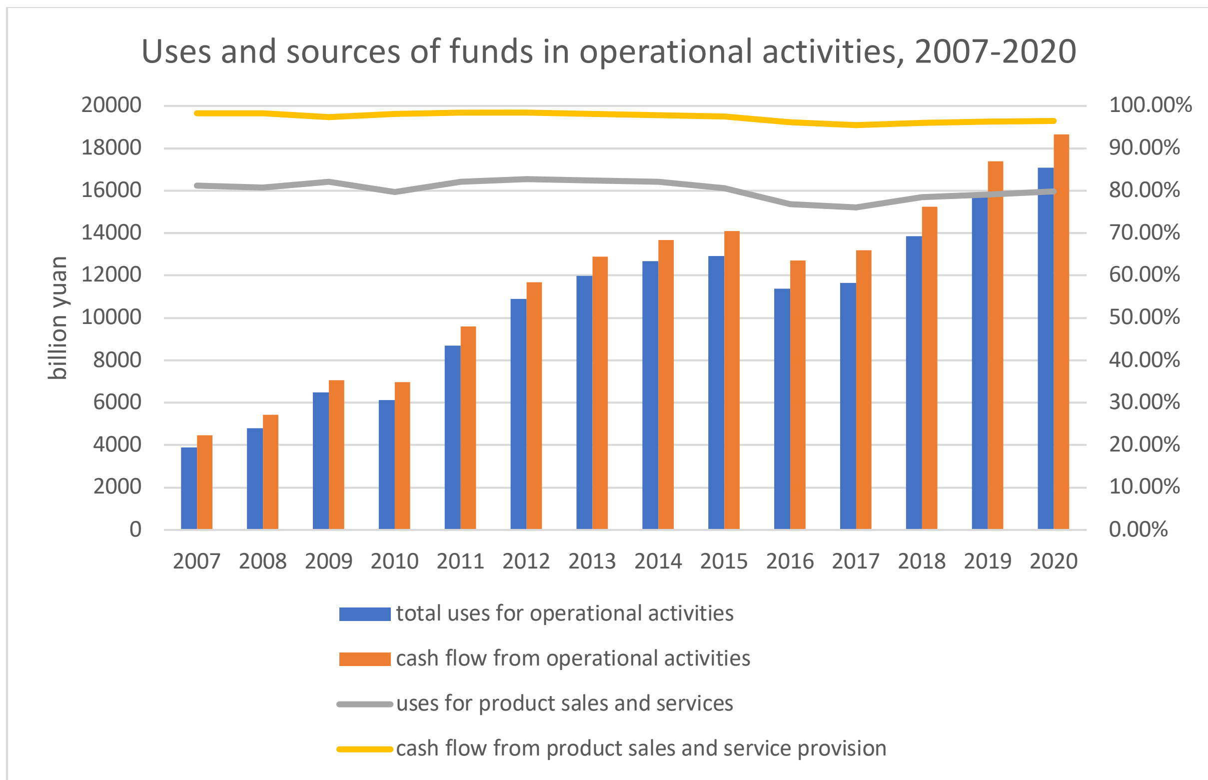

Figure 24 Uses and sources of funds in operational activities for China's publicly listed central SOEs, 2007-2020.

Source: author's calculation based on data from *Wind*.

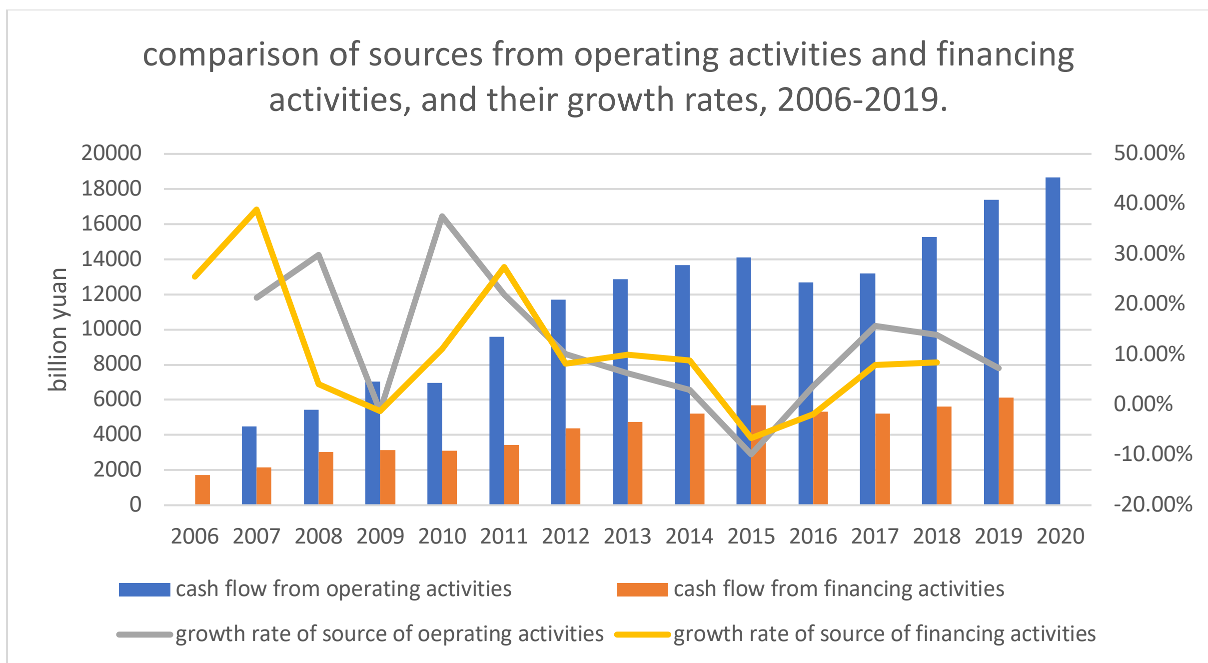

Figure 25 Comparing sources from operating activities and financing activities, and their growth rates, 2006-2019.

Source: author's calculation based on data from *Wind*.

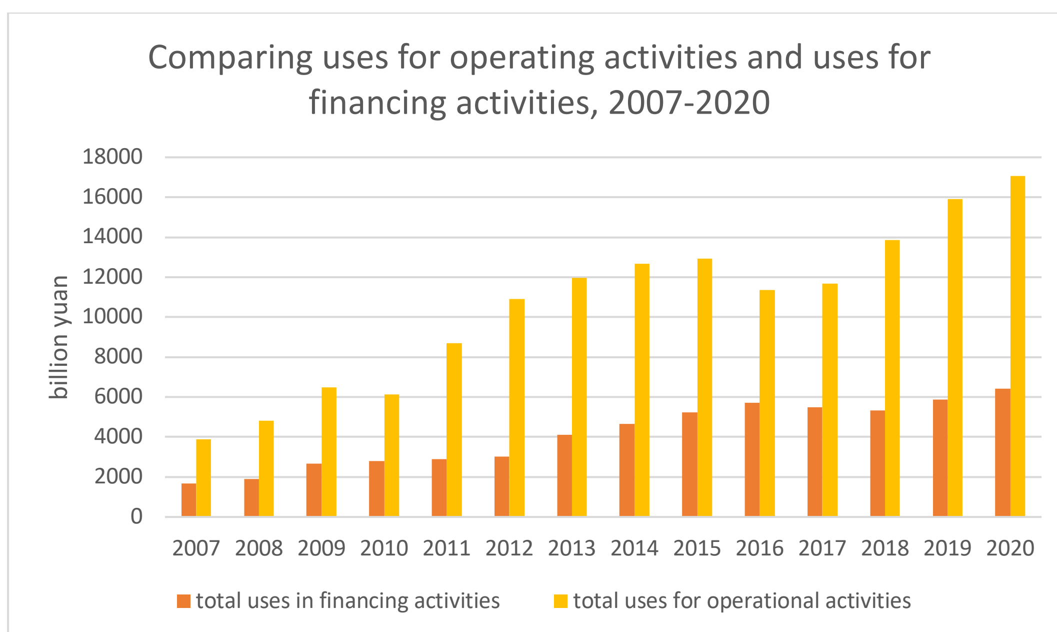

Figure 26 Comparing uses for operating activities and uses for financing activities, 2007-2020.

Source: author's calculation based on data from *Wind*.

5.7 Discussion and conclusion

So far, the financing pattern of Chinese publicly listed central SOEs outlines a completely different picture from that of the big businesses in the mature capitalist countries. To sum it up, the balance between the internal and external finance has not changed fundamentally between since the 2000 and 2017 as shown in Figure 28. While monopolistic enterprises in the US and the UK had larger amount of retained earnings, that of China's state monopolies were consistently lower than the bank borrowings and trade credits, let alone the total amount of the external funds, except for 2018 and 2019, as shown in Figure 29.

The state monopolies borrowed heavily from banks and used an increasing amount of trade credit at the same time, which is very unusual. To make it more different and peculiar, the

publicly listed central SOEs were the net trade credit recipients, instead of trade creditors. Even though they have acquired strong financial skills through their long-term stable relations with banks and through their newly developed financial arms within the business group, these skills have not been exercised in the market as the evidence shows that the market finance only accounted for roughly 1/3 of the equivalent of bank borrowings or trade credits.

Regardless of the change of the balance between internal and external, the increasing amount of internal and external finance did not transfer into the increase in the investment. These publicly listed central SOEs have experienced a decrease in the gross and net investment since 2009 as shown in Figure 9, implying that these external finances were not sufficiently used in the reinvestment and expansion of the enterprises, but the operating income and profits both saw a rise.

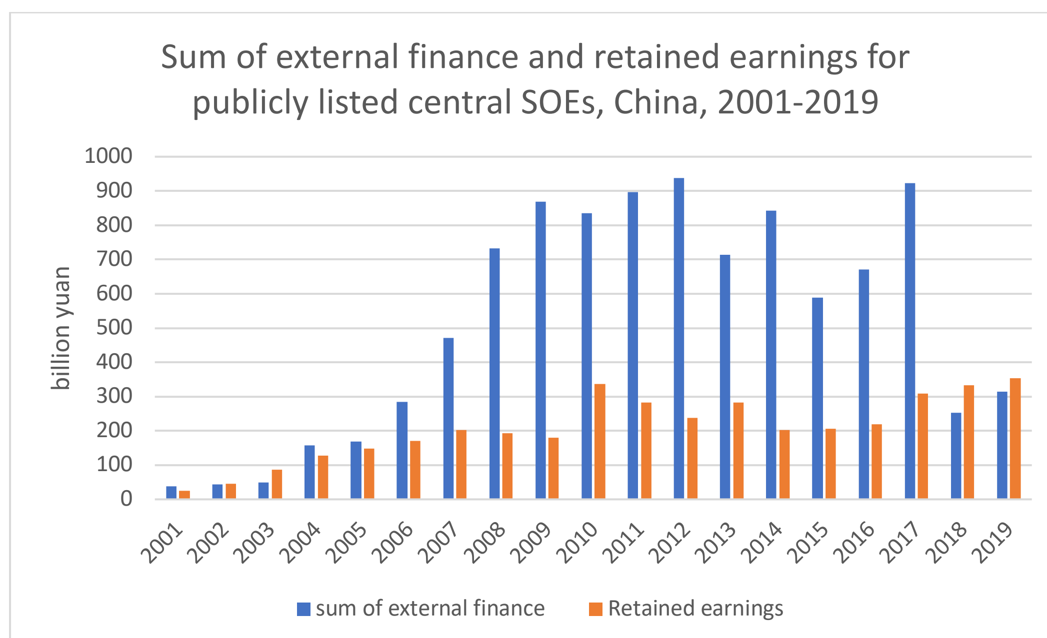

Figure 27 Sum of external finance and retained earnings for publicly listed central SOEs, China, 2001-2019.

Source: author's calculation based on data from *Wind*.

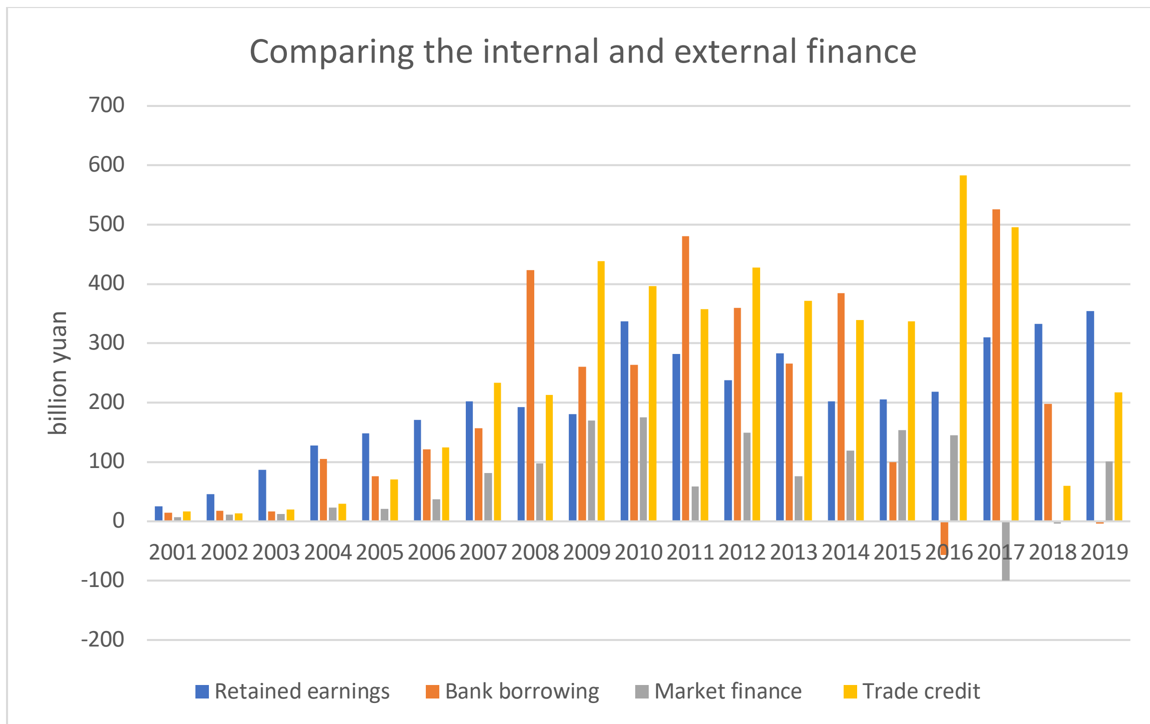

Figure 28 Comparing the internal and external finance for publicly listed central SOEs, China, 2001-2019.

Source: author's calculation based on data from *Wind*.

To identify financialisation, it is important to know not only the change of balance between the internal and external finance, but also how exactly these state monopolies handle different types of finance. Bank credits for SOEs have been extensively studied in the existing literature, but the trade credits need further research, providing its rapid increasing and large amount for the Chinese state monopolies.

These central SOEs do not always use the trade credit as a tool of financing, rather they use it increasingly as a way of cash flow management and possibly a way to generate profits. As stated in previous chapters, central SOEs are privileged in getting bank loans whereas it is the opposite for the small and medium sized enterprises (SMEs), so the latter have to seek informal finance as one of their sources of funds (Ge and Qiu, 2007; Wu, 2017). The difficulty of getting payments on their trade credits made their financial situations even worse. In the

case of China's publicly listed central SOEs, they take advantage of the difference between various lending rates by borrowing from banks at a relatively low rate, and then lending to its member enterprises at a higher rate via the in-house financial arms to earn an interest margin. For the lending and borrowing that happen in the same business groups, they are documented under the trade credit in accounting bookkeeping. This has been supported by the existing literature that SOEs redistributed their excessive amount of loans to other less privileged firms via trade credits (Cull et al., 2009; Gilina Hale and Long, 2011).

As mentioned in section 5.3 in the trade credit section, the publicly listed central SOEs take advantage of their market power to buy products on credits from their suppliers. However, this is not the entirety of the problem. These central SOEs purchase products from their suppliers on credit and then pay with various commercial papers or innovative financial derivatives developed by their own in-house financial institutions, which exactly confirms how the commercial bills emerged at the first place. This, again, is how the central SOEs take advantage of their monopolised position in the economy. As much as they prefer the cash payment, the suppliers have to accept alternative payments because they could get nothing otherwise, according to the concrete factory owner. The most frequently used commercial paper is commercial acceptance bill, a non-interest-bearing commercial paper that issued by the debtor via commercial banks and accepted by a non-bank payer, under which the payer shall unconditionally pay the determined amount to the payee or the holder of the bill on a designated date.

There are various kinds of commercial papers and notes. The two most frequently used are commercial acceptance bills and bank acceptance bill. Creditors would prefer the bank

acceptance bill because the bank would pay them on the debtor's default. However, the bank acceptance bills are gradually replaced by commercial acceptance bills and other forms of financial derivatives. When default happens on these commercial acceptance bill, there is no enforcement measures forcing the debtors to pay on the designated date because the commercial acceptance bill is purely based on the trustworthiness between two parties, leaving the creditor nothing but an empty promise. With the help of their own financial arms, the state monopolies pay for their trade credit to their disadvantaged suppliers with their own financial instruments, such as supply chain finance or others, which creates huge difficulties in cashing in the funds for the suppliers as these instruments are normally tied with certain banks, so that the suppliers would have to open an account in that bank if they do not have it previously.

Paying by commercial bills and other financial derivatives are certainly favourable to the central SOEs as they only endorse or pass one promise to pay to the suppliers as its own payment for inputs. They successfully removed themselves from several lending-borrowing relationship by transferring the lending-borrowing relationship of itself with a third party to the relationship between different third parties. So, the difficulties of getting cash payment are now passed to the suppliers who ideally could do the same. But in reality, it is not always possible because whether an enterprise could use commercial bills as their means of payment depends on their relative positions in the industry as well as the competitive pressure they face. As mentioned previously that the non-state enterprises which have business relations with these large central SOEs normally have much less market power and face larger market competitiveness. The heavy use of trade credit essentially increases their financial constrain.

According to the empirical research, The late payment of the trade credit has already been recognised as a contributor of SME's distress and failure (Wu, 2017).

The informal talk with the chief accountant of the aforementioned concrete factory in March 2021 provided evidence for it. She suggested that 95% of their received commercial acceptance bills faced late payments in 2021.[20] To keep the business running with enough cash flow, the factory had to use an extra person to ensure the payment of the trade credits, which added more cost to the business at its hardship. In the case of default, they had to sue their debtors, which is not usual to see in China's context. There are two main reasons for it. The first is embedded in the asymmetric market power of the trade creditor and the trade credit debtor. The debtor who pays the creditor with the commercial acceptance bills are those enterprises which have high credibility, healthy cash flow and a strong ability to repay. In China's context, they are mostly large enterprises. In the construction industries that my interviewees are in, most of their trade credit debtors are SOEs within the handful of mega SOE business groups, whereas the creditors are mostly private SMEs that are in competitive markets, which have only limited market powers compared with these SOEs. The second reason is that their business relations would be put to an end if the creditor sues the debtor, which most of the non-SOE creditors could not afford.

As a piece of evidence, the concrete factory sued 12 of its debtors in 2021, and the value involved accounted for 55% of its total receivables. Amongst the 12 sued companies, 95% of them are SOEs. By suing the debtors, the factory owner was hoping to get its advances back,

[20] The proportion might not be the accurate number as she tends to use large but not necessarily the exact number to describe the seriousness of the situation.

but at the same time, the enterprise must also prepare itself to lose clients, or even exit the market because their business relations were already sabotaged by this legal action. Of course, this is an extreme case for multiple reasons, including the economic hardship caused by COVID-19 and its restrictions, as well as the tightened regulation in China's real estate sector. But on average, according to the chief account of the concrete factory, there were about 15% of the commercial acceptance bills could not be paid in full on maturity before 2020. In July 2022, I had the last talk with the chief accountant to update their situation. She told me that the legal actions had their effects. Unless the creditor had serious financial difficulties, most of them have paid back their advances. But as expected, they had lost them as future clients because of the legal actions.

This piece of evidence confirms the empirical findings that has been drawn from the public data, and at the same time indicates the strong market power of central SOEs over non-state SMEs. The informal payment also signifies the extensive use of shadow banking instruments that will be further discussed in next chapter.

To summarise, these empirical evidence does not suggest financialisation of these state monopolies. First of all, the balance between the external and internal finance did not change until 2018. [21] While the retained earnings increased steadily, the external finance rose more rapidly, making the retained earnings significantly smaller than the external finance, and smaller than the components of the external finance, such as bank borrowings and trade

[21] As stated in Section 5.2 that the data before 2008 were in relatively low quality and the number of publicly listed central SOEs had quite large difference from the following years. Thus, the change of balance between internal and external finance prior and post 2008 did not necessarily indicate qualitative transformation of these enterprises. All the changes before and after 2008 has to be interpreted with great caution.

credits. Until 2018, the components of external finance collapsed, making their balance change. They have definitely become increasingly involved in the financial process on an independent basis, but this is different from the US-type financialisation where the internal finance was significantly higher than the bank borrowings and the market finance.

Secondly, the pattern of external financing was extraordinarily peculiar as the central SOEs are exercising more power on financial realm, transforming towards financially sophisticated operators. However, the transformation is quite different from that of the western large enterprises which turn to market finance and prioritise the shareholder value. The transformation of Chinese large enterprises shows its unique Chinese characteristics -- using large amount of trade credits and bank credits with a stably low share of cash flow to pay dividends to shareholders. At the same time, they took advantage of their easy and cheap access to bank credits and the convenience in lending member companies within the same business group to arbitrage in the interest market to earn financial profits, which is proved by the increasing financial incomes. In this sense, these large central SOEs has transformed slightly towards the financially sophisticated operators, but the core of their financial operation stays credit-centric. The US-type financialisation has not yet appeared in China's state monopolies as they did not exhibit more reliance on the market finance for funding, nor were they distant with banks. Rather, they kept close relation with banks and showed great ability to generate trade credits, showing a fair degree of underdevelopment of its financial operation. On the other side of the same coin, it also suggests that the non-financial large enterprises are more closely integrated with the financial system, despite its different way from the core capitalist countries.

Chapter 6. The transformation of Chinese financial system

6.1 Introduction

Starting from a soviet-type of mono-bank system in the 1970s, Chinese financial system has developed into a massive system with the western-like market structure after a forty-year reform. With the full set of capital market and money market and various financial institutions that play in these fields, banks are still standing firmly in the centre of Chinese financial system. Not least because bank loans, including Renminbi-denoted and foreign currency-denoted bank loans accounts for majority of total social financing from the financial sector to the productive sector, and more loans were hidden as alternative accounting subjects (Sun, 2020). Additionally, banks are proactively involved in many market operations, such as bank-trust cooperation and bank-security cooperation and so on, taking the responsibility of the capital or the money market.

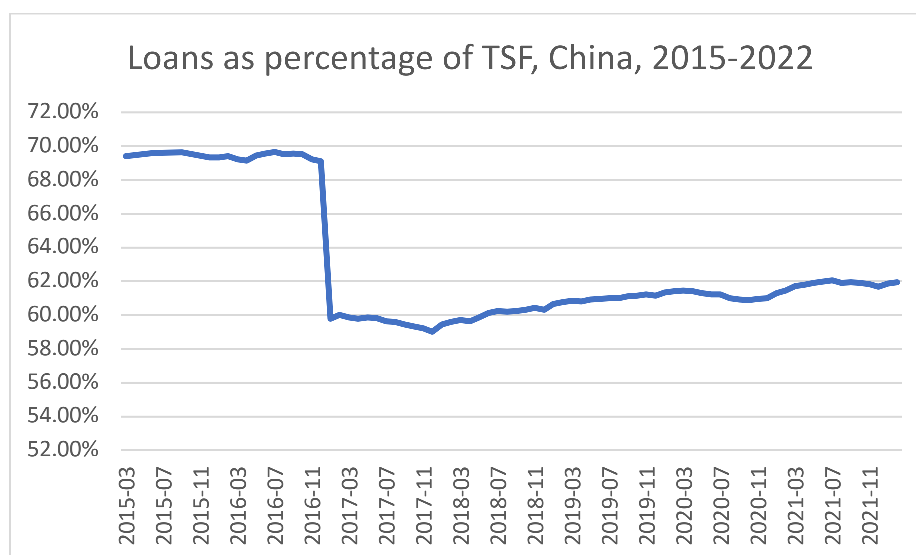

Figure 29 Renminbi denoted loans, as percentage of total social financing of China, 2002-2019.

Source: author's calculation based on data from *Wind*.
Note that loans here equal the sum of RMB-denoted and foreign currency-denoted bank loans.

The state is not involved in the day-to-day operation of the state-owned financial institutions, but the state's power prevails in the financial system. Top leaders of large financial institutions are part of the *nomenklatura* system which is subject to the Party's appointment, removal and evaluation. The same as the centrally managed non-financial SOEs, the major decisions of merge and acquisition, insolvencies among others have to be conducted upon SASAC's approval. Financial institutions are under the regulation of various state regulatory bodies, such as the central bank, i.e., People's Bank of China (PBOC), CSRC and CBIRC, and they have to be in coordination with the national development goals and central planning. [22] So far, the nature of the Chinese financial system, thus, has been revealed—that is bank-based, partially liberalised and state strongly presented.

The bank-based and state-controlled financial system, on the one hand, makes room for long-term investment planning, but on the other hand, hinders the growth of the market-based finance. The state not only could control the interest rate, but also could directly intervene the distribution of the bank credit across different economic sectors. With the liberalisation of the interest rate after the Opening and Reform, the deposit rate ceiling, lending rate floor and the loan quota were removed, but the interest rate was still under window guidance. Since the 2008 Global Financial Crisis, direct credit allocation was in the form of stimulus package or reloans becoming the typical Chinese centralised way of providing liquidity. The direct credit creation by the central authorities also became an important monetary policy instrument.

[22] CBIRC was established in March 2018 by merging China Banking Regulatory Commission (CBRC) and China Insurance Regulatory Commission (CIRC). It then got dissolved in 2023 and was finally replaced by State Administration of Financial Supervision and Administration on 18th May 2023.

The strong presence of the state in the financial system can be detrimental to the activeness of the financial market in certain ways. Because of the state-monitored interest rates, the money and the capital market could not behave as they unusually do in liberalised financial systems. And there are various restrictions on the strategy and amount of high-frequency trading, on entry and operation of foreign capitals and investors, so on and so forth. Nevertheless, capital will always find its way to its best place. With the coexistence of state intervention and partially liberalised interest rates and markets, Chinese financial market and banks started to transform into a very peculiar form of shadow banking, or more precisely, into “banks in the shadow” (Sun, 2019; Wang et al., 2019). State’s intervention in the financial sector and the central role of the bank in the financial system are reinforcing each other.

Very much like it in the industrial sector, it is still the state that creates and runs large capital in the financial sector. The state-owned banks have undergone the shareholding reform since the Opening and Reform, transforming themselves to commercial banks. Central Huijin, the holding shell of the large state-owned financial institutions, was established in 2003 as the shareholding entity on behalf of the state. Thereafter, the way that the state controls the financial institutions transformed, too, as part and parcel of the shareholding reform, from direct state ownership to holding the majority of their equities. So far, it has been clear that the way that the state manages its financial capital has been increasingly through financial means and followed the logic of the market.

This chapter focuses on the nature of China’s financial system and the transformation of the banking sector with the rise of finance, aiming to identify financialisation through the changed

economic conduct of the financial sector, as well as the changing relations between the financial sector and other actors in the state sector, namely, SOEs and governments. The remainder of this chapter will proceed as follow: section 6.2 goes back to the pre-reform era to introduce how the banking sector was evolving into a multi-tiered ones from a mono-bank system. This is considered as the first transformation of China's financial sector. The bank's central role in the current financial system is partially inherited from the Soviet-type legacy. Within the banking sector, state-owned banks are the pearl of the crown. Characteristics of state-owned banks are illustrated in section 6.2.2. Section 6.3 introduces the state-monitored interest rates which are regarded as the culprit root for underdeveloped money and capital market. They are introduced in section 6.4. Section 6.5 follows how exactly the state manages the financial sector. Building upon the five sections, section 6.6 focuses on how the banking sector transformed into "banks in the shadow" with the rise of finance, which is regarded as the second transformation of China's financial sector. Finally, section 6 concludes.

6.2 Bank's central role in the financial system

6.2.1 The multi-tiered banking sector

At the beginning of the reform era in the late 1970s, there was barely any genuine financial institution in China, not to mention the financial sector. Financial system was fully absorbed into the fiscal system (Zheng and Huang, 2018). PBOC was the only "bank" in China under the planning system, and served as no more than a "cash agent for the government", allocating all the resource to the real economy under the mandatory central planning (Bottelier, 2009, p. 53; Lo et al., 2011, p. 269). [23]

[23] Other scholars refer it as "accounting office in the Ministry of Finance" (Zheng and Huang, 2018, p. 345). The wordings are different, but the idea is the same.

Before the establishment of the commercial banks, PBOC was the main credit provider in China's financial system. To establish a competitive banking sector, the mono-bank system was transformed into a two-tier banking system by stripping out all financial intermediary functions from PBOC, which were taken over by the newly established specialty banks. By 1984, all commercial activities were separated out, and each of the state-owned specialty banks specialised on one or several specific businesses. Specifically, Agriculture Bank of China (ABC) was established in 1979, specialising on providing financial support to rural reforms and rural development. Bank of China (BoC) was established in the same year by taking over the businesses related to international transactions from PBOC to mainly support foreign exchange and foreign trade. China Construction Bank (CCB) was separated from the Ministry of Finance (MOF), serving the needs of the long-run capital-intensive developments. Industrial and Commercial Bank of China (ICBC) picked up the commercial activities of PBOC to serve the rest of the economy. These four state-owned banks then were called "the Big Four".

At the same time, three policy banks were established, namely, China Development Bank[24], the Export-Import Bank, and the Agricultural Development Bank[25]. Since then, PBOC has begun to transform into a proper central bank and has entrusted with macroeconomic policies (Zheng and Huang, 2018, p. 346).

Ten years later, the specialty banks started to transform into commercial banks, and promulgation of *Law of Commercial Banks* in 1995 created necessary conditions for it. Thereafter, the Big Four began to expand their business scopes without simply focusing on their specialties. And they were no longer managed in administrative ways by the state, rather, they were required to operate in accordance with the market mechanism -- be responsible for own risks, losses and profits (*zizhujingying, zidanfengxian, zifuyingkui, ziwoyueshu) [自主经营，自担风险，自负盈亏，自我约束].*

[24] China Development Bank (CDB) was established as a policy bank and experienced a short-term transformation into a to commercial banks post-2008. Finally, its role as a development finance institution was re-clarified in 2013 by the Ministry of Finance (MOF). Compared with policy banks, development finance institutions have a longer term of investment, higher investment risks, and the autonomy of selecting the investment project, whereas the policy banks primarily serve as the tool of policy financing. In this sense, CDB provides medium- to long-term financing facilities that serve China's long-term economic and social development. It is now the largest development financial institution in the world, as well as the largest bank in China in terms of providing medium- and long-term credits and issuing bonds. Further details can be retrieved from MOF: http://www.mof.gov.cn/zhengwuxinxi/caijingshidian/jjrb/201504/t20150413_1215747.html, last accessed on 14/05/2019; and the official website of CDB: http://www.cdb.com.cn/gykh/khjj/ ,last accessed on 14/05/2019.

[25] The Export-Import Bank (EIB) and the Agricultural Development Bank (ADB) are two state-funded and state-owned policy banks with the status of an independent legal identity, relying on the state credits to support China's foreign trade and 'agriculture, rural areas and peasants' issues (*sannong wenti*) [三农问题], respectively. They are not profit-oriented banks. ADB overlapped with commercial banking business post-2004, and so in 2013 it was required to clarify the boundaries of the policy-oriented businesses and commercial bank business. After 2013, both policy banks (EIB and ADB) were required to meet the condition of capital adequacy ratio for their sustainable development. Information can be retrieved from the news page of Ministry of Finance: http://www.mof.gov.cn/zhengwuxinxi/caijingshidian/jjrb/201504/t20150413_1215747.html, last accessed on 14/05/2019; and official website of EIB and ADB from: http://english.eximbank.gov.cn/tm/en-TCN/index_617.html and http://www.adbc.com.cn/n4/index.html, respectively, last accessed on 14/05/2019.

The non-performing loans (NPL) became the pressing issue at the end of the 1990s. In 1997, NPL for the Big Four reached 25%, which was large enough to claim the insolvency of the Chinese banking sector according to the western benchmark (Lardy, 1998) [26]. Throughout the 1990s, the state-owned banks mainly focused on dealing with the bad loans that emerged with SOE's bankruptcy and restructure. The unprecedentedly high ratio of NPL was one of the legacy that left by SOE's soft budget constraint (García-Herrero et al., 2006; Zheng and Huang, 2018).

The three major tasks of state-owned bank's reform thereafter became corporatisation, marketisation, i.e., listed onto the stock market and to establish the modern corporate governance, as well as to reduce NPL. As the solution, four asset management companies (AMCs) were set up in 1999 to strip the Big Four's NPL for the equivalent of $170 billion to convert them into equity (García-Herrero et al., 2006; Zheng and Huang, 2018). They were to buy up bad debts of the Big Four and dispose of them over a ten-year period (Ma and Fung, 2002). Table 1 shows the match.

In 1996, variegated joint-stock banks with various ownership type sprung up in the rehabilitation of the market, finally the two-tier banking system upgraded to a multi-tier one. Joint-stock commercial banks and the city commercial banks newly emerged in the mid-1990s, becoming increasingly important components of China's banking sector. Joint-stock commercial banks are partially owned by local governments and SOEs, with a rising share of private ownership, and sometimes foreign ownership. The city commercial banks are formed

[26] The ratio was even reportedly higher in other sources, see (García-Herrero et al., 2006, p. 308).

by restructuring and merging urban credit cooperatives, which are much smaller in terms of the size of assets (García-Herrero et al., 2006).

After the major restructure, the multi-tier banking system in China had finally established and lasts up until today. Currently, the central bank, i.e., PBOC is on the top of the multi-tier banking system, then follows three policy banks. The next layer is constituted of the Big Four, which had already expanded to six main state-owned commercial banks in recent years with the Bank of Communication (BOCOM) being the fifth largest state-owned commercial bank and Postal Saving Bank of China (PSBC) being added to the list in 2012.[27] The next lower tier consists of 12 national joint-stock commercial banks, and then follows 1262 regional/city joint-stock commercial banks. The bottom levels are made up of 965 rural cooperative banks (Sun, 2020). Besides, there are also 17 private banks and a number of foreign subsidiary banks, and other companies with banking operation licences, such as assets management companies, money brokage companies and trust companies as of the end of 2017 (ibid).

Table 1 China's Asset Management Companies and matched SOCBs in terms of NPL transfer.

Asset Management Company	Corresponding SOCBs
China Huarong	Industrial and Commercial Bank of China (ICBC)
China Great Wall	Agricultural Bank of China (ABC)
China Oriental	Bank of China (BoC)
China Cinda	China Construction Bank (CCB)

Source: Ma and Fung (2002, p.1)

[27] When it comes to the state-owned commercial banks, it is normally not included PSBC.

6.2.2 Characteristics of state-owned banks

state-owned commercial bank's position in the financial sector mirrors that of SOE in the real economy. As the state asset concentrated in the large centrally managed SOEs, the assets in the banking sector are concentrated in the five largest state-owned commercial banks, as Figure 31 shows below. Assets of five largest banks always accounts for more than half of the total commercial assets. It is higher than the five-bank concentration of the US, but lower than that of the UK in the years after 2017. [28]

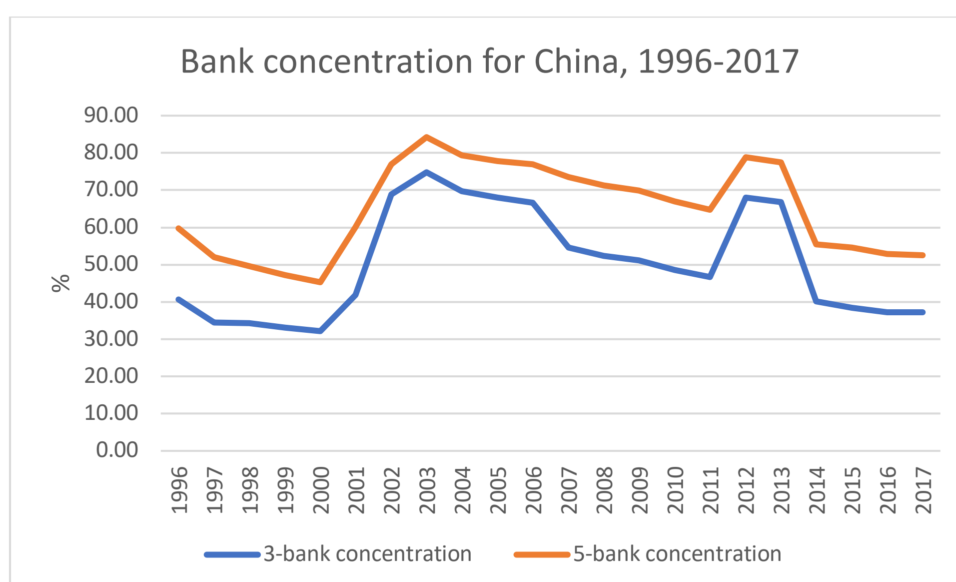

Figure 30 Bank Concentration of state-owned banks in China, 1996-2017.

Source: World Bank, retrieved from FRED, Federal Reserve Bank of St. Louis.

In terms of the profitability, state-owned commercial banks not only outperform other banks in China, but they are also among the most profitable companies in the world. [29] Three of the Big Five were on the list of 10 most profitable companies in 2021. The net profits of the whole

[28] Data is retrieved from FRED, Federal Reserve Bank of St. Louis, available from https://fred.stlouisfed.org/searchresults/?st=concentration,last access on 30 March 2022.
[29] Fortune Global 500 Ranking for Most Profitable Companies, 2021, available at https://fortune.com/global500/2021/search/?fg500_profits=desc , last access on 10 March 2022.

banking sector were around 2% of China's GDP, which is even more than China's annual military expenditure, as shown in Figure 32. [30] To put it in a comparative context with the US, the return of assets (ROA) of the US banking sector was systemically higher than that of China before 2006, and it reversed in 2007, and then the ROA of US and Chinese banking sectors were pretty much the same in the next ten years, as is shown in Figure 33 below. In China, the net interest margin for banks was consistently lower than that of US banks, even during years when Chinese banks were more profitable. This is shown in Figure 34.

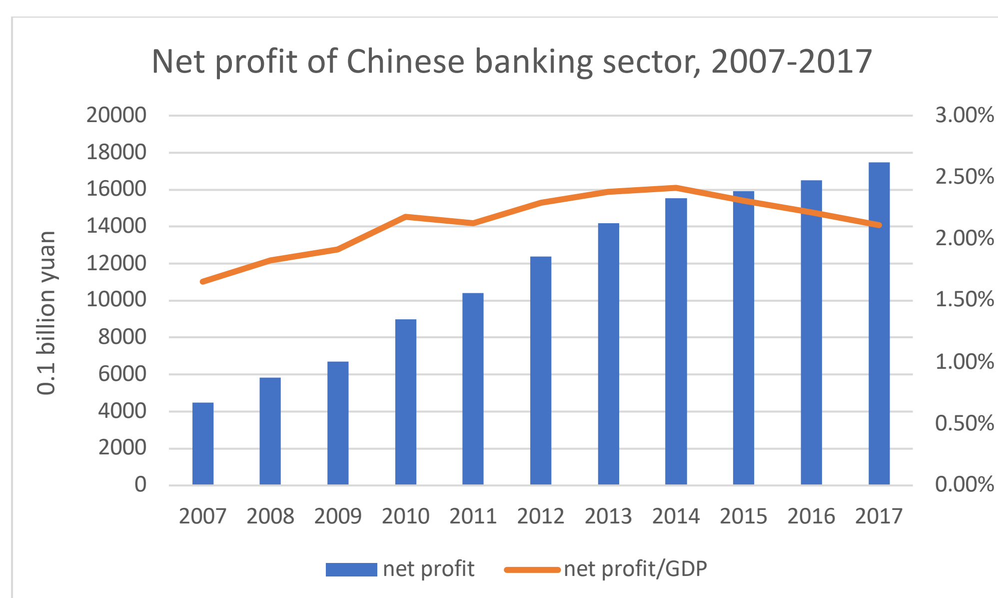

Figure 31 Net profit of banks in China, 1996-2014.

Source: China Bank and Insurance Regulatory Commission and Financial Statistic Yearbook (2011).

[30] China's annual military expenditure has been no larger than 2% of its GDP since the mid-1990s. The data can be retrieved from the World Bank, available at https://data.worldbank.org/indicator/MS.MIL.XPND.GD.ZS?locations=CN, last access on 17 March. 2022

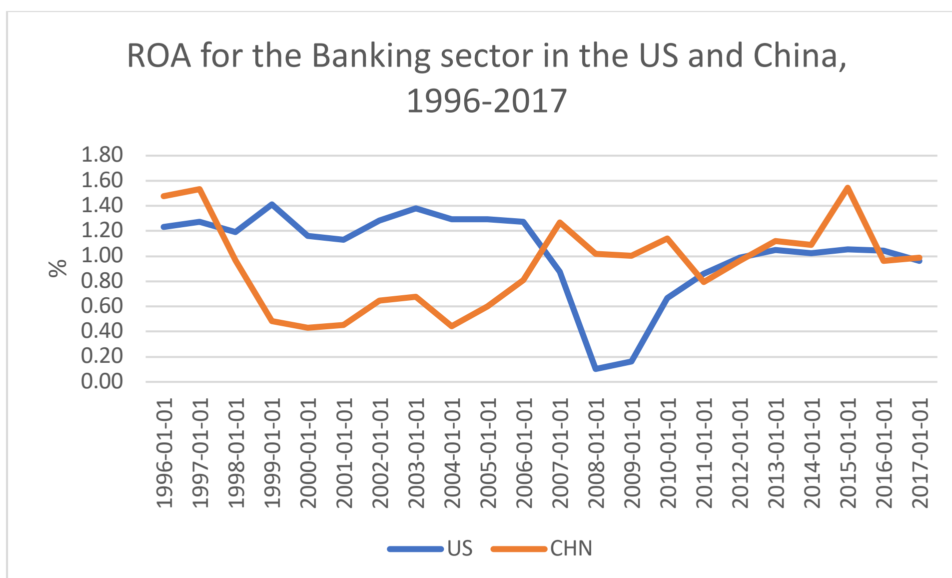

Figure 32 Return on Assets (ROA) of banks in China and in the US, 1996-2017.

Source: Federal Reserve Bank of St. Louis.

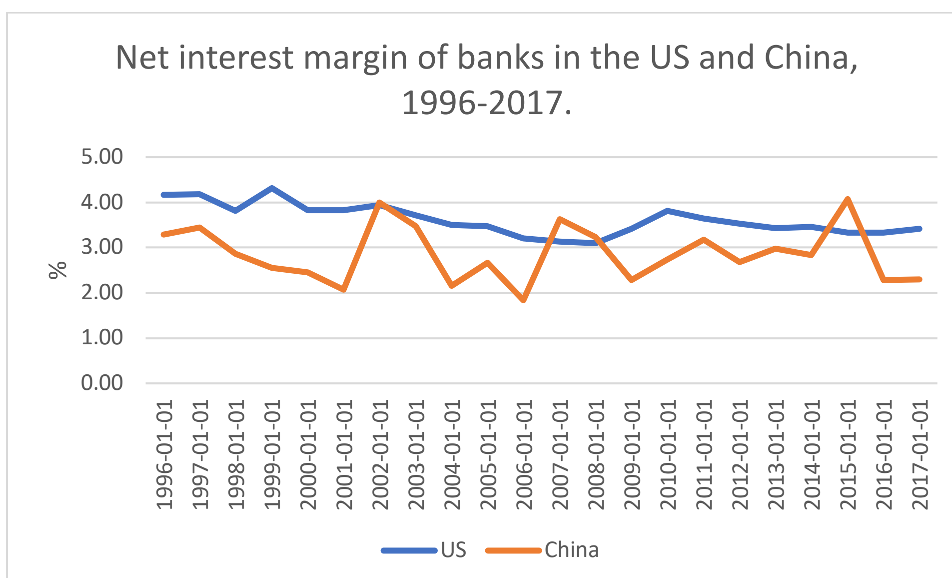

Figure 33 Net interest margin of banks in the US and China, 1996-2017.

Source: Federal Reserve Bank of St. Louis.

The composition of the profit of China's banking sector had changed with the proportion of non-interest income growing continuously in the new century and grew significantly faster in 2013, as shown in Figure 35, indicating the tendency of banks turning away from traditional borrowing-lending activities. However, they were slightly different for various types of banks.

The proportions of non-interest incomes of state-owned commercial banks and national joint-stock banks were systematically lower than the average of domestic banking sector, implying that the proportion of other types of banks, namely, city commercial banks, rural cooperative banks and other companies with the banking license were obtaining excessive non-interest income than average. The non-interest incomes signal the change of business structure in China's banking sector, which are associated with the increasing involvement in shadow banking businesses.[31]

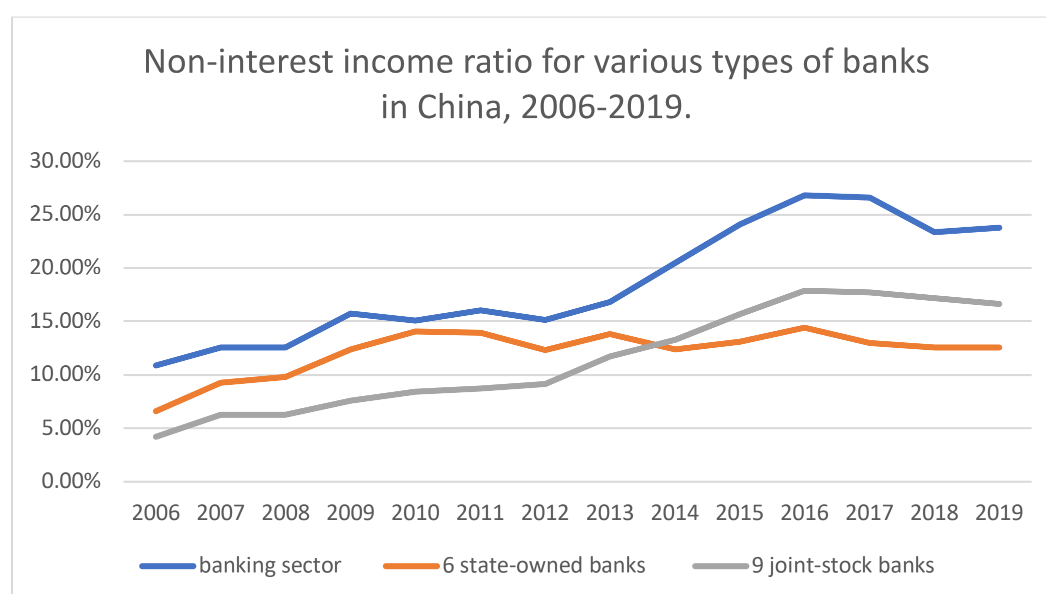

Figure 34 Non-interest Income Ratio for Various Types of Banks in China, 2006-2019.

Source: *Wind,* Fed St. Louis, and CBRC.
Note: 9 national joint-stock banks are China Merchant Bank, Industrial Bank, Shanghai Podong Development Bank, China Minsheng Bank, China CITIC Bank, China Everbright Bank, Ping'an Bank, Huaxia Bank, China Zheshang Bank. They are all publicly listed commercial banks.

6.3 Monitored interest rates

The interest rate, which is considered the fundamental instrument in the financial system, continues to be monitored and guided by the state, despite significant progress in

[31] Postal Saving Bank of China (PSBC) were not included in the state-owned commercial banks until 2012.

liberalisation. The interest rate is the most evident example of the characteristics of China's financial system—partially liberalised and state-presented. This section will quickly go over the liberalisation of the interest rates to help understand the factors that prevent China's financial system from developing full market mechanism and facilitate the transformation of the financial system.

The interest rate, as the monetary policy target and a tool to intervene the money market, was under central authorities' rigid control before the Opening and Reform in 1978. The central authorities managed the interest rate by two disciplines: quality controls and quantity controls (Chen et al., 2018), or price-based controls and quantity-based controls (Lardy, 2008; Wang et al., 2019). Essentially, central authorities imposed bank deposit rate ceiling, bank loan rate floor and bank loan quota (Wang et al., 2019). By 2015, PBOC removed the deposit rate ceiling and lending rate floor for commercial banks, but the interest rates are still subject to various formal instructions or informal window guidance (Liang, 2021; Wang et al., 2019). At the moment, bank lending is still constrained by loan-to-deposit ratio (LDR), the legal ceiling on the ratio of bank loans to bank deposits imposed by PBOC (Chen et al., 2018).

The quantity-based regulation is, in effect, equivalent to controlling the overall money supply (Wang et al., 2019). What is fundamentally different from the liberalised financial system is that China's monetary authorities not only use interest rates , but also utilise the centralised way to directly adjust money supply and bank credit to implement its monetary policy (Chen et al., 2018; Huang et al., 2020). The most frequently used credit provision tool is the reloan, a typical Chinese central bank operation. Through "reloans" the central bank supplies credit to commercial banks, and then commercial banks further lend to enterprises in targeted

industrial sectors or geographical regions to achieve policy goals of supporting them by granting more bank credits (PBOC, 2021). The central bank effectively acts as cashier to the state, as in the pre-reform era.

For example, during the 2008 Global Financial Crisis, other than reduced benchmark rate and RRR,[32] central authority anxiously injected a 4-trillion-RMB stimulus package to the already overheated economy (Sun, 2019; Wang et al., 2019; Zheng and Huang, 2018). Only a quarter of it was direct funds from the central government, and the rest of it, amounting 3 trillion RMB were in the form of local government financing vehicles and loans from financial institutions, primarily from banks (Chen et al., 2020; Sun, 2019; Wang et al., 2019). Similarly in the economic emergency caused by COVID-19 in 2019, China's central bank also reduced the RRR and the lending rate (PBOC, 2020). Other than that, it provided credit through "reloan" for several times to boost the sluggish demand dragged by the health and economic crisis.

In recent years, not only the quantity but also the quality has been monitored by the monetary authorities, which is called "the safe-loan regulation" by some researchers (Chen et al., 2018). China Banking Regulatory Commission (CRBC) prohibited commercial banks from expanding bank loans to risky industries such as real estate industries. To ensure the robustness of bank loans, in practice, banks were not allowed to lend more than 75% of their deposits before October 2015 despite the fact that the required reserve ratio (RRR) in China was already exceedingly higher than the major capitalist economies (Wang et al., 2019). Specifically, the RRR in China was 17% and 15% for large and small and medium sized banks,

[32] This can be retrieved from central government new released at that time, http://www.gov.cn/jrzg/2008-10/08/content_1115613.htm [last access on 30 March 2022].

respectively, whereas that was only 10%, 1% and 1.3% for US, EU and Japan, respectively in the beginning of 2008 (ibid). The interest repression left no room for financial market to grow, other than to seduce the overgrow of state-owned banks, which then catalyses the growth and expansion of shadow banking in every possible way.

6.4 Underdeveloped money market and capital market

Beyond the banking sector, the liberalisation reform also introduced elements of market finance into China's financial system. The capital market and money market were set up in the 1990s by mimicking the western style. However, the western-like fully liberalised money market and capital market had never emerged in China. Instead, they have been functioning differently since day one from the place where they originated because of the different role that the state has played in the financial market.

6.4.1 The capital market

China's financial opening was influenced by neoliberalism and Washington Consensus, but unlike other developing countries which completely liberalised their financial sector by following the neoliberal recipe advocated by IMF and the World Bank, China adopted its gradualist approach in financial reform, too, by partially liberalising its financial system while holding the most crucial and strategic elements under state control. For instance, the current accounts have been fully convertible since December 1996 and most of the capital accounts are still under certain degree of state's control (Huang, 2020). At the same time, China started to build up its financial infrastructure to facilitate international trade and the large SOEs "going global". The capital market have been playing an important role in helping restructure

China’s economy and raise the international recognition and competitiveness of its companies (Petry, 2020).

The bond market was among the earliest submarkets to be developed in the capital market. The resumption of treasury bonds began by MOF in 1981, signifying the start of China’s bond market (Amstad and He, 2020). Commercial banks were authorised to issue financial bonds in 1985 in order to diversify their financial assets and fundraising sources, and three years later, non-bank institutions obtained the permission, too (Lin, 2009). After their establishments, the three policy banks became the major issuers of financial bonds. By the end of 2017, China’s bond markets had become the third largest bond market in the world, with its capitalisation standing at one half of Chinese GDP and 9% of global GDP (Cerutti and Obstfeld, 2018; Petry, 2020). Two years later in 2019, it was almost equal to (98%) Chinese GDP (Amstad and He, 2020). For comparison, the capitalisation of bond market in the US was over two folds of its GDP in 2019 (ibid).

It is worth to note that the issuers in China’s bond market are primarily government and entities that the government owns directly, namely SOEs and state-owned commercial banks and local government financing vehicles (Amstad and He, 2020; Cerutti and Obstfeld, 2018). Compared with the US bond market, the proportion of China’s government bonds were systematically lower than US treasury bills after 2013 with China’s government bond accounting for less than 60% and US being above it (Amstad and He, 2020). China’s financial bonds and corporate bonds have increased dramatically over the years since the 2008 global financial crisis, especially the financial bonds. In terms of the segmented market, about 89% of the total outstanding bonds were in the interbank market in 2019, which has been closely

intertwined with the banking system ever since the establishment of bond market in 1997 (ibid). And the rest 11% were in the exchange (ibid).

Despite the rapid growth of China's bond market in terms of its size, it is still underdeveloped in many other dimensions. First of all, Chinese government bonds are not as liquid as that of the US treasury bills (Amstad and He, 2020). Secondly, Chinese bond market has faced challenges to further exposure to international financial system. Foreign participation in Chinese bond market has risen, but it still remains trivial in the total outstanding bond, with the number stabilising around 1.5% of total value (Cerutti and Obstfeld, 2018). And the foreign holdings of Chinese bonds are concentrated in government bonds (ibid).

The statistics of the bond market does not necessarily reveal the crucial and unique fact that China's commercial banks plays an important role in the bond market (Amstad and He, 2020; Ehlers et al., 2018). Commercial bank's participation in bond market are primarily through two channels, one is the direct on-balance-channel where the bank buys and sells bonds and engages in arbitrage trades in the interbank bond market through its own financial market division; another channel is the off-balance-sheet channel where the bank raises funds through WMPs and then invested in the bond market (Amstad and He, 2020; Ehlers et al., 2018). This has suggested that some sorts of bonds, in many cases, corporate bonds, to a certain extent, can be regarded as a form of "disguised bank financing" (Amstad and He, 2020, p. 126). More of the linkage between commercial banks and bond market will be discussed fuller later which focuses on the mechanism of shadow banking and bank's central role in it.

Shanghai Stock Exchange and Shenzhen Stock Exchange were established by the end of 1990, along with SOE's transformation into the joint-stock companies. A third stock exchange was newly established in September 2021 in Beijing, primarily serving the needs of domestic small and medium sized enterprises. All of them are state-owned stock exchanges under the supervision and governance of CSRC. Thirty years after their establishment, stock market capitalisation of listed domestic companies in China was only slightly smaller than its GDP. [33] Remarkably, as of the end of 2020, Shanghai Stock Exchange had ranked 2nd, 3rd and 4th in terms of capital raised, total market cap, and total turnover, respectively, becoming one of the most active stock exchanges in the world.[34] Despite the rapid development in terms of the market cap, the lack of openness of China's stock market remains the crucial problem. By 2017, the foreign holding as percentage of total market cap in China stock market has reached a historical high of 2.7%, but still significantly lower than its BRIC counterpart India, and is not comparable with the US (Cerutti and Obstfeld, 2018).

The function of capital market in mature capitalist countries is to provide a marketplace for companies, enabling and facilitating the pursue of private profit. However, the state-owned security market in China does not and cannot work in the same way. With its parastate status, the exchanges have to be integrated into the national development plans, and to direct the market outcomes towards the achievement of the national development goals, instead of towards pure private profits (Petry, 2020). On top of that, more than 90% investors (in terms

[33] In 2020, the stock capitalisation was more than $12 trillion, only slightly less than Chinese GDP of that year ($14.732 trillion). Data are retrieved from the World Bank. GDP data: https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=CN , stock market cap data: https://data.worldbank.org/indicator/CM.MKT.LCAP.CD?locations=CN ,last access on 20 March 2022.
[34] The data can be found in the overview of Shanghai Stock Exchange, available at http://english.sse.com.cn/aboutsse/overview/ , last access on 21 March 2022.

of the number of account rather than the market capitalisation) in the stock market are individuals, so the state has greater incentive to keep the stock market relatively stable in order to further keep the social and political stability (Jiang et al., 2016; Petry, 2020; Yang and Xu, 2016). The capital market is under the 'see-through monitoring system' that allows these state-owned exchanges to trace every single trade to the original investors (Petry, 2020, p. 220). For these reasons, China's capital market is claimed to be the only market in the world that does not encourage speculation.

6.4.2 The money market

China's financial reform prioritised the capital market over the money market, leading to an unbalanced development where the capital market is better developed than the money market. Money market is the arena for short-term capital flows. However, in China, the domestic money market was pulled behind by the centrally managed interest rates and the cross-border short-term flows which are subject to tight state control. Although the money market saw an extensive progress in the recent several decades, it still showcases its developing nature with incomplete market operation and less effective regulation. Nevertheless, the money has to find its place, then something will happen out of the existing box. That is the reason why shadow banking businesses have been quickly gaining grounds in China.

China's current money market is constituted of several sub-markets, namely, interbank lending market, repo market, bond market, bill market and others (Xie, 2001). They started to gradually take shape only after 1978, the beginning of the Opening and Reform, before which time there was no properly functioned monetary policies other than the central credit

plan (Huang et al., 2020). Even though the submarkets of money markets existed in China nominally, they have not functioned entirely independently from central authorities, and every submarket is centred around banks. For instance, financial institutions have to obtain the qualification before it could operate in the interbank market after January of 1996. Financial institutions were put under different classifications—some large state-owned or joint-stock commercial banks, city commercial banks, financial companies and securities companies are members of interbank market, while others are ordinary participator. The classifications further determine differentiated scope of their businesses (Xie, 2001). Additionally, central bank put a restriction on the maturity and the amount of interbank lending (Xie, 2001). As a result, the critical role of banks is reinforced repeatedly in the single market operation, or cross-market cooperation, such as bank-trust cooperation and bank-security brokage cooperation which will be fully discussed in subsequent sections.

Unlike the money market in western capitalist economies where the submarket's ups and downs were driven by the market primarily, and the central banks only use the interest rate as the target to implement monetary policy, China's sub-market's prosperity and depression were highly contingent on state's grand policy or national development goals. On top of that, they are dependent on banks, which is clearly policy-driven as stated earlier. So, the money market could not develop in full market mechanism. As a result, it was difficult to see the submarkets were growing simultaneously, rather, they were developed in a supplementary fashion. For instance, the repo market grew rapidly between 1995 and 1999, during the time when the interbank lending market was shrunk greatly under the strict central bank regulation (Xie, 2001; Ying, 2021). Repo market was started as a replacement when the banks were seeking alternatives to the interbank market.

6.5 Strong state presence: how the financial sector is managed by the state

Because of the strong state control and the direct intervention in the financial market, it is impossible to develop a full market mechanism in China's financial system. And for the same reason, the relational and government-controlled structure in finance has not been able to be replaced by the arm's length and private mechanism of finance. This section will reveal how the state directly control the financial system and how the financial system is, therefore, governed by the state.

6.5.1 State's control of the capital flow

The clearest evidence of state control on finance and the sharpest difference with the USA is offered by the regulations that permeate the cross-border flow of capital. Before 1978, the foreign exchange was strictly controlled and centrally planned. The government bought up all foreign exchange revenues from enterprises, and centrally planned and allocated foreign exchange on demand. [35] Moreover, the government tried to avoid foreign debts and did not accept any foreign investments, with exchange rate working as the tool of accounting. [36] State Administration of Foreign Exchange (SAFE) was set up to serve the needs of managing the foreign exchange in 1979, when the foreign exchange reform commenced. After a four-stage reform of foreign exchange, current account convertibility was achieved in December 1996 (Huang, 2020). However, there are still 43 out of 53 items in capital account that have some degrees of control (Habermeier et al., 2017). Although Chinese authority classifies the

[35] Information is collected from State Administration of Foreign Exchange (SAFE) official website, retrieved from http://m.safe.gov.cn/safe/lsyg/index.html [last access on 03/05/2019]
[36] Same as footnote 18, SAFE.

openness and convertibility in a slightly different way, there is no doubt that several key items in capital account still remained tight control, including cross-border portfolio investment (ibid).

At the moment, the Qualified Foreign Institutional Investor (QFII) and Renminbi Qualified Financial Institutional Investor (RQFII) are allowed a limited access to Chinese financial market, and the latter must use Renminbi to invest whereas the former may use any currency but with a quota capped at $5 billion per investor except for sovereign funds, central banks and governments (Habermeier et al., 2017). Similarly, for the outward portfolio investment, the Qualified Domestic Institutional Investor (QDII) system allows qualified domestic institutional investors, including banks and nonbank financial institutions such as securities firms and insurance companies, to invest in overseas financial markets (ibid).

Direct investment is among the least controlled categories, and SAFE consider it as convertible. Specifically, outward direct investment is liberalised by and large, whereas the inward direct investment has significant restrictions. Even so, China has been the biggest Foreign Direct Investment (FDI) recipient since 2003. [37] Policymakers have favoured the capital inflows more than outflows in terms of facilitating domestic economic development (McCowage, 2018).

While holding the tight control of capital flows, internationalisation of renminbi has progressed as an important policy goal before 2015. International use of the renminbi began

[37] Data is collected from World Bank, Foreign direct investment, net flows.

in 2009, mostly in settlement of cross-border trades and as part of China's response to the huge losses it faced on its dollar reserves due to US quantitative easing (Wang, 2017). In addition, the central bank of China signed bilateral currency swaps with several countries to promote the use of the renminbi in trade and investment. In 2016, China's currency was also included in the basket of Special Drawing Rights (SDR). Even though, after a decade of internationalisation, the renminbi accounted for an insignificant proportion of global payments by value and of international reserves. Nevertheless, it is still a nice try as a move to surmount the US Dollar's role as a quasi-world money. Keeping the key items of capital account under control and promoting the RMB internationalisation are great efforts that Chinese authorities have been doing to resist the subordinate financialisation, which, in most cases of developing countries, are transmitted from mature capitalist countries through financial liberalisation by "imperial relation" (Lapavitsas, 2013a; Powell, 2013).

6.5.2 Agent-based governance over the financial sector

Echoing the management style in the productive sector, similar structure had been created in the financial sector, too. In the early reform era, the state structure was in a vertical alignment where each of a ministry managed a specific sector, including the financial sector. MOF was not only the nominal owner of the state-owned banks in the 1980s, but also their regulators. With the segmentation of the financial market, the corresponding institutional reform was carried out to shift the vertical management to a more horizontal configured organisation (Wang, 2015). Several new regulatory bodies were newly established in the late 1990s and early 2000s to take over the role of regulator of each submarket.

In the same year of the establishment of SASAC, its counterpart in the financial sector — Central Huijin-- was established, performing the role of controlling shareholders of the state-owned commercial banks. In the same year, China Banking Regulatory Commission (CBRC) was established, too, performing the duty of the monitor and the supervision of the banking sector. CSRC was established in 1992 as the regulator of securities and futures market. CIRC was established in 1998 as the regulator of commercial insurance. CBRC, CSRC and CIRC were all subordinate to the State Council. In 2018, CBRC and CIRC were emerged as new China Banking and Insurance Regulatory Commission (CBIRC). Five years later, it got dissolved in 2023 and was finally replaced by State Administration of Financial Supervision and Administration on 18th May 2023.

Similar as the SOEs and their shareholders, state-owned financial institutions and its owner have faced the similar power conflicts that are caused by the change of relative economic and political strength. The situation is a bit more complicated in the banking sector than in others because of the function overlap of multiple regulatory agents, namely PBOC, CBIRC and MOF. Central Huijin is the best epitomisation of the bureaucratic battle, primarily between MOF and PBOC (Wang, 2015).

In the beginning of 2000s, state-owned commercial banks needed to be recapitalised and to deal with the NPL issue, which should have been done by the MOF. However, the MOF was reluctant to do so because this was such a heavy budgetary burden on itself, so PBOC seized this opportunity and stepped in by establishing Central Huijin, a corporate entity to recapitalise the Big Four with China's huge reserve holdings (Wang, 2015). In 2003, Central Huijin Investment Limited was created and then it became the major shareholder of the Big

Four. Central Huijin "mandates to exercises and the obligations as an investor in major state-owned financial enterprises, on behalf of the People's Republic of China ("the state")". [38] Soon, PBOC recapitalised Bank of China and China Construction Bank via Central Huijin in 2003, becoming the behind-the-scene shareholder (Wang, 2015). As a result, Central Huijin held 100% and 85.2% shares of Bank of China and China Construction Banks, respectively by 2004. Additionally, PBOC filled Central Huijin's board with its own people (ibid).

To not lose this game completely, MOF seized the opportunity to recapitalise the other two of the Big Four—ICBC and ABC. Finally, each of MOF and PBOC possessed half of the total share of ICBC and ABC by 2009 (Wang, 2015). MOF learnt its lesson, so it created its own corporate agent—China Investment Corporation (CIC) in 2007, which was claimed as China's official Wealth Sovereign Fund. Shockingly, part of the capital contribution that MOF injected to CIC was initially obtained by MOF who acquired ALL share of Central Huijin from PBOC in September 2007 through issuing special treasury bonds. [39] Put it differently, MOF replaced PBOC to become the owner of Central Huijin in 2007. Table 2 shows the latest result of this bureaucratic battle.

By 2017, Central Huijin has held more than 1/3 shares of Industrial and Commercial Bank of China Limited (34.71%) and Agricultural Bank of China Limited (40.03%). And it is also the largest shareholders of Bank of China Limited (64.02%) and China Construction Bank

[38] It is the introduction of Central Huijin on its own official website: http://www.huijin-inv.cn/huijineng/About_Us/index.shtml [last access: 24/03/2022]
[39] See footnote 18, introduction of Central Huijin.

Corporation (57.11%)[40] and MOF eventually became the ultimate largest shareholder of the Big Four.

Table 2 The Proportion of Shares Held by Top 10 Shareholders of Big Four, 2017.

	Central Huijin	MOF	Other state shares	Foreign shares	Others
Industrial and Commercial Bank of China Limited (ICBC)*	34.71%	34.60%	N.A	24.35%	N.A
Agricultural Bank of China Limited (ABC)	40.03%	39.21%	4.49%	9.41%	0.28%
Bank of China Limited (BoC)	64.02%	N.A	3.89%	28.23%	0.22%
China Construction Bank Corporation (CCB)	57.11%	N.A	2.86%	37.20%	N.A

Note: This table only shows the proportion of each type of shareholders among the ten largest shareholders, except for ICBC*, which shows the composition of total shares. N.A represents the data is unavailable.
Source: official websites of Bank of China and Industrial and Commercial Bank of China, retrieved from: http://www.boc.cn/investor/ir4/201501/t20150114_4461543.html and http://www.icbc.com.cn/ICBCLtd/%E6%8A%95%E8%B5%84%E8%80%85%E5%85%B3%E7%B3%BB/%E8%82%A1%E7%A5%A8%E5%8F%8A%E5%88%86%E7%BA%A2/%E8%82%A1%E6%9D%83%E7%BB%93%E6%9E%84/, respectively. The rest two are collected from Jinrongjie, retrieved from: http://stock.jrj.com.cn/share,601288,sdgd.shtml and http://stock.jrj.com.cn/share,601939,sdgd.shtml for Agricultural Bank of China Limited and China Construction Bank Corporation, respectively.

Unlike SASAC's dual function, Central Huijin is plainly an equity investor on behalf of the state. It does not conduct any other commercial businesses, and does not intervene the day-to-day operations, either. However, Central Huijin does not act merely as a rubber stamp to completely follow the state's instruction. In fact, Central Huijin has cast 2/3 of the total negative votes at meetings of board of directors, mostly centering on issues of merge and

[40] Figures are collected from the official website of Central Huijin: http://www.huijin-inv.cn/huijineng/Investments/Shareholding.shtml,last accessed on 25/04/2019.

acquisition, the procurement of capital assets and senior managers salaries and bonuses (Wang, 2015).

Similar as state keeping its monopolistic position in the strategic sector through granting operational license to certain SOEs, the state used the same means to keep its financial authoritarianism. Financial institutions wishing to conduct financial activities in China have to obtain the corresponding licenses from central authorities. Licenses for different businesses are controlled by different authorities, including CBIRC, CSRC, PBOC, and Ministry of Commerce. State-owned financial institutions once again became the best beneficiary of this policy because its parastate status. The aforementioned four state-owned asset management companies which were set up for stripping the NPL of the Big Four had acquired various licenses in different submarkets, namely, banking, insurance, futures, financial leasing, trust, among others (Wang, 2015). By granting licenses, the state also effectively controlled the entry of foreign capital and entities into its domestic financial system, avoiding the same tragedy that had happened in other developing countries under the neoliberal treatment of financial liberalisation. The best examples are the aforementioned QFII and RQFII.

One thing that the Chinese state is distinct from other states is that the pervasive state intervention could override the market mechanism. Because of the restriction, capital could not move as freely as in liberalised financial systems. The credit tightening in 2010 has explicitly restricted the debt accumulation and investment in real estate by local governments, and curbed the commercial bank loans, too (Sun, 2019). This restriction also applies to other over capacity industries (ibid).

The state also imposes strict monitoring and regulation of the exchanges by taking advantage of their state ownership. Preventing overspeculation in the financial market is one vivid example. Speculation was supposed to be an integral part of the financial market, but Chinese authorities have put restrictions on commonly used techniques to lower its risks, such as restrictions on high-frequency trading in stock market and futures market (Petry, 2020). And in Chinese futures markets, investors have to specify the purpose of trading—hedging or speculating, which would face different position limits and regulations (ibid). The hedging activities are monitored on a daily basis (ibid). And the investors would face fraudulent punish if they were caught a mismatch in their trading (ibid). As stated earlier, 90% of accounts in China's stock market and futures market are held by individuals, preventing the overspeculation is also out of the consideration of mitigating the risk that individuals are facing, and further to ensure the financial and political stability.

As the "revolving door" between government officials and SOE top executives, there is also the tradition of reshuffles between the post of top leaders of financial institutions and posts of the regulatory bodies (Petry, 2020), especially in between posts of state-owned banks, regulatory bodies and the central bank. Once again, it signifies the crucial importance of the banking sector in China's financial system. And it is also often seen that they took secondments being the top leader of local governments. Guo Shuqing, current chairman of CBIRC used to work as the Chairman of CCB Board of Director and Vice President of PBOC. He was also the first Chairman of Central Huijin's Board of Director upon its establishment in 2003. In between these posts, he also worked as the (deputy) governor of Shandong Province between 2013 and 2017. With similar experience, Yi huiman, current chairman of CSRC was used to be the Chairman of ICBC Board of Director and the President of ICBC. Just the same

as the non-financial sector, interest groups are easy to form and the SOCBs accumulated enormous power making it possible to influence policy making.

Of course, the Party plays decisive role in financial policies (Heilmann, 2005). There are several different committees in the CCP to take charge of the economic and financial planning. Five-Year Plan that mentioned in earlier chapters are more like industrial policies, whereas in the realm of finance and economic planning, it is the Central Economic Work Conference (*zhongyang jingjigongzuo huiyi 中央经济工作会议*) that set the tones for the economic and financial development goals for next year. The goals are not necessarily economic or financial policies as they are not promulgated as law, but The Conference definitely works as a guidance for capital and personnel which move into the industries that it was pointed as the key for further development. This is inherited from the socialist system, and it is very peculiar to the capitalist market. The planning plus the centralised governance structure makes financialisation impossible in China's state-owned financial sector.

The longest lasting organ in the Party of economic and financial planning is Communist Party Central Economic and Financial Affair Committee *(zhongyang caijing weiyuanhui 中央财经委员会)*, which was established in 1949, and experienced several times of abolishment, reinstatement and renaming, finally stood at the core of China's economic decisions. It renamed in 2018 as The Office of Communist Party Central Financial and Economic Commission (*Zhongyang caijing weiyuanhui bangongshi 中央财经委员会办公室*). In the latest institutional reform in 2023, a Central Financial Committee (*Zhongyang jinrong weiyuanhui 中央金融委员会*) was newly established to strengthen the centralised and unified leadership of the Party Central Committee over financial work.

The state-owned financial institutions are also part of the nomenklatura system, so the Party also plays decisive role in appointing and removing the top leaders of some of the state-owned financial institutions, especially the state-owned commercial banks, the four largest insurance companies, three policy banks and three State Council directly managed investment companies. The state-owned financial institutions are similar like SOEs that they are classified in different political rankings. The top leaders of these financial institutions are managed by CCP Central Organization Department.[41] The Party branch of each regulatory bodies, namely PBOC, CRBIC and CRSC, also have the power to nominate, appoint and remove the lower-level officials in the financial system.

6.6 The transformation of the banking sector—the rise of the shadow banking

Shadow banking in China evolved out of the informal finance, and it was deemed as a consequence of "systemic mismatch" of financial resources (Zheng and Huang, 2018, p. 287). The informal finance is a typical legacy of the Chinese relational and government-controlled structure. When it combined with the controlled interest rates, it became the unique Chinese shadow banking. The rise of shadow banking can be considered as the second transformation of China's financial system.

First of all, SOEs were long privileged in receiving subsidised bank credits through banks, and particularly through state-owned commercial banks, while private firms had difficulties raising funds from the formal banking sector, especially the small and medium private

[41] This information is from Fuxi Management Company, available from http://www.fuxiwealth.com/ziliaoku/15.html [last access on 26 March 2022].

businesses, which were left with no alternatives, but to turn to informal financing (Tsai, 2015; Zheng and Huang, 2018). A survey conducted in 15 provinces of China in 2012 suggested that 57.5% SMEs have ever participated in informal credits market (Tsai, 2002). In the first two decades of the reform era, it is estimated that at least 1/4 of all financial transactions were informal finance in China, and the number has become even higher in the beginning of 2000s (Tsai, 2002, p. 36). The informal finance was gradually taking shape, and eventually becoming shadow banking.

Secondly, the control of interest rates has distorted the operation of the financial sector in China, which indirectly led to the emergence of the shadow banking. Specifically, the shadow saving instruments emerged as a replacement to circumvent the bank deposit ceiling and the lending floor (Borst, 2013; Dang et al., 2014; Sun, 2020). Investor’s desire for higher-return investment has spurred the rise and growth of shadow saving instruments, not least the wealth management products (WMPs), whose return are not constrained by the deposit ceiling (Dang et al., 2014; Ehlers et al., 2018). In the past two decades, the average return of WMPs was roughly twice as much as that bank deposit rate in China at the same time, as shown in Figure 36 & 37 and Table 3 below. Households, hence, treat WMPs as better alternatives to bank deposits because of the higher return.

But at the same time, households are dragged into the risky and less regulated shadow banking system. As of the end of 2016, 80% of the total outstanding WMPs are not guaranteed, meaning banks have no obligations to compensate the investor in case of a default. However, because plenty of WMPs are sold in banks, including state-owned banks, customers would

like to believe that they are ultimately guaranteed by the state (Ehlers et al., 2018), which is actually not the case. Guaranteed WMPs were abolished at the end of 2021.

Last but not the least, the long existed informal finance made the Chinese financial sector lack the credit culture. State-owned banks were institutionally biased towards SOEs as they were "within the system", thus, the credit officer would expect to be forgiven or less harshly punished for making the bad loans when the default happened (Huang et al., 2020; Tsai, 2002). Even if banks were willing to extend loans to private businesses, they had no idea how to process a request from an individual business, let alone the evaluation of the creditworthiness of enterprises as the credit officers "were trained as bureaucrats, not commercial bankers" (Tsai, 2002, p. 35). It, therefore, somehow enhanced the systemic mismatch where the private small and medium enterprises crave for credits but could get it from banks whereas the SOEs have more than enough of them, further, stimulated the emergence and growth of shadow banking. Overall, the origin of China's shadow banking is deeply embedded in the relational and government-controlled structure of finance.

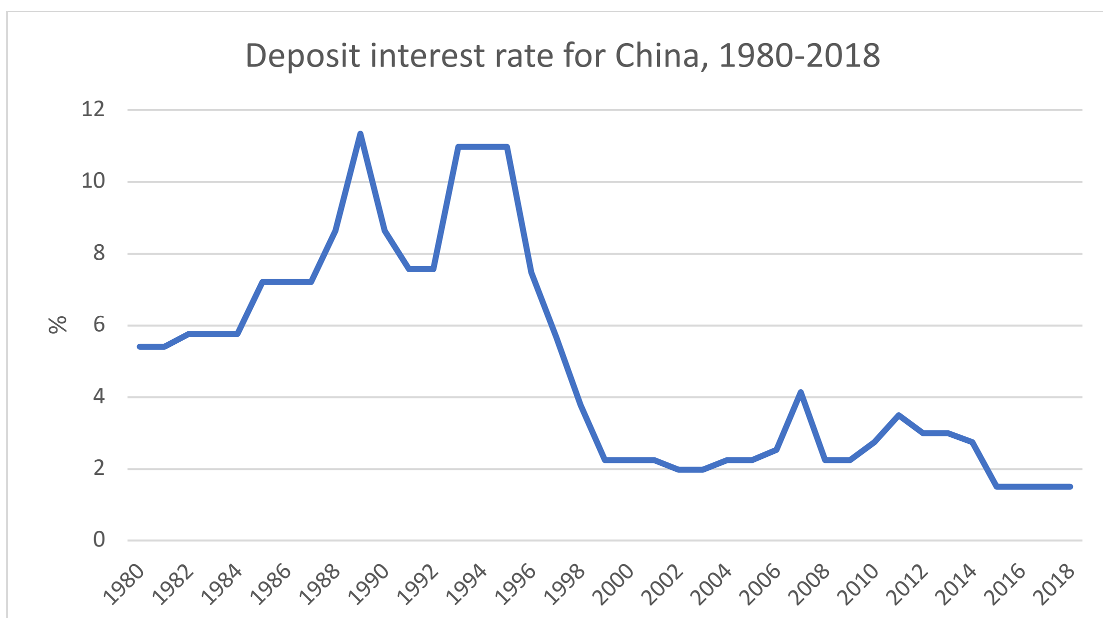

Figure 35 Deposit interest rate for China, 1980-2018.

Source: World Bank.
Note: Deposit interest rate is the paid by commercials or other banks for demand, time and saving deposit. The original data was collected by IMF as representative interest rates offered by banks to resident customers.

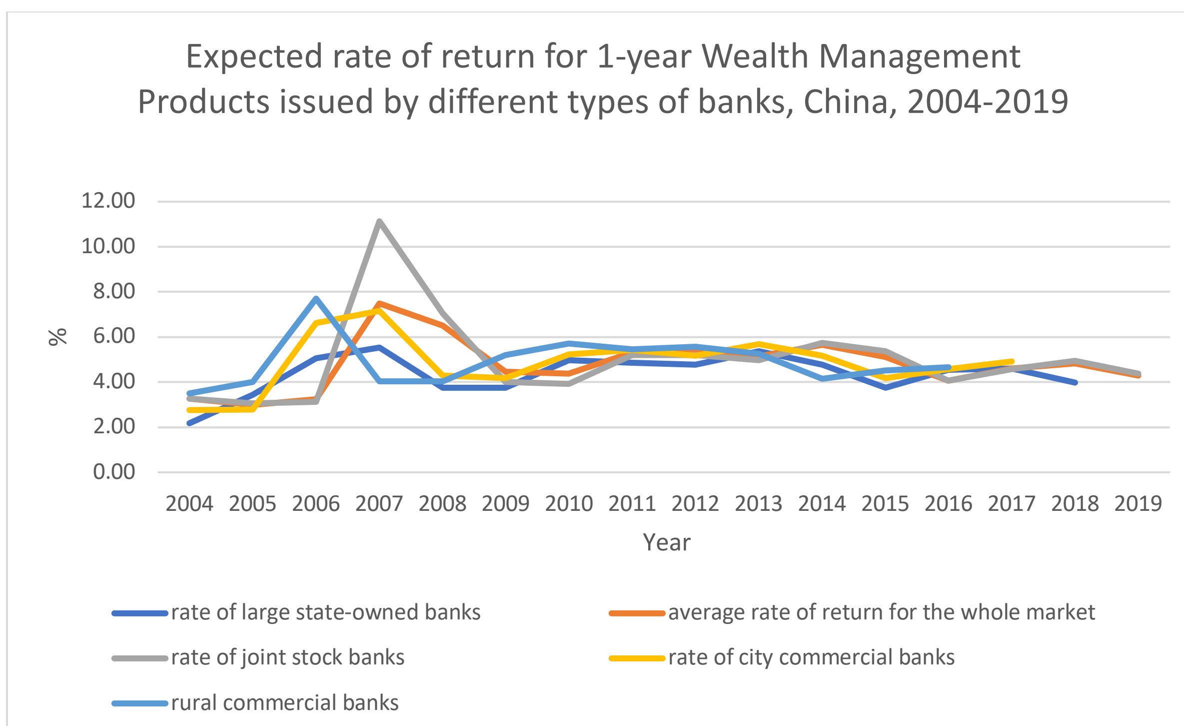

Figure 36 Expected annualised rate of return for 1-year WMPs issued by different types of banks, China, 2004-2019.

Source: Author's calculation based on the data from *Wind*.

Table 3 Comparison of average deposit rate for the whole market and the average expected rate of return for Wealth Management Product (WMP) for the whole market.

	Current account deposit rate	Annualised expected rate of return for 1-week WMP	Time deposit rate	Expected rate of return for 1-year WMP	Inflation rate
2012	0.4	3.41	3.38	5.34	3.78
2013	-	3.53	-	5.14	2.613
2014	0.35	4.16	3	5.65	2.29
2015	0.34	3.95	2.27	5.13	1.432

Source: *Wind*

Shadow banking drew more attention since 2008 Global Financial Crisis. Scholars have not reached an agreement on its definition, but shadow banking is broadly regarded as financial intermediaries that are outside the conventional banking system, circumventing the regulation system normally through financial innovations, such as asset securitisation and financial derivatives (Adrian and Shin, 2009; Financial Stability Board, 2011, p. 1; IMF, 2014). Because of the differences of financial structure and economic development level in different countries, shadow banking are in various forms across the globe (Financial Stability Board, 2013). Growth in shadow banking in China stands out in the emerging economies, and the scale of China's shadow banking is even larger than many of the developed countries, ranked 5th place among Financial Stability Board's jusridictions in 2012 (IMF, 2014). Estimates of the scale of China's shadow banking by researchers vary greatly – from 8 to 80 per of GDP (Ehlers et al., 2018; Elliott, et al., 2015; Tsai, 2015), whereas Chinese official estimates are much higher at 65-114 per cent of national GDP (CBIRC, 2020).

6.6.1 The mechanism of China's shadow banking

Distinguished from advanced economies, China's shadow banking is dominated by commercial banks (Ehlers et al., 2018; Sun, 2020, 2019). Chinese shadow banking system is composed of trust loans, WMPs, undiscounted bankers' acceptances, peer-to-peer lending, and so forth (Chen et al., 2020, p. 48; Ehlers et al., 2018). Among them, the two most important categories are trust loans (including both trust and entrusted loans) and WMPs, which are handled by commercial banks and trust companies primarily (Chen et al., 2020, p. 48; Ehlers et al., 2018). By and large, the shadow banking businesses in China can fall into two generic types: one is banks providing funds for enterprises in the form of loan, but could bypass the regulations by manipulating the accounting bookkeeping, and the other is channelling the bank loans out of the banking system through trust loans, asset management plans, mortgage among others by non-banking financial institutions, such as trust companies, securities companies, and many others (Chen et al., 2018; Ehlers et al., 2018; Sun, 2020, 2019).

The first category is essentially identical to bank loans which are provided by banks to enterprises to meet their funding needs but channelled through a third-party, either a bank or a non-bank financial institution, which is often referred to as "banks in the shadow" (Sun, 2020). By doing so, the balance sheet will be expanded but not in the name of loans. Rather, it could be interbank assets if it is channelled by other banks in the form of interbank payment, or investment assets, such as account-receivable investment (ARI) or off-balance-sheet items, such as WMPs (Chen et al., 2018; Sun, 2020).

The second category is the "traditional shadow banking" that has discussed by a great many scholars. It is "traditional" in the sense that the credit creation mechanism and products of

this type of shadow banking is in comparable with the shadow banking in the advanced countries where the shadow banking plays the role of credit intermediary and provides the products including primarily asset securitisation (Ehlers et al., 2018; Sun, 2020). This type is fundamentally different from the first one that the scale of credit has increased but money supply is unchanged because the credit is created by channelling it off the balance sheet of banks to somewhere else (Sun, 2020, p. 28, 2019).

Generally, shadow banking in China works in a way that banks collect "deposits" from the ultimate creditor, namely, retail depositors, institutional investors and enterprises and then lend to ultimate borrowers, namely, SOEs (including large SOEs and LGFVs), governments, and other enterprises, may or may not through a third-party financial institution, which can be trust companies, securities companies and bank wealth management arms. [42]

The most frequently used shadow borrowing instruments is the entrusted loan, a credit transaction between two non-financial firms with a financial institution in the middle being a trustee, normally a commercial bank or a non-bank financial company (Chen et al., 2018; Ehlers et al., 2018). Entrusted loans have become the second largest financing sources of loans after the traditional bank loans since 2009 (see Table 4 for the data after 2015). Majority of the entrusted loan are from the large and well-capitalised enterprises with considerable

[42] In Sun (2020, p.32), he believes that the flow of funds of shadow banking started with the state banks, whereas in Ehlers et al. (2018, p.10), they believe that all types of banks in China have been involved in shadow banking activities, with the smaller joint-stock banks and city commercial banks being more actively and directly involved. And Chen et al. (2018) have found that non-state banks played larger roles than state banks in funnelling the entrusted lending in the monetary tightening period. And more stylised facts that have been displayed in this chapter also contradicts Sun's (2020) claim. However, to avoid the inaccuracy, I did not explicitly different state banks and non-state banks here.

savings at disposal looking for a higher return, and the loans end up in the real estate sector or other industries with excessive capacity (Allen et al., 2019; Chen et al., 2018; Sun, 2020).

There are two different types of entrusted loans: affiliated loans and non-affiliated loans (Allen et al., 2019). The former is the entrusted loans that are made in between two companies with prior relations, in most cases, from a parent company to a subsidiary or between supplier and customer (Allen et al., 2019). And the latter is made between two companies without prior relations. Affiliated loans are essentially pass-through loans whose rate is essentially the same as the official bank loan rate and tend to be within-industry loans, whereas the non-affiliated loans are lent to borrowers at a higher rate, which is roughly twice as much as official bank loans (ibid). The non-affiliated loans are very likely to end up at the industries with over capacity or real estate sectors (ibid).

Large central SOEs belong to the major lender of entrusted loans (Allen et al., 2019). Large central SOEs are large and well capitalised enterprises, which lend out their excessive savings to financial constraint firms through entrusted loans because entrusted loan offers a higher yield than bank deposit does by and large (ibid). Large SOEs also borrow from banks at a rate equal or below the official bank loan rate, and then lend to borrowers at a higher rate to earn the interest margin as financial institutions (ibid). It has been found in the existing research that large central SOEs are increasingly involved in the affiliated loans, lending to their subsidiaries and associates (ibid). This is exactly what the financial arms of the large central SOEs do. Other firms with excessive cash but low growth rate are the main lenders of non-affiliated loans. Either way, it is safe to infer that the large amount of retained earning that

central SOEs have possessed becomes the resources of its engagement in entrusted loans in the help of the in-house financial companies.

Entrusted loan becomes the vehicle that helps commercial banks to dodge the safe-loan regulation, as well as a new means for cash abundant firms to profit. The bank, as a passive facilitator also earns a handling fee despite the dispute among scholars whether the risk has been brought to bank's balance sheet or not. [43] Shadow banking successfully turns the productive capital into the interest-bearing financial capital, promoting the detachment of the productive capital and production, signifying a transformation towards financialisation. However, unlike the financialisation in the mature capitalist countries where the enterprises are growing apart from banks to exercise their acquired financial skills, Chinese enterprises, no matter state-owned or non-state owned, they created a tight link with banks under the assistance of the shadow banking – banks channels idle funds from capital-abundant companies, in many cases, central SOEs, to financial constrained firms, mostly small and medium sized non-state ones, which, in effect, are better off in terms of their financing needs (Galina Hale and Long, 2011; Lu et al., 2015)

Table 4 Selected components of total social financing (TFS) for China between 2015 and 2022.

Year	TSF (stock)	RMB loans	Foreign currency-denominated loans (RMB equivalent)	Entrusted loans	Trust loans	Undiscounted bankers' acceptances	Loans proportion	Shadow banking proportion
2015	138.28	92.75	3.02	11.01	5.45	5.85	69.26%	16.13%

[43] Chen et al. (2018) believe that banks bring back the risk of entrusted loans to its own balance sheet by purchasing the TBRs as investments, whereas others, such as Allen et al. (2019) argue that banks do not bear the risk of the investment. I lean towards to the former idea because banks do not bear risks in channelling the loans, however, when they buy back the TBRs as investment, the risk of the TBRs comes along with the asset, appearing on the balance sheet, and this is in line with the analysis of Ehler et al. (2018).

2016	156.00	105.19	2.63	13.2	6.31	3.90	69.12%	15.01%
2017	174.71	119.03	2.48	13.97	8.53	4.44	69.55%	15.42%
2018	200.75	134.69	2.21	12.36	7.85	3.81	68.19%	11.97%
2019	251.41	151.57	2.11	11.44	7.45	3.33	61.13%	8.84%
2020	284.75	171.60	2.10	11.06	6.34	3.51	61.00%	7.34%
2021	314.12	191.54	2.23	10.87	4.36	3.01	61.69%	5.81%
2022	344.22	212.43	1.84	11.24	3.75	2.66	62.25%	5.12%

Source: People's Bank of China.

6.6.2 The characteristics of China's shadow banking

In general, the shadow banking in China has two distinct features which set it apart from shadow banking in other countries—the commercial bank plays a central role in the shadow banking system, and the bank credit instead of securitisation makes the core of shadow banking in China. The characteristics and the origin of the shadow banking precisely reflect the fundamental nature of China's financial system: bank-based, credit-centric, partially liberalised and state-presented. Also, the shadow banking in China has not successfully changed the relational and government-controlled structure in finance to the arm's length and private mechanisms. Rather, the Chinese-type shadow banking reinforced the former.

Banks play the central role in China's shadow banking activities. They perform as middlemen to facilitate shadow banking activities in various ways. In a direct way, banks provide loans to SOEs, LGFVs and other private enterprises with the funds that they collected from WMPs (Ehlers et al., 2018). Or in an indirect way, banks play intermediatory roles in entrusted loans and peer-to-peer (P2P) lending where they stand in the middle between two non-financial firms, which should not have been permitted to borrow from one to the other, as trustee banks to charge channelling fees and commissions (Chen et al., 2018; Ehlers et al., 2018).

Banks also link the banking sector and other sub-markets, especially the bond market, through the shadow banking system, in particular, WMPs. WMP, as the biggest component of shadow banking in China, is the most important vehicle to connect back to the banking system (Amstad and He, 2020, p. 126). Roughly 40% of the WMPs were invested in the bond market, and the rest of them were invested to other money market instruments, including bank deposits (Amstad and He, 2020; Ehlers et al., 2018).

Other than strengthening the linkage between the bond market, banks also innovatively involve themselves to a wider financial market through bank-trust or bank-security cooperation in order to bypass the regulation (Ehlers et al., 2018, p. 17). As mentioned earlier that the bank could reclassify loans as investment receivables, also called account-receivable investments on the balance sheet, and thereby lower non-performing loan (NPL) provisions and circumvent loan-to-deposit (LTD) ratio constraints (Chen et al., 2018; Ehlers et al., 2018). This operation also helps generate tighter and more complex linkages between the formal banking sector and shadow banking entities (Ehlers et al., 2018, p. 12). The typical way of operation is that a bank transfers an on-balance-sheet loan to a trust company. Because the direct loan transfer is prohibited, the trust company, therefore issues a trust product whose underlying asset is the transferred bank loans. Then the trust product is issued to the bank by the trust company as trust beneficiary rights (TBRs) (Ehlers et al., 2018). The T-accounts below illustrates how the loans move between the balance sheet of the bank and that of a trust company (the same colour represents its corresponding direct transfer relations). This could also be done with a bank and a securities company in which case the debt securities are transferred to an asset management company and the asset management company issues a direct asset management product (DAMP) to the bank in return (Ehlers et al., 2018).

T-account for the bank

Asset	Liability
Loans -100	
TBRs +100	

T-account for the trust company

Asset	Liability
Loans +100	Trust product +100

Figure 37 T-account illustration of loans transfer between the formal banking sector and shadow banking entities.

Note: 100 is an indicative example.

The blurring boundary between banks and the shadow banking reflects the commercial banks are transforming themselves towards the shadow banking in two ways. One is that commercial banks are freely engaging in the unregulated activities, such as channelling the loans of one enterprise to another and gaining the role as market mediation through the shadow banking operations. Another one is that commercial banks turn to households and individuals for funds raising by issuing higher-than-bank-deposit-return WMPs, dragging them into the risky, unregulated, thus, vulnerable shadow banking. On the other side of the same coin, the shadow banking bears some responsibilities which should have done by commercial banks or the money markets.

However, the shadow banking in China remains credit-centric, which is the second characteristics of China's shadow banking that set it apart from that of the US. Shadow banking in China hardly involves any securitisations, a process in which the financial assets are pooled so that they can be repacked into new assets that are tradable on financial markets (Ehlers et al., 2018). Instead, with the central role of the commercial banks, China's shadow banking is much more alike the traditional banking that the funds flow from the ultimate

lenders (creditors) to the ultimate borrowers (debtors) via one or multiple middlemen, as opposed to the market-based (non-bank) credit intermediation in the US. Because of the credit-centric and bank-based characteristics, China's shadow banking is less complicated than that of the US. China's credit intermediation normally involves only one or two steps, whereas a typical US shadow credit intermediation vertically slices the traditional bank's credit intermediation into a typical seven-step process from loan origination to wholesale funding through various steps of asset-backed security issuance, warehousing and intermediation (Pozsar et al., 2010).

State-owned banks and non-state-owned banks participate in the shadow banking in different ways in terms of the scale and type of activities. It argues that state-owned banks are involved in the shadow banking in a less extensive way than joint-stock banks and smaller city commercial banks. Specifically, as of the end of 2015, joint-stock banks became the largest issuer of WMPs, and state-owned banks were at the second place. By the end of 2016, joint-stock banks accounted for 42% of total issuance of WMPs, and state-owned banks accounted for 32% of that (see Figure 39 below). In general, the increase of non-interest incomes could partially reflect bank's detachment from the traditional lending-borrowing businesses and the degree of turning to shadow banking businesses. Traditional banking businesses are borrowing and lending, and the banks earn interest margin, whereas banks earn non-interest income when participating shadow banking businesses, such as fees and commission as they provide other financial intermediary services. Figure 40 below shows that the non-interest incomes of Big Five state-owned commercial banks were systematically lower than that of the whole banking sector, indicating that state-owned banks were not the ones that most heavily involved in shadow banking businesses. They are in line with the literature that joint-stock

commercial banks are the most exposed in the shadow banking businesses (Ehlers et al., 2018, p. 20).

In this sense, China's shadow banking is literally the 'shadow' of commercial banks, with the non-state banks more actively involving in shadow banking activities. Consequently, the arm's length and private mechanisms have not been nurtured in China's financial system. The core of China's financial system remains bank-based, credit-centric, partially liberalised and state-presented, which shows steady continuity. Thus, financialisation is too early to be identified in current Chinese financial system despite the two historical transformations.

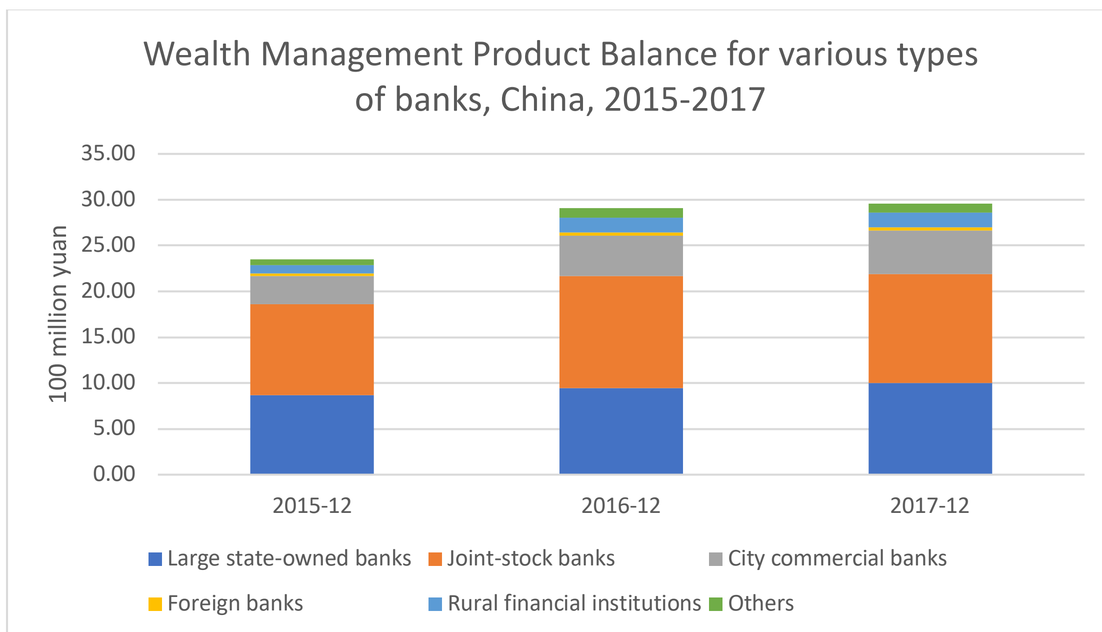

Figure 38 Wealth Management Product Balance for Various Types of Banks, China, 2015-2017.

Source: *Wind*

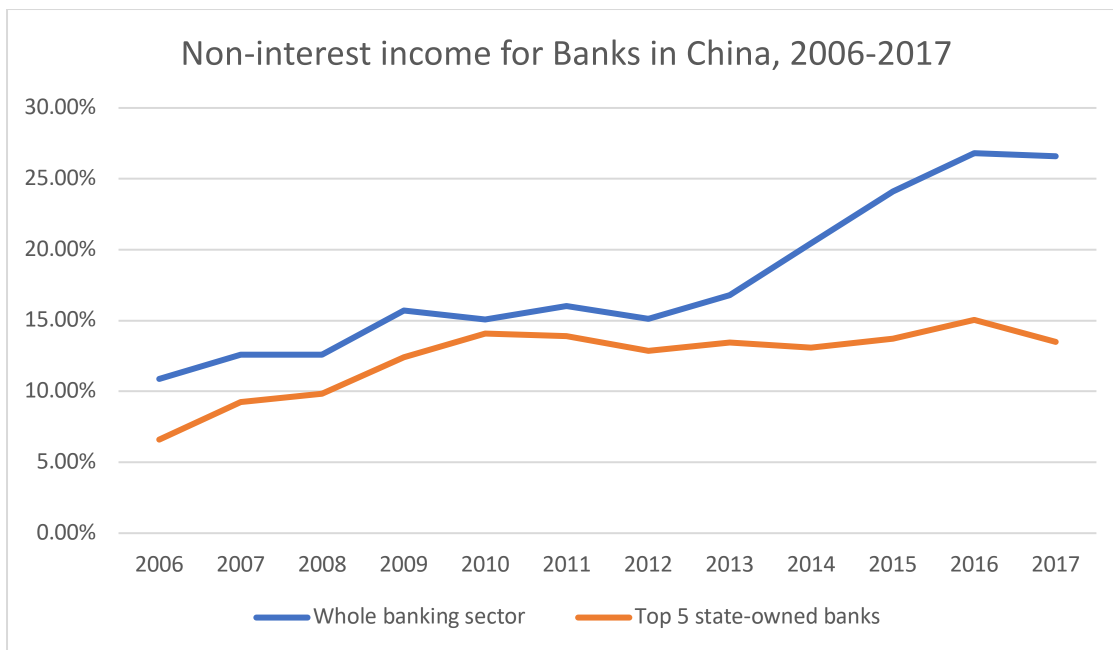

Figure 39 Non-interest incomes for banks in China, 2006-2017.

Source: World Bank Global Financial Development Database and *Wind*.

6.7 Conclusion

This chapter has approached financialisation of China's financial sector from two transformations of China's financial system. The first transformation started with a state-led financial liberalisation reform, ended up with a western-style financial system which has a multi-tiered banking system and a full set of money market and capital market. The second was a spontaneous market-led transformation which was initiated by the state intervention after the GFC and then led by the rise of shadow banking. The second transformation made the banks transform towards "banks in the shadow" and establishing a closer relation between banks and other submarkets, effectively enhancing bank's central role in China's financial system.

To look at the core of China's financial system, it is found that China's financial sector displays great continuity even after the two transformations. Precisely, China's financial sector is still

bank-based, credit-centric, partially liberalised and state-controlled. And the relational and government-controlled structure prevails. The continued characteristics of China's financial sector make it impossible for the arm's length and private mechanism of finance to grow. In this sense, financialisation is too early to be identified in the current Chinese financial system.

Chapter 7. The transformation of China's local governments

7.1 Introduction

The earlier chapters have discussed how the state creates and runs the large industrial and financial capital at the central level during the reform -- large capitals have accumulated gigantic economic clouts, which led to equally enormous political influence over the policy making. Through a wider lens, the main economic agents at the local level should also come into play because they are the actual implementors of the state policies, and the fundamental building blocks for the Chinese economy, which in turn become important shaping powers of the reform.

As discussed previously that China has formed a vertical hierarchy where the centre is at the top and the province, city, county, township and village are one level down by each, which could all be referred to as the "local level" in general. Local level shares similar organisational settings as the centre, but with lower political ranks. This chapter is going to bring the local level—including local government and local SOEs into the picture. Some local SOEs are also large in size, and some of them are even internationally well-known. They will not be discussed in this dissertation as they share great similarities with those central SOEs. A special type of local SOE—local government financing vehicles (LGFVs) which share close relations with the local governments and with the financial system will be discussed in this chapter.

This chapter argues local governments are corporatised, behaving increasingly like central SOEs. The transformation of local governments is embedded in the hierarchical institutional settings where the central-local system is connected and coordinated by the same chain of

command but is rather loosely coupled (Zhou, 2020b). The legitimacy of the local authority comes from the delegation of power from the central authority, which creates a fundamental tension between the centralisation of the authority and the effectiveness of local governance (ibid). The local only has "symbolic compliance" to the centre, and it inherently has behavioural deviations (Zhou, 2021, p. 672). In this centralised system where the centre has the absolute dominant political power, the local has to be in compliance with the top-down instruction to survive. However, it also has to reconcile with different circumstances which "pull and push the actual policy implementation in different directions" to behave accordingly (ibid). Put it against the Chinese reality, it works in the way that the centre sets the policy goal and the local implements it with its autonomy and some degrees of discretion. The autonomy and the discretion could be large enough to lead to behavioural deviations from the original policy, which serves as the foundation of the transformation of local governments.

Additionally, a dualism between loose coupling and responsiveness that prevails between the centre and the local also effectively facilitate the transformation of local governments. On the one hand, the system has considerable flexibility due to the vague policy goal and unclear incentive structure, which effectively leaves room for the local discretion. On the other hand, the system ensures a strong mobilisational mechanism via the party line, personal loyalty among others (Zhou, 2021). When the government stimulated the economy with the 4-trillion stimulus package, the GDP tournament among localities and the land sale encouraged the local government's borrowing, which could in turn benefit the local development and then further prolong the governor's political life (Zheng and Huang, 2018). Local governments were sensitive to this general goal, so they responded quickly by establishing the LGFVs and borrowing heavily via them. Under such a fiscal-financial connection, local governments have

gradually behaved business-like and revenue-oriented. At the same time, they were too carried away by their autonomy, so that they were always deviating from the policy goals and then created another monster—a high debt level. Some of China's local government debts are hidden on banks' off-balance sheets, especially those municipal corporate bonds (MCBs) through asset management plans (Chen et al., 2020). The growing LGFVs accelerated the new financial markets (Chen et al., 2020), which accelerated the transformation of local governments towards corporations.

The transformation of local governments could not be possible without the facilitation of shadow banking, which is considered as the consequence of the transformation of the banking sector in this dissertation. The strong ties between the banking sector and local SOEs have not been replaced by the arm's length and private mechanisms. The relational and government-controlled structures prevail in the operation that involves local governments and LGFVs.

As for local governments, despite they have developed even stronger relations with the local SOEs, in particular, the LGFVs, which have been caught in the fiscal-finance connection, they have remained their developmental characteristics, i.e., the commitment to overcome underdevelopment and the aspiration for economic development (Johnson, 1999). Specifically, local governments have been dedicated the fiscal revenues to the public investment for local development regardless the efficiency of these investments. In this sense, the transformation of local governments has effectively promoted the economic growth of localities. Additionally, local governments exercise their acquired financial skills on bank-based and credit-centric instruments, including the shadow banking activities and

instruments, enhancing the characteristics of China’s bank-based and credit-centric financial system. Thus, it is difficult to capture financialisation in China’s local governments at the moment.

The remainder of this chapter proceeds as follow: Section 7.2 will introduce the trajectory of fiscal reform, equipping the readers with the background as to why the local governments were incentivised to participate in the increasing revenue-orientated activities. Section 7.3 will elaborate on how the local governments have adopted the practices of corporations by revealing the local governments' manoeuvres in pursuing high fiscal revenues and the way that local governments and local SOEs (particularly LGFVs) form a strong tie to participate in the shadow banking. Finally, section 7.4 concludes.

7.2 Fiscal reform before the new century

The local government has similar bureaucratic designs as the centre with systematically lower political rank, but the operating mechanisms are massively different in the local from that of the centre. The centre is more likely to follow the logic of politics whereas the economic and money motives always dominate the local (Zheng and Huang, 2018). This difference was rooted in the fluid central-local power balance in the fiscal reform in the 1980s and 1990s. However, the reform has gone through, the relational and government-controlled structure in finance had not changed. The close tight between the local government and local SOEs are even reinforced in the new century with the rise of finance. The clearest manifestation is the fast-growing LGFVs after the GFC. The local government, therefore, has seen a transformation towards corporations. This section will first elaborate the fiscal reform that facilitated local

government’s transformation, equipping the reader with essential institutional backgrounds of the transformation.

The fiscal system was centralised under the planned system in pre-reformed China. MOF was responsible for financing the nationwide economic activities by using the tax revenue, a primary part of which was supplied by SOE’s profits (Zheng and Huang, 2018). Under such centralised planned system, the local government did not have enough autonomy on their fiscal revenues and expenses, which led to the low incentive on productivity growth.

To solve this problem by transforming the provincial government as independent fiscal actor, decentralised fiscal reform started in the 1980s. Firstly, separate tax bases were created for the local and the central SOEs’ revenues in the 1980s (Zheng and Huang, 2018, p. 344). However, the new tax base was insignificant for the local fiscal revenue, so the local governments still had to rely heavily on the redistribution of central government. It was essentially still a centralised fiscal system based on the centralised revenue remittance and redistribution (Zheng and Huang, 2018).

In 1985, a shared tax base was created to consolidate the fiscal decentralisation. The shared tax base worked in a way that provinces with fiscal surplus remitted a proportion to the central government whereas the provinces with fiscal deficit got subsidy from the shared tax base. This was simply to ensure each province as an independent fiscal actor could balance its own budget (Zheng and Huang, 2018). In 1987, the fiscal reform went one step further to the place where the central and provincial governments established a fiscal contract—some provinces share their fiscal revenue proportionately with the central government while other

provinces remitted a fixed amount of revenue to the centre (Lou, 2009; Zheng and Huang, 2018). At the same time, the provincial government were required to finance their expenditure by their revenues (Lou, 2009). Because of the pressure of the economic development and the competition between localities, local governments tried to avoid sharing their revenues with the central government, which naturally led to the sharp decrease of central fiscal revenue (Lou, 2009; Zheng and Huang, 2018).

The fiscal contracting system dominated the fiscal relation of each level of government and the next level down but the relation became less formal and looser in the lower level governments, which led to the increase of extrabudgetary revenues (Lou, 2009; Zheng and Huang, 2018). The primary part of the extrabudgetary revenues came from non-tax revenue of the locally managed SOEs, i.e., township and village enterprises (TVEs) as well as their contracted shares of the profits. [44] This signals the start of local corporatism because local governments have incentives to foster the SOEs in their own jurisdictions, and in fact, they control the TVEs through resource allocation, including assigning the investment projects and allocating bank credits (Zheng and Huang, 2018). This fiscal arrangement effectively built the foundation of local government's corporatisation because each local government had to strive for their own tax bases and profit sources.

The decentralised fiscal reform in the 1980s and early 1990s was to empower the local government at the expense of the centre losing direct control over the local. As a result, the central government revenue dropped significantly from 40% of total government revenue in

[44] Extrabudgetary revenue/funds are also referred to as "off-budgetary revenue/funds" in some scholarly works, see for example Zhang et al., 2014.

1984 to less than 30% in 1992 (Lou, 2009), whereas the local government became more aggressive interventionist when dealing with the relations with the local branch of the central bank and state-owned banks (Zheng and Huang, 2018). Moreover, the central government had to borrow from local governments, adding more weights on the already "weak trunk and strong branches" situation (Lou, 2009, p. 156).

To turn this situation, China experienced a new round of financial and fiscal reform in 1994, aiming to recentralised the fiscal system to build a fiscally strong state and an efficient market (Zheng and Huang, 2018). This new financial-fiscal system was called "94 system" *(jiusi tizhi 九四体制)* (Zheng and Huang, 2018). The fiscal aspect of the new system was to create a tax-sharing system (*fenshuizhi 分税制*), an attempt to replace the old "discretion-based system of revenue-sharing" with a new "rule-based system of revenue-sharing" through an institutionalised central-local transfer (Lou, 2009; Wang, 1997, p. 802; Zheng and Huang, 2018, p. 350). Specifically, taxes were divided into three categories: central, local and shared (Wang, 1997). The centre and local had separate tax administrations, which were responsible for collecting central and local taxes (Lou, 2009; Wang, 1997; Zheng and Huang, 2018). To replace the old SOE "tax-for-profit" system, the new system were based on the production-based value-added tax (VAT), corporate income tax and business tax where the VAT constituted the major part of the tax base (Wong and Bird, 2008; Zheng and Huang, 2018). As for the shared tax, they were divided between the central and the local by an set formula: 75% VAT went to central coffers, and the rest went to the local (Wang, 1997; Zheng and Huang, 2018).

The situation of "weak trunk and strong branches" was reversed as an immediate result of this new fiscal arrangement as more than half of the local tax went to the central coffer in

between 1994 and 2012 (Zheng and Huang, 2018). However, this system went to another extreme where the local fiscal capacities were heavily undermined, bringing about the dysfunctional local government on public provisions (Wong and Bird, 2008; Zheng and Huang, 2018). The mismatch of the expenditure and revenue pushed the local government to the highway of seeking more extrabudgetary incomes, such as the sale or the transfer the state-owned assets or miscellaneous fees to finance the local development (Wong and Bird, 2008; Zheng and Huang, 2018). This is arguably the reason why local governments were involved in land finance and have accumulated such significant amount of debts. [45]

The corporatisation of local governments, therefore, becomes the most unintended consequence of 1994 tax-sharing reform and 1995 budget law reform, which was further enhanced by the rapidly growing extrabudgetary funds/incomes and a new source of fiscal revenue from land. [46] Many scholars have called it "local state corporatism" despite their differences in definition (see, for example, Fewsmith, 1985; Oi, 1992; Schmitter, 1974). Others did not use the word "corporatisation" or "corporatism", but they indeed have observed the blurring line between "government" and "business" at the local level (Duckett, 1998; Wong and Bird, 2008).

[45] Other scholars might take on different views. For example, Lan (2021) claims that the roots for the high government debts is not the insufficient revenue, but the excessive spending. Exploring whether the root of high local government debt is insufficient revenue or excessive spending requires more rigorous quantitative analysis, which is obviously beyond the scale and scope of this dissertation. Nevertheless, he believes that the local governments take on too many roles in the local economic development, which is in line with the argument of this dissertation.

[46] Many scholars use the word "local state", for example, (Oi, 1992; Zheng and Huang, 2018). Yongnian Zheng believes that China has a *de facto* federal institutional arrangements (Zheng, 2007; Zheng and Huang, 2018). The exploration and the discussion are beyond the scope of this chapter and this thesis, but to avoid the misunderstanding about China's vertically centralised political system, this research remains to refer it as "local government".

Together with the fiscal reform, the 1990s market-oriented housing reform added more weight to the corporatisation of local governments. Before the reform, houses were publicly provided by the state for the individuals who work in the state sector, such as employees in governments, SOEs, and/or in other state institutions, including hospitals, universities, and state-owned financial institutions. After the first reform in 1994, state sector employees were allowed to purchase the full or partial right of usage of a house [47] at a subsidised price as a welfare to state sector employees (Liu and Xiong, 2020). After 1998, the monetisation of housing went all out -- the house needed to be purchased at a market price. Because the abolishment of the housing-provision system, in addition to the process of urbanisation, a huge demand for houses was created. At the same time, a series of policies were carried out to stimulate the purchase of the house. In 1998, the central bank approved that households could obtain a residential mortgage at a subsidised interest rate. The interest rate was lowered five times to encourage the purchase of a house between 1998 and 2002. By 2005, China has become the largest residential mortgage market in Asia (ibid). Simultaneously, more types of real estate loans were encouraged to be developed and the real estate developer were allowed to presale the house.

7.3 How the local governments transform into corporations

The fiscal revenue and the way to collect and to distribute such revenue matter significantly for the transformation of local governments. This is because the ownership of land is in the hand of the central government whereas local governments are responsible for the regional development which local governments have incentives to collect large amount of revenues

[47]'House' here refers to the flat or apartment. Majority Chinese urban citizens live in a flat or an apartment, rather than a house.

to power. Further, larger fiscal revenue generally leads to better local development, which further results in higher GDP. Thus, under the GDP tournament among provinces, the fiscal revenue became a measurement of capabilities of the local government, which is then closely associated with the political reward of their governors. Hence, both the local governors and the local governments themselves have the incentive to obtain greater fiscal revenue, which effectively facilitates the transformation of local governments.

Land market and real estate market are the arenas of the local government's final transformation towards corporations. And the essence of the "land finance" is the "real estate finance" (Lan, 2021, p. 67). The land transfer via land auction system was instituted in 1998, allowing the land use rights to be transferred from the local government, the *de jure* owner of the land in their geographical jurisdictions, to the real estate developers at land's economic value (Liu and Xiong, 2020; Zheng and Huang, 2018). This is the primary land market (Liu and Xiong, 2020). In the secondary land market, the local government could profit from selling the leasehold to a real estate developer, who will later resell the leasehold to a third party (ibid). In the first decade of the 2000s, the revenue from land transfer became the primary source of the local fiscal revenue, and in some years, it could account for up to 50% of their regular tax revenue (Zheng and Huang, 2018). Then, the real estate developer imputes the cost into the final price of their estates. Under this arrangement, local governments had to perform as profit-oriented corporate-like entities to strive for more funds for their local development.

Houses in China are both shelters and an investment instrument for Chinese households. Thus, the demand for houses increased dramatically given the ongoing process of urbanisation, and the lack of investment opportunity for Chinese households due to the underdeveloped capital

and money market gives another boost to the housing demand (Liu and Xiong, 2020). The strong demand pushed up high housing prices and stimulated the prosperity of the land market, namely, the increasing demand for land and ever-rising land prices, from which the local government could accrue huge amount of revenue. Current and future revenues of the land also serve as collaterals for the fundraising through LGFVs. Additionally, these LGFVs with implicit local government guarantees rely on real estate as the collateral to borrow intensively from banks or via MCBs, through which the local government participate in shadow banking. This will be elaborated fuller below.

LGFVs are essentially state-owned enterprises, which are set up by the local government as a platform to raise funds from banks and investors for infrastructural and real estate development (Amstad and He, 2020; Chen et al., 2020; Zheng and Huang, 2018). They were called variously by the name of development or investment corporation and helped to generate continuous cash flows and credits from the land (Zheng and Huang, 2018). To carry forward the stimulus package, the central government effectively relaxed the restrictions on the financing of local governments and explicitly encouraged them to take on bank loans through financing platforms or local financing vehicles in late 2008 (Chen et al., 2020). Thus, the burgeoning of LGFVs and massive amount of bank loans have been observed in the following years. The number of LGFVs increased drastically across the country from nearly nonexistence to around 10,000 by the end of 2010 (Zheng and Huang, 2018). Banks happened to be willing to lend to LGFVs because banks could charge a higher rate than they typically do with SOEs, and the credit risks are relatively low as LGFVs have implicit local government guarantees (Sun, 2019). Local borrowing, thus, increased dramatically after the GFC due to

the collective effect of the central government's stimulus plan, local economic tournament and the land sale (Chen et al., 2020; Xiong, 2018).

Local government's borrowing is primarily through two channels: obtaining loans from banks and/or issuing bonds, both of which are under the assistance of LGFVs. Local government could directly issue municipal bonds, or they could issue MCBs via LGFVs. [48] The municipal bond is a type of government whereas MCB is, in essence, a type of corporate bonds because it is issued by a business entity-- LGFVs (hence the name *corporate*), but it has implicit local government guarantees (hence the name *municipal*) (Amstad and He, 2020; Chen et al., 2020; Sun, 2019).

Municipal bonds emerged after the 1994 tax-sharing reform which prohibited local government direct borrowing but allowed the issuance of municipal bonds via MOF (Chen et al., 2020). They grew steadily during 2009-2014, and suddenly collapsed at 2015 as an outcome of de-leveraging the local government (Amstad and He, 2020). No. 43 Document of State Council put a restriction on LGFVs raising funds for new investment projects, but still allowed LGFVs using MCBs to repay existing debts, and also encouraged local governments to replace the maturing debts with municipal bonds (Chen et al., 2020). As a result, local government swap two trillion RMB of its newly issued municipal bonds with the debt that initially raised by LGFVs under the so-called "local government bond swap program"(Amstad and He, 2020; Chen et al., 2020).

[48] Municipal corporate bond (MCB) is also referred to as LGFV bonds, urban investment construction bonds or chengtou bonds (*城投债 Chengtouzhai*), with the chengtou bonds being the transliteration of its Chinese name, see for example (Ang et al., 2018; Gao et al., 2021; Liu et al., 2021).

LGFVs are also deeply involved in the shadow banking system. Even though LGFVs are SOEs in essence, unlike large central SOEs which play the role of lenders in the shadow banking system, LGFVs in most cases are borrowers with implicit government guarantees. A typical funding flow for LGFVs financing through shadow banking is that LGFVs issue MCBs with the implicit guarantee of local governments, and trust companies hold MCBs, which are financed by WMPs through commercial banks, whose funds ultimately come from the households and individuals (Chen et al., 2020, pp. 44, 47). The obtained funds are eventually used to support LGFVs to carry out long-term infrastructure projects.

The funds that were raised through bonds or loans, together with the fiscal revenue which was collected from the land transfer, were invested in the local infrastructure development, which, in turn, pushed up the future land prices, and the cycle sustained (Zheng and Huang, 2018). This explains why the most developed cities are those with the highest GDP as well as have the best infrastructure and the highest housing prices simultaneously. Local governments are deeply entrenched in this closed cycle that is pumped up by land sale and real estate development, gradually transforming itself into a profit-pursuing corporate-like entity which borrows massively, invests extensively and fundamentally revenue-oriented.

However, under the cover of transformation towards corporations, the core of local governments has not fundamentally changed. For one thing, the essence of the local government borrowing is still the bank credit. As mentioned earlier the local government borrows heavily primarily through bank loans and bond issuance. And the majority of the bonds are MCBs, a type of corporate bonds that are disguised by bank loans. Secondly, the transformation has not changed the relational and government-controlled structure of the

Chinese economy. Specifically, local governments and local SOEs, in particular, LGFVs had not broken the tight relations with the rise of finance and the transformation. Instead, the relationship between them was reinforced by the emergence of the LGFVs and shadow banking. The arm's length and the private mechanism had not been properly cultivated in the Chinese economy.

Overall, despite the local government had seen an apparent transformation toward corporations and the financial logic prevails in the local development, the core of the collusion within the state sector had not changed, and the bank credits have been dominating the financing conducts of local governments as well as the shadow banking activities that they have participated into. Therefore, the transformation of local government does not imply financialisation, rather, it looks like an expansion of bank credits.

7.4 Conclusion

In summary, this chapter explains how the local government is transformed with the penetration of finance, and in turn, these transformations accelerated the growth of shadow banking. Specifically, local governments have been behaving like corporations as they strive for more revenues by selling land or selling the leasehold of the land to the real estate developers, or directly borrowing through LGFVs. Local SOEs, using LGFV as an example, established closer relations with local governments and reinforced the relational and government-controlled structure. Through local SOEs, not least the LGFVs, local governments take on more roles other than the exogenous regulator of the market. It also becomes the endogenous market player.

The transformations of different actors in the state sector are intertwined together. The transformation of the local governments and the local SOEs would not be possible without the transformation of banks in the first place. At the same time, local governments and SOEs are active players in the shadow banking (Chen et al., 2020). Precisely, the local government provides implicit guarantee of shadow banking (Cong et al., 2019), and its corporatisation went on an overdrive under the assistance of shadow banking. Local SOEs, not least the LGFVs are often seen as ultimate borrowers.

Nevertheless, what happened for the local government is not financialisation. First of all, the core of the conduct of each actor in the state system has remained unchanged. The increasingly business-like local governments remained their developmental characteristics, focusing on economic development. To be more specific, the local government coordinates a simultaneous move of various entities to achieve the goal, and in this process, it represents the national interest, or at least the regional interest. The local government provides a vision for the future development of the economy, which fits with long-term development. This cannot be done by simply following current price signals and the profit motive. Second, the financial skills that have been practiced by the local government are not relevant to the sophisticated securitisation or financial innovation. Rather, they are different forms of bank loans, or the shadow instruments which are considered as disguised bank loans. Last but not least, the relational and government-controlled structure have not replaced by the arm's length and private mechanism. That is to say, the rise of finance in China does not bring further institutional change.

Interestingly, there is an important “entrepreneurial” dimension in the role of the developmental state and seems to be confirmed by the transformation of the Chinese local government (Chang, 1999). It is necessary not to dismiss state entrepreneurship as risky, but to build a mechanism that will enable the state to put together different dimensions of its role to create a consensus out of it for both the economy and society. In this sense, the transformation of Chinese local government does not fundamentally deviate from its developmental role. On these grounds too, it is not possible to state that China’s local governments have been financialising.

Chapter 8. Conclusion

This dissertation is a quest for the answer to the research question of *whether the Chinese economy has become financialised*. It is approached by examining the two operationalised questions: first, *how is the conduct of each of the main economic actors within the state sector (i.e., SOEs, banks and governments) transformed with the rise of finance in the past twenty years?* Second, *do the transformations represent financialisation?*

The concept of financialisation takes on various forms depending on the unique historical, institutional, and political backgrounds of different economies. China's economy is considered a non-typical capitalism, making it difficult to apply existing analytical frameworks to discuss its possible financialisation. This dissertation focuses on the state sector as it possesses the commanding heights of the Chinese economy. As such, financialisation, as a concept that refers heavily to monopoly capital, is better discussed in the context of the state sector.

To answer these questions, this dissertation revises and syntheses the existing analytical framework from within the Marxist political economy and proposes a somewhat new analytical framework to capture the core of financialisation by examining the altered conduct of each actor in the state sector as well as their changing relations. By specifically looking at the SOEs, the financial sector and the local governments, this analytical framework grasps the specificities of the Chinese economy and reveals the transformation of each state actor, casting light on the aggregate Chinese economy.

With the help of this analytical framework, this dissertation concludes that each actor in the state sector has experienced great transformation since the Opening and Reform that commenced in the 1970s. Specifically, SOEs are transforming into more financially sophisticated enterprises, banks are transforming into "banks in the shadow" and local governments are transforming into corporations. On top of these changes, the state increasingly uses financial means to govern each of the actors within the state system. However, these transformations display great continuities in the historically specific function of the Chinese economy, which do not allow us to identify financialisation in China despite the tremendous growth of its financial sector.

The remainder of this chapter proceeds as follows. Section 8.1 answers the first operationalised question *(how is the conduct of each of the main economic actors within the state sector, i.e., SOEs, banks and governments transformed with the rise of finance in the past twenty years?)* by synthesising the empirical findings through the lens of financialisation. Section 8.2 interprets the political economy of the empirical findings to uncover the second operationalised question, i.e., *do these transformations represent financialisations*. Before closing the whole dissertation, this chapter finally delineates the implications of the study and points the direction for further research in section 8.3.

8.1 The synthesis of research findings

By applying the analytical framework, empirical findings are presented in Chapter 4 to 7. Chapter 4 and 5 characterise the transformation of SOEs, particularly the central SOEs, as well as the changed states' governance towards these SOEs. Chapter 6 introduces the nature of the financial sector with an emphasis on the banking sector, as well as bank's transformations

towards the "banks in the shadow". Chapter 7 works on the transformation of the local governments. This section will synthesise the empirical findings of each actor in the state sector to scrutinise their transformations.

To explore financialisation of the state sector, the first step is to figure out how each of the actor in state sector works. Starting from the SOEs, it argues in Chapter 4 that SOEs possess the commanding height in the Chinese economy. They are also politically crucial for the same reason as well as for the reason that their business leaders are included in the *nomenklatura* system making them cadre-entrepreneurs. The central government specifically created and ran large central SOEs, facilitating their expansions into business groups and their going-out to become "national champions" to compete globally with other multinational corporations. This structural change was enabled by the state and paved the road for their transformations.

The state governance over SOEs increasingly relies on the financialised means, which not only was unable to prevent their transformation but even effectively accelerated this process. The state plays two different roles—it could either be an exogenous high power as the regulator or an endogenous player in the market, i.e., the investor/owner. The dualism intrinsically undermines the strength of the state's governance over these central SOEs. Consequently, these large central SOEs possess enormous political and economic clouts that are large enough to form their own "small kingdoms", which become the foundation of central SOEs' transformation towards financially sophisticated enterprises.

To identify financialisation, more concrete empirical evidence should be displayed to uncover the core relations of financialisation-- the financing behaviour of central SOEs. Due to the data

availability, 362 publicly listed central SOEs are selected and formed a subsample of SOEs to represent the monopoly capital in the state sector. By constructing a firm-level dataset that is composed of 362 publicly listed central SOEs, and analysing it from the perspective of the Uno tradition of Marxist political economy which believes the two-way relationship between finance and real accumulation, it finds that the publicly listed central SOEs used increasing amount of trade credits in the first two decades of new millennium, which was generally regarded as the informal financing, indicating the underdevelopment of these state monopolies and China's financial system. At the same time, the bank credits were still the dominant financing channel for them with the market finance only accounted for a trivial proportion (roughly 20%) of total external finance. This piece of evidence confirms the argument in Chapter 6 that despite the rise of market finance, China's financial system is still bank-based and credit-centric.

In terms of the balance of the internal and the external finance, it had not changed fundamentally. The external finance was significantly larger than the internal finance throughout the first twenty years of the 2000s. The retained earnings are disproportionately less important than the external finance for these publicly listed central SOEs, but undistributed profits as the largest component of the retained earnings are crucial for them as they are the source for the enormous economic and political power of the "small kingdoms". In terms of the composition of the income, the proportion of financial income stayed at a low level (lower than 5%) despite the increasing interest incomes over the years in the observed period. The cash flow information once again confirms that these publicly listed central SOEs were heavily involved in bank borrowing.

In sum, these empirical findings suggest that central SOEs have not been distant from banks, rather, they rely heavily on bank borrowing, which implies the unbreakable tie between SOEs and state-owned commercial banks, further indicates the relational and government-controlled structure of finance in China. At the same time, the publicly listed central SOEs use increasing amount of trade credits and a small amount of market finance, which for one thing implies their involvement in the Chinese type of shadow banking businesses, and the other suggests the underdeveloped nature of China's financial sector. Overall, the central SOEs are found to be more financially sophisticated but had not seen the shifted towards financialisation.

Moving to the financial sector, it shows in Chapter 6 that finance has risen significantly in terms of its volume and importance in China's political-economic system, and it has experienced two transformations so far, but the financial sector had not changed fundamentally. Specifically, the first transformation is a state-led financial liberalisation, a process that rehabilitated market in the Soviet-type of banking system. By the new century, Chinese financial system has evolved into a western-style finance with a multi-tiered banking system and a full set of money and capital market. The second transformation was a market-led one, starting after the GFC, when the shadow banking was gradually taking grounds. The second transformation features the transformation of the banking sector towards "banks in the shadow", i.e., to undertaking off-balance-sheet businesses to bypass the regulation and performing as middlemen in between financial markets and non-financial enterprises and creating tight links between the banking sector and various different submarkets in financial markets. However it changed, the core of the banking sector, the core of China's financial sector remains a bank-based, credit centric and partially liberalised system where the

relational and government-controlled structure had not been replaced by the arm's length and private mechanism in the financial system. And the state keeps its strong presence in the financial market, typically, it controls the interest rates and international capital flows. Thus, the transformation of China's financial sector lames the essence of financialisation.

The transformation of banks triggers further changes of other actors in the state sector, as well as their relations. The changing relations between banks and SOEs have been stated in Chapter 5 and 6, and the transformation of local governments is presented in Chapter 7. Local governments have been behaving like corporations, especially through 'land finance'. Specifically, local governments sell the land for funds to finance regional development. A higher level of regional development leads to higher housing prices, which in turn pushes up the land prices again, and the land finance sustains. In the process of regional development, LGFVs could also chime in to provide more funds by issuing MCBs, a disguised banking credit. As a special type of local SOEs, LGFVs enjoy local government guarantees. Overall, inside this closed circle, local governments participate in the economy directly as revenue-oriented and business-like endogenous market players. In this sense, they are transforming towards corporations. This transformation also indicates the prevailing relational and government-controlled structure in China, and the developmental core of the local governments. Thus, it is not easy to identify financialisation in China's local governments.

8.2 Financialisation or what?

To synthesise the findings in the core empirical chapters and to present a comprehensive answer to the research questions, this section will work on identifying the characteristics of the transformation of each actor of the state sector, *i.e., whether its transformation is*

financialisation or not? It will be analysing and arguing in this section that the seemingly transformation of the state sector, in fact, has not changed the essence of the behavioural characteristics of each actor. Thus, it is too soon to identify financialisation in China's state sector. In certain ways, the transformation looks like credit boom instead of financialisation.

This dissertation has stressed that financialisation is by no means an escape of productive capital into the financial realm seeking for higher profits, or production is being crowded out by the finance (ibid, c.f. Lo, 2018; Orhangazi, 2008; Stockhammer, 2008). Instead, financialisation is regarded as an epochal transformation in this dissertation. This epochal transformation reflects a) "the extraordinary growth of the financial sector relative to the rest of the economy" (Lapavitsas and the EReNSEP Writing Collective, 2023, p. 38); b) the spread of financial practices and concerns amid the agents of capitalist accumulation, namely, non-financial enterprises, banks and the local governments. Moreover, this epochal transformation also requires wider institutional change except the rise of finance, especially the transformation towards a market-based financial system and the arm's length and private mechanism (Karwowski and Stockhammer, 2017; Lapavitsas and the EReNSEP Writing Collective, 2023).

Departing from the definition of financialisation, the empirical findings of this dissertation do not provide adequate evidence to support China's financialisation. First of all, the transformation is only a cover of the unchanged core of the behavioural characteristics of each actor in the state sector. Specifically, central SOEs as the sample of China's non-financial enterprises have not seen drifted apart from banks. On the contrary, they keep their close and formal relations with banks through obtaining large amount of bank credits. The

increasing amount of trade credits are also handled by the banks. Additionally, bank borrowing made up the largest proportion of both the uses and sources of cash flows of the publicly listed central SOEs. Adding up the above three aspects, it shows that the central SOEs in China have not been distant from banks by any means. Thus, the relations between central SOEs and banks are enhanced through formal banking businesses.

Other than that, SOEs have been deeply involved in shadow banking businesses where banks play the central role. Instead of being distant from banks, the relationship between banks and SOEs is again enhanced through informal shadow banking activities, such as entrusted loans and trust loans. Although central SOEs and local SOEs participate in shadow banking activities in slightly different ways, the essence of these off-balance-sheet banking businesses is credit-centric. Specifically, central SOEs as the most privileged recipients of bank loans, they could borrow massive amount from the commercial bank at a discounted rate and then lend the idle funds to other enterprises through shadow banking or their own in-house financial arms to earn interest margins (Allen et al., 2019; Ehlers et al., 2018; Wang et al., 2019). Central SOEs normally perform as ultimate creditors in the shadow banking system, whereas the local SOEs, typically the LGFVs are always ultimate borrowers. Although they also have easy access to bank loans, LGFVs issue massive amount of MCBs, a disguised form of bank loans.

The state monopolies have only very limited interactions with the open market, and it is difficult to see the shift towards the shareholder value orientation. These altogether indicate the prevailing relational and government-controlled system in finance where the SOEs have been institutionally privileged against the non-state enterprises by the banking sector. The state-owned-banks-dominated financial system ensures this practice. It further implies that

the bank-based financial system has not been replaced by the market-based system. This is very different from what has observed in non-financial enterprises in other countries where they became distant from banks when financing their investments. They hold large volumes of liquidities that are available for lending (Lapavitsas, 2013a). And they turn to the open market to meet their needs for finance, which is relatively independent of banks. Therefore, the transformation of China's non-financial enterprises and their relations with the financial sector do not suggest financialisation at the moment. Rather, it looks more like a credit boom.

Secondly, to look at this from the perspective of the financial system, especially the banks, it is clear that the financial system keeps the same as what it was—bank-based, credit-centric, partially liberalised and strong state presented, despite the extraordinary growth of finance. However, financialisation is typically reflected by the shift from bank-based to market-based system in emerging countries, as well the replacement of the relational and government-controlled system with the arm's length and private mechanism. In this sense, China's financial sector has not been financialised.

Zooming in on the financial system to look at banks, they show the tendency of transforming into "banks in the shadow" as they expand new sources of profits other than conventional lending and borrowing businesses, turning to mediating in the open market. However, China's shadow banking is not based on securitisation, but on bank credit. The transformation of SOEs and banks, as well as the seemingly financial innovation, are still based on the expansion of bank credit instead of securitisation. So the shadow banking in China is essentially the shadow of banks (Amstad and He, 2020; Sun, 2020). Additionally, what is fundamentally different from the financialisation in other countries is that shadow banking in China effectively

promotes the growth of the small-and-medium-sized enterprises by relieving their financial constraints and further contributes to the economic growth (Galina Hale and Long, 2011; Tsai, 2017). There is no doubt that a great amount of funds is funnelled to the enterprises with overcapacity and/or in the real estate sector. However, the portion of funds that were allocated to financially constrained firms had a positive impact on the real economy, which contrasts with the concept of financialisation.

In terms of the state, it uses increasing financial means to govern SOEs and the state-owned financial institutions. On the central level, it manifested as the state being the shareholder of the SOEs and the state-owned financial institutions. On the local level, governments behaved like corporations with the rise of finance. These surely represent a huge change of the state's role in the market—changing from an exogenous high power to a hybrid role of being both the exogenous high power and an endogenous market player. However, it did not lead to the fundamental change to the relation between the state and the market—the state controls the commanding height of the economy. And it did not bring wider institutional change—the relational and government-controlled system in the market has not replaced by the arm's length and private mechanism. Besides, the government has not abandoned its developmental characteristics—the raised funds were heavily invested in the infrastructure despite some went into real estates and the industries with over capacities. Last but not least, the state intervenes the economy through monitoring and controlling the interest rates directly via the state-owned commercial banks, unlike other capitalist countries which have to intervene the economy indirectly through the market by adjusting the benchmark interest rates. And the capital account is still under the tight control of the state. Thus, it is hardly to speak of financialisation of the state in this sense.

To sum up, the transformations of each actor in the state sector have not changed the core of the Chinese economy, rather, they simply represent the expansion of the bank credit, and a normal trajectory of financial development, which naturally leads to the expansion of finance. Financialisation normally comes along with certain structural changes, and the most pervasive one is that bank-based financial system is transforming towards a market-based financial system (Karwowski and Stockhammer, 2017; Lapavitsas and the EReNSEP Writing Collective, 2023). It does not seem to be true to China's case as China's financial system has always been dominated by the banking sector, so has been the rising shadow banking system. China's credit-based shadow banking system effectively fills the blank space that should have been taken part by the capital market and the money market. Therefore, without the shifting to a market-based financial system and the replacement of the arm's length and private mechanism, it is impossible to identify financialisation of the Chinese economy at the current stage.

8.3 Directions for further research

This dissertation has made a first attempt to develop an analytical framework from the conduct of basic agents of the state sector to examine financialisation. The explanatory strength of this analytical framework and the Marxist political economy have already been demonstrated in the empirical chapters. However, they do not constitute the whole picture of the Chinese economy. This section serves as a self-critique and also points out the possibilities of further research on the topic of China's financialisation.

First and foremost, the analytical framework has pivoted on the transformation of each actor of Chinese state sector. The choice of this framework is a strategic one—only the state sector is examined. Further research can be focused on the non-state sector, especially the non-state large business groups. How was they formed, and how they transformed their behavioural characteristics will shed light on financialisation of the non-state sector, and further on the financialisation of the broader Chinese economy. Moreover, the household as one of the fundamental economic agents in the economy also merits scrutiny. By looking at both the state and non-state sector, and all the basic agents of the economy, namely, non-financial enterprises, financial sector and households, as well as their interactions, it would be able to comprehensively understand financialisation of the Chinese economy.

Secondly, on the question of financialisation of China's state sector, I concentrate on the domestic dimension in this dissertation. Performing under the less opened financial system, the domestic and international dimension of the state sector can be better isolated than in any other countries with a fully liberalised financial system. In this sense, the transformation of each actor within the state sector is more of a consequence of the intertwined relations among themselves inside the domestic dimension. Therefore, leaving the international dimension out of the current research has no problem at all.

Although the international dimension plays a rather limited role in this dissertation, it does not follow that it is not important. On the contrary, the international dimension should be given further attention as the source of a paradox that has long existed in China. The country has the largest manufacturing and the trading economy in the world whereas its currency only plays a trivial role in the international financial system. Besides, China holds large amount

of the US treasury as its official reserve, reflecting the USA' hegemonic and China's subordinate position in the international financial system, which potentially implies high costs and high risks to the Chinese economy. Thus, in future research, the international dimension can be included to create new avenues of investigation, such as how the intertwined domestic and international dimensions mutually influence each other and altogether affect the transformation of the state sector, and further of the broader Chinese economy.

The large state-owned banks and these central SOEs are "national champions" that are designed to compete with other multinationals globally, they have separate mechanisms for operating internationally. For instance, these large publicly listed central SOEs are normally listed in three different places, New York, Hong Kong and Chinese Mainland, each with a proportion of their shares. During the time that the dissertation is under its final refinement, the US has accelerated its decoupling with China, including the finance. Five central SOEs, including Sinopec and China Aluminium, voluntarily delisted from the US capital market. This move does not imply any significant retreat of financialisation, but a political move that protects China's commanding height. The international dimension will soon be assigned greater importance as Sino-US relations had taken a sharp downturn and had every sign of turning to the worse.

Third, the local government's transformation towards corporations is closely related to the massive local government debts. LGFVs have local government guarantees, so the borrowing of LGFVs is also considered as implicit local government's debts. By 2016, non-bank local government debt had risen to 48% from only 1.5% in 2008 (Chen et al., 2020). As argued in this dissertation the transformation of the local government has not shown financialisation

because it has the developmental side to it. Officials are required to carry out visible infrastructure investments during their tenure which is only three to four years (Lan, 2021). New officials do not need to be concerned with the previous debts, as they are not held responsible for the liabilities incurred during their predecessors' terms before 2016 (ibid). As a result, a large amount of debt accumulates. Over time, the economic benefits of the continuing investment in infrastructure will eventually diminish. More investments will decrease the overall economic efficiency and exacerbate the overcapacity issues (ibid). This problem has already begun to surface. This could also explain why China's overall investment rate is declining. Once the cycle reaches a certain scale in infrastructure and urbanisation, it becomes difficult to sustain and has a higher risk of being financialised.

The current transformation towards corporations is not helpful in dealing with the significant amount of government debts, whose root arguably lies not in insufficient revenue but in excessive spending, as the government has arguably taken on too many roles and responsibilities in the economic development (Lan, 2021). The accumulated local government debts and the further transformation of local government will have great implications on financialisation, and they are worth continuous attention.

Last but not least, financialisation of the non-state sector is immediately relevant to the issue of the further development and reform of the Chinese economy. The topic should include financialisation of large non-state enterprises and that of households and individuals. Large non-state enterprises have also restructured themselves in the same fashion as the SOEs, i.e., they have aggressively merged and acquired small businesses horizontally and/or vertically to form giant business groups with the parent company at the top as the holding shell and

many kinds of subsidiaries, including a financial arm. Moreover, cross share holding between state and non-state business groups makes their shareholding structure as well as the ownership more complex. Does it reflect a shift towards shareholder value practices? And how is the transformation of the non-state sector being different from that of the state sector? Answering these questions would lead to a more comprehensive understanding of transformation of the Chinese economy.

In sum, this dissertation sheds light on the transformation of the Chinese economy and offers implications for its further development and financialisation. China is now in a predicament where it is the second largest economy and the largest manufacturing economy in the world, but it only plays a trivial role in the international financial system. Its currency is far from a world currency, and its international capital flow is under rigid state control. The contrast between its place in the world market and that in international money and finance is sharp. Thus, a further transformation of the conduct of the fundamental economic agents would certainly change the outlook of the Chinese political economic system as well as global capitalism.

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