



# **Bad Banking with Chinese Characteristics:**

## Financialized Political Capitalism in China

PHD THESIS 2018  
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PHD THESIS 2018 · ISBN 978-87-7209-187-7

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PhD. Thesis submitted 29<sup>th</sup> of April, 2018

PhD thesis 2018 © Tomas Skov Lauridsen  
ISBN 978-87-7209-187-7 (Printet book)  
ISBN 978-87-7209-191-4 (E-book)  
Printed by SL grafik, Frederiksberg, Denmark (slgrafik.dk)

## Abstract (English)

Why does China have a state capitalist system and how does it work? It is this overarching question within political economy that this PhD dissertation is looking to contribute to. It does so through a case study following the 1999-2013 evolution of the four Chinese asset management companies, from policy tools for the state to reorganize the banking system in China, to state-owned shadow banks – some of the largest shadow banks in China in terms of assets.

The purpose of the case study is to propose a mechanism that can contribute to explaining how the political economy of state capitalism works. The argument put forward is that through using the conceptualization of capitalism developed through Weber and Veblen, the nature and mechanisms of Chinese state capitalism can be usefully defined and theorized. Specifically, the dissertation is based on using process-tracing methods to build a theory proposing a key mechanism at work in Chinese state capitalism – Financialized Political Capitalism.

The dissertation is structured into eight chapters – after developing the research question in chapter 1, chapter 2 explores and reconceptualizes capitalism within the debate around

China's political economy. After a method chapter and a chapter outlining the generalities of AMCs, the next three chapters 5-7 present the empirical core of the thesis. Finally, chapter 8 will offer an analytical conclusion where the theoretical conceptualization of capitalism is used to structure the process-tracing analysis and the generalization of the findings into the concept of Financialized Political Capitalism.

## Resumé (dansk)

Hvorfor har Kina et statskapitalistisk system, og hvordan virker det? Det er dette overordnede spørgsmål inden for politisk økonomi, som denne ph.d.-afhandling ser ud til at bidrage til. Det gøres gennem en casestudie som følger af udviklingen i de fire kinesiske bank

omstruktureringsvirksomheder 1999-2013, fra politiske redskaber til statens omorganisering af banksystemet i Kina til at blive statsejede skyggebanks - nogle af de største skyggebanks i Kina målt på aktiver.

Formålet med casestudiet er at foreslå en mekanisme, som kan bidrage til at forklare, hvordan statskapitalismens politiske økonomi virker. Det fremførte argument er, at ved hjælp af en begrebsliggørelse af kapitalisme udviklet gennem Weber og Veblen, kan kinesisk statskapitalismes natur og mekanismer defineres og teoretiseres frugtbart. Specifikt er afhandlingen baseret på brug af processporingsmetoder til at udvikle en teori, der forklarer en nøglemekanisme i kinesisk statskapitalisme – Finansialiseret Politisk Kapitalisme.

Afhandlingen er struktureret i otte kapitler. Efter at have udviklet forskningsspørgsmålet i kapitel 1, udforsker kapitel 2 begrebet "kapitalisme" i konteksten af debatten om Kinas politiske økonomi. Efter et metode kapitel og et kapitel der beskriver

bankomstruktureringsselskaber generelt, fremlægger de næste tre kapitler den empiriske kerne af afhandlingen. Endelig giver kapitel 8 en analytisk konklusion, hvor den teoretiske begrebsliggørelse af kapitalisme bruges til at strukturere processporinganalysen og generaliseringen i form af begrebet Finansiell Politisk Kapitalisme

*Keyword: China, Political Economy, State Capitalism, Veblen, Weber, Financialization, Political capitalism, Bank Restructuring, Shadow Banking*

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# Chapter 1. Introduction

The central paradox examined in this dissertation is how the neo-liberal reforms of the 1990s contributed to the creation of central state capitalism as it exists today in China. It makes the bold argument that China's present-day central state capitalist model was developed because of, rather than despite, the neo-liberal reforms of the 1990s, which introduced new technologies of power imported from "the West". At the core of this state capitalist system sits "the emperor of finance"<sup>1</sup> – the state party-controlled banking system.

## **The paradox of convergence: capitalism without the transition from state to market?**

China's remarkable transformation has traditionally been presented within the framework of a transition from a state planned economy to a market economy (Naughton, 2007b). China was viewed as resembling the transition economies of the early 1990s in post-Soviet Eastern Europe and the former Soviet Republics. Common to all these economies was the fact that Western observers saw them as having a failed or failing economic system and as being in the process of developing a "Western market economy" through a process of transition (Sachs, 1996). This view, which was developed during the heyday of the neoliberal discourse in the West in the 1980s and 1990s, has also been applied to laggards like China. The only remaining question is the speed at which the country would adopt this solution.

This idea created a framework that still dominates China observers in the West, where the term "reform" is used as a euphemism for market liberalization, and change is conceptualized as being either counter to or supporting "reform". In this narrative, reform means adopting and conforming to global liberal norms of economic governance consisting of a regulatory state focused on providing public goods to citizens and fixing market failures, an independent central bank performing macroeconomic governance through monetary policy, limited state ownership of the corporate sector, a flexible labor market, an open trading and capital account regime and a market-based financial system.

This framework presented a paradox: if the global gold standard of institutional design for governing and creating a market economy was both known and performative, why didn't China converge with it in terms of institutional design, and why, despite this apparent lack of convergence,

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1 Term adopted from Walter and Howie (2011).

did China experience the largest period of economic growth in human history, with forty years of rapid expansion? If a market economy governed by a democratic and constrained state was indeed optimal for economic performance and development, why did a country with authoritarian government, uncertain property rights, extensive state ownership, powerful vested interests and extensive industrial policies experience the highest sustained growth rate? Furthermore, even when China imported economic institutions like modern banking, the corporate form or debt-resolution agencies from the West, why did these imported institutions and practices fail to transform the Chinese economy into a market economy? Finally, among the transition economies, China appeared to be special in terms of governance, politics and the pace of change. Concerning the latter, if China is still “transitioning”, it has been doing so for longer than its period as a state-planned economy.

This tension between economic performance and the lack of “reform” has fueled a peculiar genre of China-watching: “the China-crash watcher”. Observers like Gordon Chang have been predicting the collapse of the Chinese growth model since the early 2000s (G. G. Chang, 2001). More measured observers like Yasheng Huang have argued that, while the directional liberalism<sup>2</sup> of the 1980s and 1990s drove a healthy marketbased growth, the post-2000 economic growth model has become unbalanced and been captured by vested interests and the state-party (Huang, 2008b). In this narrative, this capture of the state by vested interests has blocked reform and led to monopolization and economic waste by investments being poured into state-owned enterprises (SOEs) or infrastructure projects that did not make economic and financial sense.

While this description is undoubtably true in a broad sense, it relies on using a “pure” market economic model where investments are allocated by the pricing mechanism and where that pricing mechanism accurately reflects the economic and financial value of the investments. But are the problems in the Chinese growth model really just a result of vested interests blocking reform and of bad political choices, or is there a deeper internal logic at play?

## **The poverty of the market economy and the richness of capitalism**

The market economy is a concept with a strange triple nature: it is at once an idealized theoretical construct within economics, a political concept and a description of a really existing form of economic organization (Polanyi, 1957; Watson, 2017). First, as an idealized theoretical construct, the market economy is conceived as an infinite set of markets at equilibrium which is used to form

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2 Directional liberalism was Huang’s shorthand for the argument that it was the process of liberalization – that is, the direction of change towards market coordination and private property rights – rather than the degree of market coordination and private property rights that was the key driver of “virtuous” economic development.