On a path towards financialization?

The expanding role of finance in China's growth regime

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1. Introduction

Since the 1990s, China's economic growth has been characterized by rapid extensive accumulation, based on an investment-led and export-oriented growth regime maximized by the underpricing of factor prices (Fabre, 2013). As an export-oriented economy, China was highly vulnerable to the fallout of the global financial crisis (GFC) and the global contraction of demand it caused, but government policy, including a large-scale stimulus program, have managed to cushion the expected severe impact of the crisis. Thus, ironically, in the aftermath of the GFC, 'communism saved capitalism' in the eyes of Chinese observers through the decisive implementation of a huge macroeconomic stimulus program; this provided the People's Republic of China (PRC) and the global economy – through the PRC's prominent role in global trade and global chains of production – with urgently needed demand. Since 2010, however, the formerly exceptional GDP growth rates produced by the Chinese economy have been in constant decline, revealing not only a possibly lasting impact of the GFC on global demand, but also fundamental weaknesses and contradictions within the Chinese growth model itself.

The investment-led extensive growth regime, relying on cheap migrant labour, created overcapacities and substantial imbalances, with the latter expressed in a strong increase in the profit share of national income to the detriment of wages. Accordingly, household consumption as a share of final demand has been declining, compensated for by exports (Zhu and Kotz, 2011; Molero-Simarro, 2015). At the same time, however, relentless accumulation in the labor-intensive industries has, as early as 2005, led to the appearance of labor shortages in the eastern and southern coastal manufacturing centres, which opened the way for a sustained increase in real wages in subsequent years. Because the labor-intensive private sector operates in an environment of cutthroat competition and restricted access to long-term financing, investments have not provided sufficient increases in productivity to compensate for the increase in wages. Thus, overproduction/insufficient demand, as well as a looming productivity crisis, are signalling the end of the artificially 'cheap China' model.[1]

Since Deng Xiaoping's policies of 'reform and opening', economic growth has become a central element of a new social contract between the Leninist cadre party and the population:

the Communist Party of China (CPC) stayed at the apex of China's political and economic order, delivering a constant improvement of living conditions and promising the return of the Middle Kingdom to its old international standing. In this regard, growth policies have an even clearer connection to fundamental issues of the political order than in most advanced economies. They are crucially linked with the legitimacy and stability of China's authoritarian political regime. In terms of economic policy, the current conjuncture of unfavourable economic developments presents a number of formidable challenges to the CPC, illustrated, for example, by a policy turnover apparently replacing policies for boosting demand advocated by Prime Minister Li Keqiang at the 2012 Central Economic Works Conference, with new supply-side policies, advanced since late 2015 by president and party chairman Xi Jinping.

Aside from such oscillations, reforming finance and financial regulation has continued to be a core concern in the CPC's recent economic policies, in the hope that the development of the financial sector will facilitate the transition to what may become a new 'epochal' growth (Kuznets, 1973). In part driven by the stimulus program, Chinese finance and real estate have already expanded rapidly, although the nature and quality of this development are yet unclear. Relying on financial instruments to sustain China's economic growth that in turn lies at the heart of the political order raises substantial issues. China's leadership had carefully avoided premature liberalization and opening of its financial sector in spite of its WTO commitments (Andreosso-O'Callaghan and Gottwald, 2013), arguably also to avoid the potentially negative impact of a liberalized financial sector on economic stability. But financial repression within the Chinese system led to the emergence of a multilayer system of financial services outside the official banking sector. This process, which had long gone unnoticed by the powers-that-be, may now pose a threat to economic and possibly political order in China, as banks and companies expand their shadow banking activities. The 'financialization' of China's economy, promising to facilitate economic reform and risking economic stability, thus presents a double-edged sword for the CPC.

Before this background, based on a survey of the theoretical discussion on financialization, this chapter surveys the evidence for financialization of the Chinese economy looking at micro- and macro-level economic developments and innovations in regulatory policy.

2. The study of financialization and its significance to China

2.1 The phenomenon of financialization

The phenomenon of financialization has recently drawn increased attention in economic and social science research (Engelen, 2008). Although there is some consensus in the literature about the empirical phenomena that financialization entails, perspectives on the conceptual and theoretical foundations of financialization differ (Zwan, 2014). In its most basic meaning, financialization refers to the growing importance of financial markets and financial institutions in the economy (Orhangazi, 2008: 863), and it can be linked to a number of developments, such as

> . . . the deregulation of the financial sector and the development of new financial instruments, the liberalisation of international capital flows, and increasing exchange rate volatility; the creation of powerful institutional investors; shareholder-value orientation

> and changes in corporate governance; facilitated access to credit for social groups previously described as 'underbanked' [. . .]
>
> (Stockhammer, 2014: 34)

Financialization is thus closely linked to the emergence of global financial markets, including their underlying principles and ideologies. Processes of financialization have first been identified in the advanced economies of the United States and Europe, but the global integration of financial and investment activities merits a closer look at comparable developments in the emerging economies of Brazil, China, and India.

So far, existing research on financialization can broadly be divided into two distinctive approaches: the first research perspective focuses on the effects of financialization on the micro- and meso-levels of the economy, namely on firms and industries in the financial as well as nonfinancial sectors. The second perspective approaches financialization from a macro perspective and is concerned with structural changes in the capitalist political economy that have occurred since the end of the 1960s and accompanying developments in the regulation of financial activities.[2]

2.2 Financialization in the financial and nonfinancial sectors of the economy

In the financial sector itself, which comprises financial institutions including insurance companies and real estate firms, financialization has been marked by intense competition leading to processes of rapid concentration, at least in the case of the United States. At the same time, profits of the financial sector have grown extraordinarily fast, which Crotty (2008) explains by the very high growth in demand for financial products, over-the-counter trading, and increased risk in financial investments.

Growing profits can also be explained by the growing importance of the unregulated or underregulated shadow banking sector. Shadow banking can be defined as "a complex credit intermediation network operating outside of the regulated banking sector" (Lysandrou and Nesvetailova, 2015: 1). Lysandrou and Nesvetailova identify two arguments in the literature regarding the explosive growth of shadow banking since the end of the 1990s. The first argument explains the rise of shadow banking through factors endogenous to the banking sector. According to this view, banks increasingly conduct financial activities off-balance to fully profit from regulatory arbitrage and financial innovation outside the existing regulatory framework. The second argument explains the rise of shadow banking by factors exogenous to the banking system, such as the rise of new financial institutions, including hedge funds, investment funds, money market funds, and private-equity funds, competing for profitable investments (Stockhammer, 2014: 40). Given the low profitability of traditional investment opportunities, shadow banking developed in response to demand for new and more profitable investment opportunities, which grew exponentially during a decade of very low interest rates in many advanced economies.

In the nonfinancial sector, financialization describes changes in corporate governance and management strategies, as well as a shift in investment activities and profit sources away from core businesses towards finance. Here, the rise of the concept of shareholder value has emphasized the distribution of profits to shareholders as a corporation's primary objective, de-

emphasizing the earlier focus on investment. Grounded in agency theory and the principal–agent problem of firm ownership and control, the emphasis on shareholder value has been the pretext to wide-ranging shifts in the distribution of wealth and power between shareholders, management, and labor at the firm level (Zwan, 2014). In this context, the behavior of management has shifted away from the objective of achieving long-term growth towards the objective of satisfying the short-term motives of (institutional) shareholders (Crotty, 2005).

Consequently, at the level of the firm, financialization can also be described as a process of wide-ranging changes in firm behavior regarding investment and profit strategies, as has been demonstrated by a number of studies on the US economy (Aglietta and Breton, 2001). On the one hand, with financialization, nonfinancial corporations derive a greater share of their income from financial sources and divert more income to financial markets. Consequently, and on the other hand, investment of firm income in productive assets has relatively declined. These changes in firm behavior may, since the 1980s, have led to the decoupling of the development of firm profits and investment spending (Van Treeck, 2009: 923).

These shifts in investment strategies and profit sources of firms lead some researchers to suggest that financialization can be understood "as a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production" (Krippner, 2005: 174), reflecting the trend that for nonfinancial firms, profits from investments in trade and production have declined in favor of profits from investment in financial products and subsidiaries.

2.3 The macroeconomic perspective on financialization

At the macro level, financialization has been predominantly researched by scholars located in heterodox economics, the *régulation* school, economic sociology, and critical and Marxist political economy, where financialization is interpreted as a substantial structural shift in the patterns of accumulation and circulation with respect to investment and consumption in the capitalist political economy. In this view, financialization has emerged in the wake of the crisis of productivity and profitability of postwar capitalism. It represents the shift to a new kind, or even to multiple kinds, of growth or accumulation regimes (Aglietta, 2000). The finance-led accumulation regime constitutes a turn away from earlier Fordist modes of regulation that were based on a capital–labor compromise characterized by strong ties between productivity growth and wage-led demand growth within a predominantly nationally regulated political economy. Stockhammer (2014) shows that since the 1970s the financial sector and financial dealings in the United States have grown dramatically faster than the commodity-producing economy.

The decoupling of profits and investments observed as a result of changes in firm behavior, as described in the previous section, corresponds to wider shifts in macroeconomic cohesion. For the US case, Van Treeck (2009) argues that the process of financialization has enabled firms' profit income to increase despite a decline in investment expenditure since the 1970s because of an increase in household consumption expenditure for financial products. This increase in household expenditure has been facilitated by the redistribution of firms' profits as dividends to households, a decline of household savings, and an expansion of credit to households. Furthermore, government debt and foreign capital inflows were also predominantly used to increase consumption.

Boyer (2000) develops a hypothetical model of a 'fully developed' finance-led accumulation regime, which can help to relate several observable phenomena of financialization. In this model, firm governance and competition between firms are dominated by the shareholder value principle, emphasizing profits over investment, and shifting the field of competition between firms from product to financial markets. The wage–labor nexus is decoupled from investment and productivity and instead subordinated to the profit expectations of shareholders and financial markets, requiring the flexible adjustment of the wage bill, affecting wages, working hours and employment. Households whose employment and income are adversely affected by changes in the wage relation procure additional income through extended access to financial products and credit, sustaining or even spurring the level of consumption. The state's ability to incur debt is restrained by the financial markets' willingness to lend as household investments in government bonds are reduced. The tax base shrinks as it shifts away from mobile capital to labor and fixed assets. The task of monetary policy moves from coordinating growth and inflation to regulating finance and especially preventing the growth of financial bubbles (Boyer, 2000: 118).

Following a more international perspective and informed by an analysis of causes and consequences of the financial crisis, Stockhammer (2014) argues that financialization in predominantly Anglo-Saxon economies has led to the creation of two growth strategies that are to a certain degree complementary, one debt led, mostly in Anglo-American countries, and the other export led, as, for example, in China, Japan, and Germany. Thus, on the level of the international economy, the phenomenon of financialization can be connected to capital account liberalization and subsequent increased financial flows between countries, which, it can be argued, served as a significant precondition for the emergence of debt-led and export-led accumulation regimes. The sustainability of this accumulation regime has been put to question by the global financial crisis. It is important to note that current account liberalization has been one of the factors contributing to a number of earlier currency and financial crises in emerging economies such as the Asian crisis or the Latin American debt crisis, among others (Stockhammer, 2014).

2.4 Financialization as a framework for understanding China

The phenomenon of financialization has spurred research in a number of disciplines. Due to the diversity and novelty of this research, financialization is still a predominantly descriptive concept with fuzzy boundaries rather than a coherent theoretical framework.

Research on financialization has predominantly focused on developments in the US economy and to a lesser extent on other developed economies. The question thus remains whether financialization as a concept can explain developments in emerging economies such as China. Following Engelen (2008), the research would have to be careful to test the empirical applicability of the concept to new cases and find out if it can provide meaningful explanations that other concepts cannot. Research on emerging economies such as China may provide insights into the interconnectedness of financialized and financializing or nonfinancialized economies (as, for example, in Froud *et al.*, 2014). Little research on financialization has been done in political science; hence only limited attention has been paid to the politics of financialization, that is, the role of political actors in financial governance and regulation (Heires and Nölke, 2014), with the notable exception of Krippner (2011).

In view of this theoretical discussion, the following sections will analyze economic and political developments in China through the lens of financialization, exploring the extent to which it can be meaningfully applied to the Chinese case.

3 Financialization in China: the economic trend

3.1 Macroeconomic indicators

Macroeconomic data on post-GFC economic growth reveal the extent to which the export- and investment-led growth model of China has been brought into question. Figure 2.1 shows how the reliance on the Western (essentially US) markets has led to a downward trend of Chinese exports since 2007 and how investment (gross fixed capital formation) has plateaued after the effects of the November 2008 stimulus package have waned.

Of specific relevance is the way total investment has evolved vis-à-vis total savings[3] in the recent past and specifically before the crisis so as to infer some preliminary conclusions relating to the issue of financialization. Also shown in Figure 2.1, savings and investment have tended to be decoupled between 2004 and 2011, with total investment flat when savings were rising at the beginning of the period and total investment rising sharply during the two years preceding the crisis, whereas savings were declining during that time.

Turning to profit rates, Figure 2.2 shows profit rates (as defined by the returns on assets [ROA]) of state-owned enterprises (SOEs) and other manufacturing firms in China. As can be seen from this figure, the profitability of industrial SOEs in China as a whole was largely in line with that of non-SOEs, only 1 to 2 percentage points lower, before the crisis. Other similar profitability indicators show roughly the same picture. The gap has nevertheless quickly widened since 2008. Although industrial SOEs as a whole show reasonable performance relative to non-SOEs, there is substantial variety at the sectoral level. SOEs in all control 44 percent of total assets in industry, but across different industrial sectors this share varies significantly (Fabre, 2013). Moreover, there is a positive correlation between the performance of SOEs and their market shares in individual sectors, a result which might suggest that SOEs profit from their monopoly power (Lardy, 2014: 98).

Declining opportunities for profitable industrial investment (gross fixed capital formation [GFCF]) might signal an incentive to turn to property investment or other financial investment. Regarding the former, the main evidence shown by Figure 2.3 is that over the period 2007–14 (and particularly during 2010–11) the increase in residential real estate investment has generally surpassed the growth rate of the economy. The figure shows that the adjustment brought about by the global financial crisis in terms of investment in residential real estate has been erratic. The decline of growth rates from 2007 onwards has been paralleled with declining real estate investment rates. Again, the short-term effect of the 2008 stimulus package can be seen (with an upward trend in the GDP growth rate after March 2009). Subsequent developments, however, show that this trend has been unsustainable, as real estate investment growth rates drop below GDP growth rates.

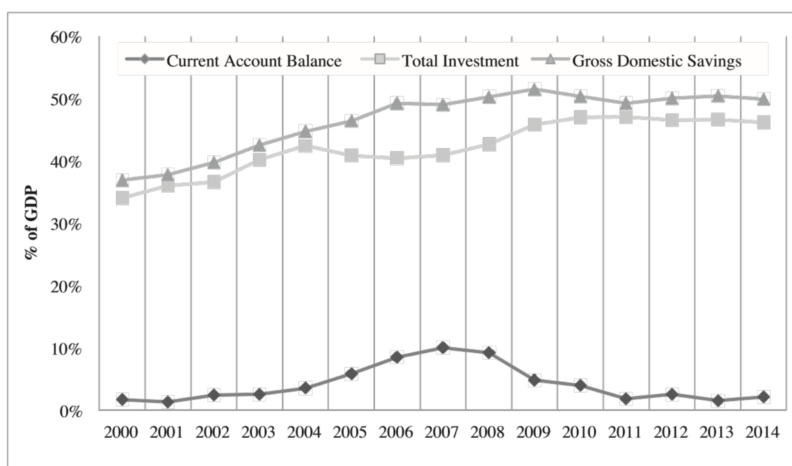

Figure 2.1 China: current account balance, investment, and savings
Source: Derived from World Bank DataBank (http://databank.worldbank.org) and CEIC Data China Premium Database (www.ceicdata.com), last accessed March 6, 2016.

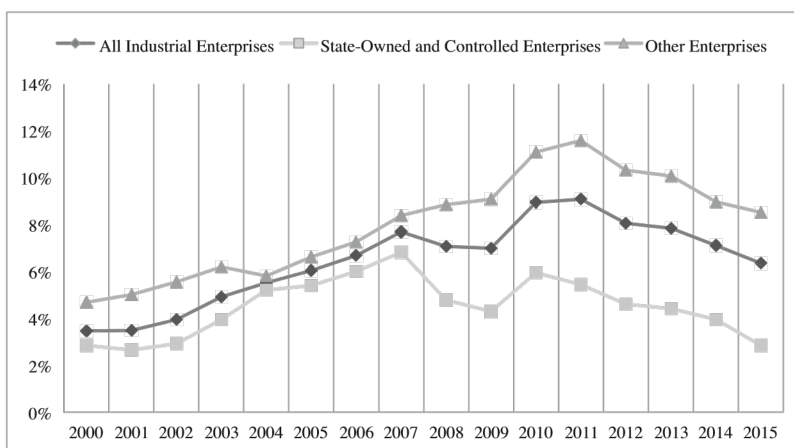

Figure 2.2 China: profitability of industrial SOEs and non-SOEs (profits as a share of assets)
Source: Derived from CEIC Data China Premium Database (www.ceicdata.com), last accessed March 6, 2016.

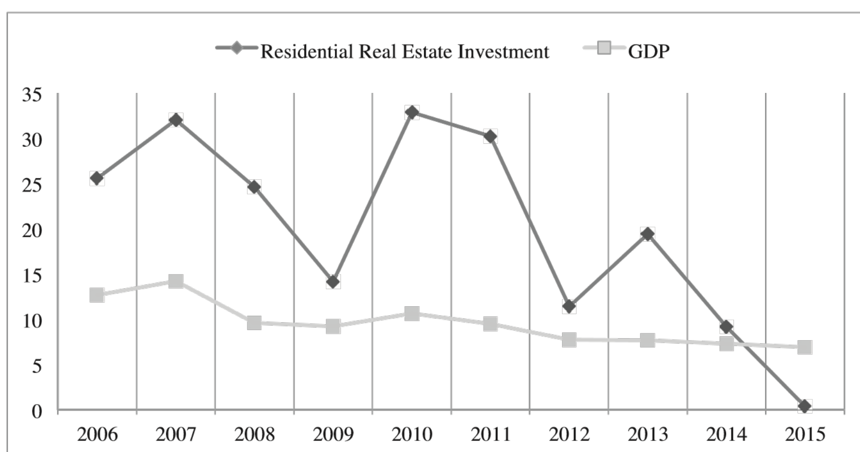

Figure 2.3 Residential real estate investment and GDP growth rates (%)

Source: Derived from CEIC Data China Premium Database (www.ceicdata.com), last accessed March 6, 2016.

3.2 The growing importance of China's capital and financial markets

The growing importance of China's capital and financial markets can be appraised through an analysis of both stock market capitalization and its more dynamic development compared with the nonfinancial sector.

Table 2.1 and Figure 2.4 show the formidable increase of market capitalization in China's stock exchanges over a 11-year and a 14-year time span, respectively. Although much of the evolution is due to a catching-up phenomenon, given China's underdeveloped stock markets, the increase (from US$512 billion in 2003 to the current US$6 trillion in 2014, Table 2.1) is quite impressive. When relative figures are used (Table 2.2 and Figure 2.4), it appears that the extent of market capitalization in China accounts only for a fraction of that of the United States. However, the figures of both Table 2.1 and Figure 2.4 also clearly show that in spite of having stock markets still very much in their infancy, China has caught up extremely rapidly with Western countries in only a few years. In 2004, the China–US ratio of the stock traded as a percentage of GDP was 24.2 per cent; in 2012, this ratio grew to 53.4 per cent, implying that the gap between China and the United States is narrowing or that China's stock market trading as a percentage of GDP is more and more in line with that of the United States.

In addition to the formidable increase in stock market capitalization, the traditionally strong reliance of the Chinese economy on bank financing has grown in importance since the GFC, also shown in Figure 2.4. Although the Chinese insurance and stock markets are still relatively underdeveloped compared with those of the United States, data in Figure 2.4 show that bank credit has grown in importance in China since the GFC.

A comparison of listed firms in the financial and nonfinancial sectors shows that profits and fixed asset investment in the financial sector of the economy have been growing faster than in the manufacturing sector between 2000 and 2011 (Zhang *et al.*, 2013). It can thus be shown that the financial sector has not only grown in size, but has acquired a more privileged position in terms of wealth accumulation and generation in recent years within the Chinese political economy.

Table 2.1 Market capitalization and stocks traded: United States and China compared

	Market capitalization companies (current mn.		*Stocks traded (total value of GDP in %)*	
	United States	*China*	*United States*	*China*
2003	14,266,265.65	512,978.77	148.8	23.5
2004	16,323,726.33	447,720.26	168.6	26.3
2005	17,000,864.47	401,852.25	211.3	17.3
2006	19,568,972.5	1,145,454.87	238.8	42.5
2007	19,922,279.82	4,478,866.53	300.8	179.0
2008	11,590,277.78	1,778,784.04	353.7	85.7
2009	15,077,285.74	3,573,152.46	215.9	154.8
2010	17,283,451.68	4,027,840.3	203.5	136.7
2011	15,640,707.04	3,412,108.29	282.9	89.1
2012	18,668,333.21	3,697,376.04	211.6	59.4
2013	24,034,853.52	3,949,143.49	208.7	81.1
2014	26,330,589.19	6,004,947.67	236.9	115.5

Source: Derived from World Bank DataBank (http://databank.worldbank.org), last accessed March 6, 2016.

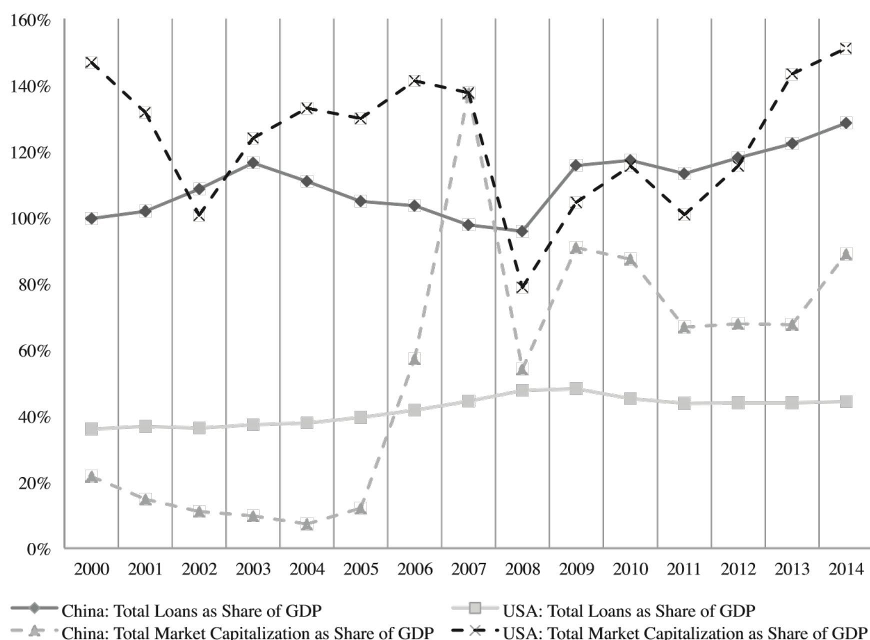

Figure 2.4 Loans and stock market capitalization in China and the United States compared (% share of GDP)

Source: Derived from CEIC Data China Premium Database (www.ceicdata.com), last accessed March 06 2016.

Table 2.2 Various estimates of the extent of shadow banking in China

Source	*Year*	*USD trillions*	*% of 2012 GDP*	*% of bank assets, end-2012*
GF Securities	2012	4.8	57%	31%
Citi Research	2013	4.5	54%	29%
Barclays	2012	4.1	49%	27%
Hua Tai Securities	2012	4.0	48%	26%
UBS	2012	2.2–3.9	26–46%	14–25%
ANZ Bank	2012	2.4–2.7	29–33%	16–18%
Bank of America/Merrill Lynch	2012	2.3	28%	15%

Source: Li (2014: 199).

3.3 Shadow banking and financialization of nonfinancial corporations

Shadow banking activities have expanded greatly, especially in conjunction with the post-GFC stimulus package, between 2008 and 2010. Various estimates of the size of shadow banking in China are given in Table 2.2. According to the different estimates, shadow banking represents between a quarter and more than half of China's GDP in 2012. In the United Kingdom and United States it accounted for

363 and 180 percent, respectively, in 2012, with a global average share of shadow banking in GDP of 117 per cent (Li, 2014). These preliminary figures suggest that although shadow banking has expanded quickly in the Chinese economy, its size relative to GDP is still low when compared with other more advanced economies. However, some other sources put the Chinese figure at around the size of GDP (Wei, Davies and Shen, 2014).

Undoubtedly, shadow banking played an important role in the extension of debt in the Chinese economy, which – based on data by Fitch – could rise from 128 per cent of GDP in 2010 to 216 per cent in 2013 and further on to 271 per cent in 2017 without proper political measures. Moreover, 43 per cent of local government debts of 17.9 trillion RMB (June 2013) were channelled by nonbanks, with 11 per cent by shadow banks, according to the China National Audit Office (Wei, Davies and Shen, 2014).

Contrary to experiences in the West, the expansion of shadow banking is not a result of deregulation, but a response to a further tightening of lending regulation, such as stricter reserve requirements and interest rate controls, which were put into place to ensure that the intended expansion of lending activities caused by the stimulus package would conform to certain quality standards (Li, 2014). As a reaction to tightened regulations on lending, commercial banks, local government entities, and state-controlled corporations, all entities with relatively easy access to the formal credit system, expanded their shadow banking activities to channel stimulus resources into less regulated and more lucrative lending, and especially to private borrowers.

For example, local government finance vehicles used the original 4-trillion RMB government stimulus package to raise 12 trillion RMB in credit funds to invest in real estate, infrastructure, and other capital-intensive projects. Furthermore, statecontrolled enterprises and local state entities have utilized their facilitated access to formal credit to provide loan guarantees for private businesses and real estate developers, guarantees which were in turn collateralized as wealth-management products.

A further rapidly expanding field of informal finance is that of internet-based P2P (peer-to-peer) lending (Tsai, 2015). Early concerns regarding the risk of P2P development in China (Wang, Liu and Yang, 2014) were substantiated in 2016 when 21 people were detained over the breakdown of the Ezubo platform in 2016 (Han, 2016). As the previous discussion has already indicated, the expansion of shadow banking activities has created new financialized uses of capital predominantly for the capital-intensive, state-controlled sector and has created new financial sources for the labor-intensive private sector, which is notoriously underbanked, with the former now lending to the latter outside the regulated commercial banking sector. These developments can be interpreted as initial steps into the financialization of nonfinancial corporations with access to formal finance.

Research into corporate financialization in the nonfinancial sector in China is still uncommon (Cai and Ren, 2014). One of the most comprehensive studies in this regard is by Zhang and Zhuge (2013), who apply Milberg's (2008) criteria for

studying financialization in the United States to the Chinese case. Looking at nonfinancial listed firms, they find that, contrary to a clear upward trend in the United States, income from securities as a share of total profits has been fluctuating widely among different nonfinancial industries, showing no clear trend towards financialization, which would require that financial sources of income in the nonfinancial sector grow at least as fast as in the financial sector.

As such, there appears to be little evidence for a general trend towards financialization of nonfinancial firms in China to an extent witnessed in the United States and other advanced economies. Nevertheless, as the Chinese manufacturing industry has in recent years suffered from a shrinking general demand, overcapacity, rising costs, and a lack of technical innovation, which have led to a sharp decline in profit margins in the core business of nonfinancial firms (cf. Figure 2.3), some large listed companies have started to test the waters for financial investments, so that corporate financial assets are showing a gradual upward trend (Xie *et al.*, 2014), possibly linked to the development of shadow banking described earlier.

4 The politics of financialization and financial regulation

Financial markets constitute an extremely sensitive policy field for the Chinese leadership. They are closely interconnected with some of the most important aspects of China's socialist market economy. It is therefore important to keep in mind that various generations of Chinese leaders have postponed full-blown reforms of the financial area. Whereas other sectors of the economy were targeted earlier on in the reform process, banking, insurance, and securities were only addressed in the late 1990s following the Asian financial crisis and in preparation for China's admission into the WTO in 2001 (Naughton, 2009; Gottwald and Collins, 2014). Obviously, control of the key pillars of the economy was and continues to be of great significance for the Chinese leadership, eager to promote a stable financial system to safeguard economic and ultimately social stability. This might help explain why China's financial sector developed into a premature, multilayered financial system with a specific regulatory setup that seeks to balance party–state influence with local funding needs and requirements resulting from gradual and partial integration into global markets.

4.1 Key drivers of financial reforms in China: a path towards more financialization?

Two dynamics have characterized China's economic reforms since 1978: reforms that were implemented without explicit formal encouragement of the central authorities but that proved successful and beneficial, and reforms initiated by the central authorities. The first group of reform initiatives took place in various localities and established an impetus for policy changes – if successful – or for political measures against it – if considered either threatening or disadvantageous by the authorities (Nee and Opper, 2012). In addition to these 'bottom-up' reforms,

central authorities embarked on various 'top-down' reform initiatives either allowing experiments in various sorts of special zones or granting special rights to specific institutions. In the area of financial services, top-down reforms include the restructuring of China's supervisory structure, as well as the encouragement of the biggest banks to take an active role in the go-global strategy (Gottwald, 2011).

Several crises provided important critical junctures for the central authorities to rethink their policies and test alternative approaches: the fiscal crisis of 1992–93 led to a thorough reform of China's tax system and the role of the central bank (Yang, 2005); the Asian financial crisis of 1997–98 offered first-class insights into the risks of prematurely opening up the financial sectors and the need for a strong and efficient regulatory regime; the 2008 GFC now calls for various reform measures, ranging from the gradual liberalization of the RMB via the commitment to allow 'private banks' on a level playing field, to the reform of local finance. Following a well-established pattern, a new special zone has been set up: the China (Shanghai) pilot free trade zone (FTZ) to create new insights into the privatization and liberalization of finance. "The zone is considered an integral part of China's economic and foreign exchange reform under Xi's leadership" (Chen and Ren, 2014). Toplevel support helped to push through contentious plans to allow for (nearly) free convertible accounts in Shanghai, the so-called offshore accounts, within days after an announcement on May 25. Xi Jinping expressed his support by calling Shanghai a "trailblazer" for reforms (*paitoubing*) and the pilot free trade zone an important new measure (Xinhua, 2014). Three more FTZs were established in 2015.

Another key driver that stimulated intensive rounds of regulatory and corporate reforms was China's accession to the WTO in 2001. Achieved against major reservations, particularly in the state-owned sector of China's economy, WTO membership technically required an opening of the well-shielded banking and securities sectors (Schlichting, 2008; Martin, 2012). Early steps to increase the role of foreign companies and international experts, however, did not lead to a full liberalization of China's financial markets. Yet, increased internationalization of the dominant domestic players allowed for the incorporation of China's big five banks into the go-global strategy of the Chinese government, including the successive listing of all of them abroad. A prominent role was taken up by China Development Bank, technically a governmental development bank that reinvented itself into one of the most innovative and politically astute financial services providers in China (Forsythe and Sanderson, 2013).

The China Development Bank had a significant role in supporting China's big companies to establish themselves abroad. It supported the Chinese leadership in its drive to secure access to resources and markets in Africa and Latin America. It became the largest provider of development finance in the world, and it changed dramatically the landscape of local finance in China itself by introducing cash-starved local authorities to the more creative ways of leveraging the income from land sales and setting up Local Government Finance Vehicles (LGFVs) (Forsythe and Sanderson, 2013). Local authorities needed additional income, not only to cater

to particular interests among local elites, but also to provide essential social services to their communities. With official sources of income severely restricted and with local bonds banned by the central authorities, leveraged income from rezoning of land, which was repackaged into semilegal private wealth products, became a key driver of financialization in the late 2000s as some of the statistical analysis earlier suggests. Because the sale of land that was bought off farmers, then rezoned into developmental sites and sold at a massive profit lay at the heart of this development, it linked two severe threats to the legitimacy and the stability of the party-state: the issues of land rights and their abuse by the local authorities with the exponential growth of shadow banking.

In the recent past, the main driver for Chinese financial innovation, however, seems to have been the need to access a broader variety of financial products than offered by the official banking system. All relevant groups of actors – local authorities, the big banks, large SOEs, SMEs, and private customers – have turned to the shadow banking sector. The provision of credit, as well as more attractive returns on savings, have both contributed to the development of new products, which more often than not have been accepted by the legal authorities even if they were deliberately kept outside the official regulatory system (Elliot, Kroeber and Yu, 2015). Silent acquiescence on behalf of the regulatory authorities indicates a willingness to let the financial sector increase its significance for the Chinese economy, even in the face of political problems and a growing number of scandals.

4.2 China's system of regulation in the face of financialization pressures

These trends continue to exert substantial pressure on China's regulation of financial services. Since the 1990s, the PRC had established a regulatory regime for financial services that sought to combine elements of state-of-the-art technocratic regulatory agencies with pillars of the party-state. This 'Chinese model of regulatory capitalism' (Gottwald and Collins, 2014) preserved features of the developmental state that seemed to be in stark contrast with the idea of independent bodies, transparency, and independent intermediaries usually associated with the regulatory state (Heilmann, 2005; Pearson, 2005, 2007). Yet it was successful in creating a framework for market activities that seemed compatible with Anglo-Saxon and European institutional setups and provided a basis for processes of experimentation and learning (Heep, 2014). Built around a central bank with limited independence yet increasingly influenced by macroeconomic policies, the regulatory regime has specialized agencies for banking (China Banking Regulatory Commission), securities (China Securities Regulatory Commission or CSRS), and insurance (China Insurance Regulatory Commission). With the help of business associations, asset companies, and the state's sovereign wealth funds, which are all actively involved in the domestic banking sector, the system allows for control of personnel and access to credit by the party-state (Andreosso-O'Callaghan and Gottwald, 2013). The occasional direct interference by cadres, however, is mitigated by turf wars

among competing bureaucratic systems (*xitong*) and conflicting policy imperatives for financial reforms.

Thus, despite far-reaching venues for interference, actual control by the partystate is occasionally piecemeal and limited. It came as a shock to both the wider public and apparently the Chinese leadership when the amount of losses inflicted to Chinese investment vehicles due to their involvement with US institutions became known in 2008–09 and, again, when a report by the Chinese Academy of Social Sciences highlighted the volume of debts by local authorities and their LGFVs in 2011–12. With direct central control of – or as a result of recent reforms – substantial political leverage over interest rates, credit allocation, and foreign exchange, the biggest banks still enjoy a built-in cushion against market pressures. Yet even the big banks are actively seeking to benefit from financial innovation through their links with the shadow banking sector.

In summary, many characteristics generally found in economic policy making in China can also be found in the policy fields of finance and financial regulation and in the dialectics of 'bottom-up' innovation and 'top-down' regulation, which in some respects may present initial steps to a more comprehensive process of financialization.

Below the central level, a magnitude of provincial banks, local banks, and investment vehicles have flourished. De facto barred from direct business with the largest SOEs and often well linked with local political authorities, they have become a major player in creating new ways to provide funding for local governments and enterprises in creating new investment mechanisms. Equally innovative has been the move of some leading Chinese enterprises into the area of consumer credit and P2P lending. Although the activities of local banks might have taken place below the radar of the central authorities, the increased activity of a company like Alibaba in the credit business was developed in consultation with the relevant state authorities. Thus, on the one hand financial innovation – private capital, Internet banking – further increases the challenges for regulators and the government, yet on the other hand it provides the leadership with room for experiments with new products, marketplaces, and businesses without committing to a complete liberalization of its financial system. This underscores the willingness of the Chinese leadership to intensify the role of financial products and financial innovation in the Chinese economy, even if the current macroeconomic indicators do not yet portray levels of financialization in line with those of Western economies.

5 Conclusions

Financialization is a concept with fuzzy boundaries that has been appraised from different disciplines primarily to study the case of Western economies such as the United States or the United Kingdom. This chapter has attempted to evaluate whether this concept can meaningfully be applied to the case of China, observing economic developments and bearing in mind the role of political actors in financial governance and regulation. The use of a number of macroeconomic indicators

shows that investment (gross fixed capital formation) has tended to move away from savings before the GFC and has plateaued during the crisis; that profit rates of SOEs have declined sharply with the crisis; that the growth rate of residential real estate investment has, until very recently, surpassed the growth rate of the economy; that the stock market capitalization has soared, in spite of underdeveloped stock exchange markets; that there has been a substantial upward trend in corporate financial investment; and that the size of shadow banking could be as large as the Chinese GDP. Overall, investments and profits in the financial sector have been growing faster than in other sectors of the economy. Concerning its size as a share of the economy as a whole, all the measures do not put China in the league of the most financialized economies in the world, but they do show that regulated and unregulated finance in the past 10 to 15 years have gained in proportion, even if the developments in certain subsectors such as real estate have been unsteady.

Whereas the financial sector has been expanding in relative terms, there exists, as of yet, no systematic research or evidence showing that financial sources of income have become widely and systematically integrated into the core businesses of nonfinancial firms until 2013, constituting a process of financialization in the nonfinancial corporate sector. More recently, however, firm-level, bottom-up financial 'innovation' has contributed to a surge of shadow banking. Local state entities and mostly state-controlled corporations with access to formal finance, channelling these resources into unregulated financial products, may in hindsight prove to be forerunners of a wider trend of corporate financialization.

The discussion has suggested that the politics of regulation in China are not sufficiently described as a cat-and-mouse game between financial innovators regularly outpacing regulators. Indeed, on the political level, financial developments in the aftermath of the GFC may be built upon to achieve some wider reform objectives, such as the move away from the now-faltering extensive investment-led and export-oriented growth model towards a model emphasizing innovation-driven productivity gains and domestic consumption, by creating a deeper and more systematic role for finance in investment and consumption patterns. Such developments would confirm a general pattern of experimental policy making defined by the relationship of central and local actors and their competing or colluding interests in China's party-state. Whether local practice will be turned into official policies and whether they can be reconciled with a control-oriented regulatory financial system remains to be seen, depending in part upon how the 2013 Third Plenum reforms will be implemented.

In some ways, financialization, as an important approach to better understand China's political economy today, has very much been and is still an 'ad hoc' type or coincidental financialization, tied to various crisis dynamics currently observable. This could suggest therefore that uncertainty is paramount with regard to the question of how finance can be integrated systematically or even sustainably into a new and reformed growth regime. It will remain to be seen whether the many phenomena of financialization observable in China will provide the nuclei of a future fully developed financialized growth regime in the theoretical sense, of which

there is currently no evidence. Just as likely, current developments may provide the basis of potential economic (and political) instability arising from 'disordered' financialization in China.

Notes

1 Views differ as to whether these years constitute a Lewis turning point, including the issue of whether the Lewis turning point is a valuable indicator due to institutional distortions of the Chinese labour market like the *hukou* system (cf. Cai and Du, 2011; Golley and Meng, 2011).
2 A third research perspective that will be of lesser importance to this chapter focuses on the financialization of everyday life and is located in the fields of social accounting and cultural economics (cf. Zwan, 2014).
3 Total national savings comprise government savings, corporate savings, and household savings (the largest component).

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