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Market Creation by Leninist Means: the Party-State, Private Authority and the Regulation of Financial Services in the People's Republic of China

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ABSTRACT: *The People's Republic of China (PRC) is a unique challenge for Western social theory. A Leninist one-party state that has been pursuing market economic reforms for more than three decades should – by all accounts – find itself in dire difficulties. While views on the stability and sustainability of China's Socialist Market Economy differ significantly, an average growth rate of nearly 10% p.a. over 30 years under the guidance of the Communist Party of China raises important questions regarding the integration of private property and private authority into a state-dominated economic order.*

Within the Chinese transition from a centrally-administered to a more market oriented economy, financial services have played a very special role. Reluctance on the side of the central leadership had long delayed major changes to a state-owned financial system. The Asian Financial crisis of 1997 highlighted the risks of both a further deferral of reforms and a too liberal approach to opening up banks, securities trading and insurances. Therefore, the party-state deliberately developed a strategy to incorporate key elements of the well-established Western model of a regulatory state into the Chinese economic policy in order to develop a modern, increasingly open and efficient financial system. The reform of the central bank and the establishment of technically independent regulatory agencies – the China Banking Regulatory Commission, the China Securities Regulatory Commission, and the China Insurance Regulatory Commission – seemed to lead China down the path of OECD 64 economies. Apparently, the Chinese leadership used 'private' actors and 'independent' experts to reform its financial services.

These policies, however, never fully incorporated the notion of private authority. While on the surface the state withdrew from key areas of economic and supervisory activity and while international financial service providers and regulatory communities were invited to play a vital role in the creation of a Chinese market in financial services, the Communist Party of China strengthened its control of top personnel, the judiciary and the media. Thus, what looked like a Western market economy state turned out to be a Leninist regulatory model.

The mechanisms through which the Chinese leadership managed to bring in external and semi-private internal stakeholders into the policy of market creation deserves close attention as China emerges from the current economic and financial crisis as an alternative model of economic governance. While the perceived stability of its banks and financial services providers has found acclaim among many observers, a closer look indicates substantial deficits, which threaten the long-term sustainability of this

approach. The absence of real private actors and an independent judiciary as well as the limits to public scrutiny create ongoing challenges to the future development of financial services. Thus, the PRC becomes an example how precisely the lack of democratisation and a reliable rule of law limit the viability of state-controlled market creation. While private authority poses a threat to the CCP monopoly on political power, the attempt to use only semi-private organisations to develop financial markets undermines the long-term stability of the political and economic order.

Introduction

> …the whole point of a Leninist-style party is that it should take decisions and act in the name of the people, and should possess sovereign authority in doing so.
>
> (Robin Porter, *From Mao to Market: China Reconfigured*)

For Chinese communists, the mechanisms of the state are a veneer for party control. Market and associated regulatory institutions are tested and calibrated by their usefulness to the state's central purposes. Given the scale, complexity and lack of clarity associated with Chinese economic and social development, however, those purposes are not always easily devised. In many areas of policy, therefore, China presents paradox of conformity and confusion. This paper seeks to explore the establishment of regulation in the financial services sector to illustrate the pervasive and persistent relationship between Leninist means and 'socialist market' ends. It will show that the Chinese state shares with others the imperative to appear to be adhering to global standards in its regulatory regime but that, when these clash with party priorities, local considerations triumph. Indeed, this paper takes as its understanding of a Leninist state that it successfully defines its autonomy from other social and economic forces to a degree unmatched in most other models.

The financial and economic crisis that erupted in the United States in 2008 shines a light on the Janus head nature of financial markets: while they are the key to economic growth and development in open market economies, their capacity for socio-economic destruction cannot be ignored. While the world had grown accustomed to crises originating from financial instabilities in emerging markets, proponents of the idea of never-ending beneficial financial innovation in Western de-regulated capitalisms had to learn the hard way that they were not immune to failure. For some, their eyes have turned to the People's Republic of China (PRC) which has been much less – or at least very differently – affected by the global crisis. Its apparent escape from the global fall-out has deepened the gap between China analyses from experts in global politics and China-watchers: while the first discuss the impact of China's unstoppable "rise", the latter are raising serious issues about the stability of China's financial system. Thirty years after China's leading politicians launched the policies of reform and opening, the PRC has moved to the centre stage of the new global order (Breslin 2007; Helleiner/Pagliari 2010).

In this paper, we argue that the Leninist-style introduction of market reforms in combination of constant learning and adapting in the light of external and internal experience has created a very specific post-regulatory state with Chinese characteristics. The policies of market creation adopted by the leadership of the Communist Party of China (CCP) followed the rationale of preserving its dominant position in Chinese politics. On an individual level, this allowed leading representatives of the party-state to pursue business opportunities. On a collective level, it provided the ground for a much more efficient and comprehensive utilisation of Chinese and foreign savings for the unqualified pursuit of economic growth. Reform of the financial sector was closely tied to the reform of the state-owned enterprise system and deferred to a relatively late moment in China's opening up. Once it was approached with remarkable stamina by the Zhu Rongji government in the late 1990s, it followed the fundamental path of attempting to outgrow its inefficiencies and structural problems (Huang/Saich/Steinfeld 2005). This strategy preserved some old structural flaws, like political meddling in management issues, and it created new issues, such as the turf wars between various administrative systems (*xitongs)*. In general, the policies of market creation in the financial sector did not follow the logic of creating an optimum framework for a maturing market economy but, rather, how to get the best out of two realities:

- Leninist control of a key sector of the economy; and,
- open access for foreign and domestic capital into Chinese business.

While these policies have been successful in preserving growth rates even under the severe conditions of the 2008 crisis, the underpinnings of the Chinese financial system have continued to weaken. In this paper, we provide an analysis of the policies of market creation by the Chinese leadership as an attempt to integrate Leninist structures into a regulatory state model.

Following earlier works by, among others, Heilmann (2005a, 2005b), Pearson (2005, 2008), Green (2005), Schlichting (2007, 2008), or Yeo and Painter (2011) we revisit the process and outcomes of China's regulatory reforms in the light of the current global crisis. In a political context, it is unclear whether positive developments in the markets will impact encouragingly on the broadening of reforms. We examine the improved foundations for capital markets and the gradual opening to external actors (Herd/Hill/Piggot 2010). These developments stand alongside continuing issues in corporate governance and politicised selection of issuing companies. We express our doubts that the specific reform path the Chinese authorities have taken constitutes a model to be followed by other nations and, therefore, question the validity of widespread expectations that China will become a major source of future global regulation.

The fundamental questions about the abatement of direct party-state interference have not been answered. How and how far can the CCP stand back from the financial markets? Indeed, current speculation leaves room for frightening scenarios of doom (Walter/Howie 2011). After all, the issue for some remains whether and not 'When China rules' (Jacques 2009). For others the spectre is of the increased inadequacy of the Chinese party-state to deal with economic institution-building (Guo 2011) Finally, the question must be posed as to how far Western 'efficiency based' models of analysis properly reflect China's uniqueness (Maswana 2009).

Market creation as a political process

In our perspective, markets are institutions setting incentives for actors to pursue their interests (Williamson 1982; North 1991; Furubotn/Richter 1993). They are the product of actions, are embedded in specific socio-cultural contexts, and need consistent supervision, preservation, attention and innovation (Lütz 2002: Vogel 1996; Laurence 2001). They are, therefore, dynamic not only in relation to economic activity but also regarding changes of their institutional settings. Understanding this logic, market participants follow a dual logic: maximising their interests within the existing framework and pursuing various strategies – most prominent exit and voice (Hirschmann 1986) – in influencing the change of institutions. Changes to the framework of markets occur consistently on an incremental basis and sometimes in a more radical fashion ('big bang'). Often they are as a result of profound changes in the external environment (crisis) or a change in political leadership accompanied by or expressing a paradigm shift in market oriented thinking (Gottwald 2010). In this regard, crises are ruptures of the developmental path that might weaken path dependencies, but in most cases, do not completely terminate the impact of customs, traditions and other unofficial institutions. This integration of markets and their creation into a broader socio-political context is usually referred to as the politics of regulation and is closely linked with the interrelated perspectives of the regulatory state and varieties of capitalism (Levi-Faur 2011a, 2011b) which have had a growing influence on the political conceptualisation of as well as academic research on China's Socialist Market Economy.

The Chinese way of creating a market in financial services has gained substantial significance in the context of the global crisis. The project of globalisation has often been lined with a so-called Washington Consensus of market opening and national liberalisation. International bodies are working on the presumption of universally shared acceptance of certain principles and rules that allow fair competition for all enterprises globally and locally. Leaving the issue of fairness and universality aside for a moment, the implementation of global best practice, norms, standards and rules has profoundly changed the framework for financial services. Since the breakdown of Lehman Brothers, the pressure to formulate a coherent global crisis-response and a set of new rules for global capital has increased. China has taken a central role in the Group of Twenty (G-20) Finance Ministers and Central Bank Governors established in 1999. It is intent on contributing to the reform of the global architecture for finance (Zhou Xiaochuan 2010).

Market creation within China's socialism with Chinese characteristics

Since the late 1970s, the PRC has explicitly Sinicized its economic order as well as their economic policies. Following imperial tradition of seeking to adopt Western tools without affecting the Chinese essence (Thøgersen 2009)[iii], the Chinese leadership gradually integrated core market mechanisms into its socialist society. According to its Constitution, the 'state has put into practice a socialist market economy' (Constitution of the PRC 2004/2008). While most areas of economic activities were allowed to grow out of centralised mandatory planning, the CCP kept a strict hold on the political system and continues to control key sectors of the economy through a mixture of party hierarchy and selective access to resources. Without an independent judiciary, the local, provincial and the central cadres have ample opportunities to push aside private competitors (*guo jin min tui*).

In recent years, Chen Yun's famous 'cage' for the 'bird' economy might have turned wealthy and huge but still remains a serious barrier to freedom (Chen Yun 1982). China's reform policies have been described as the evolution of a Chinese capitalism (McNally 2006; Breslin 2004) - the rise to power of a cadre capitalists (Dickson 2008; Tsai 2005; 2007) adapting to a changing international environment[iv] and implementing western techniques in the business of governing business (Pearson 2005; 2007). China's socialist market economy exhibits an 'institutional amphibiousness' (Ding 1994) of a market-oriented system based on strong involvement of a one-party state controlling the judiciary, the media and most of the large enterprises through partial ownership, control of top management positions and privileged access to finance. Overall, the two key pillars of the Socialist market economy are the public ownership of enterprises in the economic realm and the leading role of the CCP in politics (Ma Hong 1993).

Nobody would doubt the tremendous degree of change within the Chinese one-party state. Nevertheless, progress towards a democratic multi-party system representing differing interests within the society, the implementation of a rule of law guaranteeing individual freedoms and private property rights, even in confrontation with the CCP, is still absent (Bergsten *et al.* 2007). Changes take place within the limits of the CCP dominated and controlled Leviathan (Yang Dali 2005). The issue of whether China's Socialist market economy meets to Western market standards is highly political. The EU flatly refuses to grant market economy status to this form of 'cadre capitalism' (Heilmann 1996) on the grounds that China is not fulfilling the relevant criteria (Remond 2007). In international comparison, entrepreneurial freedom in China is average at best (World Bank 2010).

The CCP has managed to preserve and even strengthen its grip on power by successfully co-opting new elites (Dickson 2008; Tsai 2007). This includes the rebuilding of party committees in enterprises and social organisations (Zheng 2009:6-15; Shambaugh 2007). The CCP provides access to entrepreneurial opportunities and economic rents. The party controls the elites in politics, administration, law, major enterprises and leading societal organisations. While pursuing ambitious reforms of the legal system and proclaiming the objective of rule of law in China, there are only limited attempts to bring the CCP under the control of the judiciary. Thus, the Chinese legal system rather aims at rule by law then rule of law (Clark 2008).

The policies: creating capitals markets within China's socialist market economy

The 1997/98 financial crisis in East Asia is usually considered a watershed in China's attempts to reform its financial system (Naughton 2006). China's leaders had left financial services outside their reform policies for a relatively long time (Zeng Tianyong/Zhu Lianyu 2008). The first official stock exchanges were opened in 1990/1991 in Shenzhen and Shanghai as a direct response to increased speculation through China's vibrant underground banking system. Following the usual reform pattern of the Deng Xiaoping era, access to both stock exchanges remained strictly limited. Provincial governments had a key role in the selection of those enterprises that were allowed to pursue listings. These provided ample opportunities for individual and local enrichment and strengthened the asymmetry between investors and enterprises in China's stock markets (Heilmann/Gottwald 2002). Famously, China's stock markets were compared to casinos with the proviso that gambling houses generally operate according to a set of rules.

China's state-owned banks were slowly transformed into specialist commercial banks. At first, they were refinanced by the government and then, in 2004/2005, opened for foreign investment (Gottwald/Schlichting 2005). Substantial areas of its banking and insurance market, however, are still closed for foreign investment (OECD 2005; Hui Huang 2010). The single Bank of China has been transformed into a central bank – the People's Bank of China (PBC). Three policy banks were part of the overall reform policies. These reforms under the leadership of then Premier Zhu Rongji were hastened by the massive impact that the withdrawal of short-term foreign capital had on China's Asian neighbours. Using the means of the Leninist party-apparatus, a Central Work Group was set up and national conferences were held to promote the cause of and develop a strategy for a revision of China's regulatory and supervisory structure. The objective was clear - to reform the state-owned banks that were caught in a mutual destructive relationship with large and predominantly loss-making state-owned enterprises without giving away too much room for foreign and domestic speculation (Okazaki 2007).

These reform policies followed two conflicting imperatives: to establish viable, open and stable markets and, at the same time, solve the financial issues of China's state-owned enterprises (Heilmann 2001/2002). Heavy support for the biggest banks owned and controlled by the central government led to the establishment of an unbalanced financial system consisting of four commercial banks under the control of the central government - the Bank of China (BOC), the China Construction Bank (CCB), the Agricultural Bank of China (ABC), and the Industrial and Commercial Bank of China (ICBC). These banks were set up between 1979 and 1984 ending the era of a single bank administering credit and taking the functions of a central bank between 1949 and 1979. In 1994, three specialist policy banks were spun off these banks to separate political and business oriented operations: China Development Bank, Agricultural Development Bank of China and China Export-Import Bank (Hui 2010:220-222; Zheng/Zhu 2008: 2-4). Together with several banks on the provincial and local levels that are generally established as joint stock companies of private and public funds, they constitute the most important sector of China's financial system. The introduction of two stock exchanges in Shenzhen and Shanghai in 1990/1991 and the introduction of various other markets for bonds etc. were closely linked with efforts to put the state-owned enterprises on more stable footing. Trading the shares of meticulously selected enterprises initially nominated by provincial governments on the stock exchanges provided an alternative venue for financing and took at least some of the burden off the commercial banks (Heilmann 2002). The introduction of large insurance companies and several securities-related businesses complemented the emergence of a 'typical' market-style financial sector in China. Hopes by the government that these steps would lead to a diffusion of China's large underground banking system seem to have been over optimistic. As shadow banking and illegal provision of credit continue to play a vital role particularly for the private sector which finds itself at a strategic disadvantage against companies run by the state.

Overall, the PRC benefitted from several distinctive advantages: a high savings rate; the proximity to Hong Kong with its experienced and advanced banking sector and globally significant stock exchange; high foreign investments into the Chinese economy; the ability of the inner-party apparatus to secure control of personnel and access to significant resources; control of the media and the courts; as well as the size and significance of state-owned enterprises.

- Three sets of policies stood out. The government:
- changed the regulatory framework emulating Western agencification;
- stregthened and stablised the balance sheets of its main commercial banks through a series of direct transfers from the state coffers; and,
- turned central administrative units into special vehicles for global portfolio investment adding another area for direct competition between China's financial service enterprises and their governmental principals to the financial system (Gottwald 2009).

These steps benefitted from the Chinese political order with the central role for the CCP leadership. In the wake of the reforms, however, it emerged that these policies developed significant new challenges for the central government and new leeway for local authorities. They encouraged policy driven credit expansion and the increased global role of China's finance. This tested the capacity of the central government to control the developments.

The Outcomes: regulatory agencies, the Central Bank and self-regulation in the context of the Party State

In the period between 1948 and 1978, the Chinese leadership abolished the remnants of a private financial sector as part of its attempts first to follow the Soviet model of a centrally administered economy and then the Maoist ideal of socio-economic development through mass mobilisation. All functions that in market economies are divided between central banks, regulatory authorities, and commercial entities were concentrated within the PBC. With the beginning of the policies of reform and opening up, the PBC was formally given a certain degree of independence. Following a global trend, regulatory reforms in China brought three major changes:

- the complete overhaul of the central bank system, which freed the regional branches from interference of provincial governments (Yang Dali 2005);
- the foundation and dissolution of the Central Finance Work Commission; and,
- the introduction of the China Securities Regulatory Commission (CSRC), the China Banking Regulatory Commission (CBRC) and the China Insurance Regulatory Commission (CIRC).

As detailed accounts of the introduction and working of these commission has been provided elsewhere (Green; Zheng /Zhu; Naughton; Lardy XXX), the following analysis will focus on the specific content and organisation of governance.

The CSRC, CBRC and CIRC are 'institutions under the State Council', the Chinese government as is the PBC. They are officially part of the central government. Even the PBC must implement the policies of the State Council, seek and follow its advice in important matters and has its leaders appointed by the State Council and the National People's Congress. As a result, nearly all their senior and mid-level staff are ranked party members.

The PBC has lost staff and some competencies to the new agencies, but still remains arguably the most powerful organisation in the regulation of financial services. Its mission statement still gives it the responsibility for the general regulation of financial services including the inter-bank markets and the preservation of financial stability. In addition to these regulatory agencies, China created the State-owned Assets Administration and Supervision Commission (SASAC) in 2002/2004 (Naughton 2005)[v], widened the role of the State Administration of Foreign Exchange (SAFE) and set up its first official sovereign wealth fund, the China Investment Corporation (CIC).

The regulatory authorities are trusted with the objective of prudential regulation as well as code of conduct supervision. In established market economies, regulatory agencies are complemented with independent self-regulatory bodies. The Chinese case differs significantly. The rising number of business organisations, sectoral bodies etc. notwithstanding, the regulatory bodies control the governing bodies of these organisations and, thereby, blur the lines between regulatory agencies and self-regulatory bodies (Huang Hui 2010). Other important elements which are considered a prerequisite to the US-European model of regulation, an independent judiciary, free press and unfettered representation of consumer interests, are also absent (Gottwald/Colins 2011). In its formal sectoral organisation, the Chinese regulatory regime has been strongly influenced by the US model. It thus incorporates the concept of regulatory competition between various organisations (Li/Quan 2009:14). In addition, it raises the issue of how to coordinate the work of sectoral bodies and their supplements *vis-à-vis* their political principals and a growing number of integrated products and financial service conglomerates (Huang 2009:2-3).

Regulatory competition is considered a rather useful instrument at least in some cases (Li/Quan 2009). It stems partly from the incremental approach the Chinese government took towards economic system reform. After several rounds of enterprise reforms, the SASAC is still in charge of central-owned enterprises. It has the power to regulate among other things, overseas investments. But even in its official statements, it hints at the problems of ensuring compliance by lower level supervisory bodies to its rules (J. Jiang 2011).

Due to the occasionally opaque system of governance, rumours are rife of pending changes to the regulatory structure. One consideration has gained traction during the financial crisis: the establishment of a ministerial-level body overseeing all central government controlled financial services providers following the SASAC model for industry. At an earlier stage, Central Huijin Investment Ltd., the domestic investment arm of China's sovereign wealth fund, had taken on similar functions without unifying control in its hands but rather becoming part of the broader turf war between the various organisations within central level government. Coordination between the various bodies is provided at the highest level by the State Council, in National Finance Work Conferences and through the Joint Conference on Financial Supervision but is often considered to be insufficient (Xiaohong/Tian 2010). Thus, every now and then the establishment of new superior body that would either integrate or supersede the other regulatory bodies finds its way into public discourse (Lim/Koh 2011; Xiaohong/Tian 2010; He Ming 2004). A new ministerial level super-regulator would even allow raising the rank of its president solving the issue that most regulators face with leaders of the large companies who, as party members, match or even outrank their regulators in the party hierarchy. Therefore, a new regulator ought to be led by a Vice-Prime Minister to establish the necessary authority of the regulator. But even an upgrade of this scope would not necessarily solve these issues as an increasing number of financial conglomerates, banks, and private equity are run by family members of leading CCP cadres. These well-connected and well-networked ‘princelings’ are able to mobilise substantial political clout beyond their official party rank. Thus, even the most powerful weapon in the arsenal of the party-state, the reliance of party hierarchy, has become to lose its effectiveness: cadre control in the face of increasing political power of revolutionary families (Bardsley 2011; *The Economist*, 23rd June 2011).

The many faces of the CCP in China’s financial markets

The specific path of market creation by Leninist means has created a unique situation. The CCP has allowed a quasi-private market in financial services to emerge while preserving substantial influence in all areas of the market through the cadre management of the party, control of substantial funds and integration of the regulatory authorities into the party-state apparatus. It appoints and assesses the leading managers of the biggest banks, exchanges, intermediaries, regulators, the media and the judiciary. It also owns substantial shares in all major financial service companies, directs credit and decides about venues for recapitalisation. In addition, it sets funding requirements and options and controls foreign access into the market as well as outward investments. The party sets and enforces the scope for investigative journalism and reporting. Therefore, the CCP wears many hats and has many faces in the context of financial services. It would be wrong, however, to assume a total control as different interests within the party-state and difficulties to enforce central policies on the ground act as an important counterweight against central party control.

The degree to which the regulatory agencies are fully embedded into the party-state has amply been demonstrated. The party state selects the leading managers and decides staffing levels as well as subordination through party groups in the making of their policies (Heilmann 2005; 2005a; Pearson 2005; 2007). Nevertheless, their establishment led to closer links with the global regulatory communities and changes in the content of regulation (Schlichting 2008:153-174). Different systems within the State Council and conflicting interest between key players, particularly the Ministry of Finance and the PBC, add another degree of opacity to the regulation of China's finance industry. In high-profile cases, like the activities of SAFE and the CIC or the responsibility for the oversight of the remaining central government owned companies, conflicts of interest have been documented. The dual functions of the PBC as a vehicle of government policies – including the financing of the largest commercial banks and the financing of China's enormous foreign exchange reserves – mean it is much more heavily involved in the actual market place than would be good for a guardian of system stability. Its exposure to debt has reached levels that caused some observers to speculate about a hidden insolvency of the PBC (Chang 2011).

In addition to the three regulatory agencies, the powerful National Development and Reform Commission (NDRC), the Ministry of Finance, SASAC, the Ministry of Finance, the PBC and Central Huijin Investment Ltd are all involved in the policy-making and implementation in the area of financial services. The handling of every day issues, such as dealing with non-performing loans within China's banking system, has been likened to a family business moving assets around the various organisations without significantly reducing, never mind resolving the problem (Widmer/Howell 2011). The CCP controls human resources management for top positions in all regulatory bodies and defines policy goals. Besides, the CCP steers the party committees within the enterprises, whose re-establishment seems to have accelerated under the government of Wen Jiabao. Top enterprise leaders have the party-ranks equalling ministerial levels.

Formally, the highest authority for the supervision of financial services in China, especially the control of the supervisors, rests with the State Council. It defines the general political aims for the development and regulation of financial services for the administrative market supervisors and self-regulatory bodies. Of course, the State Council has to adhere to the fundamental guidelines of overall economic and social policies – financial market regulation is rather perceived as a means to promote economic growth and social development than to be an end in itself. In both the formulation of economic policies and the regulation financial services, supra-ministerial commissions rather than single ministers have played a crucial role.

The National People's Congress (NPC), while the ultimate organ for policy-making according to the constitution of the PRC, is comparatively weak in real terms. It has gained significance as a forum for discourse and lobbying and, in some instances, has used its role as a lawmaker to influence the distribution of gains and losses by setting 'technical' standards. It is not, however, a real legislature but subject to party discipline. In relation to financial services, however, the legislature is clearly much less central as a forum for policy discussions than the Politburo and its National Finance Work Conference, a high-profile event held every five years to outline central policies for the sector. Main policies are coordinated by the Leading Small Group on Finance and Economics, which brings together the leading cadres from the central committee, the State Council, the ministries and other leading (Miller 2008). The amount of conferences and working groups involved in defining the main direction of regulation has been criticized within China (Kam /Tian 2011). It contrasts sharply with the unified appearance of a one-party state. While the party machinery can be extremely efficient in dealing with specific challenges – such as the 2008 crisis – it has proven much less coherent when dealing with the incremental development of the regulatory framework. For external observers, it has been a regular phenomenon that issues that have long been under consideration are suddenly abandoned in the favour of unexpected new regulation. Fair participation and transparency in the workings of the regulatory bodies are one core principle of the modern regulatory state. Yet they are hardly evolving in the PRC.

The close integration of the banking sector into the party-state became obvious during the current financial crisis: first, the Chinese leadership stimulated and then reigned in the provision of credit by Chinese banks through informal telephone calls. Second, a conference of the main regulatory bodies led to a new policy linking the financial services industry in China to the overall strategy of promoting Chinese enterprises abroad, the so-called 'Go Global' Strategy. In sum, the close relationship between the party and the financial industry is pervasive and persistent (Anderlini 2009; He 2010).

The concentration of control in the hands of the party-state adds more structural flaws. All regulatory bodies are subject to intensive lobbying, but in the case of China privileged links to top party officials provide alternative venues for both influencing market activities as well as pursuing political objectives. The state controls the credit volume and the interest banks are allowed to pay and to accept. The state controls the admission to the stock markets and the most important investors. Private investors act under the uncertainty of unstable and unreliable property rights. While media reporting has improved and several series of investigative articles have led to the detection of scandals and fraud, there is only limited independent control of market activities through intermediaries and news magazines. The lack of independent media reporting might help explain why the true costs of recapitalizing banks in the 1990s went more or less unnoticed by larger parts of the Chinese population in spite of the fact that it constituted a 'very large transfer of wealth from households to banks and borrowers' (Pettis 2011). When dealing with the outfall from the 2008 financial crisis, the party hierarchy ensured that 'phone calls to leading managers expressed support for the policies of the day such as the extension of credits, even at the risk of producing significant amounts of non-performing loans, or the calling back of credit (including that of international customers).

Due to different strands of political control of the individual organisations conflicting interests at the top level can slow down and counteract the party levers. Particularly in the case of dealing with local investment vehicles, the central government was apparently unaware of the high volume of debts resulting from speculation in property and has found it difficult to rein in credit growth both by macro-economic regulation as well as by party-mechanisms. Besides, while political lines of hierarchy are clear on paper, it is not specified whether the central government has to ultimately guarantee local government debt or which mechanisms should be employed to resolve issues (Orlik 2011). This underlines the costs resulting from China's incremental approach to creating a market in financial services: political responsibility and financial accountability are hard to establish.

The external dimension: market creation and integration into global markets

Since its entry into the WTO, China has increasingly adopted global norms and standards even if it deliberately obfuscated the domestic implementation of important elements of the WTO agreement. In financial services, it has come a long way to accept global standards and principles. Nevertheless, its incremental policies of market creation required a careful case-by-case approach towards global governance. The piecemeal opening up of the Chinese market for foreign banks and the partial withdrawal of large global players from China highlights the difficult balance between using foreign funds, expertise and know-how for domestic development and preserving control of key elements of the sector.

Following the pattern of intensive study and meticulous consideration before committing to multilateral initiatives, the Chinese leadership needed a substantial amount of time to define its position to the global crisis management. During the end of 2008 and the beginning of 2009, China used all its channels of bilateral and multilateral cooperation to define its policies. At the Washington Summit in November 2008, President Hu Jintao stressed the need for close cooperation and a fundamental review of global rules but with due respect to individual circumstances. At the same time, he warned against premature moves trying to buy time for the complicated policy making process in Beijing (State Council 2008). China's leaders were careful not to echo voices from China's domestic discussions calling for Chinese redefinition of the global order (*Caijing*, 28 November 2008).

For the party-state, an increased role in the revision of global governance conflicts with several principles and interests. First, the PRC takes economic security very seriously and considers economic sovereignty an absolute precondition for successful modernisation. The G-20 proposal to install a global banking regulator with authority over Chinese banks is deemed unacceptable (*FT Online* 2009). Second, it acknowledges the intrinsic link between global and domestic reforms; therefore, the international level should support the improvement of the market framework with Chinese characteristics but not destabilise the complex web of party involvement (Qi Bao 2008). One of the main – and less risky – objectives of China's policies in the context of the G-20 is to ensure it sits at the table when all new rules and policies are drafted. Therefore, it continues to push for a stronger representation in the Bretton-Woods organisations and other global financial bodies (Gottwald 2011b). High-ranking officials repeatedly stressed the crucial importance to reform the IMF in the context of the global crisis management (Wu Chong 2010).

The issue how far China's unique approach to market creation can be accommodated within a new global framework has come to the fore in the reform of the Financial Stability Forum (FSF) for the coordination of selected policies in global finance. In April 2009, the FSF was transformed into the Financial Stability Board (FSB), a potentially powerful tool for transnational supervision of national finance systems. The FSF had had very little success in promoting global rules and codes of conduct in financial services prior to the crisis but took a central role in identifying and addressing key factors that had led to the global financial crisis of 2008 (Carrasco 2010:205). Emerging markets were not represented: homogeneity was deemed more efficient than inclusion of major nations (Liberi 2003:549).

The PRC supported the establishment of the FSB and joined it well aware that this step increases the pressure to adopt international standards. Accordingly, domestic voices called for the setting up of a Chinese financial stability board to support the State Council in the supervision of the financial system and to improve coordination among the existing supervisory authorities (Yan Pei 2010). These proposals are opposed by the PBC which wants to preserve its authority in the area of macro-prudential supervision (Zhou Xiaochuan 2010b). In the view of some observers, the mandate for the FSB 'present[s] significant threats to national sovereignty, as it gives the international community the authority to review and regulate the financial and operational structures of private enterprises, potentially bypassing the jurisdiction of national regulatory systems' (Kelly 2009). The PRC has already in general accepted the principle of peer reviews of regulation and regulatory reforms with the explicit aim of introducing a race to the top regarding the quality of regulation (G20 2010:19). In this regard, the FSB follows similar procedures within the G 20. However, all measures decided by the G-20need unanimity and, thereby, leave room for a veto. Calls for the introduction of new banking levies and a global transaction tax were vetoed to the disappointment of EU leaders. The PRC might trust the weak institutional set-up (Kawai/Pomerleano 2009) that should leave enough room for a preservation of the Chinese characteristics.

Conclusion

The piecemeal approach of the Chinese party state to the creation of a market in financial services followed the over-arching interests of the CCP to preserve and focus their influence within a market-oriented framework for economic activity. This approach dovetails nicely with the observation that the PRC has not just established another version of the regulatory state, but that it has used the main characteristics of this internationally accepted paradigm to further improve its Socialist Market Economy. Ths step-by-step introduction of reforms, experiments with various models, learning and adaption can all be recognized in China's financial system. The central role of party-organisation and control of financial resources are balanced by an increasing diversity of interests within the party-state. The image of an all-pervasive party-state is thus countered by bureaucratic turf wars and piecemeal and uncertain implementation of policies.
Unless a major crisis unites the leadership and allows for a combination of the best of two worlds – a state of the art regulatory apparatus and the powerful instruments of top-down Leninist party hierarchy. The campaign style provision of extra credit in the context of the macro-economic stimulus package proved to be much easier then the retrenchment that is supposed to follow. Central authorities seem to be particularly successful in steering their provincial and local counterparts into action when the latter reap direct benefits. The issue of who will have to foot the bill of excessive spending and lending, however, is far from clear and will provide another important case study of the interplay of market and party-state forces in China's finance system.

Three decades of market creation in the area of financial services have left China with some of the largest banks in the world. Their shares are traded internationally yet still dominated by state-guidance and party control. While the strong state involvement and strict limits to business activities have protected China's financial sector against the worst fall-out from the current global crisis, it has preserved substantial flaws.

Due to the long experience of dealing with commercial banks which are close to local and provincial cadre, the century old underground banking system continues to flourish. Even in localities famous for their bottom-up development of export-oriented industries like Wenzhou local business owners still engage with alternative sources of credit which are completely outside the official regulatory structure. But even where the party-state officially occupies the commanding heights of the society, it finds it increasingly difficult to rein in creative financing vehicles set up by local authorities to benefits from China's rampant property speculation.

Having been cut off alternative funding by the central government, China's lower level authorities have invested heavily in property and property related areas during the macro-economic stimulus package. The exact amount of credit amassed by different sorts of special vehicles stunned the central authorities and was first reported in the Chinese media with reference to the US scholar Victor Shih. In the typical learning-by-doing bureaucratic policy process, the central government took several steps to improve oversight of these funding vehicles while at the same time ensuring the domestic as well as the foreign audience of the limited risk these developments are supposed to bear for the Chinese economy as whole. This adds to an increasing awareness of the peculiar strategy and style in addressing issues within China's financial sector radically criticized for its focus on internal dealings ad party-state control.

China's way of creating markets in financial services hardly offers a blueprint for other economies. Some states with a similar party-state structure might feel encouraged from the initial success of China's reform policies, yet they lack the size, attractiveness and, particularly, a gate such as Hong Kong to emulate the Chinese reforms. Preserving and improving state involvement and state control within the formal framework of a regulatory state model, however, has become the fashion of the post-2008 crisis management. Most European countries and the US have taken significant steps in re-introducing and strengthening public authority within the private realm of financial services. China has been called upon to take more active role and pride leadership in these global efforts due to its economic size, the capacity of its biggest banks and investment vehicles and its limited crisis exposure. But taking into account the specific nature of the Chinese gradual policies to set up markets to enforce – and by no means replace – party-state guidance and control of the financial sector, the PRC had little choice but to calm down over-optimistic expectations regarding its future role in global governance.

The integration into the global economy has increased the pressure on the PRC to create a market framework that allows for global standards, norms, and business practices to take (partial) root in its Socialist Market Economy. While initially China had to adapt to rules decided upon in forums and organisations were the PRC yielded little influence, the Chinese leadership has made it clear that it is sitting right at the head of the table in the current effort to find a new architecture for financial services. Again, the Chinese leadership has to accept that joining the global community limits its domestic policy choices. Hence the old dichotomy between attempts to reserve the original Chinese structure or essence (ti) while adopting external practices and technology (yong) is currently at play. Globally, the PRC hesitantly participates in the new regulatory framework for financial markets. At home, it tries to balance conflicting interests within its government and between different market participants. This increases the dynamic of seeking individual gain in the area of financial services – the basic concept of a market economy.

Despite the process of adjustment to both global imperatives and unparalleled economic development, the basic shape of the PRC's Leninist *modus operandi* remains intact. Regulatory reform have been introduced through traditional hierarchical Leninist institutions and, just as in other areas, lower-level cadres have been able to blunt their impact. Nevertheless, one party rule, state domination of the economy and an adroit use of ideological rhetoric are key features of China's market creation by Leninist means. Non-state actors may aspire to important secondary roles but the CCP diva commands the stage.

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[iii] Reminiscent of the famous *ti-yong* debate of late 19th century China.

[iv] Although the underlying assumption of China thereby following a similar process of development as the UK, Prussia, the Netherlands or France in the 19th and early 20th century is highly debatable for empirical reasons (international context) as well as normative one (risking to enter again a one-way perspective towards the evolution of a Western market economy).

[v] The law on SASAC was passed in 2002 and first measures were promulgated informally in the name of SASAC which officially started work in 2004. See www.sasac.gov.cn.