China’s Financial System: The Promise and Peril of Modernization

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Overhauling China's Financial System

What is the impetus?

Combination of financial malfeasance, corruption, debt risks…

CCP leaders are convinced that neither business nor technocrats/ bureaucrats can discipline or be disciplined by financial markets. They are mostly right.

An unprecedented challenge:

Can China have modern financial markets with a highly centralized political system?


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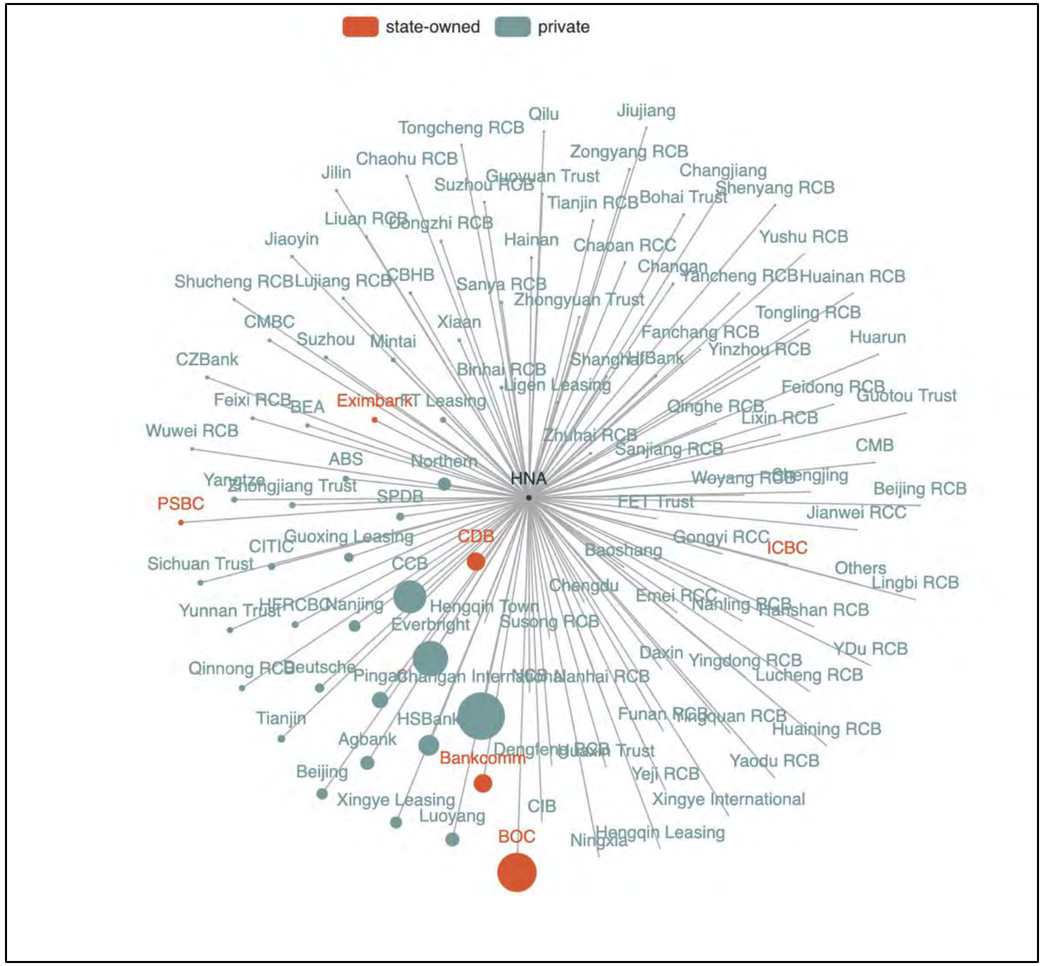

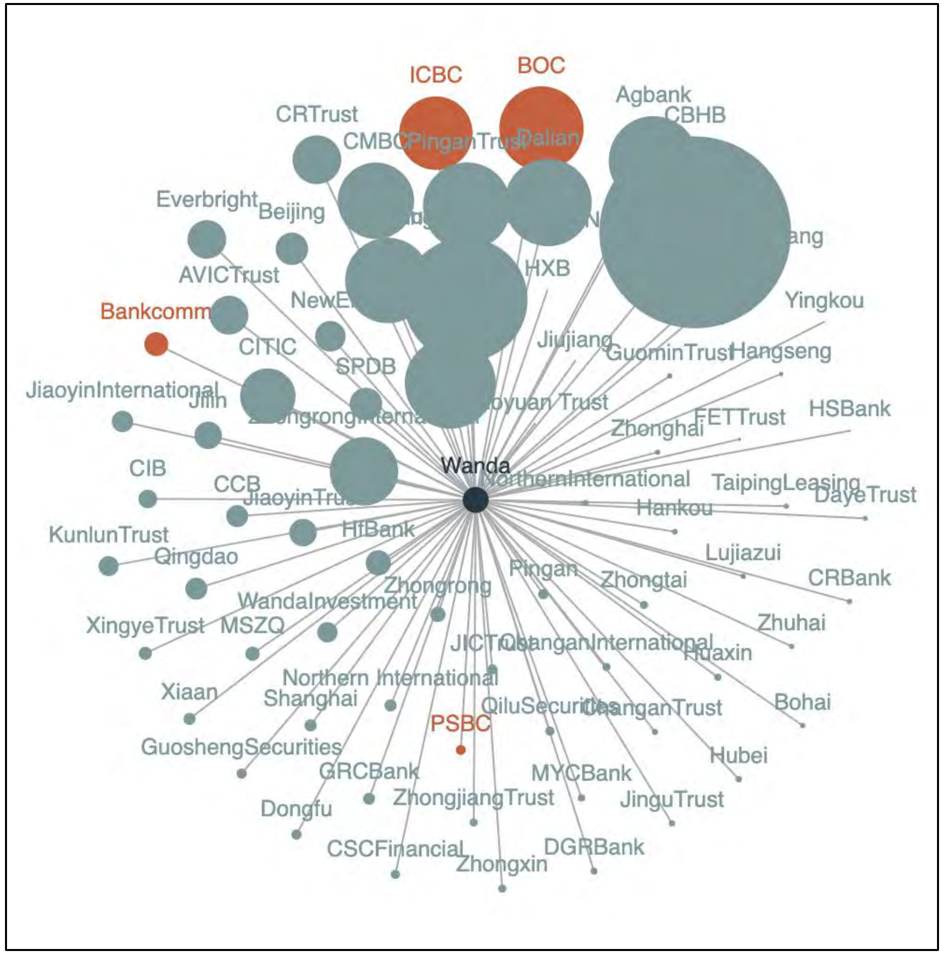

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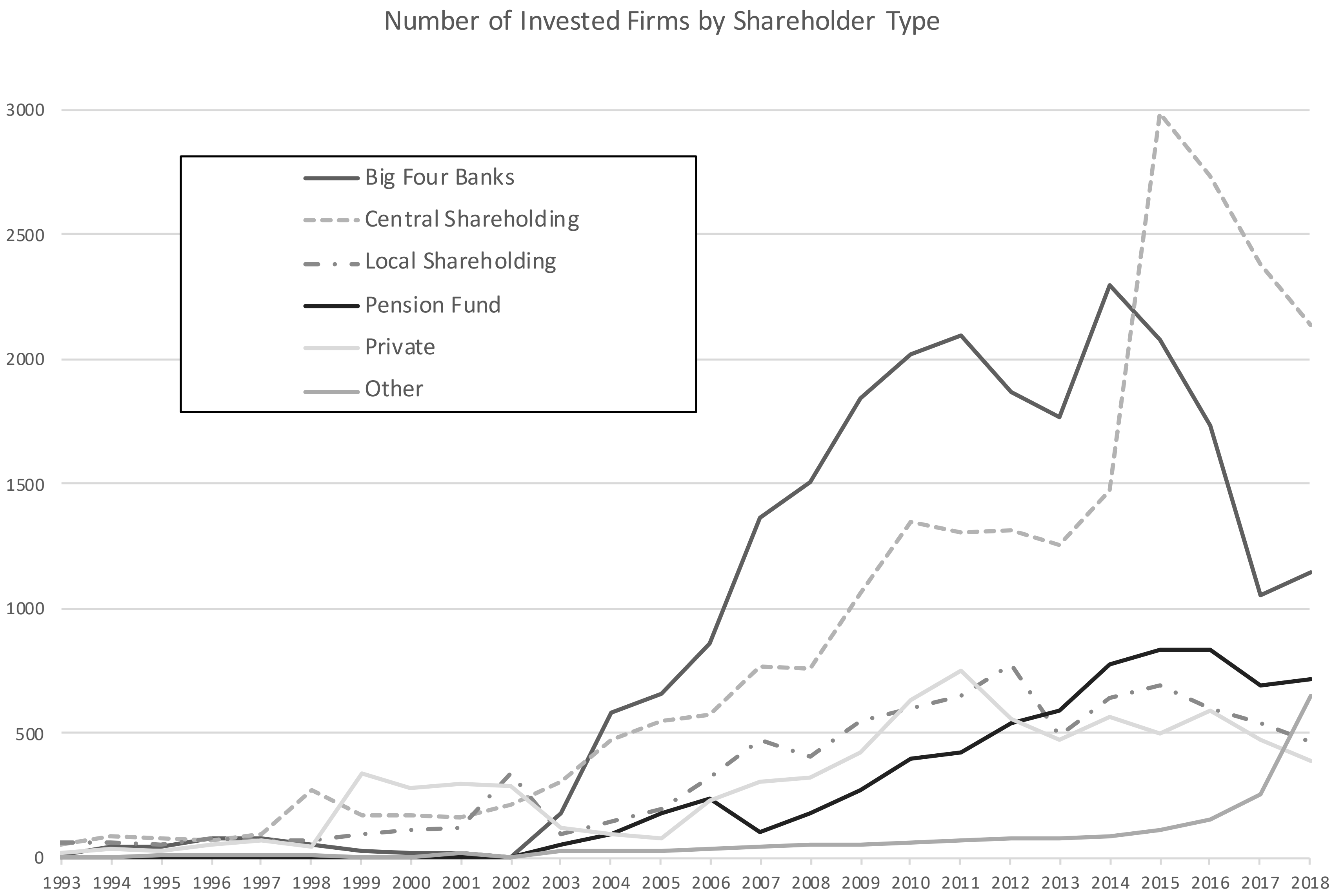
CCP leadership convinced that markets and regulations alone cannot discipline financial actors.

They might be right…

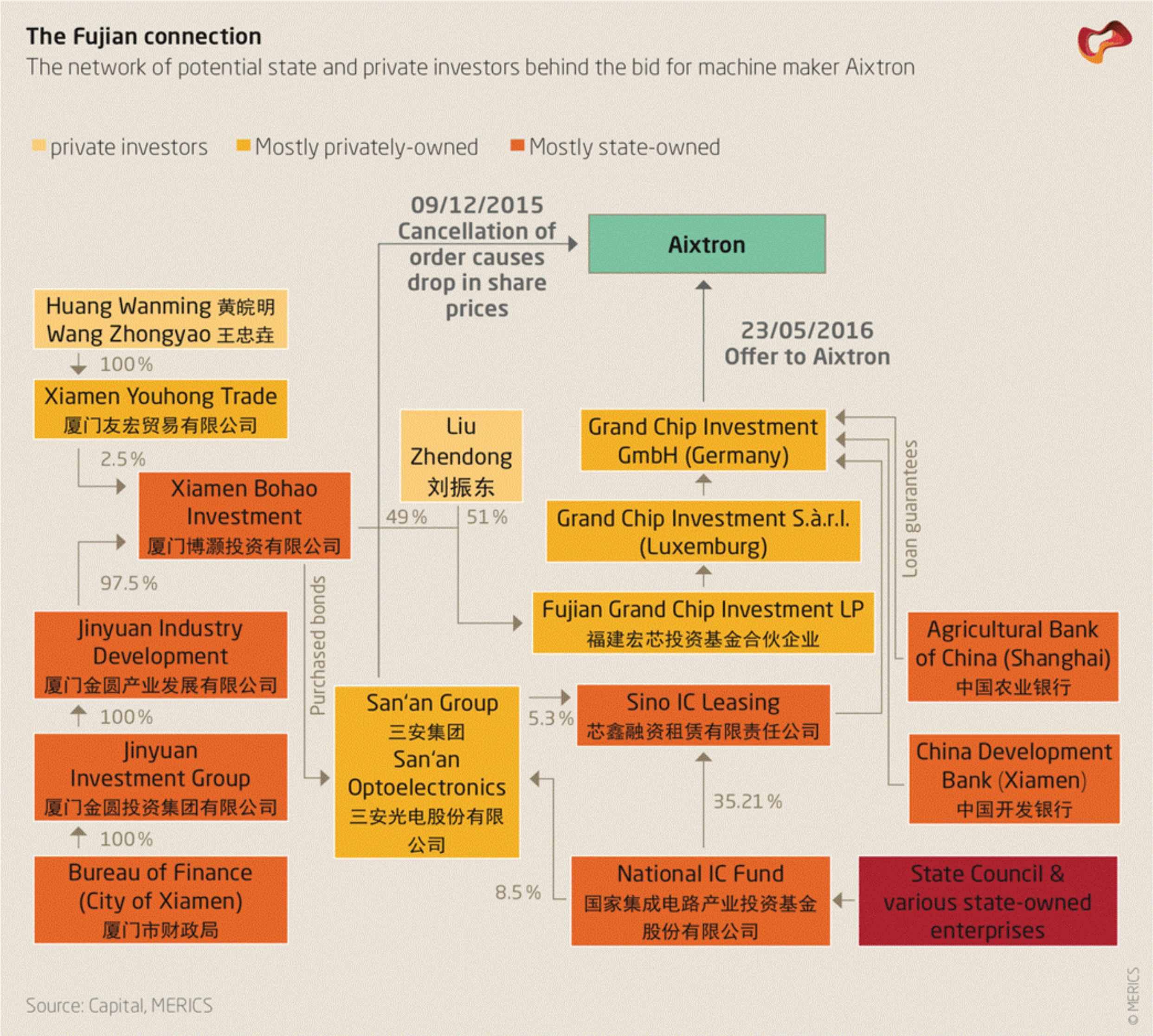
Short time horizons

Dual regulatory system

Lack of transparency and rule of law



Source: Chen & Rithmire, 2020



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The Malaysianization of China

A party-state’s role in corporate shareholding

Discipline through state action (rather than markets)

Constant bailouts and intervention

Limited innovation, persistent drain and flight

China's Financial Challenge

How did China grow without "requisite institutions" for so long?

- private sector willingness to take risks
- endowments and a favorable external environment

Next stage: growth through innovation and consumption, and it requires a financial sector

Modern financial sectors require trust, accountability, transparency, and impartial enforcement of rules