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Stephen Green

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**The Development of
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Equity politics and market institutions

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Stephen Green : The Development of China's Stockmarket, 1984-2002: Equity Politics and Market Institutions (Routledge Studies on China in Transition) before purchasing it in order to gage whether or not it would be worth my time, and all praised The Development of China's Stockmarket, 1984-2002: Equity Politics and Market Institutions (Routledge Studies on China in Transition):

0 of 0 people found the following review helpful. Economic Reform in China viewed as a Bailout By James R. Maclean Many readers are probably looking for a straightforward account of China's equity markets. For recommendations on alternatives, please see the end of this review. This book is actually much more ambitious. First, it includes a lot of quite detailed information on the structure and MO of the Chinese government. This includes relevant agencies and basic rules of bureaucracy (Green includes simplified Pinyin transliterations of most Chinese entities mentioned in his book, and many basic conceptual distinctions in Chinese legislation). This is quite useful, especially if supplemented by Shih (2008); but in terms of subject matter, there is no overlap. Second, Green's mission is to apply a particular variant of the economic theory of regulation (ETR) to China. ETR is an attempt to treat legislators as if conventional economic agents, essentially seeking to translate regulatory regimes into economic rents that can be harvested as campaign funding, etc. (1) Ambitiously, the ETR was supposed to not merely predict the sort of legislation that would appear, but also axiomatically explain why. In order to apply the ETR in any form to China, its economic transformation has to be treated as though the state and capital markets were stable; but in a transformation, any political-cum-managerial system has an affinity for explosive ("discontinuous") changes (2). Green therefore has an uphill battle, but he does an impressive job. Instead of treating business as a client of politicians, Green treats different layers of the Chinese bureaucracy as clients of the layer above, with the seldom-invoked Central Committee of the CCP at the top. The CSRC emerges as a supplement to the State Council's main managerial organ (the SCSC), initially sharing power with it and using it as a platform for deregulation, then later as a money pump for China's equities. The authorities in China needed a capital market, and over the time period covered in this book (1984-2002), this attribute remained consistent: they needed it help recapitalize the financial system, and eventually realized they needed CSRC to win back investor confidence, not defeat needful regulation. Green did some amazing detective work to interview many people present at the creation of the CSRC, China's newish securities regulator. This allowed him to get a clearer idea about what sorts of behavior were considered morally suspect by Chinese professionals, as opposed to merely different from Western norms. However, the book is wholly focused on behavior of the government part of the equation and ignores the impact of commercial actors on events. AND? China's transition to a capitalist (but non-market) economy has led to dire consequences that are usually papered over: by the authorities, for obvious reasons, but also by Western observers who feel that failures in transition arise to precisely that extent that China has failed to adhere to the market ideal. After all, those consequences include huge waste of effort and resources in unproductive investments. It's not much of a secret that China's banking system is not only sitting on vast pools of bad assets--loans that have no hope of being repaid--but the industrial system, dominated by its need to execute mammoth projects, has continued to produce more bad assets (3). One strategy for carrying the bad assets indefinitely (and profiting when they eventually do get sold) is persuading China's household sector to buy shares in state-owned enterprises (SOEs), frequently under conditions contrived to deceive investors about what they are investing in. The bad judgements have already been made, and the meltdown in asset values has already occurred in Reform-period China, just as it has in the USA, Japan, and in Europe. In the other economies, the meltdown was impossible to ignore and resulted in a major political crisis; in China, this has generated little political crisis, since the same financial elite and its quasi-public official handmaids have remained smugly in charge. Green writes very little about the banking system; this is mostly an investigation into the institutional health of the State Council's policy making. (In effect, the huge economic losses of the SOEs and their financial entourage can be taken as an artifact of China's pre-Deng Xiaoping epoch; the banking system, as suffering from SOEs regulated by state owners. There's no way the State Council's management of its own management can be assessed with ETR, since regulation/legislation are meaningless concepts here. With shares trading regulation, everything is different.) Green is tactful and discrete; he's conducting an investigation, not an expose acute;. But the question lingers: is the constituency for securities legislation in China the international equities market? Or is it the capital markets, where SOEs get another hit of dumb cash for recapitalizing? Or is it, finally, the new parvenus of China, determined to make the regulator of the stock exchanges loyal to enterprise management?

NOTES (1) Variants of the ETR have proliferated and I don't know if Green came up with the idea of combining the ETR with information economics. Credit goes to George Stigler, Sam Peltzman, and Oliver Williamson; Stigler, in particular, proposed the idea that legislators (not regulators!) are interest-maximizing agents who "sell" regulation to industries in order to make market entry difficult and ensure monopoly rents for the incumbent firms. In exchange, they are bribed" through campaign contributions, etc. Sam Peltzman's essay on ETR, "The Economic Theory of Regulation after a Decade of Deregulation" (1989) gives a pretty good idea of what happened with ETR but doesn't discuss the taxonomy of ETR varieties. Initially, ETR sounds realistically cynical about motives, but ignores countervailing interests (i.e., consumers of a regulated good who are themselves producers of another good). (2) Apologies for sloppy use of these terms. During a transitional phase, such as a revolution or the collapse of Communism in Europe, the regime either lurches in a particular direction--the bandwagon effect--or else gets locked in a stalemate. The changes, quantitatively, are discontinuous in the 2nd derivative, if not the 1st. (3) From 1954 or so to 1978, there was only one bank in China, the People's Bank of China (PBoC). From 1978 to 1984 the PBoC was removed from the business of business lending and converted into a dedicated central bank. During the premiership of Zhao Ziyang (1980-1987), the four state banks--ICBC, BoC, CBC, and ABC--were [re]created and

began making loans to their particular sectors of the Chinese economy. By 1994, these big four banks had made so many loans to state-owned enterprises that three policy banks (ADBC, CDB, and EXIM) were created. See "China's Policy Banks," *_Caijing_* (9 Sept 2009); these also ran up large portfolios of bad loans. In 1999, the Ministry of Finance set up one asset management corporation (AMC) for each of the big four banks, with a ten-year remit to dispose of their gigantic portfolios of nonperforming loans. Later, the AMCs became publicly traded entities. See Philip B. Gilligan, "China NPLs: Trends and Future Issues," from Gruson Reisner (editors), *Regulation of Foreign Banks*, LexisNexis (2005). All this is summarized in Tang Linowski (2011), p.8 of the PDF file I'm using for reference. In all this time, the AMCs have continued to buy more NPLs and make a profit managing the underlying assets. This is an obvious example of pseudo-market entities socializing losses and privatizing gains. Bonds issued by the AMCs are backed by the PBoC, allowing the AMCs to report most liquidations of NPLs as profit. The AMCs transfer this subsidy to the Big Four Banks (et al.) by buying NPLs at face value.

RECOMMENDED READING (R-1) The development of China's equity markets: Junhua Tang Dirk Linowski, "Corporate Governance at the Chinese Stock Market: How it Evolved," p.107 of Alexander Brink (editor), *Corporate Governance and Business Ethics*, Springer (2011). Complete text of this paper is available online. This paper lacks Stephen Green's information on the structure of the Chinese government.

(R-2) Salih N. Neftci; Michelle Yuan Meacut;nager-Xu (editors), *China's Financial Markets: An Insider's Guide to How the Markets Work*, Elsevier (2007). Both this one and Tang Linowski (2011) include detailed information on banking and other financial sectors. The next two provide valuable background on the economic reforms in China.

(R-3) Victor C. Shih, *Factions and Finance in China: Elite Conflict and Inflation*, Cambridge University Press (2008). This book is a narrative of the factions, their membership and ideology, and 2nd order effects of their ascendancy.

(R-4) Yasheng Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State*, Cambridge University Press (2008). Unlike the others, which are mainly factual, this vehemently decries the faux capitalism and expropriation of rural farmers who had pioneered China's experiment with market economics. Huang's book is valuable largely because it explains the rise and fall of the "township and village enterprises" (TVEs) in the context of China's reforms. And these relate to the economic theory of regulation (ETR).

(R-5) Johan den Hertog, "Review of Economic Theories of Regulation," Utrecht School of Economics, Tjalling C. Koopmans Research Institute (Dec 2010): very well-done taxonomy of different variations on the ETR.

(R-6) Jean Tirole, "Hierarchies and Bureaucracies: on the Role of Collusion in Organizations," **Journal of Law, Economics, and Organization** vol. 2, no. 2 (Fall 1986): not about the ETR, but about the principal-agent paradigm from information economics. Cited by Green as a theoretical source, it differs from the usual principal-agent exposition by allowing for sub-networks to mitigate the assumed loss of efficiency from a hierarchical system.

As China's government manages a transition away from the socialist plan, how does it build the regulatory institutions it needs to manage the new market economy? Without the correct institutions, laws and agencies that implement the laws in place, the remarkable growth witnessed in China over the last two decades will falter. Financial sector reform lies at the heart of China's economic transition and China's stock market has become critical to the reform of state-owned industry, the supply of fiscal revenues and in building a modern pension system. *The Development of China's Stockmarket* takes a close look at the policy-making and regulatory institutions the government has created to manage equity development and shows how, in contrast to neo-institutional and economic theories of regulatory development, public actors have controlled institutional development. Based on extensive field research in Shanghai, Shenzhen and Beijing and over forty interviews with regulators and market players, *The Development of China's Stockmarket* provides the first detailed academic analysis of the country's stockmarket. With a comprehensive review of Chinese language literature available on the subject, this book is essential reading for all scholars with an interest in Asian Business and China's transition from socialism.

'Stephen Green has written an intricately detailed and important book.' - *The China Journal* 'The book is required reading for anyone who wants to understand the growth of the equity or stock market in China.' - *The China Journal* About the Author Stephen Green is the Head of the Asia Programme at The Royal Institute of International Affairs at Chatham House, London.