How Proximate and ‘Meta-institutional’ Contexts Shape Institutional Change

Explaining the Rise of the People’s Bank of China

This paper charts and explains the rising monetary policy influence and authority of China’s central bank; the People’s Bank of China (PBC), especially in relation to the leadership of the Chinese Communist Party; the ultimate authority within the Chinese state. The PBC has been increasingly influential and authoritative in the monetary policy realm and as an inflation fighter, especially since the mid-to late 1990s. This was a contingent not an inevitable outcome. A key underlying basis for this ‘rise’ has been the PBC’s enhanced institutional capacities – essentially rules and resources. A turning point was the mid-1990s following earlier inflationary crises and change in the party leadership. This shift saw the PBC rise from a marginalized and constrained institution to one that would become increasingly central in the monetary policy arena, largely based on proximate and wider meta-institutional changes that led to increased mutual dependency with the leadership. The PBC was awarded new legislative foundations defining its role as a central bank charged with fighting inflation. More importantly, the PBC has increasingly developed specialised resources and capacities – information, monetary expertise, and innovative policy instruments – that have substantially boosted its role as an inflation fighting central bank. The PBC has also been active in exchange rate and wider financial reforms aimed at augmenting its monetary policy capacities. Although it has experienced setbacks, these resources and capacities far surpass those possessed by the PBC at the beginning of the reform era. Thus far these resources and capacities have helped the PBC establish a credible policy track record.

We argue that the PBC’s enhanced institutional capacities and policy track record have provided the basis for a relationship of growing mutual dependency between it and the party-leadership. It is this reciprocal and mutually dependent relationship that has provided a key basis for the PBC’s growing policy influence and authority. Our lens on this process focuses on the agency of the PBC’s leaders as shaped by their proximate institutional context, by their institutional resources and capacities, and their dialectical relations with an array of wider ideational, economic and political contexts, all of which helped shape the PBC and strengthen its relations with the party-elite, which ultimately contributed to the rising authority of the PBC.

If underlying institutional change has been central to the PBC’s rise, how should we conceptualise and explain institutional change? Here institutional theory has had difficulties. Historical, sociological and rational choice institutionalism typically apply heavy doses of institutional conditioning, ending up with essentially ‘structuralist’ or overly “sticky” accounts of institutional life, depicting institutions as rule-bound, highly constraining and as either resistant to change or as shaping change along defined paths. Building on the work of a

group of more 'flexible' historical institutionalist (HI) scholars who have given greater emphasis to institutionally-situated agency (Steinmo and Thelen 1992, Streeck and Thelen 2005, Mahoney and Thelen 2010, Lewis and Steinmo 2006, Crouch 2005, and Campbell 2004, 2011), Bell (2011) presents an approach which emphasises institutionally-situated agency and which accepts that agents and institutions are mutually shaping over time. Bell (2012) has recently extended this approach by also emphasising the role of wider 'meta-institutional' contexts in shaping institutional change. This approach focuses on agents within given institutions and how they interact dialectically with wider 'meta-institutional' contexts in both constraining and empowering ways in shaping institutional change. This paper applies this approach to help explain the rising authority of the PBC. Our focus in the first instance is on the PBC's leaders and how they interact with their immediate or proximate institutional context. We then focus on the PBC's interactions with a wider set of meta-institutional contexts, which have shaped institutional change at the PBC, and ultimately its rising authority. We thus place the PBC's agents at the centre of analysis and trace the mutually shaping interactions between these agents and their institutional and wider contexts over time.

The question of meta-institutional contexts has not been central in institutional theory and considerations of it have been ad hoc; driven by diverse theoretical perspectives. Our aim here is to treat the question of such contexts more systematically and to address it through a more unified theoretical approach which shows how wider contexts can constrain but also *empower* actors. We show how agents within the PBC interacted with key contexts, including their proximate institutional context, but also wider ideational contexts, policy contexts, structural contexts, crises, and wider power contexts, including interactions with powerful elites in the party-leadership. The latter involved the growth of strong mutual dependencies between the PBC and the leadership of the party-state; all of which in turn helped underpin the growing monetary policy influence and authority of the PBC. This approach enables a broader framing of institutional change, enabling us to bring the dynamics of politics more fully into the explanatory accounts of institutional life.

The paper first reviews relevant institutional changes and the rising policy authority of the PBC. Then it looks at some of the extant problems of institutional theory in explaining change, followed by a theoretical reformulation focusing on the role of agency in evolving institutional and wider meta-institutional contexts. This framework is then applied to explaining how the interaction between agency and changing contexts helped shape the rise of the PBC.

Changing Institutional Foundations and the PBC's Rising Influence and Authority

The rising influence and authority of the PBC has stemmed from underlying institutional change, especially rising institutional and policy capacities. This marks a substantial shift because the PBC emerged out of the former planning era as a weak and marginalised institution, with a rudimentary monetary policy constrained by the institutional and policy legacies of the planning era. The PBC had reached an earlier nadir when it was relegated and absorbed into the Ministry of Finance (MOF) in 1969. On the eve of the reform era, the State Council approved the PBC's independence from the MOF in 1978 and later clarified the Bank's status and institutional mandate as a

central bank in 1983. Subsequent expansionary macroeconomic settings and indiscipline at the local level in the 1980s and early 1990s saw China wracked by inflationary crises. This helped install a new reformist party leadership in the early 1990s and propel a new round of central bank reforms which saw further legislative strengthening of the PBC's role as a central bank and as an inflation fighter, embodied in the Central Bank Law in 1995 (Chen and Zhou 2011; He 1998; Qian 1996). This, combined with the restructure of the PBC's provincial branch system into a Fed-like regional structure in 1998, helped insulate the PBC from the MOF and from local governments (PBC 2011).¹ The latter was important in giving the PBC greater clout in reining in local growth fevers and credit surges; historically an important inflationary impulse in China (Huang 1996). Another institutional change, in 2003, was to hive off the responsibility for banking supervision from the PBC, a move which helped to insulate the PBC from pressure from the large state banks (Heilmann 2005), to emerge as a meta-regulator over a series of lower regulatory agencies (Feng 2006), and to help further focus the PBC on monetary policy and fighting inflation (Xia 2003).

The PBC has also beefed up its institutional capacity by harnessing unique forms of information and expertise embodied specialised data collection and research, interaction with the international central banking community and with the IMF, and by boosting the quality of the Bank's personnel and recruitment, partly through high quality recruitment and training within its own Graduate School and by recruiting top overseas trained Chinese economists (Wang and Wang 2011).

The PBC has also been transforming China's monetary policy framework, particularly in developing and utilising an array of direct and indirect policy instruments. Since the mid-1990s, and especially since the phase-out of the Credit Plan in 1998, the PBC has been increasingly using more market-oriented, indirect policy instruments, such as interest rates, bank reserve ratios, and open market operations (Geiger 2008). At the same time, the Bank also retains direct, administrative commands, such as window guidance; an instrument reflecting hierarchical state traditions. This combination of policy tools, both direct and indirect, has awarded the Bank enhanced flexibility and has strengthened its institutional and policy capacities in its core business of monetary policy.

The PBC has also been more assertive in policy terms since the mid-1990s, especially when it helped crunch a major outbreak of inflation and engineer a soft landing in 1996. It has also complemented its anti-inflation focus by pushing for a degree of exchange rate liberalisation and flexibility and in successfully arguing for a non-devaluation strategy in the wake of the Asian financial crisis, an event which led Liew to argue that the central bank had become 'the most influential ministry in economic affairs' (Liew, 2004, p. 50). Reflecting his ideas of a more market-determined RMB to aid the effectiveness of monetary policy, the PBC and its governor Zhou Xiaochuan (Zhou et al. 1993) managed to weather domestic debate on RMB revaluation, and eventually convinced the leadership to shift to a partial liberalisation of the exchange rate regime in 2005; a major move which saw the RMB appreciate 20% against the US dollar by July 2008.² Here, the PBC largely defined the macroeconomic analysis and policy responses for the establishment of a more flexible market-oriented exchange rate and monetary policy regime. According to Fred Hu, who has worked with Zhou on banking and other issues, Zhou 'chose a clever way of using

nationalist sentiment and turning it around to say that [China] needs to be bolder and quicker to push the RMB' (Davis 2011). Subsequently, Zhou became known as 'Mr RMB' in the international media.

The PBC has also been influential in using quantitative instruments to help sterilise ballooning domestic money holdings and to issue innovative central bank bills designed to soak up liquidity. It has also been influential in its efforts to spearhead reform of the financial sector and the ailing state banks; again aimed at increasing the role and effectiveness of monetary policy. The PBC used to be a mere fiscal agent for the Ministry of Finance (MOF) in previous bail-outs of the state banks, but in 2003 it seized the leadership of the bank reform agenda for a period from the fiscally strapped MOF by utilising financial resources under its own discretion, namely China's ballooning foreign reserves, to recapitalise the state banks. This enabled the Bank's Governor, Zhou Xiaochuan (1999a, 1999b), to implement a more market-oriented strategy on banking reform that was devised back in the late 1990s. The PBC also imposed more sharply focussed governance and accountability regimes on the state banks using its new purpose built Huijin investment corporation (Feng, 2006a).

Another example of agency-based discretion is the PBC's role in fostering China's emerging bond market. Frustrated by the deadlock under the powerful National Development and Reform Commission (NDRC), and insisting on the benefits of direct finance, Governor Zhou Xiaochuan and the PBC took matters into its own hands by securing regulatory authority over bonds with maturities of less than one year in 2005. Sales of those instruments boomed. In April 2008 the central bank further extended the term of the short-term bills that were under its jurisdiction from one year to five years, which effectively created a new, medium-term corporate bond market 'at the stroke of a pen' (Wheatley 2008). This has led to explosive development of the bond market since then (Cookson 2010).

In 2003 the PBC directly tested the authority of the party-leadership with its unilateral, pre-emptive action against asset price inflation (Davis 2011). The PBC's administrative monetary controls combined with the growing use of market-based measures gave it a wide ranging set of monetary tools. In this instance, the PBC relied on window guidance, a move designed to 'technically' avoid invoking an interest rate hike which would have needed formal approval by a hesitant State Council.³ In the face of resistance from the NDRC and the Ministry of Construction, which have a vested interest in the property market, the PBC subsequently resorted to indirect instruments such as raising bank's reserves twice and establishing a differential reserve regime for commercial banks (PBC, 2004, p. 3-4). Finally the PBC persuaded Premier Wen to raise interest rates in October 2004, the first time in nine years. In commenting these events, Ba Shusong, a renowned economist, argues that 'the recent several important decisions of the PBC demonstrate... evidence of the rise of the operational independence of the PBC' (Du, 2003, p. 7). Barry Naughton (2004, pp. 3-4) similarly argues that 'Zhou Xiaochuan, as head of the PBC, was beginning to interact with other economic decision-makers in China in a way not terribly different from the way that Alan Greenspan does in the United States'. These views are somewhat overstated because the PBC does not have formal operational independence, although they do nevertheless attest to the rising influence and authority of the Bank.

The PBC has also established a reasonably credible policy track record in monetary policy, thus far. Given a similar average rate of economic growth between the two periods of 1978-1994 and 1995-2010 (10.1% and 9.9% respectively), the average rate of CPI inflation was reduced on average from 7.7% in the first period to only 3% in the second period. Although the inflation figure in the second period was partly offset by the deflation induced by the Asian financial crisis, the PBC's growing capacities and influence since the 1990s arguably have nevertheless helped moderate inflation during this period. Significant challenges such as credit expansion remain but the PBC has thus far helped achieve moderate overall inflation in China's high-growth economy.

Nevertheless, the rise of the PBC in the reform era has occurred in the shadow of the Communist Party that sees delegation of monetary and financial authority as a potential threat to its political power. This is why the PBC has not been granted independence and why major policy moves (such as interest rate and exchange rate policies) have to be approved by the State Council. Nor has the PBC's rise been smooth. As noted, the PBC experienced a slow start in the 1980s, followed by a surge in capacity and influence in the 1990s and early 2000s. However, it has experienced set backs on some fronts and is constantly engaged in bureaucratic struggles. For example, the PBC lost some momentum on banking reform after 2005 in a turf war with the MOF. Walter and Howie (2011) argue that the change in party leadership in the mid-2000s also impacted on the PBC's banking reforms, although it still managed to sustain the reform momentum on a number of fronts, including finalising the initial public offerings of the major state banks, pushing through reforms in the domestic bond market, and pushing for the resumption of the RMB's gradual appreciation. Monetary policy prudence also experienced a temporary setback as the party leadership insisted on a massive stimulatory credit expansion in 2008-09. Moreover, although the PBC is credited with establishing a modern framework for monetary policy, the rapidly growing informal sector poses challenges to the PBC's policy reach, especially the growing level of local public debt and local government financing platforms (PBC 2011), growing off-balance sheet operations in the banking sector (Chen and Zhou 2011), and an unsustainable level of informal finance in the private sector (Wang and Wang 2011).

These ongoing challenges remind us that the PBC is deeply enmeshed in intense bureaucratic politics within the Chinese party-state and faces constant battles to enhance its authority and disciplinary capacity in the monetary realm. Clearly, the PBC's rise and reform momentum has experienced ebbs and flows and the PBC clearly faces evolving challenges. We nevertheless suggest that the PBC has established itself as a substantial force within Chinese macroeconomic policy. Overall, it has managed to build its expertise and policy capacities in the monetary arena and thus far at least a credible policy track record in dealing with inflation, all of which has helped to cement supportive relations with the leadership and in turn its policy authority.

Explaining Institutional Change

Accounts of rising central bank authority in developing countries often focus on demands from international financial markets for low and stable inflation and central bank independence. Yet, a key argument in the literature, that the growth of central banking authority represents a credit worthiness signalling device to the markets (Maxfield, 1997), is not applicable in the China case, largely because China has emerged as one of the world's leading creditors. We argue instead that the rise of the PBC has been substantially shaped by *domestic*

institutional change dynamics and their impact in shaping political relations between the PBC and key elements of the party-leadership. The literature on central bank authority also gives little attention to central banks themselves, particularly in terms of the development of specific institutional capacities. Yet these have been central in the China case.

Our lens on this process focuses on the agency of the PBC's leaders, their institutional capacities and their relationship with the party-leadership. The logic of the analysis starts with situated agents within the PBC and works outwards, tracing interactions between these agents and the wider meta-institutional contexts noted above, including political relations with the party-elite. At bottom institutional theory is about how institutional settings shape the behaviour and capacities of institutionally-situated agents. Institutions matter because of the ways they reflect, refract, restrain and enable human behaviour, whilst in turn, it is the behaviour of agents that reproduces or transforms institutions over time. Agents actively interpret their situation and weigh up the costs and benefits of change, based partly on contingent assessments of resources and capabilities.

We adopt a particular version historical institutionalist (HI) theory that is critical over overly constraining versions of 'sticky' HI theory and its limited account of agency and its highly constrained notions of institutional change (for a critique see Bell 2011). Instead the approach used here builds on the work of a number of HI scholars who have emphasised agency and endogenous institutional change and the dialectical interplay between agency and institutions (Thelen and Steinmo 1992, Streeck and Thelen 2005, Mahoney and Thelen 2010, Campbell 1997; 2002; 2004; Crouch, 2005; 2007). This approach has been further developed by Bell (2011, 2012) who argues that agents operate not only within proximate institutions but also within wider 'meta-institutional' contexts which help shape behaviour and patterns of institutional constraint and enablement. Established theory has tended to focus on intermediate institutional dynamics, and to the extent that wider contexts have been addressed, they have been modelled as crises which propel change (Krasner, 1984), as external political factors which reinforce path dependency (Pierson, 2000a; 2000b), as changing 'environmental conditions' that alter institutional power distributions (Mahoney and Thelen, 2010), as ideational contexts that shape actor preferences (Hay 2006; Blyth 2002; Schmidt, 2006), and as policy contexts (Taylor, 2009) or as external structural environments which shape institutional change (Pontussen, 1995). The problem however is that the treatment of such contexts has been inconsistent; some studies deal with context, others do not. Also, the treatment has been as hoc, with theoretical assumptions underpinning these approaches varying widely.

The approach here is to explore more systematically the impact of external or meta-institutional contexts on institutional change and to do so through a more coherent theoretical approach. This also offers a way of synthesising previously jarring theoretical elements by combining exogenous shock and endogenous incremental change approaches (Mahoney and Thelen 2010) through a greater focus on how institutionally-situated agents deal with changing contexts and opportunities. Moreover, far from being largely constraining, as 'sticky' versions of HI theory assume, proximate institutional and wider meta-institutional contexts can also be positively *empowering*; offering agents important resources and opportunities. Institutional and wider contexts can exert important, though

always agency actualised, effects (Archer 2000, p. 465), by imposing costs or benefits on agents, by shaping actor interpretations and preferences, by shaping the scope of agent’s discretion, and the resources and opportunities that are available to actors (for a full account see Bell 2011, 2012).

In the analysis below we show how key agents, especially within the PBC, interacted with proximate institutional and wider meta-institutional contexts over time to exploit opportunities and to build institutional capacity within the PBC. As noted above, these contexts, included the proximate institutional context of the PBC itself, wider ideational contexts which helped define the PBC’s mission and role, crisis contexts which helped spur political and institutional change, wider policy and structural contexts, as well as the wider political context in which the PBC operated (especially in relation to the party leadership), all of which helped shape institutional change and elevate the PBC’s authority.

Agents, Institutions and Wider Meta-institutional Contexts

The PBC as a Proximate Institutional Context

Institutional theory suggests that the rules, norms and operating procedures of given institutions help shape the behaviour of agents within them, and this is certainly true for central banks. The PBC has pursued central bank reform and inflation fighting; institutional agendas that have broadly reflected a new wave of central bank formation and modernisation in emerging market and transition economies (Marcussen 2005; Johnson 2003, 2006). In particular, the PBC’s norms and approach have also been shaped by liberal-minded, western trained officials pushing for central bank modernisation and professionalism and for a greater role for market-oriented policy instruments, as well as by those who endorse more traditional hierarchical and administrative policy orientations (Dai 1998).

As for the institutional incentives faced by the PBC’s leaders, Shih’s (2007) ‘political survival framework’ suggests that becoming an ‘indispensable problem solver’ is a sound strategy for building political capital and institutional clout in China. However, Shih (2007: 1246) also suggests that because ‘administrative accomplishments are evaluated by short-term results’ actors have incentives to ignore longer term issues and have ‘strong disincentives to carry out fundamental reforms’. Here Shih’s argument is about political agendas and how political obedience to the Party is weighed in top bureaucrat’s policy choices vis-à-vis their institutional mandate. To be sure, top officials may be a political appointment sanctioned by the appointee’s elite patron, but as Shih notes, future career development is also shaped by institutional performance. After all, the Party needs capable problem-solvers more than incompetent loyalists. Therefore, the political and careerist incentives of top PBC officials mostly align with the longer-term institutional interests and clear performance criteria of the central bank, especially dealing with inflation. For example, former Governor, Dai Xianglong has argued that: ‘The practical experiences of the past 50 years attests that, resolutely fighting against inflation and stabilising currency value and finance should always be the primary function and historical responsibility of the central bank’ (Dai 1998: 12). More specifically, as the central bank’s core business is monetary policy and inflation fighting, the PBC’s leadership incentives are aligned

with effective monetary policy, overall financial stability, the introduction of more market-based policy instruments in order to help strengthen and widen monetary policy capacity, with exchange rate liberalisation that will give the PBC greater monetary policy autonomy, and with banking and financial reforms that address not only a systemic source of financial instability but also the highly distorted transmission mechanisms on which the PBC's monetary policy has to rely. None of these are short-termist projects but instead require long-term commitments to institution building and reform, of the kind pursued by the PBC.

These commitments have also reflected processes of international ideational and policy diffusion, highlighting the importance of wider ideational contexts that have been highly relevant to institutional reform at the PBC.

The Wider Ideational Context

In recent years one response to sticky HI theory has been to establish a new 'constructivist' or 'discursive' institutionalism which elevates the role agency and especially the ideational and discursive practices that agents use in interpreting and defining their realities (Blyth, 2002; Hay, 2006; Schmidt, 2006). This approach 'puts agency back into institutional change', according to Schmidt (2008, p. 316). For Hay, this means a focus on 'strategic actors', 'who must rely upon *perceptions* of their environment and whose 'desires, preferences and motivations' are 'irredeemably ideational' (our emphasis)(Hay, 2006, p. 63). However, this approach has been criticised by Bell (2011), largely because the new constructivists underemphasise the role of institutional and wider meta-institutional contexts in shaping behaviour.

Despite these problems in extant work, constructivist perspectives usefully point to the importance of subjective and inter-subjective ideas and wider discourses in shaping institutional life. Internationally, central banks have been increasingly animated by a broadly common set of norms and policies about how central bankers should behave and operate. These have had an impact in China. As noted, the leadership of the PBC has been increasingly animated by ideas such as fighting inflation and developing market-based monetary instruments. Such ideas are widely shared amongst central bankers and reflect international policy diffusion and elite networking (Johnson, 2003). In post-communist transition states in Eastern Europe, for example, Johnson (2002, p. 1, see also 2006) found that, 'Established central bankers integrated the post-communist central bankers into their community, changed their ideas about the proper role of a central bank, and led hands-on efforts within the post-communist central banks to develop modern tools of central banking'.

Such accounts throw useful light on the China case where the PBC's leaders have been receptive to ideas that promised useful policy principles and procedures, and international status. As one PBC official commented, 'I feel that central banks are like a club. As a Chinese central bank, we want to be a member of it'.⁴ The PBC's exchange with international institutions, particularly the BIS and IMF has also been an important channel for external influence.

Despite these external dynamics, a decidedly one-way, outside-in approach tends to obscure the key domestic factors that have also shaped change. The international policy diffusion literature tends to underplay the

role of mediating domestic dynamics and institutions (Bell and Feng 2012). Such dynamics – especially relating to China’s transition economy and its hierarchical party-state - have mediated and constrained policy diffusion and convergence, as Bell and Feng (2012) have argued. Indeed, many overseas policies and institutional designs could not easily be aligned with the legacies of the past, with the gradualist dynamics of the transition economy, with China’s immature markets, its managed exchange-rate system, and its hierarchical political and administrative order. Hence the Chinese party-state has rejected central bank independence and there has been much local adaptation of market reforms, reflecting an increasingly sober view of the applicability and effectiveness of western ideas in China’s political and economic system. As a PBC official suggested, ‘As the reform deepened, we come to realise that the economic transition in our country is so unique that few of the western theories can give us sound explanation and guidance’. And as another PBC official suggested:

There have been basically two camps within the central bank. One is the market faction, or camp, consisting people with experiences of studying abroad or with a background in modern finance and economics. The other camp consists of people that believe in the effectiveness of state administration. Over the years, however, even the major figures from the market camp began to have second thoughts in the applicability of western ideas in China... It’s not that we question the validity of the western monetary doctrines. It is that they simply don’t work in our scenario. We have to navigate the system and take advantage of it.⁵

An important adaptation in this regard has been the way in which the PBC has been able to creatively blend market instruments with more traditional administrative approaches to policy, as well as working to adapt local institutional arrangements (eg. the exchange rate system) to better fit with imported monetary policy ideas and approaches.

The Policy Context

Many institutional studies tend to conflate public policies with rules and hence with institutions. In a recent contribution, however, Taylor (2009) distinguishes between policies and institutions, arguing that exogenous policy changes can be an important source of institutional change. As he suggests, ‘while institutions have a demonstrable effect on policy choices, the opposite path is also highly significant Policy change occurs relatively frequently and, like water flowing daily through a riverbed, can gradually mould institutions to its flow’ (2009, p. 487, 491). For example, in the case of the Brazilian Central Bank, Taylor (2009) shows how policy shifts, such as the Brady Plan for sovereign debt repayment, moved foreign debt management from the Bank to the Treasury and allowed the Bank to hone its focus on monetary policy and build its capacity and authority. Similar arguments are made by Bell (2004) in relation to exchange rate liberalisation and its institutional impact on the Reserve Bank of Australia.

In China, and in contrast to many other transition cases, the Chinese state has remained relatively intact with the communist party thus far maintaining its hegemony (Breslin 1996; Hu 2000; Huang 2008; Liew 1995; Shambaugh 2008). This particular Chinese characteristic has proved crucial for it has meant that there has existed a potentially powerful source of centralised *policy* authority able to push through change or clear logjams in particular settings. One aspect of this was a major reorientation of economic strategy during the so-called second reform era

from the early 1990s (Naughton 2008) that saw many of the planning elements gradually phased out and slowly replaced by a more market-oriented albeit state-orchestrated policy system. As part of this second reform era, the party-elite also beefed up the system of patronage politics that also helped re-centralise authority.

In relation to the PBC, local administrations had exerted heavy influence on its monetary policy up until the late 1990s (Huang 1996), but this situation was partly alleviated through policy and administrative re-centralisation that strengthened the PBC. Also, although the bandwagon strategy and decentralisation of the first reform era had seen greater authority devolved to the bureaucracy in the 1980s, rapid developments in the emerging market in turn demanded a more responsive, efficient, and sophisticated mode of governance, which the older fragmented bureaucracy could not offer. A second wave of administrative reform policy was thus rolled out, aiming at transforming state governance from an older pattern of administrative supervision to a more modern form of market regulation (Yang, 2004). Overall, the Chinese state began to shift at least some way towards an emerging market-oriented 'regulatory state' (Yang, 2004; Pearson, 2005; Levi-Faur, 2005), in which the leadership increasingly relied on legally mandated and professionalised regulatory institutions to oversee market activities, including and perhaps especially in relation to a modernised central bank.

These changes were also associated with significant policy shifts which helped elevate the PBC, especially the phasing out of earlier forms of centralised financial planning. As a PBC official commented: "in strict terms, China's genuine monetary policymaking actually started from 1998 when we abandoned the credit plan."⁶ Yet the PBC continued to operate with an intermediate control system involving direct administrative controls combined with efforts to develop more market-oriented indirect instruments such as open market operations and interest rate setting. The increasing range of instruments at the disposal of the PBC however has meant that it has been able to open up space for initiative and a degree of discretion in shaping monetary policy, especially compared to the 'single instrument' monetary policy arrangements typically found in the west.

The Structural Context - the Economic Transition

Thelen and Steinmo originally argued that the focus of historical institutionalism was on 'intermediate-level institutions', distinguishing these from 'macro-structures such as class' (Thelen and Steinmo 1992, p. 110). However, Pontussen (1995) has criticised historical institutionalism for focussing too narrowly on 'intermediate level institutions,' and ignoring wider structural environments and their impact on institutions. Structures are often materially defined, for example, a demographic structure or the structure of an economy. Broader social phenomena might also be thought of in structural terms. For example, Pontussen (1995, p. 126) argues that 'the centralisation of state power might be considered a structural feature that underlies various political institutions'. More abstractly, structures can be defined as "strategically selective" terrains, establishing incentives or disincentives or other rationales that may lead agents to favour certain developments or choices over others (Hay 1996, Jessop 1996). Because structural factors are typically the result of embedded historical processes they arguably form a broader background context in which specific institutions operate and change. HI scholars have often conflated institutions and structures or used the terms interchangeably (eg. Cortell and Petersen 1999). This conceptual muddling is not helpful because it prevents us from examining how agents within institutions dialectically interact

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with wider structures (Archer 2003). Although ‘structuralist’ accounts in political analysis are often handled in a way which implies deterministic patterns of *constraint*, in reality, structures can help both constrain and empower agents. Structural effects will also typically be interpreted and mediated by institutions and the agents within them.

Perhaps the most important structural context that has shaped the rise of the PBC has been the market transition. This has unleashed new inflationary forces stemming from sectoral economic changes and new mechanisms of market pricing. As production factors were gradually liberalised the basic pricing mechanisms (once managed under plan-centred preferential policies and subsidies) needed systemic realignment to reflect supply and demand forces. Coupled with the increasing monetisation of the economy, radical price reforms of major commodities tended to lead to open inflation; as did the forces generated by the evolving central-local relationship which prompted considerable local investment fetishism and economic overheating (Huang, 1996, 2002; Naughton, 1991). The impact of inflationary crises helped restructure elite power, as we argue below, but it was also the persistent momentum for further reform unleashed by the market drive, which also propelled institutional change as the market reforms partly displaced key elements of the previous planning regime and emphasised the need for new market-oriented institutional and regulatory capacities. Indeed, as Heilmann (2005) argues, although the leadership resorted for a time to a form of centralised personnel control over the financial sector in a typical knee-jerk response to the external crisis in 1998, the demise of this approach in 2002 and its replacement by a more market-oriented regulatory agency represents a boost for the emerging market over the old Leninist approach. At the same time, these changes were also spurred by economic growth and the success of the market transition itself, by learning effects as agents developed and mastered new policy and administrative systems, and by the impact of wider complimentary institutional reforms that helped further embed the market drive.

The PBC in particular worked to expand the scope of its market-oriented policy capacities by developing wider complimentary reforms and new institutions to better embed and support the market transition, especially reforms aimed at establishing a sound transmission mechanism for monetary policy, including moves towards the liberalisation of interest rates and exchange rates, and reforms of the banking sector. The structural impact of these imperatives and the wider forces and increasing returns of the economic transition, and their associated institutional correlates, have thus slowly helped restructure authority dynamics within the Chinese state. As Naughton (2008, p. 91) argues, ‘the political hierarchy itself has been reshaped in response to the forces unleashed by economic transition’.

Indeed, the key challenges posed by the transition – especially building new market and regulatory institutions - has helped empower key agents, especially within the PBC, by rewarding those with technical expertise and the capacity to steer the course of the transition. Hence both the transition and the technical capacities to cope with it and indeed prosper from it have thus far at least served as the resource for the PBC. The initial pattern of transition in the 1980s marked by strong institutional legacies and the shadow of the former planning system gradually gave way to a situation where the structural context of the transition itself increasingly helped support and empower key agents. In such a context the PBC’s leaders were able to garner authority by building their own institutional capacities and by building supportive relations with party-leaders. As we show below, the

evolving pattern of mutual dependency between the PBC and the leadership of the party-state, both institutionally and politically, has been important in raising the policy authority of the PBC.

Crises and Changing Power Contexts

Sticky historical institutionalist theorising tends to see institutional change as a crisis-induced episode of ‘punctuated equilibrium’, typically followed by a period of stasis or slow moving path-dependent change. Katznelson (2003, p. 283), for example, sees periods of crisis as those when the normal ‘constraints on agency are broken’, opening up opportunities for agency. In contrast, more flexible, agent-centred versions of HI posit more agency-driven patterns of incremental or evolutionary change (Streeck and Thelen, 2005; Mahoney and Thelen, 2010). These types of distinctions have had a major impact on institutional theory, with Taylor (2009, 488) commenting that ‘theories of institutional change can be loosely categorised according to whether they describe causation by exogenous or endogenous forces and whether change occurs under exceptional or ordinary circumstances’.

Such either/or conceptions are problematic and a more flexible, agency-centred approach can help overcome such dualisms. There is no reason why exogenous/critical juncture dynamics and endogenous, more incremental change dynamics cannot be handled by such an approach. In this view, the level of actor discretion may increase under crisis conditions when existing arrangements might be seriously called into question, but even in more ‘normal’ periods, agency-based processes typically underpin evolutionary or incremental patterns of change through ongoing actor engagement with institutional environments and wider contexts.

In the case at hand, it is clear that institutional change at the PBC was on several occasions spurred by crises and critical junctures. For example, in the late 1970s, the party-leadership began to embrace market reforms and economic opening in the wake of the obvious and growing limitations of central planning and the near economic collapse following the Cultural Revolution in the 1970s. A second critical juncture occurred amidst the crackdown at Tian’anmen Square and outbreaks of high inflation in the late 1980s and early 1990s. In China inflation is widely seen as leading to chaos (*luan*) and therefore is seen as a direct threat to stability and ultimately regime survival (Tsou, 1995). Along with concerns about corruption, the breakout of inflation helped restructure power within the party leadership, leading to a three-year economic retrenchment by party conservatives between 1989 and 1991 and a steep decline in the state’s fiscal revenues, as well as declines in the profits of the state owned enterprises (SOEs). As Naughton (2008, p. 114) puts it, ‘through the early 1990s, the Chinese government seemed to be facing a gathering crisis of effectiveness’. These challenges as well as generational change in the party elite led to a ‘sudden collapse of “elder power” in 1992 (Naughton 2008, p. 114) and helped restructure elite power. This helped deliver a new more market-oriented reform drive by more cohesive elite led by Jiang Zemin (Secretary-General of the Party, 1989-2002) and strongly supported by key reformers such as Zhu Rongji (Vice Premier 1991-98; PBC Governor 1993-95; Premier 1998-2003) who became closely linked to the PBC. An important challenge was to tackle inflation and in this context the reform of the central banking system and the wider financial sector entered into a new and vital stage that helped strengthen the role and authority of the PBC.

Moreover, crises or critical junctures are not just exogenously imposed but might also be generated by endogenous, institutionally embedded processes. In the current case, the inflation crisis was not simply an exogenous shock from the macro-economy. It was also a product of endogenous institutional relations, especially between the PBC and credit hungry local governments, which the PBC had had trouble disciplining in relation to credit expansion, especially during the 1980s. Therefore, exogenous and endogenous and crisis induced and more informal incremental patterns of change were all linked. The pattern of change was propelled not only by critical junctures but also by institutionally-based patterns of informal incremental change (North 1990). In applying this reasoning to the China case, Tsai (2006: 117) argues that agency-driven patterns of ‘adaptive informal institutions’ or ‘informal coping strategies’ can play an important role in endogenous institutional change. The crisis of the late 1980s and early 1990s may have helped further propel market reforms which helped strengthen the PBC, but wider patterns of incremental change within the PBC itself were also working in the same direction. For example, the PBC’s growing monetary expertise, its development of a growing range of policy instruments, and its control over burgeoning foreign exchange reserves, were all ongoing institutional changes that were important in shaping the PBC’s capacities and rising authority. Hence, there is no need to analytically distinguish between exogenous or endogenous forces or between changes under exceptional or more ordinary circumstances. Crises should simply be seen as yet another context in which agents within given institutions interact.

The Wider Power Context – the Party Leadership and the Chinese State

In recent years, agency-oriented approaches within HI have given greater attention to institutional power struggles as actors exploit their institutional positions and deploy resources to win battles and reshape their institutional environments (Streeck and Thelen 2005, Mahoney and Thelen 2010). In extending this approach it is useful to explore the way in which wider constellations of power might impact on specific institutions. In China, the leadership of the party-state is a central power constellation and in this final section we explore in detail the way in which key agents within the PBC were able to trade on their institutional capacities and policy track record to garner influence and authority by forging relationships of mutual dependency with key players in the party leadership. We define party elites as members of the Communist Party’s politburo, the central decision-making body of the party. While leaders of the PBC often concurrently hold (sometimes senior) party positions, they seldom hold formal politburo membership.⁷ In forging supportive relations with the party-elite, the leaders of the PBC were operating in a key power context that helped them win influence and promote the authority of the PBC.

The extant literature on financial policymaking in China has emphasised deeply rooted factional conflicts within the party leadership (Li 2001, Dittmer and Wu 1995, Tsou 1995). Shih’s (2008) recent account depicts a ‘generalist’ faction, whose members have a broad political responsibility with a pro-growth propensity, and a ‘technocratic’ faction (including the PBC), concerned more with specific policy arenas. However, this approach overlooks important informal connections between generalists and technocrats, as in the alliance between Premier Zhu Rongji and the leaders of the PBC. The Chinese Communist Party (CCP) has retained as much control of the monetary and financial sphere that it deemed vital for the ultimate goal of sustaining the regime and its authoritarian rule. Nevertheless, the Party has increasingly banked its legitimacy on economic development and welfare

enhancement in an increasingly market-oriented environment. This has led to increasing institutional and political dependencies between the party-elite and the PBC.

This is not an atypical pattern in central bank-government relations. Taylor (2009, p. 504) shows how the Brazilian Central Bank was able to garner greater authority through an 'ongoing cycle of evolving political relations in which policy success drove confidence in the monetary authority'. Bell (2004) makes a similar argument with respect the Reserve Bank of Australia, based on the Bank's growing capacities and the way in which it helped promote a sustained pattern of strong and stable economic growth with low inflation, especially from the early 1990s.

In China, traditionally, party elites have not been well equipped with essential expertise, especially in complex arenas such as monetary and financial affairs. Given their typical skill sets and the requirement to cover a wide range of issues, party leaders do not have the time or expertise for dealing fully with monetary policy or the intricacies of the financial system. Compared with government recruitment that has increasingly emphasised meritocracy, the party has always been slower to refresh key leaders with higher educational backgrounds, especially at the top level, which is still dominated by political and factional considerations (Wong and Zheng, 2002). In this context, the imperatives of a transitional economy, the need to check local investment opportunism, the growing penalty of monetary mismanagement in the emerging market, as well as a relative lack of experience on the part of the political leadership, are necessary, but not sufficient conditions for the rise of the PBC. The latter also rests on the institutional capacity of the central bank itself, particularly in building the necessary expertise and experience to conduct an effective monetary and financial policy. Moreover, the fragmented structure of the Chinese bureaucracy lends itself well to the development of specialised expertise. Lacking the information and expertise necessary to fully evaluate the recommendations of lower-level units, political leaders will often permit those units to become influential in their own policy spheres. As the literature on bureaucratic authoritarianism makes clear (Hamrin and Zhao, 1995), by occupying key posts in the policymaking regime and playing a coordinating role in the policy process, bureaucratic heavyweights can be influential in crafting and filtering information and ideas selectively and thereby shaping elite preferences and agendas. In the case at hand, for example, Xie Ping, a senior PBC veteran with experience in its research and executive branches, argues that the Chinese central bank has effectively gained 'technical independence' from the leadership by deliberately limiting policy options, often to just one or two, which left the party elites often with few alternatives but to adopt those favoured by the Bank (Xie, 1995).

Central banks have also established close relationships with the markets and financial intermediaries and are in constant 24/7 touch with market developments, able to react at a moment's notice. Very few other bureaucracies or regulatory agencies face the need to develop such specialised capacities or occupy such a critical, real-time market-state interface. In other words, the PBC is now performing crucial functions in complex monetary and financial environments that state leaders themselves can no longer fully deal with. The inevitable division of labour between the central bank and state leaders in such arenas has increasingly conferring greater influence and authority onto the PBC, especially in the monetary policy realm.

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In a relationship-based society such as China, personal relationships (*guanxi*) and exchanges between party leaders and top bureaucrats also form an important source of informal bureaucratic authority. The nature of such relationships is that of patron-client, with ‘reciprocal accountability’ (Shirk, 1994, p. 18-9). Top government officials are accountable to their patrons, the party elites, who appoint and promote them. At the same time, party leaders also rely on the loyalty and support of bureaucratic clients as an important part of their power base in political competitions. In this manner party elites exchange institutional authority for political support. Top bureaucrats in major ministries are also typically Party members. In the party-state featuring a strict vertical power hierarchy, rankings in the Party echelon of the bureaucratic executives and the authority of their institutions are mutually reflective: the higher the director’s political ranking in the Party, the more authoritative and powerful the institution, and vice versa.

The older generation of party leaders, such as Mao and Deng, were able to legitimise and sustain their personal authority through their revolutionary legacy, popular charisma, and extensive webs of networks in the party, government and military. These assets are not as plentiful for their successors, most of whom have only a technocratic background with a much narrower career path. This has made it imperative for the new breed of party leaders to enlarge their power bases by expanding networks of supporters and clients (including those in the bureaucracy), and elevating the formal or informal status of the institutions under their spheres of influence, exchanging institutional authority for political support (Hamrin and Zhao 1995).

PBC Governors had a relatively minor status in the 1980s, but this began to change in the early 1990s and reflected the reform push by the rising new faction of party leaders intent on dealing with economic instability and pushing forward market reforms (Naughton, 2008). A key indicator of the Bank’s rising stocks was the appointment of Zhu Rongji as PBC Governor in July 1993. At the time of appointment, Zhu was already a member of the Politburo’s Standing Committee; Deputy Director of the Central Finance and Economics Leading Group (CFELG), and the deputy premier of the State Council. A rising star that later climbed to number three in the Party, Zhu’s governorship and long-term supportive legacy greatly boosted the PBC’s status within the centre. Zhu Rongji’s close relationships with the central bank and its successive Governors (Zhu’s protégés), saw the rising authority of the Bank become an indispensable link in Zhu’s strategy of political survival and advancement. Zhu had long been widely recognised as a reform-minded economic thinker and political leader fashioning a ‘can-do and iron-fist style’, which was rare among the party politicians and earned him the title of China’s ‘economic tsar’.⁸ Zhu established his reputation in Beijing by taking the lead in addressing tough issues such as triangular debt among SOEs and other enterprises and a national fiscal reform that greatly strengthened the financial capacity of the centre (Gao and He, 1993). For the Bank, Zhu’s political profile was unprecedented. Yet as a relatively new-comer in the central government, Zhu needed the bureaucratic support from the Bank to help support his reforms and to help him establish his reputation. To achieve this, Zhu needed to delegate authority to the Bank and elevate its *de facto* authority to make the Bank a powerful platform for his ambitious reform agenda. As one insider commented: ‘It was very much like I look after you, and you look after me’.⁹

The central bank's ascendance also benefited from a leadership change, which saw Zhou Xiaochuan taking over the PBC's Governorship in December 2002. Zhou, an engineer-turned economist and a staunch promoter of market initiatives, was regarded by both domestic and foreign analysts as 'the brightest financial star in government' (Murphy, 2003, p. 30). He is also an experienced central banker and commercial banker, once serving as vice governor of the PBC and Governor of the China Construction Bank (one of the Big Four). Most importantly, he was a party heavyweight with close ties with both the outgoing Jiang Zemin-Zhu Rongji administration and the new Hu Jintao-Wen Jiabao regime installed just months after Zhou's appointment. Zhou's father was a mentor to Jiang and facilitated his promotion at key moments during his early career (Murphy, 2003, p. 30). Zhou was highly regarded by Zhu Rongji who took him as his right-hand man and who had a vital say in Zhou's PBC tenure. There was also a special relationship between Zhou and Wen, both of whom were followers of the earlier reformers, such as Zhao Ziyang in the 1980s and Zhu Rongji in the 1990s (Gao and He, 2002). This formed a special relationship between Wen and Zhou, in which Wen 'effectively delegated authority and decisive action to Zhou' (Naughton, 2004).

Overall, then, the PBC operated in a wider political context that saw its growing institutional capacities increasingly recognised by key power holders in the party leadership. These political ties embodied increasingly important relations of mutual dependency which supported the political agendas of the leadership and the bureaucratic agenda of the PBC, all of which helped support the rising authority of the central bank.

Conclusion

This paper has charted and explained the rising policy authority of the PBC in the monetary policy arena by pointing to the way in which its leaders were able to build institutional capacity and garner resources and support through interaction with a range of wider meta-institutional contexts. An important turning point was the economic crises of the late 1980s and early 1990s which helped change the power configuration in the party-leadership, which subsequently promoted policies that accelerated the economic transition. This in turn required an increasingly sophisticated and capable central bank able to effectively steer the transition and develop much needed policy and institutional capacities. The PBC was able to develop specialised expertise as well as a credible policy track record and exploited these as key resources in its quest for greater authority. This in turn greatly strengthened mutual dependencies between the party-state and the PBC at the institutional and political levels and saw the PBC both being granted greater authority as well as being better placed to be able to win greater authority through its own endeavours. Although various laws have elevated the status of the PBC, more important have been *informal* exchanges and accommodations in which the party elite have increasingly recognised the views and policy authority of the PBC's central bankers.

The political connections between likeminded political leaders and central bankers have thus been instrumental in elevating the PBC's influence and authority. However, relationships of this kind can be contingent, often subject to political contestation and leadership changes. This suggests that in the longer term the authority of the Bank is likely to be best promoted by further developing its expertise-based institutional capacity and policy track record.

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More broadly, in terms of approaches to explaining institutional change, the current study challenges ‘sticky’ depictions of institutional life featuring highly constrained notions of agency. True, institutions can be constraining. It is also true, however, that institutions are often populated by resourceful, interpretative agents seeking opportunities for change. Hence instead of ‘sticky’ depictions of institutional life we see the relations between agents and institutions as a dialectical process of mutual shaping over time. We have also sought to move beyond a focus on discrete institutions and expand the range of relevant shaping environments with which agents interact. Hence, besides the minutia of institutional rules and norms and their effects on agency, institutions are also shaped by wider meta-institutional contexts. The contexts examined in this paper have been picked up in previous research as having potential impacts on institutional change dynamics. But thus far approaches have been ad hoc and there has been no consistent theoretical approach underlying the treatment of such external contexts. This paper has attempted to correct this theoretical lacuna. It has suggested that an approach that starts with relevant situated agents and that works outwards to consider the dialectical interactions over time between agents located within specific institutions and wider meta-institutional contexts can be useful in understanding institutional change processes. This might be referred to as an ‘agents in contexts’ approach (Bell 2012).

This approach can incorporate either exogenous or critical junctures and endogenous or more incremental change dynamics, which have often been segregated in previous theoretical approaches. Our approach is also sensitive to the dialectics of change processes, tracing interactions between institutionally-situated agents and wider contexts over time. Future research might usefully explore a wider set of cases to scan for other types of meta-institutional context which help shape institutional change. The focus could be on a range of different types of institutions located within suitably defined contextual fields. Hence, the focus in institutional analysis can usefully be shifted outwards, from examining proximate agent-institution interactions to exploring how given institutions are embedded in wider contexts of influence. Certainly, important causal shifts in this case would have been overlooked if analysis was focussed solely on intermediate level institutional dynamics.

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30 ⁷ This is with the exception of Chen Muhua (a politburo member while being PBC governor between March 1985
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