Abstract

In this paper we review the roller coaster ride of the Chinese stock market and more recent reforms in financial institutional infrastructure that have sought to tame the market and deal with rampant corruption and state predation. We interpret the subsequent reform push as a process of institutional change and focus on the drivers and theoretical explanations of such changes in China’s stock market and the shift in the broader institutional infrastructure from a predatory mode towards a more developmental mode. We thus advance a model for understanding institutional change, Chinese style. We argue that, initially, the institutional environment constructed the dynamics of transition – the juxtaposition of the Leninist state and the emerging stock market. This provided huge incentives for state corruption in the emerging market. As the market transition proceeded, the societal and political costs of corruption also grew and produced a crisis that eventually attracted the attention of powerful leaders of the party state. We argue from this case that the broader political context in which specific examples of institutional change occur needs to be examined. Specifically, we argue that powerful agents who are external to given institutional environments can play an important role in institutional change, thus highlighting the political dynamics of an authoritarian state amidst systemic transition and global integration.
Reforming China’s Stock Market
Institutional Change Chinese Style

Some have referred to the maverick performance of the Chinese stock market as the new ‘China Syndrome’ (Preston 2005). The latter half of the 1990s saw the stock market surges that peaked in July 2001 on the back of a relatively slower GDP growth. However, when the economic engine picked up speed between 2001 and 2005, when GDP grew at around 9 per cent a year, share prices collapsed with the benchmark Shanghai Composite Index (SCI) plunging to an eight-year low by June 2005.¹ What followed was even more dramatic: the market staged a stunning comeback in 2006, one that nearly tripled the SCI with record high trading volumes by the year end, making it one of the best performers in the world that year (The Economist 24 November 2006). While temporary fluctuations in the stock market do not necessarily coincide with the real economy, in a longer time frame they should be positively correlated with economic fundamentals. Thus, the stock market acting as a reverse barometer of the real economy in the last decade in the Chinese case is puzzling, even to frequent observers of China’s political economy.

This paper aims to provide an institutional explanation of the boom-bust cycles in the Chinese stock market, particularly the drivers of institutional reform around 2005 that has underpinned the recent market boom. Although the complicated nature of the processes surrounding the stock market warrants myriad explanatory perspectives, we argue that the underlying institutional arrangements, whose parameters were most decidedly drawn by central political elites, hold the key to understand the dynamics of the Chinese trajectory. In broader terms, we argue that elite activism and elite-bureaucracy interaction in the reform process largely defined the momentum of institutional change Chinese style.

Viewing the Chinese stock market as an evolving institutional complex, we argue that the market has shifted through three phases: an early embryonic stage beginning in the 1980s aimed at facilitating the shareholding reform of state-owned enterprises (SOEs); a period of rampant corruption and state predation in the market for most of the 1990s, followed by a period of institutional reforms by the Wen Administration aimed at dealing with emerging crises, tightening market regulation and achieving wider developmental goals. These changing institutional settings generated profound implications for the market. The state monopoly and political distortion helped boost ferocious speculation and manipulations in the market under the guise of superficial prosperity in the first two phases. This was followed by the collapse of investor confidence due to state predation and the early regulatory reforms that pricked the bubble and sent the market tumbling after 2001. More recently the critical reforms on share ownership structures in 2005 have laid a solid foundation for the latest market rally and could establish healthy market institutions in the long run.
These institutional shifts are explored in relation to theoretical questions about institutional change in the context of elite politics and market transition in China. In particular, we focus on the dynamics of the recent institutional reforms to the stock market from a predatory mode towards a more developmental mode. We see the reforms as a process of institutional change and explore it in relation to two so far largely unconnected theoretical literatures: theories of institutional change and theories of Chinese elite/bureaucratic politics. We thus advance an account for understanding institutional change, ‘Chinese style’. Extant theoretical debates about institutional change give too little weight to certain potentially important specifics about agency and political power. Thus far, most theorising about institutional change has focused on relatively rule-bound, socialised agents within given institutional environments – we call these ‘internal, sticky agents’. In such a context, debates have focused on the causal conditions that allow agents the capacity to effect change: typically via exogenous shocks or sometimes via slower moving processes of internal change. In contrast, we argue from this case that the broader political context in which specific examples of institutional change occur needs to be examined, with a particular focus on the role of powerful external agents lodged in the party state.

This case highlights many common drivers of agent-centred but institutionally embedded change. It also highlights the political dynamics of an authoritarian state like China amidst its systemic transition and global integration. Specifically, we argue that powerful agents who are external to given institutional environments can play an important role in institutional change. In this case, initially, state domination in the stock market provided huge incentives for state and crony corruption. As the market transition proceeded and the market grew, the societal and political costs of corruption also grew. This produced a crisis that inevitably attracted the attention of powerful leaders of the party state who eventually stepped in and changed the course of practice via the mechanism of ‘management by exception’, a unique institutional setting of China’s political system.

The paper proceeds first with a brief review and partial critique of the extant literature in institutional change theory in general and its application to the China case in particular before a more convincing model is constructed. This approach is then applied to the case of China’s stock market to explain the institutional reform of the market around 2005 that sought to address the critical issue of state monopoly in the share ownership structure. Finally, we explore some broader implications of our approach and findings in relation to the debate about institutional change, post-communist transitions and China’s political economy.

**Theorising Institutional Change Chinese Style**

The contours of the ongoing debate between the developmental state (DS) and predatory state (PS) thesis reflect competing conceptualisations of the Chinese state in the reform era. Mainstream accounts on the state-led economic take-off in China since the late 1970s have partly mirrored the DS model previously attached to its East Asian neighbours, such as Japan and South Korea. Given a traditionally
weak society in China, the state’s developmental role in helping to foster rapid economic growth has been apparent. To the developmentalists, China’s story has involved determined leadership to revitalise the communist party and the country through reform and external integration (D. W. Chang, 1988; Feng, 2006), a broad political coalition within the polity that helped foster reform (Naughton, 1995; Oi, 1999; Shirk, 1996), a set of institutional arrangements that secured a ‘credible commitment’ by the government to the marketisation course (Montinola et al., 1996; North and Weingast, 1989), and a series of strategies to make the most out of China’s comparative advantage in an increasingly globalised world market (Lardy, 1992).

However, this perspective has not silenced another camp of analysts who are more suspicious about the underlying structure of wealth distribution stemming from a predatory state model, which sees the state as a ‘grabbing hand’ that constantly engages in resource extraction from the public (Colander, 1984; Frye and Shleifer, 1997; Shleifer and Vishny, 1998). On the empirical front, as the reform process deepens, the ‘externalities’ of market reform, such as social and environmental problems, become increasingly salient and corruption has become more systemic and rampant since the 1990s (Gong, 1997; Wedeman, 2004). Some argue that China’s market-oriented fate will succumb to corruption and a form of ‘booty socialism’ or ‘trapped transition’ (G. Chang, 2002; Lü, 2000; Pei, 2006). Indeed, as this paper argues, the history of China’s stock market in the 1990s and early 2000s has been a case of state predation, in which public investors were preyed on by both central government to finance the moribund state enterprises, and local officials for personal gains.

But these broadly neoliberal accounts in relation to the grabbing hand thesis do not fully square with Beijing’s ongoing reforms to its administrative governance, economic management and social integration; all of which have underpinned national development in the last three decades. The main problem with the predatory model in relation to the China case is that it underestimates the capacity of the centre and political elites vis-a-vis their subordinates. All too often, the centre is portrayed as weak and therefore incapable, often overwhelmed by self-serving localities with unprecedented fiscal and administrative autonomy thanks to the decentralisation process in the reform era (Moore, 2002), or outmanoeuvred by a government bureaucracy that misinterprets and misimplements elite initiatives and strategies to their advantage (Lampton, 1987).

Yet this assessment does not square with the communist party’s efforts in keeping its authoritarian rule relatively intact. Despite talk about a ‘fragmented authoritarianism’ that sees decision-making often muddled in inter and intra-bureaucratic bargaining and incrementalism, an important element of the Chinese state is the institutional configuration of China’s hierarchical political system that ensures that the centre and top party leadership ultimately have the upper hand vis-à-vis the localities and central bureaucracy (Lampton and Lieberthal, 1992; Lieberthal and Oksenberg, 1988). The key to understanding this is the party’s dual control of the government (and also the military): its monopoly of the nomenklatura power of personnel appointment/promotion and its thorough penetration of the bureaucracy through party cells established at all levels of government institutions (Lee, 1991; Yan,
It is true that the party has delegated to the government much of the policymaking authority on routine issues in the reform era, especially in the economic sphere, but overemphasising its impact, as do the various ‘weak-centre’ models, obscures the critical role of the party elite in key issues of Chinese politics and political economy. For instance, Feng’s (2006) recent account of China’s accession to the World Trade Organisation provides a good example of a determined leadership (Jiang Zemin and particularly Zhu Rongji) in running over institutional resistance to push forward China’s entrance to the global trade regime. Yang (2004) also argues that leadership dynamics, in combination of external conditions and crisis, have been a crucial determinant of the timing and scale of China’s governance and institutional reforms.

In terms of the stock market, Green’s (2004) in-depth account on the regulatory reforms of the market concludes that the state was ‘capable at times of organising dramatic changes in policy as well as remarkable co-ordination in implementing those changes’ (p. 226). While Green correctly rebuts the fragmentation model, at least in the case of stock market, his identification of the reform drivers is nonetheless ambiguous in the juxtaposition of notions such as ‘the state’, ‘the centre’, ‘central government’ and ‘senior leadership’. Even in terms of his depiction of the role of ‘senior leadership’, the exact mechanisms of their interaction with the bureaucracy are broadly brushed if not missing.

**Theorising Institutional Change**

The variable or ambiguous account of the commanding role of party elite in much of the extant literature suggests the need for an overarching theory of elite politics in explaining broader institutional transformations witnessed in reform China. Therefore, we analyse in this paper the activities of the key actors in question from the perspective of agent-centred theories of institutional change. In this context, most strands of institutionalism have tended to emphasise the constraining role of institutional legacies, socialisation, sunk costs and path dependency, and have thus tended to be better at explaining institutional stasis and continuity rather than episodes of change. At their worst, such forms of analysis ‘over-condition’ actors, producing the ‘calculating automatons’ that Hay and Wincott (1998, p. 951-7) find in some approaches to rational choice theory, or the over-socialised ‘cultural dopes’ implicated in sociologically-based organisational institutionalism. The challenge therefore has been how to describe and conceive of agent-centred discretion (arguably the ultimate propellant of institutional change) within a context of constraint, conditioning and even stickiness associated with institutionally embedded agents.

Two broad sets of conditions have been specified under which agents might gain the capacity to effect change. The predominant approach originated with Krasner’s model of ‘punctuated equilibrium’ in which institutional inertia is suddenly disrupted by an exogenous shock or crisis: ‘Change is difficult…Institutional change is episodic and dramatic rather than continuous and incremental. Crises are of central importance’ (Krasner, 1984, p. 234). The problematic implication, as Mark Blyth (2002) explains, however, is that: ‘Theoretically, no exogenous factor can in and of itself explain the specific forms that institutional change takes’ (p. 8). Cortell and Peterson (1999) agree and argue that, ‘by focusing on periods of radical change precipitated by crisis, a model of punctuated equilibrium
downplays the role of individuals’ (p. 179). Alternatively, a more recent approach to explaining institutional change has criticised the distinction between stasis and rapid change built into the predominant model and has instead argued that active agents are often at work in incrementally seeking to change or modify institutions.

These approaches are useful though arguably not exhaustive when it comes to explaining institutional change. Although agents external to particular institutional environments have not been wholly ignored, extant institutional change theory does tend to focus on agents within institutions and on the general stickiness of situations therein. But this focus could be problematic in situations where the main change agents are external to the institution in question. What is also striking about extant theory is the treatment of political power. Conflict and the exercise of power are not wholly neglected in extant theory, but the overriding assumption is that such phenomena are constrained and shaped by institutional environments. Another issue is that most extant studies of change are set in western liberal democracies, raising questions of whether the dynamics of institutional change vary among different types of political regime?

**Elites, External Agents and Institutional Change Chinese Style**

The case examined here, institutional change in an authoritarian political system, appears to throw up interesting counter examples to the way in which we normally think about institutional change. As the case study below shows, the change agents in question are not ‘sticky insiders’ but powerful outsiders in the political elite lodged in the party state, who, when prompted by certain exigencies, appear capable of reaching in and altering institutional arrangements. Here, the notion of ‘political elite’ refers in particular to members of the communist party’s politburo, particularly members of its standing committee, the party-state’s paramount decision-making group. While each member of the standing committee is normally assigned to a cluster of portfolios, they are not directly involved in policy processes on a routine and day-to-day basis, especially compared with lower ranking politicians and bureaucrats. Moreover, the President and the Premier are even more ‘outsider’ than other members of the politburo because of their role in more general, across-the-board and strategic decision-making. The authority and distance from routine affairs of such elites does not of course pre-ordain their behaviour, but in the case at hand these factors as well as the reform volitions of key external elites did, arguably, play an important role in propelling market reform.

Although most of the routine administration is delegated from the party to the government bureaucracy in the reform era, the political leadership ensures its capacities on the ground through a specific mechanism, which Lawler (1976) and Shirk (1992) call ‘management by exception’. The rule of the game is that, consensus or problems that cannot be reached or dealt with in subordinate levels is often referred to the upper level and, ultimately, to the top of the party hierarchy. From the principal-agent perspective, this seemingly ‘inclusive’ arrangement saves the leadership (the principal) costs of constant intervention on routine issues whilst exploiting the superior information of the bureaucracy (the agent). More importantly, this enables the political elite, vis-à-vis the thick bureaucratic institutions, to retain the
authority of taking significant policy initiatives and direct intervention on its key concerns, and have the final say in balancing conflicting interests, ironing out strong disagreement in the bureaucracy, and pushing through bold programs on sticky issues or issues with ‘overwhelming urgency’ (Shirk, 1992, p. 76). Recent work by Bell and Feng (2007) demonstrates how the leadership activated this mechanism in overturning a protectionist trade policy favoured by some powerful agencies and avoided a major showdown with its key trading partner. In the present case, the persistent downturn of the market produced a crisis, although it is also true that external pressure has to be translated into political will and elite action. Thus leadership dynamics, via elite politics in the form of ‘management by exception’, can crucially determine the timing and scale of the institutional reforms.

Thus, we argue that models of institutional change should be regime-specific. In particular, we argue that changes in authoritarian regimes such as China should take into account wider political dynamics and external agency. In the process of systemic transition, China’s bureaucracy in general terms either does not have the incentive to push for reforms that will curtail their superior authority and privileges enjoyed in the old days of central planning, or (in this case) resist reforms that will endanger their vested interests in the partial reforms and transition itself that facilitated the state predation and crony plunder. Given the especially sticky bureaucracy in China’s context, the party elites, as powerful external agents, found themselves being the drivers of reform/institutional change, seeing their legitimacy increasingly resting on economic performance that could only be achieved through continuous reforms. Therefore, in cases that involve ‘management by exception’, institutional change is ultimately an elite-centred process. Typically, external shocks or crises, serious enough to penetrate the thick bureaucracy/institutions, invite attention and a sense of urgency among party leaders, whose ideas affect the matrix of values, incentives and choices available.

This model – involving a combination of perspectives from the literature on institutional change and Chinese elite politics - is applied in the following case study of China’s stock market, an episode of institutional changes that marks a crucial effort of the party elite in establishing a modern financial infrastructure.

The Entrenchment of State Predation

Much of the two decades’ history of China’s stock market can be characterised as state predation on two levels: on the macro level, the stock market served the political ends of the party-state to salvage the moribund SOEs by extracting funds from the public. On the micro level, the stock market was also a vehicle for government officials and their cronies to pocket public investment through fraudulent, corrupt and speculative dealings. The political function of the stock market and these crony interests, coupled with a weak and rudimentary regulatory infrastructure, formed the impediments to institutional reforms at the beginning of the twenty-first century that have sought to establish market rules and reduce state distortion.
Before explaining state predation, we have to first understand state monopoly in the stock market, an institutional arrangement that enabled state predation and that therefore became a core dimension of the structural reform from 2005. The Chinese stock market has been effectively state-owned. More than 90 per cent of all listed companies were majority-owned by the government; the two stock exchanges are governmental institutions (shiye danwei); most of the securities companies and intermediaries were set up by local and central governments, and most of the funds in the market were from state institutions and state banks. As (shareholding) SOEs, directors with government backgrounds formed the majority in the corporate directorate and management (average 73.5%). Most of these ‘key persons’ were party cadres, government officials and former government members. The state also had an absolute control over the share structure through market segmentation. About two thirds of the total shares of the listed companies are held by government, government institutions and other SOEs. These so-called ‘state shares’ (guojia gu) and ‘legal person shares’ (faren gu) cannot be traded in the market. Only the remaining one third of shares available to public investors can be traded on the market. The market was also segmented into A and B shares to limit the entrance of foreign investment. A Shares are available only to domestic investors and purchasable in renminbi, the Chinese currency, while B Shares are those available to foreigners and Chinese investors purchasing in foreign currencies (US dollars in Shanghai and Hong Kong dollars in Shenzhen). However, A shares account for 95% of total tradable shares (J. Chen and Thomas, 2003). It was this unique ownership structure of state domination that served as the institutional context that offered huge incentives for the government and crony agents in question to engage in rent seeking, speculation and indeed the looting of public funds in the stock market. This context reflected, institutionally speaking, the tightness of the state-market nexus, an artefact of the earlier planned economy. The huge economic interests at stake also meant the lack of incentive, if not fierce resistance to reform, at the administrative level.

**Government Predation**

The financing of highly inefficient and debt burdened SOEs which have been preponderant in the domestic economy has been the major political incentive behind the government’s extraction of capital from the stock market. By 1999, SOEs accounted for 53 per cent of total investment on fixed assets and 41 per cent of urban employment. However, they only contributed 28 per cent of total industrial output (China Statistical Yearbook 2000). The government tried to reform the method of financing state enterprises in the 1980s by switching from direct capital injection from the treasury to a form of (state) bank loans. As a result, the state banks were obligated to provide about 70 per cent of their loans to the SOEs with little prospect of repayment. The soft budget constraint on SOEs accumulated mounting bad loans (commonly estimated to be around 40 per cent of total bank assets) which could potentially trigger a nationwide financial crisis. Forming joint ventures with foreign capital was another financing option, but this was limited, partly for ideological reasons and partly because of the parlous condition of the SOEs (Tan, 2004). Hence, with a fragile domestic banking sector, reluctant overseas investors, and a surge of stock transactions at the two exchanges, public finance through the capital market provided a possible way to bail out the SOEs.
The financial monopoly by the state ensured the flow of public funds into the stock market. Through capital control, the public, with savings of around 14 trillion yuan (US$1.75 trillion) by the end of 2005, are barred from investing in attractive assets (including securities) overseas. In addition, the government lowered interest rates consecutively and imposed a 20 per cent income tax rate for bank deposits (J. Chen and Thomas, 2003). Thus with few alternatives, the newly rich urbanite were driven into the stock market. At the same time, the state could overprice its shares by restricting the supply side. Shares can only be released and traded in the two stock exchanges that are owned by the government. The amount of initial public offerings (IPOs) was also controlled by the government through a quota system. Furthermore, because of state control of the listed companies, corporate decisions such as shareholders’ dividends and the usage of the capital raised in the market was at the state’s discretion, which, coupled with a judicial system policed by the state, left individual shareholders with few means of holding the public companies accountable. It is estimated that less than 10% of listed companies on average distribute cash dividends to shareholders (Xu, 2002). As a result, stock market became a low-cost channel for the government to suck in public funds for financing SOEs.

Given the extremely limited IPOs at the early stage, the index was pushed to a high level, boosting stories of overnight millionaires, which in turn fuelled the market boom. However, what happened next was yet another example of what Moore (2002, p. 308) calls the ‘irony of success’ in China, an ‘insidious process’ in which an initial achievement of an industry was often vulnerable to ensnarement by the state. In this case, it was not long before market investors were preyed on by the local, and later, the central government, especially when the SOEs under their jurisdictions were in turn running loses from the early and mid 1990s respectively.

Local governments were the first to explore this opportunity. In order to get approvals for listing, many local governments acquiesced or even became involved in making fraudulent corporate financial reports to deceive the public. In addition, the stock market was also an important source of financial revenue for the local governments, especially for the Shanghai and Shenzhen governments that have the two exchanges in their jurisdiction. Initially the central government was cautious towards the market rush generated by local governments but the its attitude took a great turn around 1998, when central authorities, especially in the bureaucracy, joined local forces in exploiting the market. Zhu Rongji made it a political goal of his premiership to rejuvenate large and medium SOEs to profitability in three years by 2001. Given the mounting budget deficits to boost domestic demand and a problematic banking sector, direct finance in the capital market became a political imperative for the state. With (unrealistic) political goals and huge economic interests at stake, the central government jumped on the bandwagon in draining public funds into SOEs. Thus there came an editorial in *People’s Daily* on 15 June 1999 as the government planned to launch more IPOs for the SOEs. Although carefully worded, the propaganda campaign sent the strongest ever signal to the market that the central government encouraged the Chinese public to take part in the ‘creation of wealth’ by putting their savings into stocks. Suddenly, securities investment was seen as a patriotic duty. Under the political fanfare, accompanied by declining interest rates on bank deposits, the population flocked into the stock market. The following ten days saw
historical trading volumes of 83 billion yuan (US$10 billion) in the two exchanges, marking the beginning of a two-year state-led bull market (A. Wang, 2000).

Crony Predation

However, SOE finance alone cannot explain the enthusiasm of state officials toward the stock market without referring to the personal gains from the market promotion. Instead, the main force behind the government predation was largely the private predation of state and public wealth by government officials and their cronies under the banner of SOE finance. The emerging stock market was quickly identified as a convenient vehicle to continue the game of public-to-private transfer of wealth by the privileged group without much scrutiny. Indeed, the stock market provided more liquid forms of assets (shares and/or cash) than other forms of public property. The plunder of public investment could be undertaken through what seems to be legitimate market transactions, a relatively covert form of money laundering. And disclosing such corrupt conduct was a daunting task, especially in a poorly regulated market and a judicial system that lacks the necessary professional expertise in relation to financial crimes. The state control of the listed companies also ensured the officials and cronies had the insider control of the enterprises and informational advantages over other market participants. The huge economic interests encouraged many cases of institutionalised corruption in the IPO process as well as rampant and fake corporate disclosure and speculation in the secondary market. Therefore, Wu Jinglian, a prominent Chinese economist, sees the Chinese stock market ‘worse than a casino’, in that one cannot see the other’s card in a casino game but one can in the China’s stock market because the card is in one’s own hand.

The Regulator?

The predation outlined above was carried out under the nose of an awkward, incompetent and in many ways a ‘captured’ regulator, the China Securities Regulatory Commission (CSRC) (Xie and Lu, 2004). Despite being consolidated into the sole national regulator of the securities market in 1998, several factors constrained its strength in market regulation and its role in future reform.

First of all, the CSRC was placed in a paradoxical position of one servant for two masters (the party-state and the market). As a regulatory institution in a market economy, it was meant to have neutral interests in ensuring the stability of the market. As a government institution, however, its resources were initially directed to sustain and propel market prices (read ‘promote’ the market) to serve the Party’s political goal of SOE finance. The institutional dilemma this created severely constrained the CSRC’s capacity in fulfilling its regulatory mandate. Second, the CSRC also initially lacked the authority to regulate the market. With its administrative ranking similar to that of provincial governments in China, the CSRC often found it impossible to discipline companies whose main shareholders were powerful government agencies and high-ranking members of the party. In addition, special personal relationships were developed over the years between CSRC officials and market players, which rendered the independence of the regulator from the entities they regulate dubious at best (Naughton, 2002). At the same time, the alliance between government officials and crony capital also sought to keep the market in
a disorderly fashion by resisting reforms regarding regulation and supervision. Furthermore, the agency itself was not immune to corruption. Given the huge economic benefits from market listing and the very limited number of IPOs allowed each year, the approval authority has been a valuable and scarce resource for rent seeking. The arrest of Wang Xiaoshi, an official from a CSRC department in charge of stock issues in late 2004 presented a fresh example of internal corruption of the regulator. The CSRC tended to see this as a single case, but the public believed this was the tip of the iceberg.

**Elite Politics and Management by Exception**

We argued above that the predatory orientation and capacities of specific sectors of the state has been contingent on political and institutional conditions. Changes in these conditions are thus implicated in any change from a predatory towards a more developmental mode in relation to the stock market and its institutional infrastructure. The empirics of China’s stock market as a product of an on-going case of institution building and developmental change has been discussed in the literature, but here we focus on the drivers and theoretical explanations of this pattern of institutional change.

Important questions in this regard concern the key change agents and the nature of the change process. For example, did those close to the stock market at various levels push for reform? The short answer is yes; there were reform-minded officials and party cadres at various level of the government who have pushed for changes (Tan, 2004; Green, 2004). However, few of them wielded the resources and power to facilitate a substantial change of policy. Incremental changes in the stock market, delivered by the internal, bureaucratic agents, did happen, such as the centralisation of the regulatory power of the stock market and the administrative authority of the two stock exchanges from local to central government, particularly in relation to the CSRC in 1998 (Green, 2004). This raises the question of whether central efforts formally to push institutional change of the kind we emphasise, rather than representing the start of a new radical phase of reform, might better be seen as the final culmination of political processes and momentum for change bubbling up through the system. The problem with such an interpretation is that the incremental institutional shifts in question largely failed to change the fundamental dynamics of market predation. Rather, they merely shifted authority to the centre and simply further facilitated the central bureaucracy and the SOEs they directly manage to tap into public wealth (Yuan, 2004, Chapter One). Moreover, as discussed above, the CSRC was also too weak to fulfil its new role as the sole regulator of the market. Due to entrenched bureaucratic and crony interest in market plunder, there has been a lack of endogenous incentive for a genuine reform. Instead, it was the key reforms and institutional re-engineering by the party leaders more external to the system that, as we outline below, have had more decisive and profound implications for the reform of the market. Thus, rather than incremental changes providing a platform for more radical changes, the limited nature of the incremental changes, only further justified more radical interventions later.

The context of such radical changes, as suggested by Yang’s (2004) theory of Chinese elite politics and by much of institutional change theory, has been a severe crisis. Yang argues that such crises in China often arise as part of the path of economic development along a market trajectory under the impact
of changing economic conditions. In this case the stock market was exploited by the state and its agents in a damaging way and eventually collapsed. First, the stock market failed to achieve its political function of SOE financing and reform. Due to institutional arrangements outlined above that cemented state domination in the share structure, the ownership issue was left unaddressed, if not worse: the ‘public’ companies were neither accountable to the government nor to their non-state shareholders. As a result, public listing did not ‘rejuvenate’ the enterprises, but instead fostered low-efficiency and highly corrupt institutional arrangements. A recent study concludes that the non-listed companies in China are more competitive than listed ones; yet more evidence of the failure of the stock market’s function of shareholding reform.\(^{17}\) Even for SOE finance, the market mostly achieved the redistribution of social wealth into the hands of a few at the expense of the mass. Since 1991 when the two exchanges were established, about 2.45 trillion yuan (US$300 billion) has been invested in the market, in which only 800 billion yuan was raised for SOEs. Amongst the capital raised, a considerable part had been publicly or secretly transferred to the parent companies (Wilhelm, 2001, p. 46), or reinvested into the stock market only to see it either create more market bubbles or diminish when the market went bust.\(^{18}\)

The incessant predation of the investors and public funds by the state and its cronies resulted in a stock market that was on the verge of collapse. In 2000, for example, investors paid 91.2 billion yuan for stamp duty and commissions for brokerage while the net profit of the all the listed companies was less than 80 billion yuan, which means the operating cost of the market well exceeded the wealth it created (T. Chen, 2001). Among the 25 million domestic investors,\(^{19}\) more than 90 per cent of them face absolute losses and more than half of the brokerages are effectively bankrupt. More importantly, the huge amount of bad loans in the banks that resulted from securities investment could well extend the risks in the stock market to the entire financial system given the dominance of state banks in the system.\(^{20}\) In the wake of prolonged downturn, the market failed to be a fund-raising channel for domestic companies. Many of those large and good-quality companies had to get listed in the foreign market, so much so that the total capitalisation of China’s 296 overseas listings by the end of 2004 ($349.2 billion) was 2.47 times than that of the total 1377 domestic ones ($141.3 billion). Most critically, the government’s credibility, which had been vital in sustaining the market, was in tatters. Repeatedly deceived by policy and media campaigns sanctioned by the state, a sense of betrayal and distrust among the public toward the state and its agencies not only rendered the market insensitive to any new government or piecemeal reforms, but led to widespread public resentment that threatened to shake the political and social stability the Party had fought so hard to keep.

Ultimately, the main concern of the communist party is its grip on power, which has mostly relied on positive economic performance. Among various explanations of the origin of developmental state tendencies, the ruling entity is seen either to choose to go developmental in order to extract a bigger slice of the pie through the promotion of economic growth (Lal and Myint, 1996), or is forced to do so due to systemic or structural pressures from the international system, such as the post-war economic take-off in South Korea and Taiwan which was spurred by severe geopolitical insecurity and/or resource endowment constraints (Doner et al., 2005; Gunnarsson and Lundahl, 1996). Market reform under the
guidance of the Chinese Communist Party is also a case of regime survival, but this has had more to do with domestic legitimacy than external threat. The on-going political turbulence and economic hardship the communist regime had experienced, culminating in the Cultural Revolution, produced a legitimacy crisis for the post-Mao leadership. The only way out, as visaged by Deng, was a strategic shift from forging politics-in-command mass political and ideological campaigns to fostering continuous growth and raising people’s living standards through economic liberalisation and market-oriented reform. In essence, the party became a political shareholder of the reform enterprise, whose ultimate concern with sustaining power was thus tightly bound to economic development. Increasingly, however, the negative consequences of corrupt plunder in the stock market, such as the collapse of government credibility and the widespread grievance of investors, became politically unaffordable to the party-state. Once such grievances spilled over into political and social instability, the leadership had to take serious measures to clean up the market and initiate institutional reforms to ensure genuine market development.

Institutional Reforms under the Wen Administration

Given the weak status of the CSRC and entrenched resistance from the vested interests both in the local and central governments, only the top political leadership held the capacity to overcome the bureaucracy-crony alliance and defuse the time bomb of the stock market. The fact that Premier Zhu had put much of his political capital on a state-led market rush in 1999 meant major reform initiatives could not be originated from his administration, although Zhu must have been alarmed by the emerging signs of the burst of the bubble when the market index began to slide from mid 2001. It is true that Zhu did install reformers like Zhou Xiaochuan to the CSRC leadership, hoping that patchy reform jobs such as strengthening market regulation would fix the problems of the market. Ironically, the market index went down further as a series of hard restraints and harsh penalties from the CSRC were imposed on speculation.

It is widely seen that cycles of reform and elite activism often flow from a change of leadership in China (Naughton, 2004; Yang, 2004). Serious reforms were not initiated until Zhu Rongji was replaced by Wen Jiabao in 2003, a leader who had had less direct involvement than Zhu in the stock market. In such contexts not only can the loyalties and baggage of the past be partly displaced, but it is also clear that new generations of Chinese elites appear increasingly committed to institutional reform. As it eventuated, Zhu’s stock market legacy became an urgent and formidable task for his successor, Wen Jiabao. Wen’s administrative experience covered a wide range at the central level from agriculture to financial affairs before taking up the premiership in 2003; exactly when the stock market was in its third straight year of plummeting.

There was also a change of ideas toward the stock market between Zhu and Wen. Even for reformist leaders such as Zhu, the stock market in general terms was merely a funding channel for ailing enterprises. This opportunistic attitude toward the market was representative among party leaders and state officials under the Zhu Administration. The persistent market downturn made leaders like Wen
realise the need to reposition the function of the stock market from predatory SOE finance (wei guoqi quan qian) to a broader agenda of institutional reforms that seek to make the state market-friendly. This is reflected at least in the fact that phrases such as ‘protecting the interests of small and medium investors’ became a fixture in official and Wen’s personal rhetoric, amidst a growing consensus within the government and the general public that the way out for the stock market was to reform or die (Liu, 2003).

Wen’s blueprint of an ambitious institutional reform of the stock market, known as the nine-point guide (guo jiu tiao), was issued at a cabinet meeting on 31 January 2004. This put the capital market on a national, strategic level and called for further reform, opening-up and ‘stable’ development of the capital market (K. Chen, 2004). The plan illustrated a significant political move by the leadership to lay out a series of systematic principles for establishing a new-generation capital market that is aligned with market mechanisms rather than plagued by state distortion.21 This was a key institutional reform that amounted to distancing the market from the state, a critical step in the political economy of transition in China. On 14 September Wen reiterated the government’s commitment to the nine-point guide and called for speedy actions to substantiate the guidance into concrete policies (Anderlini, 2004). The Wen administration also worked on the legal framework that ensures market transactions. The most recent progress is the revision of the Securities Law in October 2005, primarily aimed at regulating IPO processes to ensure the quality of the listed companies and the establishment by the state of a special protection fund for ordinary investors (X. Wang, 2005). Consequently, the protection fund was set up with funds drawing from the Ministry of Finance (6.3 billion yuan) and the central bank (60 billion yuan in the form of designated reloans) (Shi, 2005).

The notion of ‘stable development’ highlighted in the nine-point guide can be contrasted with the earlier irrational growth sanctioned by the government and fuelled by speculative cronies deeply embedded in the market. In Chinese communist terminology, ‘stable’ is the term that always refers to policy emphasis on regulation and supervision. Consequently, the regulatory authority of the CSRC has been considerably strengthened. As mentioned earlier, Zhou Xiaochuan, a famous advocate of liberal reform and a hawk against market corruption, was appointed by Zhu as the chairman of the CSRC in 2000. External expertise was also invited into the agency. Among the outside experts recruited, Laura Cha was a key appointment as the vice-chairwoman in March 2001. A US-trained lawyer with twenty years’ management experience in the US and Hong Kong, Cha had been at the centre of a series of regulation reforms under her ironclad principle of establishing a stock market based on ‘fairness, justice and transparency’. For example, in the first nine months in office, 51 new regulations on market supervision were promulgated. Many new rules such as an independent director system, a sponsor system and regulatory rules on restructuring and delisting in China’s stock market were introduced. The CSRC also stepped up its crackdown on illegal trading in the secondary market, a move dubbed by the domestic media as a ‘regulation storm’ (Beijing Review 8 March 2004). Zhou and Cha’s appointments to the leadership of the CSRC and the subsequent measures to clean up the market demonstrated the elite’s
efforts to establish a more independent and stringent regulatory institution, a policy shift from the earlier predatory regulation by the state and a signal of a determination of the party elite to change track.

On the market side, the stamp duty rate for stock transactions have been cut gradually from 0.4% to 0.2% in 2001 and then to 0.1% in January 2005. This is a favourable policy for investors in that it directly reduces their transaction costs. In May 2004, a Small and Medium Enterprise Board was launched in the Shenzhen Stock Exchange (People’s Daily 28 May 2004). The Board was designed to establish a fund raising channel for those small and medium sized (mostly private-owned) companies that had been excluded from the stock market. Given the fact that these enterprises are hailed as highly dynamic and fast-growing actors in the domestic economy, the establishment of the board will provide financial support and thus facilitate the development of these companies. Foreign capital was also invited into the RMB-denominated A share market in November 2002, although under strict control of the government, under the Qualified Foreign Institutional Investor scheme (China Daily 12 November 2002). As of October 2004, 22 overseas institutions have been granted quotas worth a total of about US$2.8 billion (Anderlini, 2004). The introduction of foreign institutions is significant to the Chinese market in that it brings fresh liquidity, market confidence and financial expertise that have been largely absent among domestic investors. Domestic companies will also need to improve their transparency and corporate governance given the much tighter scrutiny of international investors and institutions.

However, the implementation of the full circulation of shares could be the most critical part of the market reforms in that it directly addresses the fundamental issue and key source of state monopoly and distortion in the capital market, which, as discussed above, had been a major institutional driver of state predation in the 1990s. However, the resolution of this issue was for a time impeded by conflicting bureaucratic interests and bargaining among several agencies with regard to the pricing of the state shares if they are allowed for floating. Back in 2001, the government tabled a plan favoured by the Ministry of Finance to sell off part of the non-tradable shares in exploitation of the market spike, hoping the proceeds would compensate for the mounting deficits of the social security fund. The proposal was called off in the wake of panic among individual shareholders who deemed the price was too high and (legitimately) feared the existing shares would have been diluted by the state’s massive selling. Although the plan was shelved, the timing and pricing of the US$300 billion state shares have been the biggest uncertainty haunting the market and investors, and tackling this issue through a structural reform has been both unavoidable and imminent.

Following the inclusion of ‘steadily resolving the issue of non-tradable state-owned shares’ in the nine-point guide, research and consultation was conducted on how to take the critical step. For a time the process was slowed by bureaucratic bargaining between CSRC and the State Asset Supervision and Administration Commission (SASAC). Mandated to ensure the protection and promotion of state asset values, the SASAC is the bureaucratic representative of state shares, favouring higher sales prices for its stock of securities. On the other side, the CSRC is institutionally concerned with the stability of the market and was mostly eager to recover from the slump of the market and to regain the regulator’s
credibility, therefore tended to be the guardian of the interests of small and medium investors. However, the SASAC is the party that CSRC had to reach agreement with, not only because of the former’s institutional stand, but its actual control of 168 listed companies, a majority of the largest companies in China, accounting for 33.8 per cent of domestic stock market value (Naughton, 2005). Thus, the conflict of interests between the big shareholders (the state in this case) and small investors was mirrored by a tug of war between the two institutions, the CSRC and the SASAC, whose reluctance to concede retarded the reform progress for almost two years, during 2003 and 2004 (K. Chen, 2004; Naughton, 2005).

Despite the lack of incentive and agreement at the bureaucratic level, the persistence of market doldrums and the sense of crisis propelled the building of the consensus among top leaders that structural reforms were needed to rejuvenate the ailing stock market, including reforms on such fundamental issues as floating state shares (Zhu, 2005). To shore up support from the industry and gather momentum, in late 2004 Premier Wen sent vice Premier Huang Ju, who was in charge of financial affairs, to organise a closed-door session with brokers and fund managers at the Shenzhen Stock Exchange where Huang revealed that resolving the problem of state shares was on top of the government’s agenda (Zhu, 2005). Later, Wen used the opportunity of his press conference at the National People’s Congress in March 2005 to send his signal to the public. Wen demonstrated that he was very much aware the magnitude of the issue and the ramifications of the market crisis. He admitted that the issue ‘has the highest click rate on the Internet. It is also one of the biggest concerns of the people’ (People’s Daily 15 March 2005). The fact that the full circulation reform was finally given a green light two months later, in May 2005, suggests that the top leadership, particularly Wen, had taken measures to ensure the momentum of reform is not lost in bureaucratic inertia. Given the prolonged bargaining between CSRC and SASAC, the decision could only be the result of the activation of ‘management by exception’ at the elite level.

The final program of state share conversion (into public, tradable shares) had to be, understandably, a compromise with the SASAC, for example, granting the SASAC right to participate in selecting pioneering companies for the full-circulation experimentation. But the agreed program was more in the CSRC’s favour in terms of protecting individual shareholders’ interests. The sell-off will be undertaken in an incremental fashion, avoiding a sudden flood of state shares that could tumble the market. The terms and conditions of the conversion is to be negotiated between tradable and non-tradable shareholders on a case-by-case basis and the final program has to be strictly voted on and approved by at least two thirds of all the owners of tradable shares. Even Wu Jinglian, who was famous for his ‘casino’ theory, sees the current arrangement more in favour of individual investors (Huang, 2005). By the end of 2006, 1,184 of the 1,400 listed companies have finished their shareholding reform, accounting for 90 per cent of the market’s total capitalisation (Aredy, 2006). More than 100 of the rest have tabled plans for share restructure (Wu and Lin, 2006).

The structural reform marked a major milestone, if not a revolution, in the marketisation of the stock market. Although not a panacea for all the problems associated with the emerging market, it nevertheless provides a healthy platform and infrastructure for the market. With nearly all shares tradable (at least in
theory), share pricing is more aligned with a rational pattern so that the market could perform its valuing function. The price of existing shares will return to their market value and will become the central signal in the market reflecting corporate fundamentals rather than a tool for corruption and manipulation. Relatedly, listed companies would have to make genuine effort in strengthening corporate governance as well as performance. This has also made genuine merger and acquisitions (M & As) possible in the secondary market, facilitating more efficiency in resource (capital) allocation. The old days saw big shareholders (with non-tradable shares) speculating in the market at the expense of the small investors. Now both find their interests increasingly aligned together in achieving the maximisation of share prices.

The potential liquidation of state shares in the market could give the government more options in its industrial strategy to acquire or shed some of the state’s industrial assets and open the door for SOE privatisation. More importantly, the structural reform helps re-establish the investors’ confidence in the market with the credible commitment of the government and perceived gradual ownership retreat of the state. Although short-term reasons, such as the oversupply of domestic liquidity and expectations of RMB appreciation, may have fuelled the recent market boom in 2006-07, the institutional reforms initiated in 2005 is arguably the turning point of the market and will have profound long-term implications for future development (Ba, 2006; Han, 2006).

**Conclusion**

The institutional evolution of China’s stock market has demonstrated a changing role of the state from a provider of public bads to public goods. A capital market that was designed to facilitate the SOE reform was turned into a channel of political exploitation by the state and financial predations by the crony networks, thanks to the institutional monopoly of the state, a hangover of the old Leninist regime. However, what we see as central in this case is the top leadership’s role in recent institutional change that could dismantle the existing share structure and lead the market onto a more developmental path. The reforms could not have been initiated by the internal agents of the state institutions, the bureaucrats in the central and local governments. These political and major market players have entrenched interests in sustaining state domination and a disorderly market for the purpose of manipulation and speculation in association with the crony capitalists. It was also an impossible mission for the regulator, the CSRC, to canvass a bold plan and enough support for a sea change, given its dubious mandate and weak administrative capacity vis-à-vis preponderant agencies such as the SASAC. On such national, strategic issues with conflicting and irreconcilable interests on both industry and bureaucratic levels, the top leadership, led by Wen, determined that in the face of a possible hard landing of the market, this could spill over into a national economic and political turmoil. Wen took decisive measures to discipline the bureaucracy and carry out the badly needed reforms to establish fair rules of the game and effective ownership protection in the stock market.

Meanwhile, we should also keep in mind that, given the bureaucratic resistance and the top-down nature of the policymaking process, the necessity of ongoing reforms to the emerging market infrastructure will be another challenge for the Chinese leadership further. Without major catalytic events such as the market crisis in this case, sudden institutional changes are not expected to occur. However,
with the leadership consensus and determination and the broad support from the public, the latest round of institutional reform marks the beginning of turning the state’s ‘grabbing hand’ into a ‘helping hand’.

At a theoretical level, this study has attempted to weave together two previously unconnected theoretical strands in order to explain the key dynamics of this case: a variant of institutional change theory highlighting the role of powerful external actors, and theories of Chinese elite politics. Seen as an episode of institutional change, what is striking is the role played not by entrenched institutional insiders but by powerful external agents lodged in the party-state. In this context the stock market crisis eventually invited management by exception as the party elite stepped in. Examining this type of institutional change process invites us to more explicitly link the dynamics of institutional change to regime type. China’s political regime is marked by a steep power gradient – a powerful authoritarian regime – in which power can be quickly mobilised to effect change if needed. This power structure is institutionalised into the mechanism of ‘management by exception’, providing the top leadership with institutionally legitimate means to meet their ends.

The case of China’s stock market also has important empirical implications. First, the decentralisation process that sees local governments enjoy unprecedented fiscal and administrative discretion, although spurring regional economic growth in the reform era, shifted and concentrated the systemic risks upward to the Centre. The Party leaders in Beijing find themselves increasingly acting in a fire-fighter mode to defuse the risks generated by reckless practices of local governments and central ministries (in this case, the rampant corruption in the stock market) that have national and international consequences. As China’s economic reform entered a stage where public policy involves more complex trade-offs among different interests, including regional and bureaucratic interests, more issues could be referred to the top level for decision through the mechanism of ‘management by exception’. While this mechanism empowers the elite against the bureaucracy, there is a danger the elite could be over-extended if conflict proliferate. Further bureaucratic restructuring may be needed in future to help deal with this potential danger.

Finally, this case reveals problems for the Chinese state in becoming a modern regulatory state that can effectively steer the emerging market economy and external integration. Over the decades a set of seemingly comprehensive bureaucratic institutions has been set up to administer/regulate the economy. In the financial sector, for example, there is the central bank in association with the regulatory commissions for the banking, insurance and securities industries respectively (in this case, the CSRC). However, as this case suggests, these arrangements could not prevent both state predation and crony plunder in the market due to a lack of a constitutionally restrained political power and the protection of private property, the footstones of a modern market economy and a regulatory state. Absent these fundamental settings, the regulatory institutions, no matter how technically sophisticated, are less likely to constrain state despotism. The problem of state domination and therefore state predation in the stock market may be fixed by elite-sanctioned reforms in a crisis-management fashion, but a transformation of an authoritarian state into a regulatory state, in China’s case, hinges on the long-term establishment of the
rule of law in the polity and a systematic reshaping of the state-market nexus.

Notes

1. In 2004 alone, the SCI slumped by more than 25 per cent and the average market price fell by half from its peak in 2001, a sharp contrast to the 9.5 per cent GDP growth in the same year. See Feliciano, 2005.

2. ‘Cultural dopes’ comes from Giddens, 1984.

3. Similarly, Thelen and Steinmo (1992) argue that we need to unpack the institutional black box and focus on the activities of ‘strategic actors’, and how they are capable of acting on ‘openings’ provided by shifting contexts. Scharpf (1997) has argued along similar lines with his notion of ‘agent-centred’ institutionalism. And as Jens Beckert (1999) argues, ‘if we assume that in many situations agents “make a difference”, it becomes a weakness of institutional theories if they cannot account for the role of strategic agency’.

4. Given the typical stickiness of institutional arrangements, however, such change processes happen only slowly. As Streeck and Thelen (2005) have recently argued, incremental or slower moving adjustments can gradually work around or adjust existing arrangements and eventually produce substantial change.

5. A small number of Chinese companies are also listed in Hong Kong, whose shares are called H shares.

6. Between 1990 and 1991, there were only eight IPOs in the Shanghai Stock Exchange, the so called ‘the Old Eight’.

7. For example, in 1995, fraudulent issuing accounted for 100% of the stock market related offences. See Yu, Zhang and Qi, 2005.

8. For instance, in 1996, the stamp duties collected from the stock market was 10.14% of the total government revenue in Shanghai and 28.63% in Shenzhen. Green, 2004.

9. In fact, the predation by the crony alliance can be traced back to the early years of economic reform. By manipulating resources and prices in the dual track system that was characteristic of China’s gradual economic transition, it is estimated this ‘special group’ managed to turn its political and bureaucratic privilege into an economic benefits of 600 billion yuan (US$75 billion). By selling heavily discounted...

10 For instance, the legal representative of the listed company Emeishan A was the deputy mayor of Emeishan City. The board chairman of the notoriously powerful brokerage CEDTI that was associated with many scandals in the stock market such as T-bond futures speculation in 1995, Yin Guangxia and the Oriental Electronics, was a vice minister from Ministry of Finance, and the post of chief executive of the Company were consecutively taken by departmental directors from the Ministry. See Yuan, 2004 and Ma.

11 Some faked administrative and financial records to get listed, such as the companies of Daqing Lianyi, Hongguang Shiye and Maikete. Daqing Lianyi Petrochemical, for example, fabricated all the necessary records under the direct auspices of the Heilongjiang provincial government, the Daqing municipal government, the local accounting firm and law firm, and the securities company Shenyin Wanguo. In turn, 179 government officials from 76 departments in the central, provincial and municipal governments ‘purchased’ more than 940,000 shares worth 11 million yuan of market price. Some inflated profits to raise IPO price and reduce financing cost, such as Zhangjiajie and Huoli 28. Some even fabricated their listing approvals, such as Lan Tian Corp. See Guangzhou Daily 5 December 1999.; Lu and Fu, 2003 and Wilhelm, 2001, p. 46.

12 A Ministry of Finance analysis at the end of 2000 concluded that out of 159 listed companies it investigated, 157 had inflated their 2000 corporate earnings while 146 had falsified their asset values. Hamlin, 2002, p. 142.

13 The rampant and fierce market speculation created an extremely turbulent market. Prices in Shanghai exchange are about 800 times more volatile than those on the NYSE. See Du and Yong, 1998.

14 This awkward status is best illustrated in the two propaganda campaigns in the 1990s. As former CSRC president, Zhou Zhengqing, admitted, it was CSRC that organised the drafting of the two infamous editorials in the People’s Daily in 1996 and 1999 (Zhongguo zhengquanbao 13 August 2003). In the case of 1996, CSRC’s intention was to curb market fever and speculation, whilst in the 1999 campaign, it was the CSRC’s top priority to ‘talk up’ the market in anticipation of more SOE IPOs flooding the market to meet Premier Zhu’s short-term political goal of SOE salvation in three years.
Wang was convicted of accepting bribery of 720,000 yuan from a company in Fujian during its IPO application process. See Wang, W. (2005).

See, for example, Chen and Shih, 2002; Green, 2004; Groenewold, et al., 2004; and Tan, 2004.


From January to July 2001, listed companies raised 70 billion yuan, of which 30 billion was reinvested through securities funds. See Yuan, 2004.

As of 30 November 2005, the total registered accounts in the two stock exchanges were 70,217,870. However, those whose account balance is zero are not taken as active investors, which amounted to 44,711,866. See Gao, 2005.

Although state banks were legally barred from participating in the stock market for most of the 1990s, it is estimated that some 600 billion yuan (US$72.5 billion) of bank funds managed to seep into the market through a variety of channels. See Hamlin, 2002.

The document contains nine point guide for the institutional reform of China’s capital market. They are: deeply grasp the significance of developing capital markets; promote guiding principles for enforcing change, openness and stability of capital markets; perfect policies to improve the stability and development of capital markets, such as IPO approvals, market liquidity and converting non-tradable shares; perfect corporate governance of listed companies; build securities and futures companies into competent modern financial companies; strengthen supervision of capital markets, and encourage media supervision; perfect and control market risks and punish illegal activities; steadily open the market further to foreign investors. See Chen, K., 2004.

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