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Not Just Another Shadow Bank: Chinese Authoritarian Capitalism and the ‘Developmental’ Promise of Digital Financial Innovation

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ABSTRACT


China’s financial system is rapidly evolving. Both the emergence of shadow banking since 2009 and the growth of fintech since 2013 as forms of ‘non-bank credit intermediation’ have catalysed market-oriented institutional change beyond the banking system, with potentially far-reaching economic and political implications. In this article we assess these developments in the broader trajectory of China’s financial reform and economic development. Through an analysis of two key sectors of non-bank credit intermediation – wealth management products and online lending platforms – we find that the growth of both shadow banking and fintech can be located in the same trajectory of reform and development that has animated Chinese financial policy since the early 1990s. The toleration of WMPs and promotion of internet lending constitutes the latest stage of the Chinese Communist Party’s efforts to construct a more efficient and sustainable market economy whilst simultaneously preserving political supremacy and custodianship of macro-social development. The difference in policy response is commensurate with the degree to which each financial sector meets the Party’s twin objectives of economic development and political control. Counterintuitively from a Western liberal perspective, the very forces behind deep and broad financial liberalisation are also consolidating the Chinese Communist Party’s overall legitimacy and ruling capacity.

KEYWORDS

China; financial regulation; financial inclusion; fintech; institutional change; online lending; shadow banking

Introduction

The image of China’s financial system as deeply repressed and dominated by a few large state-owned commercial banks (SOCBs) is rapidly becoming outdated. Although in quantitative terms the SOCBs remain its beating heart, since 2009 financial innovation beyond the traditional deposit-loan model has dramatically affected not only the structure but also the nature of the Chinese financial landscape. In the wake of the global financial crisis, non-bank credit intermediation (NBCI) has witnessed explosive growth in China. Two related phenomena have been key drivers of this transformation in the financial services sector. First, a complex shadow banking system¹ emerged as banks sought to evade credit restrictions implemented following the implementation of a RMB 4 trillion post-crisis stimulus package. The second is the rise of fintech (金融科技),² and especially the growth of internet lending platforms, leading to China’s emergence as the world’s most important market for digital financial services, both in absolute size and as a source of digital financial innovation.

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This article investigates patterns of continuity and change in Chinese financial governance during this period of institutional change, as new actors develop alternative channels of financial intermediation with potentially far-reaching impacts on the Chinese political economy. It relies on a combination of archival research, using both publicly available regulatory reports and internal (内部) documents, and interviews with regulators, financial practitioners and experts conducted in China and Hongkong in 2016–18. How should we make sense of the rise of NBCI in the broader trajectory of Chinese financial reform and economic development in which domestic market-oriented financial reform has long lagged behind other sectors of economic reform? Both the rise of shadow banking and of fintech have catalysed market-oriented institutional change within the financial system, but have elicited different responses from policymakers and regulators. Why have authorities promoted the flourishing of Chinese fintech, in contrast to the lukewarm response to the growth of shadow banking?

Our core argument is that the underlying political economic priorities of Chinese developmentalism – deeply rooted in China's CCP-led authoritarian capitalism – have shaped the policy response to financial innovation and regulatory arbitrage in the post-crisis financial system. The paper analyzes two sectors of NBCI, wealth management products (WMPs) as a key subsector of shadow banking (offline NBCI) and internet lending platforms as a key subsector of fintech (online NBCI). We find that the growth of both shadow banking and fintech can be located in the same trajectory of reform and development that has animated Chinese financial policy since the early 1990s. Chinese developmentalism grapples with a longstanding tension between two objectives at the heart of China's socialist market economy (社会主义市场经济): economic development and Party control. These priorities have remained consistent, but the role of the financial system in pursuing them is evolving. The rise of fintech and its attendant policy discourse constitutes the latest stage of the CCP's efforts to construct a more efficient and sustainable market economy on the one hand whilst preserving the CCP's political supremacy and custodianship of macro-social development trends on the other. The financial activism evident in promoting and supporting fintech therefore represents a continuation of rather than any radical departure from the policy agenda towards the post-crisis emergence of NBCI.

Even though WMPs and fintech both accelerate the 'liberalization' of the traditionally bank-dominated system, they meet the twin objectives of the CCP – economic development and political control – to different degrees. In contrast to WMPs, fintech constitutes an important element of financial reform that supports a broader programme of supply-side structural reform and economic rebalancing. The fundamental objective of reform of the financial system is not 'liberalization' per se, but to enhance the infrastructural underpinnings of the real economy, which in turn is expected to reinforce the performance legitimacy and ruling capacity of the CCP. Simultaneously, the risks of fintech-driven financial reform to the CCP's political authority are mitigated by an increased capability to monitor and supervise digital financial activities.

These findings lead to a conclusion that is rather counterintuitive from the perspective of many Western liberal observers (eg. Lardy 2014): that the very forces behind deep and broad financial liberalisation also consolidate the CCP's overall legitimacy and ruling capacity. This has important implications for how we think about the political economy of Chinese authoritarian capitalism, as well as the role of the state in economic development amidst rapid technological changes and the broader processes of both financial globalisation and financialization itself. Far from retreating from the developmental process as it seeks to foster the growth of dynamic new areas of economic activity, the Chinese party-state is taking an active role in the financial institutional change necessary for the transformation of China's growth model and developing novel forms of governance to ensure that this institutional change unfolds in accordance with its core political objectives.³

The remainder of the article proceeds as follows. In the following section we briefly chart the growth of China's NBCI and address conceptual issues surrounding the regulatory discourse on 'shadow banking'. The third section critically surveys the literature on Chinese financial governance, and puts forward a contrasting framework for mapping institutional change in the financial system,

identifying the core political economic priorities of Chinese policymakers and regulators in responding to institutional innovation and guiding the developmental process. The subsequent sections then empirically trace how these priorities have influenced the policy approach to regulating Chinese NBCI: firstly with the growth of NBCI in the post-crisis conjuncture, and secondly with the rise of fintech as a key element in economic reform that also offers promise of maximizing the CCP's power and influence over the course of China's broader economic transformation. The final section then concludes with a discussion of implications for future research on the political economy of Chinese financial governance and of technological change in financial services more broadly.

The Growth of China's Non-Bank Credit Intermediation

We adopt the Financial Stability Board's (FSB) definition of NBCI as that portion of a financial sector that constitutes 'credit intermediation involving entities and activities (fully or partially) outside the regular banking system' (FSB 2011, p. 3). Most recent IMF research estimates the size of China's NBCI sector as 31.2 per cent of GDP, with bank assets (at 218.4 per cent of GDP) comprising an additional 143.5 per cent of total social financing (IMF 2017). Estimates of the size and composition of China's NBCI are fraught with problems of over- and under-counting and consequently range widely, from 5 to RMB 46tr (USD 0.7–6.9tr) at the end of 2013, equivalent to between 8 and 80 per cent of GDP at the time.⁴ The sector remains small in terms of GDP when compared with advanced economies, although its share of global assets has increased rapidly since the crisis (Figure 1).

This definition of Chinese NBCI includes credit intermediation through both online and offline lending channels, both of which have grown rapidly since 2009. The emergence of China's NBCI is at its core a story of the consequences of long-standing financial repression (Lardy 1998, Gruin 2013), leading to financing and efficiency gaps on both the lending and borrowing sides to SMEs and low-income households (Feyzioğlu 2009, Hsiao *et al.* 2015). The financial dominance of the SOCBs combined with their political subordination in the immediate aftermath of the 2008 crisis staved off a sharp decline in growth through their implementation of a RMB 4 trillion stimulus

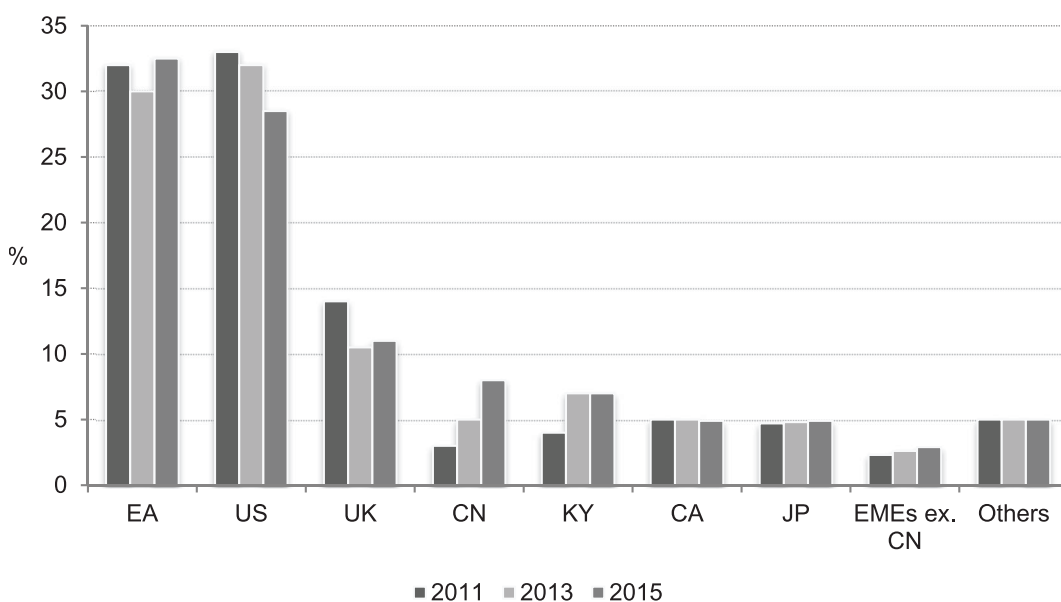


Figure 1. China's portion of global shadow banking assets. EA – Euro Area, US – United States, UK – United Kingdom, CN – China, KY – Cayman Islands, CA – Canada, JP – Japan, EMEs – Emerging Market Economies. Source: FSB (2017, 17)

package, but by early 2010, financial institutions that had engaged in credit expansion started to receive mixed signals from policymaking and regulatory authorities (Hsu *et al.* 2014, W. Tsai 2015, Shen 2016). The People's Bank of China (PBOC) was tightening monetary policy in earnest, raising capital adequacy ratios and imposing credit restrictions on banks, yet there remained significant political pressure – both formal and informal – to continue supporting long-term infrastructure investments (see Figure 2). This resulted in the rapid proliferation of novel financial products as banks sought to move liabilities off-balance sheet, and non-financial institutions such as trust companies stepped in to extend credit to those borrowers now cut off from access to bank loans. The majority of capital for these securitised and non-securitized products is sourced from WMPs, issued directly by banks themselves, trust companies, or through 'bank-trust cooperation', and marketed to ordinary retail investors as alternatives to low-yielding bank deposits.

China's online NBCI sector has expanded even more precipitously since 2013. Alongside the rapid emergence of P2P internet lending platforms, Baidu, Alibaba and Tencent – the so-called 'BAT' of the Chinese internet and technology sector – are utilising new technological infrastructure and big data analytics to grant dramatically improved and faster access to financial services than banks, which traditionally channelled bank credit to SOEs and large private enterprises. The numbers are substantial and belie the fact that as recently as 2013 the market for almost all digital financial services in China was virtually non-existent. Although internet lending is equivalent to less than 5 per cent of domestic bank loans (O1Caijing 2017), China has become the largest fintech market worldwide, with a 2015 lending volume of \$100bn that dwarfs that of the United States (\$34bn) and the United Kingdom (\$4bn) (CGFS and FSB 2017). The State Council estimates that by 2020 fintech will grow to be a RMB 6 trillion industry (CNTV 2016). China's largest fintech firm Ant Financial, Alibaba's financing arm, alone has granted loans to more than 4 million businesses with a total amount of RMB 700 billion in direct lending (Cheng 2017). These trends are highly likely to continue; as Figure 3 illustrates, capital is pouring into what is already the world's largest fintech sector.

Before proceeding, a brief note on terminology. Although the FSB's definition of NBCI technically includes fintech, the regulatory discourse centred at the FSB on 'shadow banking' since it emerged

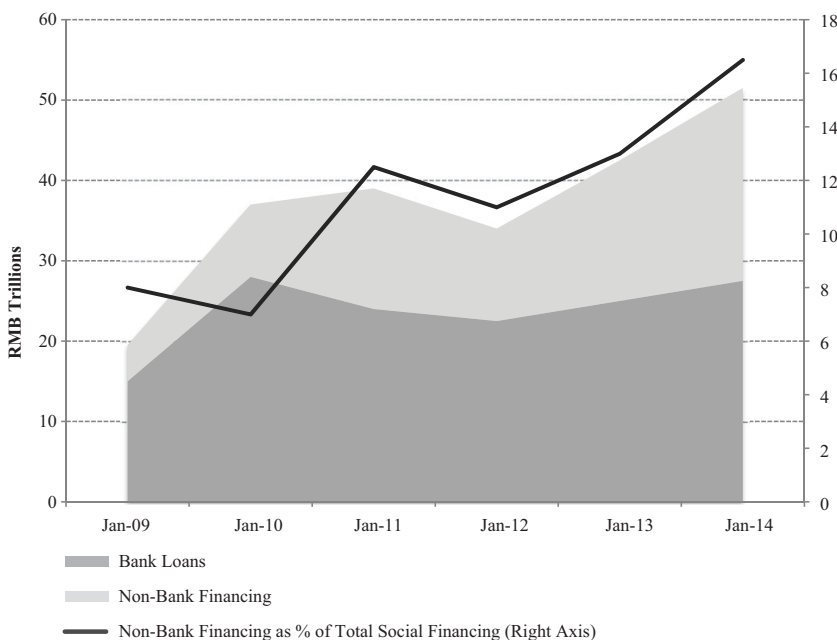


Figure 2. Growth in non-bank financing. Source: CEIC

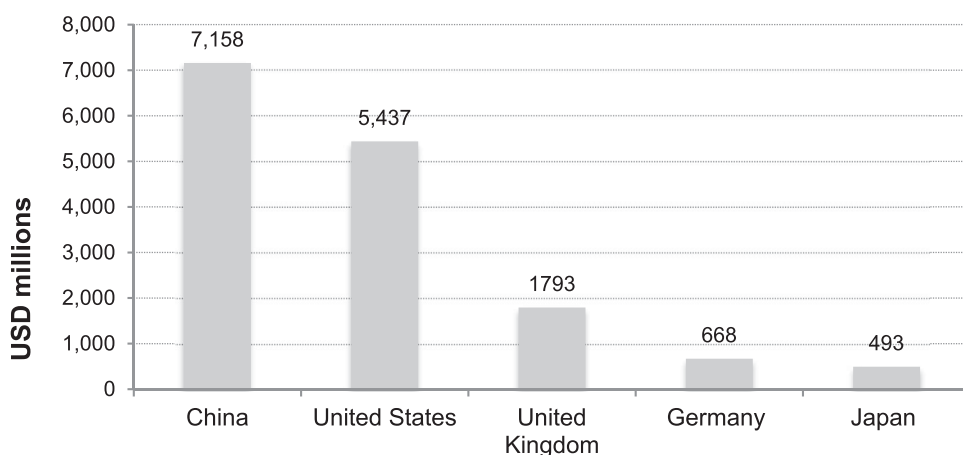


Figure 3. Fintech venture capital investment, 2016. Source: McKinsey Global Institute (2017).

Note: Based on the nationality of the venture-capital investor. Co-invested deals are counted under each nationality.

following the US subprime crisis tends to exclude fintech, focused as it is on systemic risk and financial stability. In contrast, the Chinese discourse on ‘shadow banking’ does generally include fintech as a mode of credit intermediation (Q. Chen 2014, L. Yan and Li 2014, Shen and Huang 2016). This reflects the structural characteristics of China’s financial system in which traditional banks have historically dominated credit markets, such that all forms of NBCI – including fintech – are seen as representing financial innovations and regulatory arbitrage that challenge the existing bank-dominated system. Accordingly, in this article we approach the issue of NBCI and financial reform not from a regulatory perspective but from a political economy perspective that differentiates forms of Chinese NBCI on the basis of their implications for financial reform and development. We do so because, as we argue below, China’s financial policymakers are incorporating fintech into a programme of financial and economic development that deepens and broadens the reform process that WMPs and other offline forms of NBCI initially catalysed in the post-crisis conjuncture.

It also however raises important questions for observers of Chinese financial reform. In this period, financial policy has featured efforts both to guard against the potential systemic risks inherent in NBCI as well as their promotion as a positive force for institutional change in China’s broader financial and economic ecosystem. This returns us to a key theoretical question for observers and scholars of Chinese economic and financial reform: under what conditions is market-oriented financial reform likely? If fintech represents such a potentially disruptive force for change within the financial system, then how do we explain its embrace by financial policymakers over other forms of NBCI, when both a need for financial reform (economic rebalancing and financial inclusion) and the policy tools and institutional mechanisms for achieving it (NBCI, interest rate marketisation, and dismantling the SOCB monopoly on credit) have been in existence for a considerable number of years?

Theorising Financial Reform in China’s Authoritarian Capitalism

Our focus on the priorities of Chinese developmentalism stands in contrast to existing frameworks for theorising the conditions for market-oriented financial reform in China’s political economy. Scholars have emphasised processes of learning and socialisation into the norms of ‘modern financial governance’ (cf. Johnston 2008), and China’s over-compliance with Basel III is commensurate with such expectations (Knaack 2017). However, Beijing’s stance in the debate over the regulation of global shadow banking indicate that China is seeking to develop its own particular framework for promoting and regulating the industry (Knaack and Gruin 2017).⁵ Others have adopted a factional and

jurisdictional politics perspective, arguing that technocratic reformers have overcome entrenched resistance to broader financial reform by using the growth of NBCI as *de facto* interest rate marketisation (Shih 2011). Yet the parameters within which the factional politics of financial reform play out have narrowed significantly as the policy debate increasingly revolves around issues of timing and pace, rather than the direction of reform itself, even if this direction remains normatively anathema to Western neoclassical economists. The factional framework might help explain the emergence of NBCI, but it sheds little light on how CCP-led authoritarian capitalism is now responding to digital financial innovation. As proponents of the factional perspective acknowledge, deeper political and developmental priorities at the State Council level, and more importantly within the CCP Central Committee itself, override the preferences of such interest groups (Shih 2011). Finally, there is little evidence that the BAT's meteoric rise to prominence has resulted in their playing a significant role in the course of financial reform policy. Rather, their growth has replicated a longstanding pattern of private sector development, in which demonstrating allegiance to core CCP principles is not merely a matter of survival, but forms a key element of a successful business strategy (Dickson 2008).

Whilst these narratives capture important and undeniable aspects of Chinese policymaking, they fail to provide adequate theoretical tools for understanding of Chinese financial reform in the broader – and in our view, more deeply significant – trajectory of the relationship between financial capital and political authority in China's political economy. This relationship is the hallmark of Chinese developmentalism, which consists of a blend of market-led innovation and the regulatory state, each under the political authority of the CCP. As Thurbon (2018) demonstrates in this special issue, the importance of taking account of the socio-historically constructed developmental 'mission' of a state remains undiminished (see also Thurbon 2016). Furthermore, the normative continuity of China's developmental trajectory since its founding in 1949 should not be discounted (Horesh and Lim 2017). Contemporary developmentalism is thus institutionally malleable, but can be conceptualised as cohering around a nationally shared set of ideas amongst the policymaking elite about political-economic goals, as well as about the best means of achieving them (Thurbon 2014). Whether China should be labelled a 'developmental state' is not the central point.⁶ What matters is that any assessment of change and continuity in China's financial policymaking should take account of these deeper and normatively embedded developmental factors as an important 'meta-institutional' context (Bell and Feng 2014) informing the proximate policymaking process. This accordingly demands that we theorise how the role of the state responding to and guiding financial innovation is shaped by the deeper developmental objectives at the core of the CCP-led party-state.

This overarching mission remains the preservation and enhancement of the political authority of the CCP throughout the growth and evolution of Chinese economy and society. To this end, Chinese developmentalism comprises a core set of political and economic priorities that are pursued in conjunction with one another and cannot be easily, if ever disentangled. Contrary to the widespread perceptions of China's 'growth obsession', material economic growth and the sustainable distribution of that growth serve not as goals in and of themselves, but as key instruments of performance legitimacy and therefore socio-political stability.⁷ This authoritarian capitalism is characterised by a market-based regime of accumulation and production coupled with an insistence on deploying these markets as tools, subservient to political structures and goals. Furthermore, such economic growth is not pursued with firm ideological distinctions between market-led economic innovation and state-guided economic upgrading, since either mode of change must remain within the purview and control of the party (Heilmann 2005, McNally 2012, Gruin 2016). The financial system has functioned as the cornerstone of this developmental model, enabling experimental economic reform in conjunction with continuous centralised political control under the CCP (Gruin 2013, Collins and Gottwald 2014, Chen and Naughton 2016). The challenge of Chinese financial governance accordingly lies in how policymakers achieve the delicate balance of enabling institutional innovation in the financial sector whilst simultaneously retaining control over the macro-consequences of this innovation (Heilmann 2008, Pistor 2013).

This conception of CCP-led developmentalism has significant implications for how policy is formulated and implemented in response to institutional innovation and regulatory arbitrage in the financial system. Our key explanatory factor for the incorporation of fintech into a broader programme of financial reform is therefore its congruence with the political priorities of the CCP itself as it seeks to manage economic restructuring at the same time as upgrading the CCP's 'ruling capacity'. Economically, in the context of an economic structure centred on manufacturing and industrial upgrading, the SOCB-dominated financial system functioned as a cornerstone of the CCP's capacity to achieve such growth without allowing excessive financial risk to accumulate or alternative sources of political power to emerge.⁸ The limits of this growth model and the accompanying role of the financial system have become increasingly apparent, as future economic growth demands a financial system capable of servicing a consumption- and services-driven economy (Huang and Wang 2017). The traditional SOCB-dominated banking system comprised an effective set of institutions for achieving these goals in the context of China's investment-oriented economic growth model that focused on industrial and infrastructural upgrading, but it is increasingly unfit for serving the needs of the 'new economy' that is forming the centrepiece of the economic ambitions for China's twenty-first century consumer society. Politically, in line with its post-Mao transition from a 'revolutionary' to a 'governing party' (Heath 2016), the overarching objective of contemporary Chinese governance remains the preservation and enhancement of the political authority of the CCP throughout the growth and development of Chinese economy and society. Put succinctly, these overarching developmental priorities of the CCP have not changed, but the role of the financial system in achieving these priorities has. Table 1 charts the evolution of these roles of the financial sector and summarises our findings and arguments, depicting how different forms of institutional change in the financial sector affect these core priorities of economic growth and political control. In the following two sections we provide empirical support for these arguments by tracing the policy process surrounding WMP as a key sector of offline NBCI and internet lending as a core element of fintech.

Toleration of Shadow Banking: The Case of WMPs

'Shadow Banking' and Economic Growth

Wealth management products are a core financial instrument in China's shadow banking universe. One motivation for tolerating the growth of shadow banking in general and WMP in particular was to capitalise upon non-bank credit as both a 'back-door' mechanism for introducing market forces into the financial system and as a necessary means of supporting post-crisis economic growth. Historically, the desire for interest rate marketisation on the part of the PBOC and CBRC had a strong financial inclusion argument, since doing so would give incentive for greater lending

Table 1. CCP's political priorities in financial sector development.

Financial sector development options	Relation to CCP objectives		Policy response
	Economic growth	Political control	
Full domestic financial 'liberalization' ¹⁶	New investment avenues Credit access for SMEs and big companies, not for local governments (LGs)	Systemic risk through increase in complexity	Minimal progress
Shadow banking: WMP	New investment avenues Credit access for LGs and large firms	Systemic risk Opacity challenges regulatory capacity	Toleration
Fintech: Internet Lending	New investment avenues Credit access for SMEs and consumers (Bonus points) Boost international competitiveness through 'tech national champions'	Localized rather than systemic risk Transparency enhances (1) regulatory and (2) surveillance capacity (Bonus points) Direct influence over key (private) actors	Promotion

to SMEs, boosting productive employment and increasing financial efficiency (Xie *et al.* 2001, p. 29). The PBOC deputy governor Hu Xiaolian pointed out in 2014 that the shadow banking system had become an alternative channel to finance those restricted from normal bank loans (Ruan 2016). This reflected the PBOC's emphasis in its 2013 Financial Stability Report on the benefits of shadow banking, which stated that 'as an integral part of the financial market in a broad sense, shadow banking plays a positive role in facilitating social investment and financing' (PBOC 2013a, p. 199). Similar arguments were made by prominent scholars in central government think tanks, including the State Council Development Research Center (Ba 2010) and the Chinese Academy of Social Sciences (CASS 2013, Zhang *et al.* 2014), and leading financial regulators (Yan and Li 2014, Sheng and Soon 2016). This influential group of financial policymakers and scholars thus explicitly linked shadow banking regulation with the prerogatives of economic development, thus laying the basis for a perspective on the risks and rewards of shadow banking that diverged from the negative views prevalent within the global regulatory discourse (Knaack and Gruin 2017).

The PBOC and the CBRC therefore cautiously welcomed the growth of WMPs as a diversification of the investment channels available to depositors and retail investors,⁹ and the increasing pressure on banks to adopt more market-oriented lending practices did play a role in catalysing the acceleration of interest rate marketisation in 2012 and 2013 (PBOC 2013b). WMPs however only provided partial relief to financially repressed economic sectors. Despite the general positive view of shadow banking as a benefit to the real economy, there is limited evidence that WMPs were genuinely either alleviating the credit drought of SMEs or spurring on the growth of consumer finance markets (Chao *et al.* 2017). An estimated 57per cent of funds from WMPs are channelled to the bond market, with an additional 17per cent invested in trusts and other non-standardized debt assets according to research conducted at the Bank for International Settlements (Ehlers *et al.* 2018). SMEs are of insufficient scale to access capital from bond markets and trusts. And while retail investors were a key driver of WMP growth, retail borrowers were not beneficiaries of such funds (Wang *et al.* 2016, Collier 2017).

The deepest connection between WMPs and the real economy was in their assistance in maintaining growth rates in the aftermath of the credit tightening, by continuing to channel capital to Local Government Financial Vehicles (LGFV) and large firms. In this sense it predominantly fulfilled a 'credit-replacement' rather than 'credit-enhancement' function, but one which was nonetheless necessary in

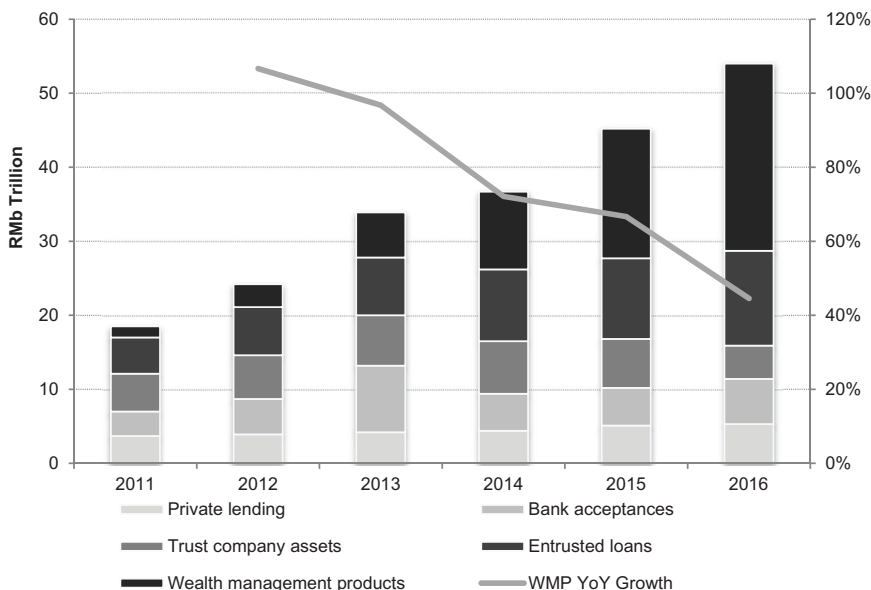


Figure 4. Growth of select NBCI product categories, 2011–2016. Source: Xi and Xia (2017)

striking a compromise between countervailing economic and political objectives.¹⁰ That this credit intermediation took place within the shadow banking system rather than through formal banking channels was an inevitable consequence of the PBOC's monetary tightening as the full implications of the 2009 credit expansion became apparent. Between 2011 and 2016, even as the growth in money supply and of bank loans moderated (see [Figure 2](#) above), the WMP market continued to expand relatively rapidly ([Figure 4](#) below).

In this manner, the growth of WMPs served the PBOC's goal of incrementally advancing financial reform without threatening the politically sensitive position of the SOCBs. But shadow banking and WMPs in particular did not benefit the real economy so clearly as to justify more concerted efforts to promote it as a force for financial and broader economic reform. And more importantly, doing so would have endangered broader financial stability, an issue we examine in the following subsection.

WMPs and Political Control

Although there was incentive for using WMPs to promote deeper marketisation of the banking sector, doing so at a time of deep uncertainty over headline growth and key employment sectors posed a significant threat to financial stability and therefore broader party control. The growth of the WMP market presented a number of challenges to regulatory control over systemic risk in the financial system. At the time these risks were perceived as manageable. In 2012, Zhou Xiaochuan argued that China's shadow banking sector was (and remains) much smaller in terms of size and risk than those of advanced economies (Xinhua 2012). This assessment was backed up by thorough CASS reports in 2013 and 2014 that recognised that China's shadow banking sector contains risks derived from maturity and liquidity mismatch and imperfect credit risk transfer, but argued that the risk of triggering a systemic crisis was very small (Chinese Academy of Social Sciences 2013, M. Zhang *et al.* 2014). Yan and Li (2014, p. 41ff) distinguished between shadow banks in the wider (NBCI) and in the narrower sense (posing systemic risk), thus deprioritizing regulatory arbitrage as a problem indicator.

These policy positions were reflected in the first stage of the regulatory response to shadow banking, which emphasised transparency, disclosure, and monitoring, rather than an attempt to eliminate outright banks' shadow finance operations (Mao 2013). On 6 July 2009 the CBRC had begun to implement regulation (CBRC 2009) aimed at increasing the visibility and clarity of the risk factors inherent within the rapidly blooming bank-trust cooperative arrangements (Hu and Zheng 2016), followed by more restrictive measures January 2011 (CBRC 2011) that made significant but limited inroads into addressing the transparency problem of the off-balance sheet activities of the banks, and also slowed the growth rate of WMPs, contributing to a commensurate decline in overall shadow financing growth (Y. Liang 2016).

The systemic risk challenge posed by WMPs resulted largely from arbitrage within a fragmented regulatory system. Although by 2012 it was clear that the CBRC was to adopt primary regulatory responsibility for WMPs, a fuller regulatory response was required, which came in the form of the late 2013 issuance by the State Council of Document 107 (State Council of the PRC 2014a), the key foundation text for both clarifying the nature of shadow banking and outlining an effective regulatory framework for monitoring it (Guo and Xia 2014). Document 107 contained the first comprehensive definition of shadow banking (B. Li 2014). It paved the way for a clearer delineation of regulatory responsibilities over a rapidly changing financial ecosystem, but did not offer a reform blueprint for how to harness 'shadow banking' as a positive force for change in the financial system. Rather, Document 107 and the regulatory measures surrounding it provided space for WMPs to grow, whilst seeking to articulate a regulatory framework for monitoring the systemic risks accumulating within the system.

Document 107 and the overall policy response to shadow banking was therefore one of cautious tolerance. It recognised both sides of the shadow banking debate, holding that the emergence of shadow banking was a necessary result of financial development and innovation, and that it

functioned as a financing channel that complemented the traditional banking system, but that its opacity also presented regulatory challenges for adequate monitoring and supervision of systemic risk. For as long as the cost–benefit calculation of taking more comprehensive steps to either seize the opportunity for broader market-oriented financial reform or to eliminate outright the ‘shadow’ WMP market and enforce their wholesale return to bank balance sheets remained ambiguous, the policy agenda was stuck in limbo.

Inclusive Innovation: Promoting Fintech in China’s ‘New Economy’

The graduation of NBCI into the digital realm marked a critical juncture in the policy priorities towards the sector, which until that point had remained closely tied to an increasingly unsustainable economic growth trajectory. The necessity of a vibrant and growth-facilitating financial system that serves a changing real economy is broadly recognised amongst economic policymakers and has steadily increased since the 2013 CCP Third Plenum. For this reason, the nascent policy discourse on fintech emphasises its positive role within China’s ‘new economy’ by furthering financial inclusion and assisting with deeper structural economic rebalancing. As the following two subsections explicate, this positive role in fostering economic growth is complemented by an increased capacity to control financial risks and enhance political control, the other core priority that has long eluded policymakers interested in deepening financial reform.

Fintech and Economic Growth

The promotion of fintech as a viable avenue for market-oriented financial reform is closely tied to a broader array of efforts to address China’s current delicate macroeconomic conditions, within which the 2016 Central Economic Work Conference defined the central tone of economic policy as ‘making progress while maintaining stability’ (Huang *et al.* 2017, p. 49). The emergence of the BAT and other ‘tech national champions’ is seen by policymakers as leading a new era of economic growth led by household consumption and service industries catering to an increasingly prosperous middle class. The major policy push came in the form of the 2015 *Internet Plus* initiative that seeks to develop new growth drivers by integrating mobile internet, cloud computing, big data, and the internet of things with the manufacturing and services sectors (Jingu 2015).

This push to develop new economic growth drivers whilst preserving financial stability has placed fintech at the heart of debates around how to improve an increasingly inefficient credit-growth ratio. This reflected the changing effects of financial repression from a growth-enhancing ‘Stiglitz effect’ through the 1990s to a growth-detracting ‘McKinnon effect’ in the 2000s (Huang and Wang 2011, 2017),¹¹ itself a symptom of the broader economic reform process that comprised asymmetric marketisation of product and factor markets. As the limits of the investment-driven growth model became apparent in the wake of the 2009 stimulus, it became increasingly clear to policymakers that concerted efforts to liberalise credit markets and thus grant SMEs driving growth in the ‘new economy’ greater access to production factors is a crucial element in future prospects for a sustainable macroeconomic growth trajectory.

For financial policymakers, fintech is accordingly one important element of such progress. It shares many of the same characteristics as other forms of NBCI that undercut the existing banking system by permitting interest rates and capital allocation to be more freely determined by market forces and thus representing an important driving force for financial reform.¹² The crucial difference between fintech and previous NBCI lies in the fact that whilst WMPs alleviated the plight of investors seeking higher returns in a financially repressed environment, fintech offers promise of both generating higher returns for retail investors as well as generating a more efficient and inclusive borrowing environment for the small and medium enterprises at the heart of the ‘new economy’.

The close connection of fintech to a broader shift in China’s economic growth model has therefore prompted the Chinese state – in contrast to other fintech markets around the world – to take a highly

active role in promoting financial inclusion via digital financial innovation (MGI 2017). More importantly, it also represents a significant shift in how financial innovation and reform is perceived by the CCP as a mechanism for sustainable and inclusive economic development. Li Keqiang has been one of the most vocal supporters of the fintech sector. In March 2014, he began to draw explicit connections between digital finance and financial inclusion, stating that authorities should ‘promote the healthy development of digital finance [...] allow [it] to become a liquid pool, better irrigating small and micro-enterprises, the ‘three rurals’,¹³ and other trees of the real economy’ (K. Li 2014). *Internet Plus* prioritises the development of fintech as both a source of digital innovation that will spillover into other sectors, and as a supply-side structural reform in itself.¹⁴

One key touchstone of financial reform policy is therefore not only increasing support for the real economy, but increasing support to particular areas and activities of the ‘new economy’, whose growth is negatively correlated with that of traditional sectors (Y. Shen *et al.* 2016), but which has historically experienced difficulties in accessing financial capital. Following on the heels of Li Keqiang’s *Internet Plus Initiative*, on 31 December 2015 the State Council issued its *Plan for Advancing Inclusive Financial Development, 2016–2020 [Inclusive Finance Plan]*, which laid out the basis for developing financial inclusion (普惠金融) as a key pillar of national development and financial reform (State Council of the PRC 2016). The *Inclusive Finance Plan* stressed the central role of big-data analytics, cloud computing, and the integration of offline and online commerce in enabling fintech firms to overcome these historical difficulties through both intra-industry and industry-government cooperation (State Council of the PRC 2016). In March 2016, the National Internet Finance Association (NIFA) was established in Shanghai, with CreditEase as Executive Director, and Li Dongrong, former PBOC Deputy Governor, serving as President. In September 2016 the PBOC and the NIFA jointly launched the new digital Credit Information Sharing Platform (F. Yang 2016), which offers promise of solving the problem of one of the biggest hurdles for internet lending platforms operating in the absence of traditional in-depth credit assessment procedures: information asymmetry and completeness, as well as data sharing across multiple platforms.

17 leading internet lending platforms have joined the platform, including Ant Financial, JD Finance, and Lufax. It operates by way of a generalised information dissemination system, so that customer and competitive information remains protected. Accordingly, if a borrower applies for a loan, that applicant’s outstanding loans will be shared, without revealing the source of that loan. One clear example of fintech providing a crucial missing link between the financial sector and the ‘new economy’ is the lending model employed by Ali Small Loan, the small- and micro-loan wing of Ant Financial (Figure 5). Similarly, MYbank, Ant Financial’s online-only private bank, provides a ‘310’ loan service (3-minute application, 1-second approval & grant and 0 manual intervention) that is specifically geared towards micro and small entrepreneurs that have grown up within the

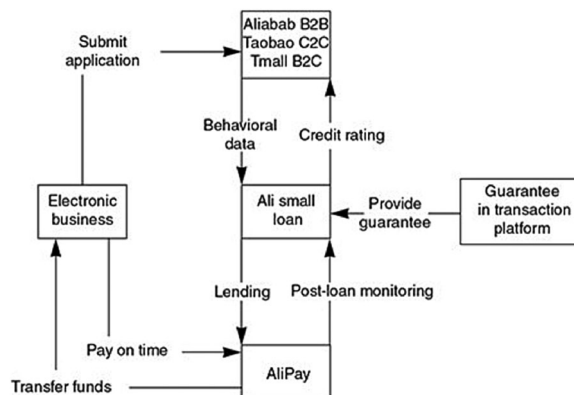


Figure 5. Ali Small Loan Lending Model. Source: Ant Financial

Alibaba e-commerce ecosystem (Cheng 2017). The use of big-data analytics in credit risk assessment has led to JD Finance having served over 100,000 SMEs with supply chain finance solutions amounting to a total of RMB 250 billion, concentrating not on a traditional loan model but by using big-data analytics to offer loan packages with characteristics tailored to individual enterprises such as flexible amortisation rates. This reflects a substantially new paradigm in addressing the financing needs of the real economy; as argued by Chen Long (2016, p. 226), chief strategy officer of Ant Financial, Chinese fintech should be regarded as 'finlife', a phenomenon that integrates finance and real life scenarios and thus produces a virtuous circle between technology, finance, and real-life needs. As a means of capitalising upon the Chinese consumer class as an economic force central to China's broader structural economic rebalancing (Barton *et al.* 2013), the economic incentives for promoting online financial inclusion and innovation are clear to Chinese policymakers and are increasingly forming the basis for economic development plans (S. Y. Li and Yi Tin 2016, p. 175).

In addition to its role in furthering financial reform, another important motivating factor in the Chinese state's promotion of fintech is the prospect of gaining international competitiveness in the form of 'tech national champions'. Since the 'going out' (走出去) strategy for China's large national firms was first initiated by Zhu Rongji in the 1990s, China's SOCBs were hindered in their global aspirations by remaining deeply embedded within a domestically oriented economic growth model, such that in 2011 the head of ICBC, then the world's largest lender with USD 1.9 trillion in assets stating that 'we are not yet a real global bank' (L. Yang 2014). Shadow banking provided few opportunities for catalysing change to this situation, instead tying the fate of the banks more closely to the fate of domestic economic reform and growth. The emergence of the BAT as global market leaders in e-commerce has generated deep incentives for Chinese financial policymakers to promote their development as international pioneers in digital financial services.

Fintech and Political Control

The rise of fintech within the 'new economy' is accordingly both propelling an increase in financial efficiency and providing an opportunity for more comprehensive reform of the institutional structure of the financial system. Yet financial reform nevertheless continues to present numerous risks, not just to financial stability, but to the deeper resilience of Communist Party macro-social and economic authority over an increasingly diverse range of actors wielding influence over market dynamics and the capital allocation process within an evolving economic growth model. The answer to this conundrum for the CCP has been to develop mechanisms for control and oversight over key actors in the emerging fintech ecosystem, representing a commensurate upgrading and transformation of how the CCP exercises control over both the economic and political dimensions of China's changing political economy. This is not just a matter of upgrading otherwise benign but ineffective financial regulatory structures, but also the consequence of a political intent to exercise greater control over the financialization of broader Chinese society. This is taking two principal forms: firstly the enhancement of monitoring capacity over online financial activities and the integration of financial credit scores with broader social credit scores. Secondly, the CCP is extending direct influence into the organizational structures of the key actors in the new digital economy and the financial institutions operating within it.

Financial reform is inevitably inducing the financialization of economy and society more broadly. In response, the CCP is developing a comprehensive social credit scoring system (SCSS), the preliminary plan for which was announced in 2014 (State Council of the PRC 2014b), and forms an important element in Li Keqiang's *Internet Plus* policy framework. The plan was further developed in September 2016 with the release a high-level strategy document that details the aims of objectives of using algorithmic credit rating methodologies to produce quantified assessments of financial creditworthiness and social trustworthiness. Both the empirical data sources as well as the algorithmic scoring techniques being developed across the range of fintech players are emerging as integral elements in transferring the practice and methodologies of financial credit rating to a broader range of quantifiable social and political benchmarks (Yan and Li 2014, p. 291f). The SCSS undoubtedly goes beyond

the immediate usage of big-data driven credit scoring for financial investments, but it is the mutability of these technologies for diverse and contingent social and political functions that is providing the CCP with the infrastructural capacity to maximize its influence over the financialization of society that is inevitably accompanying the immediate process of financial reform. Xie *et al* describe it thus,

Financial services will be available to all, and everyone will enjoy the benefits. In this way, internet finance is more democratic than a finance controlled by professional elites. ... through social networks and search engines, we will get a reliable picture of [stakeholders'] creditworthiness. Social networks also enable the accumulation of 'social capital' among people, with which costs of financial activities will drop considerably and opportunistic behaviors will be constrained. (Xie *et al.* 2016)¹⁵

Such descriptions underscore just how fine a line there is between the use of credit scoring algorithms for evaluating financial creditworthiness on the one hand and socio-political 'trustworthiness' on the other. The social credit rating score expands the concept of credit ratings far beyond financial metrics, to include social, political, and environmental factors both in terms of data inputs and rating outputs. The intent is clear: a constant monitoring presence of automatically generated and updated credit rating scores, which will – in the terms of official discourse – constitute 'self-disciplining enforcement' mechanisms, at the level of both the individual citizen (个体自我约束) and the corporate entity (企业自我约束) (State Council of the PRC 2017). If this seems somewhat far removed from the fundamental processes of financial and economic reform, it is important to note that the leading firms developing social credit scores are Sesame Credit (an Ant Financial subsidiary), and China Rapid Finance (the credit rating partner of Tencent). Sesame Credit already administers a system of social credit ratings to which tens of millions of users have voluntarily subscribed (Botsman 2017). By 2020, the social credit scoring system will mandatorily encompass every citizen and corporate legal entity in the country, giving rise to a novel paradigm of social and market regulation of unprecedented scope and influence.

The second key form of control over the liberalising forces unleashed by fintech involves ensuring that the CCP retains direct influence over the key actors and firms advancing the sector. More than 35 tech enterprises, including key e-commerce firms JD.com, Baidu, Alibaba, Tencent and Sina have established party committees in order to ensure that they are developing in accordance with CCP developmental objectives, to recruit party members, and further to advertise that their party ties also advance their prospects for commercial success (Feng 2017). As JD.com Vice President (and Party Secretary) Long Baozheng put it:

Under the guidance of the Party, JD.com is a major beneficiary of the deepened reform and constant improvement of business environment ... We will assist the structural supply-side reform and rejuvenate the real economy by opening up our platforms and capabilities, and shoulder more corporate social responsibilities. (M. Liang 2017)

In addition to such organizational ties, the CCP is assuming a role as a direct investor in tech firms through the development of 'special management shares', in which the party takes a minor financial stake in exchange for board representation and input into firm strategy and operations (Y. Li 2017). At a time of steady consolidation of CCP power under Xi Jinping, it is clear to firms that in order to pursue business strategies that involve market-oriented financial services and the opening up of new modes of capital allocation, deepening party-firm cooperation is not only a necessary survival strategy, but constitutes a key source of competitive advantage itself.

Conclusion: Financial Liberalisation Meets Authoritarian Capitalism

In this article we have argued that the rise of fintech as a mechanism for market-oriented institutional change in the financial system can be explained by its congruence with the core politico-economic priorities at the heart of China's authoritarian capitalism. Although the emergence of Chinese shadow banking and particularly the proliferation of WMPs in the wake of the 2009 stimulus policies represented an opportunity for 'stealth liberalization', it offered financial policymakers only a limited

capacity to further drive financial reform in support of a rebalanced economic growth model or to ensure that a more market-oriented system of credit intermediation remained subject to the broader imperative of CCP authority over financial capital and the prevention of systemic financial crisis. By contrast, fintech both represents a long-term opportunity for developing more inclusive and efficient financing channels necessary for the rise of the 'new economy', as well as an infrastructural capacity for close regulatory monitoring over the capital flows and firm-level operations within this system.

These arguments make a number of contributions to our understanding of central issues at the heart of Chinese political economy, as well as to the future of state-market relations more broadly. The opportunistic and uneven path of Chinese financial reform has long presented dilemmas for observers and scholars seeking to identify the core drivers of change in Chinese financial and economic governance. Although the Chinese policymaking process and overall trajectory of reform is undoubtedly fragmented and highly contested, there has always existed a set of core economic and political priorities at the heart of the CCP's developmental mission and ambition for the evolution of Chinese society. Contrary to the expectations of many Western observers, fintech-led financial 'liberalization' thus in fact consolidates, rather than diminishes CCP authority and power. The promotion of fintech as a tool for advancing this mission supports the view that since 1993 and the advent of the 'socialist market economy', the process of market-oriented reform has not been resisted by the CCP for ideological reasons, but is one that will only be permitted to take place without jeopardising key tenets of CCP ruling authority.

More broadly, our arguments in this article provide an insight into the current and future potential roles of the state in interacting with technological innovation as an historic shift in how financial and potentially many other economic services are provided. The Chinese case illustrates the potentially far-reaching political implications of the deployment of big-data analytics and automation of financial services, and is of deep relevance for how we think about the role of the individual, social trust, and economic exchange in increasingly financialized capitalist societies in which faith in liberal democratic values is fast eroding. More critically engaged research and attention is needed into how the economic advantages of sometimes seemingly innocuous digital technological advances may be less conducive to the 'liberal' market and social visions pinned on them by many.

Notes

1. WMPs in China differ from notions of 'wealth management' that connote a professional advisor with fiduciary responsibility for portfolio investment strategy, instead comprising structured financial products that are marketed directly to retail investors by financial institutions.
2. Also referred to in China as 'internet finance' [互联网金融]. For the purposes of this article we concentrate on online credit intermediation only, leaving aside non-credit fintech products such as blockchain currencies or payment systems.
3. This construction of increasingly sophisticated mechanisms of financial regulation and governance as a permissive basis for financial 'liberalization' echoes Vogel's (1998) 'freer markets, more rules' interpretation of the drivers and outcomes of (financial) liberalisation in advanced industrial economies.
4. For summaries and discussion of recent estimates see Elliott et al. (2015); Sheng and Soon (2016); Shih (2017).
5. Interview, Institute for Digital Finance (Beijing, September 2017)
6. For discussions surrounding this question, see Beeson (2009), Chen and Lees (2016), So (2016), Wong (2004).
7. That the CCP's willingness to accept lower headline growth rates and the current emphasis on 'quality' growth has surprised so many Western commentators is testament to this misconception of Chinese developmentalism.
8. There is considerable evidence as to the positive role of financial repression and close centralised political supervision of the financial system in driving China's economist growth. See Huang and Wang (2017), and Xu and Gui (2013) for recent discussions and summaries.
9. This had the further advantage of thus alleviating pressure from overheating property markets.
10. For deeper discussion of this distinction, see an FGI report by Sheng et al (2015).
11. Stiglitz (1993) reasons that at early stages of economic development, underdeveloped financial markets are often not capable of efficient financial capital allocation, and financial repression in the form of state intervention can promote confidence and enhance conversion of savings into effective investment. At a more advanced level of

financial development, in line with McKinnon's (1973) the effect of financial repression on economic growth becomes negative by virtue of less effective capital allocation and the emergence of moral hazard.

12. Whilst at the end of 2016 the Shanghai interbank rate was 3 percent, and the Wenzhou informal curb rate was 15 percent, the average P2P investment rate hovered around 10 percent (Huang and Wang 2017).
13. Referring to the three issues of 'peasantry, rural areas, and agriculture'.
14. Lin Nianxiu, vice chairman of the National Reform and Development Commission (NDRC) provided the most definitive statement of connection between inclusive finance and the *Internet Plus* plan (Lin 2016).
15. This passage is worth quoting at length. The book's lead author Xie Ping is one of the most respected senior financial policymakers in the Chinese financial system, and one of the leading proponents of the Chinese 'fintech revolution'.
16. We restrict our conception of 'full domestic financial liberalization' to interest rate marketisation and credit sector privatisation. Although other aspects of domestic reform such as bond and capital market development are important, we here focus on changes to the system of financial repression that has lain at the heart of China's developmental trajectory.

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