Review Article

CHINA & WTO REV. 2021:2; 411-416
http://dx.doi.org/10.14330/cwr.2021.7.2.09
pISSN 2383-8221 • eISSN 2384-4388

CWR
China and WTO Review

CONCEPTUALIZING THE REGULATORY THICKET: CHINA'S FINANCIAL MARKETS AFTER THE GLOBAL FINANCIAL CRISIS

By Wei Shen
(New York and Oxon: Routledge, 2021), 340 pages
ISBN: 9780367410537

Daile Xia* & Kuangran Li**

After the 2008 global financial crisis, China's banks fled the bogs far better than their counterparties in Europe, the US and Japan. China has achieved outstanding success in modernizing its banking sector and financial markets. The theory of law and finance generally acknowledges a close correlation between vibrant financial growth and a function of legal and regulatory system. But this theory may not apply to China. A group of scholars attributes China's success to its top-down Party-state model of "rule by law" scheme. This book intends to thoroughly examine China's financial regulatory system in the first decade after the global financial crisis, and provide insights to China's market liberalization and economic development. This author indicates that China's current regulatory system on financial market is still restrictive and mainly government-dominated. To further promote the development of financial markets and market economy, more market-led reforms to regulatory system and the expansion of the markets are needed.

Keywords: Global Financial Crisis, China's Financial Market, State-Owned Banks, Financial Regulatory System, Market Liberalization

* Assistant Professor of Law at Shanghai University of Finance and Economics Law School, China. LL.B.(ECUPL), LL.M. (Columbia), LL.M. & Ph.D (Peking). ORCID: https://orcid.org/0000-0001-6190-8838.The author may be contacted at: xia.daile@mail.shufe.edu.cn/Address: No.777 Guoding Road, Shanghai 200433, P. R. China.

** Ph.D. candidate at Shanghai Jiaotong University Law School; China. LL.B. (ECUPL), LL.M. (McGill & Boston U.). The author may be contacted at: kr.lee@sjtu.edu.cn/Address: No.1954 Huashan Road, Shanghai 200030 P. R. China.

In the first decade after the 2008 global financial crisis, China's success in overcoming financial crisis and maintaining its economic development as a whole is indisputable in the limelight, especially compared with those developed economies which are still struggling to recover from the economic recession after the financial crisis. The support from the financial sector was an undeniably significant factor for China's economic recovery. At the first glimpse, as the Chinese financial system is prosperous, its economy is booming. The banking sector made a successful turn. The Big Four banks did much better than their Western counterparties in terms of profitability and equity return ratio, while they were on the edge of technical bankruptcy almost 20 years ago. Statistics shows the nonperforming loan problem seemed to be perfectly resolved.[1] As new forms of financing like P2P lending marketplaces and shadow banking institutions thrive, China's financial market is more open than before as the WTO Agreement required.[2]

Traditional theories may be difficult to explain how the colossal nonperforming loans (NPLs) were resolved without affecting the China's financial stability, as the Chinese financial system is dominated by state owned banks. How did the state-owned system fight against the low efficient regime? Are there any hidden troubles in the way to the prosperous future?

This book, written by Professor Wei Shen at Shanghai Jiatong University, is the first research monograph systemically reviewing China's financial market in the first decade after the global financial crisis. Just as the preface states, Professor Shen tries to solve these puzzles in this book through scrutinizing the legal grounds of each financial sector, including multi-tiered capital market, state-owned banks, private banks, foreign invested banks, private lending market, P2P lending market and shadow banking in China.

The author examines the regulatory framework, regulatory objectives, logics, instruments, failures, and responses in China's financial markets. He provides enormous number of references in this book which may help readers understand the political economy of China's financial regulatory system deeply and broadly including the real market players.

Examining the regulatory interplay carefully, the author has found that the old burdens that caused the dilemma of the state-owned banks in the early 2000s were actually not solved, but shifted to other sectors to be difficult to detect and solve. In other words, the inefficiencies and risks remained unsolved through the so-called "multi-tiered capital market approach"[3] and were deeply embedded in the Chinese financial system, just like being hidden deeper in the jungle. Meanwhile, without a real functional market and rule of law, this mercantile approach could result in systematic risks.

This book is also dealing with the so-called financial innovation trilemma, which refers to that "clear rules, market integrity, and financial innovation cannot exist simultaneously, and only two out of these three goals can be achieved."[4] Recent financial innovations in Chinese financial system are successful in some sense, at least on its face evidenced by the number of largest unicorn companies of China. In the beginning, the government showed an encouraging attitude, leaving market player enough room to explore and grow. However, economic functions of these innovations soon were distorted from the regulatory idea as market players finally began to use these innovations to circumvent regulatory restrictions. When regulators realized the risks shifted to the new areas due to regulatory arbitrage, strict regulatory tools would have a hard landing to declare the end of financial innovation. In this regard, China's regulatory framework has little tolerance to financial innovation as financial risk is often cited as a legitimate ground to have a ring-fence of state-owned financial sector.[5]

To completely solve these technical problems reflected at the micro-level, the author suggests to go to the causations at the macro-level because China's current regulatory system covering financial markets is risk-oriented and government-dominated.[6] The author further maintains that a more market-led reform to regulatory system is necessary for the purpose of promoting the development of financial markets and equipping SMEs with more funds.[7] However, market-led reforms may be opposite to the government's ideology because "market-oriented economic reform and competition ... may be detrimental to China's political structure or stability."[8] As a result, regulatory reforms are distorted to use "more liquidity for economic growth" through financial markets.[9]

A key contribution, among others, this book made is to reveal the black box of the Chinese financial system. Devils are in every aspect. The author provides rich details in this book to show the conflicts between the market and the government, and between the local government and the central government. Revealing the motivation of each (market, political or economic) player, the author shows the landscape of China's financial system together with regulatory failures to readers (both insider and outsider) clearly.

Both materials and perspectives offered by this book are fresh. The author has caught new developments in Chinese financial market, including interest-rate reforms, pilot private bank, new open-up policy of the banking sector, P2P lending marketplace, debt-for-equity swap, among others.[10] The author further introduces a systemic perspective to review China's financial system, keeping an eye on the connections of each section, so that he has detected the movement of cashflow, market demand and corresponding risks in different sectors.[11] This approach covers the interactions between the financial system and economic institutions on a legal ground. The explanations and solutions provided by the author are coherent.

According the author, behind the rosy picture, old problems that dragged Chinese commercial banks down more than 20 years ago still exist in China's financial system and the transition from a planning to market economy is still far from the end. It is highly recommended for those who seek to understand the China's market economy, financial system and tangled regulatory policies to read this book. Professor Shen finally urges the continuation of market-based reform, pinpointing the "disguised" success of China's banks.[12]

Through the extensive use of cases, diagrams and web materials, this book is more friendly and attractive to the readers who hope to understand the landscape of Chinese financial markets clearly. It will serve as a channel for a comprehensive study on China's tangled regulatory policies and complex financial system, including, but not limited, to state-owned banks, private banks, foreign invested banks, private lending market, P2P lending market and shadow banking, the internationalization of renminbi and recent financial regulatory policies. It will be a valuable reference for those who are interested in Chinese lessons and experience of financial reforms. The book covers the first decade after the global financial crisis. It would be interesting to see how China's financial market and financial system evolve along with the global market and global financial regulation especially given the COVID-19 pandemic and the ongoing US-China trade war. This can be the author's follow-up topic of the future book.

Received: May 15, 2021
Modified: July 15, 2021
Accepted: Aug. 15, 2021

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11. *Id*.
12. *Id*. at 174.