

RESEARCH ARTICLE

## Financialization and Enhancement of State Resource Mobilization Capacity

Liu Changxi<sup>1</sup> , Gui Yong<sup>2</sup> , Yu Qin<sup>3</sup> 

### Abstract

From the financial perspective, this article discusses how China as a developmental government enhances its state capacity under the condition of market economy. Through constructing an analysis framework between financialization and the enhancement of state resource mobilization capacity, this article attempts to systematically discuss the core mechanism that China applies to strengthen state control and resource mobilization ability through the leading financial system. Through facilitating the growth of key financial organizations, appointing shareholding of important financial organizations and senior managers, to mold the economic and political preference of senior managers of financial organizers, control and guide the regulations of the financial market, China has realized its supervision over financial system. Thus, under the effect of financialization mechanism, double-track system of interest rate, state's capacity of controlling and mobilizing resources has been enhanced. It is believed in this article that, under the state-led financialization model, finance has its unique mechanism in enhancing state capacity, which is of great significance to understanding state developmentism.

**Keywords:** Developmental government • Financialization • State capacity

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### Introduction of the Question

Since the reform and opening up in 1978, China has made tremendous development achievements and has now become the world's second largest economy and the largest manufacturing country. Behind the miracle of China's development is the role played by the government, which is called a "developmental government" in the academic community. This theory is used to explain the East Asian economic miracle, emphasizing that the government sets development goals and industrial policies, and mobilizes limited resources to implement the catching-up strategy (Johnson, 1982). However, for China and Japan that observe developmentism, the roles of their governments are highly different in economic development. Japan pursues classical developmentalism, while China adopts new developmentalism (Gao, 2006).

For a country like China with a vast territory and a large population, how to unify into a whole and organize it in a way that can promote rapid economic development is a major challenge for the government (Riskin, 2013). In the era of planned economy, the Chinese government controlled all economic resources to achieve development goals. In terms of practice, the rapid economic development has not been achieved, on the contrary, it has fallen into a dilemma. Since the reform and opening up, China has adopted a development model that is fundamentally different from neoliberalism and classical developmentism. Since the 1980s, neoliberalism has gradually emerged, advocating marketization and globalization, restricting, weakening or even abandoning the government's function of intervention to economy (Yang, 2015). From this theoretical perspective, China's development focuses on the impact of China's gradual implementation of market reforms and opening up. But a fact that can be observed is that, although China has gradually moved towards marketization and become more integrated into the world, in the past 40 years, the country's role in the economy is not a linear withdrawal as a "small government", but an increasing main force of economic development. Compared with Japan's classical developmentalism, China far surpasses Japan in terms of attracting foreign investment, domestic market development, market allocation of resources, encouraging participation in the global division of labor, and strengthening economic growth (Gao, 2006). Compared with the planned economy, the proportion of resources directly controlled by the government is getting lower and lower, but the government's capacity to mobilize powerful resources for economic development is getting higher and higher.

Judging from China's development experience, the government and the market are not in opposition, but in mutual-construction. In China's economic development, national capabilities, especially the ability to mobilize resources, have been improved, and in turn have become a driving force for economic development. How does China's developmental government grow its capabilities under market economic conditions? This is a question worth exploring. Why does market-oriented reform bring about the

enhancement of state mobilization capability? This forms a theoretical paradox. In the view of people who uphold market transformation theory, market reforms will inevitably bring about the reduction of state capacity and the expansion of market capacity (Nee & Victor, 1989). As a matter of fact, the state and the market are not diametrically opposed, and the relationship between marketization and the state is manifested in diverse forms. Some scholars have discussed the enhancement of the central government's resource control capability from the perspective of the fiscal system. They believe that the tax-sharing system has realized the transition from fiscal decentralization to fiscal centralization, and institutionally guarantees the advantages of the central fiscal revenue in the entire fiscal revenue distribution and economic distribution (Liu et al., 2014; Qu et al., 2009). Some scholars also discussed the transition mechanism from "state decline and development of private capital" to "state development and decline of private capital" from the perspective of the state-owned enterprise system, thus realizing the improvement of state control and resource mobilization capabilities (Yuan, 2012). Finance and state-owned enterprises are indeed an important mechanism for improving state resource capacity. In addition, finance is also an important mechanism for the improvement of state resource capacity. Because of the permeability and covertness of finance to the improvement of state resource capacity, it has gained less attention from scholars. This article believes that the financialization of the state by leading the marketization of the financial field is an important mechanism for strengthening the state's control and mobilization capabilities.

From the financial perspective, this article discusses how China as a developmental government enhances its state capacity under the condition of market economy. This article is divided into five parts: The first part puts forward the research question of how China improves the state mobilization capacity in the process of marketization reform; the second part builds the analysis framework of financialization and state mobilization capacity improvement; the third part specifically analyzes China's marketization and finance process; the fourth part explores the mechanism of finance to strengthen the country's capacity to control and mobilize resources; the last part compares the government's role in different types of financialization and the unique mechanism that finance enhances the country's mobilization capacity compared to finance and state-owned enterprises.

## **Framework of Analysis**

### **Developmental Government and State Capacity**

In the 1960s and 1970s, the economies of Japan, South Korea, and Taiwan of China experience economic take-off and high-level development. The theory of developmental state emerged in response to the right time and conditions, which emphasized the mode

of effective government intervention in the economy. The developmental government's strong intervention in the economy stems from its specific elements, including bureaucracy, political system, and organizational structure that are conducive to promoting the economy. The developmental government has a huge and not highly paid team of bureaucratic elites with outstanding management talent (Johnson, 1982). The bureaucracy is highly consistent, compact, and cohesive (Evans, 1998). In terms of political systems, officials have certain levels of governance to ensure its effective performance (Johnson, 1982); in terms of system characteristics, it is manifested as a strong government, implementing a model of "political authoritarian" and "economic intervention"; in terms of governance goals, economic development is counted as a priority goal, and the government has some autonomy in formulating industrial policies. The developmental government has strong autonomy, and the strong government model enables the government to have the ability to mobilize economic resources and deploy social resources to support economic development goals.

Focusing on the two characteristics of government intervention in the economic intensity and economic development as the priority, China meets the positioning of a developmental state. However, based on the political system and specific institutional arrangements, the role of the Chinese government in economic development has shown great particularity. With the same strong resource mobilization power of a developmental government, China is different from other developmental countries in terms of the ways and means of mobilizing resources.

China has implemented market-oriented reform for 40 years since the reform and opening up. The reform is divided into multiple stages. In the early stage of reform, China adopted a "strong government-weak market" model. During the period from December 1978 to October 1984, the government implemented the policy of "planned economy as the mainstay and market regulation as the supplement." The overall pattern of the planned economy system remained unchanged, and the role of market regulation was slightly expanded. From January of 1984 to 1991, a dual-track system of coexistence of planning and market was implemented. The power of the market grew larger, but it was still regulated by the government. From 1992 to 2008, the reform of the relationship between the government and the market entered a new stage, which backed market development. Under a series of institutional arrangements, China's market has experienced rapid development, and market mechanisms have been established, becoming the basic force for the allocation of social and economic resources; since 2008, market has played a supporting role in the proactive fiscal policy and moderately loose monetary policy. The market has shown sustained and strong vitality, and the relationship between the Chinese government and the market has shown the characteristics of "strong government-strong market". In the process of reform, the Chinese government's intervention in the economy has been mighty in any stage.

Seemingly, market power has been on a linear increase. In fact, each stage of reform is accompanied by the government's reform of the system and the improvement of the system, which brings about adjustments in the relationship between the government and the market. The adjustment has not weakened the government's capacity to mobilize resources to intervene in the economy.

China's economic boom has benefited from the role of local governments. The reason of the function of local governments is that after the reform and opening up, the central government has implemented power decentralization to local governments, and local governments assume key responsibilities in promoting regional economic development and social management. However, power decentralization doesn't mean weakening of concentration of power. Beginning in the 1990s, marked by the tax-sharing system reform implemented in 1994, the central government has achieved "soft centralization" through the strengthening of the tax-sharing system and vertical management (Yu & Gao, 2012). The fiscal decentralization system demands local governments to be responsible for their own profits and losses. Local governments actively participate in economic development based on profit-seeking to increase local fiscal surpluses (Oi, 1992). Besides, the vigorous development of Chinese township and village enterprises and land finance are the products of this system reform. As a result, China's unique "local development-oriented government" has been formed, that is, "a government model that aims to promote economic development, takes long-term responsibility for economic development as the main method, and regards economic growth as the main source of government legitimacy" (Yu & Xu, 2004). The institutional arrangement for the expansion of the autonomy of local governments in economic development is called "fiscal federalism with Chinese characteristics" (Montinola et al., 1995). However, local governments are "the economic embodiment" as well as the "political embodiment". The central government achieves absolute control over the localities by controlling personnel and cadre appointment rights. Local behaviors must be interfered and guided by the central government. This institutional arrangement is called "decentralized authoritarianism" (Landry, 2008). In considering the promotion of local officials, local economic growth performance is particularly emphasized. This "political championship system" (Zhou, 2008) not only strengthens the central government's control over local governments, but also encourages local governments to promote economic development.

As a prototype of developmental government, China's political system and institutional arrangements endow the government with strong resource mobilizing ability. This ability is especially revealed in the mobilization of institutional resources, economic resources, and cultural resources. Among them, the ability to mobilize economic resources plays a vital role in state development. The case of China's economic growth is a significant embodiment of the state's capacity of mobilizing

economic resources. For industrialized countries, economic mobilization capacity may affect the country's legitimation capacity and political control capacity. The stronger the country's capacity in public absorption, the higher its degree of legitimacy and the more likely it is for the state to exercise effective control. The state mobilizes and obtains economic resources mainly through the following ways: the first method is that the state obtains taxes through the fiscal system, the second method is that the state obtains economic resources through the financial system, and the third method is that the state uses a variety of non-tax means to obtain the profits of various departments (Ma, 2011). In the modern state system, taxation and finance are two mainstream ways for the country to mobilize economic resources (Zhou, 2003). Whether the country can absorb appropriate economic resources through taxation and finance will affect the realization of governance goals of modern states.

### **Financial Means and State Capacity**

For a state, resource mobilization can be realized through two means, taxation and finance. The academic community shows more concern for taxation, while neglecting the boosting effect of finance to state capacity. Compared with taxation, financial means has its own characteristics in terms of preconditions, resource allocation mechanisms, operating costs and possible profit space, and potential social risks.

First, taxation depends on the establishment and improvement of the taxation system, while finance depends on the financial system. Taxation is a form by which the state uses political power to compulsorily distribute certain social products and obtain fiscal revenue without compensation in accordance with legal regulations (Zhu & Lu, 2017). If a state intends to levy taxes compulsorily, free of charge, and fixedly, it must have a taxation system, and on this basis, it is possible to draw certain economic resources from the society. Whether financial means can be effectively implemented is related to the importance of finance in economic development. When finance occupies a large proportion of various economic activities and economic operations are increasingly dependent on the financial system, the state can apply financial means to promote the realization of development goals. Different from the systematic taxation policies, a state should establish a special channel including a series of financial tools to ensure efficient operation of finance.

Second, taxation means are public, while financial means are relatively covert. Taxation is a systematic targeted distribution mechanism. The allocation of resources realized in the whole society presents a localized and field-specific zero-sum game relationship; financial means are relatively covert, and it is a cycle and matching mechanism of economic resources (Chen, 2017), the allocation of resources in the two dimensions of time and space is more flexible, and the social resource allocation relationship caused by finance presents the characteristics of a global and seemingly non-zero sum game.

Different from the resource allocation role played by taxation, finance is more covert. Both the resource allocation process and its results are covert. First, finance can transfer and redistribute social wealth. Certain groups and sectors of the financial system can obtain more wealth through finance through specific financial instruments and financial systems. Second, finance can realize socialization of cost. After finance has become the dominant resource allocation system, certain departments can socialize costs through financial means. For example, financial institutions in many countries are often “big but not down”. This is related to the status and influence of such institutions in the economic system. The government often mobilizes various resources to pay for the mistakes of these institutions. Third, some departments can obtain special competitive advantages through finance. Finance is very powerful in gathering resources across time, space, and departments. If a department can obtain continuous resource input, then it can easily gain a competitive advantage that other departments cannot match.

Third, the cost of taxation means is high with smaller amount of resources mobilized, low cost of financial mean, and a huge amount of resources mobilized. The political and social costs of operating taxation methods are relatively high, and the volume of taxation is relatively fixed. A state has limited room to benefit from taxation; the political and social costs of operating financial means are relatively low, and the potential volume of finance is actually very large, so there is considerable room for the state to benefit from the financial system. Finance absorbs the economic resources held by the people into the financial system through the establishment of a credit market. Through the trading activities of financial institutions and market entities, the scale of financial assets can be expanded, and the value of financial assets can be enlarged. The government only needs to maintain corresponding control power over financial institutions and financial markets, it would be very convenient to draw social resources through financial channels, and due to the wide range of financial objects and the complexity of financial operation mechanisms, it is difficult to see the diluted interests of individuals. Therefore, the contradictions between social members and the state will not be prominent in a short period of time, and social conflicts are easily resolved. The political cost and social cost of the state’s financial means are lower. From the perspective of the country’s possible benefit gaining space: taxation, as the main source of state fiscal revenue, is mainly affected by the level of economic development (Guo & Lv, 2004). In the case of a country’s stable economic development, tax revenue is unlikely to fluctuate greatly, and tax revenue is limited for the government. The case of finance is not the same. By means of over-issuance of currency, the issuance of national debt, and the replacement of local debt, the state can draw more socio-economic resources while diluting the wealth of the people. The financial system has greater operating space to create revenue, and financial revenue is rich in expansibility. The state has more room for gains through the financial system.

Fourth, the possibility of systemic risks caused by taxation is relatively small, and the potential systemic risks brought by financial means are huge. Improper operation of taxation means and financial means may lead to social conflicts, making society unstable and increasing the possibility of social disorder. However, the potential social risks brought by the two means are different. The improper taxation methods of the state will cause a wide distribution of social risks, and the risks develop gradually. When instability develops to a certain level, explosive social conflicts may break out in small quantities. Finance may trigger a one-off nuclear conflict, which has a more serious impact on society.

### **State-led Financialization and State Capacity**

Due to the convenience and concealment of financial means and the effectiveness of drawing resources, it is more possible for a state to adopt financial means. Especially when a state's financialization continues to deepen and finance has become the central system of the economy and society, a state will consciously and unconsciously adopt financial means to a greater extent.

The condition for financial means to take effect is that the state is becoming more and more financialized, and profits are increasingly concentrated in the financial sector, and the financial sector has increasingly highlighted its dominant position in the national economy (Epstein, 2006). Since the 1970s, the western economic system has undergone three major changes: neoliberalism, globalization and financialization, of which financialization is the dominant force (Foster, 2007).

The result of financialization is that finance has become the central system of the economy and society, and resources have been concentrated in the financial field. But who is beneficial to this kind of resource concentration not only depends on the result of market competition, but also belongs to the political and social structure of financialization. Logically speaking, there are two types of financialization: interest group-led financialization and state-led financialization. Whether the financialization of a country is led by interest groups or by the state is not the result of free choice. Political and social structures constrain the financialization of the state. Interest group-led financialization means that interest groups play a leading role in the process of financialization, and the group acquires special benefits. For example, after the global financial crisis in 2008, the Occupy Wall Street movement broke out in the United States. The protesters' slogan was "We represent 99% of society, and we no longer endure the 1% greed and corruption." It is thus clear that the biggest beneficiaries of American financialization are financial groups represented by Wall Street. State-led financialization means that the state plays a leading role in the financialization process and becomes the core of the financial system. Through financialization, the state's ability to control and mobilize financial resources is enhanced.



In the process of increasing global financialization, the level of financialization in China is getting higher and higher. As far as China is concerned, its financialization has typical state-led characteristics. The state applies financial means to mobilize and draw economic resources in a covert manner. The mechanism for state-led financialization to enhance state governance capabilities is: First, through market-oriented reforms, various economic entities are activated to create more economic resources. Market-oriented reforms have brought about various motives and opportunities to create wealth, and have achieved leapfrog economic growth. In particular, the continuous advancement of marketization in the financial sector has promoted the financial system to become the center of the economic system. Second, resources are gathered in the financial system through financialization mechanisms. Financialization has realized the control and mobilization of various economic resources, and its ability to control and mobilize resources far exceeds conventional mechanisms such as finance. Third, through the state's control over the financial system, various resources are brought into the track of achieving economic development goals. This shows that the state's ability to control and mobilize resources has actually improved rather than weakened. The state has gained greater capabilities through financialization.

Without doubt, whether the financialization of a country is led by interest groups or by the state is not the result of free choice. Although there are rational choices, it is more restricted by the entire political and social structure. In the process of China's financialization, the government is at the core of the financial system and can mobilize more financial resources for national development.

### **Financial Marketization and State-led Financialization**

The financial system has its uniqueness in China, and China's financialization path is different from that of Western countries. Before the reform and opening up, finance was basically in a dispensable position in the entire economic system. After the reform and opening up, especially after a series of market-oriented reforms in the middle and late 1990s, the status of finance gradually became prominent.

### **Financial Marketization and Financialization**

Before the reform and opening up, China's finance was basically completely suppressed. There was only one bank, People's Bank of China in the whole country, which only undertook simple deposit and loan business, mainly serving the government and state-owned enterprises, and heavily dependent on finances. After the reform and opening up, although a number of state-owned commercial banks have been established to strengthen their commercial banking nature, China's financialization had basically not started until the mid-1990s.

A series of financial system reforms in the mid to late 1990s laid a solid foundation for financialization. The first is to emphasize the independence reform of the central bank. The *People's Bank of China Law* promulgated in 1995 aims to strengthen the central bank's role in macro-control and financial supervision. The implementation of this law has laid down basic rules for financial development and laid the foundation for development. The second is the shareholding reform and independence reform of state-owned commercial banks to strengthen the attributes of these banks as commercial banks. The shareholding reform of state-owned commercial banks endowed them with the impulse to pursue profits. At the same time, the independence reform has also allowed state-owned commercial banks to change their status as subordinate to local governments and improve the control of the headquarters over branches, so that they can better formulate and implement bank development strategies. Third, through exchange rate reform to let the banks deeply get integrated into the globalization process.

On the basis of these institutional reforms, China's financialization process has been accelerating in the past ten years, and a large amount of resources have been concentrated in the financial field, and finance has increasingly become the central system of China's economy.

### **The Central Position of Finance: The Main Manifestations of China's Financialization**

1. From the perspective of M2/GDP indicators, the degree of monetization of China's economy has ranked among the top in the world.

Economic monetization refers to the proportion of goods and services traded in currency in a country's national economy in its total output and its changing process. The financial influence is first expressed in the form of currency. M2/GDP is usually used to measure the degree of economic monetization. As shown in the figure below, since the reform and opening up, the degree of China's economic monetization has continued to deepen. From 1978 to 2019, the ratio of M2/GDP rose from 0.24 to 2.02<sup>1</sup>.

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1 Calculated based on relevant data on the website of World Bank.

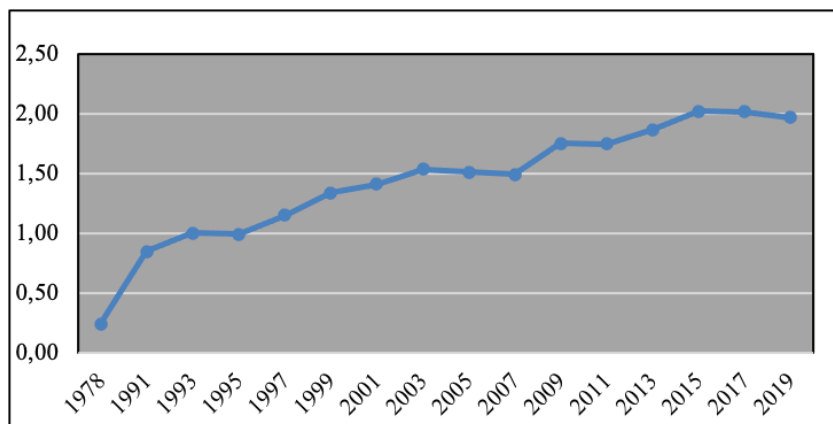


Figure 1. The changing trend of proportion of M2/GDP in China<sup>2</sup>

Compared with developed countries, China's economic monetization has exceeded that of developed countries in Europe and the United States, as well as emerging market economies. Taking the proportion of M2/GDP in 2011 as an example, the value of China is 1.8, that of Eurozone is 1.73, that of the United Kingdom is 1.66, that of the United States is 0.87, that of India is 0.78, that of Brazil is 0.74, and that of Russia is 0.53. China's economic aggregate is only one-third of that of the United States, but its currency is 1.5 times that of the United States.<sup>3</sup>

2. From the perspective of financial market size and total financial assets, the status of finance in the economy is constantly rising

An important indicator for financialization is the amount of resources that the financial system can gather. The size of the financial market and the proportion of GDP are used to measure the amount of resources gathered in the financial system. Specifically, this article calculates the size of the financial market with the total amount of credit funds used each year, stock transactions, bond transactions, futures transactions, and fund transactions, and then divides the current year's GDP by this value. The larger the proportion means the more resources the financial system gathers. As shown in the figure below, from 1998 to 2017, the ratio of financial market size and GDP increased from 2.04 to 9.21. Since 1998, this ratio has experienced a leaping increase, and has since risen in turbulence, reaching as high as 16 in 2015. Although there are statistical errors, this indicator reflects to a certain extent that the status of finance is constantly improving, and it is increasingly able to gather large-scale resources<sup>4</sup>.

2 Calculated based on relevant data on the website of World Bank.

3 Calculated based on relevant data on the website of World Bank.

4 Calculated based on relevant data on the website of World Bank.

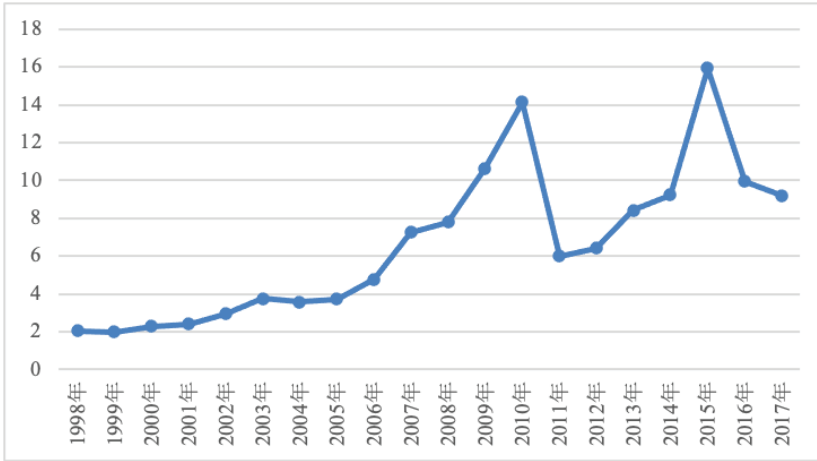


Figure 2. The changing trend of the financial market size of China and proportion of GDP in China.<sup>5</sup>

Financial assets are also a good indicator of the ability of finance to gather resources. Studies have shown that China’s total financial assets have increased from 341.75 billion yuan in 1978 to 191099321 billion yuan in 2010, with an increase of nearly 559 times. The average annual growth rate of total financial assets is much higher than that of GDP. The total domestic financial assets and GDP rose from 94.6% in 1978 to 496.6% in 2006. Later, due to the impact of the financial crisis, the value fell to 302.5% in 2008, which was the lows in recent years; in the following two years, it passed 400% mark again, reaching 405%. From 1978 to 2010... the growth rate of the financial superstructure was 4.5 percentage points faster than the growth rate of the real economy.” (Ba & Huang, 2013).

3. From the perspective of profitability, the profitability of the financial industry is much higher than that of the non-financial industry

The profit rate of an industry is an important manifestation of the competitiveness and influence power of an industry. In the first half of 2019, A-share listed companies achieved a total net profit of 2.14 trillion yuan. Among them, the financial industry’s net profit reached 1.14 trillion yuan, and in the financial industry, the four major banks’ net profit was 550 billion yuan. Since 2008, the operation revenue of the five state-owned commercial banks accounted for about 6% of the total top 500 companies, but their total profits accounted for about 30% of the total top 500 companies (Lu, 2013).

4. From the perspective of residents’ asset composition, the proportion of financial assets continues to rise

<sup>5</sup> Calculated based on relevant data on the website of World Bank.

The composition of residents' assets also reflects the importance of various assets in residents' wealth to residents to a certain extent. Since 2004, the proportion of residents' physical assets has gradually declined, while residents' financial assets have gradually increased. This shows that the impact of finance on residents is gradually increasing. Studies have shown that by the year 2017, the ratio of household debt to disposable income in China was as high as 107.2%, which has exceeded the current level in the United States and is even closer to the peak before the US financial crisis (Tian et al., 2018). As of the end of 2018, the scale of real estate among Chinese residents' wealth was approximately RMB 325.6 trillion, accounting for 70% of total residents' assets, while the scale of financial assets was approximately RMB 139.5 trillion, accounting for 30%.<sup>6</sup> In fact, real estate, which accounts for 70% of residents' total assets, essentially has strong financial attributes.

### State-led Financialization Process

The mechanism of financialization is to promote finance to become the central system of the economy and to promote the concentration of various resources in finance. In the financialization process in China, the state plays a leading role. Through the state's dominance of the financial system, not only can it directly obtain more financial resources, but it can also indirectly control and mobilize more financial resources.

The state's dominance of the financial system is mainly reflected in the following three aspects:

First of all, it is reflected in the strong support for core financial institutions to make them continue to grow. From the perspective of China's current financial system, bank occupies a core position in the entire financial system, and the four major state-owned commercial banks stands at an advantageous position. At the end of 1990, when the four major state-owned commercial banks were facing the dilemma of "technically bankrupt", the state successively established the four major asset management companies to divest the non-performing assets of the four major state-owned commercial banks, and incurred huge costs for this. At the same time, it also injected capital into the four major state-owned commercial banks to supplement the capital adequacy ratio. On this basis, by introducing strategic investors, improving the corporate governance structure of banks, and finally the state urged most of them to be listed, so as to obtain financial support.

Secondly, it is reflected in the equity holdings of important financial institutions and the appointment of senior managers, so that the senior managers of these financial

6 Data come from the research report of Jiang Chao, Li Jinliu and Song Songxiao: *The era of real estate speculation is drifting away, increase allocation of financial assets: the current situation and comparison of residents' wealth allocation*. August 19.

institutions have dual economic and political preferences. State-owned financial institutions are a major part of the entire financial system and are in a monopoly position to some extent. These financial institutions have a strong motivation to maximize profits. Therefore, with the support of the government, they enjoyed favorable conditions, and had more development opportunities than private financial institutions. At the same time, through institutionalized control, the resources controlled by these state-owned financial institutions can be controlled and mobilized by the state to a certain extent.

This is once again reflected in the state's control and guidance of financial market rules. The financial market is basically one of the most strictly controlled markets in China. From interest rates to market access, China has a set of strict rules. Especially in the bank-dominated financial system, the state has not only shaped the profit-seeking motives of banks through a series of capitalization reforms of banks, but also led to the formation of institutionalized preferences for state-owned enterprises and government loans.

### **Financialization and Enhancement of State Resource Control and Mobilization Capacity**

From the perspective of financialization, China's financialization is also a part of global financialization. Since the 1970s, the global financialization process led by the United States has been started. The rise of Wall Street's ability and status brought about by the financialization of the United States is called "Wall Street rules the world", while the financialization of China has brought about the improvement of state capacity. And what is the mechanism?

### **Financialization Mechanism: Great Improvement of Government's Capability of Directly Acquiring Financial Resources**

Financialization mechanism refers to the improvement of the government's ability to control and mobilize resources through financial means. In the past decade or so, with the acceleration of the financialization process, China's fiscal financialization mechanism has been mainly manifested in two aspects: one is that the central government obtains seigniorage through the dominant currency issuance rights, thereby achieving an increase in fiscal revenue; the second is that the government has improved its financing capacity through the financial market.

Due to the huge difference in the face value of currency printed currency, the central bank obtained a huge amount of capital income through currency issuance, that is, seigniorage income. This income is transformed into the fiscal revenue of the central government in the form of central bank profits. Therefore, the central bank has let the

government hold a huge wealth of resources by monopolizing the currency issuance power. In related studies at home and abroad, due to the controversy over the definition of seigniorage, the calculation caliber is also quite different. As shown in the figure below, since 2002, the total currency seigniorage has increased from 172.04 billion to 111.934 billion.

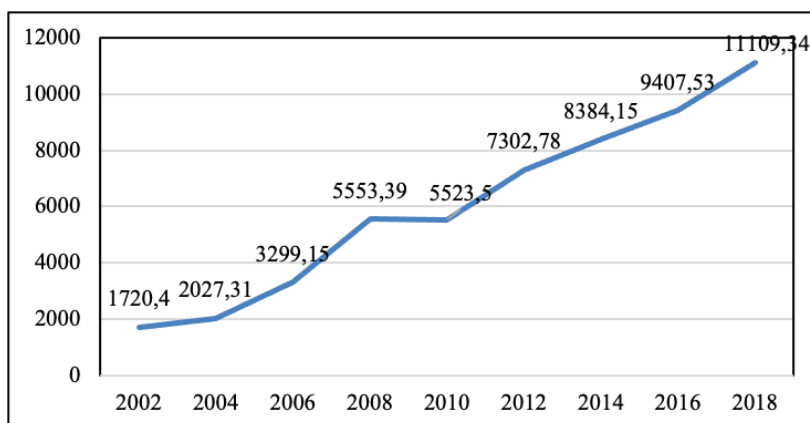


Figure 4. Seigniorage change trends since 2002 (Lu & Zhu, 2014).

National debt is a special credit and debt relationship formed by the central government as the main debtor by taking advantage of state credit. From 1994 to 2018, China's debt balance increased from 228.64 billion to 14.960741 billion, with an increase of 65 times.

With the acceleration of financialization, governments at all levels have greatly improved their ability to obtain financial resources in the financial market, thereby making up for the rigid constraints of fiscal revenue. The ability and methods of local governments to obtain financial resources in the financial system have also undergone major changes. "Before 1994, local governments had strong control over the local branches of state-owned banks. Governments at all levels often use their dominance over commercial banks to force commercial banks to provide loans for government investment projects" (Liu et al., 2014), which is called the "second finance." In the past two decades, the bank-led financial system has grown rapidly, and the financial resources that governments at all levels have truly obtained from the financial system have experienced hypernormal increase. According to public data from the Ministry of Finance, the total amount of local explicit debt in 2017 was 16.5 trillion. Chinese scholars generally estimated the total amount of local hidden debt in 2017 to be between 30 and 50 trillion yuan (Bai, 2018; Zhang et al., 2018).

## **Dual-track Interest Rate System: The Improvement of the State-owned Sector's Ability to Obtain Financial Resources**

In the past decade or so, state-owned institutions (including state-owned financial institutions and state-owned non-financial institutions) have all reversed the dilemma of bankruptcy in the 1990s, and their asset scale and profitability have greatly increased. Other than the above-mentioned state-owned banks, the state-owned enterprises of other categories have also enjoyed rapid growth. “In 2018, the total assets of state-owned enterprises (excluding financial enterprises) nationwide were 210.4 trillion yuan, and the total liabilities were 135.0 trillion yuan, and the total state-owned capital equity was 58.7 trillion yuan. Among them, the total assets of central state-owned enterprises are 80.8 trillion yuan, the total liabilities are 54.7 trillion yuan, the total state-owned capital equity is 16.7 trillion yuan, and the average asset-liability ratio is 67.7%. The total assets of local state-owned enterprises are 129.6 trillion yuan, the total liabilities are 80.3 trillion yuan, the total state-owned equity is 42.0 trillion yuan, and the average asset-liability ratio is 62.0%.”<sup>7</sup>

State-owned institutions not only “rejuvenated”, but also achieved rapid growth by leaps and bounds. The hidden reason is related to a series of state-owned enterprise reforms carried out by the state. “In the mid to late 1990s, the central government adopted a series of institutional reforms for the capitalization of state-owned enterprises. On the one hand, state-owned enterprises were transformed into profit-seeking micro-economic entities, becoming the main body that controls economic resources.... In terms of effects, the capitalization reform of state-owned enterprises has achieved the expected goals. Since 2004, China has changed from the original “state decline and development of private capital” to “state development and decline of private capital”, and a large amount of economic resources started to gather in state-owned enterprises” (Liu et al., 2014).

On the other hand, it is inseparable from the fact that state-owned institutions can obtain more financial resources at lower costs and higher opportunities. For an enterprise, its development mainly depends on two aspects: one is to obtain market recognition through its products or services; the other is to continuously obtain the funds required for rapid growth. Due to the existence of the dual-track interest rate system, state-owned institutions can obtain funds for development at a lower cost. The dual-track interest rate system refers to the deposit and loan interest rates (the upper limit of deposit interest rates and the lower limit of loan interest rates) determined by the central bank and the currency and bond market interest rates determined by the market. It is found through research that the upper limit of deposit interest rate has long been lower than the equilibrium level (He & Wang, 2011). For banks, the dual-

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7 Data come from Comprehensive report of the State Council on the management of state-owned assets in 2018. <http://www.sasac.gov.cn/n2588025/n2588119/c12390466/content.html>.



track interest rate system enables banks to obtain huge profits through deposit and loan spreads. For state-owned enterprises, the ability of obtaining funds at an interest rate lower than the equilibrium level of the market is equivalent to obtaining subsidies through financial means in disguised form. Meanwhile, due to the bank's incentive mechanism, banks prefer state-owned enterprises when lending. Therefore, related research shows that, the interest rates and financing costs of state-owned enterprises are much lower than private enterprises (Liu & Zhou, 2011).

### Foreign Exchange Reserve Growth Mechanism: An Increase in the Ability to Obtain International Resources

Foreign exchange reserves refer to claims in foreign currencies held by the government of a state. The amount of foreign exchange reserves determines to a certain extent a country's ability to obtain resources in the world economic system. With the acceleration of financialization in China, China's foreign exchange reserves have undergone a change from "shortage" to "huge sum". As shown in the figure below, before 1994, China's foreign exchange reserves were at a relatively low level. After 1994, it entered a stage of continuous growth. After 2002, it entered a stage of accelerated growth. China has become the world's largest foreign exchange reserve country.

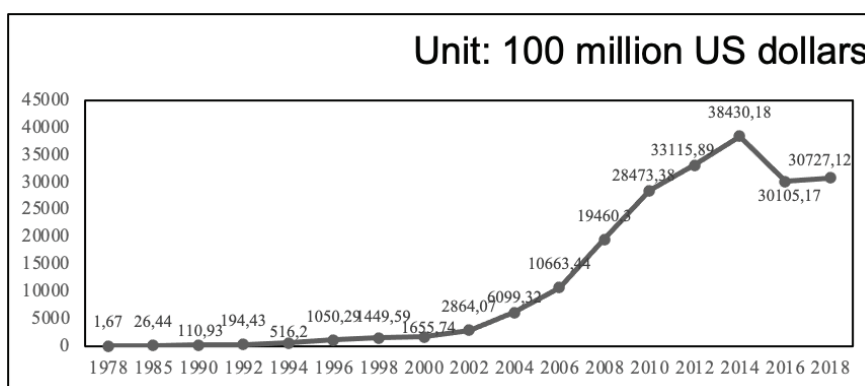


Figure 5. Change of foreign exchange reserve of China since 1978.<sup>8</sup>

### Dual Preference Mechanism: Enhancement of Indirect Resource Mobilizing Ability

As mentioned above, through state-led financialization, the state's direct control and mobilization capabilities have been enhanced. At the same time, because the dominant financial institutions have the attributes of state-owned enterprises, they

<sup>8</sup> The data are based on relevant data from the National Bureau of Statistics website and relevant data from China Statistical Abstract 2020.

have both economic and political preferences. One is that through capitalization reform, these state-owned financial institutions have greatly enhanced their profit motives, and they will take advantage of the special status granted by the state to achieve extraordinary development in the market. The second is that these state-owned financial institutions with economic preferences also have political preferences, consciously or unconsciously subject to the overall political situation. The state always demands the cooperation of these financial institutions when achieving its specific goals. For example, after the 2008 financial crisis, China introduced a 4 trillion stimulus plan, and the four major state-owned commercial banks backed up their requirements to cooperate with the implementation. After that, these state-owned commercial banks were fully lending loans, and their loan experienced extraordinarily rapid growth.

## Discussion

### State-led Financialization and State Capacity

This article analyzes the improvement of China's national resource mobilization ability from a financial perspective. The influence of state-led financialization and interest group-led financialization on the country's ability to mobilize resources is essentially different, depending on the government's position and power in the financial system.

The financial system is a social structure, and the positions and powers of different types of actors vary greatly. In the power structure of the financial system, different actors are usually unequal due to historical, institutional and market reasons (Liu et al., 2020). Although the government is an important actor in the financial systems of all countries in the world, its influence varies greatly. In the financial system dominated by interest groups, the government often plays the role of a "referee". Even the governments of some countries cannot perform their supervisory functions well. In China's financial system, the government plays a unique role.

First, the government not only holds the core financial power in the financial system. The central government has the lead in determining currency issuance, interest rates, and exchange rates, which are core financial rights. The central government impose influence on the operation of financial system and power structure through such power. In the past four decades, capital has been a very scarce market element. In order to reduce the capital cost of economic growth, China has long adopted financial repressive policies that are lower than market interest rates. Through the financial system, the low interest rate policy converts national savings into project investment funds at a reduced cost, laying the foundation for the rapid economic growth. As a matter of fact, it is a systematic way in which the depositor subsidizes the investor (fund demander).

Second, the government has a strong lead in allocating financial resources. On the one hand, China's financial system is dominated by financial state-owned enterprises, which are more compliant with national development goals. On the other hand, through market-oriented reforms, financial state-owned enterprises will actively cooperate with the development strategies of the central and local governments for organizational benefits. In the course of economic growth, the cultivation of some industrial advantages and regional development advantages can not do without financial support. In order to achieve rapid economic growth, China has adopted an investment-driven growth model. While the financial system accumulates resources, investment entities can obtain financial resources at a lower cost. Meanwhile, governments at all levels are also important investment entities. The financial resources directly and indirectly controlled by the government have made important contributions to the realization of economic growth.

### **The Unique Mechanism of Financialization and the Enhancement of State Capacity**

Finance, fiscal policy, and state-owned enterprises have jointly promoted the improvement of the state capacity to control and mobilize resources from three aspects, but the mechanism by which finance enhances national capabilities is relatively fundamental and unique.

First, finance plays a more fundamental role in the improvement of state capacity. As mentioned earlier, through the fiscal financialization mechanism, the central fiscal capacity has been further enhanced after the tax-sharing system reform. In the sectors that fiscal policy hardly functions, finance plays an even more important role. Fiscal capacity is subject to taxation, which is difficult to exceed taxation capacity. The role of finance is precisely that it can realize value conversion across time and space, so it can drive resources far beyond finance. An important support for the improvement of the capabilities of state-owned enterprises is the financial system. The reform of state-owned enterprises in the 1990s or the continuous expansion and strengthening of state-owned enterprises in the past two decades cannot be achieved without the financial support. From the perspective of financial reform in the 1990s, the state aims to obtain more resource support for economic construction by improving the central position of finance in the entire economic system.

Second, the improvement of state capacity by finance is more concealed and permeable. Financial revenue and expenditure have clear targets, and the value and benefit distribution are very clear. Finance is relatively hidden when it comes to value conversion and benefit distribution. There is no clear subject for who benefits from it and who suffers from it. Meanwhile, the impact of finance is not as obvious and specific as fiscal policy and state-owned enterprises, but more permeable. For example, through

finance, the interests that span time and space can be transformed, and the interests of cross-groups can be reshaped, and the specific objects of benefits and losses are not as clear as the fiscal method.

Third, the enhancement mechanism of the three states capacity, finance, fiscal policy, and state-owned enterprises supplement each other. The improvement of fiscal and state-owned enterprise capabilities has further intensified financialization, which further enhanced fiscal capabilities and state-owned enterprise capabilities. Although finance, fiscal policy, and state-owned enterprises strengthened each other and together led to the formation of a resource-concentrated state governance, this is a coincidence or an unexpected consequence of many key institutional changes, not the result of intentional arrangements.

Compared with other means, such as fiscal policy, the use of financial means to achieve the enhancement of the ability to control and mobilize resources has more space of operation, it still produced many negative effects. For example, local debt has played a major role in the process of industrialization and urbanization in various parts of China. At present, due to its large scale, potential financial risks cannot be ignored.

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