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Should The Proud Dragon Repent? A Relative Theory for China's State Capitalist Banking Sector Based On East Asia's Experience

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Should The Proud Dragon Repent? A Relative Theory for China's State Capitalist Banking Sector Based On East Asia's Experience

YUEH-PING (ALEX) YANG*

Abstract

Amidst the U.S.-China trade war, China's banking sector, the backbone of China's economy, plays a key role in this battle. China's banking sector, however, poses a puzzle to contemporary studies of state-owned banks ("SBs"). According to the property right theory, the mainstream SB theory, SBs are negative for the financial and economic development of an economy because it is susceptible to more serious agency problems, excessive political intervention, and conflict of interest between state regulators and state owners. That said, the economic success of China, whose banks are mostly owned and controlled by the Chinese party-state supports the development theory, a minority theory that highlights the development function of SBs in mobilizing domestic investible funds to support strategic industries.

To have a clearer understanding of China's banking sector, I engage in the debate between the property right theory and the development theory by comparing the experience of four East Asian developmental states, Japan, South Korea, Taiwan, and Singapore. After comprehensively reviewing the banking evolution in these economies, I put forward a "relative theory" to account for SBs. I argue that the relative success and failure depends on the relative efficiency of the state sector vis-à-vis the private sector in promoting development. In the early stage of an economy's development, the private sector might have collective action problems to come up with a coherent development policy for the economy; hence, the state sector is relatively better positioned in allocating the investible fund, and its ownership of banks thus promotes development. Nevertheless, as an economy develops and the

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corresponding institutions mature, the private sector might become relatively more efficient in allocating the investible fund, which demands the state to reduce its intervention in the banking sector. According to this relative theory, the success of China's SBs in promoting economic development might not be sustainable. At some point, the Chinese party-state would need to readjust its role. That said, this does not necessarily lead to the privatization of SBs in China. As East Asia's experience suggests, there may be a variety of ways for China to transition to a banking system that is less dominated by the party-state. The current trade war might offer this turning point as it evolves into a finance war.

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I. Introduction

The U.S.-China trade war has gradually evolved into a finance war. Trade sanctions adopted by the United States not only impacted directly on the trade performance of Chinese business sectors but also threatened the stability of China's financial sectors indirectly. The near-bankruptcy of Zhongxing Telecommunication Equipment Co. ("ZTE") in 2018 after the United States banned its companies from selling hardware and software to ZTE illustrated the financial impact of the trade war on Chinese enterprises.[1] After several bankruptcy cases emerged in China in 2018, the Supreme People's Court of China also warned that the trade war might lead to a bankruptcy wave among Chinese enterprises.[2] As the risk of corporate bankruptcy escalates, the threat to Chinese commercial banks, the major creditors of China's corporate sectors, has also become increasingly real. Industrial and Commercial Bank of China ("ICBC"), China's largest bank, admitted in 2018 that the trade war had the potential of threatening the bank stability.[3] Recently, the United States has started to aim at China's banking sector even more directly. In 2019, the District Court for the District of Columbia found three large Chinese commercial banks in contempt because they refused to comply with subpoenas in investigating violations of North

1. Jeb Su, How *The U.S. Export Ban Effectively Bankrupts China's Telecom Giant ZTE*, FORBES (Apr. 17, 2018), https://www.forbes.com/sites/jeanbaptiste/2018/04/17/how-the-u-s-export-ban-effectively-bankrupts-chinas-telecom-giant-zte/#1b744041720c; Claire Ballentine, *U.S. Lifts Ban That Kept ZTE From Doing Business With American Suppliers*, N.Y. TIMES (July 13, 2018), https://www.nytimes.com/2018/07/13/business/zte-ban-trump.html.

2. Sidney Leng, *Many Chinese Companies 'Will Go Bankrupt', If US Delivers on Tariff Threats, Court Newspaper Warns*, SOUTH CHINA MORNING POST (July 25, 2018), https://www.scmp.com/news/china/diplomacy-defence/article/2156810/many-chinese-companies-will-go-bankrupt-if-us-delivers.

3. Engen Tham & Shu Zhang, *China's Top Bank ICBC Flags Trade War Risks as Profits Rise*, REUTERS (Aug. 30, 2018), https://www.reuters.com/article/us-icbc-results/chinas-top-bank-icbc-flags-trade-war-risks-as-profits-rise-idUSKCN1LF1W3; Evelyn Cheng, *Beijing is Holding Firm, but Many Chinese Firms Acknowledge They're Worried About the Trade War*, CNBC (Sept. 12, 2018), https://www.cnbc.com/2018/09/12/us-china-trade-war-many-chinese-firms-acknowledge-business-worries.html.

Korean sanctions,[4] and the U.S. Court of Appeals upheld the fines.[5] Considering that this action can cut off these Chinese banks from the U.S. financial system, it has the potential to cause a panicking effect on China's banking system. In sum, as the U.S.-China trade war escalates, China's financial sector might gradually become the next battlefield.

China's financial sector, featuring a gigantic banking sector dominated by the Chinese party-state,[6] can be resilient or fragile. Backed by the party-state, Chinese commercial banks are less susceptible to market panics and runs. The party-state's leadership can further coordinate Chinese commercial banks to rescue troubled sectors and prevent financial turbulence. In 2019, China Banking and Insurance Regulatory Commission ("CBIRC"), China's banking and insurance regulator, directed Chinese commercial banks to support the under-financed rural areas.[7] People's Bank of China, the central bank of China, also indicated that it would coordinate China's large SBs to finance leading securities firms to support China's non-banking financial sector.[8] These instances illustrate the coordinating and rescuing functions of a banking system dominated by the party-state. That said, the high leverage in China's economy casts doubts on the capability of the Chinese party-state in supporting China's economy. After all, China's total stock of corporate, household, and government debt has neared 304

4. Spencer S. Hsu, *Chinese Bank Involved in Probe on North Korean Sanctions and Money Laundering Faces Financial 'Death Penalty'*, WASH. POST (June 24, 2019), https://www.washingtonpost.com/local/legal-issues/chinese-bank-involved-in-probe-on-north-korean-sanctions-and-money-laundering-faces-financial-death-penalty/2019/06/22/0ccef3ba-81be-11e9-bce7-40b4105f7ca0_story.html.

5. Spencer S. Hsu, *In First, U.S. Appeals Court Upholds Contempt Fines Against Three Chinese Banks in North Korean Sanctions Probe*, WASH. POST (July 30, 2019), https://www.washingtonpost.com/local/legal-issues/in-first-us-appeals-court-upholds-contempt-fines-against-three-chinese-banks-in-north-korean-sanctions-probe/2019/07/30/18585108-ae38-11e9-8e77-03b30bc29f64_story.html.

6. For studies on China's party-state-dominated banking sector, see Yueh-Ping (Alex) Yang, *Crouching Tigers and Hidden Dragons on the Great Wall Street: Decoding the Corporate Governance of Chinese Commercial Banks*, 28(1) WASH. INT'L L.J.1 (2019) [hereinafter "*Crouching Tigers and Hidden Dragons*"]; Yueh-Ping (Alex) Yang, *The Cloud for Dragons and the Wind for Tigers: Bank Governance Reform in China and an Executive-Based Proposal*, 24(2) STAN. J.L., BUS. & FIN. 47 (2019) [hereinafter "*Cloud for Dragons and Wind for Tigers*"].

7. Norihiko Shirouzu & Yilei Sun, *China Banking Regulators Tell Banks to Boost Support for Rural Economies*, REUTERS (Mar. 10, 2019), https://www.reuters.com/article/china-economy-loans-rural/china-banking-regulators-tell-banks-to-boost-support-for-rural-economies-idUSL3N20X04N.

8. Liang Hong & Denise Jia, *China Urges Big Brokerages to Support Smaller Non-Banks*, CAIXIN (June 18, 2019), https://www.caixinglobal.com/2019-06-18/china-urges-big-brokerages-to-support-smaller-non-banks-101428013.html.

percent of its gross domestic product ("GDP") in the first quarter of 2019, which might keep climbing as the trade war continues.[9] More troublingly, because the party-state intervenes in the lending decision of commercial banks for long, which compromises the loan quality, the rescuer itself might need to be rescued when the economy goes down. In 2019, several Chinese commercial banks went into financial troubles: In May, Baoshang Bank became the first bank failure case in China over the past two decades, leading to CBIRC's takeover. Later on, Bank of Jinzhou, a Hong Kong-listed bank, encountered liquidity risks, leading to the suspension of the trading of its shares in Hong Kong. Heng Feng Bank, one of the twelve national banks in China, further went into restructuring due to the credit crisis.[10] These instances alarm the Chinese party-state that the cracks in the armor might be appearing.

To better understand the strength and weakness of China's banking sector, the theories of SBs can shed us more lights. SBs have received more attention in the post-financial-crisis era. For one thing, the Global Financial Crisis of 2007-2008 (the "Global Financial Crisis") highlighted the countercyclical function of SBs. Much literature has devoted to examining how the state can use SBs to maintain credits during an economic recession and prevent cyclical credit crunches.[11] For another, bank bailouts adopted by the Treasury of the United States heated the discussion.[12] To provide

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9. Amanda Lee, *China's Total Debt Rises to Over 300 Per cent of GDP as Beijing Loosens Borrowing Curbs to Boost Growth*, SOUTH CHINA MORNING POST (July 7, 2019), https://www.scmp.com/economy/china-economy/article/3018991/chinas-total-debt-rises-over-300-cent-gdp-beijing-loosens.

10. Orange Wang, *China's Small Banks Still Struggling to Obtain Funds to Lend Three Months After First Bank Failure in 20 Years*, SOUTH CHINA MORNING POST (Aug. 15, 2019), https://www.scmp.com/economy/china-economy/article/3022948/chinas-small-banks-still-struggling-obtain-funds-lend-three.

11. *See e.g.*, Martin Cihak & Asli Demirguc- Kunt, *Rethinking the State's Role in Finance*, 13-15 (World Bank Pol'y Res., Working Paper No. WPS 6400, 2013); Ata Can Bertay et al., *Bank Ownership and Credit over the Business Cycle: Is Lending by State Banks Less Procyclical?* (World Bank Pol'y Res., Working Paper No. WPS 6110, 2012); Eva Gutierrez et al., *Development Banks: Role and Mechanisms to Increase their Efficiency*, 8-9 (World Bank Pol'y Res., Working Paper No. WPS 5729, 2011). *See also* Alejandro Micco & Ugo Panizza, *Bank Ownership and Lending Behavior*, 93 ECON. LETTER 248 (2006); Eduardo Levy Yeyati et al., *A Reappraisal of State-owned Banks*, 7(2) ECONOMIA 209, 224, 231-32 (2007).

12. For related debates about the government ownership of banks in the U.S. context, see J. W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice*, 27:2 YALE J. ON REG. 283 (2010); Marcel Kahan & Edward B. Rock, *When the Government is the Controlling Shareholder*, 89 TEX. L. REV. 1293 (2011); Barbara Black, *The U.S. as "Reluctant Shareholder:" Government, Business, and the Law*, 5:2 ENTREPRENEURIAL BUS. L.J. 561 (2010); Benjamin A. Templin, *The Government Shareholder: Regulating Public*

additional liquidity to credit markets and prevent failures of systemically important financial institutions, the U.S. Congress established the Troubled Asset Relief Program ("TARP") in October 2008,[13] which resulted in the Treasury's equity injection[14] of around $205 billion into 707 financial institutions.[15] The concession of the United States, the leader of the liberal camp, to state ownership of banks during the Global Financial Crisis evidences the practical importance of SBs.[16]

Contemporary studies, however, generally discredit SBs. The property right theorists argue that state-owned enterprises ("SOEs") incur more serious moral hazard problems and agency problems than private firms[17] and thus suspect that the state can operate SBs efficiently. Specifically, they have three major concerns. First, SBs incur more serious agency problems because they are owned by the government which is essentially owned by all taxpayers and thus have the most dispersed ownership structure and most serious separation of ownership from control problem.[18] Second, SBs

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Ownership of Private Enterprise, 62:4 ADMIN. L. REV. 1127 (2010); Matthew R. Shahabian, T*he Government as Shareholder and Political Risk: Procedural Protections in the Bailout*, 86 N.Y.U. L. REV. 351 (2011); Marcel Kahan & Edward B. Rock, *When the Government is the Controlling Shareholder: Implications for Delaware*, 35 DEL. J. CORP. L. 409 (2010); Saule T. Omarova, *Bank Governance and Systemic Stability: The "Golden Share" Approach*, 68(4) ALABAMA L. REV. 1029 (2017); Yueh-Ping (Alex) Yang, *Government Ownership of Banks: A Curse or a Blessing for the United States?*, 10(3) WILLIAM & MARY BUS. L. REV. 667 (2019).

13. For an introduction to the U.S. government's investment under the TARP, see HAL S. SCOTT & ANNA GELPERN, INTERNATIONAL FINANCE: TRANSACTIONS, POLICY, AND REGULATION 78-82 (21st ed., 2016).

14. Kahan & Rock indicated that the TARP originally aimed at stabilizing the financial system by authorizing the Treasury to engage in purchase of troubled assets from troubled financial institutions, but the Treasury took advantage of the broad definition of "troubled assets" to obtain the entitlement to purchase shares of troubled financial institutions. Kahan & Rock, *supra* note 12, at 1309-10. Shahabian also reviewed legislative history and suggested that Congress, when passing the TARP, intended equity purchase to be only a secondary tool to toxic assets purchase. Matthew R. Shahabian, *supra* note 12, at 357-58.

15. U.S. Department of the Treasury, Capital Purchase Program, http://www.treasury.gov/initiatives/financial-stability/programs/investment-programs/cpp/Pages/capitalpurchaseprogram.aspx (last visited Aug. 18, 2019).

16. *See* IAN BREMMER, THE END OF THE FREE MARKET: WHO WINS THE WAR BETWEEN STATES AND CORPORATIONS? 21-22 (2010).

17. Related literature often cites Armen Alchian as the leading proponent of the property right theory. *See generally* Armen A. Alchian, *Some Economics of Property Rights*, 30 II POLITICO 816 (1965). For other literature following this line, see Enrico Perotti, *State Ownership: A Residual Role?* (World Bank Pol'y Res., Working Paper No. 3407, 2004).

18. *See generally* Armen A. Alchian, *Some Economics of Property Rights*, 30 II POLITICO 816 (1965). For a summary of the agency problems intensified in GOBs, see I. Serdar Dinc,

typically implicate political intervention under which politicians influence SBs to serve their interests instead of public ones.[19] Third, the government acts as both the regulator and owner of SBs and thus have conflicting interests which prevent it from providing a level playing field for all banks.[20]

China, however, challenges the wisdom of contemporary studies. Compared with the United States and the European Union, which were seriously hit by the Global Financial Crisis, China's economy was relatively successful. Between 2010 and 2018, the world's GDP grew by US$ 19.75 trillion, of which China contributed US$7.52 trillion, or 38 percent of the world's growth.[21] Parallel to its economic success, China has maintained an authoritarian party-state regime dominated by the Chinese Communist Party ("CCP").[22] CCP heavily dominates China's economy through the so-called "state capitalism" model.[23] This model also extends to China's banking sector. Most major Chinese banks are under the state's ownership. As of spring 2019, among the fifty largest domestic commercial banks in China,

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Politicians and Banks: Political Influences on Government-owned Banks in Emerging Markets, 77 J. FIN. ECON. 453, 454 (2005).

19. *See generally* Jacob Yaron, *State-owned Development Finance Institutions (SDFI): Background, Political Economy and Performance Assessment,* at 10-14, http://www.iadb.org/res/publications/pubfiles/pubs-492.pdf (2004).

20. Gutierrez et al., *supra* note 11, at 4-5.

21. World Bank Open Data, *GDP – World & China*, https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=2018&locations=1W-CN&start=2010 (last visited Aug. 18, 2019).

22. For a comprehensive discussion of the CCP's influence in China's political regime, see RICHARD MCGREGOR, THE PARTY: THE SECRET WORLD OF CHINA'S COMMUNIST RULERS (2010). To be sure, by using the term "party-state," I do not suggest that CCP is a unitary party system which has only one voice from the top. CCP's party system is complicated. The central party system contains different factions pursuing different values and interests. The central party system also possesses different horizons with the local party system, and the former cannot always discipline the latter. Each local party system also pursues different local interests and often competes with each other. For a discussion of how the different factions within the CCP affect China's monetary policies, see VICTOR SHIH, FACTIONS AND FINANCE IN CHINA: ELITE CONFLICT AND INFLATION (2008).

23. *See, e.g.*, Li-Wen Lin & Curtis J. Milhaupt, *We are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, 65 STAN. L. REV. 697 (2013); Li-Wen Lin, *State Ownership and Corporate Governance in China: An Executive Career Approach*, 3 COLUMBIA BUS. L. REV. 743 (2013); Curtis J, Milhaupt & Wentong Zheng, *Beyond Ownership: State Capitalism and the Chinese Firm*, 103 GEORGETOWN L.J. 665 (2015). *See also* BENJAMIN L. LIEBMAN & CURTIS J. MILHAUPT EDS., REGULATING THE VISIBLE HAND? THE INSTITUTIONAL IMPLICATIONS OF CHINESE STATE CAPITALISM (2015) [hereinafter REGULATING THE VISIBLE HAND]. For a thorough introduction to the state capitalism around the world, see BREMMER, *supra* note 16.

only two do not have state controlling shareholders.[24] Taken together, it appears that SBs do not compromise China's economic development.

China explains its relative success by a faction of conventional development economics which offers a development theory for SBs. According to this theory, when a state cannot create a friendly environment for private investment, direct state ownership of production can substitute.[25] Specifically, for countries where under-developed economic institutions hinder private banks from supporting economic growth, the state's ownership of banks can fill the gap and improve the general welfare.[26] This developmental account of SBs provides theoretical support for China's repeated claims that the party's leadership is necessary for developing China's economy.[27]

In this paper, I propose a relative theory to harmonize the property right theory and the development theory and account for the partial success and upcoming challenges of China's SBs. I argue that the success of China's SBs might contain a temporal element, depending on the relative strength and weakness of private sectors vis-à-vis state sectors in developing China's economy. In the early development stage of an economy, the state sector perhaps mobilizes the development more efficiently. Nevertheless, as an economy develops, the state's relative advantage would gradually decline while its relative disadvantage becomes more prominent. When the critical intersection arrives, reducing the state's intervention and leaving more space to private sectors would become more efficient. Hence, it is a matter of finding a balance between the state and private sectors. China's success by far might reflect efficient use of the state sector in its earlier phase of development, but this may be unsustainable. At some point, China will need

24. They are China Minsheng Bank and Ping An Bank.

25. *See, e.g.*, Andrei Shleifer, *State versus Private Ownership*, 12:4 J. ECON. PERSP. 133 (1998); Joseph E. Stiglitz, *The Role of the State in Financial Markets, in* THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT 19 (World Bank, 1994).

26. After the Global Financial Crisis, academics also take note of the countercyclical role of SOBs. *See generally* Martin Cihak & Asli Demirguc- Kunt, *Rethinking the State's Role in Finance*, 13-15 (World Bank Pol'y Res., Working Paper No. WPS 6400, 2013); Gutierrez et al., *supra* note 11, at 8-9. Ata Can Bertay et al., *Bank Ownership and Credit over the Business Cycle: Is Lending by State Banks Less Procyclical?* (World Bank Pol'y Res., Working Paper No. WPS 6110, 2012).

27. *See, e.g.*, People's Congress, Decision regarding the Outline of the Thirteenth Five-Year Plan on National Economy and Social Development (第十二届全国人民代表大会第四次会议关于国民经济和社会发展第十三个五年规划纲要的决议), Chapter 2 (Mar. 16, 2016); The Standing Committee of People's Congress, Working Report (全国人民代表大会常务委员会工作报告), para. 4(3) (Mar. 9, 2016).

to readjust the party-state's role in the banking sector, and the U.S.-China trade war might trigger this point.

To support the proposed relative theory, I employ a comparative method based on the experience of four East Asian economies. Before China emerged, East Asia was the region of "economic miracles" which produced the most astonishing growth after World War II.[28] Japan was the most prominent example, whose strong economic performance in the 1980s amazed the world at a similar level with current China. Other than Japan, South Korea, Taiwan, Hong Kong, and Singapore all delivered impressive economic performance during this period.[29] More importantly, except for Hong Kong, these East Asian economies did not belong to the neoliberalist camp.[30] Instead, they achieved economic success by adopting the unorthodox model of "developmental states" featuring a mix of market economy and heavy governmental intervention.[31] The government's control of finance is a particularly important element for it to exert influence over the investment pattern of their economies and guide sectoral mobility.[32] The cases of these East Asian neighbors, similar to China, supported the development theory for SBs.

Nevertheless, the later development of these East Asian developmental states also cautions against the sustainability of the SB model. After the

28. WORLD BANK, THE EAST ASIAN MIRACLE: ECONOMIC GROWTH AND PUBLIC POLICY (1993).

29. *See infra* Section III.B.

30. RODRIK, *supra* note 79, at 18-20.

31. *See generally* Meredith Woo-Cumings, *Introduction: Chalmers Johnson and the Politics of Nationalism and Development, in* THE DEVELOPMENTAL STATE 1 (Meredith Woo-Comings ed., 1999); HA-JOON CHANG, THE EAST ASIAN DEVELOPMENT EXPERIENCE: THE MIRACLE, THE CRISIS AND THE FUTURE (2006). In an abstract, developmental states possess the following characteristics. First, there is an *interventionist state* that is neither socialist nor free-market, but a plan-rational capitalist developmental state conjoining private ownership with state guidance. Second, *nationalism* is a motivation, at least in East Asia's practice, to the extent that these states face challenges from Western imperialism and use economic development to ensure their national survival. Third, *the state partners with business sectors* by formulating broad economic plans, identifying the means for implementing it and ensuring competition in designated strategic sectors.

32. Woo-Cumings, *id*. at 10-13. Other important elements include: First, the state is governed by a group of *elite state bureaucracy* which is capable and less captured by social interest groups. Second, the state develops the economy largely through *industrial policies*, under which the state designates specific sector for prioritized development, invests in capital to finance it and creates a friendly business environment to support it. Third, the state's *trade policies* also help developing its economy, in particular through the protection of the infant industry and the promotion of export. Fourth, the state's *competition policy* is managed in the sense that the state is concerned about excessive and destructive competition and thus deliberately creates an oligopolistic market structure to exploit scale economy.

splendid performance in the 1980s, they all experienced economic turbulence in the 1990s. The government's domination of the banking system was also under attack. In response, all four economies more or less reduced the government's intervention in banking systems in the 1990s and 2000s.[33] These instances evidence that even though the SB model may facilitate the initial development, it is difficult to sustain for good.[34] Drawing lessons therefrom, China should not over-claim the relative success of its SB model, especially when it is about to proceed to the next level of development. The recent slowdown of economic growth and the accelerating banking risks in China are sending the warning signal.

That said, the experience of East Asian developmental states offers a variety of ways to reach state-private balance in the banking sector. Each of Japan, South Korea, Taiwan, and Singapore adopted different approaches to transition toward a banking system that is less dominated by the government, which range from regulatory reforms, ownership privatization, market entries, to management professionalization. Depending on its economic and political backgrounds, China can develop its SB reforms to pursue development while controlling the negatives of concern to property right theorists. Specifically, privatization is not the only way forward: observers should not judge China's reform efforts solely based on if it engages in ownership privatization.

This paper can contribute to comparative finance and corporate governance literature in at least three aspects. First, it analyzes the potential benefits and challenges of Chinese SBs, which facilitates a better understanding of China's banking sector. Second, it puts forward a perspective for observing the banking evolution in East Asia which features the developmental state model. This lays down a theoretical framework for future envisagement of an East Asian financial theory. Last but not least, it harmonizes the debate between the property right theory and the development theory by proposing the relative theory as a middle ground. This theoretical intervention offers a more balanced and accurate account of the pros and cons of the SB practice.

I will structure this paper as follows. In Section II, I will introduce the SB practice in China to exhibit the theoretical debate between the property right theory and the development theory under the current SB studies. In

33. *See infra* Section IV.A.

34. Dani Rodrik offered an accurate observation of the developmental state model. While the unorthodox tools employed by the developmental states may help to reach growth in the infant stage of an economy, these tools might not be sustainable. To sustain growth, it requires more extensive institutional reform, such as independent judiciaries, stabilizing fiscal policy, political democracy, financial supervision, etc. In the end, the state's intervention has to exit gradually to move the economy forward. RODRIK, *supra* note 79, at 13-55.

Section III, I put forward the first half of the relative theory to illustrate how SBs can promote economic development in the early stage of an economy by reviewing the SB practice of four East Asian economies in their early development phases. In Section IV, I proceed to the second half of the relative theory to illustrate the challenges faced with by SBs as the economy develops, again, by reviewing the transition adopted by the four East Asian economies in the 1990s. Section V is the conclusion. Overall, the proposed relative theory cautions that the success of China's SB model is perhaps unsustainable. The Chinese party-state should learn from the Chinese classics and realize that a proud dragon, at some point, should repent.

II. State Ownership of Banks and the State Capitalist China

State ownership of banks is a controversial topic. Mainstream studies follow the property right theory and disfavor this practice. In recent years, however, the revised property right theorists seem to provide a more balanced account for the SBs. China's emergence further revives the long-forgotten development theory.

A. Contemporary Perception of State-Owned Banks

1. The Property Right Theory

Mainstream literature, based on the property right theory, disfavors the SB practice. Its rationale is simple: there is no guarantee that the government will benevolently and efficiently operate SBs. According to it, SBs entail at least three major problems.

First, SBs incur more serious agency problems. According to the property right theory, since SBs are owned by the government which is essentially owned by all taxpayers, they have the most dispersed ownership structure that entails the most serious separation of ownership from control.[35] Government officials in charge of SBs are thus subject to less supervision and incur more serious agency problems. They are also less capable of operating banks well because they typically have little business experience in banking. Therefore, SBs are inherently less efficient than private banks.[36]

35. *See generally* Armen A. Alchian, *Some Economics of Property Rights*, 30 II POLITICO 816 (1965). For a summary of the agency problems intensified in GOBs, *see* Dinc, *supra* note 18, at 454.

36. *See, e.g.*, James R. Barth et al., *Bank Regulation and Supervision: What Works Best?*, 13 J. FIN. INTERMEDIATION 205, 240 and 245 (2004); Alejandro Micco et al., *Bank Ownership and Performance: Does Politics Matter?*, 31 J. BANKING & FIN. 219 (2007).

Second, SBs incur political intervention. SBs are owned by the government which is operated and supervised by politicians, thus their activities are subject to politicians' influence. Since politicians typically care their interests, they will influence SBs to serve their interests instead of public ones.[37] For instance, it is empirically found that SBs tend to increase loans in election years, which is a product of the political intervention.[38] These political loans typically lack solid credit support and thus may easily become nonperforming and harm the safety and soundness of SBs. By extending loans to political cronies instead of productive projects, SBs also fail to invest their funds efficiently, resulting in financial repression in other productive sectors.[39]

Third, SBs also involve regulatory and competitive concerns. The government is both the regulator and owner of SBs and thus has conflicting interests that prevent it from providing a level playing field for all banks. For instance, to secure SBs' market power, the regulator might refuse private or foreign entry in the banking market, which leads to a less competitive banking market. In exercising its regulatory power, the government may also treat SBs nicer than private banks, resulting in regulatory forbearance and unfair advantage in favor of SBs.[40] These would all negatively affect the financial development of an economy.

Based on the above, the property right theorists argue that the potential advantages of SBs tend to be an illusion.[41] Mainstream empirical studies also appear to support the property right theory. The most influential piece came from La Porta et al. in 2002: based on data of SBs from 92 countries, they found that state ownership of banks in 1970 was associated with slower

37. *See generally* Jacob Yaron, *State-owned Development Finance Institutions (SDFI): Background, Political Economy and Performance Assessment,* at 10-14, http://www.iadb.org/res/publications/pubfiles/pubs-492.pdf (2004).

38. *See, e.g.*, Giuliano Iannotta et al., *The Impact of Government Ownership on Bank Risk*, 22 J. FIN. INTERMEDIATION 152 (2013); Dinc, *supra* note 18; Paola Sapienza, *The Effects of Government Ownership on Bank Lending*, 72:2 J. FIN. ECON. 357 (2004).

39. *See, e.g.*, Rainer Haselmann et al., *Real Effects of Bank Governance: Bank Ownership and Corporate Innovation* (CEPR, Discussion Paper No. DP7488, 2009).

40. Gutierrez et al., *supra* note 11, at 4-5.

41. For a further analysis of how the corporate governance weakness of SOBs appears in practice, see David H. Scott, *Strengthening the Governance and Performance of State-Owned Financial Institutions*, 3-4 (The World Bank, Fin. & Private Sector Dev., Fin. Systems Dep't, Pol'y Res. Working Paper No. WPS4321, 2007).

subsequent financial development and lower subsequent growth in per capita income.[42] Other studies during that period also reached similar findings.[43]

a. The Revised Property Right Theory

Recent literature, however, perceives SBs less negatively. According to the updated findings which I term as the "revised property right theory," the negatives of SBs as enumerated above can be controlled by some institutions of an economy. For instance, a competitive financial market can motivate government officials to run SBs efficiently because being outperformed by other banks might hurt their reputation and hinder their future promotion.[44] A transparent and uncorrupted political system can prevent government officials from tunneling the bank asset for political purpose and thus secure the operational efficiency of SBs.[45] According to the revised property right theory, the effects of SBs depend on the institutions of an economy, and developed economies tend to possess necessary institutions to control the negatives of SBs.

Several empirical studies lend support to this perspective. For instance, Rafael La Porta et al. themselves found that the negative effects of SBs were more significant in financially underdeveloped economies or economies with poor protection of property rights.[46] Marcia Million Cornett et al. found that SBs in East Asia performed more poorly than private banks in 1997 to 2000 (i.e., during the Asian Financial Crisis) but no longer the case in 2001-

42. Rafael La Porta et al., *Government Ownership of Banks*, 57:1 J. FIN. 265, 266 (2002).

43. *See, e.g.*, Gerard Caprio & Maria Soledad Martinez Peria, *Avoiding Disasters: Policies to Reduce the Risk of Banking Crises*, 25 (World Bank mimeo & Egyptian Center for Econ. Stud., Working Paper No. 47, 2000); James R. Barth et al., *Banking Systems Around the Globe: Do Regulation and Ownership Affect Performance and Stability?*, 27 (The World Bank Dev. Res. Group, Pol'y Res., Working Paper No. 2325, 2000).

44. Douglas W. Caves and Laurits R. Christensen, who compare the performance of government-owned Canadian railroads and private railroads in a competitive environment, find that both perform equally well. They explain this finding by arguing that market competition may have the ability to overcome inefficiency resulted from government ownership. Douglas W. Caves & Laurits R. Christensen, *The Relative Efficiency of Public and Private Firms in a Competitive Environment: The Case of Canadian Railroad*, 88:5 J. POL. ECON. 958, 958 (1980). Other literature also finds that government-owned firms may be as efficient as private firms in competitive environments, provided that there is sufficient competition between these two firms and that the government does not provide discriminative regulations and subsidies in favor of government-owned ones. Boardman & Aidan R. Vining, *Ownership and Performance in Competitive Environments: A Comparison of the Performance of Private, Mixed, and State-owned Enterprises*, 32 J.L. & ECON. 1, 7 (1989).

45. Tobias Korner & Isabel Schnabel, *Public Ownership of Banks and Economic Growth: The Impact of Country Heterogeneity*, 19(3) ECON. OF TRANSITION 407, 435 (2011).

46. La Porta et al., *supra* note 42, at 290.

2004 (i.e. after the crisis). They interpret this change as consistent with a life-cycle model, under which financial globalization brought about competition and thus pressured SBs to improve their banking policy.[47] Tobias Korner and Isabel Schnabel found that the negative effects of SBs found by La Porta et al. vanished in economies with highly developed financial systems and advanced political institutions.[48] At even higher levels of financial development, the effect of SBs even became positive and large.[49] These findings suggest that the potential negatives of SBs are controllable.

B. The State Capitalist China and Its Party-State-Dominated Banking Sector

Neither the property right theory nor the revised property right theory can explain China. China is one of the most successful economies in the world. At the same time, it maintains a banking system that is highly dominated by the party-state and claims that this system results in its economic success.

a. An Overview of China's Economy and Banking

Today, no one would ever underestimate the economic power of China. After four decades of super growth, China's gross domestic product ("GDP") has skyrocketed to US$13.61 trillion as of 2018, which accounted for 15.86 percent of the world GDP.[50] What makes China's economic success even more miraculous is its speed and constancy. In 1978, China's GDP was only US$ 147 billion, ranking tenth among world economies.[51] This represents more than 92 times of GDP growth in forty years. Moreover, China has maintained this rate of growth in a steady manner. Except for 1989 and 1990, for forty years China managed to maintain its GDP growth rate at above 5

47. Marcia Million Cornett et al., *The Impact of State Ownership on Performance Differences in Privately-owned versus State-owned Banks: An International Comparison*, 19 J. FIN. INTERMEDIATION 74 (2010).

48. *See generally* Korner & Schnabel, *supra* note 45. *See also* Svetlana Andrianova et al., *Government Ownership of Banks, Institutions and Economic Growth*, 79 ECONOMICA 449 (2012).

49. Korner & Schnabel, *supra* note 45, at 420-21.

50. World Bank Open Data, *GDP – China*, https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=2018&locations=CN-1W&start=1960 (last visited Aug. 18, 2019).

51. Classora Knowledge Base, *Ranking of the World's Richest Countries by GDP (1975)*, http://en.classora.com/reports/t24369/general/ranking-of-the-worlds-richest-countries-by-gdp?edition=1978&fields= (last visited Aug. 18, 2019).

percent.[52] This speedy and steady growth unsurprisingly made China a successful case from which other developing countries are eager to derive lessons.

In the course of China's economic growth, its commercial banks played an extremely crucial role. China's banking sector is the major funder of its economy.[53] In 2018, China's bank credits equaled for 161 percent of China's GDP, while in the United States this figure was only 52 percent.[54] In contrast, the market capitalization of listed domestic companies equaled for only 46 percent of China's GDP, while in the United States this figure was 149 percent.[55] As of June 2019, China's non-financial sectors received RMB 213 trillion of finance from the financial sector, of which loans accounted for 78.2 percent, corporate bonds accounted for 9.9 percent, and stock accounted for only 3.3 percent respectively.[56] Consequently, unlike the United States where economic activities obtain funds mainly from capital markets, China's economy heavily relies on banks.[57]

China's banking sector started to develop since the reform and openness in 1978.[58] At the end of 2018, the total assets of Chinese commercial banks had reached RMB 203.41 trillion.[59] This giant banking sector is comprised of four main types of banks: state-owned commercial banks ("SOCBs", with

52. World Bank Open Data, *GDP Growth – China*, http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=CN (last visited Aug. 18, 2019).

53. For an overview of China's overall financial system, see Franklin Allen et al., *China's Financial System: Growth and Risk*, 9:3-4 FOUNDATIONS AND TRENDS® IN FINANCE 197 (2015).

54. World Bank Open Data, *Domestic Credit to Private Sector by Banks – US & China*, https://data.worldbank.org/indicator/FD.AST.PRVT.GD.ZS?locations=CN-US (last visited Aug. 18, 2019).

55. World Bank Open Data, *Market Capitalization of Listed Domestic Companies – US & China*, https://data.worldbank.org/indicator/CM.MKT.LCAP.GD.ZS?locations=CN-US (last visited Aug. 18, 2019).

56. PBOC, *The Statistics Report of the Scale of Social Finance Stock as of June 2019* (2019年6月社会融资规模存量统计数据报告) (July 12, 2019), http://www.gov.cn/xinwen/2019-07/12/content_5408834.htm.

57. To be fair, China is not exceptional in this. Many advanced countries, such as Japan and Australia, adopt this bank-based model as well. In Japan, bank credits equaled for 108 percent of Japan's GDP in 2018; in 1998, this figure used to skyrocket to 196 percent. In Australia, this figure was 140 percent in 2018. World Bank Open Data, *Domestic Credit to Private Sector by Banks – Japan & Australia*, https://data.worldbank.org/indicator/FD.AST.PRVT.GD.ZS?locations=JP-AU (last visited Aug. 18, 2019).

58. For a comprehensive introduction to the banking evolution in China, see LI ZHI-HUI, DEVELOPMENT AND REFORM OF CHINA'S BANKING SYSTEM 12-17 (2012).

59. CBIRC, http://www.cbirc.gov.cn/cn/doc/9106/910601/C990691733D644B39582DEFA3EF1EF69.html (last visited Aug. 18, 2019).

46 percent market share by asset),[60] joint-stock commercial banks ("JSCBs," with 23 percent market share),[61] city commercial banks ("CCBs," with 17 percent market share),[62] and rural financial institutions (including rural commercial banks "RCBs"[63] and other rural banking institutions, together with 17 percent market share).

b.The Corporate Governance Model of China's SBs

While there is an increasing amount of studies on China's state capitalism and its implication with corporate governance, they mostly focus on Chinese SOEs.[64] Relatively fewer studies concentrated on the corporate governance of Chinese SBs,[65] the major financier of China's state capitalism. To fill this gap, in a separate paper, I conduct a comprehensive analysis of the corporate governance practice of Chinese SBs.[66] Below I briefly summarize these findings to give an overview of how China's state capitalism manifests in the banking sector.

The Chinese party-state dominates China's banking sector in at least three aspects. First, it is the ultimate owner of China's banking sector. Most major Chinese banks are under the state's ownership. Through the Central

60. SOCBs are the largest type of commercial banks in China. The majority of their shares are owned by the central government via either the Central Huijin Investment Company ("Central Huijin") or the Ministry of Finance ("MOF").

61. JSCBs are the national commercial banks that are not the SOCBs. The CCP approved their incorporation mostly during the late 1980s or 1990s to introduce market competition in the national banking market. They are mostly owned by SOEs or local governments.

62. CCBs refer to commercial banks incorporated based on city credit cooperatives. In the 1980s and 1990s, to develop the local economy, the Chinese government permitted the incorporation of city credit cooperatives to supply the finance. As these cooperatives exposed to heightened risks in the 1990s, the Chinese government approved their restructuring into CCBs to weather the local financial crisis. Most CCBs are owned and controlled by local governments and the associated local party system.

63. RCBs refer to local commercial banks which are required to extend a certain portion of their loans to local peasants, agriculture, and economic development of rural villages. CBRC, TEMPORARY REGULATIONS ON ADMINISTRATION OF RURAL COMMERCIAL BANKS (农村商业银行管理暂行规定), arts. 2 & 46 (Ch.). Most RCBs are owned and controlled by local governments and their associated local party systems.

64. *See e.g.,* Lin & Milhaupt, *supra* note 23; Lin, *supra* note 23; Milhaupt & Zheng, *supra* note 23.

65. For the literature specifically addressing the corporate governance of Chinese SBs, see Nicholas Calcina Howson, *China's Restructured Commercial Banks: Nomenklatura Accountability Serving Corporate Governance Reform?, in* CHINA'S EMERGING FINANCIAL MARKETS: CHALLENGES AND GLOBAL IMPACT 123 (Zhu Min et al., eds., 2009); Yang, *Crouching Tigers and Hidden Dragons*, *supra* note 6.

66. *See* Yang, *id.* at 9-31.

Huijin Investment Company ("Central Huijin") and the Ministry of Finance ("MOF"), the Chinese party-state holds majority ownership of all five SOCBs. Through the central government, local governments, or SOEs, the Chinese party-state also owns ten of the twelve JSCBs which are the second-tier national banks as mentioned above.[67] This ownership structure is unlike the government ownership of banks in the United States during the Global Financial Crisis. Although the U.S. Treasury held extensive ownership of 707 financial institutions during that period, most of its holdings were minority holdings and meant to be temporary.[68] Instead, the Chinese party-state holds controlling stakes in Chinese banks on a long-term basis.

Second, the Chinese party-state is the human resource headquarter of China's banking sector. Instead of passively owning banks, it actively engages in the personnel decisions of banks through CCP's party system. In most cases, regardless of the ownership structure of a bank, CCP effectively controls the appointment of its executive team, such as the board's chairperson, the supervisory board's chairperson, the chief executive officer ("CEO"), vice presidents, and other important positions.[69] For banks at the central level, this appointment power lies in either the Central Organization Committee or the CBIRC.[70] For banks at local levels, such power lies in the organization departments of the local party system in charge of the region.[71] Most senior managers at Chinese commercial banks bear party ranking and are thus subject to CCP's promotion system, rotation of jobs, and discipline of misbehaviors.[72] By exercising this appointment power, CCP ensures that the executive teams of Chinese commercial banks serve the state's policies and the party's interests.

67. As of 2019, only the China Minsheng Bank and Ping An Bank were not owned by a state controlling shareholder.

68. Except for the Fannie Mae and Freddie Mac, American Insurance Group, and Citi Group, the U.S. Treasury only held minimal ownership of the bailed-out financial institutions. For more detailed summaries of these bailout investments, see Steven M. Davidoff, *Uncomfortable Embrace: Federal Corporate Ownership in the Midst of the Financial Crisis*, 95 MINN. L. REV. 1733 1736-56 (2011). *See also* Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61:3 ADMIN. L. REV. 463 (2009).

69. LIU PENG (刘鹏), ZHONGGUO SHANGYE YINHANG BIANGE YU ZHUANXING: JINJI SHICHANGHUA ZHONG SHANGYE YIHANG DE ZUOYONG YU KECHIXU FAJAN (中国商业银行变革与转型：经济市场化中商业银行的作用与可持续发展) 170 (THE REFORM AND TRANSFORMATION OF CHINESE COMMERCIAL BANKS: THE ROLE AND SUSTAINABLE DEVELOPMENT OF COMMERCIAL BANKS IN PROCESS OF ECONOMIC MARKETIZATION) (2014).

70. Sebastian Heilmann, *Regulatory Innovation by Leninist Means: Communist Party Supervision in China's Financial Industry*, CHINA Q. 1, 17-18 (2005).

71. LIU, *supra* note 69, at 170.

72. *Id.*

Third, the Chinese party-state is a crucial customer to Chinese banks. It is reported that only one-third of bank loans flowed to private sectors,[73] which suggests the public sector's capture of Chinese banks. Moreover, the Chinese party-state fiscally backs the public sector and thus implicitly guarantees public borrowings, which makes loans to public sectors safer than those to private sectors.[74] In this context, the preferential lending in favor of the public sector in China[75] is not necessarily the product of state intervention but rather banks' own rational decision.

Through the above ties, coupled with its inherent regulatory power, the Chinese party-state tightly controls Chinese commercial banks. This allows the party-state to mobilize domestic investible funds toward targeted sectors to implement its economic plans, which is a crucial element of Chinese state capitalism.[76] To be fair, this development model is not unprecedented. As will be discussed later in detail, many East Asian economies, including Japan, South Korea, Taiwan, and Singapore, adopted similar models known as "the developmental state" in the 1980s to pursue development and growth.[77] The hand of the Chinese party-state, however, stretches farther and deeper.

c. Summary: The China Puzzle

China's prevalent use of SBs and its tremendous economic success poses a puzzle to contemporary SB studies. If the property right theory is correct, China's widespread use of SBs should result in serious financial and economic underdevelopment. That did not happen in China. Notwithstanding the economic turbulence in the late 1990s and early

73. NICHOLAS R. LARDY, MARKETS OVER MAO: THE RISE OF PRIVATE BUSINESSES IN CHINA 99-112 (2014).

74. Evan Oxhorn, *Consumer Finance and Financial Repression in China*, 7 U. PENN EAST ASIA L. REV. 397, 410-11 (2012).

75. Some estimated that SOEs could have easy access to loans at a third of the market interest rate. Shaun Breslin, *Financial Transitions in the PRC: Banking on the State?*, 35:6 THIRD WORLD Q. 996, 1003 (2014).

76. BREMMER, *supra* note 16, at 134-35.

77. For an overview of the development model of East Asian developmental states, see WOO-COMINGS, MEREDITH ED., THE DEVELOPMENTAL STATE (1999). For a discussion of how such developmental model affects the corporate governance practice in East Asia, see Yueh-Ping (Alex) Yang, *Envisaging an East Asian Model of Corporate Governance: A Developmental State Perspective*, *in* LEGAL THOUGHTS BETWEEN THE EAST AND THE WEST IN THE MULTILEVEL LEGAL ORDER: A LIBER AMICORUM IN HONOUR OF PROFESSOR HERBERT HAN-PAO MA 445 (Chang-Fa Lo et al. eds., 2016).

2000s,[78] the party-state's domination of the banking sector has not brought devastating results to China's finance and economy. To the contrary, China's economy outperformed many other large economies which adopted more market-oriented reforms.[79]

The revised property right theory cannot explain the China puzzle as well. According to the revised property right theory, only in developed economies with advanced financial and political institutions can SBs function well. China, however, does not fall into this category. It remains a developing country. Its legal and political institutions are never satisfactory according to the global standard. Its financial institutions, such as market competition and banking professionals, are catching up, but they can hardly be characterized as advanced. Their business model remains traditional, which relies heavily on interest-bearing activities such as loans: by the end of 2018, non-interest revenue only accounted for 22.1 percent of the overall revenue of Chinese banks.[80] The relative success of Chinese SBs does not seem to arise from robust institutions which discipline the party-state's operation of SBs.

III. China is "not Alone but Has Its Neighbors"

The Chinese party-state tells a different story to explain the success of China's SBs by advocating that the party-state's leadership are indispensable for China's development.[81] On this developmental account, China is "not alone but has its neighbors." The experience of East Asian developmental states echoes this development theory.

A. An Overview of East Asian Developmental States

Before China emerged, East Asia was the region of "economic miracles" which produced the most astonishing growth after World War II. Japan was the most prominent one, whose strong economic performance in the 1980s amazed the world at a similar level with current China. Other than

78. For a comprehensive discussion of the local banking crisis in China during this period, see CARL E. WALTER & FRASER J.T. HOWIE, RED CAPITALISM: THE FRAGILE FINANCIAL FOUNDATION OF CHINA'S EXTRAORDINARY RISE (2011).

79. DANI RODRIK, ONE ECONOMICS MANY RECIPES: GLOBALIZATION, INSTITUTIONS, AND ECONOMIC GROWTH 14 (2007).

80. CBIRC, *The Table of Major Regulatory Indicators of Commercial Banks (Legal Persons) (2018)* (商业银行主要监管指标情况表(法人) (2018年)) (Feb. 25, 2019), http://www.cbirc.gov.cn/cn/doc/9106/910601/3954F0B0DF6C47F2AB36C1085791F448.html.

81. *See supra* note 27.

Japan, South Korea, Taiwan, Hong Kong, and Singapore all delivered impressive economic performance during this period. More importantly, except for Hong Kong, these East Asian economies did not belong to the neoliberalist camp.[82] Instead, they achieved economic success by adopting the unorthodox model of "developmental states" featuring a mix of market economy and heavy governmental intervention.[83]

Developmental states utilize the relative efficiency of the government versus the market. Summarizing the experience of Japan, South Korea, Taiwan, and Singapore, studies highlighted that developmental states featured the government's role in the economy.[84] They argued that, for latecomer economies whose private institutions are too underdeveloped to kick-start economic development, a development-minded government may be better positioned than the market to ignite development. Such government can accumulate limited investible capital, pick and choose the industrial sectors for prioritized development, and allocate capital to them to create a "big push" for the economy.[85] Under this theory, the government's control of finance is particularly important for it to influence the investment pattern of the economy and guide sectoral mobility. At least from a consequentialist perspective, the economic success of East Asia demonstrates the practical merits of the developmental state model.[86]

B. Banking Systems in East Asian Developmental States

The heavy hand of a plan-rational developmental state particularly presides in the banking sector. After all, finance is "the nerve of the

82. RODRIK, *supra* note 79, at 18-20.

83. *See generally* Meredith Woo-Cumings, *Introduction: Chalmers Johnson and the Politics of Nationalism and Development*, *in* THE DEVELOPMENTAL STATE 1 (Meredith Woo-Comings ed., 1999); HA-JOON CHANG, THE EAST ASIAN DEVELOPMENT EXPERIENCE: THE MIRACLE, THE CRISIS AND THE FUTURE (2006).

84. *Id.* In an abstract, developmental states possess the following characteristics. First, there is an *interventionist government* that is neither socialist nor free-market, but a plan-rational capitalist developmental state conjoining private ownership with state guidance. Second, *nationalism* is a motivation, at least in East Asia's practice, to the extent that these economies face challenges from Western imperialism and use economic development to ensure their national survival. Third, *the government partners with business sectors* by formulating broad economic plans, identifying the means for implementing it and ensuring competition in designated strategic sectors.

85. For a more in-depth discussion of the rationale behind East Asian developmental states, see CHANG, *supra* note 31, at 109-133, 227-256.

86. Chang comprehensively studied how the initial conditions in East Asia before the 1960s lagged behind those in Sub-Saharan Africa, which shows that East Asia's economic success was not based on initial conditions. *Id*. at 143-175.

developmental state."[87] Below I consult the experiences of four main East Asian economies, i.e., Japan, South Korea, Taiwan, and Singapore, to illustrate how they controlled their banks.

1. Japan: A Government-Directed Banking System

Among the East Asian developmental states, Japan was the leading pioneer.[88] Throughout the 1960s to 1980s, Japan achieved marvelous economic growth, which brought it from ashes and ruins after World War II to the third-largest economy in the world now. Its economic growth was miraculously rapid since the 1960s[89] and continued until 1990. From 1960 to 1990, Japan's GDP grew from US$44.3 billion to US$3.1 trillion,[90] which is equal to 70 times growth. Japan's emergence shocked the global economy and attracted many studies of the secret behind Japan's economic success.[91]

Japan's economic model during this period is nonetheless unorthodox. Observers identified several key characteristics leading to Japan's economic success, such as the well-known main bank system, *keiretsu*, lifetime employment, etc.[92] This special bank-business-labor relationship reached a

87. Woo-Cumings, *supra* note 31, at 10.

88. Chalmers Johnson provided a pioneer study of the Japanese developmental state in 1982, which commenced the studies of East Asian developmental states. *See generally* CHALMERS JOHNSON, MITI AND THE JAPANESE MIRACLE: THE GROWTH OF INDUSTRIAL POLICY, 1925-1975 (1982).

89. In 1961, Japan's GDP growth was 12.04 percent, which commenced its golden eras.

90. World Bank Open Data, *GDP – Japan*, http://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=1990&locations=JP&start=1960 (last visited Aug. 18, 2019).

91. Earlier studies produced different schools of thoughts on the success of Japan's economy, including the "national character-basic values-consensus" view highlighting the cultural difference, the "no-miracle-occurred" view highlighting the contribution from free market and private sectors, the "unique-structural-features" view highlighting several unusual Japanese institutions, the "free-ride" view highlighting the beneficiary of Japan's postwar alliance with the United States, and the "developmental state" view. For the summary, see JOHNSON, *supra* note 88, at 7-19.

92. *See generally* Masahiko Aoki, *Toward an Economic Model of the Japanese Firm*, 28:1 J. ECON. LITERATURES 1 (1990). In brief, after World War II, capital markets in Japan, which used to be robust before the war, stagnated and never revived since then, rendering Japan a bank-led economy. Since large private banks were the major source of funds for enterprises, they became the center supporting finance to a group of businesses, supervising their financial performance and taking the necessary intervention on the board when financial conditions deteriorate (the main bank system). Businesses also grouped with and depended on each other, cross-holding the shares of each other, which established strong business ties among each other (the *keiretsu* system). Businesses, in turn, guaranteed their employees the lifetime employment, which incentivized the on-the-job training of employees and the development of their company-specific skills (the lifetime employment system). For arguments claiming that these characteristics were all urban legends, *contra* YOSHIRO MIWA

fine balance during this period and contributed to Japan's economic success. Most importantly, Japan did not achieve success by merely adopting free-market prescriptions. The Japanese government, in particular, the Ministry of International Trade and Industry ("MITI"), played an arguably leading role.[93] Its influence in the banking system was, in particular, a key to pursuing its industrial policies.

Japan's banking system during the 1960s to the 1990s featured a two-tier system. The first tier was the private banking sector, comprised of city banks, regional banks, cooperatives, trust banks, etc., which provided short-term credits,[94] as well as the long-term credit banks providing long-term credits.[95] The second tier was the government banks, including the Japan Development Bank ("JDB") and Export-Import Bank, which provided long-term loans to large firms in strategic industries, and the Japan Finance Corporation for Small Business and People's Finance Corporation which provided loans to small firms. They were all wholly owned by the Japanese government. Most importantly, they were backed by Ministry of Posts and Telecommunications, which attracted postal savings (a form of deposits) from public savers and funded these government banks according to the Fiscal Investment and Loan Plan ("FILP") co-managed by the Ministry of Finance and MITI.[96]

The Japanese government dominated or at least guided Japan's banking system. On the one hand, it guided government banks to channel their funds to serve policy purposes. MITI played an influential role here. Taking JDB for instance, although it decided its credit allocation independently from the government in principle, in practice, MITI actively "recommended" JDB to

& J. MARK RAMSEYER, THE FABLE OF THE KEIRETSU: URBAN LEGENDS OF THE JAPANESE ECONOMY 61-88 (2006).

93. MITI's tools included control over foreign exchange, imports of technology, preferential financing, tax breaks and protection from competition, which allowed it to select industries for nurturing and regulated cut-throat competition. JOHNSON, *supra* note 88, at 199. Such intervention, in particular, the industrial policies, played a crucial role in the success of Japan's economy during this period. Johnson offered a comprehensive analysis of the MITI's role in Japan's industrial policies. *See generally* JOHNSON, *supra* note 88.

94. The six main banks in Japan in that period were Fuji, Sanwa, Daiichi, Mitsui, Mitsubishi, and Sumitomo banks.

95. The three major long-term credit banks were the Industrial Bank of Japan, the Long-Term Credit Bank of Japan and the Nippon Credit Bank.

96. JOHNSON, *supra* note 88, at 210. While the FILP funding provided enormous funds to support government policies, it was separated from the government budget and was thus subject to less scrutiny of the Diet (i.e., the Congress in Japan). JOHNSON, *supra* note 88, at 211 (reporting that "from 1953 on FILP had always been from a third to half of the size of the general account budget and had ranged from a low of 3.3 percent (1956) to a high of 6.3 percent (1972) of GNP").

lend to individual firms[97] through its power to screen all loan applications and placement of its retired senior officials on JDB's board.[98] Although government lending institutions only accounted for no more than 20 percent of all bank loans in Japan,[99] their loans bear indicative effect for private banks.[100]

On the other hand, in respect of the larger part of Japan's banking system, i.e. private banks, the Japanese government also possessed some leverage. Although it did not own and control these banks, it arguably employed several tools to direct their support of the government's industrial policies. The famous one was the directed loans through "administrative guidance."[101] During the high-growth period, Bank of Japan ("BOJ"), Japan's central bank, controlled bank credits through the so-called "window guidance" practice, which not only implemented BOJ's monetary policy[102] but also supported the allocation of resources. To do it, BOJ had regular meetings with private banks, during which it instructed their lending plans. Private banks, in turn, prepared their lending plans broke down by sectors, the size of borrowers, and use of funds and sent to BOJ for approval. In

97. Akiyoshi Horiuchi & Qing-Yuan Shi, *Influence of the Japan Development Bank Loans on Corporate Investment Behavior*, 7 J. JAPANESE & INT'L ECON. 441, 447 (1993).

98. JOHNSON, *supra* note 88, at 209-10.

99. Richard A. Werner, *A Reconsideration of the Rationale for Bank-Centered Economic Systems and the Effectiveness of Directed Credit Policies in the Light of Japanese Evidence*, 30:3 JAPANESE ECON. 3, 7 (2002). For a detailed summary, see Masami Imai, *Political Determinants of Government Loans in Japan*, 52:1 J.L. & ECON. 41, 45 (2009).

100. Although the scale of loans of government banks was low relative to that of private city banks, their loans implied the government's support of the borrowers, which could comfort private banks' concerns. For instance, JDB loans, flowing mostly to MITI's designated strategic industries, were perceived the "MITI's seal of approval" on an enterprise, which had an "information effect" that indicated a desirable direction of credit expansion. JOHNSON, *supra* note 88, at 211 (reporting that during 1953-55, 83 percent of JDB loan went to four strategic industries designated by MITI: electric power, ships, coal, and steel.) For the empirical evidence of the information effect of JDB loans, see Horiuchi & Sui, *supra* note 97.

101. Some academics considered Japan as the first country which employed directed loans successfully. Werner, *supra* note 99, at 8. For an introduction to the evolution of directed loans in Japan, see Werner, *supra* note 99, at 20-27.

102. For discussion of the monetary function of window guidance in Japan, *see generally* Takeo Hoshi et al., *Japanese Corporate Investment and Bank of Japan Guidance of Commercial Bank Lending, in* JAPANESE MONETARY POLICY 63 (Kenneth Singleton ed., 1993); James R. Rhodes & Naoyuki Yoshino, *Window Guidance by the Bank of Japan: Was Lending Controlled?*, 17:2 CONTEMPORARY ECON. POL'Y 166 (1999); Tomoyuki Fukumoto et al., *Effectiveness of Window Guidance and Financial Environment – in Light of Japan's Experience of Financial Liberalization and a Bubble Economy*, BANK OF JAPAN REV. 1 (Aug. 2010).

essence, BOJ's approval was merely an administrative guidance[103] that was not legally binding. BOJ, however, possessed several regulatory powers to ask for banks' cooperation, such as the power to cut rediscount quotas, reduce window guidance quotas, or apply unfavorable terms to banks' transactions with BOJ.[104] Fearing regulatory retaliation, Japanese banks tended to follow BOJ's direction.[105] Therefore, the Japanese government could direct the loans of private banks to industries prioritized by the government even though it did not own or control private banks.[106]

103. Administrative guidance refers to the authority of the government to issue directives, requests, warnings, suggestions, and encouragements to the enterprises within a particular ministry's jurisdiction. JOHNSON, *supra* note 88, at 265. Administrative guidance became more salient since the 1960s because MITI lost its power to manage foreign exchange budget then because it failed to enact the Special Measures Law to continue its control power statutorily. For a thorough discussion of administrative guidance in Japan's early development era, *see* JOHNSON, *supra* note 88, at 242-74. For a different view arguing that administrative guidance never really worked in Japan, see YOSHIRO MIWA & J. MARK RAMSEYER, THE FABLE OF THE KEIRETSU: URBAN LEGENDS OF THE JAPANESE ECONOMY 115-46 (2006).

104. On the other hand, several implicit governmental protection also allowed the Japanese government to provide carrots to private banks and ask for their cooperation. For instance, through rationing the financial market, the Japanese government made banks the major financiers in the economy, which in turn ensured their business opportunity. The Ministry of Finance also controlled lending and deposit rates, which guaranteed the minimum profits of bank loans. BOJ also supplied finance to private banks and thus implicitly guaranteed their loans, which relieved the financial risks of private banks. Last but not the least, the Japanese government, in general, controlled the competition in the banking market by restricting financial products, controlling the incorporation of branches, and limiting foreign entry, etc., so that banks would not engage in excessive competition that undermined their profit margins. It was reported that the total BOJ lending to commercial banks and other financial institutions for preferential credits to strategic industries amounted to 10 percent of the total money supply (M2) in the early 1950s. Yoon Je Cho & Thomas Hellmann, *The Government's Role in Japanese and Korean Credit Markets: A New Institutional Economics Perspective*, at 11 (World Bank Policy Res. Working Paper, No. WPS-1190, 1993). Thanks to all these regulatory protections, private banks could concentrate on expanding their share of loans. In return, they were requested to enter in each new industry fostered by MITI, resulting in the so-called "one set-ism" phenomenon, that is, each bank *keiretsu*, in the end, possessed "a full complement of companies covering all the government-designated growth industries, regardless of whether it made business sense to do so." JOHNSON, *supra* note 88, at 206.

105. JOHNSON, *supra* note 88, at 266. *See also* Werner, *supra* note 99, at 8. For a detailed discussion of the administrative guidance in Japan, see Allan D. Smith, *The Japanese Foreign Exchange and Foreign Trade Control Law and Administrative Guidance: The Labyrinth and the Castle*, 16 LAW & POL'Y INT'L BUS 417, 424-33 (1984).

106. This formulated an industrial system characterized by the "pattern of dependence." As illustrated by Chalmers Johnson, under this pattern, a group of enterprises borrowed from a major private bank in an amount exceeding their capacity to repay, which might stand for about 70 percent-80 percent of their operational capital. The bank, in turn, over-borrowed from BOJ. Through this system, BOJ obtained control over the policies and lending decisions

To be sure, academics are still debating whether the Japanese government exercised such influence effectively. For one thing, different departments within the Japanese government had different policy horizons, which incurred coordination problems. MITI might be the most development-minded department, but its influence over banks was rather limited, while the Ministry of Finance and BOJ might have more effective tools, but their horizons were more soundness-oriented than development-oriented.[107] Besides, private enterprises might have initiated the development plan first while the Japanese government simply followed suit strategically.[108] Accordingly, whether and to what degree did the Japanese government guide domestic finance for development purpose, and lead to Japan's economic success remain controversial among academics. That said, it is fair to say that Japan maintained a government-directed banking system bearing similar nature with China's banking system at least in many regulatory aspects, such as window guidance, directed loans, interest rate control, implicit government guarantee, limited foreign entry, etc.

a. South Korea: A Government-Owned Banking System

South Korea is another East Asian developmental state which achieved tremendous economic growth during this period.[109] From 1960 to 1995, the GDP of South Korea grew from US$3.9 billion to US$559.3 billion,[110] which was equal to 143 times growth. Except for 1962 and 1980, in these 35 years, South Korea managed to maintain at least 5 percent annual GDP growth rate.

of private banks. The private banks, in turn, could dominate their borrowing enterprises, formulating the famous bank *keiretsu* system in Japan. JOHNSON, *supra* note 88, at 203-05.

In the 1980s, however, when financial liberalization and deregulation rose in Japan, the Japanese government found it more difficult to implement its administrative guidance. For instance, the BOJ's window guidance received less compliance in the 1980s, which eventually led to the demise of this practice in 1991. *See generally* Rhodes & Yoshino, *supra* note 102.

107. Johnson, for instance, argued that MITI, as the planner of industrial policy was the pilot agency in then Japan and the center that exerted the greatest positive influence. JOHNSON, *supra* note 88, at 26. In contrast, Calder provided a comprehensive account of how different agencies in Japan had difficulty in coordinating Japan's financial policies. *See generally* KENT E. CALDER, STRATEGIC CAPITALISM: PRIVATE BUSINESS AND PUBLIC PURPOSE IN JAPANESE INDUSTRIAL FINANCE (1993).

108. *See* CALDER, *id.* at 108-12.

109. Alice H. Amsden provided the first comprehensive analysis of the developmental state model in South Korea, which was the pioneer study that was specific to South Korea. *See generally* ALICE H. AMSDEN, ASIA'S NEXT GIANT: SOUTH KOREA AND LATE INDUSTRIALIZATION (1992). *See also* JUNG-EN WOO, RACE TO THE SWIFT: STATE AND FINANCE IN KOREAN INDUSTRIALIZATION (1991); HA-JOON CHANG, *supra* note 31.

110. World Bank Open Data, *GDP – South Korea*, http://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=1995&locations=KR&start=1960 (last visited Aug. 19, 2019).

Large conglomerates known as "*chaebols*"[111] emerged: in 1986, South Korea had ten firms listed in Fortune 500 international private non-oil-producing firms, while there were only seven from all other developing countries combined.[112] In 1990, South Korea was the fifteenth largest economy in the world by GDP.

The economic model of South Korea during this high-growth period had two primary characteristics: a strong and interventionist government as well as large diversified business groups (i.e., *chaebols*),[113] which formed a reciprocal relationship. Due to the colonial history and the authoritarian ruling, strong financiers, large businesses, or land-owners that could oppose to the government were absent in post-war South Korea, which resulted in a strong government.[114] To maintain national security and to ensure its ruling, however, the government wanted industrialization, in particular, the economies of scale that could increase South Korea's industrial competitiveness. To achieve it, the government picked and chose targeted firms and industries, supplied cheap finance to subsidize them, forced them to build industries and engage in more exportation, and threatened them to withdraw the support if they failed.[115] It also artificially underpriced domestic interest rates to encourage investment and undervalued exchange rates to promote exportation. In return for the government's favor, *chaebols* endeavored in expanding their exportation, businesses, employment, etc., to meet the government's industrial plans.[116] In this relationship, the government was autonomous of private sectors to the extent that it pursued goals independent of various industrial groups (such as security or industrial transformation), but it did so in ways that favored large businesses.[117]

Under this economic model, a credit-based financial system mediated by an interventionist authoritarian government became the basis of the "Korea Inc."[118] The South Korean government possessed two primary tools for controlling finance: the power to price financial products and the

111. *Chaebol* refers to family-owned and -managed groups of companies that exercise monopolistic and oligopolistic control in product lines and industries. They are similar to *keiretsu* in Japan, except that they do not own banking institution at their core. Instead, the government mediates the flow of capital (including domestic and foreign ones) to the *chaebol* through a "designated bank." WOO, *supra* note 109, at 149-50.

112. AMSDEN, *supra* note 109, at 9.

113. Other features of South Korea's economic model included an abundant supply of competent salaried engineers and low-cost yet well-educated labor. *Id.* at 8-11.

114. *Id.* at 147.

115. WOO, *supra* note 109, at 191-92.

116. AMSDEN, *supra* note 109, at 146.

117. WOO, *supra* note 109, at 14.

118. *Id.* at 149.

ownership of banks.[119] In respect of the former, through the Ministry of Finance, the South Korean government possessed the power to set the deposit rate and interest rate, and it consciously underpriced the rates to promote industrial investment. The price was serious financial repression in South Korea between the 1950s and 1970s,[120] featuring negative real interest rate charged by banks and low savings in South Korea.[121]

In respect to government ownership, the banking system in South Korea was "the most extreme case of dependence on the state."[122] Unlike Japan, the South Korean government essentially owned all banks before the 1980s, including commercial banks and development banks.[123] This allowed the South Korean government to control nearly all capital flows in South Korea and allocate credits on a discretionary basis,[124] especially to extend loans with favorable rate to targeted firms and/or industries.[125] Under this

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119. *Id.* at 191. AMSDEN, *supra* note 109, at 16.

120. "Financial repression" typically involves the government's establishment of unattractive yields on domestic financial assets and allocation of scarce capital to selective groups of favored entrepreneurs. WOO, *id.* at 60. Financial repression was arguably what "imparted strength" to the South Korean government. WOO, *id.* at 191.

121. *Id.* at 60. The low-interest-rate retarded the accumulation of domestic savings and discouraged foreign lending, which hampered investment and economic growth. Thus, in 1965, South Korea initiated the interest rate reform to increase the interest rate to mobilize domestic time and savings deposits. As a result, domestic time deposits and savings deposits rose. In response to the rising interest rate, *chaebol* became dependent on foreign loans to finance their investment. The high-interest-rate era between 1965 and 1972, however, was ended when the government bailed out highly-leveraged businesses by issuing a moratorium on all payment of corporate debts owed to the curb market and ended all market liberalization reforms: real interest rate again went down. *Id.* at 103-05, 111-15. Under the low-interest-rate policy, business and government savings kept flowing to the banking system, which, in turn, financed major industries at cheaper rates. Household savings, however, flowed to the curb market, which, in turn, financed small and medium enterprises that had no access to bank loans. This presented a "bifurcation of the financial market." The average cost of borrowing in curb market during 1974-1980 was reportedly higher than that of general bank loans by 25.2 percentage points. *Id.* at 159-60.

122. *Id.* at 11.

123. This began in 1961 when the military government, led by the later President Park Chung-Hee, launched the coup and took over the power. The military government, acting against the United States' policy recommendation, nationalized all South Korean banks.

124. The only exception was the curb market. On the one hand, due to the rationed credit market, small enterprises which failed to be favored by the government could not borrow in the formal banking market and thus had no choice but to turn to the curb market, which created the demand for credits. On the other hand, due to the low-interest-rate environment, households were less incentivized to deposit their money in the formal banking system than to inject their money into the curb market for higher returns, which created the supply of credits. It was estimated that in 1971, the size of the curb market accounted for at least one-third of bank loans. For more discussion, see WOO, *supra* note 109, at 111-15.

125. AMSDEN, *supra* note 109, at 72-74, 149.

governance structure, bankers acted like bureaucrats than entrepreneurs, whose primary concerns were GDP instead of profits.[126]

Even in the 1980s, when South Korea was compelled to commence financial liberalization and bank privatization,[127] the government's control over the banking system did not diminish much. The government privatized all SBs by 1983.[128] At the same time, however, fearing that *chaebols* might acquire privatized banks and become too-big-to-control, the government prohibited any single shareholder from holding more than 8 percent ownership of a national commercial bank.[129] Thanks to the dispersed ownership structure, the government continued controlling commercial banks after the privatization.[130]

This government-dominated banking system contributed to two main results: the post-war development of South Korea's economy and the expansion of *chaebols*.[131] On the one hand, the South Korean government

126. WOO, *supra* note 109, at 159. *See also* Yung-Chul Park & Dong-Won Kim, *Korea: Development and Structural Change of the Banking System*, *in* THE FINANCIAL DEVELOPMENT OF JAPAN, KOREA, AND TAIWAN: GROWTH, REPRESSION, AND LIBERALIZATION 188, 189 (Hugh T. Patrick & Yung-Chul Park eds., 1994). To be sure, the ownership of these banks might be largely in private hands in the 1960s and 1970s; however, they were "de facto public enterprises" to the extent that voting rights of private shareholders were legislatively limited. Gregory W. Noble & John Ravenhill, *The Good, the Bad and the Ugly? Korea, Taiwan and the Asian Financial Crisis*, *in* THE ASIAN FINANCIAL CRISIS AND THE ARCHITECTURE OF GLOBAL FINANCE 80, 92 (Gregory W. Noble & John Ravenhill eds., 2000).

127. South Korea was forced to liberalize its finance in the 1980s for two primary reasons: First, to respond to the increasing pressure for trade liberalization from the international community, notably the United States, and second, to address the rising NPL problems. WOO, *id.* at 192.

128. In 1978, the government initiated the first bank privatization case, followed by another in 1981. By 1983, all seven banks in South Korea were privatized. *Id.* at 195.

129. *Chaebol*, however, tried certain ways to circumvent this shareholding restriction. For instance, they bought stocks in more than one bank to increase their influence in the whole banking system. They also used their subsidiaries to hold the ownership of banks. For instance, insurance companies owned a lot of bank stock, while *chaebols* controlled insurance companies. Samsung, for instance, was the largest shareholder of Commercial Bank and Hanil Bank in 1989, the two largest nationwide commercial bank in South Korea. Despite so, *chaebol* was still far from controlling the banking system. Instead, the South Korean government, through its rediscount function and the implicit guarantee of defaults, still extensively controlled privatized banks. Park & Kim, *supra* note 126, at 195-96. *See also id.* at 196.

130. Specifically, the government continued intervening in the management of banks by frequently rotating offices between bank management and governmental posts. For instance, in February 1991, the monetary authorities stepped in to name the presidents of five major banks. Through these intervening powers, the government kept its power to decide policy loans and allocate credits. AMSDEN, *supra* note 109, at 135; WOO, *id.* at 196; Noble & Ravenhill, *supra* note 126, at 93. Park & Kim, *id.* at 192.

131. WOO, *id.* at 15.

determined the allocation of credit based on export performance.[132] Between 1974 and 1980, the average cost of all loans for export industries was nearly always cheaper than loans to domestic industries.[133] Besides, coinciding with the shift of industrial policies toward heavy industries in this period, the average cost of borrowings for heavy industries was significantly lower than light industries.[134]

On the other hand, the South Korean government tended to favor large enterprises, i.e. *chaebols*. In the same period, large enterprises always incurred less borrowing cost compared with small firms.[135] There were two reasons for that. First, since the industrial policies in this period supported heavy industries, which were capital intensive and could only be met by large *chaebols*, bankers in South Korea naturally followed the government's policies and supported *chaebols*. Second, under this banking system, the lending rates were at an artificially low level with a ceiling. Thus, bankers in South Korea had no incentives to seek out enterprising yet riskier projects. Instead, they would prefer safer projects, that is, loans to *chaebols* favored by the government.[136] *Chaebols* in South Korea thus grew and became too big to fail.[137]

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132. To be sure, foreign investment also played a crucial role during South Korea's post-war growth period. In the 1970s, foreign loans in South Korea increased significantly: it was found that between 1965 and 1978, South Korea's reliance on foreign financial markets increased for almost 100 times. *Id.* at 152-53. Foreign banks were willing to lend to South Korea mostly due to political reasons: they believed that the American government, out of political needs, would support the South Korean government and acted as the last resort. This formed the primary source of fund financing the Big Push industrial policies toward heavy industries in the 1970s. *Id.* at 153-58. Foreign credits, however, flowed into South Korea mostly via the government-owned banking system. Thomas Kalinowsky & Hyekyung Cho, *The Political Economy of Financial Liberalization in South Korea*, 49:2 ASIAN SURVEY 221, 224 (2009).

133. WOO, *id.* at 167.

134. *Id.*

135. *Id.* at 166-67.

136. *Id.* at 166-68.

137. In 1978, the top twenty *chaebols* contributed to one-third of South Korea's GDP. *Id.* at 15. *See also id.* at 172-75.

The South Korean government also favored *chaebols* by relaxing the regulation of non-bank financial intermediaries ("NBFIs"). NBFIs were investment and finance companies which engaged in commercial papers as well as life insurance companies and investment trust companies. In the 1980s, the South Korean government engaged in a series of deregulation of NBFIs, including the permission of private ownership, greater flexibility in interest rates, relaxing entry barriers, removing the burden to support policy loans, expanding permitted financial activities, etc. NBFI deposit thus soared in the 1980s from 30.1 percent of total deposit in 1980 to 51.3 percent in 1987. Due to the deregulation, *chaebols* largely entered into the NBFI market through the large-scale acquisition of NBFIs. *See id.* at 196-97. In this vein, The case of South Korea supported the idea of SBs and financial repression. In Amsden's words, South Korea provided "supporting evidence for the proposition that economic expansion depends on governmental intervention to create price distortions that direct economic activity toward greater investment."[138]

b. Taiwan: A Party-State-Owned Banking System

Taiwan was another rapidly growing East Asian developmental state during this period. From 1961 to 1995, Taiwan's GDP grew from US$1.78 billion to US$279.22 billion,[139] which was equal to 157 times growth. In 1995, Taiwan ranked the 19th largest economy in the world.

Similar to Japan and South Korea, Taiwan also achieved its economic success by adopting the developmental state model.[140] Its features, however, were different. Instead of relying on gigantic private business groups, Taiwan's economic development during its high-growth period was characterized by dominant SOEs as well as vibrant small and medium private enterprises ("SMPEs").[141] On the one hand, SOEs were bigger and more

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the control over domestic finance in South Korea, to some extent, shifted from the government to *chaebols*; liberalization in effect "contributed to a rise, not to a decline, in economic concentration." AMSDEN, *supra* note 109, at 134-36. It was reported that in 1983, 69.6 percent of bank loans in South Korea went to 400 large firms belonging to 137 *chaebols*. The share of the 50 largest *chaebols* in total domestic credit was 26.5 percent, while the combined share of the three largest ones (Hyundai, Daewoo, and Samsung) accounted for over 10 percent. WOO, *id.* at 170.

138. AMSDEN, *id.* at 14.

139. Directorate-General of Budget, Accounting and Statistics of Taiwan, https://www.dgbas.gov.tw/point.asp?index=1 (last visited Aug. 19, 2019).

140. On this, Robert Wade provided the most comprehensive study of the developmental state model in Taiwan. *See generally* ROBERT WADE, GOVERNING THE MARKET: ECONOMIC THEORY AND THE ROLE OF GOVERNMENT IN EAST ASIAN INDUSTRIALIZATION (2nd ed., 2004). *See also* J. MEGAN GREENE, THE ORIGINS OF THE DEVELOPMENTAL STATE IN TAIWAN: SCIENCE POLICY AND THE QUEST FOR MODERNIZATION (2008).

141. This was partly because Taiwan's ruling party then, Kuomintang ("KMT,") was a "foreign" regime to local Taiwanese people. When KMT retreated from the mainland to Taiwan, many Mainlanders, i.e., those who came after 1949 and their dependents, migrated to Taiwan with KMT. These Mainlanders, however, accounted for only 12 percent to 15 percent of the population in Taiwan. WADE, *id.* at 233. That was why "Taiwan has always been less totalitarian than Japan between the two World Wars or South Korea during much of the Park era." WADE, *id.* at 250. As a minority ruler, KMT feared the presence of some strong local groups that could challenge its ruling legitimacy. Accordingly, instead of supporting large private business groups and risking giving too much power to local Taiwanese people, KMT preferred building Taiwan's economy on SOEs, which were under its control, and SMPEs, which were too small to become a threat. This resulted in the "SOEs+SMPEs" model in Taiwan.

prevalent in Taiwan than in South Korea. Since the 1950s, Taiwan possessed "one of the biggest public enterprise sectors outside the communist bloc and Sub-Saharan Africa."[142] These Taiwanese SOEs mostly concentrated on sectors which were capital-intensive, large in scale, and upstream. By controlling these sectors, the Taiwanese government obtained indirect influence over downstream sectors, which facilitated its control of Taiwan's economy.[143] On the other hand, unlike Japan or South Korea whose economy was geared by large private conglomerates (either the *keiretsu* or the *chaebol*), Taiwanese business groups played a less central role in Taiwan's economy.[144] In their place were small family firms which were at the heart of the economy's manufacturing revolution.[145] In light of this "SOEs + SMPEs" model, the case of Taiwan is of more reference value to China to the extent that CCP similarly builds China's economy on influential SOEs and vibrant SMPEs.[146]

Moreover, Taiwan was shockingly similar to China in political terms because it also adopted a party-state regime during its high-growth period. Similar to CCP, KMT implemented the so-called "quasi-Leninist" style of organizational structure. As Wade described, "[t]he party's organization stretches from the standing committee at the top to cells in schools, universities, factories and neighborhoods. At the higher levels it has a structure of offices to watch over the rest of the society … Almost all senior civilian officials and military officers are also party members, and many hold high party offices as well. In consequence there is a constant blurring of the

142. *Id.* at 173. Besides, the government possessed much more influence in many other firms which were not public enterprises. For instance, the government might take minority share and make up the balance through KMT's holding company. It was estimated that KMT owned about fifty firms. *Id.* at 273.

143. *Id.* at 178-80. KMT also dominated these key sectors to prevent them from being dominated by foreign enterprises.

144. In the 1980s, it was estimated that only 40 percent of the 500 largest manufacturing firms in Taiwan belonged to a business group, while most of Taiwanese enterprises remained single-unit operations. *Id.* at 66.

145. *Id.* at 66-70. This can be observed by the fact that most of Taiwan's exports came from small and medium firms. For instance, in 1976, the top 500 domestic firms in Taiwan by sales accounted for only 27 percent of total exports, indicating that small and medium enterprises also contributed significantly to Taiwan's exportation.

146. Taiwan is similar to China in other aspects as well. In cultural terms, Taiwan is also a Chinese society, sharing similar cultural characteristics, such as the language of Mandarin, the philosophy of Confucianism, and other traditions. In historic terms, the government of Taiwan during its high-growth period was KMT led by Chiang Kai-shek, which was the former government of China before CCP took over China in 1949. After being defeated by China, KMT fled to Taiwan with its remnant power and institutions, claiming that it was the legitimate government of China and hoping that someday it could recover the mainland. Accordingly, there was a historical continuation between Taiwan and China.

distinction between the party and government at the top. The party also has many industrial and commercial enterprises under its more or less direct control, through which comes much of its finance."[147] This description of KMT shockingly fits the common impression of CCP.[148]

Under this economic and political background, the ability to control finance and upstream raw materials was an essential means for KMT to possess "powerful and selective instruments of control" of the economy.[149] Due to KMT's constraint of capital markets in Taiwan, Taiwan's financial system was bank-led as well.[150] Moreover, KMT tightly administered the banking system. When retreating to Taiwan, KMT brought over the SBs from China to Taiwan.[151] It further nationalized Taiwanese private banks

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147. *Id.* at 236. For a comprehensive introduction to KMT's organizational structure, ideology, and control over the Taiwanese society, see *id.* at 228-96.

148. Besides, KMT also shared a similar ideology with CCP in economic affairs. Specifically, built on Sun Yat-Sen's Three Principles of the People, KMT placed SOEs at the centrality of the economy. Consider the following description of KMT, which again seems like a description of CCP:

Any group which wants a reduction of the government's economic role must show how such a reduction would remain consistent with the economic principles of Sun Yat-Sen. Any group which wants extensive denationalization must counter those who say that public enterprises in the commanding heights are essential to those principles.

Id. at 261.

149. *Id.* at 270.

150. KMT, similar to Japan, South Korea, and China, preferred a bank-led economy over an equity-based economy because it did not want businesses to have their source of finance that could allow them to grow out of control. Therefore, it constrained the development of capital markets in Taiwan. For instance, it controlled the stock exchange by controlling the Securities and Futures Commission which supervised the stock exchange, which discouraged many local businesses from listing in the stock market. LAI IN-JAW (賴英照), THE RETROSPECT AND PROSPECT OF TAIWAN'S FINANCIAL LANDSCAPE (台灣金融版圖之回顧與前瞻) 26-38 (1997). *See also* LIN PAO-AN, FINANCE AND SOCIETY: POST-WAR EVOLUTION OF TAIWAN'S FINANCIAL SYSTEM AND CREDITS (金融與社會：戰後臺灣金融體系與信用的演進) 17-52 (2012). Eventually, KMT built a bank-led financial system in Taiwan which was based on credit rather than equity. By 1980, it was estimated that bank asset accounted for 95 percent of the assets of Taiwan's major financial institutions. *Id.* at 159.

That said, due to KMT's policy to avoid creating large local business groups, it did not want companies to have their source of finance or build conglomerates around banks. Accordingly, it did not want a Japanese main bank system. Due to this concern, different from Japan while similar to South Korea, KMT prohibited Taiwanese banks from taking shares in the borrowing companies (even the development bank only began to take equity positions in 1982). It also prohibited holding companies or non-bank financial institutions (such as insurance companies) from owning industrial firms and restricted the growth of the official money market. WADE, *id.* at 264.

151. Before migrating to Taiwan, KMT adopted a government-dominated model for governing the banking system in China. Major Chinese banks during that period were owned

that were incorporated during the Japanese colonial ages. Based on the government-owned Mainland banks, nationalized local banks, and the newly incorporated SBs, KMT built a banking system dominated by the party-state in Taiwan.[152] Besides, KMT's quasi-Leninist ruling also extended to the banking system. For instance, the regulations governing bank employees essentially followed those applied to civil servants.[153] KMT also appointed senior bankers, dictated salary scales, and regulated annual bonuses of bank staff.[154] Despite KMT's intervention, Taiwanese banks were able to make big profits thanks to the strong demand for credits, limited competition in the market, and the government-mandated margin between the lending rate and borrowing rate.[155]

This "party-state-dominated" banking system supported Taiwan's post-war economic development.[156] Through its control of finance, KMT channeled domestic savings to targeted sectors in various ways. Institutionally, it incorporated several specialized banks engaging in

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and operated by the government (especially local governments) and subject to policy intervention. They were mostly the so-called "professional banks," supplying bank finance to specific industries or targets while incurring the waste of social resources by governments and government-owned enterprises.

152. In 1980, there were only four private banks in Taiwan, accounting for only 5 percent of deposits of all commercial banks, while the Taiwanese government owned and controlled the rest seven banks. *Id.* at 161. For more introduction to the banking landscape in Taiwan before the 1990s, see LAI, *supra* note 150, at 3-53.

In addition to government-owned financial companies, KMT also had its party-owned financial businesses, including the China Investment and Trust, China Development Corporation, China United Trust and Investment, Fuh-Hua Securities Finance, etc. Ya-Hwei Yang, *Taiwan: Development and Structural Change of the Banking System, in* THE FINANCIAL DEVELOPMENT OF JAPAN, KOREA, AND TAIWAN: GROWTH, REPRESSION, AND LIBERALIZATION 288, 299 (Hugh T. Patrick & Yung-Chul Park eds., 1994).

153. WADE, *supra* note 140, at 264.

154. *Id.* at 161-62. In practice, the premier or provincial governor typically appointed former officials in the Ministry of Finance or the Central Bank to serve the chairmen of banks.

155. *Id.* at 164. The benefits of this financial system were the reduction of savers' risks and high rate of financial savings. The costs, however, were rigidity. For instance, due to the limited competition among banks and the control of interest rate, financial repression was serious in Taiwan as well, which led to a robust curb market. It was estimated that the curb market supplied around 30 percent of total loans over the 1970s, at rates 50 percent to 100 percent higher than bank loan rates. *Id.* at 161. Under this setting, there was similarly a bifurcation in Taiwan's credit markets, where large businesses, especially SOEs, financed themselves mainly through the banking system while leaving small businesses to the curb market. *Id.* at 171. For a discussion of how small businesses overcame financial repression in Taiwan, see LIN, *supra* note 150, at 83-128.

156. To be sure, in addition to the banking system, the Taiwanese government also used special-purpose funds and loan guarantees to support targeted industries or sectors. *See* WADE, *id.* at 167-71.

specialized businesses, ranging from agriculture, land, small and medium enterprises, export-import, to development. Furthermore, it directed banks to extend preferential lending to indicated priority industries with strong export potential.[157] In practice, Bank of Communications and Medium Business Bank of Taiwan undertook the major duty to extend these strategic industry loans, and about 20 percent-25 percent of their funds came from the Executive Yuan's Development Fund with 175 to 275 basis points lower rate.[158] In this way, KMT's control of finance facilitated its industrial policies and promoted Taiwan's exportation.[159]

The case of Taiwan illustrates that a banking system dominated by a party-state, together with the adoption of industrial policies based on SOEs and SMPEs, can also create economic success.

c. Singapore: A Business-oriented Government-owned Banking System

Singapore is another worth noted developmental state in East Asia.[160] From 1960 to 1995, Singapore's GDP grew from US$0.7 billion to US$87.9

157. For instance, in 1978 it was estimated that up to 75 percent of bank loans flowed to these targeted industries. *Id.* at 166-67, 171.

158. Yang, *supra* note 151, at 308.

159. To be sure, Taiwan's government-bank-industry model differed with South Korea in scale. The amount of policy loans in Taiwan was significantly less than that in South Korea. Most crucially, the Taiwanese government preferred to rely on tax incentives instead of policy loans to pursue its industrial policies. Taiwan was portrayed as one of the first developing economies to adopt tax scheme to promote development, making incentives to industries achieving the high-performance standard, and/or engaging in strategic industries. WADE, *supra* note 140, at 182-83. This was mainly due to Taiwan's unique diplomatic status. Absent official connection with most major international organizations (such as IMF) and countries (such as the United States), Taiwan could hardly seek assistance from the international community once hit by a financial crisis. Accordingly, "[t]he government [gave] particularly high priority to economic stabilization, even at the cost of very rapid industrial restructuring," which limited "the use of selective credit as a primary instrument for steering the behavior of private firms as compared to Korea." WADE, *id.* at 296. Under this setting, the effect of strategic loans in Taiwan was less prominent. WADE, *supra* note 140, at 191-92. *See also* Yang, *supra* note 151, at 308 (reported that these strategic loans might have little impact: subsidized firms reported that they would have made investments even without the preferential loans; the loans did not reduce the cost of capital significantly, etc.)

160. *See* Alan Chong, *Singapore's Political Economy, 1997–2007: Strategizing Economic Assurance for Globalization*, 47: 6 ASIAN SURVEY 952, 953-54 (2007). For more discussion, see Thomas J. Bellows, *Economic Challenges and Political Innovation: The Case of Singapore*, 32:4 ASIAN AFFAIRS 231 (2006); Linda Low, *The Singapore Developmental State in the New Economy and Polity*, 14:3 PACIFIC REVIEW 411 (2001); W. G. Huff, *The Developmental State, Government, and Singapore's Economic Development since 1960*, 23:8 WORLD DEVELOPMENT 1421 (1995).

billion,[161] which was equal to 126 times growth. Its economic growth was also steady: except for 1964, 1985 and 1986, in these thirty-five years, Singapore managed to maintain at least 4.5 percent of annual GDP growth rate.[162] After five decades of development, Singapore has now become one of the richest countries in the world. In 2018, its GDP per capita in nominal terms was US$64,582,[163] ranking the seventh among world countries and the third in real terms. Most importantly, since its separation from Malaysia in 1965, Singapore maintains a "soft authoritarianism" regime in political terms[164] while adopting government ownership extensively in economic terms. Singapore's marvelous economic achievement accompanied by the government-led development model is appealing to many developing countries, including China.[165]

Singapore's development model is based on a "two-legged" policy that relies on multinational corporations ("MNCs") and government-linked corporations ("GLCs") for industrialization. Here I focus on the second leg.[166] The Singaporean government adopted the famous "Temasek model" to manage large GLCs to spearhead development. The Temasek model possesses two major characteristics. First, the Singaporean government has a noticeable presence in the economy through GLCs (i.e., entities in which a holding company wholly-owned by the Singaporean government has an equity interest of 20 percent or more). To manage these GLCs, the Singaporean government created many state holding companies. Among

161. World Bank Open Data, *GDP – Singapore*, http://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=1995&locations=SG&start=1960 (last visited Aug. 18, 2019).

162. *Id.*

163. World Bank Open Data, *GDP per capita – Singapore*, http://data.worldbank.org/indicator/NY.GDP.PCAP.CD?end=2018&locations=SG&start=1960 (last visited Aug. 18, 2019).

164. Marco Verweji & Riccardo Pelizzo, *Singapore: Does Authoritarianism Pay?*, 20:2 J. DEMOCRACY 18, 18-19 (2009).

165. Much China-study literature proposes that China may consider following Singapore's development model. For a summary, see Cheng-Han Tan et al., *State-owned Enterprises in Singapore: Historical Insights into a Potential Model for Reform*, 28:2 COLUM. J. ASIAN L. 61, 62-63 (2015).

166. The first leg, i.e., MNCs, is a distinguishing feature of Singapore's model as opposed to other East Asian developmental states. Instead of pursuing protectionism to develop domestic industries, Singapore depended heavily on foreign direct investment to push for Singapore's economic development. In the process of attracting foreign investment, the Singaporean government played a crucial role, ranging from regulating labor wages to create attractive labor environment, awarding tax incentives to reduce investment cost, establishing government-forced savings (i.e., the Central Provident Fund "CPF") to finance infrastructure development, to subsidizing foreign investors, etc. For a discussion, see Wolf, *supra* note 160, at 1424-30. With these efforts, Singapore creates one of the best doing business environment for foreign direct investment to contribute to Singapore's economic development.

them, Temasek Holdings, which is wholly owned by the Singaporean Ministry of Finance, is the largest one.[167] Through these GLCs, especially through its control over the personnel of GLCs, the Singaporean government ensures its control of strategically important industries.[168] Second, despite its ownership and control, the Singaporean government interferes in these GLCs only minimally to allow them to run on commercial principles. In general, the corporate governance of Temasek and all GLCs is quite profession-oriented.[169] Moreover, Temasek only proposes broad strategies to its GLCs, leaving most of the managerial affairs to the company's management instead of the board of directors.[170] The appraisal and compensation of the appointed civil servants are also based on standards of the private sector.[171] Under this government-owned-professionally-managed system, GLCs play an important role in Singapore's economy.[172]

167. Temasek is one of the two major sovereign wealth funds managed by the Singaporean government (the other one is Government of Singapore Investment Company Private Limited ("GIC")). Temasek holds subsidiaries in a wide range of industries, including transportation, logistics, shipment, engineering, telecommunications, manufacturing, properties, power, and finance, amounting to an estimated US$180 billion portfolio investment. Christopher Chen, *Solving the Puzzle of Corporate Governance of State-Owned Enterprises: The Path of the Temasek Model in Singapore and Lessons for China*, 36:2 NW. J. INT'L L. & BUS. 303, 313 (2016). For a more detailed description of Temasek's investment portfolio, see Chen, *supra* note 167, at 326-31. For a discussion of the business of Temasek, see Lai Si Tsui-Auch, *Singaporean Business Groups: The Role of the State and Capital in Singapore, Inc., in* BUSINESS GROUPS IN EAST ASIA: FINANCIAL CRISIS, RESTRUCTURING, AND NEW GROWTH 94 (Sea-Jin Chang ed., 2006).

168. For instance, it is documented that Temasek prefers to appoint former politicians, civil servants, and high-ranking military officials to positions as chairmen, directors, and senior management in the GLCs. Tsui-Auch, *id.* at 104. Although GLCs also recruits outside management talent, the Singaporean government maintains its control of GLCs through this "closely-knit political elite." Tsui-Auch, *id.* at 105-06. It is also noted that after the Asian Financial Crisis Temasek has appointed even more former officials in GLCs. Linda Low, *Rethinking Singapore Inc. and GLCs*, SOUTHEAST ASIAN AFFAIRS 282, 289 (2002).

169. For instance, all of Temasek's directors have considerable business experience in Singapore. Although Temasek appoints former civil servants on GLCs' boards, these appointees only serve a monitoring role. Tan et al., *supra* note 165, at 88-90. To be sure, some level of political intervention remains inevitable. For instance, it is reported that Temasek's decisions have sometimes been made in close consultation with the government. Temasek's CEO Madam Ho Ching is the wife of Singapore's current Prime Minister Lee Hsien-Loong, the eldest son of Lee Kuan-Yew.

170. Tan et al., *id.* at 88-90.

171. Tsui-Auch, *supra* note 167, at 104.

172. It is estimated that GLCs accounted for around 37 percent of the total stock market capitalization among Singapore's listed companies in the 2010s. Tan et al., *supra* note 165, at 67.

Singapore's banking system is also part of the Temasek system. After a wave of bank consolidation after the Asian Financial Crisis, the current banking market in Singapore consists of three main banking groups: the Development Bank of Singapore ("DBS," accounting for 39.63 percent of market share), the United Overseas Bank ("UOB," accounting for 29.38 percent of market share) and the Overseas-Chinese Banking Corporation ("OCBC," accounting for 27.81 percent of market share), which altogether dominated 97 percent of market share in Singapore in 2011.[173] They are not only the largest three banking groups in Singapore but also the largest three business groups among all Singaporean businesses.[174] Among them, DBS is owned by the Singaporean government through the Temasek. As of 2018, Temasek, directly and indirectly, owned at least 29.93 percent of DBS's shares,[175] which allowed the Singaporean government to influence around 40 percent share of Singapore's banking market.[176] The Singaporean government also borrows the practice of "*amakudari* (descent from heaven)" from Japan to increase its influence. Several former and current ministers and top civil servants have served as chairpersons and directors in these private banks,[177] which facilitates the communication between the government and banks.

The extensive government ownership of corporations and banks does not appear to compromise the economic efficiency of Singapore's industries. Empirical studies found that Singapore's GLCs perform better than private companies: their ROA and ROE are superior, their market valuation is higher, and they are also better at managing expenses.[178] GLCs also appear to maintain better corporate governance practice, such as retaining more outside directors and independent directors.[179] In the banking sector, the government's ownership also contributes significantly to Singapore's

173. SHEN CHUN-HUA (沈中華) & WANG LEE-RONG (王儷容), THE KEY FOR TAIWANESE BANKING INDUSTRIES TO GO GLOBAL: COMPARATIVE ANALYSES WITH SINGAPORE AND AUSTRALIA (台灣銀行業走向全球關鍵：與星澳之比較分析) 103-04 (2014).

174. Tsui-Auch, *supra* note 167, at 96-98.

175. DBS, ANNUAL REPORT OF 2018 210-11 (2019).

176. Despite the government's ownership of DBS, it is reported that the Singaporean government does not appear to interfere with the management of DBS or force it to extend policy credits. Chen, *supra* note 167, at 352-53.

177. Tsui-Auch, *supra* note 167, at 102.

178. For a summary of these empirical studies, see Tan et al., *supra* note 165, at 67-69.

179. For instance, compared with family business groups, GLCs retain more outside managers after the Asian Financial Crisis. Tsui-Auch, *supra* note 167, at 107-10. Besides, Temasek is a strong advocate of independent directors after the Asian Financial Crisis, and GLCs retain more independent directors than non-GLCs. Tan et al., *id.* at 90-91; Chen, *supra* note 167, at 339-47.

industrialization. Lee Kuan-Yew, the founding father of Singapore, used to publicly praise DBS that it "helped finance entrepreneurs who needed venture capital because [the] established banks had no experience outside trade financing and were too conservative and reluctant to lend to would-be manufacturers."[180]

Observers often attribute Singapore's success in maintaining an efficient GLCs system to its unique political background. Singapore is a soft authoritarianism regime ruled by a single party, i.e., the People's Action Party ("PAP"), for more than five decades. To win the popular support to sustain its ruling legitimacy, PAP is compelled to deliver good lives to Singaporeans; thus, it is incentivized to provide good economic management to improve Singapore's economy.[181] This urges the Singaporean government to manage GLCs efficiently from time to time.[182]

The case of Singapore illustrates that an authoritarian regime holding extensive ownership of the banking sector can still pursue economic efficiency and create economic success.

C. Summary: A Relative Theory of Private versus Public Sectors

In sum, many East Asian economies achieved their economic growth while maintaining a government-dominated banking system. To be sure, I do not raise these cases to argue that the government-dominated banking model is superior. As will be discussed in the next section, many East Asian economies went into financial crises in the 1990s, which suggested the limits of this model. That said, these cases, together with China,[183] present the first half of a relative theory that justifies the government's control of banking sectors.

Private sectors and public sectors possess their relative strength and weakness in developing an economy. On the one hand, private sectors

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180. Tan et al., *id.* at 81.

181. *Id.* at 69, 85-87. For instance, to deliver good economic management, PAP was forced to prioritize free-market principles and encourage foreign investment. Ashish Lall & Ming-Hua Liu, *Liberalization of Financial and Capital Markets – Singapore is Almost There*, 28 L. & POL'Y IN INT'L BUS. 619, 619-21 (1997). For an introduction to the economic and political background of PAP's ruling of Singapore in the 1960s, see Tan et al., *id.* at 69-77.

182. For instance, after the Asian Financial Crisis, to diversify the risk exposure to weather the economic downturn, Singapore responded quickly by initiating a going global policy which aimed to bring Singapore's economy beyond the region of Southeast Asia. Tsui-Auch, *supra* note 167, at 94. For more discussion, see Chong, *supra* note 160. In the process, the Singaporean government and GLCs played crucial roles in investing abroad, resulting in an interesting phenomenon of "statist globalization." *See* Chong, *supra* note 160, at 955-69.

183. For studies finding that China is similarly a developmental state, see Andrzej Bolesta, *China as a Developmental State*, 5 MONTENEGRIN J. ECON. 106 (2007).

pursue business interests based on their cost and benefit calculation, which makes them more operationally efficient. Several market failures, however, may prevent them from acting developmental. For instance, they could be short-termist and thus less inclined to invest in long-term projects that are development-promoting. In addition, they may incur collective action problems which prevent them from coordinating into a grander development project.[184] In light of the limits of private sectors, public sectors can perform better in kick-starting an economy's growth at its initial stage of development. Specifically, through the government's coordination, public sectors are more likely to mobilize related resources and concentrate on a single strategically important industry, which, in turn, employs scale of economy to formulate a complete industry eco-system. Some studies of development economics have documented that even those most neo-liberal economies (such as United Kingdom, United States, or Hong Kong) had a period of state protection and support of their financial markets before their financial markets developed.[185]

IV. The Transition of East Asian Developmental States

By far, the proposed relative theory seems supporting China's development theory. The relative theory, however, is less optimistic of the sustainability of a banking sector dominated by a party-state. The relative theory takes into account the dynamism in the course of an economy's development and thus contains a temporal element. It predicts that, as an economy develops and the private sectors mature, the relative efficiency of the state sector vis-à-vis the private sector in developing an economy might reverse. The state's control of the banking sector would thus become increasingly inefficient. For example, the state's allocation of funds might become less efficient than the market's, which results in more bad loans and less support of productive sectors. At a critical point, the state needs to readjust its role in the banking sector.

The experience of East Asian developmental states again illustrates in what circumstances and in what ways would a state-dominated banking system evolve toward a more market-oriented model as the economy grows. All these economies encountered challenges in the 1990s and thus adjusted the state's role in their banking systems. That said, due to the different

184. For a related discussion, see Randall Morck, *Finance and Governance in Developing Economies* 3 ANNUAL REV. FIN. ECON. 375 (2011).

185. *See, e.g.*, Svetlana Andrianova et al., *Political Economy Origins of Financial Markets in Europe and Asia*, 39:5 WORLD DEVELOPMENT 686 (2011).

background and institutions, each economy adopted different approaches of adjustment, which offers a variety of transition models.

A. The Adjustment of the State's Role in East Asian Developmental States

1. Japan: An Economy-driven Evolution Featuring Regulatory Reforms

Although Japan maintained a milder degree of governmental intervention in its banking system, it ran into troubles in the 1990s. In 1994, two urban credit cooperatives, Tokyo Kyowa and Anzen, collapsed and opened the banking crisis in Japan.[186] The crisis then spread to large city banks: Hokkaido Takushoku Bank collapsed in 1997. It also spread to long-term credit banks: Long-term Credit Bank of Japan and Nippon Credit Bank, went nearly insolvent and were nationalized respectively in 1998 and 1999.[187] Between 1994 and 2003, 171 Japanese banks failed, including one city bank, two long-term credit banks, one regional bank, 12 second regional banks, 23 shinkin banks, and 132 credit cooperatives.[188]

The causes of the banking crisis in Japan were many. The most proximate one was the asset bubble in the stock market and real estate market in the late 1980s and the burst of the bubble in the 1990s.[189] Compared with their respective price in 1985, the price of the stock market at its peak in 1989 and the price of the urban real estate market at its peak in 1991 almost tripled. In 2000, however, this growth had dissipated.[190] Many causes could explain the rise and burst of the asset bubble, such as financial liberalization in the 1980s, easier monetary conditions following the Plaza Agreement in 1985, the overconfidence in the prospective of Japan's economy, poor credit risk management by banks, and weak prudential regulation.[191] The burst of the asset bubble also resulted in a serious economic recession in Japan. From 1992 to 2002, known as the "Lost Decade," Japan's annual GDP growth rate

186. Hirofumi Uchida & Gregory Udell, *Banking in Japan*, *in* OXFORD HANDBOOK OF BANKING 873, 899 (Allen N. Berger et al., eds., 2014).

187. *Id.*

188. *Id.*

189. Edward J Lincoln, *Japan: Ongoing Financial Deregulation, Structural Change, and Performance, 1990–2010*, *in* HOW FINANCE IS SHAPING THE ECONOMIES OF CHINA, JAPAN, AND KOREA 143, 149 (Yung Chul Park & Hugh Patrick eds., 2013).

190. *Id.* at 149-50.

191. Wataru Takahashi, *The Japanese Financial Sector's Transition from High Growth to the "Lost Decades"*, *in* EAST ASIAN CAPITALISM: DIVERSITY, CONTINUITY, AND CHANGE 201, 213 (Andrew Walter & Xiaoke Zhang eds., 2012). For a summary of the causes of the banking crisis in Japan, see Uchida & Udell, *supra* note 186, at 901-02.

was only 0.8 percent on average.[192] The economic stagnation turned the attention of Japanese reformers to the inefficiency of Japan's financial system.

Against this background, banking reforms taken by Japan since the late 1990s were mainly regulatory, known as the "Big Bang" reform.[193] Part of the Big Bang reform aimed at establishing a modern banking supervisory structure to address the banking crisis. Japan established the Financial Services Agency ("FSA") in 1998 to assume the financial supervisory authority from the Ministry of Finance.[194] To combat NPLs in the banking system, FSA required banks to write off their bad loans in the 2000s, which shrank the NPLs of Japanese banks from 43.2 trillion yen in 2002 to 12.0 trillion yen in 2007.[195] To establish minimum protection against capital risks, FSA introduced the Basel capital rules to regulate the capital adequacy of Japanese banks. These reforms built a more prudent regulatory environment for Japan's banking sectors.

On the other hand, part of the Big Bang reform aimed at deregulating the financial sector to enhance the financial efficiency in supporting the economy. For instance, by permitting the incorporation of financial holding companies in 1997, Japan liberalized the long separation of banks from securities firms, which led to the combination of fifteen large banks and other financial institutions into four major financial holdings.[196]

The Big Bang reform also tackled the Japanese government's intervention in the banking system.[197] FILP and postal savings were the principal targets. Reformers criticized the politically-motivated allocation of funds made by FILP and postal savings and argued that these mismanagements led to excessive public works which caused the asset bubble.[198] To mitigate the governmental intervention, reformers firstly established the Postal Savings Agency in 2001 to take charge of postal

192. World Bank Open Data, *GDP – Japan*, http://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=2002&locations=JP&start=1992 (last visited Aug. 19, 2019).

193. For a summary of the Big Bang reform during this period, see Lincoln, *supra* note 189, at 184. For a brief introduction to the evolution of the banking system in Japan, see Takahashi, *id.*

194. For a brief introduction to why the Ministry of Finance's power was deprived, see Lincoln, *id.* at 180-83.

195. *Id.* at 155.

196. *Id.* at 156.

197. For a summary of the reforms targeting at government financial intermediation, see *id.* at 185-90.

198. It was found that the Liberal Democratic Party, the ruling party in Japan then, used loans from government banks for political purposes, such as their recommended electoral candidates who were electorally vulnerable or senior. *See generally* Imai, *supra* note 99.

savings services.[199] The reform further ensured the operational independence of the Postal Savings Agency by allowing it to invest its fund without turning over to the Ministry of Finance. In 2003, the Postal Savings Agency was corporatized into the Japan Post, a government-owned company. In 2006, insisted by Premier Junichiro Koizumi, the Japan Post drafted a long-term privatization plan, under which it would: first, transform into a holding company holding all the shares of the savings bank; and second, sell two-thirds of the shares of the savings bank to private investors on a progressive basis throughout 2010-2017.[200] The first part of the plan was realized in 2007: the Japan Post, a government-wholly-owned holding company, incorporated the Japan Post Bank and Japan Post Life Insurance to conduct postal savings businesses and life insurance businesses respectively. Today, the Japan Post Bank is the single largest depository institution in Japan.[201] The second part of the plan has also been on its way. In 2015, Japan's Ministry of Finance initiated a "triple-head" IPO plan, in which it sold 11 percent shares of the Japan Post, Japan Post Bank, and Japan Post Life to the public.[202] In addition to the privatization of Japan Post, other government financial institutions experienced significant changes as well.[203] These reforms "paved the way for a smaller role of government in mediating financial flows."[204]

In sum, Japan's banking reform was mainly a response to the banking crisis and economic recession in the 1990s. Japan reduced the government's intervention in the banking system by adjusting the government's role from a guider, which frequently issued administrative guidance without legal basis, to a regulator, which supervised banks based on banking laws and regulations. The case of Japan suggests that excessive governmental intervention in the banking system could result in excessive infrastructure

199. Uchida & Udell, *supra* note 186, at 886-87.

200. *Id.*

201. *Id.*

202. Atsuko Fukase, *Japan Post Prepares to Deliver $12 Billion IPO*, WALL ST. J., Nov. 2, 2015.

203. For instance, Prime Minister Junichiro Koizumi also pushed forward the privatization of JDB, which led to the corporatization of JDB into a government wholly-owned company subject to future rounds of shares privatization. Several government financial institutions also merged into a single government organization, the Japan Finance Corporation, in 2008.

204. Lincoln, *supra* note 189, at 189. After these reforms, the current financial and banking system in Japan presents a different picture, but only in a modest degree. For instance, although equity finance increases, Japan remains a bank-led system. The misallocation of funds appears to continue: corporate sectors remain investing excessively, which leads to low ROE and ROA. Lincoln, *id.* at 217-18.

investment, which, in turn, result in an asset bubble. As China's real estate price continued to soar, China should closely watch if it has proceeded into this critical intersection.

a.2.South Korea: A Crisis-driven Evolution Featuring Privatization

In South Korea, its government- and *chaebol*-driven model also came with a price. In contrast with Japan, South Korea had a strong government-dominated banking system during the fast-growth period. Under this government-dominated banking system, banks were less incentivized to establish their risk assessment capabilities.[205] The government's focused support of *chaebols* to pursue economies of scale thus resulted in hugely leveraged *chaebols*,[206] serious NPL problems in the banking system,[207] and low profitability of banks.[208] These problems forced the South Korean government to commence a series of financial liberalization and bank privatization in the 1980s, but these reforms were in general "cosmetic" as mentioned above.[209] The government continued controlling the management of privatized banks and dictating their lending decisions, which maintained the government-dominated banking system in South Korea.

The first real challenge to this government-dominated banking system took place in 1993 when President Kim Yong-Sam took his office. President Kim, as the first civilian president, shifted the national policy of South Korea from a development-oriented one to a globalization-oriented one.[210] He abandoned industrial policies by merging the Economic Planning Board to the Ministry of Finance and Economy, which symbolized the demise of planning in South Korea.[211] In addition, to apply for the OECD membership

205. Kiseok Hong & Jong-Wha Lee, *Korea: Returning to Sustainable Growth?*, *in* THE ASIAN FINANCIAL CRISIS: LESSONS FOR A RESILIENT ASIA 203, 207-08 (Wing Thye Woo et al. eds., 2000).

206. The ratio of debt to equity in the 50 largest *chaebols* was at least 524 percent in 1980 and 454.8 percent in 1985. Moreover, seven of them had a debt ratio over 1,000 percent: The highest one reached 47,699 percent. WOO, *supra* note 109, at 170.

207. The NPL ratio in the banking sector reached 13.7 percent in 1983 and 17 percent in 1985. WOO, *supra* note 109, at 170.

208. The ROA of South Korean banks was 0.56 percent on average from 1990 to 1993 and 0.26 percent in 1996. Noble & Ravenhill, *supra* note 126, at 93.

209. Yung Chul Park, *Financial Development and Liberalization in Korea 1980–2011*, *in* HOW FINANCE IS SHAPING THE ECONOMIES OF CHINA, JAPAN, AND KOREA 225, 227 (Hugh Patrick & Yung Chul Park eds., 2013).

210. Haeran Lim, *Democratization and the Transformation Process in East Asian Developmental States: Financial Reform in Korea and Taiwan*, 33:1 ASIAN PERSPECTIVE 75, 87 (2009).

211. *Id.*

in 1993, President Kim placed financial liberalization as his priority reforms.[212] Specifically, he relaxed and gradually phased out capital account regulations.[213] The liberalization largely enhanced *chaebols*' financial autonomy while reducing the government's control of the credits to *chaebols*, which shifted South Korea's development model from a government-centered one to a *chaebol*-centered one.[214]

The banking system in South Korea, however, went into troubles in 1997 when the Asian Financial Crisis hit South Korea. In South Korea, the financial crisis primarily resulted from the financial liberalization in the 1990s.[215] Due to the deregulation of capital flows, South Korean banks, financial institutions, and large businesses had greater access to cheaper foreign credits, which resulted in a spike of capital inflows from 1994 to 1996.[216] These foreign credits were, however, mainly short-term ones,[217] which flowed via the non-bank financial intermediaries ("NBFIs") controlled by *chaebols* to the long-term investment projects of *chaebols*.[218] This resulted in maturity mismatch which rendered South Korea's economy vulnerable to runs of short-term foreign credits. In the 1990s, when South Korea's trade performance turned bad due to Japanese yen's depreciation, the vulnerability of South Korea's banking system finally floated to the surface. Foreign investors began to lose confidence in the South Korean economy and run. This made the rollover of short-term foreign loans less available, which bankrupted several smaller *chaebols*.[219] At the same time, as financial conditions of *chaebols* deteriorated, NPLs of South Korean banks spiked, which eventually resulted in the insolvency of many banks.[220] As foreign investors withdrew their short-term funding, the foreign reserve held by the Bank of Korea dropped rapidly. This resulted in the downward adjustment of South Korea's sovereign ratings, which made South Korea

212. Kalinowsky & Cho, *supra* note 132, at 225.

213. Park, *supra* note 209, at 227-28.

214. Kalinowsky & Cho, *supra* note 132, at 224-27. *See also* Noble & Ravenhill, *supra* note 126, at 82-83.

215. Hong & Lee, *supra* note 205, at 208.

216. Foreign capital inflow increased from 30 percent of South Korea's GDP in 1994 to 47 percent in 1996.

217. In 1996, it was estimated that nearly 60% of credit in South Korea was short-term with a maturity of less than one year. Kalinowsky & Cho, *supra* note 132, at 226-27.

218. This provided "a seemingly unlimited credit supply" that "further pushed the *chaebol* into their high-flying and high-risk investment plans." *Id.* at 226.

219. The failure of *chaebols* started from Hanbo, the fourteenth largest conglomerate in South Korea, in January 1997, followed by smaller ones such as Sammi, Jinro and Dainong, then the Kia Motors, one of the three largest auto companies in South Korea.

220. Park, *supra* note 209, at 251.

even more difficult to roll over its short-term foreign borrowings. On November 19, 1997, the foreign reserve of South Korea finally depleted; the government had no choice but to seek assistance from the IMF.[221]

To obtain the IMF's assistance, South Korea accepted the conditionality imposed by the IMF. In the IMF's view, the flight of foreign capital from South Korea resulted from investors' loss of confidence in South Korea. To restore it, South Korea needed investor-friendly policies to attract them back.[222] Accordingly, IMF proposed a set of recipes containing large-scale financial deregulation and liberalization, including the deregulation of interest rates, free-floating exchange rates, the improvement of risk management and corporate governance of financial institutions, the revamp of the financial market infrastructure, and the establishment of an independent and unified financial regulatory agency.[223]

Financial liberalization, however, was not the major rescuer of South Korea's banking system.[224] Foreign investors did not come back to South Korea, at least not immediately, after South Korea liberalized its financial sector.[225] Instead, it was the government's massive intervention that saved South Korea's economy. To rescue the dying banking system, the South Korean government took several measures.[226] First, it guaranteed all deposits by establishing the Korea Deposit Insurance Corporation ("KDIC") in 1996 to introduce deposit insurance to protect depositors of banking and non-banking institutions.[227] Second, to rescue and recapitalize insolvent banks, the government nationalized eight commercial banks in this period, which increased the government ownership in the banking sector from 33

221. For a brief account of the events leading to the 1997 financial crisis in South Korea, see Park, *supra* note 209, at 246-51; Hong & Lee, *supra* note 205, at 206-10. For a discussion of the political factors leading to the outbreak of the financial crisis in South Korea, see Stephan Haggard & Andrew MacIntyre, *The Political Economy of the Asian Financial Crisis: Korea and Thailand Compared*, *in* THE ASIAN FINANCIAL CRISIS AND THE ARCHITECTURE OF GLOBAL FINANCE *supra* note 126, at 57, 69-76.

222. Kalinowsky & Cho, *supra* note 132, at 228.

223. Park, *supra* note 209, at 286. Other measures included abolishing the ceilings on foreign shareholdings of a South Korean company, admitting foreign hostile takeovers, permitting foreign directors in financial institutions, etc. Kalinowsky & Cho, *supra* note 132, at 228.

224. *See generally* Kalinowsky & Cho, *id*.

225. It was reported that between 1997 and 2000, net foreign capital inflow only accounted for 5 percent of South Korea's currency reserve increases. *Id.* at 230.

226. For a brief account, see Mayung-Koo Kang, *The Sequence and Consequences of Bank Restructuring in South Korea, 1998-2006 – Too Fast to Adjust*, 49 ASIAN SURVEY 243, 246-55 (2009).

227. Kang, *supra* note 226, at 247.

percent in 1996 to 54 percent in 2000.[228] To finance the nationalization, the government issued Deposit Insurance Fund Bond (a government-guaranteed bond issued by KDIC) in an amount equivalent to 28 percent of South Korea's GDP in 2000, which was "one of the most expensive in recent history."[229] Third, the government restructured NPLs. It firstly closed non-viable banks or consolidated them with viable ones, which significantly concentrated the banking sector in South Korea.[230] It then refinanced those viable ones by establishing the Korea Asset Management Corporation ("KAMCO") to acquire their NPLs.[231] Between 1998 and 2000, KAMCO resolved more than 45 percent of the total NPLs.[232] These measures significantly restructured South Korean banks. Only after the South Korean government cleaned up the mess did foreign investors return.

After foreign investors returned, the South Korean government began to sell its ownership of South Korean banks to foreign investors. The South Korean government promised to IMF that the nationalization of South Korean banks was meant to be temporary. Domestic capital, however, was inadequate to acquire the government's ownership. The government thus turned to foreign investors.[233] Foreign ownership of South Korean banks accordingly skyrocketed. By 2005, among the seven biggest commercial banks in South Korea, six of them were majority-owned by foreign investors.[234] In 2006, foreign investors held 65 percent of the ownership in the entire commercial banking sector; in 1998 this figure was only 18 percent.[235] By 2011, among the largest four commercial banks in South Korea, i.e. Kookmin, Shinhan, Woori, and Hana, foreign ownership became dominant, ranging from 67 percent in Hana to 22 percent in Woori.[236] In

228. Kalinowsky & Cho, *supra* note 132, at 230.

229. *Id.* at 231.

230. After series of closure and consolidation, the number of banks was reduced to 7 nationwide commercial banks and 5 regional banks by 2007, with the four largest banks (i.e., Kookmin, Shinhan, Woori, and Hana) accounting for more than 70 percent of bank assets in 2010. Park, *supra* note 209, at 238.

231. Kalinowsky & Cho, *supra* note 132, at 231-33.

232. Kang, *supra* note 226, at 251. For an account of the process adopted by KAMCO to acquire and resolve these NPLs, see Kang, *id.* at 251-55.

233. *Chaebol* perhaps had enough capital to buy out these banks, but this was politically inviable. Kalinowsky & Cho, *supra* note 132, at 233. For further discussion of the rationale behind the swift sales to foreign investors, see Kang, *id.* at 262-65; Lim, *supra* note 210, at 90-95.

234. Lim, *supra* note 210, at 89-90.

235. Kalinowsky & Cho, *supra* note 132, at 234.

236. Park, *supra* note 209, at 244.

sum, after the Asian Financial Crisis, foreign capitals replaced the government and became the major owner of South Korea's banking sector.[237]

The impact of these crisis-driven and IMF-guided reforms is profound for South Korea's economy. After privatizing banks to foreign capitals, the government's ownership largely shrank. Financial liberalization further compromised South Korean banks' support for investment. For instance, loans to corporate sectors dropped sharply while bank funds increasingly flowed to household and mortgage loans, which contributed to the credit card crisis in 2003 and the mortgage crisis in 2005-2008.[238] Most importantly, they dismantled the developmental state in South Korea, in particular, the collusive arrangement among the government, *chaebols*, and banks.[239] The government's reduced ownership of South Korean banks compromised its ability to implement industrial policies; it accordingly had to turn to other fiscal measures, such as subsidies, to fund industrial policies.[240]

In sum, South Korea's large-scale banking reform was a product of democratic transition, change of political leader, and financial crisis. South Korea's presidential election in 1997 for the first time elected the dissident Kim Dae Jung as the president, who was long against the authoritarian and *chaebol*-led economy. The financial crisis allowed him to introduce IMF and foreign investors to counterbalance the vested interests led by *chaebol*. *Chaebol*'s excessive expansion and poor risk management, which eventually led to the financial crisis, also discredited *chaebol* and weakened their political legitimacy. Only under this political setting did the reduction of the government's role and financial liberalization become politically feasible in South Korea.[241] Moreover, South Korea's case also suggests that an economy needs to be cautious before liberalizing its capital account. Specifically, before liberalizing its financial sectors, an efficient and independent system of financial regulation must be in place.[242] A "wrongly

237. Despite their large ownership in aggregate, they do not control the management of South Korean banks. Park, *supra* note 209, at 244-45.

238. Kalinowsky & Cho, *supra* note 132, at 239-40. *See also* Kang, *supra* note 226, at 244-45, 258-60.

239. Park, *supra* note 209, at 286.

240. Karl J. Fields, *Not of a Piece: Developmental States, Industrial Policy and Evolving Patterns of Capitalism in Japan, Korea and Taiwan, in* EAST ASIAN CAPITALISM: DIVERSITY, CONTINUITY AND CHANGE 46, 54-56 (Andrew Walter & Xiaoke Zhang eds., 2012).

241. For an account of the political economy behind the post-financial-crisis reform in South Korea, see *id.* at 234-37.

242. Park, *supra* note 209, at 292-93 (highlighting that this includes an efficient system of both micro- and macro-prudential regulations and a regime of capital controls and foreign exchange market interventions to better counter the high degree of capital movements,

sequenced liberalization," which partially withdrew the government's control of capital flows without necessary supervisory measures, may be fatal.[243]

b.Taiwan: A Politics-driven Evolution Featuring Market Entry

In the course of Taiwan's development, the Taiwanese government also reduced its intervention in the banking system, though at a less significant level. Different from South Korea, Taiwan was not hit seriously by the Asian Financial Crisis.[244] Therefore, the Taiwanese government never had to privatize its SBs to rescue its banking system[245] and thus manages to dominate Taiwan's banking system even until today. The driving force that modernized Taiwan's banking system was politics instead of the financial crisis.[246]

Taiwan's banking system encountered drastic changes in the 1990s.[247] Before 1991, there were only 10 commercial banks and 12 specialized banks in Taiwan; among them, the Taiwanese government owned all of them except for four commercial banks.[248] In 1991 and 1992, however, the "Big Bang" hit. Taiwan's Ministry of Finance approved the incorporation of sixteen

together with access to short-term reserve-currency liquidity through participation in international cooperative arrangements to prepare for an unexpected reversal in capital flow.)

243. Kalinowsky & Cho, *supra* note 132, at 227.

244. This relative soundness may be attributed to the conservative banking regulation and supervision as well as the slow pace of financial liberalization in Taiwan. Lim, *supra* note 210, at 98-99.

245. To be sure, Taiwan still ran into local financial crisis in the 1990s. Since 1995, Taiwan witnessed explosive runs in its primary financial institutions: between 1995 and 1997 10 credit cooperatives and 27 credit departments of agricultural associations encountered runs, which forced the Taiwanese government to launch the first round of financial reforms to combat these problems. LAI, *supra* note 150, at 89-90, 96-98. The scale, however, was not comparable with that in South Korea during the same period.

246. For a discussion of how Taiwan's financial system allowed it to escape from the Asian Financial Crisis but later on precluded it from large-scale financial reforms, *see generally* Lim, *supra* note 210.

247. Before the 1990s, the Taiwanese government sporadically opened the banking system to private financial institutions, in particular to foreign banks, overseas Chinese capitals, etc., but this openness was mostly strategic and small-scale. LIN, *supra* note 150, at 35-41. Financial liberalization and bank privatization, which already took place in South Korea in the 1980s, did not happen in Taiwan in that period. And one reason why Taiwan did not follow South Korea in denationalizing the banks during the 1980s was that Sun Yat-Sen's philosophy regards banks as prime candidates for tight public control. WADE, *supra* note 140, at 261.

248. LAI, *supra* note 150, at 60-62; *see also* Yang, *supra* note 151, at 298.

private banks in two years,[249] which significantly changed the landscape. After more than two decades of growth and consolidation, today these private banks have acquired equal market share with SBs.[250] The entry of these new private banks, coupled with the interest rate liberalization which was already on the way, aggravated the interest rate competition in Taiwan's banking market. As a result, loan rates declined while deposit rates increased, which benefited both borrowers and depositors.[251] Credit card and car loans also became more common, which benefited public consumers.[252] In these aspects, the entry of private banks indeed intensified market competition and improved the efficiency of Taiwan's banking industry.

Taiwan's move toward this competition-based reform can be explained by at least two accounts: an economic one and a political one. Economically, such reform responded to the financial inefficiency of SBs. Taiwan's primary financial institutions incurred some turbulence in the 1980s.[253] In addition, as the economy went up, excess money flooded into fund markets through a variety of channels, including illegal underground investment companies, which resulted in the stock market and real estate booms (or bubble). As a response, the Taiwanese government initiated banking reforms in 1989 to regulate illegal underground finance. Liberalizing the private entry into the banking sector thus served as a way to introduce underground finance into the formal banking system and subject it to the regulator's supervision.[254]

Politically, the political fragmentation and reconsolidation in Taiwan during the mid-1980s weakened the power of the Taiwanese government and reduced the government's domination of the banking system.[255] Specifically, in 1988, the authoritarian President Chiang Ching-Kuo, the son of Chiang Kai-Shek, passed away, leaving a power vacuum in KMT. After dramatic debates between different factions of KMT, Lee Teng-Hui assumed the president of Taiwan in the same year. Lee's power within KMT, however, was insecure because he was a local Taiwanese while KMT's elders were

249. For a list of these new private banks incorporated in 1991-1992, see Yang, *id.* at 321.

250. In 1992, these new private banks only held 2.76 percent of deposits and 3.90 percent of loans in Taiwan. *Id.* at 322.

251. *Id.* at 320-22.

252. *Id.* at 320-22.

253. In the 1980s, there were sporadic bank run cases, including the notorious Taipei City Tenth Credit Cooperative case, the hugest bank failure case in Taiwan's banking history. These cases, however, only involved trust investment companies and local credit cooperatives, which was relatively small in scale and did not pose systemic risks to the overall banking system.

254. *See* Yang, *supra* note 151, at 293-94.

255. *See* WADE, *supra* note 140, at 289-94.

mostly Mainlanders who could hardly respect Lee. To solidify his power and defend against the opposition from KMT's elders, Lee sought escorts from local Taiwanese businessmen. In exchange for the political support and loyalty from these locals, he released financial prerogative to them by approving the entry of private businesses into the banking system. The fact that fifteen of nineteen applicants managed to obtain approval of bank incorporation in 1991 suggested the ingratiation of the government toward local businesses.[256] Although this rapid liberalization resulted in serious over-banking problems in Taiwan,[257] it managed to reduce the government's dominance of the banking system.

During the same period, the Taiwanese government also began to privatize some SBs. The motives behind were many-fold.[258] The first one relates to the competitiveness of SBs. Taiwanese laws treated SBs as public enterprises and obliged SBs to observe the budget, audits, personnel, procurement, and business regulations that apply to governmental agencies. They also treated bankers in SBs as public officials and applied public official laws to regulate the hiring, evaluation, promotion, and retirement of these bankers.[259] SBs were further held accountable to several governmental agencies, such as Ministry of Finance, Central Bank, Directorate-general of Budget, Accounting and Statistics, Ministry of Examination, and Ministry of Civil Services, etc., as well as congresspersons, which compromised their operational autonomy.[260] The entry of private banks into the market exposed the inefficiency of SBs.[261] Privatization thus became a way out. At the same time, to expand infrastructure construction, the Taiwanese government also faced fiscal problems. Privatizing SOEs became a way to raise finance to balance the government's budget.[262] Hence, in 1998 and 1999, the Taiwanese government privatized nine SBs, representing more than 35.39

256. LIN, *supra* note 150, at 70-72. Lin also observed the capital structure of these newly approved banks and found that their capitals were from either industry, non-bank financial institutions, businesses, or the KMT, which were all business groups with special political connection.

257. Taiwan was considered the most over-banked market in Asia. Lim, *supra* note 210, at 100.

258. *See* YU TZONG-SHIAN (于宗先) & WANG CHIN-LI (王金利), THE EVOLUTION OF TAIWAN'S FINANCIAL SYSTEM (臺灣金融體制之演變) 209-212 (2005).

259. *Id.* at 223-25.

260. *Id.*

261. *Id.*

262. *Id.*

percent of bank asset and 35.05 percent of bank loans in Taiwan.[263] In appearance, Taiwan achieved impressive progress in bank privatization.

These privatizations, however, were mostly cosmetic, and the Taiwanese government never really relinquished its control. As mentioned above, Taiwanese SBs were inefficient because they were treated as public enterprises which are defined as enterprises whose 50 percent ownership or more is held by the government. As long as the government reduced its ownership to below 50 percent, the problems were solved and the Taiwanese government did not need to relinquish its dominance over these privatized banks. Accordingly, after the privatization, the Taiwanese government remained the largest shareholder of these banks and dominated their operation. Among the privatized banks, except for Taipei Bank, the majority board members remained the government's representatives.[264] Hence, despite some "privatization" cases, the Taiwanese government's control over these privatized banks did not fundamentally alter.

In the 2000s, when the opposition party Democratic Progressive Party ("DPP") for the first time won the presidential election and became the ruling party in Taiwan, the pace of privatization mildly accelerated. In 2004, President Chen Shui-Bian declared to launch the second round of financial reforms, which included cutting the number of SBs by half by the end of 2005. Unfortunately, the new administration's efforts largely went in vain after the scandals of corruption broke out in 2006.[265] Several senior officials, including the president Chen Shui-Bian and the first lady Wu Shu-Chen, were found receiving bribes from entrepreneurs on different occasions, including in several consolidation transactions between financial institutions. These scandals seriously discredited President Chen and DPP and directly resulted in DPP's loss of the 2008 presidential election. Due to the serious political backfire, the new administration suspended the plans to privatize SBs. Since then, no bank privatization ever took place in Taiwan.

In sum, Taiwan's banking reform responded partly to the reduced competitiveness of SBs and partly to the political reform and democratization. The transition of Taiwan's banking system corresponds with the political reform and democratization in Taiwan during the same

263. *Id.*

264. *See id.* at 226-28. Taking First Financial Holdings for instance, as of 2016, the Ministry of Finance, together with the government-owned Taiwan Bank, held 18.94 percent of its issued shares, but the MOF and Taiwan Bank together appointed 9 of 12 directors of the First Financial Holding, including the chairperson.

265. Other factors that obstructed bank privatization in Taiwan included the opposition from labor unions and the over-pricing of the government's shares. *See* Lim, *supra* note 210, at 101-02.

period, which indicated that the driving force behind was not only economics but also politics.

c. Singapore: A Policy-driven Evolution Featuring Professionalization

Similar to Taiwan, Singapore was less hit by the Asian Financial Crisis and thus did not need to surrender its government-dominated banking system. In addition, there are two major private banks in Singapore, UOB, and OCBC, as well as several foreign banks which compete with Singapore's SBs (mainly the DBS). What makes Singapore's model unique, however, is the governance practice of Singapore's SBs.

Although the Asian Financial Crisis did not result in a financial crisis in Singapore, the economic slowdown caused by the regional crisis prompted the Singaporean government to devote to enhancing the operational efficiency of Singaporean firms. This led to three specific moves that reduced the government's impact, i.e., globalization, divestiture of business lines, and professionalization of the management.[266] First, in light of the turbulence and economic slowdown in Southeast Asia, Singapore shifted the focus of its industrial policies toward globalization to diversify its risk exposure. In line with this policy, Singapore liberalized its financial sectors, such as removing foreign shareholding limits and issuing new full bank licenses to foreign banks.[267] This introduced market competition and reduced the influence of SBs. Second, to attract foreign acquisition, the Singaporean government also started to divest its holdings in GLCs, especially for non-core businesses which were "no longer strategic to Singapore or when viable market alternatives or regulatory frameworks are in place"[268] Although the pace of privatization remains gradual and the effects remain mixed, the government's role in GLCs reduced. Finally and most importantly, to enhance the operational efficiency of GLCs, the Singaporean government professionalized the management of GLCs and advocated independent directors. As a result, GLCs became more business-oriented and less government-dominated. In sum, the Asian Financial Crisis and the globalization wave pressed Singapore's developmental state model to evolve toward a less-interventionist fashion.[269]

266. For a brief discussion, see Tsui-Auch, *supra* note 167, at 106-15.

267. *Id.* at 106. *See also* Chong, *supra* note 160, at 970-72.

268. Tsui-Auch, *id.* at 106-07.

269. Some commentators also argued that Singapore's economy is not as splendid as most observers perceive. *See generally* Verweji & Pelizzo, *supra* note 164.

Similar reforms also took place in Singapore's banking sector. After the Asian Financial Crisis, the Singaporean government devoted to improving the corporate governance of SBs and introducing professional management. For instance, it required banks to establish nominating committees to select and appoint board members and senior officers.[270] Accordingly, SBs increasingly recruited professional managers from private sectors. For instance, DBS retained the former JP Morgan banker as its CEO, who led DBS to profits and recovery from the Asian Financial Crisis.[271] Thanks to this government-owned-professionally-managed governance model, also known as the Temasek model, Singapore's SBs incurred fewer corporate governance problems traditionally assigned to SBs. Instead, they appear safe, sound, commercialized, professionalized, and globally-competitive.

China is eager to borrow the experience of the Temasek model to reform its SOEs.[272] Many Chinese reformers believe that the Temasek model, which introduces professional management to SOEs, can reasonably constrain the government's intervention in SOE operation. They argue that this model illustrates that "a highly successful economy and system of corporate governance can be built on a foundation of corporations that have the government as their ultimate controlling shareholder."[273] On the other hand, many commentators cautioned against China's such over-optimism. Some raised several complementary factors necessary for the success of the Temasek model but absent in China, such as high-quality public governance and contested democratic election in Singapore.[274] Others attributed the overall success of the Temasek model to Singapore's tradition of employing GLCs for pragmatic instead of ideological reasons[275] and argued that China

270. Tsui-Auch, *supra* note 167, at 106.

271. *Id.* at 108.

272. Tan et al., *supra* note 165, at 62-63.

273. *Id.* at 64.

274. *See id.* at 93-94. *See also* Chen, *supra* note 167, at 362-65; Cheng Han Tan, *The Beijing Consensus and Possible Lessons from the "Singapore Model"?*, 10-15 (NUS Centre for Asian Legal Studies Working Paper, No. 2016/001, 2016). In particular, they emphasized that political liberalization with open elections in Singapore plays an important role for the PAP to detect the public's reaction to its economic measures and fine-tune its economic policies, including its use of GLCs, toward public goods. Tan, *supra* note 274, at 15-17. For different opinion arguing that Singapore's lack of true political democracy compromised its economic achievement and resulted in domestic economic problems, see Verweji & Pelizzo, *supra* note 164, at 29-31.

275. Specifically, Singapore established GLCs to address the market failure in Singapore, in particular, the inadequate supply of industrial finance from local private bankers due to their limited experience and ability. Since GLCs serve pragmatic purposes, the Singaporean government well-recognized the pragmatic limits of SOEs, such as the inherent inefficiency;

does not hold similar pragmatic attitude toward government ownership.[276] In sum, absent complementary institutions, the Temasek model could be incompatible with China's situation.

Notwithstanding the persuasiveness of these explanations, they overlook a fundamental aspect. Temasek model is business- and profession-oriented due to the direction of Singapore's industrial policies instead of the corporate governance structure. As mentioned above, the Singaporean government sometimes exercised its influence in GLCs and DBS to support its policies, such as providing industrial finance in the 1960s and 1970s and supporting the going global policy after the Asian Financial Crisis. Accordingly, the Temasek model does not preclude the Singaporean government from intervening in SBs. The difference, however, is that the Singaporean government exercises its influence in a business-oriented way. This is because Singapore's industrial policy is different. For other East Asian developmental states, including China,[277] their industrial policies aimed at building domestic businesses and targeting specific industries for development, which incur protectionism and domestic subsidies. For Singapore, its industrial policies aim at attracting foreign investment and becoming globally competitive,[278] which require a global-market-oriented and business-oriented mind. To pursue this different industrial policy, the Singaporean government needs professional managements to operate GLCs and SBs, which resulted in the Temasek model. In other words, the Temasek model still invites governmental intervention, but the government intervenes in a commercial way to attract foreign investment and go global Singaporean businesses.

The Singaporean government adopted a foreign-investment-oriented policy for a political reason. Historically, 'PAP, Singapore's ruling party, did not want strong local businesses to challenge its power. Before the independence of Singapore from Malaysia, local ethnic Chinese businesspersons were the most powerful economic and political interest group. Politically, they opposed PAP's policies.[279] Economically, they

thus it consciously evaluated GLCs based on their operational performance. Tan et al., *supra* note 165, at 83-84. On the other hand, Singapore's attitude toward free trade and free markets is also pragmatic; *see* Wolf, *supra* note 160, at 1435.

276. Others pointed out that Temasek is incentivized to behave professionally and business-oriented because its investments have operation substantially outside Singapore and must abide by foreign laws. Chen, *supra* note 167, at 365-68.

277. BREMMER, *supra* note 16, at 138-41.

278. Wolf, *supra* note 160, at 1433-34.

279. Lee Kuan-Yew, PAP's leader, himself was English educated and could not speak Chinese well, who could hardly win the respect and support from the ethnic Chinese

mainly engaged in export-import trade instead of manufacturing, which was against PAP's industrial policy that prioritized industrialization over export-import trade. Accordingly, after Singapore was separated from Malaysia in 1963, PAP maintained a policy that alienated ethnic Chinese business community. To bypass this powerful business community without harming Singapore's economic development, PAP embraced the two-legged policy and turned to multinationals and GLCs.[280] The Asian Financial Crisis did not alter the above landscape much, except that it spurred the direction of Singapore's industrial policy toward investing globally. So long as Singapore's policy remains connected to global investment, the Temasek model is a rational choice for the Singaporean government.

In sum, Singapore's banking reform is a response to the shifting industrial policies. The direction of an economy's industrial policies can affect the government's intervention in the banking system. In Singapore's case, since its industrial policies concern foreign direct investment and outbound investment, the government tends to exercise its dominance over the banking system in a commercial fashion.

B. The Relative Theory Sequel

The transition experience of these four East Asian developmental states completes the second half of the proposed relative theory. It demonstrates the dynamism of economic development and the unsustainability of the development theory. As an economy grows, the advantages of the state's domination of the banking sector (such as centralized mobilization of investible funds) would gradually fade, while the disadvantages (such as incautious lending and low operational efficiency) would become more obvious. If the state fails to find a balance, a financial crisis or even an economic crisis might occur. The case of Japan and South Korea vividly evidenced this observation, but even Taiwan and Singapore reflected this point. Moreover, the influence of economic development can extend to the political sphere. As an economy develops, the political influence of private sectors would also increase, which produces different chemistry in domestic politics. The corresponding political transition would also impose pressure on the government to readjust its role in the banking sector. South Korea and Taiwan reflected this point. In sum, to move the economy forward, at

community. Tan et al., *supra* note 165, at 70; Wolf, *id.* at 1430-32. For more discussion of why the ethnic Chinese businesspersons opposed PAP, see Low, *supra* note 160, at 417-18.

280. *See* Tsui-Auch, *supra* note 167, at 101-02. *See also* Tan et al., *id.* at 79-84; Low, *id.* at 418.

some point, a developmental state has to reduce its intervention in the banking sector and let market function more.[281]

China also had a similar experience in the late 1990s that supported this dynamism aspect. After the Chinese party-state widely used the four largest SOCBs (the "Big Four") to extend policy-based and political loans in the 1980s and 1990s, the Big Four's average NPL ratio skyrocketed to 21.4 percent by the end of 1995.[282] According to the official estimate, only 20 percent of NPLs resulted from the Big Four's mismanagement of loans while 80 percent resulted from the Chinese government's policy mandates.[283] Due to the rapid accumulation of NPLs, the Big Four's average capital adequacy ratio ("CAR") dropped to only 3.3 percent.[284] Technically speaking, China's banking sector was already bankrupt. To weather this local financial crisis, the Chinese party-state launched a series of rescue measures, including stripping off a huge amount of bad loans from the Big Four, capital replenishment, introducing foreign strategic investors, and listing. In the course of these reforms, the party-state repositioned its role in China's banking sector and introduced more foreign capital and private capital to marketize the system. These moves were even praised by some commentators as a model for governance reform of SBs.[285] China's such relative success in SB transition evidences the unsustainability of the development-oriented SB model. The transition will be necessary at some point.

The chart below illustrates the complete story of the relative theory. The horizontal axis reflects the development level of the economy. The right part refers to a higher development level while the left part refers to a lower development level. The vertical axis reflects the developmental efficiency of a sector. The upper part refers to higher efficiency in supporting economic development while the bottom part refers to lower efficiency. As the chart exhibits, in the early development phase, the state sector might possess relative efficiency over the private sector as the development theory predicts. Nevertheless, as an economy develops and passes the critical intersection point, the state sector would become less efficient as the property right theory predicts. At that point, the state needs to either reduce its role in the banking

281. For an analysis of how the state capitalism cannot sustain for good, see BREMMER, *supra* note 16, at 171-77.

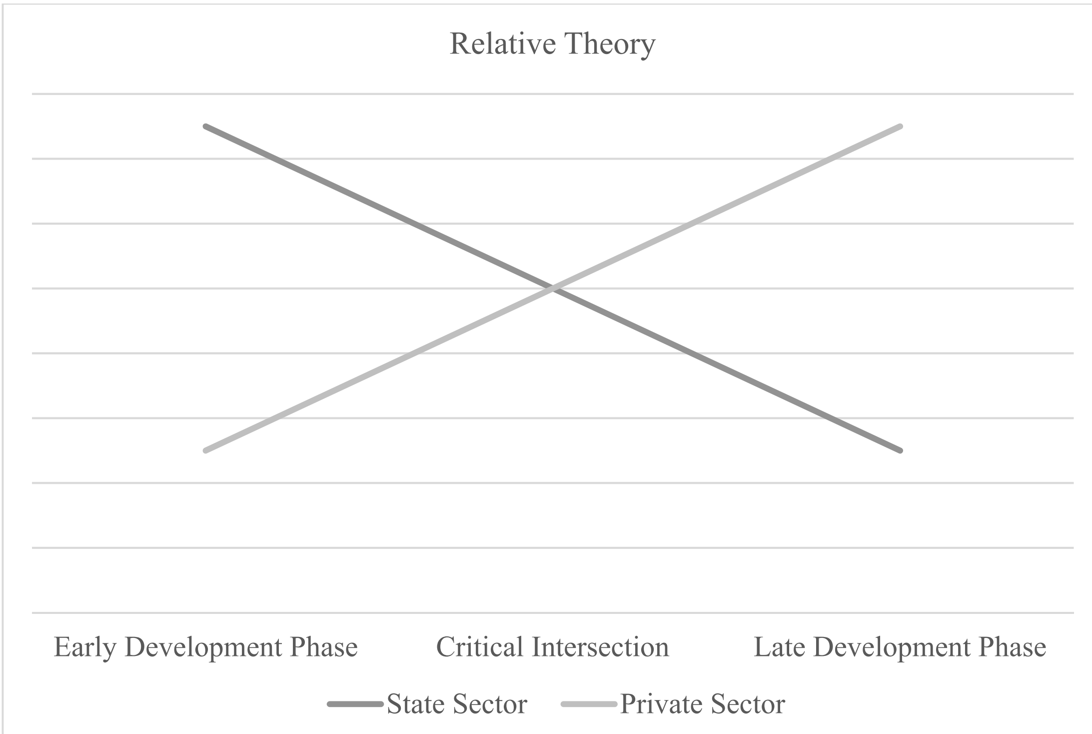
282. LI ZHI-HUI, DEVELOPMENT AND REFORM OF CHINA'S BANKING SYSTEM 108 (2012).

283. LIU, *supra* note 69, at 72.

284. LI, *supra* note 282, at 108.

285. *See generally* Franklin Allen et al., *The IPO of Industrial and Commercial Bank of China and the "Chinese Model" of Privatizing Large Financial Institutions*, EUROPEAN J. FIN. 1 (2014).

sector or at least introduce necessary institutions to improve its efficiency as the revised property right theory suggests. In either case, the state needs to take some form of transition.



That said, the relative theory does not predict any single form of transition. Specifically, ownership privatization, the best practice prescription under the Washington Consensus,[286] is not the only viable option. As the revised property right theory has noted, state ownership of banks is not always harmful, depending on the financial and political institutions of an economy. Consequently, instead of privatizing SBs, an economy can alternatively improve other institutions.[287] The World Bank

286. John Williamson, *What Washington Means by Policy Reform*, *in* LATIN AMERICAN ADJUSTMENT: HOW MUCH HAS HAPPENED? 7, 16 (John Williamson ed., 1990).

287. Bank privatization has its controversies. Empirical evidence found that privatized banks did not necessarily produce superior financial performance. James A. Verbrugge, et al., *State Ownership and the Financial Performance of Privatized Banks: An Empirical Analysis* (World Bank/Federal Reserve Bank of Dallas Conference on Banking Privatization, Washington, DC, March 15th & 16th, 1999) (finding that bank privatization in the 1990s generally improved the operational and financial performance of privatized banks, but such improvement was less pronounced than non-bank privatizations). Specifically, in developing

researches, for example, have shifted their focus to corporate governance reforms of SBs to substitute commercialization for privatization.[288] That the state needs to readjust its role in the banking sector does not necessarily mean that it has to privatize SBs.

The experience of East Asian developmental states again supports this point. Each of them pursued a different pattern of transition due to their different economic and political background. Only South Korea adopted large-scale privatization[289] while Japan focused on regulatory reform, Taiwan focused on market entry reform, and Singapore focused on corporate governance reform. Privatization is merely one of the means to the end of finding a proper state-market balance in an economy's banking sector, not the end itself.

It is perhaps the time for the Chinese party-state to reconsider its role in the banking sector. In the past years, bad loans accumulated rapidly in China's banking sector. In six years, China's bank NPL ratio has increased from 0.95 percent in 2012[290] to 1.83 percent in 2018,[291] almost doubling, and there have been no signs to suggest that this upward trend will cease. Even more troubling is the pace of NPL accumulation in these four years. Between 2012 and 2018, the amount of NPLs has increased by more than RMB 1.5 trillion. Controlling the financial risks in China's banking sector has become

countries, it is found that bank privatization failed to produce superior financial and operating performance; often time the performance deteriorated. William L. Megginson, *The Economics of Bank Privatization*, 29 J. BANKING & FIN. 1931, 1951-58 (2005) (although it also indicated that some studies found the superior performance of privatized banks in transitional countries). Privatized banks in developing countries, compared with those in developed countries, undertook more excessive risks. *See generally* Issac Otchere, *Competitive and Value Effects of Bank Privatization in Developed Countries*, 33 J. BANKING & FIN. 2373 (2009).

288. Specific recommendations include: requiring a clear mandate, aiming at specific target sector, imposing the financial sustainability requirement, stipulating the rules of cooperation with the private sector, positioning SBs as a complementary role, promoting the participation of private banks, designing standards for measuring the public policy performance of SBs, and periodically reviewing the needs of government ownership, etc. *See generally* Herinz P. Rudolph, *State Financial Institutions: Mandates, Governance, and Beyond* (World Bank Policy Research Working Paper No. WPS 5141, 2009); Scott, *supra* note 41; Yaron, *supra* note 19.

289. Although Japan and Taiwan also adopted some bank privatization, the scale and pace were never impressive.

290. CBIRC, *The Table of Major Regulatory Indicators of Commercial Banks (Legal Persons) (2012)* (商业银行主要监管指标情况表(法人) (2012年)) (Mar. 1, 2013), http://www.cbirc.gov.cn/cn/doc/9106/910601/7E1679F277BC4161982E2BCF068E5DDA.html

291. CBIRC, *The Table of Major Regulatory Indicators of Commercial Banks (Legal Persons) (2018)* (商业银行主要监管指标情况表(法人) (2018年)) (Feb. 25, 2019), http://www.cbirc.gov.cn/cn/doc/9106/910601/3954F0B0DF6C47F2AB36C1085791F448.html.

a primary task for the Chinese party-state. At some point, CCP has to face the reality that the current party-state dominated model is not sustainable and start to experiment with a new state-private balance.

In a separate paper, I proposed China to adopt executive reforms to transition toward a more commercialized SB system. In a nutshell, I proposed CCP to recompose the executive team of China's SBs and permit the private block-holders of China's SBs to appoint more bank executives. I argue that such executive reform can facilitate the deliberation between the party-state's policy needs, as represented by party-state executives, and operational efficiency, as represented by block-holder executives, and thus help SBs to reach a better balance and safeguard their soundness.[292] In addition, such executive reform appears to be the most workable solution to the rising risk exposure faced with by Chinese SBs now. For one thing, considering that the size of Chinese SBs now is too big to be evened out by new private banks, the market entry reform as adopted by Taiwan is less an option to China. For another, in China's banking practice, the executive team plays a far more influential role than the board of directors in operating a bank; hence, unlike Singapore's case, reforms in China should focus on bank executives instead of bank boards. On the other hand, considering that the Chinese party-state's back remains crucial for preventing market panics and coordinating rescue actions, large-scale privatization of China's SBs as Japan's or South Korea's case is not a viable option as well. Hence, maintaining the party-state's presence and influence in the banking sector but progressively introducing moderate and credible counterbalance from private block-holders might fit China's current economic and political situation the most.

The U.S.-China trade war might offer a potential opportunity for China to gradually transition to a banking system that is less dominated by the party-state. At first glance, this prediction might seem counter-intuitive. After all, the trade war can potentially deteriorate China's financial sectors, and the Chinese-party state might tighten instead of relaxing its control of SBs to stabilize the financial system as the U.S. government did during the Global Financial Crisis.[293] That said, as the pressure from the United States goes up, China might liberalize its financial sectors as a concession. In May 2018, as a response to the long criticism of its ceiling restriction imposed on

292. *See* Yang, *The Cloud for Dragons and the Wind for Tigers*, *supra* note 6, at 85-103.

293. And the government's enhanced intervention can be an advisable move during a financial crisis. For a related discussion in the U.S. context, see Yueh-Ping (Alex) Yang, *Government Ownership of Banks: A Curse or a Blessing for the United States?*, 10(3) WILLIAM & MARY BUS. L. REV. 667 (2019).

foreign investors on the shareholding of banks,[294] CBIRC announced its plan to abolish this restriction[295] together with other liberalization measures relate to other financial sectors such as securities and insurance. This amendment might progressively increase the influence of foreign block-holders in Chinese SBs. In a similar vein, considering that the United States long criticizes the preferential lending practice of Chinese SBs and characterizes it as an outrageous state subsidy,[296] China might consider reducing its control of the banking sector as a response in the future. The proposed executive reform then may serve a middle ground acceptable to both the United States and China: China can use it to claim that SBs are no longer the state's conduit and thus dilute the state subsidy argument while the United States sees some significant concession from China. The impact of the U.S.-China trade war on China's banking sector remains to be observed.

V. Conclusion

China's success in using SBs to promote economic development offers contemporary literature a chance to reflect on the theory of SBs. The property right theory might be correct about the weakness of the state sector, but it overlooks that private sectors are likely to be even weaker in some settings. In contrast, the development theory might be correct about the relative strength of the state sector vis-à-vis private sectors, but it overlooks the dynamism of an economy in which private sectors can grow and mature. By proposing the relative theory which highlights the relative advantage and disadvantage of the state sector vis-à-vis private sectors, I offer a more balanced view of the SBs practice. Moreover, while acknowledging the potential benefits of SBs, the relative theory also questions the sustainability of the state's domination of the banking sector. The Chinese party-state should be cautioned that the success in the past does not guarantee victory in the future. The proceeding U.S.-China trade war might push China's banking sector closer to the critical intersection depicted in the relative theory, both economically and politically. The proud dragon needs to learn when and how to repent!

294. Daniel C. Crosby, *Banking on China's WTO Commitments: "Same Bed, Different Dreams" in China's Financial Services Sector*, 11(1) J. INT'L ECON. L. 75, 88-96 (2007).

295. CBIRC No. 5 Order (2018).

296. For a related discussion, see Yueh-Ping (Alex) Yang & Pin-Hsien (Peggy) Lee, *State Capitalism, State-Owned Banks, and WTO's Subsidy Regime: Proposing an Institution Theory*, 54(2) STAN. J. INT'L L. 117 (2018).