Consumer Finance and Financial Repression in China

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China is rapidly becoming the world's largest consumer market. As the number of middle-class Chinese consumers has grown, so too has the size of China's consumer finance system. To date, there has been little scholarship on consumer finance in China. This article takes a first step at filling this gap in the literature. It argues that China's consumer finance system is fundamentally a tool of the state, which uses "financial repression" of Chinese consumers to acquire capital through shadow taxation. This political-legal system allows reallocation of consumers' capital for political purposes and underwrites China's rapid growth. But cheap consumer capital has primed the Chinese economy for an economic collapse by encouraging unsustainable asset bubbles. Ironically, this very problem makes it impossible for China to liberalize its consumer finance system, lest a shortage of easy capital precipitate a collapse. China's elite are also against financial liberalization because it is not in their personal interest. Ultimately, meaningful liberalization of China's consumer finance system is unlikely

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because change would require the type of political-legal liberalization which China's government has been unwilling to pursue.

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I. INTRODUCTION

In December 2009, one of China's richest women, twenty-eight-year-old Wu Ying, was sentenced to death.[1] Ying received the death penalty for running an informal finance organization after evidence of financial improprieties appeared.[2] Commentators speculate that her

[1] *Is China's Entrepreneurial Boom at Risk From a Political Crackdown?*, THE ECONOMIST (Apr. 18, 2011), http://www.economist.com/economist-asks/chinas_entrepreneurial_boom_risk_political_crackdown. Several associated individuals also received long sentences. *Id.*
[2] *Id.*

spectacular punishment in a country where informal finance is both illegal and widespread arose from losing money invested by politically connected individuals or from her lack of investment in political "protection."[3]

While Ying's sentence may have been payback for losing the wrong people's money or for failing to pay kickbacks, it also fired a warning shot at Chinese considering unofficial finance channels. It appears the supreme penalty was meted out not just as a personal vendetta, but with the goal of suppressing informal finance. This suppression protects the supremacy of the official financial channels controlled by the Chinese Communist Party (CCP) to enhance its power.

This article argues that controlling the consumer finance system is an important and largely unexamined component of how the CCP maintains its power. China's political-legal structure grants the government almost total control over the consumer finance system. In turn, this enables the CCP to redirect consumers' capital to support its political programs.[4]

The importance of the consumer finance system as a means of steering domestic savings to politically-favored investments represents an example of what the development economics literature terms "financial repression," namely, the use of financial regulation as a means of political control. Financial repression is used to bolster myriad government policies enhancing political stability; it forms the foundation of China's political economy.

The CCP uses the promise of financial growth to perpetuate its power. Consequently, it exerts a heavy hand in financial markets to fulfill this promise. One way it does this is through establishing a set of policies that incentivize consumer savings while simultaneously adopting policies limiting investment opportunities. These policies induce citizens to deposit their savings at state-owned banks.[5] State-owned banks use the

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[3] Xiangyang Tang & Ruoji Tang, *Considered Opinion: The Wu Ying Case*, ECON. OBSERVER, Apr. 19, 2011, http://www.eeo.com.cn/ens/Politics/2011/04/19/199377.shtml.

[4] The Chinese Communist Party and the government of China are normatively distinct entities, but for the purposes of this paper, they will generally be used interchangeably to refer to China's leadership.

[5] A deposit is functionally a loan to a bank, with the interest rate on the deposit being equivalent to the interest rate paid on a loan. In free market systems, banks redeploy the capital accumulated through deposits by investing in projects that they expect to offer a return greater than the interest rate they pay to the depositors. This is what is known as "spread" lending, with the spread being the difference between the return on the investments and the interest rate paid to depositors. China, however, uses its banking system as a way of directing capital to enterprises chosen by the state based on political criteria, rather than on market criteria. By encouraging deposits in state-run banks, the CCP creates a discrete domestic funding source for projects the state—not the market—chooses to fund. This system's key advantage is that it is an incredibly cheap funding source: the CCP controls the interest rates paid to depositors, which it keeps at *negative* rates. Depositors actually pay the state-run banks for the privilege of lending the state-run banks money, money which the banks then use for subsidized lending to state-owned

deposits to subsidize the government and allied sectors, which creates jobs and drives GDP. Accordingly, meaningful consumer financial reform is unlikely because the local government and state-owned enterprises are heavily dependent on this highly-subsidized captive funding source. Many of these entities would be unable to attract investment in a free market system, yet these entities are essential to employment and social stability.[6] Financial repression is also a useful tool in minimizing the impacts of China's rapidly mushrooming public debt.[7]

This article's examination of the role of the Chinese consumer finance system in the Chinese political-legal system adds to both the political and legal literatures on China and to the comparative literature on consumer finance.[8] The current legal literature on the world's second-largest economy has so far avoided looking behind the curtain at the legal and extra-legal norms shaping China's consumer financial system.[9] These norms indicate that while the Chinese consumer economy is booming and there is explosive growth of a Chinese "middle class," China has not developed the sort of robust consumer finance system that facilitates the consumption and investment activities typical of the middle classes in developed nations.[10]

With a weak world economy, weaning enterprises and local governments from captive funding created by financial repression would be an economically perilous endeavor, derailing China's already slowing economy. A weakened economy would rupture the social compact between the CCP and citizens, threatening the CCP's grip on power by upsetting social stability. With inflation rampant, a once-in-a-decade

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enterprises and local governments. *See Trust Belt: Trust Companies are Growing Fast, Fuelling Fears of Excessive Credit Growth*, *infra* note 33.

[6] *See* Keith Bradsher, *China's Grip on Economy Will Test New Leaders*, N.Y. Times, Nov. 9, 2012, http://www.nytimes.com/2012/11/10/world/asia/state-enterprises-pose-test-for-chinas-new-leaders.html?pagewanted=all&_r=0 (describing SOEs' "hammerlock on a long list of strategic industries" in the context of China's latest leadership transition, their role as providers of blue-collar jobs, and the "thorny political issues" that continue to impede meaningful reform).

[7] *Cf.* Minxin Pei, *Are Chinese Banks Hiding the 'Mother of all Debt Bombs?'*, THE DIPLOMAT, Sept. 10, 2012, http://thediplomat.com/2012/09/10/are-chinese-banks-hiding-the-mother-of-all-debt-bombs (discussing the "ticking debt bomb" of China's reliance on bank credit to fuel its way clear of the global recession, the central government's extension of local governments' deadlines to repay by administrative fiat, and other disturbing aspects of the shadow banking system, including significant off-balance sheet debt).

[8] For example, Reinhart & Rogoff's survey of financial repression literature includes only one mention of China—from 1932. Carmen M. Reinhart & Kenneth S. Rogoff, A Decade of Debt (Nat'l Bureau of Econ. Research, Working Paper No. 16827, 2011).

[9] Other articles mention financial repression in China in passing without exploring the issue. *See e.g.*, Ken Miller, *Coping With China's Financial Power*, FOREIGN AFFAIRS, July/Aug. 2010, at 96–109.

[10] That said, because of China's massive population and rapid GDP growth, there will still be plenty of opportunities as financial markets expand.

leadership transition imminent, and an economy starting to slow down, large-scale reforms are unlikely.

Even if such risky reform was considered, the structural and cultural norms of China's political-legal system and its benefits to the nation are fundamentally incompatible with consumer finance liberalization. A weak judiciary and corrupt local governments are unlikely to enforce meaningful modifications because they benefit from the current system. And like "pork barrel" spending in America, controlling—and capturing—the flow of consumer capital is a benefit that elites are loathe to surrender. Despite inefficiencies, the centralized nature of China's current system is well-suited to handling an uncertain economic future. China will not be interested in pursuing large-scale political liberalization essential for a liberalized consumer finance environment.

While consumer finance has recently attracted attention as a legal topic in America, virtually nothing has been written about consumer finance China, the world's largest consumer market by number of consumers.[11] This article is a first step in that direction.

II. THE CCP USES FINANCIAL REPRESSION TO SECURE ITS POSITION AND STRENGTHEN CHINA

The CCP's legitimacy rests on continued economic success. Like a bicycle that topples over when it moves too slowly, China has pushed policies to maintain a growth rate above 8% to generate enough economic opportunities to maintain political stability.[12] All national government financial decisions are consequently based on perpetuating this growth.[13]

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[11] For the studies introducing the concept, see EDWARD S. SHAW, FINANCIAL DEEPENING IN ECONOMIC DEVELOPMENT (1973), and RONALD I. MCKINNON, MONEY AND CAPITAL IN ECONOMIC DEVELOPMENT (The Brookings Inst. ed. 1973). For a more recent study of this governmental practice, and associated techniques for eliminating government debt, see generally Carmen R. Reinhart and M. Belen Sbrancia, *The Liquidation of Government Debt* (Nat'l Bureau of Econ. Research, Working Paper No. 16893, 2011), *available at* http://www.imf.org/external/np/seminars/eng/2011/res2/pdf/crbs.pdf. *See also* Carmen M. Reinhart et al., *Financial Repression Redux*, FIN. & DEV., June 2011, at 22–26 (discussing a resurgence of financially-repressive government policies during the recession and referencing the Reinhart and Sbrancia 2011 NBER paper); *The Great Repression*, THE ECONOMIST, June 16, 2011 (discussing the sovereign debt build-up in the economic crisis, and suggesting financial repression as one possible governmental response).

[12] This goal has recently been revised down to 7%. Simon Cox, *Pedalling Prosperity*, THE ECONOMIST, May 26, 2012, http://www.economist.com/node/21555762.

[13] Matthew Sweeney, Note, *Foreign Direct Investment in India and China: The Creation of a Balanced Regime in a Globalized Economy*, 43 CORNELL INT'L L.J. 232 (2010).

With such growth, China's middle class is rapidly expanding.[14] These consumers earn enough disposable income to choose whether to consume today or save their money for later. Financial repression is a series of political-legal policies that shift the benefits of consumers' capital from the individual to the state. China has implemented policies to encourage consumers to save most of their earnings in state-owned banks.[15] China then redistributes this capital to politically important projects. Many of the defining characteristics of modern China's successful political-economy are underwritten through this redistribution. Consequently, China is unlikely to abandon the benefits provided by financial repression without good cause.

A. Financial Repression

Financial repression occurs when a government uses its coercive power over law, policy, and regulations to siphon private-sector capital towards government policies.[16] Unlike direct taxation, financial repression is invisible to most consumers, even though it similarly decreases their incomes. Financial repression reached its apex in the West between the 1940's and 1970's as nations used it to reduce war debts; it still remains popular with developing nations.[17]

A common example of financial repression is an indebted State pursuing an inflationary monetary policy to reduce the amount of money it must ultimately repay. Many nations still practice light financial repression by limiting investment opportunities, requiring pension funds to purchase government debt, capping interest rates, and regulating cross-border capital flows.[18] In its more extreme form, nations seize citizens' property, reallocate their capital, grant state-owned enterprises monopoly positions, and subsidize industry with consumer capital.

China uses all of the above methods to operate a highly financially repressive regime.[19] Chinese citizens have few investment opportunities in-country;[20] Chinese citizens are allowed limited access to

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[14] China's middle class is predicted to grow to between 600 and 800 million people by 2025. DIANA FARRELL ET AL., FROM 'MADE IN CHINA' TO 'SOLD IN CHINA': THE RISE OF THE CHINESE URBAN CONSUMER (McKinsey Global Inst. 2006), *available at* http://www.mckinsey.com/insights/mgi/research/urbanization/from_made_in_china_to_sold_in_china.

[15] *See infra*. text pp. 402–05.

[16] Reinhart & Rogoff, *supra* note 8, at 4.

[17] *Id.*

[18] *Id.* at 4–5.

[19] Miller, *supra* note 9, at 96.

[20] *Cf.* Julia Werdiger & Bettina Wassener, *Chinese Investors Flock to London to Buy Real Estate*, N.Y. TIMES, Sept. 18, 2010, at B1 (describing the growth of under-the-table Chinese property purchases abroad as one of the best investments available to wealthy Chinese).

overseas investments;[21] interest rates on deposits are low or even negative;[22] and China tightly regulates capital outflows.[23] Local governments in China frequently dispossess property to pursue real estate development,[24] capital is constantly reallocated away from consumers and their choices, and the economy is dominated by consumer-subsidized, state-owned enterprises.[25]

B. China Intentionally Creates High Savings Rates

China's household savings rate is astronomical—up to 29% of urban household income is saved.[26] China uses political-legal tools to keep the savings rate high in order to provide the government with a large pool of additional capital to fund political goals. The CCP has created a society where consumers must possess an independent financial ability to acquire capital to pay for critical life-events otherwise paid for by the state in developed nations.

China's weak social safety net is a principle reason for high savings. Many Chinese are saving for retirement as the nation begins a period of rapid graying resulting from the one-child policy.[27] The need to save for retirement affects all Chinese, and is compounded by China's brittle social safety net, which requires citizens to pay for healthcare, unemployment, and disability insurance, and even for primary education.[28]

Another reason the Chinese save so much is that the government has created a financial system where middle-class citizens have access to

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[21] Miller, *supra* note 9, at 98.

[22] Tom Orlik, *Eating Bitterness in China's Financial System*, WALL ST. J. CHINA REALTIME REPORT (Mar. 18, 2011), http://blogs.wsj.com/chinarealtime/2011/03/18/eating-bitterness-in-china%E2%80%99s-financial-system/?KEYWORDS=china+banking.

[23] Aileen Wang & Koh Gui Qing, *China Sees Pressure From Rising Capital Inflows: Official*, REUTERS (Apr. 27, 2011), http://www.reuters.com/article/2011/04/27/us-china-economy-hot-money-idUSTRE73Q0W720110427.

[24] *See e.g.*, *Chinese Cabinet Warns Over Eviction of Farmers*, XINHUA (Apr. 4, 2011), http://usa.chinadaily.com.cn/china/2011-04/04/content_12272823.htm (discussing abuse by local governments in forcing the eviction of farmers).

[25] There are around 120 such organizations. STATE-OWNED ASSETS SUPERVISION AND ADMIN. COMM'N OF THE STATE COUNCIL [GUOWUYUAN GUOYOU ZICHAN JIANDU GUANLI WEIYUANHUI], YANG QI MINGLU [LIST OF STATE-OWNED ENTERPRISES], http://www.sasac.gov.cn/n1180/n1226/n2425/index.html (listing 117 state-owned enterprises in late 2012).

[26] Marcos Chamon, et al., *The Puzzle of China's Rising Household Saving Rate*, VOX (Jan. 18, 2011), http://www.voxeu.org/index.php?q=node/6028.

[27] Bob Davis, *Chinese Savings Binge to End?*, WALL ST. J. CHINA REALTIME REPORT (Feb. 15, 2011), http://blogs.wsj.com/chinarealtime/2011/02/15/chinese-savings-binge-to-end.

[28] *See generally* Juann H. Hung & Rong Qian, Why is China's Savings Rate So High? A Comparative Study of Cross-Country Panel Data (Cong. Budget Office, Working Paper No. 2010-07, 2010).

few safe investments.[29] China's weak financial disclosures and poor rule of law mean that its stock markets more resemble a casino than a true market.[30] The lack of transparency, non-existent consumer protection NGOs, and oppressive censorship prevent investors from getting the information they need to make rational investments.[31] China's capricious, corrupt government, weak corporate governance, and lack of transparency reward get-rich-quick investment strategies based more on timing the market than on fundamentals.[32] Sensible investors avoid the stock markets. For the average citizen, options for foreign investment are limited, local stock markets are risky, unofficial investments can get you killed, and savings accounts provide a low rate of return. After savings, therefore, those that can afford it invest in real estate.

Similar to American hedge funds, wealthy Chinese have access to loosely regulated financial trusts that pursue various investments directly and offer depositors a higher rate of return.[33] But even these investment vehicles are shut down by the government from time to time.[34] At the same time, the government keeps most investor capital inside China, restricting overseas investment by individuals to less than $50,000 per annum.[35] These factors combine to restrict even wealthy consumers' investment opportunities, while funneling consumer capital toward the State's goals.

A shortage of consumer credit further fuels the high savings rate, forcing Chinese consumers to fund most purchases through savings instead of credit. Many of China's rural banks are saddled with bad loans

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[29] While deposits at state-owned banks are guaranteed by the treasury as "too big to fail," deposits at private banks have no such protection. China has long debated the merits of such a plan, but there are still no concrete plans. In a further sign of the structural implications of financial repression in China, it is reportedly the state-owned banks which most oppose deposit insurance. Keith Bradsher, *China Pushes Deposit Insurance in Bank Overhaul*, N.Y. TIMES, Dec. 13, 2012, http://www.nytimes.com/2012/12/14/business/global/china-is-said-to-consider-plan-to-deal-with-failed-banks.html.

[30] *See generally* Suananda Sen, *Finance in China After WTO*, 40 ECON. & POL. WEEKLY 565 (2005) (discussing disclosure rules). Xiangyang Huang, *It's Time to Clean Up the Stock 'Casino'*, CHINA DAILY, Mar. 8, 2012, http://www.chinadaily.com.cn/cndy/2012-03/08/content_14784047.htm (discussing the casino-like aspects of China's stock market).

[31] *See* Elizabeth Spahn, *Nobody Gets Hurt?*, 41 GEO. J. INT'L L. 861, 894–95 (2010).

[32] Andy Xie, *Trapped Inside a Property Bubble: When China's Real Estate Bubble Finally Bursts While Exports Become Less Competitive, the Consequences Could be Severe*, CAIXIN ONLINE (Jan. 10, 2010), http://english.caing.com/2010-01-10/100106991.html.

[33] *Trust Belt: Trust Companies are Growing Fast, Fuelling Fears of Excessive Credit Growth*, THE ECONOMIST, Feb. 10, 2011, *available at* http://www.economist.com/node/18118975.

[34] *Cf.* Simon Rabinovitch, *Chinese Banks Fight for Deposits*, FIN. TIMES (Oct. 16, 2011), http://www.ft.com/cms/s/0/3ba4e690-f7ec-11e0-a419-00144feab49a.html#axzz1qXjzMua1.

[35] Miller, *supra* note 9, at 98.

and unable to access government relief.[36] Consequently, they provide almost no credit to many Chinese.[37] Traditionally, China's consumers and entrepreneurs have relied on their savings in concert with informal credit services to finance large purchases.[38] The informal loan industry is estimated at $2.6 trillion dollars annually.[39] The interest rates on informal loans range from 18% to 200%, and the loans rarely extend past two years.[40] Informal loans are less than ideal, and their high rates are likely to discourage consumers from tapping into them except in the most extreme situations. Consequently, Chinese rationally opt for high savings rates.

As the story of Wu Ying demonstrates, however, these illegal informal credit networks are being discouraged.[41] While the informal credit system is too vast to be completely quashed, it currently faces significant pressure, which will hurt consumers in need of capital.[42] In theory, this shift in demand away from informal markets could lead larger banks to roll out more consumer-focused products, but, as will be explained below, this is unlikely.

The weakness of China's credit markets is at least partially intentional, allowing the CCP to limit the development of independent power bases.[43] China has a robust entrepreneurial system at the local level, which entrepreneurs can fund through informal means and personal savings.[44] However, there are very few regional-, and even fewer

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[36] *See* Sen, *supra* note 30. *But see China Encourages Rural Bank Development*, CHINA DAILY, Oct. 22, 2012, http://www.chinadaily.com.cn/bizchina/2012-10/22/content_15835313.htm (describing the government-promoted expansion of new rural banks, albeit funded with *private* capital).

[37] Frank Langfitt, *Boom in Shadow Financing Exacts High Toll in China*, NPR, Oct. 25, 2011, http://www.npr.org/2011/10/25/141552651/boom-in-shadow-financing-exacts-high-toll-in-china.

[38] *Is China's Entrepreneurial Boom at Risk From a Political Crackdown?*, THE ECONOMIST, *supra* note 1.

[39] Sen, *supra* note 30.

[40] *See China's Economy: Bamboo Capitalism*, THE ECONOMIST, Mar. 10, 2011, *available at* http://www.economist.com/node/18332610.

[41] *Is China's Entrepreneurial Boom at Risk From a Political Crackdown?*, THE ECONOMIST, *supra* note 1.

[42] China has announced recent plans to restrict informal credit even further. Chris Buckley & Kim Coghill, *China's Wen Sees Progress in Inflation Fight*, REUTERS (Oct. 5, 2011), http://www.reuters.com/article/2011/10/05/us-china-economy-wen-idUSTRE7941F420111005.

[43] Credit can be an exponential force in the creation of independent power, because it can be re-loaned. Well-functioning credit markets display a strong multiplier effect. For example, Bank A loans to Factory B, which extends a 60-day credit to Retailer C, who sells a car with "no money down" to Consumer D. As these systems proliferate, the State loses control over key levers of the economy, especially when a creditor, like Retailer C, is not part of the State.

[44] See Lingling Wei, *Small Companies Teeter as Beijing Tightens Lending*, WALL ST. J. (Oct. 1, 2011),

national-level private firms.[45] A robust credit market with limited state control is necessary for entrepreneurs to expand beyond their local markets, but these firms could also become private economic forces capable of threatening the CCP. Perpetuating weak credit markets maintains firms' dependence on the CCP for capital, increasing the CCP's political supremacy.[46]

Credit cards represent a bright spot of consumer finance growth in China. Accounts grew from eleven million in 2004 to one hundred and twenty-four million in 2008, with an estimated 42% of urban residents now owning one.[47] Credit cards represent a bright spot of consumer finance growth in China.[48] But Chinese consumers approach credit cards differently from their Western counterparts. In China, just 6% of transactions are made with credit cards.[49] Banks have pursued credit cards to attract deposit accounts; they understand that they are offering a convenience service, not a loan.

There are obviously other factors contributing to the high savings rate not tied directly to financial repression. First, a massive gender imbalance has emerged as a malignant side-effect of China's one-child policy, as female fetuses are selectively aborted to ensure that a family's "one" child is male.[50] To attract a bride, young men—and their families—are competing fiercely to save enough to attract ever-fewer potential brides with the lure of a comfortable life.[51] Second, modern China's history of instability encourages liquid savings in case of disaster.[52]

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http://online.wsj.com/article/SB10001424052970204138204576602200899086370.html?gcc=88888&mod=WSJ_hpp_sections_world.

[45] *See id.*

[46] On the other hand, many argue that the recent financial crisis in America and its aftermath exemplify the opposite problem. Instead of banks in the hand of the government as in China, problems arise when government is in the hand of banks. *E.g.*, Kevin Drum, *Capital City*, MOTHER JONES (Jan.–Feb. 2010), http://motherjones.com/politics/2010/01/wall-street-big-finance-lobbyists.

[47] Nin-Hai Tseng, *Why China Won't Charge It*, CNN MONEY (Feb. 14, 2011), http://money.cnn.com/2011/02/14/news/international/china_credit_cards.fortune/index.htm.

[48] *Id.*

[49] *Id.*

[50] *See generally* Brenda Cronin, *Competition for Brides Fuels High China Savings*, WALL ST. J. CHINA REALTIME REPORT (Mar. 10, 2011), http://blogs.wsj.com/chinarealtime/2011/03/10/competition-for-brides-fuels-high-china-savings (stating that there are "1.15 pre-marital-age men for every one woman" in China today, and discussing impact of this on China's high savings rate).

[51] Shang-Jin Wei & Xiaobo Zhang, *The Competitive Saving Motive: Evidence From Rising Sex Ratios and Savings Rates in China* (Nat'l Bureau of Econ. Research, Working Paper No. 15093, 2009).

[52] In the past hundred years China experienced the fall of the Qing Dynasty, the Republican Era, the Warlord Era, the Japanese occupation and war, the Nationalist Era, the Communist revolution, the Great Leap Forward, the Cultural Revolution, and finally, Reform and Opening policies of the past thirty years.

The effectiveness of China's pro-savings policies become clear when one realizes that China experiences these astronomical savings rates despite interest rates that are nearly two points below inflation, meaning depositors lose 2%—and even 3%—of their deposited capital annually, in real terms![53] With inflation recently reaching a thirty-two month high,[54] these deposits are becoming even less valuable. As will be explained below, extraordinary savings rates and low interest payments are the foundation on which China builds its economy. While some of the reasons for the high savings are outside of the government's control, the persistence of a weak safety net and limited social services when China has trillions of dollars in reserves, coupled with poor investor protections, limited investment opportunities, and inadequate consumer credit, is consistent with the view that the State actively works to promote high savings.[55]

C. State-Owned Banks Subsidize Key National Policies Through Reallocating the Proceeds of a Shadow Tax on Consumer Deposits

China's banking sector is dominated by state-owned banks (SOBs), which control 77% of consumer deposits.[56] Unlike America's Federal Reserve, which only sets *target* interest rates, the People's Bank of China (PBC) sets the *actual* interest rates paid on SOBs' loans and deposits.[57]

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[53] *See, e.g.*, *Trust Belt: Trust Companies are Growing Fast, Fuelling Fears of Excessive Credit Growth*, *supra* note 33 (reporting close to a 2% loss on deposits); Rabinovitch, *supra* note 34 (reporting the same figure as a 3% loss).

[54] Paul Sonne & Laurie Burkitt, *China Fines Unilever for Price Comments*, WALL ST. J. (May 7, 2011), http://online.wsj.com/article/SB10001424052748703859304576306401272168750.html?mod=WSJ_hp_LEFTWhatsNewsCollection.

[55] There are a litany of other reasons cited in support of the reserves, including aiding exporters, controlling inflation, and geopolitical investments. But the importance of deposits should not be discounted. Essentially, consumers' negative interest rate deposits function as a quasi-treasury that the government can use as it sees fit through the state-owned banks without having to raise taxes. At the same time, China has indicated it intends to strengthen its social safety net during the next five years. KPMG, CHINA'S 12TH FIVE-YEAR PLAN: CONSUMER MARKETS (Apr. 2011), *available at* http://www.kpmg.com/cn/en/IssuesAndInsights/ArticlesPublications/Documents/China-12th-Five-Year-Plan-Consumer-Markets-201104.pdf.

[56] Sen, *supra* note 30, at 566. Another estimate for 2004 shows SOBs controlling 54% of assets, joint-stock commercial banks controlling 15% of assets, cooperatives with 9% of assets, policy banks with 8% of assets, city-owned banks controlling 5% of assets, foreign banks with 2%, and other banks making up the remaining 7%. KPMG, CHINA'S CITY COMMERCIAL BANKS: OPPORTUNITY KNOCKS? 4, 6 (2007), *available at* http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Documents/China-banks-Opportunity-knocks-200703.pdf. However, policy banks and city-owned banks still receive a high level of national government oversight. *Id.*

[57] Michael Pettis, *What Makes Mr. Zhang Save?,* 33 THE WILSON Q. 61 (Summer 2009).

The PBC has kept both rates extraordinarily low, resulting in an excess of cheap loans issued by SOBs.[58] These low interest rates effectively act as a shadow tax on Chinese depositors, imposing a negative rate of return on deposits equivalent to 65% of consumers' income tax payments.[59] SOBs utilize the low consumer deposit interest rates to subsidize low interest loans to state-owned enterprises (SOEs) and local governments.[60]

China remains wedded to the benefits derived from low interest rates on large consumer deposits, despite evidence that consumers would prefer a banking system designed for their benefit. For example, in early 2011, SOBs demonstrated significant initiative by tapping into this latent consumer demand.[61] In just a few short months, SOBs used regulatory loopholes to create a hundred billion-dollar market for alternative deposit instruments offering positive interest rates.[62] Despite the benefits of these instruments for SOBs and consumers, Chinese regulators banned these products in less than a year.[63] The message to SOBs was clear: financial repression will be maintained, despite consumer demand.

Essentially, the SOBs, the SOEs, and local governments are all subsidized through consumer deposits.[64] To protect SOBs' balance sheets from losses on their uneconomic loans, the PBC must continue to maintain its low interest rate policy, perpetuating this misallocation of capital.[65] The CCP has every incentive to maintain low interest rates to keep the bicycle from toppling over. Leftist commentators eagerly awaiting the rise of China's financial sector to counterbalance what they view as a malignant Wall Street[66] appear oblivious to the fact that China's financial sector is built directly on the appropriation of Chinese citizens' capital.

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[58] *Id.*

[59] Orlik, *supra* note 22. Income tax in China is in principle designed to be progressive, with rates ranging from 5 to 45%. *Overview of China's Tax System: Individual Income Tax*, BEIJING LOCAL TAXATION BUREAU, http://english.tax861.gov.cn/zgszky/zgszky09.htm (last accessed May 17, 2011).

[60] James A. Dorn, *The Debt Threat: A Risk to U.S.-China Relations*, 14 BROWN J. WORLD AFF. 151, 160 (2008); *cf.* Reinhart & Rogoff, *supra* note 8, at 6 (describing the general framework of consumer deposits subsidizing government loans).

[61] *See* Rabinovitch, *supra* note 34.

[62] *Id.*

[63] *Id.*

[64] Dinny McMahon & Jason Dean, *Fitch's Bold Call on China Banking-System Risk*, WALL ST. J. CHINA REALTIME REPORT (March 9, 2011), http://blogs.wsj.com/chinarealtime/2011/03/09/fitch%E2%80%99s-bold-call-on-china-banking-system-risk/.

[65] The majority of SOB's profits come from the roughly three percent spread earned on consumer deposits as a result of artificially low interest rates. Orlik, *supra* note 22; Pettis, *supra* note 57, at 61.

[66] *See e.g.*, Thomas Ehrlich Reifer, *Lawyers, Guns and Money: Wall Street Lawyers, Investment Bankers and Global Financial Crises, Late 19th to Early 21st Century*, 15 NEXUS J. OP. 119 (2009/2010).

The PBC is responsible for maintaining China's exchange rates as well.[67] China's currency, the *renminbi* ("RMB"), is not a freely convertible currency and is not expected to become convertible in the near term.[68] American manufacturers allege China's currency is undervalued by 40%.[69] These low exchange rates subsidize China's export manufacturers by making Chinese goods relatively inexpensive on the world market.[70] China maintains its weak currency by sending hundreds of billions of dollars, largely from consumer deposits, abroad.[71] As a result of this outflow subsidized by consumer deposits, there is less money inside China to compensate depositors through interest rates. Consumer deposits effectively subsidize China's manufacturing and export sector, a key driver of China's spectacular economic growth.

The independent China Banking Regulatory Commission directly regulates Chinese banks' compliance with prudential banking regulations.[72] At the same time, the State Council (China's cabinet) directs general economic policy through bank lending, and sometimes directly pushes specific loans to promote political goals.[73] The PBC oversees implementation of these policies.

This uneconomic approach to lending is a legacy of the SOBs' original mission of funding government initiatives for purely political—not economic—reasons.[74] Although SOBs have gained significant autonomy since the 1980s, there exists conflicting evidence over whether the banking sector is sufficiently self-interested to ensure its safety.[75] For example, China's Premier, Wen Jiabao, recently ordered banks to accept more non-performing loans from small and medium entrepreneurs.[76] During the financial crisis, banks responded to similar political requests by loosening lending.[77] And as the recent crackdown on alternate deposit

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[67] Sen, *supra* note 30, at 566.
[68] Miller, *supra* note 9, at 97.
[69] Joe McDonald, *Struggling to Cool Inflation, Beijing Turns to Last-Ditch Tool of Allowing Stronger Yuan*, ASSOCIATED PRESS, Apr. 29, 2011, *available at* http://www.winnipegfreepress.com/breakingnews/struggling-to-cool-inflation-beijing-turns-to-last-ditch-tool-of-allowing-stronger-yuan-120945384.html.
[70] Orlik, *supra* note 22.
[71] Christopher D. Luer, Note, *Red Banking: Chinese State-Owned Commercial Bank Reform and the Basel II Accord*, 20 MINN. J. INT'L. L. 171, 183 (2011).
[72] Sen, *supra* note 30, at 570.
[73] Sen, *supra* note 30, at 565.
[74] Luer, *supra* note 71, at 174–75; *see also* Yuwa Wei, *An Overview of Corporate Governance in China*, 30 Syracuse J. Int'l L. & Com. 23, 29 (2003).
[75] *Cf.* Richard Wu, *The Changing Regime for Regulating Loans of State-Owned Banks in China: Towards a System of Prudential Banking*, 26 UCLA PAC. BASIN L.J. 107 (2009) (arguing Chinese banks are moving stutteringly toward a profit-based lending regime).
[76] Buckley & Coghill, *supra* note 42.
[77] At the same time, China has promised such reforms for years, and many are skeptical that banks will significantly expand lending to small and medium enterprises. Wei, *supra* note 44.

instruments demonstrates, the State is actively discouraging entrepreneurial activity by SOBs that may distract them from their prime purpose of issuing political loans.

The SOBs can survive issuing these non-economic political loans because they are backed politically and economically by the State. SOBs have received tens of billions of dollars from the treasury to write off bad loans to SOEs.[78] SOBs also benefit from the political-legal policies that create large interest spreads on consumer deposits, allowing them to disburse political loans to state-owned enterprises and local governments at low rates[79] with less concern about repayment.[80]

State-owned enterprises dominate China's economy. SOEs are massive, near-monopolies run by Party members and their cronies to achieve State goals.[81] China's SOEs increasingly pursue funding through equity markets, but still acquire considerable amounts of cheap capital from SOBs.[82] They also dominate the economy. Fifteen of the twenty largest companies traded on the Shanghai Stock Exchange are SOEs.[83] Foreign countries complain that China's policy of creating "national champions" by subsidizing SOEs through easy capital unfairly distorts world markets and disrupts international trade.[84] These subsidies are paid for through China's financial repression policies.

The continued weakness of SOB loan portfolios gives loan officers a strong incentive to lend to politically-backed entities, like SOEs and local governments, instead of consumers. Just as "no one ever got fired for buying IBM," few loan officers ever suffered for lending to an SOE. As a further example of the uneconomic nature of SOBs, loan officers lack incentives to pursue politically riskier—but economically rewarding—loans to private individuals, even when sufficient collateral is present.[85] With loans providing such low government-mandated interest rates, SOBs can ill afford to lose money from defaults by parties whose losses are not backed by the State. Until the government lessens financial repression to make it politically and economically safer for banks to lend to consumers, SOBs have little financial justification to develop a robust

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[78] Sen, *supra* note 30, at 566.
[79] Orlik, *supra* note 22.
[80] *Cf.* Reinhart & Rogoff, *supra* note 8, at 5.
[81] *See* YANG QI MINGLU, *supra* note 25 and accompanying text.
[82] *See* Sen, *supra* note 30, at 565.
[83] William Gamble, *Why State Ownership of Enterprises Will Not Go Away*, MONEY LIFE (May 16, 2011), http://www.moneylife.in/article/why-state-ownership-of-enterprises-will-not-go-away/16409.html.
[84] *See* Doug Palmer, *U.S. Raises Concerns About China's State-Owned Firms*, REUTERS (May 4, 2011), http://in.reuters.com/article/2011/05/03/usa-china-idINW1E7FI02O20110503 (citing a U.S. State Department official who expressed concern over Chinese "state-owned enterprises" receiving regulatory advantages over American competitors).
[85] *China's Economy: Bamboo Capitalism*, *supra* note 40.

consumer finance industry. At the same time, an increase in loan interest rates to compensate for the increased risk of consumer lending would undermine SOEs' access to cheap capital (an essential foundation of the national economy), unless the government deregulated rates or created a tiered system. Significant consumer financial liberalization is unlikely where it could undermine politically-influential SOEs.

Most developed and developing nations, including China, have signed on to the BASEL series of international agreements.[86] Basel sets international standards for banking. BASEL II limits uneconomic loans. Although some argue that BASEL II's risk-based capital requirements prevent uneconomic loans by making such loans too expensive for banks in terms of the capital that they must hold against such loans,[87] the effectiveness of such regulations must be questioned due to the billions of dollars of uneconomic loans China politically forced its banks to issue during the financial crisis.[88]

Lending in China decreased throughout 2011,[89] indicating that China's SOBs may now be too exposed to bad loans to pursue good risk or implement reform. One reputable analyst predicted China will experience a banking crisis by 2013 due to these bad loans and the more than $1 trillion in other risky loans to government-backed entities issued off of SOB balance sheets.[90] China's SOBs are aware of the risk, and claim to have a handle on the situation.[91] Similarly, Chinese regulators are increasing capital adequacy ratios to 11.5% to limit risk,[92] with SOBs actually maintaining higher capital adequacy ratios indicating a defensive position.[93] Regardless of whether China's banks fail, uneconomic lending and high capital-adequacy ratios crowd out opportunities for consumer loans by diminishing the amount of capital available for loans.[94]

Equally important, China's success at maintaining strong growth through two financial crises demonstrates a key benefit of its political economy: centralized control allows the government to rapidly implement

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[86] *Parties to the BASEL Convention: List of Parties and Signatories*, SECRETARIAT OF THE BASEL CONVENTION, http://www.basel.int/Countries/Statusofratifications/PartiesSignatories/tabid/1290/language/en-US/Default.aspx.

[87] However, there is some reason to believe that China will not faithfully implement the agreement. *See* Pettis, *supra* note 57, at 186–87, 196–97.

[88] *See* Orlik, *supra* note 22.

[89] REUTERS, *China Drafts New Rules on Bank Capital Adequacy* (Aug. 15, 2011), http://www.reuters.com/article/2011/08/15/china-banks-idUSL3E7JF0Z920110815.

[90] Most analysts dispute the short-term risk. *See, e.g.*, Rabinovitch, *supra* note 34.

[91] Lionel Barber & Jamil Anderlini, *ICBC Plays Down Credit Boom Risk*, FIN. TIMES (Mar. 28, 2011), http://www.ft.com/intl/cms/s/0/2ca96956-596b-11e0-bc39-00144feab49a.html#axzz1qXjzMua1.

[92] *See* Orlik, *supra* note 22.

[93] *Id.*

[94] *See* Sen, *supra* note 30, at 567.

policies in the face of economic danger.[95] In the most recent crisis, China implemented a "lend first, clean up the mess later" program to escape the downturn.[96] For example, the Industrial and Commercial Bank of China, the world's largest bank, loaned nearly $100 billion to local governments in the aftermath of the crisis, which now accounts for ten percent of its loan portfolio.[97] Many observers believe the easy, plentiful loans to SOEs and local governments, subsidized by consumer deposits, allowed China to maintain its high growth rate.[98] The strategy could again be successful at heading off future crises, and with world markets still unstable, China is likely to preserve one of the core strengths of its system instead of liberalizing consumer finance.

Foreign banks will not exert significant pressure to pursue financial liberalization. Foreign competition for Chinese consumers emerged in concert with preparations for China's WTO ascension in 2001.[99] The initial reforms focused heavily on governance and the safety of the banking system by limiting bank exposure to non-performing loans.[100] As is typical in China, however, these regulations were blunted by weak implementation.[101] This resulted in weaker protections with less pressure for reform on banking competition. In 2009, when profits at SOBs saw double-digit gains, foreign banks like HSBC saw profits collapse by as much as 60% in China.[102] In the same year, foreign banks' Chinese market share fell from 2.16% to 1.71%.[103] This is due to myriad subtle regulatory obstructions foreign banks face mixed with external pressures the banks experienced during the financial crisis. Foreign banks are too small and burdened by external challenges to create competitive pressure in the banking sector in the mid-term.[104] Therefore, they will not be a driving force for reform.

China also uses consumer deposits to underwrite foreign aid and diplomacy. SOBs frequently issue generous below-market loans to foreign nations—to build a port, for example—on the condition that an

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[95] While implementation is often difficult in China, officials fall in to line when the national government makes a policy a priority. Sen, *supra* note 30, at 568.
[96] Barber & Adnerlini, *supra* note 91.
[97] *Id.*
[98] *Decelerating: China's Government May at Last Be Getting a Grip on its Banks*, THE ECONOMIST, Mar. 17, 2011, *available at* http://www.economist.com/node/18396286.
[99] Richard Wu, *supra* note 75, at 127–30.
[100] *Id.* at 128–29.
[101] This is largely because of a weak court system (especially in terms of the enforcement of judgments and court directives), problems registering loan securities, and large numbers of illegal or unenforceable mortgages. Richard Wu, *supra* note 75, at 134–36.
[102] McMahon & Dean, *supra* note 64.
[103] Hu Rongping, *The Decline of Foreign Banks in China*, ECON. OBSERVER (May 6, 2010), http://www.eeo.com.cn/ens/finance_investment/2010/05/06/169378.shtml.
[104] McMahon & Dean, *supra* note 64.

SOE acquires the construction contract.[105] SOBs loaned an estimated $10 billion to developing nations in 2009.[106] These loans play a key role in increasing China's diplomatic influence as Western nations retrench after the financial crisis. Often these loans include exclusive mercantilist access for SOEs to exploit a developing country's resources—resources which China then uses to fuel its own economic growth.[107]

In sum, China's financial sector is not designed to serve consumers' needs. The financial system is a political-legal tool used by the central government to pursue policies foreign and domestic. The State uses financial repression to create huge consumer deposits at SOBs. SOBs then use the artificially large spread on deposits from financially repressed consumers to pursue State policies. There is little chance of consumer financial liberalization because it would undermine social harmony, weaken China's largest companies and local governments, disrupt the underpinnings of the export economy, limit China's ability to respond to a future financial crisis, and constrain China's foreign policy.[108] These vast deposits are an easy source of capital for banks in the face of weak loan portfolios and an uncertain world. Furthermore, financial repression is preferable to direct taxation because of its subtlety, which helps maintain social harmony. Until the government finds another means of addressing all these problems, at a time of less macro-economic risk, consumer financial reform will be negligible.

III. CONSUMER FINANCIAL REFORM IS INCOMPATIBLE WITH CHINA'S POLITICAL-LEGAL STRUCTURE

This section explores the incompatibility between China's political-legal structure and consumer financial liberalization. In communist China, every legal decision is political. Consumer financial liberalization would be ineffective without broad political-legal reform on all levels of government to provide space for private economic actors. The CCP is unlikely to pursue reform because reform would undermine social harmony while limiting its power. The non-independent judiciary will be unable to enforce laws without large-scale reforms sufficient to shift the balance of power between China's government branches. Local governments and their leaders are also unlikely to implement reform because they depend on the status quo for easy capital and government revenue.

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105 *See* Miller, *supra* note 9, at 105.
106 *Id.* at 105.
107 *Id.* at 106.
108 *See* Wang & Qing, *supra* note 23.

A. China's Governmental Structure Makes Reform Difficult to Implement

The Chinese national government sets broad economic policies and national goals, but leaves financial regulation to the ministries and much enforcement to local governments. The consequence of this relationship is that the consumer financial industry is designed to promote political goals, export-oriented industrial growth, social stability, and patronage at the expense of consumers.[109] China's central government has acknowledged it faces growing challenges and is striving to make some reforms.[110] However, the conflicts of interest and structural limitations to reform that arise from China's local judiciary and local governments make meaningful change unlikely absent a wholesale overhaul.

In China, government actions are not carried out according to the rule of law when their result conflicts with the CCP's needs. A vicious cycle exists wherein these extra-legal government actions beget new problems requiring new extra-legal solutions.[111] Contrary to popular belief, however, the CCP is not a monolithic entity.[112] It is composed of various factions ranging from Keynesian capitalists to red Maoists. As a result, although the rule of law in China is weak, it is not always clear which faction will be making the arbitrary decision.

No matter which faction is deciding, the principle of preserving a "harmonious society" runs through almost *every* decision made by the national government, although factions may disagree on how best achieve this principle.[113] It appears that China's leaders believe that the benefits provided by current financial regulations preserve harmony more than reform would, further imperiling the prospect of reform. This is in part because pro-consumer structural changes would lead to severe financial losses amongst SOBs, SOEs, and local governments, which depend on consumer capital to fund many of the activities which promote social harmony.

Liberalization will be avoided because it is volatile, simultaneously disrupting the economy while limiting government resources available to maintain social harmony and political repression. The political changes needed for meaningful liberalization of China's consumer finance system, include, *inter alia*, enhanced property rights, due process, and a more predictable regulatory state, but require the CCP

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[109] *See* Sen, *supra* note 30, at 565.
[110] *See* Guoguang Wu, *China in 2010*, 51 ASIAN SURVEY 18 (2011).
[111] *Id.* at 18.
[112] Cheng Li, *Intra-Party Democracy in China: Should we Take it Seriously?*, CHINA LEADERSHIP MONITOR NO. 30, 1 (2009).
[113] Social harmony is defined as avoiding uprisings. Herbert Claiborne Pell, *Strengthening China's Regulatory Regime: How the United States Can Engage*, 6 S.C. J. INT'L L. & BUS. 53, at 61 (2009–2010).

to reform China's politics by limiting its power, something it is unwilling to do.[114]

B. China's Weak Judiciary is Structurally Incapable of Protecting Citizens' Property Rights

China's judiciary is not structurally independent of other state organs. Judges are removable for displeasing political officials.[115] They are promoted for making politically smart decisions, with judges' salaries paid directly out of the local Parties' general funds.[116] The judiciary's weakness also comes from inexperienced judges, a poor record management system for determining property rights, and debtors' ease of hiding assets.[117]

While China's constitution appears to offer consumers protection, in reality, constitutionally enumerated rights are generally inadmissible in court.[118] China's weak judiciary hamstrings lenders from recovering debts and pursuing financial innovation. The weak judiciary undermines the prospect of a liberalized consumer finance regime because banks are, rightfully, unwilling to issue loans to individuals without a practicable method of vindicating their interests.[119] Investors also have difficulty vindicating their rights through the law.

Developing a truly meaningful consumer finance regime would require a judicially enforceable makeover of China's political economy: corporate transparency and governance would need to be improved; a degree of judicial independence would be required to enforce contracts and protect consumers' rights, especially when a branch of the government or SOE was party to litigation; government regulators would need to be bound by stronger notice requirements to allow markets to

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[114] *Cf. From Sun to Mao to Now: Uncomfortable Comparisons for an Authoritarian Government*, THE ECONOMIST, Oct. 8, 2011, *available at* http://www.economist.com/node/21531524.

[115] Hilfred Ho, *In Search of an Effective Constitutional Enforcement Mechanism in Mainland China: Law and Politics, Which is in Command?*, 6 CAMBRIDGE STUDENT L. REV. 51, 58–59 (2010).

[116] *Id.* at 60.

[117] Richard Wu, *supra* note 75, at 136–37.

[118] *See* Ho, *supra* note 115, at 66–72 (describing the dialogue generated around the *Qi Yuling* case, and the subsequent withdrawal of the 2001 Reply after the change in leadership at the Supreme People's Court and the advent of a new political climate); *see generally* Keith Hand, *Resolving Constitutional Disputes in Contemporary China*, 7 EAST ASIA L. REV. 51 (describing China's recent constitutional legal developments, and providing the broader background of collective political activities—such as bargaining, consultation and mediation—within which the P.R.C. Constitution is properly understood).

[119] For this reason, banks focus their lending on safe entities backed by the government, like SOEs and local governments. Conflicts between these entities and SOBs would likely be handled politically, instead of judicially.

reflect fundamentals instead of luck; at a minimum, freedom of the business and legal press would need to be protected, and bribery and backroom deals would need to be minimized to create opportunities for the best companies to succeed.[120] The judiciary is not currently strong or independent enough to ensure that these reforms could be maintained, even if these reforms were created by statute.

Successful legal reform is, indeed, feasible in modern China. Over the past decades, China successfully reformed the sliver of its judiciary and regulations that dealt with foreign businesses, creating the legal conditions for attracting massive foreign direct investment.[121] But reforming this small slice of China's judiciary created no political risk for the CCP because it dealt mainly with foreigners, thus lacking an impact on the internal harmony of Chinese society. Consumer financial liberalization would be different; the CCP will not implement the reforms necessary for a strong, independent judiciary because such a judiciary would represent too strong check on the CCP.

C. China's Local Governments are too Dependent on the Status Quo to Implement Consumer Financial Reform

Even where the national government adopts liberal consumer finance policies, they are likely to receive inconsistent enforcement at the local level. The problems on the central government level pale in comparison to those on the local level.[122] Local governments are generally run for political ends with little concern for efficacy.[123] This makes implementing laws and pursuing consumer protection especially challenging.

Local People's Congresses (LPCs), the local arm of the CCP, oversee local governments and are generally composed of low- and mid-level party officials who concurrently serve in local government posts.[124] Since LPC representatives are often appointed by the same colleagues they are supposed to oversee, their oversight is blunted by feelings of collegiality.[125] LPCs can appoint and remove local officials for cause, but they are extremely limited in their choice of replacement candidates.[126] Local powerbrokers set the local government's agenda with little

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[120] *See generally* Pell, *supra* note 113.
[121] Sweeney, *supra* note 13.
[122] Guoguang Wu, *supra* note 110.
[123] *See* William Wan, *China's Mid-level Party Officials Spend Professional Training Time Cultivating Allies*, WASH. POST, Oct. 12, 2012, http://articles.washingtonpost.com/2012-10-12/world/35501568_1_communist-party-professors-school-administrators.
[124] Kevin J. O'Brien, *Review Essay: Local People's Congresses and Governing China*, THE CHINA J. 137, No. 61 (2009).
[125] *Id.* at 137.
[126] *Id.* at 136.

opposition, meaning implementation of national reform requires local buy-in. Absent significant pressure from the national government, it is unrealistic to believe that LPCs would implement laws that went against their interest.

The most important reason local governments are unlikely to implement consumer financial reform is that they depend on financial repression to underwrite their budgets. As explained above, SOBs funnel consumer deposits to local governments in the form of state-sanctioned loans. More directly, local governments seize citizens' property and use this cheap capital to underwrite development projects on a terrific scale. These projects are an essential revenue stream: such property sales were estimated to compose up to 70% of local government revenues in 2011.[127]

Reforming China's political economy to limit reliance on property sales would hurt consumers, likely forcing local governments to increase taxes to make up for any revenue shortfall. If the tax increase was large enough, fast enough, and obvious enough, social harmony could be wrecked by angry taxpayers. This is especially true if taxes were increased without legal reform sufficient to protect against future land seizures. Any policy that could result in decreased social harmony would be looked on with skepticism by the national government. Unless the national government offers localities another revenue stream to make up for the shortfall, local governments cannot meaningfully support an end to financial repression without undermining social harmony.[128] Without widespread reform of the structure of local government, there can be no truly credible consumer protection reform, even if appropriate national legislation were in place.

D. Reform is Unlikely Because too Many Powerful Individuals Personally Benefit from the Status Quo

On top of the legitimate structural forces deterring reform, many officials and elites benefit from the status quo. Unlike the efficiency arguments for maintaining China's status quo at the expense of equity, or

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[127] Louisa Lim, *In China, Anger Spreads Over Government Land Grabs*, NPR, Dec. 20, 2011, http://www.npr.org/2011/12/20/144001487/chinese-villagers-angry-at-governments-land-grab. In some areas, property sales amount to 80% of local government revenues. Cary Huang, *Property a Local Government Money Bin*, SOUTH CHINA MORNING POST (Jan. 6, 2011), http://www.scmp.com/article/734906/property-local-government-money-bin.

[128] Even if local governments illegally seize property in violation of national law, they are unlikely to be punished. Citizen complaints to the local judiciary will go nowhere. Citizens are constitutionally entitled to go to Beijing in person to petition the national government, but localities employ a small army of informers, thugs, and police to prevent locals from making the trip or seizing them when they do arrive in Beijing. Without judicial reform, there is no means of preventing these property seizures. *See* James Reynolds, *Lost Voices of China's Petitioners*, BBC NEWS, Mar. 5, 2007, http://news.bbc.co.uk/2/hi/asia-pacific/6420417.stm.

the structural complications of reforming state-owned industries, the judiciary, and local governments, this section argues that powerful people have strong personal incentives to avoid and subvert reform.

Government corruption is perhaps the biggest roadblock to reform. Conviction of officials (at all levels of government) for bribery increased 13% in the past decade; nearly ten thousand officials were charged in the first half of 2010 alone.[129] This increase may be due in part to increased enforcement, and China's truly vast scale; but for every official convicted, how many escape prosecution? The bottom line is that instead of protecting citizens in local financial disputes, officials may accept bribes to stand up for the moneyed interests.

Recently, LPCs were given some degree of authority to create "gap-filling" statutory amendments to apply national statutes to local problems.[130] In this capacity, LPCs would be responsible for implementing and enforcing many aspects of consumer protection laws. LPCs are far from democratic, although a multitude of opinions may be heard.[131] Unfortunately, reform-oriented LPC members are deterred by the very real fear that they may be assaulted or disappeared by local powerbrokers if they go too far in protecting consumers against powerful interests.[132] Any civic-minded desire to protect the people is balanced against a desire to protect their own lives, let alone their careers within the CCP.[133]

Another significant issue is that local officials are evaluated for promotion to higher posts largely based upon achieving economic growth targets. Local officials thus have a personal incentive to subjugate consumer protection to the needs of immediate industrial growth in order to advance their careers.[134] Meeting growth targets by redeveloping dispossessed farmland is far easier than encouraging incremental economic growth among small businesses.

The CCP also has a personal incentive to use financial repression to maintain its grip on power. In China, as elsewhere, the rich get richer while the poor get poorer.[135] Well-connected elites continue to prosper, creating a crucial base of support for the government.[136] Local powerbrokers and government officials can profit more easily through repressing consumers than through sustainable economic development based on consumer financial liberalization and strengthened rule of law.

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[129] Zhang Yen, *Bribery Cases on the Rise in China*, CHINA DAILY (Sept. 8, 2010), http://www.chinadaily.com.cn/china/2010-09/08/content_11271378.htm.
[130] O'Brien, *supra* note 124, at 134.
[131] *Id.* at 133.
[132] *Id.* at 136.
[133] *Id.* at 139.
[134] *See China's Economy: Bamboo Capitalism*, *supra* note 40.
[135] Guoguang Wu, *supra* note 110.
[136] *Id.*

Increased wealth also allows the government to increase its investment in political repression,[137] which, in turn, relieves pressure to grant citizens' rights. The continued use of financial repression is necessary to buy the support of these elites, while the additional wealth transferred by repression grants the state more space to consolidate its power.

IV. CHINA MUST MAINTAIN ITS FINANCIAL REPRESSION TO PREVENT INTERNAL ECONOMIC COLLAPSE

Even if China's political economy could undertake the massive political-legal reforms needed for consumer financial liberalization, for macro-economic reasons, reform in the near-term could be disastrous. Where many look at China and see unprecedented growth, peeking behind the curtains of its political-legal structure shows a more precarious situation. This final section explains that without financial reform, China—and the world's—economy is at risk. But for these same reasons, China must not be too hasty in its reforms.

China has created an unbalanced economy susceptible to shocks by focusing its energies on growth and repression, instead of investing in sustainable development.[138] China is at risk from a growing real estate bubble and ballooning, non-performing debts. Maintaining a regime of financial repression is an effective method for dealing with both of these problems. While maintaining financial repression is the right choice for China today, in the long run it exacerbates the same problems it claims to solve and is incompatible with a modern consumer finance industry.

A. China's Debt Problem Perpetuates the Need for Financial Repression

In recent years, China has run up trillions of dollars in debt.[139] China could have increasing trouble servicing these debts, despite its

[137] *See Id.* at 18.

[138] Michael Schuman, *China's Economic Slowdown: Why Stimulus Is A Bad Idea*, TIME, July 26, 2012, http://business.time.com/2012/07/26/chinas-economic-slowdown-why-stimulus-is-a-bad-idea (describing the dangers of China's unbalanced growth, and the possibility that China's "strained growth model," when combined with attempts by the central government to stimulate the economy during the global economic crisis, would only "exacerbate the frightening distortions within the economy").

[139] *See* Zitan Gao, *Government Report Reveals China Debt Bomb*, THE EPOCH TIMES, Oct. 25, 2012, http://www.theepochtimes.com/n2/china-news/government-report-reveals-china-debt-bomb-307579.html (citing a recent State Council Development Research Center report showing a combined local and central government debt load of approximately USD $3.8 trillion in the wake of the economic crisis and attendant stimulus).

growing economy.[140] This weakness could be undermined rapidly by a shock to the system, such as from a bursting real estate bubble, resulting in defaults across China. This may force China to recall its vast foreign exchange reserves, crippling the world economy. Even if such an extreme scenario does not occur, the catastrophic risk posed by a debt crisis will require China to continue to use financial repression to minimize its debts and provide additional capital, at the expense of consumer financial reform.

The leading thinkers on financial repression, economists Carmen Reinhart and Kenneth Rogoff, argue that easing the repayment of government debt is a principle reason for which nations pursue financial repression.[141] Financial repression allows nations to minimize debt in two respects. On one side of the ledger, governments can minimize the amount of debt they must repay through controlling inflation. On the other side, governments can use methods of shadow-taxation to boost revenue, providing additional funds for repayment. Financial repression remains popular with governments because it allows them to effectively acquire additional capital to repay a decreased amount of debt without much public awareness or criticism.

Chinese statistics are generally unreliable, but they clearly point to broad trends.[142] In the twenty years since 1990, China's foreign debt has increased from a negligible USD $52.5 billion to USD $548.9 billion, an increase of 1,045%.[143] At the same time, China's domestic debt increased from USD $93.46 billion in 1990 to at least an officially estimated at USD $1.66 trillion in 2011, a growth rate of 1,818%.[144] Much of this debt is off of the central government's books, issued to either local governments or to SOEs, but backed explicitly by government guarantees to the loan

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[140] *Id.*

[141] Reinhart & Rogoff, *supra* note 8, at 39.

[142] *Cf.* Simon Rabinovitch, *China: The Case of the Missing Inflation*, FIN. TIMES BLOG (Oct. 19, 2011), http://blogs.ft.com/beyond-brics/2011/10/19/china-the-case-of-the-missing-inflation/?ftcamp=traffic/email/content/booster//memmkt.

[143] *Compare* PEOPLE'S BANK OF CHINA, CHINA STATISTICAL YEARBOOK 1996, TABLE 7–21: BALANCES OF FOREIGN DEBT (providing 1990 foreign debt data, together with figures for total foreign debt in the years 1990–95 in line 1 (in hundreds of millions of USD)), *available at* http://www.stats.gov.cn/english/statisticaldata/yearlydata/YB1996e/G7-21e.htm, *with China's Economic Statistics*, THE U.S.–CHINA BUSINESS COUNCIL (providing 2010 foreign debt data in Table 2: China's Financial Indicators, 2010–11), *available at* https://www.uschina.org/statistics/economy.html.

[144] *Compare* PEOPLE'S BANK OF CHINA, CHINA STATISTICAL YEARBOOK 2000, TABLE 8–2: TOTAL GOVERNMENT REVENUE AND EXPENDITURES AND THEIR INCREASE RATE, http://www.stats.gov.cn/english/statisticaldata/yearlydata/YB2000e/H06E.htm (providing 1990 data), *with* CENTRAL INTELLIGENCE AGENCY, WORLD FACTBOOK: EAST & SOUTHEAST ASIA: CHINA, https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html (providing 2011 data). If other estimates are used for 2011, such as the USD $3.8 trillion dollar domestic debt figure provided in Zitan Gao, *Government Report Reveals China Debt Bomb*, *supra* note 139, China's domestic debt growth would be 3,638%.

issuers—SOBs.[145] In 2009, total debt was estimated at 60% of GDP.[146] In 2011, it was estimated to be between 70–80% of GDP.[147] Total loans to local governments' financial vehicles are estimated to be between USD $2.3 and $3.8 trillion.[148] These numbers are striking, both for their size and the velocity at which they are increasing. And as noted above, while not guaranteed by the government, highly risky underground informal loans are estimated at USD $2.6 trillion. These numbers become especially worrisome as investors start to worry about the health of China's slowing economy. One analyst has called China the "world's most crowded short."[149]

China could be facing a "debt bomb," a globally destructive debt-based collapse explored by Reinhart and Rogoff in their survey, "A Decade of Debt."[150] Applying their model to China leads to troublesome conclusions. In what can only be described as a massive Ponzi scheme, SOBs and local governments have leveraged loans upon loans to buy over-heated real estate assets. Chinese financial regulations prevent banks from issuing loans to cover down payments on real estate mortgages.[151] To work around this, SOBs seeded loosely-regulated trust companies with billions of dollars of consumers' capital.[152] These trusts then loaned the money to financial vehicles created by local governments, which, in turn, used these loans as down payments to secure much larger mortgages on development projects financed by the same SOBs.[153] The risk from these

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[145] Simon Rabinovitch, *Hidden From Sight, Debt Creeps up in China*, REUTERS (July 28, 2009), http://www.reuters.com/article/2009/07/28/us-china-economy-debt-analysis-idUSTRE56Q10920090728.

[146] *Id.*

[147] Minxin Pei, *China's Ticking Debt Bomb*, CNN GLOBAL PUBLIC SQUARE (July 5, 2011), http://globalpublicsquare.blogs.cnn.com/2011/07/05/china%E2%80%99s-ticking-debt-bomb.

[148] These figures are based on an exchange rate of 6.35 *renminbi* to the Dollar. Banks are not allowed to lend directly to local governments for real estate development. Instead, special financial vehicles are set up to receive the funding. For simplicity, these loans will be referred to as loans to local governments, because local governments service these loans through their revenue, and their assets are collateral. Gordon G. Chang, *Chinese Banks Report Outsize Profits*, FORBES (Aug. 27, 2011), http://www.forbes.com/sites/gordonchang/2011/08/27/chinese-banks-report-outsized-profits.

[149] *Shorting China: Panda Bears: Betting Against China is in Vogue*, THE ECONOMIST, Oct. 8, 2011 (quoting recently-released report by Société Générale), *available at* http://www.economist.com/node/21531523.

[150] Reinhart & Rogoff, *supra* note 8, at 11.

[151] *China Said to Warn Banks on Risks Tied to Local Government, Property Loans*, BLOOMBERG NEWS (Nov. 17, 2011), http://www.bloomberg.com/news/2011-11-17/china-said-to-warn-banks-on-risks-tied-to-local-government-property-loans.html.

[152] *See id.*

[153] This kind of land purchase is also usually tied to financial repression, as local governments frequently confiscate such land from citizens with scant compensation. *See* Michael Forsythe & Henry Sanderson, *China Debts Dwarf Official Data with Too-Big-to-*

investments is further exacerbated, because instead of building and then selling the development projects to generate cash flow, many local governments instead have further leveraged this already-leveraged land as collateral to mortgage additional property.[154] Chinese regulators recently put an end to these practices, but there are now billions of dollars of hyper-leveraged mortgages taken out by revenue-poor local governments whose properties are susceptible to price shocks.

These loans are becoming very dangerous—local governments have frequently pledged public infrastructure, like bridges and schools, as collateral; but the CCP would be unlikely to allow SOBs to seize these public goods to avoid disrupting social harmony.[155] If local governments cannot service the loans, either the SOBs or the central government will need to eat the loss. The number of local governments falling behind on their repayments appears troubling. In Liaoning province, 85% of the one hundred and eighty-four local governments defaulted on their debt obligations in 2010, although this Chinese rustbelt province is probably aberrational.[156] Despite the risks, many local governments will continue to look for methods to sidestep such national regulations.[157]

In the event of default, the banks could also seize the mortgaged properties as collateral, if they preserve their value. However, many experts warn of a major property market crash in China arising from property speculation linked to financially repressed middle-class consumers' limited investment opportunities and local government development projects.[158] In early 2011, Chinese property developers composed three of the ten largest "short" positions on Hong Kong's stock market.[159] At the same time, with inflation rates reaching a three-year high of around 6.5% in mid-2011,[160] the middle-class's biggest concern remains a lack of affordable housing.[161] The government fears a shortage

Finish Alarm: China's Under-Reporting Debt, BLOOMBERG, Dec. 18, 2011, http://www.bloomberg.com/news/2011-12-18/china-debts-dwarf-official-data-with-too-big-to-complete-alarms.html.

[154] *Building Excitement: Can China Avoid a Bubble?*, THE ECONOMIST, Mar. 3, 2011, http://www.economist.com/node/18250463. The government now requires loans to be placed into an escrow account used only for development. *Id.*

[155] *See* Chang, *supra* note 148.

[156] Wang Jing, *Auditors Point to Widespread Insolvency in Liaoning Provincial Gov't Assets*, CAIXIN (Sept. 9, 2011), http://english.caixin.cn/2011-09-09/100302306.html.

[157] Xiaoqing Wang and Xuena Li, *Battle of Wills Erupts in Chinese Property Market: Local Governments Parry Beijing's Moves, Inviting Counter-Offensive*, MARKETWATCH, Aug. 14, 2012, http://www.marketwatch.com/story/battle-of-wills-erupts-in-china-property-market-2012-08-14.

[158] *Supra* note 154.

[159] *Id.*

[160] Buckley & Coghill, *supra* note 42.

[161] Huang, *supra* note 127.

of affordable housing could affect social stability[162]—yet because of local governments' hyper-leveraged positions, national policies aimed at making housing affordable could bring down the banking system and local governments by preventing developers from selling their projects at their projected values. It will be hard to please consumers, SOBs, and local governments.

The CCP must maintain its financial repression in the face of the threat of a debt bomb. Financial repression is used to drive up consumer deposits, the lubricant necessary to keep China's economy moving smoothly. These funds capitalize SOBs, SOEs, and local governments. As these entities face a debt bomb, they need the added boost from consumer deposits now, more than ever. Consumer deposits present the government's best defense against the debt bomb because it allows the government to recapitalize these entities with little public scrutiny. Financial reform that benefits consumers will not occur because it would withdraw support for these already unstable entities at a critical time.

B. China's Debt Problem: Implications

If China does not handle its debt problem successfully, it could pull down the world economy. Reinhart and Rogoff analyzed historical financial collapses to develop a model for "fast and furious" economic collapses.[163] Applying their research to China proves sobering. The SOB's off-the-books debt could spark a "fast and furious" financial contagion if the Chinese financial system finds itself suddenly awash in unanticipated risk. This crisis could easily spill beyond China's borders.[164]

Fast and furious contagions first begin with a surprise shock.[165] By definition, a surprise shock cannot be predicted. Frequently, however, the collapse of a key bank or market sector ignites the first sparks. And China's markets are starting to appear unsteady.

The second step in a fast and furious contagion comes when the surprise shock destabilizes an economy characterized by the presence of a housing bubble and massive foreign capital inflows, causing the surprise event to spiral out of control.[166] Both conditions are present in China. A

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[162] *See* Robert Saiget, *China Campaigners Plan New Rallies After Clampdown*, THE SYDNEY MORNING HERALD, Feb. 28, 2011 (citing Premier Wen Jiabao's statements, in the context of the 2011 "Jasmine rallies," to the effect that in China, rising prices have historically often been linked to episodes of mass social instability), *available at* http://news.smh.com.au/breaking-news-technology/china-campaigners-plan-new-rallies-after-clampdown-20110228-1bbfa.html.

[163] Reinhart & Rogoff, *supra* note 8, at 19, 21, 23.

[164] *Id.* at 21.

[165] *Id.* at 19.

[166] *Id.* at 18–20.

substantial number of real estate experts believe China is experiencing a real estate bubble.[167] Chinese government officials recently acknowledged that "hot flows" of foreign capital are negatively affecting the economy, though they plan to curb these influences.[168] Although the total inflows are still relatively small, foreign banks increased their China exposure 86% in 2010, to their highest levels since record keeping began.[169] The last time rates approached these levels, the Asian Financial Crisis washed over the continent.[170] These investments could be seen as demonstrating investor confidence in China's economy. But the investments could also come from uncommitted investors chasing quick growth who plan to withdraw their capital at the first sign of trouble.

Growing inflows also upset China's attempts to control inflation and currency prices, destabilizing the larger framework on which its current export model is built. Consequently, China will continue to strengthen its banking system through continued subsidization of SOBs with consumer deposits to cushion against any shocks. These consumer deposits also provide capital necessary to maintain exchange rates and battle inflation. Moreover, if past behavior is any indication, any risk of instability will be met with a tightening of control, not with liberalization,[171] making reform unlikely if China experiences a downturn.

If the banks are sufficiently weakened in the two first stages of a fast and furious collapse, the third stage of a global contagion could occur. Reinhart and Rogoff's model describes situations where affected countries share a single lender which is forced to retrench when a sudden crisis in one nation forces it to withdraw capital from third-party nations, pulling each one down in turn.[172] While China's foreign debt is negligible, a contagion could spread through the inverse scenario: in the event of a crisis at home, China may liquidate part of its USD $1.16 trillion holding of U.S. treasuries,[173] unleashing massive turmoil in U.S. markets which would cascade throughout the world.[174]

[167] The New York Times featured a debate between ten experts. Some believed a bubble exists; others disagreed. *See China's Scary Housing Bubble*, N.Y. TIMES, Apr. 14, 2011, http://www.nytimes.com/roomfordebate/2011/04/14/chinas-scary-housing-bubble.
[168] Wang & Qing, *supra* note 23.
[169] Foreign banks lent USD $76 billion to Chinese businesses in 2010. Mark Whitehouse, *Number of the Week: Foreign Banks Bet On China*, WALL ST. J. REAL TIME ECONOMICS, May 14, 2011, http://blogs.wsj.com/economics/2011/05/14/number-of-the-week-foreign-banks-bet-on-china.
[170] *Id.*
[171] *Cf.* Guoguang Wu, *supra* note 110 (describing China's harsh backlash in response to the domestic effects of Arab Spring).
[172] Reinhart & Rogoff, *supra* note 8, at 21.
[173] *See* Tony Capaccio and Daniel Kruger, *China's U.S. Debt Holdings Aren't Threat, Pentagon Says*, BLOOMBERG, Sep. 10, 2012, http://www.bloomberg.com/news/2012-09-11/china-s-u-s-debt-holdings-aren-t-threat-pentagon-says.html (citing Treasury data reflecting USD $1.164-worth of U.S. Treasury holdings by China in June 2012).

Getting a handle on debt without disrupting social harmony may explain China's continued choice of opaque financial repression as the preferred method for minimizing debt problems. In conservative estimates, Chinese officials estimate China experiences approximately 90,000 "mass incidents" every year.[175] Public outcry in the United States was huge in the wake of the bank bailouts. Outcry would likely be even greater in China if it had to openly bail out its SOBs. Because the CCP views revolt as its biggest threat, it tries to bury unfavorable facts,[176] and is likely to continue to use consumer deposits and cross-subsidies to cushion debt exposure instead of opting for outright bailouts. The negative interest rate on deposits allows China to shrink debt without raising taxes, and consumers continue to be constrained to capitalize banks through their savings under the current system.

V. CONCLUSION

China is highly invested in the status quo, for economic and political reasons. Financial repression is essential to the CCP's policies for maintaining social stability, enabling it to remain in power while allowing the elites (often members of the CCP) to profit. In the face of China's growing internal debts and a weak world economy, the CCP will stick with financial repression to maintain growth, and to shield its economy. To the extent that some leaders believe consumer financial reform is a necessary prerequisite for future stability and growth, some reform may be possible.

It remains unlikely, though, that—with one of China's most important leadership transitions in decades still under way—China's leaders and institutions will be capable of undertaking serious reforms for

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According to one estimate, this is equivalent to about "21% of the U.S. debt held overseas and more than 7% of the United States' total debt load." Thomas Kenny, *How Much U.S. Debt Does China Own?*, About.com, http://bonds.about.com/od/bondinvestingstrategies/a/Chinadebt.htm (last visited Jan. 6, 2013).

[174] Miller, *supra* note 9, at 99.

[175] "Mass incident" is generally perceived as a euphemism for protests. *E.g.*, Will Freeman, *The Accuracy of China's 'Mass Incidents'*, FIN. TIMES (Mar. 2, 2010), http://www.ft.com/cms/s/0/9ee6fa64-25b5-11df-9bd3-00144feab49a.html#axzz1LRU97t8z (arguing that the definition of the term "mass incident" is so broad as to be misleading).

[176] *See China's Crackdown: The Vindictiveness of China's Rulers Betrays Their Nervousness*, THE ECONOMIST, Apr. 14, 2011 (discussing crackdown on expression by Chinese government in the wake of the 2008 Tibetan riots, and government's fears that if different aggrieved groups were to "coalesce" they could become a "potent force" capable of effecting regime change), *available at* http://www.economist.com/node/18560351.

some time.[177] Despite China's high-level pledges to Treasury Secretary Geithner in May 2011 to minimize the anti-competitive effects of financial repression on foreign companies,[178] serious reform remains unlikely because the revenue generated through financial repression gives the nation an economic edge at a time when it seeks a larger role on a shifting world stage. The overwhelming need to maintain economic growth in order to preserve social harmony indicates China is not interested in cannibalizing a lucrative, unperceived, and massive revenue stream arising from the shadow taxation of consumer finance in the near term.[179] More importantly, without the economic boost of inexpensive capital provided through financial repression, China—and the world—could face grim economic consequences. Consequently, China will not take the steps necessary to create a nourishing environment for consumer finance.

Many experts have argued that the growth of capitalism in China would eventually lead to democratic reform. As this article has shown, however, capitalism in China is not an independent force working against the Chinese Communist Party. Instead, it is the CCP's most important tool for governing and ensuring continued social harmony. The beneficent effects of capitalism envisioned by experts are not derived from markets *ex nihilo*—they depend on a liberalized, rights-based version of consumer financial freedom.

However, consumer financial liberalization is impossible without serious reform of the political-legal structure. Consumer financial liberalization empowers citizens with a bundle of economic rights, which necessarily limit state power. It allows citizens—not the state—to decide how to allocate capital, and it protects the consequences of those decisions from government seizure. Once citizens taste these freedoms, they are likely to demand other rights. A liberalized consumer financial regime would undermine the political and economic foundations on which modern China is built. Therefore, even after ignoring all of the economic factors that argue against consumer financial liberalization, at the end of the day, liberalization will not occur because the prerequisite reforms to

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[177] Matthew Gertken & Jennifer Richmond, *China and the End of the Deng Dynasty*, STRATFOR (Apr. 19, 2011), http://www.stratfor.com/weekly/20110418-china-and-end-deng-dynasty?utm_source=GWeekly&utm_medium=email&utm_campaign=110419&utm_content=readmore&elq=9f5a10e0cb27443aaa4c17d1bd022f0c.

[178] Robin Harding, *Geithner Hails 'Progress' in China Talks*, FIN. TIMES, May 11, 2011, http://www.ft.com/intl/cms/s/0/c834893e-7b5b-11e0-ae56-00144feabdc0.html#axzz1MT13PNSD.

[179] Although China's state-run media report that some banks may move toward market interest rates within the next five years, official pronouncements in China must be seen to be believed. *Cf.* Wang Xiaotian, *Deposit Insurance System to be Introduced*, CHINA DAILY, (Jan. 8, 2011), http://www.chinadaily.com.cn/bizchina/2011-01/08/content_11812713.htm (reporting in 2011 on an impending switch by China's central bank, PBOC, to a deposit insurance system, as a stepping stone to full interest rate liberalization).

the political-legal structure are so far beyond the status quo that nothing short of a top-to-bottom reform of China's political economy would be sufficient.