Horacio Ortiz*

A Comment on “The Institutional Transformation of China’s Stock Exchanges: A Comparative Perspective” by Kay Lyu (AEL: A CONVIVIUM, 2015)

Abstract: This note offers two short comments on Kai Lyu’s paper published by *AEL: A Convivium* in 2015. The note highlights the fact that although the historical comparative perspective is very fruitful, Kai Lyu could have gone beyond the market/state divide, and could have better integrated the roles of stock exchanges in the political economy of China and the US in order to account for their different institutional transformations.

Keywords: China, Stock Exchanges, History, Political Economy

DOI 10.1515/ael-2014-0011

Table of contents

- 1 Beyond the state/market divide
- 2 Political economy matters
- 3 Concluding remarks
- References

Symposium on “Securities Exchanges in the Chinese context: Features, Trends and Perspectives”

- 1 Lyu, Kai (2015) ‘The Institutional Transformation of China’s Stock Exchanges: A Comparative Perspective’, *Accounting, Economics and Law: A Convivium*, DOI 10.1515/ael-2013-0025
- 2 Ortiz, Horacio (2015) A Comment on “The Institutional Transformation of China’s Stock Exchanges: A Comparative Perspective” by Kay Lyu, *Accounting, Economics and Law: A Convivium*, DOI 10.1515/ael-2014-0011
- 3 Kai Lyu, The Role of State/Market Division and Political Economy in Understanding Institutional Transformation of China’s Stock Exchanges: Response to Dr Ortiz, *Accounting, Economics and Law: A Convivium*, DOI 10.1515/ael-2014-0022

Kay Lyu’s (2015) article offers an original approach to understanding the institutional transformation of China’s stock exchanges. He distances himself in two important ways from the standard analysis which consists of simply comparing

*Corresponding author: Horacio Ortiz, Research Institute of Anthropology, East China Normal University, Shanghai, China, E-mail: horacio.ortiz@free.fr

China's stock exchanges with an idealized model of "perfect markets" in order to highlight what separates them from it. First, he does not start from a formal definition of stock exchanges, but takes as a standard the historical process of stock exchanges formation in the United States, the UK and more broadly common law countries. Second, he considers current China's stock exchanges (Shanghai and Shenzhen) with a similar approach, i.e. analyzing their institutional history. The author compares these two histories, in order to assess why China's stock exchanges do not take the form of for-profit listed companies and do not engage in mergers and acquisitions with other stock exchanges. This leads him to a conclusion that seems unavoidable after reading his paper, even though it is often almost taboo to say it: there seems to be no reason to expect a convergence of the institutional framework of China's stock markets with those found in the United States, Europe and many other places.

The method is not only sound, but also very fruitful, leading to a conclusion that is hard to counter. Nevertheless, I would like to highlight two points that would, in my view, improve on the approach and thereby strengthen the conclusion. The first point concerns the need to go beyond the state/market divide. The second point concerns the complementary need to take the political economy into account.

1 Beyond the state/market divide

The first point concerns the fact that, although the author conducts an empirical comparative analysis, he attempts to establish two ideal types which he hopes would allow for categorizing the differences between Shanghai and Shenzhen stock markets and what the author calls the "Anglo-American model." I shall retain this formulation hereafter, although it is a model that has been also followed by Euronext¹, even before its merger with the NYSE, and despite the fact that I shall argue that it may be a misleading concept in important ways. According to the author, these two geographical poles can be characterized by a distinction between an "authority-imposed approach" and "market-induced approach," where "authority" refers to the state as opposed to unspecified non-state actors. This distinction poses at least two problems.

¹ Euronext is an electronic stock market, resulting from the merger of the French, Belgian and Dutch stock markets in 2000. In 2002, it integrated the London International Financial Futures and Options Exchange and the Portuguese stock exchange. In 2007, Euronext merged with the New York Stock Exchange (NYSE).

First, this distinction seems to stumble against the well-known difficulty to distinguish actors and interests in China along the market/state divide. In particular, the distinction proposed by the author between “market actors” and “authorities” is slippery in the Chinese context. Top managers of the exchanges, of the China Securities Regulatory Commission (CSRC) and of the biggest listed state-owned enterprises (SOEs), among which the main financial actors that act as financial intermediaries, are usually members of the Chinese Communist Party (CCP), or have strong links to it. State ownership and the role of the CCP imply that one cannot simply conclude that companies are “market actors” and the state is the sole “authority.” It would be more fruitful to distinguish the different social networks, ideological acquaintances and specific interests that combine and oppose each other, within this broad group of people, to ensue in the policies established through the CSRC (Baker, Biondi, & Zhang, 2010; Hertz, 1998; Hsueh, 2012). This would also imply being more attentive to the different modes of thinking that are at play and that change with circumstances.

Second, it is not clear that such a distinction holds even for the Anglo-American model. The author shows how, in the areas that he designates with this category, for many centuries, stock exchanges were in the hand of a monopoly of market agents, under concessions and privileges granted by the state, who imposed their rules to listing companies and investors. It was only at the end of the twentieth century that this monopoly was broken, by a coalition of state administrators with a free-market outlook and a rising financial power held by bankers and the institutional investors. This does not undermine the conclusion of the author, concerning the fact that there is no convergence to be expected between the two models. Yet, unlike Weberian ideal types, which aim at clarifying salient features of the object of study, the distinction between states and markets used by the author blurs social processes that may be more central for understanding why this is so. In particular, it would be more fruitful to analyze concretely which actors hold monopolies or concentrate decision-taking power in each case.

2 Political economy matters

The second point that is not raised by the author and could have strengthened his conclusion is the fact that stock markets do not occur in a void, but within a particular political and economic configuration that concerns the rest of the economy as well. This is as true for the Anglo-American model as it is for China.

The idea of an Anglo-American model is itself deceitful here, because it encompasses stock exchanges with very different political and economic roles. This poses a problem because the comparison of the different stock markets trajectory in the past, and prospects for the future may be more meaningful at the level of the political economy of which they are part.

Concerning the United States, the author does not even mention what may be the two most important moments of the history of stock markets in the twentieth century: the 1929 crisis and the reshuffle of pension systems in 1974 with the ERISA law. The 1929 stock market crash was followed by massive bankruptcies, among which those of thousands of banks, a considerable credit crunch and massive unemployment. The response, in the form of the New Deal, saw a series of regulatory measures, such as the Glass-Steagall Banking Act of 1933 and the creation of the Securities and Exchange Commission in 1934, enhancing state control over the identity and the activity of companies participating in stock markets (Belze & Spieser, 2005). Stock market performance in the United States was on the whole negative between the late 1930s and 1955 (Jorion & Goetzmann, 1999). In the meantime, growth and the orientation of economic activity during the Second World War was mainly due to the activism of the state, pursuant to policies that had started to be developed during the 1930s (Galbraith, 1975). It would therefore be very misleading to compound this period of stock markets with the one started in the last 40 years.

It is only during the 1950s, with Fordism and the constitution of a middle class with savings and pension aspirations, that stock markets started to become an important political issue again. And their reshuffle and professionalization in the 1974 ERISA law came through an agreement between big companies, trade unions and government. This gave rise to the new institutional investors, in charge of pension plans that were previously managed (and mismanaged) by employers themselves, and who benefited from the inflow of money that this new arrangement secured for them (Clark, 2000; Montagne, 2006). Thus, far from being simply “market-induced” phenomena, the stock markets of the last 40 years in the United States are the result of political negotiations around the use of middle-class savings, establishing a link between the funding of economic activity and the pension system (see also Krippner, 2011).

The US experience, in turn, is hardly generalizable, and this marks the limit of the idea that there is an “Anglo-American” model, even if the convergence of stock markets regulation worldwide along neo-liberal lines is of course a major phenomenon of the last 30 years. The US model of stock markets after the Second World War was quite unique and was linked to the particular capacity of the US financial system to generate and accumulate savings at the time. This experience is very different from that of the stock markets which constituted

Euronext, for instance². These stock markets only picked up after the reshuffle of the US stock markets, in an explicit attempt of all involved actors, including governments, to capture part of the freely circulating global capitals whose mobility was authorized and favored through the rebuttal of the Bretton Woods Accords since 1971. More than 40% of French stocks are owned by foreign investors, making French stock markets much more internationalized than US stock markets, and yet these markets play no significant role in the French pension system. These major differences did not prevent the merger of NYSE and Euronext, but it is misleading to consider the existence of these markets, and their merger, as simply a “market-induced” phenomenon.

In the Chinese case, stock markets have undergone different phases and roles in the short history since the beginning of the “opening and reform” period in the late 1970s. As the author himself remarks, in the 1980s, issuing stocks became a way of funding for SOEs and big companies. But this was the result of governmental policy which reduced other sources of funding, and it was often done by selling stock to employees without active secondary markets. The social connections between fund management companies and listed companies in the 1990s led to several scandals and to a shutting down of an important part of the investment management industry at the time (Fan, 2009; Wang, 2009). It was only with the reshuffle of legislation in the mid-2000s, and the IPOs of the big, state-owned Chinese companies, that stock markets attracted the savings of the middle classes again. The SOEs did not undergo a “privatization,” but what is termed a “corporatization”: only a minority of shares were sold, the state remained the major shareholder, sometimes with more than 70% of shares, and relinquishing of control was never really in the agenda. Issuing stocks and regulating stock exchanges have been a way to tap into savings created by the new economic model in order to fund economic projects that are often strategic in government policy (Hsueh, 2012). The Hong Kong stock market actually plays an integral role in this process, as the door through which these companies can access foreign investment without ever risking losing control to actors outside the networks of the CCP. The recent opening of the Shanghai Hong Kong Stock Connect is an important milestone in this increasing, and transforming, complementarity.

This brief overview of the political economy of the different roles of stock markets highlights the importance of studying not only the microstructure of markets, but also the broader context, including the different economic and

² I acknowledge that addressing the UK case here would be very important, but I will concentrate on the distinction between the United States and Euronext, in particular because of the merger of Euronext and NYSE.

political groups whose tensions, conflicts and negotiations contribute to the particular shape taken by stock markets.

3 Concluding remarks

Just like the differences between continental Europe and the United States did not prevent the merger of Euronext and NYSE, the different organizational structure of Hong Kong, Shenzhen and Shanghai stock exchanges does not prevent the fact that they are today part of a common political and economic configuration. The author concentrates the analysis on the issues of self-listing and mergers of markets. These may not be the best indicators of the major social drivers of the institutional transformation of stock markets. The role of stock exchanges is quite different in China and in the United States, but this difference may not be best grasped by opposing “market” and “authority” or “market” and “state.” There are political and financial relations of power in both cases. And these social relations and the political and economic projects in which stock markets exist cannot be separated from each other. Taking into account these elements, only superficially hinted at here, would probably strengthen the very fruitful methodological approach and the important conclusions of the article.

Acknowledgments: This article has benefited from the very insightful comments of the anonymous reviewers and of the editor of *AEL: A CONVIVIVUM*, Yuri Biondi. All errors that remain are of course of the author. The article was written with the financial support of the European Research Council, ERC Starting Grant 263529.

Funding: European Research Council (Grant/Award Number: ERC Starting Grant 263529).

References

- Baker, R., Biondi, Y., & Zhang, Q. (2010). Disharmony in international accounting standards setting: The Chinese approach to accounting for business combinations. *Critical Perspectives on Accounting*, 21, 107–117.
- Belze, L., & Spieser, L. (2005). *Histoire de la Finance. Le Temps, le calcul, les promesses*. Paris: Vuibert.
- Clark, G. L. (2000). *Pension fund capitalism*. Oxford: Oxford University Press.
- Fan, Y. (2009). China’s asset management industry. In M. Zhu, J. Cai, & M. Avery (Eds.), *China’s emerging financial markets. Challenges and global impact* (pp. 329–341). Singapore: John Wiley & Sons.
- Galbraith, J.-K. (1975). *Money. Whence it came, where it went*. New York, NY: Penguin Books.

- Hertz, E. (1998). *The trading crowd. An ethnography of the Shanghai stock market*. Cambridge: Cambridge University Press.
- Hsueh, R. (2012). *China's regulatory state. A new strategy for globalization*. Ithaca, NY: Cornell University Press.
- Jorion, P., & Goetzmann, W. N. (1999). Global stock markets in the twentieth century. *The Journal of Finance*, 54(3), 953–980.
- Krippner, G. (2011). *Capitalizing on crisis. The political origins of the rise of finance*. Cambridge: Harvard University Press.
- Lyu, K. (2015). The institutional transformation of China's stock exchanges: A comparative perspective. *AEL: A Convivium*. [DOI: 10.1515/ael-2013-0025]
- Montagne, S. (2006). *Les Fonds de Pension. Entre protection sociale et spéculation financière*. Paris: Editions Odile Jacob.
- Wang, D. (2009). China's securities companies: Growth and prospects. In M. Zhu, J. Cai, & Avery, M. (Eds.), *China's emerging financial markets. Challenges and global impact* (pp. 251–262). Singapore: John Wiley & Sons.