# State Capitalism and Shadow Banking in China


## Abstract

The Xi-Li administration faces the dual challenge of managing state capitalism and shadow banking as China enters a phase of more moderate economic growth. During China's first three decades of reform, private sector development occurred in parallel with prioritization of state-owned enterprises in strategic industries, and growth surged. This pattern of state capitalism rested on an unarticulated bifurcated financing arrangement whereby the formal banking system primarily served public enterprises, while private businesses relied primarily on informal finance. However, China's response to global financial crisis disrupted the preceding equilibrium of financial dualism under state capitalism. Unprecedented expansion of bank lending after 2008 created opportunities for a host of state economic actors—including SOEs, state banks, and local governments—to expand their participation in off-balance sheet activities. Yet the resulting vibrancy of the shadow banking markets did not result from financial deregulation. Financial repression remains. Instead, the government's Keynesian effort to avoid recession inadvertently incentivized the very agents of state capitalism to partake in shadow banking. The concomitant spread of Internet and social media fueled an equally unexpected "liberalization" in the technologies of and participants in informal finance. Middle class savers are investing in wealth management products through mobile devices, and those same products are being invested in a variety of private ventures promising high returns. State capitalism and shadow banking have now intersected and developed areas of mutual dependence, or more accurately, mutual liability. China's present leadership has thus signaled intentions to curb the scope of state capitalism and shadow banking, including official corruption associated with both. These efforts, however, face a variety of political and institutional challenges.