Working Paper No. 1086

Reform in the Chinese Banking System: Zhu Rongji's and Its Aftermath

by

Leonardo Burlamaqui
Department of Economic Evolution, State University of Rio de Janeiro
Levy Economics Institute, Bard College
Brazilian School for Advanced Studies, UFRJ

July 2025

* Professor at the Economic Evolution Department, Faculty of Economics and Business, UERJ. Research Fellow, Levy Economics Institute, Bard College. Adjunct Professor, Brazilian School for Advanced Studies, UFRJ.

Author's Note: I am grateful to José Antonio Pereira de Souza, Adriano Proença, Carlos Medeiros, Randall Wray and, especially, Ernani Torres Filho, for their careful reading and suggestions for improving this paper. Any remaining errors or inconsistencies are solely my responsibility.

Levy Economics Institute
P.O. Box 5000
Annandale-on-Hudson, NY 12504-5000
http://www.levyinstitute.org

ISSN 1547-366X

ABSTRACT

Between the late 1990s and mid-2000s, China's banking sector underwent a profound yet largely underappreciated transformation—arguably one of the most consequential episodes of financial restructuring in recent economic history. This paper analyzes the Chinese banking reform process through a Minskyian lens, with particular attention to the conceptual ambiguity between financial fragility and financial instability in Minsky's own formulation. The core contribution lies in demonstrating that the reforms implemented under Zhu Rongji successfully resolved a condition of deep and systemic financial fragility without tipping into full-blown financial instability. In that sense, China's banking overhaul constitutes a non-Minskyian resolution to what was, in classical terms, a Minsky-type problem. The Chinese case thus provides a rare empirical example of mounting financial fragility managed without crisis—offering critical insights for contemporary efforts at financial stabilization under conditions of systemic vulnerability.

JEL CLASSIFICATIONS: B5, E02, G28

INTRODUCTION

Between the late 1990s and mid-2000s, China's banking sector underwent a surprisingly little-noticed transformation that stands as one of the most consequential episodes of financial restructuring in modern economic history (Ma 2006, 2007; Vague 2019). Despite the decade-long proliferation of fragile financial institutions burdened with non-performing loans and nearing insolvency, the Chinese state successfully averted a financial instability-induced economic collapse.

Financial fragility is a hallmark in the framework of Hyman Minsky. It is a process that arises from a growth trajectory fueled by speculative and leveraged lending, escalating debt, euphoric expectations (progressively disconnected from economic fundamentals), and lax oversight—often culminating in a financial crisis which almost always turns into an economic crisis (Minsky 1964,1982, 1986; Wray 2016). Financial instability is Minsky's label for that final phase.

This paper offers an examination of China's major financial restructuring as a successful case of crisis resolution during Zhu Rongji's tenure, and—as a contrasting case with Minsky's framework—China's financial reform as a case of financial fragility *without* financial instability.

By 1999, the Chinese banking system was indeed riddled with structural weaknesses—overindebted, state-owned enterprises (SOEs), bad debts, and poor governance, for example—but these were resolved not through serial bankruptcies, asset fire-sales, or a financial crash followed by post-crisis hand-outs to financial institutions, as happened in both the US and Europe in the 2008–12 financial crisis (for these, see Tooze 2018).

The restructuring of the banking system was carried out through policy coordination and sovereign financial engineering. Instead of a Minskyian, crisis-induced correction in the style of the US (in 1987 or 2008) or Japan (in the 1990s), the Chinese response was preemptive, calibrated, and state-orchestrated. At the center of this process stood Zhu Rongji—a technocrat with rare political capital and economic vision—who engineered a complex and unorthodox restructuring program (Rongji 2013; 2018; Wong 2015).

The paper uses Minsky's analytical insights to reconstruct the logic, methods, and outcomes of the resolution of this acute financial fragility episode, while emphasizing its uniquely[1] non-Minskyian resolution: the avoidance of a metastasis of financial fragility into financial instability.[2] That distinction is central to the paper's core contribution and therefore demands clarification.

Financial Fragility vs. Financial Instability in Minsky's Theory: A Clarification

Hyman Minsky's Financial Instability Hypothesis (FIH) has remained a seminal reference for understanding the dynamics of capitalist economies, especially under conditions of financial euphoria and increasing systemic fragility. While Minsky did not explicitly define financial fragility and financial instability as separate concepts, his works consistently imply a distinction between them.

A persistent ambiguity lingers in the way Minsky himself distinguishes between the notions of financial fragility and financial instability. Although he used both terms extensively, a precise, formal distinction was never rigorously drawn in his writings, leaving a conceptual gap that followers have attempted to close but have never fully achieved.

[1] *Uniquely* requires a clarification here: Having studied Minsky and read through financial history and the major crises episodes in the nineteenth and twentieth centuries, I submit that *all major **financial** crisis are Minskyian.* By "Minskyian," I mean they have basically the same "anatomy," trajectory, and resolution, which is that described in the text: Their initial triggers can, and do, vary substantially, but once the process is in motion, the commonalities are much stronger than the differences. Their resolutions also differ in timing and implications for employment, "wealth destruction," and speed of recovery. Concurrently, "Big Bank and Big Government" post crisis interventions are also a common denominator. For similar conclusions, without framing them in a "Minskyian" analytical framework, see Vague (2019; 2023) and Dalio (2018). For an excellent presentation of the "Minskyian Framework," that does not make my claim but supports it, see Tymoigne and Wray (2013). For Minsky's assessment of the Great Depression, see: 1982 passim, for a Minskyian take on the Japanese 1992's bubble—not citing Minsky—see Koo (2003), for a brilliant Minskyian analysis of the Asian financial crisis 1997–98, see Kregel (1998), for Minskyian analyses of the 2008–2010 Global Financial Crisis see Tymoigne and Wray (2013), Kregel (2010), Wray (2016), and Tooze (2018). For a Minskyian assessment of the COVID crisis, see Tooze (2020) and Burlamaqui and Torres (2020).

[2] For a broader analysis of the Chinese system, including the operation of its Schumpeterian entrepreneurial state, and developmental strategy, see Burlamaqui (2015; 2020).

The Lack of a Sharp Distinction in Minsky

Minsky's *financial fragility* concept refers to the vulnerability of financial units (i.e., households, firms, banks) to absorb adverse shocks, or, more specifically, to the way they finance their operations—especially the relationship between their debt obligations and net cash flows. As their debt becomes harder to service, financial units move from hedge to speculative to Ponzi finance (his famous taxonomy), and fragility increases.

As the ratio of speculative and Ponzi units increases, the economy becomes progressively more fragile. In short, Minsky's hedge-speculative-Ponzi classification explains how the system's financial fragility increases but does not clarify how it builds into instability. In fact, and surprisingly, Minsky never provided a systematic distinction between the two. The following evidence illustrates this point.[3]

In Minsky's 1975 book, *John Maynard Keynes*, we find: "It is also evident that the economy behaves quite differently with a fragile rather than a robust financial system and that the fragility of the financial system is related to the ratio of debt payments to operations income for the various sectors and the extent to which units are dependent upon refinancing their positions in long assets in smoothly functioning short-term financial markets" (160). Here we have fragility, but not instability. As a matter of fact, in the index of the same book there are two entries for financial instability, but no clear definition, and no entry for financial fragility.

By contrast, Minsky's 1982 essay collection, "Can 'It' Happen Again?" is packed with references to financial instability. There are several versions of the Financial Instability Hypothesis (FIH), but none with a full-fledged explanation of the links between financial fragility and financial instability. On *financial instability*, perhaps the most "canonical" reference, extracted from his 1977 paper, "The Financial Instability Hypothesis," states, "[t]here is, in the financial instability hypothesis, a theory of how a capitalist economy endogenously generates a financial structure which is susceptible to financial crises, and how the normal functioning of financial markets in the resulting boom economy will trigger a financial crisis"

[3] Minsky wrote extensively, and very often repetitively, on the topics of financial fragility and on financial instability. Thus, it is risky to claim he *never* properly linked the two concepts. But the examination of his three "major" works seems, to me, to give us as a solid sample of his thinking and writing on the subject.

(included in Minsky 1982, 99). Financial instability is explained but not linked to financial fragility.

The following quotation (Minsky 1982) is, perhaps, the longest description of the process as a whole: “The financial instability hypothesis by emphasizing the way in which investment demand is generated by the combination of the valuation of the stock of assets, the financing available from internal funds and financial markets, and the supply price of investment output shows how a collapse of asset values, that occurs because of position making problems of units engaged in speculative and Ponzi finance, leads to a collapse of investment” (136). While several contributing processes are identified, the analysis lacks an explicit theoretical integration—offering neither a clear bridging mechanism among these processes nor a coherent explanation of how financial fragility evolves into full-blown financial instability.

Minsky’s 1986 book, *Stabilizing an Unstable Economy*, is often regarded as his definitive statement on the issues of financial stability and financial instability. However, the text is surprisingly sparse in explicit references to financial instability itself and notably lacks a detailed exploration of the mechanisms by which financial fragility propagates throughout the financial system and morphs into financial instability.

The following quotations are representative:

> “Financial instability is linked to the relative importance of income, balance-sheet, and portfolio cash flows in an economy” (226).
>
> “The mixture of hedge, speculative, and Ponzi finance in an economy is a major determinant of its stability. The existence of a large component of positions financed in a speculative or a Ponzi manner is necessary for financial instability*”* (232).

In conclusion, these quotes, **when seen as a whole**, suggest a processual relation—fragility leads to instability—but without explicit demarcation of the two concepts, and their interconnection, in analytic terms. *Financial fragility* appears both as a phase and a property, whereas *financial* *instability* refers to the systemic amplification of fragility into a full-blown crisis or macro-financial disruption. Instability seems more like a sudden event or a regime shift. Yet, Minsky never offered a formal definition separating their ontological status.

Attempts to Refine Minsky

Minsky's followers have tried to refine these concepts but often ended up reinforcing the ambiguity rather than resolving it. Let's pick the two most prominent and knowledgeable Minsky scholars: L. Randall Wray and Jan Kregel. Wray, one of Minsky's closest students and interpreters, wrote extensively on that subject (Wray 1992 and Papadimitriou and Wray 1997 offer good discussions of the FIH).

However, Wray dedicated a whole book to Minsky. That volume seems the proper place to search for clarification. He writes, "Minsky's view can be captured in his memorable phrase: 'Stability is destabilizing.' What appears initially to be contradictory or perhaps ironic is actually tremendously insightful: to the degree that the economy achieves what looks to be robust and stable growth, this is setting up the conditions in which a crash becomes ever more likely. It is the stability that changes behaviors, policy making, and business opportunities so that the instability results" (2–3).

While this attempts to clarify, it merely restates fragility as a tendency and instability as an outcome, without clear thresholds or operational criteria for the transition (The previously mentioned contributions [Wray and Papadimitriou 1997] do not provide the linkage I'm suggesting is also lacking in Minsky).

Jan Kregel, probably the most profound interpreter of Minsky, comes very close to an elucidation. In a 2007 paper, Kregel argued:

> In general, it was the rapid increase in bank resources that led to increased laxity in lending criteria as banks competed with each other to find borrowers, producing a decline in asset quality that emerged as soon as there was a fall in the growth rate of resources. This comes very close to Minsky's definition of financial fragility. It is the fall in the rate

> of expansion of lending that produces the fall in prices and the ensuing debt deflation. It is the change in liquidity preferences of the banks that eventually leads them to stop liquidity creation, rather than the maturity mismatch, which causes fragility. (2007, 13)

This is a very sharp formulation. However, the lack of a precise distinction between financial fragility and financial instability persists. In 2008, Kregel produced another insightful comment: “The idea of increasing financial fragility is built around the slow and imperceptible erosion of margins of safety during conditions of relative stability…. The result is a debt deflation process in which ‘position has to be sold to make position’ and the downward pressure on prices raises real debt burdens. Lower prices increase the necessity to sell and reinforce the excess supply, making it even more difficult for the investor to fully repay his/her loan from asset sales” (2008, 8).

Here, Kregel introduces the notions of amplification and self-reinforcement, linking them to declining margins of safety. It becomes clear that financial instability is a creature of the workings of the financial system. Furthermore, there is a transmission mechanism in place, but it is not used to explicitly link financial fragility to financial instability in a precise way. In Kregel (2008), the following section, titled “Endogenous Financial Fragility and Financial Instability,” includes several mentions to fragility but none to financial instability. Thus, the distinction between fragility and instability remains unclear.

Ironically, it is in a footnote—found in a 1994 chapter by Pollin and Dymski, both incisive interpreters of Minsky—that a distinction resembling the one I propose below, comes closest to being articulated. In the concluding chapter of their edited volume, *New Perspectives in Monetary Macroeconomics,* they offer the following formulation: “As used here, financial fragility connotes a state of an economic system, and financial instability connotes a dynamic process affecting that system. An economy becomes more financially fragile as financial commitments rise relative to income flows…. Financial instability occurs when disturbances in an economy financial structure- such as a stock-market crash, a major bank failure, or nonpayment of foreign debt - affect the level of real activity in that economy” (371, fn2).

This is a very good way to distinguish both concepts. The only shortcoming is, again, the lack of a proper transmission mechanism linking financial fragility to financial instability. The authors point to financial system shocks, but do not specify *how* these shocks come to affect the real economy.

A Proposal for a Precise Distinction

Building on Burlamaqui and Torres (2020), I submit that **financial fragility** is a potentially long-lasting and cumulative process—one that is evidenced also by the Chinese banking system's evolution—which tends to unfold over extended periods.[4] Its intensification is primarily driven by a declining ratio of cash inflows to outstanding debt across all agents in the system, and their impact on agent's balance sheets, including state-owned enterprises and public corporations.

As Minsky states, "[w]e can conceive of a scale of financial robustness [to] financial fragility which depends upon the mixture of hedge, speculative and Ponzi finance. As the proportion of hedge financing decreases the financial structure migrates toward fragility" (1982,76). It is important to underline here, that increasing financial fragility is a necessary, but not sufficient, condition for a financial crisis.

I argue that **financial instability** is a significantly more dangerous and destructive process—one that emerges when financial fragility within the financial system escalates to a point where asset-liability mismatches are no longer tolerated by financial units, or regulators. Under such conditions, even minor shocks can trigger a generalized liquidity preference within the banking system. Instability erupts when rising indebtedness, backed by deteriorating or vanishing collateral, is suddenly perceived as toxic and becomes unsustainable. This marks the activation of the transmission mechanism that drives the system toward a financial crisis.

[4] This definition is consistent with recent and pioneering research by Leila Davis and colleagues findings about Minky's financing regimes at firm level as long-lasting processes: "We highlight, in particular, a secular expansion in the incidence of Ponzi finance in the post-1970 US, consistent with a long wave in the distribution of firms across Minskyian financing regimes' they do not lend strong support to approaching Minskyian dynamics as a theory of the business cycle" (Davis, De Souza, and Hernandez 2019, 27).

The ensuing contagion constitutes the pivotal moment in the process, precipitating a system-wide credit freeze that rapidly mutates into a generalized "dash for cash" within the financial system. This sequence of interactions—rising defaults, falling collateral values, and growing liquidity stress fuels asset fire sales which, absent timely central bank intervention, culminate in a collapse of asset prices, triggering a self-reinforcing debt spiral and, ultimately, a full-scale financial crash with profoundly destabilizing consequences for the broader economic system.

In short, financial instability emerges from the progressive "Ponzification" of the financial system. Rather than acting as a stabilizing buffer, the financial system amplifies shocks and disturbances during such a process. With this clarification and conceptual linkage established, we can now return to the Chinese case and examine Zhu Rongji's masterful orchestration of financial reform.

INSTITUTIONAL BACKDROP: FROM MONO-BANKING TO SPECIALIZATION (1950s–1987)

China's modern financial system has its roots in a mono-bank model. Between 1950 and 1978, the People's Bank of China (PBC) functioned as both central and commercial bank, with the Ministry of Finance exercising total control over credit allocation. Banking operations during this period were not commercial in nature; they functioned as instruments of central planning. Credit, money supply, and savings channels were controlled and directed toward political and developmental goals (Naughton 1995; Lardy 1998).

Following the 1978 Third Plenum and Deng Xiaoping's push for economic reform, a gradual decentralization and specialization of the banking system began. The PBC was redefined as a central bank, while specialized commercial banks were spun off:

- The Agricultural Bank of China (ABC),
- The Bank of China (BOC),
- The China Construction Bank (CCB), and

- The Industrial and Commercial Bank of China (ICBC).

These institutions formed the basis of what would later become the “Big Four.” From 1979 to 1985, the volume of bank deposits nearly tripled, and bank loans rose by 260 percent. SOEs were granted autonomy to retain earnings and borrow from banks instead of relying solely on budgetary allocations. This marked a fundamental change for leveraging development but also created a credit channel which could easily generate financially fragile growth trajectories. That was exactly what occurred.

CREDIT EXPANSION AND TRIANGULAR DEBT (1987–97): EMERGING FINANCIAL FRAGILITY

In Minsky’s phrasing, “stability breeds instability.” A better way to put that would be to state that stability creates—by stressing liquidity conditions, increasing leverage, and risk taking—the conditions for financial fragilization. In China’s case, we have that in steroids. During the ‘80s and ‘90s, there was no “stability, or tranquil times” as Minsky used to say, but rather “creative destruction,” a very intense and uneven Schumpeterian structural transformation, and an average GDP growth of 10.6 percent between 1985 and 1997, according to the World Bank.

Within this hyper-growth regime, and a relatively “young” financial system, the emerging financial architecture was turning increasingly fragile. The state banks frequently acted as mere conduits of state policy, often lending to unprofitable SOEs. Credit decisions were development-motivated but not infrequently based on poor risk/return metrics. As a result, a massive accumulation of non-performing loans (NPLs) began to plague the system (Lardy 1998).

The post-1992 period—following Deng’s, successful, Southern Tour to counter the Tiananmen political backlash—saw another wave of aggressive credit-financed investment (Vogel 2011;

Kroeber 2020). SOEs borrowed heavily from state banks to invest in infrastructure, housing, and industrial expansion. However, many of these projects lacked immediate commercial viability.[5]

By1997, the Chinese banking landscape had grown considerably more complex. In addition to the Big Four, new institutions appeared: the People's Construction Bank, the Communications Bank, China Development Bank, and regional urban and rural credit cooperatives. What resulted was a fragmented, overextended financial system with poor internal control and little independence from state demands (Lardy 1998; Naughton 1995).

In 1999, the total assets of China's Big Four state-owned commercial banks were already huge. Approximately ¥12.4 trillion RMB (roughly 1.5 trillion USD at the time, based on an exchange rate of 8.28 RMB/USD). However, they were hampered by financial fragility due to massive non-performing loans (NPLs)—some estimates placed NPL ratios at 25–40 percent.

By the mid-1990s, the phenomenon of "triangular debt" (debts between firms, suppliers, and banks) engulfed both the banking system and the SOE sector. Enterprises owed one another and defaulted on loans. This created a systemic debt overhang by SOEs threatening the banking system. In short, the system was heading toward a "Minskyian trajectory."

Despite these vulnerabilities, China did not suffer a Minskyian instability-led financial disruption, not to mention an economic crisis, or even a deep recession. Why? Institutional architecture partly explains it (but does not provide a comprehensive explanation, as we will see). Capital accounts remained closed, foreign exposure was limited, and, crucially, the state kept ownership and control over key financial actors.

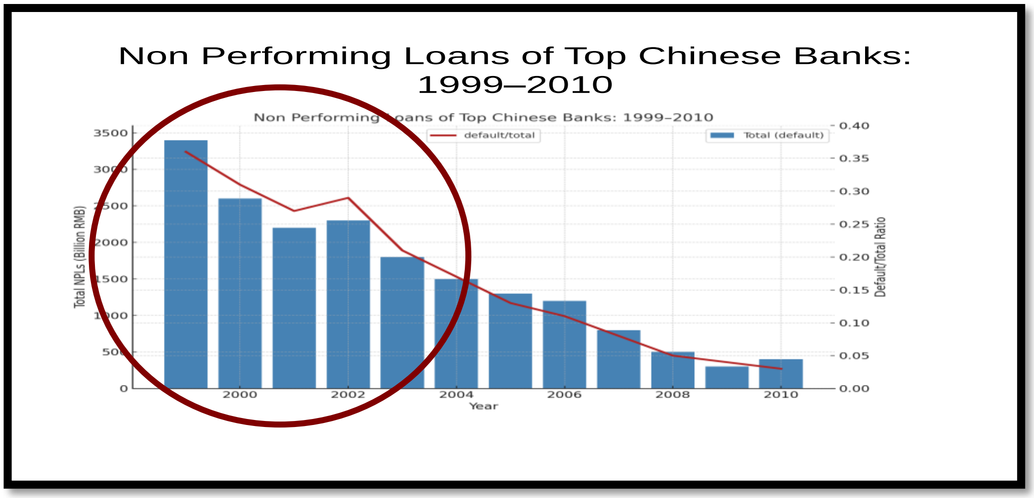
On top of these endogenous developments, the 1997 Asian Financial Crisis was pivotal for Beijing's strategic outlook. While Chinese banks were relatively insulated from the contagion due to capital controls, the crisis served as a powerful reminder of systemic risks. As Naughton

[5] All these projects might have been rational from a long-term developmental perspective, but their financial architecture was shaky.

(2015) noted, “Chinese leadership realized their banking system was even more vulnerable than they had appreciated. Structural fragility, not speculative mania, was the threat” (115–6).

Figure 1. Non-Performing Loans of Top Chinese banks (1999-2010)

(Source: Walter and Howie 2012)



According to Lardy (1998, 97), by the late 1990s, China's Big Four banks had a negative net worth. In short, they were technically insolvent. This recognition informed Zhu Rongji’s rise and reform agenda. Having served as PBC governor (1993–95) and vice premier (1993–1998), Zhu was elevated to premier in 1998. With control over both financial and administrative levers, he launched a multi-faceted reform that sought to cleanse banks’ balance sheets, recapitalize the system, and instill governance discipline—all without triggering panic or requiring external bailouts.[6] Zhu’s intervention provides us the full explanation of the Chinese banking system’s financial fragility resolution, and for its acquired resilience since then. Let’s break it down.

[6] This is not the place to examine or discuss the overwhelming contribution of Zhu to China’s unprecedented structural transformation. The financial restructuring and brief mention the SOE reforms examined here are just two, albeit probably the most consequential, of his achievements. Besides the financial and SOEs reform, Zhu was the architect of three additional reforms that adapted and improved, Deng—Ziyang’s strategy of economic and social transformation: the Tax and Fiscal Reforms (1994, 1998–2003), the preparation for China’s WTO accession and “Market Reforms” (1999–2001), and the push for infrastructure and urbanization (1998–2003). A full appraisal of Zhu’s, in a Western language, as far as I know, is still missing, but see Rongji (2013; 2018) and Wong (2015) for a start.

Restructuring-Phase I: Financial engineering, Liquidity Creation and Recapitalization (1999–2002)

Zhu's restructuring was multi-phased, strategic, and executed with remarkable coordination between state agencies. The first problem was liquidity. China's central bank solution was to inject liquidity by lowering reserve requirements from 13 to 9 percent, freeing up $33 billion in instant liquidity. Immediately, the troubled Big Four lent this amount to the government, which reinjected it as equity—a form of sovereign circular finance that started to improve their balance sheets (Ma 2006, 2007; Vague 2019).

Simultaneously, four *public asset management companies* (AMCs) were set up: Cinda, Huarong, Great Wall, and Oriental. They absorbed the initial $33 billion in bad loans at face value, providing the banks with AMC bonds in return. This balance sheet maneuver significantly improved the banks' capital positions.

These AMCs were also designed to address solvency, i.e., to *absorb the stock* of bad debts from the Big Four banks—estimated at over $170 billion—and allow the banks to clean their balance sheets (Ma 2006, 2007; Rongji 2018; Wong 2015)

The mechanics were remarkable in their elegance:

- The government reduced reserve requirements from 13 to 9 percent, instantly creating $33 billion in liquidity. That was a key regulatory change, preventing the emergence of a generalized and increasing liquidity shortage within the banking system, which could have triggered the unfolding of financial instability.
- State banks immediately "lent" this amount to the Ministry of Finance, which returned it as equity.
- These AMCs were then capitalized via Ministry of Finance bond issuance and equity swaps.
- Banks transferred their NPLs to AMCs at face value and received AMC bonds in return.

The initial liquidity injection was swift, though later supplemented by additional measures. In contrast, the recapitalization process was implemented in a phased and tightly managed manner.

It was carried out without any costs borne by the public, bankruptcies, or market panic. It was a feat of creative financial engineering, achieved through coordinated balance-sheet management between the PBC, MOF, and the AMCs.

Figure 2. Financial Restructuring in the Chinese Banking System: 2000-2002

(Source: Wong 2015)

	Cinda (China Construction Bank)	Orient (Bank of China)	Great Wall (Agricultural Bank of China)	Huarong (Industrial and Commercial Bank of China)
Establishment Date	April 20, 1999	October 15, 1999	October 18, 1999	October 19, 1999
Paid-in Capital (billion yuan)	10	10	10	10
Transferred NPL by August 2000 (billion yuan)	375.6	264.1	345.8	407.7
Share of Transferred NPL (%)	26.8	19.2	24.8	29.2
Disposal of NPL-2000 (billion yuan)	50.0	38.1	22.0	15.1
Disposal of NPL-2001 (billion yuan)	29.9	18.3	53.1	23.2
Disposal of NPL-2002 (billion yuan)	86.8	45.4	106.0	63.2

The table shows that the total volume of non-performing loans (NPLs) disposed of between 2000 and 2002 amounted to ¥551.1 billion, equivalent to approximately $66.6 billion, using the average exchange rate of 8.28 RMB per USD. In short, almost 40 percent of the Big-Four bad-debt problem balance was adressed by the end of 2002.

Restructuring Phase II: The Huijin Fund Interventions and Full Recapitalization (2003–2004)

By 2003–4, the restructuring of China's Big Four banks advanced into a deeper phase of central bank–led recapitalization, combining multiple channels of intervention designed to fully restore solvency and prepare the banks for eventual public listing. A critical instrument in this phase was

Central Huijin Investment, Ltd., a state-owned investment vehicle, established by the PBC to act as both shareholder and intermediary in the financial rehabilitation process.

Huijin injected $60 billion in equity capital into three of the Big Four banks, effectively recapitalizing them with state funds while assuming a controlling ownership stake. In parallel, it issued $96 billion in loans to the AMCs, enabling further disposal of impaired assets and providing the AMCs with the liquidity necessary to absorb distressed debt from the banks' balance sheets (Ma 2006; 2007).

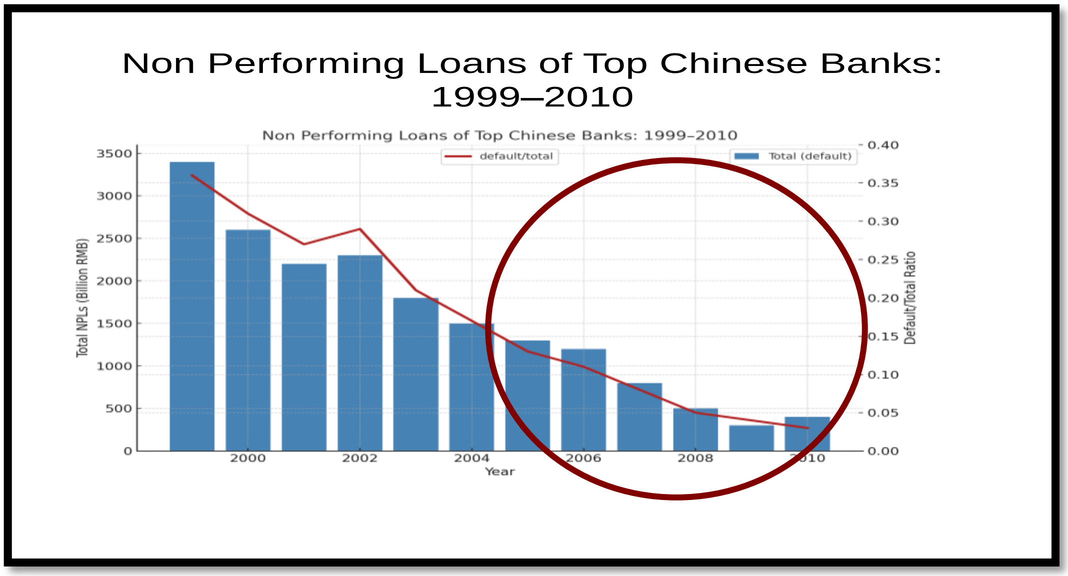
Additionally, $40 billion in non-performing loans (NPLs) were transferred to the People's Bank of China (PBC) and the AMCs, further cleansing the banks' books. These actions were accompanied by a series of debt–equity swaps, through which Huijin and the AMCs exchanged distressed debt for equity stakes in the banks or their corporate borrowers. This multi-faceted strategy not only reduced the banks' NPL ratios but also reconstituted their capital structures, shifting them toward commercial viability while keeping ownership firmly within the state's grasp (Rongji 2018; Wong 2015; Vague 2019).

Once the recapitalization of the Big Four banks—the core of China's banking system—was completed, policymakers shifted their focus to the two remaining segments of the sector: the second-tier city commercial banks and the 34,000 rural credit cooperatives (RCCs). This less threatening recapitalization was a hybrid operation, mobilizing a broader coalition of actors. Local governments, the National Social Security Fund, the People's Bank of China, and both existing and new shareholders collaborated to bring the process to completion (Ma 2006).

Summing up, by the end of 2004, the Chinese banking system was largely recapitalized. The full recapitalization was of an extraordinary magnitude, amounting to RMB 4 trillion (approximately $500 billion)—equivalent to roughly 25 percent of the country's GDP in 2005. By 2005, the system was completely restructured.

Figure 3. Non-Performing Loans of Top Chinese banks (1999–2010)

(Source: Walter and Howie, 2012)



Through state and party–led financial engineering and centralized control, China had resolved its banking fragility problem without foreign indebtedness, or post-financial instability bailouts linked to austerity programs. This restructuring was not only non-Minskyian in form, but was also a challenge to both neoliberal orthodoxies, and Minsky's own blueprint of crisis-induced *mess cleaning interventions* by "Big Bank and Big Government." Financial fragility was removed from the system, before spreading into financial instability.

When evaluating these reforms, a BIS official stated, "although one may debate about the relative merits of various ways of funding and apportioning bank losses and the probable size of the restructuring bill, there is little doubt that the Chinese authorities have moved expeditiously in meeting the challenges to the banking system" (Ma 2006, 61).

At this juncture, a discerning reader might rightly ask whether financial instability was ever a likely outcome—or whether, on the contrary, it was rendered virtually impossible by the structural characteristics of China's financial system. As previously noted, the state retained ownership and effective control over the principal financial institutions. This is a legitimate and fundamental question.[7] Any answer, however, must remain somewhat speculative, insofar as significant financial instability, in fact, did not materialize.

I argue that financial instability was indeed a plausible outcome, albeit one that, due to the "institutional architecture" of the Chinese financial system, would likely manifest in a form distinct from that observed in Western style, privately dominated financial systems. While a Lehman Brothers, Washington Mutual, or Northern Rock-style bankruptcy was unlikely under China's state-controlled financial structure, serious liquidity shortages and cumulative asset–liability mismatches were not only conceivable but did, in fact, materialize.

Without prompt, strategic, and well-coordinated action, these imbalances would likely have deepened the dysfunctionality of the banking system, leading to credit contraction, rising corporate failures, growth deceleration, and increased unemployment. Left unchecked, this trajectory could have culminated in a balance-sheet recession akin to Japan's experience between 1992 and 2003, which ushered in its so-called "lost decade" (Koo 2003). The strength of Zhu Rongji's financial reform lay precisely in its ability to forestall such an outcome.

In 2007, the restruturing process was formally concluded through a strategic act of institutional consolidation, whereby the AMCs were incorporated into Huijin without incurring any additional fiscal cost.[8] Huijin was then incorporated as a wholly owned subsidiary of China's sovereign wealth fund, the China Investment Corporation (CIC). Since the conclusion of the "Rongji restructuring," the fund has steadily expanded its strategic role within China's financial architecture.

Today, Huijin functions as Beijing's de facto "dealer of first resort" in efforts to preserve financial markets' stability. With total assets under management of $1.1 Trillion in 2024, it holds controlling or strategic equity stakes in the country's principal policy and commercial banks, including China Development Bank (CDB, 34.7 percent), Industrial and Commercial Bank of China (ICBC, 40.1 percent), Agricultural Bank of China (ABC, 64.1 percent), Bank of China

[7] I thank my colleagues Ernani Torres and Carlos Medeiros for raising this important question.
[8] In plain English, a "fiscal cost" would mean an explicit charge to the state's treasury, requiring government spending or creating a future liability.

(57.1 percent), China Construction Bank (CCB, 40.5 percent), Hengfeng Bank (20 percent), and Bank of Hunan (63 percent).

The fund also became a significant institutional investor in China's stock markets, with major holdings in key ETFs and index funds such as the Huatai-PB CSI 300 ETF, E Fund CSI 300 ETF, Harvest CSI 300 ETF, China AMC CSI 300 ETF, and China AMC CSI 50 ETF.[9]

In the words of a Beijing-based police adviser, "Huijin is becoming a strategic coordinator […] It's a convenient tool for the state to lever when it needs to tighten its grip on vital financial resources" (*Financial Times*: 06/10/2025). This financial Behemoth brings directly to mind Hilferding's discussion of the hypothesis of the tendency for a "General Cartel" in the Financial System which could be used for its socialization (1981, ch.12 and 14). China seems to have accomplished that.

The Flipside of Financial Restructuring: a Note on SOE Reform

Although this is not the space for a thorough examination of the sweeping reforms that revamped the state-owned enterprises, they must be summarized. The success of the financial reform just discussed would not be stable without this simultaneous undertaking. After all, the SOEs were the second most important vertex in the triangular debt mentioned above.

By the late 1990s, China's state-owned enterprises (SOEs) were facing a deepening crisis. Decades of operating under soft budget constraints, bloated employment, and outdated technology had left most of these enterprises inefficient and, mirroring the Big Four situation, with financially fragile balance sheets. Nearly half of China's 120,000 SOEs were loss-making by 1997 (Naughton 1995; Lardy 1998). Against this backdrop, Zhu Rongji launched one of the most ambitious reform agendas in modern Chinese economic history. His goals were to restructure the SOE sector, make it efficient and profitable, help stabilize the financial system, prepare for China's accession to the World Trade Organization (WTO), and lay the foundations for a more sustainable long-term growth.

[9] https://www.huijin-inv.cn/huijineng/Investments/Banking.shtml

Between 1998 and 2002, China undertook a far-reaching reform of its SOEs that served as the corporate flipside of the banking system's restructuring. While policymakers addressed the acute financial fragility of state-owned banks—primarily by removing NPLs and recapitalizing the "Big Four" through asset management companies—the SOE reforms aimed to stem the production-side origins of those bad loans. The symbiotic relationship between policy banks and state firms had long created a cycle of soft budget constraints, misallocated capital, and rising systemic risk. Breaking this cycle required not just financial engineering but also a structural overhaul of the whole public-enterprise sector.

At the heart of Zhu's reform was the principle known as "grasp the big, let go of the small" (Rongji 2013; Naughton 2018). This approach entailed consolidating and modernizing large SOEs deemed strategically important—particularly those in energy, transport, telecommunications, and defense—while privatizing, merging, or closing smaller and medium-sized enterprises. As a result, more than 60,000 SOEs were either shut down or privatized in the early 2000s. This was a radical departure from China's post-Mao gradualism and marked the most forceful downsizing of the state sector since the beginning of reforms in 1978.

To support the transformation of large SOEs, Zhu introduced wide-ranging corporate governance reforms. SOEs were corporatized into limited liability companies with boards of directors, subjected to modern accounting practices, and their managers were increasingly held accountable through performance-based contracts. Moreover, the reform broke the long-standing "iron rice bowl" system.[10] Over 30 million SOE workers were laid off between 1998 and 2002. These layoffs triggered widespread social unrest, but they were seen by Zhu and backed by Jiang Zemin as necessary sacrifices to restore economic vitality (Vogel 2011; Sheng and Zhao 2013).[11]

[10] The "iron rice bowl" was a term used to describe the system of lifetime employment, guaranteed benefits, and job security provided to workers in SOEs and the public sector under Maoist China. It symbolized a cradle-to-grave welfare system in which employees were assured of a permanent job regardless of performance, stable income (even if relatively low), housing, healthcare, education, and pension benefits—work units that oversaw most aspects of life, including marriages, childbirth quotas, and ration distribution.

[11] Acknowledging as a hypothesis, it is not unreasonable to think that the "bet" from Rongji was that those freshly unemployed former public servants would not wait long to find jobs, given the expected acceleration in the post-reform growth rates, coupled with their acquired skills while working in the public sector.

Another key feature of the reform was the listing of major SOEs on domestic and international stock exchanges. Flagship enterprises such as PetroChina and Sinopec were restructured and partially privatized through initial public offerings, raising capital while subjecting management to a more rigorous scrutiny.

The outcomes of Zhu Rongji's reforms in that realm were equally transformative. Most surviving SOEs became more productive and started to compete globally. These two reforms—financial restructuring and SOEs—laid the groundwork for China's entry into the WTO in 2001, which supported the hyper expansion of the Chinese economy in the 2000s. However, there were social costs. Unemployment, poverty, and urban protests rose while inequality widened. Moreover, while many small SOEs were privatized, insider deals and local corruption often undermined transparency of the process (Sheng and Zhao 2013).[12]

Notwithstanding, the reforms did not signify a retreat of the state but rather a reconfiguration. The state concentrated its ownership and control over a narrower set of large firms in strategic sectors. In 2003, the State-Owned Assets Supervision and Administration Commission (SASAC) was created to oversee these enterprises, further institutionalizing central control.

Both reforms were pivotal in stabilizing the economy, fostering competitiveness, and modernizing China's corporate and financial institutions. At the same time, they laid the foundation for a model of governance in which state control remains dominant, even as market mechanisms are used for efficiency. Today, the SOEs are the bedrock of China's Belt and Road Initiative (Chan 2022). In short, Zhu's reforms remain a cornerstone of China's economic transformation and a case study in technocratic statecraft under conditions of systemic stress.

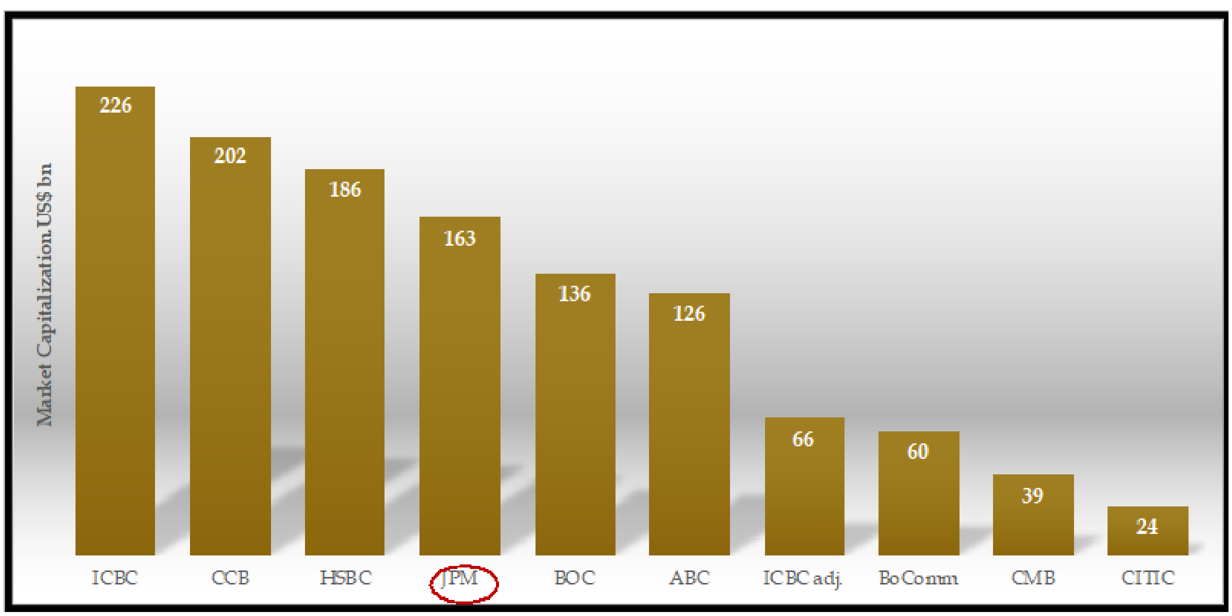
[12] The seeds of Xi Jinping's ferocious anti-corruption campaign, since 2013, can be traced here.

REGULATORY AND FINANCIAL GOVERNANCE ENHANCEMENTS

On the financial front, Beijing recognized that financial engineering and recapitalization, though essential, were not sufficient to sustain long-term financially stable growth. The government launched governance reforms. In 2003, the China Banking Regulatory Commission (CBRC) was created to improve oversight. Additionally, parts of Chinese banks were floated in IPOs, attracting foreign capital and scrutiny (See Appendix).

By 2006, China's banking system was recapitalized, diversified, and much better regulated. Importantly, Chinese banks had little exposure to the complex derivatives and toxic assets that precipitated the 2008 Global Financial Crisis (Lardy and Subramanian 2011, 88). Their conservative balance sheets, born of the reform, provided exceptional resilience during the subsequent global turmoil.[13]

Figure 4: Chinese Bank's Capitalization Compared with J. P. Morgan (JPM) in 2010. (Author's elaboration)



[13] For two excellent analyses of China's financial, fiscal, and regulatory policies during the 2008 crisis, see Lardy and Subramanian (2011) and Tooze (2018, ch.5).

Chinese NPLs declined steadily from 1999 to 2010, and these banks became global players. By 2019, China's banking sector had grown to over $40 trillion in assets, the largest in the world.

CONCLUSION: A CASE OF STATE-LED STRATEGIC FINANCIAL GOVERNANCE

The concurrent restructuring of China's banking system and SOEs between 1999 and 2006 offers a compelling example of strategic financial and corporate governance reforms under a state-party led economic regime. It demonstrates that large-scale financial fragility can be mitigated without serial bankruptcies and market collapse, using instruments of sovereign finance, state ownership, and administrative coordination.

This non-Minskyian crisis resolution—significant financial fragility preemptively removed before escalating into financial instability—was addressed not through Neoliberal principles, IMF prescriptions, or Minsky's *ex-post mess cleaning*, but through state-led financial engineering, policy coordination, cross-institutional synergy, and a firm grasp on macro-financial levers. Zhu Rongji's technocratic ingenuity was crucial to this success.

As Vague (2019) notes, "China's skillfulness and creativity in financial problem-solving made Japan in the 1990s and the United States in 1987 and 2009 look positively clumsy in comparison" (224).

The Chinese case thus provides a rare empirical example of mounting financial fragility managed without crisis—offering critical insights for contemporary efforts at financial stabilization under conditions of systemic vulnerability.

BIBLIOGRAPHY

Burlamaqui, L. 2015. "Finance, development and the Chinese entrepreneurial state: A Schumpeter-Keynes-Minsky approach." *Revista de Economia Política* 35(4): 728–44.

———. 2020. "Schumpeter, the entrepreneurial state and China". IIPP/UCL Working Paper No. 15.

Burlamaqui, L. and E. Torres Filho. 2020. "The COVID-19 crisis: A Minskyian approach to mapping and managing the (western?) financial turmoil." Levy Economics Institute, Working Papers Series No. 968.

Chan, K. 2022. "Inside China's state-owned enterprises: Managed competition through a multi-level structure." *Chinese Journal of Sociology* 8(4): 453–73.

Dalio, R. 2018. *Principles for Navigating Big Debt Crises.* Bridgewater.

Davis, L. E., J. P. A. De Souza, and G. Hernandez. 2019. "An empirical analysis of Minsky regimes in the US economy." *Cambridge Journal of Economics* 43(3): 541–83.

Hilferding, R. 1981. *Finance Capital: A Study of the Latest Phase of Capitalist Development*. London; Boston: Routledge & Kegan Paul.

Kregel, J. A. 1998. "Yes, 'It' Did Happen Again: A Minsky Crisis Happened in Asia," in *Financial Liberalization and the Asian Crisis*, edited by K. S. Jomo. Basingstoke: Macmillan.

———. 2007. "The Natural Instability of Financial Markets." Levy Institute Working Paper No. 523. Levy Economics Institute of Bard College

———. 2008 "Minsky's 'Cushions of Safety', Systemic Risk and the Crisis in the U.S. Subprime Mortgage Market." Public Policy Brief No. 93, Levy Economics Institute: 9.

Kroeber, A. 2020. *China's Economy: What Everyone Needs to Know*. London: Oxford University Press.

Koo, R. C. 2003. *Balance Sheet Recession. Japan's Struggle with Uncharted Economics and its Global Implications.* John Wiley & Sons.

Lardy, N. 1998. *China's Unfinished Economic Revolution.* Washington, D.C.: Brookings Institution Press.

Lardy, N. R. and A. Subramanian. 2011. *Sustaining China's Economic Growth After the Global Financial Crisis.* Peterson Institute.

Leeson, N. 1996. *Rogue Trader: The Original Story of the Banker Who Broke the System*. Sphere.

Ma, G. 2006."China's Financial Reform: Achievements and Challenges." BIS Papers No. 26. Bank for International Settlements.

———. 2007. "Who pays China's bank restructuring bill?" *Asian Economic Papers* 6(1): 46–71.

Minsky, H. P. 1964. "Financial crisis, financial systems and the performance of the economy," in *Private Capital Markets: A Series of Research Studies Prepared for the Commission on Money and Credit*, edited by I. Friend. Upper Saddle River, NJ: Prentice-Hall.

———. 1975. "Financial resources in a fragile financial environment." *Challenge* 18(3): 6–13.

———. 1982. *Can "It" Happen Again?* Routledge.

———. 1986. *Stabilizing an Unstable Economy*. McGraw Hill.

Naughton, B., 1995. *Growing Out of the Plan: Chinese Economic Reform, 1978-1993.* Cambridge University Press.

———. 2015. "China and the two Crises" in *Two Crises, Different Outcomes: East Asia and Global Finance,* edited by T. J. Pempel and K. Tsunekawa. Cornell University Press.

———. 2018. *The Chinese Economy: Adaptation and growth.* MIT Press.

Papadimitriou, D. and L. R. Wray. 1997. "The Economic Contributions of Hyman Minsky: Varieties of Capitalism and Institutional Reform." Levy Institute Working Paper Series No. 217

Pollin, R. and G. Dymski. 1994. "The Costs and Benefits of Financial Instability: Big Government Capitalism and the Minsky Paradox" in *New Perspectives in Monetary Macroeconomics, Explorations in the Tradition of Hyman P. Minsky*, edited by R. Pollin and G. Dymski. Michigan University Press.

Rongji, Z. 2013. "Zhu Rongji on the Record: The Road to Reform 1991-1997." Brookings Institution Press.

———. 2018. "Zhu Rongji on the Record: The Shanghai Years, 1987-1991." Brookings Institution Press.

Sheng, H. and N. Zhao. 2013. *China's State-Owned Enterprises: Nature, Performance and Reform*. World Scientific.

The Huijin Fund- https://www.huijin-inv.cn/huijineng/Investments/Banking.shtml).

Tooze, A. 2018. *Crashed: How a Decade of Financial Crises Changed The World*. Penguin.

———. 2021. *Shutdown: How Covid Shook the World's Economy. Penguin* UK.

Tymoigne, E. and L. R. Wray. 2013. *The Rise and Fall of Money Manager Capitalism: Minsky's Half Century from World War II to the Great Recession*. Routledge.

Vague, R. 2019. *A Brief History of Doom: Two Hundred Years of Financial Crises.* Philadelphia: University of Pennsylvania Press.

———. 2023. *The Paradox of Debt: A New Path to Prosperity Without Crisis.* University of Pennsylvania Press.

Vogel, E. F. 2011. *Deng Xiaoping and the Transformation of China.* Harvard University Press.

Walter, C. and F. Howie. 2012. *Red Capitalism: The Fragile Financial Foundation of China's Extraordinary Rise*. John Wiley & Sons.

Wong, J. 2015. *Zhu Rongji and China's Economic Take-Off*. World Scientific.

Wray, L. R. 1992. "Minsky's Financial Instability Hypothesis and the Endogeneity of Money," in *Financial Conditions and Macroeconomic Performance–Essays in Honor of Hyman P. Minsky*, edited by S. Fazzari D. B. and Papadimitriou. M. E. Sharpe.

———. 2016 *Why Minsky Matters: An Introduction to the Work of a Maverick Economist.* Princeton: Princeton University Press.

APPENDIX: DIRECT FOREIGN INVESTMENT IN CHINESE BANKS (2002–6)

Year	Target name	Acquirer name	Equity investment US$ millions (%)
2006	Ningbo City Commercial Bank	OCBC	70.6 (12.2)
2005	ICBC	Goldman Sachs, Allianz, AE	3,780 (8.89)
2005	Tianjin City Commercial Bank	Australia and New Zealand Bank	110 (20)
2005	BoC	RBS/Temasek/UBS/ADB	5,173 (16.2)
2005	CCB	BoA/Temasek	3,096 (14.1)
2005	Bank of Communications		1,750 (19.9)
2005	Bohai Bank	Standard Chartered Bank	123 (19.9)
2005	Huaxia Joint Stock Bank	Deutsche Bank/Pangaea	454 (20.9)
2005	Hangzhou City Bank	Commonwealth Bank of Australia	78 (19.9)
2005	Bank of Beijing	IFC	270 (24.9)
2004	Bank of Jinan	Commonwealth Bank of Australia	27 (11.0)
2004	Xian City Commercial Bank	IFC/Bank of Nova Scotia	6 (5.0)
2004	Shenzhen Development Bank	Newbridge Capital	150 (17.9)
2004	Minsheng Bank	IFC/Temasek	458 (6.2)
2004	Industrial Bank	Hang Seng Bank/IFC/GIC	326 (24.9)
2003	Shanghai Pudong Dev Bank	Citigroup	73 (5.0)
2002	Nanjing City Commercial Bank		27 (15.0)
2002	China Everbright Bank	IFC	19 (4.9)
2002	Bank of Shanghai	IFC/HSBC/HK Shanghai Com Bank	133 (13.0)
	Total		About 17.0 billion

Sources: Caijing Magazine, No. 123 (2004) and No. 136 (2005); The Asian Wall Street Journal, 20 June 2005 and 27 January 2006; The 21st Century Economic Report, 24 August 2005; and BoC (2006).