China is Stock market Crazy

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China is stock market crazy. Seemingly every new IPO is greeted by investors with such enthusiasm that first-day-of-trading-fortunes have become standard fare in Shanghai and Shenzhen. More generally, the Shanghai composite index rose 130% last year, is up 50% per cent thus far in 2007 and has registered a market value of more than 50 times earnings. With an average of 1 million trading accounts being established every week, this kind of exuberance has well warranted the stern talk and foreboding warnings and from senior state officials, most recently from Zhou Xiaochuan, governor of the People's Bank of China, on understanding asset bubbles and the inherent risks of equity trading. All this excitement, however, gives us pause to again consider the nature and lineage of China's stock market today. What is the nature of the Chinese market? How did it come to be? How is it peculiar? And what fuels it today? While liberalizing reforms in China have remarkably transformed its formerly centrally planned socialist economy into a vibrant, semi-market oriented engine of growth and possibility, the vast majority of China's domestic enterprises remain state-owed and socialist remants and inclinations still loom and frusterate progress. China has taken a fancy to calling its special brand of economy, a "socialist market economy" and without discussing the meaning or merits of such a title, sufice it to say that most of the rest of the world—probably reasonably—still officially considers China a non-market economy. Yet this strange amalgam of socialism and capitalism has produced in nearly 20 years one of the most signifanct and robust stock makets in the world. Just this past week, the daily turnover on the two mainland exchanges exceeded the rest of all the Asain markets (including Japan) combined. Traditional understanding, however, dictates that a stock exchange can be regarded as the incarnation of capitalism and a state-ownership structure is similarly the hallmark of socialism. In China the two seem completely unopposed, if not in harmony. Sonia M.L. Wong has traced the emergence of China's stock market "to a fall in the central government's revenue in the earlty 1980s, which necessitated finding new sources of capital to fund [state-owed enterprises]s' capital expenditures." In 1983 the PRC government began to phase out the financing of state-owed enterprises (SOEs) via budgetary allocations and began to have fellow SOE banks shoulder the burden through loans. Municial governments in the mid-1980s began then to seek additional sources of funding for their local SOEs and began to issue shares of a few collectively owed enterprsies to domestic individuals. It is here that we first see the emergence of private ownership and its attendant "challenge to both state ownership and monopolistic control over financial intermediation" by providing an alternative to perennially unattractive SOE bank deposit rates. In 1990 the State Council regulated that share issuance would be limited only to SOEs and collectively owned enterprises were forbidden to issue shares, in this way retaining exclusive control over invested funds. While at first share quanities were squeezed tightly both in an effort to limit the scope of their experiment and to ease the competitive element with respect to SOE banks, by the late 1990s most all restrictive regulations were relaxed and the IPO quota system was abolished in 2001. The maturation of the Chinese stock market is story of a well crafted schemne to equity finance mostly fundamentally flawed remant SOEs whose constituent social burdens demand enterprise perpetuation. In a economic regime entirely void capital markets, where the population is left to either sit on their cash as inflation devalues it or deposit in banks at rates outstripped by inflation, financial options and alternatives are, to say the least, in demand. And indeed, as China's population has gradually reaped the benefits of her remarkable economic progress, the stock market has surged. What, however, is the nature of this growth? A good deal of the reasoning behind listing SOEs is an unveiled hope that at the will of market forces, an ailing remnant enterprise will somehow adapt, remodel and qualify itself as a legitimate, profitable business, worthy of perpetuation and investment. This line of logic, however, entirely fails to account for the continued nature of government ownership. Issuing shares of a SOE in no way serves to disapate proprietary interest or negate ownship responsibilites, if anything, share issuance provides new variable elements that further confuse and pressurize social stability exigencies, with respect to "investor" and "invested" interests. Considerations of this kind compel the government to bail out and prop up their foundering SOEs though subsidies, preferential tax treatment or assets injections. In addition, the government will continue to employ SOEs to serve a political function as well "such as providing excessive employment, extending aid to other SOEs, achieving a regional development strategy, and so forth." Indeed, China's listed enterprises have not experienced much solid financial performance. From 1992 to 2003 the percentage of listed companies with negative operating profits rose from 5.77% to over 20% and "the total amount of operating profits achieved by the listed enterprises have continued to decline since 1998" despite this period seeing an average of 8% annual GDP growth. On the stock market, however, this was a period of tremendous growth. Though there are no especially reliable metrics by which to valuate an SOE, the Chinese stock market has seemingly altogether detached itself from value-informed investment and instead embraced the market as a speculative venue in which rumors of government asset injections and friendly related-party transactions constitute a frightenly large role in informing market movement. Regardless, this kind of casino has been an unmitigated success in fulfilling its original aim of raising capital via equity financing. The financial regime from which this market emerged, namely characterized by a government monolopoly on financial intermediation though strtict repression of financial markets, had so well primed the stock market for a prevalence of interest, if today we see symtoms of a bubble in stark relief, they have been slowly frothing for years. This resulting, slightly diversified, regime of today has therefore been erected on the morally tenuous grounds of self-financing by providing a lone financial alternative (void of value and replete in risk) to a population increasingly starved of economic liberty.