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Comment Zheng Song

This chapter is very useful for understanding how the financial system is governed in China. There is a widely held belief that the Chinese government (or the Communist Party of China) has firm control on Chinese financial markets. However, the underlying mechanism through which the Chinese government exercises its controls is far from clear. The problem becomes even more challenging as China has established formal ways of governing its financial sector (mimicking those in developed countries). So, more fundamentally, how can the Chinese government continue to maintain the direct state control given the substantial ownership changes over the past decade? This chapter looks at a data set covering a total of more than 150 top administrators or managers and concludes that human resource manage-

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ment (HRM) has become an important substitute to the formal governance of finance in China. The approach of the chapter is innovative: checking whether those top office holders occupy important positions at other financial organizations concurrently or have held such positions prior to their current one. This reveals a close network of financial cadres whose career life is essentially supervised by the Chinese government (or more precisely, the Communist Party's Central Organization Department).

The evidence may also shed some light on the coexistence of the inefficient credit allocation and the efficient policy implementation that has puzzled many outsiders for a long time. On the one hand, financial imperfection in China and its efficiency losses have been well documented. For instance, the Chinese banks—mostly state owned—tend to offer much easier credit to state-owned enterprises (SOE). In a recent paper (Song, Storesletten, and Zilibotti 2011), we show that such asymmetric financing ability, interacted with the resource reallocation between the state and private sectors, may explain the rapid (inefficient) accumulation of foreign reserves in China. On the other hand, however, the Chinese financial system behaves in a remarkably efficient way to implement monetary stabilization policies. A well-known achievement is that in order to cool the potentially overheating economy, PBOC has been successfully sterilizing the foreign exchange market intervention with no major impacts on the domestic interest rate. Another example comes from the massive drop in new bank loans in December 2007, right after the Chinese government decided to tighten its monetary policy (see table 1C.1). Governance through HRM can easily explain both the inefficient credit allocation and the efficient policy implementation.

An important question is whether HRM is unique to China? First of all, the concept of HRM is not new. It is actually similar to the idea of “personnel controls” in the literature of economic transition. The government exercises its ultimate control over SOEs through personnel selection and dismissal, though some control rights are in hands of SOE managers (e.g., Qian 1996). Moreover, as mentioned in the chapter, some developed countries like France also feature elite concentrations. A similar pattern of career development can even be found in the United States, though the direction of the movement is different. Therefore, I am perfectly in line with a future research plan outlined in the chapter: “Future research should focus on how

Table 1C.1 **New bank loans in December**

1 billion RMB	
2006	214.4
2007	48.5
2008	764.5

Source: PBOC website.

these structures help shape the formal structures that govern finance—not only in China, but also in the West.”

Although this chapter has explored very detailed individual data, some extra information can be potentially useful for addressing other interesting and related questions. For instance, a key issue is about the implementation of HRM. What if a bank CEO decides not to follow the Chinese government or the Communist Party? Can we reveal a reward/punishment scheme from the data? The existence of a personnel network is consistent with the hypothesis that the Chinese financial sector is governed through HRM, but it is not a direct test of the hypothesis.

Let me end with a remark about the future of HRM. The chapter points out an interesting feature of HRM: it can be compatible with the global markets and may even influence the future governance of the global financial system. However, I still want to take up two issues from other perspectives. First, given the fast development of the private financial sector in China, it would be increasingly difficult for the Chinese government to control the markets by exercising HRM within the state sector. Second, when appointing a bank COE, the Chinese government clearly faces a trade-off between her or his loyalty to the party and ability of profit maximization. Assuming that these two variables are uncorrelated (not a totally crazy assumption), a political economy model would predict a strengthening (relaxing) of HRM in periods when the government runs budget surpluses (deficits).

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