

Capitalism, Crises, and Constraints in China, 1990s–2000s

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Abstract

How do states navigate economic crises? How do crises affect state capitalist systems? This article explores how the government of the People's Republic of China (PRC) understood and responded to the 1997 Asian Financial Crisis and the 2007–2008 Global Financial Crisis. It argues that Chinese policymakers and economic decision makers were often constrained by global political factors and structures, for example, concerns over government legitimacy and domestic political support, World Trade Organization (WTO) membership, and global demand for Chinese exports. We show that the PRC had to adjust its economic policies and, consequently, its state capitalist model in response to these crises to secure its political and economic interests. This research traces the agency behind the rise of the Chinese economy and its intersection with crises, state capitalism, and global economic structural forces.

Keywords

China, crises, state capitalism, constraints, globalization

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The past three decades have seen far-reaching global economic crises affect both individual states and global economic systems. Focusing on the People's Republic of China (PRC, or China for short), this article illustrates how its government navigated two consequential crises: the 1997 Asian Financial Crisis (AFC) and the 2007–2008 Global Financial Crisis (GFC). Following recent scholarship on the history of capitalism and global history, we argue that the Chinese government was substantially constrained and influenced by global economic forces when formulating economic policies needed to deal with both crises and with post-crisis adjustment. These policies were amplified by the international expectations placed upon Beijing that the PRC would continue its integration into the global economy, as well as domestic policymakers' desire to take advantage of the post-1970s global capitalist system.

The article points to constraints such as China's dependence on foreign trade and global demand for its exports, accumulation of foreign currency reserves as a way to strengthen its creditworthiness, and the benefits of reforming its economic structure in order to meet the expectations of World Trade Organization (WTO) membership. By doing so, it pushes back against a narrative of China's rise that has overemphasized the agency of PRC policymakers and economists, instead stressing the interaction between Chinese domestic policy choices and the globalized economic system.¹ Thus we also show that China's subjugation to global economic constraints meant that, in spite of its closed capital account and controlled political system, the PRC was not immune to the damage inflicted on its economy by both crises because of its dependence on external factors. This dependence was the result of a conscious decision made by the Chinese government to progressively integrate the country into the globalized economy after the 1970s. While integration certainly brought more benefits than downsides, it partially took economic decision-making power away from Beijing. Thus, these constraints have shaped how China has pursued economic policymaking, thereby affecting its model of state capitalism.

As historians attentive to both the social and political contexts of economic policymaking and the structures of international political economy, we believe that both structural constraints and crisis response are part of this history, and we emphasize both to offer a complete narrative. Persistent constraints existed for all countries that participated in the global capitalist system, including Southeast Asian countries that tended to share similar economic structures with China. However, crisis-induced constraints impacted the PRC differently because they intersected with Beijing's global political aspirations and rising economic trajectory during two crucial moments, the late 1990s, when WTO membership was at stake, and the 2008–2009 period, when the Chinese government was in the midst of a complicated rebalancing of its economic

structure, which continues into the present. By revisiting these crises with a focus on political and social factors and attention to global structural constraints, this article offers new perspectives on historical and international political economy scholarship on crises and capitalism.

Historically, the AFC and the GFC have had the largest impact on constraining China's model of state capitalism and Chinese interactions and role in the global economy since the reform and opening era (1978 to present). This article examines how these crises led to, or did not lead to, changes in how the Chinese government fundamentally understood the role of the state and of the economy, as well as how it reacted to both crises by taking into consideration events that originated beyond its reach and could not be fully controlled. Since archival access in the PRC is increasingly difficult, we rely on speeches and policy and academic papers published by economists and state officials, especially official records from party congresses and plenums, supplemented with substantial secondary literature by economists from the 1990s and 2000s. The primary sources illuminate Chinese policymakers' perspectives on whether they thought they were facing a structural shift in the global economy or an acute, temporary event that needed to be weathered, or both, as they navigated the relationship between economic reforms and the global economy.

State Capitalism and Crises

Histories of the early reform and opening era have emphasized the party-state's role in guiding the transformation to a market-based economy by focusing on how foreign economic ideas were internalized, discussed, and rejected by Chinese economists and policymakers (Gewirtz, 2017; Weber, 2021). Many of these works do not fully show how China's approach to state capitalism was effectively shaped by the international political economy or by events and expectations that the PRC could not control and determine, such as norms regarding WTO accession and global demand for its exports.² Focusing on agency and historical contingencies allows for a better understanding of how global capitalism has effectively influenced the rise of China and its state capitalist system.

At the core of the different meanings of state capitalism is the role of the state.³ Compared with capitalism more generally, the scholarly literature on state capitalism tends to focus on the interests of the sovereign state that, while sometimes pursuing profit-seeking behavior, might also prioritize goals other than capital accumulation, such as maintaining government legitimacy, achieving foreign policy objectives, or protecting state security interests (Lee, 2018; Lu, 2022). This can include the interests of the social groups and constituencies attempting to lobby and pressure governments for the

pursuit of certain economic policies, for example, those in the PRC's coastal export-oriented sectors. Exploring the interplay between state capitalism as it manifested in China and the global economy sheds light on the nature of both capitalism and the state.

Why crises? Bringing in an analysis of crises into a study of global capitalism and state response sheds light on how crises can challenge or accelerate longstanding policies to respond to changes in global economic structures, such as a reorientation away from the partially closed borders of the Cold War era and toward more open markets, as well as acute and temporary changes, such as a credit crunch (Hay, 2016; Voltolini, Natorski, and Hay, 2020). Moreover, while China's economic responses to each crisis have been well studied, especially from an institutional standpoint, the relationship between economic crises and the constraints/limits they put on China's state capitalism has not been sufficiently explored. Crisis-driven constraints produced positive and negative consequences for China's state capitalism, which had ramifications for the PRC's ability to change its economic and social system. By stressing that China's growth depended on the structures of the globalized economy, it is possible to better appreciate the opportunities presented and the limitations imposed by each crisis for the PRC, which in turn engendered institutional adaptation to maintain, correct, or intensify preexisting growth patterns.

Why focus on the AFC and GFC specifically? The former intensified reformist trends that were launched in the aftermath of the Fourteenth Congress of the Chinese Communist Party (CCP), whereas the GFC strengthened a more interventionist approach to the management of the economy (Naughton, 2015: 131). More precisely, the AFC urgently signaled to Chinese policymakers that greater openness in its dualistic trade regime—in which some parts of the economy were linked to and depended on global trade while others remained excluded from it—and reform of the banking system, which actually was underway before the crisis, were dire necessities if the country wanted to respond to issues plaguing its economic structure. This was especially urgent if the PRC wanted to speed its integration into the global capitalist system of the 1990s, which Chinese leaders believed was a unique historical opportunity that could not be missed (Lardy, 2001: 20). Thus, the crisis greatly accelerated decisions that began a half-decade earlier during the Fourteenth Party Congress in October 1992. The sense of an unparalleled positive historical opportunity for China's integration into globalization, one that they could ill afford to waste, clearly emerged from official government reports of that period. Speaking at the Third Plenum in 1993, Party Secretary Jiang Zemin stressed that, after the end of the Cold War, the "overall development of the international situation is beneficial to us." The termination of the East–West confrontation meant that China's economy was set to benefit from

a long period of peace. Jiang underscored that the “adjustment of the global economic structure benefits our [ability to] attract foreign investment and technology,” a trend that would significantly reinforce the PRC’s economy. In a nutshell, China was facing “a great opportunity for reform and development,” and there were “not many such historical opportunities” (CCP Central Committee, 1993b). Before the AFC shocked Asia and impelled crisis-induced responses, Jiang perceived the adjustment of the global economy as a positive structural shift for the PRC, one that his country should exploit.

Given China’s understanding of the need to take as much advantage as possible of a favorable international conjuncture, it is noteworthy that the country was comparatively less impacted by the AFC. After the AFC, heavily hit Southeast Asian countries implemented a strategy of foreign reserve accumulation, interpreted as the only and safest choice that low-value-added developing economies could pursue if they wanted to avoid another external bailout. While the intensification of the export-led growth generated benefits and pitfalls, it certainly made Southeast Asian countries more resilient for the following crisis (Breslin, 2011b; Dixon, 2012; Liu, 2023; Naughton, 2015: 118; Pempel, 2015: 34). China’s subsequent approach cannot be fully separated from what was happening in the region.

Therefore, as argued by the economist Nicholas Lardy, in spite of its closed capital account, rising foreign currency reserves, and a heavy reliance on FDI rather than foreign borrowing, the AFC showed PRC leaders that “there were several alarming parallels” with Southeast Asian countries, thereby convincing Beijing “of the desirability of accelerating domestic economic reform” and protecting its economy against future crises (Lardy, 2001: 16). This was acknowledged during the Second Plenum of the Fifteenth Party Congress in 1998, which reported that “faced with the financial crisis occurring in some Asian countries, the most fundamental task is to do a good job in our domestic economy and strengthen our ability to bear and withstand risks” (CCP Central Committee, 1998b).⁴ Clearly, weakness in the face of future crises was perceived as a structural problem for the PRC government. As the above analysis from the Second Plenum demonstrates, strengthening the pillars of the economy was a desire that existed regardless of crises. Nonetheless, a regional crisis like the AFC showed the CCP that globalization could produce negative outcomes that had to be seriously preempted. CCP leaders thus also perceived the AFC as an extraordinary situation that could quickly devastate countries’ financial foundations if reforms did not take hold, hence the urgency to act promptly with reforms of the banking sector and state-owned enterprises.

Thus, the AFC was a “wake-up call” for the Chinese leadership at that time, strengthening “the conviction of China’s top leaders that China needed to enter

the World Trade Organization in order to consolidate and protect its status as one of the world's leading trading economies," as Barry Naughton has pointed out (Naughton, 2015: 116; Lardy, 2001: 16). The crisis prompted the Chinese government to strengthen the role of the private sector, increase the integration of larger pockets of its domestic market into foreign trade rules based on comparative advantage principles, ease technology transfers, and, as mentioned, reform the banking system. Many of these reforms originated from decisions taken in the aftermath of the Fourteenth Party Congress but remained under debate for several years without reaching a full consensus. In the end, they proved to be decisive factors in sealing the country's accession to the WTO in 2001 (the initial bid was placed much earlier, in 1986) (Lardy, 2001; Naughton, 2015).

Therefore, the crisis presented the PRC leadership with both challenges and opportunities. Externally, the crisis convinced the CCP to present a better offer to the United States for WTO membership, including in the agenda reforms that had stalled until that point: essentially a greater institutionalization of a more competitive environment for state-owned banks and enterprises (Lardy, 2001: 20). Internally, the stimulus the Chinese government implemented as a remedy to the crisis increased the size of the state and made the PRC run trade and current account deficits in the aftermath of the AFC. Concurrently, marketization in the PRC was also increasing (Garnaut, 2018: 37–39). At the Fifteenth Party Congress in 1997, the importance of the non-state sector was elevated to "an important, integral part of China's socialist market economy" (Lardy, 2001: 19).

Similarly, the GFC has been studied as an event that provided opportunities but also exacerbated domestic problems for Beijing. Scholars have assessed the reasons, debates, and consequences behind the large (monetary rather than fiscal) stimulus the PRC government adopted in November 2008 to guide the country out of the crisis. They have also discussed how the crisis triggered and created expectations, in China and worldwide, that the PRC would step up politically and economically, taking on greater responsibilities in an international system where multipolarity was emerging (James, 2023: 226; Tooze, 2018). China's reliance on global markets for its products, already a longstanding constraint, intensified under crisis conditions, becoming a more urgent problem as the PRC suffered because global trade volumes dropped, bringing China's exports down by 18 percent and imports by more than 40 percent by the end of 2008 (Tooze, 2018: 242–43). After the GFC, in spite of the CCP's efforts to recalibrate growth, China's heavy reliance on exports continued to be a structural constraint. As we show in the next section, Chinese policymakers perceived their country's reliance on exports, and the insufficient attention to domestic consumption, as a constraint, and acted to correct it to some extent, without fully accomplishing this goal.

Scholars have pointed out that, unlike the AFC, the GFC had a more severe impact on China. As with the AFC, however, Beijing responded promptly, this time with the strength of an economy that had enjoyed a decade of extraordinary yet often inflationary double-digit growth. Overall, the Chinese and Southeast Asian economies proved quite resilient in the face of the GFC, implementing expansive fiscal and monetary policies that limited the impact of the crisis. In China's case, the crisis was dealt with primarily through monetary rather than fiscal tools (Naughton, 2015: 120). A generous monetary policy, quickly reversing the restrictive one that was in place until just a few months before the GFC, was mainly possible because of the lowering of the reserve requirement ratio of banks and of interest rates, measures that ultimately freed liquidity to be injected into the system, mostly manifesting in infrastructure investment undertaken by provinces keen to boost spending (Naughton, 2015: 120). However, as William Grimes argues, the AFC had taught China the lesson of exposure: "The resilience of the East Asian economies was largely based on their own previous individual policies, including accumulation of large foreign exchange reserves, conservative fiscal policies that allowed them to implement massive fiscal stimulus programs" (Grimes, 2011: 294). Therefore, even though China's response was primarily monetary, the country also "was in a good position to respond largely because of the prudent policies first set in place after [and because of] the AFC," including the accumulation of foreign currency reserves, balanced deficits, and most importantly, the reform of the banking system, which strengthened it in such a way that it withstood the GFC (Naughton, 2015: 118).

Finally, China's response to the GFC convinced CCP leaders that the time was right to change their relationship with the neoliberal world order that they blamed as the sole reason for the outbreak of the crisis, in spite of the fact that the PRC had benefited enormously from that very order. Concurrently, China's persistent dependence on the mechanisms of globalization, especially on global demand for its exports, further consolidated an economic path that proved difficult to adjust. This occurred in spite of Chinese attempts to rebalance economic growth in a more domestic-driven direction, attempts that dated back to the early 2000s and were hailed in 2020 when the notion of "dual circulation"—the intention to redirect economic growth toward an even greater degree of self-reliance and less foreign dependence—was embraced by the Chinese government (Lin and Wang, 2022). Thus, we do not intend to deny agency to China's domestic politics, but rather to shed light on the structural and systemic limitations driving the PRC's economic maneuvering in certain directions that might otherwise have been delayed, or reversed.

The PRC and the Global Capitalist Economy: Benefits and Constraints

In order to understand how global economic constraints have impacted China's state capitalism, it is first necessary to historicize how the country has been integrated into and consciously chosen to engage with the world economy. During the first fifteen years of reforms, and especially during the 1990s when foreign trade and investment started to factor as a big portion of China's economic success alongside domestic reforms, China followed the model of the Asian Tigers—Japan, South Korea, Singapore, Hong Kong, and Taiwan—boosting exports initially needed to accumulate foreign currency reserves, which in turn were used to import technology and equipment necessary for the country's modernization and investment-led economy (Pettis, 2014). This model entailed protection of China's domestic industries from global competition as the PRC became more embedded within global trade (Naughton, 1996: 287). If the Tigers' success had benefited from a combination of government protection and the relative openness of the global economy during the Bretton Woods system (1944–1971), China's post-1978 growth enjoyed many similar patterns, encouraged by an international economic system in which capital flows became a lot freer, mostly as a result of the end of the dollar-gold convertibility and the introduction of free exchange rates.

As the global economy became more and more open and permeable during the 1980s and 1990s, China's initial economic rise benefited enormously from the historical contingencies in which it had started to operate (Harvey, 2007: 120). It specifically benefited from changes happening in the American economy which turned into the world's largest absorber of capital surpluses, and above all, of China's, becoming what historian Charles Maier has called an "empire of consumption" (Maier, 2007; Roach, 2014). Such a beneficial change was both structural—being produced by a rising economic globalization where capital could flow more easily across countries and where global trade accounted for a greater share of world GDP—and context specific, being produced by the entanglement of two economies, often labeled "Chimerica," that perfectly complemented each of their strengths (Ferguson and Schularick, 2007). Therefore, it is hard to imagine the PRC achieving the same growth feats had the global economy not been so open and developed countries not been so willing to buy cheap, labor-intensive Chinese goods. On the one hand, and also predominantly, this favored the PRC. On the other hand, it made the country susceptible to exogenous shocks, typically demand-side shocks, as happened during the AFC and GFC.

The 1997–1998 Asian Financial Crisis

In 1997, for the first time since the introduction of reform and opening up in 1978, the PRC faced a crisis that originated outside of its borders. The AFC laid bare the constraints that global economic crises imposed on China's state capitalism and, specifically, on its export-investment-led model. First, it showed that events outside of China could impact the country's reform process and convinced CCP leaders that reforms had to be accelerated into a "desired" direction to raise the odds of WTO membership, while also strengthening the country's economic foundations against future shocks, which we explain in the following section. Second, the prompt response of the Chinese government reinforced its export-led growth and introduced a significant degree of marketization in many sectors of the Chinese economy. Finally, the AFC showed the ability of the CCP to turn the crisis to its own advantage by liberalizing the economy only to the extent to which membership in the WTO required, which was not only an economic goal but also a political one. The result of WTO membership was a historic turning point for China's economic history. In 2000, the Fifth Plenum of the Fifteenth Party Congress declared that with WTO membership, China's "opening up to the outside world will enter a new stage. [We] must further promote all-round, multi-level, and wide-ranging opening up to the outside world and develop an open economy" (CCP Central Committee, 2000).⁵

When studying China's interaction with global economic crises, it is necessary to bear in mind that Chinese leaders expected economic growth and improvement of living standards for vast sectors of the Chinese population due to the process of economic globalization in which it had prospered, both in the late 1990s and in 2007–2009. Since 1978, the PRC had become progressively more integrated into the global value chain, especially through the development of labor-intensive manufacturing industries, despite an initially low level of external circulation, which in 1980 accounted for only 12.4 percent of GDP (Lin and Wang, 2022: 314). During the 1980s, reforms of the external circulation system set the foundations for what would later become an export-led economy by linking greater sectors of the PRC to global trade. Starting in the mid-1980s, the Chinese government had legalized the creation of several hundred corporations that could freely engage in international trade for specified items. In addition, provinces set up their own corporations to handle trade at the provincial level. Concurrently, the steady decentralization of foreign trade led to a progressive removal of several commodities from the planning list, giving more autonomy to enterprises. Financially, throughout the 1980s banks were progressively allowed to engage in foreign exchange operations, without having to transfer foreign exchange earnings to

the People's Bank of China (PBOC). Parallel to this, the foreign exchange retention scheme was implemented, allowing export-oriented enterprises to retain a big chunk of the foreign currency earnings they were making. In 1988, the retention rate for earnings made from goods and services exported above plan levels was raised to 80 percent (Lardy, 1993). By the early 1990s, mandatory planning requirements were no longer in place for exports and for 90 percent of imports. A uniform retention system was implemented, and there were no longer restrictions on sales of foreign exchange. China's share in world trade had doubled from 1 percent to 2 percent, and the country was beginning to be integrated into the global capitalist system (Tseng, 1994).

Hence, twenty years later, it was "undeniable" that the PRC had been "one of the beneficiaries of economic globalization and trade liberalization," as Yi Gang, then vice director of the PBOC, wrote in 2010 in *Qiushi* 求是, a prominent state-published periodical on public policy (Yi, 2010). Economic globalization had helped Chinese leaders maintain the CCP's political legitimacy. It was because of these positive effects, which China's decision to join the global capitalist system had produced, that Beijing consistently perceived the AFC and GFC as moments that could hamper its economic growth and therefore did everything it could to limit the damage. Consequently, the PRC's response to both crises signaled that the country possessed neither the tools nor the willingness to alter the global economic system, but rather operated to keep it substantially intact and well-functioning, in order to continue benefiting from it. Economic globalization and trade liberalization made the country "stronger and stronger," according to Yi Gang. Officials like Yi continued to see these structural trends as a "mutually beneficial, win-win" 互利共赢 phenomenon that served Beijing's "national interests" (Yi, 2010). Therefore, the evolution of China's state capitalism also served to adjust the party's role in order to consolidate its "power," as Jiang Zemin had stated in 2002 (Sixteenth National Congress of the CCP, 2002).

In the summer of 1997, prompted by weakness in several Southeast Asian countries—Thailand, Indonesia, Malaysia, and the Philippines—speculation on their currencies snowballed into panic, which resulted in the countries being unable to fulfill international payments after draining their foreign currency reserves. These countries, in addition to South Korea, had accumulated substantial foreign debt in the 1990s (Radelet et al., 1998). Toward the end of the crisis in 1998, many Asian countries saw substantially weakened economies. Between June 1997 and December 1998, the stock index of Indonesia had dropped by 44.2 percent and those of Malaysia, the Philippines, and Thailand by 48.9 percent, 33.3 percent, and 36.1 percent, respectively. Even Japan, which was relatively unaffected by the debt crisis, saw its stock index drop by 31.3 percent in the same time period (Wang, 2000: 148).

The outcome of the AFC was that the Chinese government came to believe that its interests were best served by remaining anchored to a system that had welcomed and facilitated the initial rise of China as a global economic actor, as discussed above. Understanding policymaking before, during, and after the crisis is crucial to comprehending what growth patterns existed before the event, what perceptions the PRC held about the financial slowdown, and what responses were generated. The evidence of this section demonstrates that the response to the crisis and the actions implemented existed in a context in which the CCP had become progressively convinced that its post-crisis adjustments should lead to policies facilitating WTO membership.

Before the crisis, China's integration into global capitalism was only beginning to be visible after fifteen years of reforms and an average GDP growth rate of 9.5 percent per year (Naughton, 1996: 277; Sharma, 2002: 227). As anticipated, in 1993 the PRC had officially launched a new phase of reform and opening up, the socialist market economy, where the importance of the market in the allocation of economic resources steadily increased, reaching the same importance as that of the government. Given the favorable international situation, China was well positioned to "speed up" 更快 reforms and to expect high rates of economic growth and greater integration into the global economy, while maintaining a strong government role in correcting and mitigating the excesses brought about by uncontrolled and uneven marketization (National Congress of the CCP, 1992). Jiang underscored this unevenness facing Chinese economic development: "The current problem is that the function of the market has not been fully developed in many areas, and at the same time there is a phenomenon of blind market development 市场盲目发展和 chaos in the economic order 经济秩序混乱" (CCP Central Committee, 1993b).

In 1994, the Chinese government had also decided to unify and liberalize its foreign market exchange rate, mostly for current account surpluses, pegging the yuan to the US dollar. This led to a 50 percent depreciation of the yuan, which was previously subject to the official market exchange rate but also to the official rate set by the government (Naughton, 1996: 317; Sharma, 2002: 231). However, beginning in the mid-1980s many export-oriented firms (around 12,000 by the mid-1990s) were already substantially operating at the market rate, effectively participating in global trade. Thus, the real devaluation was much less as it affected only those firms that were producing for the domestic market and which were still protected against international competition (Branstetter and Lardy, 2006: 5–6).

The goal of a deeper integration between Chinese and international markets had been formally embraced at the Third Plenum of the Fourteenth Party Congress in 1993, which had called for a "nationwide, unified, open market

system” 全国统一开放的市场体系, a “close integration of the rural and urban markets” 城乡市场紧密结合, and, indeed, a better connection between the domestic and international markets (CCP Central Committee, 1993a). Decisions like this signaled that the CCP wanted to connect China’s economy to structural features of the global capitalist system during times in which crises were not happening, thereby accepting what were going to become (and had partially already become) endemic constraints, such as a tighter integration of its firms with the international market, and hence with global demand.

Therefore, by the mid-1990s, the Chinese economy began embarking on a solid trend of increasing exports and greater inflows of foreign direct investment (FDI), no longer limited to Special Economic Zones (SEZs) (Naughton, 1996: 277–79). By the end of the decade, Chinese foreign currency reserves totaled roughly thirteen months of imports and had significantly caught up with those of Japan, another major accumulator of foreign currency reserves (Sharma, 2002: 232). In spite of China’s trend of increasing exports, in the years preceding the AFC, foreign trade accounted for 25 percent of GDP, half the percentage of “crisis countries” affected by the AFC, according to the IMF (Gruenwald and Aziz, 2003: 104). The debt-to-GDP ratio was low, and the current account remained positive (Gruenwald and Aziz, 2003: 104; Sharma, 2002: 233).

Yet the PRC’s good credit did not make the country totally immune from some of the consequences of the 1997 economic slowdown. Exports stagnated in 1998 after growing consistently from 1990 until 1997, as regional demand for Chinese goods dipped. The same pattern applied to FDI, pushing China’s ranking as a safe recipient of global investment from second place to fifth by the end of the 1990s. The Guangdong International Trust and Investment Corporation, which invested on behalf of the Guangdong provincial government, went bankrupt after losing funds it had borrowed internationally to corruption. In the late 1990s, foreign banks’ claims on China declined by more than 20 percent. Shrinking FDI and insolvent firms meant that the PRC had to repay US\$34 billion in external obligations to foreign banks, while running the first capital account deficit since 1992 (Lardy, 2001: 17). The banking system, which had undergone major reforms since 1994, was disbursing too many non-performing loans (NPLs) when compared to other Southeast and East Asian countries, in what looked like a worrisome rising trend in which NPLs rose from 20 percent to 25 percent of total GDP from 1994 to 1997 (in South Korea the same ratio peaked at 17 percent). According to Shalendra Sharma, “under pressure from international financial markets ‘for greater transparency,’” China’s financial authorities were forced to admit a real risk of insolvency and injected liquidity into the banking system to recapitalize it, in order to avoid what would have been a domestic financial crisis. Moves like

this demonstrated that the Chinese government treated the AFC as an acute threat that catalyzed a preexisting structural issue, the weakness of the banking system, to become an economic emergency. Weak sectors of its evolving state capitalist economy, in this case, its banking system, needed at least to meet international economic standards of minimum capital adequacy ratio, then set at 8 percent, given that “all four of China’s state-owned commercial banks” were insolvent at that time (Sharma, 2002: 240).

In the realm of macroeconomic stability, China arrived at the 1997 AFC after years in which its economy had cooled down after the inflationary growth of the early and mid-1990s. The CCP implemented a large and successful stimulus that represented 2.5 percent of GDP in order to stimulate aggregate demand (Lardy, 2001: 18). The result of this stimulus was that GDP growth slowed but remained high—8.8 percent in 1997, 7.8 percent in 1998, and more than 8.0 percent in 1999 (Sharma, 2002: 226). The necessity of revitalizing exports was evident in the decision to allow private firms to freely operate in the international market rather than through state-owned trading companies. Hence, the crisis was an important turning point as it further intensified the understanding within the PRC government that giving more leeway to private enterprises not only might be more beneficial for the Chinese economy, but would also improve the odds of the country joining the WTO. Only by playing by the rules of the international division of labor would the PRC be able to fully enjoy the benefits of globalization. As Nicholas Lardy observes, “it seems that China’s top leadership in the wake of the Asian crisis saw that there was no viable alternative to the globalization of production and that, indeed, China through WTO membership would benefit from greater participation in the trend,” and that a more globalized China would mean more competition for SOEs, forcing them to innovate and become more competitive globally (Lardy, 2001: 18, 20). Elevating the competitiveness of SOEs was hailed at the Fifth Plenum of the Fifteenth Party Congress, when it was stated that “large and medium-sized state-owned enterprises should establish modern enterprise systems, improve corporate governance structures, and become the main agents in market competition 市场竞争的主体” (CCP Central Committee, 2000).

After WTO accession, the country’s export sector quickly expanded and hiring trends allocated cheap labor to export-oriented industries, increasing and diversifying employment opportunities and incomes. Between 2001 and 2006, the total volume of imports and export rose from 38.5 percent of GDP to 64.2 percent, and the PRC economy prospered (Wang, 2018: 178). This was overall a move toward marketization and liberalization, including in the countryside, as was proclaimed at the Third Plenum of the Fifteenth Party Congress. The new balance was summed up in 1998 during the Third Plenum,

in the middle of the AFC: “We must continue to improve the ownership structure 所有制结构, and while actively developing the public sector, adopt flexible and effective policies to encourage and guide greater development of rural individual, private, and other non-public sectors of the economy” (CCP Central Committee, 1998a).

As has been noted, one sector in which the Chinese government chose to intervene to implement crucial reforms in the aftermath of the 1997 crisis was that of SOEs. In 1997, still in the midst of the crisis, Jiang had pointed out at the Fifteenth Party Congress that SOEs were “weak” 活力不强 and represented one of the most serious shortcomings to be addressed in order to make the economy more efficient (Jiang, 1997). Jiang was right. In the early to mid-1990s, SOEs became increasingly unprofitable and turned to banks for greater loans to finance their activities. As a consequence of this higher borrowing, their debt-to-equity ratio reached a worrisome 211 percent by 1994, similar to Japanese and Korean levels. The risk of insolvency was real and preoccupied Chinese policymakers. In 1998 the decision was taken to shut down many inefficient SOEs, limit the excessive competition that had previously forced SOEs to borrow too much from commercial banks, and inject liquidity into the banking sector to permit banks to cancel bad loans to SOEs. The result was, according to Barry Naughton, that the “increase in SOE profitability closely mirrored the increase in profitability of the nonstate sector through 2007, and total central SASAC [State Asset Supervision and Administration Commission] profits hit the psychological milestone of 1 trillion RMB” (Naughton, 2018: 353). Thousands of SOEs were closed, and the number of urban workers in industrial SOEs declined from 46 million in 1992 to 17.5 million in 2007, raising questions for the CCP about how to safeguard their living standards and, consequently, maintain social harmony during a crucial period of transition, as was publicly underscored by Premier Zhu Rongji in 1998 (Naughton, 2018: 116; Zhu, 2000). In this case, similarly to what happened to the banking system, a structural weakness of China’s economy that was a legacy from the socialist period compelled the Chinese government to quickly act in a certain direction once faced with an external crisis.

Therefore, one of the major consequences of the 1997 crisis was that it compelled the PRC’s leaders to streamline the SOE system, which itself was part of the liberalization process that was necessary for joining the WTO, a goal that was made even more urgent by the AFC (Lardy, 2001: 19–20; Naughton, 2018: 116–17). As we have shown, the process had originally started before the crisis, then intensified because of the crisis. The pressure to expand the use of the market had become more visible during the Fifteenth Party Congress in 1998. The official communiqué of the Third Plenum stated that China should “give full rein 充分发挥 to the market’s fundamental role

in resource allocation under national macroeconomic regulation and control 国家宏观调控” as well as “strengthen construction of market infrastructure, improve market regulations, and maintain market order” (CCP Central Committee, 1998a). This strong wording suggests that, from the CCP’s standpoint, the acceleration of the marketization process that had begun in 1993 was intensified because of the situational constraints produced by the AFC.

As a consequence, the Chinese economy, especially the export sector, became more marketized, even though necessary political reforms separating the role of government from that of the party were never implemented (Wang, 2018: 178–79). Scholars of China’s political economy have underscored how the AFC put pressure on the CCP to accumulate foreign currency reserves that would have been crucial for strengthening its creditworthiness. Tougher rules to prevent capital outflows were implemented in the aftermath of the crisis. For example, in late 1998, a law was passed imposing penalties for crimes involving foreign exchange transactions, with punishments that could include death (Hamilton-Hart, 2014: 876; Liu, 2023; Naughton, 2015: 116).

In the wake of the AFC, the PRC economy grew by prioritizing a savings-and-investment-led economic policy over a consumption-driven one. For example, the PRC government made political choices to please business interests in the urban coastal areas, which strongly opposed any attempt at currency revaluation and always pressed to maintain the export-driven outlook of the country. This “distributional conflict” has been analyzed by Natasha Hamilton-Hart in the context of Southeast Asia and by Ho-Fung Hung in the context of China as a factor preventing a more equitable distribution of resources (Hamilton-Hart, 2014: 882, 884; Hung, 2009). David Steinberg has argued that “on one hand, large foreign reserve holdings may enhance the Party’s survival because this promotes export-led growth and reduces the risk of future banking crises. On the other hand, large foreign reserve holdings may undermine the Party by increasing inflation in the short term” (Steinberg, 2014: 83). Rising exports also produced “spillover effects” on the Chinese economy in the aftermath of the AFC. An estimated one-third of income growth before the GFC has been attributed to rising exports, which also played a significant part in maintaining social stability, a long-term fixation of the CCP since the chaos brought about by the Cultural Revolution (1966–1976) and, later, the aftermath of the 1989 Tiananmen Square crisis (Breslin, 2011a: 188).

While the AFC did not overturn the basic structure of China’s economy per se, the PRC leadership learned that temporary but forceful crisis-driven adaptations were a more bitter pill to swallow than routine structural constraints and “grasped the essential lesson, the so-called ‘paradox’ of the Asian Financial Crisis: that strong macroeconomic fundamentals while necessary,

are not always sufficient for averting currency crises or providing immunity from financial shocks. Acutely aware of their economy's underlying structural weaknesses, they remain deeply concerned" (Sharma, 2002: 233–34). The AFC indicated that a growing integration of the country into the processes of globalization implied the need to link domestic-driven reforms to the broader realities of the international political economy, which became increasingly impossible to ignore. If a still incomplete integration into global capitalism had helped the PRC escape the gravest consequences of the AFC, the more Chinese policymakers decided that it was in their country's interest to go global, the less it could continue to ignore crises and the consequences they inevitably produced on its state capitalist system (Breslin, 2011a: 188).

The 2007–2008 Global Financial Crisis

The 2007–2008 GFC began with what Warren Buffet referred to as “financial weapons of mass destruction”—namely, derivatives. Beginning with defaults in the US subprime mortgage market, derivatives like mortgage-backed securities suffered as positions began to unwind, snowballing into multiple bank failures (James, 2023: 205–56; Tooze, 2018). The turmoil in Wall Street investment banks reverberated across the world and affected China as well.

If the AFC had prompted the PRC to accelerate free market reforms and to accumulate large quantities of foreign currency reserves to finalize WTO membership and increase its creditworthiness, the GFC showed that PRC leaders needed to at least attempt to adjust the high savings/high investment model that had been developed during the 1990s and early 2000s. Clearly, Beijing continued to depend on global demand for its products. If global demand shrank, the Chinese economy would suffer, as Yi Gang reminded the public. The correlation was as strong as it could possibly be. “Historical data,” he reckoned, “show that every one-percentage-point decline in economic growth in [the US and European nations] will cause a six-to-eight-percentage-point decline in China's export growth” (Yi, 2008). Like the AFC, the GFC forced corrections that the Chinese government had already begun to envision and implement, rendering them more urgent. Internal debates about dual circulation, the reduction of the economy's outward direction to favor a higher degree of domestic consumption as the country's GDP per capita grew, gained momentum around the time of the GFC (Lin and Wang, 2022).

It is interesting to note how both crises intersected with pre-existing domestic trajectories. If the 1997 AFC had intensified a growth model that the PRC was already embracing, the GFC signaled that the degree to which that model had worked could not be sustained any longer, which was indeed a realization that the party had arrived at before the crisis. The next stage of

reform, as hailed by Hu Jintao, the CCP's new party secretary after Jiang Zemin, at the Third Plenum of the Seventeenth Party Congress in 2008, targeted the rural rather than the urban sector, a sign that the party intended to reduce the rural–urban divide by shifting resources from (urban and export-oriented) investment to (poor rural and agricultural) consumption. The Third Plenum report published in *People's Daily* stated that “to persevere with reform and opening up” the PRC “must uphold a focus on rural reform, achieve a major breakthrough in the overall plan for urban and rural reform, inject new impetus into rural development, and add new vitality to the development of the overall economy and society.”⁶ The Third Plenum decision added that “the agricultural foundation is still weak and is most in need of strengthening; rural development still lags behind and is most in need of assistance; raising farmers’ incomes remains difficult and is most in need of acceleration.”⁷ Thus, among the new reform goals that the Seventeenth National Congress set in 2008 for 2020 were to double “farmers’ per capita net income compared to 2008” and “substantially increase consumption levels” (Renmin ribao, 2008).⁸

Therefore, the crisis accelerated the beginning of the end not of China’s export-led model, but of the sheer intensity with which that model had functioned for a decade. In spite of the newly declared intention of the CCP to alter the reform path, the Chinese government during the GFC decided to remain fundamentally anchored to its export-investment-led growth while using primarily monetary tools to stimulate an infrastructure-driven stimulus, sacrificing the marketization trend in both the public and private sectors that had defined the growth of the 1990s and of the post-AFC years (Hung, 2009; Katada, 2017: 916; Naughton, 2015: 124–25). At the Third Plenum of the Eighteenth Party Congress in 2013, the first with Xi Jinping as party secretary, while the market continued to be publicly lauded as the best tool to allocate resources, the new direction initiated by Hu was confirmed, at least in official statements. China was going to “tightly focus on better guaranteeing and improving people’s livelihoods, promoting social fairness and justice, [and] deepening social system reform.” The government would “reform the income distribution system, promote common prosperity, carry forward institutional innovation in the social sphere, advance the equalization of basic public services, accelerate the formation of a scientific and effective social governance system, and ensure that society is both full of vitality and harmoniously in order” (CCP Central Committee, 2013). Rhetorically, these statements marked a departure in the narrative Chinese policymakers used to describe their country’s reform path, while the actual economic policies remained torn between old patterns of development and new desires to change these patterns.

Unlike the AFC, the GFC generated various debates about its causes. In the West, responsibility was attributed to the unregulated capitalism that had emerged since the 1980s (Zestos, 2016). In China, it was pointed out that “through this international financial crisis, we can fully understand the essence and danger of Western neoliberalism,” as a report of the Research Center for the Theoretical System of Socialism with Chinese Characteristics of the Chinese Academy of Social Sciences (CASS) pointed out in 2012 (Hu, Liu, and Yu, 2012). The result was a shifting balance of power. At the Fourth Plenum of the Seventeenth Party Congress in 2009, Hu Jintao acknowledged that while developed countries still had several advantages in the realms of economics and technology, “elements of instability and uncertainty are increasing, providing new opportunities and challenges to our nation’s development” (Xinhua, 2009). During the Third Plenum of the Seventeenth Party Congress it was stated that China had “to seize and fully take advantage of this period of important strategic opportunity 重要战略机遇” (Renmin ribao, 2008).

Globally, new rules were put in place to introduce credit controls on the banking sector, and governments took back some control of the economy. In Europe, the crisis exposed the inherent contradiction of the Eurozone—that it was a monetary union but not a fiscal one. When the GFC took hold in Europe, it became a crisis of debt and borrowing for Southern European countries like Greece and Portugal, which perceived the fiscal policies pursued by Germany and France as the real cause of the crisis. While austerity was the response in Europe, in China the crisis was perceived as being caused by Western countries. However, because of China’s perception of the structured economic tenets that preceded the GFC, the CCP chose to navigate through the crisis by hanging on to its export-investment-led model, which began to be corrected in favor of greater domestic consumption, albeit very slowly. This time, though, the country coupled the same behavior it had adopted ten years earlier with a marked desire to recentralize political and economic power into the hands of the central government, a trend that had started before the GFC but that intensified around it (Garnaut, 2018: 41).

Hence, like the AFC, the GFC produced many consequences for the PRC. First, it rendered obvious the impossibility of continuing to export at pre-2007 levels. Exports dropped from 35 percent of China’s GDP in 2007, an all-time high, to 25 percent in the aftermath of the crisis.⁹ Second, considering the CCP’s interpretation of the crisis, a new, politically more assertive China began to emerge. Third, it further altered China’s model of state capitalism, as the country had to find a solution to adjust to its diminishing, yet still high, dependence on exports. Insisting on promoting export-led growth, in spite of the growing attention on rural poverty and consumption, signaled that the Chinese government still perceived that engaging with the global economy would

produce more benefits than downsides for its state capitalist system. This is one of the crucial points of dual circulation—it did not lead to an *absolute* reduction of exports and a drastic abandonment of the outward strategy. Even though China's ratio of exports to GDP diminished after 2007, the total value of exports rose because of rising GDP (Lin and Wang, 2022: 313–14).

When analyzing China's response to the crisis, it is important to note that, in contrast to the late 1990s, the PRC entered the GFC in a much stronger position. In the first decade of the 2000s, because of the heavy push into exporting following WTO accession, the urbanization rate rose from 39 percent to 53 percent. Despite bottlenecks, the private sector grew much faster than the state sector, with private enterprises' contribution to total industrial output surging from 60 percent to 76 percent. China had already officially become, by World Bank standards, a middle-income country in the late 1990s. By 2012, it was marching toward upper-middle-income status. GDP per capita rose from US\$1,148 in 2002 to US\$6,338 in 2012 (Wang, 2018: 180). The country had also become a strategic competitor of the United States and, since 2010, the second largest economy in the world, surpassing Japan (Drezner, 2016; Mastro, 2024).

Despite an impressive catch-up, by the mid-2000s some of the endemic problems that a quarter of a century of economic growth had created were already known to the highest ranks of the CCP. Four years before the onset of the crisis, in 2004, a document on strengthening the party issued during the Fourth Plenum of the Sixteenth Party Congress hinted that some of the spirit of the 1990s was gone, and that many of the political and economic features of reform and integration had to be reconsidered and adjusted to the new challenges facing the Chinese economy. Reforms were entering a more mature phase, one that had to be carefully handled by the party, by carrying out necessary corrections without compromising what remained a positive trajectory. The report on the one hand affirmed that the “trends of multipolarity and economic globalization . . . continue to develop,” while on the other it stressed that “hostile forces carrying out Westernization and strategically conspiring to divide our country have not changed, and we still face pressure from developed countries' advantages in the economy and technology.” In short, China's “reform and development are at a critical stage, social interest relations are becoming more complex, and new situations and problems are emerging one after another” (CCP Central Committee, 2004a).

This new phase aimed at developing the “harmonious society,” which, indeed, was a goal set at the Fourth Plenum of the Sixteenth Party Congress in 2004. In Hu's words, the harmonious society would “continuously strengthen the creative vitality of all of society, properly coordinate the interests of all parties, promote innovation in the social management system,

strengthen and improve mass work under the new circumstances, and maintain social stability” (CCP Central Committee, 2004b). At the core of the harmonious society stood a much greater emphasis on technological and educational innovation, military modernization (almost entirely overlooked during the 1990s), social stability for those left behind in the reform process, and reducing corruption among party cadres (CCP Central Committee, 2004b). The first efforts to recalibrate the economy toward more domestic consumption took the form of raising rural incomes in order to alleviate mass internal migration to cities (Hung, 2009: 20). Importantly, the posture of the party regarding its relations with the outside world began to shift toward a slightly more active role, one in which the CCP ought to “continuously improve [its] ability . . . to respond to the international situation and handle international affairs, raise [its] level of scientific judgment of international circumstances and strategic thinking, and seize the initiative in handling international affairs.” This language signaled that while remaining mostly powerless in shaping international affairs, Chinese leaders in the early 2000s had begun to envision a future in which a more active stance would define their country’s international standing (CCP Central Committee, 2004b).

Unquestionably, in the years preceding the crisis, there continued to be more advantages than disadvantages to being integrated into the global economy, albeit advantages requiring adaptation and flexibility: “Developing a market economy under socialist conditions is both a great pioneering work and a totally new problem. It is necessary to adapt to the trends of the world economy, technological development, and the new situation” of China’s reform.¹⁰ The international situation remained “relatively favorable for advancing the projects of the party and the country” (CCP Central Committee, 2004a).¹¹ What were perceived as enduring constraints remained broadly well tolerated insofar as they continued to generate more dividends than losses.

However, in 2007, before the GFC, Premier Wen Jiabao had famously claimed that China’s economy was “unstable, unbalanced, uncoordinated, and unsustainable” 不稳定,不平衡,不协调,不可持续 (Mission of the People’s Republic of China to the European Union, 2007). One of the most important bottlenecks challenged the Chinese model at the core of what had been its strength. In fact, sustained economic growth had begun to produce a rise in real wages, making it harder to sustain capital accumulation that had primarily relied on cheap labor costs coming mostly from the countryside, but also from trade surpluses and the accumulation of foreign currency reserves. Ross Garnaut has argued that the PRC by the mid-2000s was approaching a Lewisian turning point, where surplus rural labor gets fully absorbed by the modern manufacturing sector (Garnaut, 2006: 2). On the one hand, the rise in exports in the early 2000s had brought plenty of foreign

reserves into the economy, with the benefits discussed above. On the other hand, it had produced cycles of inflation that the CCP had to restrain with sterilization measures and by fixing a cap on bank deposit interest rates in order to cushion the financial system, which penalized household savings while protecting business interests (Naughton, 2015: 128–29).

Hence, when the crisis hit China, despite a much stronger economy, the country was very susceptible to external shocks as the share of exports had reached an all-time high just before the crisis, as was shown above. Indeed, the country was significantly impacted: Thousands of factories were forced to close and laid-off workers returned to the countryside. On the import side, China's solid recovery during the first quarter of 2009 did help world commodity prices to rapidly recover (Naughton, 2015: 123; Tooze, 2018: 242–43). Senior CCP leaders visited the coastal areas to offer reassurances to heavily hit export industries that the government would pursue export-friendly policies, including keeping the exchange rate competitive for exports (Breslin, 2011a: 190).

In 2009, the international system accepted China's continuation of export-led growth so long as China, together with the other developed countries, would play its part creating a global stimulus that would boost global demand. Because of the velocity with which the Chinese stimulus had helped the economy to rebound, much faster than any other country, the PRC became the de facto leader of global economic recovery. However, a greater responsibility for China also depended on the fiscal position of the United States. In 2009, the American government had implemented its own stimulus, the American Recovery and Reinvestment Act, thanks in part to bonds purchased by the PRC, which at that time accounted for roughly 24 percent of total American treasuries holdings (James, 2023: 225–26; Labonte and Leubsdorf, 2026). Hence, during the crisis, Beijing's dollar reserves continued to rise despite a worsening financial outlook for American debt. In May 2009, Moody's Investors Service underscored that the debt rating of the United States might not remain at the AAA level if the US fiscal position continued to deteriorate. Chinese Premier Wen Jiabao commented in May 2009 that he was "worried" about the PRC's exposure to American treasuries, signaling China's anxiety and fears about the sustainability of the American fiscal position, which could have hampered repayment of its debt (James, 2023: 216). The episode epitomized that an excessive reliance on dollar reserves had put the PRC in a vulnerable position in case of a run on the dollar, a worrisome scenario that a crisis like the GFC greatly amplified (Jung, 2024: 85; Katada, 2017: 916).

Scholars like Zongyuan Zoe Liu have identified this moment as a turning point, when CCP leaders understood that the country could not continue investing all its foreign currency reserves only into American debt, a policy

change driven by fears of potential crisis fallout. A more active and profit-seeking management of these reserves in pursuit of greater diversification became necessary in light of new constraints. Even before the GFC, the Chinese government had decided to inject capital into sovereign funds like China Investment Corporation to offset the huge inflow of foreign currency reserves, which were a liability for the PBOC (Liu, 2023: 62–63).

Contrary to the 1997–1998 AFC, the 2008 GFC was also a political watershed for the PRC as it signaled Chinese intentions to step up politically in a world that CCP leaders then considered officially a multipolar one. In the 2010 *Qiushi* article cited above, Yi Gang stated that “China should actively participate in the formulation of global economic and financial governance rules, and especially play an important role in the formulation of new international financial regulatory standards” (Yi, 2010). Thus, the crisis offered an unparalleled political opportunity for the CCP. At the Fourth Plenum of the Seventeenth Party Congress, Hu had made this quite explicit when he claimed that the “international financial crisis impact is far reaching, the structure of the global economy is undergoing new changes, and a new situation is emerging in the international balance of power” (Xinhua, 2009).

Perceptions of the crisis were indeed important and shaped its aftermath, both in China and beyond. While in the West the GFC was seen as a failure of three decades of neoliberal policies, in China, as documented, it was perceived as materially damaging but also as an opportunity that could be exploited to the country’s advantage. There were solid reasons for this: the contrast between China’s quick and successful recovery and the West’s long path to recovery was palpable (Tooze, 2018: 245).

Indeed, reacting to a widespread sense of urgency, the Chinese government implemented one of the largest stimulus packages ever approved in peacetime in order to maintain full employment, though most of the package was financed with a big expansion of financial credit, unleashed by local governments in order to continue to meet high growth targets (Naughton, 2015: 125–26; Tooze, 2018: 247). However, the Chinese government took a hostile position against the idea of a big, globally funded IMF stimulus, advanced by G20 countries in spring 2009, arguing that it would have been an unjust bailout that poor countries offered to rich countries. In the PRC’s view, developing countries should not rescue those that had caused the crisis (James, 2023: 225–26).

What was clear in the immediate aftermath of the crisis was that the Chinese government, at least in the short term, rejected requests to make the global economy more balanced, that is, to significantly stimulate domestic consumption and reduce exports. What was more, structural capital imbalances in the global economy had been considered one of the enabling

conditions, but not the cause, of the GFC, insofar as they brought an excess of easily recyclable capital into the US market, inflating the subprime bubble while keeping inflation and interest rates low, an outlook that convinced the US government and the Federal Reserve Bank that no preventive action was required (Naughton, 2015: 130).

Irrespective of the causes of the GFC, the imbalance between countries running big current account surpluses versus countries running big current account deficits became even more prominent in late 2010 when the Fed bought US\$600 billion of American treasury bonds, sparking fears of devaluing the dollar to initiate a currency war against developing countries, first and foremost against China. US President Barack Obama declared, “We can’t continue in a situation in which some countries are maintaining massive surpluses and other countries are maintaining massive deficits,” as the PRC registered one of its biggest trade surplus increases in late 2010, jumping from US\$16.9 billion to US\$27 billion (James, 2023: 227–29). The message Obama was sending was clear: China had to play its part in the global rebalancing of the economy, a message that was strongly reinforced after the GFC.

As noted, the crisis accelerated Beijing’s reconsideration of how to mold its economy to the new post-recession outlook, rendering more urgent problems that the CCP was already aware of before 2008. Just before the crisis, the ratio of China’s imports and exports to GDP peaked at 62 percent, an all-time high for the PRC, while in 2012, on the verge of Xi Jinping’s ascendance to the top of the CCP, it had decreased to 45 percent. The crisis certainly had partially reduced the outward direction of the Chinese economy (Wang, 2018: 180). Before the crisis, the country already had one of the highest investment rates and lowest consumption rates across developed and developing countries (Ma, Roberts, and Kelly, 2018: 196). In a paper published in 2014, Chinese economist Liu He underlined how, before the crisis, China’s growth was mostly driven by exports and inflow of foreign investments. After the crisis, however, “our strategic opportunities take the form of the domestic driving a world economic recovery, acquisition of technologies of developed countries, and investment and infrastructure” (Allison and Summers, 2014: vi). Yi Gang insisted that China’s focus should be on “expanding domestic demand, especially consumer demand, and accelerating the transformation of [our] economic development method. Faced with the situation of a slowing world economy, the economic growth method that used to rely mainly on external demand must be changed” (Yi, 2008).

Hence, boosting Chinese domestic demand was deemed beneficial not only for the rebalancing of the global economy (Pettis, 2014). As we have shown, since the early 2000s it was also progressively considered to be a viable and desirable outcome by the Chinese government, which began to

implement policy changes favoring higher consumption (Wang, 2006: 40). As the PRC grew richer, the importance of its service sector, which is not tradable, inevitably made domestic circulation a bigger portion of the economy as part of a natural process of economic development (Lin and Wang, 2022: 313). Dual circulation was not only a choice the CCP made to reorient the economy, but also an inevitable trend connected to society's enrichment.

Thus, global (and domestic) rebalancing accelerated in the aftermath of the financial crisis through a process of readjustment of China's state capitalist system. Just before the GFC, China's savings rate had reached an all-time high of slightly more than 50 percent of GDP, contributing to current account surpluses reaching 10 percent of GDP in 2007. During the 1998–2008 period, investment also grew substantially while China's total credit to the private non-financial sector as a share of GDP only rose by 10 percentage points, from 106 percent to 116 percent. The explanation for this was twofold: it was partially caused by the inflation that occurred during the first decade of the millennium, which reduced the debt-to-GDP ratio by floating the denominator. Furthermore, as Guonan Ma, Ivan Roberts, and Gerard Kelly (2018: 201) claim, "it is likely rising Chinese investment was mostly 'funded' by a surge in retained earnings arising from a booming export market after China's WTO accession."

Conversely, in the aftermath of the GFC, the PRC's current account surplus shrank to 2 percent of GDP by 2014, as a big part of the surplus savings that had been accumulated during the 2001–2007 period had to be used to finance the stimulus response to the GFC. This shrinking of the current account surplus was a crisis-generated outcome. Additionally, the PRC's total credit to the private nonfinancial sector rose from 116 percent of GDP in 2008 to 210 percent in 2016 (Ma, Roberts, and Kelly, 2018: 201). Export-oriented firms also issued more debt in light of their reduced foreign earnings. While the reduction of the PRC's surpluses eased global imbalances, it imposed drastic changes in China's political economy, reducing fiscal space and fueling debt (Ma, Roberts, and Kelly, 2018: 200–201). This embroiled China's state capitalism in a convoluted pattern that continues to be visible today. Economic growth is the mantra to be delivered at all costs, forcing local and regional governments to rely, for example, on the performance of the real estate sector that is notoriously suffering from the country's declining population. As observed by Shaun Breslin (2011a: 194), "perhaps ironically, while the crisis might have further undermined confidence in the existing growth 'model,' the immediate solutions in some ways meant a turn back to that model rather than a further move to a new paradigm."

As debt mounted and local governments struggled to meet GDP targets and fueled a real estate bubble, rebalancing toward a more consumer-driven

economy was tortuous, though the investment rate began to decline since 2011 and the consumption rate began to rise (Ma, Roberts, and Kelly, 2018: 201). It was another overlooked financial crisis in summer 2015, together with Xi's consolidation of power in the PRC, that exacerbated the emergence of a new political context that recentralized power in the hands of Xi Jinping and the central government, taking resources away from where they had yielded the greatest dividends. The sustainability of this model over the long run remains to be seen, but crises in recent Chinese economic history have always obliged the PRC to adjust its economic model not only around domestic trajectories but also around crises.

Conclusion

The 1997 Asian Financial Crisis and the 2007–2008 Global Financial Crisis demonstrate how states like China respond to crises and utilize economic policies, engagement with global institutions and structures, and capital reserves to manage actual and perceived threats. By revisiting these crises with a focus on their social and political ramifications, we offer a new perspective on the evolution and nature of China's state capitalist system. Global market forces constrained Beijing, forcing it to adapt its export-led growth model to the realities of the AFC and the GFC by significantly accelerating preexisting domestic patterns. On the other hand, these crises also presented political opportunities, such as proposing reforms that smoothed accession to the WTO and accelerated integration into the global capitalist system that benefited PRC policymaker objectives. We show that China navigated the GFC by insisting on a political economy centered on its export-investment model, albeit under harsher constraints and domestic-driven demands for significant rebalancing. Crises, as well as global, political, and social constraints, are co-constituting factors that affect how states like the PRC manage their economies and pursue state capitalist objectives.

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Notes

1. For example, the economist Isabella Weber has argued that the Chinese state fully “maintained the capacity to insulate the economy’s commanding heights—the sectors most essential to economic stability and growth—as it integrated into global capitalism” (Weber, 2021: 3).
2. State capitalism as a particular “variety of capitalism” has been one approach in the literature on East Asia by political economists (e.g., Hall and Soskice, 2001). In the work of economist Barry Naughton, state capitalism represents state management or control of a market-oriented economy in post-reform-and-opening-era China. This reflects a more traditional understanding of state capitalism as a variety of capitalism focused on institutions and relationships between the state and firms (Naughton, 2018). For the PRC in particular, scholars have used “party-state capitalism” to describe the type of state capitalism where the party-state is more deeply embedded into the economy and economic vehicles directly and indirectly serve the interests of the party-state (Pearson et al., 2022).
3. Ilias Alami and Adam Dixon’s overview of the disparate approaches to state capitalism includes discussions of state capitalism as a comparative form of capitalism or as a field of global political economy focused on the efforts of the state in areas such as state sovereignty and asserting alternative models of capitalism (Alami and Dixon, 2024: 28–40).
4. Original quote: “面对亚洲一些国家发生的金融危机，最根本的是要做好国内的经济工作，增强承受和抵御风险的能力。”
5. Original quote: “我国对外开放将进入新的阶段，要进一步推动全方位，多层次，宽领域的对外开放，发展开放型经济。”
6. Original quote: “坚持改革开放，必须把握农村改革这个重点，在统筹城乡改革上取得重大突破，给农村发展注入新的动力，为整个经济社会发展增添新的活力。”
7. Original quote: “农业基础仍然薄弱，最需要加强；农村发展仍然滞后，最需要扶持；农民增收仍然困难，最需要加快。”
8. Original quote: “农民人均纯收入比二〇〇八年翻一番，消费水平大幅提升。”
9. See <https://data.worldbank.org>, accessed December 24, 2025.

10. Original quote: “在社会主义条件下发展市场经济，既是一个伟大创举，又是一个全新课题。要适应世界经济，科技发展趋势和我国改革发展的新形势。”
11. Original quote: “国内外形势总体上对推进党和国家各项事业比较有利。”

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