China's Emerging Credit Rating Industry: The Official Foundations of Private Authority*

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ABSTRACT Although China has had difficulty improving the performance of its banks and stock markets, it has struggled even more to develop a credit rating industry. Credit rating agencies (CRA), which provide bond ratings, are vital to financial markets in advanced capitalist countries, but China's credit rating companies are weak and have had little influence over the behaviour of those who issue or invest in bonds. Some argue that CRAs gain authority through their strong reputation in the eyes of market participants, but the experience of rating agencies in China supports evidence from elsewhere that their private authority is largely dependent on government mandate, a benefit China's CRAs have only recently begun to enjoy. Many private actors, from trade associations to charity groups, are struggling to gain public influence in China, but credit rating agencies may be the best barometer to measure the Chinese government's general stance towards private authority.

China has struggled to develop a more market-oriented financial system since the 1980s. Banks still lend primarily to privileged state-owned enterprises (SOE) and those with strong political connections, forcing private companies to borrow from informal channels. Although the Shanghai and Shenzhen stock markets have helped over 1,400 companies raise new capital, the process to obtain approval to issue shares on the exchanges is heavily politicized, listing has not led to a substantial improvement in firms' corporate governance, and buying stocks is still not much safer than gambling.[1] A less understood but even more problematic aspect of China's financial reforms has been the difficulty in promoting the development of a domestic credit rating industry which could serve as the foundation of a corporate bond market. Examining its evolution can shed further light on the political economy of financial reforms as well as elucidate tensions that permeate state–society relations in China more generally.

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1 Stephen Green, *China's Stockmarket: A Guide to Its Progress, Players and Prospects* (London: Economist Books, 2003); Mary Comerford Cooper, "Local governments and the Chinese stock market," *Asia/Pacific Research Center Working Paper Series*, May 2003.

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Credit rating agencies (CRA, *zixin pinggu gongsi* 资信评估公司) are one of the most powerful organizations in capitalist countries and central to the world's global financial system. The lower their ratings of bonds issued by governments, financial institutions and corporations, the greater the probability the issuer will default. The greater risk is reflected in a higher interest rate, which acts as an added attraction to potential buyers and, conversely, as a penalty to the issuers.

Given their effect on global financial markets outside China, CRAs are one of the most important examples of the growing privatization of public authority in the global political economy. As Virginia Haufler notes, authority is not only moving down, it is also "moving sideways," into the hands of non-state actors.[2] Although there is a consensus that credit rating agencies are powerful private actors in advanced industrialized countries, the source of their influence is still under debate. Some stress the importance of the leading firms' excellent reputations developed over a century.[3] Others argue that CRAs are powerful because governments make them so, and have turned raters into surrogate regulators, forcing the investment community to obtain and act in accordance with ratings.[4]

China's credit rating industry stands in sharp relief to its counterparts elsewhere, not only in the United States but in other countries in Asia. When the PRC launched a corporate bond market in the mid-1980s, Chinese CRAs emerged as well. They rate domestic corporate bonds, the financial health of banks and insurance companies, and stocks listed on the Shanghai and Shenzhen bourses. However, until very recently China's CRAs have been bereft of influence. Both sophisticated institutional investors who sit in glass-windowed offices and common retail investors who congregate around street-side brokerage houses have paid little attention to ratings issued by local CRAs.

Why has private authority in financial markets emerged in other capitalist systems but struggled to take root in China? The Chinese case reinforces the comparative evidence that state policy is critical to the health of CRAs. Market actors have largely discounted the opinions of Chinese CRAs, but the ultimate source of their poor reputation is state policy. Interviews with officials and industry participants show that some quarters of the Chinese government have encouraged CRAs, but they have not fully won the political battle against other

2 Virginia Haufler, *A Public Role for the Private Sector: Industry Self-Regulation in a Global Economy* (Washington, DC: Carnegie Endowment for International Peace, 2001); Miles Kahler and David A. Lake (eds.), *Governance in a Global Economy: Political Authority in Transition* (Princeton: Princeton University Press, 2003).

3 Timothy J. Sinclair, "Bond rating agencies," *New Political Economy*, Vol. 8, No. 1 (2003), pp. 147–61; Timothy J. Sinclair, *The New Masters of Capital: American Bond Rating Agencies and the World Economy* (Ithaca: Cornell University Press, 2005); Torsten Strulik, "Rating agencies and systemic risk: paradoxes of governance," in Adrienne Windhoff-Heritier (ed.), *Common Goods: Reinventing European and International Governance* (Lanham: Rowman & Littlefield, 2002), pp. 317–35.

4 Dieter Kerwer, "Standardizing as governance: the case of credit rating agencies," in Windhoff-Heritier, *Common Goods*, pp. 293–315; and Frank Partnoy, "The Siskel and Ebert of financial markets? Two thumbs down for the credit rating agencies," *Washington University Law Quarterly*, Vol. 77, No. 3 (1999), pp. 619–712.

organs that have sought to inhibit the development of a domestic bond market, and consequently have wanted to restrict the space necessary for CRAs to survive, much less thrive.[5]

The Chinese case highlights how differently the Chinese government and those of advanced capitalist countries treat private authority. China has permitted privatized governance by business associations, charity organizations, neighbourhood associations and degree-granting private schools. Yet the authority of these actors is circumscribed and vulnerable to state intrusion. Private actors seeking to fulfil a public role often have to sacrifice some of their independence in order to operate.[6] The problems of CRAs in China are typical of the difficulties of private authority in the PRC more broadly.

This article first shows how government intervention has been critical to the evolution of the credit rating industry around the world. It then examines the evolution of China's bond market and credit rating industry. The analysis shows that the state has been the largest obstacle to the industry's evolution, but that the tide may be turning to create more robust conditions for CRAs to exhibit genuine authority. The article concludes by considering the political and economic implications of an empowered rating industry.

The Rating Industry's Authority

Ratings are not about how companies or governments performed in the past but about the likelihood they will meet their obligations in coming years. Given the difficulty of such estimates, according to some, CRAs are dependent for their livelihoods on their reputations for having unique expertise that is reflected in consistent ratings accuracy. The importance of reputation has reportedly had two important effects. First, CRAs have power by dint of their record as good soothsayers. Thus, Sinclair concludes that they are "private institutions that possess a specific form of social authority because of their publicly acknowledged track records for solving problems."[7] If CRAs regularly made mistakes, issuers would not seek their ratings and investors would ignore them as useless. And second, the salience of reputation has reportedly also resulted in a highly concentrated industry. Since a strong reputation takes a long time to develop,

5 Interviews were carried out in China in the summers of 2002, 2003 and 2005 with regulators of China's debt and equity markets, executives of global and domestic credit rating agencies and securities firms, and independent analysts and journalists. To protect their identities, interviews are coded.

6 Scott Kennedy, *The Business of Lobbying in China* (Cambridge, MA: Harvard University Press, 2005); Jude Howell (ed.), *Governance in China* (Lanham: Rowman & Littlefield, 2004); Benjamin L. Read, "Democratizing the neighborhood? New private housing and home-owner self-organization in urban China," *The China Journal*, No. 49 (2003), pp. 31–59; Mok Ka-Ho (ed.), *Centralization and Decentralization: Educational Reforms and Changing Governance in Chinese Societies* (Norwell, MA: Kluwer Academic Publishers, and Hong Kong: University of Hong Kong Comparative Education Research Centre, 2004); and Qingwen Xu and John F. Jones, "Community welfare services in urban China: a public-private experiment," *Journal of Chinese Political Science*, Vol. 9, No. 2 (2004), pp. 47–62.

7 Timothy J. Sinclair, "The infrastruture of global governance: quasi-regulatory mechanisms and the new global finance," *Global Governance*, Vol. 7, No. 4 (2001), p. 441.

early market entrants such as Moody's and Standard & Poor's have had distinct advantages over latecomers. (Moody's issued its first ratings for railroad bonds in 1909.) Hence, the two firms together control over 80 per cent of the global market. The latecomers, at least 130 firms, compete for the remainder.

Although the global rating agencies have impressive technical capabilities, the reputation explanation for CRAs' influence is inadequate. CRAs' power and the industry's high concentration spring from a far more tangible source – state fiat. Governments could adopt a laissez-faire approach by leaving the ratings market untouched, or they could implement a market-support strategy by setting rules for appropriate behaviour by rating agencies. But the vast majority adopt a regulatory-licence approach: they accredit rating agencies, mandate bond issuers to receive ratings by them, and permit institutional investors to purchase only bonds that receive at least a certain minimum rating by one of the licensed raters.

In the United States, the watershed event occurred in 1975, when the US Securities and Exchange Commission created a privileged class of rating agencies, designating them as Nationally Recognized Statistical Rating Organizations (NRSRO). The US Congress and other regulatory agencies have since required that banks and institutional investors only buy bonds rated investment-grade (those giving ratings of BBB or higher) by one of the NRSROs.[8] The licence has been a boon to the NRSROs, of which there were initially only four, rising to just five in 2006: Moody's, Standard & Poor's, Fitch, Dominion Credit and A.M. Best. As oligopolists, NRSROs are some of the most highly profitable firms in the world.[9] Even large mistakes by them, such as not anticipating the bond defaults that precipitated the Asian financial crisis, do not threaten their positions because of their regulatory role. Those without this designation have either been forced to merge with those that do or operate in niche markets.

Almost every country around the globe hoping to create their own corporate bond market has adopted some form of regulatory licensing. In Asia, countries have promoted bond markets as a way to diversify their financial systems away from heavy reliance on bank loans, generating opportunities for state-sanctioned rating agencies in the process.[10] Japan moved first when the Ministry of Finance in the early 1980s helped create the Japan Credit Rating Agency. The Japanese government licenses rating agencies, requires issuers to obtain two ratings from one of these agencies, and mandates that institutional investors must only buy

8 Partnoy, "The Siskel and Ebert of financial markets?" For a list of relevant American regulations, see Sinclair, *The New Masters of Capital*, pp. 43–44. This article follows the rating notation of Standard & Poors, which is also the scheme most widely used in China. From highest to lowest, the ratings are: AAA, AA, A, BBB, BB, B, CCC, CC, C and D.

9 In 2005, the profits of Moody's surpassed 50% of its assets, compared to over 40% for Standard & Poor's, 39% for Microsoft, 16% for ExxonMobile and 5% for Wal-Mart. Glenn L. Reynolds, Testimony prepared for the US Senate Committee on Banking, Housing and Urban Affairs, "Hearings on Assessing the Current Oversight and Operation of Credit Rating Agencies," 7 March 2006, Washington, DC.

10 *Asia Bond Monitor 2006*, Asia Development Bank, March 2006, available at asiabondsonline.adb.org.

highly rated debt. Although there is variance in how open countries are to the global CRAs, similar regulatory regimes for local raters have been adopted in South Korea, India, Malaysia and Taiwan.[11]

In sum, a state mandate has been central to the development of the rating industry, not just in Asia but in the United States as well. Conversely, as will be shown, equivocating policy has been equally responsible for CRAs' immature condition in the PRC.

Creating an Ersatz Ratings Industry

From the mid-1980s to the mid-1990s, the government vigorously promoted a corporate bond market, and developed a crude credit rating industry. In 1984, the People's Bank of China (PBOC), China's central bank and the primary financial regulator, began to permit local enterprises to issue bonds.[12] Following some experimentation, in 1987 the PBOC issued the "Temporary regulations on the management of corporate bonds" (*qiye zhaiquan guanli zhanxing tiaoli* 企业债券管理暂行条例). At the same time, it also spurred its provincial branches to create credit rating departments, the first being affiliated with the bank's Shenyang branch. From 1989 many of these departments were spun off into stand-alone credit rating agencies.[13] In early 1992, the PBOC issued a revised version of the regulations on corporate bonds. For the first time, the law created a regulatory hurdle for ratings. Although the rules only stated that issuers "could" obtain ratings as part of the application process, a government regulator reports that the intent was to make this step mandatory.[14]

During this period, the corporate bond market took off (see Figure 1). Although, relative to bank loans, corporate bonds were a tiny proportion of the country's financial assets, bond issues were quite popular across the country, as enterprises and local governments took advantage of the broader expansionist atmosphere. The PBOC, State Planning Commission and Ministry of Finance jointly set a national quota, but specific bond applications were approved by

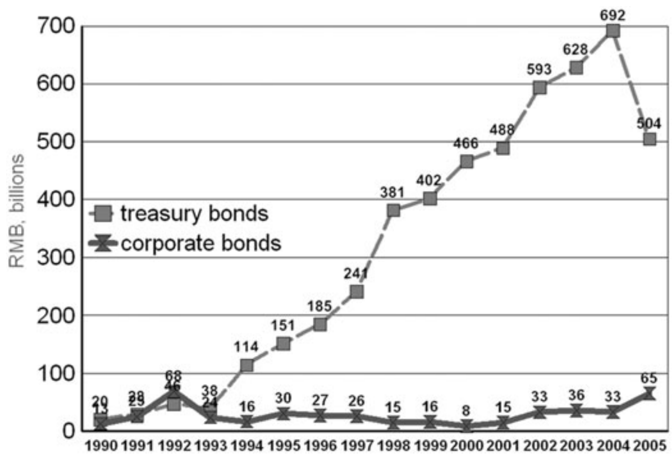
11 Sinclair, *The New Masters of Capital*, pp. 47–49, 199–248; "Global financial stability report: market developments and issues," International Monetary Fund, September 2005, p. 130; "An assessment of credit rating services in APEC economies," background paper for "The APEC Consultative Group Workshop on the Credit Rating Industry in APEC Economies – Critical Issues for Capital Market Development," Asian Development Bank, Manila, Philippines, 8–9 February 1999; and Frank Packer, "Credit ratings and the Japanese corporate bond market," in Levich, Majnoni and Reinhart, *Ratings, Ratings Agencies and the Global Financial System*, pp. 139–58.

12 Zhang Mingli and Hui Liu, "People's Republic of China," in Yun-Hwan Kim (ed.), *Government Bond Market Development in Asia*, Asian Development Bank Conference Proceedings, October 2001, pp. 146–90; Pieter Bottelier, "China's emerging domestic debt markets: facts and issues," discussion paper for a Conference on Chinese Economy Policy Reform, Center for Research on Economic Development and Policy Reform, Stanford University, 18–20 September 2003 (revised December 2003).

13 "Zhengxin guanli guize shangbao guowuyuan zhonghang choujian zixin ye hanghui" ("Credit information management rules reported up to State Council, central bank makes initial plans to create credit rating industry association"), *Caijing shibao* (*Finance and Economy Times*), 26 September 2004; "Shei shi guizede zhidingzhe" ("Who is formulator of rules?") *Zhongguo jingying bao* (*China Business*), 4 February 2006.

14 Interview no. 30.

Figure 1: **China's New Bonds Issues (1990–2005)**



local governments.[15] The number of rating agencies ballooned to over 90. Although ratings were given on most bonds, they did not serve as information for investors. Ratings were confidential and were only provided to the government authorities who decided on bond applications, though it appears they were ignored in the internal decision process as well. Not all companies received the highest ratings, but the process was bureaucratic and formalistic, and hence unreliable.[16]

The era of unbridled enthusiasm came to an inglorious end in the mid-1990s because of massive defaults, as issuers across the country refused or were unable to pay creditors the interest or principal as bonds came due. In the rustbelt provinces of Liaoning and Jilin, over half the bond obligations went into default. Fearing protests, local governments and branches of the PBOC stepped in to pay off creditors. Estimates on the cost of the bailouts range from RMB 3 to 8 billion.[17] Hoping to avoid continuing mistakes in ratings, the PBOC issued a rule in December 1997 identifying only nine of the existing 50 firms as being allowed to rate publicly issued corporate bonds, marking the initial step toward a regulatory licence regime.[18]

15 Yu Ning, "Qiye zhai qidong zai ji" ("The launching of corporate bonds is approaching"), *Caijing*, 18 October 2002; Ling Huawei and Li Yong, "Zhongguo xinyong pingjiye jubian qianxi" ("The eve of great change in China's credit rating industry"), *Caijing*, 20 October 2003.

16 Chen Huaihai, "Zhongguo zixin pingji ye: fanrong yu yinyou" ("China's credit rating industry: prosperity and worries"), *Yinhangjia* (*The Banker*), November 2003, pp. 70–73; Interviews nos. 9, 30, 42, 44. Complete data on ratings and defaults from the 1990s are not publicly available.

17 Interview no. 32; Ling and Li, "The eve of great change"; and Bian Cheng, "Cong faxing zhuti kan wo guo qiye zhaiquan shichangde fazhan" ("Look at the development of our country's corporate bond market from the perspective of issuers"), *Zhongguo jingmao daokan* (*China Economy and Trade Reporter*), 15 May 1998, pp. 34–35.

18 "Who is formulator of rules?"

But this effort was soon pre-empted by more radical moves. The collapse of Guangdong Trust & Investment Corporation (*Guangdong xintuo touzi gongsi* 广东信托投资公司) and other similar investment companies towards the end of the decade added to central government concerns about the country's financial weakness. The Asian financial crisis was the last straw, as the leadership could see the ramifications if unbridled corporate debt growth were not contained. As a result, in 1999, an internal regulation was issued centralizing the corporate bond approval process, taking it out of the hands of local governments and placing it under the direct stewardship of the State Development and Planning Commission (*Guojia fazhan he jihua weiyuanhui* 国家发展和计划委员会), in 2003 renamed the National Development and Reform Commission (NDRC, *Guojia fazhan he gaige weiyuanhui* 国家发展和改革委员会). For a year, bond approvals came to a complete halt.

Over the subsequent five years, the ratings industry made superficial progress towards obtaining substantial authority. The central planning bureaucracy still expected corporate bonds to be rated and informally followed the PBOC's December 1997 guidelines. In the first half of 2003, insurance companies and the National Council for Social Security Fund, China's equivalent of the US Social Security Administration, were given permission to invest in highly rated domestic corporate bonds by an authorized credit rating firm.[19] Three months later, when announcing a new list of bond approvals, the NDRC for the first time indicated that corporate bonds issued from that point forward could only be rated by an agency which had already provided a domestic bond rating since the year 2000.[20]

The combined effect of these rules was to reduce the number of licensed rating agencies from nine to five.[21] The accredited agencies were: China Chengxin Credit Rating Co. (中诚信), founded in 1992 by several Beijing-based companies; Dagong Rating Co. (大公), founded in 1994 by employees from several research organizations and a notary agency, and owned by a former official from the State Assets Bureau; China Lianhe Credit Rating Co. (联合), founded in 2000 by several former China Chengxin employees and financed by several Beijing- and Tianjin-based companies and individual investors; Shanghai Brilliance Credit Rating & Investors Service (*Shanghai xinshiji*上海新世纪), founded in 1992 by former professors from Shanghai University of Finance and

19 Interviews nos. 15, 16, 40; "1999 nian yilai woguo qiye zhaiquan faxing shichang yanjiu" ("Research on our country's corporate bond issuance market since 1999"), *Xinyong yanjiu* (*Credit Research*), Lianhe Credit Rating Co., No. 30, 19 December 2005, available at www.lianheratings.com.cn/yjbg/; Zhao Renfeng, "Insurers remain cool on corporate bonds," *China Daily Business Weekly*, 17 June 2003; Sun Min, "National pension fund will demand attractive returns," *China Daily*, 4 June 2003; and Ramoncito Dela Cruz, "China fosters demand for corporate bonds," *Wall Street Journal*, 3 June 2003.

20 The NDRC issued a more authoritative statement to this effect in June 2004: "Guojia fazhan gaige wei guanyu jinyibu gaijin he jiaqiang qiye zhaiquan guanli gongzuode tongzhi" ("NDRC notice regarding further reforming and strengthening enterprise bond regulation work"). Interview no. 36; "Research on our country's corporate bond issuance market since 1999"; Ling and Li, "The eve of great change."

21 One official estimates there are an additional 68 domestic ratings firms, which are limited to niche markets. Interview no. 42.

Economics and the Shenneng Group; and Shanghai Far East (*Shanghai yuandong*上海远东), founded in 1988 and jointly owned by the Shanghai Academy of Social Sciences, a company run by former employees of the Shanghai branch of the PBOC, and Shanghai Far East's own staff.[22]

Since China has not permitted foreign credit rating agencies to rate locally issued bonds independently, they have had to access the market through partnerships with one of these local agencies. In 1999, Fitch and China Chengxin started a joint venture, China Chengxin International, but their arrangement collapsed in 2003. Moody's, which had a technical co-operation agreement with Dagong in the late 1990s, eventually replaced Fitch in 2006 and reconstituted China Chengxin International with China Chengxin. In 2002 Shanghai Far East and Hong Kong-based Xinhua Finance created a joint venture, Xinhua Far East (*Xinhua yuandong* 新华远东), which provides individual stock ratings and issue stock market indices.[23]

Irrelevant Ratings

In spite of recognizing a select group of CRAs, the ratings industry lacked any substantive power. From 2000 to 2004, just fewer than 50 corporate bonds were issued, totalling only RMB 126 billion in value.[24] This accounted for less than 1 per cent of all the country's financial activity during the period. By contrast, thousands of corporate bonds are issued annually in the United States and Western Europe.

More telling than the decline in the number of corporate bond issues was government control of the entire process, making ratings irrelevant. Since 1999, to issue a corporate bond a company must receive the approval of the NDRC. Besides needing to demonstrate consistent profitability, approval depends heavily on whether an issuer's plans for the bond fit with national investment priorities. The NDRC forwards its list to the State Council, which then makes the final decision. However, since the process is opaque and outsiders only know who is approved, it is impossible to rule out personal connections or corruption playing a role. Once approved, the survivors go to the PBOC Monetary Policy Division's Interest Rate Section (*Huobi zhengcesi lilüchu* 货币政策司利率处) which sets the bond's interest rate; by law this cannot be more than 40 per cent

22 In 1999, the head of China Chengxin Rating, Mao Zhenhua, was placed under house arrest for financial misdeeds unrelated to credit ratings. Soon after he returned to work in May 2000, ten of his employees left to join Lianhe. Previously, Lianhe had operated from Fujian, but it was one of the original nine CRAs approved to rate bonds. The former Chengxin staffers persuaded Lianhe to use the licence to form a new national company with additional private financing. Chen Huaihai, "China's credit rating industry"; Ling and Li, "The eve of great change"; "Gongsi jieshao" ("Company introduction"), Shanghai Brilliance Credit Rating and Investors Service website, available at www.shxsj.com/aboutus.htm; and interviews nos. 12, 15, 26, 36, 46.

23 In its venture with China Chengxin, Moody's negotiated a larger stake (49%) than Fitch had, as well as the right to appoint the CEO and control of the joint venture's ratings committee. XFN is itself a joint venture between Xinhua News Agency and western financial firms. Interviews nos. 6, 31; "Moody's to buy 49% of China credit rating agency," *SinoCast China Financial Watch*, 18 April 2006, p. 1.

24 Comprehensive statistics on bond issues are available at China Bond Info Net, www.chinabond.com.cn.

above the savings deposit rate of the same maturity. To eliminate risk, issuers must have a guarantor, usually a state bank or a related successful state-owned enterprise, which is obliged to pay investors in the event the issuer cannot.

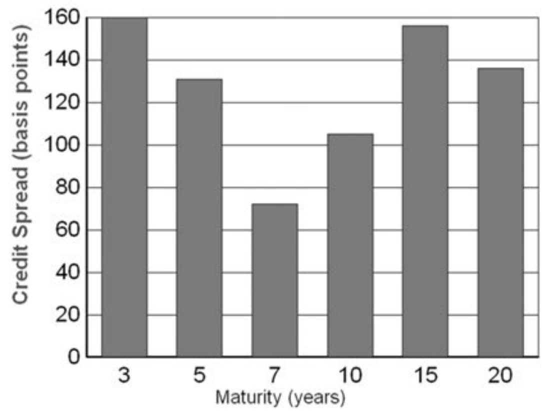
This regulatory maze makes corporate bond ratings superfluous in China, as any semblance of a market – and its associated risks – have been effectively removed. Few applications have been approved, and almost all of them have been for large state-owned enterprises that would probably have had little difficulty obtaining the same cash infusion through loans, stocks, foreign investment or bonds issued overseas.[25] In fact, bonds are often only rated after the NDRC and State Council approve the issue. Given the state's stamp of approval and the need for a guarantor, it is not surprising that all but two corporate bonds issued in the last few years have gained perfect AAA ratings. Because so many AAAs have been handed out, as one reporter notes, "credit ratings have become a kind of an ornament."[26]

The irrelevance of ratings and the significance of the state are also visible in the non-systematic variation of bonds' assigned interest rates. Although the interest rate the PBOC sets for bonds appropriately rises as their maturities lengthen, ratings have had little weight in the PBOC's decisions. This can be seen by comparing data on the credit spread (*xinyong chayi* 信用差异) for each bond, that is, the difference between the interest rates (or yields) of corporate and treasury bonds of the same maturity issued at around the same time.[27] In developed bond markets the credit spreads for equally rated bonds of the same maturity are quite close (within 10–20 basis points, each basis point being one-100th of a per cent), and the credit spreads grow as both the rating goes down and the maturities lengthen (to account for the greater risk an issuer may default as time passes). In China the credit spreads of AAA bonds with similar maturities issued between 1999 and 2004 vary widely. Moreover, as Figure 2 indicates, the average credit spread does not rise as the maturity of bonds lengthens.

The constraints on the bond market have had several deleterious effects on CRAs. Most clearly, they limit CRAs' chances to make ends meet. A typical rating earns between RMB 20,000 and RMB 80,000, depending on the issue amount. Although China Chengxin and Lianhe have done the majority of ratings, Lianhe's paltry 11 rating in 2003 is the industry record.[28] In addition, none of the CRAs has sold subscriptions of their more detailed bond rating reports to institutional investors. Managers of Chinese and foreign investment houses are unanimous in the belief that ratings on corporate bonds do not matter and so see no use in buying the reports.[29]

25 Interview no. 17.
26 Wang Qing, "Xinyong pingjiye heshi aochutou" ("When will credit rating industry proudly hold its head up"), *Zhonghua gongshang shibao* (*China Business Times*), 2 September 2002.
27 For an earlier analysis, with similar findings, see Scott Kennedy, "China's credit rating agencies struggle for relevance," *China Business Review*, Vol. 6, No. 30 (2003), pp. 36–40.
28 "Research on our country's corporate bond issuance market since 1999."
29 Interviews nos. 7, 19, 23, 25.

Figure 2: **Average Credit Spreads for AAA-Rated Bonds (2001–2004)**



CRAs have been forced to depend on other sources of income to survive. The most common are annual loan certificate ratings. Enterprises in 17 provinces and cities which plan to obtain a loan of more than RMB 50 million must pass through this perfunctory regulatory hoop each year. As with bonds, loan certificate ratings have no effect on borrowers' chances of receiving a loan or on its interest rate. Some CRAs, through contracts from the PBOC, also rate the overall loan portfolio of local bank branches, similarly with no consequences for the banks' operations.[30] And finally, Xinhua Far East began in early 2002 to issue quality ratings on about 100 of the firms listed on China's stock exchanges, earning income by selling the more detailed reports to international investors.

CRAs' limited income also leaves them vulnerable to engaging in ratings inflation. Though corporate bond issues may merit high ratings because of the firms' economic performance and strong government backing, many in the Chinese investment community have the impression that Chinese CRAs have handed out AAA ratings indiscriminately because they are so desperate for business. One source said that when told by bond issuers that they would take their business elsewhere if they did not receive an AAA rating, most CRAs comply with the demand.[31]

30 A manager from one such rating agency said that the worst penalty he had heard of for a bank that his firm had rated poorly was that the PBOC sent the bank a strongly worded letter after reading their report. Interview no. 8.

31 Interview no. 25. China Chengxin's deputy CEO revealed that when it refused to give a Guangdong-based company an AAA rating before even examining its financial statements, the firm went elsewhere for a rating. "Duanquan pingji: jianyan pingji gongsi zhen benshide shihou daole" ("Short-term commercial paper: time for testing credit companies' real abilities has arrived"), *Diyi caijing shibao* (*First Finance and Economy Times*), 23 February 2006. The exceptions to this rule are loan certificate ratings issued by Shanghai Far East and the stock ratings issued by Xinhua Far East, in which there is a wide range of ratings for both. Because there are so many rated firms, each has little leverage to compel higher ratings. Data on the stock ratings were provided to the author by Xinhua Far East, August 2003 and August 2005. For the loan certificate ratings, see Ou Zhiwei and Zhang Lingling (eds.), *2002 yuandong qiye zixin pingji baogao jingyao* (*Essential Summary of 2002 SFE Enterprise Credit Rating Reports*) (Shanghai: Huadong Normal University Press, 2003), pp. 1–6.

The Planners Ascendant

The framework governing the corporate bond market and rating agencies described above was not the product of a unified government but rather a testament to the influence of the planning bureaucracy relative to the more liberal securities and finance regulators.

The initiative for creating a ratings industry came from liberal economic reformers, originally in the PBOC, and since the late 1990s, in the China Securities Regulatory Commission (CSRC, *Zhongguo zhengquan jiandu guanli weiyuanhui* 中国证券监督管理委员会). In addition to being motivated to expand their turf, the PBOC and CSRC are staffed by a large number of young economists, some educated abroad. Moreover, through their education and regular face-to-face meetings, they hold the global credit rating firms in the highest regard, believing the industry provides a service critical to the smooth functioning of debt markets.[32] Liberals opposed the administrative process of how corporate bonds were determined, and in 2002 the CSRC drafted comprehensive regulations on the ratings industry. Their "Measure on regulating the securities credit rating business" would have accredited CRAs using multiple criteria, including having adequate experience, requiring a formal rating system with internal checks and prohibiting anti-competitive behaviour.[33]

But they were stymied in their efforts by the NDRC. The approval maze for standard corporate bonds did not change, and the CSRC shelved its ratings industry measure.[34] The NDRC's success in keeping the system in place left one credit rating executive to lament about China in a way one would no longer hear from someone in most manufacturing sectors: "This is not a market-driven economy. This is a planned economy. The [NDRC] controls everything. As such, there's no role for credit rating agencies in this system."[35]

In the wake of the defaults in the 1990s and the Asian financial crisis, the planners argued that a conservative approach with administrative guidance was crucial to preserving financial stability. In addition, as one official said, they believe that Chinese investors lack "risk consciousness" (*fengxian yishi* 风险意识) and could not accept losing their money in the event of a default even if they had been warned by a low rating.[36] Hence, a liberal bond market could also threaten social stability. Although there is no record available of the policy debate among the most senior elites, these arguments were likely to have been in the minds of China's leadership at that time. They may also have wanted to limit movement away from a directed credit system that affords them significant control over the country's investment trajectory. When financial liberalization

32 Interviews nos. 9, 12, 16, 35, 42.

33 Interviews nos. 9, 16, 26.

34 In addition to opposition from the NDRC, reform advocates suggested that the CSRC was pre-occupied with cleaning up securities firms and reviving the declining stock market, including reforming non-tradable state shares. Interview no. 38.

35 Interview no. 6.

36 Interview no. 30.

occurred elsewhere in East Asia, states lost much of their leverage to make companies adhere to government industrial policies.[37]

The Turning Tide: Creating Space for CRAs

If this were the end of the story, it would be consistent with other reports of the NDRC's strength and the relative weakness of the reformist agencies, particularly the CSRC.[38] The CSRC is lower in the bureaucratic hierarchy, lacks the national institutional reach of the planners, and its leader has only been an alternate member of the Communist Party's Central Committee, while the NDRC's has been a full member. It is surprising then that since 2003 reformers have been able to introduce meaningful changes to the debt market and the ratings industry over the NDRC's opposition by leveraging their existing bureaucratic responsibilities and by reframing the issue of economic stability in a way that encourages reform over standing still. The People's Bank of China has regulatory authority over banks, trust and investment companies, finance companies, and interest rates; the China Insurance Regulatory Commission (*Zhongguo baoxian jiandu guanli weiyuanhui* 中国保险监督管理委员会) over insurers; and the CSRC over securities firms, listed companies, and the equity and debt markets. Thus, each has some say over whether enterprises under their regulatory purview can issue or purchase bonds and over which CRAs can provide authoritative ratings. Fragmented authority may be frustrating to businesses and investors because of the multiple and potentially conflicting demands of regulators, but it has also provided the opportunity for incremental change.

The charge has been led by the PBOC and its governor, Zhou Xiaochuan (周小川). By all accounts, Zhou, an ally of Zhu Rongji in the 1990s, is an earnest economic reformer.[39] Utilizing the central bank's strong institutional position, Zhou was able to break the stalemate. The central leadership endorsed substantial reforms of the securities markets and the ratings industry at the Third Plenum of the 16th Party Congress in October 2003, and then specific reforms were detailed in a State Council document issued as part of the National Meeting of Banking, Securities and Insurance in early 2004.[40] Over this period

37 Michael Loriaux *et al.*, *Capital Ungoverned: Liberalizing Finance in Interventionist States* (Ithaca: Cornell University Press, 1997).

38 Victor Shih, "Elite decision-making in China's financial sector: a quasi-market analysis," paper presented at the conference "System Financier Chinois," hosted by the Centre D'Etudes Prospectives et D'Informations Internationales, Paris, France, 19 September 2005; and Stephen Green, "Better than a casino: some good news from the frontline of China's capital market reforms," Royal Institute of International Affairs, *Asia Programme Working Paper*, No. 6 (2003).

39 Zhou has a PhD in economic systems engineering from Tsinghua University and is the son of former State Councillor Zhou Jiannan, an advisor to Jiang Zemin. He headed the China Construction Bank (1998–2000) and the CSRC (2000–2002) before becoming PBOC governor in early 2003. Brian Bremmer, "Banking on reform in China," *BusinessWeek*, 12 December 2005; interviews nos. 43, 46.

40 "Guowuyuan: tuijin ziben shichang gaige he wending fazhande 9 dian yijian" ("State Council: nine ideas on pushing forward reform and stable development of capital markets"), Xinhua News Agency, 1 February 2006; Wang Wu, "Banking reform to be accelerated," *China Daily Business Weekly*, 17 February 2004; Yang Ruyan (ed.), *Zhongguo jinrong gongju chuangxin baogao 2005)* (*China: Innovation of Financial Instruments 2005*) (Beijing: Social Sciences Academic Press, July 2005), p. 208.

Zhou has been outspoken about the importance of reforming the bond market and developing a credit rating industry to improve China's financial markets and economic stability.[41]

The thrust of the reforms has been to shift from direct administrative regulation of debt and credit worthiness towards indirect, private regulation. The PBOC in late 2003 partially liberalized interest rates for standard corporate bonds by giving issuers and underwriters greater say in setting issue rates.[42] But the NDRC's continued role in approving issuers and requiring guarantees has limited the effect of this adjustment. Instead, the PBOC and other reformist organs have focused on three other tactics.[43] First, they created new debt instruments entirely outside the NDRC's purview whose issuance and trading are situated in a more market-like environment (see Table 1). The ultimate goal is to make approval for issuance forthcoming as long as standard criteria regarding profitability and existing debt levels are met, eliminate the requirement for guarantors, and allow the interest rate to be set by market participants. In addition, the CSRC and PBOC oversee the Shanghai exchange and interbank market, respectively, the two secondary markets where these instruments are traded. Convertible bonds (*kezhuanhuan gongsi zhaiquan*可转换公司债券), debt which can be turned into stock shares, were the first new type of

Table 1: **Recent Issuance of Various Securities in China (RMB billions)**

	2004	2005	2006
Treasury bonds	692.4	504.2	693.3
Corporate bonds	32.7	65.4	99.5
Short-term commercial paper	–	142.4	292.0
Convertible bonds	20.9	0.0	4.2
Company stock	151.0	188.3	559.4
Securities company bonds	2.7	0.0	1.5
Securities company short-term commercial paper	–	2.9	0.0
Asset-backed securities	–	7.1	11.6
Policy bank bonds	434.8	605.2	898.0
Commercial bank bonds	74.9	103.6	52.5
International development organization bonds	–	2.13	0.9

Sources:

China Securities and Futures Statistical Yearbook 2005 (Beijing: Xuelin Press, 2005), pp. 8–11, 32–33; Jia Yingzi and Lu Zunhua, "Zhongguo zhaiquan shichang bannian fenxi baogao, 2006 nian 1–6 yue" ("China securities market mid-year analysis report, January–June 2006"), China Government Securities Depository Trust & Settlement Company, 31 July 2006, available at www.chinabond.com.cn; and "Zhengquan shichang chouzi tongjibiao" ("Securities market raised capital table"), China Securities Regulatory Commission, available at www.csrc.gov.cn/statinfo/.

41 Zhou Xiaochuan, "China's corporate bond market development: lessons learned," "Proceedings of a BIS/PBC seminar held in Kunming, China on 17–18 November 2005," *BIS Papers*, No. 26 (2006), pp. 7–10.

42 In 2004, 12 of 19 corporate bonds were given such floating rates. Yang Ruyan, *China: Innovation of Financial Instruments 2005*, pp. 198–99; interview no. 41.

43 For useful summaries, see *Asia Bond Monitor 2005*, Asia Development Bank, November 2005, Box 1; and Yang Ruyan, *China: Innovation of Financial Instruments 2005*, pp. 190–254.

debt in which issuance approval was made more objective. First approved by the CSRC in 1998, they were issued in substantial amounts beginning in 2002.[44] The most significant new instrument, created by the PBOC in 2005, is short-term commercial paper (CP, *duanqi rongziquan* 短期融资券), a bond with a maturity of one year or less. But unlike standard corporate bonds, any Chinese company with appropriate profit and debt levels can issue CP, no guarantor is needed, and the interest rate is set by the market.[45] Between May 2005 and June 2006, 191 separate CP were issued worth a combined value of RMB 281.5 billion, surpassing the value of standard corporate bonds issued since 1998. Equally significant, one-sixth of the issuers were privately run firms, a contrast to SOE-monopolized corporate bonds.[46]

The second component of reform has been to increase the demand for credit ratings by issuers and investors. In its regulations, the PBOC has stipulated that permission to trade most of these instruments on the interbank market will only be provided if they have received a credit rating. Once optional, the CSRC in May 2006 made the same requirement for convertible bonds. At the same time, the China Insurance Regulatory Commission issued a rule in August 2005 permitting insurance companies to invest only in highly rated securities. The next month the CSRC issued a similar regulation directed at money market fund managers.[47]

The last strand has been to create a new regulatory framework for credit rating companies and authorize only a portion of them to rate these various instruments. In November 2003, the PBOC created the Credit Information System Bureau (*Zhengxin guanli ju* 征信管理局) to oversee the development of systems to monitor both personal and corporate credit worthiness. They believe they are the best placed institution to oversee the ratings industry because they control the database of the country's bank loans, a central component of determining firms' financial health.[48] In regulations for corporate bonds (December 2004), financial bonds (April 2005) and short-term commercial paper (May 2005), the PBOC stipulated that ratings could only be provided by a "capable locally registered ratings agency."[49] Although the language is vague

44 *Ibid.* pp. 156–89.

45 "Duanqi rongziquan guanli banfa" ("Measure on regulation of short-term commercial paper"), PBOC Order No. 2 (2005), 23 May 2005, available at www.cbrc.gov.cn.

46 "Duanqi rongziquan tisheng minqi xinyong du" ("Short-term commercial paper raises private enterprise credit level"), *Zhonghua gongshang shibao* (*China Business Times*), 23 June 2006.

47 The CSRC notice requires investors to sell off the debt within 20 days if the rating falls below a certain threshold. And if the instrument has ratings by a foreign and domestic rating agency, the domestic agency's rating prevails. "Baoxian jigou touzizhe zhaiquan touzi guanli zhanxing banfa" ("Temporary measure on management of insurance institutional investors' debt investments"), China Insurance Regulatory Commission No. 72, 17 August 2005, available at www.circ.gov.cn; "China seeks to standardize money market funds investment," *Asia Pulse*, 13 October 2005.

48 Interview no. 42.

49 *Asia Bond Monitor 2005*, November 2005; Yang Ruyan, *China: Innovation of Financial Instruments 2005*, pp. 190–254; James T. Areddy, "China eases control over corporate bonds," Wall Street Journal, 15 December 2004; "Beijing orders issuers of bonds to obtain independent ratings," Dow Jones News Wires, 26 January 2005; "China approves ADB, IFC yuan bond issues," Reuters News, 9 October 2005; "Shangshi gongsi zhengquan faxing guanli banfa" ("Measures on management of securities issues by listed companies"), China Securities Regulatory Commission, No. 30, 8 May 2006, available

and led foreign CRAs to believe they would be permitted to provide domestic ratings, the PBOC in 2005 decided to authorize only the same five CRAs approved by the NDRC and China Insurance Regulatory Commission in 2003. A year later, following release of the revised Securities Law (*Zhengquanfa* 证券法), the PBOC achieved a goal once sought by the CSRC, issuing a comprehensive regulation for the ratings industry.[50] It requires CRAs to demonstrate they have a qualified staff and a system in place to avoid conflicts of interest, report their ratings and default rates to regulators, and not engage in unfair practices such as doctoring ratings application materials.[51]

Although this regulatory-licence framework is young, it has already had an effect on the ratings industry and its authority. Demand for ratings has grown together with the rise in debt issuance. As expected, the new income has gone entirely to the five authorized CRAs, led by China Chengxin and Lianhe.[52] In 2005, several of the CRAs expanded their number of employees and offices, and they were targeted for investment by foreign CRAs. Hence, everyone in the industry saw 2005 as "the first year of domestic credit ratings."[53] More importantly, there is evidence that ratings have begun to influence both the initial interest rate and secondary market yield for short-term commercial paper, the debt instrument subject to the least government intervention. The credit spread on the highest rated CP has been somewhat narrower than for lower-rated issues. In addition, investors have begun to differentiate between the rating agencies; the credit spread for CP rated by China Chengxin and Lianhe has been narrower than for the other CRAs, indicating greater investor confidence in the judgement of these two CRAs.[54]

footnote continued

at www.csrc.gov.cn; "Quanguo yinghangjian zhaiquan shichang jinrong zhaiquan faxing guanli banfa" ("Measure on the management of financial bonds issued in the interbank market"), People's Bank of China, Order No. 1, 27 April 2005, available at www.pbc.gov.cn; "Measure on regulation of short-term commercial paper."

50 The PBOC rule was preceded by the revised Securities Law, adopted in October 2005. Article 169 mandates that CRAs are approved by "appropriate securities regulators" under the State Council and that they must have at least two years ratings experience. "Zhengquanfa" ("Securities Law"), approved at the 18th meeting of the Standing Committee of the tenth National People's Congress, 27 October 2005, available at www.csrc.gov.cn.

51 Text of "Zhongguo renmin yinhang xinyong pingji guanli zhidao yijian" ("PBOC guiding ideas on regulating credit rating"), PBOC No. 95, 29 March 2006, available at www.pbc.gov.cn.

52 "Qiye duanqi rongziquan licha fenxi" ("Analysis of corporate short-term commercial paper credit spreads"), *Xinyong yanjiu*, Lianhe Credit Rating Co., No. 33 (17 March 2006), p. 3.

53 Li Qian, "Jujiao xinyong pingji: meiyou guiju bucheng fangyuan" ("Credit rating focus: without rules it won't complete the circle"), *Jinrong shibao* (*Financial Times*), 10 April 2006.

54 "Analysis of corporate short-term commercial paper credit spreads"; Guo Jifeng and Liu Chunyan, "Qiye duanqi rongziquan xinyong chayi yu pingji jianyan (1)" ("Testing credit spreads and ratings on corporate commercial paper, part 1"), Shanghai Academy of Social Sciences Market Credit Research Centre, 4 April 2006, available at www.sass.org.cn/scxy; Tu Yanyan, "Guonei 108 jia qiye duanqi rongziquan licha shuiping fenhua riyi xianzhu" ("Dispersion of domestic 108 corporate commercial paper credit spread levels more marked day by day"), *Zhongguo zhengquan bao* (*China Securities News*), 25 April 2006; "X-rated: the dirty world of Chinese debt," *Asiamoney*, 10 April 2006.

The creation of new instruments and empowering CRAs has put significant pressure on the NDRC to follow along with reforms of its own. The surge of short-term commercial paper threatens to make standard corporate bonds irrelevant and marginalize the NDRC. Companies that had been waiting to issue standard bonds have switched to CP because of the faster approval process. Several sources also expect the PBOC to create another instrument, long-term commercial paper, which would even more directly sap interest in standard bonds.[55] Moreover, the rapid expansion of short-term CP may also create a maturity imbalance for issuers, whereby too many short-term obligations are funding long-term business projects. Such a situation would leave China resembling South Korea on the eve of the 1997–98 financial crisis. Although reformers did not intentionally hope to generate such risk, its prospect has served as another incentive for the NDRC and the senior leadership to accept reforms.[56] Perhaps as a result, the planning agency has allowed more corporate bonds to be issued, with RMB 65 billion in 2005 and RMB 50.8 billion in the first half of 2006 alone. In May 2006, the Three Gorges Project Company, with its RMB 3 billion issuance, became the first issuer of a standard corporate bond not required to have a guarantor.[57] Observers expect that when released, the revised Corporate Bond Management Regulations will eliminate the need for guarantors entirely and have more objective criteria for approval. It appears that the NDRC can only recover its relevance by accepting a reduced direct role in debt markets.

Caveats

As substantial as the recent reforms have been, they have not been without limits, nor have they left CRAs comfortable enough to disregard the preferences of state actors. The scale and type of corporate bonds have jumped, but China still does not have a laissez-faire market. Government approval for issuance is still needed. Even though the PBOC has allowed many firms to issue CP who would be refused by the NDRC to issue standard corporate bonds, the PBOC has still informally been careful to allow only issuers that it itself feels secure will be able to meet their obligations.[58] Global CRAs have been blocked from the local market and guided into joint ventures, a strategy motivated by the desire to provide protection to local CRAs and by the apprehension of having foreign raters sit in judgement of China's domestic economy, particularly its weak financial system.

China's own rating agencies have yet to gain the full respect of the investment community. Even though the government has been careful in choosing issuers, investors still perceive ratings inflation as endemic. As an executive from the

55 Interviews nos. 42, 44, 46.
56 Interviews nos. 43, 46.
57 "Three Gorges bonds to be issued," Xinhua News Agency, 6 June 2006.
58 Interview no. 44.

Hua An Fund Management Company said: "We just don't take any of the ratings very seriously." Hua An, as with investors generally, does its own credit analyses.[59] The only way CRAs will develop stronger reputations as a group will be to give lower ratings and to have some of those issuers default, as their ratings would predict. But having the courage to give lower ratings may only develop after they have adequate business so that they do not feel compelled to give a high rating to any issuer because of the effect on their own bottom line.

At the same time, because of the regulatory licence framework and the Chinese government's penchant for intervention, the private authority of CRAs depends partly on maintaining the confidence of the state. CRAs attempt to maintain a co-operative relationship with officialdom in several ways. Some of the CRAs' founders and a portion of their employees are former officials from the PBOC and other agencies. One CRA recently decided to create a Communist Party branch; it will not have a substantive effect on the firm's operations or facilitate Party oversight, but it sends a signal of political loyalty. More transparent is Shanghai Far East's co-operation with Xinhua Financial, which provides it both access to a large pool of information and ties to a politically well-placed organization. In addition, the major local CRAs regularly meet, individually and jointly, with officials from each of the relevant government agencies. Some of the meetings are organized by the Chinese Credit Rating Co-ordinating Association (*Zhonghua zixin pinggu lianxihui* 中华资信评估联席会), founded in 1997 by Shanghai Far East and which by 2004 had 30 members.[60] From the CRAs' perspective, these contacts are an opportunity to educate officials and influence policy as well as a chance to build trust. To officials, the gatherings allow them to monitor and guide the companies' behaviour. The cumulative effect of these efforts helps the CRAs develop a co-operative relationship with officials, but it may restrict CRAs' ability to be as hard-nosed as they may need to be when analysing companies' credit worthiness.

Conclusion

China's credit rating industry was promoted by the government in anticipation of a corporate bond market, not as a response to investor demand because of a lack of adequate information about issuers. The initial desire to have rating agencies reflected simple mimicry of institutions from the United States. However, transplantation has not been a straightforward process. Regulators and CRAs have gradually become aware of the variety of regulatory structures elsewhere. And the adoption and implementation of a ratings system has been

59 Jane Lanhee Lee, "Credit raters in China take generous view," *Wall Street Journal*, 22 March 2006.

60 In September 2004, the PBOC, Ministry of Finance and the Ministry of Labour and Social Security reached agreement to create a semi-official Credit Service Industry Association (*Xinyong fuwu hangye xiehui*). The original association was still meeting officials in 2005. "Credit information management rules reported up to State Council, central bank makes initial plans to create credit rating industry association."

shaped by the Chinese context, including an authoritarian regime wary of private authority, competing bureaucratic actors hoping to extend their turf, and state-owned enterprises with weak financial fundamentals. As a result, the credit rating industry is representative of how China's economic reforms have rarely been linear, and instead typically are winding, involving a contest of ideas, bureaucracies and economic interests.[61]

The findings of this article, therefore, are consistent with those who focus on how the political environments in China and elsewhere shape market development. States do not only intervene in markets, they are also central to building economic institutions. Others recognize the importance of the state's role in constructing markets, but this article goes a step further by providing a case in which the state needs administratively to mandate that market participants purchase a product (a rating) and accept it as an authoritative determinant of price (the bond's interest rate). In this sense, states are even more central to mature market economies than is often recognized.[62]

The ratings industry case also provides a good barometer for the Chinese government's overall attitude towards private authority. Business associations and charity organizations face similar constraints in their operations, but the government may be particularly sensitive to CRAs. Because the primary issuers of debt are state-owned enterprises and banks, CRAs' ratings are indirect yet public judgements about the performance of the government. Just as Chinese political leaders are not willing to countenance popular elections above the village level, they may see credit ratings as a form of voting to which they are reticent to subject themselves. Hence, if current trends continue and CRAs become powerful gatekeepers, one would expect to see greater support for private authority in other areas.

Ironically, a profitable credit rating industry may not be a good indicator of China's economic health. As issuers see CRAs as part of the regulatory structure they may be driven to focus on clearing the regulatory hurdle, and investors may focus on a company's rating instead of the more complicated underlying credit risk. In addition, CRAs could make mistakes. They have primarily rated blue-chip enterprises; they have little experience analysing more troubled companies or complicated instruments, such as derivatives. The chance that they could be fooled or misinterpret data is real. And lastly, given the stakes involved, it is reasonable to ask whether Chinese CRAs can maintain their objectivity or whether they could be unduly influenced by those they rate. Besides practising

61 For other examples of this pattern, see Barry Naughton, "Claiming profit for the state: SASAC and the capital management budget," *China Leadership Monitor*, No. 18 (2006); and Margaret M. Pearson, "The business of governing business in China: institutions and norms of the emerging regulatory state," *World Politics*, Vol. 57, No. 2 (2005), pp. 296–322.

62 This point is also made by Edward S. Steinfeld, *Forging Reform in China: The Fate of State-Owned Industry* (Cambridge: Cambridge University Press, 1998). On states more generally, see Neil Fligstein, "Markets as politics: a political-cultural approach to market institutions," *American Sociological Review*, Vol. 61, No. 4 (1996), pp. 656–73; and Steven Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrialized Countries* (Ithaca, NY: Cornell University Press, 1996).

ratings inflation, they might also engage in discrimination, assisting preferred issuers with high ratings and burdening their competitors with low ones. In sum, stronger CRAs may signal a more liberal political environment, but they are not a panacea for China's economy. Continued vigilance by the investment community and government regulators is needed to ensure that this growing private authority is used in the public's best interests.