

Law and Finance: The Case of Stock Market Development in China

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The stock market in China has been growing exponentially and become one of the top markets in the world within 20 years. This growth has been achieved where law in China is generally perceived as weak with 'rule of law' index below the average. It is another Chinese puzzle, because, according to the 'law and finance' thesis, a strong stock market is conditioned on strong investor protection. Is the "law and finance" thesis incorrect? Is China just an inconvenient outlier? Or is law regarding investor protection in China actually not weak? To answer these questions, this article examines the growth history of the stock market and the evolution of legal protection for investors, and investigates their relationship. The main findings are that, in the early stage, investor protection was virtually none, but the market grew rapidly; however, investor protection was overhauled between the late 1990s and early 2000s and the market saw another wave of growth since 2005. The implication from these findings is that the growth of market leads to strong investor protection rather than the other way around, but this does not mean that law is trivial, because the growth in the later stage happened when investor protection had been improved.