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INTERNATIONAL FINANCE FORUM (IFF)
Since 2003

THE IFF CHINA REPORT 2018

Insight and opinion from China's top leaders, policymakers and financiers

- China's opening-up and reform policy
- The financial crisis – A decade on
- Chinese financial system reform
- The Belt and Road Initiative
- The Bay Area Development

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Edmond Alphandery
IFF founding member
Chairman of Euro 50 Group
Former Finance Minister of France

Domenico Siniscalco
IFF founding member
Former Minister of Economy and Finance of Italy and Vice Chairman of Morgan Stanley International Limited

Justin Lin
IFF Advisory Committee Member
Honorary Dean of National School of Development, Peking University

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The International Finance Forum (IFF) is an independent, non-profit and non-governmental international organization, founded in Beijing in October 2003 under the initiation of over 20 primary international organizations such as the U.N., and a substantial number of financial institutions and leaders. As a longstanding high-level dialogue holder, research institute, strategic and diplomatic financial platform, and the leading think tank of China and other emerging economies, the IFF has been playing the full role of non-official G20, therefore, been reviewed as the world's "F20 (Finance 20)".

China's 'Going Out' comes at a testing time

Welcome to the third edition of the *IFF China Report*, which marks the 40th anniversary of China's economic reform and opening up programme, and the fifth anniversary of President Xi Jinping's visionary "One Belt, One Road" speech – the Belt and Road Initiative (BRI) is a major focus of this report.

The publication of this report comes at a time of major friction in the world economy. The traditional standard-bearer for globalisation, the US, is embarking on more protectionist policies under the leadership of its populist president, Donald Trump. In Europe, meanwhile, challenges are arising, particularly following the decision by the United Kingdom to leave the European Union, which could lead to European countries adopting a more inward-looking approach – at least in the short term.

China has remained steadfast in its efforts to transform its growth model away from heavily polluting industry and manufacturing towards high-tech and services – moving away from 'made in China' and towards 'made by China'. It has also boosted internal consumption, thus making it less reliant on trade, while committing itself to taking a leadership role in supporting international trade and development.

China's Going Out policy offers major opportunities for developing countries to learn from China's own rapid economic rise, as well as to secure access to Chinese investment and expertise. Emerging and developed countries also seem primed to gain from improved infrastructure and connectivity.

Inevitably, there will be social, cultural and geopolitical challenges – in addition to the technical issues – that need to be overcome. But China's signature BRI offers a 'once-in-a-generation' opportunity to raise economic prosperity of billions of people, indicating potential benefits should far exceed the costs. Indeed, our inaugural survey of central banks in jurisdictions participating in the BRI indicates that 92% believe the BRI will lead to an increase in their country's GDP within the next five years.

Moreover, the early reactions to the creation of China-led multilateral institutions such as the New Development Bank and the Asian Infrastructure Investment Bank are broadly positive, indicating that China can be a leader while addressing the sensitivities of other nations involved.

The *IFF China Report 2018* includes a forecast by Justin Lin that examines *Xi Jinping Thought on socialism with Chinese characteristics for a new era*, and predicts the impact of China's growth model over the next 30 years. The report is then divided into five sections: China's opening-up and reform; the financial crisis – a decade on; Chinese financial system reform; the Belt and Road Initiative; and the Bay Area Development. Each section contains a series of analytical articles and opinion pieces by leading decision-makers and experts – from China and overseas. We are privileged and extremely grateful for the support of the global leaders, policymakers, finance experts, business leaders, politicians and scholars who have contributed to and supported the publication of this report.

The aim of the *IFF China Report* is to instil in readers a thorough understanding of the situation and the challenges China faces as it embarks on the next phase of its economic transformation. We are grateful for your interest in the report and trust it provides you with important insights and a fresh outlook.

Zhang Jizhong
Chief executive officer
and secretary-general,
IFF

Christopher Jeffery
Editor-in-chief,
Central Banking
Publications

2018 Contributors

Edmond Alphandéry
Chairman,
Euro 50 Group,
and former finance
minister of France

Shaukat Aziz
IFF co-chairman, and
former prime minister
and finance minister
of Pakistan

Chen Bingcai
Professor, Chinese
Academy of Governance

Di Dongsheng
Vice-dean,
School of International
Studies, Renmin
University of China

Fang Li
Deputy director, Foreign
Economic Co-operation
Office at the Ministry of
Environmental Protection

Gao Shangquan
Former deputy director,
State Commission
for Restructuring the
Economic System,
and honorary president,
China Society of
Economic Reform

Gu Shengzu
IFF vice-chairman, and
vice-chairman, National
Committee of the
Chinese People's Political
Consultative Conference

He Yafei
Former China vice-
minister of foreign
affairs and former China
co-ordinator, Group of 20

Jin Liqun
President, Asian
Infrastructure
Investment Bank

Antony Leung
Chief executive officer,
Nan Fung Group, and
former financial secretary
of the Hong Kong Special
Administrative Region

Li Dongrong
President, National
Internet Finance
Association of China, and
former deputy governor,
People's Bank of China

Li Renqing
Secretary-general, Rural
Development Institute
of the Chinese Academy
of Social Sciences

Justin Lin
IFF member, and
former chief economist,
World Bank

Lou Jiwei
President, National
Council for Social Security
Fund, and former minister
of finance of China

Ma Jiantang
Executive vice-president,
Chinese Academy
of Governance

Rick Niu
President and chief
executive officer, Starr
Strategic Holdings, and
partner, Starr Finance

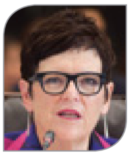
Qiu Xiaohua
Chief economist,
Minsheng Securities

Qiu Yitong
Director, Guangzhou
Finance Bureau

Han Seung-soo
IFF co-chair, and former prime minister of the Republic of Korea

Shao Yu
Chief economist, Orient Securities

Ben Shenglin
IFF Academic Committee member, and dean, Academy of Internet Finance, Zhejiang University



Jenny Shipley
Former prime minister of New Zealand

Song Min
IFF Academic Committee member, and dean, Centre for China Financial Research, University of Hong Kong

Sun Yiting
Director, China Sustainable Finance Project, World Wide Fund for Nature

Tu Guangshao
Vice-chairman and president, China Investment Corporation

Wang Xiaohong
Deputy minister of information, China International Economic and Exchange Centre

Wang Yan
Deputy director, IFF Institute, and former chief economist, World Bank

Wang Yuan
IFF Academic Committee member, and former chief economist, China Development Bank

Zhang Yansheng
IFF Academic Committee member, and chief researcher, China Center for International Economic Exchanges

Zheng Zhijie
President, China Development Bank

Zhou Hanmin
Vice-chairman, Municipal Chinese People's Political Consultative Conference Committee of Shanghai, and vice-chairman, China National Democratic Construction Association

Zhou Yanli
IFF vice-chairman, and former vice-chairman, China Insurance Regulatory Commission

Zhu Xian
Vice-president, New Development Bank

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Contents

Forecast – China 2050

Editor-in-chief
Christopher Jeffery
chris.jeffery@centralbanking.com

Editorial manager
Stuart Willes

Sub-editors
James Hundleby
Alex Hurrell

Chairman, Central Banking
Robert Pringle

Publisher, Central Banking
Nick Carver

Commercial manager
John Cook

Research
Emma Glass

Managing director
Lee Hartt

Managing director, Infopro Digital
Celine Infeld

Marketing managers
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Nicola Goulsbra
Ettyenne Guimaraes

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Chairman, IFF
Kevin Rudd

Co-chairmen, IFF
Han Seung-soo
Shaukat Aziz

Vice-chairmen, IFF
Gu Zhengzu
Zhou Yanli

CEO/secretary-general, IFF
Zhang Jizhong

Director, IFF Institute
Chen Bingcai

Deputy director, IFF Institute
Wang Yan

Deputy secretary-generals, IFF
Du Zhibin
Joanna Zhuang

Contributing editors (IFF)
Zhang Jizhong
Joanna Zhuang
Wang Yan

Other contributors
Tang Hua, Wang Yuan, Feng Qian, Huang Yunqing, Yu Lan, Shen Yongdong, Huang Lu, Zhou Mingwei, Fu Yanan, Mao Hui, Zheng Jingxing, Sun Xiao

Central Banking
28-29 Haymarket House
Haymarket
London SW1Y 4RX
United Kingdom

International Finance Forum
Ziyuntai-IFF Center
Haidian District
Beijing 100095
China

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About IFF

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Our Mission

Following the spirit of "Comprehensive and Sustainable Development — New Capital, New Value, New World" since the founding in 2003, the International Finance Forum (IFF) is committed to building itself into a world-class academic think-tank and multilateral dialogue platform with strategic insight.

Our Goals

IFF operates based on an open, transparent and fair mechanism to ensure its independence, objectivity, foresight and inclusiveness and to facilitate global financial operation and exchanges. Through in-depth research on global finance, IFF is committed to promoting sustainable development of China and the world economy. Our targets include:

1. International Financial Strategic Dialogue Platform
2. International Financial Cooperation & Exchange Platform
3. International Financial Innovation & Practice Platform
4. International Financial Strategic Think Tank Platform
5. International Financial Talents Platform

After the Congress – Interpreting China's new development concept

As *Xi Jinping Thought* is enshrined in the Constitution, *Justin Lin*, IFF member and former chief economist at the World Bank, calls for far-reaching innovation in all sectors of industry and finance to attain the goal of national rejuvenation

Justin Lin

The 19th National Congress of the Communist Party of China (CPC), held in October 2017, was a milestone, establishing President Xi Jinping at the core of the Central Committee of the CPC and demonstrating that China's development had entered a 'new era' of Chinese politics and power.

The new era and *Xi Jinping Thought*

The new era has many implications. First, the principal contradiction faced by Chinese society is now one of unbalanced and inadequate development and the people's ever-growing need for a better life, rather than one of growing material and cultural needs and regressive social production. Second, China has undergone a tremendous transformation – it has stood up, grown rich and become strong. Now, more than ever before, China is closer to – and more confident and capable of – making the goal of national rejuvenation a reality.

To achieve the Chinese Dream of national rejuvenation, the report of the 19th CPC National Congress categorised future development in several stages from now until 2050. The initial decisive period for building a moderately prosperous society has been identified as being from now to 2020 and, from 2020 to 2035, China will develop into a modern socialist country with Chinese characteristics. And between 2035 and 2050, China will become a prosperous, powerful, democratic and harmonious socialist modern country.

To realise this aspiration, the 19th CPC National Congress adopted for guidance *Xi Jinping Thought on socialism with Chinese characteristics for a new era*. This addresses all aspects of Chinese economics, politics, culture, society and ecology, and is summarised in the 'five-in-one' overall arrangement, the 'four comprehensives' and the 'five development concepts', as put forward by President Xi after the 18th CPC National Congress in 2012 (see box *Xi Jinping Thought in numbers*).

Five development concepts and supply-side structural reform

China's future development can be defined by President Xi's five development concepts. First, in the spirit of developing in the interests of the Chinese population, it is crucial to meet its growing needs for a better life. The way to development generally lies through promoting productivity, during which process, imbalance and inadequacy need to be resolved. The implementation of supply-side structural reforms is the effective way to deal with these problems.

Supply-side structural reform demands the following five aspects: cutting overcapacity, limiting inventory, deleveraging, reducing costs and strengthening points of weakness. The first four aspects can help with the imbalance of capacity manifested between supply and demand – supply-side capacity needs to be adjusted according to demand. For inventory, the imbalance lies mainly between products and market demand. If production outgrows market demand, it leads to excessive inventory and waste, leading to essential cost-cutting. This is also a problem for deleveraging – currently, overleveraging reflects the imbalance between finance and the real economy, causing high leverage and accumulating excess financial risk. Reducing costs is

XI JINPING THOUGHT IN NUMBERS

Five-in-one overall arrangement – Economic, political, cultural, social and ecological civilisation construction.

Four comprehensives – Comprehensively complete a moderately prosperous society, deepen reform, promote the rule of law, and strictly govern the Communist Party of China.

Five development concepts – Innovative, co-ordinated, green, open and shared development.

necessary primarily because of the imbalance between business operations and governance. Enterprises must bear high operating costs as a result of ineffective governance and bad administration. Strengthening points of weakness is necessary to address inadequate development, meet demand and improve productivity.

The main route to resolving imbalance in supply-side structural reform is to deepen and further reform. And strengthening areas of weakness is the way to pursue development in accordance with the five major development concepts: innovation, co-ordination, greenness, openness and sharing.

These concepts contain approaches and objectives – 'approach' indicates the innovation that can boost productivity, and the 'objective' is to avoid overcapacity and excess inventory by co-ordinating supply and demand. At the same time, development must be green to meet the population's desire for a better life. In addition, foreign and domestic resources and markets should be used fully in an open economy, and the fruits of development shared by the people.

Five categories of industry and innovation

From an economist's perspective, innovation means introducing more advanced technologies for future use and entering industries with higher values than the existing ones – also known as industrial upgrading. There are two ways of achieving technological innovation. On the one hand, if existing technology is cutting-edge, innovation simply means invention. On the other, if there is a gap between existing technology and the world's frontrunners – as an alternative to invention – innovation can be achieved by introduction, digestion and absorption.

'New Structural Economics' divides the industries in an upper middle-income country such as China into five categories. The first is catch-up industry, which exists in more developed countries as well as in China. For example, China is the world's major producer of construction equipment, while Germany is also a leading player in this field. A piece of equipment made in China costs US$1 million, while in Germany the same piece costs US$5 million. Therefore, China is still at the stage of catching-up.

The second is 'leading-edge' industry. China has several world-leading technologies, including the household appliances industry – televisions, refrigerators, washing machines, and so on – and high-speed/bullet trains.

The third is transformative industry, which refers to industries that have lost their leading-edge position because of a change in comparative advantages.

The opening session of the 19th CPC National Congress

The fourth category is corner-overtaking industry, which is characterised by a short cycle of new technological development and product upgrades, and depends mainly on human capital. As an upper middle-income country, China is relatively close to developed countries in terms of human capital. But for financial and physical capital, this is different. Developed countries have been accumulating this for more than 300 years; in contrast, China began accumulation only after the the beginning of the reform and 'opening-up' period in 1978, which has created a huge gap between China and the developed countries. When the invention of new products and technologies requires intensive human capital and has a short cycle, from the perspective of factor endowment, developed countries fare no better than China. For this kind of short-cycle industry, which requires low financial investment and uses human capital as input, China's considerable advantages are its large population – containing many talented people – and a large domestic market for new products. China also produces the most complete set of intermediate products, so when products have hardware demands, China has obvious advantages.

The final category is national defence, security and new strategic new industry. This industry is precisely the opposite of the corner-overtaking industry. It too requires high human capital, but its research and development (R&D) cycle is particularly lengthy, requiring 10 or 20 years and a huge amount of financial investment and physical capital. From the perspective of factor endowment, China currently has no advantage in this industry. There can be no guarantee of national defence and security without products purchased from abroad; therefore, China needs to support its development even if it is not currently in a favourable condition.

For new industries not necessarily relevant to national defence and security, their R&D cycles are also long and require huge amounts of financial and physical capital. Theoretically, China has no advantage, but the importance of this industry for economic development and the direction of its innovation is clear. If China does not enter this strategic industry now, developed countries will occupy the strategic high ground and, in the future, when China is ready, it may lose the right to access or the industrial technology will be too expensive to acquire. In this sense, even if China currently has no advantage, its cost and risk will be huge in the long run if it ignores this strategic opportunity of investment.

Five categories, five types of innovation

These five categories in China's existing industries each require different types of innovation. Innovation in catch-up industry is primarily based on introduction, digestion and absorption. The leading-edge, corner-overtaking, and national defence and strategic new industries rely mainly on indigenous R&D. For transformative industry, innovation can comprise entering at two ends of the 'smiling curve', including branding, product design and marketing channel management, which require product R&D and innovation in management. Or it can be transferring low value-added labour-intensive production into other domestic areas – or foreign countries where income and wages are relatively low – which requires process and management innovation according to local conditions. Applying different innovations can help a nation to become highly efficient.

In the process of innovation, there is a need to consider new platform technologies, such as artificial intelligence and the opportunities provided by the internet, and the whole process must be accomplished using green technologies. Only in this way can China achieve the goal of innovation, co-ordination, greenness, openness and sharing required by the five major development concepts.

The main route to resolving imbalance in supply-side structural reform is to deepen and further reform

Innovation and finance

Innovation requires capital investment, and therefore should be integrated with finance. Catch-up innovation is based on introduction, which requires bank loans or bond issuance, and banks have size differentiation, depending on the scale of enterprises and their needs for capital. For example, when a large enterprise carries out catch-up innovation, including mergers and acquisitions and other means, loans from large banks will be the main source. And when a small business carries out catch-up innovation, small and medium-sized banks can meet their needs. For the innovation of leading-edge and corner-overtaking industries, their indigenous innovation requires different financial sources. Enterprises in leading-edge industry are usually quite mature, and the capital demand depends mostly on financing in stock markets. For enterprises in a transformative period, for example, developing new products or marketing channel management and quality management, banks will provide major support. Corner overtaking requires indigenous innovation, and fundamentally relies on angel capital or venture capital to absorb risk. In national defence, security and strategic new industries, innovation demands government financial support since they currently lack comparative advantages, and financial support is mostly via direct fiscal subsidies. Governments can set up funds to subsidise R&D or provide financial support through procurements.

Realising prosperity

China needs to innovate in various ways as it enters the new era proposed in the report of the 19th CPC National Congress, they are needed to realise the Chinese Dream of national rejuvenation, to make China stronger and to endow the Chinese people with a better livelihood. Different types of industries require different ways of innovating. Finance serves the real economy and should support innovation with arrangements appropriate for the correct type. Furthermore, if China can carry out its innovations in accordance with the other major development concepts – co-ordination, greenness, openness and sharing – the great rejuvenation of the Chinese nation and the goal of making China stronger will assuredly be realised. ■

CHINA'S OPENING-UP AND REFORM POLICY

Lessons learnt – 40 years of reform and 'opening-up'

Gao Shangquan, former deputy director of the State Commission for Restructuring the Economic System and honorary president of the China Society of Economic Reform, reflects on the unrelenting reform and the difficulties China has surmounted over the past four decades

Since the period of reform and the 'opening-up' policy was launched at the Third Plenary Session of the 11th Central Committee of the Communist Party of China (CCCPC) in 1978, China has undergone a 40-year transformation from planned economy to commodity economy to market economy. Remarkable achievements have been made during this process. The path of China's reform has not always been smooth – it has undergone numerous difficulties – yet the pace of reform and opening-up has never slowed.

The 19th National Congress of the Communist Party of China (CPC) marked the beginning of a a 'new era' of Chinese politics and power. President Xi Jinping declared: "China today is unprecedentedly close to the centre of the world arena. We are closer, more confident and more capable than ever before of making the goal of national rejuvenation a reality." The road ahead is still full of challenges, but China remains determined to surmount them and succeed further.

As China celebrates the 40th anniversary of its period of reform and opening-up, it is entering a critical juncture at which to build on past achievements and forge ahead. At this new historic starting point, it is essential for China to review and assemble its hard-won achievements in preparation for the upcoming expedition into new reforms.

Broadly, China's economic reform originated in rural areas and moved to the cities, and from the economic field into other areas. This process can be divided into four distinct stages: objectives quest, framework construction, institutional improvement and new exploration.

Objectives quest – The inauguration of reform (1978–1992)

In this first stage, the socialist market economy was established. China initiated reform pilots, which were gradually extended by drawing on lessons from the past. China opened-up through establishing special economic zones and later allowed the outside world access to coastal areas, places along rivers and, finally, mainland China.

Framework construction – The initial establishment of the socialist market economic system (1992–2002)

Reform during this period included the following:

- The new fiscal system focusing on the tax-sharing and turnover tax systems based on value-added tax being set up.
- The basic economic system, in which public ownership forms the foundation and various forms of ownership are developed together, was established.
- The dual-price system of means of production was cancelled, the prices of competitive goods and services better decided by the market, and the factor market was gradually formed.
- A pensions and medical insurance system that integrates social pooling with individual accounts was set up.
- Unemployment insurance, a social welfare system and minimum living allowance system for urban residents were all established.

Institutional improvement – Preliminary establishment of the socialist market economic system (2002–2012)

The 16th CPC National Congress in 2002 proposed the goal of completing the socialist market economic system by 2020, and the Third Plenary Session of the 16th CCCPC laid out a comprehensive plan for building a sound socialist market economy. The CCCPC summarised the strategic concepts of a scientific outlook on development and the building of a harmonious socialist society that would be the essential guiding ideology for reinforcing reform and opening-up. Since then, China has thrust itself into a new era of perfecting the socialist market economy.

Characteristics of this period included the following:

- Non-public sectors of the economy were boosted.
- The public financial system was continuously improved, and the investment system reformed.
- Further development of the factor market for land, labour, technology, property rights and capital occurred.
- The market began playing a more decisive role in setting the prices of major resources such as water, electricity, oil and natural gas, and more individuals were covered by social security.

New exploration – Comprehensively deepening reform (2012–present day)

The new leadership core of the party was elected at the 18th CPC National Congress in 2012. Since then, the leading group for comprehensively deepening reform has held 38 meetings on such difficult or seemingly insoluble issues as the reform of the rural collective land system, the judicial system and the fiscal and taxation system. As a result of these meetings, a series of plans has been promulgated, such as the *Opinions on the reform of pilot project of rural land expropriation*, *Entry into the market of collective operational construction land and homestead system*, *Pilot programme for establishing the People's Court and People's Procuratorate across administrative divisions*, *Opinions on further promoting the reform of the household registration system* and the *Overall plan for the deepening reform of the financial and taxation system*, highlighting the courage of the new leadership in collectively tackling the conundrum of reform.

Five transformational advances

The major achievements of the past 40 years of reform and opening-up are primarily reflected in China's five transformational advances:

1. Shifting focus from the class struggle to developing the economy.
2. Leading the transition from a planned to a market economy.
3. Moving China away from isolation or 'cutting-off' towards comprehensive opening-up.
4. Propelling China from the rule of man to the rule of law.
5. Changing peoples' lives from poverty and underdevelopment to moderate wealth.

Lessons from 40 years of reform

President Xi declared that "reform and opening-up are the source of vitality for the progress of contemporary China, an important magic weapon for our party and people to keep pace with the times, and the only way to go if we want to uphold and develop socialism with Chinese characteristics". China has accumulated a great deal of valuable experience from these 40 years of reform:

- **Emancipating the mind and pushing for theoretical innovation.** Since the period of reform and the introduction of the opening-up policy, China has expanded its theory of the socialist market economy through policies and strategies, including the Third Plenary Session of the 11th CCCPC's proposals for reform and opening-up in 1978, the 14th CPC National Congress in 1992 and the Third Plenary Session of the 14th CCCPC defining the socialist market economic system in 1993. The 15th and 16th CPC National Congresses in 1997 and 2002, respectively, made further theoretical contributions on major issues such as the strategic adjustment of the state-owned economy, reform of the state-owned asset management system, the status of the non-public sectors of the economy and income distribution. Since the 18th CPC National Congress – especially at the Third Plenary Session of the 18th CCCPC – China has further clarified the decisive role of the market and has decided to reinforce the reform to extend its scope in the allocation of resource dimensions to new heights.
- **Firmly adhering to market-oriented reform.** Forty years of reform and opening-up has seen continuous consolidation of

the market's position as the prime mover in allocating resources. It is precisely this adherence to market-oriented reform that has inspired the tremendous vitality of the country's innovation and entrepreneurship – and China's economy has increased exponentially. The contribution of private enterprise to the economy has grown from 0% of GDP to more than 50%. In terms of innovation, the number of private-sector patent applications is nearly twice that of state-owned and collective enterprises – all of which are the result of a market economy.

In the era of big data, which can make planning more scientific, the growing role of the market economy needs to be steadfastly preserved. The difference between a planned and a market economy is not about planning – in a market economy, companies with well-planned agendas are more likely to overcome fierce competition. The fundamental difference is the determinant of resource allocation, administrative or market power. Big data cannot make people more creative or motivated – a market has to be a free market if successful imitation and creativity are to flourish.

- **Adopting flexible reform methodology and overall planning.** Typically, China runs pilot projects before similar trials elsewhere, which summarise the findings and lessons learned. Risk is managed effectively while successful experience is dispersed nationwide. This methodology, as well as the exploration of new developmental and institutional mechanisms, must be retained in the new era of continued and reinforced opening-up and reform.

Reform needs to be expanded more systematically and efficiently and must commit to synergetic development. China must maintain the balance between 'breaking the old' and 'establishing the new'. It needs to establish new mechanisms that comply with productivity while eliminating the obstacles rooted in its institutions. China will stress the importance of co-ordination and co-operation in overall planning, and seize opportunities to achieve major breakthroughs. Opening-up is the application of reform, so both strands must be mutually reinforcing. In this new stage of improving the socialist market economic system, co-ordinated development and planning become increasingly important because the reform of the economic, political, cultural and social systems are more interconnected. The leading group for deepening the reform was established after the Third Plenary Session of the 18th CCCPC, and was divided into four groups specialising in economics, democracy and law, culture and the social system. It has created favourable conditions for the overall co-ordination of the reform.

- **Striking a balance between reform, development and stability.** Reform is a powerful stimulus to economic and social development because the system it engenders is a fundamental guarantee of sound, rapid, long-term economic and social benefits, and the basic safeguard of social stability. At the same time, development and stability build the basic foundation for continuing reform. Handling the relations between reform, development and stability requires further orderly reform and opening-up, organically steadying the intensity of reform with the pace of development and the affordability of the society, advancing reform to development on the premise of maintaining stability, and boosting social stability through reform and development.
- **Enlightenment of values as much as methodology.** Reform is for the people, by the people – and the fruits of reform should be shared by the people. China must commit to the principle of putting people first and improving their livelihoods. It should combine efficiency with social fairness by solving the problems that most concern the vital interests of the people, while striving to balance the interests of all parties to achieve social fairness grounded in economic development. Citizens should enjoy the fruits of reform and development through the proper handling of various interests to achieve social harmony and improve livelihoods by institution-building.

Fairness should be reinforced in the market economy. The 18th CPC National Congress proposed: "We must ensure that all kinds of ownership economy make equal use of the factors of production in accordance with the law, participate in market competition fairly and be equally protected by the law." The 18th CPC National Congress addressed the importance of good governance: "The core issue of economic system reform is to deal with the relations between the government and the market." Good governance creates a market environment that provides high-quality public services and dispenses social justice. If enterprises are unable to use the factors of production equitably and equally, protected by the law, they will not have access to fair competition. A credible and fair judicial system can effectively settle common disputes among transaction subjects and restore market order. However, the legal rights of China's private enterprises and private non-listed companies in particular are poorly protected by the law, so we must create a just business environment to protect their enthusiasm for innovation and investment.

- **Deepening reform in an all-round way in the new era.** The CCCPC's *Decision on major issues concerning comprehensively deepening reforms*, adopted at the Third Plenary Session of the 18th CCCPC, has created the blueprint for China to comprehensively push for reform and opening-up in the new era. In the spirit of this decision, major breakthroughs have been made in market-led resource allocation, and notable progress was achieved in supply-side reform. The increasingly efficient and powerful market has gradually replaced the planned economy as the primary means of allocating resources.

Since the 18th CPC National Congress – the first to be held after the Great Recession and the first to deal with its aftermath – the Chinese economy has been confronted by new challenges such as continuing reconstruction, rising trade protectionism and a new world economic order. Meanwhile, domestic land and labour prices continue to rise. As the economy is more tightly constrained by resources and environmental preservation efforts, the traditional economic development pattern and structure in China needs to be readjusted. The Chinese economy is facing a dilemma of maintaining steady growth while trying to carry out structural readjustment. Under such a 'new normal' of economic growth, the government has clearly made a timely decision on supply-side reform.

Supply-side structural reform consisted of cutting overcapacity, reducing excess inventory, deleveraging, lowering costs and strengthening areas of weakness. In 2016, coal production capacity was cut by more than 290 million tons and steel by over 65 million tons. China's economy has rejected the old model of development with unwavering determination. The focal point of supply-side structural reform is to refine relations between government and market – which are key to economic reform and structural change. Since the 18th CPC National Congress, the State Council has discarded much administrative approval that may lead to rent-seeking: 618 approval items have been cut or delegated and 283 items designated by the central government to local areas have been cancelled. Investment projects that need to be approved by the central government have been reduced by almost 90%. Of pre-approval items in industrial and commercial registrations, 87% were transformed to post-approval or called off. Reform that aimed to "streamline administration, delegate more powers, improve regulation and provide better services" became more effectively implemented. Since the 18th CPC National Congress, these great strides to eliminate unnecessary procedures for administrative approval have revitalised the market economy and marked a major breakthrough in reform.

Areas awaiting reform

Four major areas are yet to move ahead with reform:

1. **State-owned enterprises (SOEs).** The reform of SOEs has undergone a long period of experimentation, seeing SOEs shift from a decentralised system to 'tax for profits' to a contract system and finally to a joint-stock system combined with a modern corporate system. However, SOE reform must proceed in tandem with general economic reform. To this end, China must adhere to the basic rules of the economic system and allow full development of the positive role played by various ownership holding enterprises – public ownership should be dominant, and the various economic sectors must develop side by side. SOE assets have reached RMB144 trillion – one-seventh of the national total – with taxes paid making up around one-fifth of the national fiscal revenue.[1]

2. **Upholding the corporate system.** The combination of public ownership and the market economy is unique to the endeavour of socialism with Chinese characteristics. China must unswervingly follow the 10th Five-Year Plan's call for reform of the economic system: "clearly established ownership, well-defined power and responsibility, separate government administration from enterprise management". China will thoroughly implement the 'three major shifts' – from business law to company law, from enterprise-based management to capital-based management and from a state-owned system to a joint-stock system.

3. **Taxation reform.** Local enterprises with high debt pose a potential threat to China's financial security, forming an important reason for deleverage. Although local debt poses no direct threat yet, no clear local financial solution exists because of the mismatch between the routine fiscal power in China's taxation system and the smaller amount of direct tax and larger amount of indirect tax to the local government. The need for a breakthrough in the fiscal and taxation system is clear from the following aspects:
   - In 2015, China's GDP was CNY67.6 trillion and its fiscal revenue CNY26.67 trillion – a macro-tax burden of 39.4%. This burden is one of the heaviest in the world, around 10 percentage points higher than that of developed nations. High governmental administrative costs increase the burden on enterprises, thus affecting their development.
   - The cost of governance – taxes paid by the general public – is higher than in other countries, partly because the Chinese government has also assumed the responsibility of investment. However, its investment efficiency is doubtful, and its behaviour does not conform to the requirements of the Third Plenary Session of the 18th CCCPC to allow the market to play a decisive role. On the basis of the Constitution, administrative reform entails constraining the government's revenue and expenditures and increasing public scrutiny while balancing fiscal and administrative power between the CCCPC and local governments.
   - Since the 18th CPC National Congress, for the CCCPC, with President Xi at its core, a priority has been improving the livelihood of the people – government should ensure the people benefit more. Compared with other countries with macro-tax burdens exceeding 30%, there is still a long way to go in terms of social welfare expenditure. Fiscal reform should neccesitate administrative streamlining and delegation of government powers, so that tax revenues can be efficiently collected from and benefit the people. In this way, reform can win widespread support.

4. **Regulatory reform for an online future.** China must identify the government's role in the internet age. The most important feature of economic and social development since the 18th CPC National Congress has been the advent of the internet and mobile internet. As of January 2017, the number of citizens that use the internet, 'netizens', in China totalled 731 million, of which 695 million were mobile internet users. The internet has had a huge impact on economic and social conditions, such as triggering the meteoric rise of e-commerce platforms such as Alibaba and JD.com, which has driven the decline of physical retail outlets – especially in apparel and small commodities. Many of these new forms of business are not covered by China's earlier regulatory systems.

   This situation challenges the regulatory concept and capacity of governments. Under conservative regulation, rivals could surpass China in new internet developments, but weak supervision will lead to regulatory arbitrage such as illegal fundraising, which will adversely affect the economic order. Judiciously balancing the regulation of new forms of commerce in the internet age remains an important test for governments now and in the future.

The government should also enhance regulation and supervision in antitrust laws. A side effect of the internet age is the increased number of monopolies, yet this is an era of intelligent manufacturing that breeds numerous, incessant innovative ideas. Sustainable economic development depends on this creativity so, in order to protect it, it is essential to strengthen the protection of patent and non-patent intellectual property rights and reduce the damage that monopolies can inflict on innovation. Special emphasis must be placed on enhancing antitrust efforts and strengthening protection of intellectual property rights and all other innovative ideas. ■

1. *The State Council 2018,* Chinese SOEs profits rise 25.3 percent in Jan–Feb, *https://bit.ly/2GtElhR*

Asian Infrastructure Investment Bank – Raising expectations

The Asian Infrastructure Investment Bank embodies international co-operation and innovation – the spirit of modern China. Strict management, openness and transparency have won the bank wide recognition and acceptance, says *Jin Liqun*, the bank's president

Launched just two years ago, the Asian Infrastructure Investment Bank (AIIB) has made an impressive debut, entering the international stage of development and co-operation with steady yet firm strides and laying a solid foundation for the future. The AIIB – proposed by China at the beginning of what is seen as a new period in history – has received positive responses from the global community. An innovative international multilateral development institution with a 21st century governance structure, the AIIB embodies China's zeitgeist and integrates with national development concept and practice. The Chinese government has kept its promises and unswervingly maintained the nature of the AIIB as an international institution, thus winning wide recognition and appreciation from the rest of the world.

International co-operation under China's leadership

First proposed by China in October 2013, it took just two years to negotiate with other countries over the articles of agreement and other important policy documents, list the bank and open it for business.

Key factors attributing to these rapid achievements were co-operation, a democratic work ethic, inclusiveness, accountability and dedication. But, from the beginning, the AIIB's motives were questioned by the international media: what geopolitical intentions does China have? Will the AIIB pose a threat to existing international multilateral institutions and trigger vicious competition in the field of development? Will its investments hurt the environment – for example, exacerbating greenhouse gas emissions and impairing the interests of people involved in the project?

In the face of many doubts and misgivings, the AIIB defended itself – not with words but with performance. The initial performance of the AIIB over the past two years has gained widespread international recognition, gradually resolving many concerns. Its membership has expanded from 57 founding members to 84, and many other countries are also considering joining this international multilateral development agency that displays the distinctive features of this new era.

The Asian Infrastructure Investment Bank building in Beijing

Jin Liqun

The AIIB epitomises the global vision and overall outlook of the Chinese government, as well as its inclusiveness and generosity. The report of the 19th National Congress of the Communist Party of China (CPC) proposed that 2020 is the deadline for completing the construction of a moderately prosperous society. Of particular note, we must prevent and mitigate major risks, and target environmental pollution as well as poverty – a difficult battle to win as China still lacks wealth. However, the 19th CPC National Congress unanimously agreed that the Chinese government would contribute 30% of investment to approve the AIIB charter in a timely fashion, a decision enthusiastically supported by stakeholders.

Embodying the Chinese development concept

The AIIB was founded in response to new challenges brought about by globalisation. It aims to boost economic and social development, improve the ecological environment and enhance connectivity through investing in the infrastructure of its member nations. Its ultimate mission is to eliminate poverty in China and its member countries and, to this end, it must adapt to the requirements of the 'new era' of Chinese politics and power. The AIIB draws fully on the best practices of existing international multilateral development agencies, while avoiding the duplication of their governance structure and mode of operation. The AIIB draws instead on their strengths, innovates and sets off on a new path in institution-building, operation mode and management style.

The core principles of the AIIB are openness, transparency, independence and accountability, and its mode of operation is "lean, clean and green". From the inception, the bank has strictly adhered to the principle of streamlining institutions, eliminating redundancies and preventing bureaucracy. It upheld its principle of probity, acting with zero tolerance towards corruption. It pursued green development by implementing the Paris Climate Agreement to tackle climate change. The AIIB must become a bank jointly owned by all its members, take into account the interests of its members in the region and beyond, listen to the voices of developing and developed countries, conform to the trends of the times, and make a larger contribution to peace and development in the region and the world at large.

Rules – Crucial from the outset

Over the past two years, the AIIB has attached great importance to institution-building for risk management through well-established supervision mechanisms and personnel training. A crucial step for any new institution is to establish rules and regulations. Under the guidance of the board of directors, the management departments have set out to establish these from the beginning: business policies, management measures, a complete procedure of project development and approval, risk prevention mechanisms, long-term anti-corruption systems and improved supervision mechanisms. Anyone, be it the president of the AIIB or regular staff, must adhere to and apply the rules and be subject to supervision. Senior managers in particular must be self-disciplined and set good examples to employees. Management departments must always bear in mind that their work is closely supervised not only by the board of directors, but by the entire international community.

To ensure systematic and correct decision-making, the AIIB has established specific committees for the board of directors and management departments, which oversee personnel management, capital operations, risk control and internal audit. The highest decision-making body of the management department is the executive committee, at which all major issues must be fully deliberated and discussed. Decisions will not be finalised and implemented until consensus is reached to avoid arbitrary decision-making. The rules dictate that, even in extreme cases, this cannot be significantly protracted, but where there is discrepancy or disagreement the president will make the final decision and assume responsibility. However, in the AIIB's two years since inception, this situation has not arisen. A democratic decision-making approach can inspire the enthusiasm of senior managers, enhance their sense of participation and responsibility, help facilitate the wisdom of the masses and prevent heavy losses caused by individual bias, thus ensuring that big mistakes are avoided and small ones mitigated.

To date, all of the AIIB's investment projects have been organised in countries and regions along the Silk Road Economic Belt, bringing tangible benefits to their inhabitants

It is precisely because of this strict management system and its thorough implementation that three major ratings agencies have awarded the AIIB the highest credit rating. The Basel Committee on Banking Supervision has also rated the bank as being "zero risk". These ratings have allowed the AIIB to raise low-cost, long-term funds from international capital markets, thereby lowering costs to borrowing countries. It was no simple matter for the AIIB to achieve these high credit ratings in the two years since its opening; to preserve its status, it must make all efforts to adhere to high standards and operate in accordance with the rules to maintain good performance.

AIIB – a driving force actively promoting the implementation of BRI

The Belt and Road Initiative (BRI) and the AIIB, both international co-operation initiatives launched by China, have different objectives but inevitable links. The AIIB is an international agency that operates in accordance with internationally accepted rules; the BRI is a platform for international co-operation attracting international support. The global governance concept advocated by President Xi Jinping – "extensive consultation, joint contribution and shared benefits" – is also applicable to the infrastructure investment of the AIIB.

Alongside other international agencies, the AIIB has signed the *Memorandum of understanding on strengthening co-operation in related fields under the BRI* with the Chinese government. The warm response of the international community to the BRI has helped expand the reach of its geographical concept and increase the number of participants.

To date, all of the AIIB's investment projects have been organised in countries and regions along the Silk Road Economic Belt, bringing tangible benefits to their inhabitants. The ethos of the AIIB is in the same key as the BRI's concept of the community of a shared future –with a shared vision for the future of mankind.

The AIIB has always been committed to investing in sustainable infrastructure projects. Three main criteria exist for investment decisions: projects must be financially sustainable, they must benefit the environment and they must be supported by local people and improve their livelihoods.

In the past two years, the AIIB has approved projects in member countries in transportation – highways, railways and ports – power transmission and transformation, and urban development. In the meantime, it will also step up efforts in loan planning in the next few years to acquire more BRI projects.

Maintaining the credibility of the AIIB

In 2018, the AIIB entered its third year of operations. As an international institution initiated and led by China, the AIIB has not found it easy to win widespread international recognition in a short period of time. This recognition would not have been at all possible without the support of all member states and the guidance of the board of directors, as well as the joint efforts of management and staff members.

The sound and compelling support of the Chinese government must be emphasised, demonstrated by its faithful commitment to not interfering with the daily routine of management and exercising its powers through the board of directors, thereby allowing the AIIB to maintain its nature as an independent international institution. This support is also manifested in the Chinese government's preferential policy that allows the AIIB to function appropriately in China. The Chinese government has acted out to perfection its role as a major shareholder, bringing convenience to management rather than restraint and winning the praise of the international community.

In the face of praise, the AIIB must remain clear-headed, continue to effectively manage the institution and maintain its credibility. Wearing a temporary halo is easy, but maintaining the brand and reputation is more difficult. Some of the achievements we have made are just the first step in another 'Long March'. China must always keep in mind the mission – and the Long March shall never cease.

In 2018, the AIIB will further improve institution-building by consolidating its capacity for implementation. Simultaneously, it will recruit more people, especially front-line development project staff. Moreover, the bank will focus more on independent projects, both within and outside the region, and begin to establish an evaluation system for project performance. ■

CDB – A vital financial force to China's reform and development

Since its inception in 1994, the China Development Bank (CDB) has, in its incarnations as policy bank, commercial bank and development finance bank, reflected the hard-won reform and development of China itself, says *Zheng Zhijie*, president of the CDB

The surest path towards the achievement of the Chinese Dream lies through reform and the policy of 'opening-up'. The same holds true for the success of an institution such as the China Development Bank (CDB) – development is not possible without reform and opening-up. Founded in 1994, the CDB is a product of China's reform of the socialist market economy, and the deepening reform of the investment and finance system. Since inception, the bank has focused on the crux of China's economic reform – relations between the government and the market. Thus, the CDB has been constantly exploring, moving forward and ultimately embarking on the road of development finance with Chinese characteristics, and has become a financial pillar to the country's economic and social development.

Reform and opening-up hold the key to the operation of the CDB. Continual exploration and experimentation has been an arduous process; every step has been like "crossing the river by feeling the stones"[1] – trying to solve the problems that restrict development and so enhance our own efficiency and vitality. Each exploration aims to broaden the bank's knowledge and calculate a path better suited to the Chinese social context and more supportive of economic and social development.

In its early years, the CDB raised funds and targeted them to key projects such as infrastructure, basic industries and pillar industries, in accordance with the orientation and operational requirements of the policy banks. This contributed a great deal to national economic growth and alleviated many financial bottlenecks. However, because of various contemporaneous factors – chiefly the government-directed operational method – it also accumulated many risks, with the non-performing loan ratio reaching as high as 42.7%.

When the Asian financial crisis broke out in 1998, large amounts of non-performing loans caused the struggling CDB to totter. In line with the central authorities' principle of "supporting economic development while guarding against financial risks", the CDB proposed that banks be set up under a market environment subject to bank regulations to achieve the government's development goals. The bank began to position itself as a development finance institution that pursued economically viable projects in line with its policy goals.

In 2008, the CDB was repositioned as a commercial bank and thus came under the strictures of commercial reform. However, the CDB's role in serving national strategy was disrupted by uncertainties around its institutional positioning, credit support and sources of funding.

A three-step strategy

After the 18th National Congress of the Communist Party of China (CPC), and conforming with the central authorities' general attitude towards financial reform, the CDB proposed a 'three-step' strategy to deepen reform and eradicate the problems affecting its own development and its ability to serve the national strategy – namely, securing permanent sovereign credit support for CDB bonds with zero risk weights, shaping up a group governance structure, and obtaining an official mandate for CDB as a development finance institution. In November 2015, the State Council of the People's Republic of China approved the plan for continuing reform of the bank and clarified the status of the CDB as a development finance institution. The approval of the new *Articles of the China Development Bank* in 2016 and the successful implementation of the three-step strategy have made the CDB reforms integral to those of China's entire financial system. Development finance has also become a crucial component of China's financial system since the 18th CPC National Congress.

In the process of continuing reform, the CDB matched the pace of China's opening-up to the outside world, expanded its international perspectives and boosted the wider and deeper embracement of development finance. Each year, the international advisory board, set up by the CDB in 1999, invites international financial and political leaders to offer suggestions on the development of the bank and the Chinese economy. In 2001, in the face of the opportunities and challenges created by China's admission to the World Trade Organization, the CDB took the

1. An expression popularised by Deng Xiaoping.

initiative of following international standards and setting the goal of building itself into a world-class bank. In 2005, in accordance with China's Go Out policy, the CDB for the first time dispatched overseas country teams to work closely with its clients and manage its projects to better serve the international operation of Chinese enterprises.

Since 2013, in response to the Belt and Road Initiative (BRI), the CDB has improved its international business management system and further optimised overseas operations. To date, it covers 197 countries and regions in the world and has developed into the largest Chinese bank for outbound investment and financing. The CDB has also actively participated in global financial governance, advanced multilateral and bilateral financial co-operation, and expanded its circle of influence by promoting the establishment of multilateral financial co-operation platforms such as the Shanghai Cooperation Organisation Interbank Association, the China-Association of Southeast Asian Nations Interbank Association, the Brics [Brazil, Russia, India, China, South Africa] Interbank Cooperation Mechanism and the China Central and Eastern Europe Interbank Association.

The development of the CDB mirrors that of China's financial system reform and the opening-up of Chinese finance – in the past 20 years, the CDB has changed from policy bank to commercial bank to development finance institution, from getting to grips with international standards to expanding international investment. In the history of China's financial development, these 20 years are the blink of an eye; however, they have reworked the pattern of China's financial sector, forcing development finance to step onto the historical stage as an independent financial ecosystem. This act represents a turning point in the vicissitudes of China's history, embodying a pioneer spirit of innovation by emancipating the old Chinese mind-set and breaking with conventional doctrine. Practice has shown that reform and opening-up are fundamental to the development and growth of the CDB – and are also a source of strength to enable the bank to play a greater role.

Economic and social development and the CDB

The CDB has also played an important role in China's economic and social development. The truth can only be tested in practice; only facts tell us whether the exploration of development finance is correct and how well it is performing. Over the years, the CDB has fulfilled its historic mission of "strengthening China's competitiveness", made important contributions to boosting China's economic and social development, and enhanced national strength and international competitiveness.

From its beginnings, the CDB has assumed the task of controlling and adjusting the sources of funds and the total amount and structure of fixed-asset investments. It has focused on building infrastructure, basic industries and pillar industries – more than 90% of loans are invested in key areas such as coal, electricity, oil and transportation. It has also provided support to major projects of national importance to the economy and the people's livelihoods, such as the Three Gorges Dam Project and the Beijing–Kowloon Railway, and solidified the foundation for national economic development. Since 1998, the CDB has cracked down on financing problems in urban infrastructure construction and helped accelerate the urbanisation process through bank-government co-operation and the joint establishment of financing platforms. It has actively sought

Zheng Zhijie

to improve people's livelihoods, expanded the scope of international co-operation and vigorously supported areas in urgent need of development.

After the onset of the international financial crisis in 2008, the CDB responded enthusiastically by taking the initiative to co-operate with central authorities in implementing those measures with the aim of "maintaining growth, expanding domestic demand, adjusting structure, promoting reform and benefiting people" and playing an active role in putting the Chinese economy back on track.

Since the 18th CPC National Congress, the CDB has actively adapted to the 'new normal', reinforced supply-side structural reform and has strived to cut overcapacity, reduce excess inventory, deleverage, lower costs and strengthen areas of weakness. The bank provided a total of RMB16.5 trillion of financing to the real economy and reduced the financing cost of enterprises by nearly RMB200 billion; the capital invested in the real economy accounted for more than 80% of the bank's total assets. The CDB's poverty alleviation and relocation loans were a top priority. more than 9 million low-income farmers have benefited, and student loans have helped more than 10 million students from economically disadvantaged families complete their studies. The bank has supported the construction of affordable housing, and loans to rebuild and regenerate pockets of extreme poverty have aided in the relocation of more than 20 million people to safer and more comfortable housing. The CDB has supported the construction of major transport infrastructure – 16,000km of highways and more than 10,000km of high-speed railways. The bank also helped initiate the establishment of a national integrated circuit industry investment fund, aiding technological innovation and cultivating new economic growth points by linking investment and loans. Loans to countries along the Silk Road Economic Belt exceeded US$185 billion to achieve mutual benefits and win-win results.

Xinjiang–Lanzhou Railyway (Xinjiang Section), a major project supported by the CDB

Conforming to the national strategy has seen the CDB itself make steady progress. As of year-end 2017, total assets exceeded RMB15.6 trillion. The non-performing loan ratio remained within 1% for 51 consecutive quarters, the provision coverage ratio was greater than 530% and the capital adequacy ratio surpassed 11.4%. The capabilities of risk prevention and sustainable development also continued to grow.

A new chapter in development finance

The CDB remains committed to advocating development financing in reform and opening-up, which, along with innovation and development, are in the DNA of the bank. Development finance is not only the road to the future, but also a road of reform and continuous self-improvement. Through exploration, the CDB maintains its pursuit to deepen its understanding of Chinese national conditions and the law of economic and financial development, accumulating valuable experience while constantly absorbing advanced financial principles both at home and overseas. These learned experiences include the following:

- Upholding a strong party leadership and ensuring that national strategy is fully and absolutely implemented.
- Persistence in reform and opening-up, and constantly increasing the momentum of development is imperative.
- Market-oriented adherence to the national strategy will help fully develop the CDB's role in connecting the government and the market.
- Innovation to better meet the diverse financing needs of economic and social development must be insisted upon.
- Implementing risk prevention and control will realise sustainable development.

The task of reform and opening-up is a never-ending one. Currently, China stands at a promising historic juncture. This is a period of opportunity for steady progress, high-quality development, innovation, and building the BRI and a shared community – a community with a shared vision for the future of mankind. Of course, a new stage of development will bring about new contradictions, but what can be done to meet the growing need of the people for a better life? What is the solution to the problem of insufficient and imbalanced development? And what should the CDB do to promote such high-quality development?

Under new development requirements, the need for reform and opening-up will never cease. Guided by *Xi Jinping Thought on socialism with Chinese characteristics for a new era*, the CDB must keep abreast of current trends, respond to the requirements of the era, listen to the general tone of seeking progress while maintaining stability, and continuously advance its own reform and opening-up. Following these principles, the CDB can explore new forms of financial services more suitable for China's economic and social development between the government and the market, help win the battle of major risk prevention and settlement, alleviate poverty, prevent and control pollution, deepen supply-side structural reform, support the construction of a modern economic system, improve people's livelihoods, fuel the new forms of opening-up and write a more exciting chapter of development finance in the 'new era' of Chinese politics and power. ■

Deepening China–EU trade relations

By creating an environment of trust and stability in the European Union, Chinese investment there can be boosted and the trade imbalance evened out, says *Edmond Alphandéry*, former finance minister of France and chairman of the Euro 50 Group

China–European Union trade figures seem encouraging, but they are sending out mixed signals. In terms of trade in goods and services, the EU is China's premier commercial partner. It is the number one seller of goods and services to China and is second after the US in terms of imports from China. Trade flows have been increasing significantly over the past decades on both sides. Chinese imports from the EU have increased by 70%, but EU exports to China are much lower. This deficit remains significant – it represents about half the value of trade. Between 2014 and 2016, EU imports increased from €300 billion to €350 billion, while exports to China remained stagnant at around €170 billion. Of course, we would like to see a perfect China–EU trade balance, but it is also important to maintain harmonious relationships by paying attention to these figures.

Financial ebb and flow between China and the EU

The stock of EU foreign direct investment (FDI) in China in 2015 totalled €168 billion, while Chinese FDI in the EU was only €35 billion, according to the European Commission. This large imbalance should not disguise the dynamism of Chinese investment in the EU – in fact, this investment in the EU is now comparable to EU investment in China. Figures produced by the Rogers Group for the European Commission released some interesting information for the first six months of 2017. EU companies' FDI transactions in China – the main sectors being the car industry, aeronautics and basic materials, and the main countries being Germany, France and the UK – dropped by 33% compared with the previous year. The EU–China FDI monitor shows that the combined value of Chinese FDI transaction in the EU – which totalled less than €4 billion in the second quarter of 2017 – is at its lowest level since the first quarter of 2015. The outlook for Chinese investment in Europe is therefore mixed, with room for progress on both sides.

Financial exchanges between China and Europe have huge economic, social and political implications, so the spirit with which both parties envision their relationships is essential. The *EU–China 2020 Strategic Agenda for Co-operation*, adopted in 2013, recognises the "potential for synergies to enhance co-operation for win-win results". It stresses that, in a world still far from being at peace, "promoting mutual multilateralism remains crucial to ensure effective, co-ordinated and coherent responses to pressing global challenges". According to this agenda, the two parties are committed to taking steps in favour of market access, investment, intellectual property protection and financial co-operation, with those strategic partnerships based on "the principles of equality, respect and trust". Going further into the economic and financial dimensions, the agenda encompasses co-operation on defence and security, protection of cyberspace, mutual co-ordination, addressing governance issues, sustainable development and implementation of effective international climate change measures, and cultural collaboration. *The EU–China 2020 Strategic Agenda for Co-operation* is, in the author's view, the framework best suited for a bilateral long-term win-win relationship in trade and investment.

Enhancing the environment for China–EU exchanges

In China, very positive macroeconomic implications have arisen. First, the rebalancing of the Chinese economy in favour of domestic spending is very good news – it not only puts the development of the Chinese economy on a firm footing, but enhances the size of the market for commercial partners of China, with the EU in prime position.

Second, the policy of opening capital accounts in China – which prioritises a framework of financial stability – must also be welcomed. Some voices within and outside of China would prefer the accelerated innovation of financial service activities. The rest of us should remain aware of the stabilisation efforts China faces – given the huge amount of access liquidity, the insufficient co-ordination of monetary policies around the world and the need for more stringent regulatory framework in monetary markets and financial activities – and appreciate the position of the Chinese authorities in taking their time to fully open its capital accounts. The EU, and the world at large, benefit hugely from the policy of monetary and financial stability in China.

Third, concerning EU investors' access to China, it is worth observing that steps were taken in June 2017 to facilitate foreign investment in the bilateral free-trade zones. The 2017 so-called 'negative list' removes restrictions for foreign investment in various sectors, including manufacturing, aviation, shipping, automotive, railroad, transportation, equipment, telecoms and pharmaceuticals. Banks and insurance companies no longer face a number of requirements to invest in Chinese financial institutions. This is good news for China as well, since the success of bilateral free-trade zones is appealing to foreign investment: the success of Shenzhen, for example, lies in its attractiveness to both domestic and foreign investors. We can only encourage Chinese authorities to pursue this policy and continue to promote certain activities and values to improve the political and business climate for Chinese firms to invest in Europe. Many Chinese investments in Europe have been a success – the Port of Piraeus, Toulouse Airport and many others have been beneficial to both parties.

Edmond Alphandéry

But it is no surprise that, in the context of trade imbalance, some European businesses realise they should expand sales in China in spheres such as more sophisticated industrial products. European businesses would also like to invest more in China's domestic market, which is rapidly becoming the largest retail market in the world. To create an environment of trust and confidence in the future of the EU, it is in China's interests in the first place that it succeeds in deepening the integration of the EU member states.

In this respect, two issues remain. First, to strengthen the eurozone – which has now successfully emerged from the euro crisis, and is doing well in economic growth – we have to complete the banking union, better integrate our capital markets and create a governance where solidarity among all member states prevails. With the election of Emmanuel Macron as president of France, there is now momentum in Europe for reform in a direction that will improve the confidence of Chinese investors in the eurozone.

Second, for Europe to deal with Brexit. It is in nobody's interests – least of all Chinese investors – for the UK to leave the EU amid a climate of disorder and bitterness. The discussion between the EU and the UK is complicated, but at the end of the day, the interest of both parties is to find a satisfactory agreement.

To demonstrate its commitment to China, the EU must go further in welcoming Chinese investors. The '16+1' co-operation platform was established in 2012 between China and eastern European countries to foster investment and trade as well as cultural collaboration. Eleven EU countries are involved in China's Belt and Road Initiative, and China has founded infrastructure projects that are useful in fostering the EU's economic development. We need to keep up with these initiatives. The European Investment Bank and the Silk Road Fund signed the memorandum of understanding for strategic co-operation to support the equity of finance across Europe, and it bodes well that the European Investment Bank is also bringing financial support for climate investment across eight Chinese provinces.

Have faith in the development of exchanges between Europe and China. Clearly, both parties understand what is at stake and are moving in the right direction. This is good news, as this is a pillar upon which we will build security and prosperity, not only for the EU and China but for the world at large.

Stage management – The long-term goals of China's reform and 'opening-up'

Planned, goal-oriented development inspires China's population to look at the big picture and work together towards prosperity and power, writes *Chen Bingcai*, professor at the Chinese Academy of Governance

China's long-term national goal

At the 19th National Congress of the Communist Party of China (CPC), President Xi Jinping set the target of building a moderately well-off society in all aspects by 2020. In the next stage – between 2020 and 2035 – he said that China will "realise socialist modernisation", and from 2035 to the middle of the century, China will develop into "a prosperous, powerful, democratic, harmonious and beautiful socialist modern country".

Formulating the national strategic goal for long-term development is an important spur to the CPC's governing the country and development of the economy, and has been an important practical factor in China's continuing success since reform began.

Strategic objectives for long-term development

China's strategic goal of long-term development has often been modified in reaction to changes in the international or domestic situation. At its founding, the CPC drew up a Constitution that worked towards the grand ideal of communism, seeking welfare for the population and national rejuvenation. During the Chinese Civil War, the goal of the CPC was to liberate China and establish a new socialist democracy under a 'people's democratic dictatorship'. Soon after the founding of communist China, the CPC proposed the objective of building a socialist power with modern agriculture, industry, national defence, and science and technology.

In 1984, paramount leader Deng Xiaoping proposed that increasing China's per capita income to US$800 by the end of the 20th century would make living standards 'comfortable'. But now China is striving to enter the higher echelon of developed countries within the next 30 to 50 years. In 1997, the 15th CPC National Congress announced two centenary goals: achieving a moderately prosperous society in all aspects by 2021, the 100th anniversary of the CPC; and building a socialist modern country that is prosperous, democratic, culturally advanced and harmonious by 2049, when the People's Republic of China celebrates its 100th anniversary.

The 19th CPC National Congress, in proposing its two-stage national development plan from 2020 to 2050, also enriched the implication of the two centenary goals by adding "beautiful" to the original text and replacing the term "modern country" with "modern and powerful country".

Since reform and 'opening-up', the CPC still advocates grand ideals and long-term goals, giving China a firm and unwavering direction of governance and the development of the economy. In this way, political leaders are well positioned to remain true to the CPC's original aspirations and keep their mission firmly in mind.

Implementing long-term strategic goals

Formulating national long-term development goals is of important historical value and beneficial to development for the following reasons:

1. **Setting long-term goals will help grasp future trends and guide future development.** Establishing a long-term goal early in the process furthers its development later on, and supporting systems and policies serve to stabilise institutional designs and policy formulation. Long-term goals are also an essential basis for system design and policy formulation and adjustment. In accordance with achieving a moderately prosperous society and increasing the gross national product (GNP), system design and policy formulation aim to build a market economy through reform and opening-up. The policies of ministries, industries and local governments should also consider the long-term goal during the process of policymaking. System design and policymaking in powerful capitalist countries always prioritise private ownership, maximum profit, the free market economy and openness, while giving less consideration to social equity. In China, however, system design and policymaking are rooted in the long-term goals of taking care of the interests of all sectors of society. For example, China's reform began in rural areas, as a response to low-income, mobilised individuals' initiative for a better harvest – clearly an issue of paramount concern in terms of human survival and the stability of Chinese society.

   If China is to build a moderately well-off society by 2020, it must address poverty through a detailed policy of poverty elimination and alleviation that will maintain the long-term stability of the country. System design and policymaking in other nations serve different goals and operate within different institutional frameworks, so resorting to conventional Western economic theories to analyse China's economy and its trends, or even judging China's economic trends based on private ownership and free market economic systems, is likely to draw unrealistic conclusions.

2. **Long-term goals serve to achieve public consensus and ensure that all of society works towards shared objectives and in concert.** China is a large country with many significant variations in landscape, culture and practices between different provinces and cities. This presents governance challenges. A long-term goal is helpful in clarifying solutions to current social contradictions and problems resting on development; there is a need to look at the big picture, rather than just tinkering with regional benefit distribution and structure adjustments. In the first stage of reform and opening-up, China teetered on the brink of collapse, with division, poverty and regression rife because of a lack of consensus on national development. In the aftermath of this crisis, a long-term goal was formulated that linked the interests of individuals and enterprises to the country as a whole. In this way, local governments, enterprises and individuals were mobilised to jointly develop the economy. As a result, China achieved a stronger economy, improved livelihoods for its population and greater competitiveness.

Moreover, during the process of reform and opening-up, China was challenged by conflicts of interest between stakeholders and social unrest. The solution to these struggles was to focus on the goal – unswervingly safeguarding political and social stability while continuing reform and opening-up by focusing on boosting the economy. These tactics remain in place today.

In the process of opening-up, China faced criticism from the international community, including objections to its political and economic system and its social values. China has always adhered to established objectives, systems and policies, and remains committed to the CPC's leadership, socialism with Chinese characteristics, reform and opening-up, and the continuous improvement of social welfare provisions such as pensions, medical care and public services so that people can share the fruits of development and enjoy a sense of benefit and happiness. The experience of the past 40 years of reform and opening-up has proved that China's political system works, through a wide range of channels rather than a single route. The key lies in looking for a political and economic system and policies that comply with China's historical, cultural, national and social context.

3. **Safeguarding the long-term goal through a phased, step-by-step approach.** Long-term goals require patience – they must be implemented in stages with specific agendas, timetables and adjustment tables on institutional and policy design. To ensure the effective implementation of long-term goals, the Chinese government has formulated Five- and 10-Year Plans for development. Ministries, local governments and enterprises will follow suit and introduce projects, companies, funding arrangements and policy designs. Annual plans, action measures and policies will be carried out in addition to the Five-Year Plan – since the period of reform and opening-up in 1978, China has implemented eight Five-Year Plans and almost 40 annual plans.

To all intents, the long-term goal set by the Chinese government has been achieved. Deng's desire was realised early in 1997, and the economic indicators of each Five-Year Plan have also been reached ahead of schedule. Compared with 1997, the Chinese economy of 2017 underwent tremendous changes, with its competitiveness rising, along with its position in the international community and its population's living standards – GNP per capita has reached US$8,000. Previously, the Chinese may have worshipped the products of developed countries, but today Chinese exports flood into foreign countries.

Establishing objectives has been crucial to the success of the Chinese economy – at ministry and local government level – as has the co-ordinated staging of a concrete plan of objective-led actions. Success has also come as a result of the formulation of long-term goals and the far-reaching and all-round thinking and arguments around combining the deficiencies of Chinese long-term development with the wisdom of domestic and foreign experts and personnel from different divisions.

Over the past 40 years of reform and opening-up, China has developed into a prosperous country. In the next 30 years or so, China must build itself into a great power with strong, comprehensive capabilities. This requires a more comprehensive system of policy design and adjustments. In an era spanning independence to prosperity, the policy is, as Deng said, to let some become wealthy first, then achieve common prosperity with an emphasis on rapid growth, active participation and advancing economic globalisation. In the years ahead, as China becomes stronger, it aims to achieve prosperity for all. Economic development should translate from high-speed growth to high-quality development, with an emphasis on the population's demand for a better life and the building of a shared community – a community with a shared vision for the future of mankind. Once the long-term goal and requirements are calibrated, the specific system and policy design will also need to be changed. China, therefore, will continue to implement reform and opening-up and introduce systems and policies to meet the needs of future development.

In conclusion, the success of China's reform and opening-up over the past 40 years can be attributed to the establishment of long-term goals, including annual plans and the Five-Year Plans for development, as well as the systems and policies that serve the goal. ■

Establishing objectives has been crucial to the success of the Chinese economy – at ministry and local government level

After the Congress – A new direction for China

Qiu Xiaohua, chief economist at Minsheng Securities, lays out his multipoint plan for a resurgent China and the dividends that reform, internationalisation and a mixed economy will bring to the country and the global community

Following the 19th National Congress of the Communist Party of China (CPC), a question has arisen: where is the Chinese economy heading?

First, the Chinese economy will serve the Chinese Dream. This comprises two goals for the next century and a three-step blueprint programme that aims to rejuvenate China. The ultimate goal is one of national development, ensuring the future stability and strength of China's economy.

Second, the Chinese economy will part from the traditional mode of development and move to a new stage. Domestically, China will shift its priority in manufacturing from quantity to quality. Industrial systems will be reconstructed to enhance the global competitiveness of China's industries by focusing on the Made in China 2025 and Internet Plus policies. Internationally, the Chinese economy will be upgraded from version 1.0 to version 2.0 through steady internationalisation of the renminbi and the implementation of the Belt and Road Initiative (BRI). China as a major power hopes to present to the world a responsible image and create a new international environment for its peaceful rise.

Third, free-trade areas are the focus of institutional reform that will provide a fair and level playing field for foreign and domestic enterprise, as well as state-owned and private sectors. In terms of market management, it will shift from positive- to negative-list management, which will meet the demands of international rules and provide an institutional guarantee for better integration of the Chinese and foreign economies. In addition to institutional adjustment, China will develop a number of new international investment and financing platforms with Chinese characteristics – including the Asia Infrastructure Investment Bank, the Silk Road Fund and the New Development Bank – to encourage Chinese enterprise to 'Go Out' while introducing foreign enterprise to the Chinese market. As part of its foreign policy, it will help countries and regions along the BRI carry out infrastructure and industrial system construction that will contribute to socioeconomic development.

A dynamic shift

There will be several distinctive features of China's foreign trade:

- A shift from a trade-oriented model to one that gives equal importance to both trade and investment. China has entered a new stage that prioritises the export of commodities and capital over the export of commodities alone.

Qiu Xiaohua

- A move from a 'bringing in' model to one that embraces both bringing in and 'Going Out'.
- Acting not only as a follower of international trade and investment rules but also as a participator and rule-maker. China's foreign trade will discard its old model and move to a new development platform.
- Complying with three new trends to realise the Chinese economy's new development:

1. **The trend of transnational management** – China will vigorously develop and expand multinational corporations to enhance the competitiveness of its international operations.

2. **Push for the integration of different fields** – China will develop new cross-border channels through connecting mobile internet, intelligence and ecosystems to achieve more co-ordinated and harmonious resource allocation.

3. **The adjustment to the new Chinese political economy's characteristics and accomplishment of cross-ownership development** – to this end, it will be seen that state-owned enterprises in the future will play a major role in traditional industries, including steel, coal and non-ferrous building materials. This will help industry structures become more

The 19th CPC National Congress

concentrated. In the new economy and industries, new forms of ownership distinguished by market orientation, and new business forms, models and mechanisms will become dominant. In this respect, the private sector will serve as the backbone of the mixed-ownership economy.

- Constantly improving the Chinese economy's unfavourable situations by identifying and accumulating new dividends, which will come from four directions: demographics, comprehensive institutional reform, continuing and reinforcing the 'opening-up' policy and innovation.

1. **Dividends of demographics** – it will support an innovative economy by providing a better and more effective leverage of human capital.

2. **Dividends of comprehensive institutional reform** – political, economic, social, cultural and ecological reforms could offer new institutional dividends to propel the development of the Chinese economy.

3. **Dividends brought by continuing and reinforcing the opening-up policy** – China will be given more room to manoeuvre in resources, markets, capital, technology and management through global resource allocation, global production and global marketing.

4. **Dividends of innovation** – China aims to achieve innovative development through various sectors, including institutions, mechanisms, business models and technologies. New dividends are intended to transform China's development model from high-speed to high-quality growth and from unbalanced to balanced development. It will move from a predominantly factor-driven approach to an innovation-driven one, from industry-dominated development to new co-ordinated synergetic development of industry, agriculture and the services sector.

- Maintaining the Chinese economy's commitment to five new concepts of development – innovative, co-ordinated, green, open and shared development. This is China's direction and will become the basic requirement for Chinese enterprises and investors to follow. It can be expected that, following the 19th CPC National Congress, these concepts will deliver fruitful outcomes and write new chapters for the Chinese economy if they can be facilitated and implemented.

Judging China's present economic development, its economy is now seeing an end to the downward period endured since 2010, and is shifting to a more stable and quality-prioritised phase that focuses on optimising structure. It is a new stage of social development that prioritises the pursuit of a better life and a fair and just society. ■

Foreign direct investment – Supporting China's leapfrog development

Wang Xiaohong, deputy minister of information at the China International Economic and Exchange Centre, believes that foreign direct investment has been integral to China's development, allowing it to become a major trading power and promote independent innovation and technological progress

Litchi Park Bridge, Shenzhen Special Economic Zone

Foreign direct investment (FDI) is a fundamental national policy critical to China's 'opening-up' and boosting the open economy. Since the start of the period of reform and the introduction of the policy of opening-up, China has persisted in making active use of foreign capital, constantly innovating its foreign investment policy and management system. It has optimised the foreign investment environment and has become a leading country in terms of absorbing foreign investment. By 2016, 864,000 foreign-invested enterprises (FIEs) had been set up, with FDI amounting to US$1.77 trillion. In practice, FDI has been proven to be the best way to effectively combine the elements of global production, service and innovation, promote upgrading of the industrial structure and achieve economic 'leapfrog' development. Although the number of FIEs in China accounts for fewer than 3% of all businesses, their import and export quantities account for about one-half of the total. With the profits of industrial enterprises – above state-designated scale – making up around one-quarter of the total, their tax revenue one-fifth and their employment opportunities around one-tenth, it is clear that FIEs are now a vital part of China's economy.

FDI in China – Four main stages

Stage one – 1978–1991

During this period, in order to solve the 'dual gap' of capital and foreign exchange, China took the first step of introducing foreign capital. In addition to using foreign loans, the government protected the rights and interests of foreign investors, and attracted FDI through exemptions from import duties, export tax rebates, the implementation of preferential policies on tax relief, and tax exemptions for foreign-funded enterprises. In the early 1980s, special economic zones were set up in Shenzhen, Xiamen and Hainan, among others, taking the lead in opening up exploration. Between 1979 and 1982, 920 FIEs were established, and foreign investment totalled US$1.769 billion. From 1983 to 1991, the number of FIEs rose to 12,978, and FDI increased to US$4.366 billion. In this period, most FDI introduced was small and medium-sized investment, and processing trade enterprises from Hong Kong and Taiwan. But it laid a solid policy foundation for attracting large-scale investments to the manufacturing industries of multinational corporations.

Stage two – 1992–2000

This period for FDI was one of rapid growth. In November 1993, at the Third Plenary Session of the 14th Central Committee of the Communist Party of China (CCCPC), the *Decision of the CCCPC on some issues concerning the establishment of a socialist market economic structure* was published, and proposed to "improve the investment environment and management measures, expand the scale of foreign investment, extend FDI to more fields and deepen the opening-up of the domestic market", and "fully develop the comparative advantages of our country's resources and markets, attract foreign funds and technologies, and promote economic development". The implementation of the 'market-for-technology' strategy was implemented and aimed to boost the technological innovation and management of domestic enterprises.

In 1992, 48,764 FIEs had FDI of US$11.08 billion. In 2000, the manufacturing industry absorbed 64% of total foreign investment. Large-scale FDI effectively alleviated the capital bottleneck in China's development. The average amount of foreign investment in China at this time accounted for around 12% of the annual total national investment in fixed assets. The manufacturing structure was constantly upgraded: labour-intensive industries such as textile and home appliances maintained their advantages, but capital-intensive industries such as the automobile, equipment, electronic information, machinery and chemical industries also rapidly developed. From 2000 to 2004, more than 100 projects – in electronics, automobiles and household appliances – received foreign investment from 30 multinational German and Japanese corporations. The remainder of investment flowed into four major industries: communications equipment, machinery, electrical appliances and chemicals.

Stage three – 2001–2011

During this period, FDI entered the stage of structural readjustment and comprehensive development. China joined the World Trade Organization, and a new round of international industrial transfer dominated by multinational corporations in the service industry commenced. The combined effect was to expand China's utilisation of foreign capital structure from the manufacturing industry to the service industry.

In 2002, 34,171 FIEs were established in China, with FDI of US$52.743 billion. One hundred service trade sectors – including banking, insurance, securities, telecoms and distribution – opened to foreign investors, accounting for 62.5% of the total service industry. This influx of foreign capital continuously promoted domestic financial services, logistics, commerce and trade, software and IT services, as well as services such as research and development (R&D), design and professional consulting expanded rapidly. By 2010, 27,406 FIEs had been set up, and FDI broke through the US$100-billion mark for the first time. Another first was that the proportion of the service industry's utilisation of FDI exceeded that of manufacturing, making it the industry with the largest foreign funding in 2011. During this period, the proportion of FIEs in the export of high-tech products increased from 80% in 2001 to 84.5% in 2009. Foreign-owned enterprises accounted for 68.6% of China's high-tech exports in 2006, and played an important role in their export.

Stage four – 2012 onwards

Since 2012, FDI in China has entered a new phase of transformation – from emphasising rapid growth to high-quality development. In 2013, the inflow of FDI to China was the second-highest in the world at US$123.9 billion. In 2016, China's service industry consumed 70% of its total foreign investment. IT, integrated technical services, construction and finance have become the most attractive areas for foreign investment. FDI in high-end service industries such as multinational headquarters, R&D and logistics centres and clearing houses is increasing; no longer are essential productive factors and preferential policies needed to entice this investment.

The focus of attracting foreign investment has gradually shifted from adopting the scale of funds to introducing high-end elements of technology, knowledge, personnel, management and service. In the past five years, the quality of foreign investment in China has been continuously improving and the structure continuously optimised, playing an active role in promoting the development of new industries, new formats and new models. In 2017, the absorption of foreign capital in high-tech industries increased by 61.7%, up 9.5 percentage points from the previous year, accounting for 28.6% of the market. Foreign capital use in high-tech manufacturing and service sectors was CNY66.59 billion and CNY184.65 billion, respectively, an increase of 11.3% and 93.2% compared with the same period in 2016.

Industrial development goals and foreign investment

Since 1995, China has continually refined the *Catalogue of industries for guiding foreign investment* according to national industrial development goals by placing foreign investment projects into four categories: encouraging, permitting, restricting and prohibiting. In 2017, the revised *Catalogue* and the *Measures for the administration of foreign investment admission in free-trade zones* – known as the 'Negative List' – was reduced by 30 and 27 restrictive measures, respectively.

This continual adjustment and improvement of foreign investment policies has been integral to China's economic development in five ways:

1. **Advancing China towards becoming a global trading power.** At the beginning of the period of reform and the introduction of the policy of opening-up, the processing trade model – driven by foreign capital – became dominant. At this stage, processing trade was characterised by the '3+1' trading scheme: '3' refers to the types of processing supplied by foreign enterprises – materials, designs or samples – and '1' refers to compensation trade. Its production process was also situated abroad – both raw materials and the market destination of the final product market were overseas. This not only solved the dual-gap problem of capital and foreign exchange, but also laid a foundation for the major trading nations and foreign exchange reserve. In 1987, the import and export of FIEs accounted for only about 5% of the country's total. After 1995, it exceeded 39%; in 2005 it reached its apogee at greater than 64%. In 2016, FIEs constituted 46% of the country's total imports and exports.

2. **Transforming China from an agricultural power to an industrialised and service power.** China has accomplished rapid industrialisation and urbanisation by undertaking the manufacturing industry transfer of multinational corporations to become the world's leading manufacturer. By introducing new types of industries such as foreign retail chains and supermarkets, the revolution in the distribution industry has been sparked, and traditional formats such as department stores have metamorphosed into new ones.

   Since the turn of the century, with the finessing of R&D, software and IT, and supply-chain management of multinational corporations, service industries such as consulting and finance have continued to flow into China, enhancing international competitiveness by boosting the overall level of the domestic service industry and the growth of emerging service industries.

3. **Cultivating a large, experienced and skilled labour force.** Multinational corporations have made extensive use of professionally trained domestic senior management and technical personnel. In 2008, more than 70% of Motorola's management in China was Chinese, nearly 80% of managers were locals, and the number of Chinese employees reached 14,000. Many people with experience working for multinational companies started business ventures of their own afterwards, including former executives, technicians, researchers, designers and developers from Volkswagen, General Motors, Microsoft and IBM. Some rural migrant workers were inspired by their experience in the processing trade and returned to their hometowns to start up their own businesses.

> *FDI in China has entered a new phase of transformation – from emphasising rapid growth to high-quality development*

4. **Promoting independent innovation and technological progress.** The number of Chinese enterprises owning independent intellectual property rights and their own brands is growing, and their technological innovation capabilities have attained an international level of advancement. Increasing numbers of multinational corporations are establishing R&D centres in China – in 2017 more than 300 of these centres for foreign capital were set up. FDI has been an important bridge to introducing technology since reform and opening-up. For example, in 2001, China signed a total of US$9.09 billion in technology import contracts, of which US$4.95 billion was technical fees, accounting for 48.3% of the total contract value. In 2013, China signed US$43.36 billion of contracts for technology imports, almost 10 times greater than in 2001. The technical cost was US$41.09 billion, or 94.8% of the total contract amount.

5. **Foreign investment policies promoting the construction of a number of open platforms.** These platforms – in China's economic and technological development zones (ETZs), high-tech zones (HTZs) and pilot free-trade zones (FTZs) – serve not only to attract foreign investment, but to encourage technological innovation and pioneering institutional innovations to help create an open economy. Currently, China has 219 state-level ETZs, 156 HTZs and 16 border economic co-operation zones. Following the establishment of the FTZ in Shanghai, seven FTZs such as Liaoning and three pilot FTZs in Guangdong, Tianjin and Fujian were set up to form a '1+3+7' development pattern covering the eastern, central and western regions. Between January and September 2017, the gross output value of industrial output and the total volume of imports and exports – above state-designated scale – in the state's economic open area increased by 7.7% and 16.7%, respectively, than the same period in 2016, forming more than 20 'billion-plus-billion' industrial clusters. ■

POST-FINANCIAL CRISIS – A DECADE ON

Ripple effect – The profound impact of the global financial crisis

Sun Shilian, researcher at the Xinhua News Agency World Research Centre, and *Zhang Jiaming*, School of Economics, Nankai University, explain why global financial governance is not as easy as it looks. They also discuss strengthening national regulation and how it will prevent the regression of globalisation, ensuring steady and healthy economic development

The world economy – Recovery and financial risks

The global financial crisis that broke out in 2007–2008 impacted on the major world economies in various ways. Economic growth remained sluggish for 10 years but is finally improving, with the US economy now performing strongly, the eurozone picking up and China entering a 'new normal' in which supply-side structural reform has been smoothly introduced. However, uncertainties still exist, and the current world economy exhibits a mixture of recovery and remaining financial risk.

The driving force of the world economy in the post-crisis era

The Group of 20's role in the recovery has been of utmost importance. Countries have enforced a series of regulatory reforms, such as strengthening financial supervision, building global regulations and bilateral financial safety nets. Co-chairman of the International Finance Forum (IFF), president of the 56th United Nations General Assembly and former prime minister of the Republic of Korea, Han Seung-soo, highlights that Asia and China have been an engine of the global economy during this uncertain period. The International Monetary Fund (IMF) predicted that Asia would make up 63% of global growth in 2017, with China contributing around half of that.

China's role in global economic growth in the post-crisis era has also been recognised by Chinese scholars. Shen Jianguang, chief economist of Mizuho Securities Asia, has discussed the corner-overtaking industries and the rapid rise of China's exports over the past 10 years to the top of the global marketplace – particularly in low- and medium-to-high-end exports to the US. China also ranks top in exports of high-speed trains, industrial robots and new energy vehicles. China's independent exploration of economic development has achieved great success; Shen believes that China's strengthening has altered the world economy as well as trade patterns, which provides a solid foundation for global economic governance reform.

Potential risks still exist in the current world economy

When it comes to the current global economy and finance, there is consensus among government officials, scholars and entrepreneurs in various countries that the world economy is still prone to potential risks. Zhu Xian, vice-president of the New Development Bank, founded by the Brics (Brazil, Russia, India, China and South Africa) co-operation mechanism, argues that, although the world economy is gradually recovering, overall the economic environment is still sluggish. Edmond Alphandéry, IFF vice-chairman, chairman of the Euro 50 Group and former finance minister of France, believes that, even though we are witnessing an economic up-trend, we still need to be aware of the possibility of similar risks, since the current world economic climate is unbalanced and we are not completely out of danger. Alphandéry also believes, despite encouraging signs – such as low interest rates, low oil prices, abundant liquidity, rising financial asset prices and a universal sense of improved wealth – an unsustainable current monetary policy could lead to future problems. It is inevitable that the world financial market will undergo adjustment, for many countries have accumulated large debts, either public or private, and the geopolitical environment also remains unstable.

The possibility of future crisis looms large. Shen indicates that the GDP of the major economies has increased, as shown by the rise of asset prices and the prosperity of capital markets. However, populism and anti-globalisation are intertwined with this situation. Shen explains that central banks' quantitative easing (QE) policy has resulted in skyrocketing asset prices and the mismatching of the real economy and labour force, which have led to a widening gap between rich and poor – and thus populism.

Whether a developed or developing country, neither can ignore certain risks. Alphandéry believes that major economies in Europe and the US all face potential dangers. For example, the monetary policy implemented by the US Federal Reserve Board may have performed well in the past, but an increasing number of commentators believe that current monetary policy is unsustainable, since a swelling market bubble could pop at any time. In the eurozone, QE has forced the European Central Bank to purchase government bonds, obscuring the fragmentation of financial markets in eurozone member countries. Marsha Vande Berg, former chief executive officer of the Pacific Pension Institute, notes that changes in the regulatory environment in the US have brought new challenges to the global financial system, and will influence driving forces in the ensuing five to seven years. She also notes the uncertainties in global politics: the US is cutting taxes for enterprises, increasing the quality of enterprise assets, as well as enhancing business confidence and global trade.

Activity among investors is increasing, and financial stability seems to be solidifying. However, many policy uncertainties still exist; for example, the advent of both populism and nationalism, and the shift from multilateralism to unilateralism. The global political environment has become interesting since the financial crisis; Vande Berg analysed the impact of the previous US presidential election, noting a series of new regulations in monetary policy and banks that may trigger challenges to the world market.

In the case of China, experts and scholars have, from different perspectives, emphasised the importance of preventing financial risks. Shen insists that preventing financial risks was an urgent task and the Chinese government's deleveraging was also crucial. He emphasised China should be concerned about the rapid increase of money multipliers. Broadly, money has skyrocketed in the past 10 years, yet this brings financial risks. At the same time, China faces challenges in real estate bubbles, credit and debt. Wan Zhe, chief economist at the International Cooperation Center of National Development and Reform Commission, declared that a major complication of the Chinese economy was its apparent trend of virtualisation. Wan said that, from the 18th to the 19th National Congress of the Communist Party of China (CPC), society has agreed the notion that finance must provide support for the real economy. The report of the 19th CPC National Congress proposed eight major reforms and a deepening of financial reform, establishing China's prime mission as one of avoiding systemic financial risk, to prevent a 'black swan' or a 'grey rhino'.

Lessons from the financial crisis – Strengthening regulation and adherence to national reality

Experts have attempted to summarise the empirical principles concerning economic crisis. Wan Zhe notes that, in retrospect, the Federal Reserve has always shifted from QE or increasing the money supply to reduce the effects of austerity before economic crises and, after the outbreak of such crises, a large amount of international capital flows out of crisis-hit countries. In addition, experts have analysed the profound impacts of this financial crisis. Zhu Xian concludes that the financial crisis of 10 years ago brought about not only cyclical but structural impacts. Economic, political and social reform was rarely effective and, with no economic structural reforms in place, negative effects might appear in middle- or long-term growth. Zhu also believes that unequal redistribution around the world could result in globalisation going into reverse.

Policymakers have all drawn lessons from the financial crisis in 2008, and improved regulatory frameworks to various degrees. Zhou Yanli, IFF vice-chairman and former vice-chairman of the China Insurance Regulatory Commission, insists that preventing and resolving financial risks are important elements of ensuring steady and healthy economic development and suggests three distinct routes. First, strengthening the regulation of the financial market and maintaining its stability is the most realistic, concrete and essential requirement. Financial risk is elusive and complex; a lack of control over it will seriously affect the stability of the financial market.

Second, financial supervision should play the important role of promoting economic development. Finance should support the real economy so that financial structure can be optimised and financial reform reinforced.

Third, attention must be paid to financial risks during the operation process, such as blindly pursuing speed or failing to enforce the regulatory system.

Loopholes in the regulatory system should be closed, regulatory improvement sped up, messes in the financial markets cleaned up and the financial industry developed steadily and healthily.

These are not the only lessons learned from the financial crisis – developing countries have also formulated a series of responses to similar crises. Shaukat Aziz, IFF co-chairman and former finance minister and prime minister of Pakistan, has told how the country adhered to the national reality and thus chose the most suitable route for economic development. In 1999, Pakistan's economy was on the brink of collapse. Aziz, entrusted with the country's future at that critical moment, found the strings attached to IMF aid difficult for Pakistan to bear, and not compliant with the national reality. Pakistan rejected the IMF's overtures and carried out its own reforms in industry and employment. Aziz stressed that, most importantly, a country should not seek economic dependency on another country or international organisation, but develop its own unique way to evade disorder and improve its economic structure through adopting a new ethos. Aziz also identified that, in comparison with developed countries, developing countries enjoy greater flexibility. Deregulation, privatisation and liberalisation are the watchwords of Pakistani reform. Important measures also include establishing competition strategies for privatisation, open markets, capital flow and foreign currency.

Fintech innovation – A double-edged sword

Fintech innovation, led by blockchain technology, has gained huge momentum, but such technology-based financial innovation remains a mystery to most. At the 2017 IFF Annual Conference, fintech experts and scholars conducted in-depth and enlightening discussions on this subject.

Technological revolution can bring about change in the financial system, and decentralisation may be the first feature of that change. Professor Cao Heping, vice-president of the Institute of Digital China at Peking University, believes that networking technologies have already upgraded the new economy and reinvented the regulatory relationship between central banks, commercial banks and banking financial institutions, and the new economy. In this sense, networking technology is the ultimate weapon, capable of weakening the position of the central bank and the traditional clearing system. Professor Cao asserts that successful blockchain technology can lead to the rebuilding of top-level accounts in the central bank, as well as new technological methods for settlement and payment systems, and possibly the future phenomenon of 'de-central banking'.

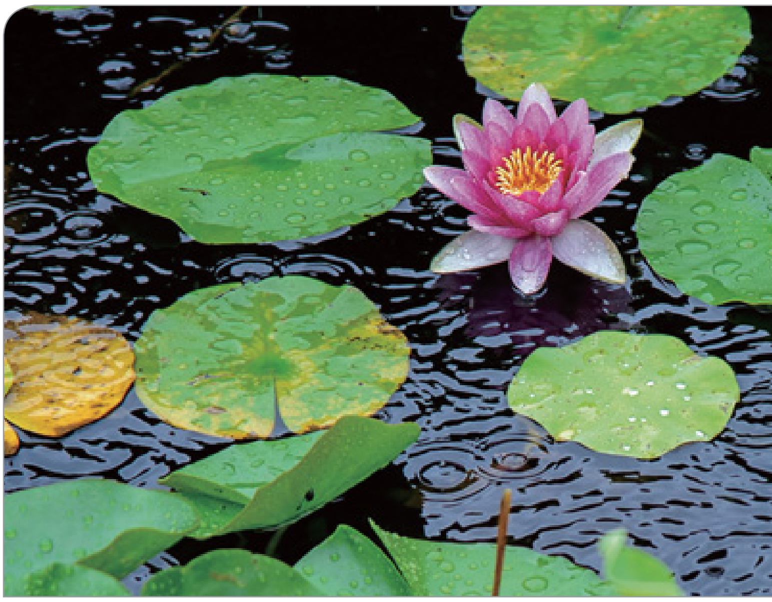
Experts and financial scholars have welcomed the positive potential of fintech innovation. Ye Yanfei, inspector of the China Banking Regulatory Commission, says that fintech can aid risk identification, management, mitigation and solution. He cites examples in the Chinese banking industry to explain the role of big data and the internet in connecting society, consumption scenarios and personal credit, and the more accurate, economical and accessible targeting of users. Technologies such as the internet, big data and artificial intelligence (AI) can enable better data analysis and personal credit rating, for example, in risk management and mitigation. When carrying out supply-chain financing, blockchain technology requires all parties involved to be registered, and classified accounts. This requirement has greatly constrained the authenticity of trade and validity of contracts, which can be of huge assistance to risk management and mitigation.

IT experts also praise the blossoming of fintech innovation. Yan Weining, managing director of Asian Pacific Net-Space Port Limited, introduced the internet protocol version 9 (IPv9) application – an alternative naming system – and is confident it will be applied in the global financial system. IPv9, with larger storage capacity and safety insurance, has advantages over IPv6 and IPv4 as it supports the spatial anchor of assets and ensures address encryption in digital currency transactions. Wei Qing, chief technology officer of Microsoft China, believes digitalisation can greatly increase efficiency – the most important feature. Efficiency improvement is equivalent to cost reduction, and can be increased as the world effectively becomes digitalised – software can define a universal measure to regulate the financial industry and increase efficiency.

Some experts incisively identify the new challenges emerging in fintech innovation. Shahmeem Ahsan, chairman of eGeneration Group, emphasises the threat of cyber attacks against financial, national defence and security systems, and the inevitable challenges to the security of information. Ben Shenglin, director of the International Monetary Institute of Renmin University of China and a member of the IFF Academy, sees three fintech challenges, and interdisciplinary and intellectual problems confronted by China in terms of financial regulation. The first challenge is that financial regulation may lag behind the development of the market. Second, some regulatory measures in Chinese fintech are inferior to advanced international practices. Third, the supervision of Chinese financial giants, and the measures to give full rein to these companies to serve both national and consumer interests, will prove difficult.

Technology, finance and fintech must be people-centred. Wei Qing recommends avoiding technological obsession about innovation; otherwise, though technology is more advanced, it cannot serve the people properly. Technologies such as AI and big data are merely mathematics or engineering tools. Wei asserts that it only takes a handful of people to create and develop these technologies for the convenience of all of society. Therefore, whoever can take advantage of these tools can seize the opportunity of this industrial revolution.

Fintech is gaining momentum, and China already ranks among the top countries in global fintech market size and depth of innovation. Li Dongrong, president of the National Internet Finance Association of China and former deputy governor of the People's

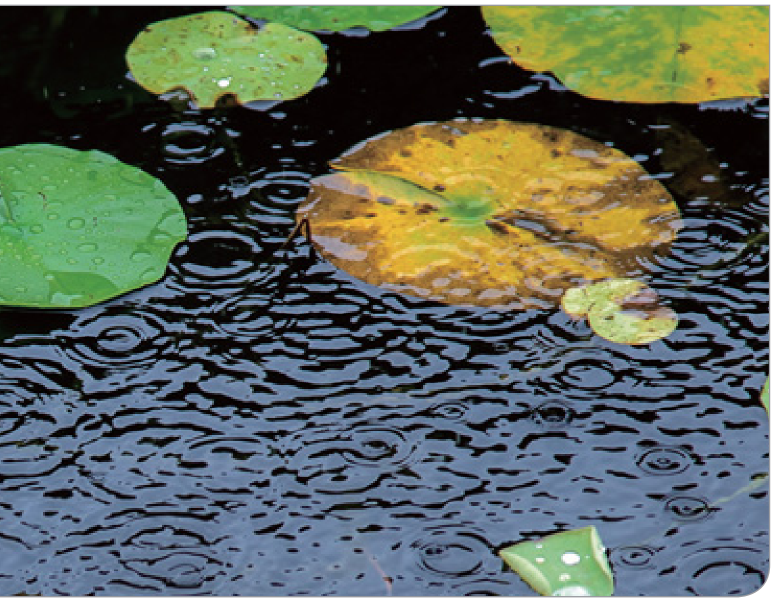


Bank of China, says that China needs to broaden its horizons and draw lessons from other countries in the experience of developing fintech. Equally, it should be practical and take a Chinese stance, fully considering China's market reality, institutions and regulations. Only in this way can it devise a fintech system with Chinese characteristics in line with the requirements of the information era, and make unique contributions to global fintech. Li also emphasises the importance of fintech's ability to carry out steady and active innovation by promoting efficiency at the level of the real economy and protecting consumer rights. Excessive innovation not based on reality and going beyond risk management's capabilities should be avoided, as should innovations that do not comply with laws and are separated from the requirements of the real economy. In addition, Li uses examples of personal experience in finance regulation to put forward the following four suggestions: pay attention to value guidance and innovation, lay emphasis on technological and institutional innovation, balance financial innovation and risk management, and co-ordinate administrative regulation and self-discipline of the industry.

Global financial governance in the post-crisis era – The role of developing countries

Consensus has been reached over joint efforts in global economic development and financial stability. Marsha Vande Berg believes that, in an effort to stabilise, the future global economy will become increasingly integrated. Countries should tackle issues from an overall perspective and promote policy and regulatory reforms to form a more stable economic system. Edmond Alphandéry posits that, in addition to the internal reforms carried out by various countries, co-operation between regions and countries is of equal importance. Only co-operation can ameliorate global imbalances and future financial risks.

Developing countries should demand louder voices to achieve equal consultation. Ashfaque Hasan Khan, former finance minister of Pakistan and principal dean of the school of social sciences and humanities at the National University of Sciences and Technology, emphasises countries' increased disadvantage



in formulating regulations of global financial governance that do not match with their contributions. Developing countries' participation is conducive to strengthening the rationality of the global financial governance structure. Khan believes that dissatisfaction with globalisation lies in the decision-making process, since developed countries have played a dominant role that has resulted in unnecessary, heavy and unfair losses in emerging economies since the 2007–2008 financial crisis. Khan's opinion was applauded by Chinese experts; Zhu Xian, vice-president of the New Development Bank, also asserts that developing countries should have a louder voice and a broader platform within the global economic governance system. He explains that current major policymakers are Organisation for Economic Co-operation and Development countries headed by the US – self-interested when formulating rules, and often having double standards in implementation, so that the requirements of developing countries cannot be accurately heard. However, developing countries have not yet established a clear and practical plan to adjust the current economic governance system, with the exception of the Belt and Road Initiative (BRI). The BRI is not only an interconnected proposal to build infrastructure in countries along its route, but also an opportunity for enabling the greater assimilation of developing countries into the global economy.

More and more concerns are arising around China's role within global financial governance. Former Republic of Korea prime minister Han Seung-soo believes that, despite fragility and risk, Asia and China – particularly with China's resources in supporting economic development and buffering economic crises – are integral to the global economy. On the political front, China is also determined to implement a more balanced and more sustainable reform. In this sense, it proposes the following: first, inclusive growth, rather than focusing on short-term goals, should be prioritised. Second, solving the problems of the financial sector, such as risk, credit and co-ordinated supervision. Third, emphasising the quality of assets, especially foreign investment. Han says that the stability of the Chinese market is essential to many countries across the rest of the world.

Khan believes China's leading role in the global economy is in line with the sustainability of globalisation, and that China is taking proactive measures not just in the global financial system, but also in establishing new mechanisms and financing organisations. For example, on the one hand, globalisation of the renminbi has reduced the pressure of the US dollar on developing countries and, on the other, China's Asian Infrastructure Investment Bank supplements the shortages of the World Bank's and the Asian Development Bank's infrastructure investment.

Domestic representatives also express their views concerning China's role in global financial governance: Wang Jingwu, president of the People's Bank of China, Guangzhou branch, and Administrator of the Guangdong Branch Office, the State Administration of Foreign Exchange, states that China has made remarkable recent achievements in promoting reform and innovation of the global governance system. China is now an important driving force of international monetary system reform, a proponent of IMF structure reform and a leader in promoting global finance for sustainable development. With its entry into domestic construction in the the 'new era' of Chinese politics and power, China's participation in global governance has stepped onto a new stage. China has taken further steps in providing Chinese wisdom and methods in global financial governance. It should actively participate in the reform of world financial institutions and monetary systems, speeding up the globalisation of the renimnbi. China and other developing countries also need a louder voice for formulating international financial rules, and to take advantage of financial tools to promote inclusive and green development, as well as inclusive finance.

Participating in global financial governance must emphasise the management of systemic risk. Shen Shuguang, vice-president of the National Institute of Governance of Sun Yat-sen University, underlines the dangers of systemic risk in the global financial governance system and puts forward several suggestions, including that the global financial governance system pay more attention to systemic risks – rather than technological and operational risks – and that a large amount of systemic risks can be found in the structure and direction of financial systems. In this regard, Shen has three suggestions:

1. Finance should be redirected to focus on livelihood, go green, develop technology and be inclusive.

2. China, as well as emerging markets, should have a louder voice within the global financial governance system to fully realise and understand the new situation. The financial governance system is open and has multiple participants, and is a win-win situation with many beneficiaries. However, since the skyrocketing of economic growth and the financial volume of China, as well as other emerging markets, the current systems are no longer appropriate. One solution is to allow China and emerging markets more of an input.

3. The value of the insurance industry can also encourage further steps in its development. The insurance industry has played an important role in supporting and stabilising the financial system. We can draw lessons from the experience of the insurance industry and build on it to make a greater contribution to the future of the financial industry. ■

Own your crisis – Removing the bottleneck to reform

Shaukat Aziz, IFF co-chairman, and former prime minister and finance minister of Pakistan, recommends that developing countries deal with financial assistance from the International Monetary Fund rationally, adhere to their own agendas and take their destinies into their own hands

The greatest challenge I faced when taking on the position of Pakistan's minister of finance in 1999 – when the country had negative reserves – was dealing with the International Monetary Fund (IMF).

The IMF might employ many bright people, but it insists on a cookie-cutter approach, and they can't deviate from the line at all, which was very frustrating for somebody who grew up in the private sector. Very soon after our first dispute, the IMF left financing off the table. And not once, in any review – apart from its standardised approach – did the IMF discuss growth and reform. I advised the organisation: "Be careful of the deposit deficit. If we don't have growth, the whole thing will come falling down." We continued because we needed the money, and agreed to introduce the IMF's programme.

In parallel – and not directed by the IMF – we launched our own structural reform agenda to drive job creation and remove the bottleneck that exists in any developing country and impedes economic growth. The IMF staff were very bright, but many of them were naive, because they were victims of their own structure and cookie-cutter approach for every country.

What were Pakistan's problems then – and what did we want to do to solve them? Pakistan is a country of 200 million people with a low literacy rate. How do you explain to them what the government is trying to do? We vowed to do three things to fix this crisis. The three key words I gave to the public were 'liberalise, deregulate and privatise'. Most disappointing about the IMF was that the idea of 'reform' – structural reform – was never voiced in any discussion. I was trying to make the pie bigger so we could distribute more to the people and create economic growth, which would then take care of a lot of other problems. Unfortunately, the IMF was not interested in this.

Enlarging the pie

We started liberalising, deregulating and privatising anyway. We unleashed forces on the market and economy that had never existed before. Take, for example, the telephone company – the private sector came in to manage it and immediately introduced new technology. The banking system was entirely nationalised – within a year it had been privatised. As the procedure was open and transparent, there was not a single complaint that it had been given away to somebody's relatives, or anything similar. Encouraged by this, we started on other sectors. Privatisation was the biggest driver of growth in our recovery, proving that you should think outside the box and move away from a cookie-cutter approach. If developing countries were members of the Organisation for Economic Co-operation and Development (OECD), with those standards they would have limited flexibility. But developing nations have more options.

By the time Pakistan had completed its privatisation programme, GDP had doubled in five to six years. The pie had become larger, and the economic activity engine had created an incredible number of jobs. Spending was growing because income per capita was increasing. A mere few hundred million dollars per year in foreign investment had become billions; and the biggest attraction for foreign investors was the privatisation programme.

Shaukat Aziz

My advice, especially to developing countries, is that your own strategy to get out of economic distress will be the best. Do not turn to the IMF as a drowning man clutches at a straw. Consult them, talk to them, but keep your own agenda. We have seen that structural reform agendas can only be implemented and organised at a national level. Structural reform improvement is not only the preserve of emerging countries – developed nations need it even more because they are stuck in the past. Untangle where you are and try to think with fresh oxygen coursing through your system, oxygen provided by reforms to that system. When the OECD claims it does not need reform and tries to teach you what to do, this is the wrong approach. Every country needs reform. The day you think you don't need reform, you are in trouble.

People are objective in the long run, especially when the results start coming in. They can see that jobs have been created and that the person who once rode a bicycle now drives a motorcycle. The process took nearly five years. I witnessed the expansion twice in five years at Pakistan's Honda motorcycle plant – it doubled capacity and then doubled again. Suzuki came into the market as well. The inefficient state-owned Pakistan Telecommunication Corporation was sold in open auction. It was bought by a major company from the United Arab Emirates – now there are four or five operators.

Competition is the best way to reform and promote efficiency because it forces businesses to continue honing their 'edge'. Today, mobile networks cover the entire country, even in small villages. Life changes and so do economic activities. Pakistan's success was built on having its own strategy and convincing the IMF that, left alone, Pakistan would do the right thing, even if there were a political price. Without a strategy, the worst thing a country can do when intervention comes is to let others teach it what to do and simply apply that. If you apply it, you pay the price for it. But if you take charge and have an idea – right or wrong – you can argue with them about it. You might make mistakes, but you also have a road map that will take the country out of its situation.

A strategy for the future

Pakistan's strategy is to liberalise, privatise, deregulate, open the market, open capital flow and open up external accounts to bring in money. Pakistan is a developing country with 200 million citizens – which is a lot of people. We have the same challenges as other countries, except we approach them differently. The failure of the Bretton Woods Institutions was partly because they have a standardised approach with a one-sided view of every problem. Don't implement reform out of fear but out of ownership, and you will see the outcome.

Finally, take your destiny into your own hands – don't go to any institutions with a blank piece of paper and say: "I'm under your umbrella, please tell me what to do." Have your own views, argue and debate, all the while respecting the other side because they can give you a lot of good ideas. But, by all means, take ownership. ■

The world-growth engine – Asia's new role in the global economy

The recovery from the global financial crisis was driven by Asia, in particular China. Deeper integration of China into the world economy and further critical reform is essential to continuing that trend, explains *Han Seung-soo*, co-chair of the IFF and former prime minister of the Republic of Korea

The Bund Bull statue in Shanghai, a symbol of perseverance, diligence and wealth

Han Seung-soo

Finally, after almost a decade, there is good news: the world economy is in recovery. The International Monetary Fund (IMF) revised its forecast for annual economic growth in 2017 and 2018. The global upswing in economic activity reached 3.7% in 2017, and is forecast to reach 3.9% in 2018.

The global financial crisis that began in 2008 led world leaders to form the Group of 20 and seek major reforms of global financial institutions and regulations to ensure the financial system was able to absorb shocks while functioning efficiently. Soon after the onset of the crisis, the G20 played a crucial role in stabilising the situation. As a consequence, painful but important regulatory reforms came into play: the major world economic powers strengthened their own financial regulation and supervision, and introduced countercyclical and microprudential regulations. Disappointingly, the expected recovery was lacklustre – particularly in the most advanced countries – and lasted almost a decade.

In Europe and the US, this long period of low growth and unbalanced recovery was associated with the rise of political risk and anti-globalisation, such as the Brexit vote, which resulted in significant changes in major economies. Despite many challenges during this difficult period, Asia has remained a relatively bright spot and has contributed significantly to the recovery of the global economy. In a global environment of slow growth, Asia – with China in a leading role – emerged as a world economic growth engine; in 2016, Asia contributed 68% of all global growth. In 2017, the International Finance Forum projected that Asia would provide 63% of global growth, with China alone contributing nearly half of that. This has provided room for global economies to pursue difficult structural reforms. Regardless, it is difficult to deny that China's high growth and positive effects over the past decade have been the most important factors accelerating growth after the crisis.

The less rosy picture of Chinese leverage

However, the story of growth in Asia and China is not all a bed of roses – there are a number of repercussions. Many countries in Asia, including China, have used up part of their existing buffers and are exposing themselves to new vulnerabilities – particularly large debt and pension liabilities, both public and private. For instance, the credit-to-GDP ratio in China is very high by international standards. China's corporate debt has reached 165% of its GDP, and household debt has also risen rapidly. As a consequence, the probability of variable adjustment continues to increase.

This rapid rise of leverage in China is not a unique case – many emerging and low-income economy countries have also relied heavily on credit and budget expansion. Combined with the global financial crisis, this has resulted in significantly increased leverages. Added to these new vulnerabilities, rapid credit expansion and rising leverages are urgent and critical problems common in Asia, making it difficult to maintain a strong and sustainable momentum in growth.

In this regard, three important Chinese policies were outlined last October at the 19th National Party Congress of the Communist Party of China:

1. **Moving away from short-term growth targets**. Monetary and fixed policies aimed at supporting high growth have inevitably provided incentives to slow credit rises – particularly in local governments. It is time to emphasise inclusive growth, not high growth.

2. **Tackling risks in the financial sector through better co-ordinated regulation and supervision.** The establishment of a new regulatory body, the Financial Stability and Development Committee, is a welcome development.

3. **Paying particular attention to the quality of assets associated with China's large foreign investments.** In many cases, these investments make up a significant proportion of recipient countries' GDPs, and have considerably impacted their medium-term debt sustainability. As such, sustainability, profitability and viability of those projects should be well targeted and properly managed. The stability of China's financial markets must spread beyond its borders. As the Chinese economy has grown, it has become more integrated with the global economy both in trade and finance.

China is now in the top 10 of trading partners in more than 100 economies, accounting for almost 80% of global GDP. The greater integration of China into the global economy surely means that its performance can be either a blessing or a source of major risk for many countries worldwide.

Despite the aforementioned vulnerabilities and risks, there is no doubt that Asia and China are set to remain key dynamic players in the global economy. China has the all-important resources, knowledge, buffers and political determination to manage the smooth transformation to a more balanced, sustainable economy. This is good for China, good for Asia and good for the world.

Managing financial risks and vulnerabilities is always difficult, and can be very bumpy from time to time. The implementation of critical reform is still essential to the sustainable growth of China and all of Asia. ■

Globalisation resurgent – The post-financial crisis world

Zhu Xian, vice-president of the New Development Bank, recognises that continuing to grow the power and maturity of the developing world as a player in the global marketplace depends on structural adjustment and reform

The world's major economies are gathering pace compared with 12–18 months ago, with markets and global financial organisations foreseeing better economic growth. However, the world economy is still trapped in what the International Monetary Fund (IMF) terms the "new mediocre", as improvement still appears weak. Some commentators assert that the economy might stay in the doldrums, but not go to extremes – which still sounds positive.

In these circumstances, governments and enterprises should be prepared to wait some time for the next round of constant and strong growth because the financial crisis of 2007–2008 has had not only a cyclical impact, but a structural one.

Each country's economic policies and reforms have their own distinctive directions and strengths. In politics, the economy and society as a whole, current reforms are as insufficient as a surgeon giving a pill to a patient requiring immediate surgery. However, conservative treatment is the only option for some countries because of political, economic and cultural limitations. Without more drastic structural economic reforms, negative effects may still appear in middle- or long-term growth.

The unpredictable effects of globalisation

The problem with globalisation is twofold. First, in the past two decades, unequal redistribution in finance and other areas has damaged the interests of low-income and middle-class populations worldwide. This problem should be heeded in subsequent economic or global governance reform. Unequal redistribution also reflects the conflict between the old and new economies. With the rise of populism in the West, some clearly conceive globalisation negatively, fearing damage to their vested interests. The intensity of this fear should not be underestimated.

China should be prepared to do its part when confronting these complex and unpredictable economic trends. It should press ahead with reform set out by the 19th National Congress of the Communist Party of China, in particular by rectifying structural economic imbalance, enabling it to swiftly transform the Chinese economy from one of mere investment and expansion to one of quality and efficiency.

Second, many argue that the current global governance system cannot meet the new needs of globalisation. In the past two decades, emerging market economies and developing countries have made remarkable progress, creating 80% of world economic growth, with the greatest contribution to this coming from China. Emerging markets now account for 40% of the global economy. These developing countries and emerging market economies understandably hope to have a louder voice and a greater platform in the global economic governance system.

However, progress is very slow. The majority of policymakers remain member countries of the Organisation for Economic Co-operation and Development (OECD), headed by the US. What problems does this cause? Policymakers are more concerned with their own interests when formulating rules, and often have double standards. During the financial crisis, the IMF carried out the demands of OECD countries by applying rigid limitations to developing countries, regardless of the conditions there – especially economic, social and political endurance. For example, the US and Europe adopted quantitative-easing monetary policies after the financial crisis, but few authorities considered the spillover effect on the macroeconomy.

Zhu Xian

Appeals from developing countries have not been satisfied, but the developing world has not yet come up with a clear and practical plan to adjust the current economic governance system. Developing countries account for a growing portion of the world economy, and their power, scale and maturity should not be underestimated. Therefore, the focus of future economic governance reform should be on how to maximise the interests of all parties. The last negotiations at the World Trade Organization broke down because of disagreements between the OECD and developing countries. We must work harder together to achieve a better future.

The BRI and Brics

The Belt and Road Initiative (BRI) is an interconnected proposal to build infrastructure in countries along the Silk Road Economic Belt. But, from a strategic perspective – and in accordance with China's experience of reform and 'opening-up' over the past 40 years – the BRI should be put into a global context. It can help lower-income and developing countries participate actively in globalisation and can become an opportunity for developing countries to better integrate into the world economy and the global supply chain. It should not be thought of as a mere infrastructure plan, but as an asset of high strategic value.

The New Development Bank mobilised resources for projects in the Brics nations – Brazil, Russia, India, China and South Africa – where it was founded. With the exception of China, the Brics nations foresee better economic indexes after the last financial crisis, but are also confronted by challenges. Many governments lack the political courage to carry out imperative structural adjustments, especially in 'resource-cursed' countries that rely heavily on exports of primary products and regard them as pillars of their economic structure. Owing to the relatively easy access to primary resources, other economic sectors – such as manufacturing and service industries – may suffer. Currently, the Brics nations enjoy good momentum, though this trend's continuation depends on their governments' courage to carry out structural adjustment and reform.

To summarise, the five Brics nations – all of which are large economies – can establish themselves as world pillars and the greatest endorsement of the strength of emerging market economies and developing countries.

Shifting to globalisation 4.0

Each new wave of globalisation has been preceded by crisis and a belief that globalisation is foundering. The fourth wave, characterised by radical digital progress, is no different, writes *Shao Yu*, chief economist at Orient Securities

Last year marked the 10th anniversary of the subprime mortgage crisis in 2007 and the 20th anniversary of the Southeast Asian financial crisis. It would be useful to take stock and review the course of this decade of crisis, and the anti-crisis measures that were utilised in response.

Turmoil in the US subprime mortgage market spread crisis through major global financial markets – the US, the European Union and Japan – in August 2007, evolving into a global crisis by September 2008. Major economies mobilised all of their resources in large-scale expansionary policies to combat this. By the end of 2009, the crisis was deemed to be over, ushering in the post-crisis era. But, at this critical moment, the Greek sovereign debt crisis erupted. This crisis intensified and swelled immediately, drawing in other European countries and eventually evolved into the European debt crisis. In August 2011, while markets were still reeling, the US debt-ceiling crisis in Congress shocked the world, in part prompting Standard & Poor's to downgrade the country's AAA credit rating for the first time in US history.

In response to these consecutive crises, developed countries have repeatedly resorted to quantitative easing (QE) – since the financial crisis of 2007–2008, the US Federal Reserve Board has released three rounds of QE, with assets purchased amounting to around US$3.9 trillion. The European Central Bank conducted a series of long-term refinancing operations, introduced a direct monetary transaction plan and dramatically expanded its QE policy in March 2015; the Bank of England and the Bank of Japan have significantly augmented asset purchase plans. In turn, these stimuli have triggered turbulence in international financial markets.

These crises can be traced back to the period of unbalanced globalisation prior to 2007 – globalisation 3.0. Globalisation does not maintain continual growth and prosperity; it is punctuated by stagnation, dissipation and even collapse. In modern history, there have been three waves of growth in globalisation: globalisation 1.0, the era of exploration; globalisation 2.0, the era of the UK and sterling; and globalisation 3.0, the era of the US and the US dollar. Globalisation has also manifested three major trade and economic imbalances in the real and financial economies: between China and the UK, Europe and the US, and Asia and the US. Current imbalances have been prompted by the globalisation of the US and the US dollar.

Imbalances in the global real economy are both internal and external. Internal imbalances are visible in economies seriously affected by debt crises, such as the US and the Piigs nations – Portugal, Italy, Ireland, Greece and Spain; they fail to meet their needs in the cause of pursuing deficit spending. As a result, government revenue falls below its expenditure, and private savings below consumption. In contrast, other countries – many in Asia – are working actively to save money.

External imbalances include trade deficits, such as that between the US, which runs a long-term trade deficit that has led to capital outflow, and China, which runs a trade surplus to accumulate US dollars.

The world's financial and economic imbalances are caused by problems in the international monetary and financial system, including global and regional 'centre-periphery' imbalances. The global centre-periphery imbalance allows the US to capitalise on its central position in the international monetary and financial system to obtain resources at a low cost, worldwide, to sustain and magnify the imbalance in the real economy while controlling the peripheral countries.

A converse example of the regional centre-periphery imbalance is the eurozone, where the central countries – Germany and France – are controlled by the peripheral countries. Sharing the same currency and benchmark interest rate as the periphery, Germany and France shoulder more responsibility in maintaining currency stability when crises occur. The eurozone has unified the currency, but not its finances; this mechanism leads to the containment of the centre by the periphery.

Imbalance leading to overconsumption

The US subprime mortgage and debt crises are the manifestation of the imbalance between the East and the West. Developing countries – such as China, in the East – feature export-oriented economies, whereas developed countries – such as the US, in the West – are characterised by overconsumption. The European debt crisis reflects the north-south imbalance in the eurozone – the south, as represented by Greece, Spain and Portugal, are premature consumers, while the north, including countries such as Germany, are more industrious. Their cost advantage in export has remained because of minimal wage increases over the past 10 years.

These East-West and north-south imbalances have rebalanced the books for nations, enterprises, individuals and central banks. Ten years after the outbreak of the subprime mortgage crisis, a re-examination of the state of affairs indicates that financial crises are continuing to spread.

The first of these were in the US, when overleverage led to the collapse of its real-estate balance sheet. The second emergence was in Europe with the sovereign debt crisis, meaning the collapse of the national balance sheets due to high fiscal leverage. Crises may now come to emerging markets that have borrowed large

amounts in reserve currencies while taking out the corresponding local currency to provide support. Once the Federal Reserve raises interest rates, this capital will frantically flow out of emerging markets and possibly provoke a currency crisis. During this process, the balance sheets of expanding central banks will eventually be called to account.

Globalisation serves as an important driving force, unifying all nations. From a global perspective, pre-crisis globalisation was unbalanced, and came about because of the growing ties between the real economy and the financial sector, which to a certain extent triggered three separate crises – the global financial crisis and the eurozone and US debt crises.

Deglobalisation

Since the global financial crisis, deglobalisation has become an increasingly prominent strand of thought. Its spread can be attributed to financial and economic crises causing trade protectionism and economic populism in some countries, enhancing isolation and leading to deglobalisation.

Deglobalisation gained most prominence in 2016 with the election of Donald Trump as US President, but its trigger can be considered the subprime mortgage crisis, and it has escalated since through the eurozone and US debt crises. An emerging anti-globalisation phenomenon is evidenced by rising trade protectionism, the declining year-on-year global trade growth, the fragile and uneven global economic recovery, partial marginalisation of multilateral trading systems, and the recent series of 'black swan' events. Anti-globalisation has also resulted in a slowdown in trade and investment, disrupting world economic growth and, thus, recovery.

The world is crying out for globalisation 4.0, a more sustainable, reasonable and balanced version, led by innovation, inclusiveness, shared benefits and tolerance. Lessons from the pre-crisis unbalanced globalisation and post-crisis deglobalisation will be learned – globalisation 4.0 aims to enhance the voice, influence and rulemaking power of emerging and developing countries in the real economy and financial sector worldwide to reverse past imbalances. It also requires all nations to participate in a global division of labour and co-operate in a more open and inclusive manner, rather than pursuing deglobalisation driven by protectionism. China has drawn its lessons from the old order and repeatedly emphasised openness and inclusiveness in the economy from top to bottom. Rather than shaping a parallel hegemonic structure, globalisation 4.0 intends to correct the flaws inherent in globalisation 3.0 that allowed the dominance and wealth superiority of the great economic powers to hinder the optimisation and evolution of the global governance structure. Globalisation 4.0 should be inspired by China's own reform that prioritises frontier and incremental stock.

Yet, as geopolitical frictions become more frequent, epitomised by the Trump administration's protectionist policies and Brexit – Britain's decision in 2016 to withdraw from the EU – there is a disturbing sense that the opportunities thrown up by the global financial crisis were almost certainly wasted. Apart from injecting more liquidity into the economy, progress has been otherwise limited. The world is currently experiencing three highs and three lows: high central-bank balance sheets, high debt or leverage in the real economy and a record high in risky asset prices, and low volatility, low inflation and low growth and trade levels.

The past decade has witnessed probably the most significant period of deception in currency history. Price inflation of core assets and the widening global wealth divide highlight this. The so-called macroprudential policy, or efforts to reduce the level of macro leverage, may seem progressive, but a closer look at the macro leverage of large economies reveals that few are actually under control.

Where are the modern theoretical innovators? Every previous major financial crisis has provoked intellectual breakthroughs by major figures such as Karl Marx, John Maynard Keynes and Milton Friedman. Now we see an ugly and noisy battle with nationalism and populism on the sidelines; liquidity may be abundant, but insight is clearly meagre – this is the sharpest contrast of the modern age.

A world turned upside down

The shortcomings and exaggerations of the success of neoliberalism have been exposed, and the developing world's students of globalisation have now become its teachers. As the West flounders, a confident China is now the beacon for liberalisation, globalisation and a 'third way', explains *Di Dongsheng*, vice-dean at the School of International Studies, Renmin University of China

What changes has the financial crisis wrought over the past decade? When the crisis broke out in 2007–2008, US financial commentators such as Bill Gross, the American investor and fund manager, known as 'the king of bonds', foresaw three major themes in the post-crisis era: greater regulation, deleverage and deglobalisation. To what extent have these predictions come true?

Regulation was applied – irresolutely – and failed. The real culprits of the financial crisis were not jailed but exonerated. They successfully preserved their freedom – and their wealth – with some even retaining their positions.

High leverage in the US and Europe over the past decade has merely been transferred rather than decreased. This leverage first forced the public sector to significantly expand its debt to incorporate loans and deficits diverted by the financial and private sectors; the US and European countries then capitalised on the privileges of the US dollar and the euro to push the debt interest rates down to zero or negative, turning trillions of dollars of deficit into high inflation in the global periphery.

Of Gross's three predicted themes, at that time, only deglobalisation was actually happening. Populism, isolationism and protectionism replaced the global spirit of 'opening-up', pluralism, equality and innovation. The election of Donald Trump as US president and the UK's decision in 2016 to leave the European Union highlight the major Western powers' repudiation of the ideas of globalisation they had endorsed since the term was first conceived in 1979. Neoliberal globalisation has been abandoned by its own creators and has become a discarded theory in the 21st century.

A world in reverse gear

The world rapidly went into decline in the decade following the financial crisis, when the students of globalisation became its teachers and the developing countries that had previously followed the West's guidance in promoting globalisation began to set the benchmark for its implementation. President Xi Jinping advocated the benefits of the progressive opening of China's markets at the World Economic Forum annual meeting in Davos in January 2018. He also supported implementation of multilateral governance systems and global climate governance, and is now encouraging innovation and environmental protection, managed through huge financial cost and policy reform. The International Monetary Fund's (IMF's) managing director, Christine Lagarde, has found more common ground with Chinese leaders than those in the US. China seeks a larger share, a louder voice and greater responsibilities in the IMF, whereas at least half of US citizens view such multinational institutions as inefficient and burdensome. The IMF's economists are no longer as dedicated to the liberalisation of capital accounts, although their Chinese counterparts are struggling to inject flexibility and autonomy into exchange and interest rates, and to prudently but firmly release funds for its capital projects.

The IMF's constitution stipulates that its headquarters should be located in the member country with the largest economy. In light of the growth of the Chinese economy, adjustments in statistical methods and the prospect of exchange rate appreciation, it is believed that, as early as 2021, a serious decision will need to be made on the location of the second headquarters of the IMF and the World Bank – slated to be either Pudong in Shanghai or the Xiong'an New Area south of Beijing.

In a world turned upside down, an interesting reversal has occurred in energy and emissions reduction. A decade ago, some in China were dubious of the policy of 'going green'. Its progress, driven by the EU, was conducive to the EU's global moral leadership and its new energy and environmental industries, yet would deprive Chinese people south of the Huai River of winter heating. However, with the improvement of China's energy saving and environmental protection policies, and the development in new energy industries, this doubt waned. However, it has re-emerged in the US, where it is often claimed that China conspires to push for green energy conservation and emissions reduction merely to attain industrial benefits, that global warming is believed to be pseudoscience – or 'fake news' – and that only more coal and oil can upgrade the economic structure in the US.

In China, perhaps the most enduring changes since 2008 are those in its industrial structure and its competitiveness. Ten years ago, China's GDP was less that of Japan, and ranked third in the world. China's export commodities were predominantly labour-intensive, and its so-called 'high-tech' products were the assembly of high-tech components of other countries – such as the assembly export industry of Apple mobile phones in Foxconn in Taiwan. But today, most consumer goods in US supermarkets are no longer sourced from China, but Vietnam, Indonesia, Bangladesh and even Africa. China has made great strides, ascending several steps in the industrial ladder. In the Apple mobile phone supply chain, Chinese manufacturers are not

simply assemblers, but providers of dozens of important components, with the previously commonplace tag of 'made in China' gradually being transformed into 'made by China'. China's self-branded and patented products have proved their own competitiveness in many fields, including electric vehicles, smartphones, drones and high-speed trains.

China is also playing an enhanced role in the fields of innovation and the internet. There used to be a joke that the World Wide Web could be divided into two parts: the global network and the Chinese internet. However, as a consequence of current global internet development and a lack of governance, China's policies and its reasons for their implementation may prove to be reasonable. Around 200 years ago, the advent of newspapers and other mass media attempted to shape the opinion of the majority of literate people to mainstream ideologies, resulting in 'mass politics'. Now, the traditional media is marginalised by network information, and individuals have become the communicators and processors of information rather than recipients, breaking down control by media elites. A fierce split in mainstream ideology has accelerated the collapse of a Western social consensus. In China, despite the drawbacks of information control and censorship, the proliferation of fake news has had little effect, and the social consensus is relatively stable.

China plays catch-up

China's development in IT is also proving successful in business and industry – China, the former protectionist, imitator and isolator in the internet field, is shedding its passive status and beginning to export its network services and brands to the world. Most countries are not developing seriously competitive brands and businesses in the network economy and artificial intelligence; only China's Baidu, Alibaba and Tencent can compete with the US internet giants and, as internet applications move to mobile platforms, China's internet companies have the potential to overtake them. More than one European student in China has told the author that, on their return to Europe, they realised how old-fashioned, unsophisitcated and insecure shopping with cash and credit cards is. An IT entrepreneur in Shenzhen told the author that when he visited Silicon Valley for three months to explore new ideas, he found that, on his return to Shenzhen, the pace of innovation and technological development meant that he was already behind the times, and his knowledge and ideas were outdated.

After a decade of negative and ultra-low interest rates, Western economies are now seeing light at the end of the tunnel of the post-crisis era. For example, the Bank of Japan has started to trim purchases of long-term government bonds. Over the past 10 years, what have the US, Japan and Europe relied on most to lift them out of the post-crisis era? The answer is probably their central banks. Paradoxically, the central banks of the US, Japan and Europe have dramatically expanded their balance sheets by printing money to bail out insolvent financial institutions and the public sector – but their exchange rates have not significantly depreciated. Countries struggling with significant currency devaluation include India, Brazil, Russia and other developing economies. In 1971, after the 'Nixon shock' – when then-US President Richard Nixon undertook a number of economic measures, including cancelling the direct international convertibility of the US dollar to gold – then-US Treasury secretary John Connally declared: "This is our currency, but it is your problem."

Debt borrowing in its own currency is a privilege enjoyed only by developed countries; China is now working hard to join that club by converting its disadvantaged position in this no (hard) anchor currency system through the internationalisation of the renminbi.

The change in China's status over the past decade has not made it more liberal, but more confident of its own civilisation and system. Chinese politicians and intellectuals have begun to realise the shortcomings and exaggerations of Western neoliberalism. China learned first from the former Soviet Union that totalitarianism would strengthen China rapidly. From the 1980s onwards, China learned from the US that the free-market model would make China prosperous. Yet China – the student of these policical and economic policies – found that its teachers were not perfect: the Soviet Union was too poor and despotic, while the US is too chaotic. Now, China turns its eyes to Europe, this time not looking up, but head-on. China hopes to revive the ancient Silk Route together with the major European powers and explore the 'third way' of integrating market efficiency and government control. Can globalisation gain a new life? Europe and China hold the key. ■

CHINESE FINANCIAL SYSTEM REFORM

China's macroeconomy in the 'new era' of politics and power

Lou Jiwei, president of the National Council for Social Security Fund and former minister of finance of China, explores the three key aspects of China's macroeconomic situation in the 'new era' of Chinese politics and power

Changes in annual economic indicators are better than expected

All major economic indicators in 2017 are at least acceptable, with some exceeding expectations.[1] China's GDP reached RMB82.7 trillion, an increase of 6.9% that has reversed a downward growth trend for the first time since 2011, contributing more than 30% of total global growth. As for economic activity, 13.51 million new jobs were created in 2017, maintaining the record of more than 13 million for five consecutive years. The number of newly registered enterprises amounted to 6.07 million, up by 9.9%. Regarding economic structure, the dominance of the services industry became more prominent. The proportion of tertiary industry in GDP was 51.6% – 11.1 percentage points higher than that of secondary industry. The services industry contributed 58.8% to economic growth, an increase of 1.3 percentage points over the previous year. Consumption continued to be the driving force behind economic growth, totalling 58.8% – 26.7 percentage points higher than the gross capital formation.

Regarding economic quality, energy consumption per RMB10,000 GDP dropped by 3.7% compared with 2016; and the author believes that most people will have personal experience of environmental improvement and more effective pollution control. The increase in residential consumption is apparent: the Engel coefficient was 29.3%, down 0.8 percentage points over the previous year. Per capita expenditure in 2017 was 11% on healthcare and 8.9% on education, culture and entertainment. With the further concentration on the ethos of 'manufacturing, service plus internet' and accelerated online and offline integration, high-end consumption began spreading further into middle-income groups.

In conclusion, the macroeconomy grew steadily in 2017, manifesting generally benign changes. Supply-side structural reform is gradually taking effect. Since the 18th National Congress of the Communist Party of China (CPC) in 2012, a roll-out of crucial reform measures has improved the efficiency of resource allocation, total factor productivity and advanced macroeconomic development. For instance, there was strong support for reforms prioritising the household registration system; the policy encouraging rural migrant populations to relocate to cities was fully implemented nationwide[2]; endowment and medical insurance were enacted in urban and rural areas[3]; and a unified fund was established to ensure resources for compulsory education in all regions.[4]

China also pushed ahead with market-based reform in the exchange and use of land: rural collective construction land will now, like urban land, enter the market under new land-use regulation[5]; rural rights on ownership, contract and management have been separated and the exchange of land has been enabled[6]; and agricultural product price reform[7] has optimised the allocation of land use.

A roll-out of crucial reform measures has improved the efficiency of resource allocation, total factor productivity and advanced macroeconomic development

China has accelerated the pace of 'opening-up' to the outside world by introducing a management model of pre-establishment national treatment with a negative list, in accordance with the principle that such a model can be copied and with the expectation that the model can be applied to other areas. It has also implemented a high-level trade and investment liberalisation facilitation policy to reduce import tariffs and cut trade barriers. China's business reform focused on removing inappropriate administrative controls and drastically lowering the threshold for access to the free market. Meanwhile, China has implemented judicial reform: the Supreme Court set up six circuit courts to achieve full coverage and carry out more contracts; and trials in cross-regional civil litigation cases have been made fairer. In addition, China has set up intellectual property courts in Beijing, Shanghai and Guangzhou to strengthen the protection of property rights. All of these measures have markedly improved the business environment in China – it now ranks 78th out of 190 economies, 18 places higher than in 2013.[8]

Demand management and supply-side structural reform

No target for GDP growth was proposed at the 19th CPC National Congress, but China must continue to maintain an appropriate economic growth rate to turn the 'two-step' blueprint for development – China realising socialist modernisation by 2035, and becoming a modern, prosperous nation by the middle of the century – into a reality. Realism is required to maintain economic growth within the correct parameters and achieve high-quality development. China's macro policy must focus on supply-side structural reform as there is only limited policy scope for implementing demand management in the coming period.

1. **Fiscal and monetary aggregate policies are limited.** On the part of fiscal policy, there is little scope for large-scale, concentrated infrastructure development after so many previous rounds of stimulation. On the one hand, the local debt risks proliferate, and infrastructure debt should not be increased further. On the other, it is quite reasonable to carry out infrastructure development such as transportation in accordance with the principle of advancement. A balance should be struck: with the development of a metropolitan-centred urban belt and a people-oriented urbanisation process, ample and sustained latitude exists for economically viable investment in infrastructure.

   In terms of monetary policy, China's monetary multiplier has risen rapidly, from 3.86 in 2012 to 5.02 in 2016, while the ratio of M2 to GDP has increased from 180.3% to 208.3% over the same period,[9] indicating rapid economic monetisation. The GDP growth rate has, however, been declining simultaneously, indicating that the expansion of the money supply is impacting less on the economy. To this end, stimulus through monetary policy will only aggravate over-monetisation and further amplify the shift from a real to a virtual economy while playing a limited role in stimulating economic growth.

2. **Greater latitude is needed for fiscal policy to focus on structural adjustment in line with supply-side structural reform.** Tax relief can help enterprises increase investment in research and development (R&D), as well as enhance economic vitality through innovation. Efforts can be made to cut overcapacity in expenditure, reduce excess inventory, deleverage, lower costs and strengthen areas of weakness[10] through readjustment of expenditure. Resources can also be guided to industries more in line with macro-control measures to improve the diversity and quality of supply. Fiscal policy has much to offer in these areas. Monetary policy, in principle, has all the attributes required without the need to adjust the structure. Against the backdrop of a 'new normal' in the economy, save for major external shocks or internal systemic risks, the adoption of monetary distortions similar to US monetary policy or European Central Bank structural policy instruments will be unnecessary. The European Union has a single currency, but no unified finance, so must adopt monetary policy tools to achieve structural adjustment.

Lou Jiwei

3. **Supply-side structural reform should be problem-conscious and focused on long-term goals and dedicated effort.** A report from the 19th CPC National Congress states that: "As China's socialism with Chinese characteristics has entered a new era, the principal contradiction facing Chinese society has evolved. What China now faces is the contradiction between unbalanced and inadequate development and people's ever-growing needs for a better life." The report records the unwavering national reality that China is, and will in the long term remain, at the primary stage of socialism. Its international status as the largest developing country has not changed. Supply-side structural reform must, on the one hand, adapt to the change in social contradictions, be problem-aware and serve high-quality economic development; and, on the other hand, emphasise long-term goals and institution-building and continue to introduce reform measures to increase effectiveness year-on-year.

Key issues regarding supply-side structural reform

China's economic development is still confronted by two deep-rooted contradictions. One is the reality that economic and social development cannot be advanced merely by will alone. The other is efficiency loss, caused by the distortion of institutional mechanisms, which can be corrected through reforms that aim to improve the efficiency of resource allocation and further boost economic growth.

With regard to objective reality, improvements can be made in advancing economic and social development with the aid of supply-side structural reform, but fundamental change is not possible. For example, China has experienced a decrease in its workforce since 2015, and this trend is accelerating. In 2017, the working population aged between 16 and 59 years was 902 million, a decrease of 5.48 million on the previous year. The population over the age of 60 years reached 241 million, an increase of 10 million on 2016, and accounts for 17.3% of the total population.[11] The two-child policy, introduced in 2015, has helped increase the population and the supply of future labour, but the recent drop in labour force participation has become a risk factor and has made the future unpredictable.

China has stepped up efforts in environmental protection and pollution control to meet the public's need for a better life. But there may be some trade-off, as development that caused increased pollution also resulted in GDP growth. In addition, the external environment is tumultuous – trade protectionism is on the rise. Supply-side structural reform must be concentrated on improving the identification of problems or making appropriate delays. China must, while boosting high-quality economic development, avoid major fluctuations and maintain growth.

Supply-side structural reform must contend with the distortion of institutional mechanisms and prioritise the following five aspects:

1. **Promoting the free flow of factors.** The pace of urbanisation has accelerated; the reform of the household registration system has been comprehensively carried out; rural land transfer has been piloted; market-orientated allocation of land-use patterns has also made remarkable progress; some inefficient planting areas have been gradually withdrawn, and thus the agricultural production structure has been improved. The area allocated for the production of maize, with a high inventory in 2017, was reduced by 3.6%, while the allocated area for bean sowing was increased by 6.7%.[12]

   Many obstacles stand in the way of the free flow of factors. Labour mobility, restricting people's ability to obtain cars and houses and enrol in higher education, through permanent resident permits, is still relatively common in some cities, which is not only a hindrance to the free movement of workers, but also to the improvement of income distribution as, according to the theory of development economics, the transfer of citizens living in agricultural regions to non-agricultural sectors improves income distribution. China's Gini coefficient was 0.467 in 2017, having risen for two consecutive years. Although this magnitude is small, it highlights that, despite accelerated urbanisation, barriers to the free flow of population widens the gap in income distribution. Efforts must be made to remove all benefits attached to household registration, advancing 'equal rights for tenants and homeowners',[13] providing both with access to basic public services and promoting the free movement of the labour force. This will help improve total factor productivity, advance income distribution and reduce labour costs.

2. **Streamlining administration and cutting taxes and administrative fees.** Since the 18th CPC National Congress, strenuous efforts have been made towards reforming business, streamlining administration and delegating government powers. The next step is to reinforce institutional reform. In terms of

The Great Hall of the People, Beijing, which hosted the 19th CPC National Congress

tax cuts, annual revenue for 2017 was RMB17.3 trillion, an increase of 7.4%.[14] This growth rate shows the effectiveness of tax cuts – if fiscal revenue is synchronised with a nominal GDP growth rate of 10.5% (6.9% plus 3.6% deflator), the fiscal revenue for the full year should be RMB17.8 trillion, and the RMB500 billion increase on actual income shows the effects of tax relief. Given better connectivity between fiscal income and the producer price index (PPI), estimated tax cuts would be even greater if calculated with 6.3% of PPI in 2016.[15] This highlights the obvious effect of China's tax reduction. In 2017, raw material prices rose by more than 8%, PPI by 6.3% and consumer price index by 1.6%, indicating that pressure is moving to the middle- and low-income groups. More taxes apply to high-income groups, but a limited adjustment to income distribution is effected. Further analysis reveals that there remains scope for additional tax cuts: the push for income tax reform, increasing deductions from corporate income tax in R&D, transferring personal income tax to comprehensive collection, reducing the tax burden on low-income groups, avoiding personal tax's evolution into payroll tax, and forming reverse regulation. Additionally, administrative fee cuts and charges for non-administrative licensing projects lacking a statutory legal basis of the higher authorities have been cleared at central government level. However, a persistently large number of fee-charging items not covered by local government laws should now be the focus of the next step toward lowering costs.

3. **Enhancing protection on private investment.** Since 2010, China's consumption has exceeded its investment. It is widely believed that economic growth has reached a turning point towards being primarily driven by consumption and supplemented by investment. In fact, investment – especially private investment – still has great potential for growth. Internationally, both Japan and the Republic of Korea have experienced high investment and high growth for a significant amount of time. Domestically, despite the rapid increase of resident leverage in recent years, the upturn in residents' disposable income is still higher than that of consumption, which means savings are still rising. Eventually, residents' leverage ratios will steadily decline, and the savings rate can be maintained at a certain level, which can lay a foundation for substantial investment growth. Moving forward, under the context of a limited space for concentrated governmental investment, China will focus on strengthening the effective protection of property rights and contracts and improving legal justice to provide a guaranteed external environment for the survival and development of enterprises – especially privately-owned enterprises – and fully mobilise the enthusiasm for private investment.

4. **Continuing opening-up to the outside world and advocating globalisation.** China will firmly safeguard multilateralism, support the multilateral trade system, oppose various kinds of protectionism and build an open world economy. It will strengthen its involvement with international economic and trade rules, implement more active import policies, ease market access in the financial services industry and continue to expand market access in other fields. China will establish international advanced rules as the standard, give free-trade zones

greater reform autonomy and improve their quality. Based on the lessons of free-trade zone pilots, China will implement pre-established national treatment with negative lists to create a fair, transparent and predictable market environment under the rule of law. If the flow of elements, the streamlining of administration and delegation of powers, the protection of private investment, and the continued and reinforced opening-up are in place, the business environment in China will further improve. There is also reason to believe that the economic growth in the next period will be maintained at a high level of greater than 6%.

5. **Preventing and resolving financial risks.** Failure to achieve this could lead to subversive consequences. Currently, the ratio of M2 to GDP in China exceeds 200% – roughly equal to that of Japan and more than double the US's 91%. However, the average one-month Shanghai Interbank Offer Rate (Shibor) in 2017 in China was 4.09%. In the same period, the comparable interest rate in Japan was –0.01%, and that of the US was 1.1%.[16] China's monetary environment is more relaxed while the cost of capital is even higher, indicating a serious distortion of the financial system. Overmixed operation – 'comprehensive management' – has caused financial chaos; there is a wide variety of derivatives with Chinese characteristics: peer, channel, nesting, capital pool, universal insurance of Ponzi financing, peer-to-peer, non-standard and payday loans superimpose on one other, resulting in the cost of capital constantly rising and the real economy becoming exacerbated. Simultaneously, channels of risk transmission are extremely opaque. Compared with the US financial market a decade ago – where the characteristics of risk and reward for various derivatives, such as mortgaged-backed securities (MBSs) and collateral debt obligations, were not fully understood although they are now fully recorded – China is even more chaotic and needs to scrutinise the underlyings of the products to identify the true risks and benefits. In addition to conventional banking, securities, insurance and funds, new and innovative financial and quasi-financial institutions with Chinese characteristics and regional exchange markets have been created. In this way, it is very likely that there are systemic financial risks in China. The immediate task is now to win the battle of risk prevention and control.

China can overcome this difficult challenge with hard work. First, senior leaders must understand the situation. President Xi Jinping advised at the 2015 Economic Work Conference that China "must step up the special rectification of financial risks and resolutely reject systematic regional risks". Taking the US scenario a decade ago as an example, Hank Paulson, former US Treasury secretary, explained to the author that shortly after he had taken office in 2006 he felt financial risks were swirling like a brewing storm, but there was no consensus in society and no means of preventing the outbreak of risks.

Second is an understanding of the situation by governments and financial institutions. Following President Xi's instructions, governments, and regulatory agencies in particular, have already taken actions to request the return of assets, tighten their trade contracts and strictly control disguised bonds issued by local governments. Financial institutions are also stepping up their efforts to control risks. This highlights that society has recognised the occurrence of a 'grey rhino' incident. At that time, there was no consensus in the US financial community except for warnings from a handful of people such as Paulson, economist Ben Bernanke and former president of the Federal Reserve Bank of New York and Secretary of the Treasury Tim Geithner. At that time, the grey rhino was merely a possibility and there was no expectation that the grey rhino would turn into a 'black swan'. Crisis accumulation is competing with consensus on remediation formation – the former has been running in front, and there was no remediation of chaos or consensus on rescuing a systematic outbreak of risk until the downfall of Lehman Brothers and the emergence of black swan incidents.

China has stepped up efforts in environmental protection and pollution control to meet the public's need for a better life

Third, awareness of the key risks is essential. President Xi once said: "We must not forget that housing is for living in, not for speculation",[17] and "Finance should return to its origin and serve the real economy".[18] This emphasises that the major risk points are financialised real estate and unanchored finance. Before the outbreak of the financial crisis in the US, the American Dream of owning a home was embraced by all US citizens, regardless of how implausible it was to achieve. Financial markets were subsequently flooded with MBSs, with mortgages as underlying assets and derivatives. Eventually, these became intertwined, giving rise to risks.

Fourth, the overall environment must be considered. After the outbreak of the financial crisis, the Group of 20 summit and a series of financial channel meetings saved the global economy with joint efforts, and aided the prompt formation of consensus on strengthening financial supervision and helped to roll out concrete measures. There is reason for confidence, as China's supervision of major financial institutions is now effectively in line with international standards, and major financial institutions are relatively healthy. In the US, where the environment was not so good when the crisis broke out, risks were concentrated in seven major financial institutions.

The comparison drawn between the US and China during the financial crisis offers a number of lessons – many of which are unique to China. These include the proliferation of transactional derivatives with Chinese characteristics, and the establishment of new and innovative financial and quasi-financial institutions and regional exchange markets with Chinese features, as well as difficulty in regulation. Combating financial risks is a long-term prospect, as Liu He, vice premier of the People's Republic of China, said earlier this year at the World Economic Forum Annual Meeting in Davos: "We will strive to win the battle against financial risks in the next three years or so."[19] If the problem can be resolved in around three years, so too can the problem of high nominal interest rates.

Fifth, China's introspection towards its future financial model must be considered. It is interesting that China is a global financial market, while mixed operations are rapidly developing with high risks. In the past, some local leaders have been keen on developing local trading markets, but found it too difficult to exercise regulation. Risks in regional markets will inevitably face spillovers that can be very tricky to handle, which is why these leaders are carefully reviewing these issues.

Moving forwards

As making qualitative judgements on future patterns becomes increasingly challenging, the author posits the following:

President Xi emphasised that "finance should return to its origin and serve the real economy". Should we adhere to the mode of mixed operation to have finance return to its origins? Are we capable of confronting complicated challenges on financial regulation brought by mixed operations? Is it necessary for financial institutions to bear high compliance costs once mixed supervision is implemented? Is it necessary for the real economy to pay excessive nominal interests? Is this due to high compliance cost spillovers or high-risk pricing brought by overmixed operation or multiple derivatives. In the 1990s, then-Premier of China Zhu Rongji insisted on separate management, knowing that mixed operation was destined to fail at that particular stage, as citizens were neither well disciplined nor law-abiding enough, and institutions lacked the capabilities of regulation.

Under his insistence, *The segregation supervision pattern of the China Banking Regulatory Commission, the China Securities Regulatory Commission and the China Insurance Regulatory Commission* was established, meaning financial institutions would be split according to their main businesses.[20]

In January 2010 – in the wake of the financial crisis – Nobel Prize winner and economist Paul Krugman wrote: "The US must learn from its neighbour, Canada. More specifically, Canada places more stringent restrictions on the leverage of the banking sector and limits the securitisation process. These constraints in Canada in recent years, undoubtedly, have made bankers lose many opportunities to come up with so-called clever ideas, but these restrictions have all proved to be correct."[21] Observations of financial markets worldwide often find that those in Canada are considered the most 'boring' as financial authorities strictly regulate and control mixed operation, limit the appearance and trading of derivatives, prevent infection of financial risks and make every effort to enable financial consumers to achieve the co-ordinated development of finance with the real economy. However, even after the global financial crisis, Canada's banking system was still rated by Standard & Poor's and the International Monetary Fund as the healthiest banking system in the world.[22] Its experience therefore deserves our attention and reflection.

The report of the 19th CPC National Congress reminds us that the great rejuvenation of the Chinese nation can by no means be easily achieved and the endeavour to accomplish the two centenary goals will not always be smooth. President Xi's remarks in January 2018[23] implore China to ramp up its vigilance towards danger and perservere in preventing risks.

As long as China conscientiously implements the spirit of the 19th CPC National Congress, persists in deepening supply-side structural reform and resolutely guards against risks and challenges – particularly keeping away from global risks that may delay or interrupt the great rejuvenation process and high-quality economic development – we will certainly be able to fulfil the Chinese Dream of rejuvenating the Chinese nation.

1. *Data in this paragraph comes from National Bureau of Statistics of the People's Republic of China,* Steady and excellent economic performance in 2017, Better than expected *2018, http://bit.ly/2prfCPH*
2. Notice of the General Office of the State Council on issuing a plan to promote the settlement of 100 million non-permanent registered population in cities *(promulgated by the general office of the State Council [2016] no. 72).*
3. Opinions of the State Council on establishing a unified system of basic endowment insurance for urban and rural residents *(promulgated by the State Council [2014] no. 8).*
4. Notice of the State Council on further improving the funding mechanism for compulsory education in urban and rural areas *(promulgated by the State Council [2015] no. 67).*
5. *Decision of the CPC Central Committee on several important issues of comprehensively deepening reform.*
6. *The General Office of the CPC Central Committee and the General Office of the State Council opinions on improving methods of separation of ownership, contracting and management in rural areas.*
7. *The price reform of agricultural products mainly includes the pilot projects of price reform of cotton in Xinjiang, soybeans in northeast China and Inner Mongolia, as well as subsidy system for corn producers in northeastern China and the Inner Mongolia Autonomous Region.*
8. *The World Bank,* Doing Business 2018: Reform and employment creation.
9. *Wind.*
10. *Put forward at Central Economic Work Conference in 2015. Xinhua News Agency, Central Economic Work Conference held in Beijing where Xi Jinping and Li Keqiang made important speeches, http://bit.ly/2HTEoQh*
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Fintech – Challenges to financial regulation and stability

Fintech has undoubted technological and financial benefits, but the risks of unsupervised complexity, data leaks and threatened consumer rights require the firm hand of regulation, argues *Ben Shenglin*, IFF Academic Committee member and dean of the Academy of Internet Finance at Zhejiang University

Finance and the real economy are gathering renewed momentum thanks to the rapid integration of traditional finance and financial technology, commonly known as fintech. However, the development of financial innovation, fintech and artificial intelligence (AI) also poses new challenges to financial regulation and the overall stability of the financial industry.

The challenges of fintech to finance

Recently, fintech has become one of the most talked-about financial terms in China. Finance and technological advances have always been intimately linked – in the past 70 years, the invention and integration into everyday life of the computer, the advent of credit cards and the first automated teller machines, or ATMs, have demonstrated the far-reaching effects of finance and technology combined. This trend is now accelerating faster than ever, bringing with it tremendous reverberations for the entire financial industry.

Financial development, in its modern, more technological, intelligent and virtual incarnation, is always accompanied by new challenges. First, fintech has a tendency to decentralise, undermining the role of banks and insurance institutions. Decentralisation of conventional institutions does not necessarily signal democratisation and greater equality, but rather can represent a hidden risk of industry segmentation and the advent of new centralised market actors. Striking a balance is a universal challenge.

Second, fintech is interdisciplinary. Although many fintech products appear to be simple and standardised, they are in fact comprehensive products, melding traits of both finance and technology. This mixing of models and fintech's virtualisation are two prominent factors that lead to complex channels and modes.

Third, fintech is unmanned, intelligent and mechanised. Its concepts, such as AI, big data and cloud computing, are now very popular but potentially risky. When Google's self-driving vehicle caused its first road traffic accident in 2016, authorities found it difficult to apportion blame – should the human supervisor, the software designer or the company be held responsible? Similarly, in the financial industry, robot advisers depend on AI self-learning and self-operation to master models and algorithms; if the robot were to move on to the wrong track or bring difficulty to the investment, which side should bear the responsibility: the investor, the stockholder or the programmer? Data security could be compromised by the dangerous leakage of large amounts of sensitive financial data and, in a worst-case scenario, an automated system could even generate and proliferate data leaks far beyond human control. Clearly, fintech is a double-edged sword that must be treated with caution – it has the ability to bring about miraculous improvements in convenience, but could also seriously jeopardise consumer rights.

The challenges of fintech to financial regulation

At the same time, the integration of traditional finance and fintech gives rise to significant regulatory challenges.

First, the financial regulatory system has been outmanoeuvred and outpaced by fintech and internet financial markets. For example, platforms such as Alipay began third-party payment operations as early as 2003, but authorities didn't issue their third-party payment licences until as recently as 2011. The market often trumps regulation: business operators in China commonly 'get on the bus first, before buying a ticket'. China's financial regulatory bodies now face the task of solving this problem.

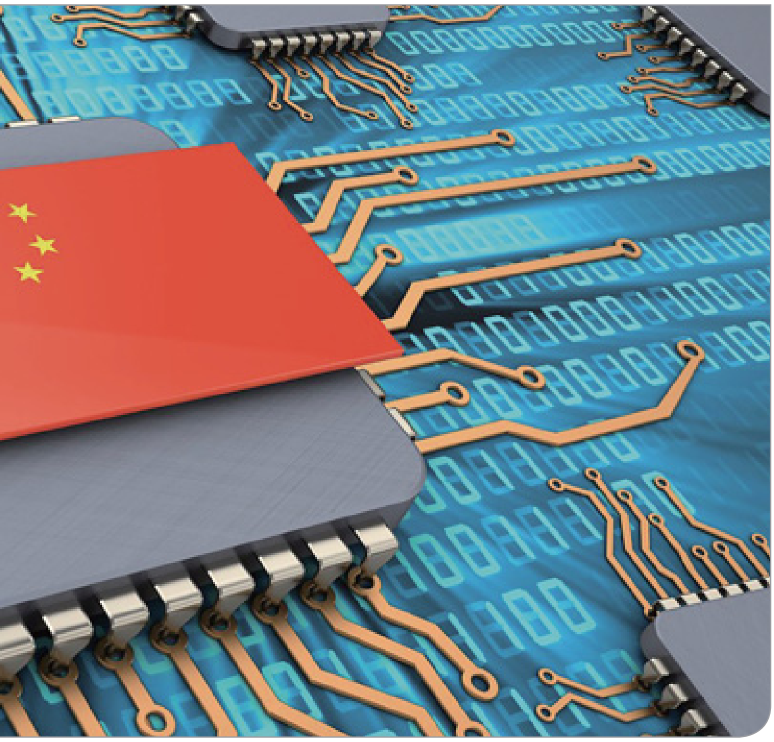
Second, China's fintech regulation lags behind more advanced overseas practices. Currently, China can outperform most nations with its booming fintech development, but the UK, Singapore and Australia, among others, have far superior regulatory infrastructures.

Third, China should better administer the relationship between fintech companies and the real economy. China is home to the majority of the world's most valuable fintech giants, which have brought many benefits to Chinese consumers and have won prestige for China in this emerging field. Maintaining fintech's role of serving the country, domestic consumers and the real economy is a major challenge.

Effective regulation of fintech

The effective regulation of fintech requires the reaching of consensus over future goals. First, financial stability should be the aim; second, finance should serve the real economy and bring benefits to society; third, finance should strike a balance between innovation, stability, and development; and fourth, consumer rights should be protected.

Fintech ultimately aims to develop a financial system that is fair, transparent, efficient and exhibits goodwill, and three tactics could be profitably employed to this end.



Ben Shenglin

1. **Learn from international experience.** Fintech is driven by three major global forces: the market, technology and regulation. The market, broadly, refers to that which is driven by consumer demands – something that is abundant in a nascent China. The application of IT in China surpasses that of most other countries – though a gap must still be bridged before attaining the levels of the US. Regulation exposes a shortage in our government, as well as regulatory agencies, systems and capabilities that must be reconciled by studying the techniques of other countries.

2. **Strengthen the construction of overall institutional capacity – not just top designs.** Current financial supervision remains localised and with Chinese characteristics: meaning local financial bureaus are burdened with huge workloads. Each level of local government – provincial, district and municipal – faces the problems of financial regulation; yet local financial bureaus continually depend on departments such as the National Development and Reform Commission, which lacks manpower and resources. A lack of human resources and limited capabilities are apparent, and therefore makes them all the more pressing for local governments to solve to promote financial stability.

3. **Create a friendly ecosystem.** To establish and maintain the sustainable development of fintech and the financial industry, market players, corporate self-regulation, trade association and regulatory agencies, as well as public opinion and guidance from educational institutions and media, should all be included in the process.

Fintech has brought many advantages and opportunities to the development of the financial industry, but it has also presented daunting challenges and possible risks. Striking a balance between development and stability, and deciding how best to regulate Chinese fintech giants for the prestige and prosperity of the country and for the advancement of humanity are urgent problems crying out for solutions. ■

Restoring the essence of finance – The F20 Initiative

The IFF seeks nothing less than to reshape and improve the world's economic system, and proposes 11 points of action to attain this goal

Global development has entered a critical stage. The most pressing issues include reviewing and rebuilding the basis of the value of human society, restoring the essence of finance to serve the real economy, and reshaping and improving the basic economic system, ultimately to boost economic recovery and comprehensive and sustainable development.

The International Finance Forum (IFF) is an independent, non-profit and non-governmental international organisation. It was founded in Beijing in October 2003 by global financial leaders, policymakers, leading scholars and experts from more than 20 states and regions – including China, the US and the European Union – and international organisations such as the UN. The IFF is a long-standing high-level dialogue platform and communications and research network in the financial realm. It aims to safeguard and improve international financial order through non-governmental, high-level dialogues featuring multilateral, equal, practical and constructive co-operation to enhance world economic inclusiveness and comprehensive and sustainable development. The IFF is committed to becoming an independent, transparent and non-governmental think tank that focuses on international financial public diplomacy and strategies.

To tackle the world's new order, circumstances and challenges, and to promote global stability and co-operative dialogues – as set out at the 2016 Group of 20 summit in Hangzhou – all members of the IFF approved its upgrade to 'F20' in the global financial sphere. This decision was based on the IFF's well-developed framework built up over the past 15 years.

The F20 Initiative aims to usher in a *New era of comprehensive and sustainable development – New capital, new value, new world.* The IFF, therefore, proposes the following 11 points of action to better equip the F20 Initiative to reshape the world economic system:

1. **Establishing the F20 global network.** The F20 global network will be established by reorganising the IFF Global Board and the executive body, setting up an open and interconnected global network centred on G20 countries and regions – with the participation of emerging economies and countries involved in the Belt and Road Initiative (BRI) – and building the IFF into the F20, a global financial organisation.

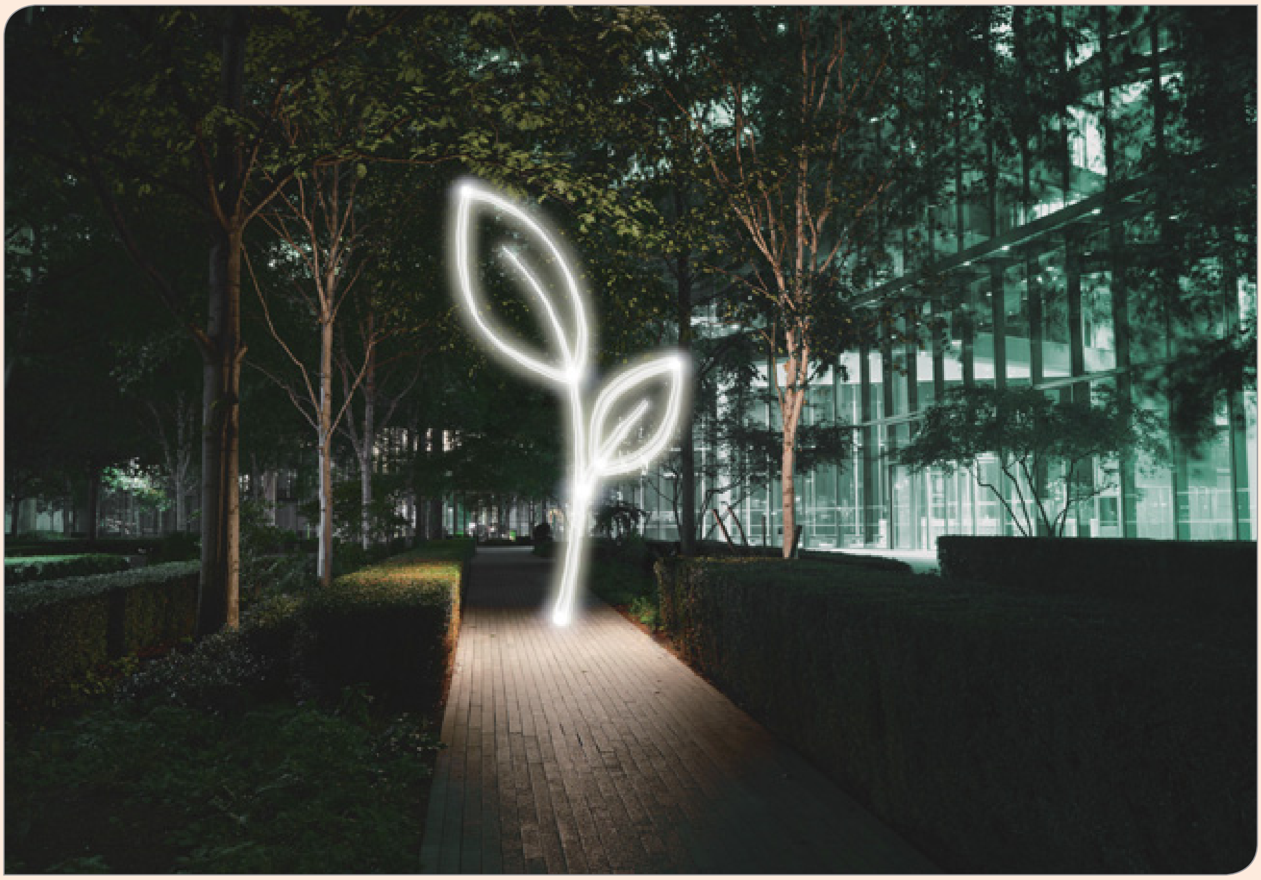
2. **Restoring the essence of finance.** The F20 will fulfil its role as a global network platform by restoring the essence of finance – to serve the real economy – by improving the basic economic system, ultimately accelerating global recovery and bolstering the comprehensive and sustainable development of the world. This will develop completely the fundamental function of financial instruments, and promote comprehensive, sound and sustainable development of the basic economy and human civilisation.

3. **Providing new drivers to global governance.** This will be acheived through the F20 dialogues, by supporting the role of the G20 as a major international economic forum to strengthen co-operation on macroeconomic policies, reinvigorating global trade and investment, accelerating reform of the international financial system and enhancing studies on the world financial order, global financial governance frameworks, financial stability and relations between finance and world peace.

4. **Facilitating national and regional financial co-operation dialogues.** The IFF platform will facilitate financial co-operation dialogues through regular F20 summits and meetings on national and regional financial co-operation, the sharing of ideas and experiences of development among all member countries, furthering profound discussion relating to the G20 and international development issues, promoting the implementation of G20 summit decisions and striving to develop the F20 Initiative into a strong complement to the G20, as well as making it an authoritative platform for comprehensive dialogues, exchanges and co-operation in areas such as international economy, finance and public relations.

5. **Ensuring China and emerging economies fulfil their roles.** Participation by China and other emerging economies will be encouraged by facilitating dialogues on national and regional stability and co-operation, and encouraging financial and economic co-operation among major powers. This will also be achieved through the F20's studies on the new drivers and challenges of the G20, promotion of supply-side structural reforms, restructuring the economy, optimising resource allocation, upgrading the quality and quantity of economic growth, and invigorating emerging economies. Finally, supporting the internationalisation of Chinese enterprises to export China's capital and technologies to developing countries through direct investment will achieve mutual benefits and win-win results.

6. **Establishing a global green financial system.** Encouraging governments around the world to incorporate green finance into their national strategies, promoting comprehensive, sustainable and green growth, strengthening laws and regulations on green finance, promoting green investment and economy, establishing a guarantee mechanism for green projects, developing the green financial market and encouraging inflow of private capital by developing diversified financial instruments will all aid the establishment of a global green financial system.



7. **Promoting inclusive finance development.** Inclusive finance development will be promoted by enhancing internationalisation, global co-operation and financing for small and medium-sized enterprises, promoting balanced development in the economic and social sectors, encouraging all nations to upgrade social welfare and social security, reduce poverty, protect the poor and vulnerable, and provide more secure, convenient and safe financial services to the general public, and facilitating world peace, social stability and improving people's lives.

8. **Boosting growth through financial innovation.** The core of financial innovation lies in utilising technology to perform the fundamental function of finance – to boost the real economy's development. Growth will also be aided via strengthening governance and regulation over the digital economy and finance, emphasising supervision over the potential benefits and risks of e-commerce, enhancing the inclusion of areas such as digital revolution and blockchain technologies, and establishing a fair and effective regulatory mechanism and framework.

9. **Promoting the BRI and the Silk Road Action Plan.** The BRI has been promoted in the establishment of the Silk Road International Association (SRIA) and SRIA summits. The BRI will be further promoted by creating a development blueprint that involves the international community, global market and private capital to provide new engines for co-operation on the BRI, promoting regional co-operation, constructing win-win and multi-win landscapes, building a common interest community and facilitating world peace, inclusion and sustainable development.

10. **Establishing the IFF Institute.** The IFF Institute will be established through the IFF international academic network mechanism, to carry out profound, collaborative research on major financial issues. Discussing and putting forward proposals on promoting co-operation, enhancing the reform of the global financial system and the diversification of international currencies, establishing a fair, inclusive and orderly international financial system, and publishing high-level, forward-looking and instructive academic reports have also contributed.

11. **Establishing the IFF Academy.** A comprehensive, cross-disciplinary education institution with global influence that integrates financial training, innovation and practices has been established. It strives to cultivate qualified and multi-skilled personnel in the financial field, and equip them with innovative ideas, new knowledge and skills that meet global requirements, They will be a leading force in the field of new capital, with abundant practical experience and overall strategic vision. The institution aims to be a prominent global financial educator, as well as a platform for cultivating high-potential talent via the promotion of global exchange, collaboration and development of international finance.

The IFF firmly believes that, by continuing to develop alongside the F20 global network, the essence of finance can be restored to serve the real economy, reshape and improve the basic economic system, and ultimately accelerate global economic recovery and bolster the comprehensive and sustainable development of the world economy.

Enhancing the role of finance in supporting the real economy

Sun Yiting, director of the China Sustainable Finance Project of the World Wide Fund for Nature, discusses the static role of finance in supporting the real economy, and identifies five ways of broadening its influence

China's bicycle-sharing system is an example of an innovative industry that has benefited from a competitive market and little requirement for technology

Sun Yiting

The report of the 19th National Congress of the Communist Party of China proposed to deepen financial reform and strengthen the role of finance in supporting the real economy, which is a clear direction for the market economy under socialism with Chinese characteristics in the 'new era' of Chinese politics and power. Measures to cut costs, released by the National Development and Reform Commission, alongside three ministries and the *Implementation plan for establishment of inclusive financial business divisions by medium and large-sized commercial banks*, co-released by eleven ministries, all emphasise the major problem of finance lacking the strength to support the real economy. To address this issue, the following five fundamental problems must be resolved:

Types of projects that need support

Financial projects can be divided into three categories: mature and market-oriented projects, which can easily acquire bank loans; projects in the public interest, which are highly external and depend entirely on public capital and finance; and projects that lie between projects that have both public and private benefits, which are the focus of this article.

Four types of project deserve financial support: projects with advanced and world-leading technology; innovative projects; projects of huge influence on social and economic development; and distinctive projects that can promote local diversity. In this sense, a list of real economies that require financial support should be compiled, so banks can act accordingly. Only with a full picture of the entire industry and an understanding of clearly defined goals can appropriate financial and policy support be provided.

Encourage innovation and entrepreneurship

The development of the real economy requires financial support, but this is neither an effort towards poverty reduction nor public welfare. Factors such as commerciality, risk management, technology, business models and market prospects must all be taken into consideration. China's bicycle-sharing system, for example, is highly competitive, yet requires little technology. Comprehensive risk assessment is recommended before financial support is offered in this industry. The government has granted tax incentives and subsidies to many enterprises. However, these preferential treatments are used to improve balance sheets and increase cashflow, rather than capital operation, technological innovation and long-term planning. To continuously increase the ability of financial services in supporting the real economy, we need to encourage innovation and entrepreneurship.

Expand financing channels

For a long time, China's real economy had no access to financing, and its banking systems still have many limitations and difficulties. Different financing channels should be chosen according to the progress and characteristics of various projects. For projects in their early stages, angel funds and venture capital should be considered. In the 20th century, many industries in the US relied on private capital to achieve solid growth. In subsequent stages, private equity funds and bank loans can be turned to for further financing. Once projects have reached certain maturity, capital market tools such as bond and equity financing can be adopted. This way, different projects can have suitable investment and financing channels. To solve the problem of financing, we must also increase the number of small and medium-sized financial institutions. Large and medium-sized banks, small banks and even smaller micro-banks are all required to provide financial services to different industries and regions. To provide more help for the real economy, foreign financial institutions are welcomed to invest in shares in the Chinese market.

Ensure financial support to the real economy through carefully undertaking appropriate groundwork

Groundwork must be undertaken in four key areas. The first is information management and big data analysis. The second is the establishment of individual, business and government credit systems – government credit refers to the ability to borrow and issue debts, as well as the responsibility for commitments. In the current context, the credit system is of crucial importance in utilising finance to support the real economy. Third, the relevant legal system should be improved. Fourth, patent mechanisms should be established to encourage innovation and entrepreneurship – this is essential for innovation and the future of industries.

Give full access to market mechanisms and clarify the roles of government and market in the real economy

The government has two responsibilities. First, rules and red lines should be established for the real economy to ensure it operates within an appropriate range. Second, necessary financial and tax measures should be taken to support the real economy, and a prosperous investment and business environment must be created. Also, financial institutions need to conform with the law of the market, and all achievable governmental policies should be implemented. ■

Establishing a multilayered banking system to support the real economy

Wang Yuan, IFF Academic Committee member and former chief economist at the China Development Bank, discusses why China must let the market play the decisive role in allocating market resources

China surpassed the US as the world's largest manufacturing country in 2010. This could never have been accomplished without financial support such as bank and capital market financing, as private capital and government funds alone are far from sufficient. The course of economic reform and the transition from a centrally planned economy to a market system requires banking institutions and capital markets to play a more important role in promoting the development of infrastructure and manufacturing industries in China.


Wang Yuan

Bank financing and credit enhancement

Some argue that financial institutions did not provide sufficient finance in the real economy, as adequate support is not in place. The reality is China has relied on indirect financing for a long time, which means bank loans are the major source of finance for these enterprises. Prior to the 1980s, investment capital came largely from public finance, while banks provided only working capital. For example, working capital required by manufacturing industries was mostly short-term – no longer than one year – and the long-term investment required by state-owned enterprises (SOEs), which generally came from the public budget, was unsustainable. The expansion of the production scale was constrained by the limited source of finance. Since the 1980s, the average growth rate of the Chinese economy has been around 10% annually. It is crucial to break up the bottleneck of financing. Therefore, the reform of the financial sector, including banks and capital markets, has been a high priority on the reform agenda.

Banks provide credit enhancement as well as capital to companies to be listed on capital markets. If companies want to issue bonds, ratings companies would review the credit history of the companies with the bank. But, if companies fail to borrow money from banks, their corporate ratings be downgraded, which makes issuing bonds even harder as costs will be higher.

Making contact with high-quality customers

In the 1980s, major banks in China were specialised in their respective business areas. There was no overlap of their business, thus, no competition among the state banks. For example, the Industrial and Commercial Bank of China provided mostly household deposit services and offered loans to customers in industrial and commercial fields, the China Construction Bank focused on capital investment finance, the Bank of China provided rate finance and the Agricultural Bank of China based its activities in the vast rural hinterlands. Only the Bank of China could carry out foreign exchange business. However, in the past 20 years, banks in China have undergone massive changes and developed a completely new system.

The ownership of the banks has been diversified, in addition to those banks with the state as their major shareholder. There are shareholding banks, private banks, joint-venture banks and fully foreign-owned banks operating in the market. For the business scope, all fully licensed banks are allowed to operate in renminbi and foreign exchange.

Now banks in China are operating in a quite competitive environment, not only for attracting deposits but also for retaining high-quality customers for loans.

In the meantime, the financial regulatory system was established to put the risk control in the banks' management.

Bank of China, Hong Kong

Establishing a multilayered banking system

The Chinese banking system needs to be further diversified – if the service would cover all types of clients and vast geographic regions, in the area of financing, small and medium-sized enterprises (SMEs), small-scale regional banks and micro-financing companies play very important roles. The slogan for many microloan banks is 'know your customer', so that banks and customers share common ground, which in turn helps banks find high-quality customers. Additionally, customers who borrow from the bank can expand their businesses, which is creating a virtuous circle for both customers and banks.

The China Development Bank (CDB) is a state-owned wholesale bank. Its traditional business is financing infrastructures and urban utilities as well as high-tech industry. The bank's chairman, Chen Yuan, believes everyone should enjoy equal financing rights – an innovation in financial services. Also, the bank should perform its social responsibility in supporting economic and social development. In the past 10 years, CDB's operations have also extended to micro-finance and SMEs. The fund wholesaled the loans to urban and rural commercial banks and lend to SMEs.

The financial services industry develops a synergy with industries, as banks cannot survive on their own. Many criticise banks for not lending enough to real sectors, but limiting the funds circulating within the financial system, but the current regulatory system in China does not allow bank funds to enter the capital market, may cause turbulence within the financial system.

Supporting the real economy via banking institutions

If comprehensive reform does not occur in the area of SOE reform, the banking system will find itself trapped in a vicious circle. Banks are obliged to support SOEs. With the protection of the government, the financing from the banks will not be sustainable. Meanwhile, creating a social security system, will relieve banks of the burden of injecting loans to loss-making enterprises that otherwise would have gone bankrupt.

Many banks are now listed companies in both Shanghai and Hong Kong. Profit-making is also an important objective of these banks. They would not be able to support SOEs at their own loss.

The report of the 19th National Congress of the Communist Party of China (CPC) proposed that, in the next five to 10 years, China should continue carrying out reform and the financial industry must stay on the right track. For historical reasons, state-owned financial institutions account for a large proportion of China's financial system but, in the future, private capital must be allowed to enter the financial realm.

Recently, the China Securities Regulatory Commission announced that foreign capital is now permitted to own up to 51% of total shares of a security firm, a very big step forward to 'opening-up' the capital market in China. The shareholding structures of asset management companies and futures companies have also been relaxed.

The world is watching China with high expectations – but with concerns. President Xi Jinping identified potential future directions at the 19th CPC National Congress; however, the media merely reiterated President Xi's remarks, rather than initiating practical and realistic discussion. It is more important to openly debate how to formulate and implement policies, and identify the problems still to be solved.

Finally, an economy with mixed ownership should be encouraged. Different types of ownership were emphasised at the 19th CPC National Congress; this lays out the trajectory to give foreign and domestic private capital access to financial services. Supporting the real economy is not just a slogan – there is a need to implement the right policies for economic and social development, to have a financial regulatory system that is conducive to providing sustainable support to the real economy. To summarise, China must carry out further reform: by opening-up its economy on a larger scale, reducing administrative intervention and letting the market play the decisive role in allocating resources.

Fintech in the 'new era' – Sustainable and sound development

Li Dongrong, president of the National Internet Finance Association of China and former deputy governor of the People's Bank of China, discusses the growing importance of fintech and how innovation must be married to self-discipline for China to make a unique contribution in this field

In its growth, development, governance and continuing globalisation, the world economy is undergoing profound and multifaceted changes, and faces new risks and uncertainties. However, its upward trend means expectations for the market are gradually picking up. China's economy is also shifting from a phase of rapid growth to one of high-quality development. After the 19th National Congress of the Communist Party of China (CPC), China has extended supply-side structural reforms and promoted synergetic development between the real economy, technological innovation, modern finance and human resources that have increasingly enhanced its economic innovation and competitiveness.

Li Dongrong

Principles and policies for fintech development

A new round of technological and industrial revolution is beginning – the digital and shared economies have developed rapidly, accompanied by an explosion of artificial intelligence (AI), big data and cloud computing. Fintech is a deeply integrated combination of finance and technology, and is becoming the focus of global financial innovation and development. In recent years, many countries and international organisations have formulated policies to promote fintech development. Countries such as the UK, Singapore and Australia have begun to implement a regulatory 'sandbox' to create an inclusive and innovative regulatory environment for fintech. Before US President Barack Obama's departure from office in 2017, the US National Economic Council published a white paper entitled *Framework for fintech*, which clearly set out the administration's principles and framework policies for innovation in fintech, and aimed to promote its sound and sustainable development.

The International Monetary Fund, the Financial Stability Board, the International Organization for Standardization and other international groups have divined the huge importance of fintech, and set up research groups, working groups and specialist committees. These will undertake deep analysis of the impacts on monetary policy, financial stability and international financial governance, and will play an active role in establishing the international policy framework for fintech. After years of discussion, a global consensus of principles on fintech has been reached. Some principles emphasise the driving force of scientific and technological innovation in fintech, and that while developing consumer protection should be the premise, inclusive finance should be the highlight and risk prevention the core, thus establishing guidelines for countries intending to promote sound fintech development.

International experience in a Chinese context

Fintech is gathering momentum on the global stage, and China has been at the forefront in terms of market size and depth of innovation.

But China must also draw lessons from other countries in their experience of fintech development. Many countries, regions and international organisations have explored fintech more deeply and have acquired successful experience worth studying.

Taking a practical, China-focused stance and taking into account the realities of its market, institutions and regulations will allow China to build a fintech system in line with national characteristics and make unique contributions to the global fintech era. Reform and regulation should reflect local environments, the condition of enterprises and supporting software, including the management, accounting and standard systems. Taking a view divorced from reality will lead to insufficient development.

Sustainable global fintech – Development value

The healthy and sustainable development of global fintech can be continued in the following ways. First, there is a need to pay attention to the development value, development concept and innovation trends. An old saying in China is 'when pulling a wagon, we should both lower our heads to take care of the wagon and look up for the road', emphasising the importance of future directions of development. Finance is a widespread, wealth-oriented industry characterised by high risk and inherent vulnerability. These properties – without a correct development value or concept in place – can result in overexpansion, irrational prosperity and economic crisis. For example, the subprime mortgage crisis that began in 2007–2008 and led to the recession in the US and global financial crisis. Other crises around the globe have been caused by similar mechanisms – deviation and overcomplicated financial innovation. The development of Chinese fintech in a 'new era' of Chinese politics and power should never fall into the same trap.

Can fintech improve efficiency and quality in the real economy, and is it conducive to the protection of consumer rights, in such a way that fintech innovation can continue unabated? Excessive, unrealistic innovation outstripping the ability to risk-manage should not be encouraged, and innovations that do not comply with laws and separate themselves from the requirements of the real economy should be identified as 'fake innovation'.

Technological and institutional innovation

Second, China should emphasise both technological and institutional innovation. Currently, digital technologies such as big data, cloud computing and AI have been applied on an unprecedented scale; fintech has played an active role in enhancing finance efficiency, enlarging service range and promoting inclusive finance. While technological innovation is used to solve problems such as high cost, inefficiency and the mismatch between supply and demand, new challenges – such as the digital divide, excessive technological dependence and multiple risk overlays – may arise.

Technological innovation is not a cure-all, and fintech cannot rely solely on technological breakthroughs. Importance should be attached to promoting both technological and institutional innovation, adjusting and improving laws, regulations, inspections and standards in a timely manner, and enhancing the integration of technological and institutional innovation, identifying directions, bottom lines and rules for fintech. In this regard, the Chinese government has organised its departments to conduct positive explorations. In July 2015, in accordance with the request made by the State Council of the People's Republic of China, the People's Bank of China and 10 central government ministries and industry regulators jointly released the *Guidelines for promoting the healthy development of internet finance*, clearly setting out the fundamental rules, inspections and divisions of labour in fintech, and have introduced inspection and governance standards for online payment and individual online lending. These measures have made great progress towards legalising and standardising fintech.

Risk management

Third, throughout the history of human civilisation, finding an equilibrium between financial innovation and risk management has been problematic. Financial innovation always takes the lead in the game against regulation. However, regulation should not fall behind too far or too long; the lag should be carefully managed. In the process of fintech development, a balance of innovation and regulation must be maintained, so as to realise the dynamism and virtuous circle of regulation, innovation, re-regulation and re-innovation.

On the one hand, new tools such as the regulatory sandbox might strengthen China's fintech supervision position. By applying new tools, China can set up mechanisms for trial and error, fault tolerance and error correction. Under the premise of controllable risk, it can conduct pilot projects and product testing, providing fintech with better future performance. On the other hand, China must ensure that all financial services are under supervision and all services have market access. Prudent supplementary supervision and a long-term regulatory mechanism with full coverage of financial and technological risks should be established. The mechanism should be thorough and able to track transactions from source to the end destination, and connect all links between assets and debt. Regulators must constantly improve their regulatory capabilities and improve their management practices; after all, it is not an easy job for supervision departments to have complete control of fintech innovation – it requires hard work and capability.

Industry self-disciplining

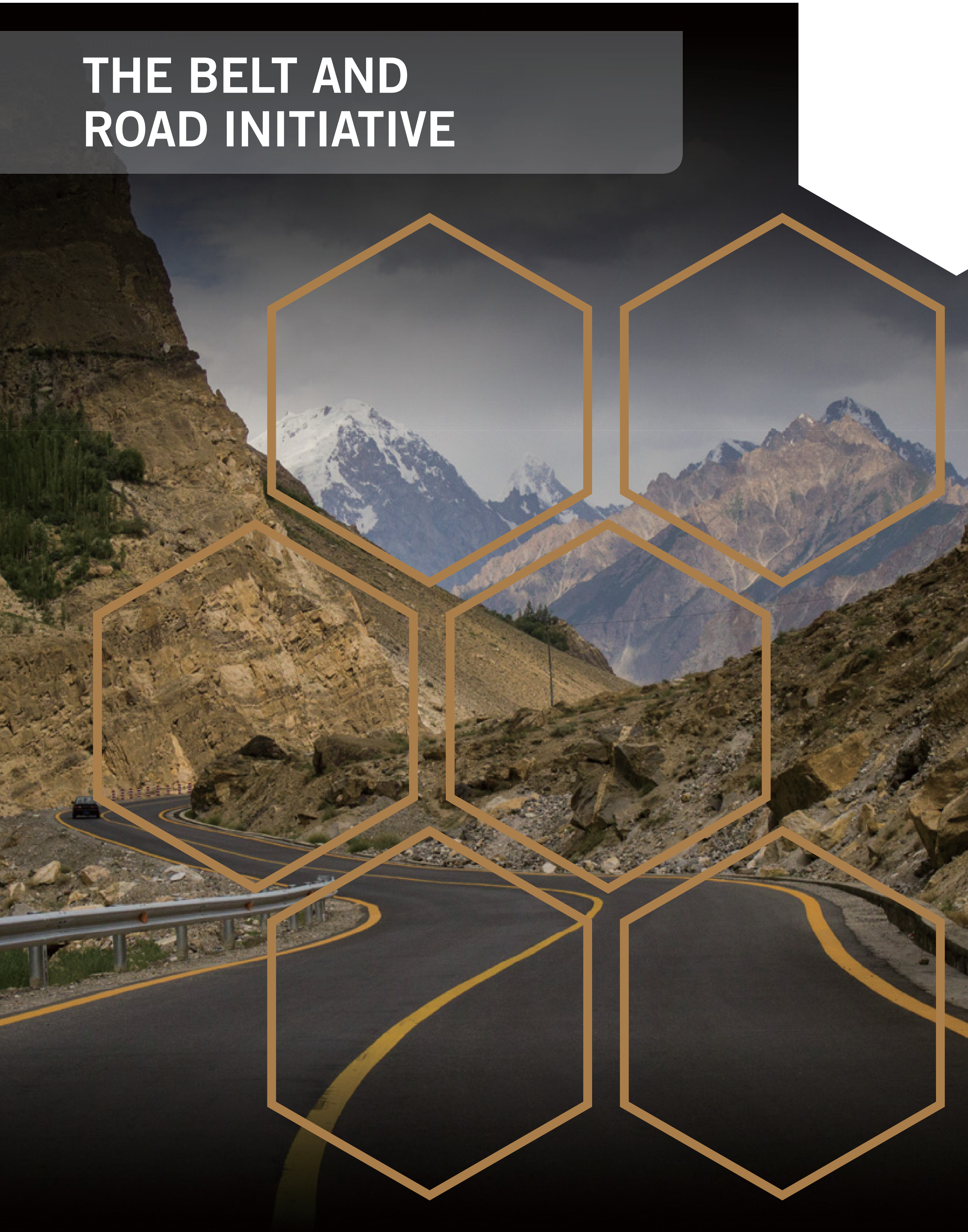
Fourth, industry self-discipline is, theoretically, a typical market-restraint mechanism. Through market-oriented standards and rules, information disclosure and self-policing, opportunistic behaviours by employers that consider only short-term interests can be reduced, and the integrity awareness of market participants can be cultivated to form positive external social capital. At the same time, industry self-discipline is an effective market mechanism for communication. With the development of fintech, the financial services market is becoming increasingly complex and overlapping. Financial industry developments have depended on difficult-to-regulate mixed operations. The complexity and interdependence of the market has caused the government and market to suffer from severe information asymmetry, resulting in onerous management of market expectations. Therefore, through industry self-discipline, standardised, transparent and centralised industry data for the government can establish effective communication and dialogue mechanisms, and reduce the cost of communication between the government and the market.

Fintech is gathering momentum on the global stage, and China has been at the forefront in terms of market size and depth of innovation

Wherever administrative regulation and industry self-discipline can be co-ordinated, a mechanism of great significance to the supervision of innovation can be established. In this respect, China has already made inroads: in March 2016, the State Council approved the establishment of a national self-regulatory organisation specialising in fintech, the National Internet Finance Association of China (NIFA). Since then, self-regulatory groups have respected the market rules and served as a bridge between the government and the market. They have also attempted to accelerate the gathering of data statistics, risk monitoring, information disclosure and credit information sharing. In particular, they have focused on the prevention and control of financial risks as well as consumer protections, and unveiled industry standards and self-regulatory rules on information disclosure, contract elements registration and deposit of funds. Progress has also been made in regulating the market order of fintech and promoting its sound development.

Around the globe, fintech is constantly developing and maturing, and many fundamental tasks still need to be explored. NIFA is willing to work together with every country to strengthen communication and co-operation, to learn from each other, and to jointly promote fintech worldwide, in order to serve the global economy and social development. ■

THE BELT AND ROAD INITIATIVE



Upgrading globalisation

Gu Shengzu, vice-chairman of the IFF and vice-chairman of the National Committee of the Chinese People's Political Consultative Conference, believes the Belt and Road Initiative will unlock connectivity and create a new, inclusive and transformational type of globalisation

In 2017, the Trump administration announced the US's intention to withdraw from the Paris Climate Agreement, which – as the world's second-greatest emitter of greenhouse gases – caused tremendous unease among the international community. UN secretary-general Antonio Guterres responded to the announcement by saying: "If the US withdraws from its global leadership role, other countries will surely replace it." President Xi Jinping described economic globalisation as a "double-edged sword" – it has fuelled global economic growth, but has also created global economic conflicts, such as a lack of robust driving forces for global growth, inadequate global economic governance and uneven global development.

Protectionism a backward step

Currently, the richest 1% of the world's population owns more wealth than the other 99%, with around 700 million people living in extreme poverty. Italy's youth unemployment rate is almost 40%, and in some US states it exceeds 30%. In the face of the problems associated with globalisation, two options lie ahead: to resort to exclusionism, protectionism and deglobalisation; or to adjust and reform traditional globalisation, moving ahead with a new version of globalisation through transformation and upgrading. The first option – an example of which is the US's protectionist move in April 2017 of launching an investigation into steel imports in the name of national security – can only lead to a lose-lose scenario.

President Xi's response to this was blunt: "Pursuing protectionism is like locking oneself in a dark room – while wind and rain may be kept outside, the dark room will also block light and air." Is the Belt and Road Initiative (BRI) a retrospective or a rejuvenating move? Is it about building up China's own back garden or a shared garden for all countries? Is it a Chinese Dream or a world dream? There are clear connections between the BRI and the Silk Route, especially in the 'Silk Road spirit'. The BRI also transcends the Silk Route in terms of geographic reach – as there will be more participating countries – and quality. President Xi intends for the BRI to improve the 'five connectivities', namely the connectivities of policy, infrastructure, trade, finance and people. At the Belt and Road Forum for International Cooperation in May 2017, he proposed building five 'roads' – to peace, prosperity, openness, civilisation and innovation. Clearly, the BRI is not a solo performance by China, but a 'chorus' by all of the countries along the Silk Road Economic Belt.

The Belt and Road Forum has accelerated the transformation of the BRI from a Chinese initiative to a global consensus – from a concept to an action. The forum also announced that the BRI will have a goal of inclusive global development.

Gu Shengzu

BRI survey results

The author conducted a survey in nine countries along the Silk Road Economic Belt on how the BRI is positioned in the process of the new type of globalisation, which concluded the following:

- The combination of chance and risk – there are huge potential risks in building the BRI, so it's critical to seize the opportunities while accurately assessing the risks.
- The co-existence of interests and obligations – the BRI is not only shaping a community of shared interests, but a community of shared responsibilities.
- The equal role of the government and the market – the government is responsible for top-level design and, as major players in the market, enterprises are equally important.
- The interdependence of economy and culture – these serve as two wheels on the BRI's drive towards globalisation.

President Xi has said that the Silk Route was a promised land of milk and honey. Today, the countries along the Silk Road Economic Belt are often associated with conflict, turbulence and challenges. There is still a long and difficult journey before the BRI can be built as a road to peace. The construction of the BRI requires joint participation of governments, enterprises, financial institutions, think tanks and media, and calls for co-ordinated action from government officials, enterprise leaders, financial managers, academic experts and media workers. Regarding top-level design, there are four requirements: to be 'new', by employing reform and innovation; connectivity, which is the most frequently used word in the BRI; to be 'together', by engaging in win-win co-operation; and the improvement of governance on a global level. In terms of systematic architecture, we need one 'top', a top-level design that aims for win-win co-operation;

two 'wheels', economic co-operation, and sustainable development and people-to-people exchanges; six 'pillars': infrastructure, trade, industrial investment, finance, energy and technological innovation; and one 'base', optimisation of the global governance system. To achieve this, the author proposes the following:

- **Promoting strategic connections with countries along the Silk Road Economic Belt.** This would reinforce the strategic consensus and improve bilateral and multilateral communication mechanisms. China will build a shared community – a community with a shared vision for the future of mankind – and achieve inclusive globalisation through win-win co-operation. It will be key how the BRI links together the strategies of the countries along the Silk Road Economic Belt and other international agreements, such as the UN's 2030 Sustainable Development Goals agreement and the Paris Climate Agreement.
- **Boosting infrastructure connectivity.** This refers not only to the connectivity of construction sites, but also of policies, rules and standards as we seek to propel free circulation of factors and optimise configuration. There is an old Chinese saying about alleviating poverty that explains the importance of free circulation of factors: 'If you want to acquire wealth, fix the road first.'
- **Establishing a balanced and equal trade and investment system.** The trade volume among countries along the Silk Road Economic Belt accounts for a large proportion of the global total. China has promised to import commodities worth US$2 trillion and set up a series of co-operation areas, which will be essential to industrial collaboration and must be guided by private enterprise.
- **Constructing a multi-tier financial system.** This will enhance global financial stability by encouraging development, commercial and inclusive finance, and promoting the connections of various financial services. The Asian Infrastructure Investment Bank and Silk Road Fund boast excellent institutional designs and can unlock financial connectivity.
- **Strengthening international energy co-operation.** China will adapt its one-way model of oil and pipeline building into a multidimensional one.
- **Advancing scientific co-operation among talented individuals.** At the Belt and Road Forum, President Xi said that the BRI should be a road of innovation, inspiring deeper scientific and technological co-operation. China has signed agreements on intergovernmental scientific and technological collaboration with 49 countries along the Silk Road Economic Belt, and many countries are calling for the enhancement of co-operation on the part of high-tech parks in the BRI.
- **Making people-to-people connectivity and cultural integration the top priority.** Cultural soft power should be built through external discourse that gains value consensus and mutual strategic trust through people-to-people connectivity. Serving as the bedrock of the others, it is the most important of the five connectivities.

> *"Pursuing protectionism is like locking oneself in a dark room – while wind and rain may be kept outside, the dark room will also block light and air"*
>
> *President of China, Xi Jinping*

China will reform the international governance system and make more contributions to the public good. For example, governance philosophy and rules that aim to raise the influence of developing countries in global governance and promote a more just and reasonable international order. The theme of the 2016 G20 Hangzhou summit was innovation, openness, development and greenness, which match the development concepts laid out in China's 13th Five-Year Plan: innovation, co-ordination, greenness, and open and shared benefits. It is fair to say that the G20 summit had a distinctly Chinese flavour. The BRI is a new platform for international co-operation, an upgraded version of China's reform and 'opening-up', a leader in new and inclusive globalisation and a new engine to drive inclusive global development. ■

Unlocking BRI success through the legal keyhole

Translating the vision of the Belt and Road Initiative into reality requires recalibration of the international legal system, believes *Zhou Hanmin*, vice-chairman of the Municipal Chinese People's Political Consultative Conference Committee of Shanghai, and vice-chairman of the China National Democratic Construction Association

Shanghai World Financial Center

An ancient Chinese proverb states that 'preparedness ensures success'. The strategic concept, vision and implementation of the Belt and Road Initiative (BRI) will not be accomplished with a single stroke but with effort over a number of decades. Of course, any international strategy must take into account the investment environment and its political, economic, cultural, social and legal elements.

From its official launch in September 2013, to when its underlying framework and principles were unveiled in March 2015, the BRI has grown from a grand concept into a vision attracting positive consensus and action with the support and participation of neighbours and international organisations. Moreover, its importance was manifested in two documents: one from the UN General Assembly in November 2016,[1] and another from the UN Security Council in March 2017.[2] Chinese enterprises invested US$51.1 billion in countries along the BRI between 2014 and 2016. In 2016, the total trade volume between China and countries along the route exceeded US$1 trillion, with China's foreign trade totalling US$3.65 trillion. Though this situation seems encouraging, the five aforementioned elements must not be overlooked.

Political turmoil and frequent chaos haunt some regions neighbouring the BRI; and some countries still have not made specific provisions of compensation for national requisition and expropriation.

Economic objectives

Over the past five years, the average annual economic growth rate of developed countries has been 2.5%, while developing countries have outpaced them at 4.0%. China's average annual GDP growth over the same period has been 7.2% – the highest in the world. However, many of its partner countries along the BRI have a long way to go towards adjusting their economic structures and establishing their economic development objectives.

Clearly, the world is still mired in the impact of the international financial crisis that began in 2007–2008. In January 2017, global economic growth was forecast to grow by 3.1% over the year; currently, predictions have been raised slightly, to 3.5%.

At the start of 2017, the World Trade Organization (WTO) forecast that global trade would increase by 1.7%. In May, after China had already registered double-digit trade growth, the WTO increased that forecast to 3.4% – still below the world economic growth forecast, and indicating that the world economy is still

1. *UN General Assembly, 71st session, Agenda item 36,* The situation in Afghanistan, *http://bit.ly/2HUkaWx*
2. *UN Security Council, Resolution 2344 (2017), adopted by the Security Council at its 7,902nd meeting, March 17, 2017, http://bit.ly/2uaNwhv*

overshadowed by the ongoing impact of the global financial crisis, as well as nebulous economic development goals and a maladjusted economic structure.

Guarding against risk

The growing tendencies towards extreme nationalism in some regions, triggered to some extent by cultural homogeneity, will require particular attention. This can be overcome by clean governance that supports the growth of investment and a fair and just social environment. Law enforcement in countries along the BRI remains inadequate and needs to be updated to build fit-for-purpose, modern legal systems.

Risks are often regarded as threats to be avoided, yet a strategy of international development and co-operation of this scale will inevitably encounter risk, and we must therefore learn to guard against it. The BRI proposes the principles of extensive consultation, joint contribution and shared benefits, which could be said to be founded on the most basic principles of international law. Extensive consultation serves as an expansion of an important principle of international law – mutual respect for sovereignty. Proceeding from this principle, all countries – regardless of their size, strength or levels of development – will work together to discuss the push to complete the BRI. The second principle, that of joint contribution is grounded in the primacy of the contract. The major issue concerning the construction of the BRI is how to carry forward the spirit of contract. Finally, achieving shared benefits requires many legal principles – property rights, labour laws and intellectual property protection.

The legal element

To translate the ambitious vision of the BRI into reality, the legal system must be reconsidered as the most fundamental element, which can be built up from the following dimensions:

1. **Legislation in China must be improved.** The Foreign Investment Law should be enacted and made a fundamental legal tenet. In 2016, China ranked third in the world in enticing foreign investment, importing about US$124 billion of investment, a slight decrease of 1% over the previous year. China's overseas investment in 2016 was US$183 billion, the second-highest in the world, with its overseas investment growth rate reaching 44.1%. Against such a backdrop, it is very important for China to promulgate the foreign investment law to enable Chinese enterprises, state- or privately owned, to make giant strides in keeping up with the rest of the world.

2. **More negotiations on international treaties should be completed.** China has, so far, signed bilateral tax treaties with 56 countries, bilateral investment agreements with 60 countries and bilateral aviation agreements with 52 countries. Those three kinds of agreements are extremely valuable – yet they are still far from enough.

3. **Capitalise on the current legal framework.** An important contribution to the BRI's progress would be, for example, partnering with non-governmental associations such as the Asian-African Legal Consultative Association, which consists of 47 member states, 28 of which are countries along the route.

Zhou Hanmin

4. **Endeavour to advance building the institution of the WTO.** Many countries along the BRI are yet to join the 164-strong WTO membership. To create a multilateral system, China must push to strengthen the WTO by urging these countries to join. Once this has been achieved, it will be essential to prioritise the negotiation of the peripheral system. The most crucial current peripheral system negotiation is the Regional Comprehensive Economic Partnership (RCEP). Those taking part in the '10+6' negotiation – including the 10 members of the Association of Southeast Asian Nations plus Australia, China, India, Japan, New Zealand and the Republic of Korea – have committed to completing these negotiations by the end of 2018. The success of RCEP negotiations could reap benefits for the implementation of the BRI, its 'six corridors' and '5+15 port constructions'. Trilateral negotiation between China, Japan and the Republic of Korea over a free-trade agreement can also play a leading, exemplary role in the development of the BRI.

5. **Dispute settlement.** Four controversies plague Chinese enterprises 'Going Out'. The first is the controversy over contract law. Risks here can be managed by finding a means of dispute resolution and the ability to guard against risks. The second controversy is protection of intellectual property rights. The third is labour law-related disputes, and the fourth is property law-related disputes. On the one hand, to resolve these disputes, we could resort to appropriate law, accounting and auditing firms. On the other – especially if disputes among enterprises arise – the 1958 New York Convention and the 1965 Washington Convention should be studied fully to extract complete awareness of successfully resorting to arbitration.

Some commentators have argued that the global legal system can be divided into a common law and a civil law system. However, no two countries have the same legal system. To this end, as an investment country, the most important means for China's enterprises to 'Go Out' while preventing risk is to gain the most thorough understanding of the status quo, structure and content of the laws of destined countries.

The first step for the BRI is to establish a sound legal environment that will serve as a bedrock and holds the key to controlling elements in the political, economic, cultural and social environments.

A new insurance industry – Protecting the BRI's interests

Political, legal and economic risks proliferate in the developing countries along the route of the Belt and Road Initiative, and China is building a modern, dynamic insurance industry to serve and actively respond to the risk protection, economic and social development needs in the region, explains *Zhou Yanli*, IFF vice-chairman and former vice-chairman of the China Insurance Regulatory Commission

Zhou Yanli

The Belt and Road Initiative (BRI) is a win-win solution for participating countries as they work together to achieve greater development, though this is not without risk. The modern insurance industry has its origins in the booming maritime trade, and the history of marine insurance is evident in the history of the global flow of goods and capital in the great navigation era. The developments of the insurance industry and advancements in insurance technology have provided strong support for globalisation over the past century. *Opinions of the State Council on accelerating the development of modern insurance industry* [1] confirmed the importance of insurance as a modern Chinese industry and a fundamental means of risk management.

By serving the BRI, the insurance industry meets the inevitable demands on it to serve national strategy and the real economy. The insurance industry must also adapt to the new situation of China's 'opening-up' to the outside world, and better serve the real economy. At this critical moment, the insurance industry must seize its opportunity and make the best of its strengths – financial support, risk management, credit management and regulatory systems – to achieve global development while providing an array of risk guarantees and financing services to invigorate the BRI's development. History has endowed a major responsibility to the insurance industry.

This article describes the significance of the BRI and analyses the risks it faces, the demands on insurance in the BRI, the development of the insurance industries in countries along the route and how the insurance industry serves the BRI. The direction in which the insurance industry must travel and the measures it must take to serve the BRI are also explored.

An inevitable choice for China's economic development

An initiative for development, co-operation and openness, the BRI has inherited the traditions of the ancient Silk Route. It is a 'bridge' connecting Asia with Europe and Africa, in line with the requirements of the times and the desires of all countries to accelerate development. Through emphasising the principles of extensive consultation, joint contribution and shared benefits, it aims to pursue equally the connectivity of policy, infrastructure, trade, capital and people. Through various forms of co-operation, the BRI is committed to boosting contacts and exchanges between China and other countries along the route, and promoting strategic partnerships for regional economies to reap win-win rewards. The implementation of the BRI is conducive to China's opening-up to the outside world, advancing China's economic transformation, ensuring the security of the strategic gateway and expanding China's international influence. Meanwhile, it can drive the economic development of countries along the route and boost global economic recovery through peace and stability.

1. *The State Council,* Opinions of the State Council on accelerating the development of modern insurance industry*, 2014 no. 29, http://bit.ly/2p6tBLC*

Facing an array of risks

More than 100 countries and international organisations are currently participating in the BRI, of which more than 40 have signed co-operation agreements with China. Many major projects have been put in place and unexpected additional progress and achievements have been made in the fields of infrastructure, project co-operation, trade and investment. However, countries along the BRI are primarily emerging markets and underdeveloped countries, often with weak economic bases, volatile political situations and ethnic conflicts. The BRI is expected to face the risk of default as well as political, economic and legal risks, which pose severe challenges to the BRI currently and will continue to do so in the future. Political risk includes geopolitical risk – action taken by major powers and regime changes; economic risk is mainly triggered by the fragility of the investment environment, the international market environment and enterprises' capabilities for international operation; and legal risk includes risks being subject to the laws and regulations of the host country and the challenges of negotiating with host governments or enterprises.

Insurance needs

The centrality of risk management differentiates the insurance industry from other financial industries. As a market-based risk management and financing mechanism, the insurance industry has accelerated the development of overseas investment insurance and other insurance businesses based on the requirements of the BRI. It has given full play to its role in loss reimbursement. The insurance industry has actively responded to the special risk protection needs in building core areas and node cities, and to the risks facing China's overseas personnel, property and investment, so as to provide comprehensive insurance coverage for the BRI. For example, in terms of property risk protection, customised insurance products and services – such as insurance covering engineering, fire, cargo transportation, transport facilities, liability and export credit – can provide property risk protections, allowing Chinese enterprises to 'Go Out'.

Meanwhile, in terms of personal risk protection, insurance for accidental worker injury and pensions for low-income, non-landowning individuals is highly suited to protecting workers constructing the BRI. In providing financial support, we can give full rein to large-scale, long-term and highly stable insurance funds and participate in the BRI through debt financing, equity investment, private equity funds, asset-backed plans and other ways under the premise of 'compliance with laws and regulations with controllable risks'.

Insurance development in BRI countries

The insurance industry has maintained steady growth against the backdrop of the global economic slowdown. The BRI involves 65 countries and regions from China through to central and eastern Europe. The quality of insurance markets in countries along the BRI is generally below the global average, and the depth and breadth of insurance coverage is relatively small. Yet the inauguration of the BRI in 2013 led to international insurance institutions becoming more active in the area through building global insurance service networks and creating customised products and services. More recently, China's insurance industry has also made remarkable achievements, greatly enhancing the capacity in serving economic and social development, expanding the scope of economic and social security, and improving its ability in infrastructure construction, positioning it well to deliver for the BRI.

China's insurance industry has emancipated its attitude and has boldly explored new ways of operating. On the one hand, it has promoted overall development while making the BRI's top-level design a success and, on the other, it has taken the initiative to connect risk protection and financing, innovate products and services, and make good progress in serving the BRI.

Most importantly, it has provided financial support. The China Insurance Regulatory Commission has accelerated market-based reform of insurance funds, reduced pre-approvals, relaxed restrictions on investment ratios, enriched investment forms and supported the participation of insurance funds to the BRI.

In addition, it has improved insurance services. The insurance industry tailors insurance solutions to the pattern of overseas investment projects and export contracts. It strengthens co-operation with banks to provide enterprises with value-added services such as information consultation and financing design, which enhances bidding advantages and investment and financing capabilities of enterprises to make large-scale exports of complete sets of equipment, overseas investment and overseas project contracting.

Finally, the insurance industry has reinforced collaborative work on supervision. It has boosted bilateral and multilateral insurance regulation co-operation in Asia and enhanced the regional influence of China's insurance regulation so as to better promote the late-mover advantage in emerging markets.

By serving the BRI, the insurance industry meets the inevitable demands on it to serve national strategy and the real economy

A new direction

The insurance industry should fully understand the importance of participating in and serving the BRI – enhancing its sense of responsibility – formulate effective development strategies and establish a long-term service mechanism. It must co-ordinate with the national strategy and be proactive in top-level design, product and service innovation, insurance investment, co-operation mechanism, and risk management and control, and protect the implementation of the BRI.

The insurance industry needs, foremost, to make co-ordinated efforts to ensure its top-level design serves the BRI. It must create more innovative products and services, it should explore new ways of directing funds, it must establish a co-operation mechanism, and it must enhance risk management and control for insurance in supporting the BRI. ■

The BRI – A new model of international co-operation

Globalisation is at a crossroads. *He Yafei*, former China vice-minister of foreign affairs and former China co-ordinator of the Group of 20, explains that China's unique approach to global challenges will light the path to a more open, inclusive and equitable world economy

The Karakoram Highway between China and Pakistan, part of the ancient Silk Route

Since the 18th National Congress of the Communist Party of China (CPC) in 2012, which ushered in a new historical era of relations between China and the rest of the world, President Xi Jinping has proposed a series of global public initiatives that embody Chinese thinking and are inspired by the success of China's domestic governance. These programmes target the future of globalisation and global governance by addressing the increasingly serious problems of deglobalisation, fragmentation and rising populism. The most critical of these is the Belt and Road Initiative (BRI). The principles of extensive consultation, joint contribution and shared benefits proposed in 2013, and the spirit of the Silk Road – "peace and co-operation, openness and inclusiveness, mutual learning and mutual benefit" – were put forward at the Belt and Road Forum for International Co-operation in May 2017. President Xi's series of guiding principles on innovating global governance not only supplies China with important guidelines, core concepts and concrete methods for more prominent participation in global governance, but also provides a public springboard for innovative ideas and models of global governance.

President Xi's way of thinking is manifested in the reaffirmation of the Group of 20 as the central platform in global economic governance and consensus on global governance reform reached at the G20 Hangzhou summit in 2016. This direction of thinking is also evident in his proposal for democratic international relations based on peace, co-operation and mutual benefit to build a global partnership network. President Xi's thoughts are also epitomised in the phrases that he popularised at the World Economic Forum Annual Meeting in 2017: "the community of shared interests" and "the community of shared future for mankind". These concepts and doctrines are intrinsically and culturally Chinese, and are closely integrated with the policy of reform and 'opening-up', as well as the acceptance that globalisation is bound to undergo great change. The international community is paying close attention to China's full assumption of its responsibilities.

The creation of a shared community – a community with a shared vision for the future of mankind – is the philosophical foundation of the BRI, and the BRI is an important path to achieving the goal of the community of shared future. Intimately connected, the two can be likened to a path and a road.

President Xi has declared that "people's aspiration for a better life is what we are striving for". This is not only the goal of China's development, but of global governance innovation. The BRI can manifest the spirit of inclusiveness, fairness and sharing, and it is hoped it can enable people in countries along the Silk Road Economic Belt to attain a greater sense of participation, economic success and happiness. People are the masters of history; they are also the owners and driving forces of globalisation. Whether it is the BRI, the collaboration of the Brics nations – Brazil, Russia, India, China and South Africa – or the Shanghai Cooperation Organisation, whether it is about establishing a global partnership or promoting the community of shared future for mankind, these new ideas and methods proposed by China always prioritise the fundamental interests of all peoples.

We currently stand at a crossroads between globalisation and deglobalisation. As Western neoliberalism declines, global governance cries out for structural reforms and a new guiding ideology and development model. The BRI has innovated the model of international co-operation, intending that countries along the Silk Road Economic Belt treat each other as equals, seeking common development, making progress together and enjoying common prosperity. Undoubtedly, the BRI combines the Chinese Dream with the world's dream, and reflects the high degree of consistency and parallels between China's national interests and the interests of the international community.

He Yafei

"The Belt and Road is not a Chinese solo [performance], but a chorus of people of all countries; it is not China's own back garden, but a beautiful garden shared by all countries." The implication of President Xi's assertion is that the BRI will encourage universal participation of people living in the countries along the Silk Road Economic Belt. Globalisation must be steered onto the right path, and success must not be the prerogative of a few countries, multinational corporations or interest groups. To usher in a new era of globalisation, the interests and happiness of people must always be prioritised.

The BRI will surely help drive globalisation forward in a more open, inclusive, equal and united way, enhancing and expanding openness and co-operation. President Xi said that only a prosperous nation could pursue opening-up with confidence and accelerate its own development. In the new era of globalisation, China will remain committed to a new pattern of all-round opening-up to the outside world – to developed and developing countries – reforming global governance by closing loopholes and exchanging Western dominance for collaboration between the Eastern and Western worlds.

The opening-up and co-operation embodied by the BRI will bring about the full integration of different civilisations in Eurasia, laying a solid foundation for the community of shared future for mankind and lending a new and robust impetus for world peace and economic growth. By supporting, guiding and serving the BRI, promoting currency circulation and expanding the breadth and depth of financial services, China will further broaden openness and co-operation among countries along the Silk Road Economic Belt.

Currently, the special fund for the BRI is beginning to take effect, and multilateral development financial institutions such as the Asian Development Bank, the New Development Bank and the Silk Road Fund have emerged. The Asian Infrastructure

Investment Bank made loans of US$1.73 billion to nine energy and infrastructure projects in seven countries and successfully implemented a public-private partnership model by leveraging US$12.5 billion. The Silk Road Fund focused on investment in hydropower, natural gas and other energy sectors with actual investment reaching US$4 billion by the end of 2016. In the meantime, the expansion of bilateral domestic currency swap settlement to countries along the Silk Road Economic Belt has become an essential vector of renminbi internationalisation. China has signed currency swap agreements with the central banks of 28 countries – including 18 countries and regions along the Silk Road Economic Belt – of up to CNY1.4 trillion.

The BRI is not a rootless tree or a 'castle in the air', but a response to the changes in globalisation rooted in China's own experience of economic development and national governance, and theoretical innovation. The key to China's sustained development is its adherence to a path of development that differs from economic neoliberalism and is in keeping with its national conditions. It has made the reliable and effective political system under the leadership of the CPC its institutional guarantee, giving full rein to both the market economy and government regulation. China has maintained the principle that development remains its foremost priority while ensuring social fairness. In line with the promotion of world peace and development, President Xi has proposed a series of new ideas for innovative global governance that embody China's new world outlook, which can be summarised in four new perspectives:

1. **A new perspective on great power.** China is now positioned at the centre of the world arena, and its ascent to power has not gone unnoticed by commentators, who highlight nascent conflicts between emerging and developed countries, and an unavoidable 'Thucydides Trap'. Yet China has fully engaged itself in global governance – the proposal and implementation of the BRI indicates that China will not resort to the traditional path of development. China advocates dialogue rather than confrontation, and partnership rather than alliance. The path to its prosperity lies in pursuing reform and opening-up, peaceful development, and win-win co-operation.

2. **A new perspective on development.** The goal of globalisation is to achieve economic interdependence and cultural integration, and to advance the community of shared interests to a community of shared future for mankind. Despite unavoidable twists and turns in the future, the big picture will remain unchanged. The BRI encourages partnership and a global network to bring about common prosperity and deeper integration of civilisations. In particular, China will aid a great number of developing countries in achieving industrialisation through infrastructure development, thus addressing the imbalance in the world's economic growth.

3. **A new perspective on international co-operation.** The BRI identifies equality, common development and win-win co-operation as fundamental principles of international relations. It aims to realise all-round co-operation with mutual respect to national development strategies and cultural differences. Truly democratic international relations call for the equal treatment and win-win co-operation of developed and developing countries. In line with changing global trends, the BRI emphasises not only co-operation between the developed and developing countries, but between the developing countries themselves.

4. **A new perspective on international order.** The BRI has reinforced China's image as a builder, defender and contributor to the international order. China not only endeavours to maintain that order, but also advocates developing countries' rights of decision-making and discourse to bridge the development gap and make the international system fairer and more reasonable.

The opening-up and co-operation embodied by the BRI will bring about the full integration of different civilisations in Eurasia

Creating new patterns

The BRI has engendered a new ideology, new developments and new patterns – three important aspects of the BRI that deserve attention.

First, inclusiveness forms a significant 'wing' of the battle against anti-globalisation. The Belt and Road Forum's message was one of the BRI bringing new co-operation opportunities and a greater sense of participation, economic prosperity and happiness to people in participating countries.

Second, the expedited co-ordination of global macroeconomic policies will achieve co-ordinated development and overcome global economic imbalances. Today's global economy requires an even more advanced level of co-ordination and co-operation. What the BRI advocates – common development, co-operation and shared development – is an excellent platform from which developing countries can benefit from the advantages of late development – that is, the ability to borrow the inventions and innovations of earlier developers – to keep pace with globalisation and adapt to global changes. The BRI emphasises the importance of interlinking the development strategies of all countries and mutually reinforcing the relationship between development and peace, thus providing new ideas for the co-ordinated development of all countries.

Third, as China implements the BRI, the world's greatest economic powers – China and the US in particular – are duty-bound to play an exemplary role in pacifying geopolitical conflicts, tracking the trend of globalisation, opposing trade protectionism, promoting global free trade and facilitating investment. Strengthening China-US co-operation will strengthen the confidence of global markets and further reduce risks. Rulemaking is at the core of the global order and international governance, and also of the BRI. The world can now clearly see whether China will seek common development, or merely act alone.

A route to economic growth

To mark the fifth anniversary of the Belt and Road Initiative (BRI), the IFF – in collaboration with Central Banking – conducted its inaugural Belt and Road Survey of central banks from more than 25 countries and regions. The survey examines BRI achievements, issues and experiences from the perspective of BRI countries. Most respondents expect the BRI to bolster their growth, but more effective co-ordination is required to fully unleash its potential. By *Zhang Jizhong* and *Christopher Jeffery*, with research by *Emma Glass*

Silk Route between China and India, Sikkim

China's Belt and Road Initiative (BRI) has the potential to be the largest development project in modern history. In terms of its scope and scale, there can be little doubt.

China's signature BRI has already signed up 71 jurisdictions, representing a combined population of around 3.5 billion, and trillions of dollars of investment have already been made in projects such as the Port of Piraeus in Greece, the Suez Canal in Egypt, a new high-speed railway in Thailand, the China–Belarus Industrial Park, the Yamal LNG project in Russia, upgrading the Serbian railway system in Belgrade and the development of Gwadar – a brand-new container port – in Pakistan and 1,800 miles of superhighway and high-speed railway to connect China's landlocked western provinces.

The BRI is not targeted as official development aid. It is a development strategy proposed by China focusing on connectivity and co-operation. Funding is expected to yield monetary returns and there will be economic consequences if projects fail to deliver on their expected returns. The sheer scale of the initiative also raises some challenges. Some are operational challenges – how capable are countries in terms of engaging into the BRI? What are the available sources of funding? What risks do they raise? Other issues are related to geopolitics. Could the China-led effort aimed at boosting economic development – in part by learning from China's own lessons from its economic development, as well as benefiting from its capital – spark tensions with the European Union, the US, Russia, Japan and India?

The International Finance Forum asked *Central Banking* Publications to survey central banks of countries participating in the BRI to gain their insight into the current state of the initiative and the challenges and opportunities it faces in the years ahead. Central banks were polled as they are key advisers to most governments on economic and financial matters, have technical competency – even in developing countries – and are often charged with financial stability in addition to being stewards of monetary policy. About one-quarter of BRI central banks have also arranged currency swap agreements with the People's Bank of China.

This article reports the findings of the survey, which was carried out in January and February 2018. The work has only been possible with the support and co-operation of the central bankers who agreed to take part. They did so on the condition that neither their names nor those of their central banks would be mentioned in this report.

Key findings

- Just under half of central banks described the BRI as a 'once-in-a-generation' initiative.
- Half of respondents said the BRI ranks above national development bank programmes in terms of importance; 21% ranked it above International Monetary Fund (IMF)/World Bank efforts; and 14% above regional development bank projects.
- Nearly three-quarters of those surveyed said the BRI has not yet resulted in greater investment from China than already expected.
- However, 92% of respondents expect the BRI to bolster domestic growth during the next five years, with 67% saying it will be greater than 0 and up to 1.5 percentage points, and 25% saying greater than 1.5 and up to 5.5 percentage points.
- Most funding is expected for major and mega infrastructure projects rather than smaller projects.
- Funding is expected to come from Chinese development banks, China-led and other multilateral institutions – financial centres scored poorly, with London (33%) ranking highest.
- Domestic currency (32%) and the euro (29%) are the most favourable funding currencies; respondents ranked renminbi and US dollar funding at the same preferred level (19%).
- Sixty-three per cent of respondents said they "actively support" or "support" expanding the capital of the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB) with reserve currencies; 60% favoured domestic currency expansion – central banks unanimously rejected the use of reserves and sovereign wealth fund (SWF) capital for BRI projects.
- There was overwhelming support for sound ethical standards and transparency in BRI projects.
- Thirty-five per cent of respondents said the BRI is evolving from an initiative to a regional/international co-operation mechanism; 35% called for the BRI to be more specific with standards; 29%

PROFILE OF RESPONDENTS

Central Banking received responses from 26 central banks in countries participating in the Belt and Road Initiative. Over half of respondents were European, while Asian respondents made up just under one-quarter of the replies. Central banks from the Middle East and Oceania also featured. Transition economies played a significant role in this survey, contributing 46% of responses. Emerging markets and developing economies made up 19% of the total, while 15% of central banks were from industrial economies.

Region	% of respondents
Europe	58%
Middle East	15%
Asia and Oceania	27%

Economic classification	% of respondents
Emerging market	19%
Transition	46%
Developing	19%
Industrial	15%

Percentages in some tables and graphs may not total 100 due to rounding.

called for it to be more transparent and relevant institutional mechanisms to be improved – European central banks believe the BRI will contribute to green finance, while most other central banks view it as "not relevant".

- Legal framework, financing and the government sector were stated as being the largest obstacles to development.
- Policy and political risks are viewed as the two greatest barriers to the BRI.
- The BRI is expected to create the greatest friction with the EU (42%) and the US (33%). There was little concern about increased strain in relations with Russia, Japan or India.
- The BRI poses the biggest risks for domestic funding capabilities (36%), followed by monetary policy (27%) and financial stability (18%).
- Most central banks are not actively advising on the BRI to their governments or official development bodies – but the majority that are advising their governments on this initiative also have direct dealings with China.
- Engagement in the BRI is still patchy – most central banks said their countries have yet to draw up BRI plans.

Survey responses

Advising governments on the BRI

The majority of central banks' respondents in BRI-participating countries surveyed said they are not playing an active role in advising the government or state development bodies about China's signature development initiative (see figure 1). Given that much of the work of central banks is related to monetary policy, financial stability, currency and payments, and market infrastructure developments, it is perhaps not surprising that central banks are not yet playing a major role. Nonetheless, as many are financial and economic advisers to governments, it is noteworthy that so few view themselves as "active" in the area, five years after the unveiling of the BRI. This is by no means the case for all. One European central bank noted that it "acts in close co-operation with its government in connection with the BRI" while a major Asian central bank added: "We regularly provide outlooks to our government on this issue."

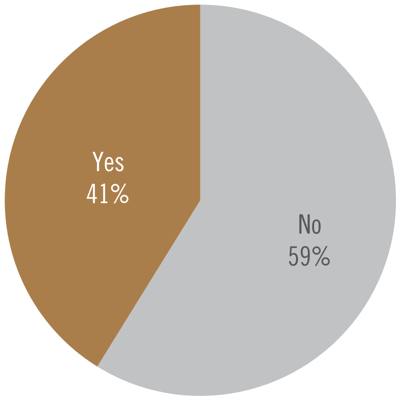
Others are engaged because of their involvement with multilateral bodies – particularly the World Bank, the European Bank for Reconstruction and Development (EBRD), the Asian Development Bank (ADB) and the China-led AIIB. At this stage, central bank governors are far less likely to be substituted for finance ministers on the AIIB board than on the boards of the Bretton Woods multilateral institutions and established regional development banks.

Some central banks are actively involved in tackling financial issues associated with the BRI. One respondent from a central and eastern European (CEE) central bank said: "The bank has been internally consulted on the main strategic guidelines of the BRI, especially the ones dealing with financial issues and financial system development."

Engagement with China

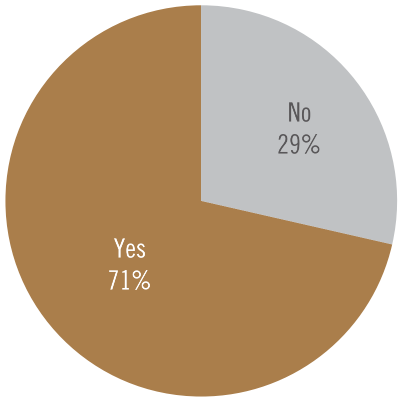
It is noteworthy that more than 70% of central banks that viewed themselves as actively advising their governments and/or state development bodies were also engaging directly with China on the BRI (see figure 1a).

Figure 1 – Does your central bank actively advise your government and/or state development bodies on the BRI?



Nine respondents did not reply.

Figure 1a – If yes, does your central bank also engage with China on the BRI?

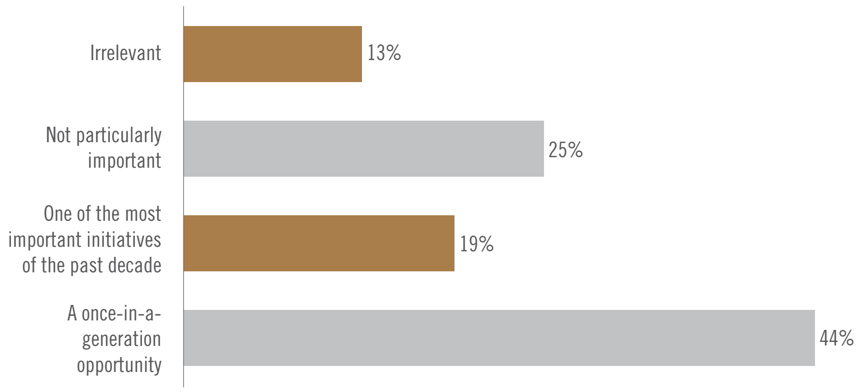


One major central Asian central bank said that it "takes part in discussions concerning interbanking co-operation". A Southeast Asian central bank explained that it "always supports [its] government's co-operation with China under the framework of the BRI", and other efforts. A European central bank added that "several initiatives have already been launched in the framework of the BRI" and it is expected "to further develop its relations with countries participating in the BRI", while another pointed to the importance of its currency swap agreement with the People's Bank of China to facilitate "commercial trade between the two countries", although this is not "formally part of the BRI".

Importance of the BRI to participating countries

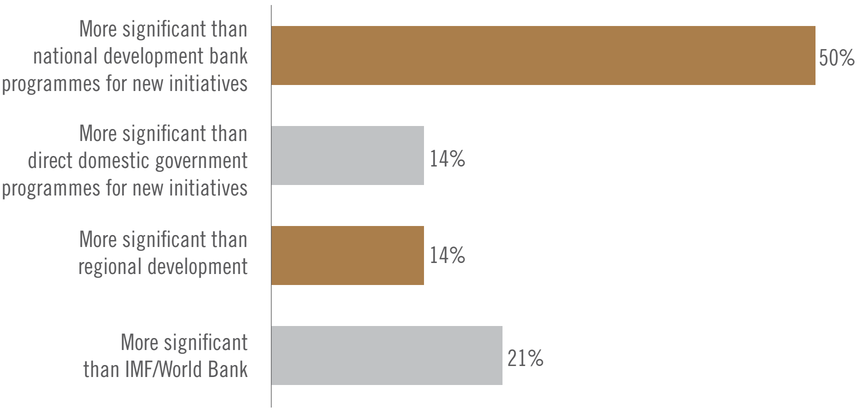
Just under half of central banks viewed the BRI as a once-in-a-generation opportunity, with another 20% ranking it as one of the most important in the past decade (see figure 2). This supports assertions that the BRI represents a major opportunity to advance

Figure 2 – How important is the BRI to your country?



10 respondents did not reply.

Figure 3 – How does your central bank categorise the importance of the BRI at a national level?



15 respondents did not reply.

transport, logistics and other infrastructure in developing countries, as well as to increase the velocity of trade and services for all countries involved.

"We support the BRI as it is expected to facilitate the flow of trade between our country and Asian countries, particularly China," said one Middle East-based central bank. "In addition, the initiative enables us to access new financing sources and boost investment in infrastructure projects."

"The BRI can significantly improve connectivity within Southeast Asia and beyond. The infrastructure networks connecting Asia with Europe and Africa, along with the project's routes, will induce closer and larger economic, social and cultural ties between China and its trading partners," added a central bank from a middle-income Asian nation.

One major central bank asserted that the BRI represents an "opportunity to increase bilateral investments", while others felt the BRI could promote development within their nation in terms of technological and social advancement. "The results of the initiative should be mostly obvious in building technological capacities, development of skills and the creation of new jobs – especially for the youth and female population. It should result in a long-term growth model, based on trading, exchange and, primarily, the activities of small and medium-sized enterprises," said the central bank of a former Soviet Bloc nation.

One CEE central bank believes the BRI "could potentially be very important, if implemented and utilised actively".

Importance of the BRI at a national level

Half of central bank respondents ranked the BRI as "more significant than national development bank programmes for new initiatives", although just 14% said they viewed the BRI as "more significant than domestic government programmes for new initiatives" (see figure 3).

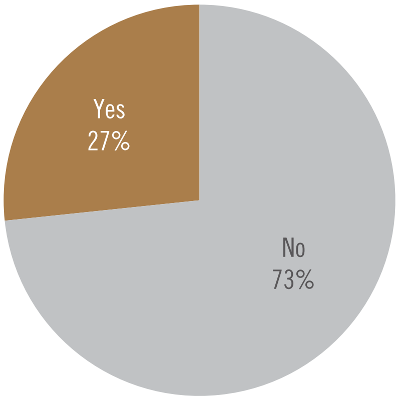
Perhaps surprisingly, 35% of respondents ranked the BRI as more significant at a national level than IMF/World Bank (21%) and regional development body (14%) programmes. "The BRI is able to promote win-win co-operation among the participating countries. The technological and financial involvement of the East can be decisive for the further development of Europe," responded one CEE central bank.

Many central banks said they found it hard to rank the BRI against existing multilateral and domestic development efforts, in some cases because these efforts are viewed as complementary. "The BRI and the programmes offered by the organisations mentioned… are different both in objectives and practices and cannot be compared directly," said one mid-sized Asian central bank.

A European central bank added: "It is very difficult to point out to what extent the BRI is more or less important … but it is certainly very much connected to all other international and domestic relations. We have a very specific position, and our economy is very much dependent on foreign direct investments. In that context it has to be highlighted that relations with the IMF… are very important, as well as the World Bank programmes. On the other hand, the involvement of the EBRD and other such institutions in the financial market is of the utmost importance for the further development of the economic conditions in our country. In our view, the BRI is accompanying these other factors."

Some central banks believed the scope of the question needed to refer, in a broader sense, to more than just public money.

Figure 4 – Has the BRI resulted in greater investment in your country compared with what was already expected from China?



11 respondents did not reply.

Increased Chinese investment as a result of the BRI

Nearly three-quarters of respondents stated that the BRI has not resulted in more Chinese investment in their country than was already expected. Most central banks asserted that Chinese investment that has taken place would have occurred irrespective of the BRI (see figure 4). There were some exceptions, however.

One mid-sized central bank discussed the development of ports by public sector Chinese companies. Another central bank from central and eastern Europe foresaw investment in the future: “We expect far more projects in railways and road-building, housing, energy, mining and other sectors in the coming years, which would be a direct result of this initiative.”

“We already have a close trade and investment tie with China,” said one Asian central bank. “The BRI may further help secure the financial support needed from the China-led development banks to upgrade our infrastructure facilities and improve connectivity with other Asian countries.”

One mid-sized central bank pointed to a major project that will target logistics and help develop high-value manufacturing, modern services and a knowledge-based society. “We aim to focus on linking innovative economies and supply chains across the region, which would be complemented by the BRI,” it said.

Expected boosts to participating countries’ GDP

China says it is keen to export its growth model to developing countries, and believes that enhanced connections of all forms will help to uplift economic growth for all parties engaged in the BRI.

A total of 92% of central bank respondents expect the BRI to bolster their domestic growth during the next five years, with the majority saying this would be greater than 0 and up to 1.5 percentage points (see figure 5) although 25% were more bullish, predicting a fillip to growth of more than 1.5 and up to 5.5 percentage points. Such growth levels would reflect favourably on the growth China itself has enjoyed during the past four decades.

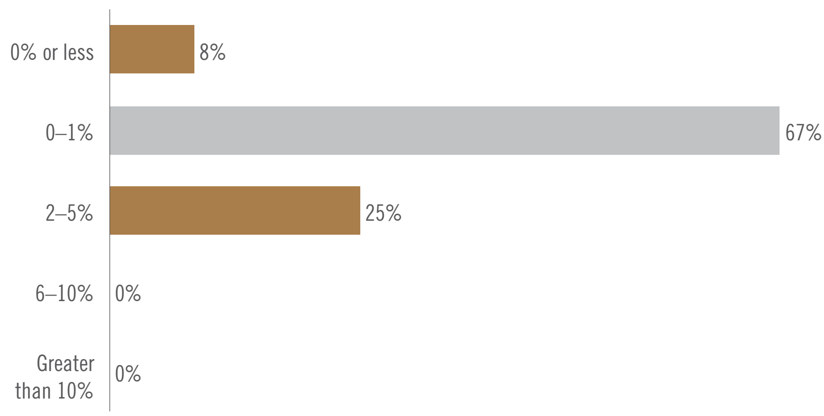
“Countries like ours have a chance to use the funds and agreements with the Chinese government and Chinese companies… to influence infrastructure development to be better connected to the region and world trading routes,” explained a CEE central bank. “In this way, better conditions would be formed for foreign direct investment and economic development. With this in mind, the government [agreed to give] full support to this new ‘Chinese economic philosophy’ and its guiding principles in financing the development of the countries along the ancient Silk Route. The BRI will certainly have a positive effect on our GDP in the next five years, but it is hard to calculate the extent of it.”

“The expected boost depends not only on engagement but also on the external opportunities,” added another CEE central bank. “The projects are in the initial phase and involve a number of institutions and decision-making bodies. For the time being, the impact on GDP can be estimated in a wide range. However, the initiative is expected to further boost economic growth.”

Other central banks found it hard to estimate the overall impact. A Southeast Asian central bank, for example, explained how its own new economic strategy would be the main contributor to future growth. “Our assumption is that the BRI would induce investment as a supplement to [our own economic strategy], thus, its contribution to our GDP is expected to be quite slim,” it explained. “That said, direct contribution may be small but [the] indirect crowding-in effect could be large.”

A number of central banks chose not to make a prediction. “It is virtually impossible to answer, as there are no necessary and stable inputs,” said one European central bank. “It might not affect our economy,” added another, located in the Middle East. “Based on currently available information, publicly disclosed projects will affect the country only indirectly, thus they will have only a marginal impact in terms of GDP,” said another.

Figure 5 – What is the expected boost to GDP from BRI-related projects over the next five years?



Figures are rounded to the nearest percentage. 14 respondents did not reply.

Figure 6 – In your country, which types of projects will receive the greatest funding support from the BRI?

	1		2		3		4		5		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No.
Mega infrastructure	4	36	2	22	1	11	1	11	1	13	9
Major infrastructure	6	55	4	44	0	0	0	0	1	13	11
Medium-sized development projects	0	0	2	22	4	44	2	22	1	13	9
Small and medium-sized enterprises	0	0	1	11	3	33	4	44	1	13	9
Financially excluded sectors	1	9	0	0	1	11	2	22	4	50	8

Votes were cast using a scale of 1–5, where 1 denotes the source of most funding and 5 the least.
15 respondents did not reply.

Figure 7 – Where does your central bank expect most BRI funding for these projects to come from?

	1		2		3		4		5		6		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.
Chinese development and state-owned banks	4	40	2	22	1	10	0	0	0	0	2	22	9
Private Chinese corporations	1	10	2	22	3	30	3	33	0	0	0	0	9
International commercial banks	0	0	1	11	1	10	3	33	1	11	3	33	9
Multilateral institutions	2	20	1	11	1	10	2	22	4	44	0	0	10
Chinese-backed multilateral institutions	2	20	2	22	3	30	0	0	2	22	0	0	9
Financial markets	1	10	1	11	1	10	1	11	2	22	4	44	10

Votes were cast using a scale of 1–6, where 1 denotes the source of most funding and 6 the least.
15 respondents did not reply.

Allocation of BRI funding

The Chinese authorities are keen to stress that BRI projects are not necessarily focused on major infrastructure developments, but rather the entire ecosystem, including small and medium-sized enterprises and the financially excluded. This focus has yet to materialise in the thinking of central banks in BRI countries (see figure 6).

Major infrastructure (railways, roads, highways, factories and agricultural water conservancy works) and mega infrastructure (power stations, the power grid, high-speed rail networks, urban underground networks and rail transit) were the two types of investments viewed as most likely to secure the greatest funding from BRI, according to central banks surveyed. A total of 55% of central banks ranked major infrastructure projects as the most likely to secure BRI funding, with 36% ranking mega infrastructure as most likely. The percentages for second-ranked votes were 44% for major infrastructure, and 22% for mega infrastructure.

"We anticipate we will be a connecting logistic hub for the whole Association of Southeast Asian Nations region," said one Southeast Asian central bank. "Having said that, infrastructure and construction projects are at the forefront of receiving funding support from the BRI."

These sentiments were echoed by a small European central bank. "Road and general infrastructure projects would probably constitute the main contributions. Some intra-regional and other types of supporting infrastructures could develop as well," they added.

Another European central bank said its response was based on "observed interest of Chinese investors in transport infrastructure and power plants projects".

"Up to now there was no interest in the projects that fall into the remaining three categories of medium-sized development projects, small and medium-sized enterprises and financial excluded sectors, and could be qualified as part of the BRI. However, there are also other Chinese investments that we do not consider part of BRI," the central bank said.

Sources of BRI funding

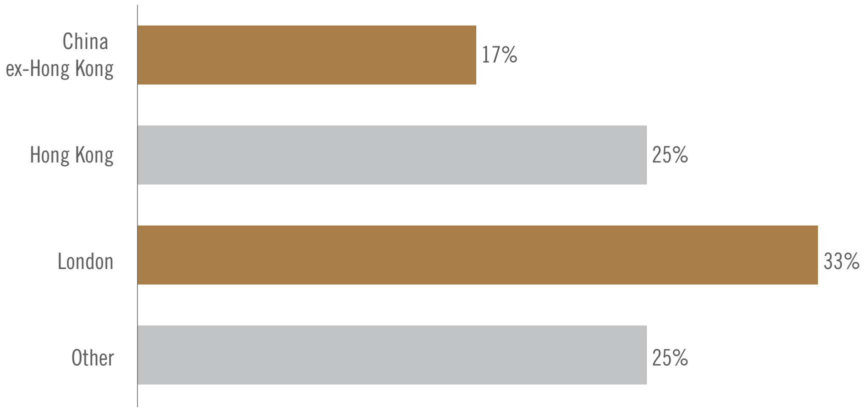
The most significant source of funding for BRI projects was expected to come from Chinese development and state-owned banks, said 40% of central banks in their first choices and 22% in their second (see figure 7). Chinese-backed multilateral institutions (20% of first choices and 22% of second choices) and, to a lesser extent, other multilateral institutions (10% of first choices and 20% of second choices) also scored highly. Meanwhile, private sector Chinese corporations (10% of first choices and 22% of second choices) are expected to play another important but smaller role. International commercial banks and financial markets are expected to play a minor role, despite Chinese efforts to utilise private capital.

"It is expected that funding for BRI projects would come primarily from Chinese development and state-owned banks and, in some part, from private Chinese corporations and Chinese-backed multilateral institutions," said one '16+1' group central bank, summing up the views of many institutions.

Some central banks said it is still too early to determine the source of funding for BRI projects. "Talks with Chinese investors on possible investments in major infrastructure projects are still at an early stage and that is why we cannot precisely rank the possible sources of funding," said a CEE central bank.

A small number of central banks alluded to involvement from European institutions. "Eurozone, EU-based markets and banks in general", will be the primary source of funding, according to

Figure 7a – If funding for BRI projects comes from financial markets, which financial markets?



one central bank, while another suggested "adding the European Investment Bank to the list of multilateral institutions" – a list that includes the World Bank, the EBRD and the ADB.

One major central bank explained how initial public offerings in Chinese financial markets are "regularly discussed" with the People's Bank of China, but "the projects have not been implemented yet".

Financial markets are not expected to play a major role in funding BRI projects for the time being, despite vast sums of pension and insurance money seeking higher returns than are currently available from many current market instruments (see figure 7a). London was ranked as the top centre for market-based funding, followed by Hong Kong and mainland China. One European central bank explained: "Given prevailing current trends, the funding might probably be expected to come from Hong Kong-based markets."

Deciding on a currency to fund BRI projects

Unsurprisingly, many central banks would prefer BRI financing to take place in domestic currencies (32%), where there is no foreign exchange risk (see figure 8). But a large number of central banks also favour the use of the euro (29%).

"Domestic currency would be preferable in order to minimise potential negative impacts on economic and financial stability," said one central and eastern Europe-based central bank. "However, local financial markets remain rather shallow, and excessive reliance on them might crowd out domestic investment projects. A combination of both euro – given our increasing EU integration trends – and [domestic] currency might offer the best combination."

A eurozone central bank added: "The euro serves as the one and only official currency, so from a financial stability point of view, it is preferable to eliminate forex risk, unless an effective/efficient hedge is made, and/or it can strongly be concluded that benefits of non-euro funding outweigh its costs."

Encouraging for those that see a greater international role for the renminbi is that the same proportion (one-fifth) of respondents favoured use of renminbi for BRI projects as those that preferred the US dollar.

"Our country is committed to strengthening financial and economic relations with China through renminbi-related agreements and initiatives," said one mid-sized central bank.

"The central bank is promoting regional currency usage," added a mid-size Asian central bank. "Regarding the promotion of renminbi usage, we have designated one of the Chinese banks as a clearing bank to deal with renminbi transactions... In addition, we have swap arrangements between the central bank and the People's Bank of China, which serves as backstop liquidity as it allows both central banks to access the local currency of the other party. This has bolstered confidence of the private sector as well as financial institutions on the availability of local currency for cross-border investment settlements."

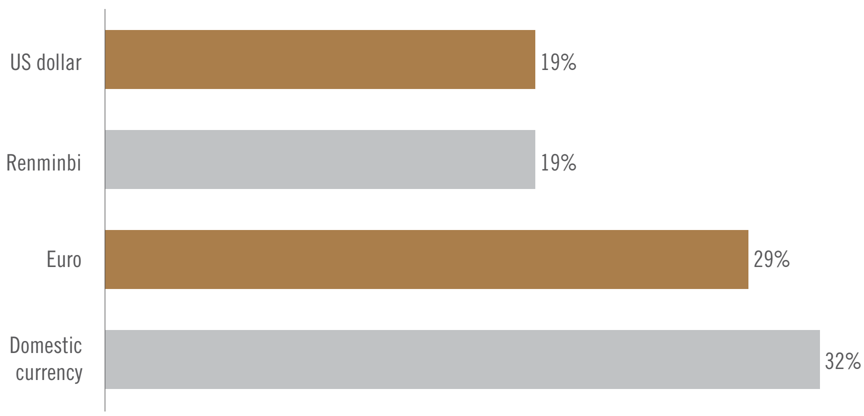
Another central bank that has a bilateral swap with the People's Bank of China said the "best solution" would be for Chinese investments to be conducted by a "direct conversion from renminbi to our [domestic] currency" and "for all project activities" to be conducted in "domestic currency". "However, BRI projects are very important for stimulating economic growth, even if they are conducted through funding in hard currencies such as the US dollar or euro."

Another Asian central bank was impartial, stating the choice of currency should be determined "by the relevant decision-makers".

Expanding NDB and AIIB capital

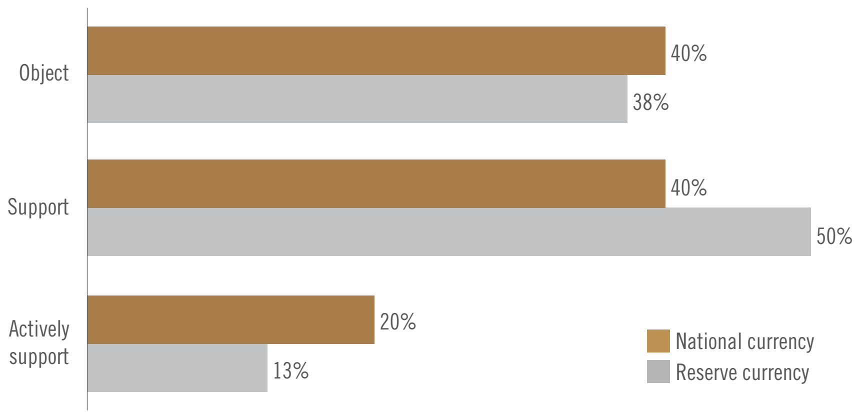
Many central banks that participated in the survey did not express a view about funding for the new China-led multilateral development institutions, the NDB – or the Brics (Brazil,

Figure 8 – What currency should be used for financing BRI-related projects?



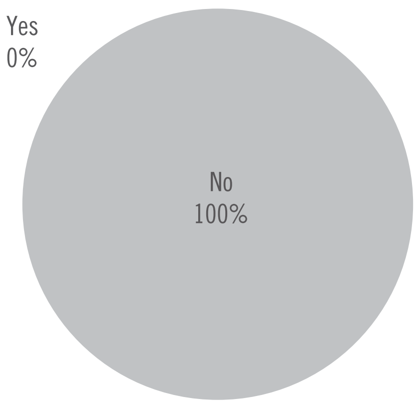
Eight respondents did not reply. Respondents were invited to select more than one answer.

Figure 9 – What is your central bank's position on expanding the capital in the NDB and AIIB with reserve currencies and/or your nation's own currency?



17 respondents did not reply.

Figure 9a – Should central bank forex reserves and sovereign wealth be used to invest in BRI infrastructure strategies?



15 respondents did not reply.

Russia, India, China and South Africa) bank – and the AIIB (see figure 9). The NDB is currently seeking to expand membership beyond its five founders.

"As we are not a member of any of the stated banks, we do not have a specific position on this issue," said one mid-sized institution. One bigger central bank added: "The central bank's involvement in the AIIB is somewhat limited as such matters fall within the responsibilities of the ministry of finance and involve the use of fiscal resources."

Nonetheless, a total of 63% central banks responded by saying they "actively support" or "support" expanding the NDB and AIIB's capital with reserve currencies, while 38% objected. Further, 60% of respondents favoured expanding capital in national currencies, while 40% objected.

"The central bank supports the capital increase in the NDB and AIIB to strengthen the role of institutions in financing the projects of the BRI," said an Asian central bank.

But not all institutions favoured additional capital raising. "Our answers concern only the AIIB as we are not a member of the NDB. The AIIB seems to be well capitalised at the moment," said one European central bank. Another stated: "The current economic conditions and fiscal position constrain us from expanding our share in the NDB."

Finding funding for BRI infrastructure strategies

Although the challenging yield environment in traditional reserve currency assets is making it difficult for central banks to earn a profit on their foreign exchange reserves, central banks that responded unanimously rejected the idea of using reserves and sovereign wealth assets in BRI infrastructure projects – despite the Hong Kong Monetary Authority unveiling plans to invest US$1 billion in International Finance Corporation infrastructure projects last year (see figure 9a).

"The role and function of central banks' forex reserves and SWF should not be changed," said one mid-size central bank.

"The purpose of international reserves is primarily to ensure a country's international liquidity. Therefore, we believe that – in line with the principles of liquidity and safety – the decision on the investment of the international reserve funds should not be bound to any specific project, but determined by the securities' credit rating," added another, echoing the thoughts of many central banks.

Indeed, this was the view even in countries that have SWFs or whose central bank reserves are viewed as being sufficiently large that they can invest in less liquid financial instruments.

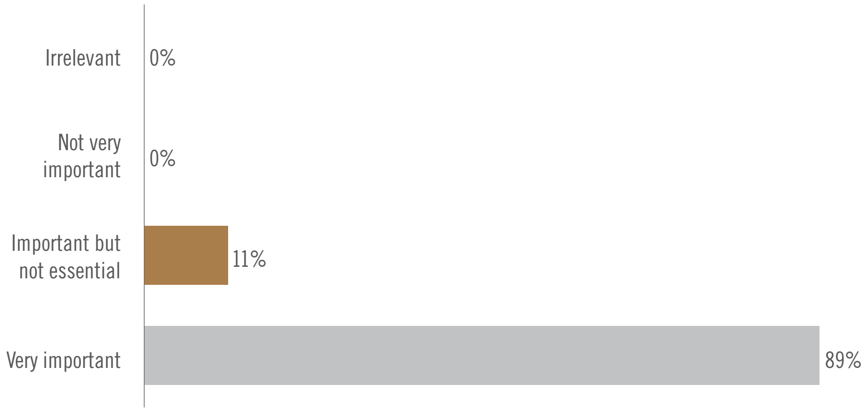
Maintaining ethics and transparency

Central banks overwhelmingly support the practice of sound ethical standards and transparency for BRI projects, with 89% of participants describing it as "very important" (see figure 10). Just 11% said ethical standards and transparency are "important, but not essential", and no central bank viewed them as "not very important" or "irrelevant".

A Eurasian central bank said: "Ethical standards and transparency are essential and very important principles for us"; while an Asia-Pacific central bank added: "Ethical standards and transparency are equally important for developments outside the BRI."

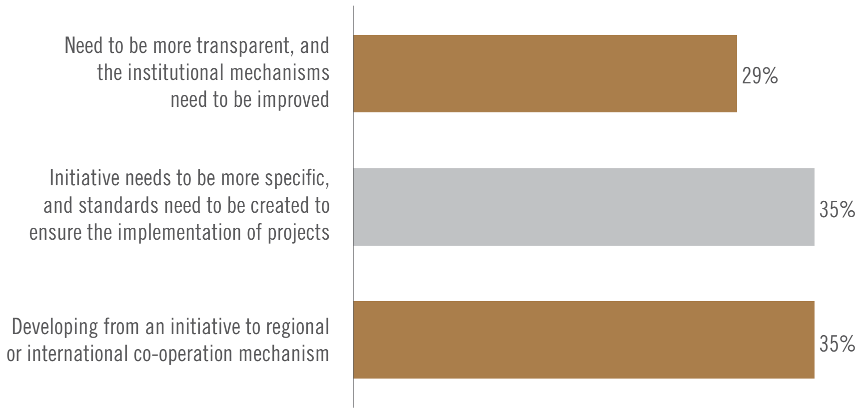
A small European central bank also highlighted the benefits of transparency: "It should always be the case with major infrastructure projects so that benefits and cost associated with it are clear to all market agents."

Figure 10 – How important are ethical standards and transparency in the development of the BRI?



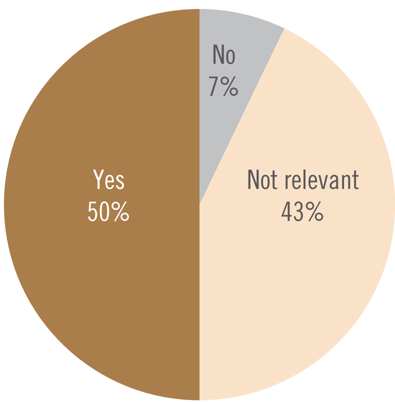
Eight respondents did not reply.

Figure 11 – Which best describes your central bank's view of the development of the BRI?



Nine respondents did not reply.

Figure 11a – Do you believe the BRI will contribute to green finance?



12 respondents did not reply.

Opinions on the BRI's development

A total of 35% of respondents say they view the BRI as "developing from an initiative to regional or international co-operation mechanism", with one Asian central bank stating: "Regional financial connectivity has long been a key driver behind the flourishing economic ties between ourselves and countries in the region" (see figure 11).

However, 35% felt the initiative needs to be more specific and that standards need to be created to ensure the successful implementation of projects; while 30% say the BRI needs to be more transparent and the institutional mechanisms need to be improved.

Contributing to green finance

There was a split between European central banks – particularly those with close ties to the EU – and other central banks when it came to views on the BRI contributing to green finance (see figure 11a). Half of those that voted said they thought the BRI would boost green finance – many of them European. "We believe that the projects under the BRI will be implemented in accordance with key international agreements regarding climate change and emerging tendencies in financing infrastructure," said a respondent from a medium-to-large-sized EU central bank.

"It is very important that all future projects within the BRI have a focus on green financing as environmental preservation and the appropriate usage of natural resources become more and more important," added a central bank based in the Balkans region.

"Our country is committed to environmental protection and believes that green funding can play an increasingly important role in securing sustainable economic growth and long-term investments," said another European central bank.

China has received criticism from some of the backers of Bretton Woods institutions for its financing of higher-polluting, coal-fired power stations in countries such as Pakistan. Bankers in the south Asian nation – which produces its own coal and has to import gas – believes it would have struggled to fund new coal-fired stations from sources other than China. This may explain why 43% of respondents – particularly those in Asia – viewed green financing as "not relevant" to the BRI (see figure 11a).

Figure 12 – What is causing the biggest roadblock to the development of BRI projects in your country?

	1		2		3		4		5		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No.
Government sector	0	0	4	44	1	11	2	22	2	22	9
Private sector	1	9	1	11	3	33	1	11	3	33	9
Financing	4	36	0	0	3	33	2	22	1	11	11
Legal framework	5	45	1	11	0	0	3	33	0	0	9
Credit rating	1	9	3	33	2	22	1	11	3	33	10

Votes were cast using a scale of 1–5, where 1 denotes the most significant roadblock and 5 the least significant. 14 respondents did not reply.

Figure 13 – What is the greatest policy barrier related to the BRI?

	1		2		3		4		5		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	No.
Investment risks	1	9	5	45	2	18	2	18	1	9	11
Policy risks	2	18	5	45	3	27	0	0	1	9	11
Political risks	4	36	1	9	3	27	2	18	2	18	12
Risk of capital account control	1	9	0	0	1	9	5	45	2	18	9
Risk of exchange rate fluctuations	3	27	0	0	2	18	1	9	5	45	11

Votes were cast using a scale of 1–5, where 1 denotes the greatest barrier and 5 the least. 13 respondents did not reply.

However, attitudes may be changing. One small central bank reported: "Investments in the power plants based on renewable energy sources could contribute to green finance." Another added: "China is putting green finance at the centre of its development plans. The BRI could be used as a platform for the delivery of green finance, [enabling a] greater amount of finance for construction of non-hydrocarbon energy-generating facilities."

Obstacles to developing the BRI

The biggest blockage to the development of BRI projects are the legal framework, financing, the government sector and credit ratings (see figure 12). A total of 45% of survey respondents ranked the legal framework as the most significant roadblock when facing the development of BRI projects, with 36% citing financing. Furthermore, 44% of second-placed votes went to the government sector, and 9% of first-ranked and 33% of second-ranked concerns were related to credit rating.

Many legal challenges are related to compliance commitments to rules that are part of being a member of an existing trading bloc. "Most impediments arise from legal rules – which originate in the EU legal framework," explained one European central bank.

An Asian central bank said that despite attempts to "streamline regulations", "foreign contractors participating in the projects may still be subject to regulatory burdens".

One central bank referred to the high costs related to Chinese funding. "The biggest roadblock to developing BRI projects is expensive financing from China, including the insurance of funding costs," said a CEE central bank. "Adjustment in this area would provide far more BRI projects."

Policy restricting BRI progess

Respondents voted policy risks (18% of first-ranked votes and 45% of second-ranked) and political risks (36% of first-ranked votes and 9% of second-ranked) as the greatest barriers to the BRI (see figure 13). "We are in a very specific position," said one mid-sized BRI country central bank. "We are based in a country that has had many political tensions in the past and many different foreign influences, so the biggest risk to development is a political risk coming from different international forums."

Some parties also highlighted a lack of clarity around the BRI. "Stakeholders are uncertain about the policy implementation plan," said one Asian central bank.

Many more central banks were worried about exchange rate fluctuations (27% of first-placed votes) and others expressed concerns over investment risks (9% of first-placed votes and 45% of second-placed).

A small European central bank worried that forex inflows "might engender exchange rate volatility and induce economic and financial stability shocks". Forex volatility was also cited by a Group of 20 central bank: "Some participants of investment projects under the BRI pointed out the importance of hedging risk of exchange rate fluctuation."

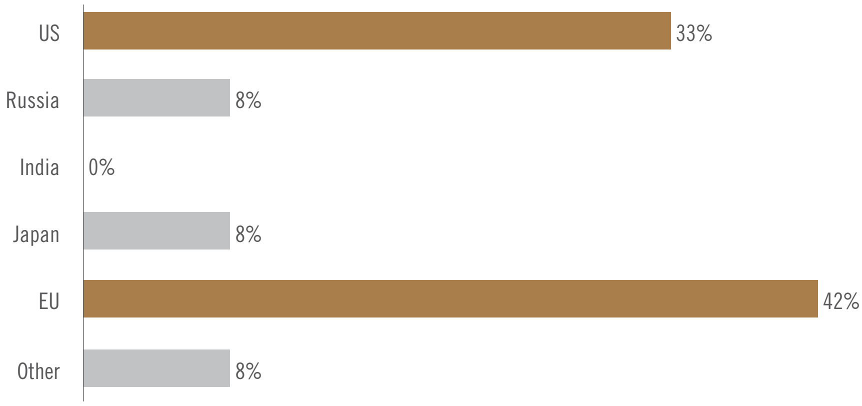
Friction with strategic partners

China has presented a philosophy of embracing nations engaging in the BRI. But with so many nations and vested interests involved there are bound to be tensions (see figure 14).

Central banks that voted in the survey believe the BRI may create greatest friction with the EU (42%) and the US (33%). This is perhaps not surprising, given the decision by EU members not to endorse part of the multi-billion dollar plan in 2017 because it did not include commitments to social and environmental sustainability and transparency. The US, meanwhile, has recently named China a "strategic competitor" and moved to impose trade sanctions on it, including restrictions on investment and tariffs on US$60 billion worth of products.

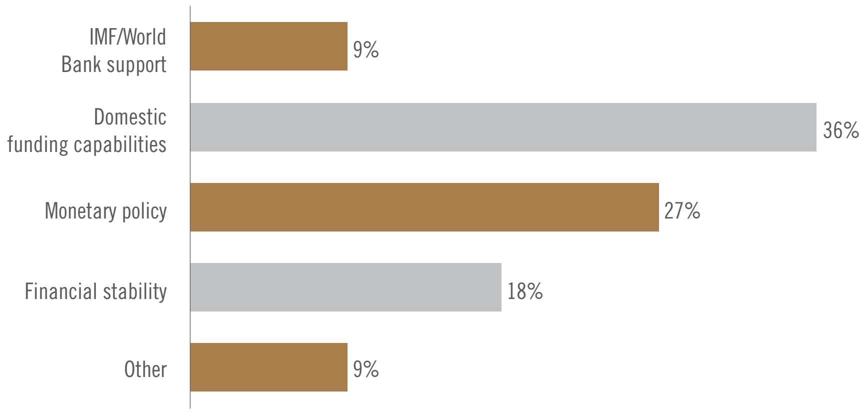
"If the [BRI] initiative does not develop in compliance with EU/US projects and policies, or does not duly take into account their economic or political concerns, the risk of friction is certainly there," said one CEE central bank. "Considering the size and

Figure 14 – Is your central bank concerned the BRI may create friction with any of its strategic partners?



14 respondents did not reply. Respondents were invited to select more than one answer.

Figure 14a – Are there concerns that the BRI may pose risks to any of these areas at a national level?



15 respondents did not reply. Respondents were invited to select more than one answer.

scope of current investments here, we do not see that they could create frictions [at the moment].”

“There is a possibility that the BRI could in some way conflict with EU goals, but we are strongly committed to the European integration process, while trying to have very friendly and prosperous relations with China through the BRI,” said another European central bank. “In our view, these two processes should accompany one another.”

A respondent from a Middle Eastern central bank also expects the BRI to offer a net benefit. “The BRI is expected to strengthen the economic and trade relations with our existing trading partners and create new opportunities and new economic partners,” the bank said.

“The BRI can be regarded as win-win co-operation. The initiative should be considered as an opportunity that is not intended to divide the countries,” added another European central bank.

“As far as we are concerned, we do not foresee any friction arising from the BRI with our strategic partners,” added an Asian respondent.

Despite many BRI countries in central Asia and central and eastern Europe falling within Russia’s traditional sphere of influence, there did not appear to be much concern about frictions with Russia and the Eurasian Economic Union. This may be in part due to Russia – itself already benefiting from BRI projects – appearing to embrace China’s strategic initiative.

“We are not concerned the BRI may create friction with any of the strategic partners,” explained a Eurasian central bank located within Russia’s traditional sphere of influence.

Perhaps surprisingly, no central bank predicted the BRI would cause frictions with India. One of the original Brics nations, India notably stayed away from Belt and Road Forum for International Cooperation in May 2017 in Beijing. It has also expressed its opposition to the economic corridor China is building in Pakistan, as it passes through the disputed Kashmir region controlled by Pakistan but claimed by India.

National-level risks

The main risks the BRI could pose for their nations, as the central banks highlighted, were related to its impact on domestic funding capabilities (36%), followed by monetary policy (27%) and then financial stability (18%) – although a large number did not answer or did not see risks in the indicated areas (see figure 14a). “We consider the BRI an opportunity that will not pose risk to the mentioned areas,” said one CEE central bank. “We do not foresee that the BRI could pose risks to the mentioned areas at a national level,” added a Southeast Asian central bank.

Central banks did not elaborate on the reasons for their concerns about domestic funding capabilities being damaged by the BRI, but they did add some details about other concerns. “Projects need to be well chosen, designed and implemented. Otherwise they can create a dangerous fiscal burden, which would then spill over to the rest of the economy – the financial sector in particular,” said one Balkans-based central bank.

Another small central bank reiterated earlier concerns about foreign-exchange funding risks. “If financing occurs in forex it jeopardises monetary policy operations,” a respondent from the central bank said. “If the projects engage in large domestic borrowing, as some of the construction contracts could be outsourced to domestic implementers, financial stability could be affected.”

Plans for BRI participation

While China has moved quickly to turn the BRI into a major initiative involving some 71 territories, engagement still appears to be patchy (see figure 15) – and the majority of central banks said their countries have yet to draw up plans to participate in the BRI.

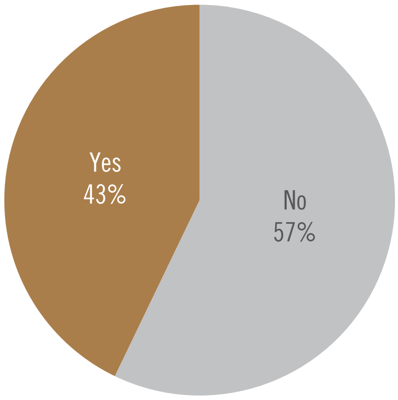
A response from a mid-size Asian central bank sums up the view of many: "We have not drawn up corresponding plans to participate in the BRI. However, our nation has signed a memorandum of understanding with the People's Republic of China on co-operation within the framework of the Silk Road Economic Belt and the 21st Century Maritime Silk Road Initiative."

Another central European central bank added: "Our government adopted a directive in May 2017 in which it gave full support to the BRI and its guiding principles, but a detailed plan to participate in this initiative is still to be developed."

One larger Middle-Eastern economy central bank said it has initiated plans for "investments of Chinese infrastructure corporations" in its country – but this has yet to be extended to the BRI more broadly.

Another central bank whose nation looks set to benefit from a major infrastructure project funded largely by the Export–Import Bank of China since 2014 said it has also signed a memorandum of understanding on the BRI in May 2017. Other nations have advanced beyond signing general memoranda of understanding on co-operation within the framework of the BRI to move towards more specific co-operation, for example, on ports and port industrial parks. This was particularly the case for some 16+1 central banks. ■

Figure 15 – Has your country drawn up corresponding plans to participate in the BRI?



12 respondents did not reply.

Bridge construction across the Indus River along the Karakorum Highway, China–Pakistan Economic Corridor

Five risks of the BRI

Han Seung-soo, co-chair of the IFF and former prime minister of the Republic of Korea, frames five of the major risks facing the Belt and Road Initiative, and discusses what should be done to negate them and the potential consequences of failing to do so

Geopolitical risks

The Belt and Road Initiative (BRI) should be inclusive, not exclusive, and not only towards Asian countries but also other regions in the Americas and Africa. Transportation is vital to society, exemplified by the fact that the Silk Route has been functioning since horses and camels were the only means of transportation. Inclusivity in the BRI is therefore imperative. An ideal starting point for widening this inclusivity could be to engage Japan – which is interested in joining the BRI, according to its prime minister – as well as the Republic of Korea, which, if a railway can be established to connect it to North Korea, has ambitions of establishing a starting point to the route along the BRI on the Korean Peninsula. The involvement of Japan and the Republic of Korea would be mutually beneficial.

Geo-economic risks

The second risk is related to the current global trends of globalisation and free trade. These trends are becoming 'bad words', but humanity will prosper if these two ideals continue to develop, and so the BRI should promote their development.

Technological risks

The Silk Road Economic Belt covers a heterogeneous region in terms of technological advancement – some countries along its route are technologically advanced, and othes are not. There are relatively advanced countries – such as China – and technologically limited ones in the Middle East and Central Asia. It is imperative to the success of the BRI that the technological gap in this region is narrowed.

Han Seung-soo

The risk of neglecting the people

During periods of economic development, material possession is prioritised over the needs and desires of the people. This narrative must change – the people should be the priority in any economic development that will acompany the BRI.

Renminbi currency risk

The importance of the renminbi is well understood – it is now part of the International Monetary Fund's Special Drawing Right basket. However, if renminbi is used to fund the BRI outside of China, it will come up against limitations, the most important of which is the attitude of the Chinese government. It was announced at the 19th National Congress of the Communist Party of China that the country is worried about the amount of outbound investment. If China makes an effort to limit foreign investment, naturally the BRI will suffer. ■

The Silk Route dates back to 207BC

Bringing the benefits of globalisation to life

Marginalised countries and regions will be able to harness the prosperity of global co-operation by participating in the Belt and Road Initiative, says former prime minister of New Zealand *Jenny Shipley*

The unveiling of the Belt and Road Initiative (BRI) by President Xi Jinping has renewed opportunities for many countries to benefit from globalisation. It is important, therefore, that the Silk Road International Association (SRIA) helps to bring meaningful life to this economic development.

New Zealand is proud to be the first market economy to support the Asian Infrastructure Investment Bank (AIIB). We believe that connected finance enabling economies to be a part of the real global economy is an extremely important concept at this time in global development. It is therefore important to create the financial architecture via the Silk Road Fund, the AIIB and other mechanisms.

Jenny Shipley

Yet there are still some obvious issues to resolve. How should less developed countries be treated versus more developed ones? And how can new infrastructure strategies be supported? It is my hope that the SRIA can bring together banking institutions, asset managers, political leaders, academics, strategists and others, to really grapple with what it takes in business model terms to realise the outstanding strategic concept of the BRI.

> *Unless we develop strategies that deliver genuine inclusion then we all suffer unintended consequences*

Situated at the end of the Maritime Silk Road, New Zealand is very much a part of the BRI concept. I have also observed over the past 30 years that unless we develop strategies that deliver genuine inclusion then we all suffer unintended consequences. The BRI invites all parties to bring their minds, skills, experiences, resources, talent and finances to meet this extraordinary challenge.

Financial strategy will not be enough. Each of these projects must take into account complexities such as religious and cultural diversity, for example, within and between countries. I have observed worldwide that many populations will not tolerate solutions being imposed upon them. Again, I hope that the SRIA can share the experiences of corporations that have been able to function within different economies where culture, religion and political experiences vary. We must bring our talent and capital together to make a difference in achieving the mutually beneficial outcomes that the BRI and, in particular, the 2030 Sustainable Development Goals set out.

We need to have 'social licence' to do the extraordinary things that we hope can be achieved. It is not a matter of mathematics; it is a matter of the human spirit. If we are to achieve the objectives the SRIA is capable of, then this can be a reality for our times – the BRI vision and the pragmatic capability of people who can look at opportunity and risk and can visualise how people everywhere can find their place within this development.

It will be very special if we can embrace social inclusion and secure that social licence to effectively lift people toward a better future. President Xi's strategy for the BRI is one of the most significant initiatives either in the East or West that I have observed in my political career.

It is now a matter for all of us to make this a realised dream – so the reality of people's lives along the BRI are as we would wish them to be – desirable, inclusive, culturally relevant and economically successful. ■

A new milestone – Introducing the Silk Road International Association

To gain greater recognition for the Belt and Road Initiative and to encourage the co-operation of countries along the routes, the IFF has inaugurated a global think tank

The Silk Road Economic Belt and the Maritime Silk Road – collectively known as the Belt and Road Initiative (BRI) – are intended to boost the prosperity and development of the countries along the routes, as well as that of human civilisation itself. The initiative has drawn intense scrutiny and elicited positive responses from the international community. However, to operate amid the complexities of global politics, economics, society, culture and religion, the BRI calls for further recognition and greater participation.

Finance plays a leading role in the BRI. Thus, with support from the UN and the Asian Infrastructure Investment Bank, and under the leadership of Kevin Rudd, Han Seung-soo, Yukio Hatoyama, Shaukat Aziz, Jenny Shipley, Jin Liqun and Zhang Jizhong, the International Finance Forum (IFF) unites representatives of the international community, the global market and private capital resources to form the Silk Road International Association (SRIA) – comprising former political leaders, experts, scholars, economic and financial institutions, and outstanding entrepreneurs from countries participating in the BRI.

The SRIA will appoint a board of directors and a permanent secretariat for the management and routine work under the IFF platform. Through deepening communication and co-operation, all members of the SRIA will enhance mutual trust and build consensus by carrying forward the 'Silk Road spirit' of peace and co-operation, openness and inclusiveness, mutual learning and mutual benefit, and win-win outcomes. With the recognition of and consensus on the core values of the BRI, the SRIA aims to provide a mechanism that boosts non-governmental collaboration and dialogue.

The SRIA Initiative was launched at the IFF's 2016 Annual Conference and has subsequently gained strong support from more than 20 financial leaders of major countries. The SRIA's inaugural meeting was held in June 2017 in Hangzhou.

The SRIA's goals are fivefold:

1. Work together as an international think tank for building a network open to the whole world. Through strategic co-operation among key countries along the BRI, a mainframe of public diplomacy and a strategic co-operation network can be set up to bring about better co-ordination and synergy.

2. Form a mechanism for dialogue, personnel exchanges and joint research among the countries and regions along the BRI. Through the SRIA platform, establish a mechanism for sharing and publishing research findings, conduct academic seminars and joint research programmes and facilitate personnel exchanges. Commission, engage and fund think tanks and scholars in their various research endeavours, identify concerns and expectations, and develop responsive strategies.


Hangzhou, site of the SRIA's inaugural meeting in June last year

3. Hold regular SRIA summits, sharing the development concepts and experiences of all member countries and discussing BRI construction and international development issues of relevant sectors. Strive to build an authoritative platform for the political, business, academic and research circles of the relevant countries to conduct comprehensive dialogue, exchanges and co-operation.

4. Provide a multilateral channel and mechanism for promoting co-operation between the international community, global markets and private capital under the BRI. When appropriate, a financial institution could be established using private capital to support the BRI.

5. Establish a board as the governing body of the SRIA, while anchored to the IFF, and the permanent secretariat as responsible for daily operations and co-ordination, and broadening the SRIA's membership.

We believe the initiation of the SRIA is a milestone, marking the wider recognition of the BRI by the international community, global markets and private capital. It will boost comprehensive and sustainable development, economic growth and the stability of the entire world.

Two plans, one vision

The Belt and Road Initiative – along with the trade and investment opportunities that accompany it – heralds the appearance of the renminbi as a player on the world stage, says *Song Min*, IFF Academic Committee member and dean of the Centre for China Financial Research, University of Hong Kong

The internationalisation of the renminbi and the Belt and Road Initiative (BRI) form part of national strategies that affect long-term development and the 'opening-up' of China. Instead of internationalising the renminbi at a single stroke, it makes economic sense to align its international use with real economic developments. The BRI represents an opportunity to do this while adhering to its core principle of a establishing a shared community – a community with a shared vision for the future of mankind. Indeed, greater international use of the renmninbi will also support the BRI – the two objectives are mutually beneficial to each other.

Partnering the BRI and the renminbi

The BRI requires the internationalisation of the renminbi, which has been seen in practice. Between the end of 2016 and the beginning of 2017 in particular, many companies' internationalisation strategies were challenged by foreign exchange flow due to tightening of capital accounts. Some overseas projects had to be suspended because forex could not be remitted abroad, even though the terms of these projects had been established. However, from a macroeconomic point of view, tightening capital accounts was the rational option. Since 2015, the renminbi has been expected to devalue. This general devaluation expectation has brought heavy pressure to bear on the decline of China's forex reserves.

Therefore, renminbi internationalisation should be a long-term strategy, but there are certain conditions required to achieve the ideal state. One necessary element is a rational and free financial system; in other words, China will need to embrace market-based exchange rates and the openness of capital accounts. A relatively free financial system requires the development and stability of the domestic financial system and an improved regulatory system. Since 2015, problems have emerged in the capital market, and forex reforms have reflected existing deficiencies in financial supervision and policies, which has destabilised financial markets. Under such circumstances, there will be many obstacles if capital accounts are blindly opened up or if there is a rush to full marketisation of forex.

Therefore, while renminbi internationalisation is a fundamental, long-term requirement to the BRI, it is a goal that needs to be achieved through steady procedure, complying with domestic development and improved regulation.

Countries along the Silk Road Economic Belt have large populations, as well as considerable total economic outputs and trade volumes. Trade and investment between these countries may consider other currencies in addition to the US dollar for business settlement – and the renminbi is not the only option. Countries participating in the BRI also have strong economies. India, for example, is an influential economy and is expected to have huge currency influence in the future. Its population and economic growth rate may also soon surpass China's.

Renminbi's big opportunity

It is not necessary for the currency in circulation to be any national currency. Why not adopt currencies that go beyond the limit of sovereign, special drawing right (SDR)-based currency, for instance – or an emerging electronic currency such as bitcoin? It is an option worth exploring, though national currencies will continue to dominate for a long time – we still need sovereign countries to provide credit support while SDRs, bitcoin and electronic goods have low market acceptance. Here, the renminbi has a better chance.

China is the largest trading body and second-largest economy in the world, and is likely to become the largest economy in the world in the near future. If a country's total real economy is the largest, the total amount of monetary economy is correspondingly large. Countries would consider a currency with the following qualities as being appropriate to a settlement currency: large trading volume, good liquidity, a large market and low transaction costs. These are the main reasons the dollar has become a major international currency, and the opportunity for the renminbi to internationalise has now arrived.

Some argue, however, that renminbi internationalisation conflicts with the spirit of a community with a shared future – when in such a community, instead of choosing one national currency, or deciding between the dollar and the renminbi, why not create a new currency accepted by stakeholders? Contradictions still exist here. Sovereign currencies, including the dollar, have many advantages as international currencies. The dollar is recognised as a public product, which can have a positive effect, but causes difficulty for the world economy because, when they are in a dominant position, US policymakers are more focused on their own interests. Therefore, in the world currency playground, it is not a bad thing to have competitive currencies.

Research has shown that the entire international monetary system remains more stable with two or three big international currencies. Renminbi internationalisation does not violate the spirit of community with a shared future if it is recognised as a public product, and the BRI is the perfect opportunity to further the internationalisation of the renminbi. ■

Forging environmental consensus – Building a green Silk Road

Fang Li, deputy director of the Foreign Economic Co-operation Office at the Ministry of Environmental Protection, hopes to step up environmental co-operation to build a green Belt and Road Initiative

The Belt and Road Initiative (BRI) not only concerns the interconnectivity of industries, finance, trade and policies, but also of people. Countries along the Silk Road Economic Belt differ in terms of economic development, resource endowments, cultural traditions and religious beliefs. So how can common values possibly be found among them? One powerful commonality would appear to be environmental protection – a cause that can unite and lead towards consensus.

At the 2015 UN General Assembly, 193 countries entered into the Sustainable Development Goals (SDG) agreement – 17 targets to be achieved by 2030 – which include bringing an end to poverty and hunger, further protecting the environment and preserving common prosperity. At the Belt and Road Forum for International Cooperation in held in Beijing in May 2017, President Xi Jinping proposed the establishment of an international coalition for the green development of the BRI, and to implement the new concept of green development in a low-carbon, cyclical and sustainable manner. Meanwhile, a big data service platform on ecological and environmental protection should be launched to strengthen eco-environmental co-operation. The BRI will be a carrier of ecological civilisation, assisting countries in the region to deal with climate change. As a result, nations along the Silk Road Economic Belt will be able to achieve the goals set out in the SDG agenda.

In China, the Ministry of Environmental Protection, Ministry of Foreign Affairs, National Development and Reform Commission and Ministry of Commerce issued *Guidance on promoting green Belt and Road*. Undoubtedly, being environmentally friendly not only helps to 'Go Out', but can also provide an important guarantee of 'going further'. China's perception of environmental civilisation has evolved – whereas previously, when promoting business and investment, local governments often paid scant attention to environmental concerns or consequences, they are now fully aware of the enormous cost of economic development. Awareness of the need for environmental protection has also greatly improved. President Xi's declaration that "green mountains and clear rivers are equal to mountains of gold and silver" has prompted different industries to set up in industrial parks, lowering the cost of enterprises and making comprehensive environmental governance possible. Such examples point towards better development through the BRI. Historically, environmental pollution has expanded geographically after the early steps of development, eventually becoming a global issue. A green BRI will tackle problems within the global environmental governance structure and achieve further development with lower resource costs and reduced environmental impact.

Since being established in 1989, the International Co-operation Centre (ICC) of the Ministry of Environmental Protection has learned a great deal by collaborating with the World Bank and the Asian Development Bank on loan-related issues. The ICC is currently the only executive body of green climate funds in Asia that aims to reduce project costs through international co-operation, and is the sole implementation agency for the Global Environment Facility in China. Many enterprises lack a basic understanding of environmental policy for the countries and regions in which they intend to start business ventures. The ICC can assess environmental and social risks to help these enterprises avoid them more deftly. Moreover, the ICC is also promoting a green finance demonstration pilot. It is now working on *Green credit guidelines* in collaboration with the China Securities Regulatory Commission and the China Banking Regulatory Commission, among others.

Fang Li

Green finance, green debt

The ICC and the UN Industrial Development Organisation (Unido) are working closely together to champion green industrial parks to reduce environmental management costs for enterprises while also alleviating some of the risks of environmental pollution. With regard to policy, the ICC is studying laws and regulations in the countries along the Silk Road Economic Belt, and looking to reduce the cost of 'Going Out'. In the field of green finance, it calls for the establishment of environmental standards in infrastructure construction and invites relevant stakeholders to participate in policymaking. In trade and production, consumers can be assured of product information through trademarks, and China has accumulated practical experience in a circular economy. On the financial front, China's green debt was zero in 2014, though the issuance of green debt now accounts for more than 40% of the global share.

> *The ICC hopes co-operation among stakeholders will play a constructive role in promoting a green BRI*

The ICC hopes for environmental protection to promote interconnectivity among people. International institutions and programmes such as the UN Environment Programme, the UN Development Programme and Unido have expressed interest in building a green BRI, and they are surely capable of endorsing participating enterprises. It is essential to jointly make good use of these resources. In short, the ICC hopes co-operation among stakeholders will play a constructive role in promoting a green BRI, allowing China to build a green Silk Road for all humanity. ■

The BRI offers global opportunities

Tu Guangshao, vice-chairman and president of the China Investment Corporation, foresees significant mutual opportunities for the Belt and Road Initiative and Zhejiang, an eastern province with a unique outward-looking attitude and a history of vigorous business development

The inaugural meeting of the Silk Road International Association (SRIA) occurred at an auspicious time and location. It took place in Hangzhou in June 2017, shortly after the successful Belt and Road Forum for International Cooperation in Beijing in May, the scene of an inspiring keynote speech delivered by President Xi Jinping.

It was clear from these two events that the participating countries in the Belt and Road Initiative (BRI) had reached consensus to accelerate its construction. The objective of the International Finance Forum, the major promoter and advocate of the SRIA, is consistent with the concept of the BRI – to maintain and improve international financial order through non-official high-level dialogue and co-operation, make global finance more peaceful, inclusive and sustainable, and offer the benefits of global co-operation an even more prominent platform.

The location of the SRIA's meeting was no less significant – the province of Zhejiang has a long history of opening up to the outside world. Its capital Hangzhou successfully hosted the Group of 20 summit in 2016, further enhancing its worldwide influence, and it is hoped that the establishment of the SRIA here can open up new channels to launch further co-operation between Zhejiang and other provinces and countries.

Significant opportunities presented by the BRI

The BRI has bred major worldwide opportunities that have injected vitality into new forms of globalisation. The spirit of this initiative – extensive consultation, joint contribution and shared benefits – has signposted a new direction. This was much-needed: in the aftermath of the international recession triggered by the US subprime mortgage crisis, all countries essentially faced one common problem – what to do about globalisation. The whole world has fallen into this predicament, which is like a headwind that forces one to either push ahead or change direction. Under such circumstances, conflicting voices and opinions will inevitably arise. It is true, for instance, that globalisation has boosted the global economy; however, many negative effects have accompanied it. So why not just simply withdraw from this global trend? In 2013, at a key historical juncture where globalisation seemed to have lost its way, President Xi proposed the BRI – a historically significant decision attempting to uphold a new type of globalisation.

Hangzhou, capital of Zhejiang Province

The 'five connectivities' proposed by the BRI – of policy, infrastructure, trade, finance and people – have opened up vast opportunity for new international co-operation and development, made possible by the initiative's capacity to stimulate huge market demand. Currently, the global economy faces the contradictions of unbalanced growth and huge demand, especially in investment and infrastructure. The BRI has energised the world economy with opportunities for major economic development and rebalancing.

The BRI has opened up new prospects of a grand Chinese entrance onto the world stage. Currently, the Chinese economy has entered the 'new normal', and the processes of economic structural adjustment and industrial restructuring confront new tasks. These are manifested in three major aspects.

First, the BRI has established a new pattern of relation between China and the world. The interactive development of China and the rest of the world is benign – China has consistently made positive contributions to global development and, in turn, global development will bring more opportunities for the growth of China. The BRI establishes a new pattern for positive interactions between the two.

Second, the BRI has set the new course of China's 'opening-up' to the outside world. Over the past four decades of reform and opening-up, remarkable achievements have been made – in particular, in trade and cross-border industrial capital flows. China has achieved 'double upgrading' from trade in goods to trade in services. It has also gained a 'double engine' – importing foreign

capital and making its own foreign investment. In 2016, China became the third-largest country for attracting foreign investment and the second-largest foreign investor; such achievements are closely linked to the BRI.

Third, China's status as a developer of global governance has grown as a result of the BRI. The dilemma faced by economic globalisation is one of matching the capacity of global governance to the development degree of globalisation. The concept and spirit advocated by the BRI have greatly enhanced China's status in global governance. As a developing country, China has changed the model of globalisation and governance traditionally dominated by developed countries to one more synergetic and rational.

Strength of Zhejiang Province in joining the BRI

The BRI has also brought new opportunities for local development. China's reform and opening-up over the past 40 years has been a fundamental force fuelling worldwide economic development while boosting China's domestic reforms. Therefore, the construction of the BRI will further expand the space for development in various provinces. As an eastern Chinese province, Zhejiang is well positioned to open up to the outside world, while central and western China boast late-mover advantage in economic development, which also calls for opening-up. Currently, all regions must confront the transformation and upgrading of their economies and industrial structures, and enhance the competitiveness of their enterprises. The BRI also provides an essential platform for local regions to transform and upgrade their enterprises' competitiveness. Optimising the business environment serves as the basis for sustainable economic development in all areas, so we must create a business environment with an international competitive advantage to attract foreign capital and lay a solid foundation for sustainable and stable development. The BRI is capable of delivering this very important opportunity for all provinces to create an internationally competitive business environment.

A provincial power moving to national level

At a provincial level, Zhejiang plays a decisive role in national economic development and opening-up that makes its participation in the BRI essential.

First, Zhejiang is fully aware of the strategic opportunities of BRI participation and is eager to enjoy the enormous benefits. Since 2013, the province has been formulating its strategy and has taken solid steps towards participation. The history of reform and opening-up reveals that Zhejiang is a leader in its strategic awareness and capacity for implementation – by joining the BRI, that capacity can be fully manifested.

Second, Zhejiang has a strong and open economy, which is able to support trade and investment in the BRI and enhance its own resource allocation and competitiveness in the global market. Yiwu, a city in Zhejiang, for example, not only occupies an important position in China's foreign trade, but also exerts a huge global impact. Trade and investment are two core areas of the BRI, and if Zhejiang can take full advantage of the opportunities brought about by the BRI, it will surely enhance the capacity of global resources allocation.

Third, the strengths of Zhejiang's geography and its internet industry complement each other, forming two pillars for its BRI participation. To the north of Zhejiang is the Silk Road Economic Belt, to the south the Maritime Silk Road. With such a geographic advantage, Zhejiang can better exert its resource allocation ability in human flow, logistics and capital flow. In addition, Zhejiang performs well in the internet industry, which can create an even broader space than its well-placed geographical superiority can. The geographical BRI combined with an online BRI will be able to fully unlock the potential of Zhejiang.

Fourth, the deep-seated Zhejiang business culture and the spirit of the BRI will converge in a reflection of the integration of Chinese culture and world civilisation.

STRENGTHENING BELT AND ROAD INITIATIVE CO-OPERATION BETWEEN THE CHINA INVESTMENT CORPORATION AND ZHEJIANG PROVINCE

Combining government and markets to form a long-term multilevel co-operation mechanism. Some project opportunities may be jointly boosted by the China Investment Corporation (CIC) and the government, and others by the CIC and related industries and enterprises, which requires the formation of different levels of co-operation mechanisms.

Linking an extensive network of overseas partners of the CIC with Zhejiang's favourable investment environment to allow the province to introduce and utilise foreign capital. As China's economy continues to grow, more overseas enterprises will hope to increase their understanding of China and seek investment opportunities there. With its extensive contacts, the CIC can act as a channel effectively connecting internal and external factors. Zhejiang also boasts an excellent investment environment. By organically integrating both the CIC and the province, and introducing foreign capital, Zhejiang can begin a programme of economic restructuring and upgrading and see its enterprises boom through the introduction of foreign capital.

Connecting overseas investment with the 'Going Out' of Zhejiang enterprises, jointly exploring and sharing investment project resources to promote investment co-operation. Businesses in Zhejiang are now taking big strides in Going Out, and the CIC is now focusing on overseas investment. If the two sides can co-operate in project and information sharing, it will inevitably contribute to mutually beneficial results.

Integrating the financial services resources within the CIC system with Zhejiang's real economy. Central Huijin Investment, a wholly owned subsidiary of the CIC, is the equity management unit of many major state-owned financial institutions. Those with CIC shares and holdings are capable operators in financial services with a strong appeal. If the CIC can extract the greatest benefits of the financial institutions within its systems to help develop Zhejiang enterprises, a new way of promoting the combination of industry and finance and driving the country's economic development is sure to follow.

Zhejiang's landscape can be roughly divided into 70% mountains, 10% water and 20% land. Behind this landscape are profound cultural accumulation, time-honoured history and vigorous business development. The kernel of Zhejiang business culture is to be hardworking, pioneering, proactive, innovative and to forge ahead. If this spirit can be integrated into the BRI spirit of openness, inclusiveness and innovation to support the spread of world civilisations and spirit of humanity, then Zhejiang can contribute significant soft power to the construction of the BRI.

Six dimensions the China Investment Corporation must operate in when constructing the BRI

1. **The China Investment Corporation (CIC) must unearth good investment projects.** It is not making policy-based investments but commercial and market-based ones, so good investment projects are key. A multitude of investment opportunities have been thrown up by the BRI; the CIC, however, will position itself and await suitable commercial and market-based projects.

Tu Guangshao

2. **It must give full rein to its strengths.** Success – be it in enterprises or investment institutions – will be achieved through exploiting strengths and avoiding weaknesses. Fully tapping into one's own capabilities will allow the capture of investment opportunities and benefits.

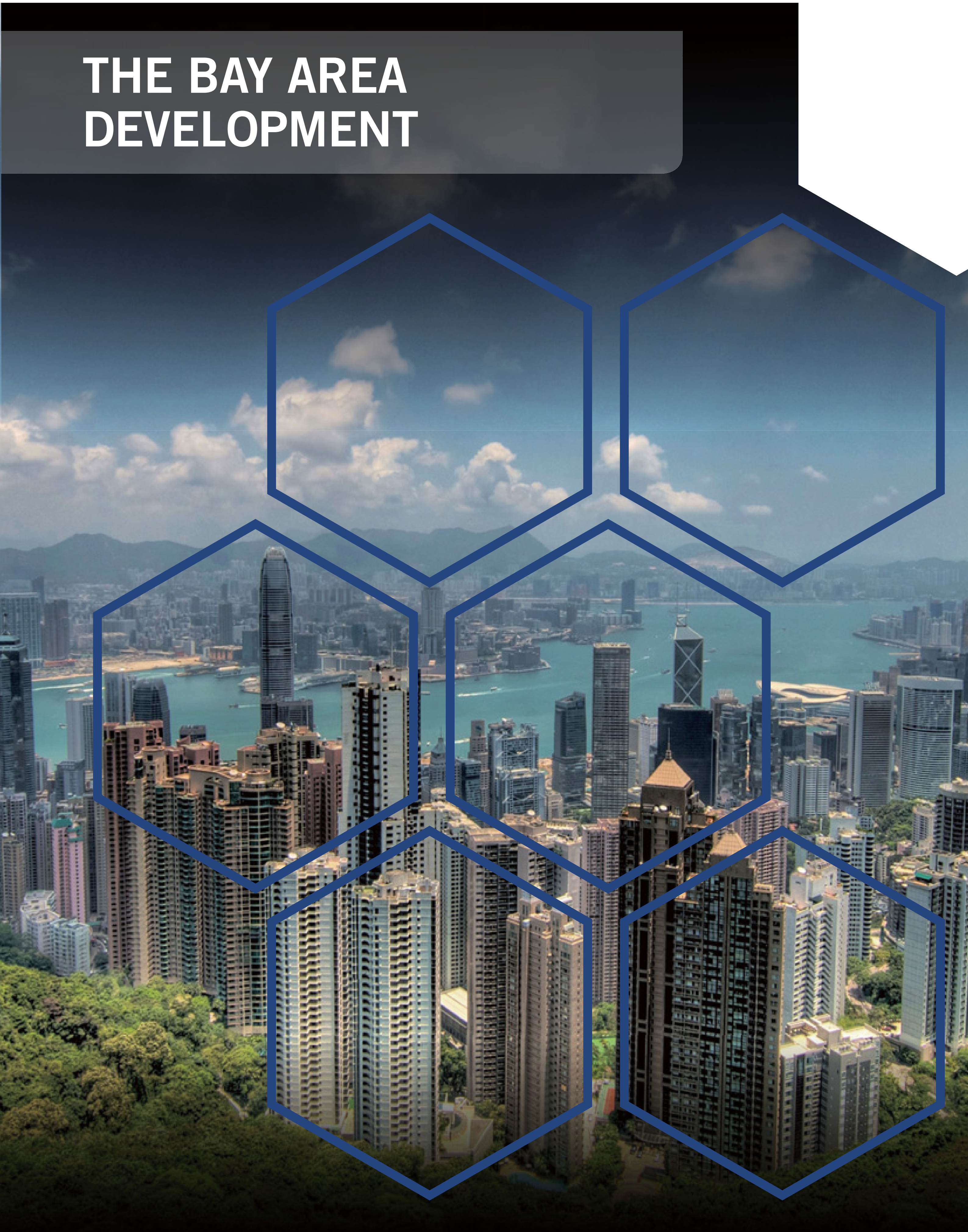
3. **It must make the most of Chinese elements.** An important objective in the CIC's overseas investment is to help key industries and enterprises 'Go Out'. Chinese elements are essential if projects are to converge with the Chinese market and its industrial upgrading. Despite increasing overseas investment by the CIC, the Chinese market must dovetail with Chinese elements; China is the largest of the developing countries, with the biggest market and relatively advanced industries. The CIC can bring more foreign capital to China through overseas investment, which is equivalent to making good use of Chinese factors and crucial to China's participation in the BRI.

4. **It must develop good partnerships.** The CIC already has a wide range of co-operation networks and partners overseas and has also established good relations with domestic investors in different fields and industries. China hopes to further expand and deepen this co-operation.

5. **It must monitor post-investment management.** The CIC is not making strategic investment, but co-investment; therefore, it attaches great importance to whether enterprises have established good corporate structure. The CIC, in this regard, is willing to make positive contributions to enhance the value of investment projects and enterprises.

6. **It must achieve its investment objectives.** These rely not only on investment returns, but also on whether the investment can bring positive benefits to economic development and employment in its own country or region. ■

THE BAY AREA DEVELOPMENT



The dragon in the South China Sea

A new coastal city cluster and growth pole is rising in east Asia. *Sun Shilian*, researcher at Xinhua News Agency World Research Centre, and *Zhang Jiaming*, from the School of Economics at Nankai University, listen to experts discuss the need for national and international co-operation in its construction

The world economy currently lacks a driving force and is experiencing a continual adjustment of economic and trade investment rules as well as of economic governance systems. It is crying out for a new growth pole and power source.

Bay areas have always been major growth poles and leaders of global economic and technological development. They are also centres of global science, innovation, finance and industry. The Guangdong–Hong Kong–Macao Greater Bay Area (the Bay Area Development) will be the world's fourth major bay area, following those in New York, San Francisco and Tokyo. The Bay Area Development in China will be in the vanguard for building world-class city clusters and participating in global competition. Experts in China and elsewhere predict that by 2030 the Bay Area Development will surpass the existing bay areas to become the world's largest and most populous.

To achieve these goals, the International Finance Forum (IFF) put into play its established operational framework and platform, and held its 14th Annual Conference, as well as the Bay Area Development Conference, in Guangzhou. On the subject of *Global Bay Area construction: New impetus, new growth and new patterns*, a panel discussed the construction of the Bay Area Development and international co-operation platforms to promote stable, sustainable, balanced and inclusive growth in China and in the world economy.

Strategic significance of the Bay Area Development

In March 2015, China's National Development and Reform Commission, Ministry of Foreign Affairs and Ministry of Commerce released *Vision and actions on jointly building Silk Road Economic Belt and 21st Century Maritime Silk Road*, in which developing the bay area was clearly set out for the first time. In March 2016, the Bay Area Development was addressed in *Guiding opinions of the State Council on deepening Pan-Pearl River Delta regional co-operation* and in China's 13th Five-Year Plan. In March 2017, the Bay Area Development appeared in the government's working report and in July 2017, President Xi Jinping attended the signing ceremony of the *Framework agreement on deepening Guangdong–Hong Kong–Macao co-operation in the development of the Bay Area* in Hong Kong.

In October 2017, the report of the 19th National Congress of the Communist Party of China (CPC) asserted that Hong Kong and Macao should be integrated into national development, focusing on the construction of the Bay Area Development, the co-operation between Guangdong, Hong Kong and Macao, as well as the regional co-operation of the Pan-Pearl River Delta. China will fully promote mutually beneficial co-operation between mainland China, Hong Kong and Macao, and will formulate well-established policies for Hong Kong and Macao residents to develop careers and operate businesses on the Chinese mainland.

The role of the Bay Area Development lies in building world-class city clusters. This is of great strategic significance for advancing and implementing the Belt and Road Initiative (BRI) and the 'one country, two systems' policy.

Vice-chairman of the Financial and Economic Affairs Committee of the National People's Congress and vice-chairman of the IFF, Gu Shengzu, identifies building bay area city clusters with world-class innovation and economies as playing an important role of the Bay Area Development. He says the Bay Area Development will be an advanced city cluster and a core city with significant influence, which can lead to better division of labour and more regional co-operation. Gu also believes that the Bay Area Development would be a high-end industry group, with a well-established supporting system of modern industry and financial services, and reasonable division of labour, which is conducive to nurturing a benefit-sharing industrial value chain.

The Bay Area Development has a vibrant and innovative start-up network: within this area are several of the top 500 universities, as well as a great deal of international innovative talent. Equipped with a well-organised infrastructure network, efficient logistics system and convenient living environment, the Bay Area Development boasts high-quality resources, an open, inclusive environment and the institutional advantages of one country, two systems.

One task of the Bay Area Development is to ensure the long-term prosperity of Hong Kong and Macao, and to deepen the integration between the Chinese mainland and the two cities to ensure that the one country, two systems policy can be fully implemented.

Li Zuojun, deputy director of resources and environmental policies at the Development Centre of the State Council,

Guangzhou City on the Zhu River

says that accurately carrying out the one country, two systems policy requires the construction of the Bay Area Development, the administration of Hong Kong by Hong Kong people and of Macao by Macao people with a high degree of autonomy. Antony Leung, former financial secretary of the Hong Kong Special Administrative Region (SAR), agrees strongly with this view.

Yu Hongjun, former vice-minister of the International Liaison Department, Central Committee of the CPC, notes that the Bay Area Development is an economic engine for the BRI and a core area for the Maritime Silk Road, due to its distinct geographical advantage and role as a gateway to the vast Chinese mainland economic market. Elaborating on the relationship between the Bay Area Development and the BRI, Yu calls for the incorporation of the construction of the Bay Area Development into the BRI.

Economic and population growth

There are currently 70 million permanent residents within the Bay Area Development – around 5% of China's total population. Xing Ziqiang, chief China economist at Morgan Stanley, believes that by 2030 the population will grow by 18 million to become the world's most populous bay area. Research data from Shenwan Hongyuan Securities shows that in 2016 the total economic output of the Bay Area Development was around CNY9.31 trillion, equivalent to about US$1.4 trillion. Xing also believes that in the next 10 to 15 years the Bay Area Development will become the world's largest bay area economy.

Ma Jiantang, executive vice-president of the Chinese Academy of Governance, is also confident about the future of the Bay Area Development. In his opinion, the development has three unique advantages. First, a distinct advantage in location and transportation, and a complete industrial chain with abundant technological innovation. The Bay Area Development is opening up on a larger scale, thus attracting many high-end talents, which in turn enhances global finance and services. Second, the Bay Area Development includes two SARs, two metropolitan cities and three free-trade zones – making it very competitive internally and externally. Third, it encompasses three distinctive economies and its diversity is unlike anywhere else in the world. Xing says that the planning and development of the Bay Area Development conforms to the new trends of the Chinese economy in that more consumption is driven by small and medium-sized cities in the clusters, more investments incline towards innovation and knowledge, and the rebound of investment has opened up a new direction for China's exports.

The Bay Area Development has the potential to catch up with the other three major bay areas. Rick Niu, president and chief executive officer (CEO) of Starr Strategic Holdings and partner at Starr Finance, is mindful of the experience and challenges of New York and San Francisco's bay areas, and asserts that typical features – such as a relatively high proportion of tertiary industry, the introduction of talented people, comprehensive law enforcement and clear differentiation – can be used for reference in the Bay Area Development. However, Niu also warns that, in the past four to five years, the New York and San Francisco bay areas have lost competitiveness to inland areas in the Midwestern and southern states of the US because of high taxation, political instability, heavy costs and regulation, and unclear incentives. On the experiences of the other three bay areas, Yao Peisheng, former Chinese ambassador to Ukraine, suggests that China should not blindly copy the model of other bay areas, and that the Bay Area Development should not be a paradise for consumers to idle away pleasurably, but a city to gather innovators. Yao says the Bay Area Development should have an innovative and advanced development concept, and plans should be made at least 30 to 50 years ahead of time.

From left: former prime minister of Pakistan, Shaukat Aziz; executive vice-president of the Chinese Academy of Governance, Ma Jiantang; 26th Australian prime minister, Kevin Rudd; former vice-chairman of the National Committee of the Chinese People's Political Consultative Conference and former chief executive of the Hong Kong SAR, Leung Chun-ying; 26th UN General Assembly chairman and former prime minister of the Republic of Korea, Han Seung-soo; and Communist Party secretary of Guangzhou and deputy Communist Party secretary of Guangdong, Ren Xuefeng. Politicians from various countries and regions, experts and scholars in the field of international finance and entrepreneurs participated in the seminar. Major officials of Guangdong Province and Guangzhou municipal government also attended the meeting

The Bay Area Development should closely follow national strategy and interact benignly with the BRI. Beginning from the perspective of developing trade ports, Yu Liming, vice-general manager of Guoxin International Investment Corporation, proposes building the Bay Area Development as a new hub of the New Maritime Silk Road. He stresses that the Thirteen Factories – also known as the Canton Factories – were the third-largest trading posts in the world in the 19th century, and that Guangzhou has always been a prosperous, world-class metropolitan city. The rise of Hong Kong following the Opium Wars, the development of Shenzhen after the reform, and the opening up and rapid construction of the Port of Guangzhou have all endowed the Greater Bay Area with a unique culture. Alongside this regional advantage, the Bay Area Development leads the historic mission of 'opening-up' China to the rest of the world. As far as international trade is concerned, the Bay Area Development has outstanding resources and capabilities, with which a China-based trading port that serves the world can be built. In addition, Yu says that Hong Kong, Shenzhen and Guangzhou as a whole have a relatively appropriate geographical span in terms of pivotal ports both at home and abroad. The three ports are located in the hinterland of southern China and are all adopting complete market operation, with Hong Kong enjoying considerable global success as a free port. Therefore, regarding Hong Kong, Shenzhen and Guangzhou ports as pivotal in the Bay Area Development is both reasonable and economical.

The Republic of Korea's former prime minister, Han Seung-soo, believes the Bay Area Development will become China's financial centre. He also predicts that it will play a leading role in further developing innovation. Zhu Xian, vice-president of the New Development Bank – a multilateral development bank established by the Brics states of Brazil, Russia, India, China and South Africa – says the current environment is ripe for building the Bay Area Development as its construction has global strategic significance and unlimited potential. Zhu claims that financial innovation would be the Bay Area Development's unique advantage. The mechanism of interconnectivity makes it easier to integrate financial innovation. Therefore, a broader platform for investment and financing can be provided for enterprises to 'Go Out', and to march forward towards a higher global value chain.

The Bay Area Development can achieve co-ordinated development through Guangdong, Hong Kong and Macao complementing each other's advantages. When interpreting opportunities and future directions, former Hong Kong finance secretary Leung asserts that, first, the Bay Area Development is in line with the trend of international development and, second, the world has shifted from an era led by industrial economy to a knowledge-based or innovative economy. To realise the organic combination of industrial and financial innovation, the development of the Greater Bay Area and city clusters is not only necessary, but it also conforms to the current situation and complementary advantages.

Wang Yan, deputy director of the IFF and former chief economist of the World Bank, highlights that the nine cities and two SARs appear in different parts of the 'smiling curve', making these regions highly complementary. China lags behind in world service trade, which hinders its manufacturing industry. However, Hong Kong and Macao have a great comparative advantage in service exports – therefore, in terms of service trade, Guangzhou should strengthen its co-operation with Hong Kong and Macao.

Institutional co-ordination of Guangdong, Hong Kong and Macao

Gu Shengzu says that the future of the Bay Area Development is promising, but its construction will be challenged by obstacles and hardships. He emphasises the problems of sectionalism, homogeneous competition and institutional obstacles in the process of bay area integration. To aid co-operation, the Bay Area Development and the Chinese mainland must narrow the divide between the operational mechanism and the institutional and cultural environment. To build a co-ordinated and innovative mechanism in the Bay Area Development, requirements must be met on the following: complementary advantage and labour division, the integration of each party's demands, the consolidation of advantages, the shifting from individual to common development, the co-operation of research and development (R&D) with enterprises and the nurture of innovative talent. Zhu Xian also posits that the construction of the Bay Area Development faces many challenges. For example, under the principle of one country, two systems, China requires co-ordinated and innovative institutional mechanisms.

In addition to macro problems and challenges such as institutional mechanisms, some scholars have incisively identified specific problems that might be encountered during construction. Xia Le, Asia chief economist at BBVA, believes that the Bay Area Development means to achieve balance, and that long-standing competition in the three regions should be repaired and adjusted. However, he also says that the government must consider how to maintain an open and competitive market while carrying out intervention.

One of the most crucial experiences of the past 30 years is that competition between local governments can lead to economic success, but the boundary between government and the market should be carefully drawn. Xia also notes that the Bay Area Development must streamline the flow of information. Research and education should be improved on the Chinese mainland, and it is important to ingest information from the outside world.

Unfortunately, both information and the flow of talent are hindered, while attracting talent and alleviating poverty also brings challenges. If a city wants to retain its talent, housing problems need to be resolved – governments need to contemplate how housing costs can be reduced and renting markets can be developed. At the same time, policies on adjusting building indicators inside the Bay Area Development, as well as market-based housing subsidies outside of it, deserve attention. Currently, around one million people living in Hong Kong are below the poverty line. If income distribution cannot be improved – however rapid the pace of the development – it cannot be regarded as a success. These insights are applauded by participating experts and scholars. The division of the Bay Area Development – such as with barriers between markets, capital and talent – impedes interconnection and interworking. Antony Leung believes that, if China wants to develop the Greater Bay Area to be the largest, most economically successful bay area in the world, it must break down these barriers, even if it takes time.

Leading on innovation

Following Guangdong, relying on Hong Kong and Macao

In developing the Greater Bay Area, China should be aware of regional differences, which participating experts recognise. On this basis, Guangdong, Hong Kong and Macao will be able to exert their own respective advantages and promote mutual development.

Chen Bingcai, inspector at the Ministry of National Administration, posits that Guangdong should play the leading role in the construction of the Bay Area Development, with Hong Kong and Macao providing assistance. In the past 15 years, the total economic output in Guangdong has increased by a factor of eight to nine. If Guangdong takes the lead and other regions develop accordingly, advantages can be fully applied. The division of labour and co-operation among cities is a great advantage to economic development. The city clusters, regardless of size, should have specialised divisions of labour, rather than concentrating resources in central cities.

The Bay Area Development in China will be in the vanguard for building world-class city clusters and participating in global competition

Experts from Hong Kong believe the SAR could support the development of the Greater Bay Area by providing talent and financial leverage. Antony Leung suggests two essential contributions that Hong Kong might make. First, talent attraction – Hong Kong, international and diverse, with easy access to education and medicine, is institutionally favoured by much overseas talent and can serve as a long-term centre for gathering international talent. Second, finance, as Hong Kong is a global financial centre. According to Leung, Hong Kong should work with neighbouring regions – especially Shenzhen and Guangzhou – to develop high-end industries such as biotechnology, big data and artificial intelligence. He highlights three points in respect to more prosperous development: a breakthrough of different economic elements flowing between Hong Kong and mainland China; increasing collaboration in industries such as biotechnology and big data; and a higher level of co-ordination mechanism should be established in the context of one country, two systems.

Hu Weixing, professor of politics and public administration at Hong Kong University, concludes that Hong Kong can play the role of 'super co-ordinator' in developing the Greater Bay Area. He lists what he believes are Hong Kong's three major advantages: the financial services industry, the competitiveness of its professional services and its natural ties for international exchange and co-operation. Besides being the super co-ordinator, Hong Kong should also actively participate in construction to further integrate into the Bay Area Development and achieve wide consultation, joint contribution and shared benefits.

In this regard, Hu makes two suggestions. First, business departments in the two SARs, nine cities and Guangdong Province should communicate honestly and clearly to fully implement policies and projects. Second, people-to-people exchange is a key factor in the Bay Area Development. To this end, he proposes mutually beneficial co-operation between mainland China, Hong Kong and Macao, and to improve policies for Hong Kong and Macao residents to develop in the Chinese mainland, emphasising the historical responsibility of their compatriots for national awareness and patriotism, and to share in the national rejuvenation as well as prosperity and glory.

The Bay Area Development must streamline the flow of information. Research and education should be improved on the Chinese mainland, and it is important to absorb information from the outside world

Strengthening top-level design

Yu Hongjun, formerly of the Central Committee of the CPC, believes China must achieve co-ordinated development under a well-organised top-level design. He suggests that in terms of policies, first of all, a unified plan and outline needs to be formulated; second, cultural exchanges, dialogues and co-operation should be strengthened between enterprises, public institutions, scientific research and teaching institutions, and mass media; third, interconnected infrastructures should be established in Guangdong, Hong Kong and Macao. Deep exploration of institutional mechanisms and standards should be made to cater to all three locations. Zhu Xian argues that two of the most important internal factors for the Bay Area Development are the integration and division of labour. The Bay Area Development is intended to promote economic integration between Hong Kong, Macao and the Pearl River Delta, which requires important top-level design to promote the rational division of labour and avoid internal friction and redundancy.

The Bay Area Development can also serve as an experimental field for innovative co-operation exploring new modes of regional development. Chen Xuanqing, former inspector of the National Development and Reform Commission, suggests the Bay Area Development should speed up innovation in four main areas.

First, innovation should be considered in terms of a co-operation platform. Following the principles of co-ordinated development, resource sharing and mutual complementarity, industries of different types, levels and sizes should be integrated. Major co-operation platforms for advanced and competitive industries, modern services industries and strategic emerging industries should also be established, and key laboratories and engineering centres should be promoted. Second, China needs to bring forward new ideas for co-operation mechanisms. Infrastructure in different areas should be brought into line, and the mechanism for cross-border infrastructure construction must be improved. Cross-border port management should be strengthened. Further strategic co-operation in intellectual property should be carried out. In addition, new mechanisms concerning areas such as regional financial security, governance incentives, population monitoring and low-carbon development and co-operation should be established. Guangdong, Hong Kong and Macao should jointly establish a demonstration project for low-carbon development within the Bay Area Development to accelerate the formation of a green economy. Third, China should introduce innovative joint projects and strengthen its infrastructure interconnections. Guangdong, Hong Kong and Macao should jointly release the project of three networks and one centre, which is the network of multi-way channel, air and sea routes and rapid bus transit, as well as the centre of world-class shipping logistics. The Hong Kong International Shipping Centre will be the heart, and Shenzhen and Guangzhou will be container port hubs. Major science and technology programmes should be supported to build a financial circle. Fourth, China should create new policies of co-operation to promote liquidity in a unified market. High-level co-ordination and dialogue mechanisms should be improved to increase connectivity. Under the leadership of central government, China needs to work in unison to become a world-class bay area and city cluster.

Participating experts say the Bay Area Development must always fit the concept of a co-ordinated development, with the ultimate goal of integrated construction. Li Zuojun asserts the importance of integrated construction in the following aspects: ideology and understanding; institutional mechanisms; rules and policies; industrial development; infrastructure construction; urban systems; market development; environmental standards; public services; and brand services.

Building a modernised economic system

The Bay Area Development must always adhere to the innovation-driven strategy and promote regional development through technological improvement. Former prime minister of Japan Yukio Hatoyama says that universities play a crucial role in innovation and start-up businesses. He notes the many universities in the Bay Area Development – Guangzhou currently has more than one million registered students, who will have a great impact on the future economy. Zhang Yansheng, chief researcher at the China Centre for International Economic Exchanges, undertook a comparative study of scientific and technological innovation in Guangdong and

Hong Kong. He found that, using an index to measure the density of R&D investment, Guangdong has reached 2.56%, which exceeds the average level of developed countries and means that Guangdong has already entered the preliminary level of an innovation-driven society. In the Bay Area Development, meanwhile, the density of R&D investment is relatively low, at 0.73%. However, Hong Kong has four top-ranking universities and world-class systems for direct investment and financing, in addition to a well-organised market economy and law enforcement. Chen Bingcai proposes to develop the Greater Bay Area as a hub and model zone of transformation, upgrade and innovation. This goal can only be achieved by focusing on environmental and ecological technology, social governance, innovation in technology and products, protection of intellectual property rights, and basic education and research investment.

Finance is one of the core competitive advantages of the Bay Area Development and plays a leading role in the construction of modern economic systems. Li Dongrong, president of the National Internet Finance Association of China and former deputy governor of the People's Bank of China, puts forward some suggestions concerning the financial services system in the Bay Area Development. First, Li believes China should build a competitive global bay area with an effective and suitable financial services system. Financial markets need to be given full access to facilitate resource allocation. Thus, China can provide highly efficient financial services support to scientific and technological innovation, industrial upgrading and economic development. Second, China must give scope to financial services systems in the construction process. By measuring various economic situations, comparative advantages, industrial distribution and resources endowment, China can strengthen financial co-operation in different areas and provide financial services in an appropriate manner to achieve benign interaction and co-ordinated development. Third, fintech should be an active part of today's financial services systems. Internet finance is an emerging area of competition and resource distribution in various countries and regions in the digital age, and the Bay Area Development has important geographical advantages in the development of fintech.

The Bay Area Development needs to gather not only wealth but talent. Zhuang Enyue, vice-president of China Cinda Asset Management, suggests the introduction of more modern financial talent – especially those capable of activating assets and turning waste into value, and those with philosophical and technological mind-sets. Omar Shahzad, CEO of Meinhardt in Singapore, proposes that a well-structured Bay Area Development could effectively reduce labour costs and improve competitiveness. To encourage the introduction of talent, the Bay Area Development should be more open to welcoming and attracting global talent.

The Bay Area Development can no longer follow the old path that leads to high contamination, high energy consumption and high emissions. Han Seung-soo, former prime minister of the Republic of Korea, says the Bay Area Development, China and the whole world must shift from brown growth to green growth. He highlights the Republic of Korea's global green-growth agency, which was set up in 2010 and has already become an international institution. The IFF could also set up a green-growth centre that undertakes green finance, climate change and renewable energy research. Relying on the resources of the IFF, the green-growth centre could evolve into a heavyweight research institute in China and perhaps the rest of the world.

Ye Yanfei, inspector of the China Banking Regulatory Commission Policy Research Bureau and an expert on green finance, believes the Bay Area Development should be characterised by green finance. He suggests first trying the free flow of green capital, or setting up a green capital market to attract overseas businesses as well as BRI enterprises. Governments could issue green bonds in this area and attract overseas capital to invest in green industries. He is also confident that the green capital market will become the most popular capital market in the world.

Zhang Jianyu, Chinese programme director of the Environmental Defence Fund, proposes that the development of a green supply chain would be an important component of the Bay Area Development. To develop a green supply chain means that environmental requirements need to be added into business chain management, including efficiency, energy saving, water saving, power saving and low-carbon environmental protection. Zhang Jianyu says that China is the first to advocate a green supply-chain network in the Asia-Pacific region to promote green and integrated development. Currently, the green supply chain in Dongguan, within the Bay Area Development, has performed outstandingly. Under the leadership of municipal government, the Dongguan Index serves not only as a benchmark for manufacturing industries, but as a specific measure for energy conservation and efficiency improvement. As a global green supply-chain centre, the Bay Area Development should be a birthplace of global green organisation and a hotbed of green innovation.

Building a community of common destiny

The Ministry of National Administration's Chen Bingcai identifies that the BRI has no strings or market access attached and all related trade agreements are on an equal basis. China will also provide sufficient technology, capital and equipment support, all of which have comparative competitive advantages.

Hu Biliang, dean of the Belt and Road Research Institute of Beijing Normal University, has carried out an in-depth study of the BRI. He explored the topic of promoting stable development of the BRI in the Bay Area Development, and believes the core aim of the BRI is to strengthen the relationship between policy connectivity, economic co-operation and trade, infrastructure connectivity, financial support and people-to-people exchanges. As well as the aforementioned aspects, China must also make effective use of the Bay Area Development as a good vector for development. Other port cities around the world have successful experience worth learning from.

The readiness to begin development of the Greater Bay Area stretches across China, and Guangdong, Hong Kong and Macao have obvious location and resource advantages. China's proposal of the BRI is a firm step towards further opening-up and, alongside this initiative, the Bay Area Development's future looks very promising. Hu Biliang considers a further three crucially important factors in the BRI and the Bay Area Development's interdependence. First, opening-up should be synchronised. China should take into consideration all aspects, including the financial system, exchange rate management, services and agriculture. Second, the co-ordination of internal and external factors should work in harmony. Third, China should attract top-quality talent from home and abroad, which requires further optimisation of talent policies. ■

Construction challenges in the Bay Area Development

Zhu Xian, vice-president of the New Development Bank, explains how top-level design is needed to allow each of the three major conurbations in the Bay Area Development to play to their strengths

The strategic importance of the Guangdong–Hong Kong–Macao Greater Bay Area (the Bay Area Development) reaches far beyond China to the rest of the world. But the great potential in the development of the Greater Bay Area should not lead us to underestimate the challenges.

Hong Kong and Macao intersect

The Bay Area Development concept arose out of an increasing maturity of the development environment and economy in the region. In the past 30 years, the Pearl River Delta (PRD) economic zone, as the frontier of China's reform and 'opening-up' policy, has earned a reputation as a 'modern world factory', while undergoing a marked transformation from a low-income economy to a high-income one. It narrowed the gap with developed economies by advancing the construction of infrastructures and proliferating economic interconnections with Hong Kong and Macao. Reviewing the past 30-year period of reform and opening-up, it is clear that the economic development of the PRD couldn't have been achieved without Macao and, in particular, investment and financial support from Hong Kong. Today's economic maturity is building on 30 years of regional integration. A trend for further integration is obvious, and the potential for a world-class Greater Bay Area megacity is promising.

The Bay Area Development shares common traits with the successful major bay areas in New York, San Francisco and Tokyo in terms of infastructure, including convenient transportation, similar commercial service centres and investment/financing platforms, crucial manufacturing hubs, human-labour capital, and a range of scientific research and higher-education institutions.

Creating a regional hub

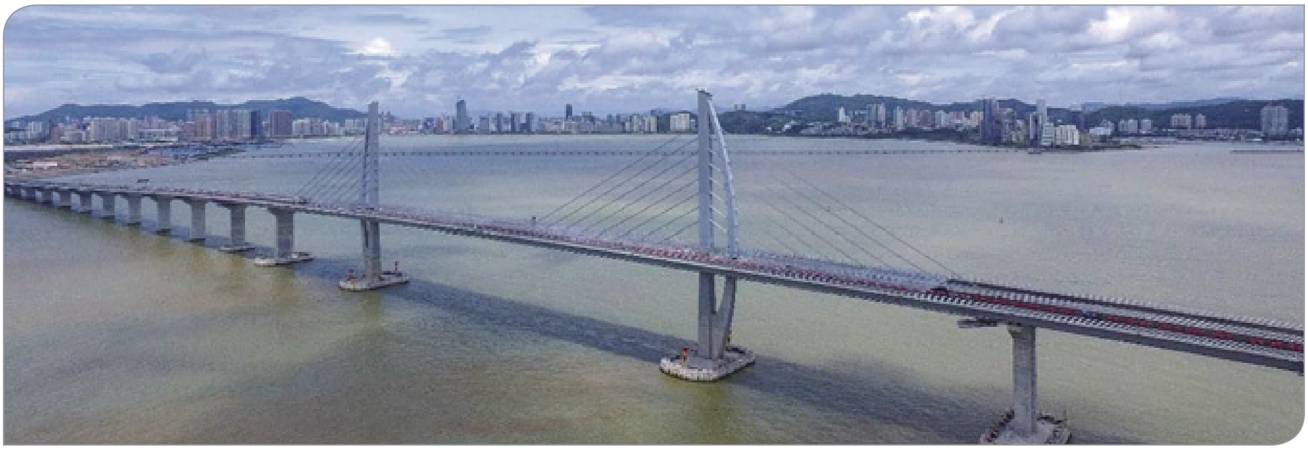
An important internal condition of the construction of the Bay Area Development is in the integration and division of labour. On the one hand, the advent of the Bay Area Development will result in deeper economic integration in the region. On the other, a top-level design is necessary to expedite rational division to avoid internal expense and redundant construction.

The Bay Area Development will be the hub of the Belt and Road Initiative's (BRI's) construction through industry gradient transfer. In other words, the region should establish an economic belt

Zhu Xian

dominated by the Bay Area Development, building an economic hinterland in the Pearl West Economic Belt and driving growth in the mid-south and southeast regions of China – possibly extending out to south and Southeast Asia. But consideration should also be given to resource sharing and internal urban integration of the Bay Area Development.

Economic aggregates in Guangzhou, Shenzhen and Hong Kong are almost equal, which drives the need for a strategic view of the cities' division and respective identities in the development of the Greater Bay Area. In terms of division, emphasis should be placed on innovating shipping and ports, and finance and technology. In light of Hong Kong's position as an international port of transshipment, Guangzhou and Shenzhen – each with their own unique functions – should compete and differentiate themselves as ports. Hong Kong is an international finance centre, Shenzhen is the finance centre of south China and Guangzhou is developing a financial industry to become a regional financial services centre. In technology innovation, Hong Kong boasts a well-established financial infrastructure and mature capital markets. Shenzhen aims to become China's equivalent of Silicon Valley, and Guangzhou is planning a future as an international innovation hub. These cities require diverse top-level design to ensure competition over division of labour can proceed seamlessly.



The Hong Kong–Zhuhai–Macao Bridge

The other nine cities in the PRD should also clearly identify their strategic positions. Under this premise, they could learn from each other, avoid local protectionism and disorganised competition, and enhance overall competitiveness, gaining benefits by allowing local synergy to flourish.

Financial innovation

Financial innovation is a unique strength of the Bay Area Development – during construction, the cities will make financially innovative contributions of their own. Shenzhen has the qualities to become the pinnacle of innovation, generating new development forces and advancing traditional industry; Guangdong has well-established industry and stable manufacturing foundations; and Hong Kong can exert financial strength through mature capital markets and financial services. As part of an interconnecting mechanism, the Bay Area Development will form integrated superiorities in financial innovation, which will provide broader investment and financing platforms for regional enterprises and drive it towards the top of the global value chain.

Hong Kong has become a business hub for global offshore renminbi while the type and magnitude of renminbi investment products in the market is increasing. Therefore, innovative capital in the Bay Area Development will have more approaches to outward expansion, while Hong Kong can meet the requirements of regional offshore renminbi settlement financing and asset management.

In the future, China should strive to cultivate financial co-operation platforms in Guangdong, Hong Kong and Macao; to further two-way opening-up and the connectivity of financial market elements between mainland China and Hong Kong, and mainland China and Macao; and to build a financial hub to lead the PRD and expedite Asia's ability to serve the BRI .

An equal stake

Although the construction of the Bay Area Development offers promising potential for further development, challenges are inevitable and should never be underestimated.

First, under the 'one country, two systems' framework, construction of the Bay Area Development requires the innovation of institutional mechanisms. There is a divide between Guangdong, Hong Kong and Macao in regard to their institutions, cultures and business operations. Achieving institutional innovation through top-level design and integrated consensus will therefore be a challenge, and China must strengthen co-ordination between policy and planning, maximise the benefits of one country, two systems, and minimise the cost of diversification.

Second, circulation in the Greater Bay Area must be upgraded. Its integration must expedite the free flowing of key elements – including people, logistics, capital and information in the region – and optimise the allocation of productive factors through market orientation. For example, the customs clearance system should be reformed on the Guangzhou–Shenzhen–Hong Kong Express Rail Link and the Hong Kong–Zhuhai–Macao Bridge to enhance traffic efficiency and maximise the advantages of people and logistics reaching maximum capacity.

At the same time, China should utilise the cities' complementary and comparative advantages, established in their own areas of strength. Clear recognition of this is required in every region and entity in the Greater Bay Area, allaying the effect of inert thinking and breaking any patterns of interest. The Bay Area Development should pursue complementary development and aim for mutual benefit and win-win outcomes through deeper communication and co-ordination.

Finally, the continuity of policies should be maintained. Governments at all levels in the Greater Bay Area should clearly identify the threshold between government and market by discarding the 'one case, one project' model in favour of individual case analyses and evolving conventional preferential policies. In accordance with the instructions set out in the 19th National Congress of the Communist Party of China report, enterprises registered in Chinese territories should be treated equally and fairly, and policies related to the construction of the Bay Area Development should reflect good prospects, continuity, predictability and impartiality under viable conditions to avert variable, uncertain and frequent change. Thus, the market will be able to retain its dominance in resource allocation, providing full access to the leading role of the enterprise.

The announcement of the construction of the Bay Area Development is a strategic move with global significance. However, relying on mere potential and possibility is inadequate – construction will only proceed smoothly if China assesses the Bay Area Development impartially and finds solutions to its attendant problems. ■

Riding the technology wave – Innovation in the Greater Bay Area

Ma Jiantang, executive vice-president of the Chinese Academy of Governance, looks at how a remodelled Chinese economic landscape combining the best elements of free markets and state planning creates fertile ground for rapid transformation and innovation-driven growth

Ma Jiantang

The global economy is recovering and trending upwards. The deflation and weak demand that have plagued it for a decade are expected to go into reverse. The International Monetary Fund's world economic outlook shows a global economy on the upturn, with growth rates in 2017 and 2018 reaching 3.7% and 3.9%, respectively – significantly higher than 2016's 3.2%.

Why are commentators so confident that the international economy is drawing away from its 10-year abyss? Fundamentally, because the next-generation technology revolution – characterised by commercialisation and industrialisation in areas such as the internet, artificial intelligence, life sciences and technology – has created a vast amount of new industries, forms, models and services.

New economies breed expansion through expedited urbanisation and the rapid transformation and upgrading of traditional industry – this is now a new sustainable engine for the world economy. China's priority has switched from high-speed growth to high-quality development, creating a crucial juncture in improving quality and efficiency, and changing driving forces.

Implementation of innovative strategies and supply-side structural reform is profoundly remodelling the Chinese economic landscape and the dynamic structure of economic growth.

First, innovation produces new growth drivers, supports sustainable development and improves the quality of the national economy. Thorough implementation of innovation strategy engenders an unstoppable wave of 'mass entrepreneurship and innovation', which in turn accelerates a new round of technological revolution. As a result, China is seeing the rapid development of new industries, formats and patterns, as well as the transformation and upgrading of traditional industries.

More than one-third of the world's 'unicorn' companies – start-ups valued at more than US$1 billion – were founded in China. Riding the overwhelming wave of science and technology development, China fosters sharing, platform and digital economies, among others, while new products and services constantly emerge to increasingly support the structural optimisation of energy transfer, stable employment and quality efficiency ascension.

Second, reforms such as supply-side structural reform restored to some extent the supply-and-demand pattern, and rebalanced the economy.

China insisted on prioritising supply-side structural reform, and implemented the significant undertaking of 'three cut, one reduction, one supplement', which included a cut in excess capacity, enterprise mergers and reorganisation, transforming the long-term pattern of supply exceeding demand. The supply-and-demand pattern not only advanced supply-side quality, but also increased the price of industrial products – especially bulk raw materials – thus increasing business profit and fiscal revenue.

In the meantime, China has optimised its business environment by simplifying governance and decentralising power. In the first three quarters of 2017, nearly 16,000 new enterprises registered each day to further stimulate the market's vibrancy.

The intersection of an optimised economy for national development with the long-term cycle powered by the technology revolution's marketisation and industrialisation, opens up historic opportunities for sustainable and healthy development while creating new engines and patterns for the Guangdong–Hong Kong–Macao Greater Bay Area (the Bay Area Development) and its economic growth.


San Francisco downtown and bay area

Regional benefits

To the north, the Greater Bay Area connects urban agglomerations in central China, while to the south it links with Southeast Asia. It is flanked by the Western Taiwan Strait Economic Zone to the east, and the Beibu Gulf Economic Zone to the west.

As an important component of the BRI, the Bay Area Development is equipped with advanced transportation, a comprehensive industrial chain, abundant science and technology innovation, and human talent and intelligence. It enjoys a high degree of openness and distinguished international financial services. Therefore, the Bay Area Development is on a mission to propel internal and external regional co-operation, and to enhance its function of radiating economic benefits through co-ordination in infrastructure and enhancement of talent exchange, information and communication.

The Bay Area Development has demonstrated its unique advantages and become a bright star in the global economic firmament. The success of New York's bay area is based on the prosperity and strength of its financial services industry; San Francisco's bay area benefits from the emergence of high-tech industry; and Tokyo's bay area drives on two wheels – the financial services and shipping industries. These three bay areas adopted similar developmental approaches – infrastructure integration, synergies in regional division of labour, liberalisation of element flow and inclusiveness of business environment. They transferred from port, industrial and service economies to innovation economy and ultimately achieved multi-stage growth by expanding the scope of their economic activities.

The Bay Area Development has a solid economic foundation and tremendous potential for growth – its gross GDP is equal to that of New York's bay area and twice that of San Francisco's. Its trade volume is more than three times larger that of the Tokyo bay area, and its passenger transfer volume places it among the world's three largest ports and airports.

Moreover, the Greater Bay Area's tradition of regional strengths in talent and intelligence, institutions, policies and industries is becoming increasingly prominent.

In the future, the Bay Area Development will drive a new round of economic growth, aided by a more open economic structure, more efficient resource allocation, a more influential spillover effect and more advanced international networks. It will not only promote the development of the Pan-Pearl River Delta (Pan-PRD) – including the mid-south and southwest regions – but will also establish itself as a hub for the Belt and Road Initiative (BRI) in finance, information, commerce and technology.

The Bay Area Development will strengthen China's role in international labour, economic globalisation, global governance and the "community with a shared future for mankind".

Socialism with Chinese characteristics has entered a 'new era' of politics and power, which brings with it new opportunities and requirements. In this new era, the Bay Area Development will further excavate, integrate and exploit its three unique advantages, which are regional, systemic and advantages of integration.

Advantages of integration

The Greater Bay Area covers two special administrative regions – two first-tier cities and three free-trade zones – all with internal and external competitive advantages. In the new era, it is necessary to exert new advantages and creativity, and assert better overall planning and resource integration to take a new economic leap, co-building a healthy Greater Bay Area and a high-quality living community. Furthermore, this should actively encourage free flow of all kinds of production factors to form a favourable ecological environment benefiting industrial transformation and the cultivation of new industries. Financial development should spur a two-way flow between Hong Kong, Macao and mainland China to nurture a global financial hub that leads the development of the Pan-PRD and serves the BRI.

Systemic advantages

One of the most distinguished features of the Greater Bay Area is the 'one country, two systems' policy. Three distinct, diversified economic systems have differentiated the Greater Bay Area from its global competitors.

Skilful use of this diversification would attract multiple cultures and complement each city in the Greater Bay Area; moreover, it would generate compliance advantages for economic development there. The megacity cluster comprising Guangzhou, Shenzhen and Hong Kong can move to a new stage by extending its economic reach, driving resource sharing, talent and intelligence gathering for the Greater Bay Area, further developing the PRD and equipping China with new propulsive powers for its greater economic leaps forward.

Building a more prosperous and civilised Greater Bay Area forms an organic part of the Chinese Dream that aims to achieve the great rejuvenation of the Chinese nation. It is also a shared historic mission for the generation bearing the weight of hope, endeavour and hard work. ■

Co-ordinated development – The gateway to the Bay Area Development

Gu Shengzu, vice-chairman of the IFF and vice-chairman of the National Committee of the Chinese People's Political Consultative Conference, discusses the importance of interconnectivity and innovation – in transport, regulation, industry and finance – to achieving world-class economic hub status for the Greater Bay Area

The Guangdong–Hong Kong–Macao Greater Bay Area (the Greater Bay Area) has been an enduring growth pole for global economic development and a source of new technologies, industries and business models, as well as a hub for innovation and development. The Greater Bay Area is a '9+2' urban agglomeration formed by nine cities in Guangdong Province – including Guangzhou, Shenzhen, Zhuhai, Foshan and Dongguan – and two special administrative regions, Macao and Hong Kong. A vital driver of regional economic growth, it is China's gateway to fully implementing the policy of 'opening-up'.

The Greater Bay Area possesses an advanced port infrastructure, comprehensive industrial clusters and a highly developed urban mass, and forms a high-quality habitat and innovative ecological resource network, with prospects of becoming an economic bay area of world-class status. Promoting the development of the Greater Bay area is of great strategic significance, and will deepen the integration of Hong Kong, Macao and mainland China, drive forward the development of the Pan-Pearl River Delta (Pan-PRD) and aid the construction of the Belt and Road Initiative (BRI). It will broaden China's influence by spearheading a new round of innovation and development and a new type of globalisation through the construction of a highly competitive innovation centre.

The key to the construction of the Bay Area Development is to achieve mutually beneficial co-operation and co-ordinated development. Co-ordinated development emphasises the ideas of making up for weaknesses, of opening up and advocating interaction to achieve common prosperity and promote cross-regional capacity and competitiveness. However, deeper integration within the Bay Area Development is currently challenged by conflicts between regional departments, and ingrained institutional and cultural differences. Therefore, Guangdong, Hong Kong and Macao must build a mechanism for regional integrated development and institute an over-arching plan. This requires allowing full rein of the market in resource allocation and inviting enterprises to collaborate with the government in policymaking to dismantle regional co-operation restrictions and administrative regional barriers, and release the

Gu Shengzu

systemic dividends of the 'one country, two systems' policy. Based broadly on a regional integrated development mechanism, this policy in the Greater Bay Area should enhance multifarious co-ordination in exerting innovative potential and competitiveness, for example, by optimising the industrial structure, enhancing talent aggregation, improving financial services, promoting innovation and co-operation, continuing and reinforcing opening up and strengthening infrastructure interconnection – thereby jointly building a world-leading bay area city cluster. This article proposes six suggestions for transforming the Greater Bay Area into a leader among global economic hubs.

1. **Encourage joint development.** Industrial division should be enacted only on the basis of complementary advantages – core cities can establish themselves as leaders, but the comparative advantages of other cities should be recognised. A systematic industrial chain offering the benefits of sharing should be cultivated. Each city in the Greater Bay Area has different advantages in resources and function, so huge potential exists for synergy and complementarity. This combination of factor endowments and industrial strength will lead to a multilevel and diversified urban industrial division and synergy system, and raise the level of industry convergence. It will encourage joint development in the region

Hong Kong Science Park, home to more than 600 technology companies and approximately 13,000 technology talents, is an innovation hub in the Greater Bay Area

and create a community of mutual benefits and common prosperity. To strengthen the agglomeration and spillover of economically beneficial effects from the core cities, a transferral should take place of some industries from metropolitan cities to small and medium-sized ones. This will drive the formation of specialised industrial clusters in the surrounding areas and thus build three comprehensive and co-ordinated chains for industry, technology diffusion and market division. Priorities include augmenting Hong Kong's position as the nucleus of the financial, shipping and trade circles of the Greater PRD; building Shenzhen into a high-quality industrial innovation centre at the heart of China's own 'Silicon Valley'; and securing Guangzhou as the core regional manufacturing, science and education centre and benchmark for intelligent manufacturing and the regional/education/cultural tourism industry. Great efforts should be made to upgrade industry and prioritise high-end manufacturing and modern service industries through intensive division and co-operation, replacing the past concept of the 'world factory' with the new 'intellectual economy', and advancing Guangdong, Hong Kong and Macao to the top of the global high-end industrial chain.

2. **A platform for talent exchange.** A talent development strategy should be implemented in the Greater Bay Area to jointly cultivate diversified talents and build a platform for talent exchange. Talent flow and creativity must be encouraged via a better, more mobile intellectual mechanism across regions and industries. Talent is the strategic resource for realising national rejuvenation and besting international competition. To gather more high-quality talent, the Greater Bay Area must address regional differences and remove restrictions on talent mobilisation, joint talent cultivation and talent exchange. First, it is necessary to deepen co-operation in the education sector in the Greater Bay Area by integrating high-quality educational resources and permitting private capital access to it. Newly formed university clusters should use their knowledge, skill and innovative capability to train talent. Second, an inter-regional talent exchange platform should be established to create diverse student-exchange programmes, explore mechanisms for mutual recognition of academic credits and degrees, and encourage young people to participate in academic exchanges and co-operation in research and development across regions and disciplines. At the same time, institutional arrangements that support the flow of talent and solve the cross-regional and cross-industry barriers created by the two systems policy must be streamlined. A high-end talent settlement, housing guarantee and green-card clearance system should be instituted, and free-flowing and optimised human resources allocation in the Greater Bay Area facilitated. The Greater Bay Area will be an open, free, inclusive and harmonious social and cultural environment that is a high-quality habitat, is business-friendly and will attract more international and versatile talents.

3. **Systemic financial improvement.** The Greater Bay Area should boast an improved financial regulatory system, and promote and strengthen the co-ordinated development of its financial markets. Healthy financial development will allow the economy to thrive. Two-way liberalisation of financial markets must be accelerated and the integration of elements such as trade, technology and manufacturing into finance should be deepened. Co-operation between financial institutions in Guangdong, Hong Kong and Macao should be promoted, including interconnectivity of financial markets, mutual recognition of products, mutual exchange of financial infrastructure, interaction of financial talents and enhanced compatibility of regional capital markets. Making full use of its advantages as an international financial centre, Hong Kong should be considered as an interpreter and a converter in resolving the differences between domestic and overseas financial systems. The two major domestic and international financial markets should be closely connected with Hong Kong, and all financial resources must be efficiently

utilised. The connectivity mechanism in capital markets such as the Shenzhen–Hong Kong Stock Connect, the Shanghai–Hong Kong Stock Connect and the Primary Equity Connect should be aided to allow Hong Kong and Macao's financial service agencies to enter markets in the Chinese mainland, assist mainland China companies' listings in Hong Kong and promote the two-way opening-up of capital markets. This will advance the utilisation of digital financial technologies such as the internet and big data, expand cross-border electronic payment services, increase cross-border renminbi transactions, and promote the free flow of goods and currencies. The mechanism of financing and financial risk regulation should be improved by enhancing co-ordination and co-operation in regional financial regulation, promoting linkage and data exchange between financial regulatory information systems and laws and regulations, and establishing better information exchange among individuals and enterprises in the credit reference system.

4. **Collaborative innovation.** A mechanism for regional co-operation, collaboration and innovation should be established to strengthen in-depth co-operation in production, learning and research, integrating resources for regional innovation and stimulating the innovative vitality of entrepreneurs. Collaborative innovation is key to the co-ordinated development of the Greater Bay Area. Already, it possesses great potential in innovation because of its high number of top universities and scientific research institutions, its mature and highly experienced industrial cluster, its complete industrial chain and large manufacturing capacity. However, the main innovators often fail to co-operate and interact. Therefore, to release the bottleneck that hinders the rational flow of innovative elements, the logical allocation of innovative resources, complementarity of innovative functions and potential to mobilise various types of innovative entrepreneurs should be utilised. The Bay Area Development must broaden co-operation between industry, academia and research, and promote a winning combination of knowledge and technological innovation to jump-start innovative capability, innovative efficiency and the market value of technological achievements.

   An open innovation system will be established in the region to strengthen the introduction and application of scientific research achievements by domestic, international and multinational corporations. Cross-region innovative alliances and innovation centres will also be at the top of the development agenda to help Chinese mainland enterprises develop cross-region business. The Greater Bay Area should combine Shenzhen's strengths in entrepreneurship, innovation and technological achievements with Hong Kong's in invention and financial services, and Guangdong's in manufacturing to accelerate the cultivation of its influential core technology, brand advantages and business model. Full use should be made of the leading role of large scientific and technological enterprises in encouraging regional innovation and co-operation in small, medium-sized and micro-enterprises.

5. **Strategic interlinking.** The Greater Bay Area's regional advantages should spur on the construction of bonded areas and a free-trade zone, and more intertwined internal and external linkage to serve the BRI. Opening up and interaction are integral concepts to the development of the Greater Bay Area, and an impetus for propelling it to world-class status. The global stature of its aviation and shipping markets entitle the region to become an international integrated hub. The Greater Bay Area also enjoys a superior geographical position in both its bay and its vast economic hinterland. As the heart of the Maritime Silk Road and the main driver of the Silk Road Economic Belt, connections between home and abroad, via sea and land, can be realised via the construction of the BRI in tandem with the Greater Bay Area. If the Greater Bay Area acts as a bridge linking China with the countries along the BRI, it should become a productive service hub for the BRI and an integrated transport hub in the Asia-Pacific region by establishing an international mechanism of dialogue and exchange, and a platform for economic and trade co-operation. The Greater Bay Area's cities should also be encouraged to strengthen strategic linkages with countries along the BRI and develop international co-operation in industries, energy sources, finance, technology and services. The Bay Area Development must improve the modern freight logistics system, strengthen the integrated functions of international trade, facilitate trade and investment, and further liberalise the investment and trade policies on the basis of the existing Mainland and Hong Kong Closer Economic Partnership Arrangement, free-trade zones, special economic zones, state-level new zones and comprehensive reform pilot zones. With the preferential policy of Hong Kong's free port to the Chinese mainland, the opportunity should be seized to transform the Greater Bay Area into the largest bonded area and free-trade zone in China, and achieve trade liberalisation and market integration between mainland China and Hong Kong. The Greater Bay Area should embrace globalisation to create an internationally compliant business environment to further enhance its internationalisation.

6. **Infrastructure interconnection.** Integrated infrastructure in the Greater Bay Area should increase the accessibility of land, sea and air networks, facilitating efficient and unlimited flow of various production elements. The governments of Guangdong, Hong Kong and Macao should make comprehensive cross-region plans for a transport system, manage major road transport infrastructures and optimise the spread of transportation networks such as expressways, railways, urban railways and inland waterways. Commuter lines around the Hong Kong–Zhuhai–Macao Bridge should be harmonised, and relevant services such as traffic and border control, ports, ecology, and communications and signalling optimised. It is necessary to simplify customs clearance procedures in Hong Kong and Macao, establishing a 'one-hour living area' in urban agglomerations through internal and external connectivity. To enhance efficient and effective information services, the Bay Area Development will further develop information infrastructure and build a shared information network. Sophisticated technologies such as logistics networks, big data, cloud computing and artificial intelligence should be introduced into traffic management systems to establish the Greater Bay Area as a world-class harbour terminal and a global shipping centre. Once this is achieved, the harbour area and airport complex will supply a superlative international business service and ceaselessly spread its economic benefits throughout the region. ■

Mutual benefits – Bay area development in China and the US

Rick Niu, president and chief executive officer of Starr Strategic Holdings and partner at Starr Finance, examines what China can learn from the experience of the US of bay area development in New York and San Francisco, and sees advantages accruing to both countries as China's own Bay Area Development continues to surge forward

In their attraction of talent, venture incentives and construction of legal and regulatory infrastructure, US bay areas have exerted a powerful influence on the Guangdong–Hong Kong–Macao Greater Bay Area (the Bay Area Development). Economic and trade co-operation between China and the US will be mutually beneficial to their respective bay areas.

When comparing New York's bay area on the east coast with San Francisco's on the west coast, similarities and differences become apparent. One aspect the two areas have in common is that a large proportion of their economic output – between 80% and 85% – comes out of the real economy, particularly the services industry. Disparities between the two are also noteworthy. They are distinguished by their progress along very divergent development paths – San Francisco towards the technology, agriculture and wine industries, among others, and New York specialising in media, international trade and biotechnology.

Learning from US problems in bay area construction

The US has many lessons to teach China about bay area construction, not least from these major problems that were overcome:

- A far from ideal business environment – New York and California have traditionally been high-tax, less business-friendly states.
- Instability fostered by the political gamesmanship of the Republican and Democratic parties have resulted in a lack of policy continuity.
- High living expenses.
- Increasing financial supervision following the financial crisis, which has jeopardised the innovation and sound development of local markets.
- Compared with the Midwest and southern states, the mechanisms for encouraging innovation were insufficient in bay areas.

These shortcomings brought about the loss of some competitive advantages for the two US bay areas, and allowed the Midwest and southern inland areas to compete more successfully. It is, therefore, necessary to attach great importance to the top-level design and practical policies of the Bay Area Development.

Diversity between the local idiosyncrasies of a bay area and those of the neighbouring regions is key to bay area construction. It is particularly crucial in formulating policies and creating incentives to start-up enterprises and raise capital in accordance

The Statue of Liberty in New York's bay area with local social and economic realities. Although China and the US have starkly different ideologies and outlooks, their economic interactions and exchanges can be stimulated by the burgeoning growth of the Bay Area Development.

Future China-US co-operation

The Bay Area Development requires preferential national policies to encourage its progress. With further 'opening-up' and liberalisation in the financial sector following the 19th National Congress of the Communist Party of China, a large number of supportive financial policies are expected be promulgated. The Bay Area Development should seek their proliferation, and strive to be a beacon for China to attract greater attention and investment from the US and other Western countries.

Provinces and cities in China have accumulated hard-won experience and achieved great success in attracting foreign investment. In doing so, they have prioritised 'bringing in' rather than 'Going Out'. However, drawing on the experience of US bay area construction, insight has been drawn and it can be inferred that a Go Out policy ensures more successful bringing in. The Bay Area Development should therefore follow the principle of formulating foreign strategies that encourage the simultaneous capture of both these objectives.

The Bay Area Development could become the focal point of interest for China-US co-operation in the construction of the Belt and Road Initiative (BRI). The Trump administration may have withdrawn the US from the Trans-Pacific Partnership, given up its initiative in the Asia-Pacific region, and expressed only scepticism of the BRI, but many US enterprises are, in contrast, eager to participate in the BRI. The Bay Area Development is able to lend a cutting edge to market and capital approaches, and involving US enterprise and capital in the BRI would lead to positive effects by enhancing mutual commercial benefits in the two countries. ■

Rick Niu

Constructing a modern economic system in the Greater Bay Area

Zhang Yansheng, IFF Academic Committee member and chief researcher of the China Center for International Economic Exchanges, explains the research and development trends of the Bay Area Development and the need for private capital in the Greater Bay Area

Zhang Yansheng

The construction of the Guangdong–Hong Kong–Macao Greater Bay Area (the Bay Area Development) must conform to the new requirements of the 19th National Congress of the Communist Party of China on the construction of a modern economic system. This modern economic system that China will build will be an industrial system comprising the real economy, technological innovation and the co-ordinated development of modern financial and human resources.

The greatest difference between the current round of development and those of the past three decades is that, in the past, China has emphasised rapid growth but is now focusing more on high-quality development. Thus, the Bay Area Development needs to establish an industrial system that is tied to the real economy, technological innovation, and modern financial and human resources, and will promote the transition from high-speed growth to high-quality development in the Greater Bay Area.

A core indicator of high-quality development is the growth of total factor productivity in the Greater Bay Area through changes in quality, efficiency and motivation. Therefore, to develop such a strategic emerging market, the construction of the Bay Area Development must move towards a new era of high-quality progress.

The seven strategic emerging industries identified by the Chinese government comprise IT, biotechnology, new energy, new-energy automotive, high-end equipment manufacturing, new materials and energy savings. To integrate these strategic emerging industries into the Bay Area Development, technological innovation is the priority. The indicator of progress in science and technology innovation should be investment in research and development (R&D) – it should be the whole year's expenditure of social research and experimental funding as a share of GDP. In 2016, the intensity of R&D investment in Guangdong Province reached 2.56%,[1] surpassing the Organisation for Economic Co-operation and Development average of 2.4%.[2] From the perspective of R&D and innovation input, the Bay Area Development already possesses the foundation and conditions for developing strategic emerging industries driven by innovation.

However, this index only indicates that the input flow has reached its goal. To achieve the stock of R&D and innovation inputs, Guangdong will need 10 or even 20 years of hard work. In the Greater Bay Area, Hong Kong's R&D intensity is 0.73%,[3] which is relatively low. The Hong Kong Special Administrative Region Government has explicitly proposed that R&D investment intensity in Hong Kong should reach 1.5% by 2022. By then the total funds invested in R&D in the Bay Area Development will exceed RMB220 billion annually.[3] Currently, the R&D input intensity in Shenzhen is 4.1%.[4]

Despite the low intensity of R&D and innovation in Hong Kong, it still possesses some of the advantages that Guangdong lacks. First, it has four world-class universities, while neither Shenzhen nor Guangdong is home to any of the world's top 100

1. *Guangdong Information Statistics Network 2017,* Guangdong's R&D expenditure exceeded RMB200 billion in 2016, *http://bit.ly/2Gv7hma*
2. *Organisation for Economic Co-operation and Development 2018,* Main science and technology indicators, *http://bit.ly/2aMiVuk*
3. *The Hong Kong Special Administrative Region of the People's Republic of China 2017,* Speech by the chief executive delivering *The chief executive's 2017 policy address* to the legislative council, *http://bit.ly/2zcy2b3*
4. *Shenzhen Bureau of Statistics 2017,* The Municipal Bureau of Statistics convened the 107th Statistical Professional Committee meeting to discuss the R&D expenditure and count it into the city's GDP work, *http://bit.ly/2pdX5Ho*

Beijing, Jingjinji metropolitan region

universities. Second, establishing modern and world-class direct financing systems is of crucial importance to the construction of the modernised economic system in the Greater Bay Area.

There are perceived shortcomings in the direct financing systems in Guangzhou and Shenzhen, and Hong Kong has a global advantage in providing multi-level and diversified modern direct financing tools for technological innovation. Third, with a high degree of internationalisation, a sound economic environment and complete legal conditions, Hong Kong is capable of forming a complementary joint mechanism with Guangdong.

In China, several areas are able to compete with the city cluster in the Greater Bay Area. For example, the investment in innovation in the Yangtze River Delta (YRD) metropolitan region in 2016 reached RMB420 billion – about twice that of Bay Area Development. In the YRD metropolitan region's major cities, R&D intensity reached 3.82% in Shanghai, 2.43% in Zhejiang and 2.66% in Jiangsu[5] – meaning both Shanghai and Jiangsu's R&D intensity ratios were higher than that of Guangdong. Another example is the Beijing–Tianjin–Hebei region – known as the Jingjinji metropolitan region. Its investment in innovation reached RMB240 billion, slightly more than that of the Bay Area Development. In this region, the R&D intensity of Beijing in 2016 and 2015 was 5.96% and 6.01%, respectively.[6] This is the highest in all of China, reflecting Beijing's position as the location of China's best universities, research institutes and enterprise innovation platforms, and some of the most outstanding scientific and technological innovation talent in the country.

Xiong'an New Area further strengthened the innovative advantages and potential of the Jingjinji metropolitan region, Beijing–Tianjin–Hebei. The key to future development lies in the region's leadership-building strategically emerging industrial bases and world-class city clusters. In this regard, the Bay Area Development and the YRD metropolitan region, along with the Jingjinji metropolitan region, will surely enter into fierce competition with each other.

Globally, the benchmarks for the progress of the Bay Area Development will be the bay areas of New York, a hub for global finance; San Francisco, a global tech innovation hub; and Tokyo, a global hub of modern manufacturing. There are three metropolitan areas in the Greater Bay Area. First, the Guangzhou–Foshan–Zhaoqing metropolitan area, which is on a mission to connect with Hong Kong and Macao, to identify its function in the Bay Area Development. Second, the Shenzhen–Dongguan–Huizhou metropolitan area, which will give full rein to mutually beneficial advantages compared with Hong Kong and Macao, advancing diverse development. Third, the Zhuhai–Zhongshan–Jiangmen metropolitan area, which has the task of strengthening co-operation with Hong Kong and Macao to exert their own advantages. The disparities in the three metropolitan areas determine the approaches adopted to building a regional and even a global financial network centre, an innovation network centre and a modern service network centre that can participate in international competition in the Greater Bay Area.

Construction of the Bay Area Development must rely on a high standard of investment, business and market environment. Over the past 30 years, Guangdong has accumulated rich experience in co-operation with Hong Kong and Macao. Most important has been the combination of the 'invisible hand' of the market with the tangible hand of the government, as well as the strengths of a harmonious society, and 'opening-up' to form a systematic co-operation mechanism to promote economic and social reform and development.

Over the past 30 years, the proportion of private-owned enterprises in China's manufacturing industry has reached 61.2%, that of foreign investment has reached 11% and state-owned enterprises (SOEs) has reached 27.8%. It is not difficult to see that China's manufacturing industry has formed a mixed-ownership structure.

However, not all industries are the same. For example, in the financial industry, the share of SOEs is 90.7%. In the medical and healthcare industry, this number is 89.9%. In the fields of culture, education, scientific research, retail and wholesale, the proportion of SOEs is above 60% in all instances. Therefore, for an improved construction of the Bay Area Development, it is necessary to create a fully open market, and an investment and business environment that leads to a rational distribution system for private enterprises, SOEs and foreign investment in different fields. ■

5. *Shanghai Municipal People's Government 2007,* Statistics communique on the national economic and social development of Shanghai in 2016, *http://bit.ly/2pcrODY*

6. *Xinhua News Agency, 2017,* In 2016, Beijing's R&D expenditures accounted for about 6% of GDP, *http://bit.ly/2paLwRu*

Hong Kong – Flagship of the Bay Area Development

Antony Leung, chief executive officer of Nan Fung Group and former financial secretary of the Hong Kong Special Administrative Region, discusses Hong Kong's crucial role in the construction of the Bay Area Development and why it must collaborate with its neighbours to achieve success

The 19th National Congress of the Communist Party of China (CPC) set out a clear direction for the nation's development, with the Central Committee of the CPC recognising the development of the Guangdong–Hong Kong–Macao Greater Bay Area (the Bay Area Development) as a key project – but what exactly is the development's agenda?

The Greater Bay Area will be developed in accordance with requirements for China's international development, to meet the needs of this era and the objective development status of its region. In an Organisation for Economic Co-operation and Development forum convened in Paris some decades ago, it was asserted that future development of the world's economy would include not only competition between nations or cities, but also competition between city clusters. Internationally, examples of this include the major bay areas in San Francisco, Tokyo and New York, and the Hangzhou Bay Area and the Bay Area Development in China.

Additionally, this is a demand of the 'new era' of Chinese politics and power. The world has transformed from a predominantly industrial economy into a knowledge-based economy, and some argue that we are now in an innovation-based economy. The organic combination of industry and financial innovation requires the development of a bay area or a city cluster.

Finally, the Bay Area Development meets the growth needs of the Pearl River Delta (PRD), Hong Kong and Macao. Shenzhen, in the PRD, is becoming one of the world's most innovative cities – along with Dongguan, it has developed leading manufacturing industries. Macao has made the most of the 'one country, two systems' advantages of tourism. Similarly, Hong Kong has exerted its strengths of talent and intelligence. By utilising each other's expertise, the cities will complement one another in the process of diverse development.

Stronger together

Diversity could offer a unique contribution to the construction of the Bay Area Development. During a visit to the region in July 2017, President Xi Jinping declared that Hong Kong can seize three great opportunities – construction of the Bay Area Development, the Belt and Road Initiative and renminbi internationalisation. Hong Kong can contribute to national Chinese strategy in three aspects.

The first aspect is the attraction and cultivation of talent. With regard to an innovative economy, talent not only refers to human labour, but to innovative capacity and knowledge.

Hong Kong has a unique advantage in attracting talent with a well-developed regulatory mechanism. It is one of the world's least fettered economies – an environment in which a lot of talent prefers to work and reside. The city has a straightforward and low-rate tax system, as well as superior education and medical care, creating a comfortable working and living environment. It offers a lifestyle that caters to the expectations and requirements of elite talent. For example, within the San Francisco city cluster lies Silicon Valley, where Google is headquartered. However, 40% of Google's employees prefer to live in San Francisco rather than Silicon Valley. With a similiarly excellent living environment, Hong Kong could also cultivate and attract talent from across the region.

Antony Leung

Second, Hong Kong is an international financial centre helping to push the innovation economy. Hong Kong should contemplate making full use of the financial market and providing further support to the innovation economy, especially by investing in start-up enterprises at an early stage of the process and helping them with the requirements and procedures of becoming a listed company.

By connecting Hong Kong to the PRD, biotechnology could be a major project in the Greater Bay Area through collaboration and innovation

Third, Hong Kong can support the development of biological science and technology, including medical treatment. Hong Kong boasts two world-leading schools of medicine and several internationally prominent scientists. However, due to its small-scale market, it has limited clinical experience. By connecting Hong Kong to the PRD, biotechnology could be a major project in the Greater Bay Area through collaboration and innovation.

Collaboration can also be facilitated by the following:

- Free flow of various economic factors, including human resources, commerce, information and services. For example, a green path for talents from Hong Kong to mainland China or more punitive taxation policies for Hong Kong and Macao residents for stays on the Chinese mainland exceeding 183 days.
- Developing joint research and collaboration in various fields.
- With construction of the Bay Area Development currently under the leadership of the National Development and Reform Commission, a higher-level co-ordination mechanism could bring about a more prosperous Greater Bay Area. ■

Green policies flowering in the Greater Bay Area

Li Renqing, secretary-general of the Rural Development Institute of the Chinese Academy of Social Sciences, looks at a greener, cleaner Bay Area Development, melding urban and rural settings that are set to be an example for the rest of the world

When creating innovative green growth centres, the first question to ask is where the impetus for green growth comes from. In the 1970s, debate raged on the limits of growth and the environmental problems caused, in particular, by industrial and petrochemical development. The maxim that China advocated – that 'development is the absolute principle' – resulted in rapid yet blind and excessive growth. China achieved staggering economic gains, yet at a huge cost to the environment, jeopardising its citizens' well-being and the sense of achievement gained by economic development. This is the fundamental reason that drives policymakers to adjust development strategies and identify green development as the priority set out in development guidelines.

Green development effectively seeks to increase people's happiness and well-being, which is the real goal worth pursuing. Development has many facets, of which the environmental is at the fore as a global issue. The world in which we live is a community of shared destiny, and the time is ripe to build an ecologically sound community for all mankind. However, until we identify common interests, the ideal of a shared community – a community with a shared vision for the future of mankind – will not escape the dilemma of moving away from a carbon-based economy while ensuring economic growth. A spirit of innovation is required in technology, institutions and mechanisms.

Green growth in the Greater Bay Area

Rapid and all-encompassing technological revolution in the 'new era' of Chinese politics and power offers both opportunities and challenges for green growth. Breaking through old constraints offers a new direction and motivation for industrial growth, while the development of clean energy provides new opportunities for environmental improvement worldwide. Environmentally friendly technology becomes the core of regional and national economic development, which commands a response to new challenges. As the regional leader of economic development, the Guangdong–Hong Kong–Macao Greater Bay Area (the Bay Area Development) is at the forefront of a mission to seize historic opportunities and lead a revolution in transfer development models and economic structure.

If China can facilitate green growth and revolution, as a pioneer, leader, model and disseminator of green growth it can be a beacon to the rest of the world. Green growth possesses great potential not only for the Bay Area Development but also for China as a developing country. China's industrial structures and developmental models experience periodic transformations, avoiding unsuccessful paths already trod by developed countries and thus not falling into the same traps. China has made excellent progress in the IT revolution and now has the capability of making new contributions in overhauling its industrial and developmental structure.

Li Renqing

China enjoys great privilege in its market potential and size, a powerful force driving industry transformation, especially in comparison to developed countries; yet institutional innovation is still needed to tackle existing problems. Clean development and green growth primarily require technology innovation, which is heavily supported by intellectual property and government subsidies.

On a trip to Israel, the author observed low-income individuals reducing pests, diseases and pesticide spills through technological innovation. They increased production by breeding honey bees, thereby increasing pollen transition; while innovation through infertility technology was adopted to disrupt *drosophila* (fruit fly) breeding, thus inhibiting the proliferation of pests. These measures significantly reduce damage to the environment while simultaneously fostering a successful enterprise. China's environmental issues are closely relevant to its entire economic development, characterised by externality and retardance, and can be addressed via similar innovation.

Rooftop solar installation, Shenzhen

The environment is a global issue and no country can escape the consequences of environmental breakdown. The challenge is how to build an equal, fair and inclusive environmental system. In Zhejiang Province, public service fees and sanitation expenses were extended into large tracts of the countryside; although not extending to every corner, positive effects were seen in resolving rural waste-pollution problems, where the greatest challenges lie. Pollution in rural areas is a cross-industry, cross-regional and cross-border problem demanding regional development accompanied by fiscal and social support. In these aspects, the impasse with traditional institutions must be broken, in accordance with the guidance of the 19th National Congress of the Communist Party of China, and institutional innovation between rural-urban integration.

Bolstering environmental governance

Chinese governance is distinguished by its capacity for dominance, implementation and integration, allowing it to comprehensively address the challenges emerging in regional development. Environmental problems, however, require a higher level of social participation and market mechanism. The foundation of addressing environmental concerns lies in the community of shared interests. Mere administrative measures are insufficient: market mechanisms can resolve difficulties in the livelihoods of people threatened by pollution and environmental protection. In Germany, the core environmental and green development policy was built around small and medium-sized enterprise transformation and raising employment. In the process of rural-urban integration, new employment opportunities were increased due to the new focus of industrial growth as a result of industrial transformation.

City afforestation offers huge potential for employment in the process of rural-urban integration marked by sharing and common prosperity. The community of shared interest requires connectivity, co-operation and mutual benefit to create new growth. Conversely, the environment – as a 'joint asset' – requires new evaluation systems and management institutions. Government needs to strictly confine sources of contamination and depend on environmental governance as a key performance appraiser, exerting its strength of integration and implementation.

Environmental issues and industrial adjustments are a core objective in the next stage of development, an area that is imperative to resolve in order to correct the imbalance and deficiency impairing the pursuit of a better life by the population. These ideas have become the social norm; and how this can be translated into changed behaviours and form new developmental institutions has become the important question.

In conclusion, innovation and openness are imperative going forward, combined with the Go Out policy and introducing advanced development experience. Based on international accord, creativity is required to resolve environmental problems and issues caused by China's economic development, accomplishing the objective of green growth by adjusting industrial structure and by grasping the opportunities offered by the clean energy industry. ■

An innovative financial hub in Nansha

The Administrative Committee of China (Guangdong) launched the Guangdong Pilot Free-Trade Zone with aspirations for the Guangzhou Nansha Free-Trade Zone to become a central financial innovation hub of reform and 'opening-up'. By the *Administrative Committee of Development Area in Nansha*

The Guangzhou Nansha International Financial Island Project

The cradle of the ancient Maritime Silk Route, Guangzhou is a top-tier Chinese city that has developed into an international trade centre and transport hub. The Nansha District is located in the southernmost part of Guangzhou, bordering the South China Sea and adjoining Hong Kong and Macao. It also sits at the geometric centre of the Guangdong–Hong Kong–Macao Greater Bay Area (the Bay Area Development). Guangzhou endeavours to accelerate the implementation of national strategies, including other new areas and free-trade zones, and fulfils its potential by driving Guangdong Province to becoming a hub of openness and a developing urban subcentre of Guangzhou.

Ports, dealing in trade and finance, usually promote prosperity. As the primary port of Guangzhou and the seventh largest in the world, Nansha accomplished container throughput of more than 14 million 20-foot equivalent units in 2017, and became the largest individual port area in southern China. This hub port has enabled the new trade patterns of Nansha and its innovative financial industry to thrive.

In 2017, Nansha's cross-border e-commerce accounted for one-sixth of the national total; the financing lease industry expanded rapidly; the first deal of cross-border US dollar ship-charting transaction in assets and the first offshore aircraft lease in the free-trade area of Guangdong Province was completed; and the balance of financing leasing contract exceeded RMB170 billion.

As further evidence of Guangzhou's success, Nansha port became the largest centre for aircraft leasing in southern China; Guangzhou Shipping Exchange has become the largest shipping trading platform in southern China; and the Pearl River's shipping price index has become a crucial reference for the development of the global shipping market.

Cross-border trade is booming and cross-border renminbi settlement amounts exceed RMB190 billion. The International Finance Forum (IFF) has also settled in Nansha and an HSBC College launched. Nansha established the first national energy finance demonstration area, and hosts more than 700 venture capital, equity investment and private equity funds. In addition, registered capital totals more than RMB200 billion.

Guangzhou's strength, which is exerted in building an international financial services hub for the Belt and Road Initiative (BRI), will help Nansha to build a premier brand for financial services by prioritising the financial services system and developing innovative services in the field of technology finance, shipping finance, cross-border finance, wealth management and Bay Area Development financial co-operation. Success will be realised via the following five plans of action:

1. **The Guangzhou Nansha International Financial Island Project should apply high standards to planning and construction.** The IFF has its operational headquarters in Guangzhou, along with many other international financial organisations. It should welcome important institutions as well as international towns funded by green finance, and an international financial academy and think-tank zone to create an economic landmark in the Greater Bay Area.

2. **Promoting trade liberalisation and financial innovation in the Bay Area Development.** In accordance with the principles of complementarity, diversity and reciprocity, this free-trade zone will develop its own financial services system, covering the fields of business, tourism, logistics and information, and will adapt to service and trade liberalisation. Efforts will be made to forge in-depth co-operation mechanisms in the insurance market and establish structures in the Bay Area Development that recognise Hong Kong and Macao insurance products, and capital markets connectivity. Additionally, opening financial branch institutions and augmenting the quantities of Hong Kong-invested and jointly ventured securities companies will allow the Bay Area Development to explore the in-depth co-operation mechanisms of the financial services system.

3. **Building an innovative platform of international finance co-operation to satisfy the demands for services from the Nansha international shipping and investment trade.** This platform can attract new financial institutions and sharpen the district's edge by connecting domestic and overseas finance businesses, as well as financial trade and services. Additionally, space will be created for cross-border investment and the innovation and development of overseas institutions and domestic bank settlement account systems. Channels for offshore and onshore capital will be opened up to optimise cross-border payment platforms. Cross-border transaction platforms for finance assets will be set up with various products and services. The advancement of a cross-border financing structure in financial markets will continue, broadening investors' scope, capital flow, production innovation and management.

4. **Further integrating industrial finance**. Endeavouring to innovate in industrial finance services will provide effective and efficient platforms for industrial development. Nansha will actively support enterprise to conduct model innovation for cross-border and offshore leasing, and explore direct financing in capital markets to promote the construction of local capital market services that offer comprehensive services of industry acceleration, venture capital and list cultivation for domestic enterprises.

5. **Sparing no effort in constructing a leading area of financial technology.** Given Hong Kong's strength in financial services and the advanced technology of Guangzhou and Shenzhen, Nansha is capable of building a highly developed brand of financial technology, introducing high-tech finance enterprises, advanced research institutions and modern financial services in the field of venture capital, private equity and financial leasing. Integration between finance, science and industry will be reinforced, as will the industry-academy-research nexus. Authoritative institutions will establish a Guangdong–Hong Kong–Macao institute of financial technology in Nansha and set up a Greater Bay Area international finance technology forum.

Nansha is a dynamic area for investment and entrepreneurship, a shining pearl in the Bay Area Development and a promising city of the future. The district welcomes all those who wish to collaborate and work for mutual benefits. ■

The Liede Bridge over the Pearl River, Guangzhou

Guangzhou – A city of commerce for the millennium

Having been at the forefront of commercial innovation and foreign trade for centuries, no city is better placed than Guangzhou to become the world's leading financial innovation centre, writes *Qiu Yitong*, director of the Guangzhou Finance Bureau

Guangzhou was the major port of the ancient Maritime Silk Route, thriving under the Ming and Qing dynasties, and has enjoyed a long and prosperous history of more than 2,000 years. As trade in commodities and funds in the city continues to flourish, the financial services industry in Guangzhou has also boomed, becoming the bridgehead for foreign capital into the Chinese financial market.

In recent years, finance in Guangzhou has adhered to the path of reform and innovation. The Guangzhou Private Financial Street is the first private financial hub in China that integrates capital borrowing and lending, wealth management, payment and settlement, and information release. Guangzhou established the 'Guangzhou price' for private financing, which became the benchmark affecting the private financing price for the entire Pearl River Delta (PRD) and China as a whole. Guangzhou started the Ligen Micro-credit Re-lending Company to provide loans to microcredit companies within Guangdong Province, which defines it as a 'small loan central bank' and it represents a breakthrough in creative financing channels for small loan companies in China. Relying on the Guangzhou Equity Trading Centre, China Youth GEM was first established as the integrated financial service platform for university students to start their own businesses. To date, the innovation and entrepreneurship projects of 2,407 college students in 16 provinces across the country have already launched.

The plan for a 'financial function zone in each district' was first set up in China, and includes Guangzhou Private Finance Street (Yuexiu District), which features peer-to-peer (P2P) finance; Guangzhou International Financial City (Tianhe District), the headquarters of numerous financial institutions; Guangzhou New Financial Innovation Service Zone (Huangpu District), a hub of technological finance; Nansha Modern Financial Service Zone (Nansha District), for cross-border finance; Guangzhou small and mini enterprises Financial Service Zone (Zengcheng District), specialising in small and micro-finance; Guangzhou Green Finance Reform and Innovation Comprehensive Experimental Zone (Huadu District), for green finance; Bai E Tan Industrial Financial Service Innovation Zone (Liwan District), for industrial finance; Wanbo Fund Town (Panyu District), encompassing industrial funds and venture capital; Guangzhou Hot Spring Fortune Town (Conghua District); Guangzhou Ocean Bay Venture Capital Town (Haizhu District); and so on. All of these areas have effectively boosted the accumulation and balanced development of financial resources.

Qiu Yitong

Guangzhou established the first financial services outlet in China and, to date, 580 community financial services outlets have been established, covering 38% of the city's communities. Furthermore, 238 rural financial service outlets have been built to cover the entire rural area outside the city, breaking the barrier between the general public and accessible finance. Guangzhou took the lead in achieving full coverage of the industrial investment funds of the cities and districts, and was the first city in China to set up an inclusive finance industry association – the Guangzhou Pratt and Whitney Finance Association. It also built the first local financial infrastructure – the Guangzhou Financial Risk Monitoring Prevention and Control Centre, the first national centre covering nine forms of local financial risk monitoring and early warning platforms such as P2P, local trading venues, microloans, equity investments, finance leases, commercial factoring and pawn, and so on. In recent years, Guangzhou has launched four national financial reform and innovation pilots, including the PRD Financial Reform and Innovation Pilot, and the Guangzhou Green Finance Reform and Innovation Pilot, making Guangzhou the Chinese city with the greatest number of regional financial reform and innovation pilots.

A first among equals

Driven by reform and innovation, Guangzhou finance has achieved remarkable results. From 2011 to 2016, the added value of Guangzhou's financial industry has increased by 133%, more than any other major Chinese city. It was estimated in 2017 that the added value of the financial industry would exceed RMB200 billion. The total assets of the city's financial industry will exceed RMB7 trillion and the number of financial employees will reach 160,000, becoming the fifth pillar industry in the city, after IT, manufacturing, bio-industry and creative. Guangzhou, for the first time in 2017, was therefore incorporated into the Global Financial Centres Index system. The International Finance Forum (IFF) has permanently settled in Guangzhou and successfully held its 14th annual global conference in the city. *The Wall Street Journal* and *Financial Times* have both covered the increasing international influence of the financial industry in Guangzhou.

As a city with thousands of years of history in commerce, Guangzhou is inherently open to innovation and will give full rein to that spirit, enhancing the capability of financial services for the real economy. In the meantime, the city will reduce financial risks, optimise the financial environment and take the lead in the areas of fintech, cross-border finance, green finance, Belt and Road Initiative (BRI) finance, and Guangdong–Hong Kong–Macao finance to become a leading global financial innovation centre.

Six ways to become a financial innovation centre

1. **Fintech innovation.** Guangzhou was blessed with the conditions to develop fintech after HSBC established China's only fintech innovation centre there. Furthermore, the city will create special fintech support policies and development plans, build financial- and technological-gathering areas in concentrations of technological enterprises, and improve systems to attract large financial institutions to set up fintech innovation centres in Guangzhou and test out the 'regulatory sandbox'.

2. **Supply-chain finance (SCF) innovation.** As a millennial commercial city, Guangzhou has provided superior conditions for SCF. Commercial banks and third-party platforms will become the best SCF providers in the future, which will help banking institutions in Guangzhou to focus on making it a core business. At the same time, the city will strongly encourage third-party platforms such as SCF service companies to set up guidance funds.

3. **Cross-border finance innovation.** By making the best of the policy strength of the Guangzhou Nansha Free-Trade Zone, home to the Guangzhou Nansha Bonded Port Area, and the geographical advantage of Guangzhou in adjoining Hong Kong and Macao, new ideas on cross-border renminbi business such as two-way loans, bond issuance, settlements and capital pooling can be brought to life. Meanwhile, new ways of conducting cross-border business of both domestic and foreign currencies within the Guangzhou Nansha Free-Trade Zone with 'NRA+' – a non-resident account – as a special symbol can be promoted onshore, as well as at the offshore renminbi exchanges in Guangdong, Hong Kong and Macao.

4. **Green finance innovation.** Guangzhou has been approved by the State Council of the People's Republic of China to build reform- and innovation-integrated pilot zones in green finance and remains the only green finance pilot zone in the four 'first-tier' cities in China – Beijing, Shanghai, Shenzhen and Guangzhou. It will also consolidate resources and strive to become a pinnacle of green financial innovation. For instance, local banks will be transformed into green investment banks to co-operate with major global financial institutions, research and formulate innovation policies on green finance, and establish large-scale green finance development funds to accelerate the building of the Huadu District, and strive to be the first in the country to reap favourable results that inspire other cities.

5. **BRI finance innovation.** Every effort will be made to encourage the Asian Infrastructure Investment Bank and the Silk Road Fund to set up branches in the Guangzhou Nansha Free-Trade Zone. Overseas renminbi investment funds for countries and regions along the BRI will provide investment and financing services for mergers and acquisitions in their enterprises' attempts to 'Go Out'. The multinational corporations that joined the BRI will start the centralised operation of the renminbi in Nansha and will set up settlement centres. Guangzhou will introduce funds from countries and regions along the route to participate in setting up an industrial investment fund across its districts. Guangzhou will explore the establishment of a cross-border financial assets trading platform through private equity to carry out the issuance and transfer transactions of financial securities products such as stocks, funds and bonds in Hong Kong, Macao and the countries along the Maritime Silk Road.

6. **Finance innovation in the Guangdong–Hong Kong–Macao Greater Bay Area.** A vigorous push for the completion of the International Commercial Bank, Guangzhou Futures Exchange and other major projects in the Greater Bay Area at an early date will be made, as well as efforts to fully use such platforms as the IFF and the China (Guangzhou) International Investment & Finance Exposition to strengthen financial exchanges between Guangzhou, Hong Kong and Macao. The co-operation between new forms of business such as fintech and digital inclusive finance in Guangzhou, Hong Kong and Macao will be improved. The Guangzhou Financial Monitoring and Prevention Centre's findings lead to the apportionment of financial big data in these three areas. Guangzhou, Hong Kong and Macao will work together to develop the Greater Bay Area into an international financial centre that rivals New York's bay area. ■

國際金融論壇

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