

Seppo Honkapohja: Financial liberalization in China

Opening remarks by Mr Seppo Honkapohja, Member of the Board of the Bank of Finland, at the Conference on financial liberalization in China, Helsinki, 18 September 2014.

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Continuation of China's economic growth and integration with the rest of global economy has increased its importance for other economies. Increased trade ties and their effects on China and the rest of the world are certainly one major area for economic research. We economists often feel that increased trade in real goods and services is relatively straight-forward topic to understand. However, this trade is only part of increasing economic integration. Very recently, China's increasing financial integration has become a new and important challenge for both policy makers and research. Given the size of the Chinese economy, the consequences of its financial integration with the rest of the world are potentially very large.

Financial liberalization is a much more encompassing development than just technical lifting of controls. Market-based financial systems contain new risks and uncertainties when compared to tightly controlled systems. The behavior of financial institutions in a liberalization process involves major challenges as the market participants learn to understand their new operational environment. A competitive financial system affects the effectiveness of banks and other institutions and they must be ready to carry out efficiency-enhancing reforms in order to cope with the new business environment. Strengthening of the capital base and reforms of supervisory systems are important ingredients to the process of financial liberalization.

Let me mention one specific topic that is fundamental in the process of financial liberalization. Freeing of cross-border capital flows poses a specific challenge to macroeconomic policy making. As is well known, it is not possible to control simultaneously amount of domestic finance, interest rates and the exchange rate of a country's currency. The so-called impossible trinity must be respected when capital flows are free and finance is market-based.

More generally, financial liberalization poses a large number of other questions for research and policy making. I am happy to see that so many top researchers in the field have traveled to our conference to discuss the various topics. Obviously the whole phenomenon of financial liberalization is very multi-faceted, ranging from integration of offshore and onshore currency markets to development of China's own capital markets and to issues of international finance. All of these areas are important, and they are also potential sources of financial instability, if things do not go as well as is now planned.

I am sure conference presentations and discussions will provide us all with valuable insights into possible consequences of China's financial liberalization, both for China itself and for others as well. Given the size of the Chinese economy, other countries should monitor the developments. It is my pleasure to open this conference and welcome you to the Bank of Finland.