

Zhou Xiaochuan: The opening-up of Chinese economy - from manufacturing industry to service industry

Keynote speech by Mr Zhou Xiaochuan, Governor of the People's Bank of China, at the 2017 Lujiazui Forum "Financial reform and steady development from a global perspective", Shanghai, 21 June 2017.

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Distinguished guests,

Ladies and gentlemen,

Good morning! It's a pleasure to attend the 2017 Lujiazui Forum. China has built a socialist market economy to promote social and economic progress and reach prosperity through competition and optimal resource allocation. During this process, opening-up has played a significant role. I'd like to share my understandings of opening-up based on relevant international and domestic experiences.

1. The opening up of manufacturing industry turned China into a world factory

The manufacturing industry of China opened up relatively early. There were different opinions on opening in the early days, but it was relatively easy to reach a consensus. This made the manufacturing industry an adequately opened industry. An observation on the opening-up of the manufacturing industry showed that most industries which participated in opening-up and competition early grew faster and became stronger eventually. Opening-up is a process of optimizing the resource allocation by market force and competition mechanism.

Specifically, in terms of bringing in foreign capital, we opened up via importing foreign products and inviting foreign companies to invest and build factories in China, which in turn competed with domestic companies. Before reform and opening-up, Chinese companies had no foreign competition and only little domestic competition. The pressure of competition has driven industrial firms to make great progress.

In terms of going global, domestic firms compete with global players via export and doing business internationally. At the beginning, Chinese companies rarely participated in international competition and only exported commodity related products. In the 1980s, very few believed that Chinese manufacturing products export could have a bright future. As a result of opening-up, both processing trade products and manufactured products were able to compete globally and domestic firms started to go abroad. Instead of losing the competition, Chinese manufacturing industry and Chinese firms experienced fast growth. China became a leading manufacturing country and gained the reputation of world factory. Many industries have been moving to the higher end of global value chain.

It is competition that breaks up monopolies. There was a less competitive environment in China, especially among the foreign trade enterprises. Foreign trade companies, including Sinochem, China Minmetal, COFCO and etc. were divided by sub-industries, such as agricultural and animal husbandry, textile, light industry, machinery, and so on. They were in charge of import and export of their respective sub-industry and adopted different financial rules. There was no competition among the companies. In order to attract foreign investment, China introduced the first Sino-foreign joint venture Law in 1979, after which domestic companies competed from foreign companies and industry segmentation and monopolies began to fall apart.

Competition has driven the SOEs to make great progress. Industries with more sufficient opening-up and fiercer competition have developed more rapidly. The manufacturing industry has flourished.

2. Opening-up has promoted domestic policy reform

The opening-up has strongly impacted the traditional centrally planned policy making system, and triggered a series of major domestic reforms, including pricing system reform, value-added tax reform, export tax refund reform, market-based exchange rate regime reform, and negotiation for accession to GATT and WTO. In the early 1980s, in order to attract foreign investment, the domestic policy system must move more closer toward the market rules and provide a level playing field. Subsequent consideration was to make sure Chinese enterprises compete fairly in the international market.

Fair competition and opening-up are inter-connected. It involves not only competition between Chinese and foreign-funded companies, but also equal and adequate competition among Chinese companies. Opening-up accelerated the access of domestic private capital, and subsequently brought in the concept of national treatment. Market access criteria should be the same for domestic and foreign-funded companies. The opening-up facilitated three major policy reforms, i.e., trade and investment liberalization, market-based exchange rate regime reform, easing of exchange control, including lowering the market access threshold. As a result, competition and market gradually became generally applicable policy mechanism.

3. Service industry has opened up in a similar process

In the past, economists treated the service industry as a non-tradable industry. However, with the rapid progress of information technology, transportation and globalization, many services became tradable. People began to say that “the world is flat”. The opening-up of the service industry in China followed a similar pattern of the manufacturing industry: opening-up brought in competition, boosted efficiency and quality of service, and facilitated domestic policy reform.

In the industrial field, the market competition rules are not applicable to a very small number of industries such as defense industry, but most industries can open up and bring in competition. In the service sector, there are also sensitive industries, and some services can't be delivered across the border. Thus, the market mechanism cannot cover all of them. But most other service industries can open up. The understandings of service industry opening-up and the necessary policy reform followed a similar process like that of manufacturing industry. The opening up to foreign capital started in industries such as hotels, restaurants, transportation, and etc., and expanded to other service industries. In terms of Chinese services going global, the export products and their after-sale service of industrial companies were the first, followed by banking, insurance, medical, shipping, tourism, software, retail, payment, cultural services, and etc. Shanghai's shipping industry is a typical example.

4. The experience of regional pilot programs has enhanced the confidence in opening-up

In the early days, decisions were made to open up and develop four special economic zones, and there were different opinions at that time. Later on, the successful experiences of special economic zones were introduced to other places. There were also different opinions regarding China's accession to the WTO, but fact has proved that the WTO membership had a profound and positive influence on China. The government advanced the experiment of Shanghai Free Trade Zone (FTZs) after the new leadership took office. There are 11 FTZs now. Many experiences from the FTZs have been applied nationwide, the benefits of opening up has been tangible and well recognized.

5. Financial service sector is a competitive service industry

Finance is an important component of the service industry, as reflected in its weight in the WTO negotiation and in Chinese statistical system's classification of service industry. Finance

is regarded by many at the core of any modern economy. In 1993, at the third Plenary Session of the 14th CPC Central Committee in 1993, the financial industry was described as the lifeline of country's economy. I think this can be attributed to the background at that time. First, the financial sector, especially the banking industry, played a prominent role in resource allocation; second, with each specializing in one field, there was little competition among the four specialized banks in the banking industry; third, big financial institutions still undertook policy-related businesses and were not operating fully on a market-basis; fourth, the absence of stability in the financial sector might trigger major chaos. Would this affect the market nature of the financial industry? Is financial industry a competitive service industry?

In 1990s, according to the 50 articles specified in the third Plenary Session of the 14th CPC Central Committee, the policy functions were split from specialized banks and formed independent bodies; four specialized banks were turned into full service commercial banks in the competitive market. The Third Plenary Session of the 18th CPC Central Committee has made it clear that the market would play a decisive role in resource allocation, meaning all important functions should adopt a market approach. We have learned the lessons from the global economic crisis that, to prevent financial crisis, we should first guarantee the healthiness of financial institutions, and never tolerate high leverage, low capital adequacy and large chunks of non-performing loans. When an environment is not open and competitive, it tends to tolerate low standards. Thus, the attribute of financial service industry as a competitive service industry in the market economy is obvious.

According to global experiences, most financial industries are competitive service industries. When foreign banks were first introduced into China, the initial aim was to bring in foreign capital. Looking back, domestic commercial banks have learnt a lot from competition, resulting in a series of changes in the financial industry, including product evolution, market building, business models, management experience, and etc. Later, competitive joint stock reform and listing have elevated the operation efficiency, asset quality and governance of Chinese banks. The entry of foreign-funded banks also exerted reform pressure on domestic policy reform, including accounting standards, supervisory standards, replacing business tax with value-added tax, and etc.

For consideration of their own interests, some individuals advocated protecting the financial industry to enable it to grow stronger before opening up the market, and then allowing these banks to participate in international competition. Experiences from many countries (including China's own experience) show that protection tend to create problems such as laziness, soft financial constraint, rent-seeking, and etc., damage the competitiveness and the industry's development, and the market and institutions end up becoming unhealthy and instable. One example is what happened before and after the Asian financial crisis.

Nowadays, many Chinese financial institutions have gone global and adapted to international competition. Their risk management, pricing and anti-money-laundering have had gone through substantive changes. Today, five Chinese financial institutions have become global systemically important financial institutions and operate soundly on a commercial basis with adequate capital. The sound development of China's financial market has attracted attention of agencies that compile international bond and emerging market stocks indices. These all show that financial service industry, as a competitive service industry, has benefited from opening-up and needs further opening-up.

6. The Belt and Road Initiative provides new opportunities for financial sector opening-up in China

Given the positive reaction China received after the introduction of the Belt and Road Initiative, various Government ministries has pushed the implementation of relative policies. The initiative

is an approach to opening-up and involves many new patterns of financial cooperation which requires further opening-up. It will also provide new opportunities for China's financial sector opening-up and international cooperation.

Development finance can play a positive role in the initiative. China has explored the development finance as a financial model to better serve national strategies. It operates independently and is based on market principles. The model emphasizes long term investment and relies on credit support instead of government subsidy. It only requires marginal profits with principal protection which is also financially sustainable. This model can play a greater and more active role in the initiative and will help avoid various problems, such as the crowding out effect, moral hazard and market distortion. The construction of the Belt and Road could provide extra room of development to financial institutions, for them to open offshore branches and provide better financial services for trade, investment and capital management.

In short, looking back at the reform experience at home and abroad, we have a better understanding of and stronger confidence in opening up and are determined to continue opening-up. Based on the opening-up experiences of both manufacturing and service industry, it is reasonable to conclude that the rule of competition and opening up also apply to the financial sector. The financial sector is no exception. In the process of the opening-up, competition will bring pressure, motivation, progress and prosperity, and financial industry will have a brighter future.

I am confident that with support and concerted effort, China's opening-up will move to a new level, the experiment of SFT and its experiences will spread more widely, and Shanghai will make new achievements in building an International Financial Center.

Thank you all.