Guo Shuqing: Rejuvenation of China is unstoppable

Speech by Mr Guo Shuqing, Party Secretary and Deputy Governor of the People's Bank of China, at the Tsinghua PBCSF Global Finance Forum, Beijing, 25 May 2019.

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Distinguished guests, professors, students and friends,

Good morning!

It gives me great pleasure to attend the Tsinghua PBCSF Global Finance Forum. Taking this opportunity, I would like to share with you my observations on some economic and financial issues of common interest. I would also welcome your questions and comments later on.

I. The escalation of trade friction by the United States does not help solve any problem.

On May 10th, the US government announced the increase of tariffs on $200 billion of Chinese exports. It then further declared to impose ban on Huawei and other Chinese companies, and also decided to launch anti-subsidy investigation on the renminbi exchange rate. Such actions did not surprise the Chinese government, companies and people, as we have believed that a trade war does not help solve any problem, but could only do harm to the others while not benefiting the inflictor, resulted in collateral damage to the whole.

From the perspective of China, though in theory the US could raise the tariffs on Chinese exports to the maximum, the impacts on China's economy would be very limited. Firstly, the vast majority of China's exports to the US are suitable for domestic sale. Now China is right in the process of consumption upgrade, which means a rapidly expanding domestic market could absorb a large amount of the products intended for export, without exerting a "crowding out" effect on the existing consumer goods. Secondly, the export market has been further diversified. With great progress made in the Belt and Road Initiative, Chinese products are also welcome in overseas markets other than the US. Thirdly, despite the tariff increase, a substantial amount of the Chinese products are still expected to export to the US, as on the one hand, there is currently no better substitute for these products, and on the other, the US importers are more than willing to share the increased cost given the ample profits of the import business. Fourthly, China is now upgrading its industrial structure, which requires the transfer of certain production activities to overseas, and thus facilitating high-quality growth in China. Fifthly, financial market in China withstood the over-impacts caused by the trade tension last year. Hence, it has become more resilient to stand up to any further shocks.

From the perspective of the US, it would expose to the corresponding backlash of tariff increase to almost the same extent. For example, the US exports to China will contract, which would undermine the interests of many US companies and lead to notable income decline of some US high-tech firms. A large number of the US companies that have been long accustomed to relying on the processing, assembly, transportation and distribution of the Chinese exports for creating value added will be severely impacted, with some even face the danger of going bust. The US consumers would also pay higher costs, with the low- and middle-income people, farmers and blue-collar workers in particular, suffering more welfare losses in real terms. Besides, the US has huge assets and liabilities overseas, and relies on the Wall-street dominated international financial system more than any other country. A trade war will undoubtedly lead to market fluctuations and ultimately a lackluster international financial market.

From the logic perspective, the US tariff increase aims to reduce trade deficit with China. But with China's retaliatory measures, the forthright outcome of tariff increase could be quite murky and even counter-productive in the end with other factors considered. Firstly, to put China's high-tech firms on its sanction list, to which the US government explicitly forbids the sale of products and technologies by its companies, is an action of directly increasing the trade deficit by the US itself. Secondly, the launch of a the trade war has sent waves to the international financial market, leading to a rapid depreciation of the renmibi, which again aroused the US government concern of compromising the effect of tariff increase. Thirdly, a substantial tariff increase would inflate commodity prices, denting the advantage of a low inflationary environment enjoyed by the US economy. Fourthly, the gap left by curbing Chinese imports would be filled by exports from other economies, resulting in unchanged total US trade deficit.

From the perspective of history, the trade frictions between the US and other rising economies have been lasting for over 40 years, such as first with Germany, then Japan, and later the four Asian Dragons. In 2000, China overtook Japan as the country recorded the biggest trade surplus with the US. Now, countries such as India, Vietnam, Indonesia, the Philippines, Bangladesh and some Latin American countries are developing with strong momentum, which are jointly promoting the change of international pattern of trade in goods and services. Hence, China's exports to the US may decrease gradually, but the overall pattern of US trade deficit will be hard to change.

II. The United States has benefited substantially from its trade deficit with China.

If we only look at statistics, it seems that the US has been on the losing side given its large value and percentage of trade deficit with China. But with more granular analysis, it is not difficult to see that the US has actually got huge benefits from trade with China in many aspects. To use a metaphor here, the US gained benefits from bilateral economic and trade exchange with China are just like peeling several layers of skins off the same bull.

First, the US importers and multinationals have grabbed the lion share of the added value of the trade balance. Nearly 60 percent of the US-China trade deficit in goods was attributed to foreign-invested companies in China, most of which are US-owned companies. Thus, sales of these products ultimately contributed to the revenue and profits of the US companies. 61 percent of the trade imbalance between China and the US comes from processing trade, and China gets very little in the actual value distribution. Besides, one-third of the growth in US companies' overseas sales was contributed by the Chinese market.

Second, the US consumers have enjoyed huge "consumer surplus" through trade with China. According to statistics, about one-fourth of retail goods in the US market were imported from China. For example, 26 percent of the products sold by Wal-Mart came directly from China. The steady flow of China's inexpensive and quality products into the US has helped lower the cost of living for the US households and improved welfare.

Third, it is China that supported the prices of US exports of products and services. For example, if without China's large purchase of commodities such as grain and energy, as well as civilian aircrafts and chips, their prices would by no means be at today's level. Besides, according to US statistics, it has a surplus of more than $40 billion in trade services with China every year.

Fourth, the US has experienced the miracle of "high consumption and low inflation" since the 1990s. Even during the ten years of quantitative easing, there was no distinct inflation in the US. One of the significant reasons is that China, with its population larger than that of Europe, the US and Japan combined, and in the matured stage of industrialization, has unprecedentedly increased the global supply of consumer goods.

Fifth, the US has gained from a huge volume of cheap capital repatriation. The capital accumulated by China through its trade surplus underpins US consumption and investment in the form of China investing in the US dollar-denominated assets such as the US Treasury bonds. By the end of last year, China held a total of $7.3 trillion worth of international financial assets, more than half of which were denominated in US dollar. With continued inflow of the Chinese capital, the funding cost of the US market has remained extremely low, creating extremely favorable conditions for US economic recovery and prosperity.

Sixth, the US has long occupied China's huge savings resources. The Chinese people are hardworking and frugal. Even when their monthly salary was around a dozen or dozens of dollars, they tried to put aside some money for savings. Hence, China's domestic savings rate and household savings rate have always been at a relatively high level. While on the contrary, the US has had a relatively large investment-to-savings gap. By that token, the US huge current account deficit with China means a US occupation of China's net savings of the same scale.

Since the capital repatriated from China into the US mainly takes the form of securities and other assets investment, coupled with a high share of direct financing in the US financial system, deposit creation in the US has remained low. Over the past several decades, broad money supply and cash in the US have both been growing slowly, in sharp contrast to the phenomenon of the 1970s and 1980s, sufficing to explain a new secret of the US, that is, it has even saved lots of money from printing and issuing the dollar notes. In that sense, the famous Triffin dilemma in the international economics study has found an effective solution.

III. The alleged "China's theft of US technology" is the logic of power politics.

Forty years ago, China started to introduce foreign investors, who were allowed to set up three different kinds of foreign-invested enterprises (i.e. Sino-foreign joint ventures, Sino-foreign cooperative enterprises and wholly foreign-owned enterprises), and have since gained huge profits in China. Now the market sales of foreign investors in China have amounted to trillions of dollars and with profits reaching hundreds of billions of dollars. All these were based on the principle of reciprocal cooperation with mutual benefits, without any one of the investment contracts forced to be signed by the Chinese government. Strict observance of the contract has always been advocated by Europe and the United States, and is gradually appreciated by the Chinese enterprises and residents. But now all of a sudden, the US alleged that Chinese laws and economic practices impose "forced technology transfer", "forced IPR transfer" and even used the word "theft". That was not only a challenge to the basic facts, but also a humiliation to the Chinese people.

It is a common practice for any rising economy to learn the knowledge and experiences of developed countries. That is why there emerged the so-called "catching up and imitation" concept in development economics. Over more than ten centuries in history, China's science and technology was second to none in the world. Our intangible assets have made exceptional contributions to the development of human civilization. The well-known "Four Great Inventions" of Ancient China have contributed to the emergence of capitalism in Europe. Without gunpowder, compass, and the printing technology, there would be no modern industrial economy. Great men in history such as Francis Bacon and Karl Marx have all spoke highly of that. That being said, it seems in retrospect that our ancestors have their own regrets. Though they have invented so many things, they only failed to invent "IPR".

Looking back into history, it should be noted that imitation and even plagiarism of technology among countries were very common during the industrial age of Europe and the US. Some companies even tried to acquire advanced technology through dishonest and unprincipled means. This is a specific historical time phase which can not be bypassed. The developed countries have all gone through the process of standardizing intellectual property protection. But it is by building upon the work of their predecessors that each of the country achieved new breakthroughs in and made new contributions to technological advancement. Thus, we believe that no country, including the US, can realize modernization by theft. But rather, modernization can only be achieved through hard work and strenuous efforts of their own peoples.

It was originated from the western countries to trade technology for market or to trade market for technology. Based on the principle of fairness, technology trading is a fundamental market economy activity commonly accepted. Over the past years, developed countries, including

European countries and the US, have always claimed to voluntarily transfer knowledge and technology on the principle of free and fair trade, so as to help the third world countries get rid of poverty and backwardness and realize economic independence. If such goal can be achieved, it will undoubtedly be conducive to the development of the world economy. But now it seems that US does not have the willingness to fulfill its commitments.

By technology transfer, developed countries have been continuously gaining substantial returns. Through such means as patents grant and franchising, developed countries have made huge profits with their technologies applied in the developing economies. Some of the profits were in turn re-invested for research and development (R&D), forming a “perfect cycle” for the technological advancement of the developed countries. Besides, many of the technologies were tested through application in the developing countries. With contributions from project managers in those countries to further improve the technologies, the overall technological capacity of the developed countries was further promoted.

It is totally groundless for the US to make the accusations against China by citing intellectual property protection as a cover while aiming in essence for trade protectionism. In contemporary world, China is already a firm defender and active builder of international intellectual property rules. The Director General of the World Intellectual Property Organization (WIPO), Francis Gurry, said in an interview with China Intellectual Property News in 2019 on the sidelines of the high-level Forum on China IP Protection that “China is now a world leading player in intellectual property creation and protection”. Only a few years ago the US government, agencies, and politicians openly acknowledged China’s progress in intellectual property protection. Are these all changed overnight?

The history has proven, and will continue to prove that, sanction and blockade will not stop a country’s technological and economic development, but on the contrary will make it further determined to continue its own research and push forward its technological development. During the 1950s and the 1960s, despite the blockade and embargo imposed on us, China still developed the atomic and hydrogen bombs, missiles and man-made satellites under poor, backward and tough situations, gradually making itself one of the leading science and technological powers in the world.

IV. China will further deepen the reform of renminbi exchange rate regime.

China’s CPC Central Committee and the State Council have decided to deepen the reform on renminbi exchange rate formation mechanism, increase the flexibility of renminbi exchange rate and keep it largely stable at a reasonable and equilibrium level. Over recent years, the renminbi exchange rate against a basket of currencies has kept stable in a global context. The Chinese government has made great efforts to maintain a balance between the flexibility and stability of renminbi exchange rate, which was widely recognized by the international community.

Since the early 1990s, the US has constantly threatened China with the allegation of “exchange rate manipulation”. By definition of the US Treasury Department, three quantitative criteria need to be fulfilled concurrently to become a currency manipulator, including: 1) an annual trade surplus of over $20 billion with the US, 2) a current account surplus accounting for 3 percent of GDP, and 3) the value of foreign exchange purchased for exchange rate interference purpose exceeding 2 percent of GDP. In 2018, China’s current account surplus was only 0.37 percent of its GDP, and there was no large amount of foreign exchange purchase, neither did China gain competitive advantage of trade through currency depreciation. So the US government can hardly label China a currency manipulator.

Over the past decade, all dramatic renminbi depreciations were triggered by external factors. The most recent one in May this year, when offshore Chinese yuan dropped over 3 percent against the dollar, was totally caused by the escalated trade friction by the US government. Over the years, developed countries had always called for greater flexibility of renminbi exchange rate.

However, once the renminbi exchange rate formation mechanism became more market-oriented and more elastic, some countries soon adopt an attitude of “Lord Ye’s Love of Dragons”, the actual fear behind professed love, with unfounded suspicion and accusation towards China, which is absolutely ridiculous.

As is well-known, despite the recent FX market fluctuations, so far there is no panic among Chinese firms and residents. More and more people have realized that it is not realistic to make money from currency speculations. Nor is it safe to transfer financial assets overseas. In sophisticated markets, nearly no companies or individuals live on investment returns of foreign currency speculation. Even the so-called Mrs Watanabe in Japan actually turned out to be an overstated investment story.

It is normal to have temporary fluctuations on renminbi exchange rate. But for the long run, given China’s economic fundamentals, continued renminbi depreciation is unlikely. With huge market size and growth potential, China remains to be the biggest engine for global economic growth. As the quality of China’s economic development improves, the renminbi exchange rate will keep approaching the purchasing power parity (PPP), and the speculators who tried to short sell the Chinese currency will inevitably suffer huge losses.

V. China does not practice the so-called state capitalism.

In recent years, there have been views in the world that the rapid development of China’s economy is the result of the practice of “state capitalism”, which explains why Chinese products are extremely competitive in the international market. That is a groundless reasoning.

In fact, China’s economic structure has become increasingly diversified, with the market share of state-owned enterprises continuing to decline. Factoring in public services by the government, China’s state-owned economy now accounts for less than 40 percent of GDP. Many of the state-owned enterprises have got listed in China and abroad, thus having become companies with mixed ownership in nature. Enterprises 100 percent state-owned are now very limited. For large state-owned enterprises, a number of their subsidiaries’ ultimate control have been transferred to private companies. Even among the central government-owned enterprises, they compete with each other. More than 20 years ago during the reform of the military industrial enterprises, each sector was divided into two or more companies.

At present, private and foreign capital can enter into almost all industries and sectors, only with few facing legal or policy restrictions. Be it rail transportation, equipment manufacturing, or raw energy materials, enterprises with different kinds of ownership structure are found in all these sectors. China adopts the principle of neutral competition, emphasizing that all market players are treated equally. We encourage them to both compete and cooperate, and to complement each other for a win-win relationship. China’s industrial and credit policies are of a guiding nature. When implementing those policies, the principles of the market and law must be observed. Such policies are no differences from the US National Export Initiatives and the European Industrial Renaissance. Internationally, there are always people complaining that the Chinese government provides huge subsidies for all products. In fact, this kind of criticism is logically difficult to stand. If all enterprises are to be subsidized, resources must be equally taken from all of them.

The financial industry has also cultivated a diversified structure. China has state-owned financial institutions, as well as foreign-owned ones. Listed institutions and rural credit cooperatives even have natural person shareholders. There are more than 3,000 private-controlled institutions out of 4,588 banking institutions in China, and most of the 170 Chinese insurance companies are private-controlled. Most of the securities companies and fund companies are private-owned as well. Even for the top five commercial banks, foreign ownership accounted for as high as 25 percent a decade ago, while at that time it was very difficult for them to even apply for a branch in the US. Currently, the big banks’ ownership shares from private sector, domestic or foreign, account for an average of 30 percent, with some even exceeding 40 percent. It shall also be pointed out that although the KPIs of the top five banks are improving, their market share continue to decline, now only 37 percent. So in terms of market concentration, China is notably lower than some major economies, like the US and the European countries.

Another typical example is China's Fintech, which takes the lead in the world. The most important underlying reason is that the government adopted a prudent yet inclusive attitude towards private internet companies, thus creating a fair competition environment. Large state-owned banks adopted the attitude of both competition and cooperation from the very beginning toward Fintech companies. For example, more than a decade ago, Ali-pay was born and swiftly grew through cooperation with the large and medium-sized banks, including China Construction Bank. Now, all Fintech companies have established strategic cooperative partnerships with the large and medium-sized banks. Other banks themselves have also made great efforts to develop Fintech business. They carried out all-round cooperation with IT companies in fund raising, account opening, payment and settlement, inclusive finance etc. They draw on each other's strengths to make up for each other's shortcomings, and have achieved remarkable results. Thus, it demonstrates that even in such most significant and essential field, the Chinese government didn't simply exercise state monopoly.

VI. The goal to improve corporate governance structure will remain unchanged.

In recent years, some foreign institutions and organizations have been skeptical about China's corporate governance, especially about the CPC's role in it. Private enterprises in China have always been operating independently and effectively based on their Articles of Association and governance structures. They are independent entities operating in the market and abide by the rules of the market. The CPC has not interfered in their operation.

In the state-owned enterprises, the leadership of the CPC has always played a central role. It is the most distinctive feature of the Chinese corporate governance model to integrate the leadership of the CPC. President Xi Jinping has stressed that it is a major political principle to adhere to the CPC's leadership in state-owned enterprises, which must be implemented consistently; and that the reform of state-owned enterprises should follow the direction of establishing a modern enterprise system, which must also be implemented consistently. To further deepen the reform of state-owned enterprises, corporate governance must be improved while the role of the CPC must also be fully recognized, so that the two can integrate with and better promote each other.

From the perspective of global theoretical research and empirical studies, there is neither a unified model of corporate governance nor an "optimal model" that can be blindly copied. The fundamental corporate governance principles and framework of Chinese enterprises are in line with the international prevailing standards. At the G20 Hangzhou Summit held in China in 2016, we have made clear in the communiqué to support the principles of corporate governance advocated by the G20 and the OECD. Under such a general principle and framework, it complies with the international common practices to make some adjustments and refinements in practice to reflect each country's specific conditions.

Establishing a modern enterprise system and upholding the CPC's leadership are fully compatible with each other. First, of in terms of establishing a mechanism where effective checks and balances are in place, the general meeting of shareholders, the board of directors, the senior management and the board of supervisors are encouraged to assume their respective responsibilities and roles in accordance with the law. The CPC Committee mainly takes the responsibility to lead the direction, to manage the overall situation and to ensure implementation. It plays a key role to ensure that the company abide by the law and policy, cultivate a healthy corporate culture and fulfill social responsibilities. Business strategies and decision-making are up to the board of directors. Second, in the protection of stakeholders, good corporate governance means taking full account of the legitimate rights and interests of shareholders, employees, customers, communities, creditors, as well as that of the upstream and downstream companies of the supply chain. CPC has always adhered to the fundamental principle of serving the people. It has both rich experiences in mass work and the capacity to organize and motivate, which can better protect the legitimate rights and interests of all parties. Third, the CPC organizations adopt collective leadership, and the members of the CPC Committee, the board of directors, and the board of supervisors can also be cross-appointed, which can better solve problems like internal controls, large shareholder manipulation, inadequate performance of directors, and the non-independence of independent directors, and so on.

Past practices have proved that cultivating a corporate governance model with the Chinese characteristics is absolutely feasible. For example, the core leading roles of the CPC Committee have been fully brought into play in the five large banks, i.e. ICBC, ABC, BOC, CCB and BOCM. These banks have made historic breakthroughs in corporate governance and business performance after a series of major initiatives such as reform of ownership structure, introduction of strategic investors, and getting listed domestically or overseas. Some of the banks had won international awards on corporate governance more than a decade ago. These banks have also been highly internationalized with a global network of shareholders and outlets. Some key business indicators of these banks have reached the international advanced level, including productivity, return on capital, cost-to-income ratio, capital adequacy ratio and provisioning coverage ratio, to name just a few. It also shows that while learning from the international experiences, China is capable of proactively exploring good corporate governance models with the Chinese characteristics.

VII. China will unswervingly keep opening up the financial sector.

The opening-up of the financial sector is the trend of the times, and it will neither stop nor go backward. In 2013, China overtook the US to become the world’s largest trading nation. In 2018, the imports and exports of China accounted for 10.8 percent and 12.8 percent of the world’s total respectively. China has been regarded as the largest trading partner by over half of the world countries. Compared with the production and exchange of commodity goods, the opening-up of China’s service industry has been relatively lagging behind. The financial sector is a vital part of the service industry and needs to further open up to better serve the real economy and people’s lives.

In 2018, 15 pieces of opening-up measures in the banking and insurance sectors were announced. In May this year, 12 new opening-up measures were further unveiled. All these measures are being implemented step by step on schedule. Going forward, there still remains ample room for further opening-up, since currently foreign capital only takes up 2 percent of China’s A-share market capitalization and 2.9 percent of China’s bond market, while foreign-funded banks account for 1.6 percent of the total commercial banking assets, and foreign-funded insurance companies account for 5.8 percent of the total insurance assets in China. Foreign institutions with good market reputation, sound credit record, and expertise in risk management, credit rating, wealth management, factoring, consumer finance, pension, health insurance and other business areas are particularly welcome to do business in China. With participation of those institutions, financial market entities can be further enriched, financial product innovation further promoted and the financial market vitality further unleashed.

In the process of further opening up, the complexity and contagion of financial risks will no doubt further increase. For a large developing country like China, it is crucial to mitigate and control financial risks, in particular, large-scale inflows and outflows of cross-border capital and the speculation of “hot money". Efforts must also be taken to resolutely prevent excessive bubbles in the property market and financial assets.

VIII. China should also have its own house cleaned first.

The fate of the Chinese nation should be held firmly in the hands of itself, as no external forces can alter the direction of its development. At present, the whole country is advancing the transition from high-speed growth to high-quality development in accordance with the strategy made by the 19th CPC National Congress. China's stable development depends on whether some internal challenges can be well addressed, especially those prominent ones such as ageing population, environmental pollution, income disparity, imbalanced regional development, weakness in innovation capacity, and etc.

In China, people aged sixty and above account for approximately 18 percent of the total population and are expected to reach over 300 million by 2025, making China a typical ageing society then. The accelerated ageing pace will bring profound impacts to all aspects of the economy and society. There will be less participants in the labor force with lower savings rate, which is detrimental to long-term economic development. In addition, China's elderly care, health care and social security systems will also face critical challenges.

Meanwhile, environmental pollution remains a serious problem in China. Every year, the economic losses caused by environmental pollution and ecological damage could be as high as hundreds of billions of yuan. The CPC Central Committee led by President Xi Jinping attaches great importance to ecological preservation. As underscored by President Xi Jinping, "clean waters and green mountains are invaluable assets". Despite the high cost of pollution control, firm actions must be taken to combine economic, legal and administrative measures to address this issue so as to protect the interests of the Chinese people.

Income disparity is another prominent issue. Since the reform and opening-up, income gap in China has widened across industries, sectors, classes and communities. Among that, income gap caused by certain unfair competition was particularly acute. Though the imputed rent of owner-occupied property in China is significantly underestimated and the calculation methods of household income needs to be further optimized, China's Gini coefficient remains at a high level, which deserves high attention. Currently, China is facing the critical task of winning the battle against poverty. Even when the phased-in objective is achieved, poverty alleviation will still remain a long-term social undertaking.

Regional gap is also distinct. Marked imbalance in economic development exists between the eastern and western regions as well as between the southern and northern regions. Some old industrial areas and resource-dependent cities in particular are faced with the huge pressure of unsustainable development. A more severe problem is the net population decline in some regions. If this problem is not handled well, it will adversely affect industrial transformation, even posing threat to the sustained national economic development.

In addition, insufficient innovation restricts economic development to a large extent. In recent years, despite the attention, efforts and investment made in the development of science, technology and education, the outcomes are not quite satisfactory. There remain institutional barriers in such fields as science, technology and education. For example, the evaluation mechanism of scientific and technological outcome, together with corresponding governmental resource allocation mechanism, should be further improved. Economic transformation toward high quality growth has been restricted by bottlenecks in the transformation and application of technological achievements as well as by key impediment to grasping core technologies.

The above-mentioned issues need to be addressed with comprehensive deepened reform, multiple-pronged measures, integrated approaches and on-going efforts. The financial industry can make great contributions in that process, which I believe, is also the direction and objective of the financial supply-side structural reform. We are convinced that under the strong leadership of CPC Central Committee with President Xi Jinping as its core, the Chinese people will achieve the two centenary goals with great success!

Last but not least, I wish the Forum a great success.

Thank you!