



Overview of the 5th National Financial Work Conference: China Seeks for Financial Stability and Development

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Over the weekend of July 14 and 15, 2017, the National Financial Work Conference (NFWC) was held in Beijing, China. The conference was launched in November 1997, immediately after the outbreak of an Asian currency crisis. Since then, the conference convenes twice a decade, and the recent one is numbered as the 5th of the conference. In this article, the author tries to find out the contents and meaning of the meeting, and consider the future development of China's financial administration.

1. Overview of the recent meeting of the National Financial Work Conference

(1) Participants and the atmosphere of the meeting

The Xinhua News Agency, a Chinese state-owned media agency, reported on its website the details of the conference together with a video made by the state owned China Central Television¹. In a spacy conference room with tables arranged like in school classrooms, sat at the lecturers' table five top Politburo Standing Committee members, namely, General Secretary and President Xi Jinping, Premier Li Keqiang, Mr. Yu Zhengsheng, Chairman of the Chinese People's Political Consultative Conference (CPPCC), Mr. Wang Qishan, Secretary to the Central

¹ The Xinhua reports the contents of important speeches. In addition, it is possible to see the atmosphere of the conference room and faces of the participants through the videos.
http://news.xinhuanet.com/politics/2017-07/15/c_1121324747.htm

Commission for Discipline Inspection (CCDI), and Vice Premier Zhang Gaoli. Meanwhile on the audience side, nearly 400 high ranked officials of the communist party attended (Table 1). At the frontline table, there sat leading party members including three Vice-premiers of Liu Yandong, Wang Yang and Ma Kai, and Mr. Li Zhanshu, Secretary of the Secretariat of Central Committee, together with Mr. Cai Qi, party chief, Communist Party Secretary of Beijing, Mr. Han Zheng, party chief of Shanghai, Mr. Hu Chunhua, party chief of Guangdong Province, Mr. You Quan, party chief of Fujian Province and other senior officials from local governments². Also attending were PBOC Governor Zhou Xiaochuan, other top officials from financial supervisory agencies and top leaders from financial institutions. There was an appearance of former chairman of China Development Bank Chen Yuan. Almost all the participants were in their shirt-sleeves while some of the officials wore uniforms, like members of Central Military Commission and People's Armed Police. The participants were looking into the speech text in their hands uniformly with a strained look³, while attentively listening to the important address by General Secretary Xi Jinping. The conference was the place not to discuss practical financial matters but rather the place to deliver the message of the top management of the party to each party member with the coming political schedules in mind.

Table 1 : Participants in the latest National Financial Work Conference

Representation	Participants and their affiliations
Communist Party of China (CPC) Politburo Standing Committee members	General Secretary (President) Xi Jinping (key address); Premier Li Keqiang (address); Yu Zhengsheng, Chairman of the Chinese People's Political Consultative Conference (CPPCC); Wang Qishan, Secretary to the Central Commission for Discipline Inspection (CCDI); Vice Premier Zhang Gaoli (These five persons took a seat on the podium.)
Politburo members	Vice Premier Ma Kai (Summing-up Remarks)
Senior officials with speeches	Secretaries to Beijing City and Fujian Province, PBOC Governor, Chairman of China Banking Regulatory Commission (CBRC), Chairman of China Securities Regulatory Commission (CSRC), Vice Chairman of China Insurance Regulatory Commission (CIRC), Chairman of Industrial and Commercial Bank of China
Senior officials without speeches	CPC Central Committee members/Central Secretaries (Wang Yang, Li Zhanshu, Han Zheng, etc.), Standing Committee executives of the National People's Congress, State Council members, President of Supreme People's Court, Prosecutors-General of Supreme People's Procuratorate, Executives of Chinese People's Political Consultative Conference
Other participants	High officials of Provinces, Cities and autonomous regions, executives of financial institutions, Central Military Commission and Armed Police.

(Source) Various Xinhua Reports

² At the Conference, Secretaries of Beijing City and Fujian Province gave speeches at the podium. Other officials from the local governments including the one from Shanghai city which has been pursuing its way to an international financial center were not given a chance of speech.

³ On the first day of the conference, Mr. Sun Zhongcai, a member of the Politburo and secretary of Chongqing City did not show himself because he was under the inspection by the Central Commission of Discipline Inspection (CCDI) and his discharge from the post was published the next day. The sudden personnel shift at a time shortly before the Party's Congress surprised the participants greatly and to make them have strains.

(2) Overview of the Conference

At the Conference, President Xi Jinping delivered an important statement on the financial matters, which was followed by a speech by Premier Li Keqiang⁴. Vice Premier Ma Kai gave concluding remarks. The essence of these addresses has been reported by media. The key address of General Secretary (President) Xi Jinping had a strong idealistic aspect of putting forward the message of the CPC Politburo. It broadly covered the items relating to the economy and finance, but without exploring each of them in greater detail. Those of Premier Li Keqiang and Vice-Premier Ma Kai touched more practical issues but they did not go into details in order to let the president's key address have more presence.

The followings are the essential points of their addresses that are summarized in line with the author's understanding. Please refer to the table 2 below for more details of each speech.

- (i) To strengthen the guidance of the Party in all aspects of finance.
- (ii) To prevent the financial sector from becoming autotelic (an end onto itself), and encourage it to serve the real economy.
- (iii) To establish a "Financial Stability and Development Committee of the State Council" to prevent financial risks and strengthen the financial supervisory administration. To improve and reinforce the risk management power of the Peoples Bank of China (PBOC, Central Bank). To prevent an occurrence of systemic financial risks and maintain financial stability.
- (iv) To promote a sound financial development and deepen the financial reforms. To strengthen direct financing and reform indirect financing, making them serve the real economy more effectively. To cautiously promote the internationalization of the RMB, reforms of foreign exchange regime and liberalization of capital account, while utilizing the market mechanism in harmony with the guidance of the CPC and government.
- (v) To promote structural reforms on the supply side. To encourage the central and local state-owned enterprises (SOEs) to deleverage their debts while appropriately administering the debt management of local enterprises. Irresponsible and disturbing fund raising⁵ that is seen in some provinces should be definitely inhibited, with the persons in charge never failing to be investigated even after the personnel changes.

⁴ The address by Premier Li Keqiang remained at about 40% in length of the key address by President Xi Jinping.

⁵ There are cases where banks give unspoken guarantees to private enterprises to let them raise funds by bond issuance or make illegal lending disguised in a form of PPP (Public Private Partnership).

(vi) To maintain the stability of financial markets in order to contribute to a successful convention of the 19th Party Congress slated for this autumn.

Table 2 : Outline of Addresses of General Secretary Xi Jinping, Premier Li Keqiang, and Vice-Premier Ma Kai

Main Points	Contents/Explanation
Summary of the Conference (Summarized based on the Xinhua reports)	<ul style="list-style-type: none"> • Finance is an important power for competition that is at the core of the nation. Stability in finance is an important composing element of a national security. Financial system is an important basic institution for economic and social development. • It is essential to reinforce the guidance of the party in the financial area. It is important to oversee the development of finance and guide it while maintaining a stable and steady trend. • It is important to let financial sector serve the real economy, while the government preventing financial risks and promoting financial reforms (Three government missions as described later) • China will develop and improve the ways to manage and control its financial sector. It will complete an efficient corporate financial system and market system. It will accelerate the change in financial development, reinforce laws and regulations, and secure the national financial security. Through implementation of these measures, it will promote the virtuous cycle of the economy and finance and their sound development.
Four major principles (Basic principles for dealing with financial issues)	<ul style="list-style-type: none"> (i) To return to the origin of finance: to let finance serve the economy and development of the society (ii) Structural Reforms: Emphasis of quality and efficiency. Improvement of usability, lower cost, and improvement of risk management. (iii) Reinforcement of oversight: Prevention of systemic risks and institutional reforms for that purpose (iv) Market-oriented policies: Achieving effective distribution of resources by utilizing market mechanism and making proper adjustment of relationship between the government and the market.
Three missions (Main challenges for the coming 5 years)	<ul style="list-style-type: none"> (i) To let the finance serve the real economy. <ul style="list-style-type: none"> • Finance is a blood stream of the real economy. It should contribute to the real economy. (ii) To prevent financial risks. <ul style="list-style-type: none"> • The bottom line for preventing the outbreak of systemic risks is an eternal theme. By early detection and rapid address to the risks, we should promote prevention and management of risks scientifically. • The government establishes the “Financial Stability and Development Committee of the State Council” and reinforces the macro-prudence management by the PBOC. • We will promote the deleverage of excessive debts of SOEs and disposition of zombie enterprises. We will halt an irresponsible and reckless fund raising of the local governments and steadily manage and dispose their existing debts. • We will try to close the loopholes in financial supervision, strengthen the oversight of new kinds of financial intermediation such as financial conglomerates and internet financing, and construct a better financial order and credit system. • We will strengthen the financial oversight in each region to prevent risks. (iii) Promote financial reforms <ul style="list-style-type: none"> • We will give much value on the quality and efficiency of finance. • We will make reforms on the system of financial institutions, management of state-owned financial institutions, promote improved foreign exchange market, and implement reforms of governance and related systems of financial institutions. • Along with the structural reforms on the supply side, development of direct financing will be promoted and indirect financing will be improved.

Establishment of “Financial Stability and Development Committee of the State Council”	<ul style="list-style-type: none"> • In the financial supervision, the committee will give enhancement of the authority and efficiency of the cooperative actions taken by the People’s Bank of China (PBOC) , China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission (CSRC) and China Insurance Regulatory Commission (CIRC) (combined referred to as One Bank and Three Commissions) • It will enhance the professionalism and consistency over the financial supervision, and try to stabilize and develop the financial system. (Secretariat is to be established within the PBOC but its organization, authority and personnel are still undecided)
Other missions than the above three	<ul style="list-style-type: none"> • External opening will be promoted. Reform on the foreign exchange rate formation mechanism of the RMB will be deepened. Internationalization of the RMB will be promoted steadily to realize its convertibility on the capital transactions step by step. • The leadership of the Party will be strengthened to foster financial people gifted with both morality and talent. • We will address the actual assignments with an enhanced sense of responsibility and sense of duty.

(Source) News reports of Xinhua

The characteristic of the Conference was that President Xi, who has been seeking a concentration of power as a core person in the Party Central Committee, exerted his leadership also in the financial area, revealing his basic ideas on it. It also has drawn our attention that he referred to the debts of state owned enterprises (SOEs) and local governments in relation to the deleveraging of the economy, which was one aspect of the supply side structural reforms that had become a crucial issue since the end of 2015.

(3) What the timing of the conference suggests

The recent NFWC was convened at a politically sensitive timing with the 19th National Congress of the CPC⁶, held every 5 years, coming in about three months. After the Party Congress, the National People’s Congress will be convened in March 2018, and the second term⁷ of the Xi Jinping administration will formally start. By that time, personnel affairs, in addition to those for the Party’s highest class, will be fixed for vice premier in charge of financial affairs in the State Council, members of the newly established Financial Stability and Development Committee of the State Council, and the next governor of the PBOC. If the things go smoothly until then, the practical works on the financial affairs will be launched in full swing.

⁶ At the Politburo meeting on August 31, the central party organization announced that they would hold a National Party Congress on October 18, 2017.

⁷ In China, both the Communist Party and the government are managed on a 5 year term.

In the autumn 2018, about a half year after the start of the second Xi Jinping administration, the 3rd Plenary Session (3rd Plenum) of the Central Committee of the CPC will be held. As was the case in the 3rd Plenum⁸ held 5 years ago, fundamental discussions are expected to be made over the reform issues in general. Financial reform will be on the table, too.

Taking into account these important political schedules slated for in the future, it can be seen that the recent NFWC was a special strategic move made by the party leadership. In fact, the recent conference was the place to convey a political message from the highest class to the lowers and from the incumbent administration to the next administration. Top officials of the PBOC, the CBRC, the CSRC and the CIRC⁹ (combined together referred to as One Bank and Three Commissions) stood on the podium to make a speech¹⁰, but no contents of their speeches were made public, which seems to suggest that the conference was not intended to focus on the practical business.

(4) Records of the NFWC convened in the past

Table 3 shows the past records of the NFWC meetings. Except for the first meeting, the conference was held at about one year before the Party Congress, but apparently this year the fifth conference was convened at a fairly closer timing to the Party Congress.

Each meeting has a relatively long interval of 5 years in between and the contents of the meeting reflect the economic conditions and international environment of the moment, although there has been some continuity of the themes. For instance, the previous (the fourth) meeting was convened in January 2012, a little more than 3 years after the global financial crisis of 2008, where an assertion that the financial industry should serve the real economy was presented and it has been carried over to the latest meeting.

Table 3 : Past records of the meetings of the NFWC

Time of Meeting	Contents and main topics	Time of Party Congress	Host of the Conference
The First Meeting: November, 1997	The meeting was held just after the outbreak of the Asian financial crisis. The urgent task was to deal with the non-performing loans of the State-Owned banks and four large asset management companies were established. The CSRC and	(the 15 th Session) September, 1997	Formally General Secretary Jiang

⁸ At the 3rd Plenum of November 2013, it was decided that the government would continue to promote reforms that aim to further utilize the market functions.

⁹ The CBRC oversees depository institutions like banks, and the CSRC oversees security firms and securities market and futures market, and the CIRC oversees insurance companies and insurance market, respectively.

¹⁰ Executive members who made speeches are as shown in Table 1.

	the CIRC were newly established.		Zeming, and actually Vice Premier Zhu Rongji
The Second Meeting: February, 2002	The CBRC was newly established. Reforms to transform the state-owned banks to stock-based commercial banks and prepare for its IPOs were promoted. Central Huijin Investment Ltd. was established. The government started to reform agricultural finance.	(the 16 th Session) November, 2002	
The Third Meeting: January, 2007	Reforms of state-owned commercial banks deepened. Transformation of agricultural banks to stock-based commercial banks was decided. Transformation of National Development Bank was decided as a step of policy bank reform. Promotion of efficient management of foreign exchange reserves and issues of corporate bonds.	(the 17 th Session) October, 2007	Premier Wen Jiabao
The Fourth Meeting: January, 2012	The first meeting held after the global financial crisis. Service of finance to the real economy, improvement of fund raising by the agricultural finance and middle-and small businesses. Prevention of systemic risks. Debt problem of local borrowers. Development of money and capital markets.	(the 18 th Session) November 2012	
The Fifth Meeting: July, 2017	Better service of financial sector to the real economy, prevention of financial risks, deepening of financial are the three main missions. Establishing a Financial Stability and Development Committee of the State Council with strengthened macro-prudence management function by the PBOC.	(the 19 th Session) October 2017	General Secretary Xi Jinping

(Source) Various news reports

The conference was formally hosted in the name of General-Secretary and President Jiang Zeming for the first and the second meetings, but the actual host was Premier Zhu Rongji (Vice Premier at the time of the first meeting). The third and fourth meetings were hosted by Premier Wen Jiabao under the Hu Jintao administration. This was because in the decade of the Hu Jintao administration there was a division of responsibility among the members of the Central Politburo Standing Committee and the fiscal, economic and financial area was under the responsibility of the premier. The responsibility was returned at the fifth meeting to the General Secretary and President Xi Jinping, and the level of the host side was upgraded with five members of the Politburo Standing Committee taking a seat on the podium. This implies that the top officials of the current administration have recognized the importance of finance in a higher degree than ever. The current administration thinks China should never be the originator of the next financial crisis and at the same time it seems to attach the greatest value to the stability of finance.

(5) Follow-up developments after the Conference

After the close of the latest Conference, internal meetings have been held in various ministries and institutions under the State Council to learn about the contents of the important speech given by the General-Secretary Xi Jinping. At the PBOC, for instance, Governor Zhou

Xiaochuan held an expanded meeting on July 17, two days after the NFWC, and shared the spirits of the President speech with the participants¹¹.

Further, the Supreme People's Court, an independent organization from the State Council, issued in August a public circular, declaring that it would crack down on various illegal and criminal behaviors that have been frequently seen in the financial and securities markets¹². In the past, institutionalization of anti-corruption movements and prevention of corruption were discussed within the Communist Party, but the schemes to crack down the financial crimes will be strengthened from now on. In relation to this, there has been a move to establish State Supervision Commission since 2016, which is highly probable to be established at the National People's Congress slated for in March 2018.

2. Financial risks that came up to surface in the past two years and ones to be watched for in the future

(1) Cases of Financial risks that emerged since 2015

What was to be especially noted since the last conference meeting seems to be the fact that President (General-Secretary) Xi Jinping accepted the shift down of the economic growth to “middle-to high speed” by referring to a new economic situation called “New Normal” in May 2014. In the adjustment process to a slowdown of the economic growth, defaults on the specific financial products began to increase, and in 2015, the whole financial market happened to experience an extensive destabilization¹³ which continued into 2016.

The major cases of financial destabilization since 2015 are summarized in the Table 4. The Party and the government have taken substantial measures to deal with each case, controlling the risks to a certain extent. However, there is no guarantee for them to succeed in controlling the risks if a new case happens to come up in the future. So, it can be said that the recent NFWC

¹¹ Website of the PBOC <http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3346465/index.html>

¹² The circular was issued announcing that “the Supreme Court tries to realize the spirit of the NFWC and reinforce the work of financial inspection”, in which the following message drew attentions. The Supreme Court will adamantly attack the crimes that threaten the financial stability and destroy the financial order, and thoroughly investigate the “giant alligators of finance” (big alligators that cause waves in the financial markets in and out of the country), and “internal devils” (those demons that live within the party and domestically and engage in interest transfers through backdoor trades with authority (power) in exchange for money). It will strictly crack down the actions that disturb and destroy market order, such as crimes in the securities market and futures market, frauds at a time of issues stocks and bonds, bonds, circulation of rumors, and insider transactions.”
http://www.spp.gov.cn/zdgz/201708/t20170822_198842.shtml

¹³ The time when financial risks came up to surface in China overlapped the start of normalization process (correcting the extraordinarily easy monetary policy) in the US with the rate hike by the FRB coming into sight.

had a meaning of raising awareness of senior party members and ringing an alarming bell for the future financial instability and possible occurrence of a systemic risk.

Table 4 : Major Financial risks that emerged in China since 2015

Time	Case of a financial risk	Remarks
June, 2015	Plunge of stock prices in June 2015 in Shanghai and Shenzhen stock markets	It was reported that media fueled the price rise. After the plunge, the party and the government acknowledged it as a systemic risk and worked out price supporting measures.
August, 2015	The exchange rate of the RMB plunged in both onshore and offshore exchange markets. The stagnant trend took hold for some time, placing the internationalization of the RMB in an adverse wind.	The government promoted in collaboration with the IMF a reform of foreign exchange rate formation mechanism, and the devaluation of the RMB provoked a “RMB shock”.
Summer 2015	Property prices plummeted in many coastal cities including Shenzhen, Shamen and Nanjing with concerns whispered over the financial products for properties and emergence of bubbles. (A potential financial risk increased noticeably.)	After the rapid rise of prices, local governments introduced relatively strong countermeasures in October 2016, with some success in cooling down the overheating of the market. While in the coastal areas the market saw a lull at high level of prices, the price rises gradually had spread to the inland cities.
Early 2016	The global financial markets were destabilized in tandem with the fall of the RMB and global stock prices. Weak RMB rates were entrenched in the market.	The incident took place while the memories of the “RMB shock” in August 2015 still fresh in people’s mind.
2016	Defaults on corporate bonds increased. Some bond holders had an actual loss.	Defaults on corporate bonds occurred in state-owned enterprises both of central and local governments. It became an actual issue to deal with zombie companies and non-performing loans.
November, 2016	At the future government bond market, the future prices of long-term government bonds declined sharply.	The prices fell nearly 2.6% within a month from middle October to November.
2016~1 st half of 2017	The accumulation of stocks of China Vanke Ltd., a leading real estate company, began to overheat, drawing an increased attention.	An acquisition that exploited the loopholes of insurance administration occurred. It attracted attention as a money game played on the money market.
2016~middle 2017	A boom came in fashion for overseas investment and M&As by the Chinese companies. External capital outflows, fall of the RMB and decline in foreign exchange reserves went on simultaneously. The authority adopted an emergency response mode to cut a chain reaction of negativity among them.	In the second half of 2016, the government introduced practical capital control measures. In 2017, the government practically restricted a large scale overseas investment by specific private enterprises.

(Source) Various media reports

In 2017, the business conditions picked up reflecting the improved external demand, progress in the adjustment of excessive production capacity of steels and others, and a continuing boom in the housing market. Against these good economic backdrops, cases of financial

destabilization decreased. However, it is still too early to say that the risks have disappeared. In preparation for the Party Congress slated for this autumn, the government has implemented a series of economic supporting measures making it a top priority to ensure the financial stability, but it will be impossible to continue it. Depending on the economic development hereafter, there is a possibility that the financial risks come to the forefront again. If the government tries to promote the deleveraging of the SOEs' debts, it will have to keep a cautious eye on any possibility of risks.

(2) Possible financial risks to be watched for in the future

Since Mr. Xi Jinping took the office of General-Secretary, his administration started to reveal its awareness of big power while advocating a "Chinese Dream," and tried to appeal it to the Chinese people. In spite of these efforts, if the domestic financial sector should become destabilized by any political mistakes or external factors, leading to a systemic risk, the administration would lose face not only domestically but also in the international scenes. Since the plunge of stock prices in 2015, the leaders in the present administration seem to have recognized that the financial instability has a risk to shake the Chinese governing structure. In China, the existence of various financial risks is pointed out as shown below, and the government does acknowledge the need to appropriately control these risks.

(i) Risks in the financial markets

- As the interbank market and direct financing market (capital market) grow in their scale, vulnerabilities have also grown. Transactions that get past the regulations have increased, and financial products that package plural asset management products or stocks and bonds that are issued under a loose screening have been traded.
- The government aims at expanding direct financing market, but in addition to an enhanced market oversight, it is an urgent task for it to construct a financial infrastructure that enables it to evaluate objectively the values of bonds and stocks. It will also need to be watched whether the debts-to equity swaps to deal with non-performing assets will be implemented properly or not.

(ii) Risks arising from the slow reform of financial overseeing system

- The present system of financial oversight has not caught up with the development of financial innovation. There are moves that the internet finance has been connected to

crimes. The vertically divided functions of financial oversight have led to an unsatisfactory administration over the financial conglomerates.

(iii) Risks for a lagged market-oriented reform that should be promoted in tandem with the internationalization of the economy and finance

- In spite of the heightened willingness for overseas advance of the Chinese enterprises, the government had to introduce de fact capital control measures in the second half of 2016. The government ability will be tested in the days ahead, whether or not it can improve the regulations for more transparent ones.
- The reform of foreign exchange rate formation mechanism has been lagging although there are indications on the possibility of narrowing trade surplus in the medium term, or risk of trade frictions with the United States.

(iv) Risks on domestic debts leverage that may not be properly administered

- The public sector and household sector still have a room to expand their debts, but the debts of non-financial corporate sector have already reached the level that cannot be neglected. The management of debts of SOEs, both in central and local regions, and of local governments is an important agenda for the time to come¹⁴.

(v) Difficulty to control the emergence of real estate bubbles

- When the property (housing) prices continue to rise, monetary tightening accompanies a possibility to trigger a burst of bubbles. Therefore once bubbles have been formed, they will decrease the policy options to be taken, making the policy response very difficult.

(vi) Risks of expansion of non-performing loans of banks

- As the interest liberalization advances, bringing about a financial environment of stricter competition, some of the financial institutions are actively engaging in unreasonable reckless lending or shadow banking business, and there are risks that these moves lead to an increase of non-performing assets once the economy slows down.

(vii) Risks for insufficient consumer protection on finance

- Consumer protection and education to prevent financial crimes have not followed the reality.

¹⁴ The Growth of GDP continues to be a political objective of the local governments and it is not easy for them to depart from growth dependent expanded debts. In some regions, there are cases that the local governments raise irresponsible funds by utilizing enterprises under the influence of the governments, according to the report by the National People's Congress (NPC) of July 24, 2017.

http://www.npc.gov.cn/npc/xinwen/jdgz/2017-07/24/content_2026109.htm

3. Some Considerations on the recent NFWC meeting and newly established Financial Stability and Development Committee of the State Council

(1) Inconsistency between strengthening of financial administration by the party and market-oriented reform

In order to deal with the plunge of stock prices that took place in the summer of 2015, the government implemented nationwide measures to support the stock market. However, the crisis management taken by the party and the government was the one that largely neglected market functions and had a very bad reputation both at home and abroad.

In 2016, there was a capital outflow from China, accompanied at the same time by the depreciation of the RMB and a decrease in reserves. As a result, China was forced to introduce de fact capital control, but the method of the Chinese authorities was mainly dependent on oral guidance which was quite unclear¹⁵.

At the recent NFSC meeting, it was decided to strengthen the party's guidance on the financial matters. This raises a concern that it may go against the market-oriented reform. That is a concern that in the future China might utilize more ways of management dependent on administrative methods and oral guidance than market functions, rolling back the rule of law while increasing uncertainties. The meeting was convened at a time of heightening political tensions. It is hoped that the step-up of the party guidance will be limited just to secure a short-term stability, but it's possible it is not¹⁶. More recently there are moves that some Chinese SOE listing on the Shanghai Stock Exchange have amended their articles of incorporation to allow the increased involvement of the Communist party in their management.¹⁷ There is a risk that these moves will decrease transparency of their business management to stakeholders and weaken the functions the market will play.

¹⁵ When the IMF took a decision in November 2015 to include the RMB in the currency basket of a new SDR, China promised to implement further financial reforms. However, just before the launch of a new SDR (October 2016), China was forced to introduce capital controls, which were implemented through oral guidance with no documents so that it should not be viewed that China was moving against reforms.

¹⁶ Mr. Yi Huiman, chairman of the ICBC and secretary of the Party Central Committee attended the NFWC and delivered a speech at the podium and on August 9 he wrote on the internet that he deeply re-acknowledges the spirit and try to realize the new actions. This revealed that the party became a new important stakeholder after shareholders, customers, and financial regulators.

http://www.zgg.gov.cn/zhtbd_5658/dfjdown/shgg/201708/t20170809_659057.html

¹⁷ "China's Communist party writes itself into company law," *Financial Times*, August 15, 2017
<https://www.ft.com/content/a4b28218-80db-11e7-94e2-c5b903247afd>

(2) Establishment of Financial Stability and Development Committee of the State Council

In China there has been a long discussion over the reform of current financial regulation system based on “One Bank and Three Commissions.” The “One Bank and Three Commissions” system is a system based on the division of roles, where the PBOC takes the top responsibility to manage and oversee the financial market, while the CBRC mainly oversees depository institutions like banks and trust banks, the CSRC oversees securities firms and securities market and futures market, and the CIRC takes care of insurance industry and insurance market. This system has worked well in so far as the financial products and industries have remained in the framework of the system.

However, as the economic stimulus package amounting to 4 trillion yuan was implemented in 2008 and shadow banking began to grow, regulations tended to follow their development. Innovation of financial products and their complication have rapidly progressed with the financial products across the business category developed daily, leading to an increase in transactions that utilize loopholes of regulations. In addition, there emerged financial conglomerates along with the rapid development of financing that utilizes information and communication technology (ICT). There was an increase of the cases that no regulatory institutions could cover with their supervisory authority, and adverse effects of vertically divided administration have emerged.

Since the plunge of stock prices in the summer of 2015, debt-equity swaps have been discussed to promote supply side structural reforms. The local governments have started to raise funds through Public Private Partnership (PPP) or similar ways. It is difficult to address these methods by the vertically divided financial supervisory system, and in this sense the recent announcement of reforms came a bit too late, we regret to say.

After studying overseas cases by the related persons¹⁸, China decided to establish a “Financial Stability and Development Committee of the State Council”¹⁹ with its secretariat based within the PBOC. The objectives of its establishment are to enhance the authority and effectiveness of the cooperative actions taken for supervision of financial system by the One

¹⁸ Among the reform discussions, it is reported that there was an option for One Bank and One Commission regime, by integrating three commissions into one to create Financial Regulation Administration Committee (tentative name), similar to the Japanese financial administration.

¹⁹ The decision reminds us of the circular of the State Council on the “strengthened regulations and supervision on shadow banking” (State Council Circular No.10). This highly canonical circular took a style to give the PBOC a coordinating and accommodating role among the CBRC, CSRC, and CIRC in strengthening the regulation on shadow banking.

Bank and Three Commissions, and to improve professionalism and integrity of financial supervision while promoting financial stability and development. How it is actually managed will become clear after the organization is formally launched and its personnel are finally fixed.

4. Conclusion and Outlook

Communist Party of China is now moving toward enhancing governance by the party. The recent NFWC was held to enhance the governance by the party in the area of finance. However, when an uncertain situation emerges in the financial market, the financial authorities will not be able to timely prevent the increase of risks if they always wait for instructions from their superiors. In order to prevent such a case, it is necessary for the authority to transfer the powers appropriately, and then reinforce regulations after securing sufficient flexibility. It is important to properly balance the maintenance of order through the financial administration and the increased exercise of market vitality. It is hoped that the “Financial Stability and Development Committee of the State Council” will take this point into account and play the role of good coordinator and promoter of regulation so that the financial market will be managed in a rational and effective way.

The regulation on transactions introduced in 2016 to prevent capital outflows was introduced in a way of somewhat unclear administrative means. If these methods continue to be taken in the days to come, it will not be easy for the regulators to get market confidence. It is worth noting how the Chinese government will normalize the capital controls hereafter. Further, such issues as the reform of exchange rate formation mechanism and improvement of various infrastructures for the development of direct financing will also constitute an important challenge in the financial matters for the second-term Xi Jinping administration.

On the other hand, irresponsible and reckless fund raising by the local governments was criticized at the NFWC meeting. The current administration will not tolerate it. Also the resolution of excess debt problems and zombie companies will be gradually promoted, but in the process of deleverage, a heavy burden will be placed on the financial system. Especially when the economy enters the phase of slowdown, risks are easily expanded, and an advance simulation will be required to deal with the situation.

It should be closely watched whether the government can respond to each of these challenges steadily and flexibly enough.

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