Building an Open and Market-Oriented Financing System for the Belt and Road Initiative

Speech at the Belt and Road Forum

Finance is fundamentally about the mobilization of money from those who have it to those in need of it. Because the risk appetites of those with money, the investors, do not match with the risk profiles of those raising money, there is a need for a financial system involving financial intermediaries performing basically three functions. First is to transform risks, as in the case of banking where the credit risk of borrowers (in servicing and repaying bank loans) are transformed into the credit risk of banks (in repayment deposits to depositors). Second is to transfer risks, as in the distribution, underwriting, securitization and packaging of debt issued by fund raisers and transferred to investors. Third is to transact risks, as in the case of secondary market activity in the stock market, so as to provide the necessary liquidity and reliable price discovery to attract the interest of investors in subscribing, trading and holding the financial assets concerned.

It is not difficult to see the benefits of an open financial system in the performance of these important functions. Openness in terms of allowing the presence of foreign financial institutions brings experience, expertise and competition, and therefore greater efficiency in the provision of the different types of financial services. Openness in terms of allowing the international mobility of capital promises, through the diversification of investment opportunities and funding sources, higher rates of return for domestic savings and lower costs of money for borrowers.

It is also not difficult to see the benefits of a market-oriented approach to finance. The invisible hand is simply far more efficient than the visible hand in the allocation and the pricing of financial resources to the most efficient users, thus enabling the economy to be better served.

But, while we should all be enthusiastic in embracing an open and market-oriented financial system, we must also be alert to, understand and be in a position to manage well, the risks inherent in such a system. In the limited time available, let me just draw your attention to three high level issues for reference in your effort to build an open and market-oriented financing system for the BRI.

First, international capital is volatile, voluminous and vicious, and in conducting its affairs it pays little or no regard to the national interest of the host jurisdiction. The risks to monetary and financial stability are genuine and have to be prudently managed. I believe, however, that decisions behind capital flows are made rationally, having regard to all relevant factors that have an influence on the prospects for achieving the expected return on capital, including the basic economic fundamentals, financial sector developments, etc. Embracing international capital therefore demands rather strict macroeconomic discipline, a robust financial system and transparency in the making of financial policies.

Second, financial markets are very potent creatures, particularly when the financial intermediaries are left relatively freely to do their own things, introducing innovative financial products and complex financial arrangements that embody unfamiliar and possibly systemic risks. Financial markets can and do fail, and the consequences are often debilitating, involving serious disruptions to the crucially important basic process of the mobilization of money in support of the economy, with investors incurring huge losses and funding drying up for borrowers. There is simply a need for financial authorities proactively to harness financial market potency. This, I believe, they can achieve, by exercising their authority to regulate financial markets and supervise financial institutions with the clear objective of ensuring that activities in the financial system are oriented towards serving well the economy.

Third, finance as an industry has developed a self-serving culture, relegating the importance of the fundamental role that justify its existence of serving well the economy. With due respect to my private sector friends in the financial system, they are all in a privileged position, protected by different types of licences or registrations, to influence where money comes from and where it goes to in the economy. Regrettably but understandably, they exercise that influence for the purposes of maximizing profits for their institutions and awarding astronomical compensation to their management.

But profits and bonuses, and the huge overheads of financial institutions, and the hefty fines for misconduct that all too often they are charged, are all part of the cost of financial intermediation in the economy, which are paid for by users of financial services. It is not difficult to see that the cost of and the efficiency in financial intermediation have an inverse relationship. This self-serving culture in finance, very much originating from Wall Street, is definitely something that we should guard against.

The BRI involves a group of economies with very heterogeneous degrees of financial sophistication. Building a BRI-specific financing system that is open and market-oriented, and enables participating economies to derive real development benefits from it, while ensuring financial safety, is a big challenge. The risks that I have just identified will need to be carefully managed by individual jurisdictions, having regard to their different stages of financial development and cautiously sequencing their steps for further embracing openness and market-orientation of their financial systems. Meanwhile, there is a need for close cooperation of the financial authorities of BRI in:

(a) The creation of orderly channels to facilitate the mobility of capital among BRI jurisdictions;

(b) The creation of a platform accessible to BRI jurisdictions for the transformation, transfer and transaction of risks;

(c) The provision of liquidity to facilitate the use of the domestic currencies of BRI jurisdictions in the conduct of the relevant financial transactions; and

(d) The creation of a mechanism for objectively establishing the risk profiles of funding raisers, including the use of credit guarantees and credit enhancements provided by international financial institutions and national authorities.

Let me conclude with an advertisement: Hong Kong stands ready to contribute its expertise in these very worthwhile efforts.

Joseph Yam

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Beijing