2023

China - U.S. Symposium on Building the Financial System of the 21st Century

How Do US-China Tensions Impact Transnational Financial Institutions?

Managing differences

- U.S.-China relations
  - Rising political tensions
  - Continued economic interdependence & mutual benefit
  - G2 and the imperative of global public goods
- Coexisting as different systems
  - Contrasting law, regulation, capital movement, industrial policy
  - Need to cooperate despite differences – distinguish areas of cooperation, competition, contention
  - Third countries don’t want to take sides
  - Hong Kong as connector and safety valve
  - Decoupling vs. derisking – is there a difference?
- Dangers of decoupling

Has financial decoupling begun?

- Declines in cross-border financial activity
  - Two-way declines in FDI
    - Across M&A, PE, VC
  - HK turnover is down, IPOs are down
  - Is China giving up on U.S. investors, and vice-versa?
- Appears not to be just cyclical or blip
  - Economic rationale
    - Parallels slowing domestic private investment in China, economic growth
    - But economic complementarities and benefits still exist
  - Impact on investors' options for global diversification
- Politics and policy
  - "Small yard, high fence": U.S. outbound investment restrictions, sanctions policy
  - U.S. concerns over Chinese capital controls, tech promotion policies, perceived tightening of approvals
  - Regulatory risk and uncertainty

Is decoupling inevitable?

- Countercurrents
  - PCAOB Agreement – encourages U.S. fundraising and improves China auditing
    - Watching and waiting
  - China continuing its mission of financial opening and liberalization
  - Chinese provinces and municipalities eager to attract FDI in midst of slowdown
  - Internal reorganizations to stay in China (Sequoia, Astra Zeneca)
- Opportunities for Hong Kong
  - Common law system, regulatory capacity, and rule of law
  - “One country, two systems” proving its worth to China and foreign firms
  - Competition with Singapore and “double hubbing”
- Politics and decoupling
  - U.S. sentiment toward China increasingly negative
    - Are Chinese people’s views of U.S. more positive? Will that enable policy flexibility
  - Taiwan situation is wild card
  - Are there buffers?

Digital Assets:
Innovation and Regulation

Dawn of digital finance

- Blockchain technology and digital assets
  - New rail for communication and transaction
- Potential benefits
  - Transaction speed, reduced settlement risk
  - Cheaper and more efficient
  - Verification trading, assets
  - Can enable anonymity or identification
- Applications in commerce
  - (e.g., trade finance and supply chain management)

Emergence of digital finance

- Blockchain Applications in Finance
  - Financial institutions: payments, custodianship
  - Advantages: transaction transparency, encryption of identity, speed and certainty
  - “Putting digital assets on legacy systems defeats the point”
  - Need for regulators to ensure investor protection, financial stability
- Digital Assets
  - CBDC
  - Stable coins
  - Crypto assets
  - Tokenized assets (e.g., investment funds, real estate)
- DeFi vs. alternative intermediated trading, distributed vs. permissioned ledger
- Concerns: effects on investors, stability, illicit activity

Regulating digital assets

- Principles for regulating crypto and stablecoins
  - "Same activity, same risk, same regulation" (technology neutrality)
  - Must balance innovation, stability, investor protection
- China as leery
  - Concerns over criminal activity, monetary sovereignty, investor protection
  - Continued interest of Chinese investors in digital assets as opportunity for HK
- U.S. as laggard
  - Political divisions and basic disagreements hamper legislation
  - Divided regulatory system => regulation by enforcement
- Hong Kong as leader
  - Quality regulation supports market development
  - <u>Should</u> HK seek to become leading market for digital?
    - Advantages: tech, capital, regulatory capability, regional connectivity
  - Need for common standards among global first-movers (Japan, EU, Singapore)

CBDCs

- Use-case and rationales
  - Faster, more efficient payments systems
  - Path to multicurrency world?
    - Concerns of weaponization of USD payments system via sanctions
  - Wholesale vs. retail
    - Wholesale: improve efficiency and timeliness of monetary policy, interbank payments,cross-border payments, and reduce international dependence on USD
    - Retail: promote digital financial inclusion, but concerns over privacy, impact on banking system
- Tech innovation and digital financial inclusion – contrasting approaches
  - China: actively moving ahead with CBDC, retail as well as wholesale
  - US: cautious approach to tech, monetary impacts, privacy
- Open questions
  - Monetary policy and disintermediation
  - Safety and soundness
  - Financial stability concerns

UPCOMING EVENTS

Asset Management Roundtable (Washington, DC)
September 26, 2023

Central Bank Digital Currency Roundtable (Washington, DC)
October 17, 2023

Japan-U.S. Symposium (Karuizawa, Japan)
November 16-17, 2023
Japan

To receive an invitation to other PIFS Symposia,
or to recommend your colleagues for participation, please contact:

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