Session Title: What could make China financial markets take off at long last?

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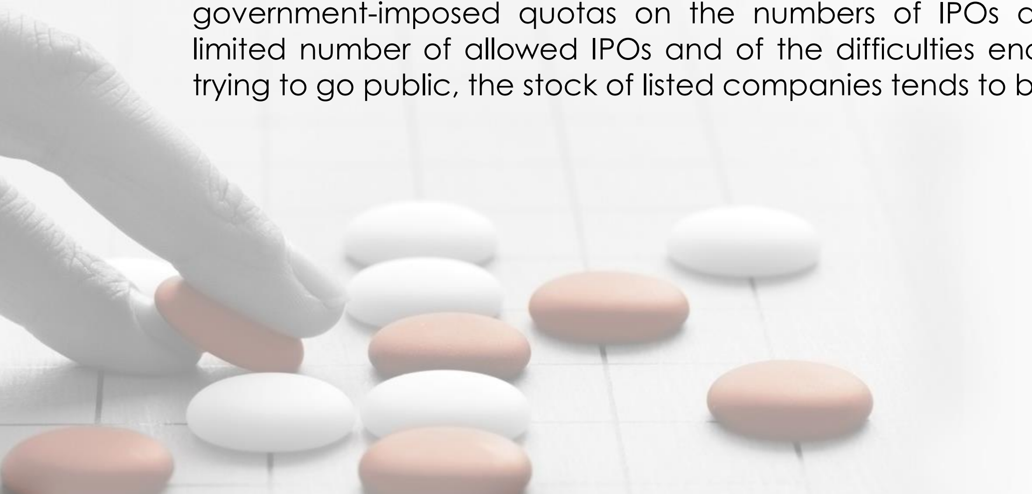
China is committed to opening up its financial markets and to improving its regulatory framework so as to create more transparency, reliability and greater depth. This would enhance China's attractiveness to foreign investors and support the country's economic development.

Victor Chu highlighted that the birth of China's stock market is one of the greatest achievements in the global financial sector. In terms of market capitalization, China ranks 3rd or 4th in the world, and its overall trading volume is larger than big cities' including New York.

The rapidly developing Chinese stock market provides growing opportunities for Chinese companies to receive financing. The stock market has also helped companies improve their corporate structures and increase the transfer of foreign expertise to local business. The Qualified Foreign Institutional Investor (QFII), a program launched in 2002 in China to allow licensed foreign investors to buy and sell Yuan-denominated "A" shares in China's mainland stock exchanges, has been largely successful. The new Renminbi Qualified Foreign Institutional Investor (RQFII) is also set to attract more investors into China's stock market. In the very near future, China will allow international companies to be listed on both of its stock exchanges. The stock market also benefits Chinese consumers since it has taught them about investment. This is especially significant, since China's transition to a market economy is fairly recent.

These changes come with challenges for the Chinese government. There are government-imposed quotas on the numbers of IPOs annually. Because of the limited number of allowed IPOs and of the difficulties encountered by companies trying to go public, the stock of listed companies tends to be overvalued.



In addition, the government is both a regulator and a majority shareholder in the Chinese financial markets. There may be conflicts of interests, which may be a threat to policy transparency. This institutional problem makes it very difficult to enhance the efficiency of China's financial markets, and reforms are likely to take a long time.

Moreover, the cost of short selling in China is very high, at around 8 or 9%, which is many times higher than that of Western financial markets. This places many restrictions on investors to short sell when the market outlook is favorable to do so.

Furthermore, the practice of shadow banking in China is an issue: creditors take on bank loans at very low interest rates, and then lend the money at higher rates. These high interest rates make it very difficult for struggling small and medium enterprises (SMEs) to obtain financing.

In the past, companies that were public were not entirely chosen by the market, but according to a quota. Each province required 10 companies to be listed. As a result, some of the companies that are currently listed were not selected according to purely economic and financial criteria.

What could Beijing do to make its capital markets more attractive to foreign investors? The government should not influence the price of stocks, but set up rules to allow the market to allocate resources efficiently. Firstly, it should ease the IPO process to allow companies to go public easily as long as they follow the rules. Conversely, delisting of companies should also be easier. The government should also come up with a proper short selling mechanism to prevent valuation from becoming too high.

Furthermore, the government should act fast for the market to become more mature and to increase the efficiency of asset allocation. Market conditions may vary and become unfavorable, which may lead the government to impose even more controls, thereby creating a vicious cycle. As much as possible, China should minimize government intervention in the markets.

A way to do this would be to encourage the cross listing of Hong Kong and Singapore shares with Chinese-listed shares. This is easy to implement, and carries benefits such as greater liquidity and trading volume, and creates more choices for the Chinese government. Beneficiaries include the government, the markets, and the investors: investors have access to a wider pool of better quality companies, and companies have access to more liquidity. These cross-listings would have positive spillover effects in the region.

Chew Sutat acknowledged the upsides of cross listing, but he stressed that its success is largely dependent on establishing trust and credibility in the financial sector. Market discipline and transparency are of high importance because the market cannot be truly successful if investors do not trust companies and regulators. For example, a trustworthy private sector needs to be established in order to attract private investors, which will in turn provide enough capital for the financial market. Also, the Chinese government's own lack of confidence in financial institutions may cause the former to make undue market interventions, which cause inefficiencies. In particular, it may hinder the success of cross listing. In addition, further internationalization of the Renminbi will be key to attract more investors.

Because of the vested interests of various interest groups, the implementation of the changes will be challenging. For example, Chen Long noted that the government may face strong resistance when it imposes regulations to delist companies. In addition, a lack of fundamental and systematic understanding of the financial sector may interfere with the proper implementation of measures.