CHAPTER 5

Financial integration

KEY MESSAGES

China is at a critical point of its economic transition, committed to continued financial reform and capital account liberalisation while simultaneously managing associated domestic and external challenges. Financial reform, capital account liberalisation and internationalisation of the RMB are interdependent reform processes that are occurring simultaneously. Capital account opening must be sequenced carefully with reforms to strengthen the financial system, maintain macro-financial stability and allow for exchange rate flexibility. Chinese capital and finance are already major forces in international capital markets, creating new opportunities for investment around the globe. The ongoing opening of the Chinese capital account represents a watershed in the financial development of the Asia Pacific economy. Managing this change will require prudent, well-informed and strategic policymaking in China and in each of the region's economies.

If the governments and private sectors of Australia and China position themselves strategically, these reforms offer a once-in-a-generation opportunity to deepen their relationship in financial services and financial flows. Australia has the unprecedented opportunity to export financial services into large and growing Chinese markets, and import increased volumes of Chinese capital to finance investment. China has the opportunity to use Australia as a testing ground as it deepens its financial reforms and opens its economy, gaining access to one of the most developed financial systems in the region and increasing its return on capital. The Australian and Chinese governments should engage with the business sectors of both countries while developing a formal program on financial services, development and reform. It would complement the Strategic Economic Dialogue and engage ministers, officials, regulators and firms in a work program to deepen bilateral financial integration that would be focused on:

- Piloting the select release of regulatory and licensing restrictions on Australian firms in China as a phase-in for regional liberalisation, through expanding the financial services components of ChAFTA.
- Developing a regular dialogue and a mutual recognition framework between financial regulators, and further supporting the development of RMB-denominated assets and securities listings in Australia.
- Reviewing regulatory barriers, including around taxation and the impact of macroprudential regulations and taxation policy to ensure that Australian and Chinese entities are better able to engage with one another in the region.
- Promoting the bilateral and regional opportunities arising from financial technology (FinTech).
- Research between Australian and Chinese institutions on financial services trade and cross-border investment.
- A stronger focus on building financial infrastructure into regional initiatives that seek to improve connectivity — such as One Belt, One Road (OBOR), the Asian Infrastructure Investment Bank (AIIB) and the Asian Development Bank (ADB) including payment systems, credit information, collateral registries and financial institutions, and ensuring China signs on to, and Australia implements, APEC's Asia Region Funds Passport and both countries advocate its use in the region.

China is now at a critical point of its economic transition. It is committed to deepening economic and financial reform in a challenging domestic and external environment. Economic growth has slowed as a result of both cyclical and structural factors. The global economy is experiencing a prolonged period of below-trend growth after the global financial crisis, which is impacting adversely on external demand and creating macroeconomic conditions that make China's reform agenda more challenging but even more essential. Against this background, the Chinese government is aiming to advance reforms while maintaining a stable macroeconomic environment.

The 13th Five Year Plan states that China's financial system reform aims to complete the establishment of financial institutions and market mechanisms, to promote the healthy development of capital markets, to establish monetary policy transmission mechanisms, to deepen reforms of the financial regulation framework, to raise the efficiency of financial services in serving the real sectors, and to effectively mitigate financial risks.

These reforms — however completely they are implemented — will profoundly shape the future of the Australia–China economic relationship. They will have implications across economic, political and social dimensions. But if the governments and private sectors in Australia and China position themselves strategically, these reforms offer a once-in-a-generation opportunity to deepen the relationship in financial services, financial flows and two-way investment which, at present, is nascent compared to the relationship in merchandise trade. In 2015, China accounted for 31.8 per cent of Australia's merchandise exports but just 11.1 per cent of Australia's financial services exports (ABS 2015a).

The earlier reform challenge of fully integrating Chinese commodities markets into international commodities markets, accomplished after China's entry into the WTO in 2001, took the time and determined leadership of former premier Zhu Rongji and former assistant minister and director-general of the International Relations Department of the Ministry of Foreign Economic Relations and Trade, Long Yongtu. Opening China's financial system is similarly an ambition that will not be achieved quickly. It will require political commitment at the highest levels.

Financial services are the largest single component of the Australian economy. With A$6.4 trillion in assets, the fourth-largest superannuation system in the world, a robust regulatory framework, the fourth most-traded currency in the world, some of the largest banks in the world by market capitalisation, and one of the least restrictive financial industries in the region, Australia has a clear comparative advantage in exporting financial services into the region (Auster and Foo 2015). Investing in deeper links and greater engagement with growing Chinese markets offers an immense opportunity to the Australian financial services industry.

As the world's largest saver, China will play a major role in shaping the global financial system into the future as its international investment position deepens and it allocates its savings globally. The role of Chinese capital in the global economy is poised to grow substantially. Based on the historical experience of other countries, China will become one of the world's largest cross-border investors by the end of this decade, with offshore assets tripling by 2020 (Hanemann and Huotari 2016). In the same way China's trade surplus has shaped the global trading system in the past few decades, China's outbound capital will profoundly shape the global financial system over the coming decades.

For China, Australia can help provide the financial products and services in banking, insurance, pension services and wealth management that will be increasingly demanded by the Chinese people as China's reforms deepen. More importantly, Australia offers China the opportunity of a testing ground for reforms that will support its continued opening and financial integration, both regionally and globally. Australia's sophisticated, globally competitive and well-regulated financial markets can act as an effective stepping-stone for China's continued opening to the region. Australia can support China across many of the reforms it is undertaking, including expanding access to insurance, liberalising interest rates, continuing the internationalisation of the renminbi (RMB), raising the proportion of direct financial intermediation, promoting inclusive finance and helping strengthen financial and prudential regulations and the institutions that underpin them.

But building this relationship will not happen on its own. It is an ambition that will not be achieved quickly and will be much more challenging than was the case in building the relationship in merchandise trade. Australian and Chinese governments and private sectors need to strategically position themselves and build the policy infrastructure necessary to foster this relationship.

There are a number of measures through which this positioning can be achieved. The Australian and Chinese governments should develop a program of formal engagement on financial services reform. It would complement the Strategic Economic Dialogue (SED) and engage ministers, officials, regulators and firms in a work program to deepen bilateral financial integration.

There are also opportunities for partnership in regional financial cooperation. This includes building a bilateral focus on financial infrastructure in regional initiatives such as OBOR and the AIIB, to improve payment systems, credit information bureaus, collateral registries and financial intermediaries and institutions throughout the Asia Pacific. China should also sign onto, and Australia should implement, APEC's Asia Region Funds Passport. Both countries should advocate its greater use in the region.

These reforms also involve risks that need to be managed. The most significant risk is associated with the sequencing of the reforms. There is a danger of precipitously removing restrictions on capital account transactions before the domestic financial system is able to manage the ebbs and flows of foreign capital. Capital account opening must be carefully sequenced with reforms to strengthen the financial system, safeguard macro-financial stability and make the exchange rate more flexible (IMF 2015b). Deepening financial markets and increasing capital flows can also carry risks for the region. These reforms will change the nature of regional financial linkages, as trade liberalisation did two decades ago, with implications not just for finance but also for the flows of trade, capital and people. Finally, there is a risk that slowing growth reduces the momentum for reform, which could then slow growth further and create even greater uncertainty and volatility.

Financial integration is the vital next step in strengthening the relationship between Australia and China. It continues a strong tradition in the Australia–China relationship, exemplified in the history of the relationship (see Chapters 1 and 6). Given the already close economic and trade linkages between Australia and China, Australia has a special role to play in the progressing of reform and financial deepening in China.

Integration to date: Australia, China and the region

Australia and China are highly integrated in two-way merchandise trade, but much less so in financial services and cross-border financial flows. In 2015, China accounted for almost 35 per cent of Australia's merchandise exports, but just 11.1 per cent of Australia's financial services exports (ABS 2015b).

Australia has a services-based economy, with the services sector accounting for around 82 per cent of the economy's real gross value added (GVA) and more than 85 per cent of employment (Auster and Foo 2015). Financial services play a particularly strong role. The financial services industry is the largest single industrial segment in the Australian economy on a GVA basis, generating A$146.4 billion or 8.8 per cent of total output as at March 2016 — slightly more than the mining industry at 8.8 per cent (ABS 2016e).

Despite its low base, China's share of Australia's financial services exports is growing rapidly. For example, exports of insurance and pension services from Australia to China increased from A$5 million in 2000 to A$49 million in 2014 (down from a peak of A$53 million in 2013), and now make up 9.1 per cent of all exports in that category compared to 0.6 per cent in 2000 (ABS 2015b).

Greater financial integration between Australia and China has been facilitated by a combination of official and private-sector engagement. Direct trading between the RMB and the Australian dollar was facilitated by a bilateral agreement signed by the Australian prime minister and the Chinese president in April 2013 in Shanghai. The practical impact of this was to reduce the costs of currency conversion by removing intermediary currencies. This agreement saw an increase in trading between the two currencies in the onshore spot market from US$324 million in March 2013 to over US$3.1 billion in May the same year (Finsia 2014). However, this trade has come back since then.

The use of the RMB for cross-border trade and investment transactions has increased noticeably over recent years and the market for the RMB in a number of jurisdictions outside of mainland China — known as 'offshore centres' — has developed further. This trend is also evident in Australia (Hatzvi et al 2014). The use of RMB by Australian entities has increased, although there remains much scope for further growth. A number of policy initiatives have been recently agreed between the Chinese and Australian authorities designed to allow the local RMB market to develop. These include the establishment of an official RMB clearing bank in Australia and a quota that allows Australian-based entities to invest in mainland China's financial markets as part of the RMB Qualified Foreign Institutional Investor (RQFII) program discussed further below (Hatzvi et al 2014).

Having an official RMB clearing hub means that there will be improved efficiency in processing RMB payments and conversions, there will be better liquidity in the market and, most importantly, this will increase confidence for Australian corporates in dealing with familiar local institutions. Similarly, in 2014, the Australian Securities Exchange (ASX) launched an RMB settlement service, enabling Australian companies to take or make payments in Chinese currency in near real-time, reducing the risk and the cost of doing business with China. These will be crucial steps in driving increased integration between Australia and China.

These developments build on existing initiatives, including the local currency swap agreement between the Reserve Bank of Australia (RBA) and the People's Bank of China (PBoC) signed in 2012 and renewed in 2015, and the RBA's investment of a portion of its foreign currency reserves in RMB-denominated assets. There has also been ongoing engagement on RMB internationalisation between Australian officials (including from the RBA and the Treasury) and the private sector through forums such as the Australia–Hong Kong RMB Trade and Investment Dialogue and the new 'Sydney for RMB Committee', a private sector led initiative (see Hatzvi et al 2014).

These policies and related private-sector initiatives have positioned Australia to take advantage of emerging RMB business opportunities. Sydney, as the main financial centre in Australia, has emerged as a fast, safe and reliable hub for RMB cash and securities settlement in the Asia Pacific region. But despite these initiatives, the Australian uptake for RMB settlement by importers and exporters remains low. The RBA has identified several reasons for this, including shortcomings in the availability of instruments allowing hedging in RMB, unfamiliarity around the RMB trade settlement process and administrative difficulties and concerns regarding payment delays and rejections (Weir and Walsh 2014). A more recent survey of Chinese firms found that awareness and use of RMB for trade settlement remains low, although the number of those using RMB trade settlement that reported payment difficulties had fallen significantly (Weir and Walsh 2015).

Financial integration in the Asia Pacific

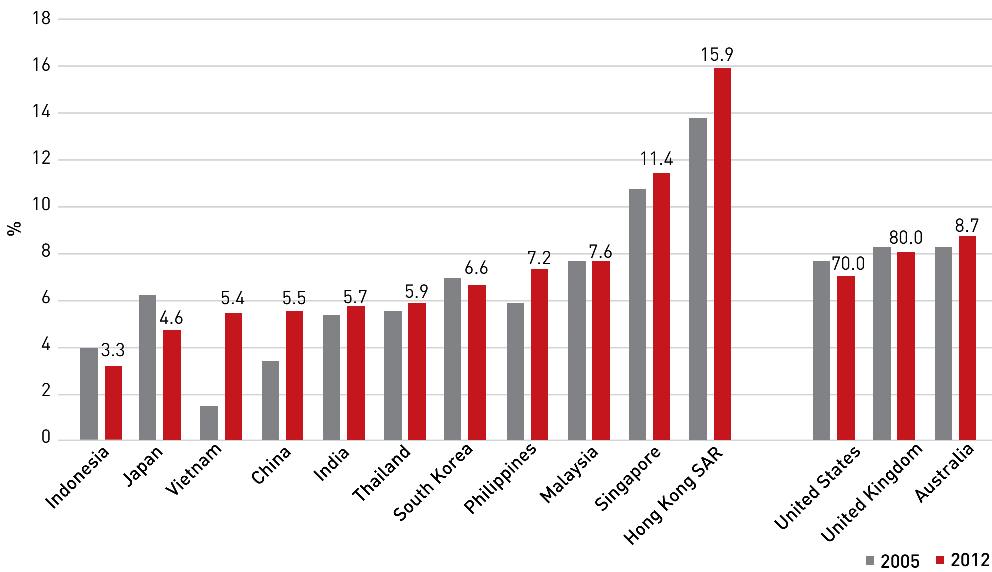
The financial integration of Australia and China needs to be considered in the context of a changing financial landscape across the Asia Pacific. Decades of strong economic growth have generated greater household wealth and increasing cross-border financial flows, leading to significant growth in demand for financial services and products. Bank balance sheets are expanding, household wealth is increasing, ageing populations are demanding more sophisticated services and products, and technology is enabling greater ease of transactions across national borders. All of these trends will impact Australia and China.

Financial integration in the Asia Pacific region is deepening, compared with the advanced economies where financial integration has backtracked since the global financial crisis. While cross-border capital flows as a share of GDP have fallen globally, in Asia the magnitude of cross-border flows is growing faster than GDP, and in many cases external assets and liabilities now exceed GDP (Auster and Foo 2015). The increasing size and sophistication of the financial services sector throughout the Asia Pacific has enabled rising cross-border flows. Cross-border flows in the region are strongest in the areas of bank lending and foreign direct investment, while portfolio investment tends to lag (Auster and Foo 2015).

The financial services industry in Australia employs 450,000 people and is the biggest net contributor to corporate income tax. Australia's financial system has proved to be sound, resilient and well managed. In the aftermath of the global financial crisis and the Asian financial crisis, both the Australian economy and the financial system outperformed most of their peers (Auster and Foo 2015). Australia's financial services industry has significant depth, with assets of around A$6.4 trillion — over four times Australia's nominal GDP (Austrade 2015). Australia's A$2.0 trillion superannuation system is the fourth-largest in the world. This pool of assets is expected to grow to A$7.6 trillion over the next two decades, largely due to the legislated superannuation scheme (Auster and Foo 2015).

Figure 5.1 shows the gross value added of the financial services industry across the region in 2012. It ranges from about 3.3 per cent of economic output in Indonesia to almost 16 per cent in Hong Kong. This graph also highlights the significant differences between Australia and China. For Australia, gross value added is around 8.7 per cent while it is only 5.5 per cent in China. But, unlike Australia, the growth of financial services in China has been substantial, more than doubling from 2005 to 2012 and reaching 8.5 per cent in 2015 (NBS 2016).

Figure 5.1: Gross value added by the financial services industry as a percentage of total output

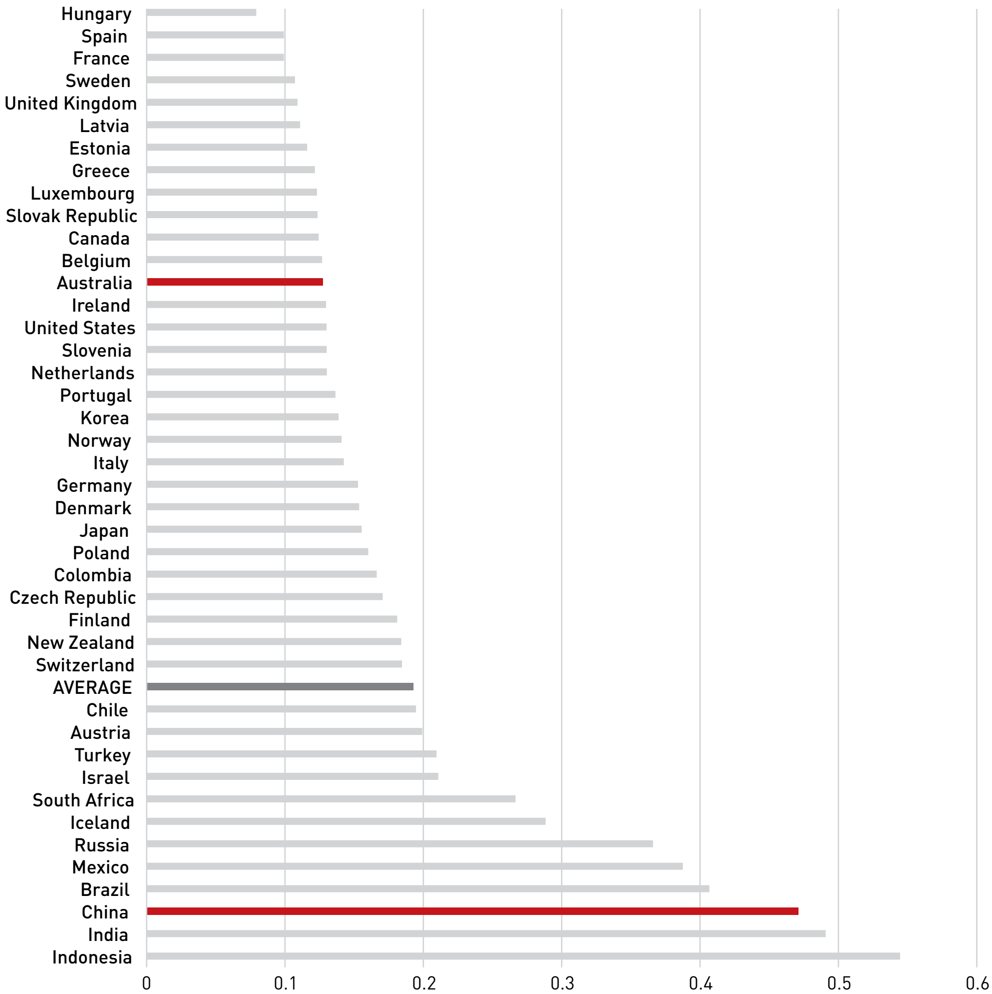


Source: Auster and Foo 2015, using data from Aggregates and Detailed Tables 2013; United States Bureau of Economic Analysis; and United Nations Department of Economic and Social Affairs. Figures for India are at 2005 and 2011 because of a lack of 2012 data.

Despite a high rate of growth, there is still a degree of financial system underdevelopment across the Asia Pacific. Assets under management in the region are only 15 per cent of the global total, and China is only the fifth-largest holder of assets under management in the region, well below its relative GDP share. These underdeveloped financial systems are inefficient in channelling credit to firms and households, and may both inhibit economic growth and reduce the economy's ability to adjust to external shocks.

In addition, the Asia Pacific region remains fairly restrictive in relation to many aspects of cross-border trade in financial services and financial flows. The OECD produces a series of 'trade restrictiveness' indices for services that measure the relative openness of economies by attempting to quantify the effect of relevant laws and regulations.

Figure 5.2: OECD services trade restrictiveness index for commercial banking, 2015



Source: OECD 2015.

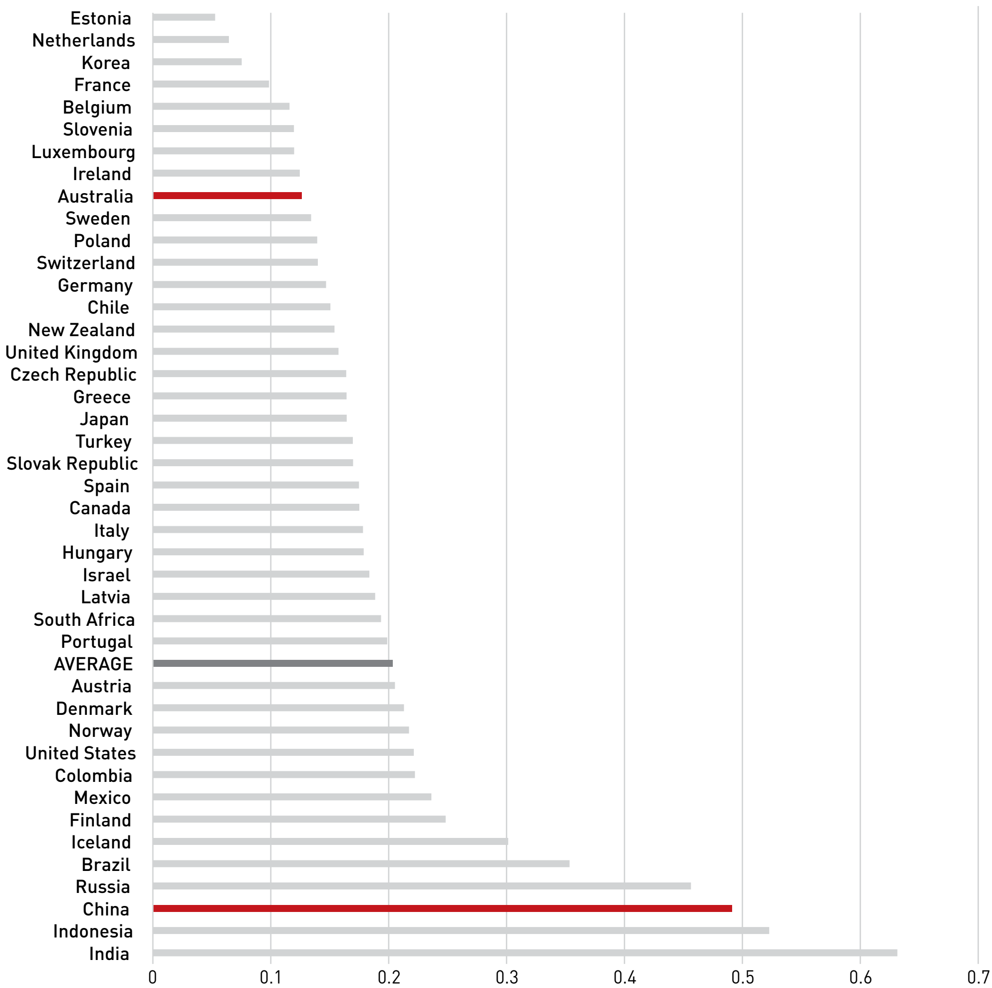
In the area of trade in financial services, the OECD evaluates commercial banking (Figure 5.2) and insurance (Figure 5.3). These show Asia has among the most restrictive practices in both commercial banking and insurance, with China, Indonesia and India being the most restrictive. Australia sits well below (less restrictive) the OECD average in both indices, with the largest contribution to restrictiveness coming from Australia's restrictions on foreign ownership and other market entry conditions.

Developments in China's reform agenda and implications for the relationship

The processes of financial reform, capital account liberalisation and the continued internationalisation of the RMB will fundamentally transform the Chinese financial system in the coming years, with the potential to bring significant benefits to the Chinese people.

The 13th Five Year Plan has a special focus on financial reform. This includes accelerating the pace of financial system reform, completing the establishment of financial institutions and market mechanisms, deepening reforms of financial regulation frameworks, raising the efficiency of the financial sector in serving the real economy, further developing capital markets to lower the financing costs of medium, small and micro enterprises, and effectively mitigating financial risks.

Figure 5.3: OECD services trade restrictiveness index for insurance, 2015



Source: OECD 2015.

The banking market in China is large and dominant, accounting for most financial intermediation in the financial system. Pension and wealth services are a nascent industry and insurance is only beginning to penetrate the Chinese market. Further progress will allow the financial services sector to properly intermediate funds between households and firms, and across the economy. Over time, this will support domestic interest rate liberalisation that will, in turn, improve the efficiency of capital allocation, enable transparent pricing, allow for smoother savings–consumption patterns and enable improved risk mitigation strategies. All of these are necessary developments for China to continue its economic rebalancing, and to move from a middle-income to a high-income economy.

China's domestic markets are already large by global standards. Even without an open capital account, China already accounts for 6 per cent of global cross-border financial transactions (Finsia 2014). China's domestic bank credit stock is larger than any other in the region, including Japan's (Auster and Foo 2015). Its equity and fixed income markets are now among the largest in the world, although they play a relatively smaller role in the operation of the economy. China's equity market has grown substantially to a peak valuation of over US$10 trillion. While recent volatility has significantly reduced stock market values, these reductions need to be considered in the context of long run growth in China's equity markets. From June 2014 to June 2015, the Shanghai Composite Index increased by 154 per cent. But this increase was unsustainable and not based on fundamentals. Despite recent volatility that saw a 45 per cent reduction in the index from June 2015 to the end of May 2016, the index is nevertheless 40 per cent higher than it was in June 2014 (Bloomberg 2016a).

Through initial public offering (IPO) listings activity was suspended from July to November 2015, China's exchanges nonetheless led the world in terms of IPOs in 2015. There were 89 IPOs valued at US$17.6 billion in 2015 in Shanghai alone — an increase of 107 per cent on the previous year. Mainland exchanges reopened in November 2015 to a pipeline of 690 companies ready to go public (EY 2015). However this, in part, reflects a distortion in China's financial markets, as IPOs require an approach to the China Securities Regulatory Commission (CSRC), which can cause a backlog.

China's fund management and insurance sectors have also grown substantially. The fund management industry first emerged in the early 1990s and has experienced tremendous advances in scale and sophistication. By the end of 1998, there were fewer than 10 fund management companies managing less than RMB500 billion. By May 2014, there were 91 fund management companies, with 48 foreign joint ventures and 43 domestic Chinese companies managing total assets of RMB5.13 trillion. RMB3.73 trillion was managed by mutual funds and RMB1.04 trillion by private funds (Austrade 2014).

The Chinese insurance industry's total assets were RMB8.3 trillion in 2013, while net assets were RMB847.5 billion (Austrade 2014). The launch of the Shanghai–Hong Kong Stock Connect program (Stock Connect) in November 2014 and the announcement of mutual recognition of funds (MRF) between mainland China and Hong Kong on 22 May 2015 marked significant developments in a series of moves which relax China's tight control of cross-border capital flows (King and Wood Mallesons 2015).

Launched in November 2014, Stock Connect is a joint initiative of the CSRC and Hong Kong's Securities and Futures Commission. It allows mutual stock market access between the Shanghai Stock Exchange and the Hong Kong Stock Exchange. Stock Connect is now complemented by a similar link for mutual funds. The organisations signed a Memorandum of Regulatory Cooperation concerning Mutual Recognition of Funds between the Mainland and Hong Kong in 2015, which allows retail public funds initially offered in the Mainland or Hong Kong to be sold to retail investors across the border (King and Wood Mallesons 2015).

China also has a burgeoning FinTech sector (an area also referred to as 'internet finance') that now supports a number of large firms supplying financial services and products. Companies such as AliPay and WeChat demonstrate the rising demand for sophisticated financial products and services in China.

China's reform agenda

Financial reform is at the centre of the new reform agenda. This includes developing efficient credit markets to better intermediate savings to productive investment at the lowest possible cost, improving the financial system's ability and efficiency in allocating risk, and ensuring appropriate regulatory and institutional settings are in place to sustain macro-financial stability.

A related but separate aspect of financial reform is financial integration. This means increasing China's integration with regional and global markets so that savings, investment and risk can be mediated globally, expanding the frontiers of production, investment and consumption. For China, financial integration will be achieved through two related processes: increased trade in financial services with overseas trading partners, and opening of the capital account to allow for increased cross-border investment.

China maintains a restrictive posture in relation to trade in financial services (Auster and Foo 2015). Unlike trade in goods, the restrictiveness of trade in financial services cannot be measured through tariffs. A primary mode of delivery for trade in financial products and services is the provision of these services through the branches or subsidiaries of foreign firms operating in the country. Restrictions on the opening or the operations of branches or subsidiaries represent a significant behind-the-border restriction to trade in financial services. The restrictions may limit a foreign firm's ability to generate a profit in the country, or may make the cost of operating in that country more expensive than would otherwise be the case. Examples of such restrictions include: limitations on the number or size of branches or subsidiaries of foreign companies; limited licenses to offer products or services in-country; requirements to hire a certain number of domestic staff per office or to set up a minimum number of offices in order to receive regulatory approvals; requirements to contribute a minimum amount of capital in the country; or limitations on the profits that can be remitted from the branch or subsidiary back to the home country. These types of restrictions are typical of what has been in place in China during the last three decades of reform.

Capital account liberalisation — that is, easing restrictions on capital flows across a country's borders — will be key to China accessing foreign markets, increasing returns on its savings, and using foreign financing to build its capital stock and grow the economy into the future. The internationalisation of the RMB is part of the opening of China's capital account, and will enable the interest rate and exchange rate flexibility that will help the economy to manage any shocks arising from sudden shifts in capital flows. To date, there has been an increasing openness to some types of cross-border investment in China, with flows of both foreign direct investment and bank lending rising significantly over the past two decades (Roberts et al 2016). In contrast, cross-border portfolio investment remains highly restricted and a binding constraint in the capital account. RMB liberalisation and its increasing use offshore does not guarantee capital account opening — it is connected, but not synonymous. RMB internationalisation is both a catalyst and an outcome of a liberalised capital account, and is key to China's future capacity for sustainable growth and ability to play a larger role in the global economy.

Financial reform, capital account liberalisation and internationalisation of the RMB are interdependent reform processes that must be sequenced carefully. In particular, capital account opening has to be sequenced carefully with reforms to strengthen the financial system, maintain macro-financial stability and allow for exchange rate flexibility. The most important difficulty in the sequencing of capital market liberalisation is the danger of precipitously removing restrictions on capital account transactions before the domestic financial system is able to manage volatility in the exchange rate and cross-border capital flows.

Financial reform in China

China has quickened the pace of domestic financial market deregulation, after periods in which the accelerating development of domestic financial infrastructure and rising banking sector fragility in the mid-1990s and early 2000s led to more gradualism in reform during the late 2000s. China's financial reforms have been part of the gradual and closely managed transition from a centrally controlled economy towards a market-based economy. The rapid expansion of domestic financial infrastructure in the 1980s and 1990s resulted from the substantial growth in the agricultural sector and the emergence of small- and medium-sized enterprises after the initiation of the reform and opening policy in 1978.

China has made substantial progress on interest rate deregulation. It has moved from a situation where both deposit rates and lending rates were centrally controlled, to one where deposit rate ceilings and lending rate floors are now being removed from official control. China has partially shifted away from a reliance on published benchmark interest rates. Over the reform period, the Chinese government has cautiously proceeded with increasing the flexibility of retail interest rates around benchmark rates through pilot programs and experiments, with the objective of protecting the profitability of enterprises.

Interest rate liberalisation also has important implications for making the transmission mechanism of monetary policy more effective. China is in the middle of transforming its monetary policy framework from one based on a quantity rule to one based on a price rule. The old quantity rule based system, which relied on direct control of credit and lending through state-owned banks, and interfered with the market allocating scarce capital to its most productive use, has become increasingly ineffective. The new price rule based system is now being put in place, although the PBoC is yet to indicate which interest rate it will target or what the timing of the change will be.

These reforms will also require a significant strengthening of Chinese institutions to ensure that regulatory and institutional settings are properly calibrated to sustain macro-financial stability. Among the problems in this area are:

- ensuring adequate accounting, auditing and disclosure practices in the financial and corporate sectors that strengthen market discipline within a robust corporate governance framework;
- avoiding implicit government guarantees that lead to the misallocation of capital; and
- ensuring adequate prudential supervision and regulation of domestic financial institutions and markets, which may help defeat corruption, connected lending and gambling for redemption (the pursuit of high-return but low-probability investments by institutions with low or negative net worth) (Eichengreen and Mussa 1998).

Of course, these reforms are not just narrow technical challenges. They will require a much more open and transparent set of institutional arrangements that push at the envelope of political reform. These challenges are embedded deep in China's political economy. They have a political dimension that will cut deeply into the close relationship between SOEs and the state. The political economy implications of reform should not be underestimated.

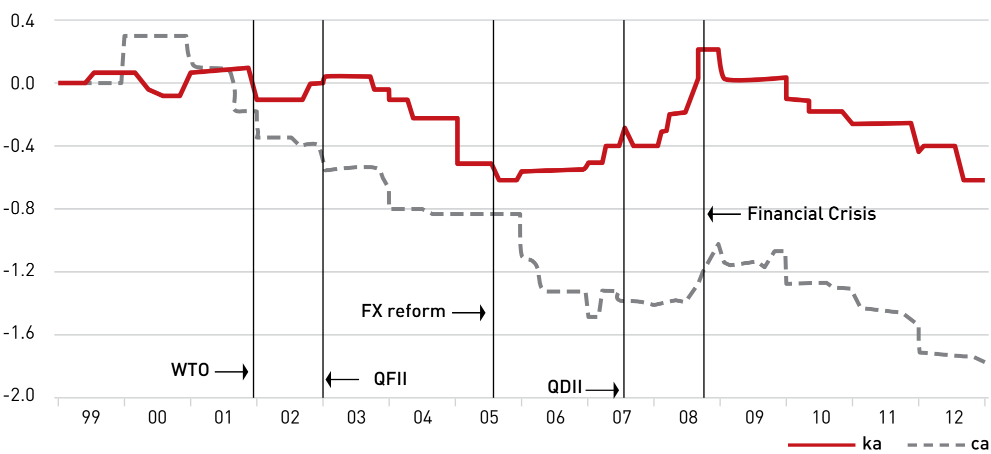
The success of China's domestic financial reforms will be particularly important for Australia. When completed, they will enhance regional stability and the depth of regional markets by laying the groundwork for a liberalised capital account and an internationalised RMB. Importantly, the reforms also provide significant opportunities to Australian financial firms in supplying financial services and products into Chinese markets. Australia, as a leading regional financial hub, has the potential to benefit significantly from this. Australia also has significant experience in financial liberalisation, which, through stronger engagement of ministers, officials and financial firms, could be an asset to China.

Capital account liberalisation in China

China's capital account has undergone significant liberalisation since the 1990s, with the exception of portfolio investment, which is still under strict control, although significant progress has been made through investment schemes such as RQFII and RQDII (Ballantyne et al 2014). Figure 5.4 shows the reduction in the index of controls on the capital account and current account from 1999 to 2013. In 1996, the current account achieved full convertibility, while the capital account remained largely controlled by the government. Capital account liberalisation was slowed by banking sector fragility that emerged in the wake of the Asian financial crisis of the late 1990s. Only recently has this process resumed.

Capital account liberalisation will provide significant opportunities for China. It is likely to result in a higher degree of financial integration with the global economy through rising volumes of capital inflows and outflows. Greater offshore integration complements interest rate liberalisation and ensures a more efficient allocation of capital across markets, diversification of risk and inter-temporal trade. The exchange rate liberalisation that accompanies the opening of the capital account also allows for a smoother path of adjustment for exogenous shocks.

Figure 5.4: Index of controls on China's capital account (ka) and current account (ca) over recent years



Source: Chen and Qian 2015.

For Australia, the incremental liberalisation of the Chinese capital account will increase China's role in international commerce and finance, including the prevalence of the RMB as a global currency. It will potentially have important implications in rebalancing the global economy in the future as demand for goods and services increases in China relative to advanced deficit economies. Over time, the integration of China's financial system into the global market via an open capital account will also fundamentally change the regional financial landscape and the nature of financial market linkages in the Asia Pacific.

As one of the region's key financial centres, and as a net importer of capital, Australia stands to benefit from increased flows of capital at potentially lower cost. This, in turn, helps fund investment, build the Australian capital stock and grow the economy. The big four banks in China have already increased their presence in Australia, which will help facilitate this increased flow of capital (Box 5.1). Liberalisation can, however, cause fluctuations in asset prices and international trade flows. In the short to medium term, capital flows may become more volatile in the region as China's capital account is further liberalised, and capital movements into and out of China could affect Australia.

There is a lot of uncertainty as to what the size and direction of capital flows would initially be if China were to liberalise further. Recent research by the Hong Kong Monetary Authority (HKMA) and the IMF on the likely implications of full capital account liberalisation in China generally suggest that gross portfolio outflows are likely to be substantial, although these papers disagree on the net impact. The rise in regional capital flows will also test Australia's capacity to absorb these flows, although Australia's floating exchange rate and strong institutional settings suggest that it is well placed to do so.

In February 2016, the PBoC took an important step in liberalising China's capital account by opening its interbank bond market to foreign investors (PBoC 2016). This builds on the development of the onshore ('panda') and offshore ('dim sum') primary issuances. The interbank bond market accounts for the bulk of China's fixed income market. Previously, foreign investors wanting to access China's domestic bond market had to use the QFII discussed above or similar programs, which placed a number of restrictions on investors (PBoC 2016). The PBoC has stated that access to the market will be restricted to medium and long term investors. AllianceBernstein estimate that this reform will cause an inflow of around US$3 trillion into China's bond market (Grigg and Murray 2016). The Chinese government has valued its total bond market at around US$10.4 trillion in size, but analysts project that this will increase significantly in coming years as the Chinese government runs larger deficits (Grigg and Murray 2016). However, as with any economy, a rise in China's debt-to-GDP ratio also carries with it certain risks that investors will need to assess carefully in deciding their level of exposure. As outlined recently by the IMF, bad loans have since been piling up on banks' books. The overall debt-to-GDP ratio in China is estimated to be 237 per cent, while the IMF estimates corporate debt-to-GDP at 145 per cent and raises concerns about Chinese financial fragility (Donnan and Mitchell 2016).

These bond market reforms should benefit the Chinese economy in a number of ways. Increased demand for the existing stock of bonds would reduce bond yields, all else being equal. This would reduce the fiscal burden of these debt instruments on the Chinese government and reduce the cost of funding across the economy. To the extent that increased flows also contribute to improved market liquidity, offshore participation may also improve market functioning and enable the fixed income market to represent a channel of transmission for monetary policy. This highlights the important stabilisation role that capital flows can play in international currency markets (McKibbin et al 1999).

BOX 5.1: CHINA'S 'BIG FOUR' BANKS IN AUSTRALIA

Although Chinese banking has a relatively long history in Australia, the number of Chinese banks, branches and the services they provide have increased significantly over the last 10 years. These banks have played a key role across a number of financial markets and have helped finance many substantial projects in Australia.

Industrial and Commercial Bank of China (ICBC) is the world's largest bank by market capitalisation. It opened a branch in Sydney in 2008 and was approved by the Australian Prudential and Regulation Authority (APRA) as a foreign authorised deposit taking institution. The successful establishment of the Sydney branch was regarded as a significant breakthrough in the bank's progress towards greater internationalisation, improving its international management standards and providing a comprehensive range of banking services to the Australian and New Zealand markets, which ICBC identifies as one of the most prosperous regions in the Southern hemisphere (ICBC 2016). ICBC has since expanded its network to Perth, Melbourne and Brisbane, offering banking services in trade finance, project finance, syndicated loans, corporate loans, deposits, foreign exchange, derivatives, remittances, settlement and clearing services. A third of its Sydney branch's corporate clients include Australian companies such as Westfield and Qantas, and it has provided capital for the State of Victoria's desalination plant, the Royal Adelaide Hospital renovation, and coal loaders in Newcastle and near Gladstone in Queensland (Industry NSW 2015).

Bank of China first established operations in Sydney in 1942 and now has nine branches in Australia, the most of any Chinese bank — five in Sydney, two in Melbourne, one in Perth and one in Brisbane. The financial services offered by Bank of China focus on trade finance, express remittance, local and foreign currency deposits, residential mortgages, commercial, construction and syndicated loans, overdraft facilities, foreign exchange margin trading and Australian dollar clearing and settlement services (Bank of China 2016). The *Australian Financial Review* recently noted the important role that Bank of China and other Chinese-owned banks are playing in filling the gaps left in the area of foreign lending by the big four Australian banks (Tan 2016).

China Construction Bank (CCB) is the second-largest bank in the world by market capitalisation. CCB opened a representative office in Sydney in 2007 and in August 2010, APRA approved CCB as a foreign authorised deposit taking institution, authorising it to carry on banking business in Australia. CCB's Sydney Branch is CCB's first branch in Australasia. It conducts wholesale banking business in Australia, including corporate lending and deposit, international settlement, trade finance and Australian dollar clearing and settlement services. CCB has noted that 'the establishment of CCB Sydney Branch will enable CCB to expand its global network and enhance customer service capability to facilitate the economic and trade cooperation between Australia and China' (CCB 2016).

The Agricultural Bank of China (ABC) was China's first commercial bank. It has the largest network of branches in China and the largest customer base, with 350 million customers and assets of US$2 trillion (Industry NSW 2015). The ABC Sydney Branch obtained the authority to carry on banking business from APRA in March 2014. It consists of seven departments including corporate banking, treasury, trade finance, operations, risk management and compliance, finance and accounting, and administration. ABC provides its clients with banking products including corporate lending, trade finance, multi-currency settlements, remittances and other services. The Sydney Branch conducts business activities with multinational enterprises, Chinese inbound investors in Australia, Australian companies and other financial institutions (ABC 2016).

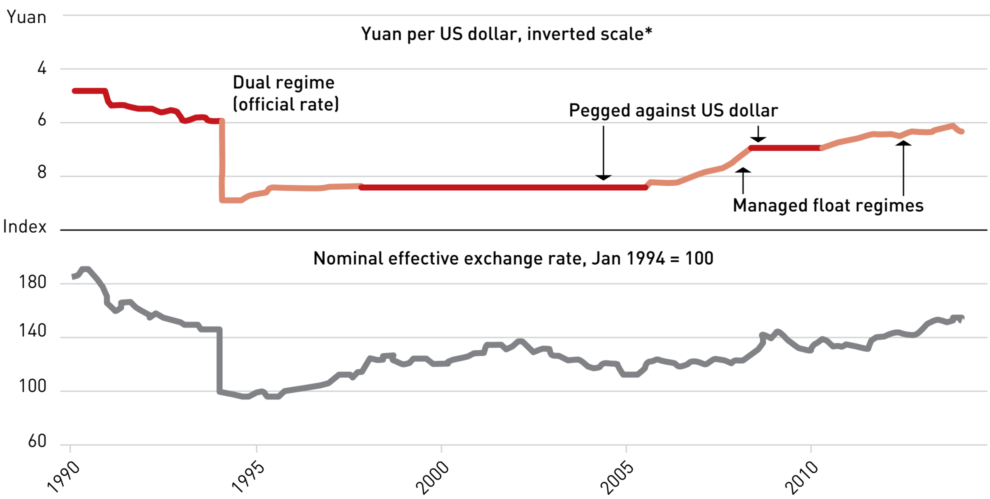
Internationalisation of the RMB and the development of an offshore RMB market

The internationalisation of the RMB and the development of offshore RMB markets are two important government-supported policy initiatives that have progressed significantly since being launched many years ago. There has been increased use of the RMB as a transactional currency over the last few years. By the end of 2014, RMB-denominated current account transactions accounted for about one-fifth of China's total current account transactions. RMB-denominated investment has also increased in recent years, but remains small relative to the value of RMB-denominated trade settlements.

The RMB has gradually moved towards a more flexible exchange rate regime over the same period (see Figure 5.5). In 1994, the official and market-determined exchange rates were unified, leading to a large RMB depreciation. The exchange rate was pegged to the US dollar from during the Asian financial crisis to 2005 to reduce the volatility of the currency. From 2005 to 2010, the official pegging target of the RMB was switched from the US dollar to a basket of currencies and the pegging was managed within a trading band of 0.3 per cent (later 0.5 per cent). From 2012 to 2014, the PBoC widened the daily trading band of the RMB against the US dollar from 0.5 per cent to eventually 2 per cent. In August 2015, the PBoC devalued the RMB by almost 2 per cent. Despite a 2 per cent devaluation being small by the standards of most currencies, this move caused one of the largest central parity shifts in the RMB's history (second only to that following the cessation of the US dollar peg). More importantly, while the RMB's fixing rate was previously persistently higher than the spot rate, in August 2015 the PBoC depreciated the fixing rate and moved to a system where the fixing rate reflects the previous day's spot close and overnight developments. This change indicates an increasingly market-driven approach to currency reform from the PBoC and also acts to close the gap between onshore (CNY) and offshore (CNH) markets (Bloomberg 2015).

The internationalisation of the RMB has an important meaning for China's global economic status. Capital account liberalisation is essential to making the RMB a truly global currency and increasing China's role in international finance. This includes the RMB's recent inclusion in the IMF's Special Drawing Rights basket. This inclusion and internationalisation of the RMB brings benefits from reducing currency risks for Chinese exporters and importers as capital account liberalisation and exchange rate regime reform proceeds. In the longer term, this also has potentially significant implications for the structure of financial and commodity markets globally as transactions and contracts may become increasingly denominated in RMB.

Figure 5.5: Nominal and nominal effective exchange rates — the RMB against the US dollar



Sources: Bank of International Settlements 2016; Bloomberg 2016b; RBA 2016.

The opportunities for financial service providers in China

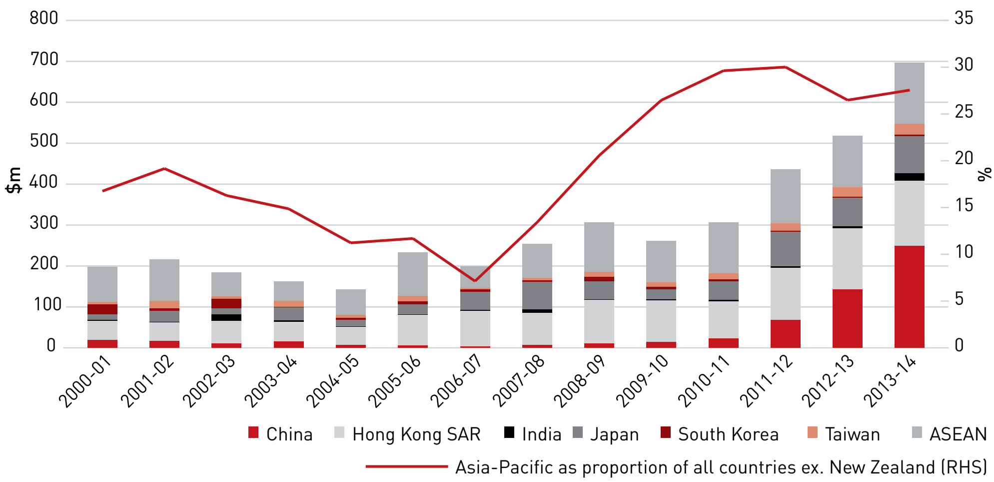
Australia can seek to engage actively in the process of China's financial reform, building off the close and established economic and trade linkages between China and Australia, and the growing potential for further financial integration. Australia must adapt and position itself strategically if it is to benefit from these reforms. One way to do this would be to increase the volume and value of trade in financial services between the two economies.

At first glance, trade in financial services does not appear to be an important part of Australian trade, or of the Australian economy. According to the ABS, total exports of 'financial services' and 'insurance and pension services' stood at A$3.9 billion in 2014, or just 6.4 per cent of Australia's services exports and slightly over 1 per cent of overall exports. Financial services account for A$3.3 billion (86.4 per cent of the total), and insurance and pension services account for the remaining A$539 million (13.9 per cent) of financial sector exports (ABS 2015b).

These ABS figures omit financial services that are provided onshore in China by branches or subsidiaries of Australian firms — the offshore operations of Australian companies. Technically these are called 'foreign affiliate sales'. If foreign affiliate sales are included, financial services are possibly Australia's largest single services export category, with a value that is likely over A$50 billion annually (Auster and Foo 2015). When foreign affiliate sales are included, China is a much smaller financial services trade partner for Australia when compared with the United States, the United Kingdom and New Zealand — but also Singapore, Thailand, Indonesia and Japan (Figures 5.6, 5.7 and 5.8). High barriers to financial services trade and cross-border investment in China may be inhibiting Australian firms and investors from growing their connections with the country. According to the OECD, China has highly restrictive regulatory and legal regimes in both commercial banking and insurance compared to OECD nations. Australia is among the most open economies in the Asia Pacific region, with a degree of openness that exceeds the OECD average.

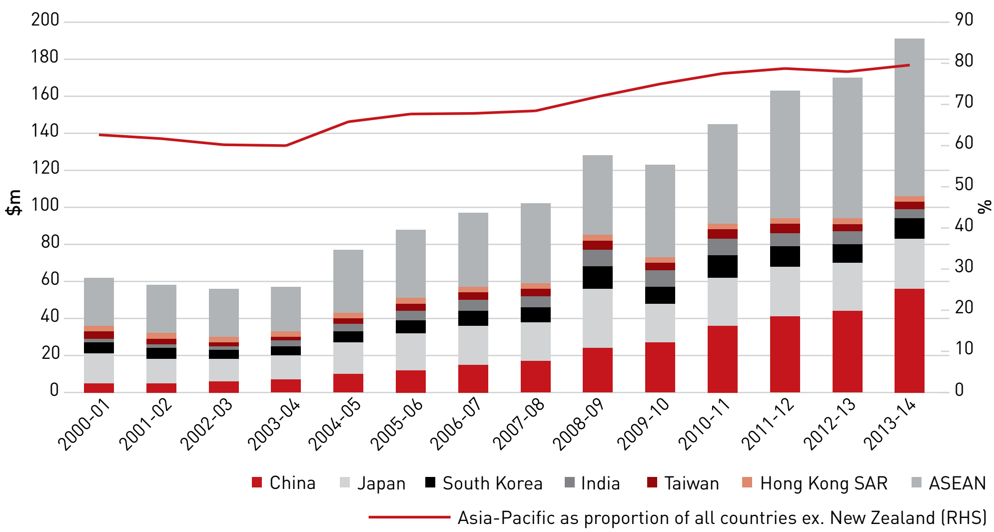
Doing business in China's financial services industry remains very challenging. There are strong government regulations and vastly different business cultures and market environments. But the potential rewards for companies that are successful are significant. Although China is perceived as a challenging market for foreign insurers, Australian financial services companies have entered and many have established local representative offices (Box 5.2) or joint ventures in numerous areas (Box 5.3). Recent research from Munich Re predicts that China's ranking in global insurance premium volumes will climb from 10th in 2006 to third in 2020, behind only the United States and Japan (Austrade 2014).

Figure 5.6: Australia's exports of financial services to the Asia Pacific region



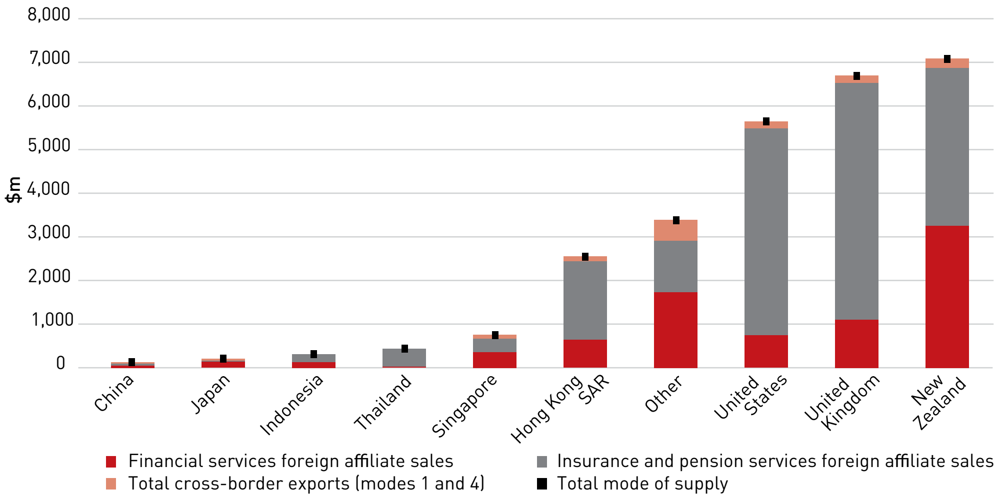
Source: Auster and Foo 2015.

Figure 5.7: Australia's exports of insurance and pension services to the Asia Pacific region



Source: Auster and Foo 2015.

Figure 5.8: Total sales of financial services and insurance and pension services by Australia by mode of supply, 2009–2010



Note: Caution should be exercised in interpreting this chart as the ABS does not allocate Financial Intermediation Services Indirectly Measured (FISIM) to individual countries for mode 3, but does for modes 1, 2 and 4.
Source: Auster and Foo 2015; from ABS Cat. No. 5485.0, Table 4a, 2011.

BOX 5.2: AUSTRALIA'S 'BIG FOUR' BANKS IN CHINA

Australia and New Zealand Banking Group (ANZ) has been in China since 1986 and today it has seven branches and four sub-branches as well as an operations hub in Chengdu. Over the past three decades, ANZ has continued to expand its footprint and remains one of Australia's largest investors in China with successful partnerships with the Bank of Tianjin and the Shanghai Rural Commercial Bank. In 2010, the Australia and New Zealand Bank (China) Company Limited (ANZ China) was established, making ANZ the first Australian bank to be locally incorporated in China. ANZ is the only Australian bank with both local and foreign currency capabilities in retail and corporate banking in mainland China. ANZ China has around 500 employees as of April 2016.

Commonwealth Bank (CBA), Australia's largest bank, has been operating in China for over two decades. It has been granted a RMB licence for its Shanghai Branch by the China Banking Regulatory Commission (CBA 2015). The RMB licence enables CBA to broaden its institutional offerings to incorporate all aspects of trade and investment for clients doing business in the fast growing and deep trade corridor between Australia and China (CBA 2015). CBA has a branch in Shanghai, a branch in Beijing, a presence in the recently expanded Shanghai Free Trade Zone, a network of 15 branches across Henan and Hebei provinces, a life insurance joint venture with the Bank of Communications and two other key joint ventures (Finsia 2014). These are:

- Jinan City Commercial Bank (Qilu Bank) in Shandong province, northern China, of which CBA owns a 20 per cent stake purchased in 2004. This is the 10th-largest city commercial bank by assets in China, and CBA's partnership aims to introduce new financial products and technical skills, speed up compliance with international standards and improve the bank's competitiveness.

- Bank of Hangzhou: CBA has owned 19.9 per cent of this bank since 2005, with A$100 million invested.

National Australia Bank (NAB) provides a range of corporate, institutional, trade and selected personal banking services from a branch location in Shanghai and a newly established branch in Beijing. These branches support Australian and New Zealand businesses looking to trade with or invest in China and the rest of Asia. NAB's stated purpose is also 'to support institutional and corporate customers from China and Asia looking to trade with or invest in Australia and New Zealand, particularly in the bank's areas of expertise: the energy, utilities, natural resources, food and agribusiness sectors' (NAB 2015).

NAB first opened an office in China in 1982, and currently has a representative office located in the China World Tower in Beijing. NAB has partnerships and relationships with national bankcard association China UnionPay and banks including China Development Bank, Agricultural Development Bank of China, Shanghai Pudong Development Bank and Industrial Bank. It also works with wealth management institutions China International Industrial Trust and China Huarong Asset Management Corporation (Finsia 2014). In addition to the new Beijing branch, NAB's recent approval from the China Banking Regulatory Commission for a RMB license for its Shanghai branch will also help customers explore wider business opportunities, better manage foreign exchange risks and enhance business efficiencies in China (NAB 2015).

Westpac first opened an office in China in 1982, and since then has established offices in Hong Kong, Beijing, Shanghai and a Shanghai Free Trade Zone sub-branch with specialist teams focused on trade, structured commodity and asset finance, debt capital markets, derivatives, foreign exchange and natural resources (Finsia 2014; Westpac 2016). It has recently deepened its offerings to support increasing domestic and international RMB flows, and in 2013 was awarded a RMB-dollar market makers licence to trade the currency pairs in mainland China, followed by a derivatives licence. Westpac established an Asia Advisory Board in November 2013 to strengthen its connectivity across Asia.

In April 2012, Insurance Australia Group purchased a 20 per cent stake (since diluted to a 16.9 per cent stake) in Chinese general insurer Bohai Property Insurance Company Ltd to form a strategic partnership and increase its footprint in China. Similarly, in January 2010, CBA and China's Bank of Communications formed a 51:49 per cent life insurance joint venture (Austrade 2014).

These acquisitions, combined with organic growth strategies among some firms, suggest that the Australian financial sector can be one of the largest direct investors into China. Recently there has been a slowing in this process as some Australian financial services providers reduce their investments in China. ANZ, for example, recently reduced its stake in China's Bank of Tianjin, reportedly because of onerous capital requirements and restrictions it faced in operating in China. These issues are discussed in detail in the sections below.

BOX 5.3: AMP CAPITAL AND CHINA LIFE

In April 2006, Australian financial services company AMP Capital secured Australia's first QFII licence. Platinum Investment Company and Macquarie Bank followed in 2008 and 2012 respectively (China XBR 2016). The QFII program allows selected international investors to access RMB-denominated capital markets such as the 'A-shares' traded on the Shanghai and Shenzhen stock exchanges.

Though AMP Capital has had a presence in China since 1997, its engagement and cooperation with the Chinese financial sector expanded substantially following its QFII approval. The partnership between AMP and China Life, China's largest life insurance company, began in 2006. After three years of collaboration on QFII investments, the two companies entered a MoU to explore potential partnerships in pensions and fund management in late 2009 (Somasundaram 2013).

In June 2013, regulations came into effect that allowed insurance companies in China to establish fund management companies offering public mutual funds to retail and institutional investors (AMP 2013). AMP went into a partnership later that year with the China Life Asset Management Company (a China Life subsidiary), establishing the China Life AMP Asset Management Company. By January 2014, the new company had raised RMB11.9 billion (A$2.2 billion) on initial public offering for its first public mutual fund (AMP 2014). According to the Asset Management Association of China, China's managed funds market was worth US$2.5 trillion in 2015, up from US$100 billion 10 years earlier (Smith 2015).

In 2014, AMP announced its acquisition of a 19.99 per cent stake in China Life Pension Company, the largest pension company in China. The acquisition, worth A$240 million, meant that AMP was the first foreign company in the world to purchase a stake in a Chinese pension company with full licenses allowing end-to-end services throughout China (Austrade 2014).

Not all of AMP Capital's ventures have been as stable as its collaboration with China Life. The company's China Growth Fund increasingly came under fire from activist investors due to its discounted trading value, before investors voted to wind it up in July 2016 (Robertson 2016). The AMP Capital Asia Quant Fund, a long-short equity-focused fund, closed operations in February 2016 (Wille and Waite 2016). On balance, however, AMP's initiatives in China have continually been one of the company's most significant engines of profit, withstanding the volatile equity market periods in the second half of 2015 and January 2016.

Overall, AMP and China Life's partnerships have been a success story of ongoing bilateral cooperation. The China Life AMP Asset Management venture's exceptional growth was a major force behind AMP's record profits in 2015 (Letts 2016). Flow-on gains from the partnership have run both ways. AMP's property funds have benefited substantially from Chinese capital support, while the Australian company is initiating a pilot program for China Life insurance agents to gain financial advisory skills (Smith 2015).

The success, according to former AMP Capital CEO Stephen Dunne, is due to the closeness of the partnership. 'We could have partnered with a securities company or a regional bank but we took a strong view that China Life was a good partner because we share a lot of similarities and we like their distribution reach,' Dunne told the Australian Financial Review in 2015. 'We can't really put numbers around the opportunity that exists for us in China', said Dunne (Smith 2015).

A formal engagement program on financial integration

Australia has a strong comparative advantage in financial services in the region. It offers China the opportunity of a testing ground for reforms that will support China's continued opening and integration, globally and regionally. The current reform processes in China offer Australia a once-in-a-generation opportunity to establish the links necessary to supply the financial products and services that China needs and to strengthen Australia's position in global markets.

This outcome will not happen of its own accord. It requires the Australian and Chinese governments and private sectors to strategically position themselves and create the bilateral architecture necessary for collaboration to occur. This architecture should be centred on a formal engagement program on financial services and reform. This would complement the Australia–China SED, including the Australia-China Investment Cooperation Framework (Box 5.4), and engage ministers, officials and firms in a work program to deepen bilateral financial integration. The engagement program would have five key areas of focus (each is discussed in turn):

- piloting the select release of regulatory and licensing restrictions on Australian firms in China as a phase-in for regional liberalisation, expanding the financial services components of ChAFTA.
- developing a regular dialogue and a mutual recognition framework between financial regulators, and supporting the development of RMB-denominated assets and securities listings in Australia.
- reviewing regulatory restrictions, including those relating to taxation and to macroprudential regulations and dividend imputation schemes to ensure that Australian and Chinese entities are better able to invest and work together in the region.
- exploring the bilateral and regional opportunities arising from FinTech and digital finance to promote financial inclusion.
- commissioning research between Australian and Chinese institutions on financial services trade and cross-border investment.

Australia has experienced the benefits and the costs of economic liberalisation, having opened its economy and developed its financial infrastructure, institutions, regulatory settings and macro-financial frameworks over the last three decades. These reforms have been difficult, complex and time-consuming. They have required years of commitment from successive governments and have, at times, resulted in significant financial and economic volatility. Australia's experience in undertaking these difficult reforms is an asset for China as it undertakes the difficult processes of financial reform, capital account liberalisation and RMB internationalisation.

There is significant scope for Australian ministers and politicians, government officials, corporate regulators and private-sector financial firms to collaborate with the Chinese government and Chinese businesses on financial reform. There is great interest within Australia to share this experience with China.

BOX 5.4: THE AUSTRALIA–CHINA INVESTMENT COOPERATION FRAMEWORK

As discussed in detail in Chapter 4, the elevation of the Comprehensive Strategic Partnership into a Comprehensive Strategic Partnership for Change will be important to deepening the Australia–China relationship. This will add momentum over the next decade for moving to put in place a treaty-level commitment covering both countries' mutual interests in open markets, resource and energy security, sustainable agricultural development and food security, and reliable access for foreign investment in both countries. The Australia–China Strategic Economic Dialogue provides an opportunity for Australia and China to explore opportunities for closer economic ties and to discuss issues within the global economic environment. The inaugural SED was held in 2014 in Beijing and was attended by then treasurer Joe Hockey, then minister for trade and investment Andrew Robb and the Chairman of China's National Development and Reform Commission, Xu Shaoshi.

At the inaugural meeting, Australia and China established an Investment Cooperation Framework. The Framework goes beyond ChAFTA and creates new pathways for promoting the export of financial services, for realising two-way investment in new sectors, and for identifying roadblocks for investors from both countries. This allows significant opportunity to deepen the relationship at a number of levels including expanding services exports from Australia to China and improving investment opportunities.

'The investment cooperation framework goes beyond the free trade agreement', Australian Treasurer Joe Hockey said. 'The focus is to deepen the everyday engagement between China and Australia with some identifiable projects, and this is as much about investment in Australia as it is about Australia investing in China'. (see Chapter 4.)

Piloting the select release of regulatory and licensing restrictions

Australia's sophisticated, globally competitive and well-regulated financial markets can act as an effective stepping-stone for China's continued opening to the region. Australia can support China across many of the reforms it is undertaking, by piloting the select release of regulatory and licensing restrictions for Australian firms in China as a phase-in for non-preferential regional and global liberalisation.

There are multiple reform priorities that have been outlined by the Chinese government, and which Australia can assist. These are discussed in more detail in the sections that follow, but include:

- lowering barriers to entry — for example, by fast-tracking licensing for Australian firms and removing restrictions on branch locations, the number of branches, opening hours and other restrictions on foreign financial institutions.
- reforming policy institutions — by deepening official engagement between Australian and Chinese financial regulators and developing a mutual recognition framework between them.
- raising the proportion of direct financial intermediation — by piloting the select release of regulatory and licensing restrictions on Australian financial intermediaries operating in China.

- expanding access to insurance and reducing precautionary savings — by easing restrictions on Australian insurance firms and reforming macroprudential regulations to facilitate joint-partnerships, such as that between AMP and China Life.
- promoting inclusive finance — by sharing information on financial inclusion and financial resilience programs in Australia and by developing a private sector funded grant program on programs to promote financial literacy.
- promoting financial innovation through new markets and products — by exploring the bilateral and regional opportunities arising from FinTech and digital finance to promote financial inclusion and intermediation.
- liberalising interest rates, exchange rates and government bonds — by sharing Australia's experience in undertaking such reforms through the program of formal engagement on financial services and reform.
- achieving internationalisation of the RMB — by supporting the development of RMB-denominated assets and securities listings in Australia, including for bonds but possibly also extending to commodities contracts in gold, coal and iron ore.
- strengthening financial regulation and prudential regulation — through the above-mentioned mutual recognition framework and by undertaking mutual reforms to allow better engagement between Australian and Chinese firms.
- developing the deposit insurance system and resolution mechanisms — by easing restrictions on Australian insurance firms.
- developing financial infrastructure — by collaborating to give the OBOR initiative and the AIIB a focus on regional financial infrastructure investment (see below).

ChAFTA can serve as a bridgehead for the expansion of bilateral financial services trade. ChAFTA, and the institutional mechanisms that underpin it and can be built around it, offer significant opportunities to both countries in designing effective and efficient financial linkages through a gradual and pragmatic process. ChAFTA secures a range of financial services commitments between China and Australia. These commitments represent the most substantial market access commitments that China has agreed to with any FTA partner, and could create new commercial opportunities for Australian banks, insurers and securities firms. They facilitate deeper participation by Australian financial institutions in China, strengthen financial services trade and investment in both directions, and enable future growth in the broader bilateral economic relationship (DFAT 2014a).

Under ChAFTA, China agreed to comprehensive treaty-level commitments on financial services, including agreement to provisions on transparency, regulatory decision-making and streamlining of financial services licence applications. A financial services committee will be established under ChAFTA providing for deep engagement between Chinese and Australian financial regulators on issues of mutual interest, allowing issues to be addressed quickly and efficiently (DFAT 2014a). The work of this committee needs to be supported by the formal engagement program on financial integration through the Australia–China SED, to ensure that it advances reform priorities and deals with the regulatory challenges outlined above. Importantly, Australian and Chinese officials should engage more comprehensively with business and industry representatives prior to these bilateral negotiations so as to provide a mechanism for their input to be considered as commitments are developed.

Both sides have identified a range of areas for further cooperation to reduce barriers in the supply of financial services, which cover many of the issues listed above. These include Australia's foreign investment regime, as well as a range of barriers that Australian and other foreign firms face in China, such as limitations on bank branch openings, minimum capital contributions, maximum offshore funding from within the same institution, required onshore presence, domestic hiring requirements, domestic housing of data, and limited or long wait times for licenses to take RMB deposits. Issues around these restrictions have been raised by many of the financial institutions consulted for this Report.

Strengthening dialogue and mutual recognition between governments and private sectors

Australian and Chinese policy leaders, ministers and senior officials have a greater range of opportunities for engagement now than ever before. The bilateral relationship is officially a Comprehensive Strategic Partnership, which includes the annual Australia–China SED.

But despite the significant implications of China's reform processes, and the significant opportunities for financial service providers, there is no designated bilateral framework through which a specific focus on these issues can take place between policymakers in both Australia and China. By comparison, in other areas such as tourism, Australia and China have a MoU on strengthening cooperation.

The formal engagement program on financial services described above needs to be a proactive, strategically-led process, with a framework for bilateral policy development set out through the annual visits of finance and trade ministers (supported by other relevant ministers for financial services) followed through by taskforces of officials from three key areas: finance ministries, central banks and financial regulators.

There is also scope for expanding bilateral engagement between the central banks of Australia and China. This would complement existing multilateral engagement through institutions and forums such as the G20, and would build on bilateral initiatives such as the local currency swap line agreed between Australia and China. A stronger bilateral dialogue will be increasingly important as China deepens its reform process and achieves greater financial integration with Australia and the region. A routine dialogue can be particularly important in times of financial volatility and crisis when safety net arrangements, including bilateral swap lines, regional arrangements (such as the Chiang Mai Initiative Multilateralization, which does not include Australia) and multilateral arrangements (such as the IMF), may need to be accessed and coordinated.

In recent years the Australian government has developed mutual recognition frameworks with other countries. Mutual recognition means that the regulators in one country recognise the regulations of other countries so that businesses are not required to satisfy two parallel sets of regulations when they are working across borders. Mutual recognition frameworks improve the ease of doing cross-border business by reducing inefficiencies, decreasing compliance costs and saving time.

Mutual recognition frameworks can cover a range of different regulatory settings, including securities market regulations, fund management, collective investment schemes and licensing requirements for financial advisors, accountants, fund managers and lawyers. The general approach of the Australian government to recognising foreign regulation of financial markets and financial services providers has been based on unilateral recognition of the foreign jurisdiction.

In June 2008, Australia undertook its first mutual recognition agreement on securities offerings with New Zealand. Issuers of securities can now use one prospectus to offer shares, debentures or managed or collective investment schemes to investors on both sides of the Tasman Sea, subject to certain requirements.

Following this, Australia and Hong Kong extended mutual recognition to authorised collective investment schemes, which will facilitate the sale of retail funds in each other's market. The APEC Asia Region Funds Passport (discussed below) is similarly a form a mutual recognition that Australia is leading in APEC.

In August 2008, Australian authorities signed a third mutual recognition arrangement, with the United States Securities and Exchange Commission (SEC). The mutual recognition arrangement provides a framework for the SEC, the Australian government and ASIC to consider regulatory exemptions that would permit US and eligible Australian stock exchanges and broker-dealers to operate in both jurisdictions, without certain need for these entities to be separately regulated in both countries. It reduces the barriers that US and Australian investors face in investing in each other's markets.

As China's reform processes deepen, a goal should be the development of a mutual recognition framework between Australia and China. One of the pre-conditions of mutual recognition is that the regulatory framework of each jurisdiction must be substantially equivalent, thus ensuring investor protection and market integrity irrespective of the location of the investor. For this reason, a mutual recognition framework between Australia and China is not a goal that will be achieved in the near term, but is a goal that should be part of the broader future engagement program between the two countries. Importantly, this engagement program and greater collaboration between Australian and Chinese regulators will itself facilitate the move towards a mutual recognition framework.

In the private sector, there has been ongoing, albeit informal, collaboration on economic and financial reform. Given the opportunities for increasing the financial connections between Australia and China — and the vital role of the private sector in making this happen — a more formal approach to private sector engagement is necessary. Furthering this collaboration through the formal engagement program on financial services should therefore be a key priority. Australian financial firms have hosted dozens of delegations from China over the years — from policymaking and regulatory bodies as well as from financial services firms — to share knowledge about Australia's financial system and reform history. Within China, several of Australia's largest financial institutions have significant joint venture partnerships through which the transfer of technical and managerial knowledge and expertise has been taking place. Chinese financial services firms that have established operations within Australia have engaged proactively with the Australian financial services sector, including through groups such as the Australia–China Business Council.

A more formal mode of engagement by the private sector in China's financial sector reform has recently developed — the Sydney for RMB Committee. Formed in 2013, the Committee now comprises 30 senior financial sector professionals representing organisations that have a deep interest in developing greater financial connectedness between Australia and China. It is led by the private sector but has the support of the NSW and federal governments. The Committee has written several white papers and supported RMB offshore development by identifying the key blockages to increased take-up of RMB among Australian firms and by promoting Sydney as an important hub for RMB trade, finance and investment transactions in the Asia Pacific region.

Mutual regulatory reforms to increase engagement

Along with the mutual recognition framework discussed above, there is scope for other reforms in regards to professional services, regulatory restrictions around taxation and macroprudential regulations, which should also be explored to increase financial integration between Australia and China.

According to the Australian Chamber of Commerce in Beijing, the trained talent pool in China's financial services sector is limited, particularly when taking account of foreign language skills and depth of experience. For some specialist roles, it is increasingly difficult to recruit and retain staff (AustCham 2016).

Australian and Chinese academic institutions have an important role to play in supplying the next generation of financial services advisors. There is scope for joint ventures between Chinese universities and Australian financial institutions, which would result in a specialist talent pool that is trained on current international industry practices. A longer-term talent management plan needs to include an education push to enhance professional skills within the financial services sector.

The Chinese and Australian governments could also improve the attractiveness of their financial services sectors as career destinations for international talent. The Chinese government could give consideration to providing tax incentives comparable to Hong Kong or Singapore for employees, as well as for employers to invest in experienced foreign trainers who can educate local talent. The Australian and Chinese governments could partner with private firms from both countries to provide training and policy support in the development of the Chinese financial system through programs that encourage collaboration between Australian and Chinese financial firms.

While much of this chapter has considered reform processes in China, there are domestic regulatory settings that the industry suggests inhibit Australian firms from expanding into China and the Asia Pacific. Regulatory settings, including capital reserve requirements set by the Australian Prudential Regulation Authority, need to be carefully calibrated to ensure there are no unnecessary barriers to Australian firms' take-up of opportunities provided by free trade agreements that raise the maximum threshold of foreign equity in a joint venture financial services firm in Asia (Auster and Foo 2015).

The 2014 Financial System Inquiry recommended reviewing the state of competition in the financial sector, including identifying barriers to the cross-border provision of financial services. The Australian government endorsed this recommendation and committed to task the Productivity Commission to undertake this review by the end of 2017. It noted that 'deeper cross-border linkages promise enormous opportunities, if properly harnessed' and that 'our policy settings must facilitate entry of these disrupters rather than acting as a blockage' (Government of Australia 2015c). It is important that this review goes beyond Australia's traditional investment partners and looks specifically at the barriers to investing in China and other countries in the Asia Pacific region.

The Australian Financial Centre Forum's 2010 report on 'Australia as a financial centre' (Johnson Report 2010) also raised a number of tax issues where Australian regulations currently raise the costs of offshore capital borrowing and restrict Australian banks from accessing offshore retail and wholesale deposits (Finsia 2014). These issues should be examined as part of the Australian government's focus on tax reform.

Australia's Productivity Commission (2015) notes that strong competition and the growing levels of wealth in Asia mean that barriers to financial service exports from Australia will be increasingly costly. It notes there are regulatory barriers constraining the growth of exports from the managed fund sector in Australia (in particular, from managed investment schemes) as well as through taxation arrangements for international investment in managed funds.

Bilateral and regional opportunities arising from FinTech

Financial technology — or FinTech — is transforming financial systems and potentially entire economies. Globally, FinTech investment reached an estimated US$20 billion in 2015, a jump of around seven-fold over the last three years (Australian Treasury 2016). The FinTech industry has great potential to not only help drive expansion and growth in financial services and exports, but will also deliver benefits through new services that create value or bring new efficiencies. For these reasons, the engagement program on financial services should have a special focus on the opportunities arising from this sector.

China has a burgeoning FinTech sector that supports a number of large firms supplying financial services and products. Companies such as AliPay and WeChat demonstrate the rising demand for sophisticated financial products and services in China. This highlights the crucial importance of a free and open internet. The OECD recently warned that worldwide efforts to clamp down on cybercrime and terrorism, in particular, are putting the economic benefits of the free and open internet at risk. The OECD highlights the important link between innovation and internet freedom (OECD 2016) Australia and China must ensure a free and open internet if they are to capture the benefits of increasing economic activity in FinTech and other innovative sectors that are crucial to future prosperity. It is estimated that the uptake of information and communications technologies in Australia in the 1990s added upwards of 0.2 percentage points of multifactor productivity growth to Australia's annual economic growth (Gretton 2003). The absence of domestic and international impediments to internet access is essential to capturing the productivity-enhancing benefits of these technologies. The positive productivity-enhancing effects of openness to FinTech innovation are likely to be increasingly important as the industry matures.

During a FinTech roundtable organised by the Chinese government in Shanghai in February 2016, Lufax, the second-largest peer-to-peer lender in China, spoke about real-time personalised insurance options such as car insurance that could account for the places you might be driving through or to on a particular day, including weather and traffic conditions. During another FinTech roundtable in Shanghai, Chinese internet services giant Baidu, explained their 'Internet Plus' strategy was not about becoming a FinTech operator, but to enable them to act as an aggregator. They are focused on bringing together the partners needed to realise a new product or service to fill the gaps and to satisfy consumer demands by leveraging their digital distribution networks, data and insights (Australian Treasury 2016).

FinTech is about stimulating technological innovation so that financial markets and systems can become more efficient and consumer-focused. This can help drive improvements in traditional financial services and, perhaps more importantly, promote disruption through innovative new products and services, which can offer benefits to consumers and other sectors of the economy. FinTech is also reducing information asymmetry in the marketplace and thereby helping to mitigate risk and promote the efficient allocation of scarce resources (Australian Treasury 2016).

FinTech solutions hold enormous potential benefits to all business, especially new and existing small businesses. Small- and medium-sized enterprises (SMEs) are crucial for economic growth and jobs but some can face difficulty in securing the financing they need to survive and prosper. FinTech can offer solutions that are efficient and effective at lower scale, which will benefit small businesses and provide them with increased access to more diverse funding options. Innovative FinTech products can be better tailored to the needs of small businesses. These include marketplace (peer-to-peer) lending, merchant and e-commerce finance, invoice finance, online supply chain finance and online trade finance (Australian Treasury 2016).

In addition to financing and access to capital, FinTech can help all businesses through improved payment systems, customer relationship management and invoicing and collections. FinTech solutions include e-invoice management portals and supply chain finance solutions.

The Australian government outlined in a recent report (Australian Treasury 2016) that it is committed to working with the FinTech industry, regulators and other stakeholders, on the key issues that underpin this continued innovation in financial services. The government has publicly supported the industry's objective of making Australia the leading market for FinTech innovation and investment in Asia by 2017. Australia's fledgling but flourishing FinTech industry is attracting talent, promoting innovation in Australia's financial services industry and exporting talent abroad, such as:

- incubators (Stone and Chalk, and Tyro);
- venture capital funds with a focus on FinTech (H2 and Reinventure);
- personal and business finance (SocietyOne, Prospa, Ratesetter, Spotcap and Moula);
- capital market technology (OzForex and Pepperstone);
- payments providers (Tyro Payments and PromisePay);
- wealth management providers (Stockspot, Simply Wall Street and PocketBook);
- business-enabling technologies and data analytics (Avoka, Metamako, and Quantium); and
- crowdfunding platforms (Equitise, TMeffect and CrowdFundUp).

Research on financial services trade and cross-border investment

The Australian Centre for Financial Studies (Auster and Foo 2015) identifies a lack of research and data as an impediment to financial services integration in the Asia Pacific region. It argues that many of the enablers and impediments to greater integration, or their potential impact, are not well researched or understood and that policymakers, regulators and practitioners lack a strong evidentiary base from which to make well-informed decisions on matters of significance to the Australian and Chinese economies.

Australian and Chinese organisations should commission and encourage collaborative research programs to be carried out by Australian and Chinese institutions, to better understand and assess the impact of financial integration in the Asia Pacific. The research should look specifically at the drivers and mechanisms of financial integration, the impact of global regulatory reforms such as those resulting from Basel III and the Financial Stability Board, the institutional mechanisms that drive reforms, and Asia's voice in these mechanisms.

This research could have a specific focus on 'behind the border' barriers and the broader impacts of China's reform processes for Australia and the region. There is little substantive research that analyses the impacts of the opening of China's capital account on the Australian economy from a whole-of-economy perspective. Some industry studies predict increased investment or commercial flows in particular sectors, but no studies have looked at the Australian economy as a whole, or the impact on relevant sectors within financial services. Further, there is significant data development still to do on measuring and reporting China's financial data, including cross-border capital and investment flows.

Regional collaboration on financial services and flows

As the Chinese financial system opens to the region, there is a significant opportunity for these flows to finance productive investment, build capital stocks and increase economic growth in the region. For Australia, as a capital importing country, there is a great opportunity to import Chinese capital to finance investment and reduce the cost of capital to Australian firms and households. For China, these reforms offer the opportunity to increase the returns on the capital of firms and households, which is key to improving living standards and addressing challenges related to the ageing population. This section identifies a number of initiatives to help facilitate regional integration in financial services and flows.

One Belt, One Road

As the 'top and tail' of the region identified by the OBOR vision, collaboration between Australia and China on financial sector reform and developing financial infrastructure across the region will be an important source of stability to help ensure economic prosperity for future generations. As discussed in detail in Chapter 4, the partnership between Australia and China must be enabled on both sides by the provision of supporting financial infrastructure (including access to each other's financial services markets), the ability to make investments that support further trade and service delivery, and continued and easier flows of people between the two countries.

The OBOR initiative involves building a host of new infrastructure connections between China, Asia, Africa, the Middle East and Europe. A complementary series of ports and other infrastructure projects across the Indian Ocean and surrounding seas called the Maritime Silk Route adds a maritime leg to land-based connections including the China–Pakistan Economic Corridor (CPEC) and the proposed Bangladesh–China–India–Myanmar Economic Corridor (BCIM).

China has already established major financing bodies, including the AIIB and the Silk Road Fund, to help fund an estimated US$250 billion worth of OBOR projects (Australia–China OBOR Initiative 2016; Brewster 2015). OBOR represents an opportunity to further strengthen financial integration by complementing its trade networks and physical infrastructure investments with greater investment in financial infrastructure.

Along with infrastructure investment in Northern Australia, this represents another key way in which Australia and China can collaborate on OBOR. Investment in financial infrastructure such as financial institutions, financial intermediaries, payment systems, credit information bureaus and collateral registries should be seen as critical complements to the broader OBOR objectives of deepening trade and commercial links, and thus should receive the same level of attention and financial support.

APEC's Asia Region Funds Passport

Under the auspices of APEC, the Asia Region Funds Passport (ARFP) will, once implemented, provide a multilaterally agreed upon framework to facilitate the cross-border marketing of managed funds across participating economies in the Asia Pacific. The view is that a mutual recognition approach may be more realistic than pursuing regulatory harmonisation; in funds management, the ARFP is the preferred regional vehicle for cross-border marketing of managed funds. In the longer term, the ARFP could also facilitate funds from the Asia Pacific region being marketed in Europe through an Asian/European mutual recognition agreement.

The Australian Financial Markets Association states that the Passport provides a 'practical template for cooperation in the Asian region'. The Financial Services Council (FSC) says that the ARFP is its 'preferred mechanism for cross border trade in funds management, alongside bilateral and multilateral free trade agreements'. The FSC also notes that taxation regimes, both in Australia and overseas, are complex and that 'Australia will not be a successful participant in [the ARFP] unless accompanying domestic reforms are undertaken' (Productivity Commission 2015).

The ARFP is a region-wide initiative that was initiated by Australia, New Zealand, South Korea and Singapore. In September 2013, these four countries signed a Statement of Intent to jointly develop the ARFP to facilitate cross-border offers of funds in the APEC region. In April 2014, the signatories, together with the Philippines and Thailand, issued a joint consultation paper on the proposed rules and arrangements for the ARFP. Japan signalled its interest in participating in 2015. These seven 'pilot' economies have been working towards the launch of the ARFP. Five other APEC members not currently signed up to the ARFP — China, Hong Kong, Indonesia, Malaysia and Vietnam — have nevertheless joined parallel discussions on the ARFP rules (APEC 2015).

On 28 April 2016, a Memorandum of Cooperation (MoC) was signed by Australia, Japan, South Korea and New Zealand. The MoC comes into effect on 30 June 2016. The ARFP initiative is open to any APEC economy that signs on, and participating economies have up to 18 months from 30 June 2016 to implement domestic arrangements. Activation of the ARFP will occur as soon as any two participating economies implement the arrangements under the MoC.

The Australian government intends to legislate to give effect to the ARFP in the second half of 2016 (Productivity Commission 2015). The government should continue to progress the ARFP and, through work in international forums, encourage other jurisdictions to participate. China has been involved in discussions around the rules of the ARFP and could consider signing up formally to the initiative as a key way of attracting talent and expertise into its finance sector (APEC 2014b).

RCEP negotiations

There is significant scope to use RCEP negotiations to strengthen the supply of financial services throughout the Asian region. In the financial services sector, many types of services can be performed across borders, without sacrificing appropriate prudential supervision. These services include buying and selling financial products, participating in and structuring transactions, and providing investment advice. RCEP should consider permitting firms to provide cross-border services to clients and qualified investors without establishing an in-country commercial presence or being subject to the separate licensing and approval requirements that generally apply to firms commercially present in a market (see Chapter 7; and see discussion in Australian Services Roundtable 2013).

Managing risks

The liberalisation and opening of the Chinese financial system brings with it great opportunities for both China and Australia, but, as with Australia's reform experience, carries with it a number of risks (see Chapter 6). These include greater exposure to negative external shocks and contagion, challenges in relation to cross-border supervision and enforcement, and adverse effects from potentially higher volatility in capital flows — which can cause rapid changes in domestic asset prices for equities, bonds, commodities, foreign exchange and derivatives.

Increasingly correlated prices between different countries and asset classes reduce the benefits of portfolio diversification, while also potentially creating channels for contagion. The global financial crisis highlighted the fact that large capital flows can increase vulnerabilities at the macroeconomic level and exacerbate systemic risks in financial systems. The liberalisation and opening of China's financial system will fundamentally change the nature of financial linkages in the Asia Pacific region, with implications not just for finance but also for flows of trade, capital and people.

The flexibility of Australia's economy, particularly its floating exchange rate and inflation-targeting monetary policy, helps it weather volatility from international markets. As it has done in the past, this will play a fundamental role in Australia managing any future volatility resulting from China's reforms and regional integration more broadly. Financial reforms of past decades and the integration of Australia's capital markets into the global system have delivered the basis for sounder macroeconomic policy, more diversified portfolios for Australian investors and the development of tools for hedging risk. The Australian financial system proved resilient throughout the global financial crisis while others did not.

For China, risk management should be based on ensuring that reforms are properly sequenced in their implementation and undertaken at the appropriate pace. The Australian experience supports the notion that strong institutions and regulatory practices can go a long way toward mitigating the risks of deep financial reform.

Both Australia and China have a strong incentive to ensure that there is a well-resourced and flexible financial safety net in the region. On 4 February 2016, IMF Managing Director Christine Lagarde warned that the global financial safety net has become too fragmented, particularly in Asia, and needs to be reformed and strengthened. Reforming the safety net would benefit China, Australia and the Asia Pacific region (Lagarde 2016). This crucial task is discussed in more detail in Chapter 8.

Australia and China must focus their efforts in the G20 and in the IMF on ensuring that there is a holistic approach to addressing the root causes of safety net fragmentation in the Asia Pacific. This requires a focus on increased and more permanent funding for the IMF (although there are real constraints on this), better-tailored financing facilities to meet the needs of Asian economies, a new phase of IMF reforms that give Asian economies a greater voice, and better cooperation between the IMF and regional financing arrangements. These are perspectives that Australia and China should advocate for in the IMF and in the G20 (see Chapter 8).

Regional and bilateral arrangements, such as the use of currency swap lines and arrangements like the Chiang Mai Initiative Multilateralization, should not be discounted. They play an important and complementary role to the IMF. The IMF needs to look at how it can better cooperate with these arrangements by setting up guidelines before a crisis erupts in order to help guide how that cooperation would take place during a crisis. This is critical to the safety net's ability to respond quickly, flexibly and consistently to crises and is key to promoting market confidence in the safety net.

While many of these measures are politically difficult, China's G20 host year has seen incremental and pragmatic first steps, through the IMF's report to G20 finance ministers in April 2016, to bolster the adequacy of the safety net. The G20 must seize this opportunity to begin a conversation on these issues (see Chapter 8).

Finally, there is an increasing risk that slowing growth in China, as well as slowing growth regionally and globally, could dampen the motivation and drive for undertaking the reforms outlined in this chapter. Losing the momentum for reform would have significant consequences. It would not only risk the gains achieved thus far but could lead to increased volatility from a negative market response. The Australian and Chinese governments should emphasise the importance of these supply-side reforms in creating growth and boosting job creation in a sustainable and balanced way into the future. A weak global economy, combined with the decreasing effectiveness of macroeconomic policies in many countries, means achieving structural reforms and reducing barriers to international trade are now more important than ever.

The future of bilateral financial cooperation

China has achieved significant progress regarding the liberalisation of its domestic financial system, retail lending and deposit rates, usage of its currency in global trade settlements and offshore RMB markets, flexibility in its exchange rate regime, and openness of capital flows into and out of China. These developments have important implications for China's institutional and economic structure through reducing distortions in factor and financial markets and allowing a larger role for the market in the economy, while still maintaining an active state control of the process and increasing China's position in the global financial system.

However they turn out, the reform processes underway in China will profoundly shape the future of the Australia–China economic relationship. They will have implications across economic, political and social dimensions. The central argument of this chapter is that, if the governments and private sectors of Australia and China position themselves strategically, these reform processes offer a once-in-a-generation opportunity to deepen the relationship in financial services and financial flows which, at present, is nascent compared to the relationship in merchandise trade. This will be a long process, but this chapter has outlined a number of steps through which it can be achieved.

Most importantly, this chapter proposes that the Australian and Chinese governments develop a program of formal engagement on financial services and reform. The program would complement the Strategic Economic Dialogue and engage ministers, officials, regulators and firms in a work program to deepen bilateral financial integration. It is recommended that a key focus of this program be on piloting the select release of regulatory and licensing restrictions on Australian firms in China as a phase-in or 'testing ground' for regional liberalisation.

The chapter also recommends measures, which should be driven by bilateral commercial need, to improve the dialogue between Australian and Chinese central banks and regulators. The aim should be to develop a mutual recognition framework to improve the ease of doing business, progress the development of RMB-denominated assets and securities listings in Australia, review regulatory restrictions including in regard to taxation and macroprudential regulations, promote the bilateral and regional opportunities arising from FinTech and digital finance, and commission research between Australian and Chinese institutions on financial services trade and cross-border investment.

The chapter also recommends that these bilateral initiatives be complemented by a focus on regional financial cooperation. This includes building a bilateral financial infrastructure focus in regional initiatives such as OBOR and the AIIB to improve payment systems, credit information bureaus, collateral registries and financial intermediaries and institutions throughout the Asia Pacific. China should also sign on to, and Australia implement, APEC's Asia Region Funds Passport and both countries should advocate its greater use in the region.

This combination of a strengthened bilateral architecture and regional initiatives aimed specifically at financial services and financial integration will be key to catalysing greater financial integration. This is the vital next step in strengthening the relationship between Australia and China.

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