Demonstrators call for banking reform at a rally to mark the 10th anniversary of the 2008 financial crisis, outside the Royal Exchange building in London, Britain, on September 15

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What Financial Crashes Teach Us

Targeted structural reforms are essential to economic growth and stability

By Wang Yongli

Erupting in September 2008, the global financial crisis has lasted a decade. After the crisis, the worldwide trend of surplus production capacity and inadequate demand could not be reversed and the world economy has remained sluggish, leading to significant changes in the world and creating serious social problems. We need to analyze the root causes and lessons of the crisis so as to better address any likely new crisis.

After the crisis, many reasons were listed, such as greedy financial institutions and financial product investors who cared only for high investment returns but were regardless of the high risks; loopholes in the accounting system and problematic practices and principles of the industry; irresponsible rating firms whose credit scores were not in line with facts; and excessive financial innovation but incompatible financial regulation, which caused systemic risks.

All these need to be rectified, but they are not the root causes of the once-in-a-century crisis. Against the background of globalization and the history of the 20th century, we can figure out the real root cause: the massive surplus caused by information asymmetry and inadequacy during the process of international capital and production capacity transfer. It led to both the Great Depression in the 1930s and the recent Great Recession.

Causes of the crisis

Since the end of World War II, increasing amounts of international capital and production capacity have flowed to Latin America, Southeast Asia, East Europe and then China, accelerating economic globalization and changing the world trade structure. Along with the arrival of global capital and production in a certain region, asset bubbles and financial risks also emerged and intensified while these funds and production capacity promoted local economic and social development. Once such problems occurred, capital soon moved to other markets, causing financial or economic crises. Affected economies had to input more money and production capacity to rescue the economy, leading to more redundant liquidity and production capacity. As such crises expanded, there was a worldwide surplus of capacity and liquidity, triggering a global financial and economic crisis as a result.

With the expansion of world population and a restriction of the globe's bearing capacity, there has been overcapacity and inadequate effective demand throughout the world, which will not be reversed within a short time. Under such circumstances, stimulus policies will only cause more problems, challenging the effectiveness of many major economic theories and macroeconomic policies.

After the global financial crisis broke out in 2008, major economies of the world significantly increased money supply and expanded production capacity. Although this curbed rapid worsening of the crisis and helped avoid the collapse of the financial market, it also created more risks and new factors for crisis, exhausting the potential of existing policy instruments. Together with rising trade protectionism, unilateralism and

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populism, a more serious crisis is looming over the world.

China's actions

After the crisis broke out, China immediately readjusted its macroeconomic policy and launched a massive stimulus package, making it the first major economy making a rebound. China then became the second largest economy in the world, with its role in international affairs remarkably improved. But after that China faced increasing economic downward pressure, entering a new stage of development where deeper and more extensive reform and opening up is needed.

As China became the second largest economy and the gap with the United States narrowed, the United States has sought to contain China.

The National Internet Finance Association of China is inaugurated in Beijing on December 14, 2016, as part of efforts to regulate the burgeoning industry

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Inside China, the economic downward pressure continued from 2011 to the end of 2017.

The 19th National Congress of the Communist Party of China in October 2017 established a goal: By the middle of the 21st century, China will have become a global leader in terms of composite national strength and international influence. This goal is of vital importance. But it inevitably worried the United States. Now the United States has launched a trade war against China, posing new challenges to China's development. Like the first half of the 20th century, the first half of this century is also an era of drastic internal changes and external challenges for China.

China has now entered a key stage of economic transformation, facing various daunting tasks. Of them, preventing and addressing major financial risks has become a top priority.

Since China's accession to the World Trade Organization in 2001, as the economy grew rapidly, its financial sector also grew at high speed. The country ranks first in the world in terms of monetary aggregate, scale of central bank assets, foreign exchange reserves and total financial assets. Rankings of its financial institutions in the world are also improving. After reform and opening up, great changes have taken place in China's financial market.

However, China's financial development still faces many problems in spite of great achievements. Because of the weak basis but rapid development, those in the financial sector have not fully understood monetary finance. Also, the responsibilities of financial regulators remain unclear, leaving many potential risks in the financial structure and financial legal system.

Until now China has not experienced the real test of a local financial crisis. After the bankruptcy of Hainan Development Bank in 1998, no Chinese bank went bankrupt. From financial institutions to regulatory authorities and even the coordinating agency at the national level, none has adequate experience in forecasting and addressing financial risks.

The way ahead

Compared with the financial systems of advanced countries, the Chinese financial sector still falls behind in terms of vitality, inclusiveness, the level of opening up and competition, and in particular, the international influence. As part of the country's core competitiveness, the financial sector has yet to live up to expectations. Therefore China urgently needs to deepen financial reform and opening up in an all-round way.

A decade after the global financial crisis, facing even more complicated international and domestic economic and financial conditions, China needs to reflect and summarize lessons and experiences from the crisis to address new and more serious crises.

Despite the huge challenges, China still has vast opportunities and great comparative advantages: It is the largest developing country in the process of industrialization, urbanization and informationization, with huge space and dividend for reform. China has $3 trillion of foreign exchange reserves but its debt level is low, enabling it to withstand external impact; the debt level of the central government is very low, leaving a great space for carrying out proactive fiscal policy; the overall interest rate level is high, leaving ample room for supply-side structural reform in the financial sector; and financial institutions have become more able to address risks. There are good reasons to believe that China will effectively prevent and address financial risks and realize better financial, economic and social development.

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The author is former vice president of Bank of China and a senior researcher with the Chongyang Institute for Financial Studies of Renmin University of China

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