



**Law, regulations and economic growth: a complex
relationship**

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abstract

The legal and regulatory systems define the rights of everyone in the markets. Without these rights there would be no saving, no investment and no trade. This means that also the opening of domestic markets, and their progressive integration, are necessarily linked to the process of convergence or divergence of the legal systems that regulate them.

This article addresses two connected topics in order to remind the context in which the dialogue and cooperation between China and Europe is set nowadays.

The first topic is the relationship between economic development and law, i.e. the observation that the development of a market economy requires not the absence of regulations but rather their reinforcement.

The second topic is the link between the policy of gradually opening the Chinese market to foreign investment and the parallel policy of strengthening the domestic market regulation system undertaken in China over the last few years.

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Law, regulations and economic growth: a complex relationship

1. Italy, China and the post-pandemic environment

In this complicated phase of post-pandemic economic recovery, the complex interrelationships that link every country to the global economy have become increasingly clear, from global production chains to the production of global public goods, such as scientific research, fighting against climate change and safeguarding people's health.

From a strictly economic point of view, there are three fundamental issues that all the leading economies will have to deal with in the near future: how to move on from highly expansionary monetary and fiscal policies, how to recover from the unprecedented amount of private and public debt, and how to relaunch and stabilise the production of goods and services along international production chains, avoiding trade restrictions, the result of which would be higher inflation and lower global growth.

These are objectives of common interest, which should be certainly shared by Europe, USA and China, and which cannot be resolved by a competitive/conflictual approach, but instead require responses that can only come from responsible international cooperation and coordination among the main actors, namely the main advanced economies.

This means reinforcing multilateralism, but also and above all ensuring consistency in how individual countries create the domestic conditions necessary for interlinking their respective markets and the firms that operate in them.

These thoughts bring us to reflect about the law as a bridge for cooperation and dialogue. Markets exist because there are rules under which individuals and firms operate, produce and carry out

trade. In other words, it is the ‘law’ that defines a market and how it functions.

The legal and regulatory systems, together with the system for enforcing these rules, define the rights of everyone in the markets. Without these rights there would be no saving, no investment and no trade. This means that the opening of domestic markets, and their progressive integration, are linked to the process of convergence or divergence of the legal systems that regulate them.

This preamble leads me to look at two connected topics in order to remind you of the context in which the dialogue and cooperation between China and Europe is set nowadays.

The first topic is the relationship between economic development and law, i.e. the observation that the development of a market economy requires not the absence of regulations but rather their reinforcement.

The second topic is the link between the policy of gradually opening the Chinese market to foreign investment and the parallel policy of strengthening the domestic market regulation system undertaken in China over the last few years.

In every country and in every historical period, the evolution of the legal and regulatory system is the result of changes in the production system, in technology and in society, yet at the same time it is precisely the adaptations and changes in the legal system that allow the economy and the production system to evolve and make progress.

If we look at the history of China’s rapid economic growth over the last few decades, we cannot fail to notice, for example, certain similarities with the much longer history of modern economic development in western capitalist countries.

In the West too, over the course of the last century, periods when economic growth was particularly rapid, entrusted to the free initiative of entrepreneurial ‘animal spirits’, alternated with periods when the further growth of markets and trade required more regulation to counter the build-up of monopolies, safeguard competition and tackle the growth in inequalities.

The creation of antitrust rules and rules to protect investors and savings encouraged rather than hindered the opening of domestic markets and the globalisation process in the West, as did the construction of systems for social protection and social cohesion.

It is no accident that nowadays in the advanced capitalist countries, the criticism on globalisation and the opening of markets is a consequence of the new phase of rapid technological progress, which has led to the establishment of new monopolistic concentrations around internet giants, to difficulties in ensuring the fair use of users’ personal data and to the increase in inequalities and social distress. These are issues that the European regulators are struggling to deal with and that American regulators are sometimes not inclined to tackle with due decision.

These are problems that are at the centre of attention for Chinese regulators too, at a stage in history when in China too, the ‘animal spirits’ of innovation and initiative have raised up the Chinese internet giants, competitive at global level, and when the huge and growing quantity of savings of Chinese people in search of return is fuelling both the rapidly expanding financial market, including the swift growth of its FinTech component, and the real estate market. In this kind of situation, the way to reassure the domestic market and at the same time keep it open to foreign capital and firms may in fact be to strengthen the regulatory system.

The growth of legislation that is gradually opening the Chinese markets to foreign investment, including the financial and credit market, and the almost parallel strengthening of the regulatory

system for these markets do not seem to be happening by accident. They are two sides of the same coin that need to be properly understood and recognised by foreign companies wishing to work in China and by governments that want to engage in a fruitful dialogue in order to strengthen cooperation between the two countries.

2. Two core reforms

To support the considerations above, I would like to recall just two of the main reforms of the regulatory system of Chinese markets.

The first is as follows: until 2017, the structure for China's banking and financial regulation was based on the Chinese central bank, i.e. the People's Bank of China (PBOC), and three committees, for regulating the banking sector, the insurance sector and the securities market respectively. This structure was reformed in 2017, with the establishment of the Financial Stability and Development Committee (FSDC), directly under the State Council and entrusted with supervising monetary policy and of financial regulation as well, and then in 2018, with the merger of the regulatory committees for the banking and insurance sectors into a single regulatory body, the China Banking and Insurance Regulatory Commission (CBIRC). Among other things, the CBIRC has the power to grant licences to and to regulate foreign banks that open in China. At the same time, greater powers were assigned to the PBOC for the macro-regulation of the financial sector and for formulating guidelines for banking legislation.

The reform aimed to exercise more effective control over banking and insurance activities, whose extremely rapid growth has come with growing risks. Much of this regulatory activity is based not only on the laws promulgated by the State Council, but also on rules, guidelines and prescriptive notes issued directly by the central bank and by the CBIRC for the purpose of tackling, by means of specific measures, the various regulatory problems that arise in a changeable and growing market.

One example is a ‘note’, issued at the end of 2020 by the People’s Bank of China and the CBIRC, aimed at limiting the excessive concentration of loans from banks and financial institutions to the real estate sector, in order to reduce both risk for individual credit institutions and possible systemic risk.

In addition, a revision of commercial bank law is under way to strengthen consumer rights and the protection of deposits, to define the risk levels permitted and the capital requirements and, lastly, to regulate the collection and fair use of customers’ personal data, especially in the FinTech sector.

The People’s Bank of China is also committed to enforcing the application of the Basel Committee’s standards and to applying financial stability principles and standards, since, together with the Ministry of Finance and the CBIRC, it is a member of the Financial Stability Institute.

The second reform I would like to recall is that of the market regulation aimed at preventing monopolies and abuse of market power, ensuring the quality of industrial products and the control of trade, combating fraud, and protecting intellectual property and safety in healthcare. This reform, which was also introduced in 2018, led to the State Administration for Market Regulation (SAMR), and to join into a single agency under the control of the State Council the responsibilities that were previously distributed among several offices and agencies, including those reporting to the anti-monopoly Committee of the State Council and the anti-monopoly Office of the Ministry of Trade.

This reform is also motivated by the search for greater incisiveness and capacity to manage data, information and analyses, in order to be able to intervene in a market that is constantly expanding and dominated by large-size firms and in sectors where information technology permits rapid market concentration or distortion. It is not by chance that, in July 2021, the new agency forbade a merger in the

internet sector for the first time in China, specifically between companies involved in interactive entertainment video businesses, both of which are linked to Tencent, one of China's giant internet companies.

In short, this reinforcement of China's legal system, above all of the area that concerns the regulation of the financial and industrial markets, has accelerated from the years 2017- 2018 onwards, in close connection with the opening-up policy gathering pace, i.e. for further opening the Chinese market to foreign investment, both industrial and financial. I believe that both the Italian government and Italian banking and financial institutions quickly grasped the importance of this reform process and the opportunities that it would create.

It was against this background that in the summer of 2018, during a visit to China as the Italian Finance Minister, I reached an agreement with the Chinese Finance Minister, to launch a structural bilateral Financial Dialogue between the two Ministries. The agreement was signed by the two Ministers the following November and in July 2019, the first China - Italy Financial Dialogue was held in Milan, with the participation of the Finance Minister, Liu Kun.

The Forum was favoured by a series of prior agreements, including the agreement aimed at avoiding double taxation for firms operating in both countries, which I believe to be a very important one.

Unfortunately, the pandemic meant that the bilateral Financial Dialogue could no longer take place in person, although it continued remotely to the satisfaction of both parties. I call to mind this initiative because it began in the year when China was promulgating the new laws and regulations for the opening of its markets. It was in fact in March 2019 that a new and fundamental law on foreign investment was enacted, followed by several other rules for its implementation and updating.

Nevertheless, for laws to be effective they must be known, understood and tested to see if they function in practice. This is the reason why the Financial Dialogue initiative between Italy and China aims to maintain a constant dialogue on the evolution of Chinese, Italian and European policies and the regulatory frameworks within which to set up working agreements based on cooperation and reciprocity between the two countries. The aim is to encourage businesses in banking, insurance and financial intermediation by qualified operators from both countries in the respective markets, within the framework of the respective regulatory systems.

Alongside the dialogue established at government level between the two Ministries, and again in 2018, the idea of setting up a bilateral Italy-China Think Tank was born in Shanghai with an agreement between the Shanghai Administration Institute, under the patronage of the Municipality of Shanghai, and the University of Rome Tor Vergata, under the patronage of Italy's Ministry of Economy and Finance.

The purpose of this Think Tank is to examine in depth the topics relating to the opportunities for economic and financial cooperation, following China's decision to carry on gradually the opening up of its financial and banking market, and to promote dialogue designed to provide the respective government authorities with ideas and proposals for improving regulation.

As a matter of fact, opening the markets requires careful consideration of the national legal systems in which business activities are to be carried out. Even with the differences in the overall systemic frameworks of the various legislations, economic and financial activities still require coherent and complete regulatory systems within which to operate. They benefit from a regulatory regime that, though taking account of the greater or lesser rigidity of each system, aims to ensure the stability of markets, especially financial ones.

Perhaps we should remember the teachings of the American economist and Nobel prize winner Robert Shiller who, long before the crisis in 2008, raised the topic of the ‘irrational exuberance’ of financial markets. In other words, Shiller was warning us that investors are not always rational and often act on the wave of a sentiment, a kind of euphoria.

It is also true that without this ‘irrationality’ on the part of entrepreneurs, economies would be far less dynamic, and innovation and growth would slow down. Yet this also explains the difficulties for legislators who, on the one hand, have to regulate and limit this ‘irrationality’, namely the exuberance of the ‘animal spirits’ of entrepreneurs, to avoid systemic crises that have varying repercussions among citizens and economic operators, and, on the other hand, have to guarantee innovation and a free market to sustain growth.

It is not always easy to find a balance between the two needs, and it is perhaps for this reason that in the history of western capitalism, just as in the history of Chinese economic development, periods when policies favour the second objective, that of rapid and disorderly growth, are followed by periods when there is a need for excesses to be corrected, for the system to be consolidated and stable, and for well-being to be distributed more fairly. This is also to reduce systemic risks, which would impact all investors and savers.

Today, we are perhaps in a phase in which in China, just as in European and other advanced countries, the rapidity of technological progress and of its spread worldwide mean that both these needs require a response. Scientific and technological progress is changing production methods and finance in ways that are hard to predict, and what happens in one country has global repercussions. Hence the idea that regulatory systems need to converge with regard to both the goals of combating climate change, of limiting the concentrations of economic power and of the systemic influence of the IT platform giants, and of ensuring the transparency and stability of financial

markets and monetary order. It is a question of re-establishing the rules of the game at global level at a time when the instruments for playing the game and the playing field are completely new.

From this point of view too, what happens in China concerns all of us and in certain respects shows the western world to be in arrears, as while in some ways it seems more advanced in the drawing up of legislation and in its capacity for monitoring and control, in other ways it seems to be behind, in part because the phenomenon of the 'regulatory capture' by those who should be regulated.

In conclusion, the convergence of rules from different systems lowers transaction costs for industrial firms and for financial intermediaries operating in foreign countries and increases trust between systems, a trust that arises from dialogue, knowledge and understanding.

The law may have a role of 'bridge' in the dialogue between the countries, but a bridge is only crossed both ways if those who cross it find welcome and safe shores.