Strengthening the EU-China Financial Cooperation

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Abstract: The EU-China financial cooperation has covered various areas such as financial institutions, financial market and financial infrastructure, global financial governance and monetary policy coordination, financial regulation, etc. Major obstacles restricting the EU-China financial cooperation include: firstly, the large gap between financial systems of both sides, various challenges confronting Chinese enterprises' investment in Europe, and lower scale of the EU-China financial cooperation than trade cooperation; secondly, it is now facing the risk of changes in US-dollar-denominated financial assets, Brexit, deficiency in the EU-China mutual trust and other impacts. However, the common interests of the EU-China financial cooperation far outweigh the harm caused by competition, and the EU-China financial cooperation enjoys tremendous space and potential in the imminent decade. To strengthen the EU-China financial cooperation, the principle of "limited objectives, finite cooperation, and moderate advancement" is required so as to gradually promote the EU-China reciprocal financial opening. In the short term, further promote the cooperation in financial market, financial infrastructure, financial regulation and policy coordination as well as global financial governance. In the long term, the EU-China exchange-rate coordinating mechanism is expected to be established on base of three implementation plans: firstly, to establish the EU-China exchange-rate coordinating mechanism by drawing lessons from Chiang Mai's experience; secondly, to construct RMB-swap fund pool; thirdly, to displace reserve fund through substantially issuing government bonds, to influence interest rate through dealing in government bonds, and to give full play to functions of interest-rate adjustment mechanism.

1. Analysis of Status Quo and Demands of the EU-China Financial Cooperation

1.1 Present States of Cooperation: the EU-China Financial Cooperation is an Inherent Appeal

1.1.1 The Deepening of the Cooperation of Financial Institutions and Financial Market

——**China and the EU have accelerated in cultivating multi-lateral bank credit market.** In 2015, Britain, Germany, France and Italy have successively announced to join Asian Infrastructure Investment Bank (AIIB); in 2016, China formally acceded to European Bank for Reconstruction and Development, which symbolized the EU-China financial cooperation has entered into a new phase.

——**The cooperation between China and the EU bond market has been deepening continuously.** Both sides have accelerated the development of multilateral bond market.

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In 2014, China Development Bank issued 2 billion yuan-denominated bonds; [2] in October 2015, Shanghai Stock Exchange, Deutsche Boerse Group and China Financial Futures Exchange co-invested 200 million RMB to jointly establish China Europe International Exchange (CEINEX) AG in Frankfurt, Germany, aiming to co-construct an off-shore transaction platform for RMB and financial tool; in the same period, by adopting the book-building method, People's Bank of China successfully issued 5bn yuan-denominated one-year central bank bills with a coupon rate of 3.1% in London, which was also the first batch of yuan-denominated central bank bills issued outside China; On May 26th, 2016, China's Ministry of Finance issued 3bn RMB government bonds in London and was listed for trade on London Stock Exchange, and this was the first time for the Chinese government to issue off-shore government bonds outside Hong Kong.

——**The cooperation in the EU-China insurance market has started up.** On June 15th, 2016, China and the EU signed *Memorandum of Understanding between China Insurance Regulatory Commission and the European Insurance and Occupational Pensions Authority*. This would further enhance mutual understanding between insurance regulatory agencies of both sides, and strengthen the existing cooperation mechanism.

——**The cooperation in the EU-China investment fund continuously to expand.** Aimed at leveraging 50bn euro credit fund of the program, Sino-CEEF Fund was established with an estimated scale of up to 10bn-euro in November 2016. Moreover, China and the EU have jointly expanded cooperation in third-party market, and are currently promoting cooperation in Sino-France-Africa non-tripartite enterprises and financial institutions. In 2014, ICBC (Europe) initiated the Collective Investment Fund in Transferable Securities (referred to as UCITS Fund) invested in Chinese bond market, and became the first locally-registered Chinese-funded bank that entered the investment fund industry in Europe.

1.1.2 Close Cooperation in Financial Infrastructure

—— **Cooperation in settlement.** The setting ups of branches or subsidiaries of Chinese-funded financial institutions overseas on the one hand facilitate Chinese enterprises' local investment and settlement. Chinese-funded bank branches can provide reliable and convenient channels for Chinese enterprises to invest and finance in Germany, provide RMB clearing services, and help enterprises reduce the costs of currency conversion. On the other, it can provide support for local enterprises to invest in China. For example, ICBC has set up branches in 20 cities in Europe, with Bank of China 6 in Germany, which greatly enhanced the service capability of Chinese-funded financial institutions in Europe.

—— **Cooperation in RMB swap**. Currency swap arrangement and RMB bank clearing

[2] Geng Mingying, *Contemplation on Accelerating Construction of Multilateral Financial Market under "the Belt and Road" Strategy— On Opportunities of the EU-China Financial Cooperation, Practice in Foreign Economic Relations and Trade,* Issue 11, 2016.

have strengthened the links between RMB and euro, and most large European banks have considered or are considering including RMB into foreign exchange reserves. In October 2013, People's Bank of China signed a 45bn-euro three-year bilateral currency swap arrangement with European Central Bank, and extended the validity of this arrangement for three more years to October 8th, 2019 on October 2016,.

——**Cooperation in clearing system.** Since 2014, China has signed RMB clearing agreements with Britain, Germany, Luxembourg and France respectively, while four off-shore RMB financial centers in London, Frankfurt, Luxembourg and Paris have become increasingly mature Britain, in particular, has become the second biggest off-shore RMB clearing center after Hong Kong in the world. Data from Society for Worldwide Interbank Financial Telecommunication (SWIFT) reveals that 72.5% of RMB payments were handled by Hong Kong, while 6.3% by Britain and 4.6% by Singapore; 40% of all transaction payment between Britain and China were denominated by RMB, 24% by HKD and 12% by GBP. In addition, “CEINEX”, opened in Frankfurt in 2015, has effectively connected markets of China and Germany and spurred on 24h RMB transaction. It is now playing an increasingly important role in opening of Chinese capital market and internationalization process of RMB.

1.2 Cooperation Fields

1.2.1 Cooperation in Financial Governance

In 2016, G20 Hangzhou Summit in China initiated the reform of global financial governance framework, including global financial safety net, green finance, global financial system etc. Pierre Moskovic, commissioner of the EU economic and financial affairs, addressed: “China has been committed to accelerating the reform of global economic and financial governance, especially in improving the representativeness and raising the voice of emerging economies and developing countries. The EU welcomes China to play a positive role in global economic stability and healthy development.” He deemed that emerging economies, especially China’s integration into the international financial system is conducive to the EU[3].

1.2.2 Coordinating the EU-China Monetary Cooperation

In recent years, China and EU have prevented excessive competition by coordinating the EU-China monetary cooperation. Competition between currencies is quite common and inevitable, but how to avoid vicious competition and damages on both sides in global monetary system becomes a major objective for the EU-China financial cooperation. At the crucial point of European debt crisis, China has firmly supported the stability of euro and European economic integration and has provided assistance to EU through bonds purchase and imports increase. Meanwhile, Europe’s positive attitude towards RMB’s entry into SDR, construction of off-shore RMB center etc. has

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[3] Liang Linlin, Shuai Rong, et al. *An Overview: Europe Expects G20 Summit to Improve Global Financial Governance*, http://www.xinhuanet.com, August 28th, 2016.

effectively boosted internationalization process of RMB.

1.3 Political Coordination in the EU-China Financial Cooperation

—— **Strengthening the EU-China coordinated political cooperation.** There are primarily three platforms for the EU-China coordinated financial-policy cooperation: regular meeting mechanism of China and EU leaders, the EU-China financial dialogue mechanism and the EU-China High-Level Economic and Trade Dialogue (HED). The multi-level, multi-field dialogue and communication serve to coordinate bilateral financial policies and promote financial cooperation between both sides

—— **Strengthening the EU-China supervision cooperation.** The People's Bank of China has set up representative offices in London and Frankfurt for conducting exchanges and cooperation with the European Central Bank as well as central banks and financial regulatory authorities of EU members; China Banking Regulatory Commission (CRBC) has signed memorandum of understanding for bilateral regulatory cooperation and regulatory cooperation agreement with banking regulatory authorities of multiple European countries; China Insurance Regulatory Commission has established the EU-China insurance regulatory dialogue mechanism with EU Insurance and Occupational Pensions Regulatory Commission. Moreover, stability and development of both sides have been promoted by means of financial supervision, revision of financial stability standards and other aspects of policy cooperation.

2. Risks and Challenges Confronting the EU-China Financial Cooperation

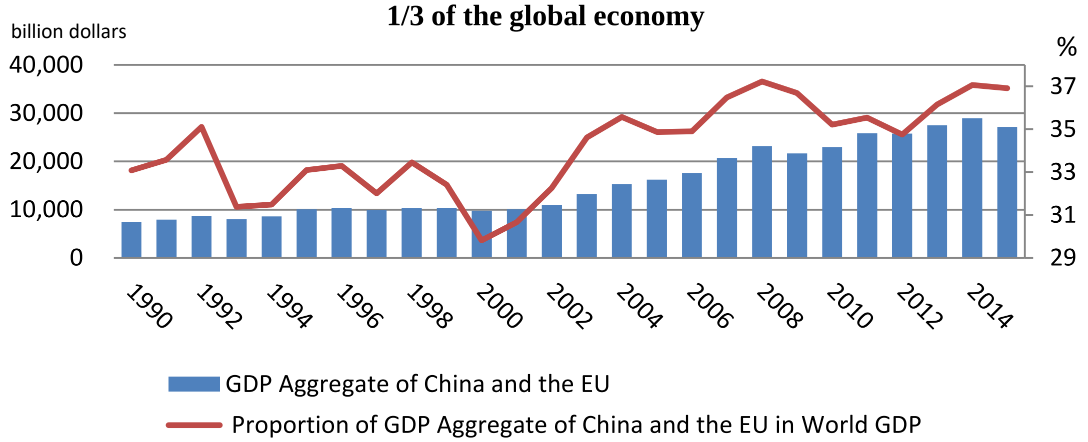
There exists competition between China and EU financial cooperation. However, in terms of costs and benefits, the mutual interests of bilateral cooperation outweigh much the harm caused by competition.

2.1 Main Problems and Obstacles Restricting the EU-China Financial Cooperation

2.1.1 The EU-China Cooperation in Trade is much more than that in Finance

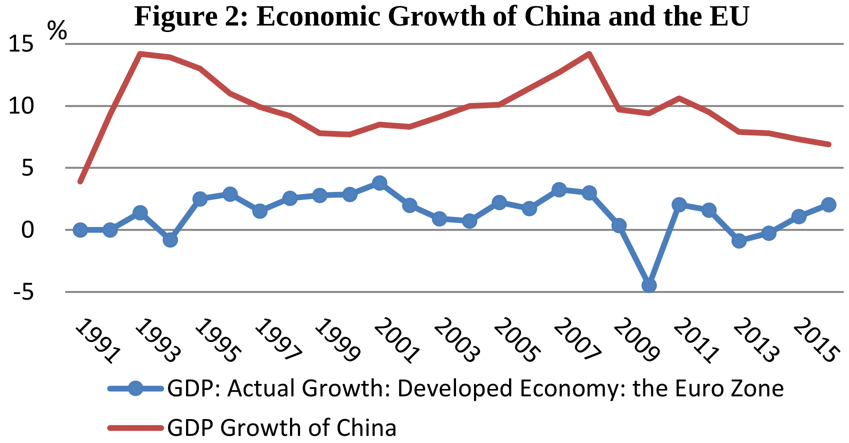
In recent years, the EU-China bilateral trade has remained steady, and the European Union has become the largest trade partner, the largest source of technology transfer and an important investment partner, the largest source of imports and the second largest export market of China. The aggregate economic volume between China and EU has accounted for 1/3 of the global economy and 37% in 2015; the EU-China bilateral trade volume has doubled over the past decade, and reached 564.8 billion US dollars in 2015; the two sides jointly developed the *EU-China 2020 Strategic Agenda for Cooperation* which covers cooperation in nearly 100 areas. However, the pace of the EU-China financial cooperation is relatively slow, and the scale of mutual investment remains relatively backward especially. In recent years, despite the substantial increase in the scale of mutual investment between China and EU, it only accounts for 6.1% and 1.6% of the total volume of foreign direct investment of both sides. It is incompatible with their economic aggregate and thus still leaves great space for investment between both sides.

Figure 1: Aggregate economic volume of China and EU accounts for 1/3 of the global economy



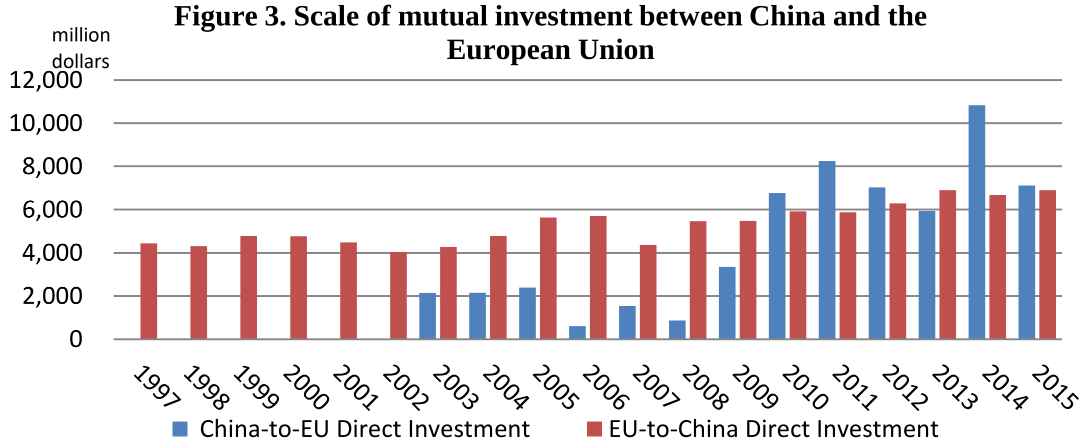
Data Source: *Wind* Info

Figure 2: Economic Growth of China and the EU



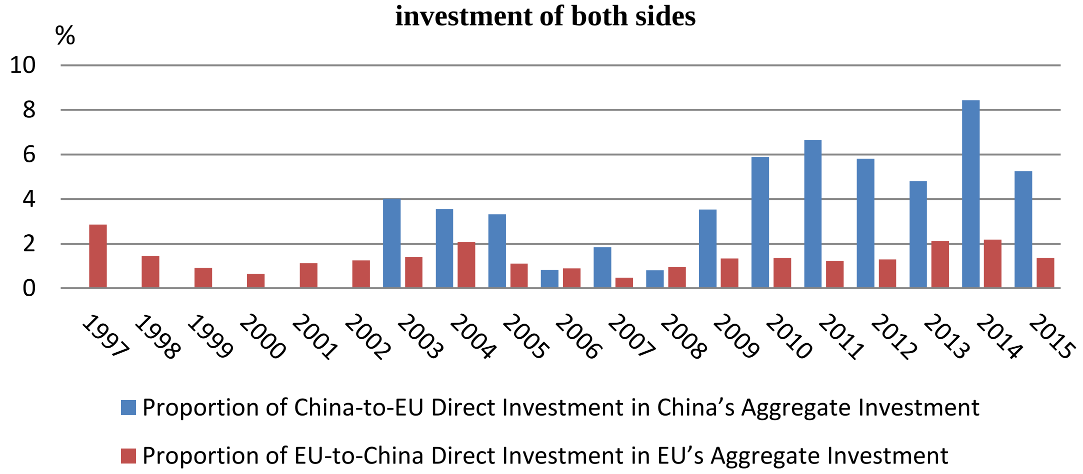
Data Source: *Wind* Info

Figure 3. Scale of mutual investment between China and the European Union



Data Source: *Wind* Info

Figure 4: Scale of mutual investment between China and the European Union accounts for only a small portion of foreign direct investment of both sides



Data Source: *Wind* Info

Table 1: the EU-China bilateral trade volume has doubled over the past decade (Unit: ten million US dollars)

2015				2016			
Country (Region)	Import/Export	Export	Import	Country (Region)	Import/Export	Export	Import
Total Volume	395,690,073	227,494,984	168,195,089	Total Volume	176,068,645	96,907,284	79,161,361
Europe	61,836,566	36,345,596	25,490,970	Europe	33,022,904	21,537,149	11,485,755
EU(28 Countries)	56,475,484	35,587,590	20,887,894	EU(25 Countries)	27,230,233	18,198,335	9,031,898
Euro Zone(19 Countries)	41,895,071	25,007,989	16,887,083	EU(15 Countries)	25,636,142	16,902,480	8,733,662
Germany	15,678,368	6,916,091	8,762,277	Germany	7,819,443	4,031,571	3,787,872
Holland	6,825,540	5,946,295	879,244	Holland	3,451,216	3,086,079	365,137
France	5,141,010	2,675,309	2,465,701	France	2,518,851	1,390,976	1,127,875
Italy	4,469,236	2,783,737	1,685,499	Italy	2,457,657	1,597,340	860,317
UK	7,851,830	5,958,168	1,893,663	UK	3,066,959	2,416,321	650,638

Data Source: organized according to the data on official website of the Ministry of Commerce of PRC

2.2.2 Great Differences between China and EU Financial Systems

——**significant differences exist between financial systems in China and EU.** The euro zone is equipped with a unified monetary union that can effectively carry out money market management. European Central Bank (ECB) is responsible for financial and monetary policies in the European Union and the euro zone. Europe's foreign exchange market, money market and bond market are of high maturity and has perfect mechanism. However, iinstitutional defects in the euro zone, including the lack of a unified fiscal union, unified fiscal policies, monetary unification and fiscal decentralization, are roots for the debt crisis.

Different from the EU, China has unified monetary and fiscal policies. The People's Bank of China (PBOC) is responsible for formulating monetary and financial policies to manage the total amount of RMB currency, foreign exchange reserves and gold reserves, and carry out macroeconomic financial regulation and control. The Ministry of Finance is in charge of fiscal policy, managing government expenditures and tax revenues as well as government bonds. In other words, People's Bank of China manages currency and economy of "China", while the Ministry of Finance manages bills of the "government".

The European financial market system has become relatively mature while China's financial market is still in the reformation phase: there exists imperfect financial system, gap in regulatory level and technical conditions compared to that of EU and lack of experience in dealing with international financial risks. International experience reveals that an immature financial market and intense turbulence in the market may invite international hot money shocks and thus trigger a financial crisis; the lack of regulatory capability and experience may lead to the loss of strategic resources and thus influence economic development of a country; virtual economy expansion that severely departs from the real economy will give rise to accumulation of financial risks and thus become the blasting fuse of a financial crisis.

—— **Differences exist in market access standard of China and the EU.** The core difference of financial system between China and EU is market access, including subsidiary conditions of market access and incongruous standards in aspects like human rights, intellectual property rights, environmental protection and labor welfare,. These have hindered further development of the EU-China financial cooperation.

——**The main line of China's future financial development is to serve the supply side reform.** Five key concepts for future China's financial development are: innovation, coordination, greenness, opening and sharing. China will orderly promote two-way opening of the financial sector, fully implement post-establishment national treatment plus negative list management system, and expand accesses for banking, insurance, security, pension and other markets; promote two-way opening of capital market; enhance openness of the stock and bond markets; establish accounting standards, regulatory rules and legal regulations compatible with international financial market, and elevate internationalization level of financial market.

2.2.3 Various Challenges Confronting Chinese Enterprises' Investment in Europe

Chinese enterprises' investment in Europe is still facing various challenges. First, European government and people have certain bias against Chinese enterprises, believing that China is using "enormous savings to purchase cheap jewelry in Europe". Second, high legal costs and barriers prevent Chinese enterprises' investment in Europe. Since the EU presently does not have a unified direct investment policy, there are large differences in policies and regulations, market access and supervision methods in member countries, resulting in high legal costs of Chinese enterprises' investment in Europe. In the meantime, foreign investment in infrastructure and other areas is limited or requires approval, while some competitive areas are hindered by industry associations. Thus enterprises may find it difficult to find an access due to high hidden thresholds. Third, high-standard labor requirements and high labor costs have brought greater pressure to Chinese enterprises' business in Europe. Fourth, it is relatively difficult for Chinese enterprises to obtain business visa, work permit and residence permit, and therefore problems like short residence period, time-wasting application for extension, cumbersome handling procedures still exist. Fifth, Chinese enterprises have to confront with finance difficulties in investing in Europe. Influenced by their credit, scale and accounting standards, Chinese enterprises may have difficulty in obtaining loans from financial institutions not only in China but in foreign countries. On the other hand, some Chinese enterprises suffered from frustration and failure in investment in Europe due to their own problems. Firstly, without sufficient research and detailed investment plans, Chinese enterprises often blindly expand themselves and pick a cheap bottom, which result in investment failure. Secondly, devoid of the understanding of European society and culture, Chinese enterprises may fail to be acclimatized and localized. Thirdly, lacking of international professional talents, Chinese enterprises fail to accommodate international business philosophy. Fourthly, some enterprises have ignored the influence of local labor unions, failed to properly handle the relationship with them and thus encountered tremendous resistance.

2.2 High attention to Dollar-denominated Changes in Financial Assets

China and the EU both confront with risks brought by sharp turbulence of dollar-denominated financial assets. For example, Deutsche Bank is now facing a typical external shock. If German government and German government refuse to get involved in the risk, a new round of crisis in the euro zone may ensue. Of course, the premise of such risks lies in risks of dollar-denominated financial assets. In other words, the second half of the global financial crisis will recur, and a new round of oscillation is expected. Therefore, China must pay high attention to and closely monitor the changes of dollar-denominated financial assets.

2.3 Keeping Track of Brexit's Impacts on Financial Institutions

After the Brexit referendum, there will be wider space for Sino-British financial cooperation. Pound would like to strengthen its close cooperation with RMB, RMB-denominated assets as well as corresponding financial institutions to raise its status and influences, especially strengthen the position of London as a financial center. However, when and how Brexit actually takes place brings tremendous uncertainties to its economic and financial aspects Also, political factors should be taken into consideration.

2.4 Focusing on Political Consideration in Financial Cooperation

The EU-China financial cooperation should be based on mutual political trust, instead of suspicion. As a regional alliance, the European Union is highly sensitive to its unity and stability, and attaches more importance to politics. For example, the construction of Central and Eastern Europe Railway by China, UnionPay in the Central and Eastern Europe and the Asian Financial Cooperation Association in works are considered as actions splitting up and disintegrating the European Union.

If European financial institutions stay out of those organizations, they may eventually be marginalized in the market and suffer heavy loss. They will also be subjected to impacts on pricing power, capital transfer, networking services and global coverage, especially in standards since the next step is to jointly set standards for security, insurance and fund.

Therefore, cooperation between financial institutions in China and EU should be propelled by market power. In the process of promoting docking to “The Belt and Road Initiative” and Junker Plan, China and the EU should not only reply on government efforts, but also mobilize and organize power of financial market.

3. Conception of Deepening the EU-China Financial Cooperation in the Next Decade

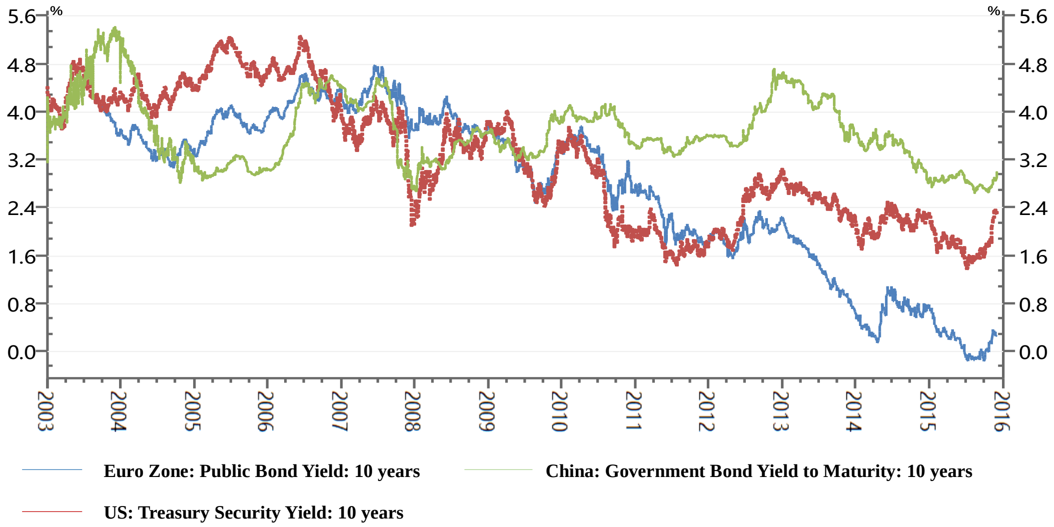
To strengthen the EU-China financial cooperation, the principle of “limited objectives, finite cooperation, and moderate advancement” should be followed to gradually promote the EU-China reciprocal financial opening. In the short run, further intensify cooperation in financial market, financial infrastructure, financial regulation and policy coordination, global financial governance, etc. In the long run, construct the EU-China exchange rate mechanism and financial trading platform.

3.1 Short-term Objective: Strengthen Cooperation in Various Areas including Financial Market

3.1.1 Strengthening Cooperation in Financial Market

—— **Cooperation in issuing bond and fund.** The EU-China financial cooperation focuses on dealing with medium- and long-term financing issues and requires issuing long-term bonds, while the key point lies in how to attract investors to purchase them. However, due to excessive global liquidity and redundant high-quality assets, bonds have become scarce. In global bond market, bond yield is now on the rise. Therefore, how to attract financial investors to buy long-term bonds and thus effectively provide long-term support has become a critical issue. The European bond market is the most mature one in the world. At present, China can draw lessons about structural design and product development of the bond market etc. from experience of the Europe in promoting the development of Asian bond market. The 2 billion RMB-denominated bonds issued by China Development Bank in London in 2014 are of symbolic significance.

Figure 4: Trend Chart of Bond Yields in Euro Zone, America and China



Data Source: *Wind* Info Chinabond.com

——**Cooperation in establishing cross-regional credit rating agency.** Currently, there are only three internationally-recognized authoritative professional credit rating agencies: Standard & Poor, Moody's Investors Service, and Fitch Ratings International Credit Rating Limited in the United States. China and Europe can jointly set up credit rating companies to provide rating services for Chinese and European enterprises, financial institutions, structured financing, local governments and state sovereignty, and promote the EU-China financial cooperation.

——**Cooperation in the EU-China investment and financing guarantee institutions.** That is, to provide guarantee for local bond issuers' issue and credit solicitation.

——**Cooperation in technical assistance to regional monetary pricing.** European credit market is highly developed and the global money market price takes London LIBOR rate as the benchmark interest rate. It's worth consideration to take Shanghai SHIBOR rate as a base to establish currency pricing benchmark for Asian region. Since interest rates as well as the exchange-rate formation mechanism in China have not yet become fully marketized, there exists certain control against capital projects and China is still not equipped with currency pricing power. But in terms of technical assistance, China and the European Union can carry out cooperation in fields like training and R&D.

3.1.2 Strengthening Cooperation with Financial Centers in European Countries

London has become the second largest off-shore RMB center only after Hong Kong and is now playing an increasingly significant role in RMB internationalization process. Statistics show that Britain has accounted for more than 40% of global foreign exchange transactions in 2015, while London still remains the world's second largest RMB settlement center, with the average RMB-denominated daily transaction volume of 60bn dollars compared to 90bn dollars in Hong Kong. China should strengthen cooperation with major RMB settlement centers in Paris, Frankfurt, Switzerland and Luxembourg as well as with Britain and France in banking and insurance industries. Moreover, intensifying cooperation with Frankfurt in financial service sector and small- and medium-sized Sino-German financial institutions, enhancing cooperation with the neutral financial center Switzerland in private banking services and with Luxembourg in asset management, and consolidating dialogue and cooperation with Belgium, where the headquarter of the European Union lies are also of great importance.

3.1.3 Strengthening Infrastructure Investment Cooperation

There is a huge demand for infrastructure investment such as road, railway, power grid, and pipeline construction in EU. Meanwhile, China possesses strong infrastructure capability in areas like highway, high-speed rail and bridge. Data suggests that China has spent about 8.5% of its GDP on infrastructure construction from 1992 to 2012, which far exceeded the EU's average of 2.6%. Thus, China and Europe can reinforce cooperation through bonds or mutual funds in infrastructure so as to enhance financial supporting ability for the real economy. Besides, China and European countries can enhance support to projects like overseas merger, overseas market expansion, technological upgrading, resource and power acquisition and intellectual property rights so as to further widen the depth and breadth of the EU-China financial and investment cooperation[4].

3.1.4 Strengthening Regional Financial Cooperation

During the Boao Forum for Asia 2016 the Asian Financial Cooperation Association (hereinafter referred to as the "AFCA")was formally initiated It is a non-governmental Asia-based regional international organization that operates following the rules for regional international non-governmental organizations , strives to promote information exchanges among financial institutions inside and outside the region, boosts cooperation in financial infrastructure, financial business and risk prevention and control and aims to enhance the influences of Asian financial institutions in international financial market. A total of 38 financial institutions from 12 countries and regions in Asia, Europe and America initially joined AFCA, and currently the membership has extended to 100 countries, including a number of financial institutions engaged in related financial services as well as financial infrastructure like banking, security, insurance, fund, trust and other payments and settlements. In terms of market entity, almost all financial markets, financial and service institutions with businesses of banking, security, insurance, fund and trust, have joined the Association which make its comprehensiveness and representativeness go far beyond that of Asian Infrastructure Investment Bank (AIIB). From the aspect of market, APCA has covered business

[4] Zhang Monan, *Expanding the EU-China Financial Cooperation, Promoting RMB to Enter SDR, China Securities Journal*, June 27th, 2014.

cooperation among all financial institutions, including syndicated loan, joint loan, parallel loan as well as business like cooperation among banking, security and insurance.

3.1.5 Strengthening Financial Supervision and Policy Coordination

Since the outbreak of financial crisis, the European Union has adopted a series of major financial reform measures including crisis response and management measures like establishing mobile firewalls, crisis relief mechanism for member states, and monetary policy tools innovation, as well as financial supervision measures like setting up new regulatory agencies, strengthening macro-micro prudential supervision, creating single-rule manual and constructing banking alliance. EU's philosophy and measures in financial system reform are of vital reference value for China. China should attach importance to liquidity management of commercial banking system, innovation of monetary policy tools and acceleration of banking bankruptcy and liquidation system construction while guarding against debt risks during the deleveraging process of China's economy[5].

3.1.6 Strengthening Global Financial Governance Cooperation

China and the EU should strengthen communication and coordination under the G20 framework and support G20 to play an important role in international economic cooperation as a major forum Both sides should further improve global economic and financial governance, sustain the expansion of SDR usage, reinforce global financial safety net, promote share and governance reform of International Monetary Fund (IMF), ameliorate sovereign debt restructuring mechanism as well as the monitoring and management of capital flow, and establish a more stable and resilient international financial architecture.

3.2 Long-run Objective: Constructing the EU-China Exchange Rate Coordinating Mechanism

3.2.1 Constructing the EU-China Exchange Rate Coordinating Mechanism

RMB internationalization will be a new domain in the EU-China financial cooperation. In Europe, there are already some off-shore RMB central cities such as London, Frankfurt, Paris and Luxembourg. The continuous deepening of the EU-China financial, economic, trade and investment cooperation has put forward new requirements for maintaining stability of the exchange rate between RMB and Euro. Therefore, it is necessary for China and the EU to establish the EU-China exchange rate coordinating mechanism, form expectations of an ordered global capital market and reasonable capital flow and prevent systematic risks triggered by excessive fluctuations of exchange rate. The following schemes are proposed to promote the establishment of the EU-China exchange rate coordinating mechanism:

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[5] Zou Zongshen, *Mirroring and Extension of the European Financial System, Reform*, Issue 8, 2016.

Scheme 1: Drawing Lessons from Chiang Mai's Experience in Establishing the EU-China Exchange Rate Coordinating Mechanism

As the most important institutional achievement of Asian financial integration, the *Chiang Mai Initiative* is of far-reaching significance for preventing financial crisis and promoting further regional monetary cooperation. Member states of Chiang Mai Initiative Multilateralization (CMIM) consist of a total of 14 economies, including all 10 member countries of ASEAN, China, Japan, South Korea and China's Hong Kong SAR. Currently, the common reserves of CMIM have reached 240bn US dollars, aiming to assist relevant countries when they run into short-term financial difficulties, so as to prevent financial crises and ensure global financial stability on regional level. CMIM has become an essential part of international financial system.

The establishment of the EU-China exchange rate coordinating mechanism can draw lessons from experience of the *Chiang Mai Initiative* and implements contents as follows: First, to sign the *Cooperation Agreement for the EU-China Exchange Rate Coordinating Mechanism* on a regional level, expand the EU-China financial dialogue to conference between finance ministers and central bank governors and further reinforce information exchange and policy coordination between both sides; Second,, G20 platform can be fully utilized to strengthen the EU-China exchange rate coordination on a global scale. Meanwhile, both sides can work together to improve international monetary system, promote currency diversification of international reserves, advance the formation of international reserve currency system with currency stability, ordered supply and adjustable total reserves and fundamentally safeguard global economic and financial stability.

Scheme 2: Constructing RMB-Swap Fund Pool

To actively build RMB swap fund pool can effectively expand the "one to many" RMB swap and clearing systems so as to promote the development of its clearing function and effectively prevent risks. Both sides can borrow experience from the Bank for International Settlements (BIS) to carry out bilateral differential swap and balance settlement in terms of the calendar year, establishing a daily account system and gradually a capital account system. In direct bilateral settlement financing, it is encouraged to center on RMB internationalization to implement indirect bilateral swap and get rid of "dollar trap". Both sides should support trend stability of Euro, comprehensively coordinate future competition between RMB and Euro from infrastructure, policy coordination to market construction and maintain stability of RMB against Euro.

Scheme 3: Displacing Reserve Fund through Substantially Issuing Government Bonds; Influencing Interest Rate through Dealing in Government Bonds; Giving Full Play to Functions of Interest-rate Adjustment Mechanism

The issue of RMB exchange rate is essentially the issue of RMB interest rate. To reform China's financial system, three points are needed. The first is to realize marketization of interest rate. The second is to issue short-term RMB-denominated government bonds and improve the bond yield curve. The third is to improve China's bond market and set government bond yield to risk-free interest rate.

China should vigorously develop and promote the opening of its bond market and allow domestic and foreign financial institutions to invest in RMB-denominated bond market. At present, China's interest rates are generally higher than that of other countries and RMB government bonds issued by China are of higher yield rate, which may attract greater demands in international market. Government bonds issued by central or local government of first-tier cities will receive recognition and popularity on the market.

It is advised to displace reserve fund through substantially issuing government bonds. Presently, the reserve ratio in China's banking sector is 17%. If the ratio is lowered, the currency may be too loose and give rise to various problems. China can consider displacing reserve fund through substantially issuing government bonds, which can not only increase fiscal spending but also alter the balance sheet structure of banking sector. In this way, a considerable portion of bank assets is government bond. If all reserves are displaced, that is 1/5; if a portion is displaced out, at least 1/10 is government bond. Therefore, macro-control has actually changed. In other words, banks can obtain liquidity and influence interest rate through selling and purchasing government bonds, and then interest-rate adjustment mechanism can take effect. Moreover, government bond issue must stabilize fiscal deficit and thus expectations. To take US macro-control for an example, government bond has played an important role in macro-control while treasuries of US central bank are interactive and they jointly maintain an orderly bond market through interest-rate transmission mechanism.

3.2.2 Creating the EU-China Financial Trading Platform

As an open platform, the EU-China comprehensive trading platform supports all products, including stocks, bonds, futures, commodities, works of art and intellectual property rights, to be traded on it. China should create such a trading platform and construct the platform-based coordination of infrastructure, payment settlement, custody, credit, ratings, guarantees and regulations. In this way, a the EU-China-centered global trading market is to be anticipated.

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