

*Think*

*new things*

*Make*

*new connections*

# **Geofinance: the impact of China, cyber security and strategic issues on the global financial system**

A Ditchley conference at Greentree, building on the series of conversations on geofinance launched at Mill Reef in 2019

22-24 April 2022

**DITCHLEY**

# Terms of Reference

This Ditchley discussion, to be held at the Greentree estate on Long Island, New York, will be an in-person event, with no virtual participation. The conference will bring together leading thinkers in finance, foreign policy, defence and national security to discuss the strategic context for the evolution of the global financial system: what do geopolitical tension with China; ever increasing cyber threats and other stresses of the global system such as adaptation to climate mean for finance? What are the opportunities alongside the threats? We aim to enable a frank and protected conversation, creating a rare opportunity to develop shared strategic thinking. The conversation will build on Ditchley's series of discussions on geofinance, begun at Mill Reef in 2019 and continued virtually in 2021.

## Detail

Modern global finance evolved in conditions of relative openness with an expectation that global connections would grow stronger and that political liberalism would follow. The Indo-Pacific is increasingly the engine of global growth, but this is likely to be in the context of increasing geopolitical tension.

At the centre of this tension is the systemic rivalry between the US and China. China has become more assertive and more far reaching – with increasingly strident demands that relationships are conducted on its terms – but also more insular and closed off from the world. The pandemic emboldened China's stance, but it is also now a matter of policy, imposed not by the United States pushing back against China, but by President Xi Jinping's assessment that openness had served its purpose but has overshot its mark.

In the context of slowing growth (in part as a result of COVID and global headwinds, but also because the CCP has chosen political control of a dual-circulation economy that loosens dependencies on the West, over optimum growth), President Xi Jinping has launched a 'rectification' campaign to reassert traditional Chinese Confucian values under the banner of 'common prosperity'. The policy is aimed to defuse the tensions among the hundreds of millions of Chinese people who remain below the poverty line by global standards and to address signs of disaffection amongst the young middle class. The targets are selected entrepreneurs, technology companies and symbols of westernisation such as boy bands, film stars and sports stars. Despite this switch in direction, the campaign is so far highly selective and symbolic. Plenty of wealthy Chinese, and especially the princelings of the Party, remain untouched and China is still a highly capitalist country.

What does the changing domestic scene in China mean for the stability of the global financial system? Is the partial turning inward in China a temporary phase or a permanent change that could intensify if China's growth slows further? Is continued investor interest in Chinese government bonds, especially in Europe, wise engagement or a growing systemic risk in the event of a crisis, for example over Taiwan? Beijing sees courting Wall Street as part of gaining influence in Washington. What are the implications for US national security?

On the US side, there is close to political unanimity in an otherwise divided country that now is the time to push back against China, competing across multiple spheres but also co-operating when essential. But can that balance be sustained? How far should the US go on decoupling supply chains in strategic industries?

The AUKUS nuclear submarine deal was in part a response to China's increasing military capability through installations in the South China Seas and the development of hypersonic missiles that could

deliver nuclear warheads. In the Indo-Pacific it has been welcomed by some but seen by others as a raising of the temperature. A number of countries are worried that, increasingly, they will be asked to choose one orbit or another, the US or China. What are the risks of a crisis over Taiwan or some other flashpoint in the South China Seas? What would be the implications for global growth and the financial system? If China moved against Taiwan, what would be the US' options for a reaction (and what could the US and allies do to deter a Chinese invasion?) How would disruption of semi-conductor supply chains disrupt the global economy broadly and finance specifically?

Cyber security is a growing threat and doubly so in the context of growing geopolitical tensions given that both China, Russia and the DPRK have significant cyber capabilities. How vulnerable is the financial system to state sponsored cyber attacks at scale? Hitherto, it has been assumed that China at least would not want to attack a system in which it is a global player and would not want Russia to do so either. Is this likely to remain the case or, if tensions continue to rise, could this change? Will the development of parallel alternative financial systems (for example an alternative to Swift) alter this calculation? At the high level, what steps could be taken to increase the resilience of the financial system to large scale cyber attacks? Is a switch to cash a scenario for which Western countries should actively plan? How can finance contribute to cyber deterrence and the establishment of norms? Is the increasing digitalisation, and through blockchain, decentralisation of finance, a risk or an increase in resilience?

Systemic competition between the US and China is not taking place in a vacuum but in the context of a series of global challenges. How will competition and these challenges interact and play out through the global financial system? What could be the impacts on the economy, energy security and national security?

Is inflation transitory and can it be kept at a relatively comfortable 3 to 4 percent, taking the edge off the massive government debts accrued during the pandemic or is there a risk that it will rise out of control, requiring strong central bank action? What are the risks of stagflation? What will be the impact of government stimulus and infrastructure packages, as for example in the US? Quantitative easing has pumped the world full of cash, driving up debts. How is this now to be handled in the context of recovery from the pandemic?

Can the financial system remain insulated from political turmoil in the US? Is a move away from a dollar-centric world inevitable, given the imbalance between the use of the dollar in global finance and the US contribution to world GDP? How is the use of the dollar as an instrument of policy changing and what are its effects? What would be the impacts of a Chinese digital yuan (traded in support of Chinese exports) on the reserve currency position of the US dollar, Euro and the British pound sterling – and on US dollar-linked financial sanctions? More broadly, what are the risks and opportunities from the increasing deep merger between finance and technology and the digitisation of money?

Finance as a sector is committing itself seriously to ESG and particularly to action on climate. Economic growth now needs to pay for the green transition. What are the financial risks of this transition? Does the restriction of funding for fossil fuel development risk escalating and prolonging inflationary pressures on the global economy by restricting supply of fuels before renewable alternatives are available at reasonable price? What are the potential consequences, intended and unintended, on industries critical to national security such as steel and weapons? What is the right balance between the relative prioritisation of energy security, national security and climate action?

For the middle part of the conference, we will split into three working groups so as to be able to discuss these issues in more depth. We will define the scope of each working group once we know who is able to attend and from which sectors.