FinTech as a Financial Liberator

Greg Buchak, Jiayin Hu, and Shang-Jin Wei

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Discussant: Hyun-Soo Choi (KAIST)

Disruptive Innovation in Financial Market by FinTech

Reshaping how financial services are delivered and consumed.

- Digital Payments and Mobile Wallets
- Peer-to-Peer (P2P) Lending and Crowdfunding
- And others...

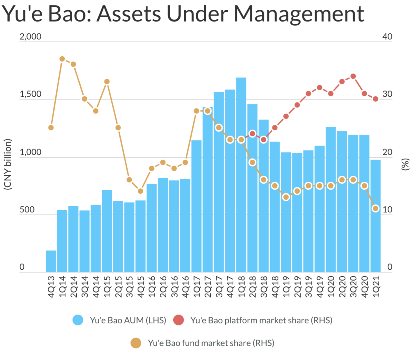
Common targets of innovation

- High transaction costs
- Limited access to financial services
- Lack of transparency and trust
- Rigid banking infrastructure (*)
- Regulatory overhead (*)

This paper: FinTech as the financial liberator against financial repression.

China's landmark financial innovation: Yu'ebao

- Alipay + Tianhong Asset Management: June 2013
  - Minimum investment: 1 RMB
  - Liquidity: T+0 Redemption
  - Integration: Integrated to Alipay
  - Accessibility: 24/7
  - Higher returns than bank deposits
- Once the largest MMF in the world (2018)



Other funds introduced onto platform from 2Q18
Source: Fitch Ratings, Yu'e Bao fund data

Summary of results

Using detailed proprietary data on the adoption of Yu'ebao in June 2013, the paper finds that

- Higher **% of Alipay usage** (before Yu'ebao introduction) and a shorter **distance to Hangzhou** increase the **% of Yu'ebao subscription**. (Both at the city and bank level)
  - **% of Yu'ebao subscription** leads to higher fundflow to Yu'ebao. (city level)

- Banks with higher weighted-**% of Yu'ebao subscription**
  - higher **deposit outflow** (demand deposit, not time deposit, not firm deposit)
  - lower bank loan growth (especially to small firms)
  - higher probability of offering a similar product
  - but no significant changes on net interest margin, net interest spread, bad loan ratio, risky asset ratio.

- Very thoughtful discussions on many of the identification possibilities, the results are solid.

Comment 1: Potential endogeneity in timing

Financial repression is a kind of development strategy adopted by early-stage developing countries. And it has an end.

- South Korea is a good example.
- 1960s-1980s:
  - interest rate ceiling (keeping deposit/lending rates below the market)
  - directed credit to strategic industries (shipbuilding, electronics)
  - control over banks (state-owned or tightly regulated)
  - capital controls
- rapid industrialization and export growth, but with the cost of
  - misallocation and moral hazard
  - financial innovation lagged
  - inequal growth (for small firms and rural areas)
- 1980s-1990s: liberalized interest rates and removed credit controls.
- Similar story can be found in Taiwan. (-80s repression, liberalization from 80s)

Comment 1: Potential endogeneity in timing

If the timing of the adoption of Yu'ebao coincides with the timing of financial liberalization in the Chinese market, the adoption of Yu'ebao might not be the main driver of financial liberalization.

1. PBoC's move toward interest rate liberalization
   - June 2012: PBoC started to relax lending rate controls
   - July 2013: PBoC removed the lending rate floor
   - Hinting at interest rate liberalization
2. IMF report (2014) on "China's Monetary Policy and Interest Rate Liberalization" argues that they identified a structural break in the Chinese financial market in 2009:Q1, putting pressure on price-based instruments.
3. Could Alipay have introduced Yu'ebao in 2023 if the government was very strict on the interest rate ceiling?

It can be the case that financial liberalization was coming, but FinTech worked as a catalyst.

Comment 2: External validity: magnitude

Alipay also might pick the year 2013 as the optimal timing for the introduction of Yu'ebao. (Carefully timed deployment)

- Idle funds in Alipay
  - Predicted the success of the product.
  - If Ant didn't think users were ready for this, they wouldn't have linked it to the most passive action — leaving money in Alipay.
- Consumer readiness
  - 2013: smartphone adoption in China crossed a tipping point.
    - i.e., Mobile takes the #1 internet access mode at the end of 2012.
  - User trust in Tech-platform was high while the dissatisfaction with the bank was peaking.

- The magnitude of the paper can be the upper bound for other general FinTech effect.

Similarly, there seems to be a list of prerequisites for FinTechs to liberate the financial market to be applied to other countries.

Comment 3: Regarding the substitution of bank deposit

High Alipay penetration in a city can proxy

- the population with strong trust in tech products in the city.
- the tech-savviness of the population in the city.
- i.e., age structure in the local population

Then the slower growth of bank household deposits may include the movement of funds to some other tech products.

- P2P lending (Lufax and Dianrong) around 2012-2014
- Wealth management products with online distribution

Then the reduction in bank retail deposits due to Yu'ebao can be smaller.

- Can control for city-level population structure.

Comment 4: Growing risk in banking sector

Retail depositors migrating to MMF through FinTech.

- Choi and Choi (2021, MS) found that the heavy usage of WSF by banks before the financial crisis can be explained by a rapid increase in FFR.
- When facing FFR rises, banks should face the outflow of retail deposits, which will then be replaced by wholesale funding (i.e. MMF) to continue the profitable lending.
- This substitution in the bank funding structure made the financial system much fragile.
- Ineffective monetary transmission channel as bank funding structure changes.

Need to check the bank funding structure to evaluate additional risk on banking system due to FinTech MMF.

Minor Comments

- Overlapping in timing of the construction of the main variables of interest.
  (1) Alipay adoption by cities as of May 2013: IV
  (2) Yu'ebao adoption by cities as of Dec 2013
  (3) Cumulative fund flow to Yu'ebao from June 2013 to May 2014
  (4) Banks' deposit/loan growth from 2012-2014
- The explanation of Figures 3 and 4 needs to be updated.

Conclusion

In sum, I think this is a great paper.

- Really enjoyed reading and learned a lot, especially on the FinTech growth in the Chinese market.
- Very thoughtful identification and detailed discussions on every aspect, making my job as a discussant hard.
- Wish for good luck for the publication in the top journal.