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**THE ROLE OF GOVERNMENTAL REGULATIONS OF DEVELOPMENT OF INTERNET FINANCE MARKET (CHINA CASE)**

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**Abstract**

This thesis summarizes the current governmental regulation of Internet Finance Market, and analyzes the evolution of government role orientation in China. Study found that: In China's Internet financial regulation system, the current role of the government is "Facilitator and Supervisor". Under this role, the public policy formulated by the government is to assist the development of the market and implements limited supervision under the legal framework. The development trend of the government's role is "Intervener". Under this role, the public policy formulated by the government is to rectify the existing market order and reformulates some market rules. With governmental regulation of Internet Finance Market as the main line of the study, combined with the actual problems in China, this thesis focusing on such problems as what principles do the government should follow when formulating regulatory policies, What role the government play and the development trend in the market, etc., to explore the ultimate direction of government's role in the Internet Finance Market.

**Key words**: Internet Finance, financial regulation, regulatory policy, role of governmental regulation

**Аннотация**

Эта работа обобщает текущее государственное регулирование рынка интернет-финансов и анализирует эволюцию роли государства в Китае. Исследование показало, что в китайской системе финансового регулирования Интернета текущая роль правительства - «фасилитатор и супервайзер». В соответствии с этой ролью государственная политика, сформулированная правительством, заключается в содействии развитию рынка и осуществлении ограниченного надзора в рамках законодательства. Основная тенденция развития роли правительства - «Intervener». В рамках этой роли государственная политика, сформулированная правительством, заключается в том, чтобы исправить существующий рыночный порядок и переформулировать некоторые рыночные правила. Государственное регулирование рынка интернет-финансов в условиях Китая как основная линия исследования раскрывается в работе в анализе таких проблем, как, какие принципы следует придерживаться правительству при разработке политики регулирования, какую роль играет правительство и развитие этой тенденции на рынке и т. д. Исследуется стратегическое направление деятельности правительства на рынке интернет-финансов.

**Ключевые слова**: интернет-финансы, регулирование финансов, нормативная политика, роль государственного регулирования

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Introduction

From the GDP data, it can be seen that since the 1980s, the Chinese economy has entered a period of rapid growth. Summarizing the course of development of the Chinese economy over the past four decades, public policies that have a positive impact on China’s economic growth include: 1. Opening Market; 2. Encouraging the development of private companies and developing the stock market; 3. Promoting international free trade and developing export-oriented Economy; 4. Developing the urbanization and promotion of real estate economic development; 5. Developing the infrastructure. Ports, Railways, Highways; 6. Development the Internet+[Huang Huang, 2015], Sharing Economy and Internet Finance[Zhang Xinhong, 2017; Yan Jian, 2017].

Since its appearance, the Internet has fully and deeply penetrated into and deeply changed various fields of the economic and social development, profoundly affecting and changing the business model in all areas. Just as it has profoundly affected retail, publishing, music and other industries, the Internet has also profoundly affected the financial industry[Eric K. Clemons, Lorin M. Hitt, Bin Gu, Matt E. Thatcher, Bruce W. Weber, 2002].

The vigorous development of Internet Finance has aroused the attention of Chinese governments at all levels and has also been clearly supported by governments at all levels[Feng Guo, 2016]. Meanwhile, the barbaric growth of Internet Finance has brought about an increasingly prominent problem of risk[Michael Klafft, 2008;]. Due to the combination of high-risk attributes of the financial industry and the Internet industry, Internet financial risks are spreading faster, with greater harm impacts and risk management more difficult[Harpreet Singh,Ram Gopal,Xinxin Li, 2008]. Once Internet financial risks occur, it will easily cause serious losses, affect the security and stability of the financial system, and strengthening the prevention and supervision of Internet Financial risks has become an objective requirement for the healthy development of the industry.

*This paper selects the role of governmental regulation in the Internet financial market as a thesis research topic*. Mainly explores the position and development trend of the role of government in the Internet financial market, and the related issues such as what principles the government should follow when formulating regulatory policies.

***Firstly***, I will study and analyze the definition and connotation, the development status and the risk of the Internet Finance in China. ***Secondly***, I will focus on current situation of regulation system in China, such as the necessity of regulation, the general policies on the Internet Finance Market. ***Then*** I will discuss the role orientation and future trends of the Chinese government combined the international experience. ***Finally***, I will propose suggestions based on the above analysis.

**Literature Review.** Many scholars have studied and analyzed the definition, characteristics, risks and regulation of Internet Finance. In the definition of Internet finance, Xie Ping and Zou Chuanwei (2012) first proposed the concept of Internet finance, and believed that the Internet financial model is different from commercial banks indirect financing and also different from the third type of financial financing model for direct financing in the capital market. Li Jizhun (2015) put forward the “grassroots” and universal benefits features of Internet Finance, which are low in cost, high in efficiency, and convenient in service. The core competitiveness lies in the function of relieving information asymmetry. Before that, researchers focused more on specific forms and models of Internet Finance, Andrew Verstein (2011) believes that technological innovation and financial innovation have made P2P network lending connect borrowers and investors in a way that was previously unimaginable, and analyzed the regulatory issues of P2P network lending. Eric C. Chaffee (2012) studied the regulation of P2P network lending after the Dodd-Frank ACT. was introduced.

The research of Internet financial supervision mainly focuses on the necessity of risk prevention and supervision, supervision principles, and regulatory systems. He Hong (2013) believes that Internet finance has risks in the four aspects of supervision, law, capital, and information. Xie Ping; Zou Chuanwei; Liu Haier (2014) believes that Internet Finance cannot adopt a laissez-faire regulatory philosophy because it is immature, and should promote development through supervision. Yin Haiyuan and Wang Panpan (2015) believe that with the rapid development of China's Internet finance, there are defects such as the ambiguous legal status of operating platforms, widespread fraud, lagging legislation, inconsistent regulatory systems, and difficult regulatory efforts.

The research on market regulation mainly focuses on the characteristics of different regulatory systems and the impact of various systems on economic development. Scharpf (1997) believes that to understand regulation as a response to new policy issues, then we have the responsibility to determine the ability of different regulatory systems to actually solve problems. Robert J. Shiller (2013) believes that any new technology may increase the risk, and the regulatory authorities cannot be absent. Fan Xueyi (2008) believes that before deciding whether to intervene in the market, the government must first evaluate whether it can obtain more information on the market failure than the market itself, as well as the cost of collecting information and implementing market policies. She Yuan (2010) believes that the improvement of China's market regulatory system should strengthen the self-discipline mechanism in market supervision. Liu Xianwei (2016) proposed the following policy recommendations: Integrate government supervision functions to strengthen market supervision, improve the management system, and strengthen supervision of monopoly industries.

In Chinese academia, the role of the government in Internet Finance market regulation has led to many discussions. Wang Lili(2016) believes that the government should actively intervene and impose strict supervision to guard against financial risks. Ma Haitao; Hao Xiaoyu; Sun Li (2016) believe that the government should pay close attention to and respond with low-key in order to ensure the development of the market. Li Wenhong (2017) believes that it should follow the principle of "technology neutrality" and insist on the supervision of the nature of financial services. Feng Qian and Wang Haijun (2017) believe that “penetrating” regulation should be implemented to plug regulatory loopholes and regulate arbitrage behavior.

There are many researches on Internet Finance in China, but few researches focus on the role of the government is in a dynamic change. This paper based on the analysis of the logic of the government's role change analyze the future trends and make suggestions for the formulation of future regulatory policies.

**Research methods.** In the process of research and writing, this paper focuses on the comprehensive use of research methods, which focuses *on the combination of qualitative analysis and quantitative analysis, and theoretical research and case analysis*.

The first is the combination of qualitative analysis and quantitative analysis. Qualitative analysis emphasizes the use of textual language to describe the characteristics of things. Quantitative analysis emphasizes the characteristics of digital language to describe things. This paper focuses on qualitative analysis, supplemented by quantitative analysis. When it comes to proving issues related to Internet finance and Internet finance supervision, it first analyzes the concepts and problems, and then uses quantitative data to support the qualitative research conclusions. The arguments are well-founded.

The second is the combination of theoretical research and case studies. The purpose of theoretical research is to find the theoretical basis for the study of the article. The purpose of the case study is to make the study more convincing. Based on the existing theories, this paper studies the role of government supervision in the Internet financial market, and comprehensively applies theoretical knowledge such as financial supervision theory, public interest theory, and market failure theory to analyze and study the key issues involved in this paper. This article also summarizes the experience of Internet financial supervision through key case analysis.

1. Theoretical Foundations of a Governmental Role in Market

In all modern states, as the government has emerged as a active force in guiding social and economic development, functions of government have greatly expanded. In particular, the rise of modern capitalism and the prosperity of the market economy, on the one hand led to the growth of social wealth and the improvement of people's material and living standards; on the other hand, they have brought new problems that the market itself can not solve, the so-called market failure. Therefore, the growth of economic wealth has prepared the material conditions for the government to fulfill its economic functions, and the emergence of various problems has provided the legitimacy justification for the government to intervene in the market [Sun Guanhong, 2008]. In countries with a command economy, the government has extensive responsibilities for many types of economic behavior. In countries those choose social democracy, the government owns or manages or regulates business and industry. Even in the free market economy like in United States, in most societies, there are still more rules than the government should just adjudicate on the competition of other social forces - some levels of government regulation, such as the use of credit controls to prevent economic fluctuations, are now accepted with relatively little question[Zhang Xu, 2014].

The relationship between the state and the market has three modes of laissez-faire, trade-off, and controlling [Jorge Bateira, 2012; José Reis, 2012]. In the laissez-faire model, the government seldom intervenes in the market [Rand. Ayn, 1967]. The government adopts a laissez-faire attitude towards market development [Dostaler. Gilles, 2007]. The problems that arise in the development of the market are determined by the market players themselves. In this model, the market itself is often unable to quickly and effectively form a solution to market loopholes, so that the development of the industry is easy to chaotic disorder [Barnett, Vincent, 2013]. This model is most effective only if the financial markets themselves are extremely effective [UK FSA, 2009]. In the trade-offs model, the government has limited involvement in market regulation, and market autonomy still has room for self-reliance [Gerald W. Scully, 2002]. Government regulations and market autonomy work together to pursue the healthy development of the industry. In this model, because the market loopholes are filled by government regulation, the industry development is more orderly. In the controlling model, the market rules are completely set by the government, and the space for market autonomy is almost zero. Whether the government can establish a complete market order is the only factor in the orderly development of the industry [Gerald W. Scully, 2002]. In this model, the government has unlimited power and responsibility, and the development of the industry is manifested in an orderly or relatively stagnant state due to the state of government power.

1.1. Market failure and State Intervention

Although many people think that “free markets” are naturally occurring, it is difficult to imagine them operating without some form of state. The shortcomings of market outcomes is the principal justification for state intervention. In the West, scholars often use the theory of market failure as a rationale for government activity. Market failure is a situation in which the allocation of goods and services is not [efficient](https://en.wikipedia.org/wiki/Economic_efficiency" \o "Economic efficiency), often leading to a net social welfare loss. Market failures can be viewed as scenarios where individuals' pursuit of pure self-interest leads to results that are not efficient – that can be improved upon from the societal point of view [John O. Ledyard, 2008]. The performance of market failure mainly includes the following;

1. Negative externalities. Externality refers to the negative or positive impact of the commercial activities of market actors on other subjects, consumers, and society as a whole. Because the market is rational "economic man" pursues the microscopic behavior logic, only considered in decision-making has a direct effect on its own interests of costs and benefits, without considering the costs and benefits of outside their own interests. Generally speaking, active external activities have some kind of "public welfare", which is not the preference of rational economic people; Instead, rational economic people prefer activities that can pass costs on to others or to society [DeMartino, George, 2000]. The external phenomenon requires the government to intervene in the market, promote positive externalities, reduce negative externalities, and maintain the optimal state of social resource allocation.

2. Natural monopoly. The law of increasing competition is determined by the law of increasing remuneration. "Where economic activities are subject to increasing returns and decreasing marginal costs, markets will again fail to generate efficient outcomes. Under conditions of decreasing costs, the lowest cost mode of production would be achieved by a single producer. Consequently, a free market will result in monopoly." When a certain area of a monopoly producer and supplier, is unable to reflect the advantages of competition, and occupy the monopolist development space and the possibility of enroach on consumer interests. Monopoly can also destroy the balance of resource allocation mechanism, make resource allocation inclined to monopolize, and the resource allocation of non-monopolists is insufficient. In addition, monopoly of monopoly on price and other information can also cause consumers' loss of interest. Therefore, it is necessary for the government to control the monopoly to overcome the bad influence of monopoly.

3. Incomplete information, also called insufficient information or information asymmetry. Market theory assumes that the information of buyers and sellers is complete. If one party fails to obtain information, especially the buyer, the market cannot achieve the best. In the real market, information is incomplete due to the barriers in the market, the sensitivity of both parties, the technical ability of obtaining information and the imperfect information divergence mechanism. Information does not completely put the two parties in an unequal position, so that one party, especially the consumer, is at a disadvantage, resulting in unfair competition and market failure [[Joseph E. Stiglitz](https://en.wikipedia.org/wiki/Joseph_E._Stiglitz" \o "Joseph E. Stiglitz), 1998]. Therefore, the protection of consumers and the unified information are the important reasons for the government to enhance the market function by providing information.

4. Unequal distribution. The function of the market to individual income distribution mainly depends on the law of value and the principle of supply and demand. This distribution system is of great significance in stimulating social enthusiasm and improving individual ability. However, depending on the market mechanism to adjust income distribution, the social income gap will be widened, and even polarization will deepen the unequal distribution of social wealth. Aiming at this phenomenon, the government of market income redistribution is especially important, and how to protect the interest of a few people at the same time also take care of the equality of the majority of people, is the important responsibility of modern government.

Based on the above analysis, it is believed that the government should properly intervene in the market to overcome market failure, mainly including:

1. to develop public services and provide public services that private individuals are unwilling to provide.
2. maintain market competition order, control the emergence of market monopoly, and protect the fair opportunity of each participant.
3. improve the market information disclosure system and ensure the smooth and symmetric market information.
4. ensure social fairness and maintain social stability. However, in the case of market failure, two things should be kept in mind: First, not all market failures can be fixed by the government; Second, the government's intervention in the market will also lead to another new problem: the failure of the government. Therefore, the government and the market as two kinds of regulatory mechanisms is not an optional issue but one that is more or less. The key is to address the problems to be solved, regulating the weight of government and market in the hybrid regulation mechanism.

A national government's intervention in the social and economic life, at least not entirely a matter of science, also by its political system and ideology, economic development level and the market economy foundation, under the rule of law, and the world situation, time trends such as the influence of various factors at home and abroad [Sun Guanhong, 2008].

1.2. Public Interest and Financial Regulation Theory

George Joseph Stigler (1971) proposed that the purpose of the regulation was "to protect the interests of producers". Before that, the traditional view generally accepted by the economics community is that government regulation is to suppress the incompleteness of the market to protect the interests of the public, that is, the existence of public goods, externalities, natural monopolies, incomplete competition, uncertainty, and information asymmetry. In industries such as market failure, in order to correct the defects of market failures and protect the interests of the public, the government directly intervenes in the behavior of microeconomic entities in these industries so as to achieve the purpose of protecting the interests of the public.

According to this theory, under the above conditions, especially in the presence of natural monopoly and external conditions, unrestricted competition will undermine economic efficiency. The fundamental problem of the natural monopoly industry lies in the contradiction between configuration efficiency and production efficiency. The government's price and access control can achieve unity of configuration efficiency and production efficiency. Because the admission control only allows one production to achieve production efficiency, price control limits the price to the social optimal price to meet the requirements of configuration efficiency [Misham, E. J, 1969]. When there are externalities and market failures, government regulation can improve social welfare.

The basic idea of the public interest theory is that the law should reflect "public opinion", represent the entire people, or "the best interests of the overwhelming majority of the people."

This theory is premised on the strict boundaries of the political realm (pursuit of public interest) and the economic market (pursuit of self-interest). It is rooted in methodological organicism (such as the super-people's state, the mysterious "public interest") and the assumption of altruism.

The operation of the financial industry is often accompanied by financial risks [Dewatripont, M. and J. Tirole, 2012]. Once the financial risk breaks through the critical point, it will evolve into a financial crisis, bringing disaster to people's lives and social production. In order to prevent financial risks and financial crisis, ensure the stability of the financial order and the security of the financial system, the theory of financial regulation emerged and changed along with the development of financial regulation practices.

From the beginning of the 20th century to the 1930s, the central bank system was generally established in China. In the real sense, financial regulation began to appear, and the theory of financial regulation began to sprout. After the 1990s, the theory of financial regulation advocates both safety and efficiency[Wang Aijian, 2013]. The first is to focus on functional regulation and financial regulation from a functional perspective to better maintain the stability in the formulation and implementation of laws and regulations, and to better adapt to the needs of different countries and financial internationalization, and to reduce the possibility of regulatory arbitrage. The second is to focus on capital regulation, put forward the minimum capital adequacy requirements, implement the asset business restrictions of financial institutions, and avoid cross-infection and excessive competition in financial services. The third is to focus on market discipline regulation. The combination of government regulation and market constraints will improve government regulation efficiency. The fourth is to focus on incentives and regulation, linking the regulatory incentive scheme with the right to demand.

The theoretical basis of financial regulation mainly includes theory of financial risk [Bouchaud J. P., Potters M., 2000], social interest theory, investor interest protection theory and so on. According to the theory of financial risk, the financial industry is a special high-risk industry. There is a “domino effect” in the financial system. The risk of one link will result in a chain reaction of the entire financial system. Financial risks will directly affect the stability of the monetary system and macroeconomics [Laffont J J，Tirole J., 1993]. Therefore, it is necessary to supervise the financial industry. The social interest theory holds that the starting point of financial regulation is to safeguard the interests of the public; investor protection advocates create a fair and just investment environment for investors.

1. Definition of Internet finance and related issues

The concept of “Internet Finance” was first proposed by the Chinese academic society and financial industry then became a hotspot research issue. In the United States, where Internet and finance are most developed and used, also as the origin of Internet finance, Internet innovation has long led the dramatic change in the financial industry. However, there has been no such term as Internet finance, it is just generally called online finance or electronic finance and so on. From the reality, these terms are difficult to fully cover the concept and format of Internet finance. For this reason, this section will define the relevant concepts of Internet finance and define the scope for the following study.

* 1. The rise of Internet Finance

The combination of the Internet and the finance has given birth to Internet finance,which offers consumers especially vulnerable groups a way to meet the needs of financing and wealth growing. In fact, in China, the Internet finance industry began to appear as early as in 2007. In 2007, the first P2P network loan “PaiPai Dai” was put into operation. However, Internet finance has really caught people's attention after the official operation of “Yu’e Bao”. In June 2013, Alipay and Tianhong Fund launched the “Yu’e Bao”. Yu’e Bao quickly broke out of the enormous energy of the Internet and financial integration, and the users and scale have grown rapidly[Takeshi Jingu, 2014]. Benefited from the "Yu’e Bao" Tianhong Fund has quickly become the largest number of users and the largest public fund for public offerings from an obscure small fund. In 2013, it was also called the first year of China's Internet finance development.

With Yu'ebao's officially going online as a symbol, Intemet finance began to grow explosively. Internet finance has improved the efficiency of financing, promoted the process of inclusive finance, and become a useful supplement to the existing financial system. However, because there are no related laws and regulations about Internet finance nor risk prevention and supervision system which adapts to the characteristics of Internet finance[Yan Shen, Yiping Huang, 2016], the Internet financial industry grow in a savage state, all kinds of risk problems have arised. Strengthening risk prevention and supervision has become a practical need to promote the sustained and healthy development of Internet finance and maintain the security and stability of the financial system.

* 1. Definition and connotation of Internet Finance

**Definition of Internet Finance.** As a normal phenomenon in the continuous development and continuous improvement of Internet Finance, many experts and scholars have made different definitions from various angles.

Among them, there are several representative opinions, Xie Ping, Zou Chuanwei, Liu Haier (2015) first defined this concept in the formal literature. They have positioned Internet finance as a third type of financial financing model that is influenced by Internet technology and Internet spirit, which is different from indirect financing of commercial banks and also different from direct financing of capital markets. Ma Yun (2012) distinguishes “Internet Finance” from “financial internet”. The former is an Internet organization that uses the ideas of Internet and technologies to do finance, and let finance return to the essence of service. The latter is the Internetization of the financial industry. On July 18 2015, The People's Bank of China, Ministry of Industry and Information Technology, Ministry of Public Security, Ministry of Finance, State Administration for Industry and Commerce, State Council Legislative Affairs Office, China Banking Regulatory Commission, China Securities Regulatory Commission, China Insurance Regulatory Commission, and State Internet Information Office jointly issued the Guiding Opinions on Promoting the Healthy Development of Internet Finance, Among the Guidance, the Internet finance has been clear defined.

Based on the above analysis, we can see that Internet finance is literally composed of two words: Internet and finance. However, Internet is not subversive but rather integrated in finance. Both Internet and finance are organically integrated. The definition is not a simple summation of the two concepts of Internet and finance, but should be combined with the characteristics of the Internet industry and the financial industry.

Therefore, this thesis will use the Guidelines’ definition of the Internet finance for research purposes: “*Internet finance is a new financial business model whereby traditional financial institutions and internet enterprises use internet technology together with information and communications technology to provide financing, payment, investment and information intermediary services*”.

**The Business Model of the Internet Finance.** According to the different forms of business and clients, the business model of Internet Finance can be classified into three categories [Xie Ping, 2014].

(1) The payment and settlement category, mainly means the third-party payment platform. Currently, the Internet finance industry can be divided into: the Internet-based payment companies, mainly based on online payment; Financial payment enterprises which focus on demand of industry and development of industry; third-party payment companies serve as credit intermediary. According to the payment form, it can be divided into internet payment and mobile payment.

(2) Financing operation category mainly includes P2P network loan platform, big data finance, and crowdfunding model. P2P is point-to-point borrowing, which refers to matching of lenders and borrowers through the Internet. Funds demanders directly find fund providers who have the ability to borrow and are willing to lend on certain conditions, so as to achieve capital lending. The financial services platform based on big data mainly refers to financial services carried out by e-commerce companies that have large amounts of data. Crowdfunding refers to public fundraising or crowdfunding. It is a new model for enterprises to use the Internet to finance the public. Companies that need funds will give project planning to the crowdfunding platform. After the review, they will create their own pages on the platform website. Used to introduce the details to the public. At present, the crowdfunding model will provide another solution to the increasingly difficult status of corporate public financing.

(3) Financial wealth management products. The main platform is the Internet financial portal. It is a platform that uses the Internet to sell financial products and provide third-party services for the sale of financial products. It puts the products of various financial institutions on the same platform so that users can select suitable financial products by comparing the prices and characteristics of each product.

The main business types of Internet finance can be divided into seven kinds as follows:

* Third party payment service.
* Online peer-to-peer (P2P) lending.
* Equity crowdfunding.
* Online fund sales.
* Online insurance.
* Online trust.
* Online consumer finance.

**Development Status of Internet Finance in China.** According to the "Statistical Communique on National Economic and Social Development in 2017" published by the National Bureau of Statistics of China, the income of urban and rural residents continues to increase. The per capita disposable income of urban residents was 36,396 CNY, 8.3% increase over the previous year, and the per capita disposable income of rural residents was 13,432 CNY, 8.6% increase over the previous year. The wealth of residents continued to accumulate, and this was accompanied by a growing demand for residential investment and wealth management.

In 2016 and 2017, online wealth management kept growing vigorously. Especially, in 2017, affected by the high interest on the interbank market, financial products based on account balance became increasingly popular. However, on the whole, the demographic dividends of the users of online financial products are disappearing. This is mainly because since the emergence of Yu’e Bao, there has been no significant innovation in the model of online financial products. As a result, growth if the users is slowing down and the industry is growing at a pace that is similar to that of the securities industry, both “a game of luck”.

According to the iResearch data, the number of Internet Finance users and growth rate in China, as shown in the following figure:



1. The payment and settlement category

According to the iResearch data, in 2017, mobile payment was around 100tn CNY, the number of non-bank payment was around 450 billion, the average payment was around 280 CNY. In China's third-party payment industry, mobile payment is still developing rapidly. With mobile payment developing in the offline area, the positioning of the seven major businesses covered by payment licenses also began to change. As the policy changes, integrated payment companies began to change to enterprise service platforms and their role as “mercenaries” becomes even more obvious. While, the connection between bank card acquiring and mobile payment becomes closer, which brings a glimmer of hope to the businesses that are almost "dying".

1. Financing operation category

According to data from the National Bureau of Statistics, In 2016, the volume of online loan industry reached 2.038672 trillion CNY, an increase of 110% compared to the total volume of online loan transactions (982.3 billion CNY) in 2015. In 2016, the cumulative volume of P2P online loan industry history exceeded 2 trillion and 3 trillion CNY in succession, and the single month trading volume exceeded 200 billion CNY. In 2016, the "net loan double 11" single day Once again exceeded 10 billion CNY, achieved 11.607 billion CNY, this series of achievements reflect the fact that the P2P online loan industry is still favored by a large number of investors.

1. Financial wealth management products

The Online Wealth Management is Becoming Less Inclusive. In 2017, the scale of online assets in China was about 3.5 trillion Yuan as shown by following figure 1.. Compared with the credit market which is developing rapidly, the growth rate of online assets management has declined. Part of the reason is that as online assets becomes common, China's Internet Finance in the area of wealth management is gradually becoming less inclusive. Ordinary users enjoy the wealth appreciation effect brought about by online assets, and the channels have not been substantially broadened in the past two years.

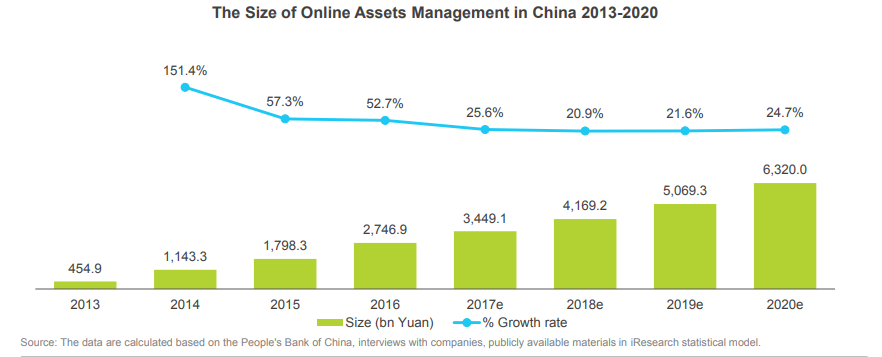


figure 1. The size of Online Assets Management in China 2013-2020

* 1. A Comparative Analysis of Internet Finance and Traditional Finance

The emergence and development of Internet Finance has caused people's controversy over the impact of Internet Finance on traditional finance, resulting in a variety of perspectives [Cheng Xuejun, 2013]. Therefore, here this thesis gives a brief comparative analysis of Internet finance and traditional finance.

Internet finance has three salient features: First, it has a platform effect, the platform itself does not produce financial products, but it can facilitate the financial transactions between multiple parties [Beck, T., Demirgǜc-Kunt, A. and Levine, R., 2003]; second, Internet finance generates and precipitates valuable transaction data in addition to currency transfer. The data of these valuable transactions will have a greater value than money after further excavation in accordance with the relevant laws. Third, Internet finance is more to serve small and micro enterprises and ordinary consumers.

As a kind of financial innovation, Internet finance only changes the financial business technology and business model, and does not change the nature and function of finance [Gong Xiaolin, 2013]. Internet finance and traditional finance are essentially the same, their core functions remain unchanged, and the concepts of financial risks and externalities do not change. The impact of the emergence and development of Internet Finance on traditional finance is more of a supplement than a subversion or substitution. In the future development, there is bound to be competition between Internet Finance and traditional finance, but through the integration to strengthen competition, it will eventually form a healthy financial services environment [Wang Ping, Zhang Wenjian , Liu Jiao, 2017].

Compared with traditional finance, Internet finance has significant advantages in reducing transaction costs, mitigating information asymmetry, improving resource allocation efficiency, and financial service quality.

In the Internet finance, the boundaries of transaction possibilities are expanded, the transaction costs and information asymmetry are reduced, and at the same time, the democratization and universalization of Internet finance are also conducive to meeting the needs of SMEs (small-and-medium-sized enterprises) and low- and middle-income groups. These have complemented the deficiencies of the traditional financial model.

The number of corporate organizations in China is in an inverted pyramid form. Small and medium-sized enterprises account for more than 90% of the total number of enterprises. They absorb and contribute nearly 50% of employment and tax revenue. However, only 10% of financial institutions can obtain financial support; 10% of large companies can enjoy 90% of financial support. This asymmetric financial demand contradiction has severely constrained and affected the development of most SMEs. The financing needs of SMEs in China are characterized by four characteristics: short term, small amount, high frequency, and urgent use of funds. The characteristics of high efficiency, low cost, scale, and inclusiveness of Internet financial services can precisely meet the financial needs of SMEs.

* 1. Risks of Internet Finance in China

First of all, The Internet finance has a financial intermediary to the characteristics, broaden the channels of direct financing in our country, further covers the traditional financial institutions ignore the "grassroots" customers, achieve inclusive financial effect, which led to the enthusiasm of the public entrepreneurship, innovation [Michele Braun, James McAndrews, William Roberds, and Richard Sullivan, 2008]. At the same time, The Internet finance is the interest rate market pioneer and promoter, promote the process of China' s financial market. Pure internet financial transactions online, virtual custom er experience, greatly saves the consumption of resources, saving the financial costs, direct investment and financing to improve the efficiency, speed up the market economy.

But it is also the Internet Financial inherent concealment, cause easily lead to illegal behavior, illegal fund-raising fraud, which provided convenience, and government regulation has not been in place in the background, let the criminals have to take advantage of the machine.

Secondly, the Internet Financial itself is innovative and forward-looking, but also to advance regulation caused certain difficulty. Then caused the Internet financial regulatory vacuum and regulatory lag in the long-term situation. The Internet financial development in our country, government is always in a wait-and-see position, let its barbaric growth, to the spectators rather than development of The Internet finance regulators attitude observation. But the recent two years, the government gradually realized the necessity and urgency of regulation, government regulation gradually strengthened. But at the same time the regulatory loopholes also gradually, P2P lending platform network fraud, run away phenomenon is still g rowing, a series of problem s similar to the E platform to rent treasure concentrated outbreak, so that investors suffered huge economic losses.

Financial risks have the characteristics of concealment, rapidity of diffusion, destructive results, complexity of types, and sociality of influence. The platform on which Internet finance develops is the Internet. The Internet has the characteristics of technicality, virtuality, openness, sharing, and innovation. These characteristics of the Internet have made the Internet financial risk different from traditional financial risks.

Internet finance contains complex risk status. Its risks are affected not only by financial risks but also by internet risks. The conventional risks consistent with the traditional financial field include market risk, credit risk, operational risk, liquidity risk, reputation risk, etc.; and the special risks specific to Internet Finance formed by the use of Internet technology, Internet spirit, and financial innovation. There are legal and policy risks, technical risks, and information security risks.

3. The Governmental Regulation in Internet Finance

Based on the above analysis, due to its unique advantages, Internet finance is developing rapidly and rapidly, and it has quickly seized a large number of traditional financial markets. However, due to the short development time, the market structure is still not perfect, and the state also gives support to the policy, so there is a large number of regulatory blank areas. The regulation of Internet finance is not to limit its development, but to remove barriers to its development and establish an orderly market rule. In order to promote the healthy development of Internet finance, the government needs to supervise it, establish market access rules, and improve relevant laws and regulations.

3.1. The Necessity of the Regulation of the Internet Finance

In the financial industry, the main purpose of the market participants is to be able to obtain more profits. The premise to achieve this goal must be based on rational investment and make reasonable plans for their investment behavior. Under such rules, individual self-interested behavior can ensure market equilibrium through rational investment, and any information can be expressed through market prices in an equilibrium state. From this perspective, in the process of financial supervision and management, it must be supervised by a laissez-faire idea. Its main purpose is to prevent market non-effectiveness intervention and affect the normal development of the financial market. However, this is only an ideal state. For China's financial market, there are many factors that affect market development. Among them, information asymmetry is the most typical one. Due to the existence of these factors, it often leads to the non-regularity of market development. The phenomenon occurs. For this reason, it is not appropriate to use laissez-faire supervision concepts at this stage.

(1) Irrational investment behavior

As the investment process, the main purpose of individual investment is to be able to obtain more profits. When the market is out of control, irrational investment will occupy a dominant position, especially for high-risk and high-income behavior, the market is even more difficult to grasp. Such as credit loans, although the market can conduct risk assessment based on the behavior of the lender, but it cannot make an effective prediction of his future risks, so the risk will be beyond of control.

(2) Individual rational behavior cannot represent collective rationality

In today's internet financial market, there are many product Internet products like Yu’e Bao that use money market funds and third-party payments to collaborate. When investors invest in Internet, they are essentially buying money market funds, but investors can According to their own needs, they can redeem their funds at any time. However, for money market funds, these funds cannot be redeemed at any time. Instead, they need some time before they can be redeemed in the end. This leads to deadline mismatches and Problems related to flow conversion. In particular, when the party's financial and currency markets undergo major changes, investors generally choose to redeem their own funds in order to reduce their investment risks [Bachmann A., Becker A., Buerckner D., Hilker M., Kock F., Lehmann M., and P. Tiburtius, 2011]. This is a rational investment behavior. But if this rational behavior achieves the overall goal, once the money market changes, it will cause the overall redemption of funds, which will lead to problems in the money market.

(3) Lack of effective market discipline

In today's financial markets, because China has a relatively short period of time in the world, there are still some problems in the system, laws and other aspects, so there are many obvious or implicit investment risks. For example, in the process of selling a lot of fund products, banks often adopt a sales principle that avoids aggression, and pass various advantages of the products they want to sell to their customers. For information such as risk, the information is as small as possible. Involved, this will lead to some risks. This phenomenon is extremely common in the financial market. Therefore, in order to be able to avoid this situation, to maximize the protection of the interests of consumers, it is extremely necessary to strengthen the supervision of the market.

Therefore, Internet finance cannot adopt a laissez-faire regulatory philosophy because of its immaturity. It should promote development through supervision and encourage innovation in Internet finance under a certain negative list, bottom line thinking, and regulatory red line.

**The Current Situation of the Regulation System in China.** Financial regulation has failed to keep up with Internet finance's rapid growth [Takeshi Jingu, 2018]. Even though there has been a huge increase in the number of emerging service providers of Internet financial services and new customers subscribing to Internet financial services on a daily basis, there has been a legal vacuum until recently, when the Chinese authorities issued a series of regulations to tighten their grip on Internet finance. Among financial regulators, the People's Bank of China (PBoC) looks approvingly upon Internet finance. The PBoC has called Internet finance a beneficial complement to the existing financial system and said it improves financial efficiency through different channels than traditional finances.

The China Securities Regulatory Commission (CSRC) warned in November 2013 that it will crack down on illegalities in online fund sales. In 2014, the CSRC announced a crackdown on illegalities related to sales of certain funds offering high returns (e.g overemphasis on returns without adequate risk disclosure, advertising funds' returns inclusive of bonus interest intended to promote sales). The CSRC has already ordered some companies to rectify such practices. Regulators are thus finally starting to pursue consumer (investor) protection in the Internet finance sector. In addition to being a new business, Internet finance is a sector populated by not only financial institutions but also nonfinancial companies, most notably e-commerce and other Internet companies.

On July 28, 2015, ten Chinese central regulatory agencies and industry regulators, including the People’s Bank of China (PBOC), the China Banking Regulatory Commission (CBRC), the China Insurance Regulatory Commission (CIRC) and the China Internet Information Technology Office (CIITO) jointly released the Guiding Opinions on Promoting the Healthy Development of Internet Finance (Guiding Opinions). This is the first comprehensive regulation issued by the Chinese government in relation to Internet finance. The guidelines explain how China’s financial and internet regulations would apply to the country’s growing Internet Finance industry. Before the guidelines, there was no high-level legislation systematically addressing the framework and regulatory principles in this field.

The table 1. shows regulators for specified categories of Internet Finance business which guidelines specify corresponding.

|  |  |
| --- | --- |
| Category of business | Regulator |
| Third party payment service | the People’s Bank of China (PBOC) |
| Online peer-to-peer (P2P) lending | China Banking Regulatory Commission (CBRC) |
| Equity crowdfunding | China Securities Regulatory Commission (CSRC) |
| Online fund sales | China Securities Regulatory Commission (CSRC) |
| Online insurance | China Insurance Regulatory Commission (CIRC) |
| Online trust | China Banking Regulatory Commission (CBRC) |
| Online consumer finance | China Banking Regulatory Commission (CBRC) |

Table 1. Current Regulator in Internet Finance of China

In 2016, the State Council released the Plan to Implement Special Rectification Work on Internet Finance Risks 2016(2016 Internet Finance Rectification Plan). The plan seeks to standardize the regulation and supervision of Internet Finance by balancing the often competing goals of protecting consumers and encouraging financial innovation and intends to launch a nationwide campaign to deal with non-compliance in this area.

**General Policies on Internet Finance in China.** In general, China's Internet finance experienced four stages of development: the outbreak phase, the frenzy phase, the synergy phase, and the maturity phase. 1999-2012 is the outbreak period of China's Internet finance, and 2013-2015 is the period of frenzy. After 2016, China's Internet finance has entered a turning point. Regulators, industrial professionals, and academia are all rethinking and adjusting the development path of Internet finance. Through the establishment of systems, restructuring, and innovation, they have standardized the development of Internet finance.

In the Guiding Opinions, the government sets out general rules (including governmental policy commitments), basic rules and specific preferential measures relating to Internet finance covering Internet payment, online lending, equity crowd funding, Internet fund sales, online insurance services and Internet consumer finance. The Guiding Opinions’ positive attitude towards Internet finance is demonstrated by a variety of supportive policies and rules.

First, according to the Guiding Opinions, innovation in relation to Internet finance platforms, products and services will be encouraged to stimulate market vitality.

Second, the Guiding Opinions require that the financing channels available to Industry Players be broadened and that the financing environment be improved.

Third, the Guiding Opinions require all supervising bodies to simplify their administrative procedures and fully support the development of Internet finance while performing their supervisory functions, in order to create an environment that is beneficial to the development of Internet finance. Further, the Guiding Opinions clarify the division of responsibilities among the relevant regulatory agencies.

Fourth, the Guiding Opinions include certain specific preferential measures to promote the development of Internet finance, including preferential taxation policies.

Lastly, according to the Guiding Opinions, the government will push forward the construction of a credit infrastructure as well as nurture the Internet financial supporting service system.

Table 2 is showing the general relevant laws and regulations which have been promulgated and implemented from 2016 to 2018 in China.

|  |  |  |
| --- | --- | --- |
| Release Time | Policy | Main Content |
| 2018.01.17 | Announcement on Conducting Self-examination and Remediation of Payment Services for Unlawful Virtual Currency Transactions | The announcement pointed out that the agencies should immediately carry out self-examination and rectification work in itself and its branches, forbidden to provide services for virtual currency transactions, and to take effective measures to prevent payment channels for virtual currency transactions. |
| 2017.12.29 | Announcement on Adjusting the Ratio of Concentrated Delivery of Client Payments to Payment Institutions | Then announcement stipulates that from 2018 onwards, the proportion of centralized payment for payment from customers of payment institutions will be increased from the current 20% to 50%. |
| 2017.12.27 | Notification of the People's Bank of China on Printing and Distributing "Barcode Payment Service Specifications" | Notification requirements, regulate the limit management of individual customers' barcode payment services, and the risk prevention capability reaches Class B. The cumulative transaction amount for a single bank account or all payment accounts for the same customer should not exceed 5,000 yuan in a single day, and the C level should not exceed 1,000 yuan. The level does not exceed 500 yuan. It will be implemented on April 1, 2018. |
| 2017.12.22 | Notification on Regulating Payment Innovation Business | The regulatory agencies regulate the business innovation of banking business financial institutions and non-bank payment institutions, competition order, and acquiring management. |
| 2017.08.23 | Guidance on information disclosure of business activities of Internet lending information intermediaries. | To establish the information disclosure system of online credit information intermediary agencies and their branches through the official website and other Internet channels to the public to publicize the basic information of network credit information intermediary agencies, operational information, project information, major risk information, consumer information channels. |
| 2017.02.22 | Guidelines for Online Credit Fund Depository Business | All organizations are required to establish a third-party depository system for client funds, to realize the separate management of customer funds and online credit information intermediary agencies' own funds, and to prevent the risk of misappropriation of network credit funds. |
| 2016.11.30 | Guidelines for Registration and Registration Management of Internet Lending Information Intermediaries | Establish and improve the registration and registration management system for internet credit information intermediary agencies, and strengthen the supervision of internet credit information intermediary agencies |
| 2016.10.12 | Promote several policies and measures for the healthy development of private investment | Promotion of investment growth, improvement of financial services, implementation of relevant fiscal and taxation policies, reduction of corporate costs, improvement of comprehensive management service measures, and development of related laws and regulations etc. 26 specific measures |
| 2016.04.14 | Implementation plan for special rectification of equity crowdfunding risk | The goal of the plan is to regulate the behavior of equity financing on the Internet, punish the illegal financial activities such as the illegal distribution of securities and illegal fundraising through the Internet, and effectively protect the legitimate interests of investors. |
| 2016.04.13 | The implementation plan of the special remediation work on P2P online lending risks. | To establish a mechanism for sound industry reward and punishment mechanisms, reporting mechanisms, information disclosure and investor protection mechanisms. |

Table 2. Relevant laws and regulations

3.2. The International Experience of Governmental Regulation in the Internet Finance

To promote the vigorous development of the Internet financial market, the key is to grasp the dialectical relationship between governmental regulation and development so that it can encourage innovation and development, and regulate the market and prevent risks. Therefore, a proper mode of governmental regulation plays a decisive role. As a new form of international economy, the international experience of the governmental regulation model of Internet finance has great significance for us.

**United States of America.** The American model focuses on the role of the government. The government takes legal measures as the main method, and administrative methods assist the regulation of the Internet finance. Although it attaches importance to the role of the government, its main purpose is to promote the development of Internet finance[La Porta, R., Lopez-de-Silanes, F., 2000]. Therefore, it emphasizes that the government does not interfere too much, adopts a cautious and relaxed policy by supplementing and perfecting existing laws and regulations, and combining with the supervision of traditional finance to promote the healthy and stable development of Internet finance.

As early as September 2008, American academics pointed out that retail payment is shifting from paper to non-cash transactions, which will bring many risks such as liquidation risk, credit risk, operational risk, systemic risk and legal risk. They believe that for the regulation of new retail payments, regulators should believe in the market, but they cannot follow blindly. [Michele Braun, James McAndrews, William Roberds, and Richard Sullivan, 2008]

Specifically, the main government regulatory measures of the U.S. model are:

1. Appropriately lower market access thresholds and listing standards. [Ajay Agrawal,Christian Catalini,Avi Goldfarb, 2013] Compared with the traditional financial industry, in order to encourage the development of Internet Finance in the United States, the market access thresholds and listing standards in US are low. Take the listing of companies in the Internet financial industry as an example. The US basically does not make excessive demands on the equity structure of Internet companies, and recognizes the equity governance structure in which the founders have greater decision-making power; for shareholders of listed companies The number of people is not excessively rigid; usually, they are allowed to be listed after being approved by the exchange, and there is no profit limit.
2. Strict legal supervision. Although the access threshold for the Internet finance market in the United States is low, its laws and regulations are quite strict. Although no new legislation specifically designed for Internet finance has been established, its legal supervision procedures are strict and have a wide scope. Take a crowdfunding company as an example, on April 5, 2012, the “Jumpstart Our Business Startups Act” (or JOBS ACT) passed with [bipartisan](https://en.wikipedia.org/wiki/Bipartisan" \o "Bipartisan) support, and was signed into law by President [Barack Obama](https://en.wikipedia.org/wiki/Barack_Obama" \o "Barack Obama), which may be the most significant update to securities regulations since 2002. Per the final rules, under Title IV of the JOBS Act (commonly referred to as Regulation A+) companies will be permitted to offer and sell up to $50 million of securities to the general public subject to certain eligibility, disclosure and reporting requirements.
3. Pay attention to protecting the rights and interests of consumers. In 2011, the United States passed the “ Dodd–Frank Wall Street Reform and Consumer Protection Act” and decided to establish the United States Consumer Financial Protection Bureau under the Federal Reserve to supervise financial institutions that provide financial products and services to consumers to protect financial consumers so as to protect the rights and interests of financial consumers[Jack R Magee, 2011]. Taking P2P as an example, In the case of P2P, for example, the protection of consumer rights in the United States has created a variety of ACTs to promote fairness, protect privacy, and increase awareness: The Dodd–Frank Wall Street Reform and Consumer Protection Act, The Equal Credit Opportunity Act (ECOA) , and Fair Credit Reporting Act (FCRA), etc.
4. Perfect credit system. The United States has the most mature and complete credit system in the world, thus supporting the Internet finance in the United States. The relevant laws include 15 laws and regulations such as The Fair Credit Billing Act (FCBA). The most worth to learn is the United States' personal credit system: By restricting individuals through credit records and credit ratings, sharing information, reducing information asymmetry, and thereby reducing risks. By establishing a government-led credit system, Internet financial security is higher and there is less possibility of default among business users.

**United Kingdom.** Different from the American model emphasis on the role of government, The United Kingdom pays more attention to the self-discipline of the industry for Internet finance, and governmental regulation only plays a supporting role. Specifically, it has the following features:

1. The industry has a high degree of self-discipline, and various industry associations have matured and are protected by industry regulations. Take the P2P industry as an example. In 2005, Zopa, the world’s first P2P network microfinance company, was established in the United Kingdom. After 6 years of development, in 2011, Zopa, RateSetter, and Funding-Circle established the P2P industry association, and successively formulated the P2P credit industry standards, business model and internal control mechanism. So far, the P2P Association has 8 membership criteria, 10 operational rules and other detailed rules and regulations to restrict the behavior of its members, and P2P association members account for about 95% of the industry's market size. Before the government introduced relevant laws and policies, it was basically these industry standards that regulated all of the industry's development.
2. The government is regulated by legal means. Still taking the P2P industry as an example, the association requires the government to supervise the industry and issue corresponding laws. In 2013, the British government established the Financial Conduct Authority (FCA) and issued the first P2P industry law, “The FCA’s regulatory approach to crowdfunding over the internet and the promotion of non-readily realisable securities by other media，PS14/4”. This is also the only institution and law in the UK that regulates P2P. It is simple to set up on the regulatory body, and it is mainly controlled by legal means. It is highly efficient.
3. A relatively perfect credit system. Similarly, the United Kingdom has a well-developed personal credit system. The government directly manages the credit rating agencies through the Office of the British Information Commissioner. The credit rating agencies have a credit report for most citizens. According to the credit report, the P2P online loan company can intuitively judge whether or not to provide loans. Loan risk, thereby increasing the efficiency of lending and reducing the risk of lending.

In summary, whether it is the United States model or the United Kingdom model, government supervision has played an important "supervision role" in the Internet financial market. Therefore, in order to establish a well-regulated market order and better promote the healthy development of the Internet finance industry, what role should government supervision play?

4. Government Role in Internet Financial Regulation

4.1. Two Models of Government Role in Internet Financial Regulation

**The intervener: Based on the theory of public interest.** The public interest theory believes that a strong government intervention can correct market failures and achieve protection of the public interest[Wu Chaoping, 2015]. The government role in this model has the following characteristics:

1. The government has more information

The government's effective intervention in the market depends on the sufficient information it has obtained. Only when the government fully understands the industries to be supervised, but also whether it is possible to maximize the public interest of the proposed regulatory strategy and has sufficient information, can the rationality of the intervention be guaranteed. Otherwise, the government's limited access to information will lead to the "government control" model characterized by "subjective randomness" of intervention strategies, and even cause huge economic losses.

1. The government has a richer intervention strategy.

The government has the power to coerce so that it can implement certain strategies to achieve management and control of specific industries. The government can implement supervision and support for certain industries through multiple intervention strategies. These strategies include: Implement government subsidies, set entry barriers, restrict substitutes and supplements, and implement product pricing.

3. The government intervention costs less.

As the law enforcer, the government needs to spend costs in implementing the market regulation legal system. If the cost of government intervention is too high, market regulation will outweigh the benefits. The implementation of the system is related to the following factors: first, the degree of honesty of the enforcer; second, the pay of the law enforcer who has a close bearing on the honesty of law enforcement; and third, the existing typical violations. Behavior; Fourth, the price paid for violations. Only when all four factors are in place, the government's intervention costs will be smaller.

**Facilitator: Based on trade-off model.** Because the financial regulation implemented through the government's high-profile intervention in the market does not always succeed, and on the contrary, the government has its own independent interests. It will inevitably be affected by certain interest groups and achieve its own interests instead of maximizing public interest decisions. The trade-off model believes that the maximization of social public interests cannot rely solely on governmental regulation, but on the need to balance trade between market self-improvement and governmental regulation, that is, develop private supervision and reduce the scope and intensity of government intervention in the economy. The government role in this model has the following characteristics:

1. The purpose of government intervention is limited

Under the trade-off model, in the financial supervision, the government should avoid “grabbing hand” and maintain its “helping hand”. In the government's “grabbing hand model”, the government abuses power for its own sake; in the government's “helping hand model”, the government uses power to help the economy19 (Shleifer，A.and Vishny，R.W. 1998). In the low-key-assisted government intervention model, the target range of government intervention is to support the economy.

2. The degree of government intervention is limited

By helping the market itself improve, it weakens the government's efforts to intervene in the market. Shleifer and Vishny (1998) have proposed correcting the "predation model": against government corruption, privatization of state-owned enterprises, and improvement of financial institution construction.19 These proposals are all aimed at reducing government's compulsory intervention and promoting the development of private supervision.

3. The way of government intervention is restricted by law

According to legal theory, all market players, including the government, must respect the law and act within the scope of the law. Through legal protection and policy assistance to market entities, the financial market itself can be improved to promote the realization of maximization of public interests. For example, in the legislation, the market investors' rights and interests are meticulously stipulated; in law enforcement, the effect of law enforcement is ensured, so that the rights and interests of investors can be implemented.

4.2. The Evolution of Government Role Orientation in China

Since 2014, "Internet finance" has been mentioned in the government work report for five years:

In 2014, “Promoting the Healthy Development of Internet Finance”;

In 2015, when reviewing its work in 2014, the government report mentioned that “Internet Finance has risen suddenly”; when it deployed its work in 2015, the report again put forward “promote the healthy development of Internet finance”;

In 2016, "regulate the development of Internet finance";

In 2017, "should be highly vigilant against the accumulated risks of Internet finance";

In 2018, " perfect the Internet financial regulation.".

From the initial "promoting development" to "regulation development" to "vigilance risk" and then this year's "perfect the Internet finance regulation", the change of wording reflect the government's rethinking about its role in the Internet financial market.

**Current Positioning of Government Role: Facilitator and Supervisor.** In July 2015, ten ministries, including the People's Bank of China, the Ministry of Industry and Information Technology, issued the “[Guidance on Promoting the Healthy Development of Internet Finance](http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/2813898/index.html" \t "https://www.frbsf.org/banking/asia-program/pacific-exchange-blog/china-sets-the-rules-for-internet-finance/_blank)” . Non-depository Organizations Loan Regulation (Draft for Comment) and "Interim Measures on the Management of Internet Lending Information Intermediary Business Activities (Draft for Comment)" ,etc. have been issued. The government has paid more and more attention to the regulation of Internet finance. Judging from the existing system, the current role of the government is positioned as “low-key facilitator and supervisor”.

1. Facilitator : Assisting the development of the market. Policies and regulations that are more influential in the field of Internet finance, which are respectively “encourage innovation, prevent risks, avoid risks and develop healthy development”, “promote the healthy development of private equity crowdfunding industry”, “promote healthy development of the market” and “promote online lending healthy development”, as the purpose of institutional design, clarifies the government's attitude towards encouraging and supporting the development of the Internet financial market.

Specifically, the orientation of the “Facilitator” of the government can be summarized in the following aspects: First, government departments at all levels fulfill their duties and create a good environment for market development. Administrative departments such as industry and commerce, telecommunications, etc. shall exercise supervision within their respective duties and provide protection of intellectual property rights [Yu Hongkai, 2013]. Second, the implementation of tax incentives to support enterprise development. To meet the requirements of Internet finance companies, especially for their R & D expenses to implement preferential policies to encourage innovation [Cheng Xuejun, 2013]. Third, support the construction of related auxiliary facilities and create conditions for market development. The government supports the construction of facilities in the field of network technology and provides related guarantees for the construction of credit information sharing platforms. Fourth, adopt relevant incentive policies to guide the healthy development of the market. For example, improve the financing environment of enterprises and encourage technological innovation and cooperation among enterprises.

Supervisor: Limited supervision under the legal framework. First, the way government is regulated is limited by law. According to legal theory, all market players, including the government, must respect the law and act within the scope of the law. Through legal protection and policy assistance to market entities, the financial market itself can be improved to promote the realization of maximization of public interests. The "Opinions" establish "regulation according to law" as a general principle. In the absence of sound Internet financial regulatory laws and regulations, government supervision still abides by the principle of “regulating according to law”. Second, the government has implemented a series of regulatory measures, but it still leaves room for market development. The second part of the Opinion sets out the regulatory framework. However, no specific system has been introduced yet. This shows that the government is cautious about supervision. The “Non-Deposit Organizations Loan Regulations (Draft for Comment)” issued in August 2015 implements a registration and registration system for online lending institutions and filing registration does not constitute recognition of the operating capabilities of online lending institutions. This also shows that the government hopes to have interventions of Internet finance in the business to maintain a certain limit.

**The development trend of government role: Intervener.** With the vigorous development of the Internet financial market, especially the appearance of market loopholes, the public began to urge the government to strengthen supervision. At the same time, in a recently issued draft regulations, but also tends to play the role of the government's bundle, re-enact part of the prevailing market rules. Mainly reflected in the following points.

Intervener: Rectify the existing market. On the one hand, the market has its own hard-to-solve loopholes. Taking the P2P network lending business as an example, The report recently published by the Internet Lending House shows that, as of the end of August 2017, the number of normal operating platforms in the P2P lending industry has dropped to 2,065, a decrease of 170 compared to 2,235 a year ago. There were 3858 platforms closed down. The public urges the government to rectify the existing market. The government is also responsible for regulating the market order. Due to the plan of financial supervision, before the end of June 2018, the P2P online loan platform must complete the rectification and inspection, registration and registration work. According to incomplete statistics, from January to March 12 in 2018, there were as many as 210 problem platforms in the entire industry, of which 85 were closed. Most of the online lending platforms set up under the background of regulatory lag have to face zero results under the dual role of current market and regulation.

4.3. The Theoretical Logic of the Evolution of Government Role Orientation

When we discuss the theoretical logic of the evolution of government's role, there two factors that cannot be ignored are as follows:

1.The relationship between the government and the market

In the part of theoretical framework, we discussed three models of government and market relations: laissez-faire, trade-off, and controlling.

Before we discuss how the government should regulate the Internet financial market and what kind of policies it should implement, we must first clarify the relationship between the government and the market so that we can form a unified and systematic regulatory framework to better promote the healthy development of the market. The government cannot fully safeguard the public interest while promoting the healthy development of the Internet financial market. In China's Internet financial market, the pursuit of government's role is a trade-off model.

1. Restrictions on government intervention and methods

After the development of the market itself exposed many problems, the mainstream view believes that government intervention is a magic weapon to solve the market difficulties. Some views regard the success or failure of regulatory measures as the success or failure of the development of the Internet financial market, saying that "the improvement of the regulatory system is the key to the development of Internet finance." There are even views that government intervention is the only way to ensure the orderly development of Internet finance. However, there is not enough discussion about the extent and methods of government intervention.

At the present stage, the role of government with “Facilitator and Supervisor” is in the initial stage of the trade-off model. The government's role in positioning the "intervener" development trend reflects the transition from the initial period to the mature period of the trade-off model. The theoretical logic behind the evolution of the role of government is the increasingly mature model of trade-offs.

**The goal that is pursued: Trade-off model.** The trade-off model believes that in order to maximize the social public interests, it needs to be weighed against the market's own perfection and government supervision, that is, through the common forces from private supervision and government intervention to achieve an orderly development of the market. In this model, the government’s role orientation reflects two characteristics. First, government regulations and market autonomy complement each other and balance each other. Both the trade-off model and the control model emphasize the involvement of government forces. However, the difference is that the government intervention in the trade-offs model is aimed at supporting the development of the industry, and the degree of intervention is limited. Second, the boundaries between government regulations and market autonomy are clarified by law[Zhang Xiaopu, 2014]. In the trade-off model, laws and regulations clearly stipulate the relationship between the government and the market, clarify the strength and content of legal protection and policy assistance to market entities, in order to achieve industry development and maximize the public interest.

**Evolution of Government Role Orientation.** At present, the position of government “Facilitator and Supervisor” is in the initial stage of the trade-off model. Under the current development situation of the Internet financial market, the government has insufficient information. The government's intervention strategy is relatively limited, and the government's intervention costs are relatively large. Therefore, the attitude towards industry supervision is more cautious [Liu Ying, Luo Mingxiong, 2013]. It is also difficult for the government to quickly control risks.

At the same time, there are no comprehensive laws and regulations in the strict sense. The existing policies only roughly locate the role of the government, and the various measures proposed are all outlining.

Judging from the current situation, the development of the trade-off model requires the government to intervene more in the industry. However, with too much involvement and interference in market development, the government may interfere with the normal development of the market through supervision. Therefore, in the process of intervening in the market, It also requires that the “government hand” be restricted and regulated. While the government is more involved in the industry, it should also encourage the market to use its ability to adjust itself, and thus develop chaotic and disorderly status into a stable and orderly state and contribute to the stability of the system. The cautious attitude of the government has contributed to the vigorous development of the Internet financial market. When the industry appears to be unable to solve its own problems, the government needs more regulation.

5. Conclusion

With the highly developed Internet technology, the integration of the Internet and finance has become a general trend, which has spawned Internet Finance. The development of the Internet financial market is very rapid, with a wide coverage and a huge impact. However, at the same time, the development time is short, the market structure is still not perfect, there are various risks in the development of Internet Finance, and there are various problems in itself. There is also a lot of gaps in supervision. To supervise Internet finance is not to limit its development, but to clear the obstacles for its development and establish an orderly market rule. To promote the vigorous development of Internet finance, the key is to grasp the dialectical relationship between regulation and development so that it can encourage innovation and development and regulate the market and prevent risks. Therefore, an appropriate role of government oversight plays a decisive role. This article analyzes the relationship between the government and the market, and analyzes the government’s current role positioning and future evolutionary trends, and proposes the following recommendations:

The role of government should be positioned to avoid the tendency of the ruling model. In this model, strong government intervention can correct market failures in the industry. However, in the actual supervision process, the government has insufficient information, the government's intervention strategy is relatively limited, and the intervention cost is relatively high. Therefore, the government's role based on the public interest theory does not apply to the current Internet financial supervision. The role of full-power rulers and high-profile interventionists does not meet the needs of the healthy development of the current Internet financial market. Therefore, excessive supervision should be avoided in the future development of government roles.

At the same time, the government should also avoid the tendency of laissez-faire. In the laissez-faire model, the government has few interventions in the market, relying solely on market self-regulation to regulate the market players and achieve a healthy development of the industry. However, in actual situations, it is difficult for market players to limit irrational behavior. Therefore, the laissez-faire model is not desirable for Internet financial supervision.

Therefore, the government should formulate laws and regulations that are consistent with the characteristics of market development. Laws and regulations should ensure the free space for market development, encourage the market to exercise self-regulatory capacity, avoid excessive interference from the government in market development, and prevent the government from disrupting the normal development of the market through supervision. At the same time, the government should encourage autonomy of the industry self-discipline, according to laws and regulations to introduce specific regulatory measures, clear its own regulatory boundaries, in order to better promote the development of the Internet financial market.

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