

The Dynamism of Innovation

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My message to the Central Business District of Beijing can be summed up in two words:
Embrace innovation.

But allow me to elaborate. There are as many different types of innovations as there are stars in the sky. They vary from the ridiculous to the sublime, from the innocuous to ostentatious, from the inconsequential to the monumental, from the transitory to the permanent. In the twentieth century, during our own lifetime, we probably witnessed more innovations and inventions than cumulatively occurred from the beginning of our species. Some of them, like the Internet, were earth-shattering. Sometimes innovation is triggered by basic research. Sometimes it is led by great thinkers. Sometimes it happens by accident. Sometimes it is the result of necessity. Sometimes it is the result of inspiration.

And sometimes it is the consequence of persistence. In 1975, as chairman of the Chicago Mercantile Exchange, I came to the Mayor of Chicago, Richard J. Daley, the father of Richard M. Daley, the mayor who recently retired after 22 years of outstanding leadership, with a special request. Although I did not know it at the time, our conversation proved to be pivotal in the destiny of our markets---and tangentially---to the city of Chicago. My purpose was simple to understand. The building that housed the International Monetary Market (IMM) of the CME had become too small. The new financial markets we had launched three years earlier, in 1972, were growing at forty percent per year. They had outgrown the building we had built and we still had many more new markets to invent. You must remember that at that time our markets were still operating in open outcry fashion, with traders and brokers in the pits shouting their orders. We needed more room for new trading pits and had to find a way to expand our building or our markets could not fulfill their ultimate promise.

Our architects, Skidmore, Owings and Merrill (SOM), told us that the only way to expand our premises was to cantilever (extend) our building over the street behind the building. In this manner we could gain forty percent in additional space. But there was an insurmountable problem. To do so we had to use the air rights owned by the City of Chicago. The City Building Department had already turned down our request. Air rights belong to the city and no one got such permission. There was only one remaining hope, the mayor of Chicago. The mayor was a very famous and respected person all over the world so I was a little scared. But I was persistent.

Upon hearing my request, the mayor asked me a curious question. “If I approve your request, what will the IMM do for the city of Chicago?” I did not hesitate with the answer. “Mr. Mayor,” I responded boastfully, “If you allow these markets to expand, I believe the IMM will move the center of gravity in finance out of New York and toward Chicago.” The Mayor clapped his hands and laughed. “I like that,” he shouted. “You have my permission to use the air rights.”

The rest is history. We expanded our building and we launched many more new financial futures instruments. Our markets became hugely successful. Financial futures became one of the world’s most important instruments of finance. Years later, we built another building where our current headquarters are located. We launched, Globex, the world’s first electronic transaction system. As we grew, so did the city of Chicago. Our markets became an economic engine for the city and one of the primary factors of its growth. Chicago rivaled New York as the world’s capital of financial markets. Our markets acted as a magnet for the location of many diverse industries and businesses. Our city became the global capital for the management of business risk. We attracted enterprises that are intertwined with the markets. We inspired the birth of new trading firms. We became a hub for information technology. We attracted accounting firms. We motivated our universities to expand educational studies in financial markets. It has been estimated our markets, directly and indirectly, employ 150,000 people in Chicago.

As a measure of our prominence, last January, on his State visit to the US, President of China, Hu Jintao, paid his respects to our city with an official visit.

This history of Chicago is symbolic of the challenges faced by Beijing at the beginning of this Century. That was precisely the goal when the Beijing Central Business District (CBD) was created as defined in its strategic plan published in May 2008: To become the primary area of finance, media, and business services in Beijing, China. By coincidence, the CBD also used the architectural skills of Skidmore, Owings and Merrill. SOM’s vision for the Beijing CBD provided the framework that will enable China’s capital city to grow as a global center for commerce. And it has already produced results. Since the establishment of Beijing CBD, it has attracted more than 117 Fortune 500 businesses in the financial, media, information technology, consulting and service industries. However, as I said at the outset, my best advice to the CBD for creating a successful business center is to do everything in its power to encourage innovation. In turn, innovation will create new industries, new jobs, and, yes, new innovations.

The fundamental reason for the success of the CME Group is that our middle name was innovation. Yes, innovation became and remains the driving force behind the growth and expansion of our markets. By supplying diverse instruments of trade, we responded to the demand for tools with which to manage existing risks in business, whether in the labor market, the capital market, or the land market. In our industry—especially at Chicago Mercantile Exchange—innovation is our existence, our *raison d’être*, our very being. Scratch beneath our surface and you will find it flowing in our veins; go deeper and you will find it in our genes.

In the history of mankind, from its very inception, innovation was a driving force of progress.

China can be rightfully proud of its own nearly 5,000 years of history. Indeed, China provided the world its first building blocks—the foundation for innovation, for learning, and for growth. China has one of the world's oldest written language systems. Indeed, historically, the cultural sphere of China has extended across East Asia as a whole. It has been the source of many of civilization's major inventions---papermaking, the compass, gunpowder, printing, and a host of other innovations and inventions too numerous to mention. Prior to the 19th century, China possessed one of the most advanced societies and economies in the world. Proudly, China is the nation that gave the world ice cream.

But there is one principle of innovation that you must not forget. For innovation to be vital and of permanent value, it must be tested and proven against competition. Innovation that is protected, or remains restricted to a local community, or to the confines of a nation's borders, has not proven its worth. Remember, the IMM was on the world stage. If the innovations we provided were not found of vital use by the world community, we would have failed. But in fact, the world was in need of instruments to manage financial risks in the marketplace. That was precisely the economic function of our new futures contracts: To provide a safety-net based on benchmark groupings of inherent business exposures or to unbundle the risks into their basic components and transfer them to those most able and willing to assume and manage each component. Consequently, the IMM's financial derivatives represented some of the basic tools necessary in the mechanics of efficient capital markets. They have become an integral part of the financial system in the world's leading economies, a process that has improved national productivity, growth, and standards of living.

In the realm of embracing competition, I am afraid China has a way to go. Current financial difficulties in the U.S. notwithstanding, and while the U.S. is far from perfect, in this regard it is far ahead of the rest of the world. From its very birth, the U.S. embraced the free market ideal. The American free market ideal is not simply an economic principle giving an individual the right to produce goods and services without coercion or government intervention. As economist Friedrich Hayek explained, the free market ideal is a social philosophy encompassing ethics, moral values, jurisprudence, ideas, and a way of life. At its core is the right to act pursuant to one's judgment; the right to examine ideas; the right to experiment and explore. From its inception, the American free market ideal unleashed a most powerful economic force. It inspired competition. Like nothing else it encouraged innovation. Its beauty lies in its inherent ability to unshackle human energies. It is said that during the 20th Century about 70% of the major inventions in the world came from Americans. The IMM is but one example.

China is clearly on the right track. Since its adoption of a philosophy of common sense economics, China pursued a pragmatic path towards economic success. The results have been nothing short of astounding. As everyone knows, China's economy during the past 30 years has changed from a centrally planned system that was largely closed to international trade to a more market-oriented economy that has a rapidly growing private sector and is a major player in the global economy. Reforms started with the phasing out of collectivized agriculture and fiscal decentralization. They promoted autonomy for state enterprises, the foundation of a diversified banking system, the development of stock and futures markets, the rapid growth of the non-state

sector, and the opening to foreign trade and investment. The policy of common sense economics lifted more people out of poverty than did the efforts of any other nation, anytime, anywhere

Additionally, in recent years under its current leadership by the People's Bank of China, the Chinese government has also taken strong action toward internationalization of the yuan. Indeed, China's currency is gaining more wide-spread use in trade, and China has encouraged international trade conducted in yuan. Last May, the CSRC announced that it has published draft rules that will allow approved foreign investors to trade stock index futures for hedging purposes. When authorized, it will be the first step in opening up its local securities market. Most important, it was recently reported that under a new pilot program, China will allow selected domestic brokerage firms to help their customer's to hedge their risks in offshore markets. The selected firms will participate in the trial program once the guidelines have been announced.

These moves are to be greatly applauded, but this journey is far from finished. What I mean is that China must open its markets to world competition. The Yuan's emergence as a global reserve currency cannot succeed until China establishes full currency convertibility by ending the strict controls on private capital outflows. It is imperative for China to allow its private sector greater access to capital markets. It must encourage its municipalities to embrace the creation of new and modern market facilities. It must open its stock and futures markets to the use by offshore participants and encourage the application of offshore expertise. Toward this purpose it should allow offshore investment in domestic exchanges. Finally and most emphatically it must promote the rule of law, install a transparent accounting system, and enact a more durable system of property rights.

I am confident China will follow this path. Such changes will promote the type of innovation of which this nation is capable. Such changes will insure that the goals of CBDC are realized. I wish you success.

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