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# Changing Environment for Opening of Chinese Financial Sector and Implications

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## I. Introduction

The opening of China's financial sector has progressed at a very slow pace, unlike the manufacturing and trade sectors that have pushed for an active opening to the outside world. The Chinese economy has been growing rapidly while serving as a global production base, but since 2012, it has become necessary to modify its approaches to achieve growth as it enters an era of medium-speed growth. Recently, new reform and opening measures have been taken in various fields to improve the quality of the Chinese economy, and the need for reform and opening in the financial sector has also increased.

Internally, the financial system centered on China's state-owned commercial banks has focused on indirect financing, which has served as a major obstacle to upgrading China's economy and industry to the next level, further increasing the need for reform and opening of the financial sector. Moreover, externally, the U.S.-China conflict which began in earnest in 2018, is applying strong pressure toward reform and opening in China's financial sector.

The Chinese government began to show a proactive attitude toward financial opening amid such internal needs and external pressure, and an important development was seen in China's financial opening when President Xi Jinping declared further opening measures at the Boao Forum in April 2018. The Chinese financial authorities have prepared follow-up measures related to financial opening, and the Chinese government's efforts toward financial opening in the three years from 2018 to 2020 yielded more results than the ten-year opening period since its accession to the WTO.

## II. Policies of Chinese Financial Market Openness

In our study, we divided the Chinese government's policies and systems in the financial opening across two categories: financial services and capital account. Financial services were again divided into banking, securities, and insurance sectors. The capital account was examined by dividing it into the stock market and the bond market.

In the case of the financial services sector, the Chinese government has taken the most active measures to ease or remove restrictions on the share ratio and scope of work permitted for foreign financial institutions across all sectors of banking, securities, and insurance.

In the banking sector, the opening measures were the earliest among the financial services sectors, but the portion of foreign-invested banks' total assets remained in the 1 percent range and the return on assets (ROA) showed a rather declining trend. In the securities sector, the upper limit on foreign investment was removed in 2020, and global asset managers are increasing their entry due to licensing-related mitigation measures. In the insurance sector, foreign insurance companies were allowed to enter the life insurance industry, which accounts for about 55% of the Chinese insurance industry, as the opening began in earnest after 2019. In 2020, global insurers are rapidly increasing their entry into China, following the removal of foreign capital ratio limits placed on life insurance, health insurance, and accident insurance.

Compared to this, the Chinese government is taking a more cautious approach in the capital market, creating and managing channels for foreign capital to enter the Chinese capital market such as the QFII, RQFII schemes, and Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect, and bond connect programs. The opening of the Chinese capital market is mainly carried out by easing or abolishing investment limits on Chinese stocks and bonds through these channels or facilitating investment.

## III. Changes in China's Financial Opening Environment Due to U.S.-China Conflict

The demands by the U.S. upon China to open its financial sector have continued since the negotiations for China's accession to the WTO. The conflict between the two countries has been complicated since the inauguration of the Trump administration, and thus, the environmental change needs to be analyzed from the perspective of intensifying conflict between them.

China's financial opening has gained pace since 2018 under U.S. pressure, and as a result, U.S. financial firms are actively entering China. On the other hand, however, as the Trump administration is pushing for various measures of U.S.-China financial decoupling after the Covid-19 pandemic, we can predict for various scenarios according to the direction of future U.S.-China conflict. Moreover, with the launch of the U.S. Biden administration in 2021, we need to wait and see how the U.S. checks on China in the financial sector will develop.

The first scenario is to conclude a second trade agreement under the U.S.-China cooperation stance, accelerating financial cooperation. The second scenario is that the conflict between the U.S. and China will expand completely, making financial decoupling a reality. The third scenario is that a partial dialogue channel is left to operate as the conflict between the U.S. and China continues.

The first two scenarios are unlikely, while the third is expected to be highly likely. In this case, China will seek to acquire advanced financial techniques and know-how by encouraging U.S. financial firms to enter the country through financial opening. On the other hand, the U.S. will limit the inflow of U.S. capital into Chinese ICT companies while also restricting access to Chinese capital by U.S. high-tech companies.

We also need to focus on how Hong Kong's status as a financial hub will develop in the future, as it has emerged as a battleground for the U.S.-China conflict since the enforcement of the Hong Kong Security Act in July 2020.

Various predictions are possible for Hong Kong's phased transition. Despite the U.S. sanctions, Hong Kong's global financial hub status is most likely to remain unchanged for a short period of time. According to the recent flow of funds in Hong Kong's capital market, no massive capital outflow or corporate exodus has been detected despite U.S. sanctions. In addition, if it becomes difficult for Chinese companies to raise global funds through the U.S. Stock Exchange, the need for Hong Kong is expected to be greater than before.

## IV. Changes in China's Financial Opening Environment Due to Digitalization of Finance

The rapid development of mobile payments such as Alipay and WeChat Pay in China is driving the digitalization of Chinese finance. Based on this development of digital finance in China, mobile payment platforms such as Alipay in China are actively entering the mobile payment market in neighboring regions with poor financial systems, such as Southeast Asia, employing QR code payment methods based on competitiveness accumulated in the Chinese market.

The expansion of international cooperation in China's mobile platforms is expected to be carried out in conjunction with China's Digital Belt and Road Initiative and internationalization of the renminbi, but the competition for hegemony in digital finance between the U.S. and China is also expected to intensify.

In the future, China's digital platforms can become the basis for digital international payments in China-centered economic blocs. China is currently building a mobile QR code-compatible international payment system using

Hong Kong's offshore yuan, but it will be possible for a new international digital payment currency to be used within a new regional economic bloc centered on China in the future.

## V. Evaluation and Implications

Since 2018, foreign companies in the financial service sector have been able to enter the Chinese market with China actively opening its financial services sector, and in the case of the capital market, free flow of foreign capital has been allowed by using channels established by the Chinese government. However, although the recent opening of the Chinese financial market is significant as an institutional opening through the revision of laws and regulations, there could be many non-institutional obstacles for foreign financial companies to enter the Chinese market and actually pursue their businesses. In addition, the Chinese financial opening measures currently remain a one-way opening, focusing on the inbound market. The two-way opening that the Chinese government aims for, especially the opening of the capital account, is expected to be possible only after the capacity of Chinese financial authorities to manage financial risks and the competitiveness of Chinese financial companies have improved.

It is necessary to watch more closely how the intensifying conflict between the U.S. and China affects China's financial opening. In particular, we may see different patterns depending on what tools are used after the inauguration of President Biden. China is expanding its financial opening in response to the U.S.-China decoupling, prompted by changes in the external environment amid deepening U.S.-China conflict, which has been in full swing since 2018. From China's perspective, it can share its risks in the real economy with the U.S. by opening its financial sector, and as for the U.S., the cooperation between the two countries is likely to continue to expand as the U.S. can earn profits from the development of China's real economy. Concerns about Hong Kong's status as a financial hub have been raised due to the U.S.-China conflict, but it looks difficult for global financial companies to move to other regions due to their business with China. However, as China's financial openness expands, competition between Hong Kong and mainland China (Shanghai and Shenzhen) is expected to intensify in the mid-to-long term.

The development of digital finance in China and overseas expansion of mobile platform companies are being driven by private companies. The Chinese government also places great importance on establishing a mobile international payment system to promote the Digital Belt and Road Initiative, so the system is expected to be established in connection with future national strategies. This linkage of China's digital platforms and international payment system is likely to be utilized for the internationalization of digital renminbi in the long term. Looking at the competitive landscape between the U.S. and China, it is expected that the U.S. will intensify checks against China's digital finance internationalization in the future. This is because China's digital international payment system is likely to threaten the current U.S. dollar-centered international currency system.

In response to China's financial opening, Korea's countermeasures are to demonstrate competitive advantage through localization and differentiation in the banking sector, cultivate its ability to integrate global resources and service transactions in the securities sector, and establish sales networks with local governments in the insurance sector. In the case of stock and bond markets, the risks associated with Chinese authorities' supervision on the foreign exchange market and the volatility in the Chinese stock market should be checked.

China's financial opening following the U.S.-China conflict is expected to serve as an opportunity for Korean financial companies to enter the Chinese financial market. However, Korea's financial industry will need a differentiation strategy due to its low level of internationalization and global competitiveness. In addition, until China's capital market is opened in both directions, it is necessary to establish strategy from a long-term perspective and opt for an approach of “selection and concentration.” However, as the U.S.-China conflict may intensify, the U.S. may impose sanctions on China through financial means, meaning it will be necessary for Korean financial authorities and companies to closely monitor developments in the U.S.-China conflict, and prepare countermeasures for each scenario.

It is necessary to prepare for the possibility of separate economic blocs forming around the U.S. and China in response to environmental changes caused by the development of digital finance in China, and to establish a direction and strategy for cooperation in digital platforms. However, prior to this discussion, it was also suggested that efforts to form the Korean digital finance market and enhance its competitiveness should be given priority.

Lastly, policy implications for Korea-China financial cooperation following the expansion of financial opening in China were derived. In regard to Korea-China financial cooperation, valid suggestions would be: expanding discussions about financial cooperation via Korea-China economic dialogue channels; establishment of a Korea-China financial stability consultative body; discussing follow-up negotiations for the Korea-China FTA and promoting pilot financial cooperation projects; expansion of research to vitalize financial investment of Chinese industries and companies; and training specialized human resources in Korea-China finance. KIEP