CHINA'S SELECTIVE OPENING UP – THE CASE OF FOREIGN DIRECT INVESTMENT

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Introduction

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"Let the breeze of openness bring warmth to the world" (让开放的春风温暖世界);[1] "China will resolutely expand its opening up to the world" (中国将坚定不移扩大对外开放):[2] these are the words from Xi Jinping's two different speeches in November 2021. As the world faces unprecedented restrictions to people-to-people interactions with China – for which the Zero-Covid policy is only partly to blame; as Chinese society undergoes a sustained crackdown on pluralism, and as the Chinese economy takes a worrying inward turn and the idea of self-sufficiency arises,[3] **it is easy to dismiss this emphasis on further "opening up" as mere propaganda.**

This Christmas issue of *China Trends* explores the environment for Foreign Direct Investment in China against these questions regarding the sincerity and the objective reality of the "opening up" narrative. **The official line is clear. China has regained the status of no. 1 destination for FDIs because recent regulatory reforms have been highly successful.** The *People's Daily* argues that China is the "promised land" (应许之地) for foreign capital because the government has firmly and timely responded[4] to the Covid-19 sanitary crisis with a series of measures reshaping the investment environment in China. In the aftermath of the adoption of China's revised Foreign Investment Law in January 2020, the Central Committee has methodically issued signals of adherence to further opening up to FDI, especially in the finance sector. The "Work Measures for Complaints of Foreign-Funded Enterprises" (外商投资企业投诉工作办法)[5] were released in October 2020, the "Catalogue of Industries for Encouraging Foreign Investment"[6] was revised in December 2020.

The sources analyzed in this issue do not fundamentally contradict this official positioning. **But reading between the lines uncovers gaps in the argumentation and leads to a more nuanced picture of the improvement in China's regulatory environment** – and of the political intentions behind those reforms.

Viviana Zhu shows that despite the triumphant posture, and the impressive record of incremental reforms, Chinese experts are aware of the regulatory gaps to be filled. A historical perspective automatically underlines the amount of work put in building a legal framework and improving it over time.

1. Shi Xizhi, "Xi Jinping: Let the Breeze of Openness Bring Warmth to the World (习近平: 让开放的春风温暖世界)", *People's Daily*, November 5, 2021, https://archive.ph/rJqQD

2. "Xi Jinping: China will unswervingly expand its opening to the outside world and share China's development opportunities with the world and members of the Asia-Pacific region (习近平: 中国将坚定不移扩大对外开放, 同世界和亚太各成员分享中国发展机遇)", The State Council of the People's Republic of China, November 12, 2021, https://archive.ph/UuKh4

3. "European Businesses Urge China to Open Up, Avoid Inward Turn", *Bloomberg*, September 22, 2021 https://www.bloomberg.com/news/articles/2021-09-23/european-businesses-urge-china-to-open-up-avoid-inward-turn

4. "Why China can become the "Promised Land" for foreign investment? (中国为什么能成为外资"应许之地")", China Central Television CCTV, May 16, 2021, https://archive.ph/laJH7

5. "Work Measures for Complaints of Foreign-Funded Enterprises (外商投资企业投诉工作办法)", Chinalawinfo Co. Ltd., August 25, 2020, https://lawinfochina.com/display.aspx?id=33867&lib=law

6. "Catalogue of Industries for Encouraging Foreign Investment (鼓励外商投资产业目录)", Chinalawinfo Co. Ltd., June 30, 2019, https://archive.ph/4gnj6

An enormous legislative compliance work has inevitably accompanied China's accession to the World Trade Organization. **These messages are objectively true but a communication strategy based on skillful omissions does not tell the full story of regulatory and hidden restrictions constraining the activities of foreign businesses in China.**

François Godement puts the "opening up" narrative in the larger context of Chinese macroeconomic and industrial policies. China remains attractive to foreign companies, and this is a political success. But **Chinese analyses also emphasize another side of good policy management: the capacity of the state to conduct open-door policies without undermining the space of Chinese companies.** And indeed, 20 years after the country's accession to the WTO, voices critical of opening up continue to shape the policy discussions in China. In fact, the sources analyzed for this issue often position themselves against those voices. What also emerges from the debate is the idea that foreign companies can be wooed because they will not have to follow the policy of their governments, which offers strategic space to China to counter the foreign forces that seek selective decoupling in some economic sectors.

Philippe Aguignier explores the case of the financial sector. Today, the share of foreign actors remains below 2% in both banking and insurance. Chinese commentators acknowledge the contribution of foreign financial institutions to the growth of China's own financial sector – and in areas such as green finance or complex hedge-fund instruments, they still have know-how to bring. **They tend to put the responsibility of their limited market share on the strategic choices of foreign actors, who have missed opportunities in the real estate sector for example, before the current storm.** In addition, a higher rate of foreign penetration in China's financial sector is not an objective in itself – and this is a lesson of the 1997/1998 Asian financial crisis.

These rationalizations about the limits placed on foreign businesses and the focus on the improvement of the regulatory environment in China skip over the rise of political risk. Chinese experts conveniently ignore this, as it is an overly sensitive topic for publication. **Strengthening the regulatory framework deserves credit, but it will not protect companies from the risk of becoming collateral victims of geopolitical games on which they have no control whatsoever.**

ABOUT
China Trends seeks understanding of China from Chinese language sources. In an era where the international news cycle is often about China, having a reality check on Chinese expressions often provides for more in-depth analysis of the logic at work in policies, and needed information about policy debates where they exist. China Trends is a quarterly publication by Institut Montaigne's Asia program, with each issue focusing on a single theme.

THE LEGAL PATH TO OPENING UP: A TWISTED NARRATIVE

According to China's Ministry of Commerce, foreign direct investment (FDI) into the Chinese mainland, in actual use, has increased from CNY 388 billion in 2001 (excluding the banking, securities, and insurance sectors) to CNY 999.98 billion in 2020, representing an increase of 157.7%.[7] In 2021, it is expected to surpass CNY 1 trillion. In 2020, China was the largest recipient of FDI, followed by the US. In terms of China's total imports and exports, the General Administration of Customs (GAC) reports a 23.4% increase in the first three quarters of 2021 from pre-pandemic levels in 2019.[8] Thus, it appears that both China's capital inflow and international trade have maintained robust growth. **This factual reality stands in stark contrast with China's closure in other areas, and with the decoupling narrative.**

> *In the current context, opening up is also perceived by Chinese experts as a measure against the worsening external environment China faces (针对中国的围堵与竞争).*

The notion of "opening up" has taken center stage in China's domestic and international narrative since 1978. It still is the case today, despite China's great closure to international people-to-people exchanges. "China's open door will not be closed – the door will only be opened wider and wider (中国开放的大门不会关闭，只会越开越大)".[9] In recent years, this sentence has become an integral part of many Chinese official speeches and expert analyses. Further opening up is often described as a means to achieve greater innovation, higher-level development, deeper global integration, etc. And in the current context, as underlined by Fan Hengshan, former Vice Secretary-General of the National Development and Reform Commission (NDRC), opening up is also perceived by Chinese experts as a measure against the worsening external environment China faces (针对中国的围堵与竞争).[10]

Historically, "opening up has been accompanied and complemented by the construction of the rule of law" (法治建设一直与对外开放相辅相成、相伴而行), and **the "legislative work has been closely integrated and coordinated with the opening up"** (立法工作与对外开放紧密结合、协调推进).[11] Promulgated in 1982, the PRC Constitution has provided the fundamental guidelines for the introduction, protection and regulation of foreign investment. Article 18 of the Constitution permits "foreign enterprises, other economic organizations and individuals, to invest in China and to enter into various forms of economic cooperation with Chinese enterprises or other economic organizations" and protect the "lawful right and interests" of these foreign players.[12]

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7. "Manufacturing sector basically lifted restrictions on foreign investment (商务部:制造业领域基本全面取消了针对外资的限制)", Ministry of Commerce, December 10, 2012, https://archive.ph/trV41

8. "China's foreign trade maintains robust growth, reports improved quality", *Xinhua*, October 13, 2021, http://archive.today/5yz0O

9. Fan Hengshan, "Some important features of China's high-level opening to the outside world (中国实施高水平对外开放的若干重要特点)", *China Daily*, October 31, 2021, https://archive.ph/HnDjx

10. Ibid.

11. "The rule of law guarantee for China's opening up to the outside world (我国对外开放的法治保障)", The National People's Congress of the People's Republic of China, August 24, 2021, https://archive.ph/JTDVZ.

12. "Constitution of the People's Republic of China", *The State Council of the People's Republic of China*, https://archive.ph/HD4DS

A paper published on the website of China's National People's Congress argues that there are three phases in the history of China's opening up from a legal perspective. Historically, China's legislation on opening up emerged from foreign investment legislation. The *Law on Chinese-Foreign Equity Joint Ventures*, passed in 1979, was the first foreign investment law enacted after Deng Xiaoping launched the reform and opening up policies. It was followed by the *Law on Foreign-funded Enterprises* in 1987 and the *Law on Chinese-Foreign Cooperative Enterprises* in 1988. Together, they are referred to as the "three foreign investment laws (外资三法)", which laid the legal foundation for the application of foreign investment in China until 2020. The 1994 Foreign Trade Law, on the other hand, set out the basic policies and major management systems of import and export of goods and technology, and international trade in services.

The second phase is characterized by improving and amending existing regulations in order to comply with WTO requirements. Liang Guoyong, an Economic Affairs Officer at the Investment and Enterprise Division of United Nations Conference on Trade and Development (UNCTAD), notes that since joining the WTO, China has carried out a large-scale cleanup and revision of laws and regulations (大规模开展法律法规清理修订工作); more than 2,300 at the central government level, and up to 190,000 at the local government level.[13] He adds that such a process has improved China's "compatibility with the outside world (对外兼容性)". In the time frame of a few months (from October 2001 to March 2002), all three foreign investment laws were amended and three key provisions incompatible with WTO were removed: 1) the requirement that raw materials, fuels, and components required by foreign-invested enterprises "shall be purchased in China as far as possible"; 2) the provision that Chinese-Foreign Cooperative Enterprises and foreign-invested enterprises "shall balance the foreign exchange balance on their own"; 3) the provision that foreign-funded enterprises should "export all or most of their products".

13. "Interview: China is a firm supporter of the multilateral trading system--Interview with Liang Guoyong, senior economist of the United Nations Conference on Trade and Development (专访:中国是多边贸易体制的坚定支持者—访联合国贸发会议资深经济学家梁国勇)", *Xinhua News Agency*, December 16, 2021, https://archive.ph/wjhjS

The goal, as noted by several Chinese news outlets, is to "act earnestly so that foreign businesses are willing to come, and able to enter, willing to stay and develop well (真正让外商愿意来、进得去、留得住、发展好)".

During the same phase, the Foreign Trade Law was revised in 2004 to further expand the scope and freedom of foreign trade operations, and the approval system for foreign goods and technology trade was replaced by record registration management. At the same time, the article published on NPC's website specifies that, in accordance with the WTO rules, some changes were also made in China's favor. For instance, **provisions on foreign trade investigations were added to provide an important legal framework to protect domestic industries and market order.** In addition, the anti-dumping safeguards, anti-circumvention measures and other trade remedy systems were improved upon to protect and support domestic industries. This is also the time when China underwent deep revision of its legislation related to intellectual property, including patent law, trademark law and copyright law.

The 18th National People's Congress marks the third phase. Since then the focus started to shift, with more emphasis being placed on "new international economic relations (新型国际经济关系)" and a "new paradigm (新格局)". A number of experiments started taking place, such as the establishment of the first Pilot Free Trade Zone in Shanghai in 2013, and the trial of a "pre-establishment national treatment" plus "negative list management" approach towards foreign investment management in the zone began. The measures were extended to Guangzhou, Tianjin and Fujian in 2014, and were eventually rolled out nationwide in 2016. Another crucial element of this third phase is the drafting of a uniform Foreign Investment Law, to replace "three foreign investment laws" that were no longer able to address the emerging challenges. As a consequence, the Foreign Investment Law and its implementation regulations were adopted by the National People's Congress in 2019 and came into effect in January 2020, thus replacing the three previous pieces of legislation. The goal, as noted by several Chinese news outlets, is to "act earnestly so that foreign businesses are willing to come, and able to enter, willing to stay and develop well (真正让外商愿意来、进得去、留得住、发展好)".[14]

These efforts currently continue. For instance, in the past two months, the Ministry of Commerce issued the "14th Five-Year (2021-2025) Plan for the Utilization of Foreign Capital", and China's National Development and Reform Commission (NDRC) jointly published a notice on the establishment of a collection and notification system for cases of negative market access list violations (建立违背市场准入负面清单案例归集和通报制度的通知). As a result, cases of violation will be regularly published on the website of the NDRC and on "Credit China (信用中国)".[15]

Chinese officials and experts attribute the good FDI numbers experienced in recent years to successful policy-making and further opening up. On top of that, Gao Feng, China's Ministry of Commerce spokesman, lists a number of other achievements to prove that China has vigorously fulfilled its WTO accession commitments and has continuously opened up. Of the 160 sub-sectors on WTO's services sectoral classification list, China has opened up around 120 (although he does not specify the level of openness). The negative list has been significantly reduced. In 2013, the negative list for the China (Shanghai) Pilot Free Trade Zone included 190 items. By 2020, only 30 items remained in Pilot Zones, and 33 items nationwide.

Overall, many opinion pieces seem to twist the "open up" concept to make it justify the key talking points of the day, "dual circulation", "common prosperity" and "win-win cooperation".

Chinese experts use the signing of RCEP as a manifestation of China's continuous opening up under Xi Jinping. Tu Xinquan, Dean and Professor of the China Institute for WTO Studies at the University of International Business and Economics, notes that **for the first time when signing RCEP, China has accepted a negative list in an international agreement.** He adds that such commitment indicates that China's "wheel of openness can only roll forward (开放的车轮只能向前)".[16]

According to Wang Baozhu, Wang Liyun and Mao Peihua from Shanghai International Studies University, China is methodically carrying out new practices through "developing (发展)", "breaking the old (破旧)" and "establishing new patterns (立新)". In sum, they argue that China is promoting the construction

14. "The rule of law to promote a higher level of openness to the outside world - written on the occasion of the implementation of the Foreign Investment Law and its implementing regulations (以法治推进更高水平对外开放—写在外商投资法及其实施条例施行之际)", *Xinhua*, January 1, 2021, https://archive.ph/A43Hk

15. "Notice of the National Development and Reform Commission on the establishment of a collection and notification system for cases of the negative market access list violations (国家发展改革委关于建立违背市场准入负面清单案例归集和通报制度的通知)", *the National Development and Reform Commission*, November 19, 2021, http://archive.today/GkQ3q

16. Tu Xinquan, "RCEP sets a new stage for China's higher level of opening up (屠新泉:RCEP为中国更高水平开放搭建新舞台)", *Tsinghua Financial Review*, November 11, 2021, https://archive.ph/Mb4Op

of a "new type of international economic relations".[17] **They also stress that China is no longer pursuing opening up just to meet its own economic development needs,** but rather aiming at constructing a "new international economic relations" that stresses "a community of shared future for mankind (人类命运共同体)", "win-win cooperation (合作共赢)", and "joint contribution and shared benefits (共商共建共享)". Overall, many opinion pieces seem to twist the "open up" concept to make it justify the key talking points of the day, "dual circulation", "common prosperity" and "win-win cooperation".

Despite the abundant amount of Chinese articles on China's opening up, it seems that there are no significant pieces pointing to the limit of China's approach. However, considering all the articles which highlight the need for further opening and improving existing regulations, one can interpret that Chinese experts still believe there is a gap to be filled.

17. Wang Baozhu, Wang Liyun, Mao Peihua, "Constructing New International Economic Relations: Theory and Practice— An Analysis of "Institutional Openness" (构建新型国际经济关系:理论与实践—兼析"制度型开放")", *Journal of Shanghai University of International Business and Economics*, November 23, 2020, https://archive.ph/8457t

ADVERTISING - AND PLEADING - FOR THE "OPEN DOOR"

Ever since the concept of "dual circulation (双循环)" has been introduced in 2020, and the so-called "domestic cycle (内循环)" has been decided to be the "mainstay", there have been frequent international interpretations that this is in effect a part of Xi Jinping's strategic shift to self-reliance, and to the great closure of China that manifests itself so strongly in politics and ideology. One can hardly recount here all the initiatives in tech policies, finance and international listing of Chinese firms, recontrol of companies, large and small, as well as private education that amount to a great closure, together with China's isolation from the world in practice through its zero-Covid policies. Yet as these developments were happening, **China accused the United States and its "Cold War" allies of an intention of "decoupling", rejecting the responsibility of fragmenting the global economy.**

A paradox has emerged in full light. Whatever the intentions of the United States or others, whatever the very real control and closure policies enacted by Beijing, China has never been more integrated into the global economy from several standpoints: foreign trade, where what was expected to be a short-term burst of exports due to needs created by the pandemic and to the early recovery of China's industries is now proving to be another extended export boom.[18] From January to November 2021, China's export of goods increased by 40 % in USD relative to 2019.[19] Foreign direct investment, whether through industrial capacity building in China or via financial inflows, is surging even as global FDI flows have been sharply curtailed. According to official sources, FDI into China will top CNY 1 trillion or USD 157 billion in 2021.[20] **What has been missing throughout this new pandemic era is the other side of global integration: domestic household consumption of goods and services, and therefore also imports, have been lagging.** This simultaneously undercuts two goals often associated with China's new macro-economic policies. The first one, which is largely sold to the international audiences, predicts that the GDP is rebalancing from export-led growth to domestic consumption. The second one, largely made to China's own public audience, suggests that the "domestic cycle" or self-reliant economy will increase in relative size.

Foreign direct investment, whether through industrial capacity building in China or via financial inflows, is surging even as global FDI flows have been sharply curtailed.

In view of these developments, one would expect Chinese experts and public communication to stress that China's international trade and investment policies remain beneficial to the world. Instead, **our Chinese sources largely focus on two aspects: China's current competitive advantages and measures contributing to the investment capital inflows; and the benefits**

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18. François Godement, "Xi Jinping's New Political Economy: Part 2", Institut Montaigne, September 17, 2021, https://www.institutmontaigne.org/en/blog/xi-jinpings-new-political-economy-part-2

19. "China's Total Export & Import Values by Trade Mode, January-November 2021 (in USD)", General Administration of Customs People's Republic of China, December 8, 2021, https://archive.ph/Px5jX

20. "China's FDI inflow expected to top 1 trillion yuan in 2021", *Xinhua*, December 9, 2021, https://archive.ph/dezvy

for China **of continuing and expanding the open-door policy that has been a hallmark of China's reforms since 1978.**

The first aspect constitutes an advertisement towards foreign partners and investors, and a claim of political victory against any Western government intentions of "decoupling" from China: **the story line here is that non-Chinese business and economic interests do not follow their own governments' policies.** The second aspect, present only in some of our sources, is more akin to pleading against "some" domestic views arguing for granting less room to foreign companies and to imports.

Although there are similar risks in much sought after Chinese sectors (such as pharma and high-tech), undervalued Chinese blue chips and banks are a magnet for future investment.

In the first category of arguments, we find negative advertising for the United States' bubble economy: according to Nie Qingping, General Manager of China Securities Finance Corporation Ltd, the Trump and Biden administrations have created approximately USD 6-8 trillion of excessive monetary liquidities in response to the pandemic – and may be on the way to USD 9 trillion (or 43% of the US GDP).[21] **By contrast, the China market "is a value investment (价值投资)".** Much of the exuberance of the US stock market – as Japan's soaring market of the 1980s – reflects cross-holdings by investors including banks: a dangerous situation when deleveraging occurs. Although there are similar risks in much sought after Chinese sectors (such as pharma and high-tech), undervalued Chinese blue chips and banks are a magnet for future investment.

Other negative arguments are cited. According to Wang Yongzhong and Wang Xueting, members of the Chinese Academy of Social Sciences (CASS), **disruptions in logistics and the supply chain have pushed foreign investors to place a larger proportion of their production chain inside China, to reduce the movement of intermediate products, to evade blockades and sanctions, and to make full use of China's industry clusters.**[22] Finally, mention is made of a June 2021 report by the World Trade Organization (WTO) according to which 39 out of the 140 trade and trade-related measures taken by G20 economies since the pandemic outbreak include restrictions on trade.

But the positive arguments are there too. According to Bian Jing , Researcher at the China Macroeconomic Research Center, China's value added manufacturing is the one in the world that has all the industrial categories listed in the United Nations Industrial Classification: 41 major industrial categories, 207 medium industrial categories and 666 small industrial categories. In addition, China's R&D spending rate now exceeds the EU's (2.4% of GDP vs. 2.2% for the EU).[23] Foreign companies focus on China's new materials, new energy, artificial intelligence, the Internet of Things (IoT) and other frontier areas. China's increasingly urbanized population and its upscale consumption hold the promise of an even greater market. In addition to the January 2020 Foreign Investment Law, the reduced number of items on the national or Special Economic Zones' negative investment list, the holding of an International Import Fair, **decarbonation and green investment are also attractive to foreigners:**[24] **in November, the central bank instituted a window for low-interest (2%) decarbonation loans.** In support of the notion

21. Nie Qingping "China remains the most attractive market for investment (中国仍是最具吸引力的投资市场)", *China Wealth Management 50 Forum*, March 14, 2021, https://archive.ph/9u8kL

22. Wang Yongzhong, Wang Xueting, "Sustained economic improvement enhances China's attractiveness to foreign investment (经济持续向好增强中国对外资吸引力)", Economic Information Daily, June 23, 2021, https://archive.ph/zjavZ

23. Bian Jing, "Why foreign investors are optimistic about China's economy (外资缘何看好中国经济)", *China Economic Net*, November 21, 2021, https://archive.ph/IL4tF

24. "'Dual Carbon' initiative enhances China's attractiveness as foreign banks promote green finance ("双碳"行动增强中国吸引力, 外资行发力绿色金融)", *Yicai*, November 19, 2021, https://archive.ph/B6cvt

that multinational companies are counting on the China market for their profits, a Chinese report cites the well-known EUCCC and AmCham recent opinion polls among their members.[25] It also emphasizes the call for local governments to hold their own dialogues with foreign investors, and it cites multiple such roundtables under the flag of the NDRC with American and European investors. Mention is also made of the licenses for full ownership of subsidiaries granted to JP Morgan, Fidelity and BlackRock. Yet this is also placed in the context of moving from preferential treatment of foreign investors to fair and competitive investment for all.[26]

Some other views, often from heavyweight figures of China's economic bureaucracy, such as Wei Jianguo, Huang Qifan or Long Yongtu, do cite advantages to foreign investors in their China ventures. But their emphasis is even more on the benefits to the national economy, often citing results from the past decades that **more should be done to keep China competitive and attractive in terms of FDI.** Huang Qifan, former Mayor of Chongqing and now Vice-Chairman of the National People's Congress Financial and Economic Affairs Committee, emphasizes the need to expand the open door to inland areas, and to move towards growth in services which are "capital and talent intensive".

This is also where we come to understand that in some quarters, there is indeed opposition to the open-door policy. Long Yongtu (former WTO negotiator and minister of Commerce) concedes that "some adjustments have to be made to the open-door policy"[27]. But he reminds his audience that China's population now favors more high-end consumption. And that more imports ensure more leverage in international negotiations and rule-making: "whoever has the imports on the international market has the pricing power, whoever holds the market trend also holds rule-making in the international system. If China is to truly become a commerce powerhouse, we must become a large importer". Starting from the case of Panasonic's China investment in 1979 and also citing auto manufacturing, Wei Jianguo, former vice-minister of Commerce, argues that China's opening up is sincere and urgent (真诚且迫切的). **He explains that foreign investors do not only make profits (引进外资不单纯是商业利益交换), they also nurture a large number of excellent industrial talents and improve the competitiveness of various industries in China,** which cannot be bought by money.[28] He argues that **the Chinese "should not be biased or enlarge conflicts to achieve our goals, and not deliberately foster public opinion that some foreign companies should "get out (滚出去)".** The behavior of some individuals does not represent the attitude of all Chinese consumers."

> *"If China is to truly become a commerce powerhouse, we must become a large importer."*

Wang Wentao, Secretary of the CPC Leadership Group of the Ministry of Commerce, goes further, writing that "with 2% of market share, foreign-funded enterprises (...) account for 1/10 of the country's urban employment, 1/6 of China's tax revenue and 2/5 of its import and export".[29] **He invokes secretary Xi Jinping's authority to criticize "one-sided interpretations, seeing too much of the domestic cycle as the mainstay (有些解读比较片面，过多看到了国内大循环为主体)".**

In a nuanced overview of China's open-door policies over time, Jiang Xiaojuan, the Dean of Tsinghua University's School of Public Policy and Management,

25. "Observation of the foreign investment situation in China (外商投资中国形势观察)", *Jiewu Information*, October 19, 2021, https://archive.ph/9yMef

26. Huang Qifan, "China's opening-up pattern will form five new characteristics (中国对外开放格局将形成五个新特点)", *Sina News*, December 4, 2021, https://archive.ph/bEz6K

27. Long Yongtu, "Changes and continuity in China's open-door policy under the New Development Pattern (新发展格局下中国对外开放的变与不变)", *Sina News*, September 26, 2021, https://archive.ph/U8fcn

28. Wei Jianguo, "China's opening up to the outside world is sincere and urgent (中国对外开放是真诚且迫切的)", *The Paper*, June 20, 2021, https://archive.ph/6PiwV

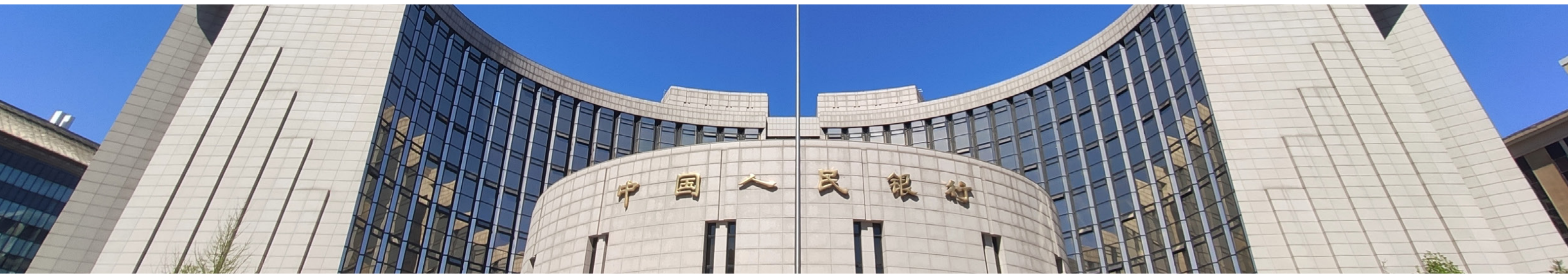
29. "Wang Wentao talks about the role and contribution of foreign investment in building a moderately prosperous society in China and the next steps for foreign investment (王文涛谈及外资对中国建成全面小康社会的作用和贡献及下一步外资工作措施)", August 23, 2021, https://archive.ph/nYQ26

stresses the gradual nature of the opening, that has prevented accidents on the way to liberalization, enabled domestic firms to improve their game, avoided losses to state enterprises.[30] In sum, **"gradual liberalization has not seriously impacted domestic industries".** This is not because China has escaped the laws of economics, but thanks to "the Chinese government's traditional ability to intervene in the economy (中国政府干预经济的传统能力)". This invites two comments: first, that the argument here is directed against Chinese opponents of the open door and not towards potential foreign investors. Second, that placing the entire reform process under the aegis of "the fundamental laws of economic opening (经济开放的基本规律)" implies that the process should not be distorted by ideology or politics: over the past year, this had been a frequent reminder by some key economic figures that the state, however powerful, cannot afford to disregard these laws. Jiang notes in fact that gradual liberalization has had its drawbacks, such as holding excessive foreign currency reserves: here we may see again a plea for loosening capital controls.

In sum, "gradual liberalization has not seriously impacted domestic industries"... thanks to "the Chinese government's traditional ability to intervene in the economy".

What appears to be a full success in keeping the attractiveness of China to foreign investment while promoting exports is apparently not enough to convince more sovereignist quarters in China. It is notable that key figures in China's economic establishment make the argument for a continued and expanded open-door, citing the existence of opponents to these views.

30. Jiang Xiaojuan, "Does China's opening up to the outside world follow the basic laws? (中国的对外开放是否遵循基本规律?)", *China Think Tank Network*, October 13, 2021, https://archive.ph/dSJtC



ELEVENTH-HOUR OPENING IN THE FINANCIAL SECTOR

"Opening to the outside world is China's basic national policy, and the opening up of the financial industry is an important part of it", emphasizes Chen Weidong, Dean of Bank of China Research Institute.[31] Although these words appear strong, the reality is much more complex and less straightforward, from the standpoint of both foreign financial institutions and Chinese economists and scholars, including Chen himself, as we will see below.

A significant step took place in 2001 with China's accession to the WTO, which a recent Chinese article celebrating its 20th Anniversary describes as the "rebirth (脱胎换骨; 涅槃重生)" of the sector.

Steady does it

China's financial sector went through different rounds of opening up since the beginning of the reform era in 1978.[32] A significant step took place in 2001 with China's accession to the WTO, which a recent Chinese article celebrating its 20th Anniversary describes as the "rebirth (脱胎换骨; 涅槃重生)" of the sector.[33] **The regulatory frame which emerged progressively allowed foreign commercial banks to establish branches or fully-owned subsidiaries in China.** On the other hand, it established caps on the foreign ownership of local Chinese banks (20% for a single shareholder, and 25% for all foreign shareholders combined), and imposed restrictions on various products and activities (e.g. underwriting certain categories of domestic bonds). These caps and most other restrictions were eventually removed between 2017 and 2020. Similarly, foreign investment banks and insurance companies were also allowed to operate in China but the establishment of majority-owned subsidiaries was off-limits. They were forced to operate through joint ventures in which they could only hold a minority share.

Besides, potential investors in banking, securities and insurance had to meet very strict eligibility criteria (in terms of minimum size or years of experience), restricting de facto access to only the largest and best established of foreign firms.

Many foreign commercial banks nevertheless took advantage of these opportunities: by establishing local subsidiaries and starting to develop their networks. Some others chose to acquire minority stakes in local banks (there were 20 such cases by the end of 2006[34]). A few did both simultaneously. Insurers and investment banks followed the trend in their respective fields.

The regulatory environment continued to evolve after 2001, but many of the changes were only of technical nature: the main restrictions remained in place, while the scope of individual products and businesses authorized

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31. Chen Weidong, "Objectively understanding the degree of openness of China's financial industry (客观认识中国金融业开放程度)", *Economic Herald*, No. 2, 2021, https://archive.ph/8VR2C

32. We will discuss here only the main sub-segments within the financial sector: commercial banking, investment banking (or securities business), and insurance.

33. Du Chuan, "20 years after WTO accession, China's economy has taken off and financial opening has deepened (入世20年中国经济腾飞，金融开放纵深向前)", *China News*, December 10, 2021, https://archive.ph/JujMw

34. Lamin Leigh and Richard Podpiera, "The Rise of Foreign Investment in China's Banks - Taking Stock", *IMF Working Paper WP/06/292*, December, 2006, https://www.imf.org/external/pubs/ft/wp/2006/wp06292.pdf

for foreigners enlarged very slowly. Foreign financial institutions and their governments (especially the US) actively lobbied to obtain the lifting of the long-standing entry restrictions, but to no avail.

Changes began in 2017, with a new wave of measures being announced in the three main fields of banking, securities and insurance.[35] **The main ones addressed the constraints imposed by the Chinese regulations outlined above; making the Chinese market accessible to a wider range of entrants.** According to China News, these measures also signaled a change of mood in China, from a more defensive approach ("the wolf is coming" "狼来了") to the "win-win common development" approach (互利共赢共同发展).[36]

These measures also signaled a change of mood in China, from a more defensive approach ("the wolf is coming" "狼来了") to the "win-win common development" approach (互利共赢共同发展).

While the tensions with the US regarding trade and the opening (or lack thereof) of the Chinese economy to US investors may have accelerated the calendar, they were not the immediate cause of this new opening. **These measures had been under consideration for some time already, so for the Chinese authorities, the concession was a good way to diffuse tensions at a low cost.** For instance, in 2017, it was announced that caps on banks, insurance companies and asset managers would be lifted in 2021. The same commitment was repeated in the US-China Phase One Agreement signed in January 2020. Eventually, the lifting took place later in 2020, one year ahead of schedule.

This new set of measures was considered a major step by Chinese authorities, but was met with less enthusiasm by foreign investors, especially as no new announcement of any foreign commercial bank taking advantage of the lifting of the 25% foreign ownership cap. The responses of insurance and securities actors have been more positive, with several players seizing the opportunity to acquire control or even full ownership of their local joint ventures. This has been the case notably of UBS, Goldman Sachs and Morgan Stanley in the securities business, Allianz in life insurance, and AXA in property and casualty insurance. JP Morgan Asset Management and American Express received approvals for new activities. But there has been no new entrant, and some players even announced a scaling down of their operations (Vanguard in asset management and Citibank in retail).

Chinese narratives: disenchanted with foreign financial players

This has led to some soul-searching among Chinese scholars and economists, eager to better understand the experience of foreign players in the Chinese market. **All agree that the market share of foreign players remains low even after several rounds of opening:** between 1% and 2% in both banking and insurance, in decline for the former and on a more positive trend for the latter. For securities, no foreign-invested firm appears in the top ten houses in the domestic bond or equity issues league tables. Foreign firms, in general, seem also less profitable than their Chinese counterparts, judging from their returns on assets (ROA).[37]

35. For a detailed description of the measures and their timing in banking, see Chen Dongyue, Huang Yixin, Guo Jingjuan, "Banking Laws and Regulations 2021 | China", in Peter Hsu and Daniel Flümann (eds) *Banking Laws and Regulations 2021*, March 19, 2021, https://www.globallegalinsights.com/practice-areas/banking-and-finance-laws-and-regulations/china
For insurance, see "New opportunities as China accelerates financial sector opening-up", Deloitte, June 2020, https://www2.deloitte.com/cn/en/pages/about-deloitte/articles/pr-china-market-opportunities-for-foreign-insurance-companies-under-the-new-opening-up-policies.html/#:~:text=As%20China%20continues%20to%20ease%20market%20access%20restrictions,the%2012.2%20percent%20growth%20of%20purely%20domestic%20players

36. Du Chuan, "20 years after WTO accession, China's economy has taken off and financial opening has deepened (入世20年中国经济腾飞, 金融开放纵深向前)", China News, December 10, 2021, https://archive.ph/JujMw

37. Xu Qiyuan et al., "Why the smaller the foreign banks, the worse they are'? (外资银行为什么"越小越不行"?)", *China Finance 40 Forum*, December 1, 2020, https://archive.ph/7aG0P

Chen Weidong, after reciting the mantra of opening in his introduction, offers some sobering observations.[38]

38. Chen Weidong, "Objectively understanding the degree of openness of China's financial industry".

First, opening should not be an objective in itself. He observes that in some strong economies such as the US or Germany, the degree of foreign penetration in financial business is relatively low. On the other hand, **some countries with high penetration rates suffered negative consequences,** such as in the case of the consumer finance crisis in South Korea in 2003, or the abrupt withdrawal of foreign capital from some countries in Eastern Europe during the financial crisis of 2008-2009.

Second, many countries have stringent restrictions on foreign presence in the financial business (he names India and the European Union), and **Chinese banks find it very difficult to expand in the US, citing the lack of reciprocity in terms of the level of openness.** He notes that there has been no case of approval of the purchase of a US bank by a Chinese one.

He also suggests that **the assessments of the activity of foreign banks are based on wrong figures:** business done with Chinese clients which takes place outside of China is not taken into account. In addition, some foreign banks derive revenues from their stake in a local Chinese bank, which may be far more than from their own operations. In such cases, the related revenues are not booked in the local subsidiary, which therefore leads to an underestimation of the size and profitability of Chinese operations of these foreign players.

There is some truth in the first argument, especially for US investment banks, which derive substantial revenues from transactions such as US listings, international bond issues, or offshore acquisitions by Chinese firms (although some of these revenue streams may decline or even disappear in the near future, namely US listing fees). The second argument is a thinly veiled jab at HSBC, which derives close to USD 2 billion revenues from its 20% stake in Bank of Communications, while its fully owned operations generate a profit of "only" USD 767 million.[39] In contrast to HSBC, most other foreign banks (including all the American ones) have already sold their stakes in Chinese banks, very often with a substantial gain.

39. "Financial Review» in Annual Report and Accounts 2020", HSBC Holdings plc, 2021, pp 100 https://www.hsbc.com/-/files/hsbc/investors/hsbc-results/2020/annual/pdfs/hsbc-holdings-plc/210223-annual-report-and-accounts-2020.pdf?download=1
"4Q20 Results Opening up a world of opportunity", HSBC Holdings plc, February 23, 2021, p 64.

He adds that the small market share of foreign banks is, to a certain extent, the result of their own choices, as they stayed away from some risky sectors of the economy (such as real estate or government platforms), which have seen the highest growth rates.

China should also pay attention to issues of reciprocity ("引进来"与"走出去"对等), and take into account what foreign players can offer in terms of support to its national priorities such as the Belt and Road Initiative.

Chen finally offers some advice to the Chinese financial authorities: opening should be pursued, but China should be clear about what it really wants from foreign players. This should not be capital per se, but rather know-how in some areas where foreign banks are strong such as cash management (especially important for Chinese corporates operating outside of China), complex risk-hedging instruments, or green finance. China should also pay attention to issues of reciprocity ("引进

来"与"走出去" 对等), and take into account what foreign players can offer in terms of support to its national priorities such as the Belt and Road Initiative.

Hu Qiyuan and his coauthors, from the China Finance 40 Forum (CF40) [40] offer more sympathetic views in two articles, albeit with slightly provocative titles: "why the smaller the foreign banks, the worse they are", and "complaints of foreign-owned institutions: unfair treatment or unaccustomed?". [41]

Echoing the point raised by Chen, but with a different twist, they first note that **"foreign banks missed the window of opportunity to develop (错过了一段发展的窗口期)".** After 2007, China's real estate market, local government financing platforms, and shadow banking have rapidly expanded, but foreign banks were less keen than local banks on these segments, due to their stricter risk assessment criteria. As a result, their assets grew relatively slower than local banks, leading to a loss of market share, as well as lower profitability. They point out that this may not be a bad thing in the end, as it also turns into a lower cost of risk for the foreign banks, now that the economic situation has gotten worse.

"Foreign banks missed the window of opportunity to develop (错过了一 段发展的窗口期)".

In its 2020 Financial Openness report, the CF40 scholars identified five key obstacles faced by foreign financial institutions.

The first two obstacles, which concern **objective restrictions and regulatory implementation that discriminate against foreign firms, would be progressively solved with a further opening.** Foreign firms are also encouraged to engage more in the elaboration of standards and regulations in China.

However, opening alone cannot solve other obstacles, "financial opening should go hand in hand with financial reforms". There may be differences in the maturity of the regulatory environments in China and in some other markets. Due to practice differences, foreign firms may be more negatively impacted than local firms on issues such as compliance, network security, or data management. There are also gaps between the strengths of foreign actors and the state of development of markets. Foreign firms are strong in complex derivatives or sophisticated risk hedging products, which are not so widely used in the Chinese market. In the same line of thought, they note that foreign banks are disadvantaged in accessing low-cost sources of funding such as retail deposits due to their limited networks.

Finally, the fifth type of obstacle, which is phrased as criticism towards foreign players, points to their insufficient efforts to adapt their products to the needs and tastes of local customers. This happens in other markets as well, and they mention Japan as a case where the banking market is open but foreigners have failed to make significant inroads. Unlike Chen Weidong, they stop at blaming foreign firms for their failure at making more progress in the Chinese market. **What they clearly believe, however, without being explicit, is that solving these type five issues is a question for the foreigners themselves to tackle.**

Other authors deal more specifically with the securities market. Given that these markets have a relatively short history in China, and that the history of

40. "Established on April 12th, 2008, today the China Finance 40 Forum (CF40) is China's most influential think tank in the field of finance and macroeconomics" from "About CF40", *China Finance 40 Forum*, https://archive.ph/7mmcN

41. Xu Qiyuan et al., "Why the smaller the foreign banks, the worse they are'?" and Xu Qiyuan et al., "Complaints of foreign-owned institutions: unfair, or unaccustomed (外资机构的抱怨:不公平、还是水土不服)", *China Finance 40 Forum*, November 24, 2020, https://archive.ph/ldGqa

foreign involvement is even shorter, their observations are less detailed than the ones we just reviewed in the field of banking.

When reviewing the history of foreign involvement, Dong Dengxin, Director of the Institute of Financial Securities at Wuhan University of Science and Technology, highlights that **there have been more failures than successes, with, in some cases, the foreign party even withdrawing from its joint venture.** [42] In his opinion, this shows the failure of the strategy of forced joint ventures, which leaves foreign parties with no controlling rights and decision-making powers. He also notes that another contributing factor of the withdrawal is the differences in business strategies or corporate cultures between the foreign and Chinese stakeholders.

42. Dong Dengxin, "Evolution and Impact of Foreign-funded Brokerage Firms' Access Policies (外资券商准入政策演变及影响)", *China Finance*, 2021 No. 18, September 6, 2021, https://archive.ph/HoxfZ
Deng mentions the examples of BNP Paribas and Daiwa, which withdrew from their securities JVs in 2007 and 2014, respectively.

This argument may also explain why insurers seem to have been slower than securities firms to seize the new opportunities. **The local partners of securities joint ventures tended to be existing players in that business sector; this may have made them more open to buyout offers from their foreign partners** (especially if the price was attractive), since they had their own business to fall back to. The insurance sector provides a completely different landscape. In many cases, the foreign partners were lacking an insurance background, [43] and given that new insurance licenses are very difficult to obtain, especially for banks, the joint venture model has a real strategic value for them and may have been their only way into the insurance business.

43. For instance, this is the case of Axa in the life insurance business, which has the largest Chinese bank, ICBC, as its partner, or BNP Paribas Cardif, associated with Bank of Beijing.

Foreign firmscan now compete in the local market, and they enjoy long experience,strong innovation capacities, and well-known brands.

Dong then insists on the progress that has been accomplished since 2017 in order to facilitate access to foreign firms, so that **these firms are now in a position to express their full capacities in the Chinese market.** He adds that some major firms have already chosen to acquire full control of their local joint ventures, and that more are expected to do so in the near future.

Dong concludes with some words of warning for local firms: foreign firms can now compete in the local market, and they enjoy long experience, strong innovation capacities, and well-known brands. **Local firms, on the other hand, are "novices (新手)" have "a shorter history", and suffer from a "shortage of professional talents, insufficient product development and business innovation capabilities".** They should therefore prepare themselves seriously for upcoming competition (做好应对全新竞争的准备).

Interestingly, these expressions of anxiety are very similar to the ones that were heard when foreign banks were allowed to enter into the Chinese market in earnest after 2003. At that time, regulators and bankers were really afraid that local banks would not be capable to withstand the onslaught of the stronger and better capitalized foreign banks. The result twenty years later, as we have seen, is a market share below 2% for foreign banks.

The Chinese narratives: between the lines

There are some other issues that local sources do not mention but deserve to be highlighted.

The main growth period for Chinese banking is probably behind us, and in any case, Chinese institutions have simply become too large to be taken over by foreign ones.

First, it may simply be a case of the recent opening measures happening too late. As some Chinese commentators mentioned above pointed out, the main growth period for Chinese banking is probably behind us, and in any case, Chinese institutions have simply become too large to be taken over by foreign ones. **The largest Chinese banks are also among the largest in the world by market capitalization, and the acquisition of even a small or medium-size bank in the context of China is likely to be out of reach for most foreign banks.** We can add to this that traditional business is disrupted in China by domestic digital innovators like anywhere else, which might discourage substantial bets on the sector.[44]

44. Viviana Zhu, "China's FinTech: the End of the Wild West", Institut Montaigne, April 2021, https://www.institutmontaigne.org/en/publications/chinas-fintech-end-wild-west

The situation is different for investment banking or insurance, where most analysts think the growth potential is still significant. Nevertheless, the markets are already huge and the barriers to entry quite high. **This may explain why the only parties to have shown an interest so far are the ones who are already there.** American firms have the additional motivation of mitigating the likely loss of some revenue streams, such as listing fees from Chinese companies in the US markets.

Finally the recent evolution of the Chinese regulatory environment in many sectors (digital, education, data management and so on), together with the more confrontational approach taken by the Chinese government in respect to many international issues may have led to a change in the perception of Chinese political risk. **This could lead to the postponement or the cancellation of investment decisions that would otherwise have been made.** It is likely that neither Chinese scholars nor the foreign firms concerned are prepared to comment publicly on this kind of issue.

In the end **it seems that both sides are to a certain extent disenchanted with each other:** Chinese authors point out that foreigners do not seem to be able or willing to seize the opportunities available to them, while foreigners have become more cautious in their assessment of the risks and opportunities.

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