The 3rd Annual PECC Finance Conference

Institution-Building in a World of Free and Volatile Capital Flows: PECC Perspectives

Sheraton Santiago Hotel & Convention Center, Santiago, Chile
June 20-21, 2004

Session I
Issues and Challenges of the International Financial Architecture
from the Asia-Pacific Perspective

Brief Account of and Prospects for China's Capital Account Liberalization

Jiang Chengzong
Secretary General
CNCPEC

Brief Account of and Prospects for China's Capital Account Liberalization

JIANG CHENGZONG

Secretary General, CNCPEC

(Adapted from a speech by Mr.Ma Delun, Deputy Administrator of State Foreign Exchange Administration of China.)

1 Brief Description to Process of Liberalization of Capital Account in China.

It is a long-term objective of the reform involving China's foreign exchange management system to effect RMB(Chinese currency) convertibility including convertibility of current account and capital account. In 1996, China introduced RMB convertibility under current account while opening of capital account is being advanced in an orderly way.

The process of liberalization in China is shown as a gradual opening pattern. The opening of capital account is guided by a principle, namely inflows followed by outflows, long-term account followed by short-term account, step-by-step opening of major business items such as FDI, debt financing, security financing.

The current picture of capital account opening is as follows: There are almost no restrictions or a few restrictions placed on nearly half of the 43 capital transaction items as defined by IMF. Over 40% of transaction items are still under more restrictions while only a little over 10% items are under strict control. As far as FDI is concerned, we can claim the degree of opening in China is even more liberal than some developed countries.

Now a pattern of two-way cross-border capital flow has initially been formed, and the channel of utilizing overseas capital is being multiplied. It may be summarized in the following:

(1) Capital in-flow has reached a pretty good size. By the end of 2003, 465,277 overseas investment items had been approved while actual utilization of FDI was US$501.471 billion. From 1985 to 2003, the total sum of foreign debt withdrawal was US$571.5 billion. By the end of 2003, the balance of foreign debt was US$193.6 billion. Overseas issuance of stocks earned a capital to the amount of US$27.715 billion while overseas issuance of B stockshares earned US$5.002 billion by the end of 2003.

(2) Out-flow of capital is increasing. By the end of 2003, there are 7,470 non-financial business institutions invested with an agreed investment capital of US$11.43 billion according to our own statistics.

    State-owned single-proprietorship commercial banks and Chinese capital shareholder commercial banks manage an equity of US$118.83 billion in overseas operation.

(3) The channel of utilizing overseas capital is being multiplied. In the initial stage, it was limited to setting up enterprises with FDI or foreign government loans. Now it has diversified to various forms such as project financing, international loans, overseas issuance of bonds and stock shares, issuance of foreign capital stock shares in China, merging or purchasing Chinese-capital enterprises by foreign capital, sharing state-owned stocks of listed enterprises in the stock market.

(4) The scale of transactions under capital account has rapidly expanded. Currently China's volume of transactions under capital account in terms of international income and expenditure has reached US$386.5 billion, 42.7 times that of 1982.

2.China's Policies Relevant to Foreign Exchange Management under Capital Account

As mentioned above, in the current stage there are still a number of restrictions in China to cross-border capital flow, particularly in strict control of short-term capital in-flow and transactions of such capital as securities. The management approaches concerning capital account include approval of transactions, control of volume and scale.

(1) Rational utilization of FDI, encouragement to Chinese enterprises for "going out".

China has for a long time followed a policy of encouraging FDI. The policy is quite liberal relevant to FDI capital in-flow, remittance, out-flow remittance, etc.

In the past two years, in line with "going out" strategy, many new measures have been introduced in terms of foreign exchange management, such as simplifying the formality of examining the source of capital for overseas investment; abolishing the guarantee deposit system for profit in-flow remittance from overseas investment; abolishing the procedure of examining foreign exchange risk for overseas investment; returning guarantee deposits; pilot schemes of reforming foreign exchange management pertaining to overseas investment and such schemes now cover up to 19 provinces and municipalities.

(2) Strict control of foreign debt, overall review and check-up foreign

debt risks

To prevent foreign debt risk, China has for a long time followed an approach to strictly control the volume of foreign debt. The ceilings of mid-term, long-term and yearly volumes of foreign debt are set, and a rational arrangement of the structure concerning business sectors, regions, maturity periods, foreign currencies is worked out. All this is done to ensure adequate clearance capacity. There are approval and registration formalities required by different levels of authorities up to the State Council.

Recently, readjustment was introduced to the way of managing foreign debt handled by overseas-capital banks. The main objective of this change is to put Chinese and overseas capital banks in China on the same level of treatment, thus creating a fair competitive environment. But the volume of foreign loans incurred with overseas-capital banks in China will be under control and short-term loans overseas in particular will be well under control.

(3) Liberalize capital account in a prudent way, be on guard against short-term capital in-flow impact.

Currently, capital account transaction and remittance pertaining to capital market in China requires approval in most cases, and there is a requirement to the qualifications of a handling agency as well.

Home entities with the State Council approval may issue stocks, bonds and currency market instruments in overseas markets. Home banks and non-bank financial institutions with relevant business qualifications may trade overseas bonds, currency market instruments and securities in the category of group investment. With the approval of the State Council and relevant authorities, companies which issue

H shares overseas may buy back stockshares in circulation abroad. With approval, state-owned enterprises may conduct future commodity deals; qualified foreign-exchange-dealing Chinese capital banks may buy extended instruments abroad, such deals should be in the nature of risk evasion and value ensurances; Chinese enterprises may conduct ensurance business under the item of foreign debt, such as entrusting banks abroad or home foreign-capital banks to do the business.

There is strict control over overseas investors investing at home securities market. Before 2002, overseas investors were only permitted to invest at B share market in China. In November 2002, China introduced QFII (Qualified Foreign Institutional Investor) system, and investment varieties include such RMB market financial instruments as stocks, bonds and funds.

Since the QFII introduction, 12 internationally known investment institutions have now acquired an investment quota of US$1.7 billion. The QFII introduction has played a positive role in inducing rational investment concept at home securities markets, promoting standardization and internationalization of China's securities markets, improving the service of home commercial banks, enhancing the research capacity and competitiveness of Chinese securities companies.

3. Prospects for China's Capital Account Liberalization

Liberalization of capital account is an issue which a country is bound to face when its economy advances to a certain stage where its economy has to be integrated into global economy and trade. It is a necessary requirement for participation in an all-round global competition.

Particularly under current account convertibility, effect of controlling capital flow is decreasing along with deepening of opening-up to outside world. Capital account liberalization becomes a natural outcome of a country's economy integrating into globalization.

In the process of realizing RMB capital account convertibility, China will continue to make an effort in readjusting policies and reforming foreign exchange regimes. In the near future, policies concerning capital account management which have been under study and will be announced are as follow:

(1) Permission will be given to transfers of legal properties of immigrants and inherited properties of non-residents. Until now, except for immigrants' transfers abroad of gains in foreign exchange from their properties in China, other deals of capital account transfer are strictly restricted. Now it will be gradually liberalized.

(2) Extensive research is being done to push forward opening of capital market. After the QFII system was introduced, research has since 2003 been done on key issues concerning home capital flowing out to overseas capital markets. A number of research reports on different capital sources such as insurance, capital, social security fund, enterprises' fund, have been written, and schemes of implementation of relevant changes including QFII, overseas investment by social security fund and insurance capital.

(3) Overseas operation of multinational companies. To facilitate foreign multi-national companies in bringing into play the advantage of their grouping management and raising efficiency of capital utilization, study is under way on management of cross-border operation by foreign multi-national companies of their foreign exchange capital.

*   *   *

In addition, big changes have taken place in the field of banks. With China's accession to WTO, 192 certificates of permission have been issued to foreign banks to operate in China, including 156 certificates for branches to be set up by foreign banks and 15 for legal representative offices. There are 209 representative offices of overseas banks. 85 overseas banks have been permitted to handle RMB business. The asset of the overseas banks in China shares 24.7%of the banks' total asset, the loans they handle share 20% of the total. Their operation areas and customers are expanding and growing.

Closing remarks:

Reforms of capital account management is undoubtedly a complex systemized project. New relevant policies to be introduced must be in line with the level of China's current economic development, and coincide with the capacity of macro-readjustment and financial supervision. It has to be taken into consideration together with other economic reforms. The process cannot go alone. But it must continue.