

The Current Situation and Risk Prevention of Cross - Border Capital Flow in China

Gongguan

School of economics, Tianjin University of finance and economics, 25 Zhujiang Rd, Hexi Qu, Tianjin Shi, China

***Corresponding author**

Gongguan

Article History

Received: 10.03.2018

Accepted: 22.03.2018

Published: 30.03.2018

DOI:

10.36347/sjebm.2018.v05i03.010



Abstract: With the opening up of China's Capital Account and Financial Account, the cross-border capital flows in China are beginning to show new characteristics. This not only brings opportunities to China but also creates new risks. Based on a comprehensive analysis of the current status of cross-border capital flows in China and combined with domestic and international factors, the paper puts forward the regulatory risks and the risks of financial fragility. In view of the above risks, this paper proposes some feasible countermeasures to prevent them [1].

Keywords: Financial Account, China's Capital Account, cross-border capital flows, financial fragility.

INTRODUCTION

The Current Situation of Cross-border Capital Flow in China. The Balance of Payments Breaks the "Double Surplus" Pattern. According to the State Administration of Foreign Exchange, data show that China's capital and financial items have suffered a continuous deficit from the second quarter of 2014 to the second quarter of 2016. This phenomenon has broken the "double surplus" pattern of the Current Account as well as Capital Account and Financial Account maintained by China's balance of payments for nearly 14 years.

China is a net capital exporter with a savings rate higher than the investment rate, but is able to maintain its capital account surplus for the long term. There are three reasons for this situation. Firstly, financial conflicts have caused structural contradictions in resource allocation. State-owned enterprises with lower financing constraints have also lower productivity. However, the private sector with higher labor productivity is more dependent on endogenous financing for financial sector friction. As the share of the private sector in the national economy rises, domestic savings rates continue to rise [3]; Secondly, in order to promote economic growth, the government adopted a regional fiscal and established policies such as land supply and tax incentives through the establishment of an economic development zone, which has attracted a large amount of FDI inflow; Thirdly, the rate of return on foreign investment in China is much higher than that of other countries. According to SAFE data, the average annual return of foreign capital to China in 2005-2011 is as high as 6.9%. In the United States, the index is 3.1%, while in Japan it is only 1.5%. Coupled with arbitrage and other factors; China has attracted a large number of foreign inflows, resulting in a surplus in Capital Account [2].

Judging from the direct investment items under China's Capital Account, the growth rate of overseas direct investment (ODI) is significantly higher than that of foreign direct investment (FDI). Until 2016, China's ODI outflow reached as high as 211.2 billion U.S. dollars while FDI inflows amounted to 152.7 billion U.S. dollars and its direct investment account deficit hit 58.5 billion U.S. dollars. Looking at other investment items under the capital account, other investment accounts began to experience a deficit in the fourth quarter of 2014 and the deficit continues to expand. Affected by the exit effect of the US QE, since 2015, the accelerated flow of non-resident capitals such as currency and deposits, loans and trade credits have become the major forms of foreign capital being withdrawn from China. Judging from the portfolio investment item under Capital Account, due to the opening up of Capital Account and diversification of residents' asset allocation, China's overseas securities investment has started to grow rapidly through QDII, RQDIII and other channels such as Hong Kong Stock Connect. Until 2016, the net outflow of foreign securities investment rose to about 100 billion U.S. dollars.

Structural changes in cross-border capital inflows

The proportion of foreign official capital inflows is rising. China's central bank gradually liberalized the restrictions on the size of RMB bond purchases by foreign central banks and international financial institutions in the interbank market and RMB into the SDR currency basket. The old pattern that the vast majority of overseas capital inflows were private capital was broken.

What's more, the proportion of financial capital inflows that are not directly related to actual production and exchange has increased, and the proportion of direct investment capital inflows has decreased. With the continuous development of China's capital market and the opening up of channels such as Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect, all these have facilitated the inflow of capital securities and promoted the inflow of financial capital.

Structural changes in cross-border capital outflows

The proportion of private capital outflows is on the rise. With the continuous accumulation of wealth, Chinese residents already have a strong willingness to invest abroad and the demand for the allocation of assets worldwide. The export volume of private capital has risen sharply. As the proportion of cross-border capital output has been on the rise, the ODI has been growing rapidly and its scale has surpassed that of FDI.

The target and direction of official capital output under new circumstances have changed. As China implemented the "Belt and Road Initiative," the output of official capital began to shift from developed countries in Europe and the United States to developing countries and emerging economies. Argues that these countries are a new growth point for the global economy in the future. Developing countries and emerging economies are rich in resources and have low labor costs but lack the necessary capital. At this stage, China's use of official capital to invest in emerging economies will increase its return on investment. At the same time, with the exchange of domestic and foreign currencies, the outward output of official capital can directly push the process of RMB internationalization and upgrade its position in the international reserve currency.

Risks of cross-border capital flow in China

Regulatory risk of cross-border capital flows. Similar to most emerging market countries, China's capital account has not been fully liberalized and exchange rate flexibility is not high. The relatively small size of domestic financial markets and foreign exchange markets cannot effectively suppress or sustain the frequent and large-scale flow of short-term cross-border capital. At the same time, China adopts an ex ante regulatory model that focuses on examination and approval in the management of cross-border capital

flows. In the meantime, China adopts an ex ante regulatory model that focuses on approval in cross-border capital flow management. There are relatively few means of macro prudential management and relies mainly on quantitative measures and more administrative interventions. The lack of timely and comprehensive monitoring and early warning has affected the effectiveness of the implementation of the policy. Multi-regulatory model is difficult to adapt to the current management needs and macro-policies lack coordination and cooperation.

The vulnerability of the financial system is exacerbated by the large-scale fluctuation of volatile international capital

In the early days, the inflow of capital out of China was mainly dominated by FDI, with very little inflow of securities investment. Combined with the control of capital projects, capital inflows were characterized by long cycle, high stability and small volatility. With the continuous development of China's capital market, the attractiveness of Chinese capital markets to overseas investors continues to rise. The proportion of financial capital flows continues to rise and the scale and proportion of securities investments and other investments with strong liquidity and volatility are continuously increasing. Therefore, capital inflows have the characteristics of short cycle, strong liquidity and large volatility, which expose China to unfavorable risks. The volatile large-scale instability of international capital has begun to trigger new adverse shocks to the stability of China's financial system and aggravate the fragility of the financial system [3].

Countermeasures to deal with the risks faced by China's capital flows

Introduce macro prudential supervision system

First of all, China should shift its thinking on cross-border capital flow management. The heavy administrative examination and approval should be shifted to heavy monitoring and early warning, the micro-micro-control should be changed to macroscopically prudent management, and the "positive list" should be converted into a "negative list". Adopt a combination of ex ante, incident and ex post, simplify administrative examination and approval procedures, and use more macro prudential tools of market-oriented. Follow the example of Brazil, Chile and other countries, collect Tobin's tax and the gratuitous reserve evolved from it, macroscopically prudently stabilize the tax, capital outflow tax, implement the bank's foreign exchange position management and other means to guide the rational and orderly flow of cross-border capital so as to reduce the Systemic risk

Secondly, as soon as possible to establish a unified all-round cross-border flow of capital real-time statistical monitoring system. The information system currently used in China is still not able to achieve the goal of real-time transaction statistics monitoring.

Compared with other countries, there is a certain gap. Therefore, China should include all kinds of capital flowing across borders into the system, using direct interface to obtain first-hand information. Pay attention to the quality of statistical data, increase the frequency of statistical analysis, and further improve the accuracy, timeliness and forward-lookingness of the analysis of the situation changes.

Thirdly, there is an urgent need to establish an effective regulatory coordination mechanism. Cross-border capital flows involve residents, enterprises, banks, securities, insurance and other departments. Therefore, it is imperative to establish an effective regulatory coordination mechanism to provide a platform for the exchange and sharing of regulatory information and to create an exchange mechanism for coordinating policy coherence. China should learn from the lessons of Thailand and other countries, avoid the repetitiveness of policies, prevent over-regulation or over-regulation and eliminate the duplication of supervision, loopholes and gaps through the coordination mechanism.

Finally, China should establish a market expectation survey system. Expected management has become an important tool for cross-border capital flows management. In the future, China can make use of the market expectation survey system to grasp the expected market dynamics while maintaining the transparency of policy information. Timely publicize the objectives, basis and decision-making process of policy control. Eliminate the factors that cause irrational expectation, effectively guide investors to form rational expectation, avoid the disturbance of irrational expectation caused by information asymmetry and reduce the violent fluctuation of cross-border capital.

Continue to promote market-oriented reform of the RMB exchange rate

The frequent movements of unstable international capital and sharp fluctuations in the exchange rate of RMB exacerbated the fragility of the financial system, while stabilizing the local currency is the core measure to manage cross-border capital flows. Therefore, it needs to constantly increase the flexibility of the RMB exchange rate and continue to promote market-oriented reform of the RMB exchange rate.

On the basis of the current exchange rate mechanism of "closing price + basket currency", China should continue to promote market-oriented reforms, enhance the flexibility of the RMB exchange rate and expand the two-way floating range. China could consider introducing a peg to the broad basket of programs to announce the exchange rate of a basket of currencies and at the same time allow the RMB basket exchange rate to fluctuate widely up and down without a fundamental change in the exchange rate relationship between the major currencies. In this mode, it will not

interfere with the foreign exchange market as long as the exchange rate fluctuates within the volatility. As the exchange rate continues to devalue, more and more investors begin to think that the RMB has devalued in place and considering the economic fundamentals and other factors, they will adjust its expectations and turn into a RMB buyer, thus exerting the market's own role, stabilizing the exchange rate and releasing the pressure of depreciation.

REFERENCES

1. Zhong Zhen, Guo Li, Jiang Rui. Current Cross-border Capital Flow in China: Characteristics, Causes, Risks and Countermeasures. *Macroeconomic research*, 2015 (12):3-13+85.
2. WANG Yuan-zhuo. New Trend in China's Cross-Border Capital Flow. *Finance Forum*; 2017:22(12):11-20.
3. Song , Zhong. Growing Like China, *American Economic Review* , 2011. Vol.101 , No.2 February: 202-241.