Johannes Petry

Global Financial Reallocation towards China: Implications for the Liberal Financial Script

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LIST OF ABBREVIATIONS

ADT	average daily trading
CFETS	China Foreign Exchange Trading System
CIBM	China Interbank Bond Market
CSRC	China Securities Regulatory Commission
ETF	exchange-traded fund
FIA	Futures Industry Association
HFT	high frequency trading
HKEx	Hong Kong Exchanges and Clearing
IMF	International Monetary Fund
PBoC	People's Bank of China
QDII	Qualified Domestic Institutional Investor
QFII	Qualified Foreign Institutional Investor
RQFII	Renminbi Qualified Foreign Institutional Investor
SAFE	State Administration of Foreign Exchange
SPV	special purpose vehicle
SSE	Shanghai Stock Exchange
SZSE	Shenzhen Stock Exchange
WFE	World Federation of Exchanges
WFOE	wholly foreign-owned enterprise

AUTHOR

Johannes Petry is a political economist researching the changing dynamics of financial globalization and its impact on the norms, institutions, and governance that underpin the global economy. His focus is thereby on China's financial system and its contestation of the liberal financial script, the role of market infrastructures in the politics of global finance, and how post-crisis shifts in the global financial system like the rise of East Asia, the BRICS, or new financial actors impact global economic governance. Johannes holds a PhD in Politics and International Studies from the University of Warwick. After his IRC Postdoctoral Research Fellowship at SCRIPTS, Johannes is the Principal Investigator of the DFG-funded StateCapFinance research project at Goethe University Frankfurt.

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Working Global Financial Reallocation towards China: Implications for the Liberal Financial Script

Johannes Petry

ABSTRACT

In 2020–2021, global investors poured into Chinese capital markets. This financial reallocation towards China took place within the context of a neoliberal, US-dominated global financial order. Although economic allocation in China follows fundamentally different state-capitalist logics, China has been gaining importance for financial allocation globally. Two outcomes are possible from this development: Does China adopt neoliberal norms and accept the contemporary order's power constellations? Or does global finance accommodate China's state-capitalist norms with implications for US power? This explorative paper develops a research agenda to investigate these questions. First, it develops a conceptual/methodological framework to analyze financial reallocation towards China. Second, it examines how state-capitalist logic persists through how China's opening process is structured. Third, it illustrates the potential malleability of global finance as it compromises neoliberal norms and impedes US financial power. These preliminary findings suggest that rather than unanimously supporting the liberal script, global finance may be accommodating China's state capitalism as the potential future center of the global economy.

1 INTRODUCTION

When in March 2020, Covid-19 ripped through the global economy, even the mighty US treasury market – the world's safest and most liquid financial asset – wavered against rising uncertainty. "The bedrock of the global financial system" was shaken by violent price swings as uncertainty in the face of the global pandemic mounted. At some points, broker screens even went intermittently blank and showed no pricing information for what is considered the world's risk-free rate and "the benchmark off which almost every security in the world is priced" (Smith/Wigglesworth 2020). Unthinkable just a few years earlier, Chinese government bonds emerged as a safe haven for international investors seeking shelter from the turmoil in financial markets (Lockett 2020b). Whereas the treasury market soon stabilized, this anecdote highlights a broader trend in global markets: the financial reallocation towards China.

Financial flows towards China have been gradually increasing over the last decade. By 2020, US investor holdings of Chinese assets increased to USD 1.2 trillion (Lysenko et al. 2021), with the Covid-19 pandemic acting as a catalyst in this process. In 2020 and 2021 alone, global investors poured more than USD 275 billion into Chinese stock and bond markets (Lockett/Hale 2020; Lockett/Kinder 2021) while global financial players scrambled to reallocate their business activities to China (Bloomberg News 2020). This financial reallocation towards China, however, takes place within the context of a contemporary global financial order, which is based on (1) *neoliberal norms* of open, lightly-regulated, internationally-integrated financial markets which are (2) guaranteed and facilitated by the US, which reproduces *US power* (McNally/Gruin 2017; Norrlof 2010). These ideas and power constellations that underpin the "rules, norms, and procedures that govern cross-border money and finance" (Drezner/McNamara 2013: 156) form a crucial part of the liberal script as they define how societies reallocate economic resources through market mechanisms (Zürn/Gerschewski 2021: 18-19).

However, while utilizing market mechanisms, economic allocation in China does not correspond to neoliberal principles of "free" markets but is characterized by a fundamentally different state-market configuration where economic allocation is influenced and partially steered by the state (Breslin 2021; McNally 2012; Naughton/Tsai 2015; ten Brink 2019). In China's state-capitalist economy, the state exercises *control* by monitoring, regulating, and intervening in capital markets, and it directs capital market outcomes towards the accomplishment of certain economic and political objectives linked to *national development*. A fundamentally different way of thinking about, managing, and governing capital markets has emerged in China that differs from the ideas that underpin the global financial order. In contrast to *neoliberal capital markets* as they exist (and are promoted) within the liberal script, in China one can observe the development of *state-capitalist capital markets* (Petry 2020a; Petry 2021; Petry et al. 2021b). However, neither these fundamental differences in how markets operate nor political issues such as the US-China trade war, political developments in Hong Kong, the regulatory crackdown on Chinese tech and finance, or the US government's investment ban on Chinese military-linked companies have reversed this trend as China continues to gain in importance for the allocation of financial assets globally (Mackenzie 2021).

Given the two different institutional logics of the contemporary global financial order and China's capital markets, there are two likely outcomes from this growing financial reallocation towards China: Does China adopt neoliberal norms of market organization and accept the hierarchies and power constellation inherent to the global financial order? Or does global finance accept China's non-liberal norms of operating financial markets with potential implications for US financial power? To address these questions, this paper develops a research agenda to analyze: (1) the growing financial reallocation towards China, (2) the mechanisms through which this process takes place, as well as (3) its consequences for the neoliberal, US-dominated global financial order.

The paper is structured as follows. In a first step, the paper develops a conceptual and methodological framework to analyze this growing reallocation towards China within the global financial order. Section 2 discusses the interplay between capital markets, Chinese state capitalism, and the global financial order, developing the conceptual puzzle originating from the increasing financial reallocation towards China. Section 3 then discusses data collection and methodology and illustrates the growing global financial reallocation towards China. The paper proposes to develop three datasets on global financial flows, financial market infrastructures as mechanisms to channel these financial flows towards Chinese markets, and the corresponding changes in the activity of global financial actors within China. Section 4 then examines China's financial opening process, whose characteristics enable continued facilitation of state-capitalist logic of market organization. Section 5 then illustrates the implications of this development for the US-dominated liberal global financial order. Initial empirical findings point towards the malleability of global finance, which accepts China's state-capitalist rules, thereby compromising neoliberal norms of how financial markets operate and impeding US financial power as demonstrated in the US-China trade war. Section 6 draws tentative conclusions and discusses the initial results of this research project. While this paper is largely agenda-setting, the preliminary findings suggest that rather than facilitating the status quo and supporting the liberal script, global finance may be gradually accommodating China as the future center of the global economy. China's rise in the global economic and financial order thereby represents a fundamental challenge for the liberal script.

2 CONTESTING THE LIBERAL SCRIPT? CHINESE STATE CAPITALISM AND THE GLOBAL FINANCIAL ORDER

How can we best conceptualize China's changing role within the global financial order? In a first step, it is crucial to acknowledge that the rapid growth of China's capital markets takes place within the context of a global financial order which is comprised of both norms and power constellations that define "the rules, norms, and procedures that govern cross-border money and finance" (Drezner/McNamara 2013: 156). In its contemporary form, the global financial order is based on *neoliberal norms* of open, lightly-regulated, internationally-integrated financial markets and is guaranteed by and equally reproduces *US power* (Drezner/McNamara 2013; Norrlof 2010). As Langley notes, global financial orders are historically constructed, resting on "hierarchical social and power relations" (2003: 3). A core characteristic of the contemporary order is the constant reification of markets as central institutions in the organization and governance of the global economy. The global financial order, therefore, forms a crucial part of the liberal script as it defines how societies reallocate economic resources through market mechanisms (Zürn/Gerschewski 2021: 18-19). While there has been some rethinking among policy and elite circles (e. g. with the advent of macro-prudential regulation (Baker 2013)), the global financial crisis has largely been a "status quo" crisis and has not fundamentally changed or challenged the contemporary liberal financial order (Helleiner 2014).

In this neoliberal global financial order, the ostensive purpose of capital markets remains the creation of "efficient" outcomes by enabling the generation of (private) profit. This is achieved through the principles of "free markets" and "free flows of capital", which are (or should be) responsible for the allocation of economic resources without state intervention (Crouch 2011: 17; McNally 2013: 36). Neoliberal is defined here as a political concept, an ideology of governing economic life; as Mudge notes, "neo-liberalism is built on a single, fundamental principle: the superiority of individualized, market-based competition over other modes of [economic] organization" (2008: 706-7). The underlying neoliberal institutional logic that informs the functioning of these capital markets depoliticizes those markets, proposes a ("supposed") separation between state and capital markets, and puts a significant degree of trust and power in the collective agency of private financial actors to achieve "efficient" outcomes by maximizing (private) profit (Major 2012). While the state is not absent, its priority is enabling private profit creation instead of other socio-economic outcomes, cementing the power of private finance capital (Harvey 2005; Slobodian 2018). Even if states attempt to use financial markets for governance purposes, within this setup, private financial actors maintain power over states through infrastructural entanglements (Braun 2020).

Moreover, by underpinning the global financial order, capital markets facilitate and perpetuate existing power relations and hierarchies within global capitalism (Bortz/Kaltenbrunner 2018) – and, most importantly, reproduce US financial hegemony (Fichtner 2017; Gabor 2021; Norrlof 2010; Panitch/Gindin 2012; Strange 1987). As Konings noted with respect to Eurodollar markets, "the creation of a highly integrated and liquid financial structure [through US financial institutions] enhanced America's structural power in international finance" (2007: 49-50). Thereby, in particular, the practices of various US-based financial actors such as credit rating agencies (Sinclair 2005), institutional investors (Fichtner 2013; Lazonick/O'Sullivan 2000), or banks (Konings 2007) facilitate the structural power of the United States. Essentially, Wall Street sustains US power within and through the global financial order.

In recent decades, capital markets gradually became a more important pillar of China's economy, as China's financial system is "currently undergoing momentous change" from being dominated by state-owned banks towards a more diversified system characterized by "substantial market independence" (Naughton 2018: 479). But whereas for a while, China seemed to converge with the US financial model, this process ended abruptly with the global financial crisis (Kirschner 2014: 221-2). As Drezner and McNamara emphasize, post-crisis debates about the role of finance in the global economy "are interwoven with continued questions about the primacy of American power and the potential rise of other actors in the international system" (2013: 155). The global financial crisis opened up room for contesting the US-led global financial order (Huotari/Hanemann 2014), feeding into debates about the decline of the US as the global hegemon (Beeson 2009; Ikenberry 2011) and the economic and political rise of China (Jacques 2009). Scholars are therefore debating whether China is a status quo power integrating into the existing liberal economic order (Ikenberry 2011; Steinfeld 2010), attempting to (partially) reform the existing order (Breslin 2013; Chin/Thakur 2010), a revisionist power challenging the US-dominated order (Hung 2013), or whether global finance is itself adapting to accommodate China (McNally/Gruin 2017).

This is also not simply a discussion about finance. Rather, China's ascent to the league of economically powerful nations and its increasing role in global economic governance has sparked heated discussions about the broader role of the state in the economy (Alami/Dixon 2020b). As a plethora of studies have highlighted, China's model of capitalism is characterized by a state-market configuration that significantly differs from "Western" capitalisms (McNally 2012; Naughton/Tsai 2015; ten Brink 2019). While China's economic system is characterized by an increasing array of market-based coordination mechanisms, the state never quite (completely) relinquishes control over the organization of economic life (Gruin 2019; Huang 2012). As McNally notes, in China, there is a "considerable distrust of markets and full-out economic liberalization" (2013: 38-9); the state rather engages in a "pragmatic use" of markets, managing markets and steering them towards specific policy goals.

This discussion is linked to broader debates on state capitalism, where some policymakers fear that China won't play by the neoliberal rulebook on which the contemporary global (financial) order is based (e. g. Bremmer 2010). In these debates, state capitalism is often defined in juxtaposition to capital markets, the epitome of liberal capitalism. This also contributes to the increasing contestation of China's rise – a case in point is the current US-China trade war during which capital markets have become a key point of contention (Long 2019). As Alami and Dixon point out, an important task is to investigate the relationship "between the new state capitalism and the Western-dominated liberal capitalist world order [as well as] the current pattern of financialized globalization and neoliberalism as the dominant hegemonic project" (2020a: 12).

While some argue that China's state capitalism has adopted elements of neoliberalism (McNally 2013; So/Chu 2015), this paper posits that merely adopting market mechanisms (e. g. capital markets) does not make China neoliberal. China's economic policies have rather been "neoliberal-looking" (Duckett 2020) and many conclude that Chinese state capitalism represents an alternative to and functions quite differently from neoliberalism (Breslin 2011; Horesh/Lim 2017; Liew 2005), especially with respect to discussions on finance (Gruin 2019; Petry 2020a, 2020b; Vermeiren/Dierckx 2012). As Evans and Sewell emphasize, Chinese politics of market development are "a far cry from neoliberal politics as epitomized by the United States" (2013: 60). While market-based finance emerged as an important economic governance tool in China (Gabor 2018), Chinese capital markets function fundamentally different from neoliberal capital markets. The defining difference between neoliberal and state-capitalist logic is not the existence of markets per se but rather the principles that underlie market organization (profit creation vs. state objectives) and the actors that dominate and shape these markets (private finance capital vs. state institutions). The state-market relationship that has emerged in post-1978 China is hence fundamentally different from the neoliberal hegemonic consensus – also in the case of finance – and the two main objectives of Chinese state capitalism are maintaining state *control* and facilitating *national development*.

Essentially, the understanding of finance, as well as its role within the political-economic system in China are fundamentally different from the Western world. While the Chinese authorities have recognized and facilitated the usefulness of market-based mechanisms of economic coordination (Duckett 1996), they also see the downsides of free financial markets after experiencing several financial scandals domestically in the 1990s as well as studying financial crises and their social and political impacts on other states and societies (e. g. in post-USSR Russia, Japan or the Asian Financial Crisis). "Free" markets are seen as something not quite to be trusted, endogenously crisis-prone, socially unproductive and leading to a loss of control over the economic system if not strictly regulated. This also applies to capital markets. While capital markets are growing in importance, this occurs within the context of China's socio-economic system of state capitalism, in which the CCP aims to maintain its control over socio-economic development, in part by managing policy uncertainties through the financial sector. In this process, one can observe that China is "extending the reach of financial capital, but simultaneously consolidating the persistently illiberal authority of the CCP over the use of that capital" (Gruin 2016: 27).

Therefore, capital markets can be understood as a site where the authorities exercise "statecraft [through] financial control" (Sum 2019: 386) which enables them to govern social and economic life (Sum 2019: 386). Control in this context should be understood both as exerting state control *within finance* by monitoring, regulating, and intervening in capital markets, as well as exerting state influence *through finance* by directing capital market outcomes towards the accomplishment of certain economic and political objectives linked to national development. This is achieved through Chinese exchanges shaping the infrastructural arrangements of Chinese capital markets according to the institutional logic of state capitalism.

While this section brings forward ideal-typical conceptions of state-capitalist and neoliberal capital markets, empirical realities are more complex. Often there are multiple, sometimes competing objectives underlying processes of market organization and management. Control and state guidance of capital markets in China are never absolute, and China's capital market development is also characterized by misguided attempts to intervene in markets, failed policy experimentation, or external pressures influencing the decisions of Chinese authorities. Sometimes implemented control efforts fall short of their objectives, regulatory reach is incomplete, and workarounds in some areas or policy experimentations fail. After all, neither the Chinese state nor its central institutions such as the CCP are monolithic or almighty entities (ten Brink 2019). Similarly, neoliberal markets are neither pure laissez-faire as considerable hybridity and entanglement between states and financial markets exist (Braun et al. 2018; Braun 2020). However, what can be observed is that a fundamentally different way of thinking about, managing, and governing capital markets has emerged in China. Rather than a break with the existing economic system, Chinese capital markets are intricately linked to and informed by China's state capitalism at the same time as global investors are increasingly reallocating financial resources, assets, and operations towards China.

3 FINANCIAL REALLOCATION TOWARDS CHINA: A METHODOLOGICAL FRAMEWORK

> To reallocate: to allocate (sth) again: such as
>
> a: to apportion or distribute (sth) in a new or different way
>
> b: to earmark or designate (sth) for a new or different purpose
>
> *Merriam-Webster Dictionary*

As the definition of "reallocation" highlights, rather than simply a different distribution pattern, reallocation can also entail different purposes for which distributed resources can be designated. Reallocation hence matters as it entails the potential for differential use of resources that can legitimize different logics and alter power constellations. Does the financial reallocation towards China simply introduce neoliberal logics into Chinese markets and facilitate a convergence towards the neoliberal global order, or does this reallocation take place despite China's non-liberal logics of how to operate capital markets, thereby implicitly accepting and supporting this alternative way of organizing economic life? Understanding the characteristics and pattern of this reallocation process is hence crucial for understanding China's role within and relationship with the liberal financial script.

How can one then conceptualise and measure the growing financial reallocation towards China? For this, I draw on a conceptual approach developed by Morgan and Goyer, who, shortly after the global financial crisis, posed a seemingly strange question: "Is there a global financial system?" (2012). They argue that rather than assuming how financial globalization created an amorphous, intangible "global" financial system, scholars should move "beyond the rhetoric of globalization" and acknowledge how global finance is constituted by *financial flows* that are facilitated by globally active *financial actors* and that take place between *financial markets* which are rooted within distinct national models of capitalism (Morgan/Goyer 2012: 120-1). To analyze the global financial reallocation towards China and its political implications, this paper proposes the development of three different datasets that enable an analysis of these financial flows, actors, and markets.

First, *financial flows* towards China should be studied through the collection of a quantitative dataset on foreign portfolio investments into Chinese stock, bond, and derivative markets from 1990 to 2020. This dataset is compiled from existing databases of international organizations (FIA, WFE, IMF), Hong Kong entities (HKEx, Bond Connect), as well as mainland Chinese regulators (CSRC, PBoC, SAFE) and exchanges (SSE, SZSE). How did the financial reallocation towards China develop over time? When and how did it accelerate? Which percentage of Chinese assets are owned by foreign investors at which point in time? This time-series data illustrates the *aggregate* development of global financial reallocation towards China over time.

Second, the destination for this reallocation is China's *financial markets*. To assess how institutional differences between the liberal financial script and Chinese markets are negotiated, the specific characteristics of China's markets must be studied. Are Chinese capital markets experiencing a Big Bang-style liberalization that allows global actors to freely roam in Chinese markets in search of yield (neoliberal logic)? Or is the opening of China's financial markets rather a gradual, partial, and controlled process that enables state control and facilitates national development objectives (state-capitalist logic)? A qualitative dataset should therefore be created that analyses the cross-border financial infrastructures enabling financial flows in and out of China's markets. As financial infrastructures shape what can be invested in, who is allowed to invest, and how this investment is conducted, their analysis offers important insights into the norms that underpin the financial reallocation towards China. Therefore, the development of financial infrastructures from 2000 to 2020 is investigated by analyzing regulations, rules, and reports issued by Hong Kong and mainland Chinese financial regulators, security exchanges, and industry associations. These offer important insights into the formal structures, rules, and mechanics of capital markets.

Third, as *financial actors* mediate financial flows, their changing activities within China should be analyzed to gain more nuanced insights into the politics of this reallocation. This analysis is based on a detailed qualitative dataset of the largest global (a) investment banks, (b) asset managers, (c) hedge funds, (d) private equity funds, (e) high-frequency trading (HFT) firms, and (f) exchanges. As most areas of global finance are highly concentrated, this dataset focuses on the ten largest firms in each of these categories (excluding Chinese firms). This qualitative dataset compares the immediate post-crisis period 2009-2012 with the 2017-2021 period, with at least two data points (one for each period) for each financial actor and a series of indicators. Rather than solely focusing on changing investment patterns, these indicators also include other important characteristics of global financial players' interactions with China, such as their business activities (e. g. banking, asset management), organizational forms (e. g. joint venture, independent organization), licenses (e. g. QFII, RQFII), assets, revenues, staff, and offices. This dataset is based on a detailed analysis of annual and quarterly reports, investor presentations, corporate brochures, and websites of those financial actors, complemented with financial news accounts and policy reports. How has the activity in China of global financial actors changed over time? What drives their business activities in China? How do they interact with Chinese markets?

These three datasets are complemented with 132 semi-structured expert interviews conducted as part of previous research (Petry 2020a) on the transformation of Chinese capital markets, part of which analyzed the financial opening process. Interviewing market regulators, market organizers (e. g. exchanges), domestic market participants, and global financial institutions, these interviews were conducted in mainland China (46), Hong Kong (43), London (14), Singapore (11), Frankfurt (11) and elsewhere (7) as well as with mainland Chinese (35 %), Western (47 %), Hong Kong (9 %), and other Asian (9 %) financial institutions.[4] These interviews enable a more nuanced understanding of the power relations mediated through those markets as well as the changing norms of market organization. This is especially important to understand the implications of the reallocation towards China, such as understanding the role of US-based financial institutions in the context of the US-China trade war and its implications for US power (Section 5).

Combining both quantitative and qualitative data and using multiple data sources is important to conduct a nuanced analysis of capital markets and remedy biases that stem from single sources. Together, these four datasets provide important insights into both the global financial reallocation towards China as well as its implications for market organization norms and power constellations within the global financial order. After

4 Due to the increasingly sensitive nature of academic research on financial market development in China, this interview data was anonymized to ensure the safety of interviewees (see Shih 2015).

conceptualizing China's relationship with the liberal financial script and developing both a conceptual and methodological framework to study the financial reallocation towards China, the following two sections present initial findings from this ongoing research project.

4 THE BEGINNING OF A BEAUTIFUL FRIENDSHIP? WALL STREET AND FINANCIAL REALLOCATION TOWARDS CHINA

In 1995, Ray Dalio, founder of the world's largest hedge fund Bridgewater Associates, stated that "China is too big and exciting to ignore" (Dalio 1995, citing Copeland et al. 2017). While still a rather small market at the time, China since became home to the world's 2nd largest stock, bond and futures markets. More and more international investors have since become active in China; from being virtually closed at the time of Dalio's statement, portfolio investment flows into China have undergone an unprecedented increase (figure 1).

Since the domestic development of China's capital markets began in the 1990s, limited steps were also taken to integrate China with global markets. The domestic A-shares stock market (denominated in RMB) was established in 1990. Two years later, Chinese companies were also allowed to issue USD-denominated B-shares in a separate market only accessible to foreign investors. As a former broker for B-shares noted, "in the early [days], there was kind of a boom in the B-share market, [...] because that was the only entry point for foreigners to entering the [Chinese] market" (Interview 12).[5] In 1993, the CSRC created another listing channel by allowing A-share companies to conduct secondary listings in Hong Kong and issue so-called H-Shares. Due to the state-controlled process of listings and corresponding backlog, other Chinese companies also listed abroad through unofficial channels: privately listing in Hong Kong,[6] Singapore, New York, or London. James Fok, HKEx's Head of Strategy, called this the "IPO era" of Chinese capital markets, during which especially Hong Kong became prominent as an offshore fundraising center for Chinese companies.[7]

However, this was essentially a parallel system. Chinese companies listing overseas simply followed the rules of neoliberal capital markets, while the B-share market was completely separated from the A-share market. Chinese and foreign investors and market infrastructures never mixed in this setup – Chinese investors were not allowed to invest abroad or in B-shares, while foreign investors could not access the "proper" A-share market.[8] Without fungibility and arbitrage possibilities between the two markets, large price differences existed between these share types, and after an initial euphoria, few international investors were interested in trading B-shares (Greene 2004: 50-2). China's capital markets were basically isolated from neoliberal global finance, and it was only in the mid-2000s that the "Opening Up era" of Chinese capital markets began.

A distinction must be made between onshore and cross-border access to China. Until January 2020, onshore access to Chinese capital markets was very restricted for global financial institutions. Foreigners were not allowed to freely participate in Chinese markets, and they could only operate onshore by forming a joint venture with

5 Interview 12 with N.N., the director of a brokerage firm, Hong Kong, interview by Petry, Johannes (10 July 2017).

6 Next to H-Shares, which are already listed as A-Shares in China, companies incorporated in mainland China could also do a primary listing in Hong Kong as "red-chips" (such as China Mobile) while Chinese companies incorporated offshore (e. g. Tencent, which is Cayman Islands-incorporated) could list in Hong Kong as "p-chips".

7 Observation: "Connecting Mainland and International Capital Markets with HKEx" Breakfast Seminar organized by the British Chamber of Commerce, Hong Kong (29 June 2017).

8 Chinese investors were only allowed to access the B-share market after 2001.

a Chinese financial company or setting up wholly foreign-owned enterprises (WFOEs).

Joint ventures were the preferred Chinese government option for onshore access. Many international banks and asset managers had established joint ventures with Chinese counterparties to gain exposure to China. Similar to joint ventures in the manufacturing sector, the idea was to facilitate a "legitimized transfer of IP [intellectual property]" (Interview 24),[9] however international firms could only be minority shareholders, and it was very difficult to maintain control over your business (Interview 10).[10]

Up until very recently, the most viable solution for foreign financial companies to access Chinese markets onshore was to establish WFOEs. WFOEs do not necessarily need to be physically based in China, but can have most of their operations in London, Chicago or Hong Kong – "the important thing is that they have a proxy, a company registered in China" (Interview 23)[11] because "they are legally required to initiate their trading in China through their Chinese entities" (Interview 30).[12] While this seems like a creative way around Chinese regulations that ban foreigners from trading, setting up WFOEs is accepted by the authorities as they are registered in China, require a regulatory license, and are subject to strict capital controls. Most importantly, they must comply with Chinese state-capitalist rules of market organization. Often established as non-financial trading companies, this "semi-legal way of accessing China" (interview 32)[13] became very popular with hedge funds, commodity traders, and HFT firms wanting to gain access to China's markets. But as a comparison of infrastructure innovation and subsequent portfolio flows highlights, these onshore mechanisms have not led to large capital inflows towards China (figure 1).

For a long time, most global investors did not venture onshore due to policy uncertainty and regulatory risk. It was only in 2020 – after two decades of substantial cross-border opening – that onshore access became sought (see Section 5.2). When taking a first look at aggregate financial flows towards China, the data clearly shows that the reallocation towards China (i.e. increasing portfolio flows) coincides with the creation of cross-border infrastructures that enable global investors to channel funds into Chinese markets. The following sections, therefore, trace the growing reallocation towards China by examining these crucial infrastructures, notably the investment quota regime (QFII, QDII, RQFII) as well as the Stock Connect and its expansion across asset classes, and how they navigate between neoliberal and state-capitalist logics of market organization. As this analysis shows, the construction of these cross-border infrastructural arrangements is conducted in a highly controlled, reversible manner. It follows China's state-capitalist logic of market organization, demonstrating China's resistance to conform with neoliberal capital markets.

4.1 BABY STEPS: THE (R)QFII REGIME

The first mechanisms that enabled such cross-border access to China were the Qualified Foreign Institutional Investor (QFII), Qualified Domestic Institutional Investor (QDII), and Renminbi Qualified

9 Interview 24 with N.N., business development department of an index provider, Hong Kong, interview by Petry, Johannes (27 September 2018).

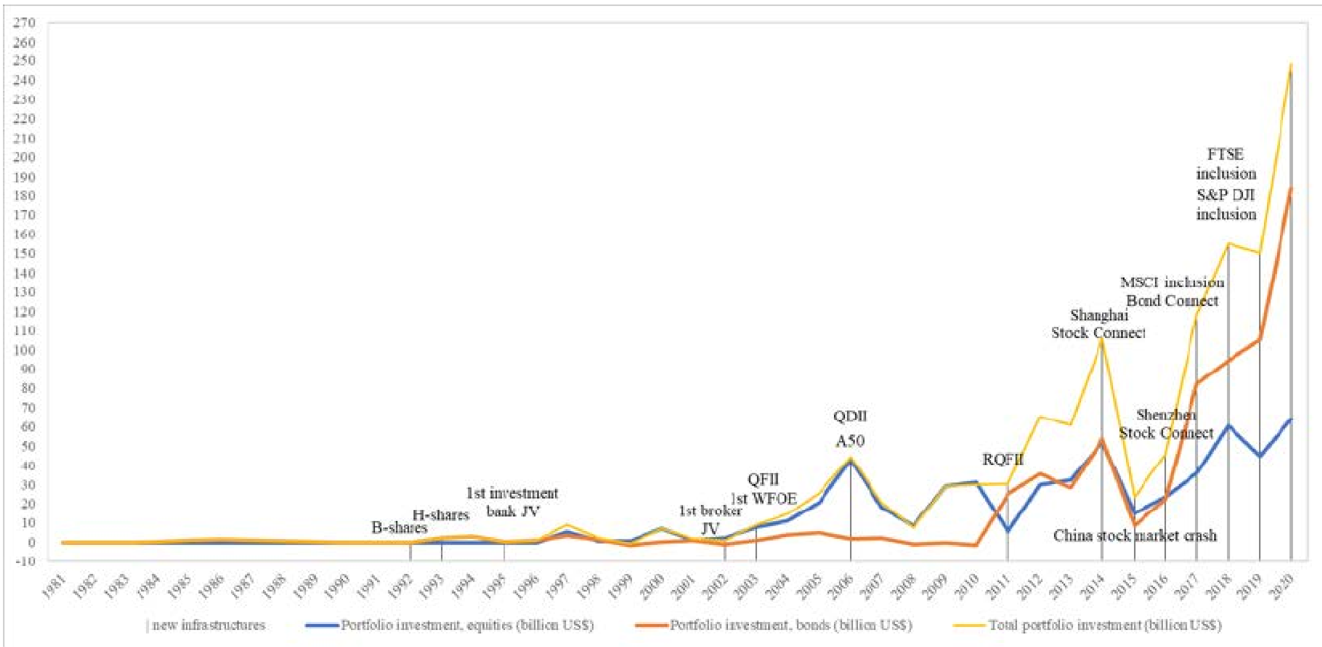
10 Interview 10 with N.N., the executive director of an investment advisory firm, Hong Kong, interview by Petry, Johannes (6 July 2017).

11 Interview 23 with N.N., research department of a Chinese exchange, Shanghai, interview by Petry, Johannes (14 May 2018).

12 Interview 30 with N.N., business development department of a global exchange, Beijing, interview by Petry, Johannes (19 September 2019).

13 Interview 32 with N.N., international department of a Chinese brokerage firm, Shanghai, interview by Petry, Johannes (25 September 2019).

Figure 1: Portfolio investment flows into China (1981-2020)



Source: World Bank Database; author's own figure

Foreign Institutional Investor (RQFII) programs which were launched in 2003, 2006, and 2011, respectively. While QDII enabled designated Chinese investors to conduct financial transactions in global markets, QFII and RQFII investors could trade in Chinese capital markets. These schemes reflected the government policy of "going out" and "bringing in", thereby enabling the control of cross-border transactions, for instance, by quelling capital outflows after the 2015-2016 market crash. However, these quotas were only issued to a few institutions, as the manager of a Hong Kong-based hedge fund explained in Interview 3:

> Basically, what this meant was that you could convert, say, USD 100 million into RMB, so it was a capital account transaction, and you use that RMB specifically to buy Chinese stocks and bonds that were approved for QFII. That was really how foreigners were able to access the A-Share market from 2002 until about 2013/14... So, if you were UBS, Morgan Stanley or Citi, one of these companies who had QFII, you had access to this market – if not, then you didn't.[14]

While some (R)QFII investors rented out their quotas to smaller investors, their quotas were often used up for their ETF business, and after 2015-2016, the Chinese regulators cracked down on these lending operations. By 31 May 2020, only 295 QFII[15] and 230 RQFII[16] quotas had been issued, often to the same global players. QDII was even more restricted, with only 152 quotas issued to mostly state-owned financial institutions.[17]

The quota system was a cumbersome, restrictive mechanism to open China's markets as not all market segments were open to (R)QFII investors, and trading was difficult. Global investors could not, for instance, trade commodity futures directly through QFII until after their Chinese broker set up a special, structured product, "so investors can invest money through a QFII vehicle and then they can run a contract, and then this contract can invest into commodities" (Interview 15).[18] Similar-

14 Interview 3 with N.N., hedge fund manager, Hong Kong, interview by Petry, Johannes (27 June 2017).

15 For a complete list of all QFII investors, see SAFE (2020b).

16 For a complete list of all RQFII investors, see SAFE (2020c).

17 For a complete list of all QDII investors, see SAFE (2020a).

18 Interview 15 with N.N., derivatives business development department of financial infrastructure provider, London, interview by Petry, Johannes (9 January 2018).

ly, although QFII investors were eligible to trade index futures to hedge their stock portfolio, this was also not straightforward:

> QFII's clients were only allowed to have one account in China, and you are not allowed to have securities and futures in the same account. [...] So, they opened it up, but [...] it took about 3-4 years for a single trade to be done on the CSI 300 index under the QFII scheme (Interview 13).[19]

While not impossible, this was a cumbersome, semi-legal process. To stop (R)QFII investors from acting like hot money, they were only also allowed to repatriate 20% of the previous year's earnings, trades needed to be pre-funded and exchange rules prohibited them from executing speculative trades or shorting index futures.

(R)QFII was the first step to opening Chinese capital markets to cross-border foreign investment. It was better than nothing but not a great success. However, over the coming years, "step by step", a much more comprehensive system of cross-border financial infrastructures was created that gradually connected China with the outside world, truly integrating it into global markets and facilitating the financial reallocation towards China (Interview 6).[20]

4.2 EXPANDING CROSS-BORDER ACCESS WITH STOCK CONNECT

The real turning point in the reallocation towards China was the establishment of the Stock Connect between Hong Kong Exchange (HKEx), Shanghai Stock Exchange (SSE), and Shenzhen Stock Exchange (SZSE) in 2014 and 2016. As one index provider argued, "Connect is the main gateway into China now" (Interview 31).[21]

Stock Connect is markedly different from (R)QFII. As discussed, only a few investors qualified for (R)QFII, trading needed to be pre-funded and was cumbersome. As one interviewee noted, "people don't like QFII because it's not flexible and unfair to the client" (Interview 14).[22] In contrast, Stock Connect is a much more convenient way for international investors to trade in China and Chinese investors to trade internationally because "[it] brings together two different market structures to facilitate seamless cross-border trading".[23] In comparison to (R)QFII, Connect is a more sophisticated infrastructural arrangement that enables cross-border trading in a much more encompassing and convenient way (table 1).

Essentially, Stock Connect is the outcome of a series of small steps to harmonize Hong Kong market structures with those in mainland China such as aligning trading hours or introducing RMB-denominated products. The result was the establishment of channels that "enabled seamless" (Interview 3) trading between these marketplaces.[24] International investors could invest in A-Shares through a special purpose vehicle (SPV) established by HKEx (Northbound trading), Chinese investors could invest into HKEx through SSE's SPV (Southbound trading). These SPVs acted as special participants in each other's markets, effectively routing orders from one exchange to another while a clearing link exists between ChinaClear and HKSCC (figure 2). Basically, Stock Connect

19 Interview 13 with N.N., business development department of exchange, Hong Kong, interview by Petry, Johannes (10 July 2017).

20 Interview 6 with N.N., APAC director of a financial infrastructure provider, Hong Kong, interview by Petry, Johannes (29 June 2017).

21 Interview 31 with N.N., research department of an index provider, Shanghai, interview by Petry, Johannes (23 September 2019).

22 Interview 14 with N.N., product development department of an exchange, Hong Kong, interview by Petry, Johannes (12 July 2017).

23 Observation: "Connecting Mainland and International Capital Markets with HKEx' Breakfast Seminar", Hong Kong (29 June 2017).

24 Interview 3 with N.N., hedge fund manager, Hong Kong, interview by Petry, Johannes (27 June 2017).

Table 1: Connect vs. Quota system

	(R)QFII/QDII	Stock Connect
eligibility	only qualified foreign/domestic investors, i. e. a few specific institutional investors	everyone, both international investors and Chinese retail investors (min. RMB 500.000)
capital controls	limits to repatriation of profits (only 20% of last year's earnings; until June 2018)	no restrictions as system functions as closed circuit
products	stocks, (only listed) bonds, ETFs, index futures	stocks (2014) (other connects: bonds (2017), wealth management (2020); ETF, Commodities, Futures (planned))
registration	difficult, long process to acquire license, many restrictions, vetting process	easy, just open HKEx-SPSA account
other restrictions	restricted order routing (max. of 3 brokers; buy and sell order must be executed by same broker; so, effectively only one broker)	no restrictions on order routing
settlement	t+0 (pre-funded trading, money must be onshore before trading)	t+1/t+2 (money can stay in Hong Kong broker account)
number of accounts	295 QFII quotas, 230 RQFII quotas, and 152 QDII quotas (by June 2020)	10,182 SPSA accounts (by February 2020)

Source: interviews, financial news, policy documents; author's own research

enables international investors to trade eligible stocks on SSE via HKEx, while Chinese investors can access HKEx's market through SSE. They built a financial infrastructure through which both international and Chinese investors "[can] get in and out very quickly, easily and cheaply without the sort of frictions of having trapped capital in the mainland" (Interview 19).[25]

These infrastructural arrangements of Stock Connect are informed by state-capitalist logic. On the one hand, Connect facilitates national development through increased but controlled cross-border market integration. As one interviewee working for an exchange's international department noted in Interview 1, "the Stock Connects help Chinese investors to grow up, [by] allowing Chinese investors to access the Hong Kong market… [because] if you play with them [global investors], you learn from them".[26] Thus, Connect facilitates the governments' objective of educating and professionalizing Chinese investors. From only 0.5% in 2014, by December 2020, already 10.2% of equity trading volume on HKEx was conducted by mainland investors. Simultaneously, by attracting international investors into their market, the regulators are "trying to make the market more stable" (Interview 2),[27] contributing to reducing volatility in Chinese markets. While (R)QFII also attempted this, its limited scope and administrative burden thwarted these efforts. This successful integration can also be seen in the gradual convergence of A/H-share valuations, indicating the formation of one large liquidity pool between Hong Kong and mainland Chinese markets. As Bin Shi, Head of Equities at UBS Asset Management, noted: "Hong Kong and China – these were two separate markets, the Stock Connect changed this! Much more so than QFII".[28]

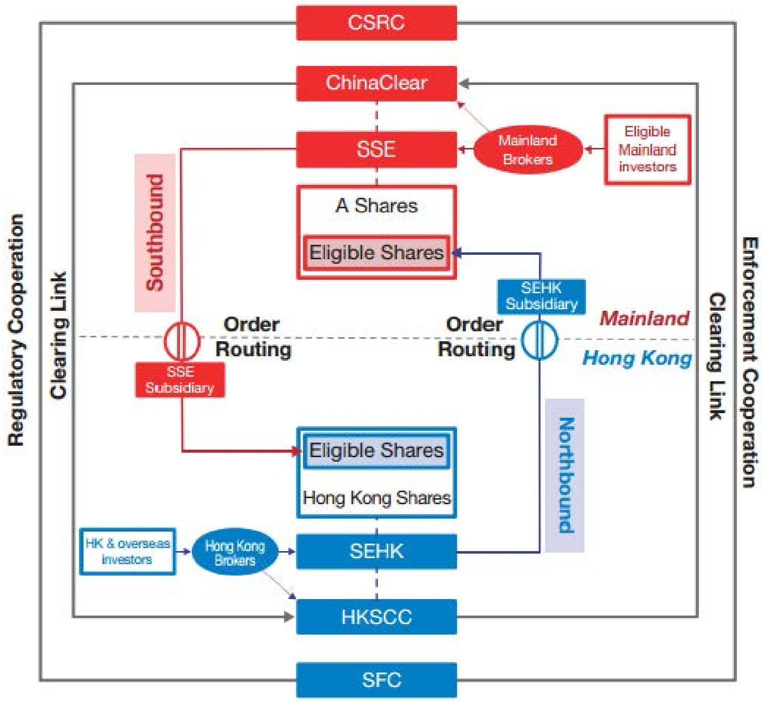
25 Interview 19 with N.N., international department of a Chinese exchange, Shanghai, interview by Petry, Johannes (26 April 2018).

26 Interview 1 with N.N., international department of an exchange, Hong Kong, interview by Petry, Johannes (21 June 2017).

27 Interview 2 with N.N., manager at a Chinese private equity firm, Hong Kong, interview by Petry, Johannes (22 June 2017).

28 Observation: Bin Shi, Head of Equities at UBS Asset Management, "Equities Market Development Including Stock Connect" Panel, 7th ASIFMA China Capital Markets Conference, Hong Kong (14 June 2017).

Figure 2: The infrastructural arrangements of the Stock Connect order routing system



Source: HKEx via Charltons (2015)

International investors are also more comfortable with Stock Connect, now often using Connect instead of (R)QFII to access China (Interview 4).[29] While (R)QFII (and WFOEs) were often used by hedge funds, HFTs, or investment banks, the Connects are also attractive for more risk-averse institutional investors because they did not have to operate within a Chinese regulatory framework. This also leads to significant cost reductions for global investors. As one hedge-fund manager explained in Interview 3, “it was the first time without any QFII/RQFII quota that foreigners could simply use their accounts on HKEx and buy a Shanghai-listed stock, no questions asked”.[30] Overall, the Connects are an important mechanism that facilitates national development by enabling cross-border integration. While in 2014 foreign investors only accounted for 0.6% of trading on China’s stock market, by 2021 this increased to around 6% (figure 3).

On the other hand, following a state-capitalist logic, the Connects also enable tight state control of financial flows and market activities. One important aspect is keeping a lid on capital outflows. Because as one interviewee stated in Interview 7,

> the problem that China always had is that [investors] take the money and do something unsavory with it, as in something the authorities don’t really want, like they start punting Hong Kong property, speculating in expensive art and wine, and we’ve all seen the headlines and we all know that this happens on a huge basis, right?[31]

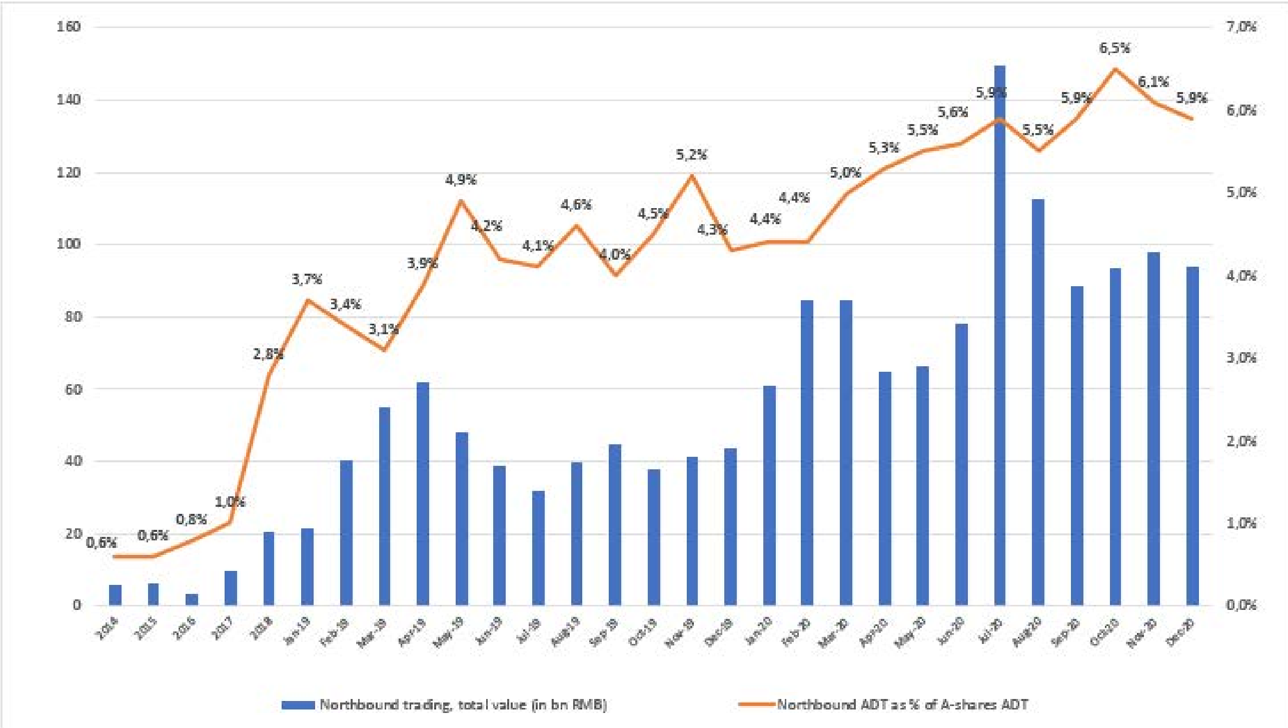
However, Stock Connect’s infrastructural arrangements prohibit such activities because they are

29 Interview 4 with N.N., CEO of an asset management company, Hong Kong, interview by Petry, Johannes (28 June 2017).

30 Interview 3 with N.N., hedge fund manager, Hong Kong, interview by Petry, Johannes (27 June 2017).

31 Interview 7 with N.N., strategy department of an exchange, Hong Kong, interview by Petry, Johannes (30 June 2017).

Figure 3: Stock Connect lures global investors in China's stock market



Source: HKEx, various trading statistics; author's own calculations

designed as "closed loops". James Fok, Head of HKEx Strategy, explained this as follows:

> The huge innovation with Connect was really something that we call the 'closed loop' clearing system. What that means is simply that when you go through the Connect scheme, you can go in and buy a security, whatever is eligible, […] and when you sell that, the money has to come back into your own jurisdiction. Particularly for mainland investors going out, what that means is that they can come out freely and buy HSBC, buy AIA or any other eligible security listed in Hong Kong, but when they sell that, the money cannot disappear, and they can't go off and buy Hong Kong, Sydney or Vancouver real estate.[32]

Stock Connect enables Chinese investors to diversify their portfolios and professionalize while at the same time prohibiting capital outflows. The same applies to international investors. As one Hong Kong-based hedge fund manager noted in Interview 3, "it's done in such a way that I can't, let's say somehow sell the shares in Shanghai, take out the money in Shanghai and go use it to speculate on property".[33] So, despite order routing and enabling transaction flows between the two markets, the Connect maintains Chinese capital controls. As several interviewees noted, "money can't leek out of a closed loop" (Interview 18)[34] because in the end, "the Connect is about trading, not capital account opening" (Interview 33)[35] and "there's no actual capital inflow and outflow" (Interview 14).[36] In addition, trading via the Connect can be regulated, as quotas can be introduced,

32 Observation: "Connecting Mainland and International Capital Markets with HKEx" Breakfast Seminar (Hong Kong, 29 June 2017).

33 Interview 3 with N.N., hedge fund manager, Hong Kong, interview by Petry, Johannes (27 June 2017).

34 Interview 18 with N.N., product development department of a global exchange, Frankfurt, interview by Petry, Johannes (2 February 2018).

35 Interview 33 with N.N., product development department of a global exchange, Beijing, interview by Petry, Johannes (14 October 2019).

36 Interview 14 with N.N., product development department of an exchange, Hong Kong, interview by Petry, Johannes (12 July 2017).

and trading can be restricted if there is too much trading and volatility. As one interviewee working in an exchange's strategy department stated, "with Stock Connect *you have this beautiful sort of capital control mechanism* [...] *they can always turn off the tap*..." (Interview 7).[37]

Steering capital flows is not the only way Connect enables market control. For the Connects, "home-rules" also apply, and the Connect "gives China a huge amount of power monitoring [...] capital market investment flows".[38] Similar to other domestic measures to dampen speculation (Petry 2020b), Chinese investors need to have a minimum of RMB 500,000 in their account, which serves as a speed bump for the scores of punters in China to not all access Hong Kong,[39] as only 4.3 million out of China's 147.5 million investors are eligible to invest through Connect. International investors must also adhere to the state-capitalist characteristics of Chinese markets such as limited order types, data availability or t+1 (no intra-day trading). Through the introduction of the so-called Northbound investor identification system in September 2018, China's domestic "pass-through monitoring system" (Petry 2020b) to identify and track the behavior of individual investors was also applied to international investors through Stock Connect. This represents an "exporting of the Chinese model" (Interview 25),[40] as the Chinese exchanges can now monitor the trading activities of every single international investor trading through the Connects – a massive departure from international practice and a level of scrutiny unthinkable in global markets.

37 Interview 7 with N.N., strategy department of an exchange, Hong Kong, interview by Petry, Johannes (30 June 2017); emphasis added).

38 Observation: "Connecting Mainland and International Capital Markets with HKEx" Breakfast Seminar, Hong Kong, (29 June 2017).

39 Observation: Orient Securities-HKEx investor presentation, Hong Kong (6 July 2017).

40 Interview 25 with N.N., regional manager of a global exchange, Hong Kong, interview by Petry, Johannes (27 September 2018).

Stock Connect was a crucial step in opening up China's capital markets. As the general manager of a global exchange in Hong Kong noted, "[it] was a major milestone, but they were very conservative with the rules around it, so it was a big step, but it was a very small step... and they could very carefully monitor it, stop it at any time" (Interview 9).[41] Following a state-capitalist logic, Stock Connect is designed to simultaneously open Chinese markets to global investors while maintaining China's market intervention and surveillance machinery as well as capital controls. Through the introduction of Connect, China resisted pressures to conform with the liberal financial script but developed an alternative mechanism that increasingly drew in global capital.

4.3 REPRODUCING A SUCCESSFUL MODEL: GLOBAL INTEGRATION, CHINESE STYLE

Stock Connect has proven to be a successful model for the Chinese government because its cross-border infrastructural arrangements successfully balance the state-capitalist objectives of national development and control. As HKEx's Head of Strategy stated, "these Connect schemes are likely to be much more long-lasting than any of us ever suspected at the start [...] this is the way that China has decided it's going global and entering the world".[42] In fact, all other mechanisms that integrate China with global markets and enable foreign investors' access are similarly designed to enable market control, intervention, and monitoring while facilitating national development objectives.

This is also the case for Bond Connect, launched in July 2017, the second most important channel to invest in China. Currently, Bond Connect

41 Interview 9 with N.N., general manager of a global exchange, Hong Kong, interview by Petry, Johannes (5 July 2017).

42 Observation: "Connecting Mainland and International Capital Markets with HKEx" Breakfast Seminar, Hong Kong (29 June 2017).

is a one-way street that facilitates foreign access to Chinese bond markets (Northbound trading), whereby global investors can use Bloomberg or Tradeweb, which are linked with China's centralized fixed-income trading platform (CFETS), to request quotes from onshore Chinese market makers. Trading is then conducted via the Hong Kong Monetary Authorities' Central Moneymarkets Unit, which establishes settlement links with SHCH and ChinaClear.

Access to China's vast bond market has also been possible since 2016 through the CIBM (China Interbank Market) licensing channel, where international investors opened an account onshore with a Chinese bank,[43] however, this license channel is quite cumbersome. Similar to the transition from (R)QFII to Stock Connect, with the establishment of Bond Connect, access to Chinese bond markets has equally developed towards an elegant infrastructure that enables easy and efficient access and facilitates foreign investment inflows.[44] Yet, Bond Connect maintains distinct Chinese characteristics of market organization. It represents another closed-loop system that maintains capital controls, Chinese data and trading rules, and the 'see-through monitoring system' as a result of which "[Chinese regulators] can look down to the bottom to see, who is that guy actually holding that asset as a beneficiary" (Interview 20).[45] Similar to MSCI's index inclusion (Section 5), due to Bond Connect, China was included in the widely tracked Bloomberg-Barclays, JPMorgan, and FTSE Russell bond indices in 2019-2020, which accelerated foreign investment into China's bond markets (Interview 34; cf. Lockett 2020a).[46] Thereby, global investors have accepted China's non-liberal rules, as indicated by growing investment into Chinese bond markets – rising from 3.6 % to 11.0 % since the launch of Bond Connect in July 2017 (figure 4).

This state-capitalist logic of market integration also applies to other cross-border infrastructures through which China opens its markets. The international board of SGE that was opened in 2014, for instance, allows foreign participation but prohibits gold transfer between its domestic and international vaults, effectively maintaining capital controls through a closed-loop system (Interview 32).[47] And global investors wanting to trade Chinese commodity futures on INE, DCE, and ZCE need to route orders through Chinese brokers to enable see-through monitoring and assure compliance with Chinese characteristics of financial infrastructures such as trading, margining, and data/market access rules. The Tokyo-Shanghai ETF Connect (May 2019), London-Shanghai Stock Connect (June 2019), and Hong Kong-Greater Bay Area Wealth Management Connect (October 2021) also conform with China's state-capitalist logic of market organization, so will most likely the planned Commodity Connect (Bloomberg 2020) or ETF Connect (Reuters 2018) as next steps in the HKEx Connect Scheme.

The mechanisms through which China integrates with global markets are designed as "controllable channels" (Interview 21)[48] and all these infrastructural arrangements "are very easy to turn off, if things don't go the way they should" (Interview 16).[49] As the CEO of a Hong Kong-based asset manager noted back in 2017, "QFII, QDII, RQFII, Stock Connect, Bond Connect... none of them is

43 (R)QFII only allow investment into exchange-listed bonds, while 80-90% are traded OTC and registered on CFETS.

44 Observation: HKEx/Risk.net "Chinese Bonds – Riding the Waves of Foreign Inflows" Webinar (28 November 2018).

45 Interview 20 with N.N., international department of a financial infrastructure provider, Shanghai, interview by Petry, Johannes (9 May 2018).

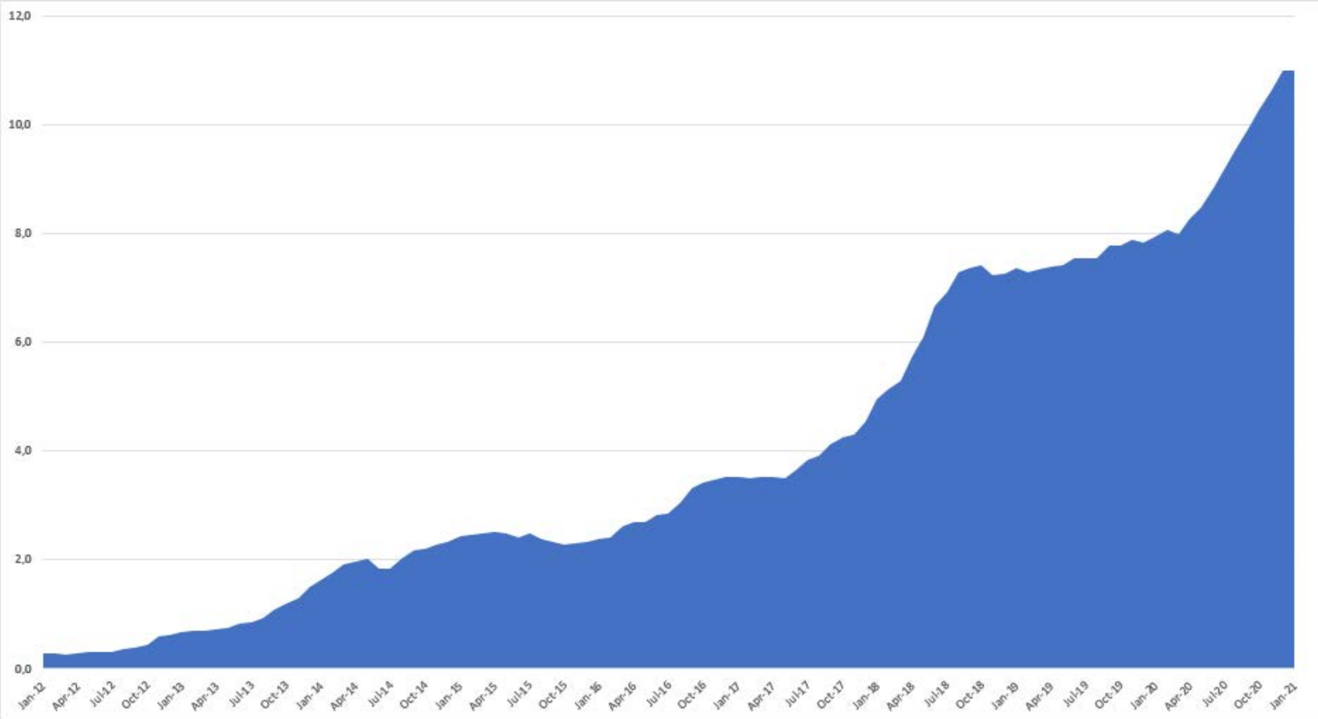
46 Interview 34 with N.N., senior manager of an insurance company, Shanghai, interview by Petry, Johannes (16 October 2019).

47 Interview 32 with N.N., international department at a brokerage firm, Shanghai (25 September 2019).

48 Interview 21 with N.N., strategy department of a Chinese exchange, Shanghai, interview by Petry, Johannes (9 May 2018).

49 Interview 16 with N.N., emerging markets strategist of a global exchange, London, interview by Petry, Johannes (11 January 2018).

Figure 4: Foreign investors' holdings of Chinese government bonds, Jan 2012-Jan 2021 (% of outstanding bonds)



Source: Bloomberg Terminal, CFETS, CEIC; values for June-November 2021 are not available, these are estimates based on December 2021 value; author's calculation

the holy grail and none of them is really going to change the world… all of them together, they will…" (Interview 5).[50] Step by step a whole market infrastructure is emerging that connects China with the outside world, but rather than following the liberal script these cross-border infrastructures function according to Chinese rules.

While this section has traced the growing financial reallocation towards China and its facilitation through market infrastructures, the following section explores China's financial opening intersects with the liberal financial script. How do global financial actors interact with China's continuation of state-capitalist market logic? How do they position themselves with respect to US attempts to hinder China's financial rise?

50 Interview 5 with N.N., CEO of an asset management company, Hong Kong, interview by Petry, Johannes (28 June 2017).

5 THE MALLEABILITY OF GLOBAL FINANCE: CHALLENGING THE LIBERAL FINANCIAL SCRIPT?

The global financial reallocation towards China takes place within the context of a liberal global financial order based on (1) (neo)liberal *norms* of open, lightly-regulated, internationally-integrated financial markets which are (2) guaranteed and facilitated by but reversely also reproduce US *power* (Drezner/McNamara 2013; Norrlof 2010). Drawing on initial findings from the research project outlined in section 3, the following sections tentatively outline the implications of this reallocation for these two constitutive parts of the contemporary global financial order. Section 5.1 focuses on how global investors gradually accepted China's non-liberal norms of market organization by focusing on cross-border investment following its inclusion into global benchmark indices. Section 5.2 then discusses the implications for US financial power by examining the changing role of

Wall Street[51] within China, which has increasingly ventured onshore despite failed attempts by the United States first to liberalize Chinese financial markets and then decouple the two financial systems. Overall, these sections demonstrate a certain degree of malleability on behalf of global financial actors who gradually accept Chinese non-liberal norms of market organization while ignoring US attempts to shape and curb the continued financial reallocation towards China. Although often perceived as the epitome of liberal capitalism, these findings demonstrate the malleability of global financial actors towards non-liberal norms (McNally/Gruin 2017).

5.1 ACCEPTING CHINA'S SONDERWEG? INDEX INCLUSION AND NON-LIBERAL NORMS

The way Chinese markets are governed and access to them is structured enables China to resist pressures to conform with liberal norms. Still, global finance is increasingly directing financial flows towards China. By drawing on discussions about the private authority of index providers, this section illustrates how their decisions to include China in global benchmark indices accepted China's resistance towards the liberal financial script, legitimized its non-liberal rules of how markets operate, and also acted as a catalyst that propelled evermore investment into Chinese markets.

It is important to note that international investors long felt ambivalent about investing in China. On the one hand, the different market logics of global investors and domestic authorities create uncertainty and erode trust (Petry 2018). State capitalist logic of intervening in markets to facilitate national development and control market behavior is at odds with international financial institutions' understanding of "free" markets and their profit-oriented business models (Interview 5).[52] China's continued market interference had held back especially risk-averse long-term investors, which was only exacerbated by difficult access to China's markets. On the other hand, global asset managers and investment banks cannot ignore the fast-growing, enormous Chinese market. Both arbitraging between Chinese and global commodity markets as well as investing into China's increasingly attractive companies create huge business opportunities for international investors, as "[global firms] can make a lot of money [...] in Chinese markets" (Interview 30).[53] In recent years, this facilitated "an increasing interest from US investors [...] looking into long-term investment into China' and [by mid-2018] we see three times as many American investors than just nine months ago".[54]

With the construction of financial infrastructures that enable cross-border investment, such as Stock Connect, the integration of China's capital market was massively expanded and accelerated. But rather than giving in to pressures to adapt to neoliberal logic, this opening has decidedly state-capitalist Chinese characteristics; as one interviewee stated: "Everyone expected, 'oh, sooner or later China will come on international standards...' That may not necessarily happen! China wants to go international with its own standards on its own terms and now has increasingly the clout and the power to do so..." (Interview 7).[55] Importantly, global finance has begun to accept China's *Sonderweg,* which is embodied

51 The analysis in this section only discusses initial finding on the changing activities of investment banks and asset managers.

52 Interview 5 with N.N., CEO of an asset management company, Hong Kong, interview by Petry, Johannes (28 June 2017).

53 Interview 30 with N.N., business development department of a global exchange, Beijing, interview by Petry, Johannes (19 September 2019).

54 Presentation: Alvin Fan, Director and CEO of OP Investment Management (Cayman) Limited, 5th Annual Hedge Fund China Conference, Shanghai (21 April 2018).

55 Interview 7 with N.N., strategy department of an exchange, Hong Kong, interview by Petry, Johannes (30 June 2017).

not least by China's inclusion into global benchmark indices.

As previously outlined, index providers such as MSCI, FTSE Russell, and S&P Dow Jones Indices form a vital part of financial infrastructures, steering capital through including/excluding countries and companies from indices (Petry et al. 2021a). With the shift towards passive investment, institutional investors that replicate or benchmark their portfolio against an index delegate their investment decisions towards index providers. These, therefore, play a role as standard-setters: their notions on what constitutes good corporate governance at the level of the firm and a favorable investment environment at the level of (national) markets helps or hinders firms and countries in attracting capital. As gatekeepers, index providers essentially decide what is investment-worthy in global financial markets (Fichtner et al. 2022). Hence, they have become private authorities whose decisions provide legitimacy to those assets that they include within their indices. In an age of passive investment, index providers "have become finance's new kingmakers: arbiters of how investors should allocate their money" (The Economist 2017).

In June 2017, MSCI decided to (gradually) include China A-shares into its emerging market index, which serves as a benchmark for investments worth USD 1.8 trillion, followed by FTSE Russell and S&P DJI in 2018. In early 2019, MSCI then announced to quadruple the weighting of Chinese A-shares to 20% using the confident slogan: "emerging markets may never be the same" (Wright 2019). This represented a milestone in China's opening process and an "accolade" for its aspiration of becoming a global financial power.[56] One FX trader likened it to "China's ascent into the Champions League" and "basically the same message to asset managers as [the IMF's] SDR inclusion was to central bankers" (Interview 17).[57] By May 2021, these inclusions had steered at least USD 180 billion of passive and active investment into China's stock market (Oliver 2021). China had truly become too big to ignore – and global finance came to grips with this.

Some observers suggested that Chinese regulators made concessions to MSCI (Interview 26),[58] while others voiced concerns that the inclusion resulted from pressure by the Chinese government and MSCI's profit expectations through increased access to China (Interview 11).[59] The *Wall Street Journal,* for instance, highlighted that Chinese asset managers suspended cooperation talks with MSCI and SSE/SZSE threatened to cancel MSCI's access to Chinese stock market data in case of non-inclusion (Bird 2019). The truth probably lies somewhere in between. Over the years, MSCI had been in close contact with Chinese regulators, advising on how to meet inclusion requirements. Consequently, the Chinese exchanges had been actively improving the suspension system of Chinese companies, improving English language information services, and assisting Chinese companies in how to become eligible for index inclusion; as one Chinese regulator noted: "The Chinese exchanges would also brief companies before MSCI came to visit them, so that they knew what to tell MSCI" (interview 27).[60] While initially Chinese authorities were not very responsive to MSCI's suggestions, "eventually foreign investors started investing, so the government was happy, and they

56 bservation: MSCI/iShares "Bring your A Game to Investing in China" Webinar (20 September 2018).

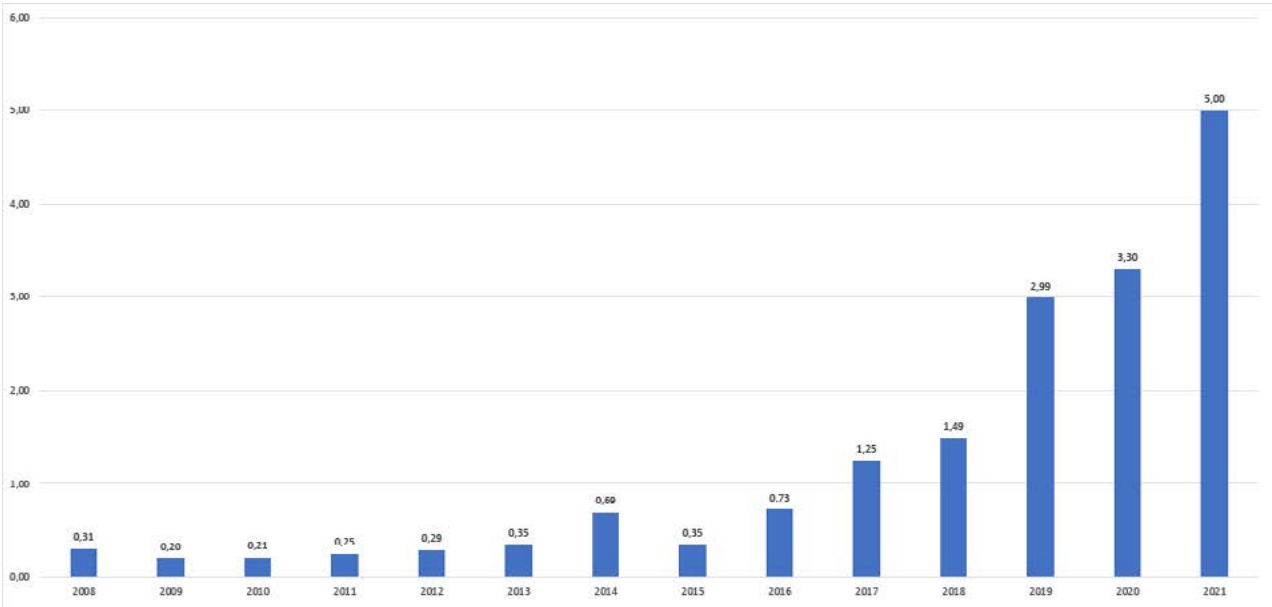
57 Interview 17 with N.N., FX trading desk of a global bank, Frankfurt, interview by Petry, Johannes (25 January 2018).

58 Interview 26 with N.N., general manager of a global exchange, Hong Kong, interview by Petry, Johannes (27 September 2018).

59 Interview 11 with N.N., business development department of a global exchange, Hong Kong, interview by Petry, Johannes (7 July 2017).

60 Interview 27 with N.N., research department at a regulator, Beijing, interview by Petry, Johannes (30 October 2018).

Figure 5: Foreign ownership of China’s stock market, 2008-2021 (% of market capitalization)



Source: Bloomberg Terminal; author’s calculations

were more open” (Interview 31).[61] But while China made some changes, none of these contradicted state-capitalist logic.

Although MSCI had pondered whether to include China since 2013, the main reason for repeated non-inclusion was restricted investor access to China’s capital market. This changed with Stock Connect, which was crucial for MSCI and other index provider decisions to include Chinese A-shares in their indices. As Chin-Ping Chia, MSCI’s Head of Asia-Pacific Equity Research, stated: “[Previously] the access scheme was based on the (R)QFII framework, and it was certainly challenging for some investors to get the license and invest… but the whole development of Connect was a very big game changer”.[62] “Institutional investors viewed the Stock Connect as a more flexible access framework compared to the QFII and RQFII regimes”,[63] and consequently many large asset managers switched from (R)QFII to Connect funds.[64] While only 1,700 SPSA accounts to trade China via Stock Connect existed before MSCI’s inclusion in June 2017, their number increased to around 10,200 by February 2020, with foreign ownership of Chinese stocks surging from 0.73 % to 5.0 % between 2016 and 2021 (figure 5).

These index inclusions were a boon for China’s integration into global markets as it brought China’s financial integration even more in line with state-capitalist logic. As one Hong Kong-based asset manager noted, while “Chinese regulators still don’t like hedge funds, fast money, […] *MSCI inclusion attracts the right kind of foreign investors* - long-term, passive, they trade very little…” (Interview 8),[65] because through the inclusions, such long-term investors were “forced into China”.[66] Similarly, Julien Martin, General Manager of Bond

61 Interview 31 with N.N., research department at an index provider, Shanghai, interview by Petry, Johannes (23 September 2019).

62 Observation: MSCI/iShares “Bring your A Game to Investing in China” Webinar (20 September 2018).

63 Observation: MSCI ‘Adding A Shares into Emerging Markets’ Webinar (22 June 2017).

64 Observation: Mark Stephenson, Index Equity Portfolio Manager for iShares MSCI China A UCITS ETF at BlackRock, MSCI/iShares “Bring your A Game to Investing in China” Webinar (20 September 2018).

65 Interview 8 with N.N., product development department at an asset management company, Hong Kong, interview by Petry, Johannes (3 July 2017); emphasis added).

66 Observation: Orient Securities-HKEx investor presentation (Hong Kong, 6 July 2017); as investors either track (passive) or are

Connect, stated: "I do consider the inclusion as sort of a trigger… […] from arbitrage and fast money going in, we finally see global asset managers to look at China, making their accounts ready, investing into China".[67]

Overall, none of the Chinese exchanges' activities to accommodate index inclusions went against state-capitalist logic: market access through Stock Connect enabled continued market control; and improving companies' English language capabilities and tightening delisting rules only improved corporate governance, facilitating economic reform. On the other hand, global finance had essentially accepted China's state-capitalist logic of integration that resisted pressures to conform with neoliberal institutional logic as evermore investors ventured into China's stock market. With its index inclusions, China had arrived in the upper echelons of global finance. However, this unprecedented inflow of foreign capital takes place according to rules set out by China's exchanges and follows a state-capitalist logic – facilitating the professionalization and institutionalization of Chinese markets (national development) while maintaining Chinese exchanges' monitoring and intervention systems and reducing market volatility (control).

So, although the world's large financial players are active in Chinese capital markets, these markets are organized an monitored by the Chinese exchanges and they must play according to Chinese rules. Malkin similarly noted that the role of foreign financial institutions has been "*internationalizing* China's financial system, not *liberalizing* it […] which implies the withdrawal of the state from determining market outcomes" (emphasis added; 2016: 240). In contrast to neoliberal, global markets, global investors are at the "very bottom of the food chain" and cannot facilitate neoliberal market logic. In the financial allocation towards China, global finance "completely has to accept the Chinese rules and the primacy of the regulators" (Interview 22)[68] – and is doing so willingly.

5.2 IMPEDING US FINANCIAL POWER? WALL STREET BEYOND THE CHINESE WALL

Despite an increasing integration with global markets, China has managed to maintain a state-capitalist logic of market organization rather than conforming with neoliberal logic. This section explores how this financial reallocation also has implications for power constellations within the global financial order which is not only based on liberal norms but also reproduces the structural power of the United States. Especially in the context of the US-China trade war, China's financial opening has become a key contention point (Petry 2020b: 231). By discussing the growing financial reallocation towards China, the paper, therefore, contributes to discussions on the financial foundations of US structural power. While existing IPE literature emphasizes the importance of US-based financial institutions (i.e. Wall Street) in facilitating American financial hegemony (Gabor 2021; Konings 2007; Panitch/Gindin 2012), this section illustrates how Wall Street has increasingly pivoted towards China despite US attempts to decouple US and Chinese markets.

Importantly, US investment banks have rapidly increased their China business activities as an analysis of their office locations demonstrates (figure 6). While before 2011 the world's largest investment banks (n=11)[69] only had 20 China offices in 5

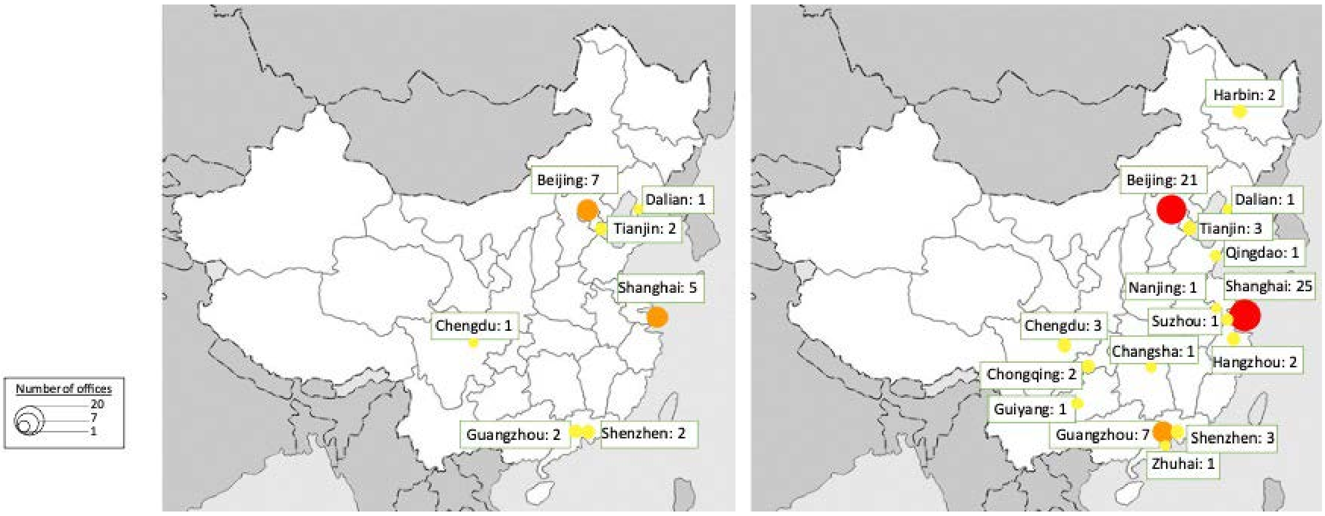
benchmarked (active) to indices, changes in index composition forces investors to adapt their portfolios; for a detailed explanation see Petry et al. (2021a: 163).

67 Observation: HKEx/Risk.net "Chinese Bonds – Riding the Waves of Foreign Inflows" Webinar (28 November 2018).

68 Interview 22 with N.N., consultant for a Chinese exchange, Shanghai, interview by Petry, Johannes (9 May 2018).

69 For this we analyse what is commonly referred to as the "bulge bracket" and "bulge plus", commonly considered the world's best investment banks: JP Morgan, Goldman Sachs, Bank of America Merill Lynch, Morgan Stanley, Citi, Credit Suisse, Barclays, Deutsche Bank, UBS, HSBC, BNP Paribas and Societie Generale; given HSBC's special role in China (it's after all the Hongkong Shanghai Banking Corporation), we excluded it from the analysis of office locations.

Figure 6: China office locations of global investment banks (pre-2011 and 2022)



Source: financial news, annual reports, websites of global investment banks

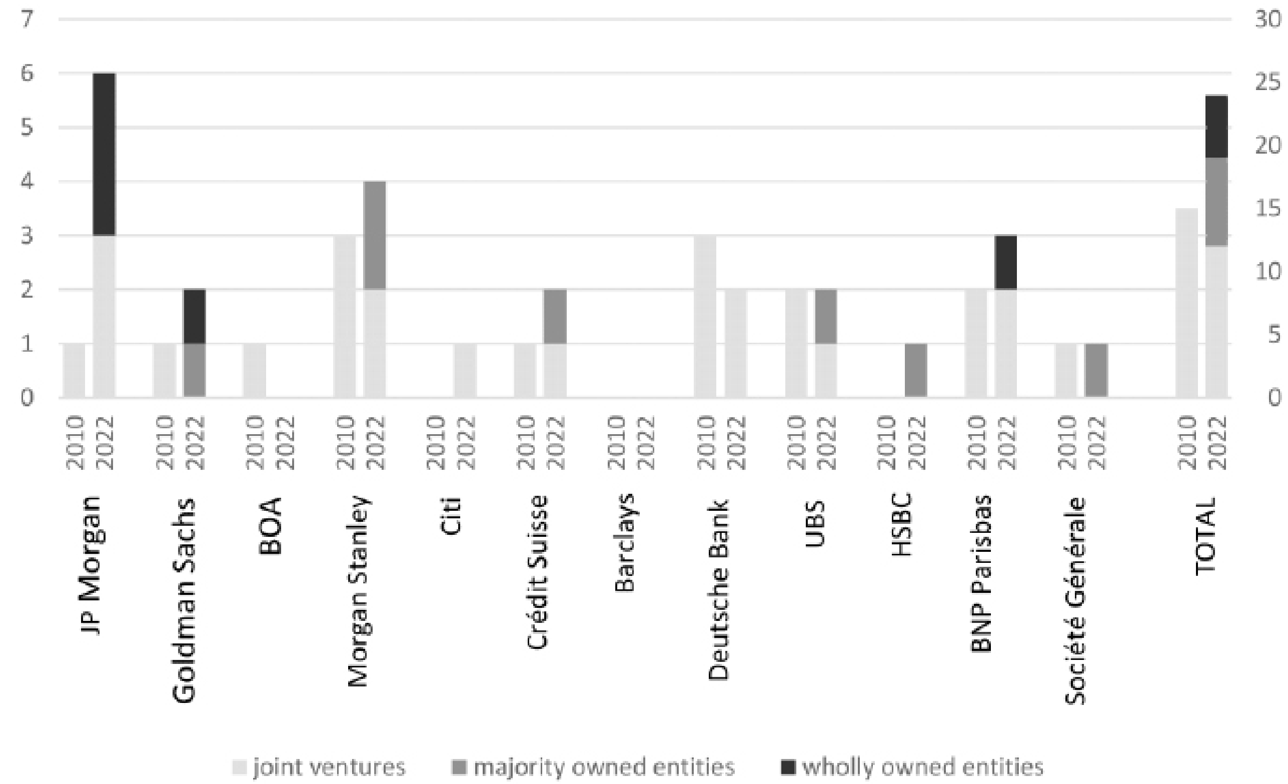
cities, by 2022 they had opened 75 offices across 16 Chinese cities.

Since 2020, US-China relations have continued to deteriorate. Increasingly engulfing finance, this development further facilitated the bifurcation between state-capitalist and neoliberal capital markets. Threats by the Trump administration to delist Chinese companies following the Luckin Coffee scandal[70] have, for instance, further bolstered China's state-capitalist markets as many overseas-listed Chinese companies are now pursuing (secondary) listings in Hong Kong and Shanghai. While SSE's STAR market was launched in June 2019 to "bring home" Chinese tech companies, it was initially unsuccessful. It was only deteriorating Sino-American relations that pushed Chinese unicorns like "JD.com" towards a Chinese listing and propelled STAR to become the world's third-largest IPO market in 2020 (Fioretti 2020). With more Chinese companies coming home, the Chinese exchanges' influence over China Inc. only increases, as state-capitalist market logic now encompasses Chinese companies previously listed in neoliberal markets. Simultaneously, China's amended *Securities Law* （中华人民共和国证券法）was enacted on 1 March 2020. This law involves "reform[s] of the registration-based IPO system, the imposition of more severe punishments for violations [e. g. for HFT], and the enhancement of protection for retail investors" (Clark 2020). While easing listings for Chinese overseas companies, the new law further consolidates existing state-capitalist institutional logic along the lines of control and national development.

China's capital markets have also become a key point in the US-China trade war negotiations, with the US initially trying to facilitate a more encompassing opening of China's financial system (Long 2019) before shifting towards a decoupling strategy. As a partial response, the Chinese authorities liberalized some aspects of their markets, especially removing foreign ownership caps on certain financial institutions. While previously, the likes of Goldman Sachs and JP Morgan were only allowed to own 49% of their joint ventures, as of 1 April 2020, they could take full ownership of Chinese securities, futures, and fund management companies after obtaining regulatory approval. Consequently, global financial players like BlackRock and J.P. Morgan ventured into Chinese markets. And now, Wall Street firms are paying a fortune for controlling stakes in their Chinese joint ventures after they had been relegated to junior partners for more than two decades. JP Morgan, for

70 Luckin Coffee is a Chinese coffee chain that targeted Starbucks' client group; after an IPO on Nasdaq in June 2019, Luckin was delisted in July 2020 after an accounting scandal in which the companies' Chief Operating Officer faked more than USD 300 million in revenues (Wang/Campbell 2020).

Figure 7: Evolution of China business activities and ownership structures of global investment banks (2010–2022).



Source: corporate reports, financial news, policy documents, author's calculation

instance, spent USD 1 billion to gain control over China International Fund Management, paying a 33 % premium. Overall, Wall Street has deepened its engagement with China as an analysis of their China operations indicates (figure 7). Whereas in 2010 the top-12 global investment banks had been minority shareholders in 15 joint ventures, by 2022 they operated 19 joint ventures – 12 as minority shareholders and 7 as majority shareholders – as well as 5 wholly-owned entities.[71]

However, most of these regulatory measures were planned already and simply introduced a year earlier. And even if foreign investors can now fully own brokerage and asset management companies, they are still registered in China, subject to capital controls, and must play according to China's rules of the game the same as Chinese entities or WFOEs. (Interview 35)[72] While (state)-ownership is, of course, relevant, a loosening of ownership rules for certain sectors of the financial system does not equal a retreat of the state as continued control over China's capital markets is guaranteed through financial market infrastructures. As one Chinese broker noted,

> [while] the regulations have been changing in the last two years, what is not changing is the infrastructure. [...] Yes, the regulation is seemingly becoming more international, [but] they will never change the infrastructure because this is where they can exercise the power (Interview 28).[73]

71 Importantly, these wholly-owned entities are not "semi-legal" WOFEs but proper financial companies.

72 Interview 35 with N.N., managing director of a commodity trading platform, China, interview by Petry, Johannes (25 October 2019).

73 Interview 28 with N.N., international department of a brokerage firm, Beijing, interview by Petry, Johannes (12 September 2019).

This was also confirmed by a Chinese regulator who noted that while there is "closer alignment towards international practices" (Interview 29) with respect to financial regulations resulting from the trade war, "the infrastructural arrangements stay the same - because this is where you can control the market!" (Interview 29)[74] From this perspective, current "concessions" do not represent a break with China's pre-existing development path. While China is further opening its capital markets, it pushes global investors to play according to Chinese rules, thereby maintaining the state-capitalist logic of China's markets.

In a second phase of the trade war, the US seems to have switched strategies. From forcing an encompassing opening of China, both the Trump and then the Biden administration pushed towards decoupling Chinese and US financial systems (Segal 2021). This was prominently discussed by the United States-China Economic and Security Review Commission (USCC), the consultative body for the US Congress on China-related issues.[75] The subsequent decision of US regulators to force the delisting of several US-listed Chinese companies (Kerber 2021), the US investment ban on Chinese companies with military links (US Government 2020; US Government 2021), as well as pressures on index providers to exclude these firms from their indices are indicative of such a shift (Reuters 2021).

But while there might be a political decoupling between the US and China (and a politically-driven decoupling in the technology sector), economic entanglement in financial markets has not decreased (Mitchell 2020). Here, one can rather observe more engagement and closer connections between US-based financial institutions and Chinese capital markets: from Chinese government bonds becoming a safe haven for international investors when the US treasury market wavered in March 2020 (Lockett 2020a); Wall Street firms proactively venturing into China (Cheng 2020); the unabated dominance of Hong Kong as China's financial gateway (Kynge et al. 2020); to China's inclusion in FTSE Russell's widely tracked World Government Bond Index, which is predicted to steer yet another USD 140 billion of investment into Chinese bond markets over the next two years (Hale/Lockett 2020). Importantly, this process takes place according to Chinese rules. Instead of converging with neoliberal market logic, it seems as if these developments rather intensify China's drive to assert its own rules of how to run capital markets.

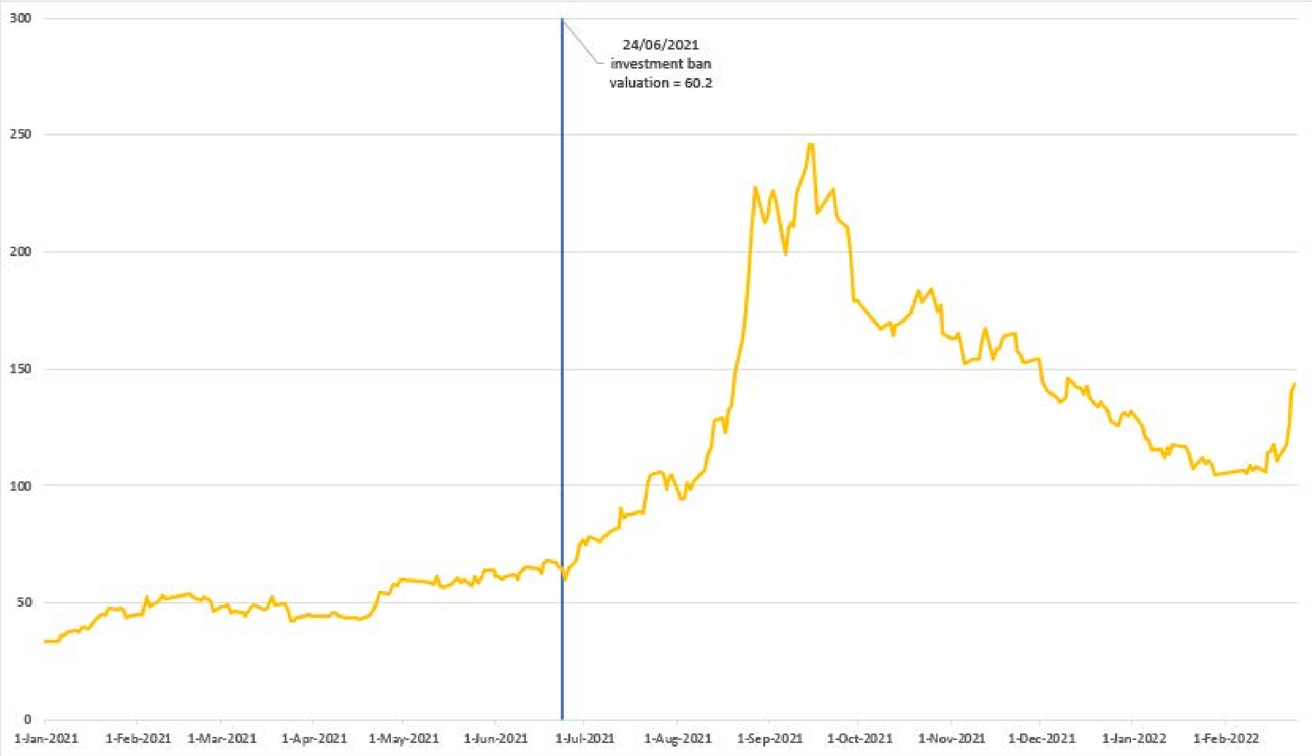
And instead of giving in to US pressures, neither have Chinese authorities made significant concessions nor have US-based and other global financial institutions divested from China. The US investment ban, for instance, does not seem to affect the financial performance of excluded companies. An initial analysis of banned Chinese companies' stock performance indicates no deviation from the average performance of China's stock market (CSI 300 index). As the example of solar-panel manufacturer Hoshine Silicon Industry demonstrates, its stock price was not affected by the investment ban at all and actually more than doubled since June 2020 (figure 7). Research by Reuters further suggests that European and Asian investors simply bought the shares that US investors had to divest from (Shen/Westbrook 2021).

US pressure to first change Chinese rules of financial opening and then facilitate a decoupling of US and Chinese financial markets could not impede the ongoing and increasing financial reallocation towards China. Unless the US completely prohibits Wall Street from operating in China (e. g. as in the case of Iran) and as long as China

74 Interview 29 with N.N., research department of a regulator, Beijing, interview by Petry, Johannes (12 September 2019).

75 USCC Hearing on "China's Quest for Capital: Motivations, Methods, and Implications" (23 January 2020) and USCC Hearing on "U.S. Investment in China's Capital Markets and Military-Industrial Complex" (19 March 2021).

Figure 8: Impact of the US investment ban on Chinese companies (24 June).



Source: Bloomberg Terminal, author's own figure

remains the world economy's engine and global financial players can potentially make a fortune in the process, global investors will continue to flock to China and play according to Chinese rules. As they thrive even in the face of unfavorable circumstances, Chinese capital markets will likely continue to form an alternative to, resist pressures to conform with, and increasingly challenge the global financial order.

6 DISCUSSION AND (TENTATIVE) CONCLUSION: CHINA, GLOBAL FINANCE AND THE LIBERAL SCRIPT

Since the global financial crisis, China has become the world's economic engine – contributing 45 % of global GDP growth (The Economist 2018). This is more than double the US share (Kemp 2019), with IMF forecasts predicting a similar pattern for the post-pandemic period. As the center of gravity in the global economy seems to be gradually shifting towards the East, we can observe an increasing integration of China into the liberal global financial order exemplified by a continuing reallocation of financial assets, resources, and activities towards China as its capital markets have developed and internationalized to an unprecedented degree. Understanding the functioning and transformation of China's capital markets is therefore of great importance for studying the contemporary global financial system and its governance through the liberal scripts.

As outlined in the beginning of this paper, two scenarios are likely to emerge from this development. Either China integrates into the liberal financial order by adopting neoliberal norms of market organization and accepting its inherent power constellation, or China resists pressures to conform with the liberal script – which in the face of an ongoing reallocation means that global finance accepts China's non-liberal norms with implications for US financial power. The preliminary results of this larger research project – which analyses financial reallocation towards China through investigating the interplay of financial flows, markets, and actors – suggest the latter. Despite China maintaining its state-capitalist characteristics throughout its financial opening process, global finance has ventured into Chinese markets both in terms of cross-border investment flows as indicated by index inclusions and in terms of onshore activities as leading global financial institutions have ramped up their operations in China despite the US-China trade war. It seems as if Wall Street is increasingly accommodating China.

The financial reallocation towards China consequently poses a significant challenge to the liberal financial order. Global finance not only adapts to China's state-capitalist practices, but by flooding Chinese markets with money, it actively supports an alternative non-liberal script, both financially and normatively, by legitimizing it. And these mainly US-based financial institutions (i. e. Wall Street) do this even though it clearly goes against US preferences. Neither the norms nor the power constellations that underpin the liberal financial script can limit China's growing footprint in the global financial system or its alternative state-capitalist script of organizing economic life. While global finance is commonly characterized as the epitome of liberal capitalism, its malleability with respect to China creates a puzzle that touches the core of the liberal financial script: Why is global finance – the perceived guardian of free markets that underpin the contemporary global financial order – malleable and willing to adapt to China?

One could argue that the promise of current and future profits from China trumps both liberal norms and US power. Global finance shifts towards China as China becomes the world's economic engine with financial markets that promise seemingly endless profit opportunities. China is home to the world's second-largest stock market that outperformed the rest of the world over the last decade. In a negative interest rate world, Chinese government bonds represent "a large, A+ rated sovereign market that pays 3% yields, with minimal volatility", which is increasingly "irresistible" for global investors, as Reuters noted (Ranasinghe/Chatterjee 2021). And the combination of a growing, investment-hungry Chinese middle class and an aging population are expected to lead to tremendous growth in Chinese asset management – not least because China's underfunded public pension system is geared to becoming more capital market-based over the next few years (Flood 2017; Le Couédic et al. 2019). The growth potential in Chinese markets is enormous, especially compared to already saturated and highly financialized Western markets. Whereas the US has USD 29,196 billion in pension assets (136.2 % of GDP), in China, they only amount to USD 223 billion (1.6 % of GDP) (Hale et al. 2021). Furthermore, according to a recent McKinsey study, China accounted for a third of the growth in global wealth over the last 20 years, more than twice the rate as the US (Miller 2021). As The Economist (2020) fittingly stated, it seems as if "Wall Street's taste for China reflects a long-term bet that finance's center of gravity will shift east". Echoing Ray Dalio's statement from the 1990s, many Wall Street firms today openly agree that China is truly "too big to ignore".[76]

This also poses the questions whether the glue that holds together the global financial script is composed of capitalist principles of profit orientation rather than US power or liberal norms as well as what the relationship between these three constitutive dimensions is. Does the freedom to allocate financial assets based on profit considerations undermine the liberal principles and power constellations that underpin the liberal script? Does the malleability of global finance

76 Cf. BlackRock (2020), Goldman Sachs (2021), HSBC (Wong et al 2021), JPMorgan (2020), MSCI (China/Wang 2014) or Vanguard (2018).

have implications for Washington's financial power? What are the repercussions of non-liberal interventions on behalf of the US – such as the recent investment ban on Chinese companies with military links – for the liberal script? Finally, how can we position other countries in this story – especially other emerging markets that are often characterized by state interventions? While this paper does not answer these questions, the preliminary findings from this research project as least suggest that the financial reallocation towards China has a destabilizing potential for the liberal script. It is not only China that challenges the liberal global financial order. It takes two to dance, and Wall Street – the perceived bedrock of free-market economics – seems more than willing to forsake liberal norms for (future) profits. Is the liberal script ultimately undermining itself?

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