Further liberalizing the Qualified Domestic Institutional Investor inside China

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There is speculation from both inside and outside China that further liberalizing the Qualified Domestic Institutional Investor (QDII) quota system that allows wealthy Chinese to invest in foreign markets will simultaneously serve to offset capital inflows, cool domestic equity markets and alleviate pressure on Beijing to appreciate the Yuan. While the reform initiative deserves praise for its further endorsement and augmentation, however modest, of financial liberty in China, its ultimate impact is likely to be minimal. The Chinese economic regime is designed to amass and monopolize domestic funds, the accrual of which is certainly the source of many of China's most contentious bi-and multilateral trade frictions. China has been and today remains perhaps the hottest emerging market in the world and PRC coffers are indeed brimming (they constitute the richest reserves of foreign exchange in the world). That the financial regime nearly completely restricts an outbound flow of capital precludes two salutary developments that the QDII program serves to moderately facilitate. First, an opportunity for Chinese funds to enter and support foreign markets working thereby to even financial-account imbalances and second, a similar opportunity to dissipate appreciation pressure on the Yuan by allowing it to be exchanged onshore and in greater quantities for currencies of another kind. While the QDII program has enabled some Chinese investors to send capital abroad (usually to Hong Kong) and in this way begin both to ameliorate financial-account imparities and increase the convertibility of the Yuan, the program's existence seems much more aimed at appeasing the most privileged classes than at rectifying considerations of international trade or financial liberty. Regardless, the program remains tightly controlled and is estimated to account for (including the latest round of reform) a mere \$7bn-\$9bn of outbound investment. The move has also been rightly understood as an effort to deflect funds away from China's vastly overheated equity markets that observers are today nearly unanimous in labeling a bubble. Chinese investors, however, seem not yet to have lost an appetite to throw the dice in Shanghai or Shenzhen and when coupled with an undervalued, gradually appreciating domestic currency, incentives to ship off RMB are not overwhelming. The scope of QDII liberalization is not great and changes affected will be similarly limited—the most significant amendment allows for greater (though rule laden) access to equity markets. The dollar amount of projected outflow is not significant enough to considerably offset China's massive flow of inbound capital and should have little ultimate impact on her financial-account surpluses or glut of foreign reserves. The stock market, in desperate need of cooling, remains a financial alternative readily available and entirely more accessible to Chinese households than offering up the minimum 300,000RMB to qualify for QDII. Today, the RMB is far from a convertible currency. Incremental reforms to allow Chinese investors the freedom to roam the globe unencumbered in pursuit of economic opportunity is not only good policy, but should also serve to alleviate appreciation pressure on the Yuan. Though enabling a sizable pool of RMB's convertibility will somewhat serve to balance the currency's massive demand and perhaps even employ some previously untapped foreign exchange reserves, the numbers all remain too small to cause waves. For China's part, however, should these be the initial efforts of fuller, more genuine reform, an approach of gradual and controlled experimentation is probably sensible and stability in this regard should breed greater confidence and further, more substantive change.