



Financial Openness and the Impact on the Chinese Economy

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Abstract. In 2018, China's economy embarked on a new phase of openness, with the Chinese financial industry actively advancing a comprehensive opening-up strategy. The primary research question in the field is that: What are the reasons for China's efforts to increase financial openness? Is it not perilous? Scholars posited that increasing access to the financial sector is beneficial for China, particularly for its citizens. Regarding the research question, the author's objective is to analyze the relationship between the liberalization of China's financial sector and its economic growth, particularly Chinese industrial structure, while focusing on the impact of financial openness.

Keywords: Chinese policy reform, Financial openness, Industrial structural reform, Granger Causality Test

1 Introduction

In 2018, China's economy embarked on a new phase of openness, with the Chinese financial industry actively advancing a comprehensive opening-up strategy [1]. This involved gradually relaxing the limitations on foreign investors' direct or indirect involvement in financial sectors and eliminating the previous restrictions on foreign ownership in Chinese-owned banks. China's latest phase of financial liberalization will draw increased foreign investment in diverse forms, thereby consistently bolstering the quality, efficiency, and international competitiveness of the financial industry's services to the real economy [1]. This will significantly contribute to China's efforts to establish a comprehensive and inclusive model of economic openness [2]. Since its accession to the WTO in 2001, China has been diligently adhering to its obligation to completely liberalize the banking and insurance industries within the agreed time frame. This has involved a progressive expansion of both the operating domains and geographical coverage. For instance, the requirements for entering foreign investment markets have been relaxed even more [2]. Foreign financial institutions are now permitted to invest in Chinese-owned financial institutes, which helps advance the reform of China's financial industry. Foreign investors are also allowed to establish and invest in different non-bank institutions, which enhances the variety of foreign-funded businesses. Additionally, the reforms of the governmental and ap-

proval system are being actively pursued to enhance the ease of doing business for foreign investors [3].

The primary research question in the field is that: What are the reasons for China's efforts to increase financial openness? Is it not perilous? Scholars posited that increasing access to the financial sector is beneficial for China, particularly for its citizens [1]. This will enable domestic-owned foreign-funded financial institutions to participate in the Chinese market, fostering competition among state, private, and foreign capital. This will enhance competitive pressure and innovation within various financial enterprises, ultimately improving the overall competitiveness of China's financial industry and advancing the development of China's financial system. The act of opening up the financial sector does not inherently create financial risks. However, the process of opening up can lead to increased complexity in preventing financial hazards. Therefore, it is necessary to continuously enhance a financial risk control system that is compatible with the opening up of the sector. Regarding the research question, the author's objective is to analyze the relationship between the liberalization of China's financial sector and its economic growth, particularly Chinese industrial structure, while focusing on the impact of financial openness.

Hypothesis: Financial openness is likely has a positive impact on Chinese industrial upgrading.

2 Literature Review

Financial-industrial integration refers to the process of combining industrial capital and financial capital within an organization through methods such as participation, shareholding, holding, and staff involvement [4]. This integration aims to achieve joint development goals and overall benefits. It possesses the attributes of complementarity, permeability, high efficiency, combined optimization, and bidirectional selectivity [5]. Financial-industrial integration often occurs in two primary modes: industry-to-finance and finance-to-industry [3]. The former suggests that industrial capital decreases financing expenses by participating in financial institutions through equity, resulting in beneficial interactions between different industries and the formation of a financial center that supports the industry. The latter signifies the intentional infiltration of financial capital into the industry through equity investment, ensuring the security and growth of financial capital by using the benefits of the real sector. It mostly appears as the allocation of funds by financial institutions, such as securities, funds, insurance, and banks, to businesses [3].

While certain experts have demonstrated that the state of being open to commerce fosters economic progress, there are others who hold a contrary perspective [1]. On the other hand, certain empirical research, such as Rahman [6] and Kong et al. [7], have discovered that trade openness actually impedes economic growth. Furthermore, the study conducted by Li [3] revealed that there is no direct cause-and-effect relationship between trade openness and economic output in Bangladesh. However, it did identify a mutual causation between trade openness and economic output in India, Sri Lanka, and Indonesia. In addition, Udeagha and Ngepah [8] conducted a study to

examine the presence of a nonlinear connection between trade openness and economic growth. They focused on the South African context from 1960 to 2016 and employed a newly developed nonlinear autoregressive distributed lag (NARDL) framework. Their findings revealed that trade openness has both short-term and long-term asymmetric impacts on economic growth. In their 2020 study, Ghazouani [9] analyzed data from Turkey spanning the years 1950 to 2014. The results of the Granger causality test revealed a reciprocal causal connection between trade openness and economic production. Opinions regarding the influence of Foreign Direct Investment (FDI) on economic growth are not uniform. The link between the two entities encompasses two primary hypotheses [1]. The idea posits that foreign direct investment yields little benefits to the host country as the majority of the returns are appropriated by foreign-invested multinational corporations, leaving only a small fraction for the home country [1]. Conversely, the deployment of capital-intensive technologies by multinational firms worsens unemployment and income issues in the economies where they operate. Gherghina et al. [10] conducted a study to investigate the relationship between the inflow of foreign direct investment and economic growth.

3 Methodology

3.1 Data and Model

By addressing the research question and goals, author collected five sets of data sample from Chinese National Bureau of Statistics, that is, industrial structural upgrading, financial openness, total employment, percentage of fixed-asset investment, and share of total import and export trade are key factors to consider. The model presents as:

$$\text{Industrial} = \alpha_0 + \alpha_1 \text{financel} + \alpha_2 \text{employment} + \alpha_3 \text{asset} + \alpha_4 \text{trade} + \theta$$

Industrial refers to the improvement of China's industrial structure, finance refers to the openness of the financial sector, employment refers to the total number of employed individuals, asset refers to investments in fixed assets, and trade refers to the overall import and export trade in China. To prevent significant fluctuations in the value of economic variables during the study, this paper conducts a numerical analysis of all economic variables.

3.2 Measurements

Dependent variable: The improvement of China's industrial structure which measured by the sum of added value from the second sector and added value from the third sector divided by the total GDP. The main principle of industrial structure upgrading states that during a country's development, the focal point of economic growth would progressively shift from the primary sector to the secondary sector, and subsequently from the secondary sector to the tertiary sector.

Independent variable: This article conducts a comprehensive assessment of financial openness, considering the three dimensions of open capital account, open currency, and open financial services.

Control variables: The total number of employed individuals is a significant determinant that impacts the industrial structure. Moreover, a plentiful labor force offers substantial support for industrial development. The proportion of fixed-asset investment in GDP may accurately indicate the investment demand at various periods of China's economic development, as well as the contribution of capital resources. Export trade fosters an increase in gross national product, thereby offering substantial financial backing for industrial upgrading.

3.3 Findings and Results

To enhance data consistency, the current literature data processing methods are employed to convert all data into numerical values, hence removing variations. The data for descriptive statistical analysis of variables is shown in Table 1, after the completion of numerical processing.

Table 1. Descriptive data analysis.

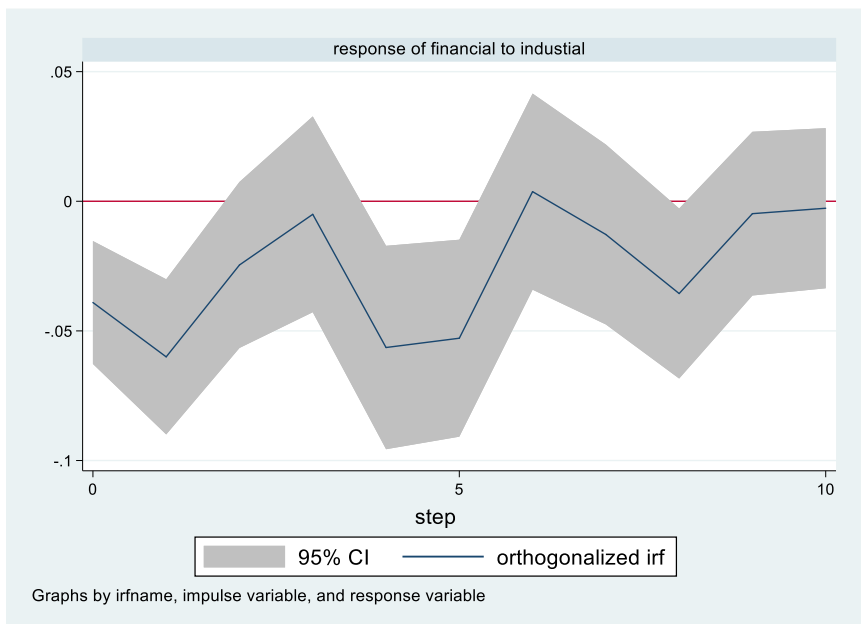
Variables	Means	SD	Min	Max	n
Industrial	4.521	0.093	4.091	4.588	32
financial	2.765	0.715	1.461	3.590	32
employment	11.143	0.150	10.788	11.291	32
asset	3.690	0.371	3.175	4.402	32
trade	3.622	0.327	2.803	4.163	32

Granger causality test. Based on the preceding analysis, all the results presented in this study demonstrate stability during the execution of the Grange Cause Effect Test procedure. This paper employs the Granger causality test method to examine the relationship between China's financial openness, industrial structure upgrading, total employment population, fixed asset investment, and total import and export trade variables. The objective is to determine if there is a causal relationship between China's opening up and the upgrading of its industrial structure. The test results are presented in Table 2. The empirical testing results indicate a reciprocal relationship between China's industrial upgrading and financial openness. Specifically, the past industrial upgradation can account for the reasons behind the growth of financial opening in China. Similarly, the growth in financial opening can also explain the growth during the industry's upgrade. Simultaneously, China's economic development has shifted its focus from the primary industry to the secondary and tertiary industries due to industrial escalation. This shift has resulted in a greater emphasis on high-quality development, as well as a more coordinated relationship between economic growth and the ecological environment. Consequently, this has laid the groundwork for the future sustainable and healthy development of the economy. As a result, there has been an increased inclination for foreign capital to enter the Chinese market, leading to a rise in Chinese financial openness.

Table 2. Granger causality test.

H0	Chi2 value	P value
Industrial does not Granger Cause financial	21.67	0.005
financial does not Cause Granger Industrial	23.776	0.007

Impulse response. The pulse response function amplifies the magnitude of the shock by the standard deviation, taking into account the disturbance in the model. The current values of the model's inherent variables and the values for the future period are influenced to different extents. Eviews, a measurement program, has generated a pulse-response function chart illustrating the relationship between our country's financial openness and industrial structural upgrading.

**Fig. 1.** Response of financial to Industrial.

The impact of financial openness on the upgrading of the industrial structure is illustrated in Fig. 1. It is observed that financial opening initially has a negative effect on the industrial structure upgrade. However, after entering the sixth phase, this negative impact reaches its maximum value. This suggests that financial opening will hinder the upgrade of our country's industrial structure during that period. Nevertheless, due to its positive impact, there is a delay in this negative effect, and the positive effect gradually becomes apparent after the sixteenth phase. Fig. 2 demonstrates that industrial structure upgrading has a generally good effect on financial openness. Specifically, during the second phase of industrial structural upgrade, the impact on fi-

nancial openness is particularly positive. The upgrading of the industrial structure in China has shifted the country's economy from rapid growth to a focus on high-quality development.

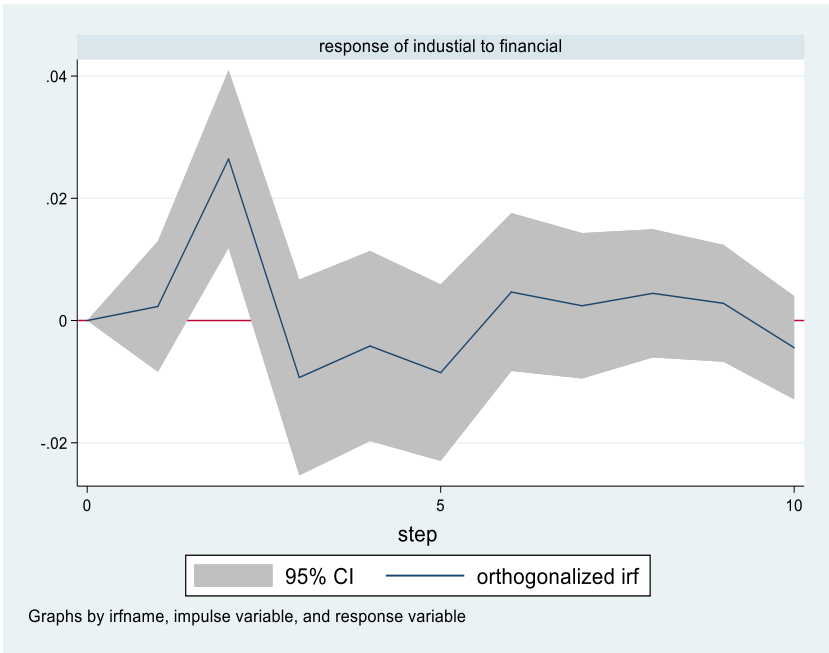


Fig. 2. Response of Industrial to financial.

4 Conclusion

This research employs the Granger Causality Test and Impulse Response Method to establish a bidirectional relationship between financial openness and the upgrading of China's industrial structure. More precisely, it shows that the process of opening up the financial sector can explain the positive changes in our country's industrial composition. Similarly, the advancement of the industrial structure can also be a major component in explaining the opening up of the financial sector. However, this has posed a challenge to the upgrading of China's industry structure. Our country has recognized the significance of ecological environmental protection and scientific development in economic development. The government has implemented preferential policies and eco-environmental management to gradually transform the industrial structure. This has led to a significant reduction in high-energy consumption and low output industries, while increasing the share of intensive industries. The third industry has been actively promoted, attracting foreign capital guided by these policies. As a result, our third industry has received substantial capital support for its development. Simultaneously, China's process of upgrading its industries necessitates a substantial

amount of cash for technological research and development as well as product enhancement. This is done to fulfill the demands of market expansion. Consequently, the Chinese government has implemented more favorable regulations to attract international investment.

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