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Financial Soft Power? Perceptions of Capital Account Liberalisation in China

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Since the launch of the Reform and Opening-up policy in 1978, China has undergone a dramatic transformation marked by spectacular economic growth. This shift has led to extensive academic and policy interest in the factors driving China's economic influence and their consequences. Nevertheless, one crucial aspect remains relatively unexplored - the shifting nature of China's financial system. China's cautious yet intentional progress towards financial liberalisation, and notably opening its capital account, has not received much attention from scholars studying global perceptions of China and the country's global positioning. The importance of China's financial reforms is even more pertinent in the current geopolitical context characterised by revived isolationism and economic fragmentation. Therefore, this essay presents an initial analysis of how China's developing financial services strategy, particularly its selective liberalisation of portfolio investment channels, influences global perceptions of China's economic role. In doing so, this essay examines if and how financial policy may be strategically deployed as a form of soft power in times of a changing geopolitical environment and increasing global competition.

Financial policy through a "soft power" lens

Since the beginning of China's reform and opening up in 1978, its financial system, comprising a variety of markets and financial intermediaries, has undergone a gradual shift from tight state control to its partial liberalisation (Allen et al., 2017). In recent years, the ensuing waves of financial reforms have been motivated by global exogenous shocks, such as the 2008 Global Financial Crisis and the COVID-19 pandemic. Following these events, the Chinese leadership has cautiously pursued modernisation of the country's financial sector by further deepening capital markets and improving financial stability (Adams et al., 2023).

Nevertheless, these policies do not exist in vacuum. As China assumes an increasingly significant role on the global stage, its policies are subject to heightened scrutiny by foreign businesses, governments, and international institutions. Financial policies related to capital account liberalisation significantly influence China's market integration with the global financial system, making them crucial for global investors and governments seeking collaboration with Chinese markets. These policies could therefore be viewed as part of a broader strategy to establish China as a credible global economic participant. As a consequence, they may be also understood as tools to not only bring about economic gains, but also be deployed as a form of "soft power" aiming to improve the overall image of China and shape global perceptions about the country.

"Soft power" was defined by Joseph Nye as "the ability to affect others through the co-optive means of framing the agenda, persuading, and eliciting positive attraction in order to obtain preferred outcomes" (Nye, 2011, p. 48). Although traditionally analysed through the lens of foreign policy and cultural and political values, some scholars suggest that economic or financial policies can also be analysed across the "economic-soft power nexus" and can serve as enablers to further economic benefits (Carminati, 2021). As described by Nye himself: "A large successful economy produces not only hard power resources, but also the soft power gravitational pull of attraction. The basic economic resources that underlie both hard and soft power are such things as […] political and legal institutions for markets, as well as a variety of shaped resources for special domains, such as trade, finance, and competition" (as cited in Carminati, 2021, p. 6). Therefore, China's financial policy, and notably capital account liberalisation, could be analysed through the "soft power" lens as having a double objective of economic gains and changing perceptions. Although actual attitudes and China's global image depend on a variety of factors, the analysis below will approach the recent changes in China's financial policy, and notably capital account liberalisation, from this dual perspective, trying to map global reactions to the gradual opening of the Chinese capital account and its consequences for its global "attractiveness", image, and credibility.

Capital account liberalisation

Capital account liberalisation refers to a transition from a closed capital account regime, where capital movement is restricted, to an open capital account system that permits unrestricted money flow in and out of the country (Henry, 2006). In 1993, China announced a plan to achieve full capital account convertibility by 2000; however, 25 years later, this plan has still not come to fruition. Despite the lack of a full-blown transformation, China has been gradually increasing its openness to global markets, particularly after the COVID-19 pandemic.

China's cautious approach to capital account liberalisation reflects inherent trade-offs of such a policy. Some of the potential benefits of capital account liberalisation include bridging the savings-investment gap, reducing financing costs, improving or establishing standards of business and corporate governance, and improved fiscal discipline (Buiter and Taci, 2003, p. 9). Nevertheless, unrestricted capital flows can also pose significant risks and exacerbate existing macroeconomic and structural problems, for example, by contributing to currency appreciation, leading to a loss of competitiveness and deterioration in debt servicing capacity (Buiter and Taci, 2003, p. 9). Moreover, emerging market economies are more susceptible to reversals of capital inflows or sudden stops owing to their institutional fragility, which in turn can trigger financial instability and crises (Buiter and Taci, 2003, p. 9). Notwithstanding these potential risks and benefits of capital account liberalisation, China's strategy of gradually opening its gates to international capital, which has been pursued with renewed speed after the COVID-19 pandemic, signals the country's strategic intent to position itself as a reform-oriented and increasingly open and mature financial power.

Chinese reforms post-COVID-19

China's reopening post-COVID-19 in 2023 has sparked a fresh wave of policies aimed at attracting foreign investment into the country. Although capital account liberalisation policies comprise different types of capital flows, including foreign direct investment, portfolio inflows and outflows, this essay focuses purely on portfolio inflows given their strong signalling function toward international financial markets and institutional investors.

Central to China's capital account liberalisation is its Qualified Foreign Institutional Investors (QFIIs) program, first unveiled in late 2002, which is the first scheme liberalising portfolio investment. QFIIs are permitted to convert their foreign exchange into Renminbi (RMB) and may invest in various

RMB-denominated assets (Miao and Deng, 2020, p. 258). In 2011, China introduced the QFII's Renminbi-denominated counterpart, the Renminbi Qualified Foreign Institutional Investors (RQFII) program, permitting investors to use their offshore RMB assets (rather than foreign currency) to make direct investments in China's domestic markets. The popularity of both of these programs was reflected in their rapidly expanding approved quota, with important reforms introduced in November 2020 when the two programs were combined under one regulatory framework called the Qualified Investor (QI) scheme. Other important changes introduced in the following years included, for example, extending the list of approved investments to include government-backed bonds and stock options, streamlining the investment process, and strengthening the supervisory regime (UBS, 2024; Norton Rose Fulbright, 2024).

These adjustments were not purely technical. As indicated in the speech of Pan Gongsheng, Deputy Governor of the PBoC, these reforms are part of a broader commitment to market accessibility and promoting higher-level opening-up of onshore markets, with a goal of making Shanghai "a high-level international financial centre based on RMB-denominated financial assets", which will "play a bigger role in advancing China's financial opening-up and high-quality economic development" (Pan, 2020). This spirit was also reflected in one of the Zhu Hexin's recent speeches, where he underlined that simplifying the fund management of Qualified Investor scheme is meant to accelerate the promotion of financial market interconnection and attract foreign financial institutions to develop businesses in China (Zhu, 2024). In this way, China aims to "uphold the concept of openness and cooperation" and "jointly make greater contributions to promoting world economic growth with high-quality financial development" (Zhu, 2024). This framing constitutes a clear signal that China aims to position itself not only as an attractive investment destination, but also as a paragon of global economic growth and development.

Stock Connect and Bond Connect mechanisms are another crucial instrument in China's financial opening. They allow offshore investors to access equity and fixed-income mainland markets through connections between the related mainland and Hong Kong financial infrastructure institutions (Amstad & He, 2020, p. 128). The Stock Connects linking Shanghai-Hong Kong, Shenzhen-Hong Kong and London-Shanghai were established in 2014, 2016 and 2019, respectively, while the Bond Connect was launched in 2017. The Connect schemes have continued to be substantially expanded in the post-COVID period. In 2022, Exchange-Traded Funds (ETFs) were included under the Stock Connect, with the number of eligible ETFs rising exponentially during the last three years (Cai, 2024). In 2023, the Swap Connect was launched, expanding the Connect programmes to financial derivatives markets. These substantial changes under the Connect schemes were framed as "all-round reforms to boost growth, enhance quality and efficiency, and promote openness", which "will create an environment where various types of capital are willing to come, stay, and thrive" (Cai, 2024). In the context of rising global scrutiny of China's domestic policies and governance model, such statements may be seen from a dual perspective of inviting capital inflows while rehabilitating the image of the Chinese market as a trustworthy alternative amid Western uncertainty.

These reforms seem to constitute an emerging trend in China's policymaking, as the 2025 Foreign Investment Action Plan announced a range of measures targeted at improving Chinese capital markets and attracting investment into China. The action plan aims to further broaden foreign equity participation by streamlining M&A processes, boosting financing flexibility, and encouraging long-term institutional investment (Interesse and Zhou, 2025). These reforms signal Beijing's intent to boost its appeal to foreign capital by improving market access, reducing financing barriers, and offering a more predictable investment environment. Nevertheless, the extent to which these reforms influence external perceptions will depend not only on their implementation but also on their interpretation by international investors, governments, and institutions. This raises a broader question of how China's evolving financial opening is currently perceived on the global stage.

Global perceptions of China's capital account liberalisation

In order to gauge the extent to which these economic policies may increase Chinese attractiveness globally and thus be perceived as a tool from the soft power repertoire, it is crucial to contrast them with the comments and reactions they have received globally. The reception of these reforms depends not only on their technical objectives but also on the broader geopolitical environment, investor sentiment, as well as questions about predictability and transparency in China's regulatory ecosystem. One of the variables that has unarguably been affecting how China is perceived on the global stage is the ongoing trade war between the United States and other countries. Therefore, the analysis below takes account of the responses to the Chinese reforms both before and after the beginning of the Trump presidency in 2025.

When China reopened after the COVID-19 pandemic, global institutional investors remained cautious about the Chinese market. In 2023, the MSCI China Index, measuring the performance of a specific group of Chinese stocks, went down by 11% (2025). This subdued performance was reflected in investors' concerns over the country's economic fundamentals, and especially China's underperforming real estate sector, weak domestic demand and so-called "policy fatigue", where the promises of measures implemented by the Chinese government did not deliver the expected results (Hale, 2024; Lau, 2024; Bailin et al., 2024). Moreover, rising tensions between the US and China in 2023 also contributed to a cooling down of US investor interest in Chinese stocks (Megaw, Darbyshire & Lockett, 2023). Consequently, in 2023, foreign investors withdrew almost USD 29 billion from stocks listed in China (Dennis, 2023).

The situation seemed to have slightly improved in 2024, when the MSCI China Index grew by 8 % (2025). Notably, in September 2024, the stock market rallied in response to a stimulus package, including interest rate cuts and dedicated funds propping up the stock market and encouraging share buybacks (Leahy and Alim, 2024). Some analysts interpreted these actions as potential catalysts for a structural rebound in investor sentiment, particularly if reforms were to continue (Lau, 2024; Abrahamian, 2024). However, others noted that deep structural weaknesses, ranging from weak consumer demand to an unresolved property bubble and deflationary pressures, are likely to dampen any sustained reengagement (Kandhari, 2025).

Investor sentiment has been further complicated by the re-escalation of the US–China trade war, which has led to greater volatility in global markets. At the same time, Washington's isolationist shift has opened a strategic window for Beijing to position itself as "the new champion of economic globalisation" (Leahy, 2025). These objectives are unarguably supported by the unrolling of the 2025 Foreign Investment Action Plan described above. A preliminary success in China's financial repositioning has also been reflected in the recent commitment of JPMorgan Chase to deepen the US bank's engagement with China's capital markets (Hale & McMorrow, 2025). However, this announcement was preceded by a rally in China's AI sector, making it difficult to isolate the impact of financial reforms from broader market dynamics.

Although investors generally remain rather cautious and adopt a "wait and see" approach when assessing the long-term implications of China's policy shifts, one commentary notes that "there have been few exits from asset managers" in Shanghai (Hale and Leng, 2024). This suggests that the perceptions of China's financial policy are yet to be crystallised and remain in constant flux. This flux in global investor sentiments do not merely reflect economic calculation, but also highlights the extent to which financial policy could function as a tool of soft power and reposition itself as a reliable, open, and law-abiding economic actor, and thus capitalize on its financial policy to improve its soft power. Given the investor's cautious, but not unilaterally negative or positive, attitudes, consistent positioning and commitment to further opening could lead to bolstering China's reputation among global investors.

Changes in China's financial policy have also not escaped the attention of international institutions and other countries. Within the EU, financial opening had historically received less political attention than trade-related considerations such as overcapacity or subsidies (e.g., Dombrovskis, 2023). Nevertheless, in 2024, both countries launched the China–EU Working Group on Financial Cooperation with the aim to collaborate in domains such as sustainable finance, fintech, and supervisory alignment (European Commission, 2023). This project demonstrates China's capacity to utilise financial policy as an effective means for diplomatic engagement, despite disagreements with the EU over other sectors, and could be perceived as a stepping stone from a soft power perspective, where regulatory forums and talks may lead to rapprochement between the two states. Moreover, following the onset of the trade tensions in 2025, Chinese attempts at rapprochement have been met with optimism from some countries. For example, the recent speech of Chair of the UK's Financial Conduct Authority's Ashley Adler, emphasised the UK's willingness to strengthen its financial ties with China and deepen UK-China market integration, by realising the full potential of the Stock Connect, and creating a new Wealth Connect scheme for private capital (2025).

These engagements show that China's financial reforms have also served as tools for diplomatic signalling. The establishment of regulatory partnerships and enhanced cooperation shows China's intention to integrate into international rulemaking processes and allows it to project a reform-oriented image. While these interactions may not eliminate mutual mistrust, particularly in other critical sectors, they provide China with an opportunity to demonstrate soft power by presenting itself as a stable, open, and cooperative financial actor within a fragmented global landscape. The reactions indicate that China's financial reforms serve not only as economic mechanisms but also possess strategic significance as instruments of soft power, intended to transform China's image into that of an open and cooperative economic participant.

Conclusion

This essay has examined how China's post-COVID capital account reforms have shaped global perceptions of its financial openness. While full liberalisation remains unlikely, Beijing's targeted reforms signal a deliberate effort to attract foreign capital and enhance its credibility as a global financial actor. Perceptions of Chinese financial policy remain mixed. While financial institutions note improved access, they also express their concerns over predictability and political risk associated with investments in China. Similarly, reactions among policymakers seem to have been motivated by regional context, with the EU being cautious and the UK showing renewed interest in cooperation, potentially encouraged by transatlantic decoupling. However, isolating the precise influence of these reforms remains difficult. Future research could adopt a qualitative approach, drawing on interviews with investors and policymakers, to more fully capture how China's evolving financial strategy affects perceptions and to further refine the theoretical link between economic reform and soft power projection.

Ultimately, although not a traditional tool of soft power, China's financial liberalisation possesses distinct signalling significance and can be perceived as one of the factors contributing to China's global image and attractiveness. As geopolitical tensions increase and economic fragmentation intensifies, these internal reforms may subtly influence foreign perceptions, especially as China's post-COVID capital account reforms project openness at a time of global fragmentation. What appears to shine through the analysis of this case study is that specific conditions, such as the current geopolitical fragmentation, could create windows of opportunity for financial policy to be transformed into soft power. Under what conditions these windows of opportunity may help financial policy achieve its strategic objectives remains a question for further research.

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