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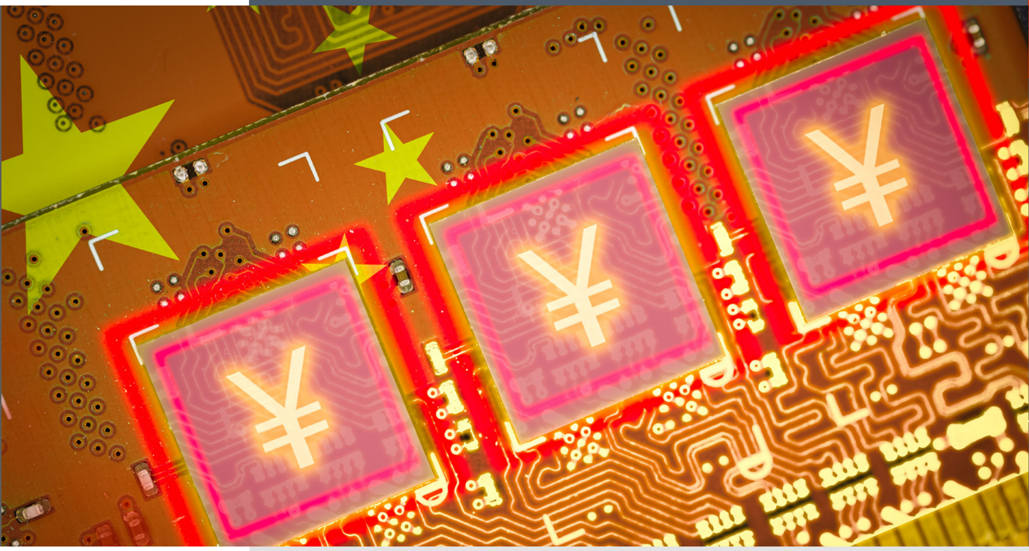

# Why Chinese Fintechs Have Failed to Reshuffle International Finance

Martin CHORZEMPA

## Key Takeaways

- New Chinese financial technologies, including unparalleled electronic payment systems, have so far failed to threaten U.S. financial dominance.
- Obstacles include protection against Chinese acquisitions and concerns about data privacy.
- Cultural and regulatory differences have also made Chinese fintechs' adoption abroad uneasy.
- Cross-border payments are even more difficult to convert to these fintechs, whose technological benefits are small compared to the advantages of U.S. dollar-based systems.
- Concerns related to financial sanctions have heightened various countries' interest in alternative payment systems, with little effect so far.

# Introduction

China is a financial technology leader that once looked poised to turn its stunning domestic digital payments innovation into the first serious threat to U.S. financial dominance in recent memory. Its national champions Ant Group, the spin-off financial arm of the e-commerce giant Alibaba, and Tencent, which combines gaming, social media, commerce, and finance under one enormous umbrella with around a billion users, appeared to have all the ingredients needed to compete globally. China's central bank, the People's Bank of China (PBOC), was and in some ways is still leading the charge on central bank digital currencies that the head of the Bank for International Settlements (BIS) sees as holding "a lot of promise" for remaking cross border payments, which today depend on the dollar.

Yet, the competitive threat has so far failed to materialize. China's fintech giants faced a tidal wave of new regulations constraining them at home and ran aground on hazards in their attempts to expand outside China. China's central bank digital currency (CBDC) has struggled even to find users at home, where the PBOC can mandate it as legal tender and force payment platforms to support it. Finance is a sensitive sector tightly tied to individual countries' sovereignty, and international success in finance is not just a matter of capital and technology but also of geopolitics; this *Briefing* will delve into why both public and private sectors in China seem to have not lived up to their international potential in this area.

On the other hand, geopolitics and technological changes are difficult to predict, and the current situation with sanctions in Russia is providing a boost to China's efforts to expand its use of the RMB, including the digital RMB, abroad.

# China's strengths in fintech

China's retail payments system long lagged much of the world. It was largely cash-based and dominated by the state-owned-card monopoly UnionPay without the kind of competitive forces that encourage innovation. However, in the mid-2000s, Chinese authorities allowed the entrepreneurial energies of its big tech firms, Tencent and Alibaba, to experiment with digital payment systems necessary to grow technology businesses in a country where few people had credit cards. With the advent of smartphones and apps, tech companies could expand those tools beyond online purchases.

Without carrying the cards UnionPay had a monopoly on, tech firms could turn phones into payment terminals and leapfrogged right from a cash-based system to one based on phone apps. Competition between tech firms for users, including sizable bonuses for consumers to encourage adoption, led digital payments to soar in the 2010s. Active users grew into the hundreds of millions, many of whom used not only payments but also a suite of other financial services like lending and investment alongside social media, e-commerce, travel, and various other activities within competing super apps. Digital payments grew symbiotically with the services it enabled people to pay for, boosting online shopping, ride-hailing, scooter rentals, and more.

*The Cashless Revolution*[1] found that the crucial ingredients for China's success with digital payments domestically hinged on several key factors that tech firms could improve upon: a permissive regulatory environment that encouraged experimentation, innovative tech firms with a strong foundation of technology, user bases from core services outside payments, abundant capital, and extensive scale. The challenge, however, was that many of these advantages did not exist outside China.

The government not only encouraged innovation but tried to engage in innovation itself

The government not only encouraged innovation but tried to engage in innovation itself. Soon after Bitcoin became popular in China in mid-2013, China's central bank, the People's Bank of China (PBOC), created a dedicated research team for digital currencies. In January 2016, it announced[2] a "strategic goal" of launching a CBDC, which it said would help financial inclusion, payments efficiency, cutting the cost of issuing and managing paper cash, giving the PBOC more monetary policy tools, and helping to fight crime. Unprecedented control and the ability to observe money flows could, for example, automate tax payments or allow variable transaction fees to either encourage or discourage money from flowing into certain sectors.

There has also long been a geopolitical angle to the effort. Soon after Facebook announced its intention to launch a digital currency named Libra, the PBOC's then-head of research said,[3] "We had an early start… but lots of work is needed to consolidate our lead." He also warned that a successful Libra could entrench a global financial system with "one boss, the Dollar, America" (Wang 2019). China then launched pilots putting experimental digital currency in consumers' digital wallets in four major cities starting in April 2020, which have steadily expanded in scale and scope. China is the most far along of any major economy in launching a CBDC, though it remains in trial mode.

# Challenges abroad

Two crucial events illustrating the contradictory forces facing Chinese fintech happened within a few months of each other in 2018. In January, the Committee on Foreign Investment in the United States (CFIUS) blocked Ant Group's proposed acquisition of MoneyGram, a U.S.-based payment provider especially strong in international remittances. The acquisition would have given Ant Group a network of licenses and a

1. M. Chorzempa, *The Cashless Revolution: China's Reinvention of Money and the End of America's Domination of Finance and Technology*, New York: PublicAffairs, 2022.

2. "People's Bank of China Digital Currency Seminar Held in Beijing", The People's Bank of China, January 20, 2016, available at: [www.pbc.gov.cn](www.pbc.gov.cn).

3. M. Chorzempa, "Who Likes Facebook's Libra Currency? Not the Chinese", Peterson Institute for International Economics, July 16, 2019, available at: [www.piie.com](www.piie.com).

commercial presence around the world, but U.S. authorities considered that the level of data on U.S. citizens—including members of the U.S. military sending money back home—a Chinese firm would obtain through the deal constituted a national security threat. Instead, Ant later bought WorldFirst, a UK company, which closed its U.S. operations to prevent the CFIUS from jeopardizing the deal.

Investors, however, were unfazed. Prestigious international investors later in 2018 contributed[4] to a record-setting $14 billion funding round that valued Ant at $150 billion, part of which would go towards overseas expansion. Ant had already made major investments in fintech wallets across Asia that by 2018 had together an empire[5] of 870 million active users. Ant provided not only money but also expertise and technology services that could knit it together with its investees. For example, it convinced PayTM, a major Indian fintech firm, to use QR codes for payment like in China. It was not hard to imagine that Ant could someday link together these firms in its own payment system, no longer needing the U.S.-dominated payment infrastructure or credit cards. Tencent, meanwhile, tried to expand its wildly successful super app WeChat, including payments, in India, Brazil, and South Africa.

China's payment regulations had kept out foreign competition

Ant and Tencent were successful at convincing retailers and payment processors in dozens of countries to accept their payment methods, in part due to the potential competitive advantage of accepting the preferred payment methods of high-spending international Chinese tourists. Nevertheless, neither was very successful at gaining foreign users. China's payment regulations had kept out foreign competition like Visa and Mastercard from RMB payments, resulting in domestic players evolving independently, tailored uniquely to China's national circumstances. In countries like India, WeChat, for example, failed[6] to adapt to local conditions like less reliable and more expensive data that made the super app model less attractive.

Countries like Indonesia were happy to allow Chinese tourists to pay with Chinese QR codes, but they drew the line at signing up local payment users. Super apps are powerful, but their model relies on collecting and leveraging large amounts of some of the most sensitive data on any individual: their financial health, what and who they spend money on, etc. Especially considering the lack of rule of law in China, many countries' authorities did not want Chinese firms gathering such data directly on their citizens. Countries also had little incentive to invite Chinese firms to compete in their home market while China protected its own from foreign competition.

4. L. Lucas and D. Weinland, "Ant Financial Valued Above Goldman Sachs in $14bn Funding", *The Financial Times*, June 7, 2018, available at: www.ft.com.
5. S. Y. Xie and J. Steinberg, "Jack Ma's Ant Financial Valued Around $150 Billion After Funding Round", *The World Street Journal*, June 7, 2018, available at: www.wsj.com.
6. S. Shaikh, "How WeChat Faded into the Silence in India", *Factor Daily*, October 8, 2018, available at: https://archive.factordaily.com.

Perhaps most importantly, Chinese tech firms did not have a strong base of users abroad. Payment is a classic two-sided market, in which people wanting to pay with a given instrument and stores accepting it need to both exist at the same time, or the system has limited utility. Domestic telecom and e-commerce providers in other countries had such user bases of merchants and users, just as Tencent and Alibaba did at home, but the Chinese firms did not. Without home-field advantage, they stumbled. WeChat was shut down in India, which has since banned a host of Chinese apps, and failed to take off in other countries.

# Advantages of the U.S. dollar

The U.S. dollar is currently the dominant way to make cross-border payments, comprising[7] at least one side of 88% of the world's foreign exchange transactions, according to data from the Bank for International Settlements. The dollar's dominance in payments stems in part from and reinforces[8] its advantage in invoicing,[9] which is much larger than its actual role in global trade. Additionally, its posture as a safe asset, making-up[10] 59% of global reserves, further solidifies its strong position. Existing network effects make trading the dollar extremely liquid, reducing cost to trade dollars and hedge risks compared to trading directly for other currencies. Thus, the interlocking pieces of the dollar system make it difficult for a challenger to catch on. Any alternative system, even with improvements to elements of it, would need enormous scale to be cost-competitive.

# Will new technologies reset the status quo?

## *Private Chinese players*

In terms of private sector initiatives, Ant group has been making a concerted effort to build a long-awaited international payment system, now named Alipay+, which links together Alipay users with mobile wallet and bank app users from other countries to all be able to pay with one system,[11] which it claims currently includes 88 million sellers in dozens of countries. It is natural that firms like Ant will learn from earlier issues, and the rise of banking apps and e-wallets around the world creates an opportunity to be the player linking them together in a network, as card networks arose to connect previously

7. "Triennial Central Bank Survey of Foreign Exchange and Over-the-counter (OTC) Derivatives Markets in 2022", Bank for International Settlements, 2022, available at: www.bis.org.
8. G. Gopinath and J. C. Stein, "Banking, Trade, and the Making of a Dominant Currency", *The Quarterly Journal of Economics*, July 2021, available at: https://scholar.harvard.edu (PDF).
9. E. Boz, C. Casas, G. Georgiadis *et al.*, "Patterns in Invoicing Currency in Global Trade", Monetary International Fund, July 17, 2020, available at: www.imf.org.
10. S. Arslanalp, B. Eichengreen and C. Simpson-Bell, "Dollar Dominance and the Rise of Nontraditional Reserve Currencies", IMF Blog, June 1st, 2022, available at: www.imf.org.
11. X. Shen, "Chinese Fintech Giant Ant Group Expands Overseas Payment Service Alipay+ to Serve Visa-free, Lunar New Year Travellers", *South China Morning Post*, January 30, 2024, available at: www.scmp.com.

Balkanized bank cards into a single payment system. However, even if the retail user sees a direct interface between their Alipay wallet and a foreign merchant, it is not clear how much of an alternative to the U.S. dollar this arrangement represents. On the back end, the payment may well go through the typical USD financial channels. It will be worth watching Alipay+ closely to see whether Ant is able to build a successful international network this time around.

Developments in China, including a wide-ranging crackdown on internet firms on competition policy, data security, data privacy, labor rights, financial stability, consumer protection and more, even if often based on legitimate concerns,[12] have reduced the strength and significantly eroded the market value of China's internet giants, which no longer look ready to take on the giants of global finance. From a projected initial public offering (IPO) valuation well over $300 billion, Ant group recently valued[13] itself below $80 billion, reflecting its diminished prospects. As Chinese policymaking has become even more authoritarian and party-led, increasing friction not just with the U.S. but with the EU and many Asian countries as well, firms like Ant will face even greater challenges convincing regulators outside China to trust it with their citizens' and businesses' sensitive data.

Among the cryptocurrency industry, China is not even in the race

In terms of private digital currency, Chinese government regulations have mostly shut down the country's cryptocurrency scene. After waves of crackdowns starting in 2013 but especially around 2017 due to the boom in Initial Coin Offerings (ICOs), many of which were frauds, Chinese exchanges and coin projects had to flee offshore or shut down to avoid the wrath of the authorities. While this has become a common talking point among the cryptocurrency industry that too much U.S. regulation will hand the digital currency competition to China, it is not even in the race.

### CBDCs and new financial infrastructure

Central banks worldwide are exploring CBDCs for international finance. The PBOC's strategic bet is that others will soon have their own operational CBDCs that could then interoperate or form a network together with the eCNY. If the technology could make such payments cheaper, safer, and more efficient than the current system, China could route more of its trade and financial transactions through this network and depend less on the dollar and the U.S.-based infrastructure, which makes it heavily vulnerable to financial sanctions. While this path is promising based on the results of experiments, its future is far off and quite uncertain. Other major economies are exploring CBDCs, but none has

12. M. Chorzempa, "China's Campaign to Regulate Big Tech Is More Than Just Retaliation", Nikkei Asia, August 3rd, 2021, available at: https://asia.nikkei.com.
13. J. Zhu and J. Ye, "Ant's Surprise Share Buyback Values Firm at Steep 75% Discount to IPO", Reuters, July 8, 2023, available at: www.reuters.com.

launched one or seems to be on the cusp of doing so in the next few years. As of the end of 2022, the e-CNY was struggling to get off the ground in China, with a former senior PBOC official saying[14] its "usage has been low, highly inactive."

The limited domestic uptake, which would require convincing consumers to use it over its already highly competitive private digital wallet rivals, is not positive for its ability to take on the dollar, but the issues involved in the cross-border market are different and are at a far earlier stage. The PBOC is working with three other central banks and the BIS on the M-Bridge project,[15] an experimental platform directly trading in the CBDC of the participants—rather than using the traditional correspondent banking system and with no dollar participation for now. The pilot program was a success, but it represents an early-stage initiative, making only 160 payments worth $22 million over six weeks. To put that into context, the Clearing House Interbank Payment System (CHIPS), the dominant venue for dollar payments, settles[16] $1.8 trillion per day.

The Clearing House Interbank Payment System settles $1.8 trillion per day

Payment systems handling large volumes of high-value transactions have an extremely low tolerance for risk. They need to be incredibly robust to control risks coming from a wide variety of sources, from cyberthreats to operational risks, before they can be fully relied upon. They also need robust governance mechanisms to determine platform ownership, its governance, and, according to the mBridge report,[17] participating countries may also need to change their domestic legislation "to achieve full legal certainty and clarity."

Programs like mBridge, however, represent one of the most ambitious ways to reimagine payments. An alternative that is already operational in some cases is interlinking two different new-generation payment systems so that retail customers in India, for example, using the Unified Payments Interface (UPI), can directly pay[18] a business on Singapore's PayNow network or vice versa. More of these tie-ups are in the works, though they may not threaten the role of the dollar if they represent a smaller volume retail channel than one used for large wholesale transactions. Still, existing largely dollar-based systems are quietly improving,[19] with new global standards for payment messages and faster processing of cross-border payments that reduce the pain points new entrants aim to solve.

14. "Former PBOC Official Says China's Digital Yuan Is Little Used – Caixin", Reuters, December 29, 2022, available at: www.reuters.com.
15. "Project mBridge: Connecting Economies Through CBDC", Bank for International Settlements, October 2022, available at: www.bis.org.
16. More details available at: www.theclearinghouse.org.
17. "Project mBridge: Connecting Economies Through CBDC", op. cit.
18. "Launch of Real-time Payments Between Singapore and India", Monetary Authority of Singapore, February 21, 2023, available at: www.mas.gov.sg.
19. "G20 Roadmap for Enhancing Cross-border Payments: Consolidated Progress Report for 2023", Financial Stability Board, October 2023, available at: www.fsb.org (PDF).

# Geopolitics: from headwind to tailwind?

Russia's invasion of Ukraine was quickly followed by major financial sanctions against Russia, as well as the major step of freezing its foreign exchange reserves not only in the United States, which Russia and the world would have expected but also in the European Union and even in Switzerland.[20] A strong multinational coalition of all major reserve currency issuers joined the sanctions, but that unity masked a deeper divide. Outside of the high-income economies, much of the rest of the world, even if they condemned the invasion, did not agree[21] to join or support the sanctions on Russia. Some, especially the BRICS countries (beyond Russia), worried about the safety of their reserves and bristled at the notion that sanctions could interfere with their own trade with Russia. As a result, the BRICS countries have made renewed commitments to building alternative payment mechanisms that do not use the Dollar, making them less vulnerable to sanctions, though "de-dollarization faces serious headwinds."[22]

"De-dollarization faces serious headwinds"

However, they are still trying. China and India, for example, have managed to retain large volumes of trade with Russia by bypassing the dollar, using instead Rubles, Rupees, and Renminbi. As a result, the share[23] of global payments denominated in RMB roughly doubled in 2023, from around 2% from 2019-2022 to over 4% by December, though it is still far behind the Dollar, the Euro, and, to a lesser extent, the Pound. These dynamics are consistent with the historical trends Daniel McDowell's book[24] *Bucking the Buck* examined. He found that countries only tend to move away from the dollar when they are actually sanctioned; even those at a high risk of being sanctioned do not do so because of the dollar's many cost and risk advantages discussed earlier. He highlights that changing payment currency requires thousands of local and foreign businesses and consumers to make major changes, which is no small feat.

# Conclusion

China has been a pioneer in financial technology at home, but its firms and its CBDC have yet to meaningfully disrupt the mostly dollar-based global financial system. Though the application of new technology in payments, especially blockchain technology, is promising and could reshape finance in the longer term, the main surprise is how little they have changed the way international finance is done today. Some of this is due to protectionism and geopolitics; some is due to the heavily regulated, often risk-averse nature of finance,

20. J. Revill, "Swiss Have Frozen $8.8 Billion of Russian Assets", Reuters, December 1st, 2023, available at: www.reuters.com.
21. C. Alden, "The Global South and Russia's Invasion of Ukraine", *LSE Public Policy Review*, Vol. 3, No. 1, September 8, 2023, available at: https://ppr.lse.ac.uk.
22. R. Greene, "The Difficult Realities of the BRICS' Dedollarization Efforts—and the Renminbi's Role", Carnegie Endowment for International Peace, December 5, 2023, available at: https://carnegieendowment.org.
23. "RMB Tracker Document Centre", Swift, available at: www.swift.com.
24. D. McDowell, *Bucking the Buck: US Financial Sanctions and the International Backlash against the Dollar*, Oxford: Oxford University Press, 2023.

and some is simply due to the fact that the advantages of new technologies as applied so far across borders cannot outweigh the scale and network advantages of the U.S. dollar-based systems. Cross-border payment is already heavily digitized, so the leap to new systems is not as large as the leap Chinese players facilitated from analog cash to digital phone-based payments.

Still, the U.S. and its allies should not be complacent, and they should be careful about the global perceptions of their sanctions. New emerging payment systems remain small for now, but they are laying the groundwork for a much greater volume if sanctions were to be imposed and could blunt their effectiveness. While technology alone cannot remake payments, technology plus concerns around sanctions could increase the willingness of more countries to invest in alternative payment systems that might not otherwise make economic sense. As technology advances, the U.S. should continue improving its infrastructure for payments and work on thorny issues of access to this infrastructure. The U.S. needs to also ensure that if CBDCs look poised to take off for cross-border payments, digital forms of the U.S. dollar and U.S. payment systems be able to competitively participate in these networks in order to avoid being caught on the back foot. To cite the Federal Reserve Chairman Jerome Powell, the U.S. may not need to be a first mover in CBDC, but it does need to "get it right."[25]

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25. "Fed's Powell: More Important for U.S. to Get Digital Currency Right Than Be First", Reuters, October 19, 2020, available at: www.reuters.com.

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