

Financial Sector Modernization – the Key to China’s Economic Future

by

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“When crossing a rushing stream, one stone at a time.” – Chinese proverb

Introduction

The economic emergence of China will not only be one of the great stories of the 21st century, but one of the most significant events in all of economic history. The world’s 7th largest economy as recently as 1999, China surpassed Germany earlier this year to become the world’s 3rd largest, having grown at better than 9 percent annually for two decades. If such growth is maintained, China could surpass Japan as the world’s second largest economy by 2020.

The implications of China’s expansion and the integration of a fifth of the world’s population – not overnight, but over time – into the global trading system are unprecedented and profound. Since 1980, more than 400 million Chinese have been lifted out of poverty. Since China joined the World Trade Organization (WTO) in December of 2001, trade between the United States and China has more than tripled, exports to China have grown at six times the pace of U.S. exports to the rest of the world, and China has risen from America’s 9th largest export market to its 3rd largest. Over the last four years, the United States and China have accounted for half of global economic growth.

U.S. Treasury Secretary Henry M. “Hank” Paulson has called the U.S.-China economic relationship “the most important bilateral economic relationship in the world today.” Without question, how this critical relationship develops and evolves will be one of the most important factors determining the growth and stability of the global economy in the 21st century.

As the U.S.-China economic relationship has grown in volume and complexity, frictions have emerged. Issues complicating the relationship include large trade imbalances, product safety, intellectual property infringements, and China’s foreign exchange rate policies. While not surprising, and perhaps even inevitable, such festering problems have caused some U.S. policymakers to question the benefits of maintaining an open and expanding economic relationship with China.

To enhance the management of the growing bilateral relationship, President George W. Bush and President Hu Jintao established the U.S.-China Strategic Economic Dialogue (SED) in September of 2006. The SED – led by Treasury Secretary Paulson and Chinese Vice Premier Wang Qishan – creates an unprecedented channel of communication between Cabinet-level U.S. and Chinese policymakers and provides an overarching framework for the examination of long-term strategic issues, as well as coordination of ongoing bilateral policy discussions (e.g., the Joint Commission on Commerce and Trade, the Joint Economic Committee). SED meetings have occurred twice each year since December of 2006, the most recent of which took place the

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week of June 16th in Annapolis, Maryland. In addition to Secretary Paulson and Vice Premier Wang, nine U.S. Cabinet officials and agency heads and 18 Chinese ministers participated in the talks. The fifth round is planned for December in Beijing.

A central focus of the SED is reform and modernization of China's financial system – including greater foreign participation. The world's third largest and fastest growing economy is currently supported by one of the world's least developed and inefficient financial systems. Like a world-class athlete with cardiovascular disease, China runs an ever mounting risk of catastrophic breakdown even as it continues to turn in robust economic growth performances.

The fastest way for any developing economy to acquire the modern financial sector it needs to fuel continued and sustainable development is to import it – that is, to allow foreign financial institutions to establish in-country operations through the establishment of branches and subsidiaries, joint ventures with domestic institutions, and cross-border mergers and acquisitions. Foreign institutions bring world-class expertise and best practices with regard to products and services, credit analysis, risk management, internal controls, and corporate governance. By helping to provide the financial products and services that China's citizens and businesses need to save, invest, insure against risk, and consume at higher levels, foreign financial institutions can help China develop an economy that is less dependent on exports, and more services-based and consumption-driven.

Regrettably, progress achieved on the financial reform front through the first four rounds of SED meetings can best be described as modest. To be sure, some important progress has been achieved, demonstrating the clear value of the SED. But progress has been painstaking and slow. Though many Chinese financial authorities understand the critical importance of financial sector reform and are supportive of accelerated modernization, a sufficient number of senior political decision-makers are resistant to a more modern and open financial system that includes greater foreign participation.

In his negotiations with his Chinese counterparts, Secretary Paulson has repeatedly emphasized that the risks associated with moving too slow in modernizing China's financial sector are vastly greater than the risks associated with moving too fast. In response, some Chinese negotiators are fond of repeating the ancient proverb, "When crossing a rushing stream, one stone at a time."

Given the critical importance of an effective and efficient system for mobilizing and deploying capital in any healthy economy, China's reluctance to embrace accelerated financial sector reform not only casts into doubt the achievement of its broad macro-economic objectives as articulated in its most recent Five-Year Plan, it jeopardizes the remarkable economic progress achieved over the last 25 years. Indeed, significant problems have already emerged: economic growth has slowed by more than 15 percent; inflation, at 8 percent, remains far above the government's targeted 4.8 percent; the Chinese stock market has fallen by 60 percent from a year ago; and Chinese exporters are struggling with the toughest conditions in memory – weakening external demand, a stronger yuan, and higher input prices.

Simply stated, China's underdeveloped financial sector presents substantial risk to the continued growth and diversification of the Chinese economy – and, therefore, to the U.S. and global economies as well.

Critical Importance of the Financial System to Any Economy

Capital is the lifeblood of any economy's strength and well-being, enabling the investment, research, and risk-taking that fuels competition, innovation, productivity, and prosperity. As the institutional and technological infrastructure – the cardiovascular system – for the mobilization and allocation of investment capital, an effective and efficient financial system is essential to the health and productive vitality of any economy.

As a financial sector becomes more developed and sophisticated, capital formation becomes more effective, efficient, and diverse, broadening the availability of investment capital and lowering costs. Broader availability of a wider array of savings and investment alternatives promotes economic opportunity and social justice by fostering the growth of a stable middle class, freeing governmental resources to concentrate on society's neediest. A more developed and sophisticated financial sector also increases the means and expertise for mitigating risk – from derivatives instruments used by businesses to avoid price and interest rate risks, to insurance products that help mitigate the risk of accidents and natural disasters. Finally, the depth and flexibility of the financial sector is critical to the broader economy's resilience – its ability to weather, absorb, and move beyond the inevitable difficulties and adjustments experienced by any dynamic economy.

For all these reasons, an effective and efficient financial sector is the essential basis upon which the growth and vitality of all other sectors of the economy depend. It is the “force multiplier” for progress and development, amplifying and extending the underlying strengths of a growing economy. Academic studies have repeatedly determined that the development, expansion, and deepening of the financial sector promotes faster, broader, and more sustainable economic growth, in developed and developing countries alike. Moreover, the more open a financial sector is to competition – which promotes efficiency, innovation, and productivity – the greater the benefits of the financial sector to the broader economy.

Importance of a Modern Financial System to China

Despite China's remarkable economic development over the past 25 years, the structure and pace of China's economic growth has produced significant problems, both economic and social. The country's fixed investment- and export-driven development – more factories to produce more goods for world markets – has left China vulnerable to economic slowdown elsewhere in the world (particularly in the United States), and to rising energy, materials, and labor costs. The manufacturing and export focus of the economy has also led to widening disparities between rich and poor, made worse by the closing or privatization of state-owned enterprises, which had provided most healthcare services in China. There are, in effect, two Chinas – a wealthy elite and a developing middle class along the coast, and 800 million poor in the central and western interior. The worsening wealth gap and the resulting social dichotomy have led to increasing political instability. Reports indicate that as many as 100 significant incidents of protest occur in China every day.

Almost immediately after assuming leadership at the 16th Chinese Communist Party Congress in 2002, President Hu Jintao and Premier Wen Jiabao sought to distinguish themselves as the “putting-people-first administration.” They also articulated the notion of a “scientific

viewpoint of development,” by which economic growth is to be balanced with social priorities such as a more equitable distribution of income, poverty reduction, education, improved medical care, and environmental protection. Such adjustments were necessary, according to the new regime, to establish a more sustainable course for China’s long-term economic growth and to achieve a more “harmonious” – which is to say, a more equitable and stable – society.

These priorities became the framework of China’s 11th Five-Year Plan, which was approved by the Communist Party Central Committee in October of 2005 and ratified by the National People’s Congress the following spring. The Plan broadens China’s development policy beyond simply promoting rapid economic growth to include a clear emphasis on “common prosperity” – an effort to extend westward the economic gains enjoyed principally in China’s east coast urban areas. The Plan seeks to address the twin problems of an economy perceived as being too dependent on external demand and the social consequences of the widening wealth gap by, among other things: 1) maintaining high rates of growth and job creation; 2) pursuing a structural shift in production from industry to services; and, 3) promoting the development of domestic consumer demand.

As part of the policy of promoting social equality by way of more even distribution of wealth, the Plan also envisions moving hundreds of millions of rural peasants to urban centers. To achieve such an ambitious social engineering objective without creating mass urban unemployment and homelessness, China will need to create tens of millions of jobs each year for decades.

Such fundamental macroeconomic adjustments present enormous challenges. Government subsidization of energy, land, and other resources continues to encourage investment in fixed assets. Indeed, recent analyses by the World Bank show that while China’s economy grew by 11.9 percent in 2007 and 10.6 percent in the first half of 2008, growth has continued “along familiar, largely imbalanced patterns,” with the growth in fixed investment outpacing the growth in consumption, and the growth in industrial production surpassing the growth in services. “These developments suggest that the measures taken so far to rebalance economic growth away from investment and industry to consumption and services have not yet had a noticeable effect,” the Bank reported.

Activating the Chinese consumer will also prove challenging. Chinese households historically save as much as half of their income as compared to single-digit savings rates in the United States and Europe. This pronounced propensity to save is related to the declining role of the state and the fact that most Chinese depend on their families and private savings to pay for retirement, healthcare, and the economic consequences of accidents or disasters. The Five-Year Plan calls for the establishment of a social safety net – from universal social security and medical care, to insurance schemes for unemployment and labor accidents – but such programs remain at the planning stage.

The critical importance of a modern and effective financial system to the achievement of China’s ambitious economic goals is clear. Creating tens of millions of new jobs each year requires maintaining exceptional rates of economic growth, which in turn will increasingly depend on an effective system for mobilizing and productively allocating investment capital. At present, China’s weak banking system intermediates more than three-quarters of the economy’s total capital, compared to about half in other emerging economies and less than 20 percent in

developed economies. Despite some improvements in recent years, China's banks remain undercapitalized, profitability remains weak, and banks' credit analysis, loan pricing, risk management, internal controls, and corporate governance practices remain inadequate. A major obstacle to better lending based on rigorous and impartial analysis has been the lack of a national credit information service to provide the information necessary for banks to competently evaluate individual loan applicants.

Meanwhile, China's equity and bond markets are among the smallest and least developed in the world. More fully developed capital markets would provide healthy competition to banks and facilitate the development and growth of alternative retail savings products such as mutual funds, pensions, and life insurance products. And by broadening the range of funding alternatives for emerging companies, more developed capital markets would greatly enhance the flexibility and, therefore, the stability of the Chinese economy.

Achieving the desired transition to a more services-based economy will require that competitively priced capital and credit be channeled to the most promising emerging service businesses, and that the array of financial products and services emerging businesses require – loans, letters of credit, accounts management services, asset management, and insurance products – be made available. At present, state-owned enterprises, though contributing only a quarter of China's GDP, receive more than a third of bank credit and account for nearly all equity and bond issues. Private enterprises, the most productive of China's economy and the engine of future growth and job creation, account for only 30 percent of bank loan balances. More developed capital markets would enhance access to bank capital for smaller businesses and consumers – banks' natural customer base – who are too often crowded out by large companies forced to rely on banks for funding.

Finally, increasing domestic demand by activating the Chinese consumer requires the availability of financial products and services – personal loans, credit cards, mortgages, pensions, insurance products, and insurance intermediary services – that will eliminate the need for precautionary savings and facilitate consumption. Some 600 million Chinese now use cell-phones, but less than a few million currently have a credit card. The WTO's 2008 Trade Policy Review of China noted that “despite the banks' recent push towards retail lending, manufacturing and real estate...remain among the largest exposures.”

In sum, a more modern, open, and competitive financial system would greatly enhance the productive capacity and stability of the Chinese economy and facilitate the achievement of China's economic goals, as described in the 11th Five-Year Plan. Research conducted by McKinsey indicates that genuine reform of its financial system would expand China's economic output by as much as 17 percent, or an additional \$320 billion a year.

Liberalization of China's Financial System Important for the U.S. Economy

Given that a stronger, more sophisticated and resilient financial system is a prerequisite to China's continued economic development, such reform is very much in the interest of the United States. Fair and competitive access to China's fast-growing middle class and business sector represents an enormous commercial opportunity for American manufacturers, farmers, and service providers, with major implications for U.S. economic growth and job creation.

Moreover, as Secretary Paulson noted during his confirmation testimony in July of 2006 and again the following September in announcing the SED, a more modern and competitive Chinese financial system would help improve important aspects of U.S.-China bilateral relationship. For example, a reason frequently cited by Chinese authorities to resist further flexibility in the exchange rate – not the cause of the trade imbalance, but certainly an aggravating factor – is the lack of expertise on the part of China’s banks, securities firms, and other businesses to develop and trade derivatives and other structured instruments used to hedge the risk associated with great currency volatility. The ability of foreign financial services firms to strengthen such expertise in China would clearly diminish those concerns. Answering a question at the September 21, 2006 press conference in Beijing regarding his notion of a “flexible exchange rate regime” for China, Secretary Paulson stated: “It is an exchange rate where the currency’s value is set in the competitive marketplace. We’re not going to be able to get there until we get China to the point where they have capital markets that are really competitive in an open financial system.”

In addition, successful adjustment of China’s economy toward the production of services, and the activation of the Chinese consumer by reducing precautionary savings – goals that, as stated above, require a more developed, effective, and diverse financial sector – are critical to successfully addressing the bilateral trade imbalance. If China’s economy continues to grow and diversify, and if China’s citizens enjoy increasing access to a wider range of modern financial products and services that help to eliminate the need for such “precautionary savings,” China’s 1.3 billion potential consumers will begin to consume at more normal levels, with profound implications for global economic growth and job creation, as the following comparison demonstrates:

Last year, the United States exported to Japan goods and services worth \$63 billion – about the same exported to China (\$65 billion). But China’s population of 1.3 billion is *ten times* Japan’s population of 127 million. In per capita terms, therefore, China consumed one-tenth the amount of American goods and services as Japan. If China’s citizens were to eventually consume American-made goods and services at the same rate that Japan’s citizens did last year, the United States would export more than \$600 billion worth of goods and services to China, 11 times what America exported to China last year, an amount equivalent to 5 percent of America’s GDP, and more than twice what we imported from China last year – replacing the trade deficit with a significant surplus.

China Has Accomplished Much – But Has Much More to Do

Under the terms of its December 2001 WTO accession, China committed to implement a set of sweeping reforms that required the lowering of barriers to trade in virtually every sector of its economy, progressively increased market access, national treatment, and regulatory transparency. The five-year phase-in period for these commitments ended on December 1, 2006. Fulfilling these commitments has required nothing short of a wholesale institutional transformation of China’s economy and the relationship between government and major industries – a transformation that has been complex, challenging, expensive, even painful, and that has no comparison in American history.

In addition to working to meet its WTO commitments, China has taken important steps to liberalize the financial sector and improve financial regulation. For example:

- the financial sector has been transformed from a single-bank system to a more diversified system with a central bank at the helm;
- meaningful steps have been taken to reduce state-directed “policy” lending, and the enactment of, and subsequent amendments to, the Law on Commercial Banks and the Law on the Peoples Bank of China have laid the foundations for commercially viable lending;
- since 1998, China has injected \$93 billion in public money into the large state-owned banks and is reported to be planning \$60 billion in additional injections – amounting, in total, to the largest recapitalization of any national banking system in history;
- the China Banking Regulatory Commission (CBRC) was established in April of 2003 to oversee all banks in China, investigate illegal banking operations, and punish violations of law; and,
- interbank, equity, and foreign exchange markets have been established and important progress made in the use of indirect means of monetary policy.

Additional progress has been achieved by way of the SED, including:

- China has agreed to allow qualified foreign companies to list on its stock exchanges by issuing shares or depository receipts;
- China has expanded its Qualified Foreign Institutional Investor (QFII) program and reduced the initial “lock-up period” for certain investors, creating new opportunities for foreign mutual funds and money managers to invest in China;
- China has agreed to allow, on a pilot project basis, non-deposit taking foreign financial institutions to provide consumer financing;
- China has agreed to ease qualifications for foreign incorporated banks to issue yuan-denominated subordinated bonds, which will allow foreign banks to raise capital in China;
- China has issued regulations specifying requirements to allow insurance companies – including foreign-owned companies – to invest assets overseas; and,
- The yuan has appreciated against the U.S. dollar by more than 20 percent since July of 2005, and the rate of appreciation has accelerated from 3.4 percent in 2006, to 6.9 percent in 2007, to 14.6 percent in 2008.

Despite these achievements, China's financial sector still faces serious challenges:

- though reduced, non-commercial and policy lending by Chinese banks continues – the Law on Commercial Banks requires banks to take into consideration “the needs of the national economic and social development” and to follow the “guidance of the industrial policies of the State”;
- the stock of nonperforming loans on banks' balance sheets remains high;
- banks remain undercapitalized and lending practices, risk management techniques, new product development, internal controls, and corporate governance practices remain inadequate;
- prudential supervision and regulation of the financial sector is opaque, applied inconsistently, and lags behind international best practices; and,
- despite rapid growth in recent years, China's equity and bond markets remain small and underdeveloped.

The fastest and most effective way for China to address the remaining deficiencies of its financial sector is to permit greater foreign participation. At the Beijing press conference announcing the establishment of the SED on September 21, 2006, Treasury Secretary Paulson stated:

“I am a very strong advocate of [China] opening up its capital markets to foreign investment. I believe that when they open up and let foreign competition in, the biggest beneficiary will be China, and it will mean more jobs in the financial services industry for the Chinese people. It will mean better training. It will mean more competitive capital markets that will have all sorts of other benefits for the economy...I can't think of a single example anywhere of a situation where a country has a strong capital market system and they haven't opened themselves up to competition.”

Foreign institutions bring world-class expertise and best practices with regard to products and services, credit analysis, risk management, internal controls, and corporate governance. In addition, the competition brought by foreign institutions would accelerate the adoption of such techniques and methodologies by domestic financial institutions. But significant regulatory and procedural barriers continue to impede greater foreign participation in China's financial sector.

Significant Barriers to Foreign Investment

Foreign investors in Chinese banks remain limited to 20 percent ownership stakes, with total foreign investment limited to 25 percent. Foreign ownership currently amounts to less than 2 percent of the Chinese banking system. Foreign-owned securities firms are limited to joint-ventures in which foreign ownership is capped at 33 percent, and foreign asset management

operations are limited to 49 percent participation in joint ventures. In December of 2005, the China Securities Regulatory Commission (CSRC) imposed a de facto moratorium on foreign investments in Chinese securities firms, a violation of both the letter and the spirit of China's WTO commitments. China lifted the moratorium in December of 2007, but only one foreign application – that of Credit Suisse, on the eve of the most recent SED meetings in June – has been granted. Meanwhile, foreign life insurance companies remain limited to 50 percent ownership in joint ventures and to 25 percent equity ownership of existing domestic companies.

Studies of the caps on foreign investment in the banking and securities sectors are currently underway at the CBRC and CSRC, but final reports are not expected until December at the earliest. Moreover, because raising or eliminating the caps is a political decision, the agencies' willingness to study the issue cannot be interpreted as necessarily indicating an impending change.

Discriminatory Treatment Regarding Licensing and Corporate Form

Efficient deployment of the capital and other resources of foreign financial institutions in any market requires the flexibility to determine which particular corporate reform – whether a wholly-owned subsidiary, branch, representative office, joint venture, or majority equity investment in an existing company – is most appropriate economically and within the broader strategic parameters of the foreign institution. Restrictions on corporate form can discourage foreign financial institutions from initiating business activities in China and can complicate the successful operation of investments that are made.

China requires foreign banks to incorporate locally with minimum capitalization of 1 billion yuan (\$120 million) and an additional one hundred million yuan for each branch. Foreign banks wishing to establish a subsidiary in China must have total assets of at least \$10 billion and must have maintained a representative office in China for at least two years prior to application. Foreign banks wishing to establish a branch must have total assets of at least \$20 billion, and must have maintained a representative office for at least two years in the area where it applies to establish the branch. China has similarly promulgated a fixed minimum capital requirement of 500 million yuan (\$60 million) for foreign securities and asset management firms wishing to participate in joint ventures. Foreign insurance companies seeking license to operate in China must have no less than 30 years of experience in the insurance business, must have maintained a representative office in China for no less than two years, must have no less than \$5 billion in total assets, and must commit no less than 200 million yuan (\$25 million) in operating capital. Such licensing requirements and restrictions across financial sectors preclude smaller foreign entrants, reduce the overall attractiveness of the joint venture vehicle, and discourage foreign direct investment in China overall.

Regulatory and Supervisory Discrimination

Foreign financial institutions operating in China continue to be subject to special, non-prudential – at times discriminatory – regulation and supervision. As mentioned above, foreign banks are required to incorporate locally before branching. Chinese authorities have also been slow to act on foreign banks' applications and permit foreign banks to open only one branch

every 12 months. Regulations continue to require three years of operation and two continuous years of profitability before foreign banks' branches are permitted to carry out local currency business. A portion of foreign banks' branch capital must be deposited in Chinese banks, and foreign banks remain subject to minimum interest rate rules when borrowing from Chinese banks. Most problematic, the 75 percent loan-to-deposit cap discriminates against foreign banks because their small number of branches – made worse by a slow approval process – limits foreign banks' deposit base. Chinese borrowers are prohibited from converting foreign currency loans into local currency, and local currency borrowers are not permitted to use stand-by letters of credit denominated in foreign currency.

On the securities side, foreign minority-owned joint ventures are limited to underwriting the A-shares (yuan-denominated, domestically traded) of Chinese corporations, and to underwriting and trading government debt, corporate debt, B-shares (U.S. dollar-denominated) and H-shares (listed and traded in Hong Kong). Trading in A-shares – the most liquid domestic market – by foreign joint ventures is generally prohibited, which significantly compromises their underwriting business. Foreign entities are also restricted in many cases from trading yuan and yuan-linked products with foreign and domestic enterprises in China. Without the ability to trade local currency, any progress otherwise achieved in expanding the permitted activities of foreign securities firms is difficult to realize competitively. CSRC regulations also continue to prohibit foreign securities firms from marketing derivative products and services.

With regard to insurance, Chinese authorities continue to approve new branches of foreign insurance firms only on a consecutive basis rather than concurrently. China's authorities have yet to approve the marketing of political risk insurance products or to provide adequate tax treatment for defined contribution pension products or producer commissions to encourage the sale of sophisticated commercial insurance products. Regarding China's recently created defined contribution pension system ("enterprise annuities"), licensing procedures have not been clearly defined after three years and no foreign company has been authorized to be a provider. Many foreign insurance companies, under pressure from Chinese authorities to do so, have sought to convert branches to subsidiaries – but the approval period, which is supposed to be no more than 60 days, often stretches beyond a year.

Lack of Regulatory and Procedural Transparency

Related to the issue of discriminatory regulatory and supervisory treatment, China continues to lag global standards regarding the critical issue of regulatory and supervisory transparency. Fair and transparent regulation plays an integral role in the development of deep and liquid capital markets that attract market participants, increase efficiency, and spur economic growth and job creation. Transparency generally means that industry participants and the broader public have the opportunity to participate in the rule-making process, to access information about proposed rules, to question and understand the rationale behind draft rules, to have sufficient opportunity to review and comment on proposed rules, and that final rules and regulations be clearly articulated and easily understood.

Unfortunately, regulatory ambiguity continues in China and administrative procedures and the rule-making process continue to be inconsistent and unnecessarily opaque. New regulatory guidelines are too often promulgated without notice or consultation with the industry.

Even when industry consultation has been sought, the response period has often been insufficient, sometimes only a few days. While China has agreed to publish the laws and regulations governing financial services as its WTO accession protocol requires, it has not committed to all of the essential elements of modern regulatory transparency, including advance notice of new rules or rule changes, public comment, and the right to judicial review.

Stones Across the Rushing Stream

With these problems in mind, accelerated reform of China's financial system should focus on:

- the critical importance of open commercial banking, securities, insurance, pension, and asset management markets to promoting the services- and consumption-led economic growth that China's leaders seek;
- the clear benefits to China of increased market access for foreign financial services firms – namely the introduction of world-class expertise, technology, and best practices – and the importance of removing remaining obstacles to greater access;
- non-discriminatory national treatment with regard to licensing, corporate form, and permitted products and services;
- non-discriminatory national treatment with regard to regulation and supervision;
- regulatory and procedural transparency; and,
- attracting sophisticated institutional investors to China's capital markets through the further expansion of the Qualified Foreign Institutional Investor (QFII) and Qualified Domestic Institutional Investor (QDII) programs.

Conclusion

China's membership in the WTO beginning in December of 2001 was the culmination of more than 25 years of political and economic engagement by the United States. But the work to help China integrate into the global economy is not finished. Indeed, in a very real sense, only the easy part is over.

Following the close of China's transition period as a new member of the WTO, U.S. policy should move beyond the monitoring of China's compliance with a discrete set of specific obligations to a policy that seeks more proactive cooperation in an increasingly dynamic relationship. The aim of such policy should be to ensure that China participates fully and constructively as a mature and responsible stakeholder in the global economy from which it has benefited so profoundly. Accelerated reform and modernization of China's underdeveloped financial sector is a crucial key to China's achievement of its own ambitious economic goals – and to a more balanced, equitable, and durable bilateral relationship with the United States.