

Executive Summary

Why is Financial Sector Reform in China So Important?

- Achieving China's economic goals – maintaining exceptional rates of growth, creating millions of new jobs each year, successfully transitioning from a manufacturing-for-export economic model to a more services-based economy, and activating the Chinese consumer – depends on an effective system for mobilizing investment capital. At present, China's banking system is weak and its capital markets are small and underdeveloped.
- A more effective, efficient, and transparent financial sector in China is also a prerequisite to successfully addressing issues that have complicated the U.S.-China economic relationship, particularly further currency reform and meaningfully reducing the trade imbalance.
- The fastest way for China to acquire the modern financial system it needs to continue growing, enable a more flexible currency, and activate the Chinese consumer is to import it – that is, by opening its financial sector to greater participation by foreign financial services firms. Foreign institutions bring world-class expertise and best practices with regard to products and services, technology, 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.

Will Reform of China's Financial Sector Help American Workers?

- Fair and competitive access to China's fast-growing middle class and business sector represents an unprecedented commercial opportunity for U.S. manufacturers, farmers, and services providers, with profound implications for U.S. economic growth and job creation. But to continue growing, China desperately needs a more open, competitive, and effective financial system.
- Over the last four years the United States and China have accounted for half of global economic growth – and that already stunning figure will only increase in coming years. Since China's accession to the World Trade Organization (WTO) in December of 2001, trade between the United States and China has nearly tripled, exports to China have grown at five times the pace of U.S. exports to the rest of the world, and China has risen from our 9th largest export market to our 4th largest.
- Last year, the United States exported to Japan goods and services worth \$60 billion – approximately the same amount exported to China (\$55 billion). But China's population of 1.3 billion is ten times Japan's population of 127 million. If U.S. exports are expressed in relation to population, the U.S. sold the equivalent of \$472 worth of goods and services to every citizen of Japan last year, but only about \$40 worth of goods and services to every Chinese citizen. 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 \$610 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 it imported from China last year – replacing the trade deficit with a significant surplus.

How Will Reform of China's Financial Sector Help Its Citizens?

- To avoid mass unemployment and homelessness, China's economy must create millions of new jobs each year, which requires maintaining exceptional rates of economic growth – which in turn depends on an effective system for mobilizing investment capital.
- Achieving China's 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.
- Increasing domestic demand by activating the Chinese consumer will require 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 such “precautionary savings” and facilitate consumption. As but one example of the potential impact of modern financial products, of China's 1.3 billion people, 480 million use cell-phones, but only an estimated 1 million currently have a credit card.
- 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 – with major implications for job creation and income growth in China.¹

¹ See “Putting China's Capital to Work: The Value of Financial System Reform,” by Diana Farrell, Susan Lund, and Fabrice Morin, The McKinsey Global Institute, May 2006.