Growth and Income Distribution Policies Drive China's Financial and Capital Market Reforms

Eiichi Sekine
Chief Representative, Beijing Representative Office
Nomura Institute of Capital Markets Research

I. Change to a new growth model still accelerating

1. The new leadership inherits core policies for managing the economy

The Chinese Communist Party held its 18th National Congress in November 2012 and transitioned to a new set of leaders. China changed its growth model with the 12th Five-year Plan covering 2011 to 2015, a change that was also noted in President Hu Jintao's keynote speech at the National Party Congress. CCP General Secretary Xi Jinping and First Vice Prime Minister Li Keqiang were newly chosen to join the Politburo Standing Committee, and with both involved in drafting the 18th Five-year plan, the new leadership appears set to continue with these core policies for managing the economy.

The keynote speech (actually called a "report") was particularly notable in that it called for a doubling relative to 2010 of both GDP and per capita income by 2020, which equates to average annual growth of 7% over the 10-year period. The policies proposed for achieving that as well as for accelerating the change in China's growth model included (1) a comprehensive deepening of economic reforms, (2) implementation of development strategies that spark innovation, (3) promoting strategic structural economic adjustments, (4) promoting the integration of urban and rural development, and (5) comprehensively raising the openness of the economy.

Of these, the promotion of strategic structural economic adjustments included the speedy establishment of effective mechanisms for the long-term growth of consumption demand and substantial development of the services sector, particularly modern services.

2. International comparisons relevant to the change in growth model

China proposed changing its growth model in response to the global financial crisis of 2008, which exposed the limits of economic development driven by external demand (exports) and investment. China will thus transition to a growth model driven by domestic demand (consumption) and services, although China's current economic structure dictates that this transition be phased in. This is happening, as made clear by a comparison of the economic structures of the world's three largest economies: the US, China, and Japan.

Looking first at consumption (private-sector final consumption spending) as a share of GDP, in 2010 that share was 70.9% in the US, 35.0% in China, and 59.1% in Japan (Figure 1). China's economy overtook Japan's in overall size in 2010, when the respective GDP figures were $14.5 trillion for the US, $5.9 trillion for China, and $5.5 trillion for Japan (based on statistics dated 9 October 2012 from the International Monetary Fund (IMF)). Nevertheless, China's investment (total capital formation) as a share of GDP in 2010 was 49.3%, significantly higher than that for Japan or the US. Likewise, exports (gross) accounted for 27.0% of China's GDP, nearly double the 15.2% figure for Japan that causes it to be deemed overly dependent on external demand. Although China's private-sector consumption grew by a factor of 3.6X over a 10-year period, from $553.9 billion in 2000 to $2.0105 trillion in 2010, it needs to grow considerably more as a share of GDP, and this necessitates changing the growth model.

Looking next at the services sector (narrowly defined) as a share of GDP, that share was 57.9% in the US, 27.3% in China, and 51.8% in Japan (Figure 2). Whether using that measure or a broader definition of services that includes construction, wholesale and retail trade, transportation, and telecommunications, China clearly needs to develop its services sector.

Figure 1: Composition of expenditure-based gross domestic product (GDP) in 1990, 2000, and 2010

(Units: US$ millions)

Country	Year	GDP (expenditure approach)	Government final consumption spending	(Share)	Private sector final consumption spending	(Share)	Total capital formation	(Share)	Goods and services exports	(Share)	(minus) Goods and services imports
Japan	1990	3,058,038	407,652	13.3%	1,620,967	53.0%	1,000,597	32.7%	316,751	10.4%	287,929
	2000	4,667,448	788,209	16.9%	2,623,959	56.2%	1,187,398	25.4%	512,742	11.0%	444,859
	2010	5,458,873	1,094,349	20.0%	3,225,629	59.1%	1,101,137	20.2%	830,620	15.2%	768,048
US	1990	5,754,800	980,500	17.0%	3,835,400	66.6%	1,016,500	17.7%	552,100	9.6%	629,700
	2000	9,898,800	1,413,700	14.3%	6,830,400	69.0%	2,036,700	20.6%	1,093,200	11.0%	1,475,300
	2010	14,447,100	2,522,700	17.5%	10,245,500	70.9%	2,195,700	15.2%	1,839,800	12.7%	2,356,700
China	1990	404,494	55,185	13.6%	197,585	48.8%	141,056	34.9%	62,733	15.5%	52,065
	2000	1,192,836	189,182	15.9%	553,900	46.4%	420,883	35.3%	279,557	23.4%	250,684
	2010	5,739,358	750,243	13.1%	2,010,504	35.0%	2,831,350	49.3%	1,547,943	27.0%	1,317,524

Note: Underlying data comes from the United Nations (dated 7 June 2012).
Source: Nomura Institute of Capital Markets Research, based on *Sekai Kokusei Zue* 2012/13 (Graphical world databook 2012/13) (in Japanese)

Figure 2: Breakdown of nominal GDP by industry activity in 2000 and 2010

	Japan				US				China			
	2000		2010		2000		2010		2000		2010	
	Amount ($ millions)	Share (%)	Amount ($ millions)	Share (%)	Amount ($ millions)	Share (%)	Amount ($ millions)	Share (%)	Amount ($ millions)	Share (%)	Amount ($ millions)	Share (%)
Agriculture, hunting, forestry; fishing	82,548	1.70	77,535	1.39	95,600	0.97	153,653	1.05	180,524	15.06	598,706	10.10
Mining and industry	1,165,886	24.02	1,198,311	21.41	1,798,700	18.17	2,385,168	16.33	483,587	40.35	2,410,987	40.69
of which Manufacturing	1,034,092	21.31	1,083,966	19.37	1,515,900	15.31	1,855,967	12.71	-	-	1,922,666	-
Construction	344,542	7.10	332,147	5.94	467,300	4.72	635,662	4.35	66,706	5.57	359,671	6.07
Wholesale, retail trade	655,689	13.51	731,659	13.07	1,586,900	16.03	2,142,495	14.67	124,478	10.39	623,325	10.52
Transport and communications	323,117	6.66	360,397	6.44	621,500	6.28	830,266	5.69	74,422	6.21	314,194	5.30
Services	2,281,140	47.01	2,895,825	51.75	5,328,900	53.83	8,454,403	57.90	268,747	22.42	1,619,055	27.32
Industry total	4,852,922	100.00	5,595,874	100.00	9,898,900	100.00	14,601,646	100.00	1,198,464	100.00	5,925,939	100.00

Note: Underlying data comes from the United Nations (dated 7 June 2012).
Source: Nomura Institute of Capital Markets Research, based on *Sekai Kokusei Zue* 2012/13 (Graphical world databook 2012/13) (in Japanese)

3. Reform, the buzzword in domestic politics

Increasing consumption will require further development of the services sector as well as reform of the mechanisms of income distribution. To achieve the former, it is essential that corporate taxes be reduced, regulations be eased, and incentives for growth be increased. To achieve the latter, it is essential to ameliorate worries about the future by providing social welfare with a pension and healthcare, while raising labor's relative share of the economy by increasing the share of corporate value added that companies distribute to their employees.

Given the limits to what can be done individually with these reforms, when President Xi visited Guangdong Province and Shenzhen on December 7-11, he emphasized the systemic, overall, and cooperative nature of reforms, arguing that both a top-down plan and an overall plan must be put together in order to deepen comprehensive reforms. At the Central Economic Work Conference held by the CCP Central Committee and the State Council on 15-16 December 2012, it was formally decided to begin work on creating reform plans. Moreover, it was agreed that clearly laying out an overall proposal, road map, and timeline for reform was essential.

We surmise from the way previous leadership changes have been handled in China that a plan focused on reform is likely to be devised in time for the Central Committee's Third Plenum, which is expected to be held in the fall of 2013, roughly a year after the National Party Congress. At a meeting of representatives from the 11 pilot provinces and cities for reform, held on 21 November 2012 immediately after the National Party Congress ended, then Vice Premier Li said that "reform is a major bonus for China," thus making it clear that reform is the centerpiece of China's domestic policy agenda.

II. Measures to further develop the services sector

While the overall plan for reform will have to wait until the Central Committee holds its Third Plenum, measures promoting reform of the services sector aimed at transforming China's growth model by 2015 are already being rolled out.

1. Promoting the financial sector

One component within the services sector is promotion of the financial sector. On 17 September 2012, China's State Council (cabinet) announced its 12th Five-Year Plan for the Development and Reform of the Financial Industry (hereinafter Financial Sector Reform Plan)[1]. This plan was devised by five financial regulators: the People's Bank of China, the China Banking Regulatory Commission (CBRC), the China Securities Regulatory Commission (CSRC), the China Insurance Regulatory Commission (CIRC), and the State Administration of Foreign Exchange (SAFE).

It comprises nine chapters, and proposes two numerical targets for China's financial industry to achieve during the 2011–2015 time frame covered by the 12th Five-Year Plans. The first target is to raise the financial sector's share of GDP to at least 5% or so, and the second is to raise the share of total social financing (fund raising in the real economy) accounted for by direct financing (stock or bond issuance) by nonfinancial corporations to at least 15% by the end of 2015.

2. Further development of the entire services sector

Another component is development of the entire services sector. On 12 December 2012, China's State Council (cabinet) announced its 12th Five-Year Plan for Developing the Service Industry (hereinafter the Services Development Plan).

This plan comprises six chapters and proposes two numerical targets for China's services industry to achieve by 2015. The first of these is to raise the service sector's share of GDP 4 percentage points by end-2015 relative to 2010. The second is to raise the service sector's share of total employment 4 percentage points by end-2015 relative to 2010. Looking first at the former, given that it took 10 years to raise the narrowly defined services sector's share of GDP by approximately 5 percentage points, from 22.4% in 2000 to 27.3% in 2010 (Figure 2 above), the plan is targeting nearly a doubling of the service sector's rate of growth over the five-year period from 2010.

The services development plan, while putting the onus of services promotion on market-oriented, self-directed activities, calls for local governments to get involved by creating plans for developing services in their jurisdictions, proposing relevant policies, determining the division of responsibility with other government agencies, including at the central government level, devising guidance for each subsector, and implementing measures related to government spending and taxation, financing, land,

[1] See Eiichi Sekine, "Program for reforming China's financial sector by 2015 announced." Winter 2013 edition, Nomura Journal of Capital Markets.

prices, managing negotiations, and quality oversight and inspection. The National Development and Reform Commission will monitor and assess implementation of the services development plan and report to the State Council.

3. Financial components of the services development plan

The services development plan divides the services that it promotes into four different categories: production services, lifestyle services, agricultural services, and marine services. It sets the following targets for financial services, which are in the production services category.

1) Development targets for financial services

During the period covered by the 12th Five-Year plan (2011-2015), raise the overall level of financial services, effectively prevent and cope with systemic risk, and strengthen the framework for macroprudential policies on the finance side.

In addition, build a safe, sound, and modern financial services system that is profitable and capable of providing well-functioning and efficient services, with a rational division of responsibility and orderly competition, thereby further contributing to the real economy.

2) Sector-specific development targets

(1) Financial markets and the banking sector

(i) Enhance the building of a financial market system and develop and innovate orderly financial institutions, financial products, and financial services so as to optimize the social financing structure.

(ii) Enhance the ability of large financial institutions to provide comprehensive services. Proactively develop small and medium financial institutions that provide services to small businesses and micro enterprises. Encourage policy banks, large commercial banks, joint stock commercial banks, small and medium-sized banks, and asset management companies to implement development strategies with an edge.

(iii) Encourage financial services to become more specialized, more focused on strengths, more detailed, and better branded. Substantially improve the financial services offered to agricultural businesses, rural areas, and farmers as well as to small businesses and micro enterprises.

(iv) Enhance the asset management and funding capabilities of such services as trust loans, securities, insurance, trusts, money management, and guarantees.

(2) Capital markets

(i) Substantially develop capital markets, make the capital market system more diverse, and promote the building of a nationwide OTC market.

(ii) Expedite the development of bond markets and improve product classifications for commodity futures and financial futures.

(3) Insurance market

(i) Give full play to the role and function of insurance, and proactively develop liability insurance and credit insurance. Consider and create policies to support casualty insurance.

(ii) Innovate methods of selling insurance, promote the development of small insurance companies with niche strengths, develop an insurance brokerage market, and build a market for reinsurance.

(4) Financial institution management and safety nets

(i) Improve rules for modern financial institutions while strengthening corporate governance and risk management.

(ii) Increase the scientificness, applicability, and predictability of regulatory oversight and ensure the safe and sound operation of financial businesses.

(iii) Strengthen the core capabilities and structure of the financial services sector, including financial laws and regulations, payment and settlement, credit, and the prevention of money laundering.

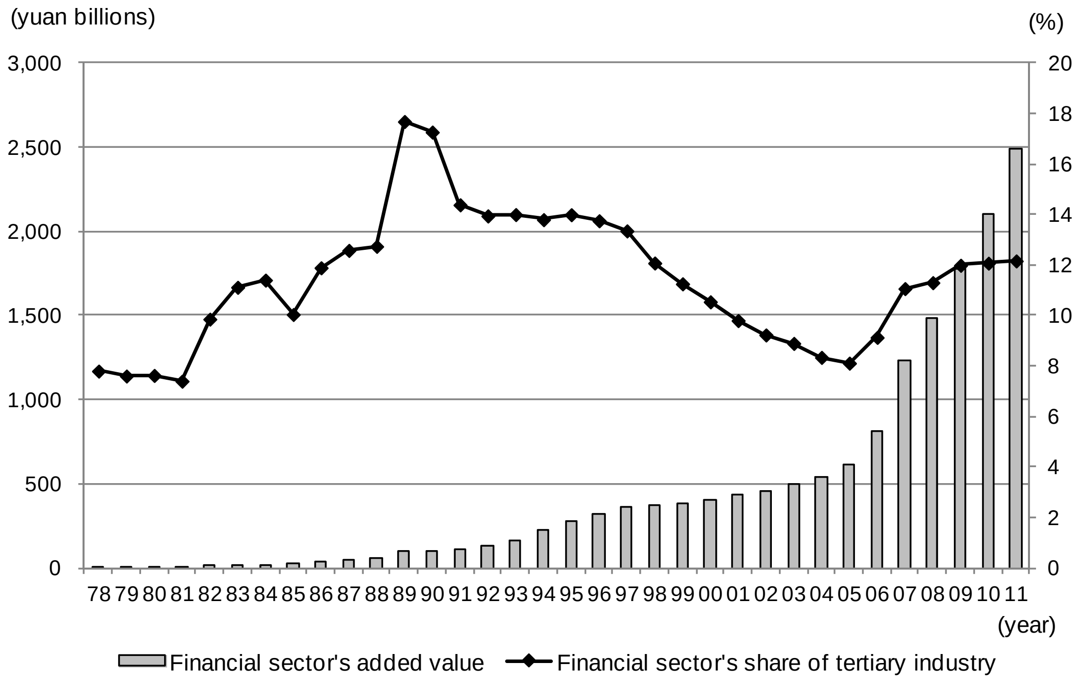
(iv) Build and strengthen systems and mechanisms for preventing, assessing, and dealing with financial systemic risk. Strengthen the oversight of systemically important financial institutions.

4. History of the development of China's financial sector

According to the National Bureau of Statistics of China, over the more than 30 years since China began its open-door policy, the value added by the financial sector increased from 6.8 billion yuan in 1978 to 2.4958 trillion yuan in 2011 (Figure 3).

Meanwhile, the financial sector's share of tertiary industry increased from 7.8% in 1978 to 17.7% in 1988 when the economy became overheated, but after that it followed a declining trend, down to 8.1% in 2005. Although it had recovered to 12.2% in 2011, its rate of increase has been close to zero since 2009. Promotion of the financial sector via the two five-year promotion plans (one for the financial sector and one for the services sector) has become an urgent issue.

Figure 3: Value added in China's financial sector



Source: Nomura Institute of Capital Markets Research, based on the China Statistical Yearbook 2012

III. Leveraging financial and capital markets in income distribution policies

In order to expedite the change in growth model as well as further develop the services sector, China's government decided at its 18th National Party Congress to push for income distribution reform, and it is starting to implement specific policies to that end.

1. Announcement of income distribution reforms

On 3 February 2013, the State Council announced its Several Opinions on Deepening Reform of the Income Distribution System, which was drafted jointly by the National Development and Reform Commission, the Ministry of Finance, and the Ministry of Human Resources and Social Security, and sent the document as instructions to the different ministries within the central government.

The income distribution reform opinions noted that although China had basically built a system of income distribution that matched China's state of affairs and level of development since implementing the reform and open-door policy in 1978, there are a number of problems with the system, including the long-standing large gaps in development between urban and rural areas and in the distribution of income between individuals, the lack of a systematic blueprint for income distribution, the problem of under-the-table and illegal income, and the impoverished living conditions of a portion of the population.

Based on an approach of adjusting the still developing income distribution structure while making efforts to create an open, fair, and just system and environment, it sets the primary goals of (1) doubling the incomes of urban and rural residents (as called for at the 18th National Party Congress), (2) gradually narrowing the income distribution gap, (3) making visible improvement in the orderliness of income distribution, and (4) rationalizing the structure of income distribution.

2. Two methods of adjusting income distribution

The income distribution reform opinions proposed two ways of adjusting income distribution so as to achieve those goals. The first it defined as improving initial income distribution by ensuring that income is distributed according to the contributions of the respective elements: labor, capital, technology, and management. The second it defined as making the redistribution system more sound through such mechanisms as taxation, social security, and transfer payments.

Policies for adjusting the initial income distribution proposed in the Opinions include (1) promoting equal opportunity for employment, (2) improving the trade skills of workers, (3) reasonable wage hikes for low- and middle-income workers, (4) strengthening controls over executive compensation at state-owned enterprises, (5) optimizing compensation systems at the government agency and business unit level, (6) improving the system of wages and compensation for highly skilled workers, (7) increasing individuals' income from assets through a variety of channels, (8) improving the system for distributing the profits of state-owned enterprises to the government, and (9) improving the system for using and allocating profit from public resources.

Likewise, the policies it proposes for making the income redistribution system more sound are (1) increasing government spending aimed at ensuring and improving public welfare, (2) strengthening and promoting equality of education, (3) making further adjustments to personal income tax, (4) reforming and improving real estate taxes (fixed asset taxes), (5) improving the basic endowment insurance system, (6) accelerating efforts to make the national healthcare insurance more sound, (7) increasing the supply of public housing, (8) increasing subsidies and assistance to the disabled, and (9) developing charitable businesses.

3. Linking income distribution reform with financial and capital market reform

The income distribution opinions also proposed increasing farmer incomes, promoting the formation of an open, transparent, fair, and rational income distribution order, and strengthening organizational guidance on deepening income distribution reforms. In the area of strengthening guidance, it put a particularly big emphasis on the need to organically link and coordinate income distribution reforms with reforms in relevant sectors, including of state owned enterprises, government administration, taxation and fiscal policies, and the financial system.

As noted earlier, income distribution reforms are closely intertwined and inseparable from financial and capital market reforms in China, given that improving primary income distribution includes increasing individuals' income from assets, while putting income redistribution on a sounder footing includes improving basic endowment insurance (i.e., the public pension program). The specific direction of these reforms is as follows.

4. Increasing individuals' income from assets through various channels

1) The direction shown in the opinions on income distribution reform

(i) Expedite the development of diverse capital markets, steadily implement a system of dividends for listed companies, strengthen regulatory oversight tools, and protect the legitimate rights of investors (particularly smaller investors and individual investors).

(ii) Promote reforms toward market-based (deregulated) interest rates, appropriately widen the fluctuation band for deposit rates, and protect depositor rights.

(iii) Strictly control banks' ability to collect (illegal) small fees.

(iv) Make such mutual fund products as bond funds and money market funds more abundant.

(v) Support the introduction of employee stock ownership plans for qualified companies.

(vi) Open up routes for the people to increase their income via rent, interest, and dividends.

2) Conditions specific to China

Of the above, "development of diverse capital markets" means to provide multiple levels of funding markets, such as the main board, a venture exchange, and an OTC market, depending on the company's growth stage. The reason for strengthening controls on the banks' ability to collect small fees is that the banks have been caught illegally charging loan applicants fees that they referred to as consulting fees.

5. Improving basic endowment insurance

1) The direction shown in the opinions on income distribution reform

(i) Comprehensive pooling of both administration and investment of the basic endowment insurance of urban employees at the provincial government level, and achieve pooling of the basic pension at the national level by the end of the 12th five-year plan (end-2015).

(ii) Promote reform by category of pension insurance at the business unit level (at government-affiliated institutions) while also researching and advancing reform of pension insurance for government employees.

(iii) Increase the pension participation rate of migrant workers.

(iv) Increase the soundness of the social pension insurance programs of urban residents and the new social pension insurance program for rural residents.

(v) Finalize and build adjustment mechanisms for pension insurance treatment based on type of work.

(vi) Develop corporate pensions and workplace pensions while improving the supplementary role of commercial insurance.

(vii) Expand the funding channels for the National Social Security Fund (NSSF) and build a system for managing the investments of social insurance funds.

2) Mechanisms and challenges for China's pension system

Understanding the above-noted improvements to basic endowment insurance requires an understanding of China's pension system[2].

First, the family registry is separated into a rural registry and an urban registry, and the social insurance system is also separated based on which registry applies.

Second, urban social insurance comprises five different social insurance programs, including basic endowment insurance (similar to the Employees' Pension Fund in Japan) and healthcare. In addition, the pension system in urban China comprises three main components: basic endowment insurance, corporate pensions, and private savings.

Third, not only is (management and investment of) China's social insurance not pooled at the national government level, it is not even pooled at the provincial government level (equivalent to Japan's prefectural government level); the only pooling that is done is at the municipal government level. The Chinese government intends to solidify the foundation of its basic endowment insurance by gradually raising the level at which pooling occurs.

Fourth, there is also a need to improve corporate pensions and workplace pensions as a way to supplement urban basic endowment insurance, as well as to develop a commercial insurance market to supplement these. Improvement of the pension systems for government employees and employees of government-affiliated institutions has only just begun.

---

[2] See Eiichi Sekine, "*Chugoku no Shakai Hoken Hou (Soan) no Kouhyou to Kouteki Nenkin Seido Kaikaku*" (Announcement of China's draft social insurance law and public pension reform), Capital Market Quarterly, Spring 2009 issue (in Japanese).

Fifth, improvement in rural social insurance has been lagging, and the Chinese government has been moving forward with planning on a separate basis from the urban side.

Sixth, the National Social Security Fund was established in 2000 as a reserve fund for future social insurance payments, and its investments are diversified globally. Meanwhile, the social insurance fund is limited to domestic investments in deposits and government bonds, and although it will eventually be pooled, the need for improving mechanisms for governance and managing investments is an issue for institutional investors.

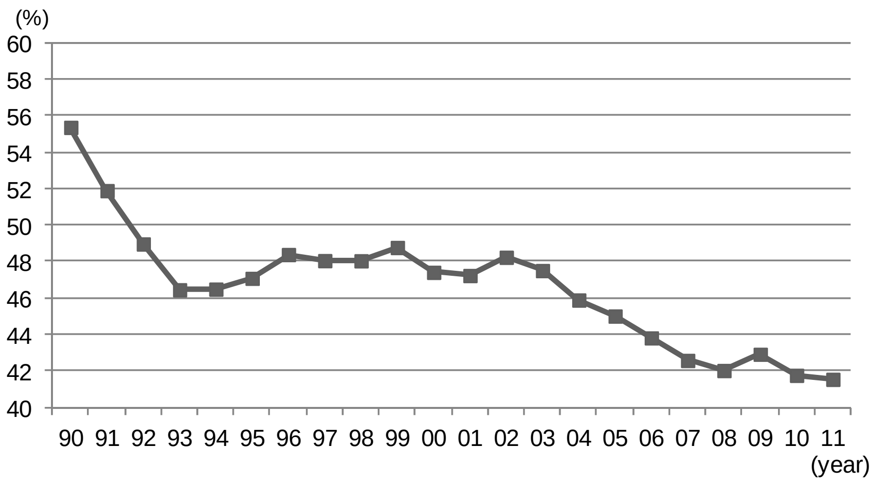
IV. The need to improve labor's share of income in China

1. Labor's share of income has been worsening in China

Although there are no direct statistics concerning labor's relative share in China, there are data available on the per capita disposable income of urban residents, per capita net income of rural residents, the urban population, and the rural population, and combining these in the numerator and putting GDP in the dominator makes it possible to estimate labor's share of income.

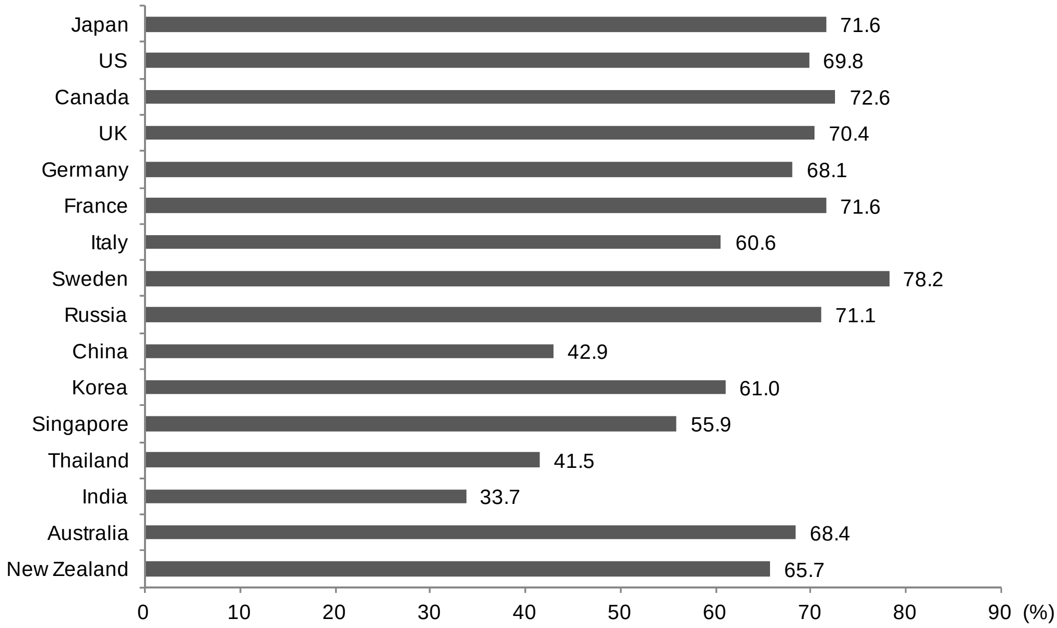
Using data from the National Bureau of Statistics of China going back to 1990, we estimate labor's share of income dropped from 55.4% in 1990 to 46.5% in 1993 and 1994 (Figure 4). From 1998, under then Premier Zhu Rongji, state owned enterprises underwent major reforms that included job reductions, but labor's share stayed in the upper 40% range, and after peaking at 48.2% in 2002, it had declined to 41.5% by 2011.

Figure 4: Labor's relative share (estimated) in China



Note: Numerator is (urban residents per capita disposable income x urban population) + (rural residents per capital net income x rural population). Denominator is GDP.
Source: Nomura Institute of Capital Markets Research, based on the China Statistical Yearbook 2012

Figure 5: International comparisons of labor's relative share (2009)



Notes: 1. Numbers for China are estimates based on data from the National Bureau of Statistics of China.

2. Numbers for other countries pulled from Japan Institute for Labor Policy and Training, 2012 Databook of International Labor Statistics, page 44.

Source: Nomura Institute of Capital Markets Research, based on the China Statistical Yearbook 2012 and the 2012 Databook of International Labor Statistics

Looking at 2009, the most recent year when comparisons with other major countries are possible (Figure 5), labor's share was 69.8% in the US and 71.6% in Japan, which had the world's No. 1 and No. 2 GDPs at the time. Labor's share of income in China was thus not as high as it was in the advanced economies, nor was it as high as that in Korea or Singapore, but it was on par with that of Thailand.

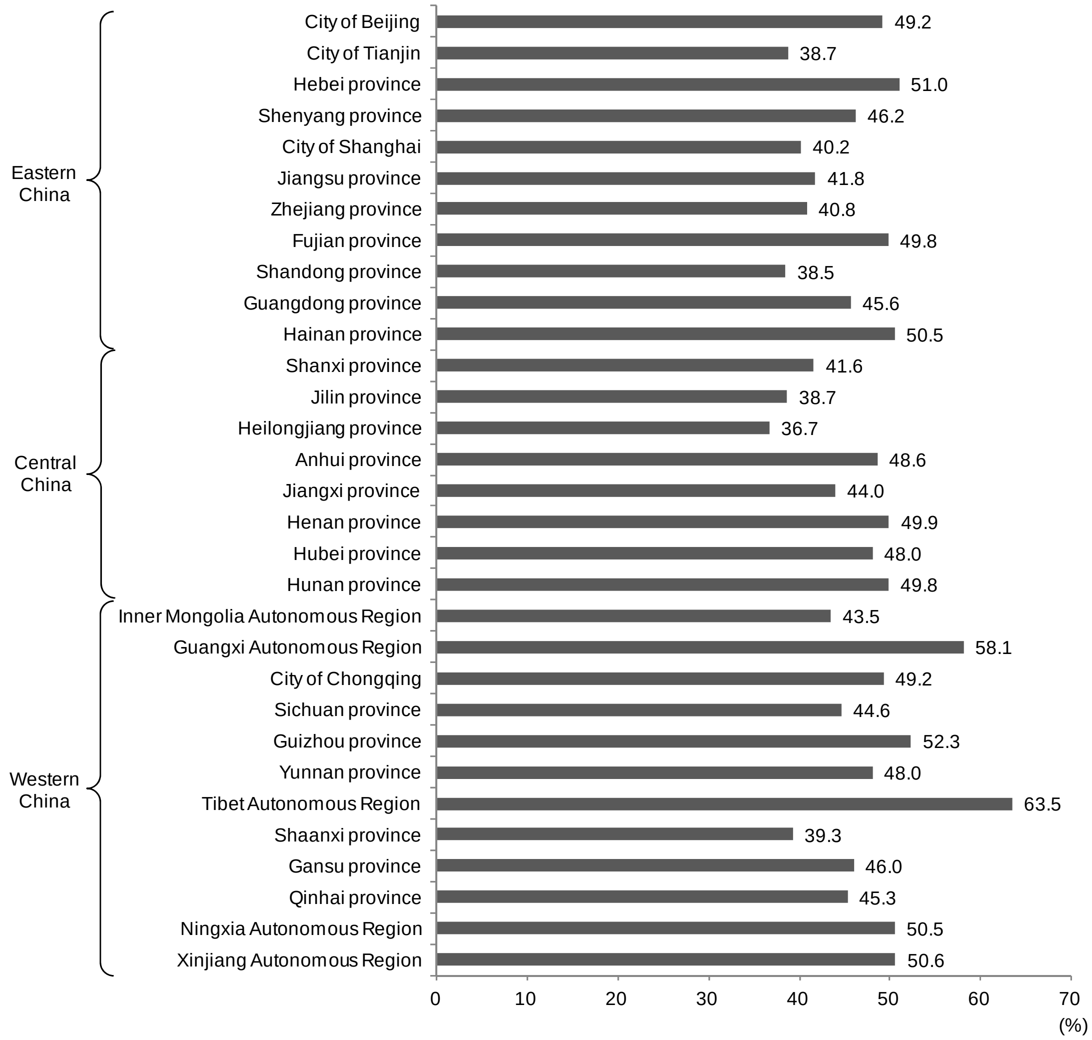
This makes it clear that from the perspective of the initial distribution of income, there is an urgent need for China's financial and capital markets to develop investment products with liquidity, convertibility, and profitability so as to support increases in income from personal assets, while also introducing employee stock ownership plans.

2. Still ample room for raising labor's share in eastern regions

It is also possible to estimate labor's relative share by region using the regional GDP data available within China.

Estimating labor's relative share by region using the latest 2011 data from the National Bureau of Statistics, the lowest share was 36.7% in Heilongjiang province in the Northeast of China, while the highest was 63.5% in the Tibet Autonomous Region. Labor seemed to have a relatively higher share of income in the western regions of China than in the eastern regions (Figure 6).

Figure 6: Labor's relative share (estimated) in China by region (2011)



Note: Numerator is labor compensation by region. Denominator is GDP by region.
Source: Nomura Institute of Capital Markets Research, based on the China Statistical Yearbook 2012

The distribution of financial assets (savings deposits) in China is clearly skewed toward the city of Beijing, Eastern China (city of Shanghai, Jiangsu province, and Zhejiang province), and Guangdong province (including Shenzhen). The story this tells is that there is considerable room for promoting the market investment of individual financial assets in the eastern part of China, where labor has a relatively lower share of income than it does in the western part of China. Consequently, although not limited only to the eastern part China, we think it is important to not only promote direct market investment by individuals, but to also improve the investment channel through institutional investors. Moving forward, supporting reform of income distribution will probably require, in conjunction with financial and capital market reform, expanding and diversifying investment routes for the National Social Security Fund, introducing and promoting corporate pensions and workplace pensions, and building a system for investing basic endowment insurance, with an eye on pooling at the national level.

V. Conclusion

As we have seen thus far, the financial services industry has been viewed in other countries as an industry worth designing a growth strategy for, but it is rarely also looked at directly as a tool for reforming income distribution in conjunction with other distribution policies. In addition, the strict deadlines and short time frames allowed for achieving specific objectives in the Five-year plans demonstrate the strength of the Chinese government's commitment.

If treated as a growth industry, the financial industry would be overseen by five government agencies, led by the People's Bank of China, and if treated as relevant to income distribution reform, it would be overseen by three agencies, led by the National Development and Reform Commission, with no overlap between the two. Ultimately, it is the State Council's role to make overall adjustments, and whether this combination of policies can fully mobilize government down to the local government level, and the extent to which market participants are able to take advantage of the opportunities created by this reform and deregulation, will probably determine what it does in the next stage.

China is likely to further examine and compare models from other countries, including Japan, during that process. Within the financial services sector, promotion of the asset management sector is particularly important from the perspectives of a growth strategy and an income distribution policy, and we expect to see more research on the experiences in other countries in designing mutual funds, corporate pensions (including defined contribution pensions) and employee stock ownership plans, as well as in investing and providing governance of public pensions. At the same time, it is also conceivable that further asset management capital and expertise will be brought in from overseas financial institutions to promote more international diversification of investment by China's asset management industry than is the case today. On the Chinese mainland, only qualified domestic institutional investors (QDII) have been allowed to invest overseas, but the CSRC and the People's Bank of China have announced their intention to create mechanisms whereby individual investors can directly invest in overseas markets. There is a possibility that new rules for qualified domestic individual investors (QDII2) could be in place by as early as 2013, and this would also create new business opportunities for overseas financial institutions.

We expect China's financial and capital market reforms to continue focusing on a combination of growth policies and income distribution policies.