

**Statement of the Honorable Clay Lowery  
Vice President  
Rock Creek Global Advisors LLC**

**Before the U.S. House Subcommittee on  
International Monetary Policy and Trade  
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Chairman Miller, Ranking Member McCarthy, and Members of the Subcommittee, I thank you for the opportunity to testify on increasing market access for U.S. financial firms in China.

I am here as a Vice President of Rock Creek Global Advisors, a consulting firm that advises its clients on international economic and financial policy matters. I am also a former Assistant Secretary of International Affairs for the Treasury Department who was deeply involved in negotiating financial service liberalization and macroeconomic issues with China during the Strategic Economic Dialogue – SED – headed by former Secretary of Treasury Hank Paulson.

It is an honor to share the table with Rob Nichols and David Strongin who represent some of our key financial institutions as well as Nicolas Lardy – a genuine expert on China’s economy. It is also an honor to follow Under Secretary Lael Brainard, who leads Treasury on these issues and many other important matters.

Given the expertise of these individuals, I thought my value to this subcommittee would be to address financial liberalization from the viewpoint of someone who led negotiations on the subject as a government official, but no longer represents the government.

In my experience working with Chinese financial officials, China makes changes when it believes it is in China’s interest, which might come as little surprise. I do not mean to diminish the impact of external pressure, but that pressure is mitigated by China’s size, the unprecedented speed of its economic growth over 30 years, and its ability to attract investors from around the world. I believe these factors embolden Chinese officials to act with a sense of pride and confidence that they know the correct pace of change, even when officials in Washington, London, Brasilia, and Tokyo think otherwise.

In my testimony, I will explain that the time is right to increase market access because it is what China wants. I will give examples of recent market opening measures and conclude by making a few suggestions of what Congress can do to help.

## **Time is Right**

The time is right to further open China's market to foreign financial firms because such liberalization is an essential part of China's broader effort to rebalance its economy. I believe that rebalancing China's economy will prove beneficial to the people of China and more importantly, in my opinion, to the people of the United States.

For a few years, various observers have noted that China's export-led, resource-intensive, production-heavy growth model could not last forever. Two major questions were asked: one, when is the turning point at which China needs to transform its economy and two, can China accomplish the transformation given the unique challenges posed by rebalancing an economy of China's size.

With regard to the first question, the timing of this hearing is excellent -- and not just because it follows on the heels of the Strategic & Economic Dialogue. China appears to be on the verge of significant transformations. As we all know, China's leadership is scheduled to change over the next 10 months or so. The new leaders who will take charge after the political transition will be responsible for taking China through what I believe is an even more important transition: vital changes to its economy made necessary by the long-term unsustainability of the Chinese economic model and changes to the underlying fundamentals of China's place in the world economy.

If the time for transformation is now, what does that transformation require? And is it even possible? In short, rebalancing China's economy means moving toward one that is driven by consumption, implying an increase in household incomes, a stronger social safety net to avoid excess savings, a more market-oriented exchange rate to diversify the factors of production, and a more liberalized services sector -- particularly financial services to allow for more competition and greater capital productivity.

The challenges to such change are significant and cannot be underestimated: entrenched interests -- whether state-owned enterprises that enjoy subsidies or even private-sector firms with strong political ties; companies that don't want to compete; potentially captured regulatory entities; or just pure politics and inertia at local levels--will work to maintain the status quo.

While the jury is out whether China can make this transition, the last 30 years suggests that China does sometime use external pressure to take liberalizing steps. Therefore, I see the S&ED as an opportunity for the United States to provide input and maybe even influence on these challenges. It has aspects of a trade negotiation but is more about creating a dialogue to make progress on macroeconomic, regulatory, and even social economic issues.

## **Making Progress but More To Do**

The difference between 2007/08 when I was working on these issues in government and today is that U.S. officials and observers are not the only ones emphasizing that China is bumping up against the limits of its existing growth model and the importance of rebalancing its economy. As the letter from many members of this committee to President Obama points out, Chinese leadership and respected organizations like the World Bank have joined the chorus, and, perhaps most importantly, change is actually starting to happen.

In many ways, financial sector development is the key to China's transition to an economy in which capital is deployed more efficiently and risk is more appropriately priced, managed and diversified. The current system, however, is influenced heavily by the state, capital markets are woefully underdeveloped, and households suffer from a form of financial repression due to deposit rate caps. This leaves small and medium-sized enterprises with little access to capital, makes entrepreneurship and innovation too expensive, stifles consumption, and leads to a banking system with growing non performing loans and an insurance system with poor risk management techniques.

As is well recognized, financial sector development depends on various factors but a key one is opening the market to global competition. World-class financial institutions introduce diversity, enhance training, improve market practices, strengthen risk management, and enhance financial stability. And it is clear that U.S. firms are some of the best in the world to assist in all these areas.

Let me take a couple of examples of progress that is being made:

Chinese drivers are required by law to have auto insurance, but foreign insurance companies have only been allowed to write voluntary coverage. So despite having one of the largest auto insurance markets in the world, the penetration rate for foreign institutions in the non-life insurance market in China is almost *de minimis*. As wealth has grown in China, consumers have continued to buy more and more cars. However, lack of competition, poor risk management techniques, and cumbersome claims processes have left Chinese consumers vulnerable. In other words, it is becoming in China's interest to allow foreign companies that have decades of experience weathering volatile economic climates while maximizing consumer benefits and maintaining high levels of solvency to compete and offer their services.

And in the recent S&ED, we saw that China reiterated its commitment to lift its prohibitions on foreign competition in the mandatory auto insurance market. This should prove good for U.S. insurance firms, China's drivers and consumers of automobiles, and potentially U.S. automobile exporters. This step, however, is only one in greater market access in the insurance market – just

as Rob and David have pointed out important but insufficient liberalization steps in the banking and securities industry areas.

Another important market access measure is the recent U.S.-China decision to resume negotiations of a Bilateral Investment Treaty (BIT). In essence, a BIT with China would provide U.S. companies with equal regulatory treatment as their local Chinese competitors, whether state-owned or private, and other foreign companies, both in terms of market access – the “establishment” of an investment -- and throughout the life of the investment. For China, the legal protections afforded by a BIT could help attract U.S. investors and address China’s misperceptions that the U.S. does not welcome Chinese investment.

For the United States, enhancing the ability of American companies to invest in the Chinese market will create, not destroy, jobs in America. Academic research has repeatedly found that expansion abroad by affiliates of U.S. multinationals tends to support their American-parent jobs, not destroy them. This is especially true when companies establish affiliates to serve new customers—long the primary goal of many U.S. multinationals in China.

### **Suggestions for Congress**

I wanted to conclude my testimony by respectfully suggesting areas for Congress to play a role.

This committee should bring the same intensity and oversight to pushing for strong deliverables at the S&ED and in BIT negotiations as Members of Congress have shown on exchange rate issues. Putting pressure on the Executive Branch to continue to work with the financial services industry to push for market access, to work with China to regulate in a fair and transparent manner, and to assist China on building out its capital markets.

If China breaks the rules, then by all means, this committee and the Administration should hold them accountable and enforce the rules. But we should also be open to working with China, engaging in vigorous, but productive, discussion with them and finding solutions that are clearly in the interest of both countries.

This hearing is taking place as our trade negotiators are in Dallas negotiating the Trans-Pacific Partnership (TPP) with 8 nations of the Asia-Pacific region. My view is that TPP is very positive for the U.S. – if successfully negotiated, it could provide greater market access for our firms, products and services, as well as new disciplines on state-owned enterprises. Moreover, it will truly help our competitiveness in the region, which I believe would place even more pressure on China to rebalance its economy and allow for greater market access.

As in the Korea Free Trade Agreement, financial service liberalization should be an area for the U.S. negotiators to emphasize – our firms are highly sophisticated, competitive, and can assist both directly and indirectly in creating jobs here. This is in our interest and it is the expertise and jurisdiction of this committee.

Let me finish by criticizing myself. When Secretary Paulson internally proposed the SED concept in 2006 as a way to create an ongoing process that could help both nations address long-term structural issues, while at the same time seek near-term results to build confidence on both sides, I admit that I was skeptical. He was the boss, of course, and I would do my best to execute. But Secretary Paulson was correct, having an S&ED provides an opportunity for the U.S. and China to have ...what I (and I promise you, not Secretary Paulson) would euphemistically call a better chance at an “adult relationship,” instead of being children in the sand box throwing sand at each other and not figuring out how to achieve common desires.

The S&ED process allows for the pursuit of a more mature and mutually beneficial relationship and Presidents Bush and Obama have demonstrated that the process is important to make progress—albeit slower than we would want—for opening market access for U.S. firms, improving China’s overall economic balance, and eventually helping the United States by strengthening ties with an important export market.

Thank you and I’m happy to field any questions.