China's New Five-Year Plan
and its Impact on the Financial Services Industry

What has happened?

China has released its 12th Five-Year Plan ("FYP"), covering 2011 to 2015. The FYP sets out the Chinese government's overarching strategy and targets for economic and social development during the next 5 years and traditionally serves as a blueprint for the implementation of governmental policy at all levels. The release of the FYP will be followed by a roll-out of new laws, pricing policies, financial incentives and investment support aimed at implementing the objectives set out in the FYP. Government officials at all levels will be assessed based on, among other things, their implementation of the guidelines set out in the FYP.

When did it happen?

The 12th FYP was approved by the People's Congress of China on March 14, 2011. The FYP will be implemented and managed by the Chinese government at all levels with immediate effect.

What is the purpose?

Even after more than 30 years of opening up of China's economy to the outside world, around 50% of the nation's GDP is attributed to state-owned enterprises. Accordingly, the central planning-style FYP is certain to have a significant impact on China's economic and social development over the next 5 years.

The 12th FYP seeks to address rising inequality and create an environment for more sustainable growth by prioritizing more equitable wealth distribution, increased domestic consumption, and improved social infrastructure and social safety net. In respect of the financial services sector, the FYP aims to further develop small-to-medium-sized financial institutions and explore the secure advancement of new financial products.

The FYP represents a shift in China's economic model. Urbanization and industrialization will continue, but growth is unlikely to follow the pattern of the past decade. There will be a focus on greater efficiency around existing infrastructure, on increased domestic consumption and on rural and inland development.

1. Economic Targets

The 12th FYP sets the following key economic targets:

- GDP to grow by 7% annually
- 45 million new jobs to be created in urban areas
- urban unemployment rate to be limited to 5%
- service sector contribution to GDP to be increased by 4%
- urbanization to be increased by 4%

2. Push for Innovation

The 12th FYP indicates China's determination to push for innovation. China will:

- further encourage enterprises to conduct technology research and development by granting more incentives and improving IP-related legal protections (which should lead to better IP law enforcement)
- expedite the establishment of an enterprise-oriented technology innovation system
- promote the establishment of technology innovation alliances between enterprises and universities

To advance technology research and development, the FYP sets the following targets:

- expenditure on research and development will account for 2.2% of GDP
- there will be 3.3 patents for every 10,000 people

3. Impact on the financial services industry

The 12th FYP emphasizes that:

- China will grant sufficient support to the expansion of small- and medium- sized financial institutions
- China will further regulate the insurance intermediary market
- China will promote the establishment of the reinsurance market
- China will actively develop the debenture market
- China will explore asset securitization on a stable basis
- China will further standardize and develop the private equity sector.
- Pension schemes will cover all rural residents and 357 million urban residents
- China will actively expand commercial insurance to supplement the basic medical insurance

Also, the link between the 12th FYP and the growing accumulation of yuan-denominated deposits in the offshore yuan market in Hong Kong is critical. Convertibility of the yuan is key to the Chinese government's growth strategy, because:

- a convertible currency will help Chinese households to invest their savings in China and overseas. The greater return on a Chinese citizen's savings, the less he or she needs to save and the more he or she can spend
- a convertible and traded currency will help China's economy to balance trade and investment flows
- a convertible currency should lead to further development of China's local capital markets and modernization of its monetary policy, including the continued liberalization of interest rates, hence helping the Chinese government to control inflation

Opportunities are likely to arise for US financial institutions to sell their expertise and experience in respect of carbon finance facilities, systems, arrangements and trading activities to Chinese financial institutions and regulators.

U.S. financial institutions may be able to collaborate with Chinese partners to invest in and trade carbon emission rights and derivatives.

U.S. banks can continue to benefit from the further liberalization of the banking sector in China and the development of the offshore yuan market in Hong Kong.

Foreign insurers (life, medical, commercial, re-insurance) will have increasing opportunities to develop local businesses in the Chinese market.

China will need to further expand the QDII and QFII schemes to provide further alternatives for investment flows into and out of China.

U.S. utilities and energy providers may become the subject of investments by Chinese power producers, which will require the involvement of financial institutions in the U.S.

Dorsey & Whitney will continue to highlight issues relating to China and your business, including matters affecting the implementation of the 12th FYP. Dorsey Shanghai's Managing Partner, Peter Corne, is listed in International Who's Who of Professionals and Euromoney Asia's Leading Lawyers. He is Chair of the Energy Working Group of the European Chamber in Shanghai. He works closely with Dorsey partners in the U.S. to assist clients to do business successfully in China and/or with Chinese parties.

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