經營學碩士　學位論文

# The Study on the Changes of Chinese Insurance Market Which Derives from China's Entry Into WTO

ＷＴＯ　가입에　따는　중국보험시장　변화에　관한　연구

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# 국 문 요 약

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중국의 보험시장은 18 세기 청조시대부터 시작되었다. 그러나 외세의 침탈을 받은 청조시대의 중국보험시장은 중국보험회사가 경쟁에서 대부분 도태되어 외국회사들에 의해 주도될 수 밖에 없었다.

1949 년 사회주의 계획경제를 표방한 중국인민공화국이 성립되면서 보험시장에 새로운 전기를 마련되었다. 그리고 개혁개방정책(1978), 세계무역기구(WTO)에 가입(2001) 등의 역사적 사건으로 인해 중국보험시장은 큰 변화를 겪게 되었다.

이 논문은 중국의 WTO 가입이 보험시장에 미치는 영향을 경제적 측면, 법적측면, 정책적 측면에서 고찰하여 설명한다.

1. 경제적 측면(시장구조적 측면)

중국의 보험시장의 발전을 보험시장구조의 변화의 측면에 살펴본다.

(1) 독점보험시장시기(1949-1988)

중국정부는 1949 년 중국인민보험공사(PICC)를 국영기업형태로 설립하여 보험업무를 전담케 하였다. 그러나 1956 년 중국정부는 외국보험회사를 추방하고 또한 요람에서 무덤까지라는 사회주의 복지정책으로 전환하여 해상보험과 항공보험을 제외한 모든 보험을 정부가 직접 관장함으로써 보험산업은 쇠퇴하였다.

1978 년 개혁개방정책으로 계획경제체제가 시장경제체제로 변화하면서 정부는 인위적으로 PICC 를 통해서 독점시장체제를 강화하였다. 이러한 독점체제는 어느 정도 보험수요에 부응할 수 있었지만 비효율성을 발생시켰다.

(2) 과점보험시장시기(1988-1992)

1986 년부터 중국정부는 정식으로 GATT 가입을 위해 노력을 시작하였다. GATT 가입에 대비하고  독점시장의 비효율성을 제거하기 위해 PingAn 보험회사를 센전에 주식회사형태의 설립을 허용하였다. 또한 China Pacific Insurance Co.(1991)가 상하이에 설립되어 3 각체제가 형성되었다.

(3) 경쟁보험시장시기(1992-  )

1992 년 중국정부는 본격적인 개방에 대비하여 처음으로 외국회사인 미국의 American International Group 영업을 허용하고 이후 카나다, 일본, 영국 등 4 개 외국보험회사 설립을 허용하였다. 그래서 2001 년 당시 14 개 국내보험회사 17 개 외국보험회사가 영업을 하고 있었다. 그리고 이 시기 직접 정부가 개입하던 방식에서 보험규제위원회(CIRS) 통해서 감독과 규제하는 방식으로 전환되었다. 그래서 보험시장구조는 훨씬 더 경쟁적인 구조로 변화하였다.

2. 법적 측면

중국정부는 1995 년 보험법을 통과시켜 임의적인 정부개입의 폐해를 시정하고자 하였다. 이 보험법은 보험계약, 보험회사설립, 보험영업규칙, 보험시장의 감독과 규제, 보험중개인과 법적책임범위 등 보험시장에서 보험사업하는데 일정한 준칙을 규정하였다. 주요내용을 구체적으로 보면 중국에서 영업면허(license)를 얻기 위해 2 년동안 중국내에서 지점운영경험, 총자산 50 억초과, 30 년이상 영업경험이 있어야 한다. 소유는 중국기업과 50-50 합작이 가능하고 상해와 광주지역내로 그리고 취급 보험상품은 손해보험과 생명보험으로 제한하였다.

그러나 1997 년 WTO 후속협상과 2001 년 WTO 가입이후 GATS 의 최혜국대우원칙과 내국민대우원칙의 적용을 받아들여 외국회사도 주식을 51%소유할 수 있게 하고 베이징, 텐진 등 동해지역 10 개도시에 보험회사 설립을 허용하였으며 3 년후에는 모든 지리적 제한을 철폐하였다. 또한 사업범위도 책임보험 신용보험을 포함한 비생명보험으로 확대하였다. 그리고 내국민대우원칙에 의해

보험중개인업무도 차별하지 않았다.

3. 정책적 측면

중국은 전체적으로 점진적인 개방정책을 추구하였으나 그 정책이 불투명하고 비공식적인 의사결정구조로 인하여 보험시장이 경쟁구조로 변화하는데 많은 장애가 되었지만 WTO 가입이후 빠른 속도로 시장구조가 변화하고 있다. 또한 사회주의 정책으로 중요시되어 정부가 직접개입하던 건강보험과 연금보험을 CIRC 를 통해 상업보험형태로 전환되어 가고 있다.

중국의 보험시장은 WTO 가입시점인 2001 년과 1981 년을 비교하면 보험회사 소득과 자산면에서 각각 205 배, 231 배 증가하였다. 이러한 급속한 성장은 대외개방 등 보험시장을 경쟁구조로 전환하는 것에 크게 기인한다. 보험시장이 작동하게 됨으로써 리스크가 제거되고 금융시장이 안정화 되어 중개비용 및 거래비용이 감소한다. 이에 따라 정부의 담보기능을 대체하고 저축이 증가되며 해외자본과 기술이 유입되어 중국의 산업이 발전되고 무역과 유통이 활성화되어 궁극적으로 지속적인 경제성장에 기여하게 할 것으로 기대된다.

중국보험시장의 과제로는 보험회사의 지불능력과 자본금의 보호장치를 마련하고 감시감독시스템의 구축, 신용평가시스템, 보험회사의 투자활동 규제범위, 보증제도의 체계화, 보험상품에 대한 소비자인식제고 등을 어떻게 수행해내느냐에 달려 있다고 볼 수 있다.

# Chapter1
# Introduction:

## 1.1 Background and purpose:

On December 11, 2001, China officially became a member of the World Trade Organization (WTO), opening the country's doors to change and a new economy. This paper looks at the long journey it took in order to achieve this goal and the future prospects of such a step. The paper begins with an historical overview of China's insurance industry and before People’s Republic of China was founded, the Chinese insurance industry was initiated for a short period and foreign insurers controlled almost 80% of the market. From 1949 to 1988, the People's Insurance Company of China was the sole provider of insurance in China. Since 1988, however, China’s insurance industry has developed very quickly. According to the World Bank, premiums in China reached at least 200 billion yuan in the year 2000. The Chinese insurance market was partially opened to foreign companies in 1992. About 202 representatives of foreign insurers now represent 11 different foreign insurance companies in China. However China’s massive market potential has led to demands from foreign insurance investors that China do more to increase access to its insurance market. Moreover, while the Chinese government has favored a "gradual, paced" policy for liberalizing the domestic insurance industry, the rapid development of China’s insurance sector is straining the government’s regulatory policies.

With the progress of China’s market-oriented economy, the Chinese government has adopted a series of social welfare reforms, particularly pension and health-care system reforms that will increase opportunities for insurance companies and also create pressure for ensuring that the private sector insurance system is capable of covering growing portions of the

Chinese population. With this concern in mind, the China Insurance Regulatory Commission (CIRC), a new insurance regulatory body, is considering how best to support the development of China's domestic insurance industry, including how or if it should open this industry to increased foreign competition.

In the middle of this big structural transformation, Chinese government faced another challenge that was what the government made commitments to the members mainly USA, EU to enter into WTO. Finally it succeeded in working at WTO as a member in November 2001. It is expected that this big event would have a great deal of an effect on a variety of sectors. So, the focus of this thesis is on describing the changes of insurance sector, which especially in three fields will be mainly illustrated: commercial field, legal field, and policy field what kind of changes take place. And the forecast on the future development of Chinese insurance industry will be added.

## 1.2 Organization of the thesis:

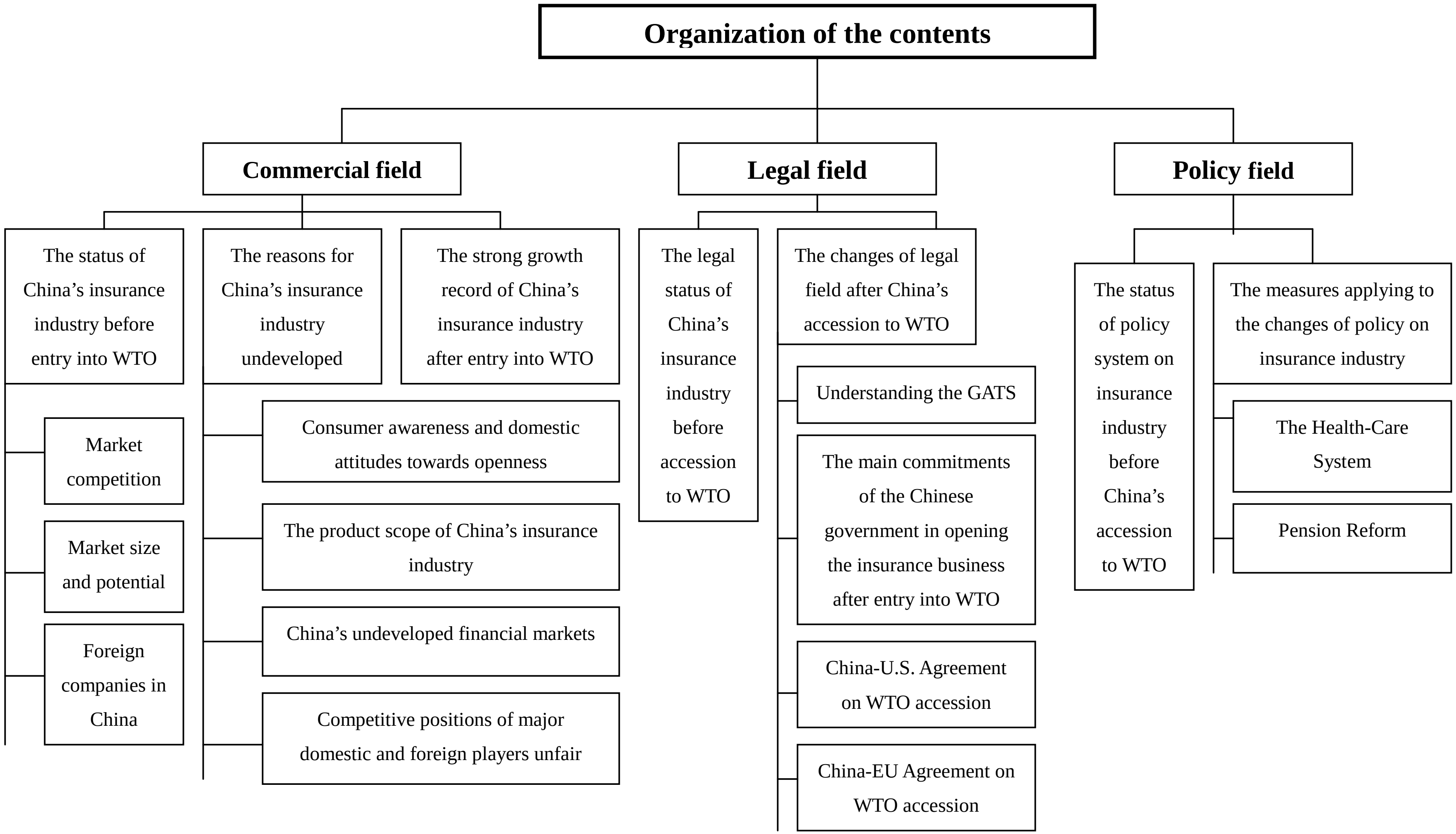
This thesis consists of five chapters:

Chapter2 introduces the background on the development and current economic situation of China's insurance industry. It also provides general information about the market for insurance in China, the international context in which China is attempting to reform its insurance policies, and the legal and policy framework that regulates the industry.

Chapter3 provides in depth anaylses of commercial, legal, political issues that affect China's ability to liberalize its insurance industry. This section also adds an analysis of policy implementation issues that will need to be addressed.

Chapter4 provides the future developments after China accesses the WTO.

Finally in chapter5 the conclusion will be made.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# Chapter2
# The history of China’s insurance industry before entry into WTO

## 2.1 The preliminary establishment of china’s insurance: (Qing Dynasty-1949)

This chapter will divide the periods according to its characteristics and specify the features, which was generated in each period.

The insurance industry emerged as a business in China in the early 1800s. The first insurance institution, *Canton Insurance Society*, was established in 1805 by British and Indian businessmen in southern China. Foreign insurers were the only participants in this market until 1865, when the first Chinese insurance company, *Yi He Insurance Company*, was established in Shanghai. Under competitive pressure, *Yi He* did not survive for long. The first Chinese insurance business with a far-reaching influence on the whole industry appeared with the foundation of the *Commercial Bureau of Insurance (Bao Xian Zhao Shan Ju)* in 1875 in Shanghai, a company whose business focused on marine insurance. [1]

From 1865 to 1912, 35 Chinese insurance companies were established, which included 27 property and casualty insurance companies and 8 life insurance companies, but by 1914, 26 of these 35 companies had become bankrupt. By then there were 148 foreign insurance companies writing policies in China’s insurance market, either through their own branches or through Chinese agencies. According to *Chinese Insurance Annual Statistics 1999*, foreign insurers controlled almost 80% of the market at that point. World War I limited the business expansion of foreign insurers, giving Chinese insurers an opportunity to develop.

[1] Insurance and China's Entry into the WTO by Stephen P. D’Arcy and Hui Xia (1999)

From 1912 to 1925, 39 new Chinese insurance companies were established, mainly in Shanghai. During World War II, insurance companies were used as a speculative financing tool to consolidate capital from many small investors, given the lack of alternative investment options for small businesses. This led to a period of extended prosperity for the insurance industry.

From 1940 to 1943, 97 new Chinese insurance companies were founded in Shanghai. By 1948 the total number of insurance companies rose to 241, which included 178 Chinese insurers and 63 foreign insurers. As the most highly populated and most developed city, Shanghai was the birthplace for China's insurance industry and has always been the main arena for insurance competition. Interestingly, in 1992 Shanghai became the first city in China after the foundation of People 's Republic of China in 1949 to open its insurance market to the world.

## 2.2 After the establishment of People's Republic of China: (1949-before China's accession into WTO)

### 2.2.1 "The era of monopoly market" (1949-1988)

With the establishment of the People's Republic of China in 1949, China's insurance industry then entered into a very remarkable period of history, rebounding between the various campaigns to create a new socialist system. In October 1949, the People's Insurance Company of China (PICC), a state-owned enterprise, in Beijing, was established by combining some domestic insurance companies and was given the monopoly over the whole domestic insurance industry. During the first decade of its operations, the PICC made rapid and steady progress, establishing regional branches and offices in all the provinces, autonomous regions and municipalities (except Tibet and Taiwan), and using branches and sub-branches of banks as its agents.

By 1956, all other insurance companies in the PRC ceased to operate and foreign insurers were expelled from the country over the next seven years. However, since the "new socialist system" had the goal of providing "cradle-to-grave" social welfare to all people, insurance was regarded as an unnecessary business. As a result, all insurance operations except international cargo and aviation insurance were abolished at the WuHan national financial meeting of 1958. China's government just kept "PICC" as the company title to all foreign customers, but actually PICC was reorganized and became a small department in the People's Bank of China (PBOC), the central bank of China. The remaining international insurance business was operated by a governmental department, not an independent enterprise. During the last two decades, the picture has changed dramatically. After the Cultural Revolution, and with the advent of the "Reform and Open" policy initiated by Deng Xiaoping[2] in 1979, a series of reforms aimed at stimulating economic growth had been launched. Due to this policy, the domestic insurance business was resuscitated and the PICC, being the sole insurance carrier in the whole China, enjoyed the strong and increasing demand for insurance products and services and consequently recorded significant growth and profitability. Restructuring business networks, recruiting new employees, and developing the market occurred over the next three years, until PICC was separated from the PBOC in 1982 as an independent insurance company supervised by the PBOC. Because this model was built not based on market demand, the structure generated many cost inefficiencies and internal control problems. I think that the period should be referred to as "the monopoly of PICC".

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[2] (1904~1997), he was the most powerful government leader in China in the 1980s.

### 2.2.2 “The era of oligopoly market” (1988-1992)

As mentioned above, “The Reform and Open policy” have had an broad influence on Chinese society and economy. The policy triggered to transform the planned economy into the competitive economy dramatically. When it comes to insurance industry, the effect of the policy was decisive. For the first decade, it helped PICC rework in the insurance market. However such an artificial restructuring the insurance industry induced the monopoly market structure, which contributed to accumulate the inefficiency and faced the internal control problem. One more thing, Chinese government needed to change it insurance market into being competitive in advance, preparing for the case that Chinese insurance market should be open to foreign companies, after making a decision to enter into WTO. So, in 1988, PingAn insurance company was permitted to be established in Shenzhen, the first special economic Zone selected by Deng Xiaoping. This company was not built up as state-own company just like PICC, but as shareholder owned company. This approval finally broke the monopoly structure in the insurance market. Three years later (1991), China Pacific Insurance Company whose headquarters is located in Shanghai was approved. Then with the establishment of Ping An in 1988 and China Pacific in 1991, the monopoly market PICC had dominated for 40 years was abolished and the market was characterized as a tripartite confrontation. (See Table 2-1)

**<Table2-1>　Chinese Insurance Companies**

| Company | Founded | Headquaters | Registerd-capitals (billion yuan) | 1996 Premium income (billion yuan) |
|---|---|---|---|---|
| PICC Group | 1949 | Beijing | 20 | 63.4* |
| People's Insurance (Property) | 1996 | Beijing | 2 | 35 |
| People's Insurance (Life) | 1996 | Beijing | 1.5 | 21.2 |
| People's Insurance(Reinsurance) | 1996 | Beijing | 2 | 7.2 |
| China Pacific Insurnace | 1991 | Shanghai | 2 | 9.82 |
| Ping An | 1988 | Shenzhen | 1.5 | 10.5 |
| Huatai General Insurance | 1996 | Beijing | 1.33 | - |
| Xinhua Life Insurance | 1996 | Beijing | 0.5 | 0.26 |
| Tai Kang Life Insurance | 1996 | Beijing | 0.6 | 0.147 |
| XinJiang Corps Insurance | 1996 | Urumqi | 0.1 | 0.24 |
| TianAn | 1994 | Shanghai | 0.2 | 0.3 |
| Da Zhong | 1995 | Shanghai | 0.21 | 0.2 |
| Yong An General Insurance | 1996 | Xi An | 0.68 | -- |
| Sinosafe General Insurance | 1996 | Shenzhen | 0.3 | -- |

*1996 premium income for the PICC Group excludes the company’s nine overseas branches but includes figures for the group's three subsidiaries-People's Insurance (Property) Co., People's Insurance (Life) Co. and People's Insurance (Reinsurance) Co. Total premium income from the nine overseas branches was over four billion yuan in 1996.

Sources:

1. Figures provided by the aforementioned insurance companies cover the year ending December 31, 1996.
2. *Insurance Reform and Development*, 1997

### 2.2.3 “The era of competitive market” (1992- )

In 1994, Chinese government took a epoch-making measure for foreign insurance to work in China. American International Group (AIG) was the first foreign insurance company to establish operations in China since 1949 for the first time, bringing new approaches to provide insurance services. By granting operation permission for AIG, China’s government began the opening of its insurance market. When an experiment was carried out to open the Chinese insurance market to the outside world, nine insurance companies from eight countries including the United States, Canada, Japan and Britain have set up agencies in Shanghai and Guangzhou and a large number of insurance institutions from 17 countries have set up representative offices in China. (See Table 2-2) Now the market is getting more competitive.

The most recent reform of China's insurance industry, culminated with the promulgation of the Insurance Law of 1995, has transformed the role of the State in risk bearing and has ended the PICC's monopoly of more than 40 years. To 1996, 18 new shareholders owned insurance companies joined the fast-growing market, including 9 domestic companies and 9 foreign insurance companies, with 4 AIG full ownership branches. In 1996, PICC was reorganized as a holding company (PICC GROUP) with three completely independent subsidiaries (Property, Life and Reinsurance). The official explanation for such reorganization was to carry out the requirement of separating life and property business according to the *China Insurance Law*, which had just been promulgated and was effective October 1, 1995. Rigid central control of operations contributed to the failure of this organization through the loss of effective internal control in corporate finance, business operations, and human resource management. Financial connections between the different branches of PICC were hard to disentangle when the companies were separated. Some of the financial relationships among the companies were not settled until the disbandment of the entire PICC GROUP two years later. At the same time, some domestic stock insurers gained the opportunity to develop quickly and gain market share. (See Table2-1 and Table2-2)

**<Table2-2> Foreign Insurance Companies in China**

| Company | Country Base | Year Approval | Type of Insurance Offered |
|---|---|---|---|
| American International Group Inc. | United States | 1992 | Life and Property |
| Tokyo Marine & Fire Insurance Co. | Japan | 1994 | Property |
| American International Group Inc. | United States | 1995 | Life |
| American International Group Inc. | United States | 1995 | Property |
| Manulife Financial | Canada | 1996 | Property |
| Winterthur Schweizerische Versicherungs Gesellschaft | Switzerland | 1996 | Property |
| Allianz AG | Germany | 1997 | Life |
| Aetna Inc. | United States | 1997 | Life |
| Roya & Sun Alliance Insurance Group Plc. | United Kingdom | 1998 | Property |
| Colonial Mutual Life Insurance | Australia | 1998 | Life |
| AXA-UAP | France | 1998 | Life |

Sources: Ji Chen and Stephen C. Thomas; US Government, International Market Insight, August, 1998; The US-China Business Council.

While both property-liability insurance and life insurance have grown significantly, life insurance premiums have grown more rapidly, and have exceeded property- liability premiums since 1997. China’s life insurance market is becoming more attractive because of China ’s huge population, the reforms to state-owned enterprises, and the growth of joint–ventures. Since

China’s government does not provide life insurance, health insurance or other employee benefits to employees of joint- ventures, these employees provide a ready market for these coverages. The life insurance business has also transformed itself from a business aimed solely at corporate sales to the simultaneous development of both group and personal business, an approach facilitated by the introduction of the personal sales agent system of AIG. One of the notable benefits of allowing foreign insurers into the market is that they bring new approaches with them, as exemplified by AIG’s market distribution system. The market for property-liability insurance has also remained strong, which can be attributed to greater corporate accountability, higher insurance awareness of managers of state-owned enterprises, more foreign investment in the east coast area, and increasing automobile and housing consumption.

Before 1997, the Department of Insurance under the PBOC took the position of market watchdog. However, during this period it was actually the central bank’s responsibility to regulate the insurance market. As a result, the potential importance of the insurance industry in the national economy was always overshadowed by the role of the banking industry. In 1998, facing market problems and intending to expand the function of financial industry, China ’s government decided to separate financial regulation into three main branches, banking, stock market, and insurance. As at the end of 1998, China had more than 25 insurance companies constituted in different legal form (state-owned enterprises, regional joint ventures between PICC Group and local investors and companies involving foreign insurers such as AIA, Tokyo Marine and Fire, Manulife and Winterthur), offering a wide variety of coverage. Since China resumed the insurance business in 1980, the market has grown steadily, at an average rate of 37.6% per annum. Insurance premiums hit 124.73 billion yuan in 1998 and increased to 139.3 billion yuan in 1999. Among these premiums, 52.1 billion yuan was from property insurance, up nearly three percent from

1998, and 87.2 billion yuan from life and health insurance, up 15 percent. The establishment of the China Insurance Regulatory Commission (CIRC) in November, 1998, combined with the requirements of WTO negotiations and pressure from the international insurance community, led China's government to expedite the pace of issuing new licenses to foreign insurers. CIRC became the new market supervisor for the insurance industry.

The founding of four above-mentioned insurance companies is a measure taken to prepare for the opening-up of the insurance market and to prepare the domestic insurance companies for the challenges and opportunities resulting from the market opening. The four companies is as follows:

1. **China Reinsurance Company (CRC)**, the only Chinese reinsurance company, was founded on March 18, 1999, on the basis of the former PICC Reinsurance. China Reinsurance Company has an independent corporate organization and is funded by the Ministry of Finance. CRC's monetary assets increased from $114 million in 1996 to $904 million in 1998. Its long-term reserves increased from $588 million in 1996 to $730 million in 1998.

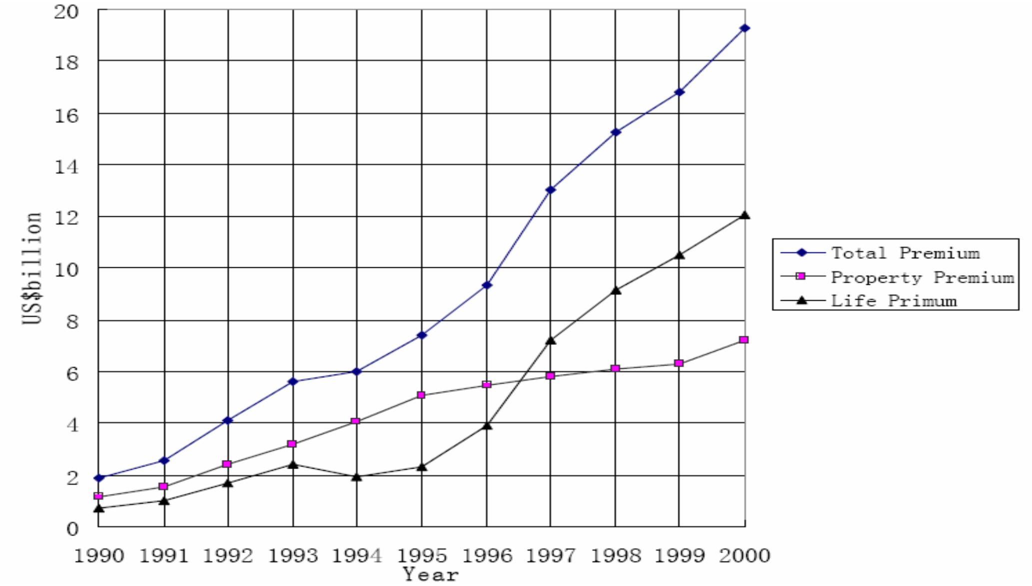
2. On March 19, 1999, **China Life Insurance Company (CLIC)**, the largest Chinese life insurance company, was established in Beijing. It was set up on the basis of the former PICC Life. CLIC is a national commercial life insurance company under the direct leadership of the State Council. It is a wholly state-funded commercial life insurance company specializing in life, health and accident insurance.

3. China's largest property insurance company, **the new People's Insurance Company of China (PICC)** was established in Beijing on March 20, 1999. It was founded on the basis of the former PICC Property. PICC has $930 million in registered capital. It specializes in all insurance services except personal insurance. PICC is a wholly state-owned commercial insurance company.

4. **The China Insurance Company Limited** announced its new leadership team on August 19, 1999, marking the end of the restructuring of the People's Insurance (Group) Company of China. China Insurance Company Limited is the state-owned holding company overseeing the China Insurance (Group) Company Limited of Hong Kong (which manages the overseas assets and operations of the former PICC Group).

Since the restructuring of PICC and the breakthrough of the monopoly with stock companies and entry of foreign insurers in 1992, China 's insurance market has been growing at a phenomenal rate of 10 to 15 percent per year. The combined insurance industry premiums were $19.27 billion in 2000, an increase of 14.5 percent over 1999, according to CIRC official statistics. The total assets of China's insurance companies reached $40.75 billion in 2000, an increase of 19.3 percent over 1999. Of this total, $7.23 billion, or 37.5 percent, were property- liability insurance, a 14.8 percent increase over 1999. Life insurance income increased 14.4 percent to $12.05 billion, accounting for the remaining 62.5 percent of the total premium income. The trend of premiums from 1990 to 2000 is shown in Figure 2-1.

**<Figure2-1> Growth in premium income in China (1990-2000)**




Source: *China insurance almanac* (1999), *China insurance almanac* (2000), www.circ.gov.cn

When China was accepted into the WTO in November 2001, there were a total of 31 insurance companies issuing policies in China's insurance market, including 14 domestic insurers and 17 foreign insurers. The 31 companies consist of 15 property and casualty insurers, 13 life insurers, 1 state-owned reinsurer and 2 comprehensive insurers. The 16 foreign insurers include six branches of AIG and two branches of MingAn (based in Hong Kong). The remaining 13 foreign insurers are preparing to begin operations. (See Table2-3) Now the insurance market in China is getting more competitive.

**<Table2-3> Companies Approved to Write Insurance in China**

| Property-Liability | Life | Comprehensive/ Reinsurance |
|---|---|---|
| PICC | China Life | Pacific |
| Xinjiang Jianshe Bintuan | Xin Hua (New China) | Ping An |
| HuaTai | TaiKang | |
| Sinosafe | Zhonghong | China Reinsurance |
| DaZhong | Pacific-Aetna | |
| YongAn | Allianz DaZhong | |
| TianAn | AXA-China Minmetals | |
| Tokio Marine-Sahgnhai | John Hancock-TianAn | |
| AIU-Shanghai | AIA-Shanghai | |
| AIU-Guangzhou | AIA-Guangzhou | |
| AIU-Shenzhen | AIA-Foshan | |
| AIU-Foshan | Prudential (UK) | |
| Royal and Sun-Shanghai | Colonial-China Life | |
| Winthur (Switherland)-Shanghai | *Sun Life (Canada)* | |
| MinAn-Shanghai | *New York Life (US)* | |
| MinAn-Haikou | *MetLife (US)* | |
| Chubb-Shanghai | *TransAmerica (AGEON) (US)* | |
| *Allianz (Germany)* | *Generali (Italy)* | |
| *Gerling (Germany)* | *ING (Netherland)* | |
| *Japan ( Ⅰ)* | *CNP (France)* | |
| *Korean ( Ⅰ)* | *CGNU (UK)* | |
| | *AIG Branches* | |

✳ Companies in italics are preparing to start business now.

Source: “Insurance and China's Entry into the WTO” by Stephen P. D’Arcy and Hui Xia

# Chapter3

# The changes China's insurance industry between before and after entering into WTO

## 3.1 The efforts to enter into WTO:

China was one of the 23 original signatories of the General Agreement on Tariffs and Trade (GATT) in 1948. After China's revolution in 1949, the government in Taiwan announced that China would leave the GATT. However, the government in Beijing never recognized this withdrawal decision, until 1986, nearly 40 years later. China notified the GATT of its wish to resume its status as a GATT contracting party. China's effort to return to the world trade regime began in the late 1970s when China started its economic reforms and adopted the open-door policy. After more than 30 years of isolation and a centrally planned economy, both China and the GATT contracting countries needed time to understand each other before China's re-entry into the GATT. China was granted observer status in the GATT and sent its first delegate to the 38th meeting of the contracting GATT parties in 1989. On July 11, 1986, China formally requested resumption of its seat in the GATT.

A Working Party was established on March 4,1987, to start the process of China's re-entry into the GATT. The main tasks of the Working Party were to examine and evaluate China's trading regime, define areas and timetables for negotiation and adjustment, and prepare a report for the GATT Council. The Working Party had seven productive meetings in the period through April 1989, but was suspended after the Tiananmen Square incident and not reconvened until 1992.

In 1992,which was a very important year in the history of China's efforts to reenter the GATT, the Working Party held three meetings and completed the general hearing and assessment of China's trading system. Negotiations on the commitment and conditions for entry into the GATT also started in 1992. More significantly, China speeded up its reform in the direction of a market oriented economy.

Following the conclusion of the Uruguay Round, China launched a major campaign to join the GATT. China wanted to become a founding member of the new WTO. Along with nationwide propaganda to promote the internationalization of the economy and disseminate knowledge on the GATT, China made a series of reforms in line with the GATT rules.

China's reforms in its external sector include:

*1.Decentralization of Foreign Trade.*

Prior to the reform, the Ministry of Foreign Trade conducted and controlled all trade. Since 1988, foreign trade has been decentralized to local authorities and foreign trade corporations (FTCs). In 1980, the central government controlled about 98 percent of total trade. By 1991, only 11 percent of foreign trade was still controlled by the Ministry of Foreign Trade and Economic Cooperation (Garnaut and Huang, 1995; Zhang, 1993). In the past two WTO working meetings, China indicated that it will release control on all trading rights after it becomes a member.

*2.Reduction of tariff and Nontariff Barriers.*

Since January 1992, China has reduced tariffs several times and brought the average rate down from 47.2 percent to 21.5 percent in 1997.China has also substantially reduced the number of goods subject to quotas and licensing. By 1994, China had eliminated quotas and import licenses for 283 products. In May of 1994, China abolished another 195 quotas. Currently, China has only 28 products (15 electronic goods and 13 others) that are still subject to import quotas and licenses, 8 (mainly agricultural products) that are subjected to nonquota licenses, and 103 that are subject to import registration.

*3.Elimination of Export Subsidies*

In 1991, the Chinese government abolished all explicit export subsidies. From then on the FTCs had the responsibility for their own losses. .

*4. Increases in Transparency*

China issued a Foreign Trade Law on July 1, 1994, to make regulations more transparent. It also started to change the method of allocating license from bureaucratic application procedure to open competition.

*5. Foreign Exchange Reforms*

Reforms in foreign exchanges market converted the RMB official exchange rate to the market rate and abolished the dual exchange rate system on January 1, 1994;

Regardless of China's effort and enthusiasm, the bilateral and multilateral negotiations were not very successful. China was still not able to return to the GATT and join the WTO after decades. The U.S. attitude toward China is firm: "China must follow the rule of the WTO if it wants to join the international trade body," remarked chief U.S. negotiator Charlene Barshefsky (quoted in Chong 1995). The United States insisted that China must meet all the WTO's rules for accession.

On November 10, 1995, Barshefsky provided a "road map" for China's accession. China's response was that this was a "positive initiative" but that it demanded too much (O'Ouinn 1996). China argued that the United States was obstructing China's accession to the WTO for political reasons. China's economic system is much closer to the WTO requirements than the United States portrays, but the gaps between the two negotiating positions remain wide.

In February and in May of 1997, China and the WTO had another two rounds of negotiations. In both of these talks, both parties made compromises so that the negotiation made som0e progress. China showed some flexibility on foreign trading rights, and the US indicated a willingness to compromise on the time requirements in the adjustment period.

Accession processes vary in length and can take several years to complete, much depends on the readiness of the applicant country to meet not only the rules and obligations of the WTO's market-economy principles, and its policies of pro-competition and non-discrimination, but also the market-access conditions for goods and services which the applicant country grants to other WTO Members. Because the Working Party makes decisions by consensus, all WTO members and the country seeking membership must be in agreement that their individual concerns have been met and that all outstanding issues have been resolved in the course of their deliberations.

On November 11，2001 in Doha, Qatar, WTO officially invited China to join the organization, culminating 15 years of arduous negotiations. The final accession package is a consolidation of China's market access commitments to the United States and other WTO members, and detailed commitments on how China will reform its trading system so that it complies with WTO rules. China has since notified the organization that it has ratified its membership and will now become a full member, the WTO's 143rd, on December 11 of this year.

## 3.2 Commercial field:

### 3.2.1 The status of China’s insurance industry before enter into WTO:

## (1) Market competition[3]:

The development of the insurance industry in the People's Republic of China can be divided into three stages as mentioned in Chapter 2.

First, from 1949 to March 1988, the People's Insurance Company of China (PICC) monopolized the market.

Second, with the establishment of PingAn in 1988 and China Pacific in 1991, PICC's monopoly was broken and the market was characterized as a "tripartite confrontation."

Third, since September 1992, more domestic companies, as well as foreign ones, have entered the market, and true competition has begun to take shape. (See Table 3-1)

**<Table3-1> Chinese Insurance Market Premiums (1991-1999)**

| Year | Total Premiums(billions of US$) |
|---|---|
| 1991 | 282.00 |
| 1992 | 564.00 |
| 1993 | 1,184.40 |
| 1994 | 2,250.36 |
| 1995 | 4,500.72 |
| 1996 | 8,551.37 |
| 1997 | 13,000.00 |
| 1998 | 15,520.00 |
| 1999 | 17,412.50 |

Source: "A strategy for opening up the Chinese insurance industry" by Dawei Cheng (2000)

As recently as 1997, however, the premium income of the PICC, PingAn and China Pacific still accounted for 96.56 percent of total Chinese insurance premiums. [4]

[3] "A strategy for opening up the Chinese insurance industry" by Dawei Cheng (2000)

[4] China's insurance market, available from http://www.latelinenews.com, accessed 12 Dec. 1998

## (2) Market Size and Potential

Although China's' insurance industry grew at a rapid 40 percent per year between 1980 and 1998,[5] insurance premiums in 1991 were still just 23.4 billion yuan (US$282 million). By 1997, however, this figure had leapt to 108 billion yuan (US$ 13 billion), and the total assets of insurance companies reached 164.6 billion yuan (US$ 19.81 billion).[6] During the first five months of 1999, total premiums were already 52.895 billion yuan, representing a 7.29 percent increase over the same period during the previous year. According to World Bank estimates, premiums in China will reach at least 200 billion yuan (US$ 24.44 billion) by the year 2000. (See Table3-2)

**<Table3-2> Company Shares of the Chinese Insurance Market (1996)**

| | |
|---|---|
| People's Property Insurance | 35.00 |
| People's Life Insurance | 21.20 |
| People's ReInsurance | 7.20 |
| Pacific Insurance | 9.82 |
| PingAn Insurance | - |
| Hua Tai General Insurance | 0.26 |
| XinHua Life Insurance | 0.15 |
| TaiKang Life Insurance | 0.24 |
| XinJiang Insurance | 0.30 |
| Da Zhong Insurance | 0.20 |
| YongAn General Insurance | - |
| SinoSafe General Insurance | - |

Source: "A strategy for opening up the Chinese insurance industry" by Dawei Cheng (2000)

[5] JingXiao Xue, The progress in multilateral negotiations on financial services and the opening up of Chinese financial industry, 1998.
[6] New star publishers, Insurance reform and development, 1997

The Chinese insurance industry is changing as it grows. According to Professor Wei Runquan, an executive member of the China Insurance Society, China's GDP reached 5,770 billion yuan in 1995, with total saving deposits approaching 3,000 billion yuan. If calculated in terms of internationally accepted norms for the contribution the insurance makes to the national economy, the potential scale for China's 1995 insurance market would have hovered between 320-360 billion yuan, or eight times higher than actual premiums that year. Wei also notes that the average per-capita outlays for life insurance coverage in Japan and the United States stand at US$3,800 and US$1,000 respectively. China's per capita outlays are just US$1.3. Professor Wei contends that national economic growth, maturation of the market economic system, the enhanced awareness of 1.2 billion people of the need for insurance, and government policies that encourage development of the insurance sector provide powerful guarantees for the continued expansion of the insurance sector.

As previously noted, total Chinese premiums from 1981 to 1994 (13 years) grew at a compound rate of 39 percent from $200 million to $6 billion. CIRC experts predict that, if premiums continue to grow at a relatively high compound rate of 30 percent a year, life and property casualty insurance premiums could total $63.6 billion by 2003. In 1997, life insurance premiums surpassed property insurance premiums for the first time, accounting for 60 million yuan (US$7.2 billion) or 56 percent of total premiums.[7] In major Chinese cities, the life insurance share of the total market was even higher: in Beijing, it was 70.7 percent, in Shanghai, 64.8 percent, and in Guangzhou, 60.5 percent. In the first five months of 1999, of the total 52.895 billion yuan in premiums, 31.276 billion yuan came from life insurance (up 11.07 percent from the previous year), and 21.629 billion

[7] China's reinsurance sector premiums were Yuan 9.6 billion in 1997, available from http://www3.xls.com.internet.

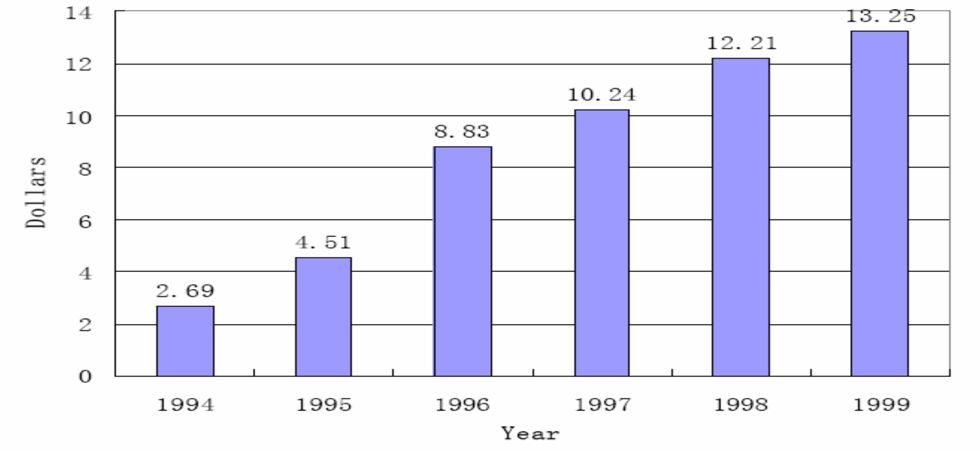
yuan came from property insurance (up 3.06 percent).[8] If growth is a more conservative 10 percent annually, the total by 2003 would still be $14.1 billion. If growth were to take off at 50 percent, the projection becomes $230.6 billion.

Despite the impressive recent growth rates for insurance premiums, the whole insurance market in China is still in its infancy because of the limited number of products available, inexperienced management of insurance companies and low insurance awareness by the public. Two key measures of insurance markets that are commonly used to evaluate the development level of the insurance industry, insurance density and insurance penetration, are still very low in China compared with developed markets. Insurance density is the average insurance premium per capita. Insurance penetration is the ratio of insurance premiums to Gross Disposable Product. In developed countries, approximately 3-5 percent of the GDP is generally spent for property- liability insurance and 4-8 percent of GDP is spent for life insurance.

Insurance Density. In 1995, worldwide per capita premium income was US$357, while China's per capita premium income was just US$6.10. In 1996, Chinese per capita spending rose to $7.64, which is higher than India's $1.70 per capita, but far below Thailand's $30. If China were to reach the worldwide US$357 per capita level, premium income in China would be US$400 billion. However this level still does not approach the levels of developed countries. In 1996, Great Britain spent $1,775 per capita, and the United States spent $2,191. (See Figure3-1)

[8] Nationwide Financial News, available from http://www.web.lexis-nexis.com internet accessed July1, 1999

**<Figure3-1> Growth of insurance density (1994-1999)**




Insurance density=written premium/population

Source: *China insurance almanac* (1999), www.circ.gov.cn.

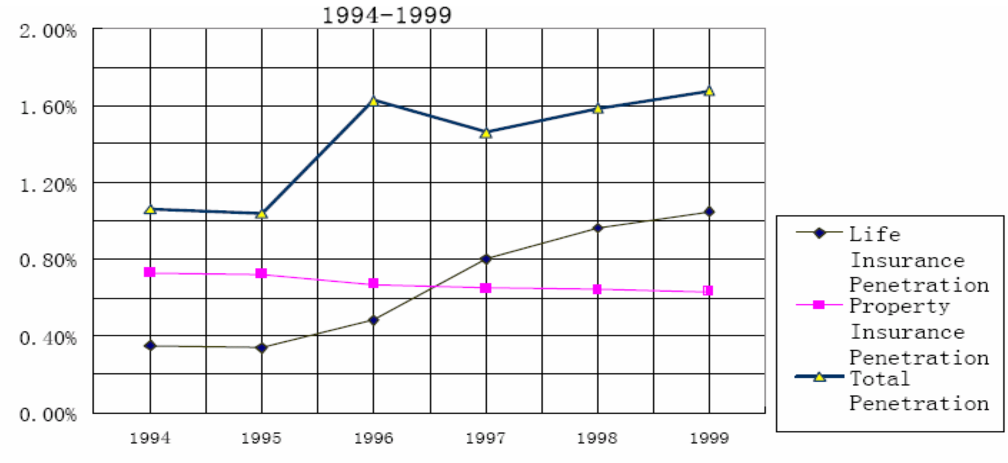
<u>Insurance Penetration.</u> Premium income in developing countries generally accounts for three to four percent of GNP. In 1997, China's premium income was 108 billion yuan or just 1.4 percent of GNP. If China were to realize the 3.5 percent average insurance penetration of developing countries, its premium income would be 261.7 billion yuan.

- Life insurance. Although China's life insurance premiums now represent nearly 40 percent of total premiums, life insurance represents 56.1 percent of total premiums on a worldwide basis, and 76.8 percent of premiums within Asian countries.

- Non-life insurance. China's market for insurance other than life insuarnce is estimated to be worth $6.5 billion.[9] (See Figure3-2)

[9]Charlotte Chapter, "China-opportunities and obstacles for the insurance industry in an emerging country", CPCU Journal, spring 1998.

**<Figure3-2> Growth of insurance penetration**




Insurance penetration=written premium/gross disposable product

Source: *China insurance almanac* (1999), www.circ.gov.cn.

As shown in Figure 3-1 and Figure 3-2, the insurance industry is still only a small part of China's economy, comprising in total less than 2 percent of GDP (China Insurance Almanac (1999)

Examination of specific rural areas' market potential provides further evidence of China's overall insurance market potential. Zhangzhou and the Yellow River Delta are representative of current economic development levels in China since both have largely rural, agrarian economies. The forecasts in both areas show that insurance premiums will at least double within the next three to five years. [10]

Zhangzhou is located in Jiangxi Province and has a total population of 7.55 million. Its rural population is 6.37 million, accounting for 84.4 per cent of the total population. Zhangzhou, like most of China, relies on agriculture as its primary industry. Accordingly, the insurance market forecast in this area gives a reasonable picture of China's market potential, and Zhangzhou's

[10] "A strategy for opening up the Chinese insurance industry" by Dawei Cheng (2000)

insurance density has grown over 100 percent in just the last three years. It is expected to grow almost fivefold over the next 10 years (See Table 3-3).

**<Table 3-3> Zhangzhou Property Insurance Market Forecast**

| Year | GNP(billion Yuan) in Zhangzhou | Total population (million) | Per capita income for rural area (Yuan) | Market potential in terms of insurance penetration | Market potential in terms of insurance density |
|---|---|---|---|---|---|
| 1997 | 222.66 | 7.556 | 2034 | 1.48 | 2.4 |
| 2000 | 290 | 8.00 | 3000 | 2.1 | 3.99 |
| 2010 | 900 | 8.75 | 10000 | 6.42 | 14.57 |

Source: "A strategy for opening up the Chinese insurance industry" by Dawei Cheng (2000)

The Yellow River Delta is located in Shandong Province and is one of the three biggest delta areas in China. Although economic development in this area has been slow to date, it is expected to develop very quickly in the next century because of its rich natural resources. The insurance industry in this region has developed very rapidly since 1992. Its insurance density has doubled in the last five years. (Table 3-4 shows the insurance premiums in this area, and Table3-5 shows the market potential.)

**<Table 3-4> Insurance Premiums in the Yellow River Delta (thousands of yuan)**

| Year | 1993 | 1993 | 1994 | 1995 |
|---|---|---|---|---|
| Property insurance | 85557 | 106453 | 128151 | 215280 |
| Life insurance | 38915 | 26732 | 23607 | 35366 |

Source: "A strategy for opening up the Chinese insurance industry" by Dawei Cheng (2000)

**<Table3-5> Insurance Market Forecast in the Yellow River Delta**

| Year | GNP (billion Yuan) | Total Population (million) | Per capita income for rural population (Yuan) | Per capita income for urban population (Yuan) | Market potential in terms of insurance penetration | Market potential in terms of insurance density |
|---|---|---|---|---|---|---|
| 1995 | 293 | 518 | 4598 | 13883 | 3.52 | 4.76 |
| 2000 | 566 | 540 | 9000 | 3800 | 7.03 | 9.72 |

Source: "A strategy for opening up the Chinese insurance industry" by Dawei Cheng (2000)

## (3) Foreign Companies in China

In preparation for (and as a result of) accession into the WTO, China expanded the number of licenses given to insurers and increased the permitted ownership levels for foreign investors (Ng and Whalley, 2004). As a result, the number of new foreign insurance companies (or joint ventures) entering the market has been rising faster than the number of new domestic companies, especially in the life business. Specifically, the number of foreign-owned life insurers and joint ventures increased from 1 in 1992 to 11 in 2002. While only six new domestic life insurers entered the market during this period.

However, despite the fact that the number of foreign participants in the insurance market has been steadily increasing, the market share of foreign insurers is still extremely limited (see Table 3-6). In 2002 foreign insurers only had 0.8% of the Chinese property-casualty market and 1.54% of the life insurance market (0.4% for joint-venture firms and 1.14% for foreign insurers).

The principal reasons for the low market share of foreign insurers are regulatory restrictions.

**<Table 3-6> Market share in the Chinese insurance market**

Panel A: Foreign and Domestic Firms in the Chinese PC Insurance Industry

| Year | Foreign Firms | | Domestic Firms | |
|---|---|---|---|---|
| | Number of firms | Market share (%) (Total Premiums Written) | Number of firms | Market share (%) (Total Premiums Written) |
| 1995 | 3 | 1.39 | 5 | 98.61 |
| 1996 | 2 | 0.78 | 6 | 99.22 |
| 1997 | 4 | 2.32 | 9 | 97.68 |
| 1998 | 5 | 0.65 | 9 | 99.35 |
| 1999 | 6 | 0.67 | 9 | 99.33 |
| 2000 | 7 | 0.84 | 10 | 99.16 |
| 2001 | 9 | 0.72 | 10 | 99.28 |
| 2002 | 10 | 0.80 | 11 | 99.20 |

Panel B: Foreign Joint Venture and Domestic Firms in the Chinese Life Insurance Industry

| Year | Joint Venture Firms | | Foreign Firms | | Domestic Firms | |
|---|---|---|---|---|---|---|
| | Number Of Firms | Market share (%) (Total Premiums Written) | Number Of Firms | Market share (%) (Total Premiums Written) | Number Of Firms | Market share (%) (Total Premiums Written) |
| 1999 | 3 | 0.11 | 2 | 1.50 | 7 | 98.38 |
| 2000 | 3 | 0.21 | 3 | 1.70 | 7 | 98.08 |
| 2001 | 5 | 0.46 | 3 | 1.35 | 8 | 98.19 |
| 2002 | 7 | 0.40 | 4 | 1.14 | 9 | 98.46 |

Source: calculated based on the data in *China statistical yearbook* (1995-2002), National Bureau of Statistics (NBS), China.

Because of the many restrictions to entry, foreign companies have so far only participated in a limited way in China's insurance market development. Since 1992, of the 19 approved foreign insurance companies, most are currently operating in China. But, they still have gained only a small fraction of China's insurance market. For example, in the first quarter of

2001, the total premiums for the entire Chinese insurance industry was RMB 43.76 billion (US$ 5.29), of which foreign-invested insurance companies received only RMB 711 million (US$85.87 million), or a 1.6% market share. Foreign premiums were up 37.52% the first quarter of 2000, slightly higher than domestic competitors' premiums, which rose 34.26%. AIG, the first foreign company to enter the Shenzhen life insurance market in October of 1999, received RMB 7.78 million (US$.939 million) in the first half of the year 2000. But their market share was only 1% of the Shenzhen life insurance market, with China Life holding a market share of 43.67%. AIG's premium income from new policies surpassed the third largest life insurer in Shenzhen, China Pacific Insurance, and they have rapidly expanded their employee from just over 100 when they opened to the current level of 500.

In addition to governmental restrictions and regulations, foreign insurance companies have also faced a number of Chinese market challenges. Joint venture management appears to be very difficult in China. For example, recently, three experienced senior managers of Sino-foreign JVs were removed from their management positions in AXA Minmetals Assurance Co (France), Allianz Dazhong Life Insurance Co. (Germany), and China Life and Colonial Life Insurance Co.(Australia). There are a number of reasons for the management challenges. First, there are cultural differences such as conflict between the JV partners and lack of mutual trust and agreement on management practices. For example, AXA Minmetals had seven managers from four different country-regions. The managers with different cultural backgrounds had different points of view on many management issues such as the insurance market, marketing insurance products, and employee compensation. They also had to answer various questions from AXA headquarters some 8,000 miles away.

Second, China's insurance market is constantly changing. There are more competitors every year. For example, in 1996 in Shanghai, there were five insurance companies, but by 2001, there were more than 20, 10 of which were selling life insurance. Therefore market research done five years ago is obsolete, making a huge gap between market data and actual operations.

Third, there is a lack of familiarity with the Chinese business climate leading to problems in the localization of international enterprises. Companies such as AXA, Manulife, and AIG, some of whom have had many decades of international insurance experience including in Hong Kong and pre-1949 China, have found many difficulties applying their experiences in the current Chinese market. For example, the foreign companies did not realize that many Chinese today have more interest in insurance or financial products that are closely linked to investment and financial management. Another social change in China that has affected marketing insurance products (as well as doing business in China generally) is that the traditional central role of "guanxi" has gradually diminished and Chinese customers therefore must be approached not only through their social groups but also as individuals.

### 3.2.2 The reasons for China's insurance industry undeveloped:

#### (1) Consumer awareness and domestic attitudes towards openness

The vast majority of Chinese people still enjoy free medical care, low-rent housing and retirement pensions. It is not surprising then that the majority also still consider insurance to be unnecessary. Even when citizens (usually in big cities) recognize insurance as a necessity, they lack basic insurance knowledge. In a survey conducted by the Beijing Road to the Future R&D

Company found that only 18.6 percent of respondents said that they know insurance well.[11]

So before starting to open up the China’s insurance industry, we should clearly understand the positions of domestic insurance consumer groups. First, it should be acknowledged that most Chinese still lack insurance awareness, and it should develop basic education materials concerning how insurance works. Because consumers from different social classes, age groups and work situations have different needs, the CIRC will need to develop multiple education approaches in order to build a broad base of consumer support.

*a) Consumers from different social classes*

Consumers from urban areas will have more knowledge of insurance than their rural counterparts.

*b) Consumers from different age groups*

It has been nearly twenty years since China began its rapid economic development, and the young generation is now accustomed to making decisions based on economic factors. The older generation, however, is having a harder time adapting to this new way of life.

*c) Consumers from different work situations*

Employees at private or foreign companies have more motivation to buy insurance than employees who have what they perceive to be stable, long-term employment at a state-owned enterprise (SOE).

## (2) The Product Scope of China’s Insurance Industry

China's insurance market is characterized by its small size and limited variety of insurance products having more savings characteristics rather

[11] Qixiang Sun, China’s insurance industry: contradiction, challenges and countermeasures, 1998

than insurance characteristics. It suffers from relatively high costs, lack of consumer knowledge about the role of insurance, and lack of a sound democratic legal and institutional environment, particularly in the area of enforcement.

Like insurance industries in other developing countries, China's insurance sector once emphasized business insurance such as marine, fire, commodity, transportation, and casualty insurance. Now, however, China permits insurance companies to offer either of two broad categories of insurance: property insurance and life (group and individual) insurance. Property insurance includes business property, family property, cargo transportation, motor vehicle, ship, and agricultural insurance. Life insurance instruments include "simple" life insurance (similar to term life); life insurance with saving features; group life insurance; "simple" and group disability insurance; group accident insurance; highway accident insurance; collective-enterprise employee retirement insurance; individual pension insurance; children's education and marriage insurance; major medical insurance; and other combination products.

But what are the principal product and market segments in the Chinese market today? Product statistics for all of China in 1999 are presented below.[12]

In property and casualty insurance, virtually all premiums are earned in three categories:

First, Motor vehicle and third party insurance – 58.5 percent of the total

Second, Enterprise property insurance – 21.3 percent of the total

Third, Cargo transportation insurance – 6.6 percent of the total.

In the life insurance sector, premium revenues are split 32.3 percent and

[12] "Business Opportunities for Foreign Insurance Companies in China's Changing Marketplace" by Stephen M. Harner

67.7 percent in the group and individual insurance categories, respectively. These figures do not indicate any trends. Based on trends evident in large cities like Beijing and Shanghai, individual insurance is growing much faster than group life insurance.

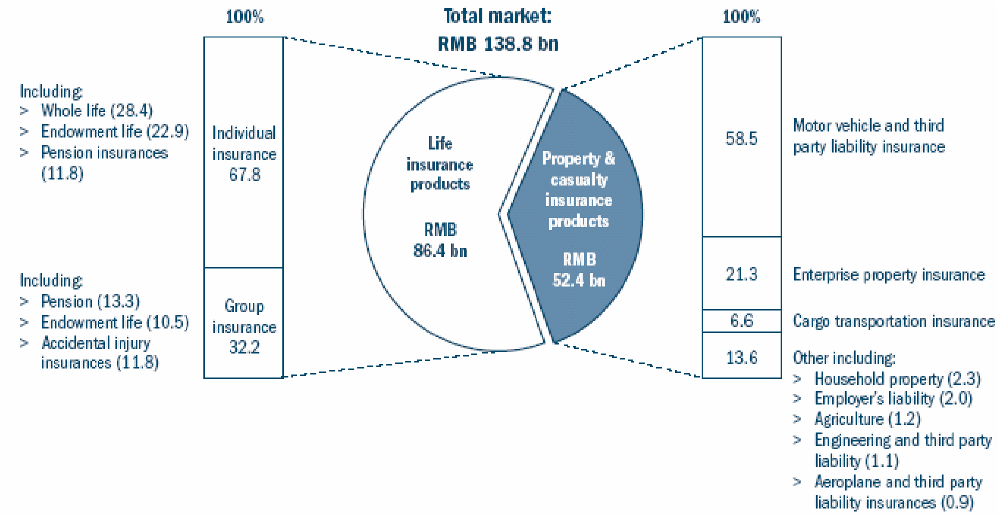
Thus, individual insurance may continue to increase substantially in the future.

Within the group insurance category, we see that the biggest product is pension insurance. We can observe from this that enterprises in China buy pension insurance for their employees. The second largest product, with a 32.7 percent share, is endowment life insurance. A third major product is accidental injury insurance, at 20.1 percent.

Within the individual insurance category, we find that whole life policies are the biggest sellers, at 41.9 percent of the total. This is followed by endowment life insurance at 33.8 percent, and pension insurance at 17.4 percent.

In late 1999 and 2000, all major life companies introduced investment-linked and dividend products to whole life, endowment life, and pension life products.

<Figure3-3> **Life and property and casualty by premiums (1999)　（%）**




Source: CIRC quoted in Shanghai insurance, April 2000

## (3) China's undeveloped financial markets

Another limitation to the growth of the insurance industry is that China's undeveloped financial markets limit investment vehicles for insurance premiums. The financial market is not well developed and deep enough to accommodate a range of investment options. As Yiji Starr, International Chief Actuary of John Hancock Financial Services points out, "The Chinese insurance market focuses on savings product rather than risk products. In order to make the savings product attractive, they have to be priced at high interest rates. The available assets are limited to deposit and some short-term bonds. These assets may not cover the interest rate assumed in pricing. Furthermore, these assets are much shorter than the liabilities sold by the insurer, thus creating an asset liability mismatch issue."

Analysts say foreign companies will need to do thorough due diligence before entering the market, then build up long-term relations with Chinese local governments and potential consumers. They also will need to develop business plans that prepare their companies to be long-term players. Many players are in the process of developing investment-linked and participating products. It is unclear how successful these products will be in China.

If the PRC meets investors' expectations about greater market access and more secure property rights, foreign investment in China will continue to expand, and the flow of new capital will create opportunities for millions of Chinese to increase their standard of living. The Chinese people will demand banking, investment, insurance and other financial services-from both foreign and domestic firms-and they will become increasingly intolerant of government policies that limit their investment choices and "cannibalize" their savings.

The dismal condition of China's state-owned banks, which are burdened with the nonperforming loans made to state-owned enterprises (SOEs), cannot be improved without the discipline of foreign competition. Just as non-state industrial firms have been allowed to grow spontaneously, private banks and financial institutions must have the freedom to develop if China is to improve its allocation of scarce capital and achieve healthy long-term growth.

What China needs is not "socialist capital markets" but real capital markets with private owners who can specialize in risk taking, who can freely capitalize expected future profits into their present values by selling shares on organized stock exchanges and who are held fully responsible for losses. That means prices, including interest rates, must be determined by the free market.

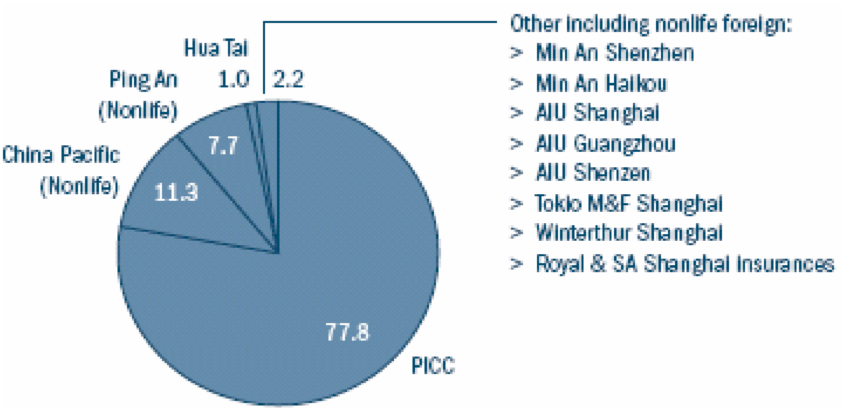
If the mainland is to become a major player in the global economy, it must stand by its commitment to liberalize its financial sector upon accession to the WTO. That means, according to the Accession Agreement, that, within five years after China accedes to the WTO, U.S. and foreign banks should have full access to the local currency market: They should be able to deal directly with Chinese citizens and business firms by using Chinese money, RMB (renminbi), they should be able to establish branches throughout China, and they should receive national treatment (i.e., the same treatment as domestic banks).

China's financial future will depend on the steps that are taken in the next several years to restructure state-owned banks and enterprises. Allowing greater foreign competition will play an important role in transforming the financial landscape, but ultimately the only way to efficiently allocate capital and de-politicize investment decisions is to privatize banks and SOEs.

## (4) Competitive positions of major domestic and foreign players unfair

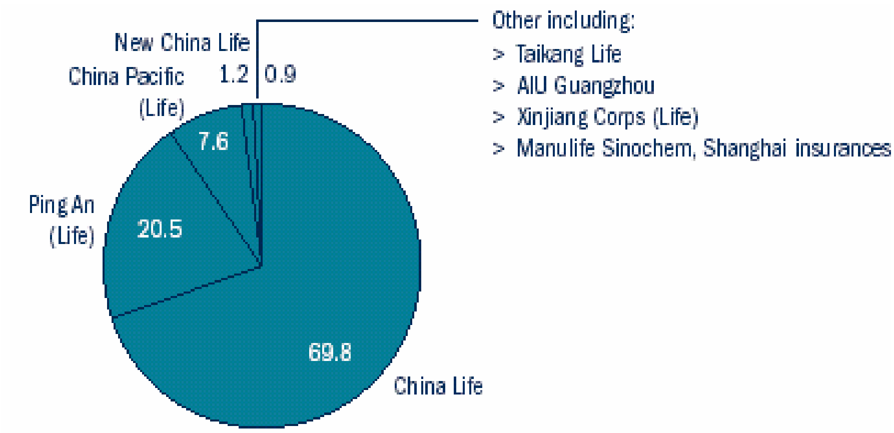
During the 1990s, the Chinese insurance market was characterized as a "tripartite confrontation" between three big state-owned insurance companies—the People's Insurance Company of China, the China Pacific Insurance Company Ltd., and the PingAn Insurance Company of China. In 1999 they comprised some 96% of the market. All three companies have licenses that allow them to operate nationwide. PICC still dominates the market. Underpinning PICC's dominance is its vast nationwide network of several thousands offices and staff of over 80,000. In many secondary, and, especially, tertiary towns and villages in China, PICC is the only service provider, giving it virtually a monopoly position. China Pacific's number two positions is sustained by its strong base in Shanghai and Eastern China, a nationwide network of some 450 branches, and strong corporate ties owing to its origin as a department of the Bank of Communications. China PingAn had a network of 553 branches at the end of 1999, making it only the third truly nationwide service provider. (See Figure3-4 and Figure3-5)

**<Figure3-4> China nonlife insurance market share (1999) （%）**




Source: CIRC and industry

**<Figure3-5> China life insurance market share (1999) （%）**




Source: CIRC and industry

The rapid growth of these three companies is not expected to change any time soon:[13]

> People’s Insurance (Life) Co. Ltd. posted a premium income of 30.33 billion yuan in the first half of 1999, and China Life seized 77 percent of China’s life insurance market in 1998.

---

[13]“A strategy for opening up the Chinese insurance industry” by Dawei Cheng (2000)

China Pacific Insurance Co. increased its premium income 13.07 percent in the first half of 1999 to reach 7.018 billion yuan.

PingAn Insurance Co. maintained growth momentum in the first half this year, with its insurance premiums rising 48 percent to 10.95 billion yuan.

Despite the growth rate of these three big companies still continues, they fell far short of meeting the needs of China’s vast insurance market, and this has opened the door for other domestic insurance companies to develop. Indeed, small domestic companies are growing very quickly and are expected to create competition for the three large carriers in the years to come.

All other insurance companies outside of the "big three" have less than a handful or, in the case of all foreign companies (with the exception of AIU), only one, branch in China. Limitations on branches, along with geographical restrictions---especially against foreign firms---account for the paltry share held by other companies.

Chinese insurance companies have further strengthened their financial position by aggressively investing in other markets. Currently, PICC has more than 80 overseas branches in Hong Kong, Britain, the United States, Macao, and other countries and regions, and this overseas growth has paralleled the growth of competition within the PRC. In Hong Kong, for example, the market share of Mainland Chinese companies rose from five percent in 1991 to more than 25 percent in 1997. The fact that mainland companies are succeeding in Hong Kong, one of the world’s most competitive markets, is a testament to these companies ability to thrive in highly competitive environments.

If China opens up its insurance market, the real impacts of foreign participation, such as how many Chinese insurance companies will be hurt and to what extent, are unclear now. However, one result is clear: The entry of foreign insurance companies into China will bring heavy pressure on Chinese companies and force them to improve their management and operational efficiency.

### 3.2.3 Strong growth record of China's insurance industry after enter into WTO:

China has the potential to become one of the biggest markets in the world for both life and non-life insurance products and services. Regional disparities are substantial but total expenditure on insurance is low and market penetration limited.

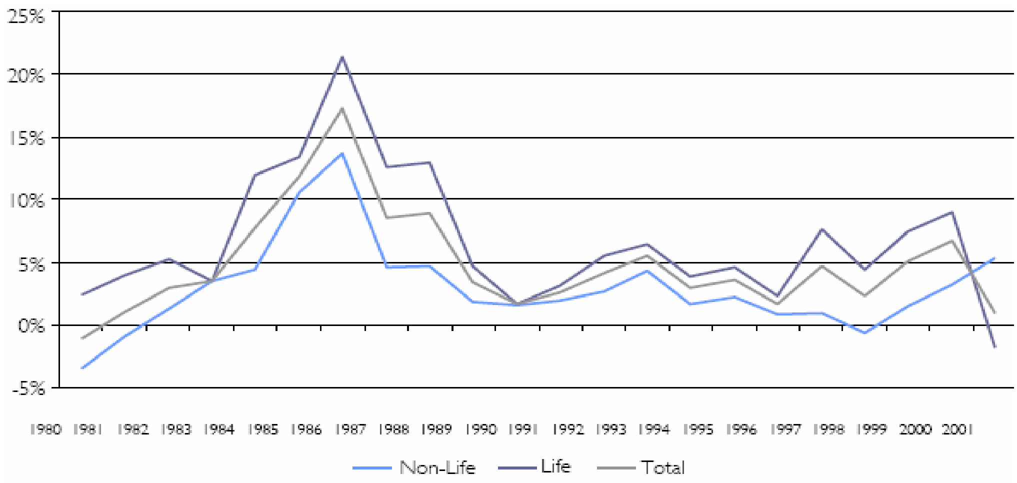
Foreigners are increasingly attracted to the growth prospects of China's insurance industry, as opportunities for growth in the developed insurance markets of North America, Europe and Japan appear relatively limited. Lack of growth in these mature insurance markets has been exacerbated by the general economic slowdown in North America and Europe and deflation in Japan. Top line growth, particularly in investment linked life products, has been under pressure. As shown in Table 3-7, this has led to a perceptible decrease in overall premium income.

**Table 3-7 Total premium growth rates of developed markets compared to China**

| | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| China | 6.6% | 11.7% | 14.5% | 31.9% | 44.7% |
| Japan | -7.2% | 8.7% | 1.8% | -11.5% | -34.9% |
| USA | 7.6% | 7.4% | 8.1% | 5.2% | 20.1% |
| World | 1.2% | 7.8% | 5.2% | -1.5% | N/A |

Swiss Re sigma *World Insurance Reports*

**<Figure3-6> Global premium growth 1980-2001**




Source: Swiss Re sigma

Figure3-6 shows the annual change in global premium income over the last two decades. Over the last decade, Western companies have tapped into the Asian insurance market with varying degrees of success. A number of Asian countries are still suffering from the effects of the 1997 financial crisis and their economies have not recovered to pre 1997 levels. China appears to have escaped from the turmoil of the financial crisis and has the added attraction of being a less saturated market. Table 3-8 shows the impact of a slowdown in economic growth in the Asian region and the effect of the financial crisis with sharp recovery in 1999. China on the other hand was the fastest growing economy in the region and one of the highest growth rates globally, recording an average annual growth of about 8%.

**<Table3-8> GDP growth rates for the ASEAN markets & Greater China**

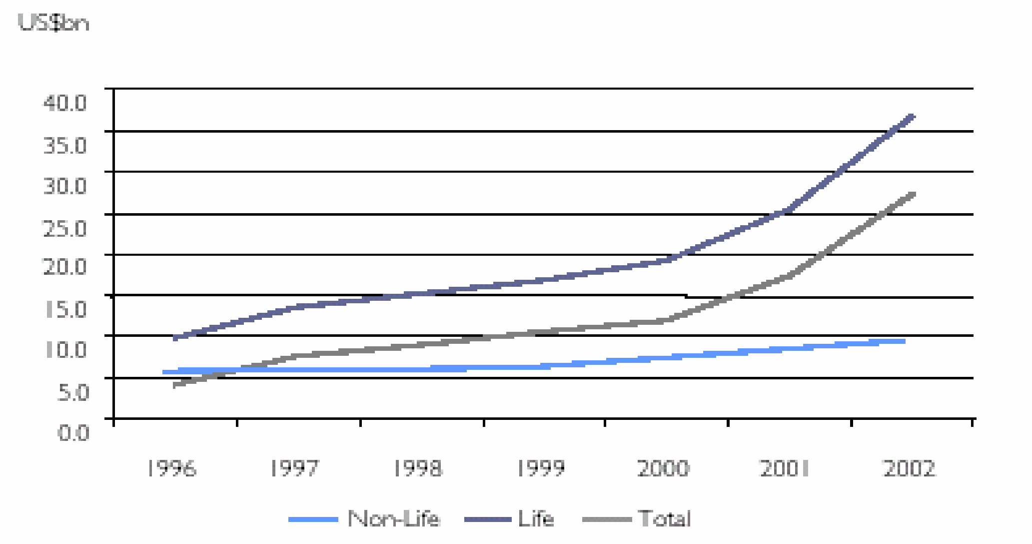
| | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| China | 7.8% | 7.1% | 8.0% | 7.5% | 8.0% |
| Hong Kong | -5.0% | 3.4% | 10.2% | 0.5% | 2.3% |
| Taiwan | 4.6% | 5.4% | 5.9% | -2.2% | 3.5% |
| Thailand | -10.5% | 4.4% | 4.6% | 1.9% | 5.3% |
| Philippines | -0.6% | 3.4% | 6.0% | 3.0% | 4.4% |
| Malaysia | -7.4% | 6.1% | 8.5% | 0.3% | 4.1% |
| Indonesia | -13.2% | 0.8% | 4.9% | 3.5% | 3.6% |
| Singapore | -0.9% | 6.4% | 9.4% | -2.4% | 2.2% |
| Japan | -1.2% | 0.2% | 2.1% | 0.8% | 0.4% |
| South Korea | -6.6% | 10.9% | 9.3% | 3.2% | 6.3% |
| USA | 4.3% | 4.1% | 3.8% | 0.3% | 2.4% |

Source: Australian Department of Foreign Affairs and Trade, IAR

As shown in Figure3-7, total insurance premiums grew by an average 25% between 1996 and 2002 with acceleration in the growth rate to almost 40% since 2000. Total premium income increased 42% in 2002 to US$37 billionn. Life premiums have been the driver of this growth and have increased at an average rate of 56% over the period. Life premium growth was particularly strong in 2002, rising 60%, and this sector now accounts for 74% of the total market: up from 41% in 1996. Non-life premiums increased 13%, reflecting rising vehicle sales and increasing private ownership of property.

When China was accepted into the WTO in 2001, there were a total of 31 insurance companies issuing policies in China, including 14 domestic insurers and 17 foreign insurers. The 31 companies included 15 property and casualty insurers, 13 life insurers, one state-owned reinsurer and two composite insurers. As at June 2003, the number of insurers had increased to 56 reflecting the lifting of restrictions on new participants entering the insurance market. Among these, 25 were engaged in non-life insurance business.

**<Figure3-7> China premium income 1996-2002**




Source: Swiss Re sigma

## 3.3 Legal field:

### 3.3.1 The legal status of China's insurance industry before accession to WTO:

The rapid expansion of China's insurance industry in the 1980s pushed the Chinese government to begin establishing laws and regulations to manage the insurance market and make it more competitive. On June 30, 1995, a national insurance law was promulgated at the fourteenth session of the Standing Committee of the Eighth National People's Congress of China; it became effective on October 1, 1995. The insurance law mainly focuses on regulating the domestic insurance industry. It also includes some provisions on foreign insurers. In 1996, the Provisional Regulations for Administration of Insurance were established to supplement the insurance supervision section in the 1995 law. The law represents a major step forward in transforming insurance regulation in China. It sets forth rules for:

1. Insurance contracts,
2. Insurance companies,
3. Insurance operation rules,
4. Insurance supervision and regulation,
5. Insurance agents and brokers,
6. Legal liability.

The law applies to all insurers, including those with foreign ownership and foreign branches. However, Article 148 includes a giant loophole stating that foreign joint ventures and branches will be governed by the law "or other laws and administrative regulations if they provide otherwise."[14]

Self-regulation by the insurance industry is developing rapidly as well. In 1994, the Shanghai branches of PICC, PingAn, China Pacific, and AIA formed China's first insurance industry association to coordinate and self-regulate the insurance market in Shanghai. By the end of 1997, insurance companies had established industry associations in 19 cities.

Chinese law and regulations stipulate that insurance companies and agencies must regard property and life insurance business as separate entities. Additionally, the 1995 insurance law stipulates that premiums can only be deposited in banks or used to purchase government and financial bonds or various other funds approved by the State Council. According to the law, "the use of premiums to establish securities institutions or invest in enterprises is strictly prohibited."

As for foreign participation in the Chinese insurance market, the insurance law lays out the following rules: [15]

## 1. Licensing

[14] It is worth noting that the Chinese approach to law is quite different than that of the West. Whereas in the West laws are made to rule man, the Chinese see man ruling the law.

[15] www.china-insurance.com

According to the insurance law and Shanghai rules, foreign companies are only allowed to obtain licenses and conduct business in China if they meet the following formal criteria. A company must:

- Have operated a Chinese representative office for a minimum of two years (although this office cannot engage in insurance sales until a license is obtained).

- Have total parent company assets exceeding $5 billion in the year prior to the application for a license.

- Have 30 years of continuous underwriting experience.

- Have a qualified senior management team that controls the company's insurance operations.

According to foreign companies, a number of other informal, non-transparent criteria have impeded their success in obtaining licenses. (For futher discussion of this problem, see the policy analysis section below). 113 companies from 11 countires have applied for insurance licenses in China and, while most meet the above criteria, very few have actually received licenses.

## 2. Ownership

Under the insurance law, foreign non-life insurance companies are licensed as branches, and foreign life insurance companies are allowed to set up 50-50 joint ventures with Chinese firms. In practice, however, foreign companies have little choice in joint venture partners. As highlighted by a 1998 China Insurance Institute study of 20 foreign insurance companies, China only has three big insurance companies, and each company can participate in only one joint venture. Although choosing a joint venture partner company outside of the Chinese insurance industry can help a foreign company obtain a license from CIRC, especially if the Chinese company is recommended by the Chinese government, the foreign insurance investor is likely to have difficulties cooperating with a Chinese company that has no insurance experience.

In short, the insurance law's provisions on ownership have effectively limited the entry of foreign companies and hampered the development of the insurance market. CIRC needs to re-think its ownership policies in order to reduce their negative effects.

## 3. Insurance Brokers

The insurance law includes two sections concerning the regulation and licensing of insurance brokers and agents. These sections are:

- Measures for the administration of brokers, and
- Provisional regulations on the management of insurance agents.

In theory, the insurance law was designed to protect consumers in their transactions within the insurance industry. However, the law is silent on whether foreigners may obtain broker licenses, and in the absence of a clear law, Chinese officials have only allowed one foreign company to obtain such a license. To make matters worse, a number of foreign companies have gone ahead and engaged in broker activities calling themselves "risk management consultants," which fall wholly outside of China's regulatory structure.

Accordingly, CIRC needs to re-think how to regulate these "risk management consultants." Just giving them broker licenses and letting them operate businesses according to the rules may be the best option. Insuarnce brokers play a very important role in the insurance markets of many developed countries. Brokers' business accounts for more than 50 percent of insurance business in the United States and 90 percent in the United Kingdom.

## 4. Geographic Restrictions

Foreign insurers are only permitted to operate in Shanghai and Guangzhong, and this requirement limits the development of China's insurance market. China’s economic development and reforms will continue to stimulate demand for various kinds of insurance services all over the country. Indeed, the case studies of Zhangzhou and the Yellow River Delta show that the Chinese market for insurance holds great potential, even in undeveloped areas. Because domestic insurers cannot meet market demand, China should begin to allow more foreign pariticpation in the market. The geographical restriction should be removed within a couple of years, and city-by-city approvals should be replace with provincial-wide licensing administrations.

In the past, China’s economic reforms have begun in Shanghai, Guangzhou and other coastal cities and then spread out to cover all of China. Since the Shanghai insurance market has already been open for more than seven years, it is now time to allow more foreign participation in other parts of the country. Indeed, the impact of foreign insurance companies in Shanghai has been largely positive.

## 5. Products and Services

China’s insurance sector once emphasized business insurance such as marine, fire, and casualty. Currently, China permits insurance companies to offer either of two broad categories of insurance: property insurance or life (group and individual) insurance.  Foreign property and casualty insurers may only do business with foreign companies operating in China, not Chinese businesses or individuals. Foreign life insurance companies may not engage in group insurance sales to Chinese citizens.

Recently, the growth of the middle class, particularly in Shanghai and other booming coastal cities, has raised demands for various kinds of insurance, such as personal property insurance. China's social reforms have also raised the demand for new types of insurance. However, compared to other developed countries, China lacks a variety of categories of insurance.

If China were to loosen its limitations on the scope of services foreigners are permitted to offer, foreign companies would quickly expand the overall business scope of the Chinese insurance market. However, if CIRC were to permit foreign insurers to engage in group insurance sales, domestic companies might suffer large, immediate losses. Therefore, the CIRC should consider allowing foreign life and property insurance companies to create new types of insurance in order to meet market demand. It should also loosen the foreign limitation on group insurance—but it needs to do this gradually in order to give domestic companies room to develop.

## 6. Investment Opportunities

Article 104 of the Insurance Law limits both foreign and Chinese insurers to investments in bank deposits and Chinese government bonds.

> *The application of funds at insurance company (sic) is limited to bank deposits, trading of government and financial bonds and other forms of fund application stipulated by the State Council.*

Currently, most Chinese insurance companies invest more than 40 percent of their funds in bank deposits and 30 percent in government bonds. Insurance companies in other countries have many more investment opportunities. In the United Kingdom, for example, insurers invest more than 28.7 percent of their capital in the stock market, 21.9 percent in government bonds, 19.7 percent in real estate and 9.1 percent in company bonds.

Clearly, if an insurance company is limited to investment in bank deposits, it will be unduly affected by the bank interest rate, and this is precisely what has happened in China since 1996—interest rates have been cut seven times and now stand at just 2.25 percent. On the other hand, if an insurance company has more investment options, it can diversify its risks. Domestic Chinese companies have long complained that investment restrictions have threatened their businesses.

In 1995, the American International Group (AIG) received the Chinese government's approval to invest in Renminbi-denominated A-share markets in China. However, because the market was still unstable, immature and somewhat speculative, AIG didn't decide to make such investments. Five years later, the Chinese stock market is more mature, and both domestic and foreign insurance companies are interested in making stock investments. In November 1999, CIRC began allowing Chinese insurance companies to invest in mutual funds and to buy into such funds on the secondary market. The next step is to consider how to widen the investment channels for foreign companies.

Despite the clarity of these provisions, the process that foreign companies must go through to obtain a license lacks transparency and each company seems to be evaluated based on different criteria. Indeed, the basic principle of current policies is still that the domestic insurance industry should be opened to increased competition in a "gradual, paced" manner and the government still controls the industry very tightly.

### 3.3.2 The changes of legal field after China's accession to WTO

#### (1) Understanding the GATS

The General Agreement on Trade in Services (GATS) is the first ever set of multilateral, legally enforceable rules covering international trade in services. It was negotiated in the Uruguay Round and signed in 1995. The agreement covers all internationally traded services, including insurance.

China participated in all the negotiations on GATS and made specific commitments to provide access to its insurance market. The extended service negotiations were reopened in April 1997, and an improved set of commitments was agreed to in December 1997, however China did not participate in this negotiation. [16]

The key principles of the GATS are the provision of market access, national treatment, and most-favored-nation (MFN) status. The MFN clause requires that the members of the WTO accord to "services and service suppliers of any other member treatment no less favorable than that it accords to like services and service suppliers of any other country." [17] Because not all of the WTO members were willing to apply the MFN principle to all service sectors, Article II of the GATS permits members to annex to the Agreement MFN exceptions in relation to specified measures. MFN exceptions reflect that there is flexibility in the GATS rules.

Under the GATS, each member country negotiated its own specific sectoral commitments, and these were listed in country schedules appended to the Agreement. Article XVI of the GATS also leaves room for flexibility. It states that limitations on market access restrictions must be eliminated but allows for countries to make reservations in their individual schedules.

Article XVII contains the national treatment provision of the Agreement. The approach here is very similar to the market access approach, with national treatment applicable only to scheduled sectors, and only then if reservations are not made to the contrary. Another significant difference between national treatment in GATT and GATS is that in the former, national treatment is established as a principle to be applied across the board, whereas in the later, national treatment is subject to negotiation—it is to be

[16] http://www.WTO.org
[17] Article II:1, GATS Agreement, 1995

granted, denied or qualified, depending on the sector and member concerned.

The GATS also provides flexibility in that, on many issues, it only sets forth principles, which are subject to further in-depth negotiation.

In GATS 1995, China made commitments concerning its insurance sector, and China has agreed to further insurance sector liberalizations in its bilateral WTO agreement with the United States. China will need to live up to these commitments, but it does not need to make any new commitments in the near future. Indeed, as seen in the case studies below, other countries such as Malaysia and Singapore that are already in the WTO and are more developed than China have given weaker insurance commitments than China. Malaysia has even backtracked on liberalization policies, lowering rather than raising allowable foreign ownership of joint venture projects.

## (2) The main commitments of the Chinese government in opening the insurance business after entry into WTO

After 15 years of effort, Chinese accession to the WTO finally got achieved. Accordingly, China’s insurance sector needs to be opened to foreign competition based on WTO rules and the bilateral agreements reached with individual countries.[18]

## 1. Form of the businesses:

Immediately after China's entry to the WTO, non-life insurers from abroad were allowed to set up branches or joint ventures in China. Foreign firms were allowed to hold as much as 51% of the stake in the joint ventures. Two years after the entry, non-life insurance firms from abroad were allowed to

[18] http://www.china-insurance.com/, WTO-China insurance industry International Conference, November 12, 2001

set up solely funded sub-firms in China, i.e. there come to be no restriction on the form of enterprise establishment. Immediately after the entry, foreign life insurers were allowed to set up joint ventures in China, and hold no more than 50% stake in the joint ventures. They were also allowed to choose their partners independently. Investors of the joint ventures are allowed to make joint venture clauses independently within the scope committed. Immediately after China's WTO accession, the foreign stake in Sino-foreign joint venture insurance brokerage companies may reach 50%, and the proportion may not exceed 51% within three years after the accession. Five years after the WTO entry, foreign insurance brokerage companies were permitted to set up solely funded sub-firms. With gradual cancellation of geographical limitations, foreign insurance companies were, after approval, permitted to set up branches. The qualification conditions for initial establishment do not apply to the establishment of internal branches.

## 2. Geographical limitations:

Immediately after the WTO entry, foreign life and non-life insurance firms were allowed to offer services in Shanghai, Guangzhou, Dalian, Shenzhen and Foshan. Two years after the entry, their business could be extended to Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan and Tianjin. All geographical restrictions were removed three years after the entry.

## 3. Business scope:

Immediately after the entry, non-life insurers from abroad were permitted to engage in "general insurance policies" and large-scale commercial insurance without any geographical limitation, and offer non-life services to overseas enterprises, property insurance to foreign-funded enterprises in China, and related liability insurance and credit insurance services. Two years after the entry, non-life insurers from abroad were able to offer all kinds of non-life insurance services to Chinese and foreign customers. Immediately after the entry, foreign life insurance companies were permitted to provide individual (non-group) life insurance services to foreign citizens and Chinese citizens. Two years after the entry, they were permitted to provide health insurance, group insurance, pension insurance and annual pay insurance services to Chinese and foreign citizens. Immediately after the entry, foreign reinsurance companies were permitted to provide life and non-life reinsurance services in the form of Branch Company, Joint Venture Company or solely funded sub-firm. There are no geographical restrictions or quantity limits in license granting.

## 4. Business license:

Immediately after the WTO entry, China is committed to abolishing the restrictions on the number of licenses issued to foreign insurers. Foreign insurers must satisfy the following conditions before applying for licenses in China: a business history of more than 30 years in a WTO member, operating a representative office in China for two consecutive years and holding no less than US$5 billion in total assets as of the end of the year prior to the application.

## 5. On large-scale commercial insurance:

Large-scale commercial insurance refers to insurance provided to large industrial and commercial enterprises. Its standards are: the annual premium paid by such an enterprise at the time when China enters the WTO exceeds RMB800 thousand, and its investment tops RMB200 million; one year after the WTO entry, the annual premium paid by the enterprise should exceed RMB600 thousand and its investment should exceed RMB180 million two years after the WTO entry, the annual premium paid by the enterprise should exceed RMB400 thousand and its investment should exceed RMB150 million.

## 6. On legal insurance scope:

China has committed that the 20% proportion for reinsurance provided by Sino-foreign direct insurance companies to Chinese reinsurance companies would not be changed immediately after the WTO entry and would be lowered to 15% one year after the entry, 10% two years after the entry, 5% three years after the entry, and cancelled four years after the entry. However, foreign capital insurance companies were not permitted to engage in third party liability insurance of motor vehicles, liability insurance for public transport vehicles, commercial vehicle drivers and carriers, and other legal insurance services.

## 7. On general insurance policy brokerage service:

National treatment would be granted. However, the geographical scope for opening to foreign capital insurance brokerage companies will follow that to foreign insurance companies, i.e., they were allowed to do business in Shanghai, Guangzhou, Dalian, Shenzhen and Foshan immediately after the WTO entry, in ten more cities two years after the entry, and in all cities three years after the entry.

## 8.On application qualification of insurance brokerage companies:

Aside from the above conditions of a 30-year operating history and running representative office for two consecutive years, there are also conditions in the aspect of asset scale: in excess of US$500 million at the time of entry, in excess of US$400 million one year after the entry, in excess of RMB300 million two years after the entry, and in excess of RMB200 million four years after the entry.

## 9. On trans-territory delivery in insurance services:

Besides, the Chinese government has, in accordance with the General Agreement on Service Trade, made commitments with regard to the trans-territory delivery and other methods in insurance services:

Except for international marine shipping, aviation and freight transport insurance and reinsurance and large scale commercial insurance and reinsurance brokerage services, the Chinese government has not made any commitment with regard to trans-territory delivery; with regard to consumption outside the territory, except for no commitment on insurance brokerage, no limits were set on others; with regard to natural personnel flow, except for trans-industrial level commitment (i.e. general commitment covering insurance industry), no commitment was made on others.

## (3) China-U.S. Agreement on WTO Accession

China formally requested accession to the General Agreement on Tariffs and Trade (GATT) on July 11, 1986. On November 15, 1999, Washington and Beijing finally reached bilateral agreement on the conditions for China's entry into the WTO.[19] The agreement includes:

- ***Prudential Criteria:*** China agreed to award licenses solely on the basis of prudential criteria, with no economic needs tests or quantitative limits on the number of licenses issued.
- ***Geographic Limitations:*** China agreed to permit foreign property and casualty firms to insure large-scale risks on a nationwide basis immediately upon accession. The country also agreed to eliminate all geographic limitations for future licenses over five years and to

[19] " Market access and protocol commitments", http//www.insidetrade.com/1999 "April 8, 1999 U.S. list of Chinese commitments" http//www.insidetrade.com/1999 "Administration fact sheet on China agreement", http//www.insidetrade.com/1999

allow access to the key cities of priority U.S. interest in two or three years.

- ***Scope:*** China agreed to expand the scope of allowable activities for foreign insurers to include group, health and pension lines of insurance, which represent about 85 percent of total premiums, phased in over five years.

- ***Investment:*** China agreed to allow majority foreign ownership of insurance companies remove onerous joint venture requirements on foreign life insurers, and phase out internal branching restrictions. Life insurers will be allowed to own 50 percent of a company and, on accession, 51 percent ownership rights will be phased in within one year. For non-life and reinsurance, China will allow 51 percent ownership on accession and allow wholly owned subsidiaries in two years.

## (4) China-EU Agreement on WTO Accession

Seven new licenses, five for life and two for non-life business, will be immediately provided to EU companies, and two more companies will be able to establish in another city (sub-branches). This will substantially increase the EU presence in China, as only four firms are currently in the market. Effective management control has been negotiated for foreign participants in life-insurance joint ventures, through choice of partner, and a legal guarantee of freedom from any regulatory interference in privately negotiated contracts, on a 50-50-equity basis. Foreign insurers will see their scope of business advanced by two years in life and non-life activities, selling the same products as their Chinese competitors. This includes health, pension and group insurance in life, and all non-life activities except for statutory insurance.

Geographically, access of accelerated. Brokers (insurance intermediaries) will have access to the Chinese market through cross-border and local establishment for the first time. Upon accession, they will be able to establish on a 50-50 equity basis (with effective management control as indicated above). Foreign majority will be allowed within three years, and within five years there will be no equity restrictions. They will be able to undertake large-scale commercial risk and reinsurance business, which is the bulk of the brokerage market.

## 3.4 Policy field:

### 3.4.1 The status of policy system on insurance industry before China's accession to WTO:

To date, the Chinese government has opened the country's insurance sector only on a "gradual, paced" basis. It has been reluctant to allow foreign investors into the market except on a tightly controlled basis. The government will need to change its policies if the demand for insurance is to be met in the coming years.

Foreign insurance companies have complained that China's licensing process is not transparent and that it is based on informal factors rather than on transparent laws and regulations. Under the current system, these companies believe that if they don't demonstrate a long-term commitment to China by offering seminars, setting up research institutes or contributing to Chinese educational institutions, they will not obtain a license.

The statistics seem to bear out their suspicions. To date, 113 foreign companies from 17 countries have applied, but although most of them met the criteria mentioned above, they have not been granted licenses. A 1998 China Insurance Institute study offers further evidence of the problem. Of the 20 foreign companies surveyed, most believed that the relations between their home country and China are the most important factor in determining whether or not licenses are granted. (See Table3-9)

Foreign companies also believe that a company's status in its home country is an important factor, as well as a company's contribution to the Chinese education system. The companies saw networking and making connections or "guan xi" as key to foreign investors in all business sectors; they believe that non-market factors are more important than economic ones. In fact, the central government, specifically, the State Council, does wield a great deal of influence in licensing decisions, meaning that licensing often has to do with political or other issues rather than legal or market factors.

As noted above, the China Insurance Institute has also studied and noted the problem of ownership for foreign firms. Foreigners simply have very few options in choosing joint venture partners. (See Table3-10)

**<Table3-9> Factors that Foreign Companies Believe Influence Their Ability to Obtain an Insurance License.**

| | A | B | C | D | E | F | G | H | I | J | K | L | M | N | O | P | Q | R | S | T | Average |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Relationship Between The Two Countries | 5 | 6 | 6 | 5 | 7 | 8 | 6 | 9 | 7 | 6 | 8 | 5 | 7 | 9 | 6 | 8 | 7 | 5 | 6 | 5 | 6.55 |
| Company's Status in Its Home Country | 6 | 4 | 5 | 6 | 6 | 5 | 7 | 8 | 6 | 4 | 7 | 9 | 5 | 7 | 8 | 7 | 6 | 4 | 5 | 6 | 6.05 |
| Historical Relationship with China | 4 | 2 | 4 | 3 | 5 | 4 | 2 | 3 | 4 | 4 | 3 | 5 | 6 | 5 | 3 | 4 | 2 | 6 | 4 | 5 | 3.90 |
| Contribution to China's Education | 5 | 6 | 7 | 7 | 7 | 8 | 4 | 6 | 5 | 7 | 4 | 5 | 7 | 6 | 4 | 5 | 6 | 7 | 4 | 5 | 5.75 |
| Company's Asset | 6 | 4 | 5 | 7 | 6 | 5 | 6 | 4 | 7 | 6 | 5 | 5 | 6 | 6 | 7 | 8 | 4 | 3 | 5 | 6 | 5.55 |
| Willingness to Form a Joint Venture | 7 | 5 | 6 | 4 | 6 | 4 | 6 | 5 | 5 | 7 | 6 | 6 | 7 | 4 | 5 | 8 | 7 | 6 | 3 | 5 | 5.60 |
| Supporting China's WTO Accession | 3 | 4 | 6 | 5 | 6 | 5 | 4 | 3 | 2 | 4 | 7 | 6 | 4 | 5 | 5 | 3 | 2 | 4 | 7 | 5 | 4.50 |
| Domenstrating a Long Term Commitment | 2 | 4 | 4 | 6 | 5 | 7 | 6 | 4 | 5 | 3 | 2 | 4 | 3 | 4 | 5 | 7 | 6 | 3 | 2 | 8 | 4.50 |

* 1-10 represents levels of importance. 10 indicates a ”most important” factor. A-T are the respondent companies.

Sources: Dawei Cheng, “A strategy for opening up the Chinese insurance industry”, Mar 29, 2000

**<Table3-10> Factors that Infuence How Foreign Companies Choose Chinese JV Partners**

| | A | B | C | D | E | F | G | H | I | J | K | L | M | N | O | P | Q | R | S | T | Average |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Partner's Relationship with the Governement | 7 | 6 | 7 | 8 | 9 | 7 | 6 | 8 | 6 | 9 | 7 | 8 | 5 | 7 | 6 | 8 | 7 | 6 | 9 | 7 | 7.15 |
| Recommended by Chinese Governement | 8 | 9 | 7 | 8 | 9 | 6 | 7 | 8 | 5 | 6 | 7 | 8 | 9 | 4 | 6 | 7 | 4 | 7 | 8 | 9 | 7.10 |
| Partner's Attitude | 5 | 6 | 7 | 7 | 9 | 8 | 5 | 7 | 8 | 6 | 8 | 7 | 5 | 7 | 6 | 4 | 5 | 3 | 7 | 4 | 6.20 |
| Network for entering Chinese Market | 3 | 4 | 6 | 5 | 6 | 5 | 6 | 4 | 7 | 6 | 4 | 5 | 3 | 6 | 7 | 6 | 4 | 5 | 3 | 6 | 5.05 |
| Partner's Status in Market | 2 | 3 | 4 | 5 | 3 | 4 | 3 | 5 | 2 | 4 | 7 | 6 | 4 | 3 | 2 | 5 | 6 | 7 | 4 | 3 | 4.10 |
| Management Skill of the Partner | 3 | 4 | 2 | 7 | 6 | 3 | 4 | 4 | 3 | 2 | 6 | 5 | 4 | 4 | 3 | 4 | 5 | 6 | 7 | 5 | 4.35 |

*1-10 represents levels of importance. 10 indicates a ”most important” factor. A-T are the respondent companies.

Sources: Dawei Cheng, “A strategy for opening up the Chinese insurance industry”, Mar 29, 2000

### 3.4.2 The measures applying to the changes of policy on insurance industry:

As part of its overall program for restructuring the country’s economy, the Chinese government has launched a series of social welfare reforms. In turn, these reforms are generating a growing need for private, commercial insurance. Commercial insurance will play an important role in maintaining social stability in the country. China’s policies for regulating the insurance sector need to be revised so that they are based on market rather than political factors.

Until recently, China’s health-care and pension insurance systems were based on central planning. Now China is reforming these systems, and the reforms will undoubtedly generate more business for insurers. If the CIRC can convince the central government to incorporate commercial insurance carriers into its reforms, the potential for Chinese insurance companies operating in China will rocket.

## (1) The Health-Care System

In rural areas, around 64 percent of the Chinese population has no health insurance. Only 120-million farm and village enterprise employees are covered by Cooperative Medical System (CMS) plans, and CMS is not an effective or efficient system even though it has been in operation for several decades. CMS lacks qualified personnel, stable financial resources, an effective fund collecting mechanism, and essential health facilities and equipment.

In China's urban areas, most workers’ health problem is covered by the government or SOE health care systems. There are many problems associated with these systems. While GDP was growing at 9.8 percent (1978-1993), the combined spending for these programs grew at an annual rate of 11 percent between 1978 and 1992, and jumped to 13 percent between 1986-1993. The government's health care budget increased from 14 percent in 1978 to 30 percent in 1993. In recent years, the 11 percent enterprise set-aside for medical expenses has simply been insufficient, and enterprises profits have had to be used to supplement the shortfall. In some cases, the shortfalls have imposed large financial burdens on enterprises by limiting their resources for reinvestment in capital equipment and for other welfare services, such as pensions.

In 1994, the State Council launched a pilot program in Jiujiang, Jiangxi Province, and Zhenjiang, Jiangsu Province with the goal of reducing health care subsidies in SOEs.[20]Three tiers of financing were introduced: Medical savings accounts (MSAs), out-of-pocket spending in the form of deductibles, and social risk pooling. MSAs provide incentives for consumers to be more cost-sensitive in their demand for health services; deductibles act to further increase cost sharing by patients; and social risk pooling aims to protect persons against catastrophic expenses. Employees and employers contribute one percent and 10 percent, respectively, of their total wage bill each year, and these contributions are divided between two accounts. Five percent goes to the social risk pool, and six percent goes to the individuals' MSAs.

The program was expanded in 1997 to over 60 other cities, and it is likely to become national policy, applicable to domestic and foreign-invested firms. However, primary data collected from these two mid-sized cities indicates that the program has some undesirable side effects. People are not allowed to choose which hospital they go to, not everyone has the same right to health care, and fraud is rampant because so many people are uninsured. The study also shows that, in 1994 in Zhenjiang and Jiujiang respectively, 13.7 and 15.9 percent of workers were not able to get their health expenditures reimbursed on time. Thus, although MSAs have become a widely proposed model for health care reform, it is not that they don't have problem. Moreover, relying on MSAs ignores the contribution that commercial providers can make. Instead of, or at least in addition to, further expanding MSA programs, the State Council should give the private sector greater latitude to provide coverage.

Indeed, the government's economic reforms are stimulating consumer demand for better quality and an expanded range of health services, and provisions need to be made for the rapidly growing segment of the population that works for private companies. In 1978, 72 percent of new urban job entrants were assigned to the state sector, but by 1985, the

[20] http://www.china-review.org/index.asp? s_year=1998

proportion had fallen to 61 percent.[21] While foreign-invested private enterprises are required to provide health insurance benefits via the Foreign Enterprises Service Corp. (FESCO), other private enterprises most often offer no medical coverage at all. The following two examples illustrate the problem:

- Zhang Jing has worked with a foreign-funded enterprise since graduating from college. Zhang earns a fairly high income when compared to her classmates assigned to SEOs. However, said Zhang, "I am constantly obsessed by a feeling of instability. For example, I could be fired for failing to do a good job, and my income may be lower than that paid by a state-owned business." The feeling of instability spurred Zhang to obtain medical and retirement insurance.[22]

- Ma Jianghua has operated a private business for 10 years. In 1988, a friend convinced Ma to buy medical and retirement insurance from Pingan's Shenzhen Branch. "I pay a fixed annual premium to the insurance company. The insurance in turn provides coverage if I am ill. The policy basically provides the same coverage as the free medical care system. In addition, at age 65, the insurance company will provide me with a monthly retirement pension. My retirement pension will compare favorably with pensions paid to employees of state-owned enterprises and institutions."

Premier Zhu Rongji announced in June 1999 that China was to set up a nationwide, integrated medical care program in three to five years. The time is ripe for CIRC to advocate liberalization of the domestic and foreign commercial medical insurance sectors.

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[21] China State Statistical Bureau, 1996.
[22] " Insurance Boom," a report from the Pingan Insurance Co. 1998.

## (2) Pension Reform

Pension reform has been undertaken in many countries. An important role in promoting it has been played by the World Bank. The World Bank advocates the reform in order to stimulate economic growth and foster development of the capital market and private pension industries, and not just to guarantee an adequate income for the elderly (World Bank, 1994). Hence, privatization of the pension system or a mixed system (three-pillar system), including a first mandatory PAYG pillar, a second mandatory funded pillar and a third voluntary insurance pillar has been encouraged by the World Bank throughout the world, with little attention to the country-specific situation.

In China the pension scheme is available for urban employees. The most recent framework for pension reform was established in July 1997. The new pension system includes three pillars: a pooling account to redistribute to all beneficiaries, compulsory individual accounts, and supplementary pensions offered by commercial insurance on a voluntary basis. The first pillar imposes a payroll tax of 17% (paid by employers) to ensure that employees who have worked more than 15 years have a replacement rate of 20%. The second pillar (paid jointly by employers and employees) establishes an individual account for each employee. The contribution for this is 11% of an individual's wage. After retirement, the employee gets a monthly benefit from this account of the accumulated value divided by 120.[23] The target replacement ratio of first and second pillar taken together is 58.5%[24]. In this system, about 60% of contributions will go into the PAYG system,

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[23] This assumes that the average life expectancy on retirement is ten years. It also means that the scheme redistributes income from those with short lives to those with longer lives. In addition, if the average life expectancy of retirees exceeds ten years, these 'funded' pensions will in fact be financed on a PAYG basis.

[24] This is based on the assumption that life expectancy is 70 and the rate of growth of real wages equals the real interest rate. If one contributes to the system for 35 years, then the individual account could provide a 38.5% replacement rate. So jointly, the two pillars have a replacement rate of 58.5%.

while 40% will be channeled into individual accounts.

There are a number of studies, which simulate China's pension reform based on the rationale for a multi-pillar system (Barry Friedman, et.al, 1996; McCarthy and Zhang, 1996; World Bank, 1997; Yan Wang, 2000). Their results show that the costs of the transition from a PAYG to FF are quite manageable, and several ways to finance the transition are suggested. However, reality is diverging from these projections. A number of problems concerning China's pension reform have arisen. These include, the heavy contributions burden on enterprises supposed to finance the transition cost, which often leads to delays in the payment of pension contributions and outright evasion, the misuse of the funds in the supposedly funded individual accounts, which remain notional, and the weak performance of financial markets, which hasn't generated a satisfactory return to the pension fund. It seems that the transition problem has been underestimated while the returns on the private accounts have been overestimated. More research is needed to compare PAYG and FF under Chinese conditions, to consider to what extent the system should be mixed, and how to keep the system financially viable.

## 1. Welfare analysis of China's pension reform[25]

Pension reform is normally discussed in a neoclassical economic framework, where utility maximization and efficiency-improvement are the main justification for reform. The main argument of neoclassical theory for pension reform is based on the different impact on savings caused by PAYG and FF. Theoretically, there is no long run effect on capital accumulation with a moderate funded system but if the funded system is expanded to a higher level, then there is an increase of capital supply due to forced savings,

[25] www.future-china.org/fcn/papers/1999011801.htm

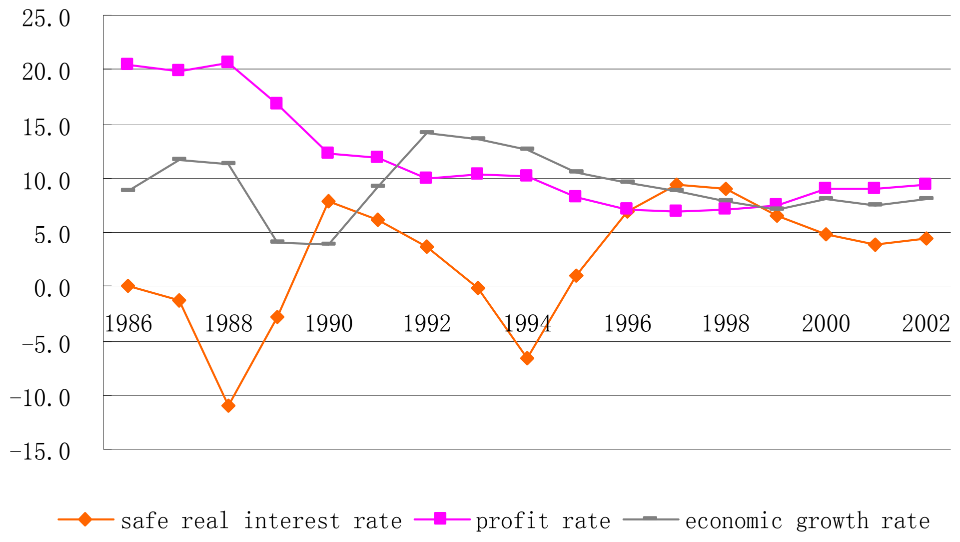
while a PAYG system has a negative effect on savings and thus the capital supply is reduced

For comparison, the data on the interest rate and rate of profit in industry in China can help us compare them with the economic growth rate. Similar to the situation in other countries, the distinction between the real interest rate and the profit rate is important[26] (Figure 3-8). Before 1996, the marginal product of assets was much higher than the rate of interest on government bonds and after that, in 1997 and 1998, the marginal product of assets was a little below the interest rate. Since 1998, because of monetary policy in China, the interest rate has declined. If we compare the risk-free interest rate and the economic growth rate, the outcome is unambiguously that the risk-free interest rate is below the economic growth rate. However, this condition is not sufficient to establish dynamic inefficiency. The essential point is that it doesn't take productivity shocks into consideration (Abel,et.al, 1986). Furthermore, in China the risk-free real interest rate is a result of direct intervention by agencies of the state rather than the equilibrium of the demand for and supply of funds.

Possibly, we can assess dynamic efficiency by comparing the profit rate and economic growth rate. Figure 3-8 shows in some years the profit rate is higher than the economic growth rate, but in 1992-98, the economic growth rate is higher, which suggests that the economy was then dynamically inefficient. However, it is not sure the profit rate calculated in this way correctly denotes the rate of return of capital, which makes it uncertain whether China's economy is dynamically inefficient or not.

[26] Abel et.al (1986) thinks this distinction is a meaningful one if profitability, the value of capital and the growth rate are uncertain. The higher return of assets is a compensation for the risk that the price will decline if the future profits fall off.

**<Figure 3-8> A comparison of real interest rate, profit rate and economic growth rate in China (annual growth rate, %)**




Sources: National Bureau of Statistics (NBS), China, *China statistical yearbook* (1987-2000).

Notes: "real risk-free interest rate" is the rate of return on five-year government bonds adjusted for inflation; the exact meaning of "profit rate" is the ratio of profits, taxes and interest to average assets of all the stated-owned and non-state-owned industrial enterprises. It is calculated as follows:

Ratio of profits, taxes and interest to average assets (%) = [(Total profits + total taxes + interest payments) / average assets] ×100%

## 2. The transition features of China's pension reform[27]

When considering pension reform, the welfare aspect of the transition should not be neglected, that is the impact on the welfare levels of different cohorts during the period of transition from one system to another. In PAYG, the first generation received the pension as a gift, which created a cost inherent in the system. But it is an implicit debt in a rule that each generation gets the benefit from the subsequent one. When changing from unfunded PAYG to individual accounts, this implicit debt becomes explicit

[27] www.future-china.org/fcn/papers/1999011801.htm

and it has to be decided who should pay for the liability existing throughout the history of the system (Breyer, 1989; Homburg, 1990). It is commonly recognized that in general there is no Pareto improving way of making a transition from a PAYG system to a funded system. Such a transition would make at least one generation worse off (Brunner, 1996) no matter how high the average rate of return on assets is relative to sustainable GDP growth. On the transition path, funds need to be accumulated for the current generation while pensions must still be paid to the previous generations who have accumulated rights to receive pensions in the PAYG system. Barr (2000) considers cases of financing the transition cost by public borrowing, by taxation or by letting the transition generation bear the cost. He shows that FF could not result in a higher return during the transition period even in a dynamically efficient economy unless at the expense of the transition generation.

As for China, according to the reform framework, for those who had already retired before 1997, the original PAYG system was retained, while to those who entered the labor market in or after 1997 the new three-pillar pension system is applicable and to those who started work before 1997 and retired or will retire after 1997, a transitional plan is applied[28]. So in Chinese practice, the transition cost consists of two parts: one is the pension commitment to those who retired before 1997 which is subtracted from the amount that could be received by others from the new pooling account; the other part is equivalent to the amount needed to establish the individual accounts for those to whom the transition plan is applied.

Initially, government counted on the multiple-pillar system with a higher contribution rate and extension of coverage[29] to absorb the transition cost.

[28] In practice, the transition arrangement differs regionally, but in most cases, the replacement rates for these retirees are similar to those for retirees who retired before 1997, on average 75%-80%.

[29] China’s pension system was established in 1951 for employees in urban state sectors and one of the objectives of reform was to extend the system to non-state sectors

According to documents of the State Council (Document. 26, 1997, State Council), 4% out of the 17% contribution rate to the first pillar is for transition purposes. The benefits for the pre-1997 retirees were not to be downsized and a plan to extend the pension scheme to cover more employees was supposed to increase the inflow into the system and keep the system in financial balance. In fact, the current workers and employers bear the cost, which means a double burden for present workers: simultaneously contributing to individual accounts and paying for the current generation of retirees. On the other hand, higher investment return were expected to offset the cost, because as long as the rate of return on investment is significantly higher than the growth rate of wages, then the required contribution will be far less than doubling the contributions under the pay-as-you-go system.

However, a deficit in the first pillar soon emerged and the funds in the individual account were used to pay for the benefits to current retirees. This transformed what had been intended as an actually funded system into a (partially) notionally funded system. Notional funding undermines fiscal discipline since it makes the fiscal situation look better than it is (the deficit of the individual accounts is ultimately a liability of the state budget). Furthermore, these empty accounts with an uncertain interest rate undermined confidence in the system and individuals and enterprises lack incentives to participate in it. Furthermore, the investment return of the social security fund measured by the return on government bonds was greatly below the growth of money wages that makes it difficult to accumulate financial assets that will in due course pay a pension that has a reasonable relationship to average earnings[30]. Under these conditions, contributions to the second pillar pension scheme are more in the nature of taxes than of saving for old age. So the system only expanded its coverage slowly. In 2000, 100% of state-owned-enterprises participated in the

[30] According to Chinese regulations, not less than 50% of social security funds must be invested in risk-free assets (bank deposits, government bonds).

pension scheme, while only 59% of collective enterprises and 18% of private enterprises were involved in the scheme (MOLSS, 2001). It is obvious now that neither the contributions of current workers nor the anticipated higher investment return solved the problem of transition cost.

# Chapter4

# The future development of the Chinese insurance industry after China enters the WTO

## Impact of WTO membership on China's insurance industry

Since its foundation, the China Insurance Regulatory Commission has made a great deal of efforts with all insurance companies to energetically promote the development of the country's insurance industry. In 2000, insurance companies nationwide yielded 159.59 billion yuan in premium revenue, and their assets totaled 337.39 billion yuan, up 776 million yuan and 1.45 billion yuan, or 205 and 231 times, respectively compared with 1981. Along with the rapid development of the insurance business and continuous increases in market players, the number of domestic and foreign insurance companies has grown to 40, including five wholly State-owned companies, nine shareholding companies, 13 joint ventures (with six in the preparatory stage) and 13 foreign insurance companies' branches. An insurance market facilitating the competition of diverse insurance companies has initially taken shape.[31]

After China's WTO entry, the opening of the insurance sector will gradually move from the pilot stage to a new period of all-round opening-up with a faster pace. While following international common rules and enjoying corresponding rights and interests, China will also fulfill stipulated obligations. The impact of WTO membership on the development of China's insurance industry is mainly manifested in the following aspects:

[31] www.china-insurance.com

The opening of the insurance market will accelerate the inflow of overseas capital and technologies, promote the upgrading and restructuring of China's traditional industries and stimulate the development of the national economy and foreign trade. The rapid economic growth, on its part, will provide China's insurance industry with unprecedented market opportunities and room for development.

The opening of the insurance market will expand business scale, intensify market competition and break monopoly. At present, China's insurance sector is still in the stage of initial development with a limited scale, which can hardly meet the needs of national economic development and social progress. After China's WTO accession, a growing number of foreign insurance companies will enter the Chinese market, and competition will become fiercer. Only by upgrading its products, improving service and expanding influence can China's insurance companies survive.

The opening of the insurance market will urge Chinese insurance companies to quicken the pace of structural reform, transform operational mechanisms, and establish a modern enterprise system with clearly defined property rights and interests, separated government administration and scientific enterprise management that suit the needs of market competition. At present, there is a fairly big gap between Chinese insurance companies and their counterparts in developed countries in terms of management system, operational mechanisms and competitive capacity. Wholly State-owned insurance companies should straighten out their relations of property rights, establish a modern legal entity management structure and form effective internal incentive and restraint mechanisms through inviting foreign investors to hold stakes in them, establishing joint ventures, listing according to standard and other measures. Chinese shareholding insurance companies are encouraged to readjust their equity structure and attract foreign investors, non-public businesses and listed companies to acquire stakes in them, which will help increase their capital and payment abilities, strengthen their management structure, and promote the transformation of their operational mechanisms. Qualified companies will be allowed to list in a standard way.

The opening of the insurance market will change the sector's mode of growth. Foreign companies' entrance into China's market will bring in not only a complete internal control system and prudent management principles, but also advanced management ideas, management expertise, products, service and technology. All this will buffet the traditional concepts of domestic insurance companies, and urge domestic companies to enhance management and operational levels, accelerate the transformation of the mode of growth, and establish new points of business growth.

The opening of the insurance market will benefit the gradual formation of China's insurance market system. China's insurance sector has made marked progress in recent years. Given the tremendous potential of China's insurance market, however, the sector still lags far behind. One of the main reasons is the country's incomplete market system. Hence, China's insurance industry faces the main tasks of increasing market players, developing intermediary service, carrying out product, technology and management innovations, intensifying legal system construction, reinforcing management and regulatory functions, and gradually forming a market that is ruled by law and facilitates orderly competition.

The basic WTO rule stands for marketizing economy and trade and reducing as much as possible the government's administrative interference in economic activities. In this sense, the insurance regulatory department will feel the greatest pressure after China's WTO accession. The China Insurance Regulatory Commission, in line with relevant WTO rules, will strengthen and improve the regulatory work in real earnest, enhance the transparency and openness of management and regulation, improve work efficiency, and create a sound environment for the healthy development of China's insurance industry.

In a word, after China enters the WTO, its insurance market will open wider to the outside world. Advantageous companies will gradually expand their market share and attract more talented people. On the contrary, disadvantageous companies will face growing difficulties and contradictions. Their only way out for survival and development is to carry out reform and innovation. The invisible market force will push China's insurance industry to a brand-new stage of development.

## 4.2 The future changes of insurance in China's economic development:

China's entry into the WTO should be help speed up the process of internationalization of China's insurance industry. By then, not only will foreign enterprises come in, Chinese enterprises will also need to go abroad to participate in competition on the international market and show off their own strength. In the face of the opening of the Chinese insurance market, what domestic insurance companies need to consider is not to scramble with foreign insurance companies, but is how to join efforts with foreign companies to make the Chinese insurance market bigger than before.

### 4.2.1 The future changes in the commercial field[32]

### 1. Structuring market bodies with ample competitiveness

First, the number and type of insurance companies should be increased in order to form a multiple ownership structure, and expand the business scope to a certain degree as soon as possible. The opening up policy should be applied "outwardly" as well as inwardly. We should set up a multiple

[32] "Development, Reform and Opening Up of China's Insurance Industry" by Sun Qixiang

ownership structure of insurance firms, such as the state owned, state share-holding, joint ventures, subsidiaries of foreign companies, and privately owned insurance companies, under some conditions. Second, the management structure should be further standardized. The system of boards of directors and boards of supervisors should be strengthened in accordance with the law, and the scope of responsibility and behavior of directors and supervisors should be clarified. Third, some share-holding insurance companies can be publicly listed to expand the channels for raising capital and optimizing the capital structure. Fourth, the companies should solve the problems of resource wastage and "suicidal" premium rates caused by "repetitive insurance type structures". They should also build their core competence by paying more attention to their "target market" and introducing "comparative advantage products". Fifth, the insurance industry should replace the existing mode with innovation and technology input, and press ahead with intensified development. Sixth, the insurance industry should gradually realize electronically controlled business processes by applying IT. Seventh, the insurance industry should perfect the business process, enforce an insurance and compensation checking system, and enhance the management of various warranties and policies. Eighth, an independent internal auditing unit should be established.

## 2. Expanding the channel of capital utilization and increasing the profit of insurance investment [33]

The insurance companies should make good use of current investment channels. On the basis of guaranteeing the safety of insurance capital, the State Council and other departments concerned could properly expand the investment channels by issuing exclusive long-term national bonds of

[33] Sun Qixiang & John Maxwell, “Market Oriented Operation of Life Insurance Investment”, from *The Economic Research* Vol12, 1998

various types with appropriate interest rates, or allow industrial investment within a certain scale, so as to adjust and improve the utilization structure of insurance capital.

Life and property insurance capital should be dealt with differently. Life insurance capital comes in a relatively stable manner and extends over a long cycle. Therefore, a certain proportion of long-term investment is possible. For example, life insurance companies can grant mortgage loans to housing purchasers directly or by cooperating with banks. The supervisory department can control the insurance companies by setting the maximum amount of loans. In doing so, we can promote the current housing welfare system reform as well as rearrange the life insurance investment pattern.

### 3. Cautiously following the world trend of convergence of banks and insurance

Currently the business scope of China’s financial institutions are strictly confined to their separate functions, and insurance enterprises are no exception. This is suitable for the current, incomplete financial system and embryonic insurance industry. However, since in the international market, banks and insurance companies have started to mix their business, China’s companies should be cautious and prepared. With the maturing of conditions, they will also develop their multi-functions and improve their competitive power by moving into other financial sections through share holding. What China needs is not "socialist capital markets" but Real capital markets with private owners who can specialize in risk taking, who can freely capitalize expected future profits into their present values by selling shares on organized stock exchanges and who are held fully responsible for losses. That means prices, including interest rates, must be determined by the free market. China's financial future will depend on the steps that are taken in the next several years to restructure state-owned banks and enterprises. Allowing greater foreign competition will play an important role in transforming the financial landscape, but ultimately the only way to efficiently allocate capital and de-politicize investment decisions is to privatize banks and SOEs.

### 4.2.2 The legal directions of Chinese insurance market[34]

### 1. Financial reform and legal framework

As China's financial reform is accelerating, the task of preventing financial risks has become more important and challenging. Given the innate risks associated with the financial sector, the legal framework for the sector cannot eliminate all financial risks once and for all. However, a sound legal framework may help deter imprudent risk-taking activities of financial institutions and reduce systemic risks. Furthermore, a favorable legal environment is the precondition for the steady performance of the financial system.

In the long run, we should not only focus on legislation but also on the enforcement of existing laws. In my view, the core issue of financial legislation lies in a scientific approach. Different stages of the financial sector call for different approaches. At present, financial legislation should focus on improving infrastructure of the financial market, regulating legal relationship concerning financial innovation, advancing the coordination and effectiveness of financial supervision, and making the best use of market self-discipline.

First, we shall approach financial legislation in a coordinated, scientific and comprehensive manner. China's economic reform and financial reform are at a critical period, when the stand-alone strategy no longer

[34] "Development, Reform and Opening Up of China's Insurance Industry" by Sun Qixiang

meets the requirement. Therefore, coordinated planning and rational thinking should prevail in financial legislation.

Second, we should stick to the protection of the interest of the depositor, investor and creditor. Protecting the interest of depositors of financial institutions and the interest of investors in financial products is always an important factor in the maintenance of the reputation of financial institutions.

Third, we should stress both self-discipline and external discipline. In drafting laws concerning financial supervision, we should stress the importance of a sound and complete mechanism for corporate governance by such players as commercial banks, brokers and listed companies. While emphasizing the self-discipline of financial institutions, we should also guarantee the autonomy of these institutions in their operation and leave sufficient room for their future development.

Fourth, we should raise the public awareness of financial risks and rules, which is one of the most effective methods for preventing financial risks and ensuring financial safety. During the process, we should foster the extensive publicity of credit culture, increase the awareness of risk prevention among the public and investors, and preach the virtues of lawful investment.

## 2. Establishing and perfecting the legal system in insurance field

The five-year plan conducted by the CIRC points out that new laws and regulations should be drafted and published as soon as possible, such as the Rules for Implementation of Insurance Law, Compulsory Insurance Provisions for Third Party Liability Insurance of Motor-driven Vehicles, Rules for Export Credit Insurance, Rules for Agricultural Insurance, Managerial Provisions for Insurance Adjusters, Managerial Provisions for

Foreign-Funded and Joint Venture Insurance Companies, Managerial Provisions for Insurance Protection Fund, Managerial Provisions for Insurance Investment, and Managerial Provisions for Reinsurance. The insurance regulatory bodies should enhance information exchanges and cooperation with other departments concerned so as to ensure compatibility between insurance industry policy and national monetary, fiscal, tax and opening up policies, and to ensure stability in implementing these policies.

### 4.2.3 How to improve the policy field[35]

1. **Constructing an open and fair market by adjusting certain policies**

One of the core principles of WTO is "national treatment", referring to the principle that foreign goods and services should enjoy equal status with the goods and services of the importing nations. In the current Chinese insurance market, both foreign and domestic companies seem to have some cause to complain about not enjoying national treatment. For foreign companies, their business is restricted by region and insurance line, operating only in Shanghai and Guangzhou. At the same time however, they enjoy some "ultra-national treatment" that the Chinese companies cannot enjoy. They are less restricted in terms of investment, (According to the Shanghai Regulations, besides enjoying the same investment rights with Chinese insurance companies, foreign companies can also invest in corporate bonds, stocks and trust loans of foreign exchange.). In addition to enjoying a lower tax rate — 15% compared to 33% for domestic companies.

As indicated by international experience, most countries usually grant favorable fiscal and tax policies to the insurance industry by a levying sales

[35] “Development, Reform and Opening Up of China’s Insurance Industry” by Sun Qixiang

tax at about 3%, and adjusting tax rates according to insurance lines. In China, the Ministry of Finance, at the beginning of 1997, ruled that the sales tax rate of banks and insurance companies would be raised from 5% to 8%. According to document No. 70 (1997) of the People's Bank of China on Oct. 23rd, 1997, the deposit interest rate of insurance companies will not follow the inter-bank interest rate (which was then 7.92%), but the rate of 1.71%. However, other financial organizations such as trust, financial and security companies would continue to enjoy the inter-bank deposit interest rate of 7.02%. (Information from the Central Bank and the Bank of Industry and Commerce. Later, the People's Bank of China postponed the implementation of the decision. In Sept. 1999, the PBOC ordered, without setting a specific standard, that insurance companies should adopt an agreed deposit interest rate. Starting from Jan 2000, the Bank of Industry and Commerce had adopted a unit deposit interest rate for insurance companies' deposits for less than a five-year term. As for five-year or longer deposits, the bank either sets a rate at 5% above the normal rate or adopts a yearly floating rate.).

## 2. Paying attention to training professionals

The special operational pattern of the insurance industry demands professionals specialized in marketing, actuarial work, underwriting, investment, claim settling etc. The training of these professionals is a cumulative process. Suspension of the insurance industry for 20 years directly led to a severe shortage of trained professionals. Besides the limitation of companies' training levels, current academic training in the universities that have started majors in insurance is unable to support the development of the industry fully, due to the lack of qualified teaching staff, newly updated textbooks and advanced teaching methods.

Competition in a modern market economy is essentially based on talent. Capable people are always needed in whatever fields for product innovation, carrying out various reforms, following the trend of the world insurance industry, or for occupying a place on the world stage through competition. The following has to be done to train more insurance expertise more rapidly: (1) academic training must be strengthened; (2) the training of current employees must be strengthened; (3) the qualification examining system must be established and perfected; (4) and talents must be introduced from abroad.

## 3. Further opening up in China’s insurance market

The domestic insurance regulatory body, specialists, scholars and insurance companies all agree on the step-by-step opening up of China’s insurance market. In terms of region, cities with better developed economies, more advanced insurance markets, more mature national insurance companies and deeper consumer understanding of risk should be the first chosen for opening up. Other cities can wait for better conditions. In terms of business scope, the opening up of the property and medical insurance markets should precede life insurance. In terms of the opening up pattern, foreign insurance companies are encouraged to participate through share holding. In the meantime, the domestic insurance companies are also encouraged to compete in the international market so as to learn from their foreign counterparts, follow the latest trends and speed up the pace for connecting with the international market.

# Chapter5
# Conclusion

Insurance emerged as one of the most hotly debated issues regarding China’s entry into the World Trade Organization as a result of both historical precedents and the potential for significant market growth. The new rules for insurance operations in China under the WTO will allow insurers more freedom to enter and operate in this market. China's current insurance policy keeps focusing on its “gradual, paced” policies for allowing foreign competition into the market. The goal of the article is threefold: to introduce the history of China’s insurance industry; to compare to the changes of Chinese insurance industry between before and after access to the WTO in commercial, legal and policy three fields; to get the developing directions in according with the changes and set out series of action for liberalizing the industry.

China’s insurance industry has developed very quickly. Insurance premiums increased by nearly 40 percent annually from 1980 to 1998—a rate that far outpaced the country’s 9.7 percent GDP growth rate. Such growth shows that the insurance sector is increasingly important to the country’s economy. The growth is also attracting the attention of foreign insurance investors, even though China’s insurance sector is relatively closed.

China will need to liberalize its insurance market in the near future in order to meet the commitments it made in its WTO accession agreements. Yet even if China had not made WTO commitments on insurance, current economic and social welfare reforms in China are increasing the country’s need for a strong commercial insurance industry. Although policymakers remain concerned about how the domestic industry will fare in the face of foreign competition, past experience indicates that foreign pariticipation in the insurance market can help it grow and diversify.

In a word, China's accession into the WTO will bring about profound changes in a market poised for rapid growth. The loosening of restrictions in the insurance market should provide an expanded array of products for China's citizens and corporations, fostering growth and development. New opportunities for foreign insurers to participate in this growing market are available, but successful entrants must pay close attention to the details of regulatory policy and the unique elements of the market structure in this country. The stakes in this market, as well as the risks, are recognized to be significant, so much so that issues related to insurance markets were the last items to be finalized before WTO membership for China was attained. Insurance is understandably a key element of the future for both China and its trading partners.

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