How Attractive Is China's Market?

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As many international insurance giants eye the Chinese market after China's entrance to the WTO, the American-based Lincoln Financial Group has decided to leave China after nearly ten years in the country. In mid-January, the company confirmed that it will close all offices in Beijing, Shanghai and Guangzhou in March. This means that Lincoln Financial, which itself has been undergoing strategic restructuring, has completely abandoned the Chinese insurance market.

When many other international financial companies are rushing to China due to its WTO entry, why did Lincoln Financial Group, which has been operating in China for ten years, go against the trend? The main reason on the surface seems to be related to the company's internal strategic re-adjustment. In 1998, the Lincoln Financial Group designated all its overseas branches, except its London branch, as solely doing business in the area of re-insurance. Consequently, the Lincoln Financial Group focused on securing a business license in China for operating re-insurance programs. But no foreign investment has been allowed to enter China's re-insurance market. Later, the Swiss Re-insurance company bought Lincoln Financial's re-insurance business. With this change of ownership, it seems understandable that Lincoln Financial's Beijing branch was finally closed.

The entrances and exits of foreign financial organizations are normal occurrences. As such, the exit of the Lincoln Financial Group may not entail anything profound. Those who are worried about the invasion of foreign financial capital seem to have reason for celebration.

WAITING AND ITS COST

As early as the dawn of the 19th century, the British merchants were calculating the numbers. They figured out that if every Chinese person bought a shirt, the textile machines at Lancaster would be kept busy for many years. However, until the day the British Empire declined, the British did not see as many silver dollars as they had dreamed.

The mysterious Chinese market has brought countless foreigners the most attractive imaginations. The Lincoln Financial Group was no exception. As early as 1993, Lincoln Financial showed great interest in China. At the time, in order to enter the China market, Lincoln Financial registered a Lincoln National (China) Inc. in the U.S. Soon afterwards, Lincoln Financial opened its first office in Beijing in 1994. Two offices were subsequently opened in 1995 and 1996 in Shanghai and Guangzhou, respectively.
The chief objective of these offices, like offices of all other multi-national corporations in China, is to function as a public relations scheme, to lobby various Chinese bureaucratic agencies, or, to use Lincoln Financial's own parlance, to "look for the important

opportunities that will bring long-term impact." Thus, Lincoln Financial spent lavishly, with its chief executives busily shuttling between the U.S. Congress and the White House, launched an active lobbying campaign through letters, visits, and telephone calls, and demanded that the U.S. government develop a good relationship with China. John Bosia (phonetic transliteration), the president of the Lincoln Financial Group, was even invited to be the adviser to the Governor of Guangdong Province, and was actively providing policy advice to local Chinese governments. The Lincoln Financial Group also cooperated with the Chinese government agencies and with the Chinese insurance companies, including China's Ping An Insurance. It also organized various kinds of surveys and training activities, and even sponsored some educational projects for the frontier regions.

Every China branch of multinational corporations was engaged in this sort of "charitable activity." This was one of the necessary payments they had to make for entering the Chinese market. The purpose of setting up an office in China is just that, to make these payments smoothly. It really does not mean much. We may regard these expenditures as "lease money" made to the Chinese bureaucratic agencies in charge. They had hoped that after paying the "lease money," they would receive business licenses. However, after long periods of waiting, they usually received nothing in return.

THE PROBLEM OF ATTRACTIVENESS

The decision to pull out of China appears to have been prompted by Lincoln Financial's own strategic consideration. Lincoln Financial still has investments in China worth $400-500 million. Whether Lincoln Financial will come back to China or not should not be our big concern. But this incident also warns us that blind belief in the attractiveness of the Chinese market can make us overly optimistic about the future.

In a certain sense, we can say that the economic miracle in China in the last twenty years has more to do with China's openness than with its reform. The key to this Chinese growth has been foreign investment. However, since 1995, China's ability to attract foreign investment began to decrease. The total sum of contractual foreign investments has been in decline year after year; actual foreign investments in 1999 dropped by 11%, with only a 0.9% increase for 2000. Yet during the same period, global foreign direct investments (FDI) increased by 30% annually; China's share of global FDI decreased from 11.4% in 1995 to 4.7% in 1999, and to less than 4% in 2000. Correspondingly, China's ranking in global FDI statistics also dropped year by year. China ranked third, only after the U.S. and Britain, in 1998. Yet in 1999, Sweden surpassed China, while several countries and regions climbed ahead of China in 2000.

The good news is that in 2001, foreign investment in China started to pick up again. At this juncture, terrorists attacked the U.S. The U.S. economy went into a recession. Many people have predicted with optimism that the U.S. as the paradise of international capital has begun to disappear; that not only will new investors look for safer places to invest, but also U.S. domestic capital may possibly flow outside. Of course, most of the outflow

of capital will go to Europe. But there will always be a small portion that opts for East Asia. International capital will flow to China en mass. It is predicted that China will become the safe harbor and paradise of international capital. It is estimated that of the $6000 billion investment pouring into the U.S., even if 10% of it withdrew it would be $600 billion. Last year, China had foreign investment of $46.846 billion. If a portion of the 10% outflowing U.S. capital went to China, it would be a great number to China. However, though I don't yet have new statistics, my cursory observations tell me that the imagined influx of foreign capital has not occurred.

This is not strange at all. On the surface, China has become the ideal destination for foreign capital. But factors affecting international investments are extremely complicated. Horrendous terrorist attacks, even a recession of the U.S. economy, cannot sufficiently alter the fact that the U.S. still is the paradise of investments. The most fundamental reason for this is that though the U.S. is indeed in a recession, other places in the world are far worse. In fact, after the 9-11 attacks, the U.S. dollar has been increasing in value in relation to Euro and Yen, which testifies to the dependency of the international capital on the U.S.

Looking back at the Chinese economy, we see that it is very sluggish. Although we may feel smug about our economy if we look horizontally at other countries' economies in the world (our own statistics of growth are doubted by many), we will not feel complacent at all if we look at ourselves vertically, i.e., the annual drop in growth rate since 1995, from 12% to 7%. This trend of slowing growth indicates to a certain extent the narrowing space for gradual reforms.

THE PACE OF REFORM

In terms of the financial institutions, the degree of openness in our financial market is very low, intrinsically incapable of accepting more foreign investment. The highly mobile international capital is especially difficult to get into China. Even if we got it into China, we cannot put it into a good place. Of course, there is good reason for the Chinese financial system to remain relatively closed, because China's own financial system is extremely fragile and weak. We should be sufficiently warned if we notice that the Bank of China's violations of regulations and laws are occurring at the same time.

The National Bureau of Accounting discovered shocking cases of the Bank of China's illegal and illicit actions when conducting an auditing of the bank's assets and debts for 2000. There are flagrant operations of floating illegal loans, conducting illegal businesses schemes, and illegally issuing credit lines and Bank's cashier's checks. Twenty-two major cases of illegal actions were discovered, involving 2.7 billion yuan and implicating 35 people, of whom all are in custody of the law enforcement. Subsequently, the president of the Bank of China, Wang Xuebing, was fired. The bank's operations in foreign countries are also in trouble, violating several banking regulations in the U.S. The U.S. government fined the Bank of China $20 million.

All these problems have a symbiotic relationship with the state-owned financial banks'

ownership structure and their governing structure. These institutional factors are not likely to be changed within a short period of time. These structural problems will severely affect the resolve of the management to open financial market. Although China has joined the WTO, and promised to gradually open up its financial market, people are still fearful of the financial crisis as a result of competition once the market is opened. As a result, the authorities will inevitably slow down the pace of openness, regardless of what the WTO regulations stipulate. In order for international capital to enter China, it still needs to overcome many hurdles. Like the Lincoln Financial Group, several years of operating in China may still result in nothing. Things like this can still happen.

UNPREDICTABILITY

The Chinese stock market has been characterized by its institutional and policy unpredictability. China's governmental policy on foreign investment also contains a certain degree of unpredictability. Not long ago, the Chairman of the Board of Taiwan's Taipei Import/Export Association, Mr. Li Dongliang, made a request at a trade convention in Guangxi that the Guangxi government not wobble too much, or even self contradict too much when it comes to policies of foreign investments. Otherwise, Li warned, fatal damage will incur to the Taiwanese business investors in Guangxi.

In fact, the unpredictability as mentioned by many foreign investors has been caused by the overly favorable policies toward foreign investors initiated by various local governments. Many local officials, in order to attract foreign investments, rush to issue policies highly favorable to the foreign investors. But when the Central Government starts to crack down on irregularities or when these policies overly favorable to foreign investors become onerous, the local government officials resort to canceling these policies. The changes occur very often, creating a great sense of uncertainty amongst foreign investors. This has caused foreign investors to hesitate or even divest. Overall, the entire body of laws and policies by the Chinese government with regard to attracting foreign investment lacks two most fundamental and most important principles: clarity and consistency.

Another report also confirms this. The authorities have recently issued specific regulations on media enterprises. They stipulate that no foreign or private capital can be invested in news media within China. By these regulations, in the first half of this year, there will be a comprehensive survey to get rid of any foreign or private investment from news media through methods such as "purchase, transfer and return." "Purchase" means that state-owned news organizations, TV and radio stations will have to purchase back the share of the foreign or private investments. "Transfer" means to take the share of the foreign or private investments to state-owned businesses other than news media organizations. "Return" means to urge foreign or private investors to voluntarily withdraw their investment from these news organizations. In sum, foreign investments will be "ambushed" in the news business. (The same ambush will also occur to the private investments in this profession.). We have seen similar policy changes in retail business (such as the French chain Carrefour), in telecommunications (the earlier Lian Tong and the current WangTong). Due to various reasons, efforts to end these actions always end up in inaction. As a result, the cost of investment for foreign investors has

gone up.

The Lincoln Financial Group may be enraged until the last minute of its withdrawal from China for failure to obtain a business license in China. But, it's been reported that even those companies that have already obtained business licenses in China, such as Aetna of the U.S. and Winterthur of Switzerland, have long sold their shares in the their joint companies in China or sold their entire subsidiaries inside China, when they are still worth something.

Maybe the foreign investors are not well adapted to "the Chinese way." But if our "way" is too peculiar, it may not be a good thing to have. After all, without foreign investors or with foreign investment dwindling, we can hardly imagine what China's economy might look like.

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