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The Chinese Insurance Market and the WTO

Abstract: *An overview of the insurance market in China is provided, with a special focus on issues associated with China's accession to the WTO. Despite the rapid growth of China's insurance industry, its insurance market remains relatively underdeveloped. After China's accession to the WTO, the average efficiency of domestic insurers increased. Opening the market to foreign insurers helped to make domestic insurance companies and the national economy more efficient and improved social welfare.*

The insurance market in China has experienced positive growth for the past decade and has become increasingly important to the world economy. When ranked in terms of total premium volume in U.S. dollars in 2009, China's insurance market was in seventh position worldwide (Swiss Re 2010). Annual insurance premiums increased from RMB140.6 billion in 1999 to RMB1.137 trillion in 2009. With a population of more than 1.3 billion and a dynamically growing economy, China is expected to become one of the world's most important insurance markets. Its accession to the World Trade Organization (WTO) in 2001 signaled the opening up of the domestic insurance market to increased foreign competition.

Because the Chinese insurance market is growing but is still relatively underdeveloped, regulation is an important issue. Although China has revamped some of its insurance rules and laws, the regulatory framework is not completely ready for the regulation of both domestic and foreign insurers in a fully deregulated and liberalized market. Thus, it is important for the Chinese authorities to take steps to develop appropriate regulations to foster a well-functioning financial market, protect customers, and strengthen the national economy.

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An overview of the state of the insurance market will be provided with a special focus on issues associated with China's accession to the WTO. Lai (2002) analyzed the role of insurance in the country's economic development after China's WTO accession and suggested specific steps to aid economic development. Furthering the analysis in Lai (2002), we examine the Chinese insurance market from an alternative view and analyze the impact of the WTO on the insurance industry.

Overview of China's Insurance Market

China's insurance market has grown rapidly over the past decades. A brief history of the Chinese insurance market is given below, followed by an overview of its modern development. This will enable discussion of the competitive status of the insurance market with a special focus on the entry issues for foreign insurers, providing a basis for further analysis of the impact of WTO accession on the Chinese insurance market.

History of the Chinese Insurance Market

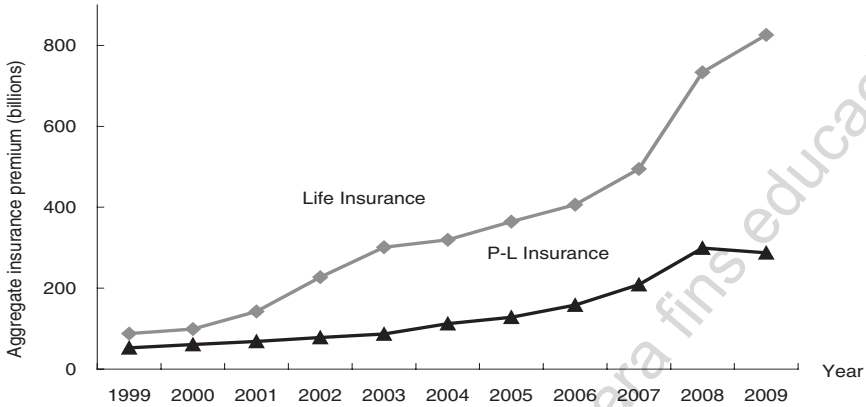
The Canton Insurance Society, established by foreign insurers in 1805, was the first insurance institution in the Chinese market. The American International Group (AIG), founded in Shanghai in 1919, was the first non-Chinese insurer in China. From 1805 to 1948, several foreign and domestic insurers entered the Chinese market, but foreign insurers were the dominant players. In 1949, the People's Republic of China (PRC) was established and all domestic insurers were nationalized. Foreign insurers were forced to terminate their Chinese operations and were expelled from the country. During this time a state monopoly, the People's Insurance Company of China (PICC), was established. In 1979, China initiated its "Reform and Open" policy with the aim of stimulating economic growth. As a result, the insurance industry grew very quickly, as evidenced by an insurance premium growth rate of approximately 40 percent per year from 1980 to 1998 (Leverty, Lin, and Zhou 2009).

In 1995, the Insurance Law of the People's Republic of China took effect, significantly reducing PICC's monopoly power. More insurers were allowed to enter the Chinese market, and in 1996 PICC was reorganized in three divisions: China Life Insurance Company, PICC Property and Casualty Company Limited, and China Reinsurance (Group) Corporation. From 1992 to 1998, China granted ten joint ventures and branches of foreign firms licenses to sell insurance. That signaled further opening of the market to foreign insurers. The number of insurers in China was 112 in 2010.

Modern Market Profile

China's insurance market has exhibited rapid growth over the past decade. Aggregate premiums for life insurance rose from RMB87.21 billion in 1999 to RMB826.15

Figure 1. Aggregate Insurance Premium



Source: China Insurance Regulatory Commission 2010; National Bureau of Statistics of China 2000–2009, various issues.

billion in 2009. Property liability insurance premiums grew from RMB52.11 billion in 1999 to RMB287.58 billion in 2009 as shown in Figure 1.[1] The industry's total assets increased from RMB260.41 billion in 1999 to RMB3.34184 trillion in 2008 as shown in Table 1. The number of insurers in China increased from 28 in 1999 to 112 in 2010.

The recent rapid growth of China's insurance market is due to several factors. These include the economic reforms, the steadily rising demand for insurance, and increased market competition (Chen, Powers, and Qiu 2009; D'Arcy and Xia 2003; Shen 2000; Yao, Han, and Feng 2007). The rising demand for insurance can be attributed to the increase in private businesses and the average annual income of Chinese citizens, the decline in state sector jobs, and reduced government benefits (Shen 2000). In terms of life insurance, for instance, higher personal income has given people the incentive to purchase investment-related policies.[2] The growth of the property liability insurance market has been attributed to increased corporate accountability, higher insurance awareness on the part of managers of state-owned enterprises, increased foreign investment in the eastern coastal areas, and a rise in automobile and housing consumption (D'Arcy and Xia 2003). The recent rapid growth in the agricultural insurance market has also promoted the growth of property liability insurance premiums (Yanli 2009).[3] More recently, the Olympic Games, new sales of health insurance, and strong economic growth resulted in a 15 percent increase in the premiums of property liability insurance in 2008 (Swiss Re 2009).

The growth of market competition has also contributed to the rapid growth of the insurance market. Restrictions on insurance operations have been gradually removed since 2001, when China joined the WTO. For instance, many foreign insurers have been granted licenses to write insurance in China, thus increasing

Table 1

Development of the Chinese insurance industry

	Premiums (RMB in billions)	Assets (RMB in billions)	Number of firms
1999	140.62	260.41	28
2000	159.80	337.39	34
2001	210.90	459.13	35
2002	305.40	649.41	44
2003	388.00	912.28	62
2004	431.81	1,185.35	68
2005	492.73	1,522.60	93
2006	564.14	1,973.13	107
2007	703.55	2,900.39	120
2008	1,033.05	3,341.84	130

Sources: China Insurance Regulatory Commission and National Bureau of Statistics of China (2000–2009), various issues.

the market competition. Given their many years of experience, foreign insurers had better management techniques, marketing systems, product innovation, investment practices, customer service, and products. The increase in market competition helped the development of the insurance market. By 2002, the aggregate insurance premium rose by approximately 13.87 percent for property liability insurance and by 59.69 percent for life insurance.

The insurance density of the Chinese market was US$121.2 in 2009, compared to US$595.1 for the global average (Swiss Re 2010).[4] The insurance penetration of the Chinese market was 3.4 percent in 2009, compared to the world average of 7 percent, indicating that more steps should be taken to aid the insurance industry's development.[5]

Competition in the Chinese Insurance Market

There are sixty life insurers in the Chinese insurance market (twenty-seven of them foreign companies), and fifty-two property liability insurers (including seventeen foreign companies). Domestic life (property liability) insurers accounted for 94.77 percent (98.94 percent) of the market in terms of the aggregate insurance premium in 2009 (CIRC 2010). The premium income of the top-five Chinese life (property liability) insurers accounted for 77.20 percent (74.13 percent) of the life insurance market in 2009. Domestic insurers are the major players in the Chinese insurance market and the market remains fairly concentrated. For example, China Life, a state-owned company, accounted for 36.23 percent of the life insurance market's total

premium revenues in 2009 and currently has US$123.89 billion market capitalization. PICC Property and Casualty Company Limited, a state-owned company, enjoyed a market share of 39.92 percent of the property liability industry in 2009.

The high degree of market concentration is due in part to the government's protectionist policies. For example, while some state-owned companies are permitted to write insurance throughout China, other domestic companies are only allowed to operate within prescribed geographical areas. In addition, some state-owned insurance companies enjoy monopoly positions in particular lines of insurance, including mega-project insurance (e.g., the Three Gorges Dam) and marine insurance. These monopolies have enabled them to increase their market shares.

The establishment of the China Insurance Regulatory Commission (CIRC), entry into the WTO, and pressure from the international insurance community have led China to open its insurance market to foreign insurers (D'Arcy and Xia 2003; Whalley 2003). In 2001, there were only twenty-one foreign insurers and joint ventures in the Chinese insurance market. As of 2010, foreign insurers and joint ventures together held forty-four operating licenses.

Although the government has allowed more foreign insurers to enter the market, domestic insurers have relatively greater protection than foreign insurers. Foreign firms have gradually been allowed to underwrite business in China's new insurance market, but still face significant entry barriers. In the past, the lack of transparency in the process of obtaining an operating license further increased the barriers to entry. Even after they succeeded in obtaining licenses to enter the market, foreign insurers were still subject to product and regional restrictions. In addition, they were only able to provide services to subsidiaries of foreign companies operating in China. As a result, the market share of foreign insurers has been limited.

In summary, increased demand and market competition are the main sources of the rapid growth of the Chinese insurance market. The impressive market growth implies that insurance will play an increasingly important role in financial markets in the future.

Role of Insurance in China's Economic Development

Several functions of insurance are important aids to China's economic development (Lai 2002; Skipper 1997).

First, as a relatively effective risk-management mechanism, insurance reduces potential economic loss. Severe losses from recent catastrophic disasters, such as snowstorms and the Sichuan earthquake in 2008, have highlighted the need for effective risk management. However, the recent high combined ratio of the Chinese property liability insurance industry might threaten insurer solvency. Under China's GAAP (generally accepted accounting principles), the country's overall insurance market had a combined ratio of 105 percent in 2006 (Horssen 2008). This suggests that the Chinese authorities could improve risk management by further opening up the insurance market to foreign insurers.

Second, private insurance, especially life insurance, can serve as a substitute for some social security programs. This aspect is important for China's aging society. The share of older people (ages 65 or older) in the total population increased from 4.9 percent in 1982 to 9.3 percent in 2007 (National Bureau of Statistics 2008). However, the total participation in the social pension insurance scheme accounted for only 15.24 percent of the total population in 2007 (NBS 2008).[6] China should provide more incentives for individuals and business owners to purchase adequate private insurance as a substitute for some of the underdeveloped social insurance programs.

Third, Chinese life insurers are ideal providers of long-term financing for domestic investment. At the end of 2007, Chinese life insurance companies had total assets of RMB2.357 trillion. These funds are critical for the current stage of Chinese economic growth. In 2009, China's government revamped the insurance regulations to provide insurance companies with a wider range of investment possibilities. The government should make even more appropriate long-term investment instruments available for insurance companies to hedge their investment risks.

Impact of WTO Accession

China joined the WTO in 2001 and further opened its insurance market to foreign insurers. Whether or not greater participation by foreign insurers will improve the benefits enjoyed by the Chinese insurance industry is a main concern of the government. To address this issue, the contents of the WTO agreement will be described, followed by a summary of the findings of the literature that has examined the impact of WTO accession on the efficiency of the Chinese insurance industry.

WTO Agreement

Following its accession to the WTO, China gradually removed the operational restrictions it had imposed on foreign insurers. China's major WTO agreements regarding insurance are briefly described below (D'Arcy and Xia 2003; Sun 2003).

Geographical Limitations

Foreign insurers were permitted to provide services in the Shanghai, Guangzhou, Dalian, Shenzhen, and Foshan regions. All geographical limitations were to be removed within three years after accession.

Scope of Business/Insurance Lines

Foreign property liability insurers were allowed to insure large-scale perils nationwide. Two years after accession, they were allowed to provide all property liability insurance products (except third-party vehicle insurance) to both Chinese and for-

eign clients. In addition, foreign life insurers were permitted to write individual life insurance to both Chinese and foreign customers. Within three years of accession, foreign insurers were allowed to provide health insurance, group insurance, and pension/annuity insurance to both Chinese and foreign customers.

Company Ownership

Foreign property liability insurers were allowed to set up branches or partnerships with a maximum ownership of 51 percent upon accession. Within two years of accession, fully owned subsidiaries were allowed. Upon accession to the WTO, foreign life insurers were permitted to have no more than a 50 percent ownership stake in a joint venture with the partner of their choice. Five years after accession, foreign life insurance firms were allowed to establish wholly owned subsidiaries.

Under the WTO agreement, foreign life insurance firms faced more barriers to entry in the insurance market than foreign property liability companies in terms of the time schedule.

Reinsurance

In the past, all property liability insurers were required to reinsure 20 percent of their business with China Reinsurance (Group) Corporation, a state-owned reinsurance company. This restriction was phased out within four years of China's accession to the WTO. Foreign insurers were then allowed to provide life and property liability reinsurance without geographical restrictions. Nevertheless, foreign reinsurers continue to be excluded from providing mandatory insurance for auto third-party liability, public transportation vehicle liability, and commercial vehicle driver liability.

Impact of WTO Accession on Insurer Efficiency

The question of whether or not the entry of foreign insurers would improve social welfare in the Chinese insurance industry was the government's main concern in opening the insurance market. Several studies have provided evidence on the issue of whether the entry of foreign insurers improved the efficiency of the insurance industry. They found that the average efficiency of domestic insurers improved after WTO accession (Chen et al. 2009; Leverty et al. 2009; Yao et al. 2007). Leverty et al. (2009) examined the Chinese insurance industry over the period 1999–2004 and found that, on average, domestic insurers improved their technical efficiency and scale efficiency after WTO accession.[7] The evidence implies that social welfare in the insurance industry improved following China's WTO accession. Leverty et al. (2009) also found that the geographical and product restrictions imposed on foreign insurers reduced their ability to positively influence the insurance market.

Chen et al. (2009) compared the efficiency and productivity of domestic and

foreign insurers from 2001 to 2007. They found that, on average, domestic insurers outperformed foreign insurers in terms of pure technical efficiency and scale efficiency, but that the efficiency gap has quickly narrowed since 2005. They argued that the higher efficiency of domestic insurers may be due to a regulatory environment more advantageous for domestic insurers and to the early stage of development of foreign insurers in China.

However, using a data set comprising twenty-two firms from 1999 to 2004, Yao et al. (2007) found that, on average, many insurers suffered from technical regress in the years surrounding WTO accession. Insurers might have had to use more inputs to produce the same level of outputs because of increasing market competition following accession to the WTO. Another interesting finding by Yao et al. (2007) was that large state-owned insurers outperformed nonstate insurers. One possible explanation for this finding was that, even after WTO accession, the state-owned large insurers still had special marketing power not enjoyed by nonstate insurers. This marketing power came from their larger operational size, government support, a powerful marketing network, a monopolistic position in certain lines of insurance and localities, and an established reputation among clients. These results disagree, however, with the predictions of Sun (2003). She argued that state-owned insurers may have been protected from competition, but also have had to bear burdens (e.g., they were required to write unprofitable lines of insurance). This problem may reduce the efficiency of state-owned insurers.

On the whole, there was a difference in the efficiency of insurers before and after China's WTO accession. The Chinese authorities should take additional strategic steps to develop a well-functioning financial market to protect customers and strengthen the national economy in a more deregulated and liberalized market.

Conclusion

No one can ignore the insurance market in China with its 1.3 billion potential customers and rapid economic growth. Thus, it is no surprise that China's market has attracted the interest of foreign insurers. After China's accession to the WTO, the Chinese authorities wondered whether liberalization and greater participation by foreign insurers would contribute to the country's economy. Recent studies have found that the opening of the Chinese insurance market to foreign insurers has helped to develop the national economy and has improved social welfare.

Notes

1. In China, most non-life premiums are from vehicle insurance. For instance, vehicle insurance premiums accounted for about 71 percent of the total non-life insurance premium volume in 2007 (National Bureau of Statistics 2008).

2. The premium growth of life insurance in 2008 was 41 percent. The strong sales of investment-related policies distributed by banks were the major growth drivers of the life insurance premium (Swiss Re 2009).

3. The total premium income of agricultural insurance throughout China was RMB5.3 billion in 2007 (Yanli 2009).

4. Insurance density measures insurance premiums per capita.

5. Insurance penetration is the percentage of insurance premiums in the gross domestic product of the country.

6. The low coverage rate of pension insurance schemes is due to the limited scope of the rural pension system (Salditt, Whiteford, and Adema 2008). See Song (2009) for details of the pension system and reform in China.

7. Technical efficiency reflects the proportion by which a firm can reduce its input usage by using the best technology. Scale efficiency indicates whether the firm operates at constant returns to scale.

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