

**Compliance with Chinese Characteristics:**  
**Evaluating China's Compliance Record with regard to WTO-related  
Liberalization Commitments in the Life Insurance Sector**

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Assignment submitted in partial fulfillment of the requirements for the degree of Master  
of Arts (International Studies) at the University of Stellenbosch



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April 2006

## Abstract

The accession of the China to the World Trade Organization represents one of the most significant political-economic events since the close of the Cold War. China's distinctive political and socio-economic history has made its process of accession unlike that of any other member-nation of the WTO. This study aims to answer the questions of how and to what extent has China complied with its WTO commitments that apply to the life insurance sector. In order to answer these questions, this study employs the qualitative method of evaluation of describing China's post-accession behavior then comparing that behavior to the liberalization commitments contained in China's accession protocol and its service schedule. Upon examination of the evidence, it appears that China has been partially compliant with the WTO-related commitments in the life insurance sector. China's compliance with market access commitments in area of ownership structure exhibits a compromise between the interests of other WTO members. China's liberalization of geographic restrictions shows that China's interest in even development of its insurance market also figures into its decision to comply. China's compliance with commitments regarding licensing, however, appears to show a maneuvering around obligations in order to protect the domestic life insurance industry. While rational functionalist approaches are more helpful in explaining China's compliance behavior in regards to market access commitments, constructivist normative approaches are more in explaining China's compliance behavior in regards to its general commitments. Compliance behavior with regard to transparency-related commitments in the life insurance sector reflects socialization or an adjustment to the WTO-norm of transparency. Compliance behavior in with regard to judicial review-related commitments in the life insurance sector reflects an adjustment to the WTO-norm in policy, but this norm is rarely observed in practice. In sum, China's compliance behavior in regards to commitments in the life insurance sector has generally been compliant with few exceptions. However, all judgments on compliance are generally subject because they reflect the interests of the parties involved. The true test of China's compliance will begin after full accession in 2007, when WTO members are allowed to file cases against China in the WTO dispute resolution panel.

## Acknowledgements

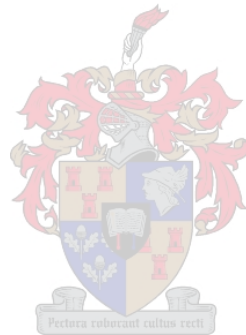
I would like to thank a number of individuals who proved invaluable in the completion of this research project.

First, and foremost, I would like to thank my supervisor, Dr. Martyn J. Davies for his assistance in all stages of this research project, from its conception through its completion.

Secondly, I would like to thank Dr. Anthony Leysens, for providing additional consultation and helping to coordinate the completion of this research project.

Thirdly, I would like to thank Dr. Patrick McGowan for agreeing to review this research project on very short notice.

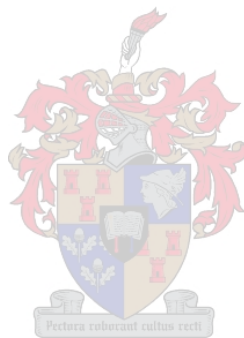
Finally, I would like to thank my family for providing me with emotional support throughout the entire process.



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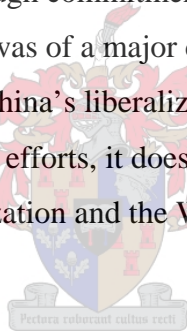
## Uittreksel

Die toetreding van Sjina aan die Wêreldse Handels Organisasie (WHO) verteenwoordig een van die mees belangrike politieke-ekonomiese ontknopings sedert die einde van die Koue Oorlog. Sjina se distinktiwe politieke en sosio-ekonomiese geskiedenis het veroorsaak dat die proses van Sjina se toetreding heeltemal anders is as dié van enige ander lid-staat van die WHO. Die doel van hierdie studie is om die vrae te antwoord oor hoe en tot watter mate Sjina aan sy WHO verpligtinge binne die lewens-versekerings bedryf voldoen het. Die metode wat in hierdie studie gebruik word om die vrae te antwoord is die van 'n kwalitatiewe evalueering en beskrywing van Sjina se na-toetredings optrede, en om hierdie gedrag te vergelyk met die liberaliserings verpligtinge wat in Sjina se toetredings-protokol en diens-skedule staan. Die getuienis dui aan dat Sjina sover gedeeltelik aan sy WHO-verband verpligtinge in die lewens-versekerings sektor voldoen het. Sjina se toegewing met mark-toegang verpligtinge in die area van besittings-struktuur wys 'n ooreenkoms tussen die belange van ander WHO lede. Sjina se liberalisering van geografiese beperkings wys dat Sjina se belange in gelykmatige ontwikkeling van sy versekerings-mark verduidelik ook sy besluiting om na te kom. Hoewel, Sjina se toegewing met die verpligtinge aangaande lisensiëring wys 'n beweging rondom verpligtinge om die binnelandse lewens-versekerings bedryf te kan beskerm. Terwyl rasionale-funksionalistiese benaderings meer nuttig is om Sjina se toegewings-gedrag aangaande mark-toegangs verpligtinge te verduidelik, is konstruktiewistiese normatiewe benaderings meer behulpsaam om Sjina se toegewings-gedrag aangaande sy algemene verpligtinge te verduidelik. Toegewings-gedrag met betrekking tot transparent-verbande verpligtinge in die lewens-versekerings sektor weerspieël sosialisasie of 'n aanpassing tot die WHO-norm van deursigtigheid. Toegewings-gedrag met betrekking tot regterlike oorsig –verbande verpligtinge in die lewens-versekerings sektor weerspieël 'n aanpassing tot die WHO-norm in beleid, maar hierdie norm is selde in die praktyk inaggeneem. In samevatting: Sjina se toegewings-gedrag met betrekking tot verpligtinge in die lewens-versekerings sektor is in die algemeen toegewend, met min uitsonderings. Hoewel, alle oordeelvellings oor toegewing is in die algemeen subjektief, want hulle weerspieël die belange van die betrokke partye. Die ware toets van Sjina se toegewing sal na volle toetreding in 2007 begin, waneer WHO-lede teen Sjina in die WHO dispuut resoluë paneel sake sal kan indien.

# Chapter 1

## 1.1 Introduction

The accession of the People's Republic of China (hereinafter PRC) to the World Trade Organization (hereinafter WTO) on 11 December 2001 marked a new phase of integration in the global political economy. One analyst has even remarked that "China's entry into the WTO is arguably *the* [original emphasis] most significant peaceful change in the global political economy in the post-Cold War world (Chan 2004:68)." At the close of a negotiation process that had lasted nearly fifteen years, China had become a formal member of the international trading regime. However, China's socialist tradition meant that significant reforms were necessary to bring China's trading practices in line with WTO norms. In an effort to satisfy its major trading partners, the PRC agreed to a gradual opening of its economy through commitments made in its protocol of accession. One area of trade liberalization that was of a major concern to China's trading partners was the insurance industry. While China's liberalization of the insurance industry is not completely representative of China's efforts, it does provide valuable insight into China's overall commitment to trade liberalization and the WTO.



## 1.2 Purpose

The central aim of this study is to describe and evaluate the degree of China's progress with the implementation of its liberalization commitments made during its accession to the World Trade Organization, in respect to the life insurance sector. In addition, this study aims to explain how this liberalization has impacted foreign life insurance firms operating in the Chinese market. The study also aims to shed light on the WTO's compliance process in the distinctive Chinese context. A final aim of this study is to make a contribution to academic literature on the insurance industry.

### 1.3 Research Questions

With this purpose in mind, this study endeavors to answer three main research questions:

- To what extent has liberalization in the Chinese life insurance sector been compliant with the commitments made in China's protocol on accession to the WTO?
- How has China complied with its WTO-related commitments in the life insurance sector?
- More generally, what are the implications of China's life insurance sector liberalization as a case study of compliance with the WTO?

### 1.4 Key Concepts

#### *Compliance*

The most important term in this study is the concept of compliance. Although compliance has traditionally been associated with legal matters, the rising importance of legally binding international agreements, such as the WTO, has made the term relevant to international relations theory. Compliance is a broad concept, however, and has been used in a variety of different ways. One of the first international relations scholars to study the concept of compliance, Oran Young (1979), suggested that "compliance can be said to occur when the actual behavior of a given subject conforms to prescribed behavior, and non-compliance or violation occurs when actual behavior departs significantly from prescribed behavior (Simmons 1998:77)." This coincides with Chan (2004) who defines compliance as, "the act of implementing and enforcing agreements, a correspondence between behavior and agreed rules (2004:56)." Other analysts, such as Fisher (1981) and Mitchell (1994), have defined compliance similarly as "a state of conformity or identity between an actor's behavior and a specified rule (Raustiala & Slaughter 2002:539)." Simmons (1998) distinguishes between "first-order" compliance, which means compliance with standing rules in international agreements, and "second-order" compliance, which involves compliance with a decision of a third party (1998:78).

While second-order compliance is important for decisions of the WTO dispute resolution panel, this study will focus on "first-order" compliance or China's adherence to the terms



of its WTO accession agreement. More specifically, compliance refers to the implementation of WTO mandated market-access commitments in the life insurance sector; the correspondence between China's liberalization and the commitments listed in the agreement.

### *Liberalization*

The term liberalization is also crucial to this study because it is one of the fundamental principles of the WTO. Liberalization can be loosely defined as the loosening of government restrictions on business, and the opening of a country's economy to firms from other nations. In regards to the financial services sector, Dobson & Jacquet (1998:3) define liberalization as "both domestic financial deregulation and the opening of the economy to international capital flows." In this study, however, the term liberalization specifically refers to the granting of market access to foreign firms. Although the study does not provide a "level of liberalization," it does provide evidence of China's liberalization efforts in the life insurance industry. This specifically entails the implementation of policies, such as increasing the business scope of foreign life insurance firms, which allows further penetration of the Chinese life insurance market by these foreign firms. While liberalization in policy is important, this study also explores evidence of liberalization in practice, meaning increasing business opportunities available to foreign firms.

### *Life Insurance*

Life insurance is a financial service whereupon the payment of a premium by the insured, the insurer agrees to compensate the beneficiaries of the insured in the event of that person's death. The Chinese Insurance Law of 2002 defines life insurance as:

A commercial insurance transaction whereby an insurance applicant, as contracted, pays insurance premiums to the insurer, and the insurer bears an obligation...to pay the insurance benefits when the insured person dies, is injured or disabled, suffers diseases or reaches the age or term agreed upon in the contract (Thomas 2002:418).

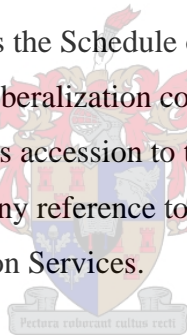
Although the China Insurance Regulatory Commission has separated the property/casualty insurance business from the life insurance business, life insurance companies recently have been authorized to conduct business in health insurance and annuities (pensions). In this study, any reference to insurance means life insurance, except where otherwise indicated.

### *Protocol*

The Protocol on the Accession of the People's Republic of China is the document which contains all the conditions under which China was allowed to accede to the World Trade Organization. In this study, any reference to the protocol means the Protocol on the Accession of the People's Republic of China.

### *Service Schedule*

Annex 9 in China's protocol contains the Schedule of Specific Commitments on Services, which details the specific liberalization commitments in the services sector that China has undertaken as a result of its accession to the WTO and the General Agreement of Trade in Services. In this study, any reference to the service schedule means the Schedule of Specific Commitments on Services.



## **1.5 Theoretical Framework**

The theoretical framework of this study rests in the theory of compliance. Theories on compliance are interdisciplinary, reflecting contributions from international relations, international law and sociological literature. Compliance theory has its origins in international regime theory, because it seeks to understand how international agreements (concluded under international regimes) have an impact on state behavior. Because compliance theory is a relatively new concept in international relations, empirical case testing of compliance theories is limited (Raustiala & Slaughter 2002:548). Krasner (1982), Chaynes & Chaynes (1993), and Simmons (1998) all provide overviews of the different approaches to compliance and regime theory. However, this theoretical framework will examine the two primary competing perspectives on compliance; one rational and functionalist and the other normative and constructivist.

### *Rational Functionalism*

Scholars such as Robert Keohane have developed a theory of compliance, which suggests that states make rational decisions when constructing international agreements. Because there is no centralized authority in the international system, regimes (or international institutions) serve the practical purpose of reducing uncertainty in the international system. Therefore, international regimes are functional because they “facilitate the making of specific agreements on matters of substantive significance within the issue area covered by that regime (Keohane 1982:334).” These regimes facilitate international agreements by “providing a framework of rules, norms, principles, and procedures for negotiation (Keohane 1982:337).”

Rational-choice theories focus on why states enter into binding international agreements rather than why they choose to comply with them. The design of these international agreements is critical, because the provisions of the agreement are negotiated rationally and reflect choices based on each state’s interests. Choices to comply represent rational decisions based on the benefits of compliance compared to the threat of sanctions. In China’s case, this implies that the Chinese government strategically weighs the benefits of liberalization with the consequences of being charged with a violation under the WTO dispute settlement mechanism.

### *The Normative Perspective*

A competing approach to compliance is offered by constructivist scholars emphasizing a normative perspective. Chaynes & Chaynes claim that states “operate under a sense of obligation to conform their conduct to governing norms” (Chaynes & Chaynes 1993:187). This view is also expressed by scholars such as Oran Young who emphasize the creation of shared expectations of behavior through social interaction (Krasner 1982:193). The implication here is that the commitments within international agreements are socially constructed provisions, which were defined through a social process of negotiation and persuasion. The process of compliance involves socialization or a learning process whereby states become acquainted with the norms of the international

institution or agreement. This process is facilitated by consultation with other members of that institution. Because the WTO is essentially a system of rules and norms which govern trading practices, China's compliance will involve adjusting its norms so that they are compatible with those of the WTO.

### *A Comprehensive Approach*

Each of these theoretical perspectives is helpful in understanding China's compliance behavior under the WTO. The point of departure for these two theories is not the question of *do* states comply, but *how* states comply with their international agreements. While rational functionalists claim that a given state's compliance behavior is motivated by strategic calculations of state interest, constructivists claim that compliance is motivated by an ongoing process of persuasion and social learning. The former perspective focuses on the negotiation process, while the latter focuses on the compliance process. However, it is difficult to distinguish compliance driven by rational self-interest, and that driven by socialization (Chekel 2000:19). Therefore, this study argues for a more comprehensive theoretical approach to compliance behavior. This approach would include elements of rational-choice theory as well as constructivism in order to fully describe and explain China's compliance behavior.



## **1.6 Methodology**

The methodology of this study involves using qualitative inquiry to evaluate China's implementation of certain commitments under the WTO. The qualitative approach involves thoroughly describing and classifying concepts to highlight specific characteristics of a given phenomenon. It then involves using inductive reasoning to determine changes in behavior as a result of a certain set of circumstances. Whalley examines several analytical structures for evaluating China's commitment with regard to the service industries, but concludes that due to lack of numerical reference points, liberalization in service sectors is difficult to quantify (Whalley 2003:30). Because of this difficulty, this study is designed qualitatively, highlighting the specific characteristics of market liberalization in the insurance sector.

The main part of this research study is comprised of a qualitative implementation evaluation. Taylor paraphrases Boone (1955) when he suggests that “evaluation consists of making judgments about programs based on established criteria (Taylor 1993:1).” More specifically, as Taylor explains “evaluation compares what has been accomplished – evidence – with what should have been accomplished – criterion – and then makes a judgment about how well it was done (1993:1)” The evaluation in this study involves a three-part process, which consists first of establishing the criteria of China’s liberalization commitments, second of obtaining the evidence of China’s liberalization, and third of making a judgment on China’s compliance based on the evidence of China’s liberalization.

First, the study establishes criteria for judgment. This is accomplished by determining exactly what China’s liberalization commitments are in the life insurance sector. Because these commitments are spelled out explicitly in the services schedule and the Protocol, they provide a specific standard against which to measure China’s liberalization. In addition, because these commitments cannot be rolled back, they serve as the constant in this implementation evaluation.

Part two of the evaluation involves obtaining evidence to make a judgment on the basis of the established criteria. This is accomplished by using empirical findings related to the established criteria from primary sources. In this study, the evidence of liberalization is used to make a judgment on China’s compliance when compared to the criteria of China’s commitments. Because liberalization concerns changes in government regulation, policy documents issued by the China Insurance Regulatory Commission (hereinafter CIRC), which controls government regulation of the insurance industry in China, are critical in assessing the extent of liberalization. In addition, because liberalization also includes the opening of the economy to foreign firms, it is necessary to consult information from foreign life insurance firms entering China. Liberalization serves as the independent variable in this study to be measured against the constant of commitments that China made in its services schedule and the protocol.

Part three of the evaluation involves making a judgment or assessment of China's level of compliance with its liberalization commitments in the life insurance sector. This involves comparing the independent variable (China's liberalization) to the constant (China's liberalization commitments) to find a measure for the dependent variable (China's level of compliance). The difficulty of measuring compliance has been noted by many scholars concerned with the concept. Chaynes & Chaynes (1998) claim that, "questions of compliance are often contestable and call for complex, subtle, and frequently subjective evaluation (1998:198)." This is another reason why this study has been designed qualitatively.

In this research study, a three-tiered rating system has been devised to measure China's level of compliance with liberalization commitments in the life insurance sector. These measures are defined below:

- Full compliance – areas where the Chinese government has satisfied its commitments completely, liberalizing its life insurance sector in both policy and practice.
- Partial compliance – areas where the Chinese government has not yet fully satisfied its commitments in the life insurance sector, or areas where liberalization is evident in policy but has yet to be implemented in practice.
- Noncompliance – areas where the Chinese government has failed to implement its liberalization commitments, and may be challenged in the WTO dispute resolution panel.

After making a judgment on China's level of compliance in each area of its commitments (Ownership Structure, Geographic Coverage, Business Scope, Licensing, Transparency and Judicial Review) a final judgment will be made by the researcher on China's overall compliance with its liberalization commitments in the life insurance sector. Furthermore, constructivist scholars hold that, "standards of compliance are socially constructed and must not be imposed by the analyst (Simmons 1998:79)." In order to support the researcher's judgment, secondary source material from entities such as the U.S. Trade Representative and investment banking firms such as KPMG, which have already

conducted similar implementation evaluations on China life insurance sector under the WTO, are also consulted.

## **1.7 Delimitations and Potential Sources of Error**

### *Delimitations*

This study has two major delimitations with respect to its scope and time frame. In regards to the scope of the study, the evaluation focuses exclusively on the Chinese life insurance sector. Although the liberalization of the entire Chinese insurance sector is relevant to this study, it is briefly discussed in the background section in the second chapter.

In regards to time frame, the evaluation conducted in this study focuses exclusively on liberalization reforms that took place after China's accession to the WTO on 11 December 2001. While significant reform of the insurance industry took place prior to China's accession and certain foreign life insurance companies had already entered the market, these issues are briefly discussed in the second chapter.

### *Potential Sources of Error*

When undertaking a qualitative evaluation using secondary sources, one must also be aware of potential biases. One example is that the assessment of China's WTO compliance made by government agencies such as the United States Trade Representative and the European Union Trade Council may not be impartial. These assessments may be overly critical in an effort to encourage the Chinese government to deepen liberalization reforms, thereby increasing business opportunities for American and European companies. One also cannot expect material published in China to be impartial because of the Chinese government's control of the media.

In addition, because the researcher is an instrument in qualitative inquiry, he can have an impact on the validity and reliability of the assessment. The researcher conducting this study is an American with only a very basic understanding of the Mandarin Chinese language. Therefore, he was not able to consult certain Chinese language sources that

may have been helpful to this study. In addition, being an American might also have unconsciously prejudiced the researcher's judgment in this evaluation because of the United States' antagonistic relationship with China. However, some of this prejudice may have been mitigated because this study was primarily conducted at a South African university.

## **1.8 Literature Review**

A review of the relevant literature illustrates how each piece of academic literature consulted by the researcher contributes to the current study. Although many academic articles have been consulted for this study, only articles that have a critical importance to the topic are reviewed in the following section. These articles are grouped together thematically in order to understand in what particular manner they contributed to the current study.

The first six articles give critical insight into the theory of compliance. The next three articles outline China's accession process and provide a general assessment of China's overall compliance with commitments made to the WTO. The following section includes three articles which examine the specifics of regulatory and legal reform across all sectors and within the insurance sector. The final three academic articles focus specifically on the impact of WTO reforms on the insurance industry. The literature review closes with an evaluation of certain non-academic sources and primary source material that provided crucial information to the study.

### *Theoretical Literature*

Krasner (1982) examines the different theoretical approach to international regimes theory. The author then provides a definition of a regime that has been used by scholars of regime theory as a baseline for their studies, and states that the principles and norms of an international regime are its defining characteristics (1982:187). Having established the idea of a regime, Krasner goes on to explore the question of "do regimes matter?" Several perspectives on regime effectiveness are examined in this section, including those of Strange, Keohane, Stein and Young; however, Krasner explains that the question of



the importance of regimes, boils down to the question of whether or not they can have an impact on state behavior or outcomes (1982:194). The author concludes by exploring different explanations for regime development. He identifies the difference between the structural perspective that regimes are created for specific interests, and the Grotian tradition, that regimes are a pervasive feature of international organizations (1982:205).

Keohane (1982) presents his demand theory on regimes in the same volume as Krasner. Keohane presents an approach to regime theory that can be identified most closely with rational functionalism. While Keohane does believe that regimes are interest-driven, he explains that the lack of supranational authority in the international system creates a necessity for regimes. In observing the context and functionality of these regimes, Keohane uses the theory of market-failure to explain certain problems with the structure of the international system (1982:335). Finally, Keohane outlines the three main tenants of his demand theory for international regimes. He states that the lack of supranational authority, the difficulty of obtaining information, and the large transaction costs associated with concluding specific agreements creates a necessity for international regimes. These regimes help by reducing transaction costs and compiling and distributing information for the conduct of negotiations between states in specific issue areas (1982:343).

Chaynes & Chaynes (1993) discuss the background to compliance theory. The authors begin by explaining the different perspectives to compliance theory – realist and normative – and that each of these schools of thought begins with a different assumptions about the general state of compliance with international agreements. Chaynes & Chaynes explain how the treaty negotiation process involves specific interests and that states weigh the costs and benefits of each commitment. The authors go on to highlight certain norms that influence compliance, one of which is the fact that states cannot be legally-bound except by their own consent (1993:179). In the next section, Chaynes & Chaynes examine what constitutes acceptable levels of compliance. The author concludes that acceptable levels of compliance are socially constructed and as such are highly subjective. The metaphor used to describe this situation is that of the highway speed

limit, where the acceptable level of compliance is may be within ten miles per hour over the stated speed limit (1993:198).

Simmons (1998) presents a thorough review of the relevant academic literature concerning compliance with international agreements. First, Simmons explores the meaning and measurement of compliance, discerning a difference between “first-order” and “second-order” compliance. While first-order compliance refers to standing rules in international agreements, second-order compliance involves compliance with the decision of a third party. However, Simmons explains that most scholars agree on the inherent difficulty in judging compliance (1998:78). Next, Simmons reviews different theoretical perspectives on compliance, which include the realist, rational functionalist, domestic regime and normative perspectives. In regards to the realist perspective, Simmons states that realists focus on issues of power and interest rather than compliance. In regards to rational functionalism, Simmons states that this perspective focuses on why states enter into international agreements. This section also has an interesting portion on technical barriers to compliance (1998:83). Next, Simmons entertains perspectives that relate a state’s compliance with the structure of its domestic regime. Finally, Simmons discusses normative approaches to compliance, stating how global norms and the negotiation process fit into the compliance picture. Simmons concludes by discussing the difficulties in assessing compliance and the difficulty in showing causation.

Raustiala & Slaughter (2002) examines the framework that connects compliance theory to the study of international relations. The authors first explain how compliance, which comes from the discourse of international law, has evolved into an international relations theory due to the increasing prevalence of legally-binding international agreements (539). Raustiala & Slaughter continue by presenting a literature review that tracks the development of compliance theory. This section includes a brief discussion on how the transition from GATT to WTO has increased the importance of compliance, due to the WTO’s legalistic nature (542). The authors explain next how norms of international behavior figure into compliance theory, and then consider the role that enforcement plays in compliance. The authors conclude by saying that the study of compliance goes right to

the foundations of international institutions, and further research into the subject will strengthen the role of these institutions (553).

Chan (2004) provides the best theoretical insights to compliance as it relates to China's accession to the WTO. First, the article sketches a chronology of China's road to accession. Next, Chan examines the idea of compliance from several theoretical perspectives. Chan continues by outlining the various monitoring mechanisms, currently being used to monitor China's compliance, with specific reference to the US effort. The author explains, however, that because states dispute what constitutes full compliance, assessing compliance is a difficult undertaking (56). This statement is important because it underscores the importance of taking a qualitative, descriptive approach toward measuring compliance. Chan concludes that although China seems to have been compliant thus far, the next few years will present difficulties for China's compliance as some of the more painful reforms begin to have an impact. Chan emphasizes the importance of striking a balance between a managerial and enforcement approach to China's compliance (68). Chan's study is important in connecting the theory to the actual practice of assessing compliance.

#### *Overall Liberalization and Compliance under the WTO*

Whalley (2003) concerns the liberalization of China's key services sectors (banking, insurance and telecoms) under the WTO. First, the author outlines China's liberalization commitments in each of the above-mentioned service sectors, while also providing potential scenarios for the implementation of these commitments. In regards to insurance, the author claims that barriers to foreign participation are more market-driven rather than policy related (15). Therefore, Whalley argues, liberalization commitments in the insurance sector will be much easier to accomplish than those in the banking sector. Next, Whalley examines several analytic structures for evaluating China's services commitments, then explores different methods for quantifying of the effects of services liberalization in China. Whalley remains skeptical about present models for evaluating liberalization in the service sectors, concluding that quantifying the impacts of services liberalization in China is extremely difficult (26).

Mallon & Whalley (2004) also concerns the issues that China faces in implementing its commitments to the WTO, but has a much broader focus than the article previously reviewed. The article begins by analyzing China's interest in becoming a member of the WTO. The next section examines the short and medium-term trade issues China will face and features only a small portion on the services sector. An additional section focuses on how regional trade agreements (e.g. CEPA with Hong Kong) will affect China's stance in the WTO. Finally, Mallon & Whalley speculate on China's role in future WTO negotiations. Despite its broad focus, this article proved useful in this study's background section on China's accession to the WTO.

Halverson (2004) discusses China's entry into the WTO, focusing on the challenges of economic reform that have confronted China as a result of its accession. The first section explores the issues surrounding China's accession process, explaining how the WTO has become a lever for economic reform in addition to locking in previous reforms (334). This section also compares China's accession to the WTO to the accession of Eastern European Countries under GATT, highlighting the differences between these regimes (339-345). The next section discusses how accession has impacted legal reform in China, most importantly in the area of transparency. This section is important to the present study because increased transparency in the CIRC has been a crucial part of China's liberalization in the insurance sector. The final section discusses the positive role the WTO could potentially play in future political reform in China. Halverson concludes by explaining that although China's economic adjustment to accession could be painful in the short term, the reforms will be positive in the long run (369-370).

#### *Government Regulatory and Legal Reform*

Pearson (2004) examines both trade policy literature and regulatory policy literature in order to gain a comparative perspective on China's accession to the WTO. The article next looks at China's accession to the WTO in comparison to other notable accessions and finds that China's situation is not so unique. What is unique, however, is the WTO's revolutionary efforts to "reach inside" nation-states to influence reform (562). The next

section examines comparative political economy literature to explain how, even in liberal democratic countries, the state still has a major economic role to play through regulation (571). The final section outlines the transition of the Chinese state from owner to regulator as a result of accession to the WTO. Pearson explains that this change has taken place through bureaucratic reorganization, increased bureaucratic autonomy and a shift in bureaucratic orientation (575-579). Although the article has a broad focus, its examination of Chinese bureaucratic politics is crucial to the present study.

Chang (2004) provides insight into the regulatory and legal issues facing foreign insurers. Chang sets about by first detailing China's commitments under the WTO in the insurance sector. Next, the author presents a substantial review of the history of the Chinese insurance industry. Chang reviews two important pieces of legislation, namely the newly amended Insurance Law of 2002 and the Administration of Foreign-Funded Insurance Companies Regulations (AFICR), and finds that these new pieces of legislation satisfy many of China's commitments to the WTO (63). Despite fulfilling its commitments, the author emphasizes the need for further reform in areas such as transparency. Chang concludes by explaining that the CIRC's broad authority to both administer and enforce the law could become problematic in the future due to the lack of any meaningful judicial review (63).

Thomas (2002) examines the role and powers of the Chinese Insurance Regulatory Commission. The author begins by placing the CIRC in the historical context of the Chinese legal system, and then provides a thorough description of the Chinese Insurance Law. One of the author's key claims is that despite the existence of judicial review, foreign insurers are reluctant to use it as an option for fear of retaliation from the CIRC (424). The implication is that although Chinese regulatory policy allows access to judicial review due to requirements under the WTO, in practice it is seldom a viable option. Thomas maintains that although commitments made upon accession to the WTO have placed limitations on the power of the CIRC, the regulator still retains broad discretion to modify, interpret and enforce the law (432). In conclusion, Thomas believes that this

discretion reduces the practical impact that WTO commitments have on the insurance industry (432).

*Empirical Studies on Chinese Insurance Reform under the WTO*

Sun (2003) examines the impact of China's insurance industry liberalization under the WTO. The bulk of the article outlines the areas of reform stipulated by the WTO protocol and discusses the challenges and opportunities of the Chinese insurance market. Sun claims that market liberalization will create a competitive environment for both foreign and domestic companies. The article goes on to discuss recent trends in the insurance industry, including methods of distribution and the growth of certain products.

D'Arcy & Xia (2003) also focuses specifically on the insurance industry in regards to China's entry to the WTO. The authors show that despite government reforms, there still remains significant obstacles to the establishment and operation of foreign insurance firms in the PRC. This article also provides insight on the role of insurance in China's negotiations to enter the WTO. The analysis of D'Arcy & Xia is clearly more focused on the commercial prospects of the industry rather than government regulation. D'Arcy & Xia focus more on the level of penetration by foreign firms. According to the authors, choosing the right joint-venture partner is a matter of selecting a Chinese company with connections to the local government. D'Arcy & Xia conclude that successful foreign entrants to the insurance industry in China must have a thorough understanding of regulatory policy as well as the particulars of market structure (24).

Ji & Thomas (2001) evaluate the role of foreign insurers in China's emerging insurance marketplace in a paper which was presented at a conference on reform of the Chinese financial sector. Like the previous articles, this article also takes the position that the Chinese government has used regulation to restrict foreign participation in the insurance industry. Both Ji & Thomas and D'Arcy & Xia see government regulation as inhibiting the progress of foreign insurance firms in China. Another important focus of this study is to identify certain strategies of Chinese government in dealing with the arrival of foreign insurers following accession to the WTO. Ji & Thomas state that the PRC has carried out

a dual policy of both developing the domestic industry as well as encouraging foreign participation, which has been accomplished through a combination of regulations that both protect and liberalize the insurance industry.

#### *Review of Additional, Non-Academic Sources*

The academic research in this study was supplemented by a variety of non-academic primary source material, such as business journals and surveys, internet news services, and direct information from foreign firms operating in China. Business sources have proved valuable in providing insight on how regulatory changes have impacted foreign life insurance firms in the Chinese market.

One business survey that has proven particularly useful is KPMG and Reuter's recent survey, *Foreign Insurers in China: Opportunity and Risk* (2005). These sources proved useful because they are often more up-to-date than academic articles, which is important given the constantly evolving regulatory environment in China. The downside to these sources is that because they are not subjected to rigorous peer review, they are less reliable than academic sources. Law firms that deal with the insurance industry in China, including O'Melveny & Myers LLP and Freshfields, Bruckhaus & Deringer, were also particularly helpful.

In addition, internet news services, such as the People's Daily, the China Daily Online and the China Internet News Service, have been useful in identifying changes in government regulation because the CIRC's website does not provide information in any other language than Mandarin Chinese. Although translations of some content on CIRC's website can be accessed, direct translations often fail to convey the full message. Since the People's Republic of China does not have a free press, these news services can be considered authoritative sources for government policy because each of these publications are tightly controlled by the Chinese government.

## 1.9 Chapter Outline

The remainder of this study proceeds in the following manner: Chapter Two provides context for the study by outlining the development of the insurance sector in China and the process of China's accession to the WTO. Chapter Three follows with an evaluation of China's level of compliance in the implementation of both specific and general WTO-related liberalization requirements in regards to the life insurance sector. Finally, Chapter Four provides a summary of compliance, discusses the implications of this study for compliance theory and presents concluding remarks.



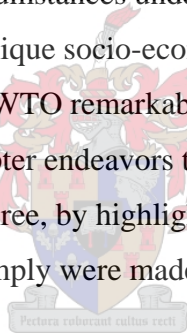


## Chapter 2

### 2.1 Introduction

#### *Providing Context for Evaluation*

Before an evaluation of China's compliance with commitments under the WTO can be made, one must first examine the context that surrounds compliance decisions. Both rationalist and constructivist approaches emphasize the importance of context when evaluating compliance behavior. Recent literature on collective bargaining emphasizes that "compliance decisions of agents cannot be fully understood without consideration of background social context and the non-instrumental interaction that occurs during negotiations (Checkel 2000:8)." This means that discussion of a state's compliance behavior must be framed by an explanation of the environment in which decisions to comply have been made and the circumstances under which commitments were undertaken and satisfied. China's unique socio-economic traditions and political history have made China's accession to the WTO remarkably different from that of any other member-nation. Therefore, this chapter endeavors to provide a background for the compliance evaluation in Chapter Three, by highlighting the institutional and domestic context under which decisions to comply were made.



#### *Insurance and Old China*

Insurance first emerged in China several thousand years ago. Chinese merchants trading goods along rivers, such as the Yangtze, devised a system of marine insurance around 3000 BC. Groups of investors in China also arranged with the owners of cargo ships to insure the safe arrival of shipments overseas in exchange for a premium, due to the variety of risks that were encountered on these long voyages (Chang 2004:36). The modern insurance industry in China, however, began with the arrival of foreigner merchants to China's coastal cities in the early 19<sup>th</sup> century. Interestingly, many of the foreign insurance companies entering the Chinese market in the past decade can trace their roots back to old China, such as American International Group, originally established in Shanghai in 1919 (Ji & Thomas 2001:3). Foreign companies continued to dominate the insurance industry after the end of the Opium War in 1842 due to the fact

that the insurance industry existed primarily to support foreign trade. At the end of the colonial period, China remained relatively open to international trade and cities such as Canton (Guangdong) and Hong Kong were becoming centers of Asian commerce.

Despite the early existence of many forms of property and liability insurance in China, however, the concept of life insurance is a relatively new one. This is because the Confucian philosophy placed a large emphasis on family loyalty. Because of the influence of Confucian ideas on Chinese society, traditionally, “the burden of caring for the aged and the less fortunate was placed on the children or the extended family (Hwang & Greenford 2005:105).” Therefore, the existence of networks of extended family made life insurance unnecessary.

## **2.2 China after the Revolution**

### *China’s International Isolation and GATT*

Following the victory of the Communist Party in the Chinese civil war, the Chinese economy was radically transformed from the capitalist system that had existed before the Japanese invasion into a socialist system. During this period the Chinese economy became a “self-sufficient, large continental economy closed to the international market, and dominated by a philosophy of self-reliance (Zhang 2003:703).” Under the leadership of Mao Zedong, China became a centrally planned economy cut off from international trade flows. The economic policies of the Great Leap Forward emphasized self-reliance through industrial production, deepening China’s international isolation. One Chinese scholar commented on the situation saying that:

The exclusion of China from the world economy was uncompromising before the 1970s. Not only was China excluded from all international economic organizations, but also Communist China was not even allowed to use US dollars to settle its international account until the early 1970s (Zhang 2003:703).

During China’s descent into isolation, the General Agreement on Tariff and Trade (hereinafter GATT) was founded. GATT began as a temporary agreement intended to reduce tariffs and liberalize world trade; however, it lacked the “constitutional and

institutional foundation” to function effectively (Brimeyer 2001:135). The origins of GATT lie in a general consensus among the major industrialized countries on the basic principles and norms of world trade. The most important of the norms enshrined in GATT was the principle of non-discrimination, which requires that goods from all member-nations be treated equitably. Although the Republic of China was a founding member of GATT, it formally withdrew from the agreement following the establishment of the People’s Republic of China in 1949 (Chan 2004:49).

### *Insurance after the Revolution*

In 1949, following the Communist takeover of China, the insurance industry was suspended. The Chinese government under the Chinese Communist Party (CCP) then established the People’s Insurance Company of China (PICC) and designated it as the sole insurance company allowed to engage in business with state-owned enterprises (Chang 2004:37). Because the CCP considered the insurance system as bourgeois, the owners of private insurance companies were forced to flee the country. By 1952, the majority of foreign insurance companies had withdrawn from China due to stringent regulations on the remittance of foreign currency (Chang 2004:37). With the exit of all private insurers, both domestic and foreign, the monopolization of the Chinese insurance market had been completed. During this period, insurance was largely considered unnecessary due to the Communist doctrine that advocated “cradle-to-grave” government social security (D’Arcy & Xia 2003:11).

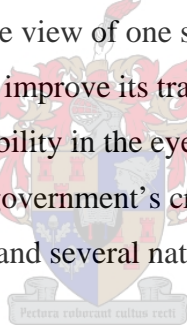
## **2.3 China’s Period of Economic Reform**

### *Participation in International Organizations*

China began its return from international isolation with its admission to the United Nations in 1971(Chan 2004:50). Rapprochement between the United States and China allowed the PRC to take its seat at the Security Council. With the introduction of Deng Xiaoping’s opening up and economic reform policies, the Chinese government embarked on a massive economic restructuring campaign in nearly all sectors (Ji & Thomas 2001:3). Through the adoption of market-based reforms China began to experience a large expansion in external trade. One important aspect of China’s integration into the

global economic system has been “membership and active participation” in international economic institutions (Freeney 1994:226). China became a member of the Bretton Woods system when it acceded to the World Bank and the International Monetary Fund in 1980 (Zhang 2003:707). In 1986, China reapplied for membership to GATT, beginning a negotiation process that would take more than fifteen years (Chan 2004:50). One important Chinese scholar has commented that “China’s participation in these global economic IGOs has prompted changes in policies, policy processes, and institutions in China (Kim 1994:432).”

By the late 1980s, the Chinese government had made significant progress on economic and legal reform and was becoming increasingly open to the outside world. However, the Tiananmen Square incident of 1989, in which the Chinese government violently cracked down on student protesters seeking greater democratic change, dealt a major blow to China’s efforts to enter GATT. In the view of one scholar, not only did Tiananmen “set back China’s effort to normalize and improve its trade links with the outside world,” it also severely damaged China’s credibility in the eyes of the international community (Chan 2004:50). After the Chinese government’s crackdown in Tiananmen Square, WTO negotiations were put on hold and several nations imposed sanctions on China.



### *Economic Reform in the Insurance Industry*

The insurance industry was one of the primary sectors impacted by the economic reforms of Deng Xiaoping. One of the government’s first restructuring moves was the separation of the PICC from the PBOC in 1982, and the establishment of the PICC as an independent insurance company supervised by the People’s Bank of China (PBOC) (D’Arcy Xia 2003:11). The monopoly of the PICC was officially broken in 1985, with passage of the *Provisional Regulations Regarding the Administration of Insurance Enterprises* (Chang 2004:38). Following these regulations, several domestic shareholder-owned insurance companies entered the market, such as the Ping-An and China Pacific Insurance Companies. However, it was not until March 1999, when de-monopolization was completed by the establishment of China Life Insurance Company, China Reinsurance Company and the new PICC as a property-liability insurer. Although the

PICC had already separated its life, property and reinsurance businesses in 1996, the financial connections between them remained until the establishment of these new entities (D'Arcy & Xia 2003:12). Today, insurance in China is very much a concentrated market and, despite the establishment of several other new domestic companies, China Life, China Pacific and Ping-An garner the vast majority of life insurance premiums.

### *Entrance of Foreign Insurers*

While most nations still had sanctions against China in the aftermath of the Tiananmen Square incident, American International Group, one of the world's largest insurance companies, began consultations with the Chinese government on the liberalization of its insurance industry. The Chinese government began by first issuing the *Shanghai Interim Management Regulation for Foreign Insurance Institutions* in 1992, which for the first time allowed select foreign insurers access to the Chinese market (Thomas 2002:415). American International Group (as American International Assurance or AIA) received the first insurance license due to the close relationship between AIG's chief executive Maurice Greenberg and Shanghai's then-mayor Zhu Rongji, who subsequently became China's premier in charge of economic reforms (Lu 1998:13). Following the AIA's approval, many other foreign insurers rushed to obtain a license in the newly opened market. These insurers included Manulife (Canada), Allianz (Germany), and AXA-UAP (France). However, concerns over AIA's success in the Shanghai market led Chinese authorities to first temporarily suspend the issuance of licenses to foreign insurers, and then insist that any future license be granted in the form of Sino-foreign joint ventures in late 1995. While AIA's initial gains in Shanghai were substantial to begin with, Chinese companies copied their approach and significantly reduced their market share within two years (Lu 1998:13). Market-based liberalization in the insurance sector was not due solely to China's drive toward modernization, however. It is important to consider that, "from the very beginning of its liberalization drive, the most important force pressuring China to open up its insurance market was its wish to resume its founding membership of the General Agreement on Tariff and Trade (Lu 1998:12)."

## 2.4 The World Trade Organization and China

### *The WTO as an International Regime*

The World Trade Organization (hereinafter WTO) was originally founded during the Uruguay Round of Negotiations for the GATT in 1995. One reason why China's accession to the WTO took so long was because of the many procedural changes in moving from GATT to the WTO. The WTO was founded as an organization to regulate world trade and institutionalize the principles of GATT. One of the most important principles of the WTO is the most-favored nation principle, which requires member-nations to give equally favorable treatment to goods from all other members. This principle evolved from the principle of non-discrimination that was enshrined in GATT. However, there are many differences between GATT and the WTO. As Chan explains; "the WTO is more legalistic than GATT; its functions are more-comprehensive, covering both trade and non-trade issues; and China was required to enter into trade agreements with all the major trading nations (Chan 2004:50[footnote 8])."

The WTO defines itself as "the only international organization dealing with the global rules of trade between nations. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible (WTO 2005:1)." This definition seems to fit with Krasner's definition of international regimes as "sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actors expectations converge in a given area of international relations (Krasner 1982:186)." To this end, the WTO emphasizes the principles of transparency in trade relations, has well-defined accession and policy review processes, and has a binding dispute settlement structure (Halverson 2004:334-335).

As stated above, the primary function of the WTO is to ensure that trade flows as freely as possible, by encouraging the ongoing liberalization of trade relations. Although states are free to conclude trade arrangements among each other, the WTO provides a multilateral forum for these negotiations. Because of this function, "the WTO as an institution is the predominant international mechanism for economic liberalization in individual nation-states, second only to markets themselves (Pearson 2004:569)."

Pearson points out that, not only does the WTO seek to regulate trade between nations, but “explicitly attempts to reach inside” the borders of nation-states “to encourage a restructuring of the economic, administrative, and judicial institutions in support of trade and investment liberalization (Pearson 2004:569).” The WTO “requires prospective members to bring key domestic economic rules in line with WTO rules – perhaps with phase-in allowances or special considerations for certain categories of states (Koremenos et al 2001:784).” Because China’s socialist economy did not comport with established WTO rules, it was required to undertake numerous economic reforms.

### *Compliance and the WTO*

Although the WTO is a legally-binding international regime, many scholars have questioned how compliant states have been with regards to their WTO obligations. Although empirical studies of compliance with the WTO are few, it is generally accepted that compliance with WTO obligations is quite good (Pauwelyn 2004:15). Although there are many possible explanations for this level of compliance, the effectiveness of the WTO suggests the rising importance of international law in international relations. However, the very reason that states have been so compliant with the terms of their accession may be the flexibility of the WTO rules. One scholar addresses this characteristic of the WTO international trading regime saying that, “trade law is riddled with exceptions, differential treatment, deviations and possibilities for re-negotiation. Without it the system would not have been erected in the first place, nor would it be as effective in offering practical solutions to real-world trade problems (Pauwelyn 2004:10-11).

Despite this flexibility, the fact remains that when one member-state does not fulfill its commitments under its accession agreement, other member-states have access to a dispute resolution mechanism, the decisions of which are legally-binding. This dispute resolution panel involves a five-step process in which a member’s failure to comply with WTO rules is addressed through consultation with other WTO members and, if necessary, arbitration (Brimeyer 2001:143-145). Since the inception of the WTO, it has generally been observed that “states typically obey the findings of the WTO dispute-

settlement procedures even though the WTO has no enforcement capacity (Koremenos et al 2001:790).” If the dispute resolution panel does decide that a member’s trading practices are not compatible with WTO-rules, it must remove the offending practices or face sanctions from other member-nations. Therefore, it is important for China to comply with its obligations under the WTO in order to avoid retaliation from other members. Chan describes the situation of China as “a latecomer to the world of international organizations” has few options and, “it either has to join them or to stay away. Joining them would require it [China] to play by the existing rules of the game (Chan 2004:55).” However, due the complex bureaucratic mechanisms involved in accessing the WTO dispute resolution panel, member-nations are unlikely to bring a case before the panel unless they are certain that it will declare the specified trade practice as a violation of WTO rules.

#### *China’s Protocol on Accession*

Membership in the WTO is essentially an agreement in which member-nations allow on member access to their markets on the terms and conditions detailed in the accession agreement. In the WTO, these agreements are commonly referred to as protocol. When a country applies to join the WTO, the General Council forms a “working party” to negotiate basic principles and policies, after which, member countries of the WTO conduct their own bilateral negotiations with the applicant country. At the conclusion of bilateral negotiations, these agreements are synthesized into a protocol which defines the member’s obligations under the WTO (Halverson 2004:2). Keohane explains that “regimes are more like contracts, when these involve actors with long-term objectives who seek to structure their relationships in stable and mutually beneficial ways (Keohane 1982:330).” Indeed, China’s accession protocol operates in much the same way as a contract, detailing liberalization requirements that China committed to during its negotiations. As one author explains, “in adopting the rules in China’s protocol of accession, the WTO framework acts as a sort of constitution, imposing economic discipline by constraining the ability of those in China’s government who would take a different course of action (Halverson 2004:5).”



## 2.5 The GATS and Insurance Services

### *Introduction to GATS*

Under the umbrella of the WTO, there are several different agreements which regulate world trade. The phenomenon of vertical nesting occurs “where institutions that deal with one issue or region are situated within a large global institution (Koremenos et al 2001:796).” The General Agreement on Trade in Services (hereinafter GATS) is one agreement that exists under the WTO. Following the Uruguay Round of negotiations establishing the WTO, several member-nations agreed in principle to a “multilateral framework of principles and rules, aimed at progressively opening up trade in services,” which became the GATS (WTO Secretariat 1999:2).” Because this study focuses on insurance services, it is important to gain a general understanding of GATS, which regulates trade in financial services.

### *Commercial Presence for Foreign Insurance Suppliers*

Article I in GATS defines the four different modes of supply that apply to trade in services: cross-border supply, consumption abroad, commercial presence, and presence of natural persons. Out of these different modes of supply, this study focuses specifically on Mode 3, *commercial presence*, which refers to the supply of a service through the establishment of a foreign supplier in another member’s country (WTO Secretariat 1999:2-3). This is because *commercial presence* is the primary mode of international insurance trade. Indeed, the WTO Secretariat has noted that *commercial presence* is the “most important mode of supply of services...and also raises the most difficult issues for host governments (WTO Secretariat 1999:3).” More importantly, because life insurance is a long-term investment and purchased infrequently, agents and brokers function like financial planners with life insurance products being sold face-to-face (Sun 2003:34). Therefore, it is crucial that foreign insurance suppliers sell their products directly to the Chinese public through an established presence. A recent study published by the OECD also explains that life insurance is most frequently supplied through a commercial presence (Kazeki 2003:9).

### *General Principles of GATS*

Article II of GATS resembles Article I of GATT, the foremost of its principles is the most-favored nation principle (MFN). The first part of Article II states that member nations are obligated to provide “treatment no less favorable than that accorded to like services and service suppliers of any other country (WTO Secretariat 1999:8).” Although this amounts to a prohibition on preferential trade arrangements, new members are allowed exemptions upon accession to be detailed in a separate annex of the protocol. Another obligation transplanted from the GATT framework is that of transparency. This principle is also detailed in Article II of the GATS, where members are required to publish “all relevant measures of general application.” In addition, this provision also includes designating a point of inquiry that will respond to request for information from other member nations. This is an important provision with respect to China’s accession because information is tightly controlled in Chinese society.

The principle of non-discrimination is also fundamental to GATS. This principle exists in the GATT but is assessed much differently in GATS, due to the complex nature of the services trade. Article XVII states that members “shall give to foreign services and service suppliers treatment, in measures affecting supply of services, no less favorable than it gives to its own services and suppliers (WTO Secretariat 1999:8).” Exemptions to the national treatment principle must appear in each member’s service schedule. However, the GATS guidelines on this principle leave open the possibility of implicit discrimination. This includes the “possibility of variable treatment through domestic regulations such as licensing, recognition of qualifications and other technical regulations (Mattoo 2002:13).”

### *Market Access under GATS*

One important part of the GATS legislation is the provision regarding market access for foreign firms. Article XVI in GATS covers market access for foreign service providers; however, these provisions only apply to sectors included in a member’s services schedule and as such are subject to limitations in that schedule (Mattoo 2002:3). In general, market access provisions in GATS prohibit six different types of limitations:

(a) limitations on the number of suppliers; (b) limitations on the total value of service transactions or assets; (c) limitations on the total number of service operations or on the total quantity of service output; (d) limitations on the total number of natural persons that may be employed; (e) measures which restrict or require specific types of legal entity or joint venture; and (f) limitations on the participation of foreign capital (Mattoo 2002:3).

This is a very important part of the GATS agreement because it opens new business opportunities for suppliers of services from other member-nations.

## **2.6 China's WTO Negotiations and the Insurance Industry**

While China's negotiations to enter the WTO were the subject of considerable debate, negotiations in the insurance industry were especially difficult. Business interests from the US, EU, Canada and Japan were heavily involved in these negotiations. This instance reflects the broader trend of increasing participation of non-state actors, in particular multi-national corporations, in the negotiation of international agreements. Victor Apps, executive vice-president of Manulife, explained that insurance sector negotiations were "one of the most talked-about parts of the accession," and, "got an unreasonable amount of discussion, considering the size of the industry (McClearn 2002:2)." Indeed, the insurance industry proved to be a major sticking point in the negotiations between the US, EU and China regarding China's accession to the WTO. At issue was the preferential treatment given to the US company, American International Group, through a grandfather clause where it was allowed to maintain a wholly-owned subsidiary (to be discussed in Chapter Three). In addition, the US and EU disagreed over the equity structure of joint ventures, as well as the method of awarding of insurance licenses. The "key turning point" of these negotiations came in November 1999, when the Sino-US bilateral agreement was approved by the US Congress (D'Arcy & Xia 2003:10)." At the end of the process, Chief Negotiator Representative of the People's Republic, Long Yongtu, was quoted as saying that "the insurance industry was always the most difficult negotiation field in the whole negotiation process (D'Arcy & Xia 2003:10)."

Negotiations are an important part of the compliance process, however, because they establish the new member's obligations under the WTO. One Chinese scholar has explained that "negotiations and deliberations are not, however, just about the conformity of the Chinese economy prior to its entry. They are more critically about compliance and non-compliance on the part of China to the WTO rules in the future after its entry (Zhang 2003:712)." The contentious nature of the insurance negotiations will set the tone for China's compliance with its market access commitments in the life insurance sector after accession. However, many observers have been skeptical about China's future compliance with its WTO-related commitments. Although some see in China a genuine commitment to trade liberalization, "many see China's approach to negotiations on its WTO entry as attempts to maximize its benefits, with as minimal commitments as possible (Zhang 2003:709)."

## **2.7 China's Service Schedule**

In accordance with GATS guidelines, China's Schedule of Specific Commitments on Services provides a timeline for the implementation of China's market access commitments in all service sectors. One Chinese scholar has characterized service schedules as attempts to "operationalize the WTO principles of free trade and economic liberalization in the Chinese economy within a given time frame (Zhang 2003:712)." The Schedule of Specific Commitments can be divided into three main parts. The horizontal commitments appear first, because these commitments apply to all sectors included in the schedule. One important horizontal commitment in China's schedule was that the establishment and operation of foreign service suppliers "will not be made more restrictive than they exist as of the date of China's accession to the WTO (WTO 2002:2)." This provision means that previous economic reforms China has made in preparation for accession will be locked in.

Next, China's specific commitments are listed by sector. This study is concerned with China's commitments in the financial services, and, more specifically, the insurance services. Aside from the obvious distinction between life and non-life insurance services, at this level commitments are divided further into different areas of that sector. For

example, China's commitments in the life insurance sector include commitments related to ownership and equity structure, geographic coverage and business scope, as well as licensing procedures. Within each of these areas are specific levels of commitment. These concern the extent of commitment, for instance, whether business restrictions on foreign firms will be lifted immediately upon accession or phased out over a certain period of time. These specific levels of commitment are the standard of commitment against which China's liberalization efforts will be compared in the following chapter.

The detailed service schedule is a reflection of skepticism in the international community with regards to China's observance of its international obligations. One Chinese scholar has described the schedule as a "vote of lack of confidence in China's commitment and changing economic practice and behavior (Zhang 2003:712)." Prior to accession, China had a significant credibility problem with international investors worried over the unpredictability of China's regulatory regime. Concerns over China's regulatory regime led many business interests in WTO members to question whether China intended to fully implement its commitments. In an effort to reduce uncertainty, "commitments under the GATS to provide market access by a precise future dates should help to overcome the credibility problem. Failure to honor these commitments creates an obligation to compensate those who are deprived of benefits (Mattoo 2002:12)."

## **2.8 Government Regulation and the CIRC**

### *Bureaucratic Reorganization*

Prior to the inception of the CIRC, the People's Bank of China (PBOC) was charged with regulatory supervision for banking, securities, investment, and insurance services (CIIC 2000:1). However, as part of the preparation for accession to the WTO, the Chinese government embarked upon a major bureaucratic reorganization. This reorganization was in-part a result of the Asian financial crisis, which caused major damage to the high-performing "Asian tiger" economies. The major lesson the Chinese government drew from this crisis was that in an increasingly interdependent world, the financial services sectors of developing economies, when liberalized too quickly, were susceptible to market failure (Sun 2003:33). One article in the Asia Times chronicles how "in 1997,

Zhu [Ronji] managed to utilize the Asian financial crisis to convince the Chinese leadership to agree on a recentralization of government power through government reorganization (Chen 2003:2).” This reorganization was wide-ranging, encompassing not only the financial services sectors, but nearly all sectors of the economy that had come under the control of provincial governments. The article explains further that, “Zhu Rongji decisively reduced and consolidated eleven powerful industrial ministries down to a single institution, the State Economic and Trade Commission (Chen 2003:2).” This Ministry was later renamed the Ministry of Foreign Trade and Economic Development (presently the Ministry of Commerce) directly under the supervision of the State Council, the primary legislative body of the People’s Republic of China in Beijing. Despite the emergence of the newly-industrializing Asian economies, China’s economic reforms continued to be driven by the effort to join the WTO. This was especially true with regard to the insurance sector because “financial service sector reforms in China since 1994 have been taken as steps towards internalizing rules and principles hammered out during the Uruguay Round of the GATT talks and incorporated into the WTO free trade regimes (Zhang 2003:713).”



#### *Establishment of the CIRC*

The CIRC was formally established in 1998, just three years prior to China’s accession to the WTO in order to strengthen insurance regulation. However, as one scholar notes, “the creation of a regulator is only the first step. Persuading the dominant interest groups to concede control is fraught with difficulty (Mattoo 2002:20).” Because of the dearth of Chinese experience in the insurance business, many of the employees of the CIRC were brought in from the ranks of state-owned companies. In one important article, the authors explain further that, “with almost half of the employees of the CIRC coming from the disbanded PICC Group, conflicts of interest could easily develop (D’Arcy & Xia 2003:17).” In his critique of China’s economic liberalization, *The Coming Collapse of China*, author Gordon Chang explains that, “the PBOC contributed some forward-looking individuals to the CIRC to help it regulate an industry still dominated by the People’s Insurance Company of China, the old monopoly. Inside the CIRC, PICC loyalists, who have no desire to open the industry, have been disposing of their liberal colleagues who

originally came from the PBOC (Chang 2002:198).” Therefore, one of the central issues for the CIRC today, is how the interests of the state-owned insurers will be balanced with the needs private and foreign-owned companies.

### *Responsibilities of the CIRC*

The responsibilities of the CIRC are quite large and encompass not only the administration of the insurance companies and enforcement of the Insurance Law, but also modification of that law. The CIRC has ten main functions and responsibilities according to the State Council. In regards to administration of the insurance industry, the primary function of the CIRC is to ensure the development of the insurance business and the industry as a whole. Another crucial administrative responsibility is the examination and approval of licenses for insurance companies (CIIC 2003:1). The CIRC is also responsible for setting premium rates, approving new products and senior management personnel, although these responsibilities have been scaled back as part of China’s liberalization efforts. Additional responsibilities include ensuring the solvency of insurance companies, providing information on the insurance industry, as well as enforcing the Insurance Law. Finally, the last responsibility, “to undertake other jobs delegated by the State Council,” seems to give the State Council latitude to use the CIRC in whatever way it sees fit (CIIC 2003:2). Because these responsibilities are so extensive, it is necessary that the CIRC have sufficient powers to execute its mandate.

### *The Scope and Powers of the CIRC*

The powers granted to the CIRC in order to execute its mandate are quite broad and expansive. One reason for this authority is that the Chinese Insurance Law has granted broad discretion to the regulator. One instance of this discretion is that “although the Insurance Law outlines the requirements for a company to be recognized and licensed as an insurer, the licensing decision is ultimately left to the CIRC’s discretion in light of the perceived needs of the industry (Thomas 2002:422).” An additional provision of the Insurance Law gives even more discretion, stating that new regulations adopted by the CIRC would override relevant provisions of that law.

However, it is also important to recognize that, because the CIRC operates under the authority of the State Council, it is not a regulator independent of government interests. This is exemplified by the fact that “personnel power to appoint board members does not lie with the commissions but with the central politburo (Chen 2003:3).” This power means that the Politburo of the Chinese Communist Party’s Central Committee (politburo), holds the final say over all decisions made by the CIRC. Because this lack of independence, many have questioned the ability of the CIRC to complete the insurance industry’s transformation to a free-market system. One author has even gone as far as saying that with the CIRC, as with all Chinese regulatory commissions, “the possibility of a drastic social change or an evolution of the civil society...is limited, if it exists at all (Chen 2003:1).

Another reason for the expansive powers of the Chinese regulatory is the limited accountability of the regulator. Unlike in developed countries where the decisions of regulators are subject to review by an independent judiciary, the CIRC is effectively not subject to judicial review. The secondary nature of the law in Chinese society has led to a situation where, “courts are considered to be at the same level as the agencies, and therefore give broad latitude to administrative agencies (Thomas 2002:416).” The specific concern in regards to accountability is that without an independent judiciary to limit the administrative power, “regulatory commissions in China can easily be transformed into rent-seeking instruments (Chen 2003:3).” Although the Insurance Law includes two provisions that set out punishment for individual regulators, it does not address the use of arbitrary discretion by the CIRC as a whole (Thomas 2002:423).

## **2.9 Regulatory Experiences of Foreign Insurers Prior to Accession**

### *Introduction*

The Insurance Law of 1995 was the first overall framework for government regulation in the insurance sector and succeeded the Shanghai Regulations (Chang 2004:41). Although the Insurance Law provided general guidelines on the establishment and operation of foreign insurance companies, many issues were left to the discretion of the industry regulator, the People’s Bank of China (PBOC). During the period between the



admission of foreign firms and China's accession to the WTO, regulatory behavior could be characterized as politicized, unpredictable and arbitrary.

### *Politicized Licensing Procedures*

The most obvious characteristic of Chinese regulatory behavior prior to accession was the politicization of the licensing process. One author has identified that, "Chinese authorities have approved companies based on the quality of government-to-government political and economic relations and in meeting Chinese foreign policy goals (Ji & Thomas 2001:6)." One example of this regulatory behavior was when the Chinese government was considering the application of Canadian insurer Sun Life;

Some observers say the application was held up by a diplomatic row over Chinese fugitive Lai Changxing, whom China wants extradited from Canada to face charges related to his alleged role in a US\$6-billion smuggling scheme. (Canada generally does not extradite criminals to countries that have the death penalty.) But the deal was clinched when John McCallum, Canada's Secretary of State for International Financial Institutions, interceded on Sun Life's behalf in Beijing (McClearn 2002:3).

This is only one example, and to be sure, insurance companies from several nations, including the US, UK and Germany, have had their license applications held up due to diplomatic circumstances. The Chinese Communist Party's central economic planning strategy makes China's international economic and business systems highly politicized. For this reason, many foreign insurers looking to secure licenses in China have contracted the help of current and former diplomats from their respective nations in order to sway the Chinese leadership. Manulife's Victor Apps described the license awarding process by saying that, "the name of the game is to get to the Premier, Zhu Rongji (McClearn 2002:2)." Foreign insurers agreed that this was best accomplished through the consultancy of influential diplomats.

### *Unpredictable Regulatory Behavior*

Not only were companies subject to politicized regulatory behavior, but this behavior was also unpredictable. Once foreign insurance companies had established a representative office in China, it was impossible to tell how long they would have to wait for a business license. Prior to accession, foreign insurance companies had to wait an average of seven years just to receive a business license in China (Ji & Thomas 2001:6). Seven years was just an estimate, and because the length of time between establishment of representative office and approval of business license was subject to the discretion of government regulators, foreign insurers were unable to weigh the specific costs of entering the Chinese market. In one particular case, Japanese insurer Minsui Marine waited twenty years to receive a business license, after establishing a representative office in 1981 (Ji & Thomas 2001:6).

The clearest example of China's unpredictable regulatory behavior in the insurance industry is the situation of AIG regarding their group insurance policies. In 1999, the People's Bank of China approved AIG's sale of insurance policies designed to be marketed to employees of companies in China. After the company began marketing the policies, "the CIRC then changed the regulations regarding such sales, noting that it considered them group insurance, and requested AIG to cease selling them immediately (Ueltschy & Klein 2004:28-29)." Because China's regulatory behavior was unpredictable, it served as a barrier to international trade in insurance services. Due to situations like this, one of the most important roles of international regimes is to "establish stable mutual expectations about others' patterns of behavior and to develop working relationships that will allow the parties to adapt their behavior to new situations (Keohane 1982:331)."

#### *Arbitrary Requirements*

Foreign insurance companies were also subject to other onerous procedures, including specific licensing procedures required by local governments. This often involved supplying additional information to the local Administration of Industry and Commerce Bureau (Ji & Thomas 2001:6). Even after an insurer was allowed to conduct business, its expansion was tightly controlled by the government regulators. As one author notes, "the

authorities are eager to see how well a company does in a city before granting it the permission to operate in a second city (Kundu 2001:5)” Therefore, it is easy to see why the experiences of foreign insurers with government regulators in China were less than satisfactory. Prior to accession, government regulation in the insurance industry could be characterized as politicized, unpredictable and arbitrary. Because “uncertainty about behavior makes cooperation more difficult in many cases” one of the central functions of institutions is to reduce uncertainty among members (Koremenos et al 2001:778). Therefore, the agreement on insurance services enshrined in China’s protocol aims to reduce this uncertainty surrounding regulation of foreign insurance companies, by the stipulation of explicit regulatory guidelines.

## **2.10 The Chinese Regulatory State**

In the two decades prior to China’s accession to the WTO, the Chinese insurance industry has undergone a remarkable transformation. The changes in government regulation and the introduction of foreign firms have taken the insurance sector from a monopoly to one of the most dynamic insurance markets in the world. The bulk of this change can be attributed to the efforts of the Chinese government where, as one author points out that the state is “evolving into a regulator as opposed to owner (Pearson 2004:571).” This evolution means that government regulators in China are less concerned with shielding their state-owned companies from competition, and are focusing more on the creating the conditions for fair competition within the insurance market. It is evident therefore, that liberalization does not mean the end of government control, but rather the restructuring of it.

However, much of this change took place during China’s WTO negotiations and occurred as a result of preparations for accession to the WTO. Therefore, it also seems evident that the WTO has influenced changes in China’s regulatory behavior in the insurance industry. Although Pearson argues that the state is the primary actor shaping regulatory change in China, she admits that another crucial factor is “the pressure of international economic regimes (Pearson 2004:574).” If this is true, the central question becomes, if regimes can influence behavioral change in states prior to their inclusion in those

regimes, can they still influence behavioral change once states become a part of those regimes? For the answer to this question, this study looks at China's implementation of its commitments under the WTO in the following chapter.



## Chapter 3

### 3.1 Introduction to Compliance Evaluation

The overall compliance evaluation in this chapter is divided into six separate subject-area evaluations. The first four evaluations concern market access commitments as they appear in the services schedule. This includes commitments in the areas of ownership structure, geographic coverage, business scope and licensing for foreign life insurance companies. The final two evaluations consider commitments, including transparency and judicial review in the life insurance sector, which are listed in the general provisions section of the protocol. Each of these evaluations comprises a three step process of establishing criteria, providing evidence, then making a judgment based on comparison of the evidence to those criteria. The criteria used to make this judgment will be established first, by examining China's commitments as detailed in China's service schedule, its accession protocol and GATS. Next, the evaluation will provide evidence of China's liberalization efforts in each particular subject area. In order to more thoroughly describe China's liberalization, several of these evaluations will also consider the impact that regulatory changes have had on foreign life firms. Finally, each evaluation will rate China's compliance; to what extent China's liberalization in the life insurance sector has satisfied its WTO-related commitments.

### 3.2 China's Compliance with Market Access Commitments

#### 3.2.1 Ownership Structure

##### *Ownership-related Commitments*

The first area of market access commitments in the services schedule defines the form of establishment or ownership structure that foreign-invested life insurance companies may take. This refers to whether or not foreign life companies will be allowed to establish wholly owned subsidiaries or whether they will be required to take on joint venture partners upon entry into the Chinese market. In regards to the ownership structure which foreign invested life insurance companies may take, China's protocol states that;

Upon accession, foreign life insurers will be permitted 50 per cent foreign ownership in a joint venture with the partner of their choice. The joint venture

partners can freely agree the terms of their engagement provided they remain within the limits of the commitments contained in this schedule (WTO 2002:29).

The problem with this commitment, which was a salient issue during negotiations, is that American International Assurance (AIA) was already operating in the Chinese market as a wholly-owned subsidiary. If AIA was allowed to maintain its existing structure accession it would have a distinct advantage in terms of profits received and control of its enterprise in comparison to foreign life insurance companies entering the market post-accession. In addition, companies such Allianz (German), Axa (French) and Manulife (Canadian), which had entered the Chinese market prior to accession, were 51 percent foreign owned (Mattoo 2002:15). Because of this situation, the ownership structures of these companies were grandfathered into the protocol through a special provision. In legal terms, a grandfather clause refers to, “any legal provision that excuses an individual or corporation from a requirement or prohibition because the person or corporation has enjoyed a certain privilege or right at some time in the past (D’Arcy & Xia 2003:22).”

This provision of the agreement states that;

the conditions of ownership, operation and scope of activities, as set out in the respective contractual or shareholder agreement or in a license establishing or authorizing the operation or supply of services by an existing foreign service supplier, will not be made more restrictive than they exist as of the date of China’s accession to the WTO (Mattoo 2002:15).

However, during negotiations EU member-nations complained that the grandfather clause violated the MFN principle of the WTO and GATS. In order to solve this disagreement, a footnote was added to the special provision stating that;

Any further authorization provided to foreign insurers after accession under more favorable conditions than those contained in this schedule (including the extension of grandfathered investments through branching, sub-branching or any other legal form), will be made to other foreign service suppliers which so requested (Mattoo 2002:16).

Although this situation was agreed upon by all of the signatories to China's protocol, it presented a difficult situation for the CIRC in regards to expansion of these insurer's operations. This is because if AIA were forced to take on a domestic partner, then the US could claim that the grandfather clause was not being respected. On the other hand, if the AIA were allowed establish new wholly-owned branches, the EU could claim that the footnote was not being respected.

### *Evidence of Liberalization*

Although the issue of ownership between AIA and other foreign firms was settled in principle by the footnote to the Protocol, the CIRC has yet to announce a formal resolution on the issue (Bullard 2005:1). While this leaves the ownership issue open to debate in policy terms, in practice, it seems as though AIA has lost the battle. Since China's accession to the WTO, AIA has not been granted any new branch licenses by the CIRC. However, the failure of the CIRC to address this issue explicitly leaves the door open for future negotiations. As of October 2005, AIA continues to argue its right to expand in its wholly-owned structure and is not currently seeking a local joint venture partner (Bullard 2005:1). China's former chief trade negotiator, Long Yongtu, has remarked that allowing AIG to open new wholly-owned branches, "would breach the agreement" made upon accession to the WTO that China would treat all foreign companies equally (Cheng 2005:2).

Although AIA's expansion has been restricted by the CIRC since China's accession to the WTO, other foreign life insurance companies entering China's market have thrived. Liberalization in the sector has allowed the entry of several new Sino-foreign joint ventures, all with a 50-50 ownership structure. As of the end of September 2005, there were 21 Sino-foreign joint ventures accounting for 11% of the life insurance market. (KPMG Hong Kong 2005:1). These companies have come from all over the world, including Australia (China Life-CMG), Japan (Nissay-SVA), the US (Metlife), as well as various nations of the EU (ING Captial). In addition, these Sino-foreign joint ventures have been expanding at phenomenal rate by obtaining licenses to operate in new cities, especially since the end of geographical restrictions. One foreign firm, CITIC-Prudential,

has received approval to operate in ten different cities since China's accession (Roder & Tan 2005:1). Despite this rapid rate of expansion, however, each of these companies has managed to maintain its 50-50 ownership structure as dictated by China's protocol and the guidelines of the CIRC.

### *Impact on Foreign Firms*

Prior to China's accession, strict restrictions on the selection of a JV partners hampered the entrance of several foreign insurers into the market (D'Arcy & Xia 2003:18). However, as detailed above in the commitments, foreign insurance companies are now allowed to select their own partners. The implementation of this commitment has had a substantial impact on the foreign life insurers operating in China. Due to this restriction, if a foreign life company wants to expand; its domestic partner must contribute equally to that expansion. The problem here is that many domestic insurers have little experience in the insurance business, and may be unwilling or unable to fund expensive expansion strategies (Roder & Hall 2005:8). Therefore, foreign life firms have turned to domestic non-insurance companies for their partners. One example of the synergy between foreign life companies and domestic non-insurance companies is the joint venture between British insurer Prudential and the China International Trust and Investment Corp. (CITIC). CITIC is large multinational conglomerate controlling assets of over \$84 billion (US) with business scope ranges from financial services to service industries (Yau 2005:2). Despite the CITIC's considerable business scope, especially in the financial services sector, the company does not provide insurance services. This allows Prudential to have managerial control over the insurance business, while still maintaining its 50% equity limit. Other joint-ventures such as Manulife Sinochem and ING Capital are also synergies of foreign life insurers with domestic non-insurance companies.

### *Level of Compliance*

Government regulations surrounding issues of ownership and equity structure are vastly important to companies establishing operations in foreign markets. In its protocol, China committed to allowing market access to foreign life insurance companies in the form of 50/50 joint ventures between the foreign firm and a domestic partner. Although the



foreign company is free to choose its domestic partner, the Sino-foreign joint venture is required to maintain its 50/50 equity structure. Upon examination of the relevant evidence it seems that China has honoured its commitment by allowing several new Sino-foreign life insurance joint ventures to establish in China. Although a grandfather clause allows commits China to allowing AIG to expand as a wholly-owned subsidiary, a separate footnote contradicts this clause. In the interest of the MFN principle, China has refused to honour the grandfather clause in its protocol. Therefore, in the area of ownership and equity structure, China receives a rating of *full-compliance*.

### **3.2.2 Geographic Coverage**

#### *Geographic Coverage-Related Commitments*

One important market-access barrier in the life insurance industry prior to China's accession to the WTO was the restriction on localities where foreign life insurance firms could operate. As discussed in the background, prior to accession, foreign firms were restricted to the cities of Shanghai and Guangzhou. Although China agreed to eliminate geographical restrictions on foreign insurance providers in its protocol, the agreement specified that these restrictions were to be phased-out over a period of three years. In regards to the geographical restrictions on the operations of foreign life insurers, it is specified in China's service schedule that;

Upon accession, foreign life and non-life insurers, and insurance brokers will be permitted to provide services in Shanghai, Guangzhou, Dalian, Shenzhen and Foshan. Within two years after China's accession, foreign life and non-life insurers, and insurance brokers will be permitted to provide services in the following cities: Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan and Tianjin. Within three years after China's accession, there will be no geographic restrictions (WTO 2002:29).

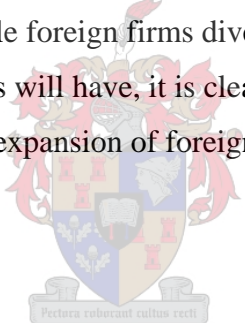
As discussed in Chapter 2, since China's accession to the WTO involved the negotiation of trade agreements with several of its major trading partners, therefore, certain details in these trade agreements had to be synthesized into China's final protocol. This was important in the life insurance sector because this situation forced China to open Dailan,

a city on the Northeast coast of China. Although the U.S. and E.U. bilateral trade agreements did not include Dailan as one of the cities to be opened immediately upon accession, it was included in China's bilateral trade agreement with Japan (D'Arcy & Xia 2003:20). Therefore, true to the principle of MFN, China was obliged to open the city to life insurance companies of all WTO member-nations.

### *Evidence of Liberalization*

The area of geographic restrictions on foreign life insurers, it is evident that substantial liberalization has taken place. China's liberalization of its insurance sector in the area of geographical restrictions has extended beyond its WTO commitments to include the opening of several Chinese cities prior to their deadline for opening as stated in China's service schedule. In late 2002, two years before China had committed to opening Beijing, Suzhou and Tianjin, it granted approval to foreign life firms in each of these three cities (USTR 2004:72). In March 2003, the CIRC formally announced that other foreign life insurance companies might also provide services in Beijing, Tianjin, and Suzhou, fulfilling its commitment to national treatment in these cities (Committee on Trade in Financial Services 2003:2). On 16 June 2003, CIRC announced that foreign life companies might also provide services in Chengdu and Chongqing (Committee on Trade in Financial Services 2003:2). The CIRC opened Chongqing, one year before China had committed to do so in its services schedule, by granting approval to a U.S. life insurer (USTR 2004:72). On 11 December 2003, two years after China's accession, the CIRC's *Announcement No.59 Regarding Implementation of China's WTO Commitments* declared that Fuzhou, Xiamen, Ningbo, Shenyang and Wuhan were cities now open to foreign insurers (O'Melveny & Meyers LLP 2003:3). Finally, on 11 December 2004, the CIRC's *Announcement on Foreign Enterprises fulfilling WTO entry Commitments* declared an end to all regional restrictions on foreign-funded insurance companies (Freshfields, Bruckhaus & Deringer 2005). Indeed, the US representative at the Transitional Review Mechanism welcomed China's action of "removing geographic restrictions as of 11 September 2004 (Committee on Trade in Financial Services 2005:7)."

Although the push towards liberalization in the form of lifting geographical restrictions began as a result of commitments made in China's Protocol, market forces have also encouraged China to open more of its cities to foreign life firms. Because much of China's economic development has occurred in the coastal areas, per capita income is higher, making citizens in coastal regions more attractive customers for insurance companies (Sun 2003:31). Due to these demographics, many insurers, both domestic and foreign, have chosen to concentrate on the coastal cities such as Shenzhen and Shanghai. Geographic restrictions on life insurance have exacerbated this concentration of insurers in the richer coastal areas. In order to alleviate this uneven development, the Chinese government, in particular the CIRC, has elected to speed investment into the central and western regions. This may have been why cities such as Chengdu and Chongqing were opened earlier than required. In May 2005, Wu Dingfu, Chairman of the CIRC, commented that his agency would be "quicker with approvals (for investment) in the west" (China Daily 2005:1)." While foreign firms diverge on how large an impact the loosening of geographic restrictions will have, it is clear that the CIRC's liberalization in this area has greatly facilitated the expansion of foreign life insurance companies in China.



#### *Level of Compliance*

Upon evaluation, it is evident that China's compliance with commitments in the area of geographic coverage has been more than satisfactory. Geographic restrictions have been gradually phased-out over a period of three years, just as specified in China's protocol. In addition, China has opened several cities before the time specified in its services schedule. Therefore, China receives a rating of *full-compliance* in the area of reducing geographic restrictions on foreign life insurers.

### **3.2.3 Business Scope**

#### *Business Scope-Related Commitments*

Another important area of liberalization in regards to the life insurance sector is the removal of restrictions on business scope. As discussed in the previous chapter, the CIRC decided to separate property liability insurance from the life insurance business.

However, prior to accession the CIRC had been silent on which companies could engage in health insurance and pensions business, because these services continued to be provided by the Chinese government through subsidies for state-owned insurers. In addition, foreign life insurers were also restricted from marketing their policies to other enterprises in the form of “master” or “group” policies. Although this regulation was enshrined in China’s protocol where, “foreign insurers are permitted to provide individual (not group) insurance to foreigners and Chinese citizens” it was also agreed that, “within three years after accession, foreign insurers will be permitted to provide health insurance, group insurance and pension/annuities insurance to foreigners and Chinese (WTO 2002:29).” Although the removal of geographic restrictions marked substantial liberalization in the eyes of China’s trading partners, the expansion of business scope for foreign life firms was much more highly anticipated.

#### *Evidence of Liberalization*

Unlike the liberalization of geographic coverage which was phased-in over a period of three years, the removal of restrictions on the business scope of foreign life firms once-off liberalization. However, in the years leading up to the liberalization of business scope several foreign insurance companies were actively helping the Chinese government prepare for this liberalization. Because China’s pension system has traditionally been funded by the state, the Chinese government had little experience with private pensions. During this time, China allowed foreign insurance companies to participate in the liberalization process by serving in an advisory role. One of those companies that contributed advice to the Chinese government on reform of its pension industry was the Dutch insurer ING, which operates two Sino-foreign life insurance ventures in China (Ueltschy & Klein 2004:31).

In the months leading up to the third anniversary of China’s accession to the WTO, the CIRC had repeatedly stated its intention to remove restrictions on business scope as stipulated in the service schedule. Finally, on 11 December 2004, the CIRC’s *Announcement on Foreign Insurance Enterprises fulfilling WTO entry Commitments* formally stated that foreign-invested life insurance companies were now allowed to

engage in health, group and pension or pension fund insurance. The announcement further stipulated that foreign life insurers may renew their 'Insurance Business License Certificates' in line with the new regulations (Freshfields, Bruckhaus & Deringer 2004). Since this was a highly anticipated move by the CIRC, many foreign life firms submitted applications in advance to expand their business scope. As a result, licenses to conduct group insurance business were issued days after the new regulation had taken effect.

### *Impact on Foreign Firms*

The removal of restrictions on business scope has had a major impact on foreign life insurance companies over the past year. Although the opening of the health and pension insurance markets presented new business opportunities for foreign life firms, it is the group insurance market, because of its volume, which has captured the most attention and had the greatest impact on the business of foreign life firms. Group life insurance is typically offered as an employee benefit, which can be converted into individual coverage upon retirement or a change of employment. As a result of the liberalization in the area of business scope, several foreign life insurance companies began applying to receive new business licenses to begin distributing group policies.

As stated above, since the Chinese government had publicly stated that it would end restrictions on the business scope of foreign life firms throughout 2004, many several companies had already applied for licenses to conduct group insurance business. Days after the liberalization announcement, several foreign firms received regulatory approval to conduct such business. One of these firms was Generali China Life Insurance Co., which was granted a license to sell group policies by the CIRC on 16 December 2004. A little over a month after Generali received its license, the company sold a group policy worth approximately \$2.4 billion (US) (Moccia 2005:1). The policy comprises a pension (or retirement) plan for 390,000 former employees of the China National Petroleum Corporation, Generali's domestic partner in its life insurance joint-venture. The group deal was world record-setting, marking the biggest ever one-off premium in the international insurance industry (Moccia 2005:1). Several other foreign companies have also received licenses to increase their business scope of operations, including joint

ventures such as Pacific-Aetna, Manulife-Sinochem and Pacific-Antai (Roder & Tan 2005:1). Like Generali, these companies have looked to their local joint venture partners to secure their first group insurance policies.

Generali's group policy sent shock waves through the Chinese insurance industry. For the first time since the industry was opened to foreign firms, AIG (parent of AIA) was displaced as the top foreign insurer in China. Although AIA had applied for a group insurance license it failed to receive one due to an ongoing CIRC investigation into illegal insurance sales by agents of AIA. At the suggestion of Chinese regulators, AIA subsequently withdrew its application for a group license (Cheng 2005:1). When AIA's difficulties in obtaining a group license are considered with the CIRC's refusal to issue licenses for new wholly-owned branches, it seems as though the Chinese government is ending years of preferential treatment for AIG. This is a strong signal that the CIRC is abiding by the WTO MFN principle.

#### *Level of Compliance*

The liberalization of business scope for foreign life insurance companies was a much anticipated move by the CIRC. The CIRC has satisfied the commitment to expanding business scope of foreign insurers and done so by the required deadline. The CIRC also announced the change in regulation months in advance so that foreign life insurers could prepare and apply in advance for a license to conduct these new types of insurance business. Therefore, China receives a rating of *full-compliance* in regards to its commitments to expand the business scope of foreign life insurance companies.

### **3.2.4 Licensing**

#### *Licensing-Related Commitments*

Another issue area in which China made significant market access commitments with regards to the life insurance sector involves the procedures used in awarding business licenses to foreign life insurance companies. This is an important issue because, as was discussed in the previous chapter, business interests were concerned about China's highly politicized and unpredictable licensing process prior to accession. This issue was first

addressed in Paragraph 308 of the Report of the Working Party on the Accession of China states that “China’s licensing procedures and conditions would not act as barriers to market access and would not be more trade restrictive than necessary (Chang 2004:53).” The commitment appears more explicitly in China’s service schedule which states that, “upon accession, licenses will be issued with no economic needs test or quantitative limits on licenses (WTO 2002:29).” This means that licensing procedures will be based solely on prudential criteria formulated by the CIRC, and not on China’s foreign policy interests. In addition to this commitment, the services schedule detailed specific agreed-upon requirements for foreign life companies to receive a business license. These requirements included that the foreign firm have a total asset base of US \$5 billion at the end of the year prior to application, have a representative office in China for at least two years, and have at least thirty years of experience in a WTO member-nation (WTO 2002:29).

#### *Evidence of Liberalization*

In the years since China’s accession, the CIRC has taken several steps to liberalize the approval of licenses for foreign life insurance firms. The *Regulation Regarding the Administration of Insurance Companies*, which went into effect in 2000, contained several clauses that were not in accordance with WTO rules. In order to bring this legislation in-line with WTO rules, the CIRC amended several clauses of the regulations. The first of these amendments established that foreign firms, if denied a license, were entitled to a written notice. Before this amendment, the CIRC was “not obligated to notify applicants if the application was declined with ‘non-notification’ deemed to be rejection (Chang 2004:50).” In addition, protectionism from regulators at the provincial and municipal level was also a major concern. To curb this protectionism, the CIRC amended the regulations eliminating “the condition that establishing an insurance branch should be beneficial to the development of the local insurance industry (Chang 2004:51).

This was a significant step towards transparency in licensing procedures, and was acknowledged as such by other member-nations of the WTO including the US. The U.S. Trade Representative claimed in its most recent assessment on China’s WTO compliance

that, the *Detailed Rules on the Regulations for the Administration of Foreign-Invested Insurance Companies*, “streamlined licensing application procedures and shortened approval times, although some procedures still remained unclear (USTR 2004:72).” Recent regulatory guidelines have also helped to clarify time-limits for licensing procedures. To this effect, Article 31 of *Implementation Rules of the Regulations of the People's Republic of China Governing Foreign Funded Insurance Firms* states that “the CIRC shall conduct examination over the application for the establishment of branches and make a decision of whether or not to approve the application for preparation within 20 days, starting from the day of receiving the complete set of application documents. Those being rejected will be furnished with a written notice and explanation (CIRC 2004:5).”

Foreign life insurers were also concerned with Paragraph 7 of Article 8 in the *Regulations of the People's Republic of China on the Administration of Foreign Capital Insurance Companies*, because it gave the CIRC substantial discretion regarding the application of “other prudential requirements,” to licensing procedures (CIRC 2002:2). In order to reduce this discretion, Article 11 of the *Implementation Rules*, clarifies the additional prudential licensing criteria used by the CIRC as “reasonable juridical person governance structure; stable risk management system; complete internal control system; effective information management system; sound operational status and no record of major illegal or rule-breaking acts (CIRC 2004:2).” This clause delineates the CIRC’s discretion in the area of licensing.

#### *Concerns Regarding Licensing Procedures*

Although clarifications of licensing procedures have been welcomed by foreign life firms as substantial liberalization in this issue area, these firms still share certain concerns about the licensing process. One major concern involves the timing of branch approvals. Chinese companies have been issued concurrent approvals to conduct business in several cities at a time. One example of this procedure is that in May 2003, the CIRC approved Min Sheng Life’s establishment of branches in Beijing, Nanjing, Hangzhou, and Shijiazhuang concurrently (Smith 2004:7). However, foreign life insurance companies in China are concerned that while domestic companies are allowed concurrent branch



approvals, foreign companies may only receive licenses on a one-at-a-time (consecutive) basis. The US Coalition of Service Industries complained in their recent testimony to the US Congress that,

A number of Chinese companies have received branch approvals on a concurrent basis, even when first establishing their businesses in China. In contrast, no foreign insurance company has received branch approvals on a concurrent basis, including when first establishing their business (CSI 2005:3-4).

At the meeting of the Transitional Review Mechanism in September 2005, the Chinese delegation responded to this issue by stating that “the licenses procedures in the relevant laws and regulations, as well as the prudential principle, should be followed,” and that “it was not appropriate to set a compulsory number of licenses for foreign insurers to be issued by CIRC at one time (Committee on Trade in Financial Services 2005:14).” If Chinese companies have been granted concurrent branch approvals while foreign companies were not, it would certainly constitute a violation of the non-discrimination principle of the WTO. However, on 16 February 2005, UK insurer CITIC-Prudential announced that it had received licenses to conduct business in the cities of Dongguan and Foshan (Prudential 2005:1). In addition to Prudential, the CIRC also issued concurrent branch approvals for the Aviva-Cofco Life Insurance Co. In March 2005, Aviva (UK) was awarded licenses to establish branches in the cities of Zhongshan and Mianyang (Aviva Asia Ltd. 2005:1). This shows that on certain occasions, the CIRC has granted concurrent business licenses to foreign companies in a similar fashion as Chinese companies, which satisfies the non-discrimination principle of the WTO.

Another concern, however, with regard to China’s licensing commitments involves the regulations related to the expanded business scope for foreign life firms. The Coalition of Service Industries, in their written testimony to U.S. Congressional hearing on China’s compliance, noted that “CIRC is yet to issue implementing guidelines that identify entities covered under group life ‘master contract coverage,’ and specify qualifying criteria for insurers interested in providing this coverage (CSI 2005:3).” In other words, although China has issued licenses for increased business scope, it has yet to detail what

specific criteria are required to receive a group license. Although this issue was reported to the WTO Council on Services Trade by the US representative in the meeting of the Transitional Review Mechanism, which took place in September 2005, the Chinese delegation simply responded that, “issues related to business scope were administered strictly in accordance with the commitments to the WTO (Committee on Trade in Financial Services 2005:5).” Because China has not announced specific criteria for the awarding of group insurance licenses, it is impossible for foreign life firms to evaluate whether or not they meet requirements for expanded business scope, and thus apply accordingly. The failure to specify these criteria leaves open the possibility for implicit discrimination between domestic and foreign life insurance firms.

### *Level of Compliance*

Prior to China’s accession to the WTO many analysts were skeptical that the above-mentioned commitments would reduce uncertainty in the CIRC’s licensing process. As Mattoo explains, in reference to the CIRC, “discretion is likely to be constrained, but probably not eliminated, by the assurance that licenses in financial services will be issued solely on the basis of prudential criteria and by the requirement of transparency of licensing criteria and decision processes (Mattoo 2002:13).” However, it does appear that regulations from the CIRC, since China’s accession to the WTO, have significantly liberalized licensing procedures for foreign life insurance firms. By outlining explicit prudential criteria for the licensing of foreign life insurance firms, in addition to specifying procedures, much of the broad discretion of the CIRC in awarding these licenses has been constrained.

Despite these efforts, the representative of the Canadian delegation to the Transitional Review Mechanism reported that “approvals for new branches and sales offices of foreign invested insurance joint ventures continued to lag compared to the speed at which domestic insurance firms were permitted to expand (Committee on Trade in Financial Services 2005:5).” Although this may be due to the superior Chinese language skills of domestic life insurance firms, it does expose a significant opportunity for discrimination by the CIRC. While both Prudential and Aviva have received concurrent license

approvals, no foreign firms have been granted approval for four branches at one time like Min Sheng. This is an important concern for WTO member-nations because, despite other steps toward liberalization in this area, “the efficiency of the approvals process could become a bottleneck and an effective control tool for China’s insurance regulators to restrict the pace of liberalization (D’Arcy & Xia 2003:20).” However, it is doubtful whether a member-nation could use the WTO’s dispute-resolution mechanism to challenge China’s licensing procedures as discriminatory. That is because this discrimination does not constitute a violation of the specific terms in China’s service schedule. However, because discrimination in favor of domestic service providers continues to exist, China receives a rating of *partial compliance* with its liberalization commitments in the area of licensing procedures.

## **3.2 China’s Compliance with General Commitments**

### **3.2.1 Introduction**

This section will evaluate China’s compliance with regard to its general commitments in transparency and judicial review in the life insurance sector. These evaluations will not consider the overall implementation of general commitments, but will specifically focus on the application of transparency and judicial review in the life insurance sector. Since the general provisions in China’s protocol are less explicit than the market access commitments in the service schedule, compliance with these general commitments will be more difficult to assess. These general provisions, however, embody core principles of the WTO and therefore are crucial to China’s compliance in the life insurance sector.

### **3.2.2 Transparency**

#### *Transparency-Related Commitments*

One of the core principles of the WTO is transparency. This is because non-discrimination between domestic and foreign service providers cannot be maintained if foreign suppliers are not notified of new rules and regulations. Since China is a country where information is tightly controlled, it was important to other WTO member-nations that China be explicitly required to share all relevant regulatory information. Regarding China’s commitments on transparency, paragraph 1 of Section 2(C) in the Protocol states

that “China shall make available to WTO members, upon request, all laws, regulations and other measures pertaining to or affecting trade in services...before such measures are implemented or enforced (WTO 2001:3).” Furthermore, paragraph 2 of the Protocol states that, “after publication of its laws, regulations or other measures...[China] shall provide a reasonable period for comment to the appropriate authorities before such measures are implemented (WTO 2001:3).”

### *Evidence of Liberalization*

Despite the tendency of the Chinese Communist Party to control information, the CIRC has grown more transparent in the three years since its accession. The first regulations affecting foreign insurance providers after China’s accession were the *Regulations of the People’s Republic of China on the Administration of Foreign Capital Insurance Companies*, issued on 1 February 2002 (CIRC 2002:1). These regulations were issued without any period for comment, however, this was most likely because the Insurance Law of 1995 was badly in need of updating, and these new regulations would provide interim guidelines until changes could be made. Furthermore, these regulations were largely deemed by some WTO members to be insufficient because they contained, “little specificity regarding the implementation of their liberalization commitments. Procedures for branching...and other fundamental processes by which U.S. insurers could procure a license and begin operations were not included (Smith 2003:2).” In order to clarify these procedures, the CIRC subsequently issued the *Administrative Regulations on Foreign-Invested Insurance Companies*, in February 2002 (Smith 2004:4). However, the CIRC also failed to submit its second set of regulations affecting foreign insurance companies for public comment. Representatives from the American Council of Life Insurers complained that although they provided comments on these regulations, no response was received from the CIRC (Smith 2003:3).

Up to this time the CIRC could not have been considered very transparent with regard to public comment, however, this behavior was beginning to change. Revisions to the Insurance Law were finally published in January 2003, and the CIRC followed with additional implementing guidelines for these new rules. In July 2003, a third set of

regulations, *The Draft Trial Implementing Rules on the Regulations of the PRC on the Administration of Foreign-Invested Insurance Companies*, was released for public comment on the CIRC website, with the window for comment closing on August 15. Just three days following the closure of the window for public comment, the CIRC requested comment on another set of draft regulations for foreign insurance companies (Smith 2003:3). The most recent guidelines, the *Implementation Rules of the Regulations of the People's Republic of China Governing Foreign Funded Insurance Firms* was issued in draft form for comment on 15 March 2004, and came into effect 15 June 2004 (CIRC 2004:1). Finally, in September 2004, the CIRC announced that amendments to the Insurance Law were under way, and that it welcomed public comments on revisions. According to Wu Dingfu, CIRC Chairman, the drafts of the revised law will be submitted to the National Congress at the end of 2006 (China Legal Publicity 2004:1).

#### *Level of Compliance*

For the many foreign insurance companies that operate in China, transparency in the regulatory regime is a primary concern. However, compliance with transparency-related commitments is often difficult to discern. Although Article X of GATS and China's protocol both require publication of trade regulations prior to their implementation, "it is often very difficult to know at any given moment whether a pattern of behavior or outcomes may be explained by an [GATS] Article X violation (Steinberg 1998:9)." In this case, WTO members are unlikely to file suit in the dispute resolution panel against China because the majority of concerns with transparency have been corrected in the over the past two years. Initial lapses in China's record of transparency tend to obscure the recent progress that China has made in becoming transparent. Therefore, in regards to compliance with transparency commitments in the life insurance sector, China receives a rating of *partial compliance*.

### **3.2.3 Judicial Review**

#### *Judicial Review-Related Commitments*

The final area of compliance which will be evaluated in this study is China's implementation of judicial review-related commitments. These commitments

compromise the designation of an independent court to review the decisions of administrative agencies such as the CIRC, and allowing access to this court for foreign companies affected by these decisions. Section 2(D) of the Protocol contains China's commitments with regard to judicial review in the trade regime specifying that;

China shall establish, or designate, and maintain tribunals, contact points and procedures for the prompt review of all administrative actions relating to the implementation of laws, regulations, judicial decisions and administrative rulings of general application (WTO 2001:4)

This section also goes on to state that "such tribunals shall be impartial and independent of the agency entrusted with administrative enforcement and shall not have any substantial interest in the outcome of the matter (WTO 2001:4)."

Furthermore, paragraph 2 of the section 2 (D) of the Protocol states that,

review procedures shall include the opportunity for appeal, without penalty, by individuals or enterprises affected by any administrative action subject to review. If the initial right of appeal is to an administrative body, there shall in all cases be the opportunity to choose to appeal the decision to a judicial body (WTO 2001:4).

### *Evidence of Liberalization*

The establishment of a judicial body with the authority to review decisions made by administrative bodies is central to the process of trade liberalization. The existence of judicial review allows the foreign companies to ensure that the administrative decisions are consistent with the principles of MFN treatment and non-discrimination embodied in the WTO. In China, this liberalization has been achieved by the establishment of the Supreme People's Court (SPC). Although the SPC has been an active interpretive authority in China since 1985, recent reforms have significantly contributed to the fulfillment of China's commitments regarding judicial review.

In August 2002, the SPC issued the *Provisions of the Supreme People's Court on Certain Questions Concerning the Hearing and Handling of International Trade Administrative Cases* (hereinafter Trade Regulation) that established the authority of the SPC to review all administrative decisions regarding international trade (Halverson 2004:360-361). This

regulation came in to effect in October 2002, and also allows foreign investors to access judicial review in connection with matters related to the WTO. The Trade Regulation limits the scope of the court's authority to issues regarding;

the truth and sufficiency of the evidence, the accuracy of the law applied, the legality of the procedure followed, whether the agency acted within its authority, whether there was an abuse of authority, whether the penalties applied were "patently unjust," and the existence of any refusals or delay in performing the agency's statutory duties (Halverson 2004:370).

However, the most important aspect of this piece of legislation may be the fact that it specifies, in cases where there are multiple interpretations of a law, the one that is consistent with China's international treaty obligations shall prevail (Halverson 2004:361). The Trade Regulation of 2002 effectively ensures that all laws governing trade are consistent with China's obligations under the WTO. The importance of this particular regulation to compliance can be best explained by concept of "enmeshment." According to Keohane, international commitments are much more likely to be observed when they are integrated into the domestic political institutions (Simmons 1998:84). Therefore, China has established the legal framework for compliance with judicial review-related commitments through the Trade Regulation, which allows judgments in WTO-related cases to be based on China's WTO-related obligations.

#### *Concerns Regarding Judicial Review*

While compliance with judicial review-related commitments has been evident in the CIRC's policies, in practice there have been notable difficulties in accessing this judicial review mechanism. Industry analysts claim that plaintiffs in these cases against the CIRC often face formidable obstacles such as "huge costs, great chance of losing, difficulty in enforcing the verdict, and implied damage to relationships (Chang 2004:54)." The last of these obstacles, implied damage to relationships, is the most formidable. This is because virtually all of the foreign life insurance companies currently operating in China say that maintaining a positive relationship with the CIRC is crucial to their operations, particularly in obtaining new branch approvals. Despite the technical availability of

judicial review, foreign firms are also reluctant to access the mechanism because of the influence of the CIRC on the court as well as the risk of retaliation (Thomas 2002:424). This risk of retaliation is very real for foreign life insurance companies. The highly competitive nature of the Chinese market for foreign insurers makes any advantage substantial. As Thomas points out, “those subject to CIRC regulations, if they intend to participate in the insurance industry, have an ongoing need for CIRC’s approval and cooperation (Thomas 2002:425).” Therefore, since insurance companies are fearful about prefer to remain in good standing with the CIRC, most refrain from accessing the judicial review mechanism.

Another major concern with the regard to the implementation of China’s judicial review-related commitments is the lack of independence in the court system. Thomas explains that, “Chinese courts are not independent. Decisions are subject to approval by judicial officers, who are subject to the People’s Congresses (Thomas 2002:417).” As mentioned above, administrative agencies tend to have a significant influence (through the Chinese Communist Party) on the courts which oversee their decisions. Due to this situation, “judges with limited education and training may be hesitant to contradict CIRC, or may incorrectly interpret the Insurance Law (Thomas 2002:425).” This is shown in the fact that the courts have frequently deferred to the CIRC on questions of interpretation of the Insurance Law. Finally, lack of uniform administration of the law also impairs to ability of foreign insurance companies to access judicial review. Several companies have claimed that judges in different areas have ruled on similar cases with differing results (China Legal Publicity 2004:4).

### *Level of Compliance*

While the Chinese government has created the legal framework for compliance with judicial review-related commitments as stated in its protocol, the actual practice of judicial review has been less than satisfactory. While the Chinese government has established a system for judicial review in regards to administrative decisions involving WTO-related matters. However, due to Chinese legal traditions and the lack of interpretive power, these courts are not independent of the CIRC. In addition, because of



potential damage to relationships and the possibility of retaliation, foreign life insurers in China are reluctant to access this judicial review mechanism. This makes independent review on administrative policies non-existent in the insurance sector. Despite the lack of meaningful judicial review, “it is unclear whether a WTO dispute settlement panel would be willing to condemn a legal system as ineffective or lacking impartiality (Steinberg 1998:10).” Therefore, in regards to compliance with judicial review-related commitments in the life insurance sector, China receives a rating of *partial compliance*.



## Chapter 4

### 4.1 Summary of Compliance: Market-Access Commitments

#### 4.1.1 Ownership Structure

In regards to market-access commitments in the area of ownership structure of foreign life insurance enterprises, China has received a rating of *full-compliance*. China has honored its WTO-mandated commitments in this area by allowing several foreign life insurance companies to enter the market in the form of 50/50 joint ventures with a domestic partner beginning immediately upon its accession. Although American International Assurance (AIA) continues to operate as a wholly-owned subsidiary of its parent company, American International Group, it seems evident that the practice of the China Insurance Regulatory Commission (CIRC) is to deny AIA any new branch licenses until it takes on a domestic partner. While a grandfather clause in China's protocol allows AIA to retain its already established wholly-owned branches, a footnote to the protocol requires any further expansion by the company to be on terms no less favorable than those accorded to life insurance companies from other WTO member-nations. China has satisfied its ownership-related commitments by honoring these specific commitments, but also has remained true to the MFN principle by ending its preferential treatment for AIA. In addition, China's market access commitments regarding ownership structure also include a provision that allows foreign life insurance companies to freely choose their domestic joint venture partners. This provision has also been honored, the consequences of which have been that foreign insurers entering typically select companies that are not in the insurance business. This is most likely due to the fact that the foreign partner is able to retain control over the insurance operations of the joint venture.

China's compliance behavior in this area can be best understood by using rational functionalist explanations. Part of the rational functionalist approach involves actors designing institutions or agreements in order to advance their individual and joint interests. International agreements are designed through the process of bargaining and negotiations which defines those interests and the outcomes of those negotiations reflect

the compromises made between actors' interests (Koremenos et al 2001:781). In this case, while the interest of the United States is in securing the advantages held by AIA, the interest of the European Union is in ensuring level playing field for its corporations in the Chinese market. The resulting grandfather clause and footnote are the outcome of a compromise between these two actors' interests in the issue area of ownership structure. This compromise in the provisions of China's protocol serves a functional purpose in ensuring that China's compliance with these commitments reflects both the interests of the US and the EU.

#### *4.1.2 Geographic Coverage*

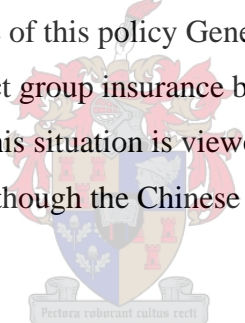
In regards to market-access commitments in the area of geographic coverage for foreign life insurance enterprises, China has received a rating of *full-compliance*. China has honored its WTO-mandated commitments in this area by phasing out geographic restrictions on foreign life insurers within the three-year timeframe specified in accession protocol. Immediately upon accession, China issued foreign life insurers licenses to conduct business in the cities of Shanghai, Guangzhou, Dailan, Shenzhen and Foshan. This was followed by the issuance of licenses for foreign insurers to conduct business in the cities of Beijing, Suzhou, Tianjin, Chengdu and Chonaqing before the service schedule specified that these cities were to be opened. China opened the remaining cities within the timeframe specified in its service schedule, and formally ended geographic restrictions on foreign life insurers at the deadline specified in the service schedule.

The CIRC's efforts to end geographic restrictions in a timely matter seem to be driven by the needs of the Chinese insurance industry rather than the decision to comply with WTO-mandated commitments. Geographic restrictions on foreign insurers have exacerbated uneven economic development in China by concentrating insurance services in the wealthier coastal areas. In an effort to mitigate this uneven development, the CIRC has decided to open cities in the Western and Central regions ahead of schedule in order to speed investment into these areas. This lends credence to rational functionalist arguments regarding compliance because it shows that compliance was driven by state interests rather than the decision to comply with specified terms in the agreement.

Although the service schedule specified that Chengdu and Chongqing were not to be opened until a year later, China opened them early in order to increase the availability of life insurance services, which assist economic development in these regions.

#### *4.1.3 Business Scope*

In regards to market-access commitments in the area of business scope, China has received a rating of *full-compliance*. China has honored its WTO-mandated commitments in this area by allowing foreign life insurance companies to conduct group, health and pensions insurance business by the deadline specified in its services schedule. The CIRC began issuing licenses for foreign life insurers to conduct these new lines of business immediately, and in the months following the liberalization several foreign life insurers secured major group policies. The largest of these policies was recorded by the Italian insurer Generali, which sold a group pension insurance policy to employees of its joint venture partner. With the sale of this policy Generali also displaced AIA, which was not granted a license to conduct group insurance business, as the top foreign life insurer in China for 2005. When this situation is viewed in conjunction with AIA's expansion restrictions, it seems as though the Chinese government is ending its preferential treatment for AIA.



#### *4.1.4 Licensing*

In regards to market access commitments in the area of licensing, China has received a rating of *partial compliance*. China has honored its commitments by not setting any quantitative limits on licenses available to foreign life insurers. Foreign life insurers that have satisfied the criteria specified in China's service schedule have been approved for licenses. The CIRC has set a time limit on approval periods for foreign life insurance licenses, as well as notified foreign insurers when their license application has been denied. Despite this liberalization, two important concerns remain regarding the China's implementation of licensing-related commitments. The first of these concerns is that the CIRC has yet to specify criteria for the awarding of group licenses even though some group business licenses have already been awarded. More importantly, there is a concern that while domestic companies have been allowed to receive licenses on a concurrent

basis, foreign life insurers have only been granted licenses on a consecutive basis. While some foreign firms have been awarded licenses two at a time, domestic insurers have been able to receive four licenses at a time, even when first establishing their business.

China's compliance behavior in this area seems to underscore the theories of rational functionalism. Upon examination of the evidence it is clear that China has not been fully compliant with these terms. One article has characterized this situation as such that China has been "trying to maneuver on the access front with few service-related bargaining chips remaining since they were effectively surrendered (Mallon & Whalley 2004:14)." Since committing to extensive liberalization in the life insurance sector, licensing restrictions and procedures are one of the few, and possibly one of the most effective tools that the CIRC has to control the flow of foreign life insurers into China. China's accession to the WTO has prompted a massive flow of foreign life insurance companies establishing representative offices in China with the aim of securing licenses. Allowing domestic life insurance companies faster license approvals on a concurrent basis is one way to protect the domestic industry from foreign insurers who typically have greater experience in the insurance industry. Therefore, it seems as though the CIRC has made a rational choice provide licensing approvals for foreign firms on a less-favorable terms that domestic firms in the functional interest that foreign competitors will not flood the market. This conclusion is empirically demonstrated by China's compliance behavior in this area.

## **4.2 Summary of Compliance: General Commitments**

### *4.2.1 Transparency*

In regards to transparency-related commitments in the life insurance sector, China has received a rating of *partial compliance*. China has honored its commitments in this area by publishing all relevant regulations regarding the establishment and operation of foreign life insurance companies. While regulations issued in the first two years of China's membership in the WTO were often vague and released with little prior warning, regulations released since the mid-2003 have been much more explicit and have allowed windows for public comment prior to the regulations going into effect. This is

an important issue because transparency is a cornerstone principle of the WTO and the Chinese Communist Party has traditionally controlled information very tightly.

Upon consideration of the evidence, it appears that China's record of compliance in the area of transparency leads credence to the constructivist argument. As discussed in Chapter One, the constructivist approaches view compliance as a learning process whereby member-nations are socialized to the norms of a particular international regime. Transparency is one of the most important norms of the WTO and for that reason it is spelled out explicitly in China's protocol. However, China's compliance with its transparency-related commitments has become progressively better in the years following its accession. Overall, regulations have grown more detailed, in contrast to the vagueness of early regulatory guidelines, and public comment windows have been extended. Since the Chinese communist government has traditionally not been very transparent, one cannot reasonably expect this behaviour to change immediately upon accession. However, the combination of transparency commitments and pressure as well as consultation from other WTO member-nations has helped the CIRC to become more transparent.



#### 4.2.2 Judicial Review

In regards to the judicial review-related commitments in the life insurance sector, China has received a rating of *partial compliance*. China has honored its WTO-mandated commitments in this area by allowing foreign life insurers to access the Supreme People's Court for judicial review of decisions made by the CIRC. With the Trade Regulation of 2002, the Chinese government ensures that in cases where there are multiple interpretations of a legal standard, the interpretation that comports with WTO-rules shall prevail. However, there are two major concerns with compliance in this area. The foremost concern is that Chinese courts are not independent and the CIRC exercises influence over courts which review its administrative decisions. Secondly, foreign firms which access this mechanism may significantly damage their relationship with the CIRC, and run the risk of retaliation because they depend on the CIRC for future regulatory approvals.

Upon careful review of the evidence, it seems as though the Chinese government has implemented its WTO-mandated commitments in the area of judicial review in policy but not in practice. This lends credence to normative approaches to compliance theory, but in a different way than China's transparency-related compliance behavior. Although the Chinese government has made an attempt to enmesh WTO-related rules with their domestic legal system, it must be understood that "where international rules do not comport well with indigenous legal culture, expectations for compliance should not be high (Simmons 1998:84)." Chinese legal culture differs considerably from the Western legal culture on which WTO legal norms are based. Therefore, one cannot expect Chinese legal norms to be brought in line with in with WTO requirements in such a short span of time. It is not that the Chinese government has rationally tried to maneuver around its judicial review-related commitments in the life insurance sector, but rather that making Chinese legal norms compatible with those required by the WTO requires a normative or cultural shift. Yet, although judicial review mechanisms are still in need of significant reforms, compliance with the basic requirements of the protocol is clearly evident.

#### **4.3 The Difficulty of Judging Compliance**

While this judgment on China's compliance with WTO-related commitments in the life insurance sector is certainly valid, there exists considerable for room for debate. Despite the efforts of WTO members to clearly define the terms of China's accession, "assessing compliance is a difficult task, as states dispute what really constitutes compliance, especially when the rules are not very clear cut and open to different interpretations (Chan 2004:56)." In this case, provisions such as "China's licensing procedures and conditions will not act as barriers to market access and will not be more trade restrictive than necessary," are clearly open to disputes on interpretation. Chaynes & Chaynes were some of the first scholars to present a flexible definition of what constitutes compliance. They explained that "what is 'acceptable' in terms of compliance will reflect perspectives and interests of participants in the ongoing political process rather than some external scientific or market-validated standard (Chaynes & Chaynes 1993:202)." These scholars

used the analogy of the highway speed limit to assist in describing compliance. In this situation, while there may exist an explicit speed limit, law enforcement officers may allow drivers a reasonable degree of deviation as long as this deviation is not excessive. The question then becomes; how much non-compliance can be tolerated?

When answering questions of compliance it is important to identify “reasonably justifiable or unintended failures to fulfill commitments – those that comport with good faith compliance standard – and to identify and isolate the few cases of egregious and willful violation (Chaynes & Chaynes 1993:204). In this case, WTO member nations may be willing to tolerate a certain degree of non-compliance in China’s implementation of its WTO-related commitments as long as China appears to be making an effort to comply with the agreement. However, if the China’s behavior departs from the terms of its accession greatly, member-nations may seek enforcement action. This breaking point may come when WTO members see China’s behavior as threatening the WTO, because of wanton disregard of its rules. This is because compliance with the WTO at the very least “means to operationalize principles and rules of the WTO, and to change economic practices and behaviour (Zhang 2003:713).” Yet, WTO members may not be in accord on this issue, and US perceptions of China’s compliance may differ considerably from the EU’s perceptions. Therefore, any judgment on compliance is likely to be subjective, especially because “there is no one in an authoritative position to make a definitive judgment [on compliance], let alone a binding one (Chan 2004:54).”

#### **4.4 Conclusion**

In sum, this research project has endeavored to provide a window into China’s compliance efforts with its WTO-related commitments in the life insurance sector only. This has been accomplished by a thorough description of China’s compliance behavior, an evaluation of this behavior in respect to the terms of the agreement, then a judgment using a pre-defined rating system on the level of compliance. So the question now is; has China been compliant? The short answer is yes. China has satisfied nearly all of the commitments of its WTO accession agreement which relate to the life insurance sector. China has liberalized this sector to allow considerable market access to foreign life



insurance companies. The Chinese government, through the CIRC, has implemented these commitments in a way that will allow the Chinese insurance industry to receive maximum benefit. China's has also undertaken considerable liberalization in the areas of transparency and judicial, although the practice of implementing these WTO-rules may not necessarily reflect the policy. However, these are normative concerns that will take will require a cultural shift to achieve full compliance. Future assessments of compliance must include comprehensive theoretical approach because neither rational functionalist of normative approaches alone can explain all aspects of compliance behavior. In conclusion, it appears that China behavior on the whole in this sector has only been partially compliant, however, it remains to be seen whether China's practices will be fully liberalized in time for full accession in 2007, or whether WTO members will challenge this level of compliance in a WTO dispute resolution panel.



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