

## **The China Challenge: The Experiences of a British Chairman in China**

### **Sir Gerry Grimstone**

One of the greatest challenges in the world today is to understand China, what is it up to, where is it going? And, closer to home, what does this mean for the UK – and my particular responsibilities, the City of London? In my experience, commentators on China approach it from quite differing perspectives – some from a belief that China is, deep down, just like us and is on a path of convergence, others that it is an autocratic totalitarian state seeking to achieve global domination. What view is correct? Of course, neither are. I will seek in this lecture to use my own personal experience and perspectives to try and steer a middle way.

My own Chinese journey started 25 years ago when because of my background as a Treasury official and one of the architects of Mrs. Thatcher's privatisation revolution, I was invited by the State Council to spend several weeks in Beijing in the depths of the winter staying in the Diaoyutai State Guest House in Beijing to advise Chinese leaders on the reform of their State Enterprises. It was a small group comprising also the Chairman of PepsiCo from the US, a leading Russian academic and the head of one of the South Korean Chaebol. We met regularly with Zhu Rongji, then Vice Premier and a leading reformer, and presented our recommendations at the end of the work to Jiang Zemin.

It was an interesting problem because Chinese State Enterprises were designed as microcosms of the State – everything was delivered through them be it production, accommodation, health care, education and pensions. My contribution was to explain how, in the UK, we too had had, to a lesser extent of course, to untangle State policy from commercial activities in our nationalized industries – and the importance of strong political leadership. Our work became the foundation of the socialist market reforms in the 1993 Third Plenum of the Communist party and I like to remind my friends in China that I was one of the policy's midwives.

Subsequently, as an investment banker heading Schrodgers in Asia I helped advise in the Nineties on some of the largest investments

made in China by Western multinationals and enjoyed being one of the few foreigners then spending in Shanghai. A colleague and I shared an apartment overlooking Fuxing Park being awakened every morning in the Spring and Summer at 0600 when elderly couples would waltz merrily to the sounds of the Viennese Composers.

But enough of history. Today I am one of the very few Westerners and Fortune Global 500 chairmen, to be permitted to chair a major financial services business in China - Heng An Standard Life which is our joint venture with TEDA, an arm of the Tianjin Government. We sell savings and insurance products to over 2 million Chinese customers from 74 sales offices spread over 53 cities in 8 provinces – one of the largest geographical presences of any Western financial services companies in China. We have around 5,000 staff including around 4,000 pounding the streets in the classic mode of the Insurance Salesman.

My role as a Chairman in China has taught me many things about China, the Chinese and the complex relationship between the Government, the Party and business in China.

I'll start with Confucius. He was a strong advocate of societal order and harmony and believed that mankind would be in harmony with the universe if everyone understood their rank in society and were taught the proper behavior of their rank. Even today, this respect for hierarchy and harmony has a profound influence on behaviours within China and within companies – it's a great environment within which to be a Chairman but it has taken time understandably to create a Board environment within which opinions can be freely expressed and constructive challenge is welcomed. But we have done so.

In consumer financial services in China, Treating Customers Fairly has an authoritarian edge to it that the FCA here would admire. Chinese customers are outspoken about their rights and will quickly resort to litigation and demonstrations if they feel their rights have been infringed. If a local regulator feels that societal harmony is threatened by a contractual term which though legal is "unfair", an instruction will be quietly issued to sort things out.

Because our 50:50 partner is effectively the State, the State Owned Assets Bureau is a powerful factor in our lives and, for example, sets the pay and performance bonus of our CEO with the unusual effect that he earns substantially less than the people who report to him – but he accepts this as the proper behaviour of his rank.

The State and the Party occupy strongly connected parallel universes but it is acknowledged by all that the Party view prevails – and I’ve witnessed this at first hand. The Party’s Organisation Department is, for example, one of the most sophisticated HR Departments in the World controlling the careers of over 70 million people with direct rights over many appointments. When a preferred candidate – always of high quality – is put forward for one of our senior posts, I don’t have to ask where they came from or which headhunter was used.....

When we first established the business 13 years ago, we imported a whole set of processes and procedures based on mutual trust – those days of somewhat naivety are long gone as we’ve learnt that Internal Audit and our control processes must have a much harder edge to them. If you’re stupid enough to have a procedure that allows someone to take advantage of you – don’t be surprised if they do. But if you do have rules, people will follow them.

My commercial activities give me a powerful position from which to better UK-China governmental relationships. I’ve accompanied the last three British Prime Ministers to China and nowadays on behalf of the British Government, I chair the International Experts Consultation Group which was set up two years ago following the first meeting between Prime Minister Cameron and Chairman Xi to advise Chinese policymakers on the development of their Free Trade Zones – the present day crucible for economic reforms in China. The Group comprises over 50 international companies based in London.

We have so far published 12 policy papers and two think-pieces covering topics such as:

- The “negative list”
- The development of bonded warehouses
- Maritime insurance services
- Private health insurance

- Implications for Free Trade Agreements
- Reform of the Mixed Economy
- Commercial legal frameworks
- Competition and how to ensure it
- Intellectual property and alternative dispute resolution
- Data collection and improved transparency
- Corporate governance and regulation
- Cross-border pensions and asset management

The papers have been republished in a book by the Shanghai FTZ and have become a text book for FTZ officials throughout China.

So what is happening in China today? I want to focus on two future years - 2021 which will be the 100<sup>th</sup> Anniversary of the founding of the Chinese Communist Party and 2049 the 100<sup>th</sup> Anniversary of the founding of the Chinese State – and also my Centenary. Anniversaries have a powerful resonance in China and by 2049 the Chinese confidently expect to regain the position they last held in 1800 when they were the major Global economic power only to be brought down by a “century of humiliation”. Even today Chinese schoolchildren are taught “never forget national humiliation”.

A distinguishing feature of both the British and the Chinese – and perhaps one of the reasons we get on so well – is that deep down we both believe we are probably the World’s most gifted people and born to be naturally supreme. In our case, of course, this is not necessarily true. A map of the world in China of course naturally centred on China has the UK as a small island in the top left hand corner of the map. It marvels the Chinese that we ruled the world from such a remote position and that we are still one of the top 5 economies in the world. They have a deep admiration for us.

Chairman Xi feels the weight of supreme responsibility resting on his shoulders. On taking power in 2012 he laid out his 4 Comprehensives and never underestimate the power and import of slogans in Chinese society. Much can be learnt from them and thus what Xi will achieve by 2021. His four objectives are clearly stated:

- Comprehensively build a moderately prosperous society
- Comprehensively deepen reform
- Comprehensively govern the country according to the law

- Comprehensively apply strictness in governing the party

The Chinese Dream cogently expressed by Xi is to build by 2021 a moderately prosperous society and realize national rejuvenation. The key words we should concentrate on are reform, the law, and strictness.

**Reform** China's present five-year plan covering the period 2016-2020 sets an average annual growth target of 6.5 % - not an accidental figure because it is necessary to achieve the previously defined goal of doubling per capita income between 2010 and 2020. This growth won't be achieved by export growth given the subdued nature of the global economy or by infrastructure spending in the short term so capital productivity clearly has to be improved and this primarily will come from:

- financial liberalisation – where a surprising amount has already been done in areas such as deregulating interest rates, substantially liberalising the exchange rate mechanism, and extending the range of asset classes which insurance companies and pension companies can invest in;
- improving industrial performance by redirecting into higher value-added products, and
- by continued reform of state-owned enterprises – my old hobby and on which I'm regularly asked to speak in China – including the forced creation of “national champions” able to function at a global level including the acquisition of large foreign companies in jurisdictions where this is allowed and welcomed.

Because of the mystique that many commentators have for China, a huge amount of intellect can be wasted on whether a smidgeon of increase or decrease in the GDP figures is a portent of huge prosperity or great disaster for the global economy. I tend to look through short term data and focus on the real economy where for example our own sales are growing rapidly.

China is not scared to experiment and to get things occasionally wrong when it reforms. The Chinese understand the importance of market forces in improving allocations within the economy but don't

want them to be unbridled. They look at the global Financial Crisis that we had in the West and don't want that repeated in China.

Financial Market developments in China have outpaced regulatory reform and it is generally accepted that China's regulatory regime must be tightened to enhance coordination and provide more consistent supervision over different financial markets. At present, other than the PBOC, there are three powerful regulators, the CBRC covering banking, the CIRC covering insurance, and the CSRC covering the Securities Markets. In the past three decades intellectual competition amongst the three regulatory bodies has been a main factor driving the rapid growth of China's financial assets. However, this competition can also lead to inconsistent regulation and has, in the gaps between the regulators, produced a supervisory vacuum leading to potentially to high risk events and financial crime.

Market volatility has been greatly exacerbated by, for example, the growth of a large shadow banking sector that draws in money from retail savers at high interest rates that are then leveraged and deployed in the Stock Market – a market where governance and transparency are sometimes poor and fundamentals are hard to fathom out. In their spheres of responsibility, Chinese regulators are of very high quality but there is a need for tighter coordination and perhaps some overarching architectural change.

This year is the Year of the Monkey in Chinese lunar calendar, and the China's stock market has lived up to the skittish behavior for which the monkey is renowned with very wide swings, driven by a toxic combination of shifts in sentiment and over-leverage. Experimenting as ever, the authorities borrowed the techniques of "circuit breakers" from the West whereby trading is suspended when shares prices change rapidly. The likelihood of the breaker being applied led to the market to anticipate it and thus it exacerbated the very moves it was designed to prevent. There is an old Chinese saying "Oranges change with environment" and there is now a wide spread belief that Chinese specific measures need to be devised and implemented. Ways will be found to encourage market forces but not too excess.

In the period prior to the Thatcher revolution nationalised industries in the UK – our version of state-owned enterprises – traded on the

credit of the Government much as happens with SOEs in China today. We over-invested, we under-invested, we set monopoly prices too high and too low and we massively misallocated resources. The debt of our SOEs was sometimes market-related and sometimes no more nor less than a subsidy in disguise. When debt is provided by the State – and remember the major banks in China are despite their market listings, arms of the State, debt can be created – and written off – at the stroke of a pen or the click of a mouse.

The answer we came to was to break the explicit and the insidious implicit guarantees that shielded the industries from market forces. China realises that over time it has to follow the same route both in relation to state-owned enterprises but also to local authorities – who have got far too great a taste for market participation in a variety of guises. There will doubtless be defaults, bankruptcies and tears – and China will take its time which because of their far greater political timescales than ours may take decades to play out. Far greater risk awareness is needed in Chinese society but a government whose detailed planning horizon stretches out to 2049 doesn't have to rush.

**Law** Much is quietly going on to improve judicial performance in China and there has been a mutually valuable drawing on British experience in this area. A recent development has been the establishing of Circuit Courts where panels of experienced Judges hear cases that otherwise would go to the Supreme Court, The Judges hear cases in geographical areas with which they have no prior associations much as in Britain when Judges on circuit would travel from town to town to hear cases. The stated purpose is to "help eliminate interference in judicial and procuratorial work to ensure that the courts and prosecutors are independent and impartial". A very important recent development on which the Great Britain China Centre are doing great work is a realisation at the highest levels in China that prosperity is inexorably linked to the Rule of Law – hence Xi singling out law as one the great Comprehensives.

**Strictness** In recent years corruption in China has been a cancer that threatened to undermine the legitimacy of the Party in the public's eyes. Ostentatious displays of personal wealth by officials angered the public and became widely known via China's vibrant social media.

Something had to be done if the people weren't to start turning against the Party. The answer was to put Wang Qishan in charge of the Central Commission for Discipline Inspection, perhaps the most feared organization nowadays in political, commercial and business circles in China. Well known and greatly respected in the City of London from his time as the Vice Premier for finance and commerce, Wang now has legions of investigators under his command. When an investigation team enters a state enterprise, all normal activity ceases. Managers, their close and distant families and cronies are turned upside down with every penny of their wealth and possessions having to be accounted for. No matter how powerful, woe betide those whose earnings – normally small – can't account for the wealth or possessions that they have. Punishment can be swift and brutal and bringing down the head of a State Enterprise may also bring down ten thousand people who have partaken in and benefited from the corruption. In response, people are adopting very low profiles, being careful not to be seen in expensive restaurants and, foreign travel has become difficult for those in the Party hierarchy. There is no doubt that it has had in the short term a marked depressing effect on decision-taking business activity and economic growth. The depth of the problem is such that it could take at least another year or two for this work to be completed and for something approaching normalcy to return.

There of course is much more to China than business. Chairman Xi has also taken care to link the Chinese Dream with military strength. "To realize the great rejuvenation of the Chinese nation, we must preserve the bond between a rich country and a strong military, and strive to build a consolidated national defence." It is not difficult to see a link between this statement, great military parades in Beijing, China's present activities in the South China Sea, and the US's defence pivot towards the Pacific and Asia.

China's rejuvenation and planned restoration to greatness is accompanied by a more muscular foreign policy. No more does Deng Xiaoping's dictum "hide light, nurture obscurity" apply. The most visible demonstration of this is the "Belt and Road Initiative" aimed at improving physical and trade connectivity throughout Asia. Huge investment is being directed to financing roads, railways, ports and power lines in undeveloped parts of Asia, Eurasia, and Eastern

Europe with all roads leading to China. At first, the scale of ambition seemed impossible to achieve – now it is beginning to look like it might be real with profound consequences for trade, investment and political flows.

So what does all this mean for the United Kingdom and the City? Due to the very skillful way, the UK Government, personified by the Chancellor, George Osborne has played his hand, it is almost entirely good news and was typified by the UK's decision to be one of the founder shareholders in the AIIB. China has clearly identified the UK as one of its key global partners and London as potentially its major international financial centre. We have made it very clear to China that their investment is welcome even in the most sensitive parts of a modern economy – power, communications and transport. Who would have envisaged 20 years ago that China might one day design, build and partially operate a nuclear power station in the UK? China realises that if it can satisfy the gold standards of regulation in Britain it can build around the world.

The City of London succeeds through intermediation and has to seek it wherever it can find it because the UK economy on its own cannot support the size of our financial services sector which in turn is so important to the UK economy. Looking to the future, one of the biggest sources of intermediation will be China – through for example offshore trading of the RMB, capital raising for companies and projects, the international diversification of Chinese investment portfolios, and the global pooling of risks. Is it any wonder that Hong Kong financiers ponder their future and Chinese banks, insurance companies and asset managers are looking to London as the centre of their international operations?

Where will all this end? I was with Gordon Brown when he met Wen Jiabao, the previous Chinese Leader and proudly proclaimed that 50,000 children in British schools were learning Chinese. Wen Jiabao deftly answered “Prime Minister, they are wasting their time, we have 50 million school children learning English”. Only time will tell whether we are wasting our time and whether the Chinese Dream will become the new normal not just in China but globally. I have to say that I rather think it will.