

## A Window On China

### What an offshore gambling mecca reveals about business in China

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NOT far from China's coast, Macau's casinos buzz with the energy and abandon of the wildly wealthy. Marble columns, gold decor and money are everywhere. But behind the glittering facades there are signs of something darker.

Macau's success is not built purely on the Chinese love of gambling. It is also fuelled by a stampede of nervous money fleeing the mainland. A look behind the scenes at Macau reveals a lot about Chinese corruption, and also about how scared many Chinese businessfolk are about the political climate back home.

Since 2004 when American casino operators first opened there, Macau has grown faster than a dealer sorts chips. Gaming revenues in the first 11 months of the year were 44% higher than in 2010; Macau is now four times bigger than Las Vegas. The former Portuguese colony, a "special administrative region" of China since 1999, is now the world's gambling capital.

High-flyers who gamble with borrowed money in private rooms, known as VIPs, contributed around 72% of Macau's \$23.5 billion in revenues last year (see chart). Because gambling is illegal in mainland China, Macau is their destination of choice. The island's idiosyncratic "junket" system helps to bring rich Chinese to Macau. Junkets are middlemen who lend high-rollers money, arrange accommodation and are paid around 40% of the casinos' take in return. (In Las Vegas casinos carry out background checks on gamblers and lend to them directly.)

But it is not just a passion for cards that brought more than 13.2m mainlanders to Macau in the first ten months of this year. Many come to elude China's strict limits on the amount of yuan people can take out of the country. A government official who has embezzled state funds, for example, may arrange to gamble in Macau through a junket. When he arrives, his chips are waiting for him. When he cashes out, his winnings are paid in Hong Kong dollars, which he can stash in a bank in Hong Kong or take farther afield.

"There are many ways to launder money, more than we can think of," says Davis Fong, an associate business professor at the University of Macau. Some bypass junkets and instead use pawnshops and other stores, where they buy an item with yuan and promptly sell it back for Macanese pataca or Hong Kong dollars—less, of course, a generous cut for the shopkeeper. No one can quantify how much money is laundered in Macau, but it's "such an obscene amount of money you would die", one resident avows.

Mainland China offers scant legal protection for private property. The rich, many of whom cut corners to get that way, know they could lose it all suddenly. Many also fear losing their political patrons next autumn, when China's Communist Party will anoint a new generation of leaders. Small wonder they are seeking havens for their money and their families.

According to the Hurun Report, a wealth researcher, some 14% of rich Chinese say they have already left the country or are filling out paperwork to obtain a foreign passport. Another 46% are considering one of these steps. A recent report by Bank of America Merrill Lynch warned about the destabilising effects of "hot money" speeding out of China this year.

The flow of money through Macau has caught the eye of the government in Beijing and may explain a temporary crackdown in 2008 on the number of Macau visas given to mainland Chinese. According to cables made public by WikiLeaks, an online troublemaker, others are also watching. A memo sent in December 2009 from the American consulate in Hong Kong to the secretary of state said that "[Macau's] phenomenal success is based on a formula that facilitates if not



encourages money laundering.” In a cable in 2008 Joseph Donovan, then the American consul-general in Hong Kong, wrote that “some of these mainlanders are betting with embezzled state money or proceeds from official corruption, and substantial portions of these funds are flowing on to organised crime groups in mainland China, if not Macau itself.”

Many have also started to worry about the junkets’ health, partly out of concern about the stability of China’s “shadow lending” system. If rich Chinese saw their businesses collapse or property investments plunge, as some fret could happen if the mainland’s economy slows, the 200 or so junkets that operate in Macau could have trouble getting their money back from gamblers. At best there would be less money to lend. But junkets that could not collect debts might implode, leaving the casinos that had extended credit to them with big losses. Many casino executives do not seem to know how much money they have lent to junkets, which makes it hard to assess the possible extent of defaults.

Casino operators, like their customers, remain sanguine about future winnings. According to analysts, no big junket has reported any issues with bad loans so far. A casino executive said recently that he worried less about a junket going under than he did about the implication of a Macanese official in a corruption scandal or a murder at a casino. Any big crime would probably encourage China to intervene more heavily in Macau’s affairs and specifically in the gaming industry.

You can bet that the casinos want to avoid that. They are trying to attract more “mass-market” customers, who actually want to gamble for fun. Such people do not need loans to play and offer better margins, because casinos do not need to pay junkets a cut. A high-speed railway being built from Guangzhou to Macau will make it easier to lure them. Some casinos are also building venues with less floor space for blackjack and more for shops, theatres and restaurants.

This may help placate the government in Beijing, which would rather see its citizens shop for jewellery than for a different currency. But as long as money feels nervous in China, it will seek a way out, and Macau is awfully convenient.

**Correction:** This article originally referred to Guangzhou as a province, when it is the capital of Guangdong province. This was corrected on December 13th 2011.