INSIGHT.

The Journal of the American Chamber of Commerce in Shanghai - Insight January/February 2019

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SPECIAL FEATURES

MEMBER NEWS

CHAIRMAN'S NOTE

ERIC ZHENG
Chairman of The American Chamber of Commerce in Shanghai

As we enter 2019, I would first like to thank former AmCham Shanghai President Kenneth Jarrett for his significant contributions to the Chamber and its members over the past five years. Under Ken's leadership, AmCham Shanghai expanded deeper into the Yangtze River Delta, including the cities of Suzhou and Nanjing, diversified its membership, improved its finances, and played a critical role as the "Voice of American Business" in China. He also successfully stewarded the celebrations of AmCham Shanghai's 100th Anniversary. But it was in the last two years, as trade frictions between the U.S. and China increased, that Ken's value as president became increasingly evident. As one of the most well-respected China hands, Ken provided unfailing counsel to numerous American companies and committed himself to making members' voices heard by both Chinese and American policymakers. Our advocacy efforts have benefited a great deal from Ken's experience and insight. As Ken moves on to the next chapter of his distinguished career, I wish him every success in his new endeavors.

Following in Ken's esteemed footsteps is Ker Gibbs, a long-standing Chamber member who has also served as the Chamber's chairman. Ker is also a long-time student of China and has held management roles at Apple, HSBC and Korn Ferry, among others. His broad commercial experience coupled with his extensive China background made him uniquely qualified for the position of president. The board is confident that Ker has the strong commitment and necessary skillset to lead the Chamber through the next phase of its development.

In conjunction with the board, one of Ker's priorities will be to keep leading our efforts to advocate win-win trade relations between the U.S. and China at a time of unprecedented tensions. That will mean keeping the spotlight on structural issues in China that concern our members like market access restrictions, IP violations, and a lack of the rule of law, while encouraging policymakers in both countries to find common ground that delivers workable and measurable solutions to the trade dispute.

As we near the end of the decade, Ker and I are committed to bringing more value to our members. We will achieve this through efforts like offering more value-added services, improving content distribution through digital platforms, scaling up our operations in Nanjing and Suzhou, and exploring other outreach initiatives. While strengthening existing committee activities will remain a priority, we will also look for opportunities to serve new or high-growth industries and segments. Last, but very certainly not least, we will continue our advocacy efforts in China and the U.S. Our role as an objective communicator of members' concerns to government officials has never been so important.

One word that recurs in the paragraphs above is "member." There is a simple reason for this: we are a member organization. You are our primary constituency, and your business success is our priority. To help you succeed, we also need your feedback. If you have any suggestions about how to improve the Chamber, we will always welcome your feedback.

Have a successful 2019!

How Big a Reset for U.S.-China Relations?

By Kenneth Jarrett, president of AmCham Shanghai 2013-2018

Imagine a special meter that could measure the state of U.S.-China relations. The meter's scale would read "cooperation" at one end and "competition" at the other. If we looked at that meter today, the needle would be pointing squarely at competition. Few would say otherwise, either in Beijing or in Washington, DC.

The United States and China are undergoing a strategic realignment in their relationship. Where will the needle stop on our special meter? Will it stop at competition, which could be viewed as a normal state of affairs between two big powers, or head off the scale into territory of far greater concern, with each country viewing the other as an adversary? That is the question on the minds of many American business leaders today.

This issue of Insight offers previews of 2019, including what we should expect with respect to U.S.-China relations. In this article, let me remain faithful to the outlook orientation of this issue, but do so mainly by looking at the origins of the current tensions before peering into my crystal ball.

As we worry about today's bilateral problems, we should remember that the U.S.-China relationship has never been free of stress. Even in the post-normalization heyday of "constructive engagement" as a U.S. policy objective, each government hedged against the other. Over the four decades since diplomatic normalization in 1979, there have been several reminders that the United States and China have some fundamental differences. Tiananmen best demonstrates this point, but there has also been no shortage of other crises, with the mistaken bombing of the Chinese embassy in Belgrade (1999) and the EP-3 plane collision off Hainan (2001) as two excellent examples. Both episodes raised questions in the minds of many Chinese about American attitudes and friendship. Likewise, many Americans have doubts as they read about China's industrial hacking and expansion in the South China Sea. And if one goes further back in time, the conflicts were even more severe: direct armed conflict in Korea and indirect conflict during the Vietnam War.

I offer these comparisons not to minimize the significance of the realignment currently underway, but simply to make the point that our two countries have faced some tough challenges before. Before we despair about current trends, let us first consider if dire pessimism is justified.

It is popular today to criticize past U.S. administrations for being naïve about China, blindly assuming, so the argument goes, that China would enthusiastically embrace market economics and allow a greater degree of political freedom. Viewed from today's vantage point, movement on both fronts seems to be in the wrong direction, contributing to the sense of disenchantment with China among many Americans. Genuine political reform, however, should not have been considered likely, which means that disillusionment in this regard is not justified.

But in the realm of economics, there are good reasons to feel disappointed. China today is the second largest economy in the world and the largest manufacturer. It is 17 years since China joined the WTO. While the private sector in China has made great strides and is responsible for most of the country's GDP, the heavy hand of the state is felt across the economy and not getting any lighter. State-owned enterprises dominate in too many industries, foreign companies remain subject to excessive restrictions, and the pace of economic reform – as understood by

A key U.S. objective of constructive engagement was to get China to participate in internationally accepted structures – to "play by the rules" in that sense. Today, China has upped the ante and wants to create its own structures.

Few would have predicted that American views toward China would harden so quickly. Perhaps this is just another example of the American tendency to either romanticize or demonize China.

Western observers – has slowed appreciably. This is not what the foreign business community thought China's economy would look like nearly two decades after WTO accession.

This is not to say that China has been standing still. There have been plenty of changes, but many in areas that only fuel the growing sense of competition and tension with the United States. For example, China's foreign policy under Xi Jinping is far more assertive than China under Deng Xiaoping or even Jiang Zemin. A key U.S. objective of constructive engagement was to get China to participate in internationally accepted structures – to "play by the rules" in that sense. Today, China has upped the ante and wants to create its own structures. Examples abound – the Asian Infrastructure Investment Bank, Belt and Road Initiative, and Shanghai Cooperation Organization to name just three. China's assertiveness even extends to offering a development model with fewer political strings attached, sometimes referred to as the "Beijing Consensus," another example of China offering alternatives to the status quo structures built since WWII under American leadership. This just strengthens the American worry that China seeks to challenge those global structures. When you add to the mix China's actions in the South China Sea, China starts to look like an aggressive actor who cannot be trusted. In short, compared to the "hide and bide" foreign policy strategy advocated by Deng Xiaoping, China under Xi looks quite different. Many Americans don't like what they see.

Moreover, the political climate within China has changed under Xi Jinping in a way that raises additional concerns in Washington, DC. There has been a gradual tightening of political controls in recent years. Local media is less daring, social media is heavily monitored, intellectuals are more hesitant to speak out, and important pillars of civic society – such as the legal profession and religious organizations – are under pressure. Xi Jinping's anti-corruption campaign, which was sorely needed and remains highly popular, has helped revive the Chinese Communist Party (CCP) as a bedrock institution in China today, but ideology is once again the 'key link' and the party is making its presence felt across Chinese society – including in the business sector. Depending on how far this goes, a revived Communist Party could become a new point of friction between the United States and China. Social credit scores, a renewed emphasis on party "cells" within companies, and the elimination of term limits for Xi Jinping in his role as head of state, conjure up negative images in the United States. Is the CCP, which had been evolving into a "market Leninist" party, now returning to its roots as an old-fashioned "Marxist Leninist" party? That is another question shaping the current U.S.-China dynamic and creates additional opportunities for conflict.

Changes in China are just one part of the equation. The United States has been undergoing change as well and shifting variables in our country are part of the bilateral calculus. The past decade has been a challenging one for Americans. Notwithstanding the current strength of the U.S. economy, the last ten years have been defined by the "Great Financial Crisis" and lingering conflicts in Iraq and Afghanistan. These have extracted a horrific toll, not just in blood and treasure, but also on the national psyche. In addition, social tensions are on the rise, domestic politics are increasingly polarized, and many Americans question the benefits of globalization. In short, America today is not the self-confident superpower of yesteryear. Thus, just when the United States is feeling anxious and uncertain about its direction and global stature, a dynamic China appears in the rearview mirror. This undercurrent shapes the bilateral relationship and contributes to the growing sense of mistrust and suspicion.

As a result of all this, China today has few friends in the United States. In fact, there seems to be a sudden convergence of views among the key American actors in U.S.-China relations – government, Congress, business, academia, media and labor – that China is a bad actor and the United States must stand firm and challenge China on all fronts. Constructive engagement as a policy approach is thoroughly discredited, even though the policy had many achievements and was supported by different administrations, both Democrats and Republican alike, over several decades. The swiftness of this collapse has been breathtaking. No wonder Beijing was caught off guard and slow to realize that the paradigm had shifted. Few would have predicted that American views toward China would harden so quickly. Perhaps this is just another example of the American tendency to either romanticize or demonize China. Our desire to reduce China to a bumper sticker remains strong and today's sticker message doesn't bode well for the future.

What then, does that future look like and what does it mean for U.S. companies active in China? Let me end this essay with some discussion of those questions.

▼ Also known as GDP

Market Leninist skyline

In the near term, one should expect further deterioration in U.S.-China relations. Within the Trump administration, policy hawks who believe China constitutes a strategic adversary to the United States occupy most key positions. The more extreme of this group advocate "decoupling" of the two economics, even if that is unrealistic and would be harmful to the United States. At the very least, the policy hawks now in command are determined not to facilitate China's further rise, hence the particular attention to emerging technologies as a key battleground. This could lead to greater conflict between U.S. industry and the U.S. government, to say nothing of greater tensions between the United States and China.

Both governments could do more to improve the atmosphere. In the case of China, it must work harder to explain its actions and objectives, especially its international ambitions. China is behaving differently than in the past but Beijing, still fumbling with the concept of soft power, has not prepared the world for this change. In contrast, China's leaders have done a much better job explaining the economic transition that has been underway in China the past 40 years. But now that wealth and prosperity provide the basis for political power and influence, China has been less successful at preparing the world for that transition. Particularly in the United States, China's new global posture is viewed with apprehension. And when the United States reacts, China views this as containment. Many Chinese believe the United States wants to stymie China's economic development and prevent China from assuming its rightful place on the world stage. We must break this vicious cycle.

If China must explain itself better, then the United States must learn to accommodate itself to a strong and powerful China.

If China must explain itself better, then the United States must learn to accommodate itself to a strong and powerful China. This will not be an easy adjustment. Since the collapse of the Soviet Union, the United States has been the sole global superpower. China may not be America's peer right now, but it could challenge the United States in ways the Soviet Union never could – particularly in the economic realm as China overtakes the United States as the world's largest economy. China is already the top trading partner for many of America's friends and allies. It will take enlightened leadership in both Beijing and Washington to increase the likelihood that the future operational framework between our two countries improves prospects for cooperation and trust rather than create an atmosphere of conflict and suspicion.

All of this translates into some difficult times ahead for American companies. On the one hand, the reasons for staying in this market are stronger than ever. For many U.S. companies, China is already their second largest market. American business activity contributes to China's economic development but also strengthens the U.S. economy. This is not an either-or situation. On the other hand, growing anti-China sentiment in the United States and a long history of Chinese ambivalence toward foreign companies adds political complexity to business decision-making. Even after 40 years of diplomatic relations, Americans and Chinese need constant reminders of the benefits of U.S.-China interaction. Commerce is a natural candidate. The American business community was once viewed as providing a kind of political ballast at times of bilateral tensions and we could again play that role.

But there are preconditions for this to happen. For Beijing, it must make clear that foreign investment in China remains welcome and that foreign companies will be able to compete and operate in China fairly and freely. If this were to happen, U.S. business will again become vocal advocates for a healthy U.S.-China relationship. For Washington, it must show that its approach toward national security is appropriate and limited and that it welcomes all other business activities. China's vague and expansive definition of national security is already bad enough for business. These are big ifs, but it is imperative we succeed. We do not want to live in a world defined by an unhealthy rivalry between the United States and China, and there is no reason why that is how our future should look. I

On Trade, Reform and the Future of Relations

A discussion with Charlene Barshefsky, chief negotiator of China's WTO Agreement

By Ruoping Chen

Ambassador Charlene Barshefsky is WilmerHale's Senior International Partner. She joined the firm after serving as the US Trade Representative – the chief trade negotiator and principal trade policymaker for the United States – from 1997 to 2001, and acting as deputy USTR from 1993 to 1996. As the USTR and a member of the President's Cabinet, she was responsible for the negotiation of hundreds of complex market access, regulatory and investment agreements with virtually every major country in the world. She is best known internationally as the architect and chief negotiator of China's historic WTO Agreement, as well as global agreements in financial services, telecommunications, intellectual property rights, high-technology products and cyberspace.

How would you analyze the G20 meeting between Presidents Trump and Xi and does that affect your outlook for U.S.-China relations in the coming year?

I think the relationship will remain volatile because each country challenges the other in many different ways and each leader uses the opposite country for political and nationalistic purposes. I think the relationship will remain unstable but hopefully sufficiently manageable that commerce can proceed with greater certainty and punitive tariffs are removed on both sides.

If a deal is not reached by March and the U.S. goes ahead and levies tariffs on another US$267 billion and raises the tariff rate to 25%, what do you believe would be the immediate consequences for both economies?

I may be wrong, but I have long held the view that the United States does not want to get to the 25% tariff level, nor does it want to add in to the equation another $267 billion of Chinese imports. The effects on the U.S. economy would be very significant and, most particularly for the Trump administration, the effect on the stock market would be potentially severe. We see stock market volatility now when the tariffs are at 10% and folks fear that talks aren't going well. What happens when in fact talks break down and tariff rates dramatically increase? I think volatility will increase to unacceptable levels. So I have had a theory for some time that the Trump administration will want to conclude an agreement — that doesn't mean it will be easy for China to meet the U.S., but it also means the U.S. will have to compromise in the interests of economic growth and in the interests of reducing stock market volatility.

How do you view the Trump administration's strategy on trade relations with China? What about the argument that he at least has gotten the Chinese government's attention?

I think there would have been a much more effective and less damaging way to get China's attention. By less damaging, I mean less damaging to the United States, and that is to have stayed in TPP. China was very concerned about TPP and its exclusion from it. Had the United States stayed in TPP, it would have begun to create an alternative to the current system. If the U.S. took the TPP agreement and expanded it some in Asia, for example adding Korea or Indonesia, and then persuaded Europe to join, you would have near 60% of global GDP, which would leave a choice for China: Either change your practices or be at a permanent and considerable commercial disadvantage.

This would have been the more effective course. It is a less antagonistic course. It is also a course that is predicated on a set of rules which in the longer term is in the U.S. interest. And it is a course during which the United States could suggest that China seriously consider joining, but only on the basis of a new set of rules. This would also have unlocked progress in the WTO, which has been stymied since the launch of the Doha Round. So to my mind, the most effective course would have been the one that Trump jettisoned on his second or third day in office, and that would have been to stay in TPP.

In your opinion, what are the most important reforms China needs to make to change its unfair trade practices?

You have of course the failure of China to maintain a reform and opening agenda. Perhaps by 2007 or so, the phrase "reform and opening," which characterized the period from Deng Xiaoping through Jiang Zemin and even very early into Hu Jintao, was no longer used and the word was simply "reform," with very few allusions to "opening." So I think first of all, China has to return to a "reform and opening" agenda, which is to say the reform is intended not merely to make Chinese companies more competitive, but to open the Chinese economy to competition.

Certainly China has to cease its discrimination against foreign multinationals. The incidences of discrimination are many, very well-documented and pervasive. China needs to curb its subsidies to homegrown industries including the state sector, rather than increase those subsidies and crowd out private sector investments as well as disadvantage foreign companies.

> "There would have been a much more effective and less damaging way to get China's attention...and that is to have stayed in TPP."

Some agreement or set of agreements is going to have to be reached on cyber espionage, forced technology transfer and intellectual property, the latter of which of course is a long-standing issue never satisfactorily resolved, although certainly progress has been made.

Those are among the basic things that would have to be done. The issue for China is not whether it should develop — of course it should. The issue isn't whether it should grow — of course it should. The issue is how it does those things and it is the manner in which they've chosen to pursue development and growth that is the issue, not that they are developing or growing.

Experience has shown that, even if China were to make policy changes, when it comes to following through on things like WTO directives, there has been regulatory obfuscation and foot-dragging. So how does the U.S. realistically enforce any agreement?

There will have to be a set of metrics and perhaps some arrangement between the two on enforcement — whether that's in the form of bilateral dispute settlement subject to exceptionally rigorous timelines and perhaps injunctive relief, or whether that's arbitration or simply a return to punitive tariffs. Certainly there will have to be some system of monitoring and a series of metrics developed against which progress can be measured.

I think that China made a grave error in the context of the Strategic and Economic Dialogue and that was to use the United States' love of process as a way to thwart responsiveness to U.S. requests. Instead, China engaged in foot-dragging, setting up committees and holding endless meetings which yielded nothing but a lot of talk. The result of that strategy was the kind of explosion you saw when Trump began talking about China. He tapped into tremendous frustration on the part of the business community and others about the way

▲ What would Sun Tzu do?

in which China had proceeded over the previous decade. China should have recognized that at some point its foot-dragging would yield the kind of result you see today. That was an outcome that was entirely avoidable had China continued on a reform and opening path during the past decade, rather than pretend to respond to U.S. requests, when even if progress was made on paper, facts on the ground got worse.

Having lived through China's rise and knowing what we know now about its plans, how do you now view China's accession to the WTO nearly 20 years ago?

There's no question China should have been in the WTO at that time and should be in the WTO now. I think the mistake was a failure to use special provisions of the protocol of accession to enforce China's commitments. The protocol of accession for China has provisions prohibiting forced technology transfer, and yet neither the Bush nor Obama nor Trump administrations have taken China to the WTO on the basis of those provisions.

China's protocol contains provisions with respect to the way in which state enterprises need to conduct themselves in commercial operations, including the prohibition on direct or indirect government involvement in the commercial decisions of state enterprises. These provisions have never been used by the United States. Lastly,

> "China made a grave error in the context of the Strategic and Economic Dialogue and that was to use the United States love of process as a way to thwart responsiveness to U.S. requests."

China's protocol had provisions that would have prevented the import surges that the U.S. saw in the decade following admission. These were provisions designed to prevent market disruption in the United States from Chinese imports.

The Bush administration denied relief to four different industries under these provisions. The Obama administration granted relief once, but in the 12 years these protective provisions were in place, almost no cases were brought. That's crazy to think about when one considers the loss of a million-plus manufacturing jobs in the U.S. during that time that reputable economists have attributed to Chinese imports. So the mistake was not in China joining the WTO — it's a fifth of the world's population and one of the great nations of the world. The mistake was in not enforcing the agreement in these very unique ways.

The U.S. did bring a series of successful WTO cases against China, but they tended to be quite rifle-shot rather than more encompassing, and consideration should have been given to bringing more encompassing actions. One can argue there should have been other forms of enforcement under Section 337 of U.S. trade laws, which prevent IP theft and so on. But there are a number of directions in enforcement that the U.S. could have taken over the 10 years — quite apart from the talk fest that went on for those years — that would have been more effective.

At the time when you were negotiating with China, what was the biggest challenge for you and can you make any comparisons or have any insight into the ways that the Chinese think and how they operate now?

The Chinese are very pragmatic, very practical, very deal-oriented and quite entrepreneurial in that regard. The Chinese are always quite willing to listen seriously to innovative proposals and creative ideas and can often be brought along. But certainly China has national aims. Xi Jinping has embodied them in the "China Dream" and the notion of tech supremacy, which can create a challenge when these kinds of aspirations become almost an ideological mantra and therefore rigidly pursued at all costs. It's the "at all costs" that of course has gotten China into trouble with its allies. Let's bear in mind it isn't just the United States that has concerns about China's commercial conduct: it's Europe, Japan, Canada, Australia — many other countries share similar concerns.

So I think that China because it is pragmatic and practical can make changes to its trade regime. I think it can begin to turn the corner from its divergent stance with respect to market economics and begin to take actions that would be more compatible with market economics. But certainly China will have to make very difficult decisions.

Many expected China to evolve into a Western-style open economy. That has not happened, and the state appears to be reasserting its control over the economy under Xi Jinping. Under Xi, where do you think China is headed?

I certainly never thought China was headed toward a Western democracy or anything of that sort. It always seemed to me that China as it became wealthier might become more pluralistic, but I also often said and believe that those are decisions for the Chinese people to make, certainly not for the United States or any other country to make on China's behalf. The second thing I would say is that this is not the end of history.

Imagine for a moment if Xi Jinping was not the president, imagine if the head of state was a reformer. Imagine if Donald Trump wasn't the President of the United States, and it was a progressive instead. So both countries have had shifts in leadership that one might not have anticipated — certainly there are never any guarantees — but so too for neither countries at the end of history. New leaders emerge over time. I'm not suggesting that we count on that happening as a solution to the current set of problems. I'm merely saying that we have to be careful that when we think about where China is today or where the U.S. is today, this is how it will be forevermore. We see the effects of these particular types of leaders on both countries. We can also imagine a situation where those leaders are no longer heads of state.

With respect to where China is today, though, I think Xi Jinping has a highly particularized vision of China in the world, and underneath that vision are a series of aspirations that are quite specific and indeed not merely aspirational but prescriptive in nature. In that regard I find this quite impressive, that is, for a country to take a longer-term view and have a plan of action against which it operates. Of course the U.S. does not have any such plan, and that is to the disadvantage of the United States. By the same token, not all plans are good plans, and not all plans are plans that fit well in a global system without disrupting that system in extremely dangerous ways, including for the disrupter, as we see today.

> "The notion of decoupling is rather fanciful, particularly if one takes into account the diminution in global growth were the two economies, which are highly entangled, to suddenly decide they shouldn't be."

I do think that, as a globalized world, countries have to think about the effects their actions on their partners and on the global economy and conduct themselves with some degree of restraint. I think that advice is also pertinent to the United States.

Given the two countries' divergent courses and the ideologies underpinning their economies, is Trump's proposed decoupling a sign of the realism with which we should approach China from now on?

I think the notion of decoupling is rather fanciful, particularly if one takes into account the diminution in global growth were the two economies, which are highly entangled, to suddenly decide they shouldn't be. That raises a dangerous specter of isolationism and genuine "beggar thy neighbor" outcomes. It would be better for the two economies to operate on a more equitable basis. It would be better if the Chinese economy in particular adhered to market-based economics rather than state-led economics, and it would be better if the two countries got along better for global stability and better for wealth creation.

So the notion of decoupling would fly in the face of those aspirations and be dangerous for those reasons. But I do think that the fundamental underpinning of the relationship, which has always been economic, does need to be straightened out. Without that underpinning, the bilateral relationship will become increasingly not just volatile but hostile, and that is not an outcome any country in the world should want. I

▼ He has a dream, too

IMAGINECHINA

THE U.S. AND CHINA

DOMESTIC ADJUSTMENT AND TRADE RELATIONS CRISIS

By Wang Yong

Wang Yong is a professor at the School of International Studies and the director of the Center for International Political Economy, Peking University (PKU). He is also a professor at the Party School of Ministry of Foreign Affairs of China, president-appointed professor for the HKSAR Senior Civil Servants Training Program on Chinese Affairs at PKU, and distinguished fellow of Munk School of Global Affairs at the University of Toronto. Among other roles, he was consultant for the Asia Development Bank, a visiting Chevelier Chair professor of the Institute of Asian Research at the University of British Columbia, and a member of the World Economic Forum Global Agenda Council on Global Trade and FDI.

The year 2018 has witnessed the celebration of the 40th anniversary of China's reform and opening up, as well as the 40th anniversary of the establishment of diplomatic relations between China and the United States. It is no coincidence that the launch of reform and opening up and the establishment of China-U.S. diplomatic relations took place at the same time, bringing China and the world into a new era. Since then, China has changed from a backward and poor country into the world's second-largest economy and the largest trading country and exporting country. While China has greatly increased its influence in the global economy, it has also become a more comprehensive regional and even a global power.

However, on the occasion of the 40th anniversary of these two big events, China-U.S. relations and the course of reform and opening up seem to be both undergoing major adjustments. Based on the tremendous changes since 2013, the 19th National Congress of the Communist Party of China proposed a new direction of development in two steps: China is set to become a medium-level developed country by 2050, and China will implement the foreign policy of a great power with Chinese characteristics. China-U.S. relations have also undergone tremendous changes. U.S.-China political trust has declined, and the U.S. launched a tariff war on imports from China. Obviously, the U.S. government and public not only worry about the trade deficit with China, but also worry about the impact of the Made in China 2025 plan on U.S. industry. The escalation of trade friction combined with U.S. suspicion over China's new policy direction explains the prospect of a "new Cold War," and even a local "hot" war possibly caused by a dispute over the issue of the South China Sea and the Taiwan Strait.

This development is regrettable. I believe that in order to find a new direction for China-U.S. economic and trade relations, China-U.S. relations

IMAGINECHINA

▲ And now for the next 40

must be placed under an historical framework. My basic view is that there are still huge common interests between China and the U.S., but we must face up to the differences between the two sides. Many problems are due to misunderstandings between each other. Clearing up these misunderstandings will help re-establish political trust between the two sides.

Domestic adjustment of the U.S. and China after climax of globalization

The policy direction of the U.S. and China has been basically the same in the past 30 years. In the first two decades, both embraced globalization. While the U.S. played the role of the leader of globalization, China has been an active follower as the largest developing country. Both believe in the benefits of economic globalization, and indeed globalization has brought tremendous growth to both countries. However, economic globalization has also produced a serious negative result: disparities between rich and the poor within each country. The U.S. is the country with the largest wealth gap among developed economies, and China has one the deepest wealth gaps among the largest developing countries.

American politicians have not disclosed the full picture of the trade flows, speaking only of the trade in goods.

As part of the responses to this severe problem, China and the U.S. made efforts to readjust domestic policies, especially after the global financial crisis in 2008. However, due to differences in the political systems, the two have adopted different adjustment policies. The election of Donald Trump manifested the rise of populism and protectionism, and "America First" has become the primary goal of foreign policy. Chinese leaders also recognize the unsustainability of the past development model and have emphasized adjustments in the past five years, including anti-corruption, poverty alleviation and rural rejuvenation, environmental protection and overall security strategy (prevention of financial crises, cyber security and so on).

Simply put, the changes that have taken place in both countries are revolutionary, and the domestic restructuring has produced spillover effects, which have aggravated the misunderstandings and tensions between China and US.

Reconfirming the truth about U.S.-China trade

Economic and trade relations have brought enormous benefits to both sides. The bilateral trade between the two has reached the highest level of any bilateral trade in history. but in contrast to the views of some people in the U.S., the bilateral trade is fair and the distribution of interests is overall even, because there is no "forced" buy and sell, and both sides are smart. Regrettably, the American public does not understand the truth of China-U.S. trade, and U.S. politicians intentionally or unintentionally conceal the truth of trade for election purposes.

The rise of the global supply chain driven by economic globalization largely account for the rapid development of China-U.S. trade. In the global supply chain, although China has made progress in high-end sectors, Chinese companies are generally in the low-end ones. The profits of Chinese factories and workers are far lower than those of Western investors and multinational companies. For example, in the case of Apple's iPhone, Chinese factories and workers have earned only 5% value added, while Apple has gained nearly 60% and the rest goes to parts suppliers from Japan and Germany. The example of Apple's mobile phone reflects the reality of international trade in the era of economic globalization: China's foreign trade is large in volume, but the proportion of profit is small. This is illustrated as well by another example: China's state-owned enterprises account for only 10% of the total exports of the country. Unfortunately, the American public and politicians don't understand this reality and complain about the high trade deficit with China. Some members of the elite in China don't understand the true picture of China-U.S. bilateral trade either, and are misled to be complacent about China's export surplus and competitiveness in the so-called "high-tech" products.

American politicians have not disclosed the full picture of the trade flows, speaking only of the trade in goods. In fact, the United States has a surplus of US$50 billion to $90 billion per year in terms of services, not to mention the $500 billion sales achieved by U.S.-owned companies annually in the Chinese market, including a large amount of U.S.-made spare parts and intellectual property. If all aspects of China-U.S. economic and trade relations are added up, they are generally balanced.

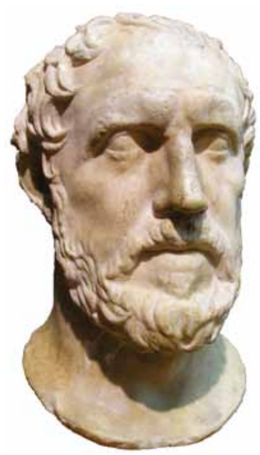
Rebuilding political trust

Politics and society in China and the U.S. are in a state of transition, and the situation is very complex. There are differences within the Chi-

Faced with the increasingly complex situation at home and abroad, Chinese leaders are stressing the need to deal with three major "traps"

nese and American elites as to how to explain the domestic changes and foreign policies of the two countries. The American elite is divided internally, and the Chinese elite also encompasses different views. However, though the left and the right in the U.S. differ on all sorts of issues, both call for policy hardening on China. Such a domestic atmosphere is actually dangerous for the relations.

Before rebuilding political trust, both sides should strive to understand each other. For Chinese leaders, it is important to understand that adjustments made to domestic policies should not be too far away from expectations both internally and externally, and it may be advisable not to go to extremes in the name of maintaining political security. But in fact, the advocacy of the "core values" of socialism are not



A stone-faced Thucydides

in contradiction with the so-called "universal" values. Also, the American elite should learn more about China's changes over the past five years. These adjustments have been largely necessary to solve the problems accumulated in the past decades; the old development model was not sustainable, politically, economically or environmentally. China's current policies can be largely explained by three "trap" concepts to which the leadership are paying close attention. Many of the policies that China has introduced in recent years are not the result of the country being strong, but because they are facing up to its shortcomings. The core driver is not a desire by China to compete with the U.S. for world hegemony (for example, the Belt and Road initiative), but fear of a shortage of "international public goods," which include institutions and resources to support international cooperation.

Faced with the increasingly complex situation at home and abroad, Chinese leaders are stressing the need to deal with three major "traps":

The first is the middle-income trap. The comparative advantage of production of labor-intensive products is gradually disappearing, and to continue to maintain economic growth, China must rely on innovation, upgrading its industrial level and technology. Made in China 2025 was conceived in this context, with the hope to use policy incentives to improve the competitiveness of the Chinese economy.

The second is the Tacitus trap, which refers to the challenge of losing government credibility. The Chinese government hopes to eliminate poverty by 2020, aiming to create a responsible government, win back the hearts of the people and consolidate its legitimacy.

The third is the Thucydides trap and the Kindelberg trap. China has tried its best to avoid the "Thucydides trap", in which emerging powers collide head-on with major powers. At the same time, in the face of increasingly inadequate international public goods supplies, China has made it ever-clearer that it is willing to provide more international public goods to strengthen the global governance structure. In order to cope with the "Kindelberg trap", which assumes that an emerging power is unwilling to provide international public goods, China has come up with initiatives such as the Belt and Road Initiative and the Asian Infrastructure Investment Bank (AIIB). China is already the second largest donor country in the United Nations, and the country with the largest number of international peacekeepers employed abroad.

These three "traps" that China's leaders have identified as needing to be overcome can be the key to the U.S. elites from all walks of life understanding China's domestic political and economic changes. Unfortunately, the U.S. media and policy research community only pay attention to the revision of China's constitution and abolishing the term limit of the president; focus only on the greater concentration of power and ignore the development and adjustment of China's domestic political economic policies from a broader perspective. For China, leaders at all levels should continue to actively communicate with the international community on the changes in China, to assure the outside world about China's future direction.

Prospect of economic decoupling

The leaders of China and the United States met during the G20 summit on December 1 and arrived at a consensus. They decided to jointly promote efforts to reach an agreement within 90 days. The summit rekindled confidence in bilateral agreements. However, there are still many uncertainties as to whether an agreement can be reached to avoid a trade war. From the current point of view, a defensive China is willing to make more concessions, including increasing market access to address the concerns of U.S. business in China, such as market opening, property rights protection and so on, in addition to importing more from the U.S. to shrink the trade imbalance. However, China and the U.S. may still be unable to reach an agreement, which would lead to an escalation of the trade war, and eventually the decoupling of the Chinese and American economies.

One may argue that there are indeed more reasons to be pessimistic than optimistic about the prospects of China-U.S. relations:

Most importantly, the security hawks, long marginalized, have taken power. Driven by factors such as ideology and big power struggle, they tend to perceive the relations as a strategic competition characterized by a "zero-sum" game. As a result, they tend to look at all forms of contact between China and the U.S.

▲ One trade war casualty

with a negative eye. The representatives of such views, Steve Bannon and Peter Navarro, believe that China and the U.S. are engaged in an economic war, and neglect the essence of mutual benefit between China and the United States.

After the incitement of populism and protectionist sentiment, coupled with the U.S. partisan competition system, the Democratic House of Representatives will launch more actions against President Trump after the midterm election, in order to win the support of voters ahead of the 2020 presidential election. In the next two years, the Democrats and Republicans, Congress and the Executive branch will likely compete with each other to see who is tougher on China. For the Democratic Party, it is more in line with its own political interests to prevent Trump from reaching a trade agreement with China.

The swing in attitude of the American business community has worsened the situation. While they do not like Trump's tariff measures, they believe the "Section 301" measures are necessary and an efficient way to force China to make concessions on market access issues. However, they may ignore the dangers of domestic politics and the growing sentiments towards China, which will make any deal with China more difficult. If the two countries cannot strike a deal, they may lose more opportunities in the Chinese market to competitors from Japan and Europe.

All these factors make future relationships very difficult. Obviously, there is no winner in a trade war, and it may not be possible to end the trade war, raising the specter of significant losses to the two countries and the global economy. As the world's two largest economies, China and the U.S. should keep in mind these lessons from history: the trade protectionist measures adopted by the U.S. Congress in the Great Depression of the 1930s caused the global economy to be torn apart and finally led to the outbreak of World War II; the "Cold War" of the 1950s resulted in several regional "hot wars" in the Asia-Pacific region and led to a zero-contact confrontation between China and the U.S. for decades. A competitive relationship between big countries is inevitable, but the two sides should further strengthen communication to avoid the harm caused by misunderstandings and misjudgments. The most important thing is to build consensus and work on common interests. This is the responsibility of the two largest economies of the world for the global economy. The next two years will be an important test for the leaders and for the public of China and the U.S. I

CHINA'S TRADE & INVESTMENT POLICY

Time to Right the Wrongs

By Brad Setser

Brad W. Setser is the Steven A. Tananbaum senior fellow for international economics at the Council on Foreign Relations. Setser served as the deputy assistant secretary for international economic analysis in the U.S. Treasury from 2011 to 2015, where he worked on Europe's financial crisis, currency policy, financial sanctions, commodity shocks, and Puerto Rico's debt crisis. He was previously the director for international economics, serving jointly on the staff of the National Economic Council and the National Security Council. He holds a BA from Harvard University, a master's from Sciences-Po, and an MA and PhD in international relations from Oxford University.

The trade negotiations between the U.S. and China are now a central concern of global markets. There is no doubt that President Trump's administration decided to start the current fight, before agreeing to a three-month truce. Yet there is also little doubt that China's trade and commercial practices are an outlier among the world's largest economies, and that – unlike in some of the Administration's other trade spats – the U.S. has a legitimate basis for challenging China's trade and commercial policies.

China's economy got big before China fully opened up. And China got big before the state – and the Party – ceased to be central institutions in China's economic life. China isn't as rich as the world's other large economies, but it has already reached a size where its deviations from global norms stand out.

It is thus not hard to understand why the trade conflict erupted, even though China's large overall trade surplus – historically a major concern of its trading partners – has shrunk substantially. There is no agreed consensus on the precise state of China's current account, but as usually measured, it also isn't far from balance. Yet the way in which the current account has shifted does matter. China's surplus in manufactures is – by nearly any measure – still quite large; both in dollar terms and as a share of world GDP, China's surplus in manufactures is about two times its size on the eve of the global financial crisis in 2008. The swing in the overall trade balance has come almost totally through rising tourism spending abroad, and above all through an enormous rise in China's commodity imports.

What does this mean, in concrete terms? Exporters of manufactures looking to sell to China without setting up shop in China still have ample grounds to claim the game is rigged against them. Relative to the size of China's own economy, China's imports of manufactures, setting aside imports that enter China under special customs provisions for reexport, have trended down ever since 2003. They now account for only around 5% of China's economy. And judging from Chinese industrial policy aims, many Chinese policy makers believe that is too high a number.

Industries singled out for support under the Made in China 2025 program account for a significant share of China's current imports. Planes, trains and automobiles account for about 20% of China's imports of manufactures for its own domestic use. Even if Made in China 2025 is officially on its way out, China's industrial policies of import substitution will continue to impact global trade.

These concerns, of course, aren't new. Back in 2009 and 2010, "China Inc." moved into the solar and wind industries using many of the techniques now associated with Made in China 2025. Its policies to support indigenous innovation attracted substantial criticism, as they appeared to reserve access to parts of the Chinese market to firms with indigenous innovation or placed the technologies in a joint venture and were thus judged to now be indigenous. Negotiations on these subjects produced cosmetic concessions but didn't fundamentally alter the trajectory of Chinese policy.

Nonetheless, during the early years of the Obama administration, there was a plausible path to a deal that China and the U.S. both could accept. China was at the time holding down its currency through heavy intervention in the market. Scaling back that intervention offered a clear win for a U.S. economy that needed jobs – a stronger yuan made it less attractive for U.S. firms to locate production for the U.S. market in China and more attractive for U.S. firms to produce in the U.S. to sell to China. At a time when China wanted to decouple the yuan from the dollar, scale back its holdings of U.S. Treasuries and reorient its economy toward its rapidly growing domestic market, this agenda also had some appeal in China.

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▲ Not a transformer

However, a deal centered on currency and macroeconomic adjustments was bound to come under pressure once the yuan stopped crawling up, given that appreciation had deflected attention away from the many ways in which China had tilted the playing field against imports and foreign firms active in China.

China also should have expected that its industrial policies would one day come under greater scrutiny as its ambitions increased. In certain sectors, Chinese firms, like Huawei, are now close to the global technological frontlines. And firms in other sectors worry that a state-backed push to expand the market share of Chinese firms might radically transform the global commercial landscape.

There are five broad categories of complaints that have substantive merit.

1. Chinese tariffs are generally a lot higher than those in Europe or the U.S. Such differences are built into the terms of China's WTO accession, but they still raise questions of fairness given China's size.

2. China restricts inward investment, and often requires inward investment, formally or informally, to be done using a joint venture with a Chinese company. The Chinese company in turn can negotiate with its foreign partner to transfer technology to the joint venture as part of the commercial negotiations over deal terms.

3. China provides massive subsidies to favored industries. No other country provides access to so much bank funding for big catch-up projects. In some sectors – like semiconductors – there are now multiple state-backed investment funds aiming to create (or buy) a world-class manufacturer.

4. China has a range of means – government procurement, state enterprise investment, private investment by firms that enjoy the support of the party and the state – to provide preference to Chinese-made products. "Buy Chinese" policies do not have to be written down to be effective; think of the many ways in which the state ensures that its airlines will support China's ambitions in civil aviation.

5. Cyber-espionage. China's spying is often directly at nakedly commercial goals.

While negotiations have now started on a broad agenda, striking a deal that addresses these challenges convincingly will not be easy.

China isn't likely to accept all calls for change, and the Trump administration hasn't articulated its real bottom line. It is consequently important for the United States to assess the trade-offs between its various negotiating goals in a hard-headed way.

The easiest path to a successful negotiation would be for the United States to accept a reduction in China's tariffs and barriers to investment, without any real change in China's domestic subsidies or its buy China preferences. Such a deal would no doubt provide incremental progress, but it would likely be insufficient to put the broader economic relationship on a truly sustainable basis.

And while a unilateral reduction in China's tariffs would be a step in the right direction, it is hard to understand why the world's most successful exporter of manufactures still needs special protection. With the yuan back at its 2008 level against the dollar, reducing tariffs on its own probably wouldn't be enough to prompt U.S. firms to invest in a U.S. supply chain to supply the Chinese market. This would be particularly true if informal "buy China" preferences remain, which is a reasonable assumption.

Lifting the joint venture requirement in key sectors would reduce a key point of leverage that "China Inc." has used to encourage the transfer of technology. But providing U.S. firms with more freedom to invest in China wouldn't necessarily address concerns about the current unbalanced pattern of trade in manufactures. Abandoning the joint venture requirement – with current tariffs and at the current exchange rate – could well provide a strong economic incentive to a number of global automakers to use their China factories and supply chains as export bases. And so long as China is determined to favor domestic aircraft production over imports, aeronautics suppliers looking to get contracts to supply China's civil aircraft production would continue to face pressure to set up wholly-owned subsidiaries in China,

There are no easy answers. China needs to converge toward global norms if it wants to participate fully in an open global economy. But the desire to support (and often subsidize) the development of Chinese national champions in a range of sectors runs deep. Ultimately, though, a China that doesn't import manufactures or technology from the rest of the world will necessarily either export less or return to running large overall trade surpluses – and a further increase in China's surplus in manufacturing seems politically untenable. Consequently, it is hard to imagine that China can succeed in its industrial policy ambitions without fundamentally changing its current economic relationships with the rest of the world – with important consequences for American businesses operating in China. I

▼ Conceived in America

CLASH OF THE TITANS

Q&A with Professor Arne Westad on China's issues of governance and U.S.-China relations

By David Hicks

Odd Arne Westad is the S.T. Lee Professor of U.S.-Asia Relations at Harvard University, where he teaches courses on global power shifts and on China's role in international affairs. Before coming to Harvard in 2015, Westad was School Professor of International History at the London School of Economics and Political Science (LSE).

There have been growing suggestions the U.S.-China trade war marks the start of a "New Cold War." As a leading scholar of the Cold War, how do you feel about that?

I don't believe the "Cold War" rubric is in any way suited for what we're seeing today in the U.S.-China relationship. Not all conflicts are cold wars. A cold war is a very peculiar kind of international framework that is based on ideological resentments and, very often, wars by proxy. We don't see those elements in today's conflict.

The world we are looking at now is much more similar to the world in the early part of the 20th century, even in the 19th century, where the competition was mainly for influence and trade advantage within a framework where nationalism and national identities drive policy. Whether that's good or bad is quite another question.

Do you think the U.S. and China are bound to always be clashing?

Well if we take the last generation as a starting point, relations between the United States and China have been pretty benign. There have been conflicts on a number of issues, but not many open confrontations.

It's much easier to count the issues on which the United States and China have been capable of working together: think about the international trade system and how, up until now, the Chinese economy has developed very much as an integral part of the global economy.

Do you think the collaboration is mostly on economic matters?

Well, I agree with those who say the trade confrontations come out of something much more basic. It is the competition to see who will be the most influential power of this generation. I think this is a rivalry that is, in many ways, overdue, and very much determined by the rise of China on a broad scale.

Probably half a generation from now China will become the dominant power within the East Asia region on all issues that are really important. That has a lot to do with location – the United States is, after all, an ocean away. It also has a lot to do with the cultural background, the links that tie the various countries together, and with China's population size and economic growth.

The question is how we get from here to there without open conflict. I think the answer will depend on whether or not the United States is capable and willing to work with China on resolving some of the regional security issues. That's the core. It's not trade. It's not the international economic change. It's not the fact that China is investing in South America or Africa. It's regional issues like Korea, the East and South China Sea disputes, and Taiwan. Those will be the key issues.

So what do you think those who argue that trade is the core tension are missing?

They're missing the regional dimension of what is happening between the United States and China, and between China and many other countries in the region.

There surely are serious disagreements

between the United States and China under the current administration on how global trade is going to work: but that's not the core issue. I think the framework for this [trade war] can only be understood in terms of the regional security challenges.

For example, if it turns out there is some long-term agreement on Korean denuclearization, I think that would do an enormous lot of good to the U.S.-China relationship in the broader sense. Probably more than any clarification with Taiwan, in the shorter run, because it's a more acute issue.

So between now and that point at which China is the undisputed dominant regional power, what domestic challenges do you think the country will need to address?

There are very, very big challenges. For more than a decade, it seems to me the big challenges have been political, rather than economic. China needs to create a better system of governance, particularly finding better balance between the central and regional levels. It needs to create outlets for people's wishes and satisfactions in the cities and regions where they live. And that will include accepting a greater degree of openness than what you see in China now – China is moving, if anything, in the opposite direction.

Some people are saying this is too much for China to handle domestically and therefore all the predictions about "China's rise" are off the table. But I think we have to be careful with that. China can go through a period of very significant domestic change without its power being much diminished. That's a matter of scale, to some extent. It's also a matter of how big the Chinese economy actually is, in terms of its significance for the region.

The sooner China gets going on meaningful political and administrative reform, the better it will be for the country. What China has done is postpone – now by almost 20 years – issues that should have been resolved in the early 2000s. And the longer these issues are postponed, the more difficult they will be to change. This is my colleague Tony Saich's point, and I think it is totally correct.

Do you see any parallels between now and any other point in history?

I see some similarities with the Qing Empire in the mid-18th century: China is taking on too many tasks, becoming too preoccupied with a small number of priorities.

But to be frank, it reminds me a little bit of the Soviet Union at the height of its power, before the period of stagnation really started to sit in, when it was much too preoccupied with trying to recentralize political power after the Khrushchev era (so this was in the Brezhnev era).

Xi Jinping has not been a reformer; he looks more like China's Brezhnev. Someone who is intent to stay in power for a really long time and doesn't have very concrete ideas about how to carry out reform.

> Probably half a generation from now China will become the dominant power within the East Asia region on all issues that are really important.

Some observers see a danger in Xi serving three terms. Others have suggested that perhaps China needs a period of long and steady leadership as the country begins what may be a bumpy transition from export-led growth to a consumption-based economy. What do you think?

Both of them are in some sense right. I'm not necessarily against a strong central government in China. I think that in dealing with some of the issues they have now – including governance issues – having a strong central executive is probably a good idea.

The problem is you then need the right people in charge of it, and the centralization actually needs to work for a purpose beyond perpetuating Party power.

Quoting my colleague Graham Allison: if I were a Chinese Communist Party voter, I would gladly have voted to give Xi a third term if he told me what he was going to use it for. If he had a concrete plan to deal with the weaknesses, then I wouldn't have any problem with centralization of power. But it has to be power for a purpose.

Do you think it's possible for an autocratic or one-party government like China's to develop a vibrant modern economy? I'm thinking of Singapore here as an example.

I haven't seen any proof that it's not possible. I mean, the whole East Asian development model (with some qualification for Japan) has been authoritarian-led. So I don't think there is necessarily a contradiction there.

I think the big problem is how you deal with the political challenges you come up against as the economy is developing. And as the other examples in East Asia have shown, if you neglect political reform, it will eventually come back and haunt you, irrespective of how your economy is doing.

Environmental concerns are a good example of this. Until now, the biggest investment a Chinese citizen could make is in their child or children. And if that child is ill for most of the winter because of pollution, that's a real issue. It's something that would concern you very, very deeply. If you have no outlet for that concern – and the government is trying to tell you that this one issue that matters to you is not something that is top of their agenda, except in a really broad sense – well, then you have a governance problem.

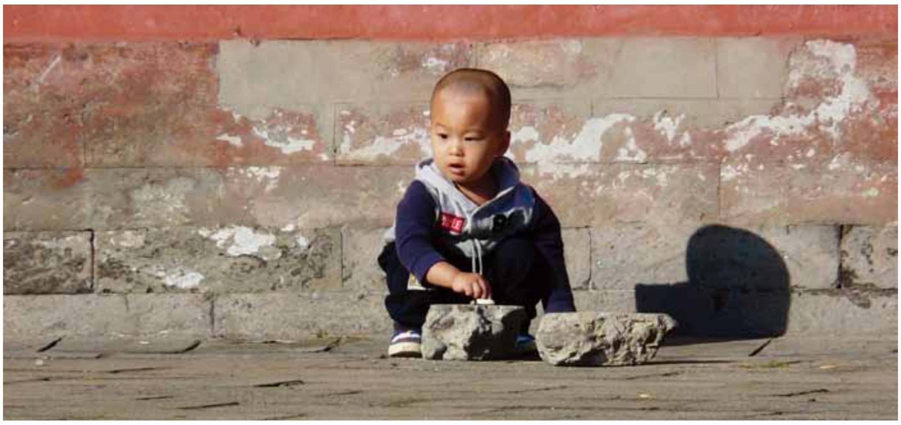
Singapore is an exception because it is a city-state, which can be ruled in a very different way because of its size. One of the things history shows is that authoritarianism, over a long period of time, is much easier to carry out in small-scale settings, where control can be much more pervasive.

There has been growing pressure from the middle class on the government with regard to things like environmental concerns, healthcare and education. Do you think this will grow into a serious challenge to the current system of governance?

I don't really have an answer for this. I think the answer is mixed.

On environmental concerns, much of the initiative for a more open society might well come from the middle class, because of the nature of their concerns.

Politically I wouldn't be surprised if the real challenge to the system comes from the working class. Factory workers who feel that, under the current economic climate (particularly these last few months) they are not taken care of by the government. There's been quite a bit of resentment there already, with a growing number of strikes and work stoppages. All of that is on the rise. And if the economy goes into a more signifi-



▲ A lifelong investment

cant downturn, my bet is we will see much more pressure from the working class.

Do you think the government is performing well?

No. Of course some things they do well, but on these broader issues of governance, questions that need to be resolved more for the future than the immediate present, I don't think they're doing well at all. I mean, they are probably one of the most reactive Chinese administrations we have seen since the early 1980s.

Does the Party control the economy, or the economy control the Party?

I get this question very often. It's impossible to answer.

The impression that the Party runs the economy is much more widely held than it ought to be. There is a popular idea – particularly the United States – that China is somehow a state-managed, state-run economy to a greater extent than other countries in the global capitalist system. But that's simply not true. There's a lot of things the Party can try to do to maneuver and massage the private sector, but it's very hard for the government to have a direct impact in terms of how the economy is run – except of course through traditional instruments at any government's disposal, like interest rates, credit and currency.

> "The impression that the Party runs the economy is much more widely held than it ought to be."

At times of crisis, the Party has been willing to use a pretty old-fashioned Keynesian approach of dealing with economic downturns, while other countries – mainly for ideological reasons – have avoided doing the same. But that's not the same thing as "running the economy." That's patching it up. I

The Pitfalls of China's Industrial Policies

By Victor Shih

Victor Shih is an associate professor of political economy at the University of California San Diego and has published widely on the politics of Chinese banking policies, fiscal policies and exchange rates. He was the first analyst to identify the risk of massive local government debt and is the author of *Factions and Finance in China: Elite Conflict and Inflation*. Prior to joining UC San Diego, Shih was a professor of political science at Northwestern University and former principal for The Carlyle Group.

As the U.S. and China begin serious negotiations on a trade deal after the G20 meeting, a likely sticking point between the two sides will be China's industrial policy. In essence, the U.S. has accused China of pursuing policies which channel billions of dollars in fiscal and financial subsidies to Chinese firms in "strategic industries," as defined by key policy documents such as Made in China 2025. Moreover, the U.S. has charged China with stifling foreign competition and overlooking allegations of intellectual property theft by Chinese firms or individuals. From the perspective of the U.S. and other OECD countries, China's industrial policies have been problematic for many reasons, from lost revenue to market access to dumping. But have Chinese industrial policies even been a good thing for China's economy? The answer is more complex than at first glance.

To begin with, Chinese industrial policies certainly have helped China ramp up production and exports of industrial goods in several sectors and have allowed China to achieve production capability and even exports in high technology sectors previously seen as being beyond China's reach. For example, according to NBS data, China is now truly a giant in the global market of mechanical and electrical equipment, exporting well over US$1 trillion in this area for each of the past few years. Chinese exports of integrated circuits and related components rose from around $25 billion in 2010 to likely over $85 billion this year. China is close to launching a medium-size commercial jet aircraft, the C919, after enormous state resources have been poured into it. A mix of open policies for foreign investors and domestic subsidies has made China into a power house in technology production in the past two decades.

Yet, what have been the costs? At least two negative consequences have plagued China's industrial economy in recent years. First, because state industrial policies have essentially granted firms in strategic areas a license to borrow large sums of money, they have often taken advantage of it and accumulated enormous debts. The borrowed funds were often not used to ramp up industrial production but were instead lent to other firms or invested in real estate. Industrial firms' liabilities as a share of GDP have hovered at a high level compared to other emerging market countries and are on track to surpass 70% of GDP and 60% of these firms' revenues by the end of 2018, accord-

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▲ Robots assembled by humans

ing to NBS data. Once foreign firms, which tend to have lower debt, are taken out, the liabilities of industrial firms as a share of revenue are likely to be even higher. This high debt ratio of course eats away at the margins of Chinese firms because a sizable portion of operational cash flows are needed to service interest payments.

Second, because the new industrial policies have attracted firms and local governments to lobby for central state subsidies, they often lead to the entry of a large number of firms into areas favored by state policies, thus driving down profit margins. The persistent overcapacity problem has kept profit margins of industrial firms at the 4-6% level, according to NBS data. This of course has driven down the profit margins of industries where Chinese exports dominate, such as steel and machinery. In industrial sectors where Western firms still do not face Chinese competitors, net margins are at 7% for aerospace and defense and a whopping 18% for semi-conductors, according to a NYU Stern School study.

When combined, persistently high debt and the low margins create pressure for Chinese industrial firms to borrow money in order to engage in speculative investments. In essence, by pursuing the production of industrial goods alone, Chinese firms can never actually make money, at least not as much as they could make by just buying a five-year corporate bond with an AA- rating, currently yielding over 7%. In the meantime, industrial policy means that Chinese firms can use proposed industrial production in strategic sectors to borrow large sums from the state banks.

Thus, to make industrial policy attractive for Chinese firms, they will need to divert a significant part of the new credit toward speculative investments with potentially large upsides, whether it be real estate or margin financing. The ultimate example of this behavior is Faraday Future, which began a reckless venture into electric vehicles partly with borrowed funds from China's state banks. The conglomerate which came to its rescue, Evergrande Healthy Industry, also took advantage of China's industrial policy on healthcare to raise funds via a trust product issued by CITIC Trust.

Ultimately, industrial policies exacerbate China's debt problem because they create expectations of low profitability among industrial firms, which, in combination with easy credit, encourage reckless borrowing for speculative purposes. And even if speculative investment succeeds in netting high profit for investors, the investors would be fearful of legal ramifications down the road and would want to siphon the bulk of the profit overseas, resulting in capital flight. Thus, many problems plaguing China's financial system today are rooted in state policies. I

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▲ No friend of the Five Eyes

China's Social Credit System

What you should know and how you can prepare

By Mareike Ohlberg

Mareike Ohlberg focuses on China's subnational politics, official media policy as well as developments in Hong Kong and Taiwan. Ohlberg holds a PhD in Chinese Studies from the University of Heidelberg and an MA from Columbia University. Prior to joining MERICS, Ohlberg spent a year as an An Wang Postdoctoral Fellow at the Fairbank Center for Chinese Studies at Harvard University and another year as a postdoctoral researcher at the Cheng Shewo Institute for Chinese Journalism at Shih Hsin University in Taipei.

China's social credit system is a massive policy package that the government has pursued on a fast track since 2014. While the Western media have mainly focused on the social credit system as a tool to monitor and control China's citizens, businesses both domestic and foreign-owned are affected at least as much. Many of the sub-systems and policy measures that are presently being rolled out target companies rather than individuals.

So far, companies are primarily affected by blacklists and rating mechanisms maintained by individual government departments. In the future, the Chinese government will intensify data sharing between government agencies and move towards an increasingly automated, big data-fueled system that aggregates and processes data from different sources, possibly in near-real time.

What you need to know

At this stage, the most important thing for international businesses in China – whether wholly foreign-owned enterprises, joint ventures or representative offices – is to gain a better understanding of how this complex undertaking may already be affecting their companies. This requires connecting the dots between seemingly separate initiatives.

The social credit system is a toolkit to enforce existing laws and regulations.

Most policies under the catchphrase "social credit system" are based on the idea that the government wants to steer the actions of individuals and legal entities. The method is to collect data on their activities and assign them grades based on whether or not these activities comply with rules and regulations. The system would then reward those with good ratings and penalize rule-breakers. By forcing companies to exercise "self-restraint," the system is meant to become a tool to enforce laws, regulations or targets set by the Chinese government. These can be labor or environmental laws, regulations on advertising, trademark infringement, and many other aspects of business.

No single agency controls everything.

The mega project is spearheaded by the National Development and Reform Commission (NDRC) and the People's Bank of China (PBOC). More than forty other ministries, bureaus and departments are involved in the construction of the social credit system at the central level. This arrangement is replicated at the provincial and lower levels of government. Though they will sometimes work together, each of the government actors involved is responsible for setting up or overseeing credit rating mechanisms within their own jurisdiction or sector. This means that companies have to deal in parallel with different government agencies to manage their credit ratings.

Data sharing between agencies is a major policy goal.

Government agencies and provinces are supposed to make credit-related information centrally available through the National Credit Information Sharing Platform. Set up in 2015, the platform contains basic

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▲ Probably not her dream job

information, such as date and place of company registration and the name of its legal representative, but also information about administrative penalties, "irregularities," and inclusion of the company on any blacklist.

To facilitate coordination, every company in China now has a "unified social credit code." This 18-digit code acts like a single identity or "national ID number" for businesses and is a prerequisite for enabling government agencies to share data with each other. Prior to the introduction of the new code, different ministries used their own department-specific codes to identify companies, making it difficult to exchange information and resulting in what the central government calls "data islands." With the new code system, it becomes much easier to cross-check and correlate data as well as to ensure that sanctions against "untrustworthy" businesses are enforced throughout the entire Chinese bureaucracy.

More than forty other ministries, bureaus and departments are involved in the construction of the social credit system at the central level.

The government publishes blacklists of "dishonest" companies.

One of the most basic features of the social credit system are blacklists for "severely dishonest" companies. "Red lists" are also in use to reward a small number of companies the government considers exemplary, but the focus has so far been on blacklisting.

One important example is the blacklist system coordinated by the former State Administration for Industry and Commerce (now part of the newly-created State Administration for Market Regulation). Violations for which companies can be blacklisted under this system include, but are not limited to, providing false information while registering a company or renewing a registration, or repeated administrative penalties (usually 2-3) for violations relating to such issues as unfair competition, false advertisement or trademark infringement over a certain period.

There are a number of additional offenses that can get companies blacklisted throughout the Chinese bureaucracy, including some that may be vague or political. These offenses are generally all things that are already illegal in China; but the Chinese government hopes that the prospect of being blacklisted will act as a powerful deterrent.

Blacklisted companies face restrictions and reputational damage.

One of the slogans with which the Chinese government advertises the social credit system is "dishonest in one area – restricted everywhere." Once information about blacklisted companies is made available to other government agencies through the central platform, other ministries are supposed to enforce restrictions against them. For this, government departments have signed various "Joint Rewards and Punishment" agreements. Among other things, blacklisted companies lose access to government land or subsidies, are excluded from government procurement and face restrictions to their social media platforms.

There are also personal consequences for company management. The legal representative of a company that has been cited for "severe dishonesty" can be banned from leading a company in the industry in China from anywhere between two years to life, depending on the offense and the severity. In some cases, this also applies to other leading personnel who are considered responsible for a violation of Chinese law. In addition, company representatives can be banned from booking flights and high-speed train tickets as well as from other forms of "high-end consumption."

Finally, blacklists are also used to "shame" companies and their legal representatives. Aside from being published on credit information platforms, blacklists can be distributed via media, public billboards and other channels. This means that companies could have to deal with potential damage to their reputation long after having resolved the problem that got them blacklisted.

For now, companies have to manage multiple credit ratings with different agencies.

In addition to naming and shaming and restrictions imposed through joint rewards and penalty agreements, industry associations and several government agencies have introduced their own credit rating measures. Separate rating systems are maintained, for example, by the General Administration of Customs (GACC), the State Administration of Taxation, and the Ministry of Human Resources and Social Security (MOHRSS). This list is not exhaustive, and more credit rating schemes by other government agencies are sure to follow.

Under these rating schemes, a company is assigned one of three or more grades – for example, A, B or C. The exact number and name of ratings differs. Companies with the highest rating (or which have maintained the highest rating for several years) enjoy preferential treatment, such as simplified procedures through a "green channel," and other benefits. Companies with the lowest rating face intensified monitoring, fewer opportunities and other restrictions.

Sectoral credit ratings will likely begin to influence one another.

Some authorities have announced that they will consider ratings and information from other agencies when assigning grades. Therefore, for instance, a bad rating with the customs authorities or MOHRSS could result in a worse rating for tax purposes and all the repercussions associated with that.

At present, it is still unclear how individual credit ratings will ultimately influence one another, but it should be assumed that govern-

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▲ The gamification of morals

ment departments will increasingly share their ratings with one another. Some provinces like Shaanxi have already specified frameworks for "comprehensive credit ratings" that use a large range of information, such as its financial situation and compliance with various policies, to assess a company.

Blacklists are also used to "shame" companies and their legal representatives. Aside from being published on credit information platforms, blacklists can be distributed via media, public billboards and other channels.

There are significant regional variations.

As with most laws and regulations in China, the social credit system is highly localized, at least for now. This means that it matters where a company is registered, especially while the system is still under construction and local experiments are encouraged. Many provinces and even municipalities, counties and districts have introduced additional regulations for specific local industries or on how to collect and handle social credit information locally. This trend of both evolving national and local measures is going to continue for several more years, making it vital to track new regulations closely.

The system will likely continue to evolve after 2020.

According to some reports, the system is supposed to be in place by 2020; however, this is not a fixed deadline but rather a result of the fact that the main plan published in 2014 only covers the period up until 2020. Based on how the Chinese government operates, we should assume that new plans will follow and, building on what has already been achieved, will introduce new goals for the period after 2020.

What you can do to prepare

The system's final form is still in flux, but even if only parts of the plans are realized, this will transform China's legal, social and economic environment. In order to be prepared, companies need to make sure they stay informed. Even though the system is still fragmented, it is probably wise in the long run to think of it as a whole when deciding how to manage credit ratings.

Stay informed.

One of the most important steps is to understand national, provincial and other local regulations and to track them in real time. The same is necessary for industry-specific regulations at all three levels. To avoid unpleasant surprises, companies should check for publicly available information on a regular basis.

The two most important interfaces for the National Credit Information Sharing Platform are Credit China (https://www.creditchina.gov.cn), and the National Enterprise Credit Information Publicity System (www.gsxt.gov.cn). Provinces and some municipalities have their own equivalents of these two platforms. Even though local governments are supposed to feed information into the national databases, more information on a company may be stored in the database at the locality of its registration. Individual central government agencies also have their own platforms that should be checked for information (such as the Credit Publicity Platform of the GACC, credit.customs.gov.cn).

Set up a system to manage credit ratings inside the company.

For deciding who should manage a company's credit ratings, it is important to think of social credit both as many systems as well as one large umbrella initiative. There are a plethora of subsystems managed by different bureaucracies and spanning many different areas. This will likely remain the case for some time to come. At the same time, all these measures and ratings are part of the same umbrella initiative and will likely be partially consolidated or at least begin to impact each other in the near future. While each company has to decide how to handle this, both the breadth of expertise needed to manage different credit ratings and the interlinkages between the different parts of the system need to be kept in mind.

▲ Social outcast button

Be wary of illegal services that manage credit ratings on your behalf.

A service industry for managing credit ratings is already forming in China. Some of these services are legitimate and offer to work with authorities to improve a company's rating where it is legally possible to do so, for instance, by providing more information voluntarily. However, the Chinese government is already wary of companies offering services to boost credit ratings or expunge negative records.

If the U.S.-China trade war becomes the "new normal," then U.S. companies can expect to receive extra scrutiny. That makes it even more important not to resort to anything you suspect might be illegal, or to let a third party do anything that may be illegal on the company's behalf.

Stay flexible to adjust to new measures.

We still do not know what the social credit system(s) will look like in the end, so over the next few years, companies will have to remain flexible to adapt to substantial changes in the system. In the end, the social credit system may not become the all-seeing, all-knowing system that some fear it will turn out to be. But at the very least, the various new social credit measures will make it more difficult for foreign businesses to navigate China's increasingly complex regulatory environment and will substantially raise the costs both of compliance and of non-compliance. I

Q&A with Ker Gibbs,

AmCham Shanghai's new president

Ker Gibbs is the new president of AmCham Shanghai, succeeding Kenneth Jarrett who stepped down at the end of December. Ker has been involved in the Chamber for many years as a member, committee leader, board member and board chair during 2016-2017. His career has spanned Asia and Silicon Valley, with executive positions at Apple, Disney, and other technology and media firms. Most of his time in Shanghai has been in banking and investments. He was head of tech and media for Greater China at HSBC. He holds an MBA from UC Berkeley and an undergraduate degree in economics from UCLA.

He talks with *Insight* about his plans for the Chamber and his decades long experience of living and working in China.

Can you give us a sketch of your career to date in China?

Before we get to that, I first want to say how honored and humbled I am to be chosen for this role. I know a lot of members are saying it was an obvious choice, but it wasn't. I don't know who all the other applicants were, but I do know there were many and that they were highly qualified. I owe it to them and to all our members to do my best to be successful in this role.

My career has been at the intersection of technology and finance. Coming out of UCLA and Berkeley, it was an obvious choice to start my career in Silicon Valley. I joined Apple, and then later some internet startup companies and things like that. Functionally I went from an R&D group – I won't say which version of the Mac operating system I worked on because it was so long ago that dinosaurs roamed the earth, but let's just say it was a low number – then into sales and then corporate development, which led me to the financial side of things. I was doing corporate development and M&A, which led me to investment banking with HSBC.

China has always had a gravitational pull on me. Right out of business school I joined the Boston Consulting Group in San Francisco. One of the senior partners happened to be from China. He put me on a plane and we worked together here in Shanghai. I learned a lot from him, and I still do. He's a close friend to this day and we talk often.

What are your short-term priorities for the Chamber?

Short term we're in good shape. Under Ken's leadership we had a strong year financially. Now I need to get my arms around all the things happening at the Chamber. I've been away from it for the past year, and the staff are involved in so many things it's hard to keep up. I need to get up the learning curve. So short term my goal is to listen as much as I can, mainly to staff and committee leaders, but also to the new board.

Do you plan any significant changes to the Chamber's strategic direction? If so, what do you have in mind?

Yes, we need some new thinking around this. The specific ideas I have for the Chamber come out of the conversations I've been having with Ken and Bob [Theleen] and others, but we need a new approach.

Our core has always been the large multinationals that give the Chamber its clout and critical mass. That won't change, but the growth comes from new businesses and those are mainly SMEs. They are doing cool new things, new economy things. Are we relevant to that group? Are they joining AmCham?

People say if Muhammad won't come to the mountain then we need to move the mountain to Muhammad. Well, new businesses aren't seeing the relevance of AmCham. We need to change that. It's not just our messaging. It's our programs, it's our approach to the market. We need to appeal to new economy businesses – blockchain businesses, apps, the fintech firms. China is the world market leader in fintech. How many fintech programs are we doing at AmCham? Whatever we're doing now, it's not enough.

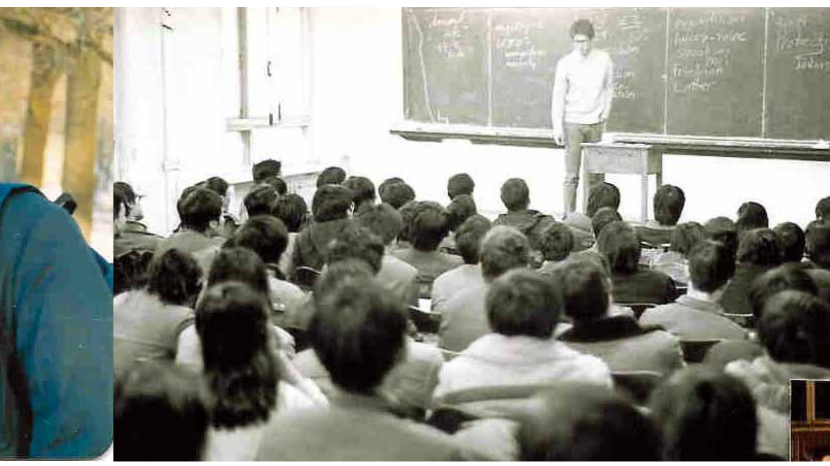
The business environment in China has changed significantly over the past decade, including trends such as rising domestic competition and increasing localization of employees. How should the Chamber adjust to these changes?

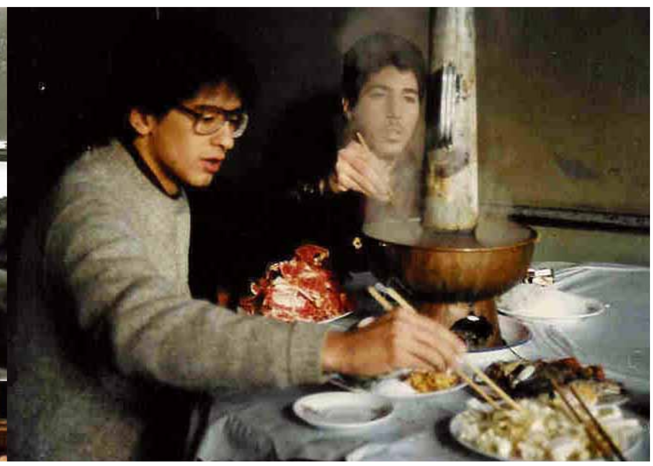
We need to better adapt to the local market, I don't think anybody will disagree with that. We just need to do it in a way that doesn't lose our unique character as an American organization. Can we become more Chinese, but with American characteristics? In Suzhou we do more programs in Chinese. Do we need to do more of that in Shanghai? What role do we want Chinese companies to play at the Chamber?

You're joining the Chamber at a challenging time in the U.S.-China relationship. How is this impacting the Chamber and its members? How do you think the two countries should work together?

This might be an example of creative destruction. We can still get back to a mutually beneficial construct but maybe it was inevitable that a major shake-up take place to get everyone thinking along different lines. The two sides are talking, and that's good. The challenge is how to get from the general to the specific. Saying that "things aren't fair" is too vague. It can't be quantified, so it can't be negotiated. We need to get something on the table that is quantifiable and agreeable to both sides. Fortunately, the Trump administration moves quickly and China, as we all know, can also move quickly.

I'm glad to see that the discussion has moved past just talking about the trade deficit and manufacturing jobs. That wasn't going to get us anywhere. The other "nothing bucket" is China leaning too heavily on their "developing economy" status. They are the number two and quickly becoming the largest market on earth. That's just a fact. How can America's global businesses – including new emerging ones – succeed if they are kept out of one of the world's largest markets? China has global companies too.





They shouldn't be kept out of global markets. China is developing companies in AI, EV and cloud computing. Once they succeed in China they will absolutely take on the U.S. market, and that's a good thing. But why can't U.S. cloud computing companies come to China?

It's true that China has development challenges, but they can't keep using that as an excuse for not opening their markets. Either they want to be part of the global trading system or they don't.

Here at the American Chamber we need to be clear. We are inextricably linked to China. Our businesses depend on that linkage. We want what's best for the U.S. but also want the Chinese economy to continue to thrive. In fact, we're counting on it. We're investing behind it. If China fails, we're all stuck. If the economies "de-couple" then we're heading into dark times, dangerous times. We know what that looks like, and we know how much courage it took for Nixon and Mao and Carter and Deng to lead us out of the period of mistrust and confrontation. It won't benefit anyone to go back there.

What long-term goals do you hope to achieve during your tenure as AmCham Shanghai president, and how do you plan to achieve these?

I'll be happy if I can help the Chamber continue moving toward a stronger financial position than we were in a few years ago. I'd like us to grow, but we face headwinds. What's important is the success of our members, and the U.S.-China relationship itself. AmCham is an enabler, so our long-term success will show up in the success of others.

What fascinates you most about China?

China drives us crazy, doesn't it? The dynamism, the complexity, the odd things that happen in the street...those are all the things that got me hooked on this place. We all go back to our homes – San Francisco for me – and things seem slow and lethargic. It's funny to talk about Silicon Valley that way, but the pace in China is incredible. It's also the optimism.

What are your three favorite China books?

I'm a huge fan of the *Judge Dee* books, by Van Gulick. I've read them all at least once. In non-fiction, Richard McGregor's books – *The Party*, and the recent *Asia's Reckoning* – have given me the helpful framework that everything else I read can fit into.

Do you have a favorite watering hole?

Too many to say just one. You'll find me at the Camel because they've figured out that this community needs a variety of sports. "Football" doesn't mean the same thing to all of us, right? The jazz bars in Shanghai are incredible. I

Board of Governors Briefing

Highlights from the November 15, 2018 meeting

CIIE

The Chair reported on the China International Import Expo (CIIE), which was designed as a public demonstration of China's commitment to opening to foreign companies. The President said AmCham was looking for feedback from members on the CIIE and what AmCham's role should be next year. BOG members noted that the CIIE had some branding and PR value while its commercial value was lower.

NEC UPDATE

As NEC Chair Tim Huang is travelling, the President provided a briefing on the elections on behalf of the NEC. There are 9 candidates for 5 slots. It is a good mix of candidates that includes SMEs, MNCs, and people with skills that would be helpful for the board such as marketing.

DIGITAL STRATEGY

AmCham C&P Director Ian Driscoll presented on AmCham's digital strategy. The strategy calls for developing better tools to track membership digital behavior, segmenting communication, hiring a digital consultancy to review our WeChat and other platform strategies, and building up video and other content.

MEETING ATTENDANCE

Governors: Eric Zheng, Robert Abbanat, David Basmajian, Eddy Chan (by phone), Sarah Köchling, Christine Lam (by phone), Nancy Leou, Stephen M. Shafer, Grace Xiao, Simon Yang

Regrets: Jonathan Heimer, Helen Hu, Helen Yang

Attendees: Ken Jarrett, Gentry Sayad (by phone) Helen Ren, Shilpi Biswas, Ian Driscoll, Titi Baccam

Highlights from the December 13, 2018 meeting

NEC REPORT

NEC member Helen Yang summarized the work of the NEC in the recent election. During the interviews, candidates offered several suggestions including: more policy advocacy work, more BD matchmaking for members, greater use of digital platforms, and moving toward a "modular" membership system that allows one to pay as one goes.

GOVERNMENT AFFAIRS DINNER

The President said that the GA dinner had an excellent outcome. Government attendance was around 90 persons, the highest ever and Vice Mayor Xu Kunlin engaged well with members during the VIP meeting. The Ambassador also enjoyed the evening and interacted actively with members.

AMENDING BYLAWS

The Board approved an amendment to the Bylaws that would provide a more formal basis for the Chamber to appoint legal counsel to the Board.

2019 BUDGET

The Board approved the proposed budget for 2019.

MEETING ATTENDANCE

Governors: Eric Zheng, Robert Abbanat, David Basmajian, Eddy Chan (by phone), Jonathan Heimer, Helen Hu, Sarah Köchling, Christine Lam, Nancy Leou, Simon Yang, Helen Yang

Regrets: Gentry Sayad, Stephen M. Shafer, Grace Xiao

Attendees: Ken Jarrett, Shilpi Biswas, Ker Gibbs

The AmCham Shanghai 2018 Board of Governors

Eric Zheng

Chairman of the Board of Governors

Board Vice Chair

Eddy Chan

FedEx Express

Board Vice Chair

Christine Lam

Citigroup

Treasurer

Helen Hu

International Paper

Tony Acciarito

Thermo Fisher Scientific

David A. Basmajian

Shanghai Disney Resort

Han Lin

Wells Fargo

Stephen M. Shafer

3M

Tom Ward

PIM China Ltd.

Grace Xiao

UCB

Simon Yang

Aptiv

AmCham Shanghai Holds 17th Annual Government Appreciation Dinner

On December 5, AmCham Shanghai again celebrated the long-standing partnership between the Shanghai Municipal Government, the U.S. business community and the U.S. government at a dinner with U.S. Ambassador to China Terry Branstad, U.S. Consul General Sean Stein, Shanghai Vice Mayor Xu Kunlin and more than 330 guests present.

▲ U.S. Ambassador Terry Branstad

AmCham Shanghai members were joined by about 90 other high-level government officials from Shanghai Municipality and representatives from the Jiangsu, Zhejiang and Anhui provincial governments. The Shanghai Municipal People's Government Commission of Commerce, Foreign Affairs Office, Shanghai Customs and many other departments sent representatives to discuss Shanghai's economic and commercial development, interact with AmCham Shanghai members and learn more about U.S.companies in the region.

Ambassador Branstad's remarks included a call for a more "fair and reciprocal trade relationship" with China, including opening business segments currently restricted to foreign competition. He also spoke about U.S concerns that China had not yet addressed key structural issues in its economy and said that true market reforms would benefit China and the global economy. He praised recent efforts by China to open its pharmaceutical sector and President Xi's commitment to declare fentanyl a controlled substance.

▲ Shanghai Vice Mayor Xu Kunlin

Shanghai Vice Mayor Xu Kunlin expressed appreciation for AmCham Shanghai's contribution to the development of Shanghai, and he also spoke about the government's intentions to upgrade the YRD integration plan and further open markets in China.

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AmCham Shanghai Chairman Eric Zheng spoke about the importance of the Chamber's advocacy role in both Washington and Beijing, particularly at a time of strained trade relations. However, Zheng also said that "longstanding structural issues in the bilateral trading relationship" needed to be addressed, and he encouraged China to use its 40th anniversary of "reform and opening" to move forward with a new wave of economic reform.

▲ U.S. Consul General Sean Stein

Zheng used the occasion to suggest that despite the current trade difficulties, both countries had overcome previous disagreements to find mutual benefit in trade. "In 1972 Richard Nixon and Zhou Enlai signed the Shanghai Communiqué in the Grand Hall of the Jinjiang Hotel on Maoming Lu. Since then the relationship between Washington and Beijing, while at times marred by difference, has been consistently maintained by an understanding that nurturing commonalities is more important to sustaining the 21st century's most important bilateral relationship than fanning differences. As a Chamber of Commerce, we hope to see meaningful progress on the issues that divide us so that the people of both countries enjoy more fully the benefits of fair and free trade," said Zheng.

▲ Gan bei!

The dinner was sponsored by several longtime AmCham Shanghai members including Stars Sponsors Bristol-Myers Squibb and Honeywell, as well as, Stripes Sponsors GM, Marriott, Nu Skin and Thermo Fisher, and Platinum Sponsors 3M, Coca Cola, Dow, ExxonMobil, Federal Express and TE Connectivity. I

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Event Report

2018 GOVERNMENT AFFAIRS CONFERENCE

On December 13 AmCham Shanghai held its annual conference on government affairs, which attracted more than 100 participants. The theme of this year's conference was "Finding Common Ground in Conflict." The conference was sponsored by Bristol-Myers Squibb, Honeywell, General Motors, Marriott, Nu Skin, Thermo Fisher and Disney.

The morning opened with a keynote address by Fudan Professor Shen Dingli, in which he expressed appreciation for the U.S. and Japanese roles in helping quickly develop China's economy and raise its living standards. Professor Shen used China's high-speed rail network as evidence of this rapid development. He also called for the U.S. and China to engage in "self-reflection" and abide by pre-existing deals and international law to deepen existing relations.

Following this, Scott Kennedy, deputy director of the Center for Strategic and International Studies, spoke about China's economic revitalization and major adjustments in U.S. foreign policy. Although both countries originally accepted a "grand bargain" in which the U.S. helped facilitate China's entry into the global order while China accepted economic liberalization, multilateralism and a U.S. military presence in Asia, this consensus has broken down in recent decades. He also warned of rising tensions if a trade deal was not reached by March 1, when the 90-day moratorium on raising tariffs ends.

Professor Wang Yong from Peking University expanded on China's economic development in his speech. The country has come a long way in establishing a market economy and reform policies. And contrary to what many in Washington believe, the U.S. has also greatly benefited from economic globalization and China's inclusion in the world order. Going forward, Beijing's major task will be balancing the relationship between the private and state-owned economy.

Ending the morning session was a panel discussion between Professor Wang, *The Economist's* Asia Economics Editor Simon Rabinovitch, and KPMG Partner David Frey, moderated by APCO Worldwide Greater China Chairman James McGregor. Up until now, neither country has felt the major economic shocks of the trade war. But this will likely change in 2019. Unfortunately, domestic political pressures and misunderstandings by both sides were hampering efforts for an agreement and diminishing chances for a new grand bargain.

After lunch, the GR personnel from AmCham Shanghai member companies hunkered down for three consecutive GR workshops. Speakers included St. John Moore and Rory MacPherson from Brunswick, Coco Zhang from Mary Kay China, Haochen Xiong from Archer Daniels Midland and Thomas Shao from Abbott China.

AUTHOR SERIES: CHINA, TRADE AND POWER

On November 27, AmCham Shanghai hosted Stewart Paterson, author of *China, Trade and Power*. Paterson has over 25 years of experience in capital markets as an equity strategist and fund manager. He began by highlighting key talking points from his new book, which discusses China's integration into the World Trade Organization and its impacts. He argued the U.S. was motivated by outsourcing, increased market access and the potential liberalization of China. Meanwhile, China's main impetus to join the WTO was CPC survival through economic growth, improved living standards, increased FDI and advances in technology. Paterson argued WTO engagement failed, as evidenced by a lack of liberalization in China and new threats to Western governments. He then detailed job losses in Western manufacturing and other industries and a decrease in wages as a percentage of GDP caused by China's inclusion in the WTO. Paterson finished by discussing inflation targeting as another caused for tension since governments utilized it to erode debt. A Q&A focus on current United States trade policy, potential solutions, inflation targeting and impacts on foreign firms doing business in China followed the discussion.

U.S. COMPLIANCE AND RECENT TRENDS OF LEGAL AND BOARD GOVERNANCE RISKS

AmCham Shanghai's Financial Services Committee and Legal Committee co-hosted the event on November 27, sponsored by Lockton Insurance Brokers LLC. The event featured several guest speakers and experts. First Carlos Ortiz, Blank Rome LLP's white collar & defense and investigation group co-chair, discussed the

U.S. Department of Justice's creation of a "China Initiative" aimed at identifying Chinese trade theft cases and the U.S. government's use of jurisdiction to protect trade secrets. He then outlined potential liabilities and methods to avoid them. Next Ramesh Moosa, Partner for Forensics & Cyber Security at PwC, presented on cryptocurrency traceability and risks associated with blockchain technology. Ramesh provided solutions to these problems, such as funds tracing, risk scoring, analyzing blockchain data of multiple currencies and applying proprietary IP. Then Dana Kooper, EVP & MD at Lockton, Inc., introduced risk management trends for individual executives. He reviewed the U.S. Individual Accountability in Federal Investigations and Enforcement from 2015, then explained that more liability claims are paid in China than ever. Lastly, company council and lawyers of Chinese law firms joined the forum and held an in-depth discussion with the guest speakers.

EXPERTS DISCUSS AI AND BLOCKCHAIN REGULATIONS

On November 14 AmCham Shanghai held its third Cybersecurity Law Compliance Workshop of 2018, sponsored by Llinks Law Offices. The first two workshops focused on regulations surrounding data localization and Critical Information Infrastructure Operators. This event ended the series by looking ahead to the upcoming cybersecurity regulatory landscape in China. Zhong Lun Law Firm Partner Ron Cai and Llinks Partner David Pan gave presentations on current and future AI and blockchain regulations. The Chinese government has prioritized strengthening and developing these sectors, but, as with other emerging technologies, their regulatory landscapes are still evolving. Both presenters outlined current domestic laws and legal issues governing these sectors and discussed what to expect in 2019. Following this, a three-person panel with Ernst & Young Risk Advisory Partner Gary Gu, Deloitte Risk Advisory Partner Steven Feng, and Control Risks Cybersecurity Partner Ben Wootliff discussed which cybersecurity regulations to watch and projected on how their implementation may affect development of China's high-tech sector. All panelists agreed that how China handles personal data is an important issue to watch in 2019.

READY, SET, GO: CHINA'S SPORTS MARKET TAKES OFF

▲ Armchair athletes

AmCham Shanghai's 2018 Sports Forum took place on November 14 with 100 participants from a variety of industries. Michael Gu of Shanghai Juss Sports opened the forum with a keynote speech on balancing public and private sectors in responding to China's sports market demands. Gu highlighted inexperienced staff, media rights, venue shortages and event risks as major challenges. A panel on sport's branding followed Gu's keynote. NBA China Senior Vice President David Wang discussed the importance of digital data while IMG China CEO Michael Wang spoke about international brands interest in local Chinese markets. Philip So, business development lead at Riot Games, further noted the opportunity e-sports created in targeting young consumers. Next, Managing Director of NFL China Richard Young and CEO International of One Championship Victor Cui discussed the challenges of bringing unfamiliar sports to new environments. They stressed an organic growth model when developing a fan base and franchise image. Last was a panel on the state of China's stadiums led by James Zhu, founder and general manager of VenueChina. Zhu spoke about stadium design in China and the switch from size- and cost-focused models to functional and flexible layouts that prioritize consumers.

2018 AMCHAM SHANGHAI CHINA OUTBOUND INVESTMENT FORUM

On November 13, AmCham Shanghai held its 2018 China Outbound Investment Forum which featured discussion on changing U.S. investment environments from industry experts. Eddie Fu, head of cross border banking at East West Bank, analyzed China-U.S. investment opportunities. Grant Thornton's Warren Clark discussed how differing values impact cross-border investment and shared advice on handling policy uncertainty. Jenny Zhan, president at Good Hope USA, walked through the U.S. real estate market, analyzed past price dynamics and offered suggestions on investment. Eason Zhou of Jones Lang Lasalle suggested buying property in New York during times of trade uncertainty since the average price of real estate in New York has increased despite downturns. A panel delved into best practices for investment in the U.S. Laurence He, director of global business development at TMF group, said that Chinese companies overlook the importance of designing an organizational structure that suits the business's activities in different circumstances. Paul Dwyer, head of International tax and transfer pricing practice at Dezan Shira & Associates, shared tactics to leverage resources and understand U.S. trade. Lastly Daniel Kollar, project director of Intralink China, offered insights on how Chinese companies can keep up with policy changes and create an organizational structure to stay relevant in the market. I

Annual General Business Meeting

AmCham Shanghai

Update on China's individual income tax reform

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With Pat Burke, President and CEO of HSBC North America Holdings Inc.

Inaugural Sports Forum

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Month in Pictures

Friendly banter

Government relations workshop

Outbound Investment Forum

Committee Chair's Corner

With Barbara Ex, co-chair of the Entrepreneurship Committee

By Victoria Hempstead

Barbara Ex is the founder and CEO of Whitespace. Her company was founded in 2016 and offers affordable and flexible short-term meeting and training spaces. Ex has more than 20 years of international experience, 13 years of which she has lived in China working at both international and domestic companies. Prior to starting her own business, Ex was the VP of Business Development for EQuota Energy and the Executive Director of Business Transformation at Lenovo in Beijing. She has an MBA from London Business School and a bachelor's and master's degree in chemical engineering from MIT.

What are your major goals and initiatives for the Entrepreneurship Committee at AmCham Shanghai?

What is interesting about chairing the Entrepreneurship Committee is how we are all growing businesses, but not everyone is an early stage start-up. Some people are established, some people have medium-sized businesses, and we operate across all sectors. The commonality is that everyone is trying to grow their business while facing limited resources. We are all limited in terms of capital, the team, or the resources we have, and the role of leadership in that situation is finding a way to grow despite those limitations.

My own network has been invaluable as I was growing WhiteSpace, and providing entrepreneurs with a platform through which they can connect is key. I try to design events that afford people that, and to give them additional resources, connections or ways of thinking that will help them through those problems.

For example, we created the Entrepreneur Fair, which brought together companies that offered expertise in a range of areas that entrepreneurs have to tackle, but are not necessarily their area. We had service companies providing free consultation in company setup, operations, HR, tax and digital marketing. It was a great chance for these service providers to get feedback on the type of problems that startups are currently facing, and of course a chance for the startups themselves to reach expertise that they might not have in their own network.

What are your main responsibilities as the founder of WhiteSpace?

As the founder and CEO of a company, your job description is to make everything go right., That makes it hard to define exactly what your job is. Right now, WhiteSpace is operationally successful. We have expanded our locations and are rapidly developing our partner network. My job is looking for even more opportunities and direction to grow, which includes finding outside investors, strategic partners and new team members that will take us to the next level.

You studied chemical engineering at MIT. How has this technical background shaped your approach to business and entrepreneurship?

It's shaped my approach to business, in that I start with the facts. When drawing a map from A to B, you need to know where A is, to understand where you are starting. Other people might lead with emotion such as "sales are disappointing" or "this partnership isn't working," and I want to quantify that. What are sales against our expectations? What aspect of this partnership is not working? This approach has also influenced my time in China because when you move to a different culture, you break away from the expectations of how things should be. Quite early in my time in China, I felt that this is just the way things are here. The expectations are different, so let's start with those and get to where we need to be together.

What are the greatest benefits that the Chinese economy offers entrepreneurs? What would you like to see change about the Chinese marketplace?

China offers incredible opportunities for entrepreneurs because everything is developing at lightning speed. No matter what the current playing field is, things will change. Your partnerships, your competitors, your opportunities and your market expectations will all change. As an entrepreneur who enjoys the challenge of growing, I am constantly in wonder when I see the kaleidoscope of opportunities and situations.

Something I would like to see is greater availability of market data. In more developed markets in America and Europe, quality market data is available, but China doesn't have market data to that extent right now. The government collects statistics and makes them available, but it's in a format that requires a lot of compiling. Greater transparency in the size and value of Chinese markets would be a great help to entrepreneurs.

What do you feel are the most common misconceptions the public has about starting a business in China?

People think it is hard to register a business or that the requirements and bureaucracy around it are really difficult but in truth they are not. Compared to England, where I lived before, or the United States, there are fewer requirements. Registering a business is not the difficult part because you can find your way through it, or you can hire an agent to help you get it done quickly. The difficulty is in understanding the fundamentals of entrepreneurship. It's about figuring out what your customers want and how to deliver that better than anyone else. Too many foreign entrepreneurs target a gap in the market that appeals to them and not enough are targeting the Chinese market directly.

For example, WhiteSpace was created initially to cater to Chinese SMEs. We sought out to solve a pain point for the companies who are under pressure to reduce costs, especially rent, but at the same time are increasing employee numbers and spending more on training. When they need to bring everyone together, there isn't enough space in their own office. The result is growing demand for flexible, affordable meeting and training rooms – that's where WhiteSpace comes in. And as we have grown, we have seen that not only do Chinese companies require our service, but we even have a few Fortune 500 clients.

What missteps are new firms entering China making?

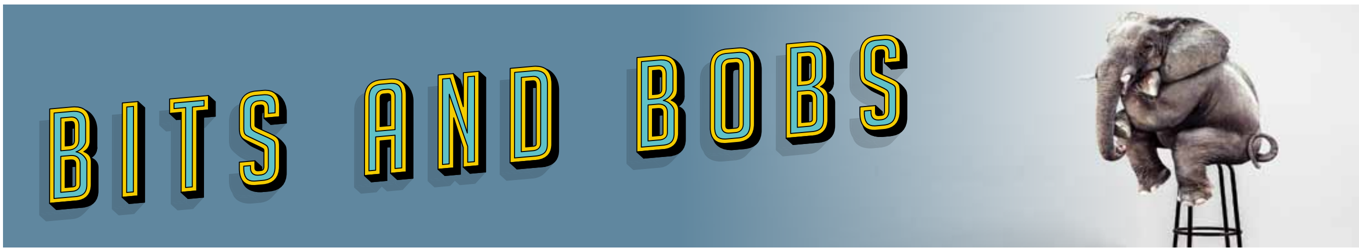
There are fewer foreign firms entering China than there were during the peak period of foreign discovery of the Chinese market between 2008 and 2012. Now new businesses are made by people who have been in China for a long time, who understand their target customers, and are looking to fill in the gaps in the market.

You've lived in a few different parts of the world. Have you faced any discrimination as a woman starting a business in China? How does that experience compare to experiences in other countries?

I've faced less discrimination as a woman in China than I have in other parts of the world. The fact that I am a foreigner doing business in China influences me more than being a woman. There is always a degree of judgment with anyone you are doing business with. As in any country, there are a number of factors that come into play when people decide whether they trust you or want to work with you.

What is the best piece of advice you have received?

It was more than advice. It was a piece of coaching that really took deep root – which is that I am in charge of my life, and that includes my business. This got down to the soles of my feet. I am the one that will cause any result that I receive; therefore, I have permission to do anything I want to do to advance my business (within legal limits, of course). A lot of us operate inside our concerns or rules about how things should be done, and giving myself permission to do whatever is necessary to create the business I think I should run has created a lot of interesting opportunities. For example, something as simple as cold emailing or cold calling someone. Of course, sometimes it doesn't work out, but occasionally it does. So why shouldn't I reach out to someone in that position? I have the right to do what I need to do as the CEO of my company. It is liberating, but also creates more work because you have to put extra thought into what you are doing in order to effectively develop your business. I



The snippets below are drawn from Weekly Briefing, the Chamber's email newsletter. In addition to business, economic, legal and trade matters, it occasionally touches on the more lighthearted, perplexing or downright crazy aspects of life in the Middle Kingdom.

Didi's drunk and disorderly

Projectile vomiting out of a speeding taxi's window is almost a rite of passage. It's also cheaper than barfing over the back seat. Didi hopes to limit both. After reporting that it receives 30,000 complaints a day about drunk passengers, the ride service will test new rules in Shenzhen in time for the holiday season. The rules give Didi drivers the right to cancel an order if a drunk passenger may endanger a trip; call for help if passengers are inebriated or refuse to exit the vehicle; or drop passengers at the nearest police station if they feel threatened. Finally, passengers will be charged a fee if they upchuck in the car. It's unclear how long the trial period will last, but Didi said that if successful, it will roll out the rules to more areas. Restaurant wheelchair purchases may slow in response.

▲ Didi don't do drunkards

Beijing tightens grip on tax system

The State Administration of Taxation announced a new tax regulation that lowers the threshold for the prosecution of tax evasion from RMB 1 million to RMB 100,000. The rule will take effect on January 1, 2019. Keen to overhaul its tax system, Beijing will now be able to target big-name and mid-tier tax-evading companies as well as individuals with the lowered threshold. According to the new regulation, a person or a company will be "blacklisted" by the government and their social credit level demoted to Class D if found guilty of evading taxes of more than RMB 100,000. Citizens with a Class D social credit record will be barred from leaving the country, purchasing plane or train tickets, applying for government jobs, and their children disqualified from enrolling in top schools.

▲ An honest accountant

The gene escapes the bottle

A researcher in China claims to have created the world's first-ever genetically modified babies, prompting a barrage of condemnation by Chinese officials and the scientific community. The experiment was conducted by He Jiankui, who says he used embryonic gene editing to protect the twin girls from contracting HIV from the father. But scientists point out that the experiment was unethical due to the risk of unknown side effects and the potential for abuse of the technology. The Shenzhen Harmonicare Hospital, listed as having given ethical approval to the experiment, denied involvement and said that the document had been forged. China's genetics-linked stocks slumped following the announcement of a government probe, including BGI Genomics Co. and Berry Genomics Co., which both dropped 3% in response.

He Jiankui has defended his research, saying that he was targeting an unmet medical need that is especially important for certain rural Chinese villages where a high percentage of residents are HIV-positive. He also claims to have consulted ethicists from Stanford and Harvard University.

▲ Two peas in a petri dish

Bad glove, bacterial love

In a story that embraces family planning, intellectual property theft and epithumia, 17 suspects in eastern and central China were arrested following police raids on several small-scale "businesses" involved in the manufacturing and sale of counterfeit condoms. The prophylactic-producing posse had churned out low-quality love gloves under international brand names Durex and Okamoto, as well as domestic labels Jissbon and SixSex. Priced to retailers at as little as one RMB per box versus the usual 20 – 150, wrote the *South China Morning Post*, the rubbers were produced in rural villages under unhygienic conditions.

Several suspects were detained in Henan, a province where fake French letter manufacturing has become the rage du jour. Beyond worries about bacteria and fungi levels in the knock-offs, condom connoisseurs communicated concerns that the compromised contraceptives could cause undesired conceptions. However, Chinese authorities have faced difficulties convincing young couples to procreate following the removal of the one-child policy in January 2016, so any punctured protection may yet prove populationally providential. I

▲ Pocket triangle

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