CHINA BUSINESS REVIEW

THE MAGAZINE OF THE US-CHINA BUSINESS COUNCIL

40 *years* of US-China Commercial Relations

The US-China Business Council looks back at how China became a $250 billion market for US companies.

COMMENTARY ON CHINA'S **LEADERSHIP TRANSITION**
P. 38

CHINA'S ECONOMIC OUTLOOK FOR 2013
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SPECIAL REPORT ON **EDUCATION**
P. 28

JANUARY–MARCH 2013
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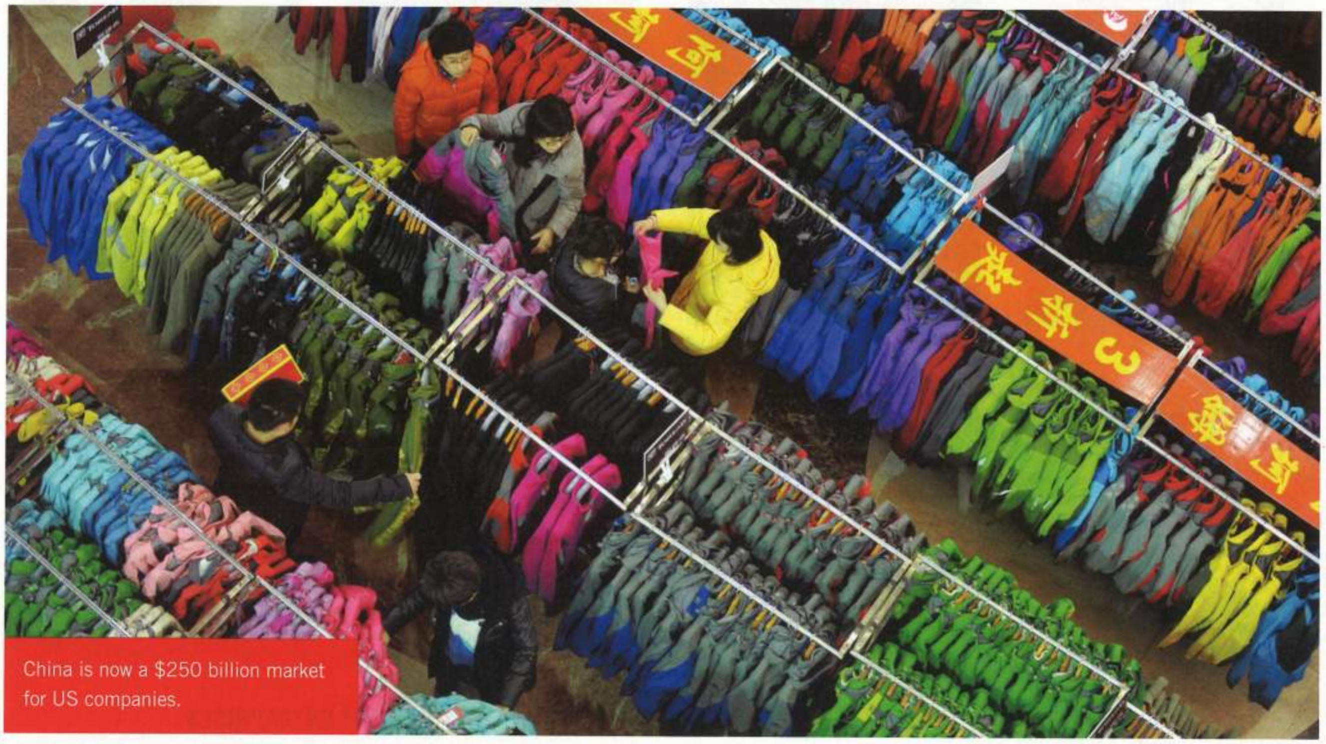
THE MAGAZINE OF **THE US-CHINA BUSINESS COUNCIL**



China is now a $250 billion market for US companies.

IMAGINE CHINA

FOCUS: 40TH ANNIVERSARY

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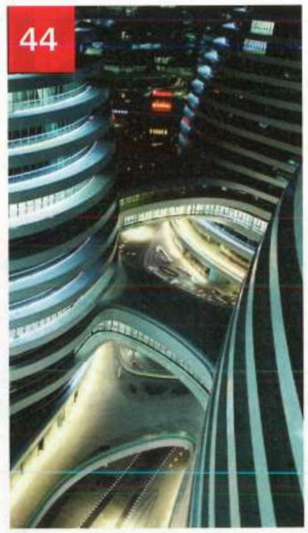

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DEPARTMENTS

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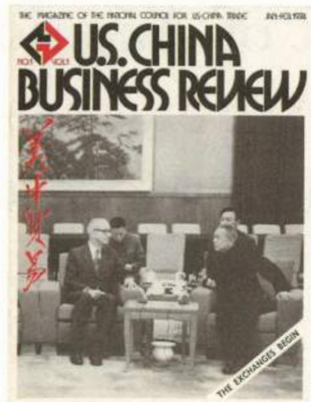
LETTER FROM THE EDITOR

The commercial relationship between the United States and China has changed dramatically since the US-China Business Council (USCBC) opened its doors 40 years ago. Since then the two countries have developed one of the world's largest trading relationships and China has become an important and fast-growing market for American goods. Both countries' economies will likely depend on each other for years to come.

This issue of the *China Business Review* (CBR) examines the evolution of US-China commercial relations and celebrates USCBC's history and role in that relationship.

This is also the last issue of CBR that will be published as a print magazine. After careful consideration of the economics of printing and distributing a magazine, as well as the changing media landscape, we have decided to transition CBR from a quarterly print magazine to a digital-only publication by April 2013.

We believe these changes will make CBR more flexible and responsive to events as they unfold, while still bringing you the high-quality articles on business and policy issues you've come to expect from us over the years.



The cover of the first issue of the *China Business Review*, January 1974 (top); cover of the May 1995 *China Business Review*

The biggest change you will notice in this transition is that you will no longer receive a print issue. Instead, articles will be available online only and you will be alerted to new content once a month by email. The digital-only edition will feature the same number of long form, analytical articles as the quarterly print issue, but spread throughout the three-month period. In addition, starting in April, chinabusinessreview.com will no longer require a username or password, and will be optimized for reading not only on your computer, but on your tablet or mobile device.

Transitioning to a digital-only publication does not mean we're shutting down CBR—we are simply distributing our high-quality content in a way that more closely matches the needs and habits of our highly educated and busy readership. We also intend to maintain the quality standards CBR has upheld since its founding in 1974.

If your subscription covers all or part of 2013, a representative will be in touch with you shortly about a refund. If you have any questions about your subscription, you should contact Mattie Steward at msteward@uschina.org. Feel free to contact me if you have questions about editorial content or other issues at cmnelson@uschina.org.

Christina Nelson

Christina Nelson

CHINA BUSINESS REVIEW

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Nearly **60 percent** of Americans surveyed said they had **chosen American products** over less expensive Chinese goods at least once in the past month.

The Affluent Will Drive China's Growing Consumer Class

By 2020, China's class of affluent consumers is expected to grow from 120 million to 280 million and account for 5 percent of global consumption, according to a new Boston Consulting Group (BCG) report. BCG's definition of affluent in the report is richer than middle class, but not as well-off as the "super rich." The affluent have an average household disposable income of at least $20,000. BCG predicts the spending of this group will grow to more than $3 trillion by 2020, nearly as much as Japan's total consumption.

Within three years, China is projected to overtake Japan as the world's second-largest consumer market, and the affluent will make up almost half of the growth, according to the report. Product categories that are expected to benefit include cars, overseas travel, and personal luxury goods, such as cosmetics.

For the survey, BCG interviewed 3,000 affluent consumers on their attitudes and behaviors. The authors found that these affluent consumers are looking for emotional gratification, status, and recognition, and want to show a greater sophistication in the types of products they buy. They say they will pay more for convenience, but they still want to maximize their return on investment and be able to justify their purchases. These affluent consumers will come from lower-tier cities and many will be women. To reach the affluent, BCG says companies will need to be in more than 500 cities. To succeed, brands will need to maintain the consistency of their products throughout China, understand local needs, appeal to a younger class of consumers, develop social media and e-commerce strategies, and sell to affluent Chinese consumers overseas.

—Ben Baden

Executive Pay in China Becoming More Competitive

Executive compensation in China has become more competitive in the last five years, according to a recent survey of more than 100 senior executives working in China. Survey respondents rank China the fourth highest-paying country globally after the United States, the United Kingdom, and Germany. Brazil ranked fifth, and India ranked sixth.

The study, conducted by the Association of Executive Search Consultants, also reports that more than half of respondents say it is difficult to reach executive-level positions in China. The respondents—77 percent of whom were expatriates working in China—cite a lack of a strong professional network (39 percent), the language barrier (32 percent), and employers favoring local talent (29 percent) as the major barriers to obtaining executive positions.

Despite these barriers, 57 percent of respondents say they plan to stay in China for five years or more and 32 percent plan to stay for three-to-five years.

—Christina Nelson

China's Top Brands

The top five brands in China are China Mobile Ltd., Industrial and Commercial Bank of China Ltd., China Construction Bank Corp., and Internet companies Baidu, Inc. and Tencent Technology Co., Ltd, according to a report on China's 50 most valuable Chinese brands by WPP Group and Millward Brown, Inc.

Private, non-state-owned companies made up 27 percent of the top 50 brands in 2012, up 5 percent from 2011. The stock market value of the top 50 brands increased by 6 percent between July 2010 and September 2012, but the top 50 experienced an overall loss in value of nearly 2 percent in 2012, the first time in the three-year history of the survey.

Other companies that made the top 10 include Agricultural Bank of China Ltd., China Life Insurance Co., Ltd., Bank of China Ltd., Kweichow Moutai Co., Ltd., and Sinopec Shanghai Petrochemical Co.

The authors of the report say the Chinese government's policies to stimulate consumer spending are having an effect. Chinese consumers, known in the past for being conservative, are increasingly buying more products and services for reasons other than price, showing that consumers are becoming more brand conscious, according to the report.

—Ben Baden

American and Chinese Consumers Will Pay More for "Made in USA"

A majority of Chinese and American consumers say they are willing to pay more for products that are made in the United States, according to a recent Boston Consulting Group (BCG) report. More than 80 percent of Americans and 60 percent of Chinese consumers surveyed by BCG said they would pay a premium for a broad range of items labeled "Made in USA."

Roughly two-thirds of American consumers say they would pay more for items in 10 product categories, including baby food, appliances, electronics, and apparel. Nearly 60 percent of the Americans surveyed said they had chosen American products over less expensive Chinese goods at least once in the past month.

Chinese consumers say they are willing to pay a 10 to 80 percent premium on American-made products in the categories tested, and nearly 50 percent say they prefer American-made products over Chinese-made products of equivalent price and quality.

—Christina Nelson

China Eases Visa Restrictions for Tourists in Beijing, Shanghai

The Chinese government recently announced that citizens from 45 countries, including the United States, will be allowed to stay in Beijing and Shanghai for 72 hours without a visa as long as they do not leave the respective city during their stay. The new policy was implemented to help boost tourism in China. It officially took effect on Jan. 1, 2013. Previously, Shanghai had allowed visitors from 32 countries to stay for 48 hours without a visa.

—Ben Baden

IMAGINE CHINA

BY **ANNE PHELAN**

A Legacy of Support for the Rule of Law in China

In the spring of 1999, when the US-China Legal Cooperation Fund issued its first call for grant proposals, there were only a handful of American organizations funding projects to promote the rule of law in China. But there were dozens of American and Chinese law schools, research institutes, and nongovernmental organizations (NGOs) with innovative ideas about how to reform China's legal institutions and processes. The proposals they submitted in that initial round—and in the 25 rounds that followed—demonstrated the diversity of ideas available to advance the rule of law in China.

At their 1997 and 1998 summit meetings, Presidents Bill Clinton and Jiang Zemin announced a commitment to enhance bilateral cooperation in the field of law. More than 30 American corporations and firms—all members of the US-China Business Council—responded quickly to that call for action, and their contributions laid the foundation for the US-China Legal Cooperation Fund in late 1998. The new fund sought to seed the bilateral cooperation the two presidents described, through projects jointly conducted by American and Chinese partners. In subsequent years, more than 40 companies and firms demonstrated their support for the rule of law in China through contributions to the fund.

Expanding economic ties between the two countries—especially after China joined the World Trade Organization (WTO) in 2001—catalyzed growing interest in the legal framework for trade and investment. With support from the fund, American and Chinese partners have educated legal professionals and law students on intellectual property rights, securities law, commercial dispute resolution, WTO rules, government procurement law, and other topics. Yet the fund's scope also has reached beyond the business sector, and grants have enabled American and Chinese partners to address criminal law, labor rights, environmental protection, and civil society development, as well as expand access to legal aid services.

Access to government information has been a recurring theme of projects supported by the fund. A partnership between law library staff at Washington University and the National Library of China offers a case in point. In 2006, the libraries began to hold annual forums on disseminating government information for scholars, government officials, librarians and information specialists. The forums introduced the US federal government publication depository system, the Freedom of Information Act, and other tools for disclosure of government information in the American context, generating discussions on how similar tools could be developed in China. This collaboration has had a tangible impact: Some local Chinese governments have set up information depository systems in public libraries and the National Digital Library, under the National Library of China, has created the Chinese Government Public Information Online portal to gather and electronically publish central and local government information (http://govinfo.nlc.gov.cn).

Even small grants play a role in promoting the rule of law. That is another lesson gleaned from the fund's 13-year history of grantmaking. For instance, Chinese citizens often are unaware of the legal protections available to people living with HIV/AIDS, or what options are available when victims encounter discrimination. Asia Catalyst, an American NGO, and the Beijing-based Korekata AIDS Law Center used initial support from the fund to staff a hotline that provided people with information on these rights. Later, they developed a curriculum to train advocates for people living with HIV/AIDS. Their hands-on training manuals instruct users on how to recognize when legally protected rights are violated, gather data to document discrimination, and conduct educational and advocacy campaigns. The manuals form a centerpiece for Asia Catalyst and the Korekata AIDS Law Center's train-the-trainer and NGO coaching workshops, and are available in print or electronic format for others to use in their advocacy efforts (http://www.asiacatalyst.org/news/kipici.html).

New opportunities for collaboration have grown substantially. Today, some of the fund's earliest grantees are able to undertake larger-scale efforts. International Bridges for Justice (IBJ), for example, first began collaborating with Chinese legal aid centers in 2001, with support from the fund. A decade later, IBJ estimates that its partnerships have trained more than 11,000 legal professionals and advised more than 59,000 individuals on their rights. More funders have brought additional, often substantial, resources to the rule-of-law field; the US government, for example, allocated $6.2 million for rule-of-law and good governance projects in China in 2010.

As a result, the fund's small-scale, seed money approach is less necessary in the current program environment supporting the development of the rule of law in China. The fund's trustees have decided to wind down the fund's operations. As the US-China Legal Cooperation Fund brings its own work to a close—after awarding a total of $1.7 million for 125 projects—its sponsors can find satisfaction knowing that the early seeds of support they planted will continue to bear fruit for years to come.

ANNE PHELAN (aphelan.writer@gmail.com) is a New York-based writer and consultant to nonprofit organizations. She served as executive secretary of the US-China Legal Cooperation Fund from 2009 to 2012.

BY **LINGLING JIANG**

Foreign Investment in Restricted Industries

In China Operations Q&A, the US-China Business Council's (USCBC) Business Advisory Services staff members answer questions companies have about business operations in China.

Q: Our business is under the restricted category of the Catalogue Guiding Foreign Investment. What is the approval process we need to go through, and how long does it usually take?

A: There is no standard process for approval of foreign investment in industries that fall under the restricted category of the Catalogue Guiding Foreign Investment—a document that defines whether foreign investment is encouraged, restricted, or prohibited in a particular industry. The actual practice can depend on the industry and investment scale. Most requests usually go through a prerequisite approval process with the industry's administration authority, which varies from industry to industry. For example, companies in the bio-tech industry would likely need to get approval from the Ministry of Health before seeking approval from other agencies. A company would then seek approval from the Ministry of Commerce (MOFCOM) and the National Development and Reform Commission (NDRC) or their local counterparts, depending on the size of the investment.

Foreign investment in restricted industries can involve even more government agencies depending on the industry and the investment amount. However, the industry administration authority is usually the agency the investor should work with first.

BASIC APPROVAL PROCESS

Once an investment is approved by an industry administration authority, a company then usually must obtain approval from MOFCOM and NDRC. Companies should seek approval from NDRC before going to MOFCOM because MOFCOM will not approve a request unless other agencies have approved it first. Whether approval is needed from the national agency or its local counterparts depends on the investment value and industry.

NDRC approval

NDRC evaluates whether an investment matches industry policies and economic development goals. According to NDRC rules, investment projects in the restricted category should be approved by provincial-level NDRC offices or above. Provincial NDRC offices can approve any investment in restricted industries below $50 million, and the national-level NDRC approves any restricted investment between $50 million and $100 million. The State Council must approve any investment of more than $100 million.

In Shanghai, for example, companies that want to invest less than $50 million in a restricted industry would need approval from the Shanghai Development and Reform Commission. But a company that wants to invest more than $50 million would submit a project application to the national-level NDRC. After receiving approval from NDRC, the company can then submit the contract and articles of association for MOFCOM approval.

MOFCOM approval

MOFCOM focuses on document requirements and general considerations, such as environmental impact and land use. Investments of more than $50 million in restricted industries require investors to submit an application to provincial MOFCOM branches, such as the Shanghai Commerce Commission. If there are no questions, the Shanghai commission sends the documents to MOFCOM for review and approval. MOFCOM usually makes an approval decision within three months. It is important to note that the other agencies must approve investment plans before MOFCOM. If the project is approved, the Commerce Commission will notify the investor.

For investment projects worth less than $50 million in restricted industries, project approvals are less expensive, less time consuming, and more flexible, and provincial commerce departments can approve projects without sending applications to MOFCOM. Companies have easier access to local officials involved in the approval process than would be the case in a national-level approval process. But companies should keep in mind that no matter which level of approval is required companies must apply to the agency that works with them directly.

Approval times

The time it takes for companies to navigate these procedures can vary depending on approval authorities, documentation requirements, and other conditions of operating in restricted industries, such as equity limitations. USCBC member companies have reported that if all goes smoothly, the entire approval process takes roughly one year. The process could take longer if approval is required from more than the usual number of agencies. In practice, if an agency is dissatisfied with the submitted documents, any of the steps in the approval process could take longer. Companies that invest in restricted industries in western China may have an easier time obtaining approval quickly because the Chinese government is trying to attract more foreign investment to interior provinces.

LINGLING JIANG (ljiang@uschina.org.cn) is manager of business and policy research at USCBC's Shanghai office.

CHINA CONFERENCE CALENDAR // JANUARY–MARCH 2013

CHINA-RELATED EVENTS NEAR YOU

Please confirm dates and venues with the organizer prior to attending events. To suggest an entry for the next issue, send an announcement to Joseph Luk (jluk@uschina.org). You can also post listings and view additional entries on the *China Business Review* website at www.chinabusinessreview.com/conference-calendar.php.

4TH CHINA AEROSPACE MANUFACTURING SUMMIT

JANUARY 9–10

Location: Harbin, Heilongjiang: Post Hotel
Organizer: Galleon
Contact: Victoria
Tel: 86-21-5155-9030
contact@galleonevents.com
www.galleonevents.com/2013AVIC/en/home.html

FINANCIAL DATA CHINA 2013

JANUARY 10

Location: Shanghai: Rainbow Hotel
Organizer: Biz Brain Group
Contact: Dianna
info@bbzgroup.cn
www.bbzgroup.cn/fida

39TH CHINA FUR AND LEATHER PRODUCTS FAIR 2013

JANUARY 15–18

Location: Beijing: China National Convention Center
Organizer: Sunry Advertising and Exhibition Co., Ltd.
Contact: Jay Ma
Tel: 86-10-8501-8374
majiechao@cofco.com
www.fur-fair.com/en/index.php

4TH ANNUAL BIO/ PHARMACEUTICAL COLD CHAIN CHINA

JANUARY 16–17

Location: Renaissance Beijing Capital Hotel
Organizer: International Quality and Productivity Center (IQPC)
Tel: 65-6722-9388
enquiry@iqpc.com.sg
www.pharmacoldchainchina.com

4TH ANNUAL CLINICAL TRIAL SUPPLY CHINA 2013

JANUARY 16–17

Location: Renaissance Beijing Capital Hotel
Organizer: IQPC
Contact: Merrylyn
Tel: 65-6722-9388
enquiry@iqpc.com.sg
www.clinicaltrialssupply.com

INTERNATIONAL CONFERENCE ON IT MANAGEMENT AND ENGINEERING PRACTICES 2013

JANUARY 17–18

Location: Hong Kong Polytechnic University
Organizer: Hong Kong Polytechnic University
Contact: Ms. Lui
Tel: 852-2766-7322
itmep.sec@gmail.com
www.itmep2013.comp.polyu.edu.hk

23RD CHINA INTERNATIONAL FISHING TACKLE TRADE EXHIBITION

JANUARY 23–25

Location: Beijing: New China International Exhibition Center
Organizer: China Fish
Contact: Li Jiang
Tel: 86-10-5820-3101
Lijiang@chinafish.cn
www.chinafishshow.org

6TH ANNUAL INVESTMENT PERFORMANCE ANALYSIS AND RISK MANAGEMENT ASIA 2013

JANUARY 30–31

Location: Novotel Hong Kong Century Hotel
Organizer: IQPC
Tel: 65-6722-9388
enquiry@iqpc.com.sg
www.iparmasia.com

14TH CHINA INTERNATIONAL AGROCHEMICAL AND CROP PROTECTION EXHIBITION

FEBRUARY 26–28

Location: Shanghai New International Expo Center
Organizer: China Council for the Promotion of International Trade, Sub-Council of Chemical Industry
www.agrochemshow.com

4TH CHINA INTERNATIONAL FERTILIZER SHOW 2013

FEBRUARY 26–28

Location: Shanghai New International Expo Center
Organizer: China Council for the Promotion of International Trade, Sub-Council of Chemical Industry
Contact: Michael Zhao
Tel: 86-10-8429 2984
zhj@ccpitchem.org.cn
www.fshow.org

9TH CHINA INTERNATIONAL AUTOMOTIVE AFTERMARKET INDUSTRY AND TUNING TRADE FAIR

FEBRUARY 26–28

Location: Guangzhou, Guangdong: China Import and Export Fair Pazhou Complex
Organizer: Jiuzhou International Media and Exhibition Group
Contact: Rita Lee
Tel: 86-20-3821-9963
info@aaitf.org
www.aaitf.org

11TH CHINA INTERNATIONAL GOLD, JEWELRY AND GEM FAIR

FEBRUARY 26–MARCH 1

Location: Guangdong: Shenzhen Convention and Exhibition Center
Organizer: UBM Asia Ltd.
Tel: 86-20-8666-0158
www.jewellerynetasia.com

40 Years and Beyond

BY **JOHN FRISBIE**

Productive commercial relations continue to need USCBC's leadership.

There is no doubt that the US-China commercial relationship has progressed since the US-China Business Council (USCBC)—then called the National Council for US-China Trade—opened its doors 40 years ago. In 1973, the United States was six years away from reestablishing diplomatic ties with the People's Republic of China, and China was more than 20 years away from joining the World Trade Organization.

Today, China is the United States' second-largest trading partner and third-largest export market. Between 2000 and 2011, exports to China have risen every year except one, expanding 542 percent. US exports to the rest of the world grew by just 80 percent during the same time period. In 2011, the US exported more than $100 billion of goods to China. At the same time, China's export-led growth has lifted millions out of poverty and has created a rapidly expanding and vibrant middle class.

The United States has a large bilateral trade deficit with China, largely because our imports from other Asian suppliers have been consolidated on the mainland over the past decade. Unlike those other Asian economies, however, China offers market growth for American companies, with a middle class expected to grow from 200 million people in 2011 to 575 million by 2020.

The next 40 years will only bring more investment and trade between the world's two largest economies, but more work needs to be done to ensure this commercial relationship benefits everyone.

Investment can be an engine of growth, but it is an area that needs attention. Chinese investment in the United States hit a record by the third quarter of 2012, with $6.3 billion in foreign direct investment projects in the United States. But Chinese investment in Europe is higher than in the United States, even in the midst of an ongoing economic crisis in Europe.

US investment in China stands at nearly $68 billion 30 years after China's reform and opening period, according to China's Ministry of Commerce. While two-thirds of respondents to USCBC's 2012 China business environment survey said they plan to increase investment in China over the next 12 months, half of the 17 percent that had halted or delayed planned investments did so because of market access and investment barriers. US investment in China actually declined by roughly 26 percent from 2010 to 2011, and although it has rebounded by 5 percent from January to October 2012, investment still remains below 2010 levels.

The US and Chinese governments will need to embrace investment in each other's countries by pledging openness to foreign investment and taking steps to create a level-playing field for US companies, develop commercial ties, and bring even more benefits to each country's economy.

In China, the government needs to continue reducing foreign investment barriers, including foreign ownership restrictions in nearly 100 manufacturing and services sector categories. China wants to become a global financial center, but this goal will be much more difficult to accomplish without reducing investment barriers for foreign financial services companies.

In fact, investment issues will move to the forefront of the bilateral agenda in the coming years. Chinese companies want to invest more in the United States. Most have done so successfully; some have encountered political or national security headwinds that feed perceptions in China that they are not welcome in the United States. Uncertainty inhibits investment, and more work needs to be done to better inform Chinese investors about navigating the US environment. At the same time, a bilateral investment treaty, if it addressed ownership barriers in China, could also provide a boost to the relationship and provide needed additional protections to US and Chinese investors in both markets.

China must continue to strengthen intellectual property rights enforcement to develop an innovative economy. This issue is also critical for encouraging more US companies to do business in China.

The Chinese government should also work to improve its innovation policies. Removing domestic intellectual property ownership requirements and implementing non-discriminatory tax incentives and other programs would better align China with international best practices. Innovation needs global collaboration, not walls.

US policymakers have plenty of work to do to advance the trade relationship as well. The United States can help American businesses by increasing the Export-Import Bank's support for exports to China, especially exports from small and medium enterprises. The US share of Chinese imports has fallen to 7 percent from 10 percent in 2000, and efforts should be made to boost our share of the pie. Working with China to adopt reciprocal, five-year, multiple-entry visas for business travelers would make it easier to build customer relationships. The US government should also accelerate sensible reforms of US export controls, regulations that limit what items US companies can sell to China, to eliminate unnecessary licensing controls on products that are no longer a threat to US security. Such reforms will boost US exports and help support and create jobs.

Only time will tell what's to come in US-China relations, but both countries can do their part to ensure that their economies, citizens, workers, and businesses benefit from a strong commercial relationship. Political transitions provide an opportunity in 2013 to develop a new long term economic liberalization framework that would comprehensively address opportunities and challenges in the relationship, rather than approach them incrementally.

Twenty-five years ago I worked at USCBC in a more junior role. I used to half-jokingly say to my colleagues that our goal should be our own demise—that business with China would become so normalized that USCBC would no longer be needed. That is still the goal, but I see a vital role for USCBC in the years and, perhaps, decades ahead. With the China market only growing in importance, the need for business-focused information, analysis, best practices sharing, and advocacy to both the Chinese and US governments is more necessary today than ever before.

JOHN FRISBIE is president of the US-China Business Council.

US President Bill Clinton meets with Chinese President Jiang Zemin in October 1997.

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40 Years of US-China Commercial Relations

BY **BEN BADEN**

From sales of airplanes and grains to today's complex commercial relationship, the US-China Business Council has witnessed 40 years of business and trade between the United States and China.

At an event in September in Washington, DC, US Ambassador to China Gary Locke gave a speech highlighting the tremendous growth in trade between the United States and China over the past few decades. "In 1972, our annual bilateral trade was less than $100 million," Locke said. "Two-way investment in each other's markets was close to zero. Only a handful of American jobs relied on trade with China. Today, more than a billion dollars of goods and services flow between our two countries each day. More than 800,000 American jobs depend on producing goods and services sold to China."

China is now the world's second-largest economy and the third-largest market for American-made products, but it wasn't always this way.

QUICK GLANCE

» When the National Council for US-China Trade was created in 1973, there was virtually no trade between the two countries.

» China is now a $250 billion market for American companies, but barriers to market access and investment remain.

» In the US-China Business Council's latest survey of its membership on the business environment in China, a record 89 percent of companies said they were profitable in China last year.

THE EARLY TALKS

In 1973, the National Council for US-China Trade, later renamed the US-China Business Council (USCBC), led the first American business delegation to China since the founding of the People's Republic of China in 1949. After a more than two-decade long trade embargo, the United States decided to once again begin talks with China after President Richard Nixon's historic trip to China in 1972. Robert Hormats, now under secretary of State for economic growth, energy, and the environment, was involved in the formation of USCBC when he was an international economist at the National Security Council. "At the time, there was very little business between the two countries, so one of the reasons behind [USCBC] was to figure out how China could do business with us and we could do business with China, because at the time there was very little China had to sell to us," Hormats says. "We tend to forget that now, but there was a period when there was virtually no trade."

Hormats recalls asking a Chinese official what the Chinese might be interested in buying from American companies. "[The Chinese official's] response was, 'We're revolutionaires. There is nothing you could sell us that we want,'" Hormats says. "That was the last time we saw him. He was no longer among our intelocuters after that, but it certainly represented a stream of thinking at that time in China. They didn't really want to trade with us. Economic relations were really a minor part of the process of normalization, which is why we wanted this group to be set up."

Eugene Theroux, then an associate at Baker & McKenzie LLP, took a leave of absence to join the staff of House Majority Leader Hale Boggs, who was traveling to China with Minority Leader Gerald Ford to observe the business environment in China in 1972. Theroux said at that time the Chinese government was extremely wary of any foreign influence. "They wanted to be self-reliant and be able to stand on their own two feet," he says.

Theroux later became USCBC's first vice president. His first trip to China with Boggs and Ford marked the beginning of nearly 40 years of traveling back and forth between China and the United States with American delegations and clients. Selling to the Chinese was difficult at that time, Theroux says. Chinese leaders had taken pride in the fact that they had been able to survive over the last 20 years cut off from most of the outside world. Those feelings were still on display in 1976 when Theroux traveled to China with a delegation of American companies that wanted to find a way to sell their products to the Chinese. "The rightward lurch at the time was so strong, and antipathy to business with foreign companies so profound, that China's leading newspaper, *People's Daily*, referred to China's own Ministry of Trade as the 'Ministry of National Betrayal,'" Theroux says. In his early discussions, the Chinese said they wouldn't buy products with American labels on them. "They wouldn't use foreign names," he says. "They wanted their specifications and their names on everything." That made it tough for US companies to gain traction in the early days. The only major deal outside of agricultural products during that period was the sale of 10 Boeing aircraft to China in 1972.

CHINA OPENS UP

Roger Sullivan took over as USCBC's vice president in 1981 and became USCBC's second president in 1986. "At that time, people were still saying to us 'trade with China is a joke. It's a poor country. They can't buy anything. They don't have any money,'" Sullivan says. "But even then, China was starting to become a major pur-

USCBC President **JOHN FRISBIE** and US President **GEORGE W. BUSH** in 2008.

OFFICIAL WHITE HOUSE PHOTO

THE NATIONAL COUNCIL FOR US-CHINA TRADE's first visit to China, November 1973.

chaser of things, particularly in those days, farm products."

Sullivan says that in the early days, trade between the United States and China usually consisted of foreigners traveling to the Canton Trade Fair in Guangzhou and buying products right off the shelves. Similarly, it was difficult for companies to sell products directly to the Chinese buyers. "It was not easy to travel around China and meet your customers," says Carolyn Brehm, Procter and Gamble Co.'s vice president of global government relations and public policy. Brehm began her career at USCBC in 1978.

Later in the 1980s, after the United States and China formally established diplomatic relations, trade with China began to take off. "The phone was ringing off the hook," says Scott Seligman, USCBC's Beijing representative from 1980 to 1982. "Everybody was interested in doing business in China." Back then, the trade balance was in the United States' favor. "The Chinese would constantly lecture us that if we didn't buy more from China, then they weren't going to be able to buy from us," Seligman says.

Still, the climate was far from open. All foreign companies were forced to set up shop in hotels due to the lack of office buildings. In addition, the only investment model available for foreign companies was to establish a joint venture with a Chinese partner. "You simply had to have a Chinese partner," Seligman says. "The idea was that you would bring in the technology and know-how, and they would work the bureaucracy and make the world safe for your business."

When Brehm left USCBC for General Motors Co. in 1984, the nature of the relationship was changing. Her first assignment was opening an office for GM in Shanghai. "[Shanghai] was still a very closed off, rather insular place," Brehm recalls. She was at GM when it created its first joint venture with Shanghai Automotive Industry Corp. Group (SAIC) in the mid-1990s. "The economics of that agreement were based on the ability to sell to foreign trade organizations, to cadres in the Chinese government, and to foreigners, and that was a relatively small market," Brehm says. "No one would have predicted how quickly the private ownership of vehicles took off." China is now the world's largest auto market, and GM sold more than 2.5 million vehicles in China last year, making it the best-selling foreign car brand in China.

FROM BOOM TO BUST

Richard Brecher, now a senior director with Motorola Solutions, Inc., joined USCBC in the fall of 1988. "When I started it was the first investment boom-let," Brecher says. "I say boom-let because we thought investment was booming, but we had no idea what was to come." The Chinese government used to publish an annual yearbook that listed all the foreign direct investment projects for the year.

"It's hard to believe they could capture all the deals in a single volume today," Brecher says. Around this time there was a surge of investment into China because of a number of policy changes, such as relaxed rules on foreign investment, permission to set up wholly foreign-owned enterprises in certain sectors, and other reforms that effectively made it easier and more attractive to invest in China.

But June 1989 was a dramatic turning point for US-China commercial relations. After the government crackdown on protesters in Beijing's Tiananmen Square and subsequent slowdown in economic growth in China, companies began to question whether China was a healthy and stable market. "Clearly, it was the nadir in the relationship and in the health and strength of the council itself," Brecher says.

The developments in China sparked negative reactions in the United States, and members of Congress began to question whether they should continue extending certain trading rights to China. The United States first granted China most-favored-nation (MFN) status in 1980, which made trading with China more attractive by lowering tariffs on goods imported to the United States. The status was subject to annual renewal. After Tiananmen, negotiating MFN status became a "political football," Brecher says. The issue surfaced most notably during the 1992 presidential election campaign. Then-candidate Bill Clinton said President George H.W. Bush "coddled" the Chinese government, which Clinton also referred to as the "butchers of Beijing."

Some members of Congress argued that as a serious human rights violator China did not deserve to have its trading rights extended. But Congress eventually began to take up the idea of allowing permanent normal trade relations (PNTR) with China, which would cement China's trading status with the United States. Those discussions lasted until 2000 when China was eventually granted PNTR status. "Strangely enough, after Congress voted for PNTR, China disappeared from the political radar screen," says Robert Kapp, USCBC president from 1994 to 2004. "I drew from that you could light a fire under the US about China, but you couldn't make it last." Once he took office, President Clinton backed off his campaign trail rhetoric. Clinton signed the trade bill into law, which paved the way for China's accession to the World Trade Organization (WTO) in 2001.

GM and SAIC sign joint venture contracts for the creation of Shanghai General Motors Co. Ltd. and the Pan Asia Technical Automotive Center (PATAC) in Beijing's Great Hall of the People on March 25, 1997. Attendees included Chinese Premier **LI PENG**, US Vice President **AL GORE**, GM Chairman and CEO **JACK SMITH**, and SAIC President **CHEN XIANGLIN**.

GENERAL MOTORS CORP.

CHINA'S ACCESSION TO THE WTO

China's trade with the world skyrocketed after it became a member of the WTO. With WTO membership, China could trade more reliably with the world. "It was important economically in all kinds of ways for China, but it was an important event symbolically for China as a sign that China was going to be open to the world," says James Bacchus, who served in the US House of Representatives from 1991 to 1995 (D-FL) and is now chair of law firm Greenberg Traurig LLP's Global Practice Group. "Had China not been a WTO member over the past decade all other countries would have been free to discriminate against China, and this would have crippled China's economic rise."

China is now the third-largest buyer of US exports, trailing only Mexico and Canada. USCBC President John Frisbie says that China is now a $250 billion market for American companies if exports and sales in China by US affiliates are taken into account. The growth in trade and investment has been two-way. For instance, before 2008 Chinese investment in the United States amounted to less than $1 billion each year, according to the Rhodium Group. By 2010, the number had grown to $5 billion, and Chinese investment in the United States is on track for a record year in 2012.

But since China joined the WTO, trade has remained a point of contention. While US exports have grown at a rate of more than 500 percent since 2000, the US bilateral trade deficit with China has reached record levels. America's traditional import suppliers from other economies in Asia have shifted their export production to China, consolidating the United States' long-standing trade deficits with the region in China.

Critics say China unfairly boosts its exports through subsidies or other unfair trade practices. In response, over the last four years the Obama administration has filed WTO cases against China in industries including auto parts, rare earths, and credit card payments. Bacchus says these disputes are a natural progression for two large trading economies. "It's only to be expected that two large countries with billions upon billions in bilateral trade will have trade disputes," says Bacchus, who was also the presiding judge in the first WTO case in which China appeared. "There is no need to see any of these as adversarial. This is simply how commercial trading partners resolve disputes."

MIXED REACTIONS ON PROGRESS

Today, foreign companies operating in China offer a range of viewpoints on China's efforts to open its economy. After China became a member of the WTO, it slowly began to fulfill its commitments over the next few years, opening up different industries to foreign companies. Some companies such as P&G have been able to gain a decent foothold in the China market. Brehm says that a growing middle class of consumers that are beginning to demand higher quality products is encouraging for foreign companies like P&G, which sells consumer products such as laundry detergent, soap, toothpaste, and shampoo. "There is no economy on earth that has transformed itself so quickly, and in that process, the 30 some years that I've been in and out of China, the changes that have occurred in individual Chinese quality of life—the increasing freedom to make decisions about one's future, about one's educational path, and about where one lives—is far greater than it was before," she says.

But other businesses that must deal directly with the government complain that not as much has changed over the past few decades. "The level of engagement and attention to and awareness of China has expanded tremendously," Brecher says. "At the same time, it's amazing how many of the issues that plague business in China are unchanged." Brecher cites a lack of transparency, the burdensome government approval process, local protectionism, and the protection of intellectual property rights as serious impediments for foreign companies operating in China. Motorola Solutions makes telecom equipment products, such as two-way radios and bar code scanners, and offers communications services to companies and governments. "These are perennial issues that have dogged the commercial relationship from day one, and remain problematic with uneven, at best, progress," he says. Brecher adds that China needs to adopt the WTO's government procurement agreement, which would open up the market of products the government and its agencies buy to international competition. China committed to joining the agreement when it became a member of the WTO more than a decade ago, but has yet to make a credible offer. Market access to China's government procurement market remains a vital issue for international companies that do business in China.

US President **BARACK OBAMA** and PRC President **HU JINTAO** at the White House, January 2011.

OFFICIAL WHITE HOUSE PHOTO

USCBC's Vice President Erin Ennis says China has fully implemented a lot of its WTO commitments, but there are a number of industries, such as telecom and express delivery, in which more must be done to give US companies an equal playing field. In addition, China maintains ownership restrictions in nearly 100 manufacturing and services sector categories in China, which inhibit foreign investment.

In USCBC's latest member survey on the business environment in China, member companies said China remains a significant source of revenue growth for their companies, but rising costs, increasing competition, and persistent market access and regulatory barriers make it a challenging area to do business. Eighty-nine percent of companies said they were profitable in China last year, which is the highest rate to date in the seven-year history of the USCBC survey. While 90 percent of respondents said they are optimistic or somewhat optimistic about the outlook for the next five years, 45 percent said they were less optimistic about the business climate than they were three years ago.

"China can be a complicated and frustrating place to do business, for companies and for government trade policy negotiators," Frisbie says. "But there is no more important relationship for the United States in the years ahead, and China will only grow more important to American companies, our economy, and employment. USCBC will continue to engage the Chinese government on behalf of our membership so that American companies can compete on an equal footing."

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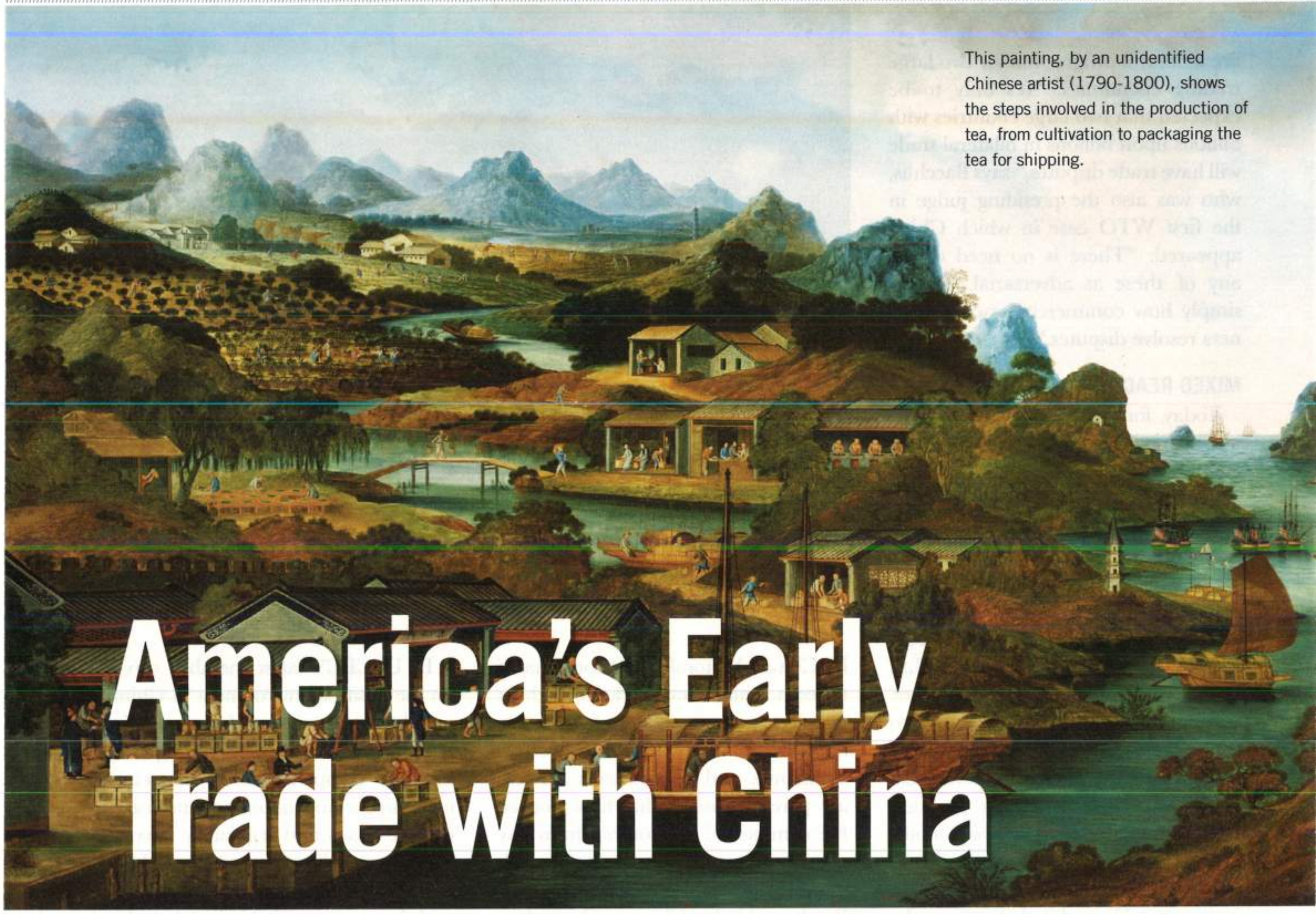


This painting, by an unidentified Chinese artist (1790-1800), shows the steps involved in the production of tea, from cultivation to packaging the tea for shipping.

COURTESY PEABODY ESSEX MUSEUM, SALEM, MASSACHUSETTS

America's Early Trade with China

An examination of trade between the United States and China in the 18th century may hold lessons for today's commercial relationship.

US President Richard Nixon's historic trip to the People's Republic of China in 1972 was an important moment in US-China foreign and commercial relations. But America's trade with China started much earlier. Prior to the Revolutionary War, American colonists had already become enamored with Chinese products—especially tea and porcelain—and some merchants dreamed of traveling to China to trade before the United States was a country. Historian ***Eric Jay Dolin****, author of the new book,* When America First Met China, *and* China Business Review *Editor* ***Christina Nelson*** *discuss the early China trade, the Americans who participated, and lessons for today's commercial relationship. This interview has been edited for length and clarity.*

We often point to the 1970s as the starting point for US-China trade, but your book takes us back to the 18th century after the American Revolution. Can you briefly describe the origins of the US-China trade relationship?

Dolin: The origins actually reach way back to the 1600s when the American colonies were part of England. It was from the mid-1600s up until the eve of the revolution that the Americans had grown accustomed to a great array of Chinese goods courtesy of the British East India Company, which had a monopoly over far eastern commerce. The way in which Americans got tea, silk, and porcelain in these early years was primarily through the British East India Company. There was also a lot of smuggling going on at the time. The Dutch were famous for bringing tea to the colonies from the Dutch East Indies, and the Americans would also travel to the Dutch East Indies and circumvent the British East India Company monopoly. Either way, it wasn't the Americans going to China to get these goods.

By the time of the American Revolution, Americans knew not so much about China, but they knew a lot about a few key Chinese goods, and they greatly desired them. Foremost among those goods was tea. On the eve of the revolution, the Americans were consuming more than 1 billion cups of tea annually. The use of china or porcelain, another Chinese invention, was widespread in the colonies. Although originally in the late 1600s, early 1700s, it tended to be the wealthier Americans who could purchase these exotic Chinese goods, by the mid-1700s the demand had ramped up, the supply had ramped up, and prices had gone down far enough so even average American colonists were drinking tea and would have china plates and bowls in their cupboards.

The Americans were well positioned to get involved in the China trade after they beat the British in the revolution. In fact, during the American Revolution a number of merchants had already started thinking about a day when they could go to China. Discussions were already underway by 1782 and even 1781 with certain merchants seeing the war might go in America's direction. After the war was over, the British East India Company's monopoly on far eastern commerce was no longer, so the Americans could go to China and they did in droves.

America's relationship with China and certainly the China trade goes far back in history, well beyond the opening of China by Nixon. In a sense, the opening of China by Nixon and what happened subsequently is a reopening of America's China trade, a second iteration.

What goods did Americans first trade with the Chinese?

Dolin: By the time the Americans got there in 1784, the Chinese had already been trading with a range of western European nations for well over 100 years. China had been trading with many of the other countries, all the way from Africa to India to Japan. When the westerners arrived and wanted to trade with the Chinese, the Chinese were open to it. One of the problems for a lot of the westerners was China wasn't all that interested in some of the things they could provide. What the Chinese wanted most of all was silver or, more specifically, Spanish dollars because that was an important element of the Chinese economy. They paid military and government officials with it, and people paid their taxes in silver.

By the end of the 1700s, Britain, which was the largest trading partner with China, was hemorrhaging silver. The Americans too faced the same problem in the early years. For the first three or so decades of America's trade with China, 65-70 percent of all our purchases over there were made with silver, so we had a trade deficit from the very beginning. The Americans, like the British, were looking for substitutes.

The Americans found a lot of other things the Chinese were interested in, but they weren't enough to eliminate the need for silver. Furs were one thing the Chinese, especially in the northern parts of China where it can get quite cold, loved. Not just sea otter furs but seal skins and beaver pelts and almost any kind of fur could be brought over there. But the number one fur, the one that earned the most money, was sea otter pelts. There are records of sea otter pelts—big ones that were in good shape—garnering more than $100 apiece. This is at a time when the average American laborer might have been earning $1-2 a day. Hundreds of thousands of sea otter pelts were brought over during a span of at least 20 to 30 years before the trade started to peter out in large part because we started wiping out the populations of sea otters in these areas. We also brought millions of seal skins, but they only sold for about 35 cents to $5 apiece.

The Americans also brought sandalwood because this fragrant wood was used to make furniture in China and turned into incense to burn in houses of worship. An American species of Ginseng plant was also brought over, and the Chinese loved it because they thought it could cure illnesses, be used as an aphrodisiac, and reenergize the body.

Anything America was producing they tried to sell to the Chinese, but the only other item that really took off and sold in huge quantities was cotton, which was increasingly coming from the south.

How did opium change the China trade?

Dolin: Opium stared being smoked in China in the late 1600s. It was thought to have been introduced, at least the smoking of it, by the Dutch. But opium was probably introduced in China well before that. It seems like by at least the 8th or 9th century opium was making its way to China on the Silk Road. It wasn't being used in any widespread form until the late 1700s when foreigners started importing much larger quantities into the country.

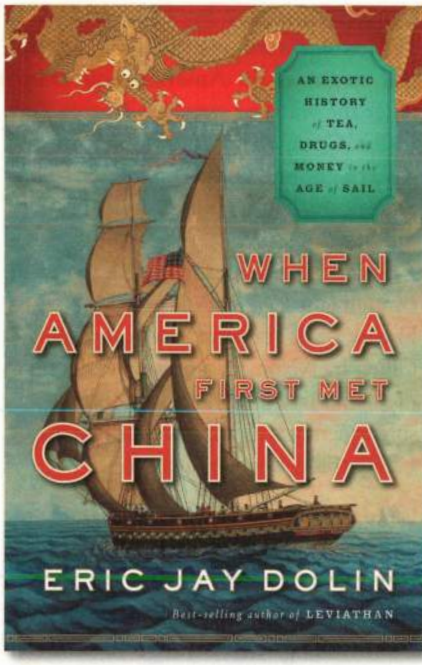
Opium became the perfect commodity for the British—and to a lesser extent, the Americans—because the Chinese didn't want people bringing opium into the country. The emperor, starting in the late 1700s, prohibited the importation of opium into the country. That doesn't stop people very often; look at our drug trade today. What happened is the smuggling trade sprang up and the westerners, with the British in the lead, would bring in increasing quantities of opium. The Chinese smugglers would pay for the drug with silver, and thus the cash flow problem was solved. Instead of funneling huge quantities of silver into China, the Chinese smugglers were paying huge quantities of silver to get opium, and the British and the Americans used that to turn around and purchase Chinese goods.

It was a good system for the west; it turned out not to be a good system for the Chinese who were very upset about the illegal opium trade. They also had a hand in contributing to it. A lot of the Chinese officials who were charged with stopping opium importation smoked opium themselves and took bribes to look the other way. Like any other drug trade, there's supply and demand, and here we had both in abundance. The trade expanded significantly up to the 1830s and then the first Opium War.

The Americans were relatively minor players in the opium trade, but in some years could bring in thousands of chests of opium into Canton. The Americans were earning millions of dollars, the British were earning tens of millions of dollars, and addiction was growing in China.

You say in the book that the China trade hastened the arrival of the American revolution. How so?

Dolin: What was happening in America prior to 1776 and 1775 was an erosion of the ties between the colonies and the mother country, and I think a significant part of that erosion can be related to things that revolved around the China trade. The Boston tea party was a time when the American colonists dumped 342 chests of Chinese tea into Boston Harbor, which was brought there by the British East India Company. The anger surrounding the tea party was not because the colonists were saying, "This is Chinese tea, we are upset that they're bringing Chinese tea." There was a great level of unrest over



the power of Great Britain as the mother country, but also the British East India Company riding roughshod over American interests.

Those American interests were divided. There were Americans who had long served as the middlemen between the British East India Company and American consumers. Right before the tea party, the British East India Company was having a tough time offloading its tea so the British government made the tea a lot cheaper and allowed the British East India Company to sell it directly to Americans, cutting out the middleman. American merchants complained that they were losing money because of this new deal.

Americans didn't like the idea of taxation without representation and this little tea tax of three pence was an annoyance that became a focus for anger because tea was being consumed so widely. That all relates to the China trade because this product was ultimately coming from China.

The China trade played a small part in that because there were Americans before the revolution that talked about going to China but couldn't because of the British East India Company monopoly and other Navigation Act restrictions. There were other currents that led to the ultimate break between American and Great Britain, but the internationalization of America's palate for things from around the world, including Chinese things, expanded their horizons at the same time that they were being restricted. That didn't sit well with the American populace, in particular the merchant class, which was growing increasingly confident in its ability to engage in trade.

Can you describe some of those early American traders who went to China?

Dolin: Probably the best character to talk about was the main backer of the ship, the Empress of China, which is Robert Morris. His story is somewhat typical of the merchants who got involved in the China trade very early on. These are people who had either been involved in trading activity prior to the American Revolution and had been rather successful. They were familiar with having ships and crews sent out to different parts of the world to gather all sorts of items, including human chattel slavery, and making a profit from maritime trade.

Another element that gave them the financial muscle to go out after the American Revolution was privateering. During the American Revolution a lot of merchants, with permission from the infant American government, went out and preyed on British shipping and won a lot of prizes. The American privateers were like our navy during the revolution, and they captured a lot of British ships and brought them back to American ports. They split the bounty—the American government got some of it but the people who went out and did the capturing got some of it as well, and some of these merchants got incredibly wealthy.

After the war, you had the combination of people who are savvy in the ways of business, savvy in the ways of maritime trade, who also have a fleet of ships at their disposal, skilled crewmen, and the money to fund these ventures. If they couldn't do it on their own, they could join forces with other merchants and create little corporate syndicates to send these ships out.

Robert Morris was a merchant

before the American Revolution. He was heavily involved in the West Indies trade, and during the war he not only became the financier of the revolution, helped the war effort, and sort of ran our infant navy, but he was also involved in privateering and he came out of the war very wealthy. He was very familiar with British trade with China and the opportunities that might be there if the Americans went over to Canton. So he hooked up with some other merchants who had money to spend, and they put together the Empress of China, which cost $120,000 to build the ship and load it up and then send it off. That was a lot of money back then.

What were American views of the Chinese before they started trading and after, when they had more direct experience? What were the Chinese views of foreigners at the time?

Dolin: Before the trade Americans had to rely on second hand information. Marco Polo, the Jesuit missionaries, and others who traveled from west to east wrote about their experiences. A lot of the greatest inventions in the world at the time can be traced back to China: gunpowder, the compass, the stirrup, the wheelbarrow, suspension bridges. The Chinese were an extremely advanced civilization—the most advanced in the world for thousands of years. When westerners got their first gaze upon China, they were very impressed.

America's entry into the China trade during the late 1700s and early 1800s was just at the time when the Chinese empire was starting to crumble. China was being beset by a whole range of internal and external problems—famine, internal rebellion, problems with the military, and the rise in opium smoking. At the time that America was starting to really come to grips with China, China was on a downward spiral.

Also, the Americans that went over there by and large during the period I talk about were merchants, and up until the end of the Opium Wars most merchants only saw a sliver of China. They were in Canton, they were in a rough, walled off part of the city, and they were exposed to some of the meanest elements of Chinese society. They felt they were being cheated, they didn't like what the Chinese ate, they made fun of how they walked, how they looked, how they dressed. There were any number of things that American merchants found less than commendable about the Chinese.

The Chinese believed that foreigners were foreign devils. They believed that all the other countries were beneath them at some level and had inferior cultures. When you have that kind of attitude going into the relationship, it's not necessarily going to breed a sense of equality among the people with whom you're trading.

In general, the Chinese held a condescending view of foreigners. But during the 1800s, China was being pounded by outside forces and humiliated in many cases. They were not being accorded the level of respect they thought their empire was due, and that created a lot of hostility that lasts to this day.

While there certainly were Americans who were writing glowingly of the Chinese, it's not surprising that American merchants developed a somewhat negative view of the Chinese. Part of it had to do with the nature of the trade. The British and the Americans really didn't like being constrained to Canton, the regulations they had to operate under, and the way in which the trade was set up. They wanted more open access to China. Westerners had this almost lottery perspective when they looked at China: They saw this huge, wealthy country just waiting for western goods. They thought, "If we can just crack it open somehow, the Chinese are going to buy so much of our products that we're going to be rich." Westerners were continually frustrated that the Chinese weren't quite as interested in western goods as they had hoped. They slowly learned that the Chinese weren't nearly as wealthy as they thought, and that's still the case today.

Now China has a rising middle and upper class and they're buying more and more, but even back then there were a lot of incredibly poor people who didn't have the option to buy something from another country.

That's a fascinating parallel to today. There's a view that if only we can access this market, we can make a ton of money.

Dolin: Maybe someday the dream of China being this unlimited market for western products will be realized. I have no idea. The point I wanted to make and I think is true is that from the very beginning of our relationship with China, up until today, the dream of China becoming this enormous potential market has yet to be fully realized.

Do you see any other links between today's commercial relationship and the past? What can we learn from the past?

Dolin: My intent with the book was to show the history and the past and let other people draw the lessons that are deeper than the ones that I drew. But I did draw some simple lessons that I think are still powerful: deficits then and deficits now and the whole notion of China being viewed through the lens of commercial opportunity.

Back then we didn't know a lot about Chinese culture or the Chinese. We know a lot more about them now and they know a lot more about us, but I still think there are misconceptions and there are a lot of things that Americans don't know, particularly about the history. Very few Americans have any concept of the Opium Wars or that we had this extensive China trade going back hundreds of years. The Chinese are certainly very aware of the Opium Wars, and that's important for westerners to know that history because there are modern day sensitivities that relate to this period.

It's also important to have a little more humility on both sides. We know more and our relationship is more important to each side than it ever was in the past. We are inextricably bound at the hip for the foreseeable future. I hope that looking at the past and realizing we have this long history can help us move into the future in a more positive way.

Highlights from the US-China Business Council's

40 YEAR HISTORY

1971

June

- United States ends 21-year trade embargo with China.

September

- First US grain sale to China.

October

- US firms attend Canton Trade Fair in Guangdong for the first time.

1972

February

- The Boeing Co. signs its first aircraft deal with China.

1973

May

- PRC liaison office opens in Washington, DC, and US liaison office opens in Beijing.
- Inaugural meeting of the National Council for US-China Trade—which changed its name to the US-China Business Council (USCBC) in 1988. Former Deputy Representative to the United Nations Christopher Phillips becomes the council's president and PRC leaders designate the China Council for the Promotion of International Trade (CCPIT) as the council's counterpart.

1973

National Council for US-China Trade members meet with Ambassador **HAN HSU** at the council's inaugural meeting in Washington, DC, May 1973.

1974

- Secretary of State Henry Kissinger delivers the keynote address at the council's first annual meeting.

1975

January

- Trade Act of 1974 takes effect, allowing the US government to grant China most-favored-nation (MFN) status.

1976

March

- The council opens a Hong Kong office to facilitate travel and business for members going to China.

1978

November

- Coastal States Gas Corp. signs an agreement to become the first US company to import crude oil from China.

1979

President **JIMMY CARTER** and former President **RICHARD NIXON** with Vice Premier **DENG XIAOPING**, Washington, DC, January 1979 (official White House photo).

UNLESS OTHERWISE INDICATED, ALL PHOTOS ARE FROM USCBC'S ARCHIVES.

1980

Opening of first Chinese exhibition in the US under council auspices, San Francisco, September 1980.

1979

- The council opens its Beijing office.

January

- The United States and China establish diplomatic relations.
- PRC Vice Premier Deng Xiaoping visits the United States to meet with US President Jimmy Carter.
- President Carter hosts, and the council sponsors, an event at the Kennedy Center with PRC Vice Premier Deng following a state dinner at the White House.
- The council's board delegation meets with Vice Premier Deng and discusses trade with Minister of Foreign Trade Li Qiang.

October

- First US-China joint-venture contract signed to build the Great Wall Hotel in Beijing.

1980

- United States establishes consulates in Guangzhou and Shanghai, and China opens consular offices in Houston and San Francisco.

1981

January

- United States awards MFN status to China subject to annual renewal.

April

- China assumes seat in the International Monetary Fund and World Bank.

1982

April

- The first US-China manufacturing joint-venture contract—between Foxboro Co., an industrial controls manufacturer, and Shanghai Instrument Industry Co.—is approved.
- PRC Premier Zhao Ziyang and State Councilor Gu Mu meet with the council President Phillips and Board Chair David Tappan. Through the council, Zhao communicates

Council board delegation to China meets with Vice Premier **BO YIBO** at the Great Hall of the People, Beijing, 1981.

1979

Deng Xiaoping Tours Ford Plant in Atlanta

The first Ford Model T went on sale in China in 1913. At the time, few manufactured goods were being exported from the United States, but Ford Motor Co. Founder Henry Ford and his business associate James Couzens wanted to "put the world on wheels," says Ford Corporate Historian Bob Kreipke.

In 1923, the company invited 100 Chinese men to the company's Highland Park plant in Michigan to learn how to repair and maintain the Model T. "Then the very next year, Sun Yat-sen [president of the Republic of China] wrote a letter to Henry Ford urging him to get involved in the development of China," Kreipke says.

Ford's Shanghai sales branch closed in 1948—shortly before US-China trade was halted. But in 1978 Ford's grandson met with Deng Xiaoping, who served as China's paramount leader from 1978 to 1982, to express interest in participating in China's auto industry. When Deng traveled to the United States in 1979, he toured Ford's Atlanta assembly plant. That same year, Ford sold 750 F-Series trucks to China.

Throughout the 1990s, the company set up dealers, sponsored a research and development fund, and opened auto component joint ventures. Ford set up a joint venture to develop a vehicle for China in 1995. Now the company has plans to introduce 15 new vehicle models in China by 2015. And in November 2012, the company reported a 56 percent increase in sales over the previous year.

1978

THE COCA-COLA CO.

Coca-Cola Re-enters China After Past Success

In 1948, a year before Mao Zedong founded the People's Republic of China, Shanghai became the first city outside the United States to sell more than 1 million cases of Coca-Cola. "China is a very important market for the company," says Phil Mooney, the Coca-Cola Co.'s archivist and vice president of heritage communications. "Historically, it's one of the first markets we went into internationally."

Before World War I, few people outside of the United States could buy Coca-Cola. That changed when Robert Woodruff took over the company in 1923 and began implementing his vision of a global company, starting with the creation of the Foreign Department in 1926. Shortly after in 1927, Coca-Cola entered China by establishing a partnership with two British mineral water firms that were selling in China.

Coke's early business in China managed to thrive while the country faced conflict between the Nationalist-led Kuomintang and the Chinese Communist Party. In 1942, Y.T. Sun, the executive director of Coke bottler Watson's Mineral Water Co., Inc. in Shanghai wrote in *The Coca-Cola Bottler* that the past year had been a great success. "We are standing on the threshold of a 1942 filled with confidence and ambition, in spite of uncertainties existing in this part of the world."

Coke's business on the mainland was halted in 1949 after the establishment of the PRC. But in 1978, Coke was selected as the only foreign company allowed to sell packaged cold drinks in China. Since then, the company has invested more than $5 billion, employs 50,000 people, has 42 production facilities in China, and is planning $4 billion of investment over the next three years.

that China hopes to maintain trade with the United States even if political relations sour over Taiwan.

1984

January

- PRC Premier Zhao Ziyang speaks at a council luncheon in Washington.

November

- 3M Co. sets up first US wholly foreign-owned enterprise in China.

1985

March

- Sheraton Corp. takes over management of the Great Wall Hotel, becoming the first foreign hotel chain to operate in China.
- Council co-hosts luncheon in honor of PRC President Li Xiannian in Washington, DC.

1986

July

- China applies for membership in the General Agreement on Tariffs and Trade (GATT), the predecessor to the World Trade Organization (WTO).

1989

June

- President George H.W. Bush suspends government-to-government sales, commercial export of weapons, and official visits between US and PRC military leaders after the violence in Tiananmen Square in Beijing.

1990

December

- China opens stock markets in Shanghai and Shenzhen, Guangdong.

1991

May

- The Office of the US Trade Representative begins investigating violations of US intellectual property rights (IPR) in China.

June

- USCBC leaders meet with PRC Premier Li Peng, who expresses concern over MFN conditions for China.

1992

March

- China accedes to the Nuclear Non-Proliferation Treaty.

1992

USCBC President **DONALD M. ANDERSON** travels to China with US Secretary of Commerce **BARBARA FRANKLIN** and a delegation of US business leaders, December 1992.

- The United States lifts high-tech sanctions imposed in 1991 in response to Chinese promises to abide by the Missile Technology Control Regime.

September

- AIG, Inc. receives license to operate first wholly foreign-owned insurance business in China.

October

- Jinbei Automobile becomes the first PRC company listed on the New York Stock Exchange.

1993

March

- Merrill Lynch & Co. opens representative office in Shanghai, becoming the first US securities firm to operate in China.

1994

January

- China unifies its currency, eliminating Foreign Exchange Certificates.

July

- New PRC Foreign Trade Law takes effect. The law regulates cross-border transactions of goods, technology, and services, and addresses the roles of government officials, foreign and domestic companies, state-owned entities, and trade associations.

2004

Chinese Vice Premier **WU YI** and former Secretary of State **MADELEINE ALBRIGHT**, April 2004.

1996

July

- China's currency becomes convertible on current account.

1997

- USCBC opens its Shanghai office.

October

- At a Washington, DC, summit, PRC President Jiang Zemin and US President Bill Clinton agree to take steps to initiate civilian nuclear trade. USCBC co-hosts event for President Jiang in New York City.

1998

US Treasury Secretary **ROBERT RUBIN**, USCBC President **ROBERT KAPP**, and CCPIT Chair **YU XIAOSONG** at USCBC's 25th Anniversary Gala, Washington, DC, June 1998.

1998

June

- President Clinton visits China to sign agreements on US high-tech exports and other issues, including initiatives on infrastructure development.

July

- US Congress votes to change references to "most favored nation" in US law to "normal trade relations."

1999

April

- PRC Premier Zhu Rongji visits Washington to discuss China's WTO accession. USCBC co-hosts welcome dinner in New York.

November

- United States and China sign agreement on the terms of China's WTO accession in Beijing.

2000

October

- President Bill Clinton signs into law the US-China Relations Act of 2000, which grants permanent normal trade relations to China.

2001

December

- China formally accedes to the WTO.

2003

December

- USCBC hosts reception and dinner for PRC Premier Wen Jiabao in Washington, DC.

2004

April

- USCBC co-hosts dinner for PRC Vice Premier Wu Yi and Chinese delegation to the US-China Joint Commission on Commerce and Trade (JCCT).

2006

HU JINTAO and **HENRY KISSINGER** at a dinner hosted by USCBC, 2006.

2006

April

- USCBC co-hosts dinner honoring PRC President Hu Jintao, who delivers an address on bilateral relations, in Washington, DC.

September

- President George W. Bush and PRC President Hu Jintao agree to create the semi-annual US-China Strategic Economic Dialogue (SED), a high-level meeting to address the economic challenges facing both countries.

November

- USCBC President John Frisbie and a delegation of board members meet with senior PRC officials, including Premier Wen Jiabao, Foreign Affairs Minister

Li Zhaoxing, and other officials.

2007

- China overtakes Japan as the United States' third-largest export market.

May

- USCBC co-hosts dinner honoring PRC Vice Premier Wu Yi and the delegation to the SED in Washington, DC.

2008

August

- China's Antimonopoly Law, which established the guidelines for China's first comprehensive antitrust policy, takes effect.

September

- USCBC co-hosts luncheon honoring PRC Premier Wen Jiabao and the ministerial delegation to the United Nations in New York.

2009

- China overtakes the United States to become the world's largest auto market.

April

- President Barack Obama and PRC President Hu Jintao rename the US-China SED the US-China Strategic and Economic Dialogue (S&ED), which is broadened to include global strategic and security issues.

July

- USCBC co-hosts dinner honoring PRC Vice Premier Wang Qishan, State Councilor Dai Bingguo, and the delegation to the S&ED in Washington, DC.

2009

Chinese State Councilor **DAI BINGGUO**, Chinese Vice Premier **WANG QISHAN**, and President **BARACK OBAMA** in July 2009 at the White House (official White House photo).

September

- USCBC co-hosts dinner honoring PRC Premier Wen Jiabao and the ministerial delegation to the United Nations in New York.

December

- USCBC co-hosts reception for US and PRC delegations to the JCCT and dinner for PRC Vice Premier Wang Qishan, Minister of Commerce Chen Deming, and other senior Chinese delegation members, in Washington, DC.

2010

August

- China surpasses Japan as the world's second-largest economy.

2011

- US exports to China exceed $100 billion for the first time.
- China becomes largest personal computer market.

2009

China Becomes General Motors' Largest Market

General Motors Co.'s business in China dates back to 1922, when the company's branch in Manila, Philippines moved to Shanghai. General Motors China Inc. began operations in 1929, with its head office in Shanghai and a branch in Shenyang, Liaoning.

GM's vehicles were the "car of choice" for China's founding father and nationalist leader Sun Yat-sen, Premier Zhou Enlai, and China's last emperor Puyi, according to GM China's Dayna Hart. "In the 1930s, Buick was one of the most popular vehicle brands in China," Hart says. "It was said that one in six vehicles on Shanghai's roads was a Buick."

Sun Yat-sen rides in a Buick in the early 20th century.

GENERAL MOTORS CO.

But Buick wasn't the only GM vehicle offered in China at the time. Chevrolets served as personal transportation, taxis, buses, and ambulances as far back as the 1920s. When GM reentered China in 1997, it only sold one model of Buick. Today, the company has 12 joint ventures in China that manufacture 40 different models under seven brands. In 2009, China surpassed the United States to become the company's largest market. By the end of November 2012, GM and its joint-venture partners had sold nearly 2.6 million vehicles, higher than total 2011 sales.

2010

STEPHEN A. ORLINS, president of the National Committee on US-China Relations; **MUHTAR KENT**, president and CEO of the Coca-Cola Co.; Premier **WEN JIABAO**; the Honorable **CARLA A. HILLS**, chair and CEO of Hills & Co.; and **JOHN FRISBIE**, president of USCBC, at a reception honoring Wen in New York in September 2010.

January

- PRC President Hu Jintao visits the United States, where he meets with US President Barack Obama and delivers a speech at a luncheon co-hosted by USCBC.

2012

February

- PRC Vice President Xi Jinping visits the United States. During his time in Washington, Xi meets with US Vice President Joe Biden and speaks to business and policy leaders at a luncheon co-hosted by USCBC. Xi also visits Iowa and California.

May

- At the S&ED, China says it will raise ownership caps for foreign investors in securities joint-ventures to 49 percent from 33 percent.

November

- Xi Jinping takes over as the Chinese Communist Party's general secretary and chair of the Central Military Commission, and is expected to become president in 2013.

2012

PRC Vice President **XI JINPING** and Vice President **JOE BIDEN** at the CEO roundtable co-sponsored by USCBC in Washington, DC, February 2012.

2012

PepsiCo Partnership Becomes Largest Beverage Venture in China

PepsiCo entered China in 1981 when it opened its first bottling plant in Shenzhen, Guangdong. As China's beverage market has grown—PepsiCo estimates that China will be the world's largest beverage market in 2015—the company has worked to expand its footprint in the country.

In 2012, PepsiCo announced that it had teamed up with Tingyi Holding Corp. Under the agreement, Tingyi's beverage subsidiary, Tingyi-Asahi Beverages Holding Co. Ltd., became PepsiCo's franchise bottler, making Tingyi-PepsiCo the largest beverage venture in China with a national distribution network and more than 70 manufacturing plants.

But PepsiCo's business in China isn't only about beverages. In 1993, the company entered China's food market when it introduced Lay's potato chips. PepsiCo says that 40 percent of Chinese households have tried Lay's products.

The company has invested in developing tastes for the Chinese palate, and it recently opened a research and development center in China, its largest outside of North America, to develop products for China and other countries in Asia. Some of the flavors unique to the China market include Lay's cucumber, hot and sour fish soup, and numb and spicy hotpot flavor potato chips. The company's oatmeal brand, Quaker Oats, offers quick-cooking congee with Chinese medicinal ingredients, such as wolfberry, white fungus, and red dates.

SADARI.COM, PEPSICO

Developing Local Talent for Future Leadership

BY **JOY HUANG**

As more multinational corporations look to promote local hires to top posts in China, companies will have to step up their employee leadership development programs.

From the world's manufacturer to the world's market, China has transformed itself in the last 30 years to become a key strategic location for multinational corporations (MNCs) around the world. Even as the Chinese economy has slowed down in the last two years, foreign direct investment into China remains strong. Along with it, the demands for talented professionals in sales and marketing, human resources, research and development, and many others have increased as well.

To better balance cost, experience, and local market knowledge, MNCs are making strides to identify, train, and promote local talent to serve the China market. To achieve this goal, companies have become more deliberate in their planning and more sophisticated and systematic in their approach to create learning and leadership development programs. Companies that successfully combine leadership development programs with the delivery of professional progressions for top talent lift the performance of their employees, but also prevent top talent from going to work for the competition. For MNCs to succeed in the competitive China market, learning and leadership development must be their top human resources priority.

LOCAL ADVANTAGE

Economic growth in China has created high demand for employees of diversified functions, industries, and experiences. All types of employees—expatriates from western countries and of Chinese ethnic origin, Chinese who return to China after getting an education and some experience abroad, and local Chinese and foreign hires—are in demand due to China's booming economy. At the same time, the pendulum has swung towards local Chinese hires and away from western expats. According to the Aon Hewitt 2010 expatriate compensation and benefits survey conducted in 2007, roughly 26 percent of MNCs in China replaced expats with local candidates. In 2010, the number nearly doubled to roughly 46 percent, and another 14 percent of respondents had plans to replace expat employees with locals. Compared to the other candidates, expat hires still have advantages. In general, expats tend to have more experience and they are more familiar with corporate cultures and practices. They can be especially effective in knowledge transfer and establishing and training new teams. But in addition to costing the company more due to relocation costs and richer benefit packages, expat employees are often perceived as lacking the in-depth understanding of Chinese market conditions, practices, and culture that can prohibit them from achieving desired results.

While the most senior-level positions at MNCs in China today are still predominantly expat assignees, mid-level management positions and below are primarily filled with local hires or ethnic Chinese returnees. At minimum, companies look for a proficient command of the Mandarin Chinese language and basic understanding of Chinese culture. Ethnic Chinese professionals who have grown up or spent many years living in the west have their own particular challenges as well. Perceived as the perfect candidates who possess both western know-how and the Chinese cultural touch, expectations for this group of candidates are very high. In reality, most ethnic Chinese employees have challenges immersing or re-immersing themselves into the Chinese market after long periods living overseas. They often feel like they are "caught between a rock and a hard place"—simultaneously managing on-the-ground realities and dealing with high expectations from their superiors, Chinese team, and customers.

Facing these challenges, and in an effort to balance cost, performance, and local know-how, MNCs are making it a priority to find, develop, retain, and promote local Chinese talent.

PRIORITIZE LEADERSHIP DEVELOPMENT

According to the American Chamber of Commerce in Shanghai's 2010 survey, foreign enterprises list "developing a leadership pipeline" as the number one strategic business challenge in the next three to five years. This was followed by challenges such as increasing market share and product and service innovations.

"When it comes to middle management, we have a huge talent gap that needs to be addressed," says Paula Green, vice president of human resources services at Qiagen, a leading biotechnology company headquartered in Germany with offices around the world. "Succession planning is our main concern. We want to have a strong local candidate pool that can fulfill senior-level positions."

Increasing competition in the China market from other MNCs, as well as from domestic companies, has also added urgency for companies to step up their leadership development programs. "Until a year ago, we did not have to worry much about competition in China," Green says. "Now we do. We need to establish our HR brand, including top notch training and leadership development programs, to attract and retain the talent we want."

What are some of the gaps that companies find in local Chinese talent? In general, the gaps in talent exist as a biproduct of the frenzied speed at which China has been growing its economy and the short history of westernized business practices in the country. These gaps become more visible and concerning as the candidates move from lower level positions to mid- to senior-level positions. Some of the current talent gaps that exist include:

» **Proficient mastery of English as a business language**
Although all Chinese hires to MNCs possess basic English language skills to conduct daily business, many local hires are not proficient enough to effectively discuss complicated issues with native English speakers.

» **Understanding company culture**
The majority of local hires have never been to the western offices of MNCs. They are unfamiliar with the corporate cultures and western business practices that are essential for them to be effective leaders in a global company.

» **Effective communication skills**
Besides language proficiency, business conduct norms and cultural differences can prohibit Chinese managers from effectively communicating, persuading, effecting change, and working with their international colleagues and clients.

» **Strategic thinking and planning skills**
Local Chinese managers tend to be younger and have less managerial experience than expat employees. They also have a reputation for weaker critical thinking and strategic thinking skills. This has much to do with the education system in China where respect for authority and rote learning is emphasized.

DEVELOPING DIVERSIFIED PROGRAMS

Leadership development needs have not changed much in China in the past 10 years. "What have changed are the methods, tools, and how companies plan and execute these leadership development programs," says Jennifer Fan, general manager of Global Leadership Development for Nokia-Siemens in China, who previously worked for a number of multinationals, such as the Coca-Cola Co. and Maersk (China) Shipping Co. Ltd. In general, leadership programs in China have become more systematic, sophisticated, and results-oriented than they were a decade ago. Three major changes to leadership programs in China are:

» **In-sourcing**
In the past, companies typically outsourced the entire design and delivery of training and leadership development programs to outside consulting firms. This was mainly due to lack of in-house know-how and resources. Now, companies are more proactive and

engaged in the entire process. Many MNCs have hired designated personnel to design training programs with outside consulting firms. They are also more sophisticated and aim to ensure that the programs align with their corporate strategies and objectives.

» Tiered programs

Programs are now deliberately tiered to meet the needs of professionals of different levels. Entry-level professionals, for example, need more technical skills required for their job functions and basic skills, such as time management and self-management. Qiagen, for example, once identified a need for local sales people to improve the way they dress to properly represent their corporate image. They conducted a training program that taught sales executives how to "dress for success." The program was met with enthusiastic and positive reception from the employees, and it helped boost their confidence in facing customers. Mid-level professionals usually need to learn people management skills, such as communication, team development, and coaching skills. Senior-level employees need strategic planning, cross-functional collaboration, self-awareness, and leadership skills.

» Diverse program design and delivery

In the past, even companies that had leadership development programs tended to use lectures as the primary teaching tool. That has changed greatly in the last several years. Leadership development programs now consist of a combination of traditional classroom-based lectures with more dynamic approaches, such as real project involvement, simulations, and overseas office rotations. Getting participants to work on a real business problem makes them apply theoretical learning in the classroom. It also gives them an opportunity to demonstrate their abilities and potential to lead. An overseas rotation familiarizes participants with the corporate culture at headquarters, and allows participants to establish relationships with key internal stakeholders so they can work together more effectively when they return to China.

RETENTION

One of the key objectives of learning and leadership development programs at MNCs in China is to retain top employees that are hard to find and even harder to keep. The Chinese workforce is extremely mobile as a result of the highly competitive job market and fast-moving market growth. A recent survey by employee engagement and leadership research and development firm, BlessingWhite, reported that among firms in China and Hong Kong, 30 percent reported turnover rates of 11-40 percent. The turnover rate for MNCs in China is 25 percent above the global average.

In an effort to balance cost, performance, and local know-how, MNCs are making it a priority to find, develop, retain, and promote local Chinese talent.

Companies have seen a little less turnover in the past two years as economic growth in China has contracted. But at the mid- to senior-level positions, it remains a highly competitive job market. Companies that achieved retention success by utilizing learning and leadership development programs did so by doing two things right.

» Retention as a performance indicator

Effectiveness of learning and leadership development programs can be measured using key performance indicators to measure how it affects retention improvements. According to Fan, Maersk China once launched a leadership program aimed at developing future director-level leaders. One of the performance indicators was to have zero turnover for high-potential employees. The program lasted four years and had a different development focus for each year. Participants with different functional backgrounds and nationalities were selected through a nomination process and approved by a steering committee. The program had high commitment from top leadership, a clear focus, and well-designed activities. In the end, the company achieved the zero turnover rate goal at the end of the four year program.

» Deliver on commitments

Having a high quality leadership development program alone is not enough to retain top talent in China. For a long time, there has been a "glass ceiling" for Chinese local hires. Top leadership positions tended to be held by expats and, in some instances, ethnic Chinese born overseas or returnees. Companies have learned that professional development programs alone are not enough. They must also promise and deliver professional rewards to prevent top talent from going to the competition. "There is little leeway to delay the delivery of such commitments," Green says. "You also have to make it visible and transparent so people know there is no favoritism that played a part in it." The Maersk China program also followed up with actual promotions for high achievers before the program ended.

A STRONG LOCAL WORKFORCE AND LEADERSHIP WILL BE CRUCIAL

Many changes have taken place for MNCs in China in the area of learning and leadership development. As companies look ahead to the next five years, the labor shortage, leadership gap, and salary hike trends will likely continue. To compete in China, MNCs will need to have a strong, committed local workforce, and companies will push to invest more resources in this area. They are also expected to become even more systematic and practical in their approach to align programs with clear corporate strategies and to deliver measurable results.

As China rises in sales, market share, and strategic importance for MNCs, companies are also realizing that local leaders in China may one day not only manage the China market, but also take on more global leadership roles. Significant gaps exist today to achieve this vision, but the increasingly sophisticated talent pool inside China, coupled with companies' strategic and systematic approach to leadership development programs, promises that this vision will be realized in the future.

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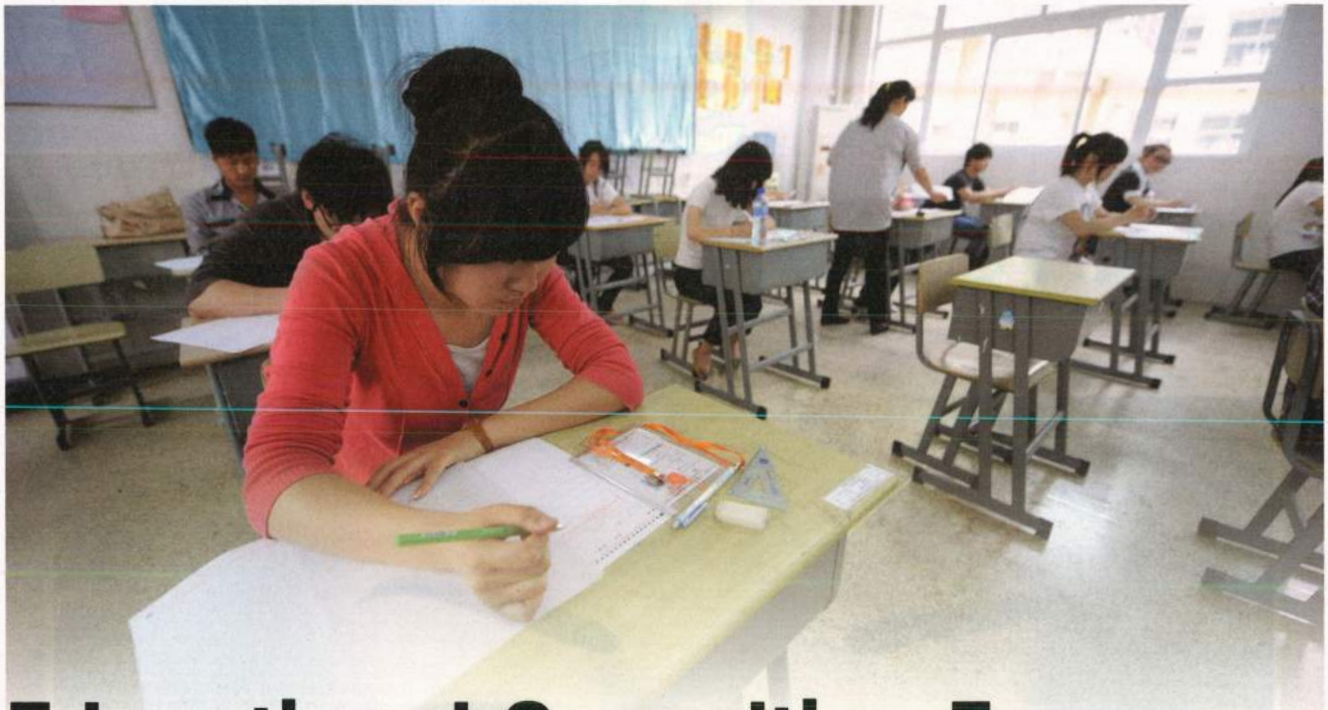

IMAGINE CHINA

Educational Consulting Faces Credibility Challenges in China

BY **JOSEPH LUK**

The boom in Chinese applicants to US universities has boosted China's educational consulting industry, but the industry still faces an image problem.

China sends more university students to the United States than any other country, and for the last four years, the number of students from mainland China has grown by more than 20 percent annually. According to the Institute of International Education (IIE), an independent nonprofit, almost 200,000 Chinese students studied in United States in the 2011-12 school year, and Chinese students generated almost $4 billion for the US higher education sector in 2010. As more Chinese students have chosen to study in the United States, the educational consulting industry in China has grown in tandem. While the industry has been lucrative, it faces an image problem that experts say will force educational consulting in China to change.

ASSISTING APPLICANTS

Educational consultants charge a fee to help students apply to universities. This can involve helping applicants find undergraduate and graduate programs that are a good fit, guiding them through the university application process, and helping them strengthen their writing and test-taking skills.

In addition to standard application materials, such as general application forms, standardized tests, and personal essays, Chinese students must also pass language tests and prepare visa applications to attend US universities. These additional hurdles have made Chinese students a niche but fast growing client base for educational consultants in China. Though there are no official statistics on how many educational consultants are in China, a 2011 National Association for College Admission and Counseling (NACAC) survey found that 60 percent of Chinese respondents said they used education consultants when they applied to US colleges.

DEMAND FOR EDUCATIONAL CONSULTANTS

As more students look abroad for a college education, the demand for educational consulting in China has increased. For many Chinese students, a degree from an American university holds more appeal than a Chinese degree. A 2010 IIE report showed that Chinese students highly value the reputation and quality of US degrees, and that the United States is also the most popular destination for Chinese students studying abroad.

Some students are attracted to the US education system's liberal arts culture, which offers students a variety of opportunities and degrees in different subjects. In China, students who want to attend a university must take the *gaokao*, the college entrance exam administered once a year to millions of students throughout China. The test determines not only if a student can attend university, but where and what they can study.

"In the United States, I could be an engineer or lawyer or doctor, but just a few points lower on China's national entrance exam means I'm going to be a laborer," says Mark Sklarow, executive director of the Independent Educational Consultants Association (IECA), a professional association that represents qualified educational consultants. "The ability to opt out of the *gaokao* just makes so much sense."

According to China's national entrance exam website, the number of students taking the *gaokao* has been declining since 2008. Meanwhile, according to the Educational Testing Service, in 2012 more Chinese students than ever took the Test of English as a Foreign Language (TOEFL), a test required for non-native English speakers applying to US universities. In addition, according to *Professionals in International Education News*, the number of Chinese students taking the Scholastic Assessment Test—a standardized test for US college admissions—is expected to exceed 40,000 in 2012, up from 20,000 just two years ago.

Educational consulting is a lucrative market in China. According to Zinch China, a social network that connects students to US universities, 53 percent of respondents who said they were interested in US universities can afford to spend at least $40,000 annually on tuition. (For comparison, Peking University—one of China's top universities—usually charges around $850 for tuition annually.) Chinese students are also willing to spend money to get admitted to a US school. Yani Zhai, an education consultant in China, says educational consultants can charge a student ¥80,000 ($12,800) to ¥200,000 ($32,000) a year for application consulting.

INDUSTRY CHALLENGES

While it is a lucrative time for educational consulting in China, a few well-documented cases have raised questions about who can be trusted in the field. In October 2012, the *Boston Globe* reported that a family in Hong Kong gave more than $2 million to an educational consulting firm to provide tutoring and funnel donations to an elite university, to boost their son's chance of admittance. When he was not admitted to the university, the family sued the firm.

In other instances, consultants have written student essays with little or no input from the student, and other consultants receive recruiting fees to place students with certain universities, a practice that is banned in the United States. Zhai cautions against calling those individuals consultants, however, and says they are usually known as *zhongjie*, which translates to intermediaries or agents. Zhai and Sklarow both acknowledge that it is easy for schools and families to conflate consultants with those agents because both groups are hired to help with admissions. They explain that agents, unlike consultants, may not have strong educational credentials, help too much with applications, and often do not follow ethical guidelines. In a separate report, Zinch China interviewed students who claimed that up to three-quarters of Chinese students have other people—in many cases agents—write their application essays.

RESHAPING THE INDUSTRY

Sklarow says the IECA is aiming to address the image problem. To ensure credibility the IECA has a multistage vetting process. "We can confirm if someone has been approved for membership," Sklarow says, "That means we checked their education, references, business model, marketing, campus visits, training, [and] quality of advice." He says that the organization's ethical standards are a premium that Chinese consultants can add to their resume if they are IECA-approved. The IECA currently has eight professional members in China and more than 30 associate members. Most consultants need to spend up to three years as an associate member—a provisional status. "Once we have confidence in their ethics and capabilities, they may become a professional member," he says.

Sklarow expects the number of members in China to grow to 25 professional and 100 associate members by the end of 2013. The IECA is vetting 15 to 20 membership applications from China. The IECA rejects about one-third of US domestic applicants, about half of international applicants, and three-quarters of Chinese applicants.

Sklarow also says the educational consulting market in China is ripe for transformation and that new business models are being devised. For example, US-based institutions, such as the Princeton Review Inc., are looking at combining test preparation with language immersion courses for Chinese students. But a company with significant brand recognition in China has not yet emerged. "US affiliation often brings a degree of legitimacy in China," Sklarow says. "US-based services are well positioned to catch up in a market traditionally dominated by domestic service providers."

Zhai says she is skeptical that credentials alone will solve the image problem for consultants, because she says customer trust is built more through word of mouth. She says Chinese students and families need to change their values to force educational consultants to be more accountable. She says parents are increasingly savvy about what they want for their children, and are beginning to understand that the goal is not to just get into a college, but to get into the right college. "Our approach is to be more of a mentor," she says. "We want the admissions process to be educational, fruitful, and worthwhile, and to best prepare them for an American liberal arts education."

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IMAGINE CHINA

Best Practices for Collaborating with Chinese Universities

BY **JAKE PARKER** AND **JIANG LINGLING**

Developing partnerships with Chinese universities can help companies recruit future employees, supplement research and development activities, and strengthen government relationships.

In recent years, companies have been investigating innovative ways to supplement their existing capabilities while minimizing costs by developing partnerships with Chinese universities. These partnerships have helped businesses defray the costs of research and development, recruit new employees, and improve government affairs functions. While these partnerships provide a number of benefits, companies considering this type of collaboration should be aware of the challenges they may face in setting up and managing Chinese university partnerships.

TALENT RECRUITMENT

Demand for qualified employees frequently outstrips availability, especially for skilled technical talent, and many foreign companies operating in China are looking for new and innovative ways to recruit and train potential employees. Companies in China are increasingly looking to replicate international practices of partnering with public institutions to conduct innovative research and create a platform for the company to play an active role in the educational development of potential talent.

The US-China Business Council (USCBC) recently interviewed several member companies to understand the reasons companies enter into these relationships in China and the potential challenges associated with such collaboration. A number of companies indicated that they viewed partnerships with Chinese universities as an opportunity to shape university curriculum, prepare a more qualified workforce, and recruit potential employees.

One company—a chemical manufacturing company with more than 20 joint research and development (R&D) projects with Chinese universities and research institutes—stressed that such projects allow for targeted training of specific skills desirable in their engineering teams. Once the research projects are completed, the company has a pool of qualified, pre-trained individuals to consider for employment.

To cultivate potential employees, Microsoft Corp. uses summer internships, technology clubs at universities across the country, and a visiting faculty program, which brings talented young faculty members to Microsoft's Asia research center for a six-month fellowship in advanced Microsoft training.

RESEARCH AND DEVELOPMENT

Many companies that enter into research relationships with Chinese universities focus on developing new or localizing pre-existing technologies for the China market. According to a recent report, there have been more than 200 joint R&D entities set up between foreign companies and Chinese universities. IBM Corp. and Tsinghua University have set up a collaborative information development center; Alcatel-Lucent has established a joint lab with Shanghai Jiaotong University; and the Procter and Gamble Co. recently established its 19th global R&D center with Tsinghua University.

Companies expressed concern over intellectual property (IP) ownership and protection, but representatives said they felt that managing IP within the context of a partnership with a Chinese university was easier than managing IP in a commercial joint-venture. University partnerships generally have a more well-defined and narrower scope of cooperation in which IP must be managed. Nevertheless, even though companies said the IP risks were manageable, they also noted that IP protection is a serious consideration and should always be discussed from the beginning of partnership negotiations. They noted that effective IP protection strategies include:

- **Requiring all researchers to sign China-specific nondisclosure agreements;**
- **Evaluating sensitive technologies with confidential information restricted to key personnel;**
- **Clearly outlining how to register any newly discovered IP in the partnership agreement;**
- **Ensuring university researchers working on company projects are not also working on projects for competitors; and**
- **Understanding if the researcher or their lab is receiving any government funding as this could impact use of IP discovered in the collaboration.**

Companies interested in forging research relationships with Chinese universities should be aware that the collaboration landscape is changing. Previously, universities pursued partnerships with foreign companies primarily for funding and capacity-building purposes. This allowed companies to largely dictate the research agenda with minimal input from their university partner.

Recently, however, due to the large influx of government funding and abundance of opportunities for collaboration with foreign companies, universities are much more selective about starting new partnerships. Companies just starting to seek research partners may find that potential partners already have relationships with competitors. Their standard partnership contracts may also have less favorable terms than in the past. Universities that decide to collaborate are also more assertive in setting the research agenda to meet their own research priorities. Finally, most university researchers are focused on publishing work to raise their standing in the academic community, which may be at odds with company practices to protect IP.

GOVERNMENT RELATIONS

A number of companies indicated that improving government relations and influencing industry policymaking were important factors in initiating partnerships with Chinese universities. The Chinese government often uses universities and think-tanks to review draft policies and provide comments before public release. Companies say that as the relationship with the partner grows, consultations on relevant government policy often increase. One company noted that controversial sections of a draft environmental protection law were removed after raising concerns with their research partner.

The reputation of a company's university partner is important. The Chinese government tends to solicit the opinion of researchers at top universities in their respective fields. In addition, this type of influence takes time to develop. Investment will not necessarily immediately lead to policy influence. Companies should be prepared to cultivate relationships for several years before they are consulted on relevant government policy. One company that pursued a partnership exclusively for the perceived government relations benefits recommended starting with projects that would make use of the researchers on mostly secondary or tangential projects and not include any sensitive IP, but would still boost the company's public profile with relevant agencies.

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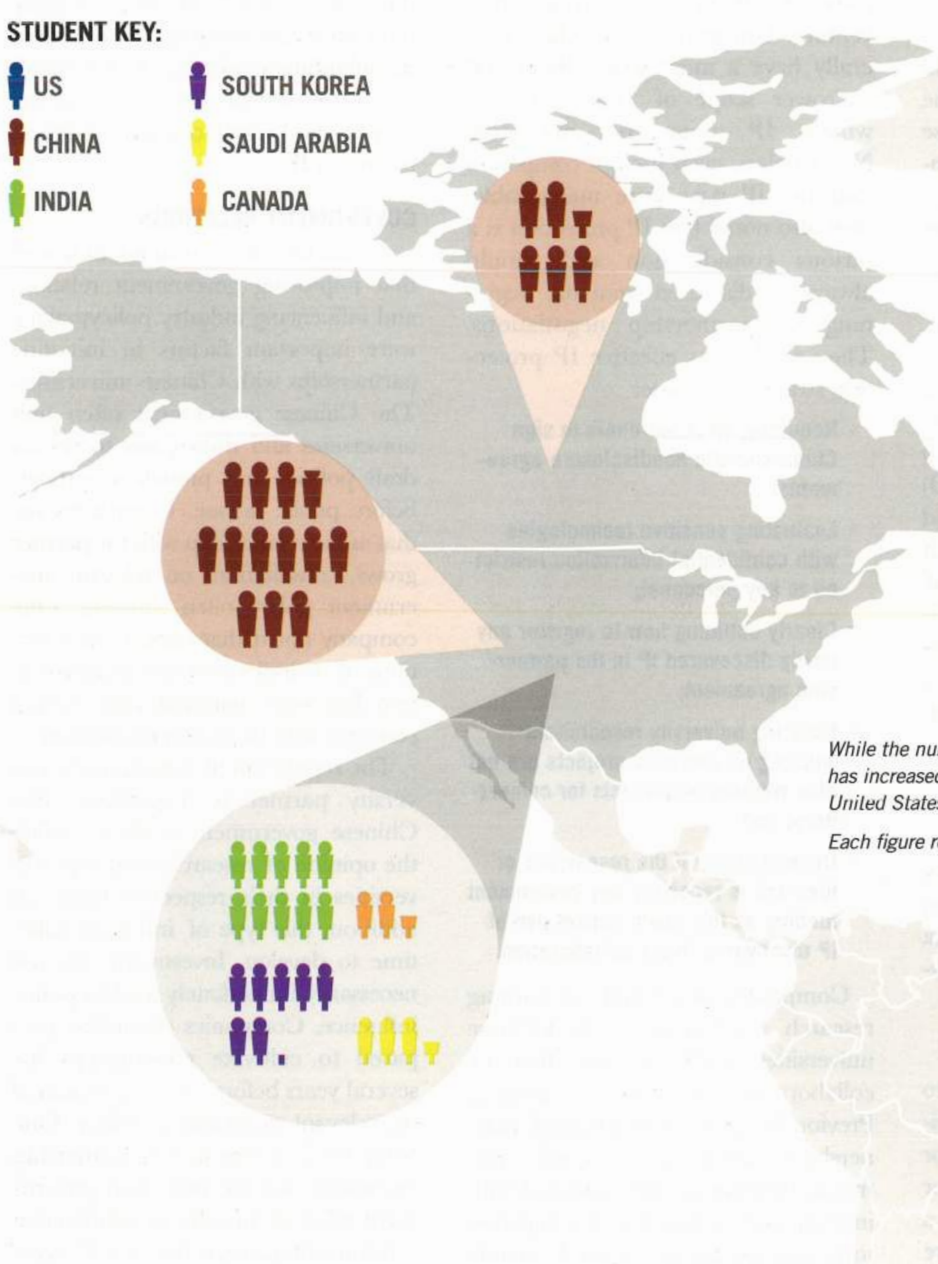
CHINESE AND AMERICAN STUDENTS ABROAD



While the number of American students studying in China has increased in recent years, Chinese students in the United States far outnumber American students in China.

Each figure represents 10,000 students.

POST-SECONDARY INSTITUTIONS

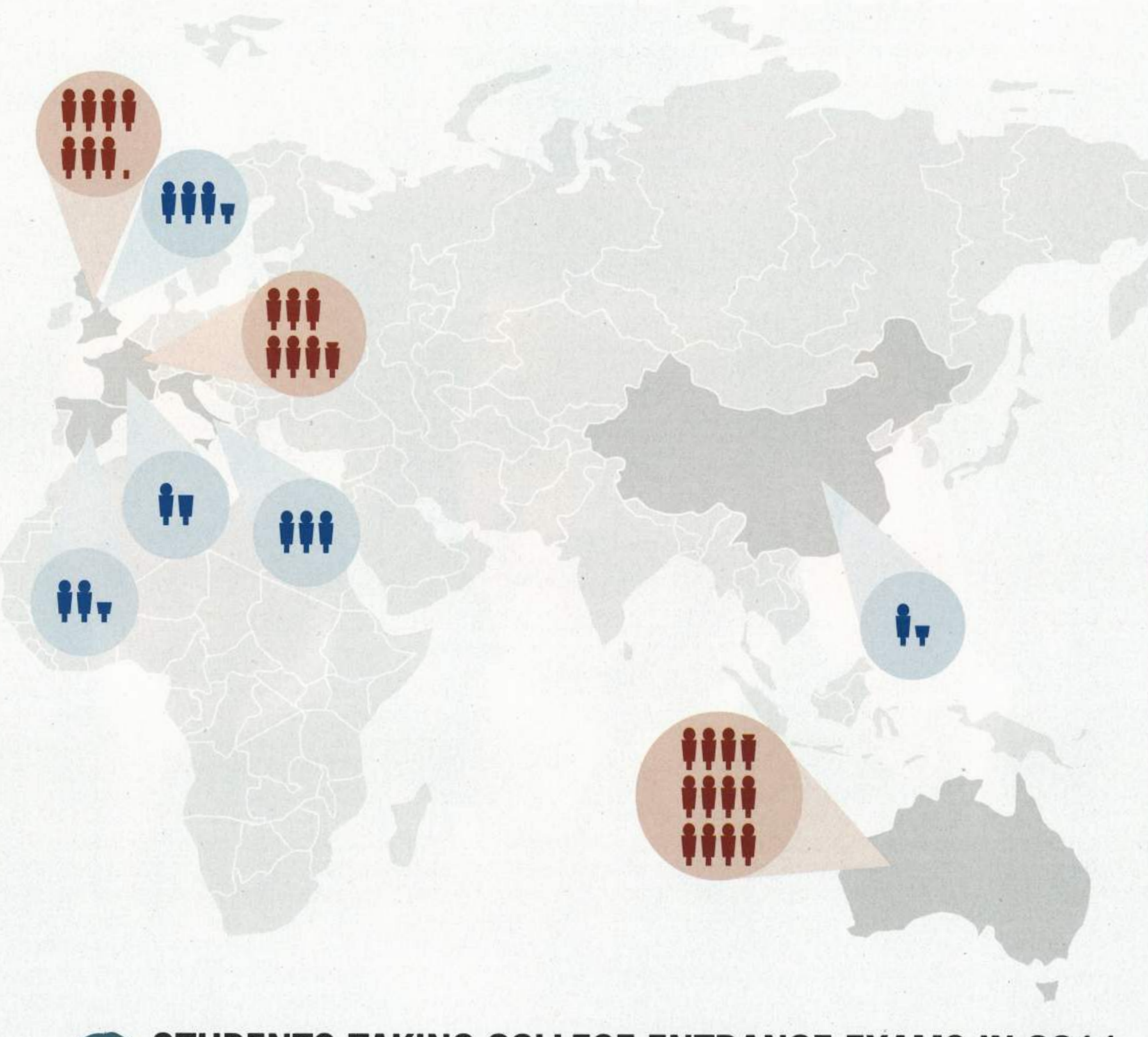
The United States has **7,234** post-secondary institutions of learning. China has **2,138** post-secondary institutions.

Sources: Institute of International Education, 2012 Open Doors Data, *World Bank, College Board, China Education and Research Network, QS World University Rankings Report, US Department of Education*

WORLD UNIVERSITY RANKINGS

14: Number of US universities that are ranked in the top 25 of the QS World University Rankings, an annual international university ranking publication.

0: Number of mainland Chinese universities that are ranked in the top 25 of the QS World University Rankings.



STUDENTS TAKING COLLEGE ENTRANCE EXAMS IN 2011

Gaokao*: 9 million

SAT: 3 million

**This examination is a prerequisite for entrance into almost all higher education institutions at the undergraduate level in China.*

COMMENTARY

Preparing for the New Chinese Government

BY **DEREK SCISSORS** AND **DEAN CHENG**

The US government and business leaders should pay close attention to subtle shifts in Chinese economic policy and foreign affairs.

FENG LI/GETTY IMAGES

China is undergoing the transition to what is often referred to as the fifth generation of political leaders. For the few true winners, the payoff is a de facto decade-long term on the Communist Party's ruling Political Bureau.

A lot can happen in a decade. When the last transition started in late 2002, China had just joined the World Trade Organization (WTO) and had improved external political relations. A decade later, China is the model for state-led economic development and has antagonized its neighbors. Despite China's mercantilist bent and assertiveness, the United States still regards the party as endorsing Deng Xiaoping's pragmatism. His famous line about cats and mice was an exhortation to put aside ideology and choose the development model that works best for the country—market-driven reform. But Deng is long gone and his designated successors will be entirely out of power in 2013. What if pragmatism itself has started to fade?

Change could be for the better. Xi Jinping, who was recently appointed party general secretary and chairman of the Central Military Commission, and Liu Yunshan, a recently appointed member of the Politburo Standing Committee with experience in managing public perceptions thanks to his time at the Propaganda Department, could put off South China Sea disputes for future settlement. Likely Premier Li Keqiang and newly appointed Politburo Standing Committee Member Zhang Gaoli could authorize money to flow freely in and out of the country. Such changes would re-invoke Deng's path of treading lightly overseas and instituting market reform at home. The United States should prepare to identify progress and respond quickly and positively.

There is danger, though, that pragmatism will be overcome by narrow party interests. An additional decade of a more advanced China behaving expansively will likely result in more extensive American alliances, basing arrangements, military exercises, and arms sales. An additional decade of an economically larger China that bullies partners and seeks advantage over the United States will spur calls for economic blocs that genuinely adhere to market-driven policies.

Chinese policy is unlikely to swing sharply in the spring of 2013, when the political transition is complete. But it could certainly shift over the course the next year or so. The United States was not prepared for what happened in 2002-03, when Hu Jintao's regime did not sustain the market reform that occurred under previous President Jiang Zemin, and dangerous macroeconomic imbalances were introduced. Because China was less important a decade ago, the fallout from getting it wrong was limited. A failure now in American policy will have far worse consequences. The United States must prepare now for the new and possibly quite different Chinese government.

THE SITUATION IN CHINA

Long-standing conventional wisdom views the party as pragmatic, and assumes that the incoming leadership will not directly confront the United States because of the attendant risks. This thinking also assumes that the party must ultimately return to market reform because that is what works.

What if this conventional wisdom is wrong? Current party cadres have made a great deal of money from state firms—it may not be clear to them that market reform works. Their legitimacy rests in no small part on rising nationalism—it may not be obvious that conciliation with neighbors and the United States is the reasonable strategy.

The first five years of Hu's reign was marked by foreign policy continuity, along the lines of Deng's admonition to maintain a low profile and bide one's time. China generally acted as a good economic partner, while largely avoiding rancorous issues such as territorial disputes. In the second half of Hu's tenure, China's foreign policy has become steadily more assertive, whether towards Japan and the Senkaku Islands, South Korea and Socotra Rock, Southeast Asia and the South China Sea, or India and Arunachal Pradesh. Since these tensions predate both the current power transition and the economic downturn, it is unclear what might have precipitated this shift. But the consequence has been a growing regional concern about China's foreign policy direction. This is exacerbated by China's military modernization. The People's Liberation Army's (PLA) growing array of modern combat systems stands in stark contrast with planned reductions in the US defense budgets over the next decade. China's ability to employ military force in territorial disputes, which could interfere with East Asia's trade routes, is steadily growing.

Meanwhile, Chinese leaders show little compunction about employing economic tools to further political ends. In 2010, China decided to institute a rare earths embargo after a diplomatic dispute with Japan. In 2012, China's central bank governor skipped a meeting of the International Monetary Fund in Tokyo, and there are ongoing boycotts and riots targeting Japanese factories.

Internally, at the 2007 Party Congress, China was supposedly still reforming, though evidence was weak. By 2010, there was an acknowledgement that economic reform had died and an insistence that a state-controlled approach had helped China avoid the worst effects of the global economic crisis. A 2012 World Bank report, issued in conjunction with the State Council's Development Research Center, argued that a return to market reform is necessary, but there are reasons to doubt the reformers will triumph.

First, the new Politburo Standing Committee, China's most powerful ruling body, suggests stolidity much more than change. Although reformers in the new leadership are almost impossible to identify—the last 10 years have seen little in the way of liberalization—none of the members is clearly linked with reform efforts.

In early 2003, the Hu regime moved decisively to expand investment and suppress consumption, which is characteristic of planned economies. Eventually, the preponderance of investment must reverse or the market experiment will end. This can only be seen as pragmatic if the end-point is a command system. High investment has been enabled by unsustainable subsidies for state-owned enterprises (SOEs). The subsidies shelter SOEs from competition. There is also a multi-industry effort to consolidate large SOEs. In 2006, the State Council asserted explicit control over energy and other sectors to go with implicit control of banking and other sectors. In 2012, the demand for state primacy was ostensibly recognized as an error

QUICK GLANCE

- » Chinese foreign and economic policy is unlikely to swing dramatically this spring, after the country's transition to the fifth generation of leaders is complete, but observers should watch for changes in the next year.
- » If Beijing continues its aggressive foreign policy, neighboring countries may take countermeasures.
- » The US government should challenge the incoming Chinese government to choose market reform and a more conciliatory foreign policy.

and the private role is supposed to expand again. But no genuine liberalization has yet occurred. Investment has also been supported by state bank lending, which surged in 2002 and again in 2008. Increased leveraging now limits monetary and fiscal options. Land and power subsidies for SOEs inflate resource use.

Guaranteed SOE profits helped make some cadres stunningly wealthy. But the subsidies are paid for by depressing consumption—creating a huge gap between consumption and investment GDP shares. What's now best for the party is not best for China.

With the new lineup, Deng's pragmatism will become more remote in time and, perhaps, personnel. China's first economic challenge will be capping liquidity. The massive monetary stimulus in 2009 has rendered further actions along these lines largely ineffective—the analogy is throwing buckets of water into a lake of existing money supply. China's M2 to GDP ratio is three times higher than America's. Deleveraging requires accepting that stimulus has limited impact and is thus politically unpleasant.

Rebalancing would require consumption to grow faster than investment for some time. Consumption cannot match the high pace of investment growth seen under Hu, so rebalancing means slowing investment significantly. The obstacle is the belief touted by government officials that China needs 8 percent GDP growth to keep unemployment levels low. This is false. Five-percent, labor-intensive growth would create more jobs than recent 10-percent capital-intensive growth. The 8 percent rule has justified investment that primarily benefits SOEs and the party, not the country as a whole.

More investment would push China toward command economy status. Consumption-led growth is better for the country, as recognized in state media as early as 2003.

IMPLICATIONS FOR THE UNITED STATES

The anticipated decade of the new government's term is likely to see considerable change. For one thing, given rules for mandatory retirement, the age of the rest of the Standing Committee members means none of them will replace Xi or Li. Another succession battle is likely to be fought at the 2017 Party Congress. This will likely discourage any attempts at any kind of reform or policy innovation over the coming five years.

The United States must prepare now for the new and possibly quite different Chinese government.

On policy, new Chinese governments have a clearer track record of economic shifts than security shifts, though Hu's regime ultimately chose both. Economic changes also tend to become visible more quickly. Analysts face different challenges in monitoring the two realms, but it is vital to good American policy. More than that, the United States must anticipate what types of changes the PRC government may undertake. China's current importance in the world is greater than in 2002, when the United States misread Hu and what his ascension signified.

The makeup of the Standing Committee suggests there is little reason to think the new leadership will support domestic political reform. The past two decades have seen virtually no movement towards democratization. The continued repression of dissidents and violent suppression of protests in Tibet in 2008 and Xinjiang in 2009 and 2011 underscore limited prospects for liberalization. Official Chinese figures report a higher rate of growth in internal security budgets (including the People's Armed Police) than external security budgets (the PLA), suggesting that Beijing seems more concerned with internal than external threats and anticipates the need for a strong hand.

In foreign policy, the new leadership has a stark choice: They can either move back toward Deng's pragmatism or maintain the more recent, assertive foreign policy stance and antagonize China's neighbors and the United States. Maintaining the recent hard line on territorial issues will likely result in some neighboring countries taking countermeasures. If Beijing militarizes these disputes, it will drive most of its neighbors to seek help in balancing China, probably from the United States. Indeed, a China threatening the regional status quo provides impetus to US military repositioning.

On the other hand, a more subdued policy would challenge Beijing at home, requiring consensus from the new leadership. This is a relatively untried group of officials, including military leaders, and one likely to be tested fairly soon by issues concerning the next succession. In the absence of a revolutionary-era leader, a more subdued policy risks both vulnerability in the intra-party jockeying and a backlash from nationalist elements. Portraying their actions regarding the South China Sea and other disputes as defending sovereignty, the current leadership adopted a stance the incoming government would find hard to alter. Popular protests over the Senkakus reflect genuine emotion, as well as government manipulation.

For the United States, the situation is tricky since any policy change may be initially low-key, marked by studious silence rather than loudly declaimed initiatives. A reversion to Deng's pragmatism might start with just restricting Chinese fishing in waters around the Senkaku or Spratly islands or altering news coverage.

On economic issues, the United States must prepare for China returning to the market reform path and continuing to move slowly back to a planned economy. The latter may seem implausible, but the investment-consumption imbalance created by the outgoing government constitutes exactly this result. And both the backgrounds of the men on the new Politburo Standing Committee and the incentives created over the past decade for lower-level cadres suggest a continuation of current policy rather than a new wave of market-oriented reform.

Members of China's new Politburo Standing Committee—**ZHANG GAOLI, LIU YUNSHAN, ZHANG DEJIANG, XI JINPING, LI KEQIANG, YU ZHENGSHENG** and **WANG QISHAN**—greet the media at the Great Hall of the People on November 15, 2012 in Beijing.

LINTAO ZHANG/GETTY IMAGES

If there is no restructuring, investment-driven economies eventually stagnate. The liquidity that China has built up over the past four years brings that day closer. However, stagnation will not be immediate, and China will continue to grow. For the next decade, the United States may have to face a China that has global reach and impact, suppresses competition at home, and subsidizes its firms in international commerce. Such an outcome might call for narrowing the scope of participation in American-led economic initiatives—reshaping the global economy so that an increasingly difficult China is excluded from American partnerships

Alternatively, Beijing could head in the opposite direction. Implementation of reform would still be cautious, but the U-turn by the incoming government could be dramatic, as in the past. Here, China would progressively become a better economic partner, in particular by putting its consumers first and allowing more foreign trade and investment access to the home market. This would not eliminate bilateral friction, but it would considerably ease heavy political pressure in the United States to sanction China.

Much slower public investment would be a definitive signal of liberalization. The share of private investment should rise and some sectors should lose their state monopoly status. Allowing more truly foreign capital—not money recirculated through Hong Kong—would help curb state monopoly power and contribute to effective liberalization of interest rates. In contrast, continued large-scale use of state banks as fiscal tools would indicate Beijing is unwilling to trade economic control and financial rewards for cadres in exchange for broader prosperity.

The first task for American policymakers is to discern which course China is following. The assignment of government positions at the 2013 National People's Congress should be informative.

WHAT THE US GOVERNMENT SHOULD DO

The US government, both executive and legislative branches, must recognize the limits of its leverage. Chinese decisions will be determined by internal costs and benefits far more than American actions.

Major Chinese initiatives are unlikely the first year, as the new leaders acclimate to their roles and each other. There will not be a quick, sharp repudiation of the approach to growth, housing, infrastructure, or other prominent economic issues. There will not be a visible Chinese "pivot," either to or away from the rest of East Asia. There are unlikely to be major changes in the trend for military or internal security spending or policy toward high-profile countries.

Nonetheless, important changes can occur in the first year. American policy makers must be attuned to subtler Chinese behavior.

» **President Barack Obama should challenge the incoming Chinese government to choose market reform and a more conciliatory foreign policy. America's pace and scope of diplomatic engagement and support should be conditional on China's behavior. If China does implement** changes, they are as likely to involve cessation of certain behavior as a loud policy shift. It is as important to see what the Chinese stop doing as what they start.

- The Department of Treasury and Office of the US Trade Representative should monitor Chinese economic policies in 2013-14 to ascertain the direction of the new government. Especially important is overcoming flaws in Chinese reporting of economic growth and the make-up of production.
- If China continues to move away from open competition, the United States should be aggressive in creating or expanding institutions that exclude such economies. An example is the Trans-Pacific Partnership, trade agreement negotiations between the United States and several Asia-Pacific nations that exclude China. If China moves back toward the market, the administration and Congress should encourage the process as much as possible. Here, a bilateral investment treaty is a worthy goal to recognize reform progress and encourage more reform by addressing Chinese complaints about investment access to the United States.
- If Beijing continues its aggressive foreign policy, the United States should counter. There must be sufficient American military capabilities in the Pacific to balance and deter. This means transferring forces in the short term and increasing defense spending in the long term. The United States should also deepen alliances. If China returns to Deng's pragmatism, the United States should foster increasing military-to-military contact and offer greater interaction under the Maritime Military Consultative Agreement and the Defense Consultative Talks—perhaps in areas such as humanitarian assistance and disaster relief.

China's New Leadership

At the conclusion of the Chinese Communist Party (CCP) Congress in November, the party announced its new leadership. Xi Jinping replaced Hu Jintao to become CCP general secretary and chair of the Central Military Commission. He is expected to be named China's next president at the National People's Congress (NPC) in March when China will announce the full lineup of new government leaders, including ministers and vice ministers.

Five new members joined Xi and Executive Vice Premier Li Keqiang, who is expected to succeed Wen Jiabao as China's next premier, on the new seven-member Politburo Standing Committee, China's most powerful political body. Because of retirement age limits some well-known Chinese officials were left off the new Central Committee, including the People's Bank of China Governor Zhou Xiaochun, Commerce Minister Chen Deming, and current National Development and Reform Commission Chair Zhang Ping, leaving openings in key economic roles for the Chinese leadership.

—Ben Baden

XI JINPING

- **General Party Secretary**
- **Chair of the CCP Central Military Commission**

Xi has a strong background in economic issues and is familiar with the United States. He visited Iowa nearly 30 years ago as a local official in an agricultural trade mission. Xi's most recent visit to the United States was in February 2012, when he visited Washington, Los Angeles, and Iowa to meet with US government officials and business leaders.

LI KEQIANG

- **Executive Vice Premier, State Council**

From 2004 to 2007, Li served as the party secretary in Liaoning, a province with a sizable foreign presence. He did not routinely meet with foreign companies during the first few years of his five-year stint as executive vice premier, but he has met many CEOs and business delegations recently.

BUSINESS GUIDANCE

Much of the business community misunderstood the last political transition and paid the price, as the open China anticipated by some analysts post-WTO accession never materialized. The obvious lesson is not to make assumptions and then be caught off-guard.

Business must prepare for further, slow regression toward a command economy. This could feature worsening policy paralysis and perhaps be punctuated by nationalist outbursts that do not only target Japan. This last risk, especially, is worth evaluating now.

On the positive side, pragmatism may yet triumph, bringing external conciliation and genuine liberalization. In this case, the broad commercial environment will improve and specific, unanticipated opportunities may arise. Reform could start in financial services, to undercut shadow banking, or in energy, given the desire to match the progress on energy made by the United States. Which sectors might see the first move could be tipped by the government positions assigned to reformers on the Politburo (even though they are not on the Standing Committee).

The companies that will outperform are those with the best information and the most flexibility. The former means staying or becoming directly engaged in China, rather than learning of developments second-hand. The latter means being able to increase or decrease commitments when the new government's intentions become clear.

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ZHANG DEJIANG

» **Vice Premier, State Council**

As a vice premier of the State Council, China's cabinet, Zhang is responsible for energy, telecommunications, and transport. He briefly served as Chongqing's party secretary after Bo Xilai was removed from power.

YU ZHENGSHENG

» **Former Party Secretary of Shanghai**

Yu took over as Shanghai's party boss after Xi was named vice president. He joined the Politburo in 2002 and is only expected to serve one term because of his age.

LIU YUNSHAN

» **Former Director of the CCP Propaganda Department**

Liu began his career with Xinhua News Agency in Inner Mongolia and later worked his way up through the Propaganda Department of the CCP's Central Committee, which is a 200-plus member group responsible for policymaking.

WANG QISHAN

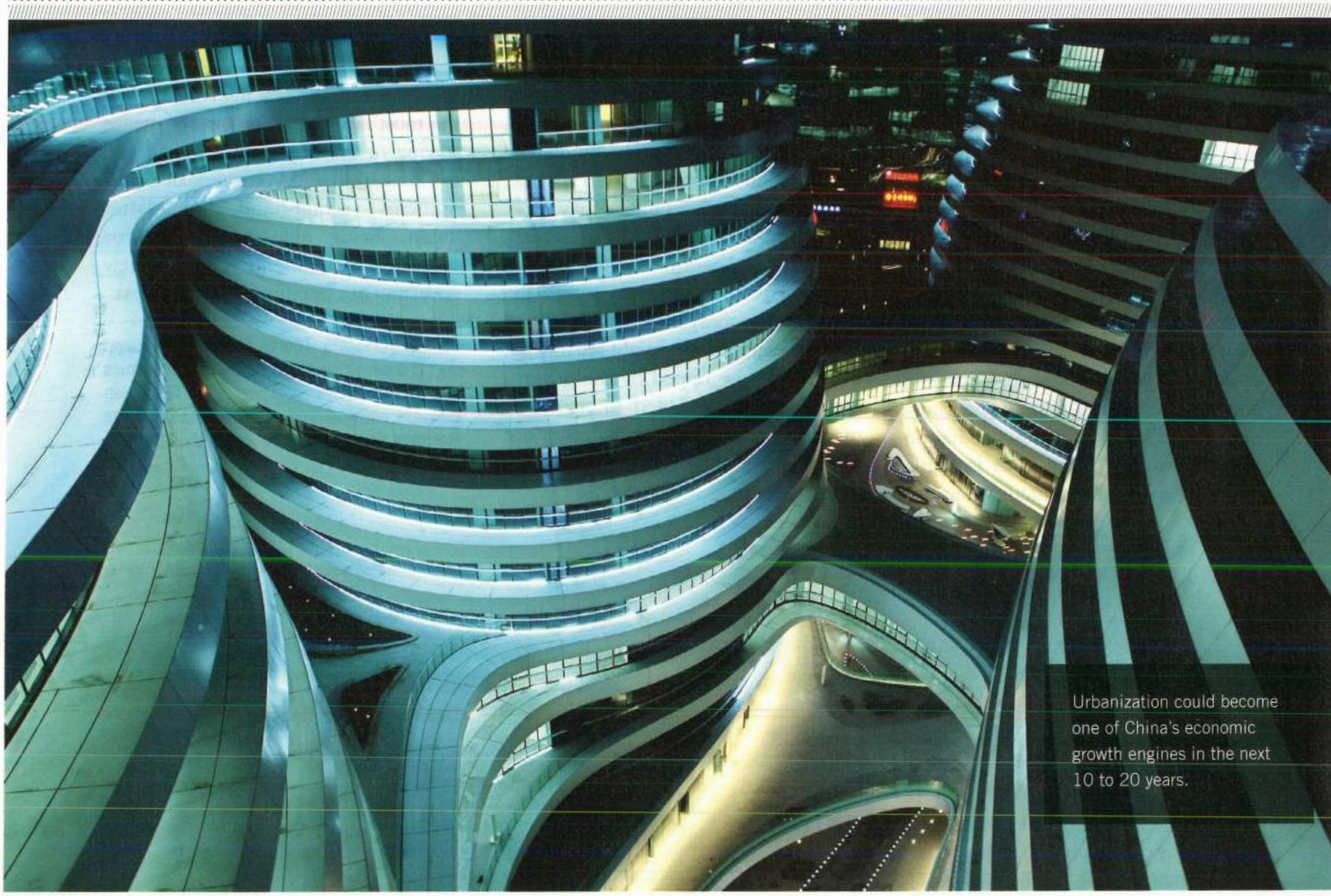
» **Vice Premier, State Council**

Prior to the 18th party congress, Wang served as China's vice premier in charge of finance. In one of the most significant personnel moves made during the congress, Wang was appointed to head the CCP's Central Commission for Discipline Inspection, which deals with internal corruption in the party. As a vice premier, Wang met regularly with foreign leaders and companies and held key roles in bilateral dialogues with the United States.

ZHANG GAOLI

» **Former Party Secretary of Tianjin**

Zhang oversaw a major boom of investment and growth in Tianjin as CCP secretary. He is expected to take on some sort of economic role once the specific government positions are announced.



Urbanization could become one of China's economic growth engines in the next 10 to 20 years.

China in 2013: A Year of Transition

BY **MINGGAO SHEN**

China's economy will continue to grow at a high rate, and the government will implement reforms incrementally.

China is entering a pivotal decade that could bring the country lasting prosperity. The 18th National Congress of the Chinese Communist Party (CCP) has concluded a full power transition for the first time in its 91-year history. This has cleared political uncertainty in the near term. But unlike their predecessors, China's new leaders are unlikely to rule over an economy growing at double-digit rates, and they have been called on to ensure economic growth is more balanced and beneficial for all Chinese citizens. The new leadership wants to double the size of the economy and per capita household income by 2020. Analysts may have high expectations for reform or rebalancing, but the reality is that reforms will likely be incremental and focus on stability.

IMAGINE CHINA

Growth in 2013 will likely be shaped by policies in three stages: on-going policies from 2012, initiatives introduced for 2013 at December's Central Economic Work Conference, and the policies announced at the 3rd plenary session of the CCP Congress in 2013. Citi expects China's GDP to grow at a rate of 7.8 percent and 7.3 percent in 2013 and 2014, respectively. A hard landing—GDP growth below 5 to 6 percent a year—can only be avoided over the next five years if the new leaders embark on substantial and timely structural reforms.

THE REBOUND IN 2012 SHOULD CONTINUE

The macro economy has shown an upward trend in the fourth quarter of 2012 and that growth will probably continue in the first half of 2013. Relatively accommodative monetary policy by the People's Bank of China and accelerated infrastructure investment have contributed to the growth rebound. This has been confirmed by various measures of China's manufacturing activity that are now showing expansion after months of contraction, including Citi's China leading indicator reading, which is a combination of variables such as steel production and power consumption. The rebound in China's GDP growth is largely driven by cyclical factors. In our view, the economic growth rebound will likely be mild and temporary unless there is more policy support from the Chinese government. Retail sales have accelerated, but given its relatively small share of consumption in GDP, retail sales alone cannot sustain this level of GDP growth.

The cyclical rebound was led by infrastructure investment and will likely be capped barring a stimulus in 2013. This trend will likely be extended to the first half of 2013 due to the low base this year. The recent rebound of infrastructure investment came with no aggressive stimulus and might have crowded out investment elsewhere. Given that policy tightening in the property sector may continue, the upside of its investment will likely be capped. Export growth will be influenced by the impacts of the "fiscal cliff" negotiations in the United States over taxes and spending. Assuming major spending cuts or tax hikes can be avoided in the United States, the export growth rate will likely be in the single digits again next year.

POLICY INITIATIVES IN 2013 WILL MATTER

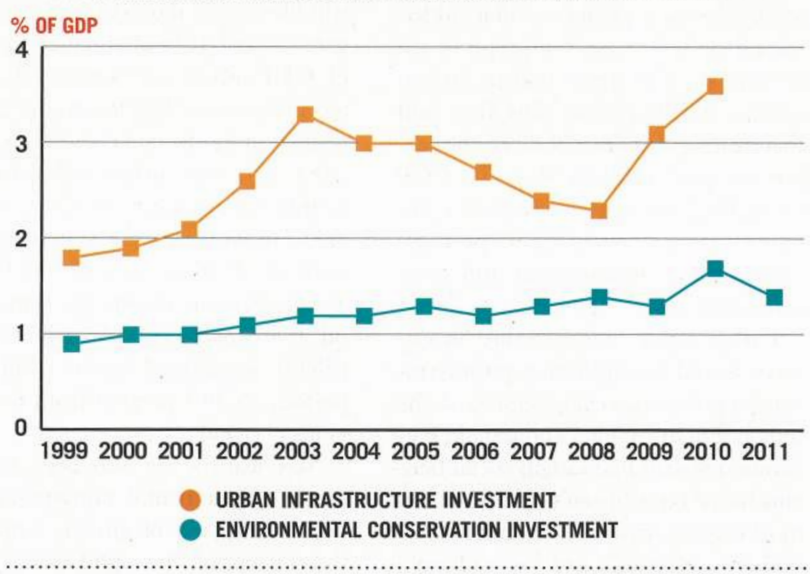
The economic recovery in China will likely be determined by policy and investment initiatives under the new leadership. During the recent CCP Congress, members of the new Chinese leadership highlighted areas of future growth that include upgrading industrial technologies, information technology, urbanization, agricultural modernization, and environmental conservation. To double the size of the economy by 2020 in real terms, the new leadership will need new policy initiatives, such as a stimulus package or other measures that would help rebalance the economy towards more consumer spending. The former requires new sources of funding, while the latter involves inventing new growth engines. The latter is more probable, although the reforms will likely be incremental.

Investment will be the key instrument to sustain growth in the near term, and Citi expects investment growth to accelerate in 2013. Unless the new leadership is willing to tolerate slower growth, policy initiatives will aim to maintain investment momentum. Historically, investment growth is strongest in the third year of each Five-Year Plan (FYP). Since 1981, when China began instituting market economic reforms, China has implemented six FYPs. Fixed-asset investment growth rates have been in or near the

QUICK GLANCE

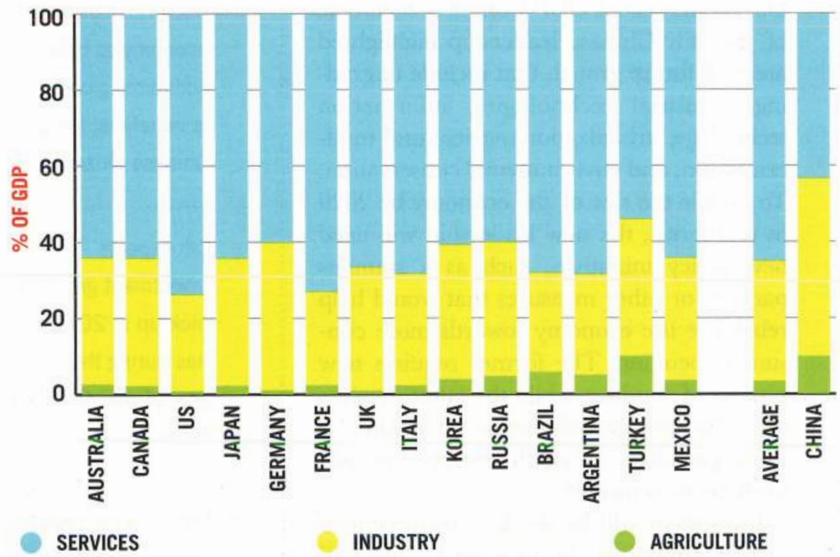
- China's new leadership must rebalance the economy so that economic growth is beneficial for all Chinese citizens.
- Citi expects investment growth to pick up in 2013 as it has during the third year of past Five-Year Plans.
- Urbanization could become one of China's growth engines in the coming decades.

fig. 1 **INFRASTRUCTURE AND ENVIRONMENTAL CONSERVATION INVESTMENT AS A PERCENTAGE OF GDP**



Source: Citi

fig. 2 **ECONOMIC STRUCTURE OF SELECTED ECONOMIES**



Source: Citi

Note: Numbers based on selected economies when they had a GDP per capita between $10,000 and $15,000.

highest level in the third year of five of the FYPs. This year is unlikely to be an exception.

New policy initiatives may offer additional support to investment growth next year. Citi expects that the reforms initiated in 2012 and earlier will likely be carried out by new leaders in 2013 and beyond to ensure policy continuity. Reforms include interest rate liberalization, more renminbi flexibility, converting the business tax into a value-added tax in the services sector, property tax reform, resource price reform, hukou reform, banking sector discipline, and financial sector reform. Out of the sectors or areas highlighted in the CCP Congress, Citi expects new policy initiatives to be introduced to promote investment in urbanization and environmental conservation.

Urban public infrastructure investment would benefit from a pro-urbanization policy, especially reform of the hukou system—China's household registration system that assigns social benefits based on a citizen's birthplace. (In most cases, citizens are assigned either "urban" or "rural" and "agricultural" or "non-agricultural" hukou status.) In addition to abolishing the hukou system in third- or fourth-tier cities, policymakers may consider extending social security and other entitlements to cover migrant workers. If policy reforms are implemented appropriately, urbanization could become one of China's growth engines in the next 10 to 20 years.

Urban infrastructure investment will likely gain momentum in coming years as well. If implemented, its share of GDP would rise consistently from 3.6 percent in 2010 to around 5 percent or more. In the 11th FYP period (2006-10), total urban infrastructure investment amounted to ¥22.1 trillion ($3.6 trillion), up 21.8 percent per year, or 23.9 percent of total fixed asset investment during the same period. It is expected that ¥7 trillion ($1.1 trillion) is planned in the 12th FYP period, up 59.1 percent from the previous five years.

New leaders are also keen to promote environmental conservation to better the quality of growth, launching the concept of "beautiful China" during the CCP Congress. New policies to increase investment to alleviate pollution and reduce carbon emissions are expected to be launched, including retiring heavily polluting and energy-intensive industries or factories. The government may also provide more subsidies to research and development (R&D) projects and innovations in environmentally friendly technologies.

Policy initiatives for environmental conservation could open more investment opportunities in related areas. During the 11th FYP period, total investment related to environmental conservation was ¥3.5 trillion ($562 billion), and its share of GDP was mostly below 1.5 percent (see Figure 1). In 2009, total investment surged to ¥905 billion ($145 billion), up 89.5 percent from ¥477.6 billion ($76.7 billion) in 2005. It is expected that total investment in the 12th FYP would be more than ¥5 trillion ($803 billion), up 42.9 percent from the previous five years.

WAITING FOR A NEW DIRECTION

The direction of the Chinese economy in 2013 will depend on the reform agenda under the new leadership, which could be laid out in the 3rd plenary session of the CCP Congress in the fall of 2013. New leaders will spell out policies to sustain growth and the policy path to transfer the manufacturing-led economic model to a more consumption-led one.

New leaders have been vocal about the necessity for drastic economic reforms. Citi believes the most likely scenario is that the next generation of leaders will be focused on a pro-stability framework and incremental reforms that will be just enough to sustain growth. However, there is always a chance that reforms or rebalancing are more aggressive than expected, or vice versa.

» **During the opening speech at the fall 2012 party congress, outgoing President Hu Jintao demanded political bravery and wisdom to deepen reforms in critical areas in a timely fashion.**

» **In his speech after the nomination as party general secretary, Xi Jinping declared that the party aims to offer** people better education, stable jobs, good income, reliable social security, better quality healthcare services, comfortable living conditions, and a less polluted environment. Xi warned the party to fight against corruption, isolation, formalism, and excessive bureaucracy.

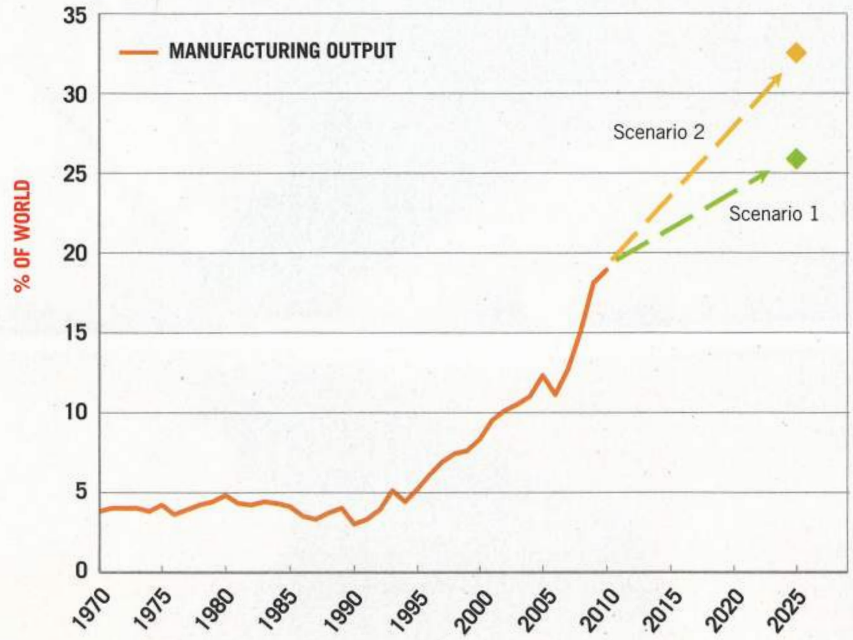
» Li Keqiang, who is expected to become China's next premier, was quoted recently in a media report as saying that "reform is the biggest dividend," although it's not clear what kind of reforms he meant.

Future actions from the new leaders will likely be consistent with the rebalancing that is necessary for China's future success. International experiences suggest that, for economies with a GDP per capita between $10,000 and $15,000, the average economic structure is 4 percent agriculture, 31 percent manufacturing, and 65 percent services (see Figure 2). Citi developed two possible scenarios for the evolution of China's economic structure, assuming China will surpass the United States to become the world's largest economy by 2025, and global manufacturing value-added as a percentage of GDP remains stable before 2025.

The first scenario uses the average economic structure of 14 selected economies, such as the United States, Germany, and Brazil, when their GDP per capita was between $10,000 and $15,000 to project China's structure in 2025. China's GDP per capita would grow to $15,000 if the government target to double 2010 GDP in a decade materializes. China's manufacturing sector would make up 26 percent of the world's output by 2025. This share is slightly lower than the historical peak of 28 to 30 percent achieved by the United States, and implies average growth in manufacturing output of only 6.3 percent per year in nominal terms between 2012 and 2025.

The second scenario uses Germany's economic structure when its GDP per capita was between $10,000 and $15,000, and manufacturing made up 39 percent of the country's GDP. Following the same assumption for China, China's manufacturing sector could make up 33 percent of the world's output by 2025, implying a growth of 8.1 percent per year in nominal terms between 2012 and 2025 (see Figure 3).

fig. 3 **CHINA'S PROJECTED SHARE OF THE WORLD'S MANUFACTURING OUTPUT**



Source: Citi

WHAT CHINA HAS TO DO TO ACHIEVE ITS GOALS

The exercise above shows that the government will have to rebalance the economy between manufacturing and consumption and services before 2020. Such an achievement would be subject to the following conditions:

» **China would have to improve the efficiency of resource allocation. Significant reforms should include restraining expansion of state-owned enterprises and local governments.**

» **China would need to invent new growth through urbanization or other channels, but this would require critical reforms, such as land reform.**

» **Facilitating job creation would be necessary to absorb layoffs from the manufacturing sector going forward, and would require deregulation of the services sector.**

Reforms would help restore market confidence in the Chinese economy but may result in a further economic downturn. During an economic slowdown in which GDP growth is lower than 8 percent, sectors benefiting from cheap input prices, such as labor and natural resources, could face more pressure. The risks of bankruptcy could also rise if reforms are implemented. Cost normalization—an increase in prices of capital that have been suppressed by government policy—will likely be a painful process. Meanwhile, households, the private sector, and consumers should be winners from a structural rebalancing. Reform should lay a solid foundation for a slower but better quality growth in years to come. Manufacturing consolidation, efficiency, and a more balanced economy are likely three key themes of China's economy in 2013 if the economic reform transition officially takes place.

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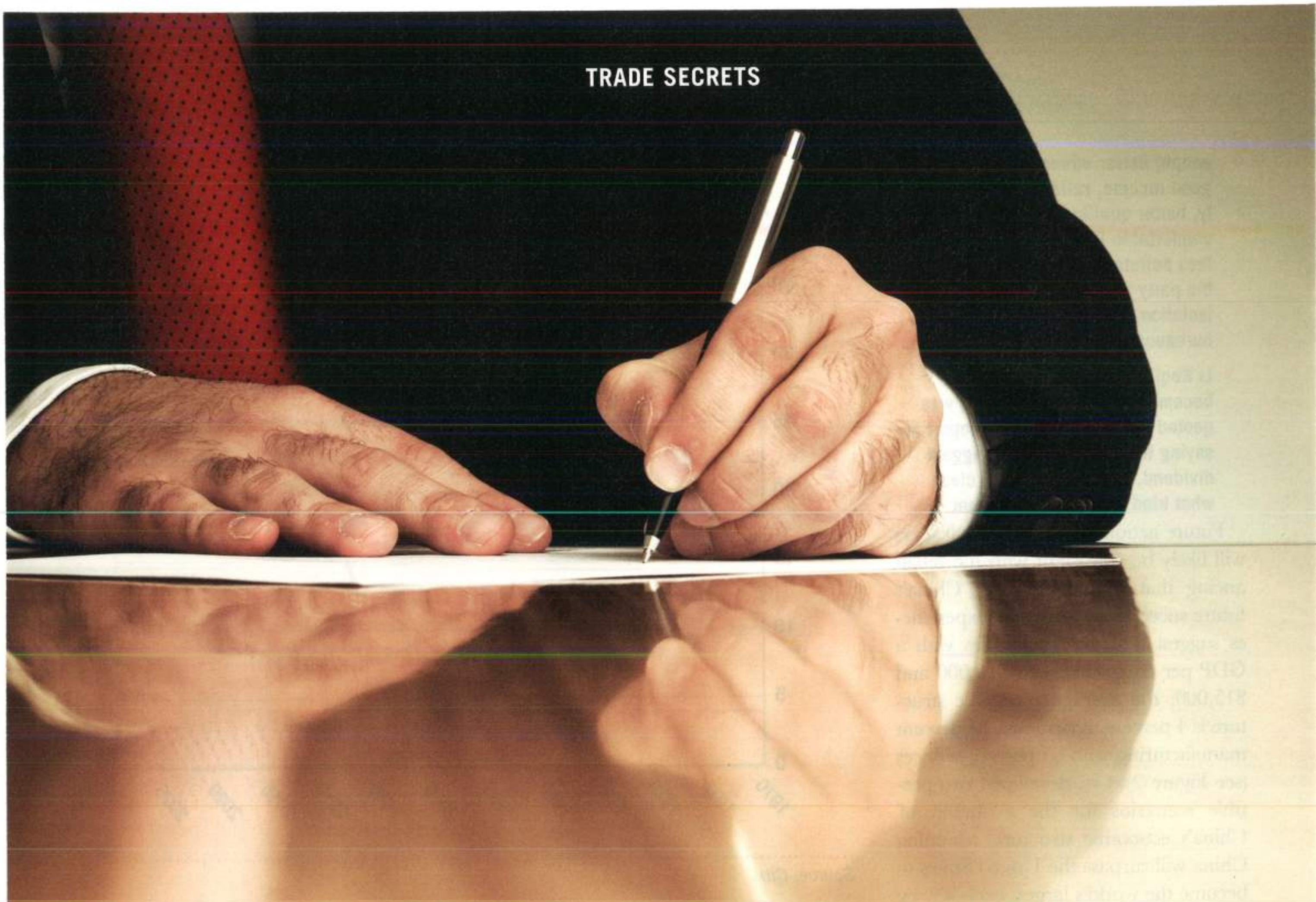

Trade Secret Enforcement in China: Options and Obstacles

BY **RYAN ONG**

Companies can better protect trade secrets by implementing best practices for prevention and enforcement.

Trade secrets issues with China have grabbed headlines in recent months, with a number of high-profile cases involving the discovery of trade secret theft or leaks to Chinese companies and individuals. For example, E.I. du Pont de Nemours and Co. (DuPont), Corning Inc., Pittsburgh Corning Corp., and American Superconductor have all brought recent cases of trade secret theft against Chinese individuals or Chinese companies. Many of the cases within the United States have prompted legal action in US courts, while cases facing US companies in China have been a part of bilateral commercial negotiations.

Trade secrets was cited as the top intellectual property (IP) concern in the US-China Business Council's (USCBC) 2012 member company survey. Thirty-six percent of respondents across a range of industries flagged trade secrets ahead of other forms of IP, such as patents, trademarks, and copyrights. Despite the growing concern with trade secrets, companies are still figuring out how to best protect them in China. Many companies have focused on preventative practices rather than seeking to enforce their trade secrets in Chinese courts. Despite the small numbers of enforcement cases, the risk of trade secret infringement remains real. The rising importance of this issue means that companies should learn their options for trade secret enforcement in China, which include administrative, civil, and criminal channels.

TRADE SECRETS BASICS

Trade secrets are defined as confidential technical or business information that are not known to the public and have economic benefits for the rights holder. The legal definition of trade secrets in most jurisdictions is written to cover a wide variety of possible information that may be important building blocks of a company's current and future competitiveness and thus worthy of protection. Examples include, but are not limited to, formulas, blueprints, product designs, manufacturing processes, customer lists, sales strategies, and management techniques.

Unlike other forms of IP, such as patents and trademarks, trade secrets are not formally registered with government authorities. While some trade secrets could be registered as patents, companies often choose to not register them and to protect them by essentially keeping them secret. Common practices can include installing physical controls and locks to prevent unauthorized access to trade secret information, regularly training employees about trade secrets policies, and signing confidentiality and non-disclosure agreements with relevant employees who might have access to trade secret information. These strategies help companies to ensure that such designs and processes stay out of the public eye, while also avoiding the time limit for protection that would be imposed with the granting of a patent.

This lack of a formal registration process, however, creates its own enforcement challenges because companies cannot benefit from the protection patents provide and lack a written document to rely on should infringement occur. Instead, when infringement is discovered, companies must prove that the trade secret is indeed a trade secret that merits protection by demonstrating to courts or other enforcement authorities that it meets the criteria used to define trade secrets in that legal jurisdiction.

CHINA'S LEGAL FRAMEWORK FOR TRADE SECRETS

Unlike the United States, which has a unified trade secrets law (the Uniform Trade Secrets Act, or UTSA), China's rules defining and regulating trade secrets are scattered among a series of laws and regulations. The most important of these is the PRC Anti-Unfair Competition Law (AUCL), which was released in 1993. The AUCL formally defines trade secrets in Article 10 as "technical and business information that is unknown to the public, which can bring economic value to the rights holder that has applicability, and for which the rights holder take measures to protect their confidentiality." The law defines illegal behaviors related to trade secrets, including direct acquisition of trade secrets via theft, inducement, coercion, use of those illegally obtained trade secrets, or other illegal means. This definition also covers use or sharing of trade secrets by third parties not authorized by the owner. A third party is liable for trade secret misappropriation under the AUCL, when the third party knows or should have known that a given trade secret that it obtains, uses, or discloses has been misappropriated.

In January 2007, the Supreme People's Court released the Interpretation on Certain Issues Related to the Application of Law in Trials of Civil Cases Involving Unfair

QUICK GLANCE

- US-China Business Council members cited trade secrets as the top intellectual property concern in China.
- China's trade secret rules are scattered among a series of laws and regulations.
- Companies can enforce trade secrets through administrative, civil, or criminal channels, which offer different levels of penalties to deter infringers.

A comprehensive view of trade secrets protection should incorporate best practices for both preemptive protection and responsive enforcement in case of leaks.

Competition, which addressed additional questions related to trade secret enforcement. This judicial interpretation clarifies how courts should define key terms in the AUCL's definition of trade secrets, and states that some controversial types of information, such as customer lists, are eligible for protection as trade secrets in China. The interpretation also lays out the rules governing civil trade secrets cases in China, placing the burden of proof in these cases on the plaintiff. To be successful, the plaintiff must prove that the infringed information meets the definition of a trade secret; that the defendant is using information that is substantially similar to the trade secret; and that that information was obtained illegally by the defendant. The plaintiff must provide clear evidence of when and how the information was illegally obtained—a difficult evidentiary challenge. Other sections of the interpretation describe the rules for determining damages and granting permanent injunctions as remedies for trade secret misappropriation.

A third document, the State Administration of Industry and Commerce's Provisions Regarding the Prohibition of Trade Secret Infringement, describes administrative procedures for handling trade secrets cases. Additional aspects of trade secret protection and management are covered in other laws and regulations, including the Contract Law (technology licenses and trade secret protection in contract negotiations), the Labor Contract Law (confidentiality-related agreements), the Labor Law (liability for violating confidentiality-related agreements), the Company Law (trade secrets obligations for senior management), and the Criminal Law (criminal thresholds for trade secrets cases).

While there has been some discussion among legal professionals about the benefits of a unified trade secrets law—and some work was done to draft a trade secrets law in the mid 1990s—there has been no indication to date that Chinese authorities will draft such a law. Nor is there any indication that the Chinese government is actively working to revise the AUCL or other existing trade secrets-related regulations.

CHANNELS FOR TRADE SECRET ENFORCEMENT

Companies facing trade secret infringement can choose from three options to enforce trade secrets: administrative, civil, and criminal. Each involves different government agencies, and offers different levels of penalties to deter infringers. While some issues that companies face are specific to the type of enforcement chosen, common challenges include:

» **High evidentiary burden**
Companies face a high evidentiary burden for trade secrets cases, particularly in administrative and civil cases where they must essentially assemble a complete case using private resources. China does not have a discovery process that would support these efforts. Companies also confront a strong preference for documentary evidence over witness testimony.

» **Limited Chinese experience with trade secret cases**
Chinese officials and courts see a small number of trade secrets infringement cases each year and have limited experience ruling in these cases. The breadth of possible information that could constitute a trade secret also means that local courts and administrative officials may not fully understand why a given piece of information constitutes a trade secret. This can affect the quality of decisions on trade secrets cases or can lead to burdensome procedures, such as lengthy expert panel reviews in civil cases to determine if a piece of confidential information counts as a trade secret.

» **Reluctance of government officials to tackle complex cases**
Trade secrets cases can be tricky to tackle. Local officials in administrations of industry and commerce (AICs), public security bureaus (PSBs), and courts are often reluctant to take cases unless they are seen as straightforward or high-value. Convincing local officials to devote limited resources to these cases only adds to the challenges companies face.

Administrative enforcement

Local AICs are responsible under the AUCL to tackle trade secrets infringement, as they are with other actions considered to be anticompetitive behavior. Should they find misappropriation of trade secrets behavior under the competition law, AICs have the authority to order a variety of remedies, including destruction of products manufactured using stolen trade secrets, the return of trade secret materials to the original owner, and fines of between ¥10,000 ($1,600) and ¥200,000 ($32,000).

As in administrative proceedings for trademark cases, companies wishing to pursue trade secrets cases have to submit a request to their local AIC for adjudication. In practice, companies looking for help from local administrative officials may have to not only submit a request for investigation, but also present local AICs a fairly complete package of evidence and educate local officials about the trade secret in question. These burdens are difficult to meet, and many companies express doubt about the ability of AICs to handle trade secrets cases. As a result of these constraints, many companies do not view administrative enforcement channels as a viable option for most trade secrets cases.

Civil cases

Civil cases are generally seen as the most viable option for trade secrets enforcement. Administrative and criminal cases face too many challenges; civil cases are the only one of the three methods that allow the rights holder to receive damages and permanent injunctions. Damages in these cases are determined using one of the various methods defined in the 2007 judicial interpretation: lost profits of the plaintiff, defendant's profits that can be traced to the misappropriated trade secrets, or a reasonable royalty. However, the plaintiff bears the burden of proof and needs to collect evidence via legal means and submit it to the court. This is a major challenge given the lack of a discovery process to obtain evidence from the defendant, and common means used by companies to collect evidence—such as use of private investigators—may not be admissible in these cases. Court-issued evidence preservation orders can help, and there is some evidence of success in obtaining these orders. In either case, however, court preferences for written documentation (versus witness testimony)—and the need under the competition law to document the act of misappropriation—add to the challenges of building a trade secrets case.

Criminal cases

Criminal court cases become an option when companies can demonstrate sizable losses due to trade secret infringement. Definitions of "serious" and "exceptionally serious" losses are described in a 2004 judicial interpretation for IP crimes that defines criminal thresholds and penalties for each of the major types of IP. Under this interpretation, serious losses should be more than ¥500,000 ($80,000), while exceptionally serious losses should be more than ¥2.5 million ($400,000). Criminal tribunals can apply fines and prison sentences of up to three years for serious losses, and between three and seven years for exceptionally serious losses. When invoked, these could provide effective deterrents against trade secret infringement.

Getting the local police on board can alleviate the heavy evidentiary burden for companies because of the police's authority to gather evidence. Like administrative cases, however, criminal cases are difficult to pursue because of the challenge of convincing local police to take on cases, particularly if the police view the case as not being high-value.

BEST PRACTICES FOR ENFORCING TRADE SECRETS

Given the challenges of accessing the enforcement options, many companies have focused on preventing trade secrets theft. Nevertheless, a comprehensive view of trade secrets protection should incorporate best practices for both preemptive protection and responsive enforcement in case of leaks. Some best practices for trade secret protection include:

- **Determining which information should be deemed as trade secrets, as well as the appropriate levels (and methods) of protection for each type of trade secret**
- **Controlling access to trade secrets, including both physical controls, such as sign-in systems and facility set-up, and digital controls, such as passwords, pop-up windows, network security, and policies for use of information transfer devices like flash disks**
- **Instituting human resources policies to protect trade secrets, including provisions in employment agreements, regular training on trade secret issues, and careful handling of employee departures**
- **Developing contract provisions and working mechanisms in relationships with outside business partners, including joint venture partners, to protect trade secrets**
- **Working with Chinese government regulators when requested to submit proprietary information to limit the confidential information provided and protect the confidentiality of submitted information**

To boost trade secret enforcement, documentation is critical, providing companies with a paper trail as to what information counts as a trade secret and why, what policies are in place to prevent trade secret theft, and to educate employees. For example, for trade secret-related human resources policies, companies can help to prepare for possible trade secrets cases by carefully documenting what policies are implemented as part of a comprehensive trade secrets program, who has access to trade secret information (and if applicable, when they had access to it), and noting in detail when employees receive training on trade secrets and trade secrets-related responsibilities.

Documentation is critical for at least two related reasons. First, companies alleging trade secret infringement must show that they have taken reasonable efforts to protect the information as a trade secret to claim protection. Second, they must be able to prove the act of misappropriation as part of building their case. Documentation can help to prove when and where theft occurred or to pinpoint the act of misappropriation.

It is also important to build proactive relationships with government agencies that have a hand in trade secret protection, particularly investigative agencies like AICs and PSBs. These relationships can be valuable since companies must convince local enforcement officials to allocate limited staff and resources to investigate their cases. While building relationships with key stakeholders prior to any negative incident is common practice for government affairs professionals in other regulatory areas, it appears to be less common within the realm of trade secrets.

While these best practices do not represent a complete list of trade secret enforcement methods, companies in China may benefit from adapting these policies and enforcement options. These considerations are an important part of a well-developed, comprehensive strategy to both protect and enforce trade secrets within China's challenging intellectual property rights landscape.

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Developing a Smart Approach to Market Entry for American SMEs

BY **CHRISTOPHER HAYES**

US small businesses should research opportunities and the business culture before entering the China market.

When Xi Jinping gave his inaugural speech as general secretary of the Chinese Communist Party (CCP) last month, many China-watchers interested in market entry were paying attention to both what he said and how he said it.

Xi indicated that change will come to China and that the party intends to rebuild trust, both hallmarks of the new Chinese leadership. He also noted that his country needs to learn more about the world and that the world needs to learn more about China. Those words convey honesty and indicate that China is open for new business.

The CCP Congress set the stage for the 12th National People's Congress and Chinese People's Political Consultative Conference in March. New state and government leaders will be announced and, perhaps most significantly, new policies will be introduced with the potential to impact various industries. Even though the CCP Congress has ended, it is important to watch what happens in China in March.

Foreign companies are entering new markets like China at a blistering pace and foreign direct investment (FDI) is skyrocketing. The World Bank reports outbound FDI deals from emerging economies alone will grow from 1,400 in 2011 to more than 4,500 by 2025. The need for market intelligence and strategic insight is greater than ever for small- and medium-sized enterprises (SMEs)—companies with fewer than 500 workers—looking to enter or expand in China.

AN AMERICAN OPPORTUNITY

As the Chinese middle class grows, so does the opportunity for American SMEs expanding into China. The US International Trade Administration says that 29,699 SMEs exported to China in 2010, a nearly 10-fold increase since 1992. Of all the US companies that exported to China in 2010, 92 percent of them were SMEs. For perspective, SMEs now account for 99.9 percent of all US businesses.

A number of economic indicators suggest that the Chinese business climate may actually be improving for American SMEs. A Brookings Institution study predicts the Chinese middle class could grow by more than 400 percent over the next decade. The result would be more than 500 million newly minted members of the middle class, who will likely play a significant role in the global economy. And these consumers could play a significant role in the American economy as well, given the 13 percent increase in US exports to China in 2011.

Another indicator, mobile phone usage, paints an even more compelling portrait. According to China's Ministry of Industry and Information Technology, the country's mobile phone penetration rate surpassed 50

IMAGINE CHINA

percent in 2009. And now, the government says that rate will reach 100 percent for the first time by 2015.

Joint ventures are by far the top market-entry strategy in China. Among stakeholders surveyed about technology companies specifically, a majority agree joint ventures are the most effective route into China. Partnerships are essential to navigating the governmental and cultural hurdles to market entry. "If a foreign company sets up a joint venture in China, it is able to operate under some special policies established by the Chinese government ... [allocating] some preferential treatment or subsidies in finance," according to one China investor. However, to take advantage of all these favorable factors, SMEs have to get smart about both the marketplace and their potential stakeholders and customers.

OPPORTUNITIES FOR INVESTMENT

Omar Hamid, head of Asia forecasting for Exclusive Analysis, a forecasting and political risk analysis firm, says he sees new foreign investment opportunities opening in several specific areas.

For example, the Chinese leadership has been trying to limit the economic downturn and stimulate the economy, injecting money through state investment companies and reallocating finance from state-owned to private SMEs in an effort to trigger consumer spending and demand. In addition, the China Securities Regulatory Commission is considering implementing several proposals that would encourage greater foreign investment in capital markets. Hamid says some potential measures are increasing the cap on foreign investment, currently at $12.8 billion, and raising the cap for individual investors from $160 million to $800 million. Edelman projects that these reforms are likely to be implemented soon, probably over the next six months.

Additionally, signs point to new policies to encourage foreign investment in renewable energy sources, especially in the construction of new-energy, hydroelectric, and clean-combustion power stations, as long as Chinese joint-venture partners retain control. While foreign firms will be encouraged, there will still be intellectual property and technology transfer risks because the Chinese want to build local capacity. Another opportunity lies in the expansion of biomass power stations, as local governments and the State Grid Corporation of China (SGCC) are providing financing, reduced taxes, cheap land deals, and guaranteed clients via the state grid. Although all of the current vendors are Chinese, opportunities for foreign companies are likely to arise in selling technology to local vendors.

CHINESE BUSINESS CULTURE

To best navigate the China market, SMEs must grasp the cultural complexities of the local stakeholder landscape. While a business trip to Beijing or Shanghai provides anecdotes about the myriad differences between cultures, detailed cultural analysis and other market and stakeholder research, provides a layered, quantitative, and qualitative approach to understand new markets.

Culturally, Chinese partners prefer companies that present a long-term strategy rooted in research and development and a sustained presence in China. The Chinese value cultivating relationships. Depending on the product or service, businesses may need to make early investments in these relationships, far before proceeding with their market entry.

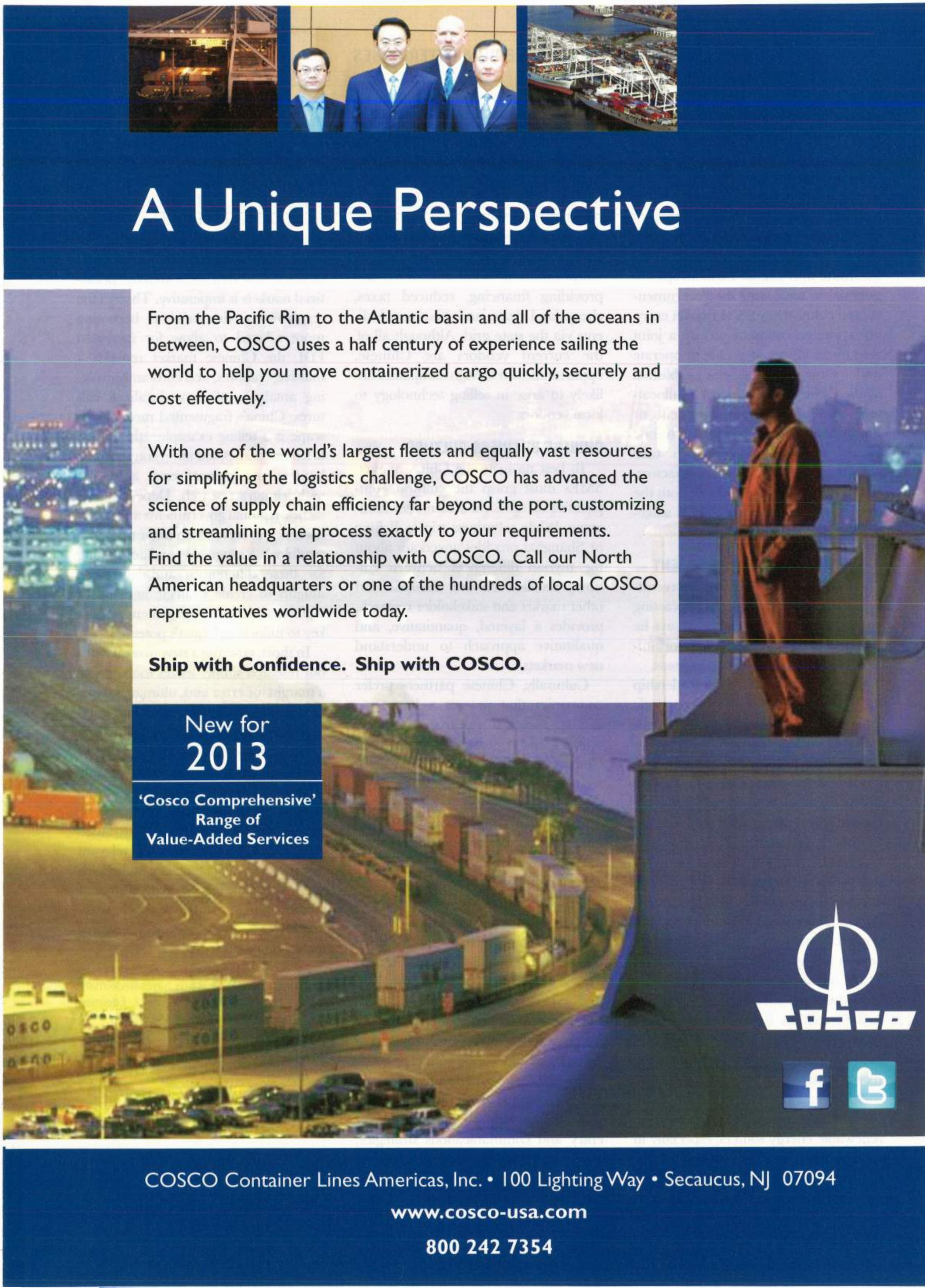
It's also important to understand and address the critical decisions that stakeholders must make. Complementing cultural insights and open-source research with timely direct intelligence from sector experts, senior counselors, and experienced on-the-ground consultants, can inform SMEs about the issues and decisions most critical to their stakeholders. By understanding the factors that most affect these behaviors (such as buying or investing), SMEs must design comprehensive market entry and communications strategies; hone their focus to specific tactics or stakeholders; and evoke the desired behavior from customers.

INTELLIGENT MARKET ENTRY

It is becoming easier than ever to do business globally, something that is especially true in China. That said, it is important for SMEs to truly understand, and be understood by, the country and market they are entering. For SMEs in particular, comprehensive and targeted research of carefully prioritized markets is imperative. Though the regulatory environment is becoming more relaxed to allow for increased FDI, the Chinese market remains a massive, complex, and constantly evolving amalgam of hyper-localized cultures. China's fragmented media landscape is a telling example—the nation has more than 3,000 television channels but few have national reach, according to Edelman's research. Depending on tactics, regional governments and stakeholders can serve as an ally or act as a roadblock. Recognizing and accounting for these differences, and leveraging insights to create strategic and meaningful stakeholder engagement will be key to unlocking China's potential.

In short, entering a new market without research simply leaves too wide of a margin for error and, ultimately, business failure. To mitigate risk and build a foundation for a successful market entry, it's important for SMEs to know the total requirements of success: truly understanding the complex cultural, political, and regulatory landscape of the company's target market; strategically building trust amongst relevant stakeholders; engaging key stakeholders in a credible way to create a smooth landing; and leveraging research, trust, and engagement to position your entry for sustained presence.

CHRISTOPHER HAYES (chris.hayes@edelman.com) is the global lead for Daniel J. Edelman Inc.'s market entry offering, Periscope.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EVENT WRAP-UP

UPCOMING EVENTS

WASHINGTON, DC

THURSDAY, JANUARY 31

Forecast 2013

For more information on USCBC or its events, visit www.uschina.org.

BEIJING

DECEMBER

Beijing Briefing on Views of the United States and China

The US-China Business Council (USCBC) and the American Chamber of Commerce in China hosted Bruce Stokes, director of the Pew Global Economic Attitudes Project, to discuss how US citizens view China and how the Chinese view the United States. The presentation included Pew data on global views of the two nations, and the potential influence these views may have on US economic and foreign policy during the second Obama administration.

CHICAGO

OCTOBER

Trade Politics and Political Transitions

The Chicago Council on Global Affairs and USCBC co-hosted a lunch program on political transitions in the United States and China. USCBC President John Frisbie spoke about how the US presidential election outcome could affect US-China trade politics.

Forecast 2013

The Preeminent Conference of Its Kind, Now in Its 32nd Year

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PROGRAM TOPICS EXPECTED TO INCLUDE:

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» New US administration and Congress: China policy and trade legislation

» The business climate in China: Top operating challenges and opportunities for US companies in the year ahead

» Keynote from senior US government official or top policy analyst

For more conference details and registration information, see ***www.uschina.org***.
USCBC contact: Director of Programs Gloria González-Micklin (Tel: 202-429-0340; programs@uschina.org)

ONLINE

NOVEMBER

Webinar on Intellectual Property and Corruption in the Global Supply Chain

David Hoffman, vice president and managing director of the Conference Board China Center for Economics and Business, and Pamela Passman, president and CEO of the Center for Responsible Enterprise and Trade (CREATe.org), discussed intellectual property protection and corruption prevention for multinational companies.

DECEMBER

Webinar on Logistical Assets and Opportunities in the Toledo/Northwest Ohio Region

Doug Born, vice president of business development at Regional Growth Partnership, Paul Toth, president and CEO of Toledo-Lucas County Port Authority,

USCBC GALA HONORS AMBASSADOR ZHANG AND GOVERNOR HUNTSMAN

The US-China Business Council (USCBC) held its 2012 Gala on December 6 at the Ritz-Carlton in Washington, DC. The event honored China's Ambassador to the United States Zhang Yesui, and former Governor of Utah and US Ambassador to China Jon Huntsman, Jr. Nearly 400 people from more than 40 member companies attended the event. Special guests included CH Tung, the first chief executive of the Hong Kong Special Administrative Region and Rep. Rick Larsen (D-WA), co-chair of the US-China Working Group.

In his remarks, Zhang said that it is a unique time for US-China relations because it is the first time in history that the political leadership transitions of both countries coincided. He noted that the United States and China should not be in a "zero sum" relationship and that China is committed to deepening its reform and opening up.

Robert McDonald, CEO and chairman of the Proctor and Gamble Co. and USCBC chair, moderated a question and answer session with Huntsman. In his discussion, Huntsman said it was important for the US-China relationship to be "humanized." He also discussed ways US-China bilateral dialogues, such as the Strategic and Economic Dialogue, could be more effective.

USCBC also made a $17,500 donation to the Peach Foundation, a nonprofit organization that helps underprivileged children in farming areas of Yunnan and Sichuan provinces further their education. The gift will provide financial aid to about 60 students for a year of their high school education.

PRC Ambassador to the United States **ZHANG YESUI** delivers his remarks at USCBC's 2012 Gala at the Ritz-Carlton in Washington, DC.

MAURICE GREENBERG, chairman and CEO of C.V. Starr & Co., Inc., **CH TUNG**, the first chief executive of the Hong Kong Special Administrative Region, and the Honorable **WILLIAM COHEN**, chair and CEO of the Cohen Group.

and Richard Martinko, director of the Intermodal Transportation Institute and Transportation Research Center at University of Toledo, discussed Northwest Ohio's integrated logistics, seaport, and air cargo and ground transportation.

SHANGHAI

OCTOBER

Shaping Future R&D Policies in Shanghai

USCBC organized a discussion with the Shanghai Economic and Information Technology Commission (SEITC) for companies to speak directly with local officials on future research and development policies in China.

Shanghai China Operations Conference 2012

USCBC hosted its China Operations Conference in Shanghai, which brought together business and policy experts to discuss new operating and policy developments in China. Ren Zhiwu, deputy director general of the PRC National Development and Reform Commission, spoke about China's strategic emerging industries. Other discussion topics included China's leadership transition, the economy, how to manage partnerships, e-commerce, and human resources.

WASHINGTON, DC

OCTOBER

Briefing on Trade Secrets Protection and Enforcement in China

Katie Feng, an intellectual property rights (IPR) expert from law firm Hogan Lovells LLC, spoke about the legal framework surrounding trade secrets, challenges companies face in considering litigation, case statistics, and legal enforcement strategies in China. Ryan Ong, director of business advisory services at USCBC, presented company best practices in trade secrets protection based on recently conducted interviews and discussions with USCBC member companies in China.

Washington Briefing on Views of the United States and China

USCBC hosted Richard Wike, associate director of the Pew Global Economic Attitudes Project, to discuss Chinese views of the United States.

MARY KAYE HUNTSMAN, Governor **JON HUNTSMAN**, Madam Ambassador **CHEN NAIQING**, and PRC Ambassador to the United States **ZHANG YESUI**.

ROBERT MCDONALD, CEO and chairman of the Proctor and Gamble Co. and USCBC chair, speaks at USCBC's 2012 Gala at the Ritz-Carlton in Washington, DC.

Rep. **RICK LARSEN** (D-WA), co-chair of the US-China Working Group, speaks with **ZHANG** and **MCDONALD**.

MCDONALD moderates a question-and-answer session with **HUNTSMAN** on US-China relations.

Briefing on Government Procurement in China

The US Chamber of Commerce and USCBC hosted a debrief with officials from the Office of the US Trade Representative (USTR) and Department of Commerce on procurement issues and ongoing negotiations related to China's accession to the World Trade Organization's Government Procurement Agreement.

Roundtable Briefing on IPR Issues in China

USCBC and the US Chamber of Commerce hosted a debrief on the US-China Joint Commission on Commerce and Trade (JCCT) IPR Working Group meeting in Washington and other IPR-related discussions. The briefing featured officials from key US government agencies, such as USTR and the US Patent and Trademark Office.

NOVEMBER

18th Party Congress Briefing

He Ning, minister of commercial affairs at the Chinese Embassy in Washington, DC, discussed China's 18th Communist Party Congress in a briefing co-hosted by USCBC and the US Chamber of Commerce. He spoke about PRC President Hu Jintao's report to the congress, and key points of interest to the US business community.

DECEMBER

Gala 2012

See p. 56.

Dinner and Reception for PRC Vice Premier Wang Qishan

USCBC, the US Chamber of Commerce, and the China General Chamber of Commerce-USA on December 19 co-hosted a dinner and reception in honor of PRC Vice Premier Wang Qishan. The dinner concluded 2012's JCCT meetings. US and Chinese working groups have interacted throughout the year to make progress on areas such as investment, intellectual property, pharmaceuticals and medical devices, information technology, standards, procurement, and agriculture.

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BY **CHRIS HASSALL**

From Cincinnati to China

A former P&G executive leaves corporate life to teach, study, and travel his way to a new career.

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After nearly 30 rewarding years living and working all over the world with the Procter and Gamble Co. (P&G), I recently retired to fulfill a personal ambition to return to China. One of the most stimulating experiences of my professional and personal life at P&G was the four years (2005-08) that I spent in China. That is why I have now returned to spend a year teaching business students, learning Mandarin, and travelling extensively to immerse myself in China's culture and heritage.

My last three years at P&G, as the company's global external relations officer, was an incredible experience, working globally as a catalyst and connector between the company and our stakeholders. My top priority was to reinvent P&G's external relations organization to build and protect P&G's reputation and business for the next decade and beyond. With this accomplished—after launching P&G's newest function, communications, in July 2012—I closed the P&G chapter of my life to return to China for a year. After this year in China, I hope to turn a new career page to connect businesses, academic institutions, and non-profit organizations around the world, with a strong focus on China-US connections.

As a starting point for this new chapter, in September I began a nine-month executive-in-residence role at Sun Yat-sen University (SYSU), one of China's top business schools. My life as a professor and a Mandarin student, living and working on the SYSU south campus in Guangzhou, Guangdong is a world away from my life in Cincinnati, Ohio working in the C-suite at P&G.

As an honorary professor, I teach students in the marketing, MBA and executive MBA programs about multinational company operations in China, brand building, crisis management, corporate social responsibility, and corporate and brand communications. While some of these students are undergraduates, most are studying for their advanced degree in business or marketing. The majority are Chinese, however, a significant number are exchange students from other countries who spend a semester at SYSU. The school is attracting increasing numbers of foreign students after it moved up in the *Financial Times'* global business school rankings. MBA students must have at least three years of work experience with a Chinese company or a multinational company operating in China. All of the undergraduates and MBA students have impressive English language skills, so my lectures are in English with no translation needed. The EMBA program, ranked 11th globally by the *Financial Times*, caters to mature students with a decade or more of deep business experience in a Chinese company, and many of these "students" own their own company. A consistent factor across this broad range of students is a thirst for knowledge and for integrating the best of Chinese and Western business wisdom.

Founded in 1924, the SYSU south campus where I live and usually teach is the oldest of the university's five campuses. It is a tranquil haven away from the frenetic pace of Guangzhou. The campus is a massive tropical garden interspersed with the university's original brick buildings and modern buildings such as the business school where my office and on-campus apartment are located.

Like many faculty and students I bike around campus, which is the quickest and coolest way to get around in Guangzhou's hot and humid climate. To get around the city I mostly use Guangzhou's very efficient subway system. As part of the major infrastructure investments for the 2010 Asian Games, the subway was expanded to eight lines, and connects all of the commercial hubs and cultural areas, the city's three train stations and airport. I occasionally use taxis but with my still rudimentary Mandarin skills, it's sometimes difficult for the driver to understand where I want to go.

By design, my part-time teaching arrangement allows me to travel extensively throughout China. While working at P&G in China, I was able to travel extensively to work with the China Youth Development Foundation to build 200 P&G Hope Schools in rural areas, and to work with P&G's sales and market research organizations around the country. My personal travels now enable me to continue learning about China and stay in touch with the rapid changes throughout the country. One of my personal goals this year is to complete visiting all of China's 33 provinces, municipalities, and autonomous regions. In October I traveled to Ningxia, a mostly rural and arid province in the far west—the 28th province that I have visited. I also climbed Huangshan (Yellow Mountain) in Anhui province, said to be China's most beautiful mountain. During my time here I have plans to visit the remaining five provinces and many other places in China. China is a vast, diverse country and in some ways is more like a continent. Having hands-on knowledge of the full range of regional, cultural, historical and economic difference across the country will help me do business with local and international companies operating in China.

CHRIS HASSALL, PH.D. is an honorary professor of marketing at Sun Yat-sen University Business School in Guangzhou. He worked in a variety of positions for almost 30 years at P&G, most recently serving as the company's global external relations officer. This is the first of a series of articles he will write about his years teaching, studying, and traveling in China.

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