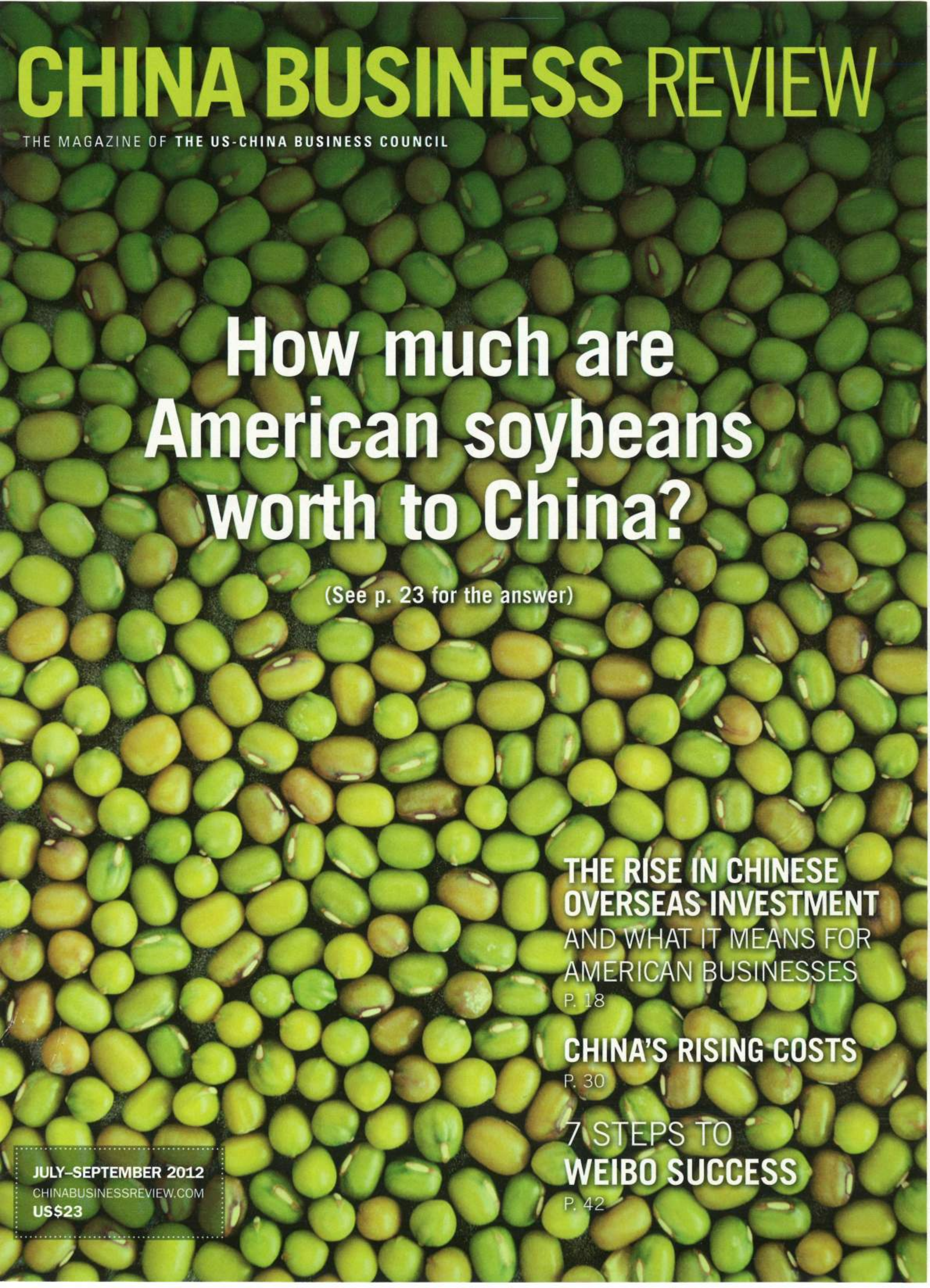


CHINA BUSINESS REVIEW

THE MAGAZINE OF **THE US-CHINA BUSINESS COUNCIL**

How much are American soybeans worth to China?

(See p. 23 for the answer)

THE RISE IN CHINESE OVERSEAS INVESTMENT
AND WHAT IT MEANS FOR AMERICAN BUSINESSES
P. 18

CHINA'S RISING COSTS
P. 30

7 STEPS TO
WEIBO SUCCESS
P. 42

JULY–SEPTEMBER 2012
CHINABUSINESSREVIEW.COM
US$23

POWER UP YOUR GLOBAL BUSINESS IN NORTHWEST OHIO

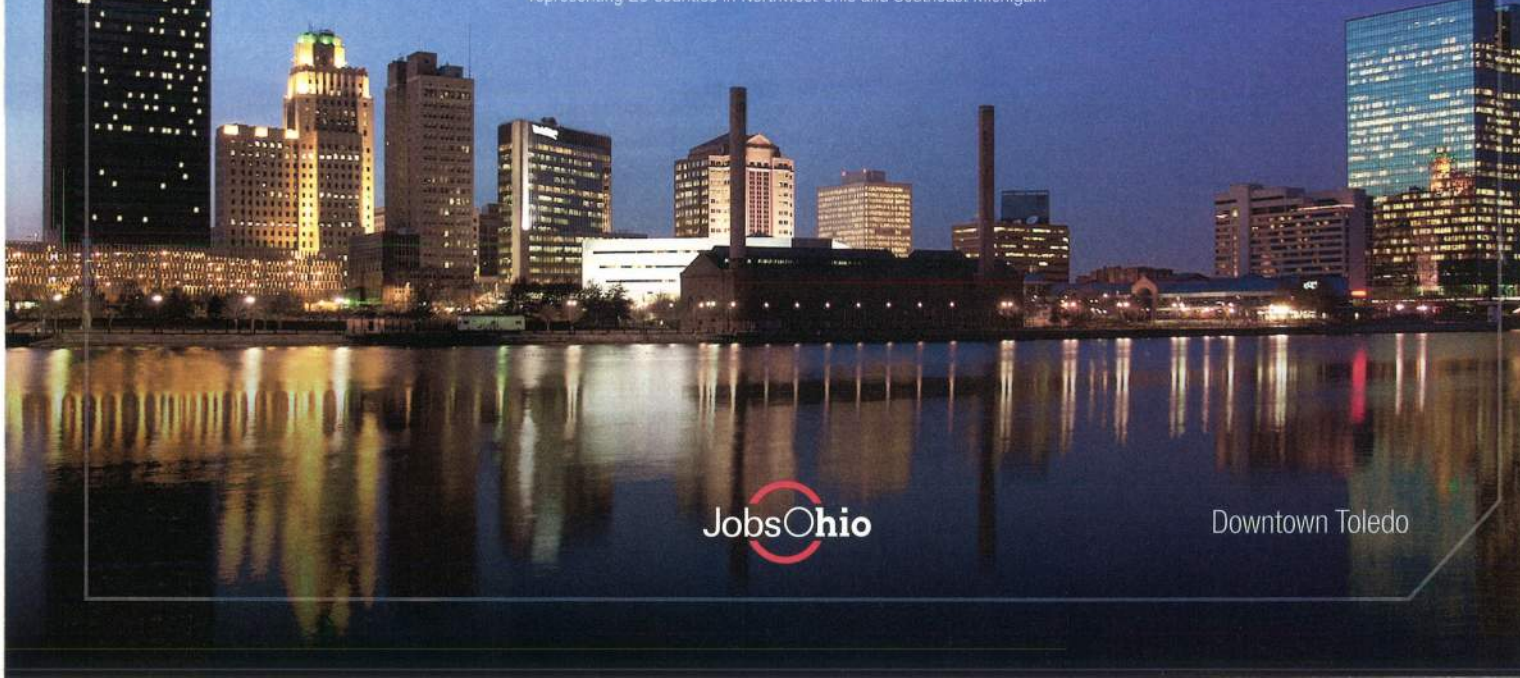
With a central location in the North American market and world-class transportation assets, the Toledo/Northwest Ohio region has positioned itself as the ideal place for international businesses looking to establish a presence in the U.S. marketplace. In the last two years alone, more than a dozen delegations representing the private, academic and public sectors have traveled internationally to promote the benefits of doing business in Northwest Ohio. And already, many Chinese companies have invested and started operations in the Toledo region.

The Regional Growth Partnership, as the lead economic development organization serving the Toledo region and 17 counties in Northwest Ohio, has prioritized the pursuit of international investment and trade and continues to establish successful associations with business groups across the world.

Discover why Northwest Ohio has become a premier location for international investment. Contact the Regional Growth Partnership at 419-252-2700 or visit us online at www.rgp.org.

Regional Growth Partnership
BUILDING A HIGH-TECH, HIGH-PERFORMANCE ECONOMY

The Regional Growth Partnership is a private, nonprofit economic development organization representing 20 counties in Northwest Ohio and Southeast Michigan.



JULY–SEPTEMBER 2012 VOLUME 39 NUMBER 3

CHINA BUSINESS REVIEW

THE MAGAZINE OF **THE US-CHINA BUSINESS COUNCIL**

SOYBEANS ARE THE UNITED STATES' LARGEST export to China. American farmers shipped $10.5 billion worth to China in 2011.

IMAGINE CHINA

FOCUS: TRADE AND INVESTMENT

FEATURES

DEPARTMENTS

The *China Business Review (CBR)* welcomes articles from outside contributors. Manuscripts submitted for consideration should be sent to the editor at publications@uschina.org. The US-China Business Council obtains licenses for all rights to articles and artwork published in the *CBR*. Articles or artwork published in the *CBR* may be reprinted or reproduced only with the written permission of the US-China Business Council. Articles in the *CBR* do not reflect US-China Business Council policy, unless indicated.

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CHINA CONFERENCE CALENDAR // JULY–NOVEMBER 2012

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.

SHARED SERVICES & OUTSOURCING NETWORK DALIAN

JULY 3–4

Location: Liaoning: New World Dalian Hotel
Organizer: International Quality & Productivity Center
Contact: Merrylyn Yeo
Tel: 65-6722-9388
enquiry@iqpc.com.sg
www.ssodalian.com

BEIJING INTERNATIONAL PACKAGING FAIR

JULY 3–6

Location: Beijing: New China International Exhibition Center
Organizer: China Packaging Federation
Contact: Wang Yuezhong
Tel: 010-6583-8785
ciipc29@chinafair.org.cn
www.chipf.com.cn

CHINA SHALE GAS FORUM 2012

JULY 5–6

Location: Shanghai: JC Mandarin Hotel
Organizer: Genesis Resourcing Consulting China
Contact: Iris Tang
Tel: 86-21-6170-2361
iris@genesis-resourcing.com
www.chinashalegasforum.com

CHINA INTERNATIONAL CONSUMER ELECTRONICS SHOW

JULY 5–8

Location: Shandong: Qingdao International Convention and Exhibition Center
Organizer: Consumer Electronics Association
Tel: 86-532-8197-8663; 1-703-907-7600
sinceszl@sinoces.com
www.sinoces.com

HONG KONG INTERNATIONAL EDUCATION EXPO

JULY 7–8

Location: Hong Kong Convention and Exhibition Center
Organizer: Neway International Trade Fairs Ltd.
Tel: 852-2561-5566
info@newayfairs.com
www.newayfairs.com/EN/Event-Frame.asp?eventID=23

INNOVATION AND ENTREPRENEURSHIP: THEORY AND PRACTICE RELEVANT TO CHINA

JULY 8–14

Location: Hubei: Wuhan University
Organizers: Lancaster University Management School; the Economics and Management School of Wuhan University
Contact: Dr. Qihai Huang
Tel: 44-15-2451-0752
qihai.huang@lancaster.ac.uk
www.lums.lancs.ac.uk/events/chinacentre/24166

CHINA INTERNATIONAL CONFERENCE ON FINANCE

JULY 9–12

Location: Sheraton Chongqing Hotel
Organizers: Tsinghua University, China Center for Financial Research; Massachusetts Institute of Technology, Sloan School of Management
Tel: 86-10-6277-3180; 86-10-6279-8348
cicf@sem.tsinghua.edu.cn
www.cicfconference.org

AVIATION OUTLOOK CHINA

JULY 10–11

Location: Shanghai: Jumeirah Himalayas Hotel
Organizer: Terrapinn Pte Ltd.
Contact: Candy Tan
Tel: 65-6322-2700
candy.tan@terrapinn.com
www.terrapinn.com/2012/aviation-outlook-china

2012 INTERNATIONAL CONFERENCE ON LOGISTICS, INFORMATICS, AND SERVICES SCIENCES

JULY 12–15

Location: Beijing Jiaotong University
Organizer: Beijing Jiaotong University
Tel: 86-10-5168-4188
liss@bjtu.edu.cn
www.icir.bjtu.edu.cn/liss2012

FOOD & AGRICULTURE 2012 NATIONAL CONFERENCE

JULY 19

Location: Hilton Minneapolis
Organizer: Faegre Baker Daniels
Contact: Kim Walker
Tel: 1-515-447-4702
Kim.walker@FaegreBD.com
www.cvent.com/d/rcq1cf

4TH INTERNATIONAL CONFERENCE ON NETWORKING AND DIGITAL STRATEGY

JULY 21–22

Location: International Meeting Center at Guizhou University
Organizers: Guizhou University; Aurel Vlaicu University of Arad, Romania
Contact: Yun Wu
Tel: 86-139-8440-3278
icnds@vip.163.com
www.icnds.org

5TH CHINA INTERNATIONAL PAYMENT TERMINALS EXPO

JULY 24

Location: Beijing International Hotel Convention Center
Organizer: AIT Events Co., Ltd.
Tel: 86-10-8586-8930
ait@ait-events.com
www.ait-events.com/en/exhibition.asp?eid=35

CHINA GAME BUSINESS CONFERENCE

JULY 25, 28, 29

Location: Shanghai: Pudong Kerry Hotel
Organizer: ChinaJoy
Tel: 86-10-6277-3180; 86-10-6279-8348
howell@howellexpo.com
www.en.chinagbc.com.cn

ANNUAL CONFERENCE ON GLOBAL ECONOMY, BUSINESS, AND FINANCE

JULY 27–30

Location: The Presidential Beijing
Organizer: Asia-Pacific Education and Research Association
gebf@acgebf.org; secretariat@gebf.org
www.acgebf.org

CHINACOM 7TH INTERNATIONAL CONFERENCE ON COMMUNICATIONS AND NETWORKING IN CHINA

AUGUST 7–10

Location: Kunming, Yunnan: Dianchi Garden Hotel & Spa
Organizer: European Alliance for Innovation
conferences@eai.eu
www.chinacom.org/show

THE 5TH ANNUAL CHINA BANKING RISK MANAGEMENT INTERNATIONAL SUMMIT

AUGUST 14–15

Location: Beijing
Organizer: JFPS Group China
Contact: Cady Sun
Tel: 86-21-5172-0126
cady.sun@jfpsgroup.com.cn
www.bankingrisksummit.com

SHANGHAI INTERNATIONAL CONFERENCE ON SOCIAL SCIENCE

AUGUST 14–17

Location: QUBE Hotel Pudong Shanghai
Organizer: Higher Education Forum
sicss@shanghai-ic.org
www.shanghai-ic.org

BIOPROCESS INTERNATIONAL CONFERENCE & EXHIBITION CHINA

AUGUST 21–22

Location: Shanghai: Grand Hyatt
Organizer: IBC Life Sciences
Contact: Rita Parasurum
Tel: 65-6508-2401
rita.parasurum@ibcasia.com.sg
www.ibclifesciences.com/BPIChina

8TH CHINA GUANGZHOU INTERNATIONAL ELECTRIC HEATING TECHNOLOGY AND EQUIPMENT EXHIBITION

AUGUST 21–23

Location: Guangzhou, Guangdong: China Import & Export Fair, Pazhou Complex
Organizers: Guangdong Enterprises Association for Foreign Economic Cooperation; Guangdong Household Electrical Appliances Trade Association; Guangzhou Grandeur Exhibition Services Co., Ltd.
Contact: Fiona Liang
Tel: 86-20-2207-4164
info5@grandeurhk.com
www.gehe.cn

ELECTRONICS ASSEMBLY AND PACKAGING TECHNOLOGY EXPO

AUGUST 28–30

Location: Guangdong: Shenzhen Convention & Exhibition Center
Organizer: Reed Exhibitions Ltd.
Contact: Vera Ng
Tel: 852-2965-1661
vera.ng@reedexpo.com.hk
www.atexpochina.com

INTERNATIONAL CONFERENCE ON E-BUSINESS TECHNOLOGY AND STRATEGY

AUGUST 29–31

Location: Tianjin: Tianyu Hotel
Organizers: Tianjin University, CeBA Canada
Contact: Jia Sun
Tel: 86-22-2740-7657
www.icets.info/2012china

THE 8TH ANNUAL PROCESS INDUSTRY ENGINEERING AND MAINTENANCE CONGRESS

SEPTEMBER 4–5

Location: Shanghai
Organizer: JFPS Group China
Tel: 86-21-5172-0126
www.pecongress.com/sh2012

16TH CHINA INTERNATIONAL FAIR FOR INVESTMENT AND TRADE

SEPTEMBER 8–11

Location: Fujian: Xiamen International Conference and Exhibition Center
Organizer: PRC Ministry of Commerce
Contact: Wang Chunrong
Tel: 86-59-2266-9821
ciipc29@chinafair.org.cn
www.chinafair.org.cn/english

THE EXPAT SHOW

SEPTEMBER 14–16

Location: Shanghai Exhibition Center
Organizer: World Events Agency
Contact: Jenny Zhu
Tel: 86-136-4192-7139
jenny.zhu@weacn.com
www.expatshowchina.com

SHARED SERVICES & OUTSOURCING WEEK CHINA 2012

OCTOBER 23–25

Location: Shanghai
Organizer: International Quality & Productivity Center
Tel: 65-6722-9388
enquiry@iqpc.com.sg
www.ssonchina.com

THE 6TH CHINA INTERNATIONAL AUTO PARTS EXPO

OCTOBER 26–28

Location: Beijing: China International Exhibition Center
Organizer: China General Technology Group
Contact: Zhang Yazhu, Lan Mingxue
Tel: 86-10-6899-1436; 6899-1903
zhangyazhu@exh.genertec.com.cn; lanmingxue@exh.genertec.com.cn
http://en.iapechina.com

CHINA INTERNATIONAL JEWELRY FAIR

NOVEMBER 1–5

Location: Beijing: China International Exhibition Centre
Organizer: Neway International Trade Fairs Ltd.
Tel: 852-2561-5566
info@newayfairs.com
www.newayfairs.com/EN/EventFrame.asp?eventID=27

2012 CHINA (BEIJING) INTERNATIONAL WINE & SPIRITS FAIR

NOVEMBER 4–6

Location: Beijing: China National Convention Center
Organizer: China Chamber of Commerce for Import & Export of Foodstuff, Native Produce, and Animal By-Products
Contact: Wang Xuwei
Tel: 86-10-8710-9873
wangxuwei@cccfna.org.cn
www.vinchina.cn/en

In 2011, Chinese firms invested *$10 billion* in Europe, **more than triple the $3 billion** they invested in 2010.

Consumer Confidence

CONSUMER CONFIDENCE RISES IN RURAL CHINA


IMAGINE CHINA

Despite slowing economic growth, Chinese consumer confidence is at its highest level since 2005. According to Nielsen's Global Survey of Consumer Confidence and Spending Intentions, China ranked the fourth most optimistic among the survey's 56 country participants in the first quarter of 2012. Overall, consumers in the countries surveyed were more confident than they were last quarter.

Nielsen Greater China's President Yan Xuan credited the PRC government's support for small- and medium-sized enterprises—including credit expansion, domestic consumption and demand-growing policies, and management of the real estate bubble—for Chinese consumers' confidence.

The survey also showed that rural consumers made up China's most confident consumer segment. Rural consumer confidence has been increasing for four straight quarters. In addition, consumer goods spending in China's rural areas have increased more than the national average this quarter.

Xuan said central government policies, such as providing subsidies for farmers' health insurance and plans to increase investment in agriculture and rural areas, also help explain the segment's confidence.

Rural consumers and second-tier cities accounted for the largest uptick in spending this quarter; consumer confidence in tier-one, -three, and -four cities remained the same. While Chinese consumers are optimistic about the job market and higher income expectations overall, their willingness to spend remained flat. In fact, the Nielsen survey showed that 49 percent of those consumers would rather put spare cash directly into savings or education for their children, up from 41 percent in the previous quarter.

Nielsen's survey is just one of several consumer confidence indices measuring China's consumption. The PRC National Bureau of Statistics (NBS) publishes its own consumer confidence survey, which dates back to the 1990s. But the NBS' lack of transparency with the survey's methodology has led corporations to create their own indices. China UnionPay, marketing firm Aegis Group plc, and the People's Bank of China all publish consumer confidence indices targeted for China as well.

Nielsen polled more than 28,000 consumers around the world, reaching 3,500 Chinese consumers. India ranked first in global consumer confidence, followed by Saudi Arabia, Indonesia, the Philippines, and China. The United States, which ranked 22nd, jumped nine points this quarter.

—*Jennifer Sun*

Investment

CHINESE FIRMS MORE THAN TRIPLED INVESTMENT IN EUROPE IN 2011

In 2011, Chinese firms invested $10 billion in Europe, more than triple the $3 billion they invested in 2010, according to a recent report by economic research firm Rhodium Group.

Chinese firms have now invested in more than 30 sectors across Europe. Communication equipment and services, industrial machinery, and renewable energy are among the industries with the most Chinese investment. Geographically, Chinese investments are concentrated in Western Europe's largest economies like France, the United Kingdom, and Germany.

Firms investing in the European Union seek European businesses' brand equity and technological edge, Europe's more advanced and business-friendly regulatory system, and price advantage from a weak Euro to compete in China, according to the study.

The study says that Chinese firms' direct investments today are driven mostly by commercial, not political, motives. The authors conclude that Chinese businesses are less affected by government and politics than many observers believe.

While total Chinese overseas foreign direct investment (OFDI) is still small compared to US or European OFDI—Chinese OFDI is $300 billion compared to the United States' $4.8 trillion—the study projects that China will invest $1-2 trillion internationally from 2010 to 2020. (For more on Chinese OFDI in the United States, see p. 18.) Through new investment projects in particular, Chinese OFDI is predicted to create significantly more jobs for workers in the European Union. Chinese companies in Europe currently employ 45,000 EU workers. By comparison, US firms in Europe count 4.3 million EU citizens on their payrolls.

—Jennifer Sun

Technology

MOST US COMPANIES OPERATING IN CHINA WITHOUT CHINESE WEBSITE

About three years after opening its Shanghai office in 2008, US health and life insurance company Aetna translated its international business website into Chinese. The company serves 400,000 customers globally, and says the website is just one of its strategies for building a customer base in China.

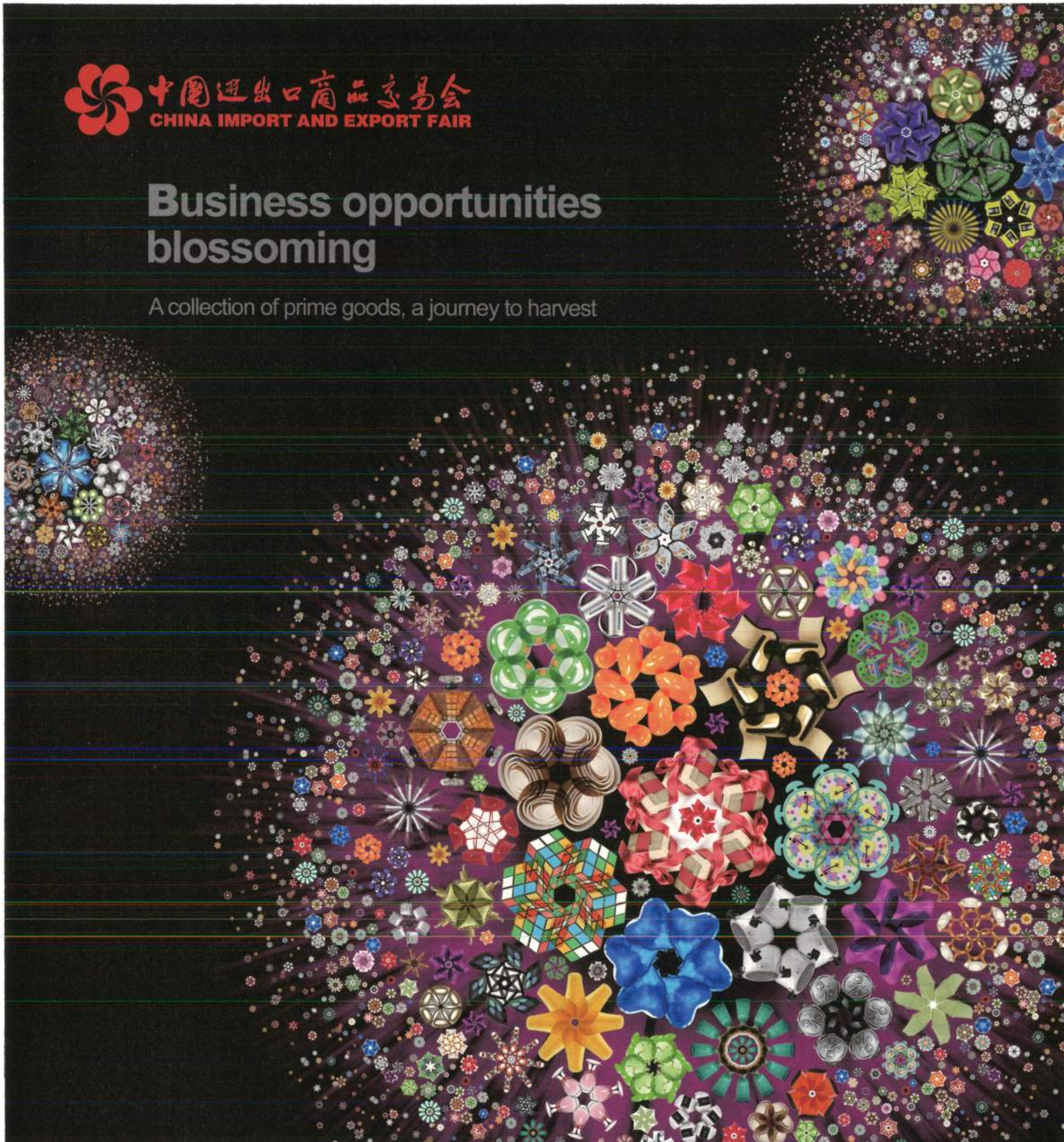
But many foreign companies in China do not translate their websites into Chinese, and some experts say they may be losing business because of it. Roughly one-third of Fortune 500 companies operating in China, or 146 companies, offer a Chinese-language website, according to a report by One Hour Translation, a professional translation company.

"A company that doesn't [localize] their corporate or consumer-facing website … is losing sales and investment opportunities," says Ofer Shoshan, CEO and co-founder of the company. A March 2012 report by management consultancy Common Sense Advisories said that companies that translated their websites to engage their employees and business partners were two-to-three times more likely to see an increase in company revenues.

Aetna's Chinese-language website generates about 1,200 visitors a month, and Aetna's Regional General Manager for the Asia Pacific Michael Elliot says he believes the number of Chinese visitors will continue to grow. The majority of current Asia-Pacific Aetna customers are expats who wouldn't necessarily visit the Chinese site. But for the customers Aetna is trying to capture next in China—local executives, high-net-worth individuals, and white-collar workers—Elliot says the website, combined with Aetna's brand, could be a competitive differentiator.

Elliot says the company is also working on translating its mobile apps and health insurance provider directories into Chinese.

—Jennifer Sun



The 112th Canton Fair

China boasts boundless opportunities as usual. The 112th session of China Import and Export Fair from October 15 to November 4, 2012, with an exhibition area of 1.16 million square meters, 58,700 stands, and business turnover of as much as tens of billions US dollars, will be the best platform for you to grow your business.

Phase 1 October 15 - 19, 2012
Electronics & Household Electrical Appliances; Hardware & Tools; Machinery; Vehicles and Spare Parts; Building Materials; Lighting Equipments; Chemical Products; International Pavilion

Phase 2 October 23 - 27, 2012
Consumer Goods; Gifts; Home Decorations

Phase 3 October 31 - November 4, 2012
Textiles & Garments; Shoes; Office Supplies, Cases & Bags, Recreation Products; Medicines, Medical Devices, Health Products; Food; International Pavilion

Canton Fair Call-Center

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4000-888-999 The Chinese Mainland

www.cantonfair.org.cn

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Venue: China Import and Export Fair Complex Hosts: Ministry of Commerce, PRC; People's Government of Guangdong Province Organizer: China Foreign Trade Centre Fax: 0086-20-28395166 Email: info@cantonfair.org.cn

PROCTER & GAMBLE CEO ROBERT MCDONALD spoke at a reception in Washington, DC to welcome McDonald as chair of USCBC's board of directors.

Procter & Gamble CEO Takes on New Role as USCBC Board Chair

As a key player in the US-China relationship, P&G's Robert McDonald hopes closer relations between the two countries will result in economic growth and higher living standards for Chinese citizens.

With annual revenues of more than $6 billion in greater China, the Procter & Gamble Co. (P&G) is the largest consumer products company in China. ***Robert McDonald****, the company's president, chairman, and CEO, was recently elected to lead the US-China Business Council's (USCBC) Board of Directors, and aims to build on the company's growth in China while helping to advance US-China relations in his new role. The Cincinnati-based company first entered mainland China in 1988, and it is now in the process of constructing its 11th manufacturing plant there. It has operations in Beijing; Shanghai; Tianjin; Guangzhou and Dongguan, Guangdong; Chengdu, Sichuan; and Nanping, Fujian. P&G has operations in about 80 countries, and it sells its brands in more than 180 countries. McDonald, who has been with P&G since 1980, has extensive experience in Asia. He previously led P&G's business in the Philippines, Japan, and South Korea in the 1990s. McDonald recently spoke with* CBR *Editor* ***Christina Nelson*** *about his new position and outlook for his tenure as USCBC board chair.*

SARDARI.COM

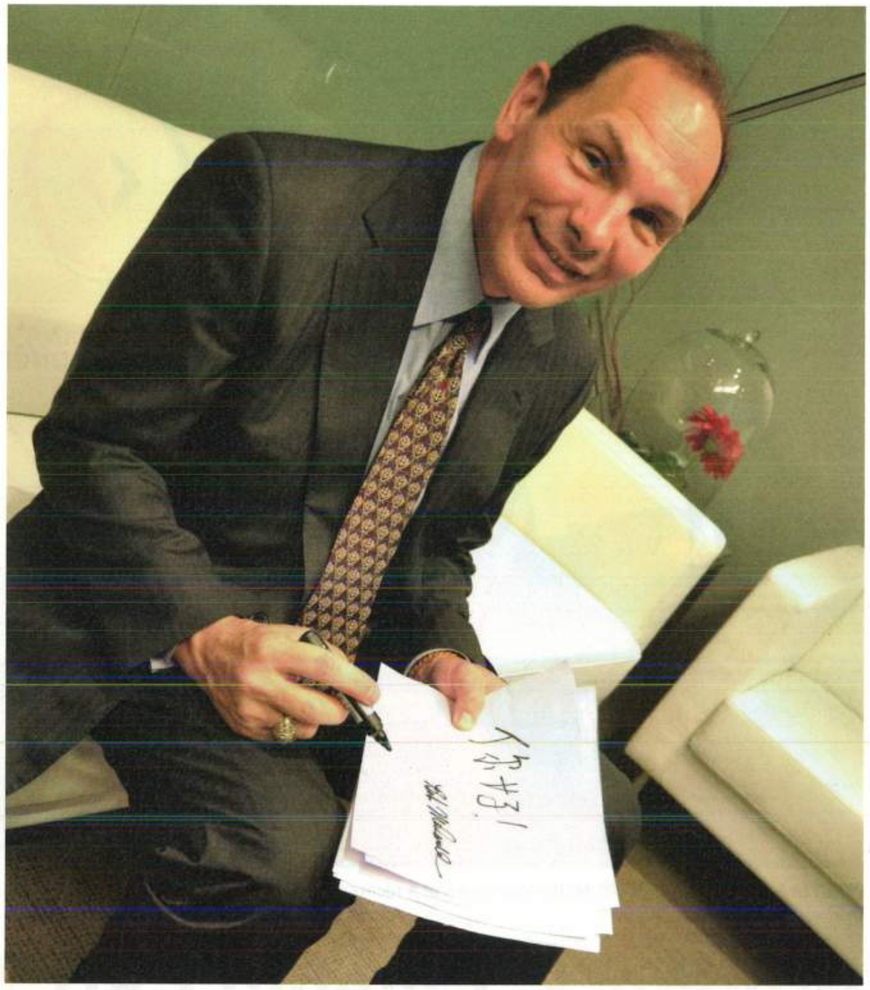
What is your short- and long-term vision for USCBC?

McDonald: The past 40 years have been marked by a remarkably stable, collaborative, and dynamic relationship between the two great nations. However, there are challenges ahead. Chief among them is to ensure that the next 40 years deliver the same track record of relative success. The stakes are high, and the outcome has enormous implications for the global economy. We need the next 40 years to be marked by our two nations working more closely together to tackle global problems and develop deeper economic bonds. As members of USCBC, we are in a unique position to help shape this relationship. We will speak openly and honestly with both US and Chinese leaders about the policies they are shaping and the language they are using. We will help influence agendas and communication between government officials to ensure they are effective at reducing tensions and solving mutual problems, and we will show that sanctions, protectionism, and counterproductive regulations and legislation are the wrong approach. We want to see problems addressed with solutions that advance the interests of both economies, not policies that would hinder trade, discourage future investments, or disrupt the bilateral relationship. We will develop stronger ties with our Chinese business leader counterparts with the belief that the engagement of the business community in every country makes for better informed policies and legislation.

What do you hope to achieve during your tenure as USCBC board chair?

McDonald: Clearly, one important task is to ensure we continue the progress achieved by outgoing USCBC Chair [and Coca-Cola Co. Chairman and CEO] Muhtar Kent. I hope to hand over to my successor an organization that has made further advances in US-China relations. There is real opportunity to make a big difference in the lives of the Chinese people and, in turn, in the lives of the people of the United States. It is our responsibility as members of USCBC to stand together and remind the governments and citizens of these two great nations just how important our future is together. We are no longer separated by culture or economy. We are tied together. The future growth of our nations, and our world, depends on us.

I firmly believe that it is only through more engagement, not less, that we'll continue to find common ground on key issues and build greater confidence.



THE PROCTER & GAMBLE CO.

How big of a role does China play in P&G's overall strategy? What are the company's future plans for China?

McDonald: Perhaps the place to start is with the importance China plays in the world economy. China has risen to become the world's second largest economy and America's third largest export market, and it continues to grow. American businesses and American workers continue to benefit from expanding opportunities to trade with and invest in China. Over the last decade, China has emerged as a top export market for US products and has consistently delivered annual growth of 15 percent. It has been almost 25 years since P&G started its business in China. Now, P&G China is the largest consumer product goods company in China with 10 manufacturing plants and annual revenues of more than $6 billion. As such, we are fully committed to improving the lives of the Chinese people. We broke ground on our 11th plant earlier this year, and it will become one of our most technologically and environmentally advanced manufacturing platforms in the world.

What are some of the top challenges P&G currently faces in the China market?

McDonald: I think that is really a matter of perspective. What some see as challenges, we view as opportunities. China has a breathtaking range of

It has been almost 25 years since P&G started its business in China. Now, P&G China is the largest consumer product goods company in China with 10 manufacturing plants and annual revenues of more than $6 billion.

demographic, cultural, and geographic diversity. Viewing it as just one single market would be a mistake. You need to understand that diversity and bring in products and services that meet those often unique needs. Trying to provide a one-solution-fits-all approach would be yet another error of judgment.

The other major opportunity is the sheer pace of change in China. China has a rapidly expanding middle- and upper-income population, and we need to serve every consumer, from the individuals that live on just a few dollars a day to the super rich and everyone in between.

While there are many other opportunities, I want to focus on one final area and that is protection of intellectual property rights. This remains problematic for both Chinese as well as multinational companies, and the Chinese government continues to work hard at addressing this major issue. We look forward to continuing that work and that dialogue so we can make further progress.

How do you see those challenges intersecting with the issues USCBC member companies in other industries face?

McDonald: As I said, I see these as opportunities, not challenges, and I think they are applicable to the vast number of our members. It is critical that we work together as a group with US and Chinese leaders to forge closer links and remove barriers that hold not just both economies back, but the economic welfare of the world.

USCBC member companies consistently rank employee recruitment and retention as one of their top challenges in China. How has P&G addressed human resources issues in China?

McDonald: Attracting, developing, and retaining the best talent is an issue the world over, and China is no different. We pioneered the concept of campus recruitment in China and now have strong relationships with the top 20 universities across China. Ninety-eight percent of our employees in China are Chinese nationals, and we have created a career management process that balances work and life commitments with the need to learn and develop. China is now becoming an exporter of talent into the rest of the P&G organization across the globe. That is perhaps why our retention levels are high and we are considered among the most preferred employers in China.

P&G entered mainland China in 1988. What are the most important lessons the company has learned about operating in and selling to China in that time?

McDonald: Fundamentally, it is about understanding your consumer and that is where we spent a great deal of time and investment. We take those insights and create products that not only meet their needs but delight them. On an operational side, when we entered China in 1988 as one of the earliest multinationals to set up business in the country, we were very fortunate to have excellent local partners. Their local connections, insights, and knowledge were critical to ensuring that we had a relatively short learning curve in China. This was a critical aspect of ensuring long-term success.

What has P&G done to adapt its products to the China market, and what products have been most successful?

McDonald: Again, it all starts with deep consumer understanding and an unrelenting passion to meet their needs. Also, importantly, we need to meet the needs of all consumers from low income to high-earners. For example, we created Rejoice Daily Care shampoo for lower income Chinese consumers; Olay Natural White and White Radiance skin care products, which were specifically designed for Chinese consumers; Pampers diapers specially designed to fit Chinese babies; and Crest Herbal and Crest Salt White toothpastes based on traditional Chinese herbal remedies.

We recently opened a state of the art innovation center in Beijing with a mission to further our understanding of the needs of Chinese consumers. Beijing is part of a network of dozens of P&G technical centers that share knowledge and expertise. The revolutionary Crest Pro-Health oral care system is a product of the innovation from Beijing. Moreover, Olay White Radiance was produced with the support of Nanjing Medical University, and Crest Herbal was designed using local consumer insights and formulation expertise.

How should future executives prepare to meet the challenge of the China market?

McDonald: Be prepared for the extraordinary pace of change in China. We feel that the world today moves quicker than ever before, but we often measure that change in months and years. In China, that pace is sometimes measured in days. China should never be considered just 'one market' but a complex collection of different socio-economic levels and needs. Understand them and you will understand your consumers. And finally, take a long-term approach. That comes easier for P&G since we instinctively look to the long-term. For others it will be a change of approach, but it will nonetheless be critical to take this long view if you are going to truly succeed in China.

USCBC PRESIDENT JOHN FRISBIE, Procter & Gamble CEO and USCBC Board Chair Robert McDonald, and former World Bank President Robert Zoellick at USCBC's board meeting in June.

Board Statement to Guide Talks with the US and PRC Governments

The US-China Business Council board came together earlier this year to outline its goals for the evolving US-China commercial relationship.

In February, the US-China Business Council (USCBC) released its first ever board of directors statement of priorities outlining its to-do list for both the US and PRC governments. The priorities cover a set of five big ideas: ensuring a fair and open investment environment, reducing trade barriers and enforcing globally accepted trade rules, ensuring equal treatment of companies and improving transparency, providing strong intellectual property protection, and adhering to mutually beneficial innovation policies. *CBR* Associate Editor **Ben Baden** spoke with USCBC President **John Frisbie** in mid-June to discuss USCBC's recently released priorities and his take on the progress that has been made in opening up the Chinese market to US companies.

Why did you choose to release the board statement of priorities now, and what do you hope to accomplish with the statement?

Frisbie: USCBC's board includes CEOs and senior executives representing some of the best companies in America. I think that both the US and Chinese governments recognize this, which is why USCBC gains such strong access to government leadership in both countries. The USCBC directors discussed over the past several board meetings whether there are better ways to foster engagement between the US and Chinese governments and make progress on issues important to the business community. One tool we had not used was to put the weight of the USCBC board behind a specific set of priorities and recommendations that would yield positive results for what has quickly become the most important bilateral commercial relationship for both countries. We need to see progress on the issues prioritized in USCBC's board statement. In the absence of progress on these core issues, support for the commercial relationship will weaken over time.

How would you describe China's overall progress to open up its market to US companies in recent years?

Frisbie: The numbers are pretty clear: Since China joined the World Trade Organization (WTO) in December 2001, US exports to China have grown exponentially and topped \$100 billion in 2011. American companies that have invested in China sell another \$127 billion in China. If you include services exports and exports to China through Hong Kong, China is probably a \$250 billion market for US companies, after eliminating overlaps.

Having said that, the market should be even bigger. China still has investment and market access barriers in numerous sectors, and intellectual property piracy further undermines sales of legitimate products that would benefit Chinese consumers. For example, USCBC has counted about 100 product or services sectors in which China imposes ownership restrictions on US companies. Licensing delays

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impact expansion of financial sector and other companies seeking to expand in China. Foreign financial companies have less than 2 percent of assets in China. Express delivery companies have continuous customs clearance and other issues that prevent the flow of goods and services. The list goes on.

Some of the issues outlined in the board statement were addressed at the Strategic and Economic Dialogue (S&ED) held in Beijing in May. Are you satisfied with the outcomes?

Frisbie: The S&ED, the US-China Joint Commission on Commerce and Trade (JCCT), and the US-China Investment Forum are all important components of expanded and continuous engagement on economic and commercial issues between the US and Chinese governments. There has also been fairly constant engagement at the presidential and vice presidential levels, as well as telephone calls in between the summit events involving Treasury Secretary Tim Geithner and Vice Premier Wang Qishan, for example. This engagement needs to continue—and probably expand to fit the size of the ever-expanding relationship.

The May S&ED did produce valuable outcomes for the business community in the areas of raising ownership caps for foreign securities firms in China, opening up the auto financing business, resuming negotiations on a bilateral investment treaty (BIT), and at least expressing intent to make improvements in access to China's government procurement market and strengthening intellectual property rights enforcement. In fact, of the 25 or so specific recommendations in the USCBC board priorities statement, about a dozen were included or touched upon in the S&ED joint statement of outcomes. The S&ED may not have solved every issue, and the agenda remains full, but progress has to continue if we are to show that dialogue is better than protectionism.

Looking ahead to the fall, do you expect further progress to be made on the US-China commercial relationship with elections in the United States and a leadership transition in China?

Frisbie: Elections in the United States and the leadership transition in China ensure that we will see a slowdown in high-level exchanges as we get into the last half of 2012 and the first half of 2013. I expect we will see a fairly robust set of working level exchanges on key items, such as the resumption of discussions between the United States and China on a BIT. Now that the Obama administration has finished its review of the US model BIT, it is time to find out if the core component of a strong BIT—the elimination of ownership restrictions on foreign investors—is something China is willing to put on the table. China has concluded something like 40 BITs with other countries including Germany, but none of them have dealt with this important level-playing-field issue.

The JCCT remains in front of us, too. I suspect the JCCT leadership meeting will take place after the US elections and, most likely, the Chinese Communist Party Congress in the autumn. That meeting will bring Vice Premier Wang to the United States, and I hope the two sides will continue to reduce trade and investment barriers through this important channel. Many observers overlook that a "mid-year review" was added under the Obama administration, at the deputy level, designed to keep pushing forward on the issues in between the annual JCCT leadership summit. That session should take place this summer, and I hope the two sides will show constituencies in their respective countries that this is a relationship that keeps moving forward and solving issues that hold back economic growth.

With a new board and board chair, where do you see USCBC headed in the future?

Frisbie: Incoming USCBC Chair Bob McDonald leads one of the great American companies, Procter & Gamble (P&G). P&G is in fact the largest consumer goods company in China—that says a lot. In our immediate future is a USCBC board delegation visit to China in late June to hold discussions with senior Chinese government officials, including the incoming premier, and Chinese CEOs on how to advance this most-important of commercial relationships. With the upcoming political calendars in each country, the timing couldn't be better. The USCBC board's statement of priorities in the US-China commercial relationship will be front and center in our delegation meetings.

USCBC BOARD OF DIRECTORS' STATEMENT OF PRIORITIES IN THE US-CHINA COMMERCIAL RELATIONSHIP

The US-China Business Council (USCBC) supports a strong, mutually beneficial commercial relationship with China. The relationship has made many positive strides over the past three decades, thanks to the collaborative work of the governments, business communities, and other stakeholders in both countries.

More work needs to be done in order to fully develop commercial ties, tackle unresolved issues, and bring greater benefit to each country's economy, companies, employees, farmers, and consumers. USCBC calls upon the US and Chinese governments to work together on the following priority issues in the commercial relationship, and lends its full support to achieving the following goals:

- **Ensure fair and open investment environments that create jobs**
- **Reduce trade barriers and enforce globally accepted trade rules**
- **Ensure competitive neutrality and improve transparency**
- **Provide consistent, strong intellectual property rights protection**
- **Adhere to mutually beneficial innovation policies**

The full statement is available online at www.uschina.org/info/board-priorities.

BY **KYLE SULLIVAN**

China's Leadership Structure and Transition

With attention focused on China's leadership transition due to an unusually large number of positions up for grabs and Bo Xilai's dismissal from his communist party posts, the US-China Business Council recently released a report outlining China's leadership structure and transition.

China's 18th Party Congress, scheduled for this fall, marks the beginning of a large turnover of China's top government and communist party leadership. Roughly 70 percent of members of China's top political institutions are expected to step down by the time the transition ends in early 2013, including President Hu Jintao and Premier Wen Jiabao. Xi Jinping and Li Keqiang, who are expected to take over as president and premier, respectively, are the only two members of the Politburo Standing Committee who are expected to retain their seats.

Before he was removed from his positions as Chongqing party secretary and a member of the Politburo, Bo had garnered significant attention in China for anticorruption efforts and his "Chongqing model" that supported state dominance in the economy. In an assessment of the upcoming transition, Cheng Li, a scholar at the Brookings Institution, wrote in a *China Business Review* article that Bo's "unconventional and bold efforts to tap public opinion for political advancement may change the dynamic in which future leaders jockey for power."

LEADERSHIP STRUCTURE

China's political system is divided into three major institutions: the government, the Chinese Communist Party (CCP), and the military. The government and military are subordinate to the CCP, which sets the national policy agenda. The CCP is organized into three major bodies: the Central Committee, the Politburo, and the Politburo Standing Committee. Each organization is respectively smaller in size and holds increasingly more political power, with the Politburo Standing Committee holding the most authority.

18TH PARTY CONGRESS AND CCP LEADERSHIP CHANGES

Leadership transitions in China are not a uniform process, and the timing of when positions are vacated and filled depends on the institution, level, and function. In the past, appointments to senior-level party positions within the Central Committee, Politburo, and the Politburo Standing Committee have been made at the party congress in the fall. The party may appoint government positions within the State Council, such as those of minister or vice minister, at the National People's Congress (NPC) in March 2013. But it's also possible that these positions will be filled after the autumn party congress or after the spring NPC meeting.

Many national- and provincial-level party leaders will be replaced due to reaching—or approaching—the targeted retirement age of 68. This includes at least 14 of the 25 member Politburo and an estimated 60 percent of the 370 full-time and alternate members of the Central Committee.

State Council and central government positions

Based on past practice, key leadership positions of the State Council and its offices will also undergo change because of retirement or promotion. These posts could include the premier, vice premiers, state councilors, and many of the heads of the State Council's 27 ministries and commissions. Though exceptions are made, government guidelines state that ministers are supposed to retire at age 65, while officials at lower levels should retire at age 60.

Local- and provincial-level leadership

Many of the party secretaries and governors of China's 31 provinces, autonomous regions, and centrally administered municipalities are also likely to be replaced.

According to the CCP Organization Department, all four levels of party leadership below the national level (provincial, municipal, county, and town) will complete major turnovers of their party positions by June 2012. This process entails selecting officials from a pool of 30 million party cadres and appointing them to positions in China's provinces, cities, counties, and townships.

Most appointments, such as municipal party secretaries and CCP commissioners within all government bureaus at all four sub-national levels of government, should be finalized by June 2012. This precedes the party congress to allow recently appointed officials to "elect" senior posts. Current provincial-level party secretaries may be elevated to more senior party positions at the party congress. This means there will likely be additional changes to provincial party secretaries following both the party congress in the fall and the subsequent appointments to state bureaucratic positions in spring 2013.

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CENTRAL COMMITTEE	POLITBURO	POLITBURO STANDING COMMITTEE
50 members	25 members	Currently comprises nine members (though number is not fixed)
Convenes once per year at "plenary sessions" during which the CCP announces policy changes	Officially recognized as the chief political decision-making body in China	Regarded as the most elite group of political leaders within the CCP structure
Members selected every five years from a pool of more than 2,000 delegates to the party congress	Members selected from the Central Committee	Members selected from the Politburo
	Members announced at the party congress every five years	Members announced at the party congress every five years

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CHINESE INVESTMENT IN THE UNITED STATES is on the rise, despite the negative impression left by US lawmakers' rejection of Chinese oil company CNOOC's takeover offer for Unocal in 2005.

IMAGINE CHINA

The Rise in Chinese Overseas Investment and What It Means for American Businesses

BY **DANIEL H. ROSEN** AND **THILO HANEMANN**

China's growing presence abroad brings new competition but also commercial opportunities.

China's outward foreign direct investment (OFDI) expanded significantly in the past decade, but the majority of the investment has gone to countries in the developing world. However, in recent years the focus of Chinese investors has started to shift to North America and Europe. Since 2009, Chinese direct investment in America and Europe has increased sharply, and developed economy-bound flows are poised to grow heavily through 2020, according to Rhodium Group estimates. Policymakers are still grappling with the proper policy response, but significant progress has been made in the United States over the past two years. The key impediments Chinese firms face when setting up US shops are inexperience and lack of capabilities rather than political shenanigans. For American businesses, the growth of Chinese investment does pose certain risks, most importantly new competition at home and abroad, but it also brings invaluable new opportunities, such as divestment of assets, co-investment, and new business opportunities in China.

Investment flows destined for developed economies will continue to grow strongly in the years ahead, and developed economies can expect to receive a substantial share of the $1 to 2 trillion in direct investment that China will make around the world over the coming decade.

CHINA'S OUTWARD INVESTMENT BOOM

China's direct investment spree started in the mid-2000s. From an annual average of below $3 billion before 2005, OFDI flows grew to $20 billion in 2006, and more than $50 billion by 2008. In 2010, China's annual OFDI reached $60 billion amid declining levels of global FDI, making China one of the world's top 10 exporters of direct investment in the post-crisis years (see p. 20). By the end of 2011, China's total global OFDI stock stood at $365 billion. However, this early investment boom was almost entirely concentrated on developing countries and a handful of resource-rich developed economies, such as Australia and Canada. Investments in most advanced economies were few and far between. That trend began to change in 2008 when investment flows to Europe and North America grew strongly.

China accounts for only a tiny share of total foreign direct investment in the United States, but the upward trend is clearly underway. A new assessment of FDI flows calculated by the Rhodium Group shows that Chinese firms are now operating in at least 37 of 50 states and have investments across a wide range of US industries. Chinese investment in the United States grew from less than $1 billion annually before 2008 to $2 billion in 2009 and $5 billion in 2010 (see p. 21). While fewer deals were made in the second half of 2011, dragging down the full year figure to $4.5 billion, investment picked up again in the first months of 2012. Several large scale acquisitions have already closed, for example Sinopec Shanghai Petrochemical Co.'s (Sinopec) $2.5 billion investment in five shale oil and gas fields owned by Oklahoma-based Devon Energy Corp. and the $2.6 billion acquisition of movie theater operator AMC Entertainment Holdings by China's Dalian Wanda Group Co. Several big manufacturing deals are also in the pipeline for 2012, such as Golden Dragon Precise Copper Tube Group, Inc.'s $100 million copper tubing plant in Alabama, and a massive $5 billion solar project by ENN Mojave Energy Corp. in Nevada. If the ENN deal goes through, it would be equivalent to all Chinese investment in the United States in 2011.

The new momentum behind Chinese investment in developed economies is spurred by changing commercial realities that are forcing Chinese firms to look abroad. In the past, the attraction of growth at home overshadowed the lure of overseas opportunities, and outward FDI was limited to securing natural resources and building the infrastructure needed to boost cross-border trade. These motives are now receding, as a shift in the growth model is pushing Chinese firms to upgrade their technology, pursue higher levels of the value chain previously conceded to foreign firms, and augment managerial skills and staffing to remain globally competitive. Macroeconomic adjustments such as renminbi strengthening are adding to the pressure. Investments abroad are an ideal solution across the board, and developed economies

QUICK GLANCE

» Chinese firms now operate in at least 35 of the 50 states in the United States.

» Chinese investment in the United States grew from less than $1 billion annually before 2008 to $5 billion in 2010.

» Growing Chinese investment in developed economies could open up new opportunities for private investment in China's domestic market.

offer the assets, regulatory environment, and workforce that Chinese multinationals are looking for. Given this shifting reality, investment flows destined for developed economies will continue to grow strongly in the years ahead, and developed economies can expect to receive a substantial share of the $1 to 2 trillion in direct investment that China will make around the world over the coming decade.

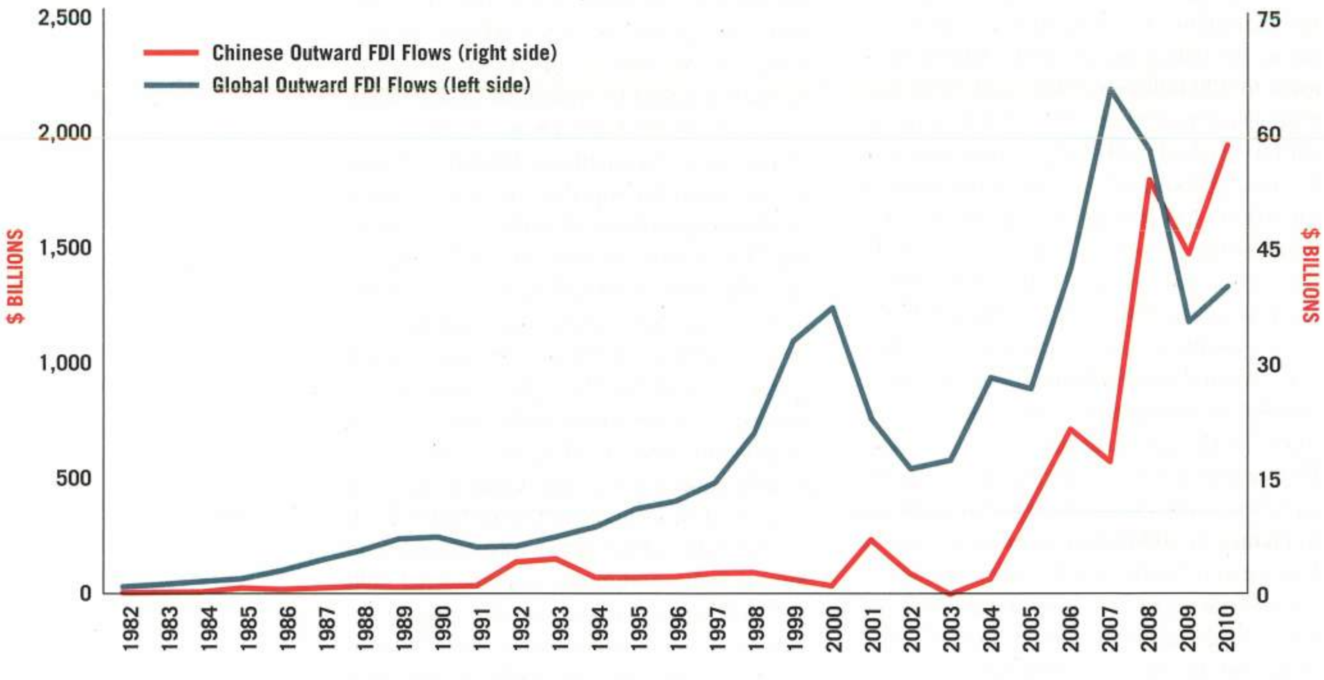
A MORE SOPHISTICATED POLICY RESPONSE

The unfolding Chinese investment boom has the potential to spur US economic growth, jobs, and innovation. Japanese investment in the United States is a good example. Japanese firms played a minor role in the US economy prior to the 1980s and were greeted with skepticism when they started making direct investments. Over the last three decades, they have contributed significantly to economic growth and prosperity in the United States. Today, Japanese firms employ more than 700,000 Americans with an annual payroll of $50 billion, account for more than $60 billion of US exports, and spend more than $5 billion every year on research and development activities. However, this success story is not guaranteed to repeat itself. Policymakers must take the right steps to ensure that inflows materialize and that the benefits are maximized.

Initially, politicians in Washington and elsewhere were caught off guard by rising Chinese investment interest in the United States. Hostile reactions to China National Offshore Oil Corp.'s (CNOOC) 2005 takeover offer for Union Oil Company of California (Unocal), a California-based oil company that later merged with Chevron Corp., left Chinese companies and officials with negative impressions of the US investment environment. US lawmakers were concerned that the deal could affect the availability of oil or endanger US national security. The shadow of the Unocal debacle still looms over the China-US investment relationship, but progress has been made over the past two years on both the federal and local levels. These efforts have helped to reassure Chinese investors that the United States is open for business.

Despite the downturn caused by the financial crisis, the Obama administration has stood firmly against calls to use national security reviews for foreign investment as a protectionist tool, and officials have repeatedly emphasized that the United States welcomes investment from China. The Committee on Foreign Investment in the United States (CFIUS), which screens investments for national security risks, has cleared the vast majority of Chinese proposals, among them acquisitions in sensitive sectors, such as power generation, shale gas development, and aviation. At the

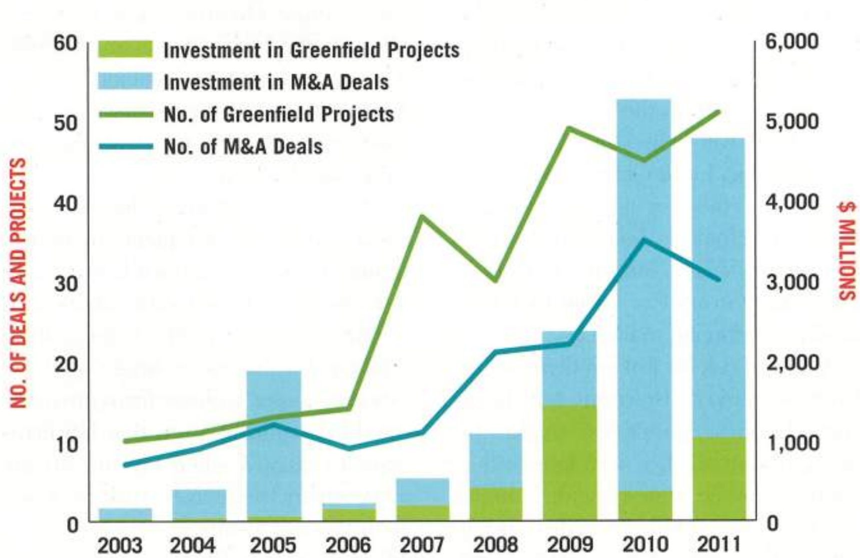
fig. 1 **CHINA'S OUTWARD FDI BOOM**



Source: PRC State Administration of Foreign Exchange, United Nations Conference on Trade and Development, Rhodium Group same time, policymakers in Washington are struggling with legitimate questions related to Chinese investment, such as how to treat investment in telecom networks and other critical infrastructure, and the potential impact of investment by China's state-owned enterprises on competition and markets given the distorted nature of their cost structures back home.

Over the past two years, the Obama administration has also stepped up the federal government's efforts to attract foreign investors to the United States. In 2011, the US government beefed up its federal investment promotion effort with a new initiative called "Select USA" to aid foreign investors. Many states have also started to ramp up their efforts to target Chinese investors specifically, opening offices and hosting road shows in China. This increased on-the-ground assistance will help Chinese investors overcome some of the difficulties they have experienced making the move to the United States.

fig. 2 **CHINESE GREENFIELD PROJECTS AND ACQUISITIONS IN THE UNITED STATES, 2003-11**



Source: Rhodium Group

HOME-GROWN PROBLEMS REMAIN KEY IMPEDIMENTS

The most significant hurdles for Chinese firms looking to expand their footprint in the United States are not US policy or politics, but a lack of capability and experience with overseas investment in sophisticated markets. In the past, most Chinese firms were focused on establishing themselves in the competitive domestic market or serving overseas markets through exports. This inward orientation has left firms ill-prepared for the challenge of going abroad. And the challenges are only exacerbated for the new generation of overseas investors—mostly firms in the manufacturing and service sectors—who are near the beginning of the learning curve, well behind early frontrunners like China's large oil firms that have been operating in overseas markets for more than a decade.

The track record of Chinese investments in North America and Europe illustrates these weaknesses. Many firms have rushed into opportunistic takeover attempts without careful planning or a clear strategy. One particular problem is that Chinese firms have to actively manage political risks on two fronts, but often lack the capacity to do so. In addition to navigating through national security screenings and politicization in host countries, Chinese corporations also have to deal with domestic politics in China. Despite gradual liberalization of China's capital controls in past years, firms still need to go through a burdensome and time-consuming approval process for overseas investments. This often involves numerous regulators and bureaucrats with different preferences and attitudes, delaying deals and diminishing the Chinese firm's chances in competitive bids. Sometimes Chinese regulators and industrial policy planners also strong-arm firms into abandoning deals, as when China's Sichuan Tengzhong Heavy Industrial Machinery Co. was forced to relinquish an attempted takeover of US auto brand Hummer in 2010. The purchase of Hummer was not seen as in line with important industrial policy goals, such as consolidation of the fragmented auto sector and the promotion of higher fuel efficiency cars.

Other home-grown factors add to the difficulties. The bias of the domestic financial system towards state-owned firms and investments in tangible assets is even more pronounced when it comes to overseas financing, especially smaller firms from China's private sector that struggle to raise financing for overseas projects. More importantly, the weak domestic regulatory environment leaves China's firms unprepared to do business in highly regulated markets. This can simply be a drag for operating in the United States, but in some cases it also makes Chinese investors more vulnerable to outside attacks by competitors or interest groups. Domestic reforms addressing these weaknesses, such as strengthening corporate governance rules, are urgently needed to accelerate the learning curve of Chinese businesses.

IMPLICATIONS FOR AMERICAN BUSINESSES

The era of rising Chinese investment will be both sweet and sour for American businesses. In many industries, the emergence of these new Asian multinationals will transform the competitive landscape. Rising overseas Chinese presence will mean new competitors for US firms. The acquisition of foreign brands and technology will make Chinese firms stronger in their home markets, which is in some cases currently dominated by foreign firms, such as autos or luxury goods. OFDI will also help Chinese manufacturers enter markets they have yet to breach. In addition to moving them up the technology ladder, OFDI will help China's pioneers establish local after-sales operations, which was the key for frontrunners including Huawei Technologies Co., Ltd., Sany Heavy Industry Co., Ltd., and Haier Group Co. to sell high-tech products in foreign markets.

A related risk for foreign firms is that Chinese market distortions and unsavory business practices might be exported abroad. It is well known that China's unique state-capitalist model and strong industrial policy distorts fair competition within China, often to the disadvantage of private and foreign-owned firms. That is the point of it after all. Growing overseas investment could result in some of these distortions spilling into overseas markets. The imminent question with regard to fair competition is the cost of capital for Chinese firms in financing overseas acquisitions. Such anxieties already played an important role in the Unocal debate, and as China will likely become the world's largest economy over the coming decade such competition concerns will swell in urgency. Convergence with international business norms, such as export credit restraints, social standards, and anti-corruption frameworks are additional matters of concern.

Finally, the emergence of Chinese multinationals will enhance competition for scarce global assets, most importantly human talent. Unlike the multiethnic and diverse workforces typical of Western multinationals, Chinese companies mostly employ young Han Chinese with very little experience in running global operations. China's new multinationals will have to adjust their structures and workforce to be successful in markets abroad, which means a massive demand for talented staff. Several industries are already experiencing a burgeoning hiring spree by new entrants, for example Huawei's local recruiting efforts in the United States and Europe. This is good news for local job markets, but may not be such good news for other multinationals keen on retaining their most valuable staff.

On the other hand, a Chinese investment boom will offer plenty of opportunities for well-positioned US firms. In a post-crisis, slow-growth world with significantly lower levels of global FDI, Chinese buyers are a bright spot for divesting assets. Chinese firms are interested in acquiring assets that US firms want to discard when moving up the value chain themselves, such as when International Business Machines Corp. (IBM) sold its PC division to China-based Lenovo Group Ltd. in 2004. The move of Chinese firms into new markets will also offer plenty of opportunities for co-investments and partnerships. China's firms are in a weak position when it comes to running overseas operations for all the reasons discussed above, and just like American multinationals entering China in years past, they will need allies to establish a presence in advanced market economies in the period ahead.

In many industries, the emergence of these new Asian multinationals will transform the competitive landscape.

One dividend from China's move abroad will be the benefit of their having to learn to play our game. For decades, Chinese businesses have operated on a purely domestic field and have therefore remained more or less shielded from foreign regulations and courts. Dumping duties were one of the few legal instruments Chinese firms had to fear. Going abroad changes this situation fundamentally. Chinese firms operating in the United States and Europe will have to comply with local laws and regulations, and they are subject to US courts and litigation, giving their competitors a greater arsenal of legal options in the case of improper behavior. Exposure to foreign regulators should also create a positive feedback loop back into China, pushing the government to realize that its own legal system is diminishing the chances for these firms to successfully compete overseas. Over the long term, China's new multinationals might even ramp up lobbying efforts with their own government for a level playing field at home, once they are able to compete in a rules-based and sophisticated market economy and see this as competitive advantage vis-à-vis less globalized domestic competitors.

Finally, growing Chinese investment in developed economies will open up new opportunities in the Chinese market. China still maintains significant controls on capital inflows, and many sectors of the economy remain closed to foreign investment, especially in services. The Chinese government emphasizes that it will continue to open these sectors to private and foreign investment, but in a gradual manner. The growing interest in outward investment in developed economies provides Beijing with an excellent reason to accelerate the pace of opening at home, to forestall the unfavorable comparisons of reciprocal treatment which will inevitably arise. This could well lead to new liberalization in China, offering wider opportunities for foreign multinationals in industries currently off-limits to them.

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PRC VICE PRESIDENT XI JINPING, left, visits a farm in Maxwell, Iowa during his visit to the United States. He is accompanied by Rick Kimberley, the farm's owner, US Secretary of Agriculture Tom Vilsack, and US Ambassador to China Gary Locke.

CHARLIE NEIBERGALL/AFP/GETTY IMAGES

From Cars to Soybeans, US Exports to China Are Booming

BY **BEN BADEN**

While Washington negotiates with Chinese leaders, local governments and businesses are making deals in China.

When Chinese Vice President Xi Jinping visited the United States in February, he made a stop at Rick and Martha Kimberley's farm just outside of Des Moines in Maxwell, Iowa. Their son, Grant Kimberley, who is director of market development at the Iowa Soybean Association, told Xi that Iowa could be a reliable trading partner, and Kimberley said Xi emphasized the importance of building lasting relationships between the United States and China. On that same trip, China signed a deal to purchase $4.3 billion worth of soybeans from the United States.

Xi had been to Iowa once before—27 years ago as a low-ranking government official from Hebei province—after the state of Iowa and Hebei had established their sister-state relationship. Now, Xi is expected to become president sometime in the next year, and Kimberley says the soybean business with China is booming because Iowa has become a trusted partner for the Chinese.

"China is a huge market for us," he says. Iowa is the largest soybean producing state in the United States. The state's efforts account for approximately 15 percent of all soybeans grown. About 55 percent of all soybeans grown in the United Sates are exported, and in 2011 roughly 60 percent of US soybean exports—or about a quarter of all soybeans grown in the United States—went to China, according to the Iowa Soybean Association. Soybeans are the United States' single largest export to

QUICK GLANCE

» About a quarter of soybeans grown in the United States were exported to China in 2011.

» The average Chinese tourist spends more than $6,000 during a trip to the United States.

» South Carolina exported $1.5 billion worth of vehicles to China in 2011, and surpassed Michigan as the largest auto exporter.

China. In 2011, US companies shipped $10.5 billion worth to China, and experts expect that number to keep growing.

In 1982, the American Soybean Association opened an office in Beijing. Back then, China was a net exporter of soybeans. But in the 1990s, because of its growing population and lack of arable land, China was forced to start importing some agricultural products like soybeans. Soybeans are used in a range of products, including animal feed, and as China's middle class grows so does its appetite for meat.

DURING RECESSION, EXPORTS SHIFT TO CHINA

Iowa is not alone in its exporting success. While the Obama administration and Congress wrestle with China on overarching issues such as currency manipulation, intellectual property rights protection, and what the United States sees as other unfair trade practices, states and cities across the country are ramping up and succeeding in their efforts to export to China. Even though the US trade deficit with China remains wide, US exports to China have exploded over the last decade.

Between 2000 and 2011, total US exports of goods to China rose 542 percent, from $16.2 billion to $103.9 billion, according to the US-China Business Council's 2011 state export report (see p.27). Total exports to the rest of the world increased only 80 percent during this period. The growth in exports to China by value exceeds every other market except Canada. "In terms of growth rates, exports to China have blown away all of the other major markets," says Daniel Anthony, research director at the Trade Partnership, a consulting firm in Washington, DC. "Export growth rates to China since 2000 more than triple those of any other country among the top 15 destinations for US exports."

With slow growth at home, US exports to emerging economies like China help drive the US economic recovery. In fact, the growth of US exports of goods and services in 2010 was the fastest single-year growth of US exports on an inflation-adjusted basis since 1997, according to Emilia Istrate, senior research analyst at the Brookings Institution in Washington, DC. Much of that growth can be attributed to China and other emerging economies. For instance, Brookings data showed the value of all US exports of goods and services grew by 11 percent on an inflation-adjusted basis between 2009 and 2010. But over the same period, US exports to China increased by 28 percent on an inflation-adjusted basis. As a result, the share of US exports to China has increased from 4.6 percent of US exports of goods and services in 2008 to 6.2 percent in

STATE	TOTAL AMOUNT OF EXPORTS, 2011 ($ BILLION)	% GROWTH, 2000-11
California	14.2	300
Washington	11.2	489
Texas	10.9	653
Louisiana	7.3	590
New York	4.5	472
Illinois	3.9	631
Pennsylvania	3.5	1,177
Georgia	3.2	873
Oregon	3.2	936
South Carolina	3.0	2,261
Ohio	2.7	838
Michigan	2.7	1,169
North Carolina	2.6	651
Alabama	2.3	1,342
Massachusetts	2.1	316

2010. In contrast, the share of US exports going to the European Union dropped from 26.6 percent in 2008 to 23.6 percent in 2010.

"US exports to China continue to grow throughout the recession and the recovery," Istrate says. "Our research has shown that the Great Recession accelerated the shift of exports to emerging markets like China. There has been a growing underlying trend of US companies selling goods and services into developing countries. The Great Recession just gave it a push."

SELLING TO CHINA'S MIDDLE CLASS

Aside from concerns about a short-term slowdown in the Chinese economy, Istrate says the key for long-term growth in the future is how quickly and successfully the Chinese government moves to a more consumption-based economy, and away from one that is reliant on fixed-asset investment and exports. "The prize in everyone's eyes is the large and growing Chinese middle class," Istrate says.

President Obama's National Export Initiative, announced in January 2010, aims to double US exports by 2014—a target that requires at least 15 percent average annual growth per year for five years. China is among the countries for which US exports have exceeded the global annual average growth rate of 18 percent in the National Export Initiative's first two years. "The cost-benefit equation keeps shifting in favor of American businesses—meaning that the cost, the difficulty, and the challenges of [selling] to China continue to diminish, more slowly than we want sometimes—but it's definitely improving all the time," says Frank Lavin, founder and global CEO of Export Now, an online service that allows US companies to sell their products online in China.

Exports of goods aren't the only bright spot. American companies provide a lot of services that cannot be shipped over in a box. US exports of services in areas such as tourism, law, finance, engineering, and architecture to China have nearly quadrupled since 2001. "All of those types of research and professional services, American firms are now doing for the Chinese," Anthony says. In 2010, the latest number available, American companies exported $21 billion worth of services to China.

Nearly one-third of all US exports are services. The share of services exports is lower in China because many services sectors are closed to US companies in China. But there are simple policies that could be implemented to change that, such as easing visa restrictions for Chinese travelers to the United States, Istrate says. Travel and tourism is the largest export industry in the United States, according to the US Travel Association. Chinese tourists are helping drive that growth. The average Chinese tourist spends $6,243 during a trip in the United States compared to an average of only $4,000 for all overseas travelers.

Whether the goals laid out in the National Export Initiative are met may depend on the success state and local governments have. "The federal government has an important role to play, but ultimately the states and local organizations know their companies better," Istrate says. "The National Export Initiative has to become more localized. It has to trickle down to reach the US companies." Currently, only about 1 percent of US companies export their goods or services.

That's why Brookings launched its Metropolitan Export Initiative to help cities develop an export strategy. Four pilot metro areas were chosen: Portland, Oregon; Syracuse, New York; Los Angeles; and Minneapolis-Saint Paul. "For too long, the discussion around exports has been focused on the macroeconomic policies," Istrate says. "It's also about services that are provided like what type of trade financing is provided to help sell abroad to China and other countries."

BUILDING "GUANXI"

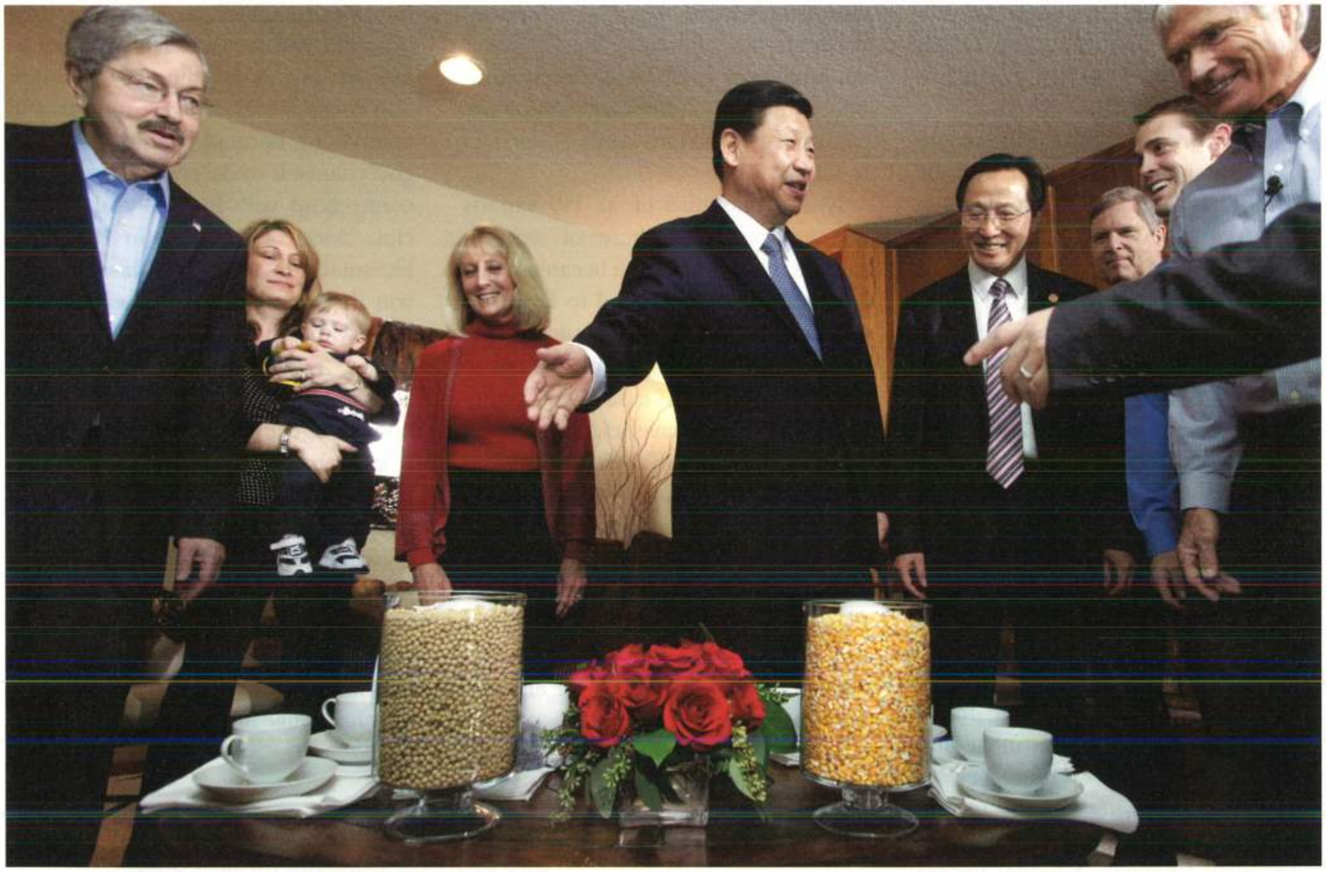
Major metropolitan areas and states across the country are organizing trade missions to China to showcase their products and services. Half the battle, experts say, is building relationships and contacts with Chinese officials and companies. Because China's system of governance is so decentralized, making connections with local officials is crucial. "Most of the cities in China act like small governments in the sense that you do need a mayor or a provincial head with you when you do business in China," says Bill Cronin, vice president at Invest Atlanta, the economic development agency in Atlanta.

In March, Invest Atlanta helped organize a trade delegation led by Atlanta Mayor Kasim Reed that made stops in Shanghai; Nanjing, Jiangsu; Hangzhou, Zhejiang; and Shenzhen, Guangdong. Companies that went on the trip already project $125 million in expected sales resulting from meetings and discussions they had while in China.

"The prize in everyone's eyes is the large and growing Chinese middle class."

—Emilia Istrate, senior research analyst at the Brookings Institution

The majority of the Atlanta-based companies that made the trip to China are in the services sector. Global design firm tvsdeisgn traveled with the Atlanta delegation. It has already helped design two convention centers, one in Nanjing and one in Beijing, and it's currently bidding on another project near the completed Nanjing Conference and Exhibition Center. "What we've learned is that even with the competition, it's about the relationships you've built," says Roger Neuenschwander, president of tvsdesign. "It's guanxi, which is loosely translated as 'relationships.' You work very hard at building relationships, friendships, and trust factors … and out of that you'll have opportunities to talk about business relationships. It's the primary driver of growing a business in China."



PRC VICE PRESIDENT XI JINPING talks to Rick Kimberley, right, and Iowa Gov. Terry Brandstad, left, during a visit to Kimberley's farm in Iowa.

CHARLIE NEIBERGALL/AFP/GETTY IMAGES

"MADE IN THE USA" REBOUNDS

Cronin says manufacturing companies in Georgia are also having success. Factors such as rising wages in China are making the environment in the United States much more attractive for manufacturers. "The main thing we're seeing is that the demand for US made goods is increasing to the point that you're seeing the Southeast, which is the breadbasket for manufacturing in the United States right now, doing a lot more exporting," Cronin says. "Those ships are not necessarily going back empty like they did five or 10 years ago to Asia where we were the mass importer of consumer goods."

He points to consumer products companies like Georgia-Pacific LLC and Kimberly-Clark Corp., as well as Gulfstream Aerospace Corp. Aircraft and paper-related products are the two largest exports from Georgia to China. Last year, Georgia exported $3.2 billion worth of goods to China. "The demand for American goods is very high," Cronin says. "I think we're starting to come to some parity as it relates to trade maybe within the next two to three to five years at most."

A new top car exporter

South Carolina has seen the one of the largest percentage increases in exports to China in recent years. From 2000 to 2011, exports from South Carolina to China have grown by 2,261 percent from $127 million in 2000 to more than $3 billion in 2011. Clarke Thompson, international trade director at the South Carolina Department of Commerce, attributes that to the $1.5 billion worth of vehicles—primarily BMWs—South Carolina exported to China last year.

Last year, South Carolina surpassed Michigan as the largest auto exporter. BMW is now the largest exporter of vehicles in the United States. "A lot of international companies have come here over time," Thompson says. "Those companies come here not only to serve this market, they're finding that, especially European companies, they're able to make it here for less, and re-export it."

As for exports to China, Thompson says China's middle class can now afford to buy nice cars. "The bottom line of the story is the growth of China's middle class, and the fact that there is money to buy these luxury products," Thompson says. "That's probably been one of the driving factors."

Airplane exports rise

Behind soybeans, America's second largest export is civilian aircraft. Last year, US companies sold $6.4 billion worth of aircraft and aircraft parts to China, and most of them originated in the state of Washington thanks to one of the country's largest exporters, the Boeing Co. Second only to California in terms of its exports to China, Washington exported more than $11 billion worth of goods to China last year. Microsoft Corp. also calls the state home, and farmers have had success exporting some agricultural products. American companies in Washington exported $3.8 billion in agricultural products and $450 million in computers and electronics to China in 2011.

Washington businesses are working to diversify their efforts. "We're getting more high-tech firms, specifically information technology, aerospace, biotech, medical services, clean energy and the environment," says Joseph Borich, president of the Washington State China Relations Council. In March, he helped lead a delegation of clean-tech investors to China, most of which had never visited the country before, so they could begin to develop relationships. "It's rare to find a company that doesn't keep an eye on China and US-China relations," Borich says.

Chinese companies set up shop in the United States

As one of the first states to enter China, Maryland officials say their efforts are paying off as the state's exports as well as foreign direct investment from China continue to grow (see p.18). Maryland first opened an office in Shanghai in 1996. It's now the state's largest international trade office. Last year, the state sold $666 million worth of goods to China. "Without any shadow of a doubt, China is by far the market where Maryland's efforts are the most aggressive," says Brad Gillenwater, regional manager for Asia at the Maryland Department of Business and Economic Development.

Last June, a delegation from Maryland including Governor Martin O'Malley travelled to China, Korea, and Vietnam. "As a result of the governor's trip, we've had $85 million worth of investment in Maryland, and it's growing just as a result of that one effort," says Maryland Secretary of State John McDonough. For instance, on the trip Baltimore-based firm Premier Rides, Inc. struck an agreement with the developer of the new Great Mall of China being built outside Beijing to construct the world's tallest indoor roller coaster.

Gillenwater says it has been a two-way partnership, and that more trade will bring more investment. Over the last four years, 15 China-based companies have opened offices in Maryland, and in April the Export-Import Bank of China, which helps finance Chinese exports to other countries, announced it would open its first office in the United States in Baltimore.

"The national arena has national issues," says Fontaine Bell, chair of the Baltimore-Xiamen Sister City Committee. "At the state and local level, the deals get done."

BEN BADEN (bbaden@uschina.org) is associate editor of *CBR*.

ANNUAL US STATE EXPORTS TO CHINA PASS $100 BILLION FOR THE FIRST TIME

In March, the US-China Business Council (USCBC) released its annual report on US state exports to China, and China once again is America's third largest export market. As a buyer of US goods, China ranks behind only Canada and Mexico—two immediate neighbors with whom the United States has a regional free-trade agreement.

In 2011, US exports to China grew by 13 percent, up from $91.9 billion in 2010. Since the beginning of the decade, which coincides with China's accession into the World Trade Organization, the results have been even more striking. Between 2000 and 2011, total US exports to China rose 542 percent, from $16.2 billion in 2000 to a record-breaking $103.9 billion in 2011 (p.24). In addition, US exports to China recovered faster after the recession than exports to anywhere else in the world.

This nearly $90 billion increase in exports to China from 2000 to 2011 exceeded the increase to every other market for US goods and farm products with the exception of Canada. US exports to Canada increased by $102 billion over the same period, while US exports to Mexico rose $86 billion. Brazil was a distant fourth with just a $28 billion increase in purchases of US products.

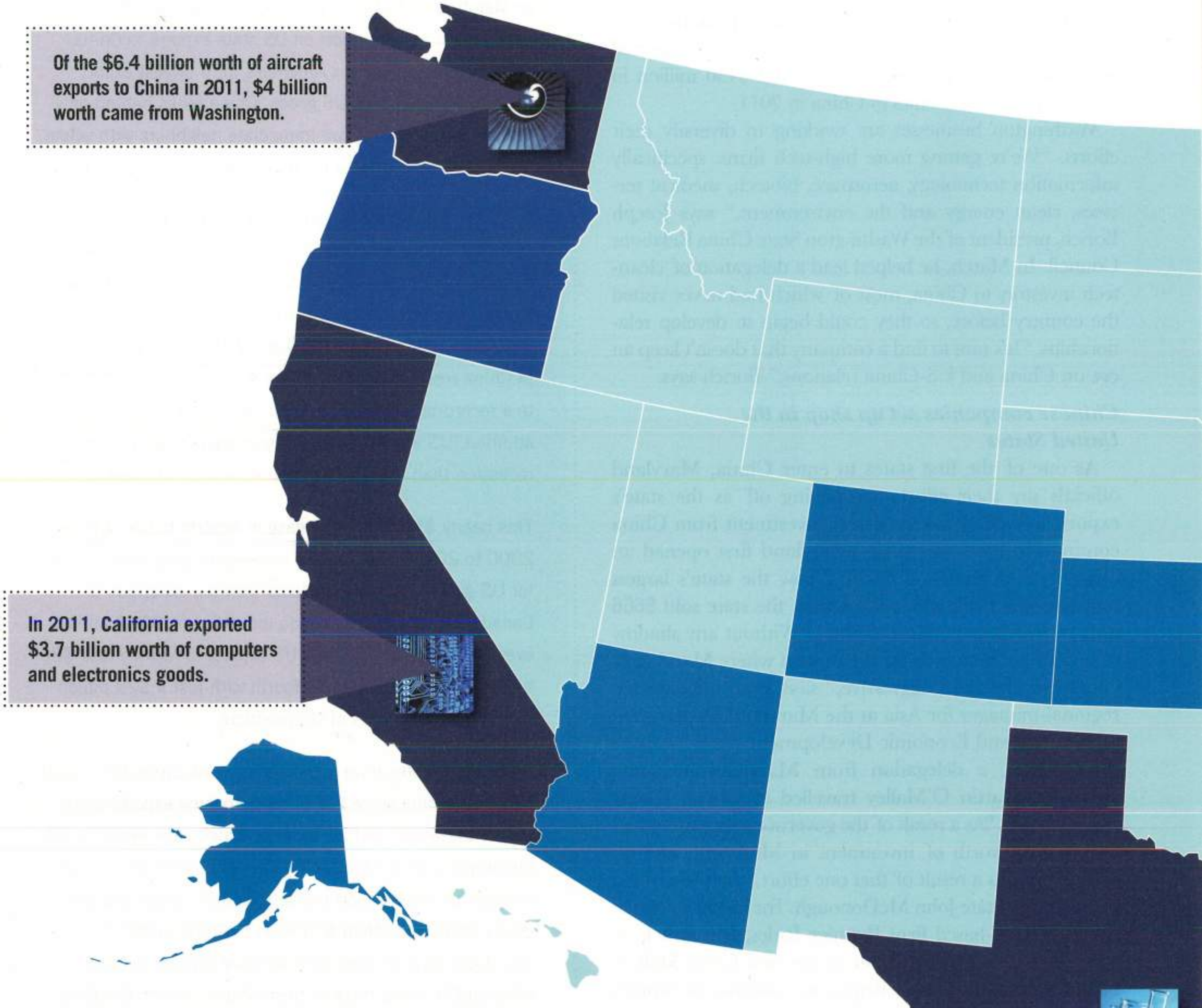
Forty-eight states have registered at least triple-digit export growth to China since 2000, far outpacing exports to the rest of the world, and 20 of those states have experienced quadruple-digit growth. Thirty states count China as one of their top three export markets, and 25 states exported goods worth more than $1 billion to China in 2011. Ten states have at least doubled their exports to China since 2009, while three of these states—South Carolina, South Dakota, and Vermont—have more than tripled their exports to China in the past two years. The list of top 15 state exporters to China in 2011 includes states not usually thought of as benefitting from trade with China: Michigan, New York, North Carolina, Ohio, Pennsylvania, and South Carolina. Top exports to China in 2011 included agricultural products, computers and electronics, chemicals, and transportation equipment (primarily aerospace and autos).

—Ben Baden

CHINA DATA // EXPORTS

US STATE EXPORTS TO CHINA, 2011

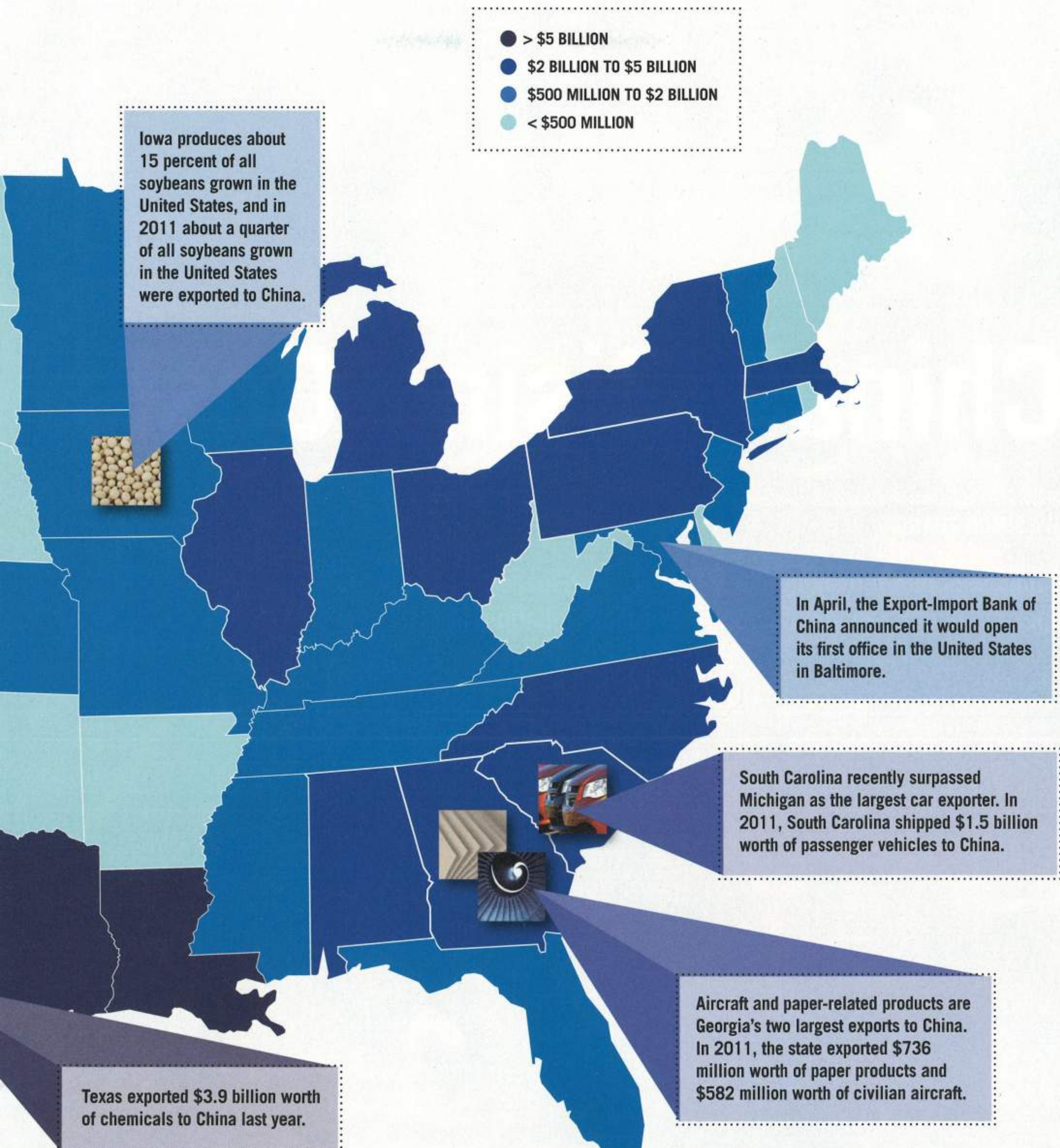
Source: US-China Business Council 2011 state export report, US Census Bureau



TOP 10 EXPORTS TO CHINA, 2011

EXPORT	AMOUNT ($ BILLION)
1. Soybeans	10.5
2. Civilian aircraft	6.4
3. Copper materials	3.5
4. Passenger vehicles (small engines)	2.9
5. Aluminum materials	2.7
6. Cotton	2.6
7. Electronic integrated circuits	2.5
8. Passenger vehicles (larger engines)	1.8
9. Recycled iron and steel	1.6
10. Unbleached paper	1.1

Source: US Census Bureau



> $5 BILLION
$2 BILLION TO $5 BILLION
$500 MILLION TO $2 BILLION
< $500 MILLION
Iowa produces about 15 percent of all soybeans grown in the United States, and in 2011 about a quarter of all soybeans grown in the United States were exported to China.
In April, the Export-Import Bank of China announced it would open its first office in the United States in Baltimore.
South Carolina recently surpassed Michigan as the largest car exporter. In 2011, South Carolina shipped $1.5 billion worth of passenger vehicles to China.
Aircraft and paper-related products are Georgia's two largest exports to China. In 2011, the state exported $736 million worth of paper products and $582 million worth of civilian aircraft.
Texas exported $3.9 billion worth of chemicals to China last year.

WORKERS INSTALL A MOTOR GRADER at Caterpillar's production facility in Suzhou, Jiangsu. Despite cost inflation, many foreign companies choose to stay in China to serve the Chinese market.

China's Rising Costs

BY **SIMON ZHANG**

Companies that reevaluate their China-based manufacturing operations can remain competitive despite inflation.

LIU BIN/XINHUA PRESS/CORBIS

Executives across China have been quick to mention rapidly increasing labor costs in recent years as one of their top concerns for their China operations. China's labor costs in the urban manufacturing sector reached ¥31,000 ($4,579) per employee per year in 2010, more than doubling from just ¥12,700 ($1,534) in 2003. This represents a compound growth rate of 13.8 percent in renminbi (RMB), or 17 percent in dollars after taking RMB appreciation into account. China's costs are growing at a faster rate than many other countries with low overall manufacturing costs, such as Vietnam, India, and Mexico. But this represents just the tip of the iceberg for foreign companies' investment prospects in China.

Many people assume that companies that invest in China do so to export goods—but for the past 10 or more years this has been the exception rather than the rule.

According to analysis by InterChina Consulting, China has reached the turning point at which it can no longer be considered a low labor cost production base, and it will likely never return to that status. However, the negative implications of this trend have been exaggerated and distorted in many cases. Foreign companies should consider factors other than costs and adopt strategies to deal with the cost issue in a strategic and sustainable way.

For enterprises in China, there are critical decision-making factors to consider other than cost alone. These include productivity in China, proximity to the local market, proximity to a high-quality supplier network, and the availability of quality labor.

COST INFLATION IS EVIDENT ABOVE THE ICEBERG, BUT WHAT LIES BENEATH?

High labor costs is just one element in a series of factors that have led to cost inflation in China. Many other costs that affect the bottom line of business operations have also spiked in China recently. For example, the purchasing price indices for raw materials and other manufactured goods as inputs increased by an average of 4.3 percent from 2000 to 2010, even accounting for a heavy dip during the 2009 economic downturn. In most of those years, price indices increased by 5 to 10 percent. Utility prices for industrial usage in many of the 15 provincial capitals InterChina monitored also increased at a compound annual growth rate of 5 to10 percent after 2005. Increases in land rental prices have made regular headlines in recent months as well.

Despite these cost increases, many foreign companies still consider China an important market. For the past 10 years, roughly 80 percent of executives have said that China is one of their companies' top three global investment destinations, according to annual surveys by the American Chamber of Commerce in China. Over the same time period, approximately 70 percent of executives reported that their firms' operations in China are profitable or very profitable. Proximity to the market has been a key determinant in Chinese investment decisions. Many people assume that companies that invest in China do so to export goods—but for the past 10 or more years this has been the exception rather than the rule. In fact, foreign manufacturing companies in China export less than 25 percent of their gross industrial output, even after including the companies in Hong Kong and Taiwan, which generally post high levels of exports.

Given this steady interest in China as a global investment destination, it is important to understand the rising labor costs against the larger context of China as a maturing, yet robust market. China's market is one of the world's largest and continues to grow at an enviable pace. Many observers also overlook the fact that China's manufacturing sector productivity, which achieved a compound annual growth rate of 16.5 percent from 2004 to 2010, has increased rapidly in recent years. Productivity gains, which were achieved largely through investment, have successfully offset the impact of the fast-growing labor costs in the past. China is now, however, taking steps toward shifting to an economy driven by technology upgrades, innovation, and revamping of business models. This trend is likely to continue to offset, at least partially, the impact of rising labor costs in

QUICK GLANCE

» In addition to higher land and raw material costs, urban manufacturing wages in China have more than doubled from 2003 to 2010.

» Capital- and labor-intensive manufacturing operations should consider new strategies to deal effectively with cost inflation and remain competitive in China.

» Some companies have moved operations to inland provinces or have automated production processes to mitigate rising costs.

coming years. Though labor costs in Vietnam and other low-cost countries are approximately one-half to one-third less than Chinese labor, productivity in many low-cost countries is considerably lower than in China.

Consumption will become one of the key drivers for business as China shifts from investment and export-driven gross domestic product (GDP) growth. The size of China's middle class is likely to triple in the next 10 years. But China's market is becoming more complex, and will require a higher degree of localization to be successful. In the future, firms that manufacture or design products in China for the domestic market will become more competitive. Highlighting this trend, many Fortune 100 companies have designated China as their second home country or second global headquarters.

China's relatively mature supply chain has also persuaded foreign companies to stay in China rather than move away. In fact, companies frequently cite less developed supply chains in many low-cost countries as a barrier to investment. Even in the well-publicized case of Nike, Inc., it has taken more than 16 years to lower the amount of raw materials the company imports to Vietnam from 98 percent to 56 percent, even with significant support from the Vietnamese government.

RUSHING TO "RESHORE"?

The issue of relocating away from China—or what some are calling the "reshoring" of manufacturing—has become a hot topic. Sleek Audio (with an estimated global revenue of \$790,000) moved production back to the United States in early 2010, citing cost issues and quality control. The Outdoor Greatroom Co. (with global revenue of \$5 million) also moved production back to the United States, citing a need for proximity to other facilities, shipping delays, and a need for greater quality control.

Companies that have so far chosen to reshore their manufacturing facilities have been export-oriented companies with little to no customer base in China and limited prospects for establishing such a base. In the past, these companies only manufactured in China because of the cheap labor costs, and the nature of their business in China has been considerably labor-intensive. Factors such as concerns over quality, high shipping costs, and delays are likely to outweigh the diminishing labor-cost advantage.

However, many companies in the past and likely most in the future will be targeting China's large domestic market. In the US-China Business Council's annual survey of member company priorities, 93 percent of respondents in the 2011 survey said their companies were in China to reach the China market. Forty-three percent of respondents said their companies used China as an export platform to non-US markets, and 27 percent used China as an export platform to serve the United States.

Both capital- and labor-intensive operations will need new strategies to deal effectively with cost inflation and remain competitive in China.

Companies with a focus on China's domestic market are likely to stay in China in the medium term, including the leaders in the value chain of the electronics, food and beverage, energy, chemicals, auto, pharmaceuticals, machinery and industrial goods sectors, in addition to the component and material suppliers involved in the value chain. Some export-oriented companies have started to balance their strategic focus in China for both export and for China's market to respond to the market trend.

Some companies, such as Nike, have chosen to diversify their production locations to other low-cost countries, rather than drastically reduce the production base in China (see p.33). Media reports have cited labor costs as playing a large role in Nike's move to Vietnam. But Nick Athanasakos, Nike's vice president in charge of global sourcing and manufacturing, pointed out in late 2011 that Nike is looking ahead to Vietnam joining negotiations on the Trans-Pacific Strategic Economic Partnership Agreement (TPP) and Vietnam-EU Free Trade Agreement (FTA), which would lead to more favorable trade policies between Vietnam and the United States and European Union. The share of Nike's shoes produced in Vietnam increased from 15 percent to 39 percent in the past 10 years mostly because of decreases in production in Indonesia and Thailand, according to its annual reports.

ADAPTING TO A NEW REALITY

While it will be easy for manufacturers to remain in China in theory, it will become difficult to stay competitive in China in practice. Both capital- and labor-intensive operations will need new strategies to deal effectively with cost inflation and remain competitive in China.

Relocating operations to inland provinces and cities is possibly the most frequently mentioned approach to cost inflation in China. Hewlett-Packard Co. began this process in the mid-2000s with a facility in Chongqing responsible for applications, infrastructure technology, and business process outsourcing for HP's enterprise customers in China and globally. HP opened in 2008 its second personal computer manufacturing facility in China in Chongqing with an investment of \$3 billion, and set up a call center in Chongqing that serves customers in China and globally.

However, HP's decision was not purely driven by the labor costs in western China. Labor costs in inland cities are increasing at a faster pace (typically 15 to 20 percent) than in coastal cities (typically 10 to 15 percent), which means the current labor cost advantage in inland cities is temporary. For HP, Chongqing provides a chance to better target China's inland market and

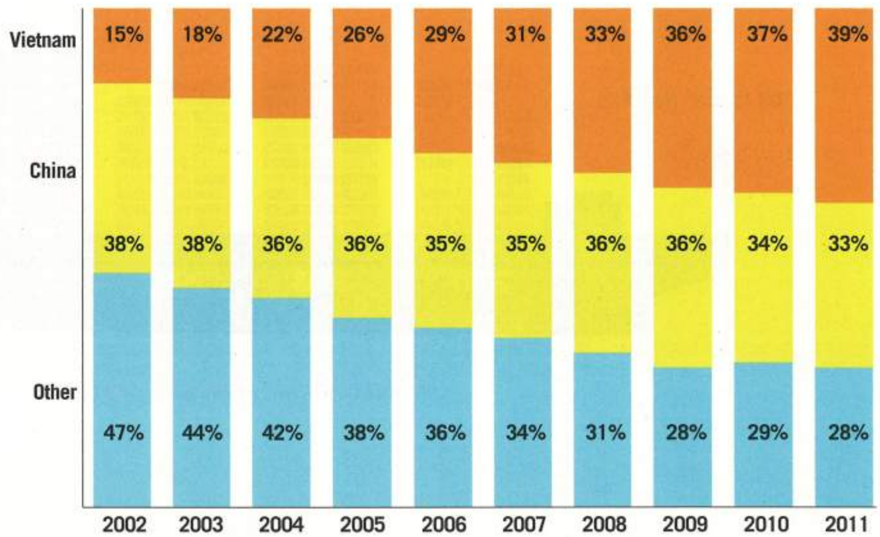
Europe. HP's plant in Chongqing will be capable of producing 20 million laptops a year once the plant is fully operational. Much of the facility's products will be exported to the European market. The Eurasia Land Bridge railway line allows companies to export products to Europe in roughly 13 days, dropping from 36 or 37 days by container ship.

Some companies will be able to further increase productivity to offset cost inflation, especially companies that could further automate assembly lines in their China operations. For example, in sectors such as home appliance components, many companies' production setup is still heavily labor-intensive or only partially automated in China. In their home countries in Europe or the United States, facilities are equipped with state-of-the-art assembly lines worth several million dollars. However, facing high cost inflation in China, many companies have decided to gradually shift their production setup to a higher degree of automation. This is not only a defensive strategy to deal with labor costs, but also a proactive action to manage high labor turnover in China, and deal with shortages of skilled workers and operators. One of InterChina's clients plans to automate two of its assembly lines to replace 18 semi-skilled workers. In this case, the company will save money even when taking into account the annual depreciation of the expensive machinery.

For export-oriented companies, especially those with relatively high value-added—such as technology, consumer electronics, fine chemicals, pharmaceuticals, and software sectors—refocusing on China or adding more weight to domestic sales in China may be a good choice. Some companies may also need to take steps to move their export business to other low-cost countries, especially to those near the target market. According to InterChina's analysis, China will likely lose its cost competitiveness between

fig. 1 NIKE'S PRODUCTION SHARES IN MAJOR COUNTRIES

Though Nike has diversified its production locations to other low-cost countries, such as Vietnam, the company has not drastically reduced production in China.



Source: Nike annual reports

2015 and 2020 when compared to other low-cost countries with similar supply chains, such as Mexico and the Czech Republic. Companies should consider long-term goals, such as global resource optimization. In one case InterChina handled, the client agreed to make the necessary optimization of capacity in North America and China, which had significant impact on future investment decisions. This export-oriented client will move its export business back to North America in the medium term, but it will develop the dedicated sales focus in China to contribute to the global top-line growth with reasonable margins in China.

Foreign companies can also offer higher value products and services. For example, Caterpillar China plans to invest $1 billion over the next few years to add more local dealerships and increase research and development, distribution, used equipment sales, and manufacturing and leasing activities. The firm also plans to improve after-sales service. These actions aim to address the challenge from increasingly competitive Chinese players and the rapid rise of cost inflation.

Cost inflation is a reality in China, but China's domestic market will remain attractive enough to bring continued rewards to those companies able to stay and localize to beat the competition. Luckily, new tools are available for foreign companies in China, though each solution has to be tailor-made for each company's individual situation and must strike a balance between the cost issue and other critical strategic issues.

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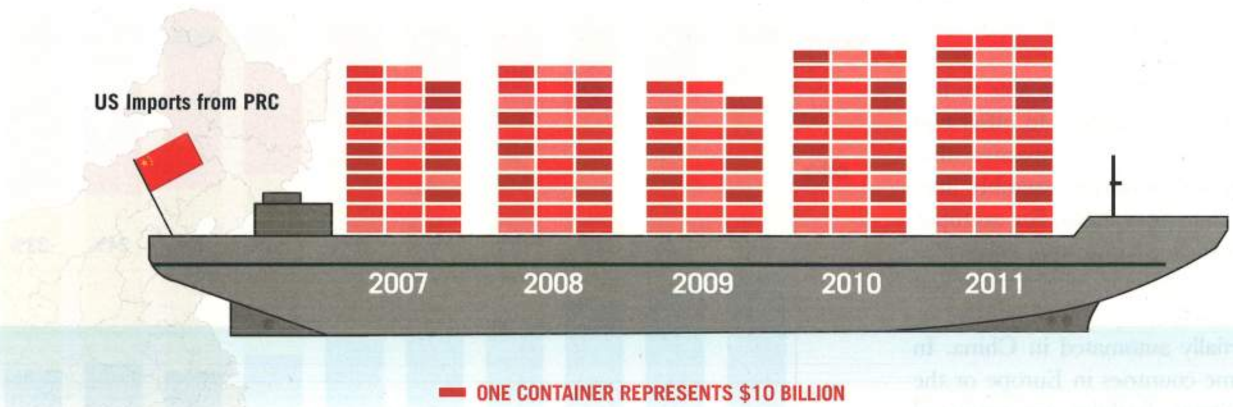
CHINA DATA // TRADE AND INVESTMENT

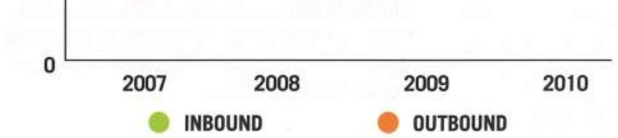
US TRADE WITH CHINA, 2007-11

The United States is China's second-largest export destination after the European Union.



CHINA'S INBOUND AND OUTBOUND FOREIGN DIRECT INVESTMENT (FDI), 2007–10

FDI into China rebounded after the global economic downturn in 2009, while China's overall outward FDI more than tripled from 2007 to 2010.

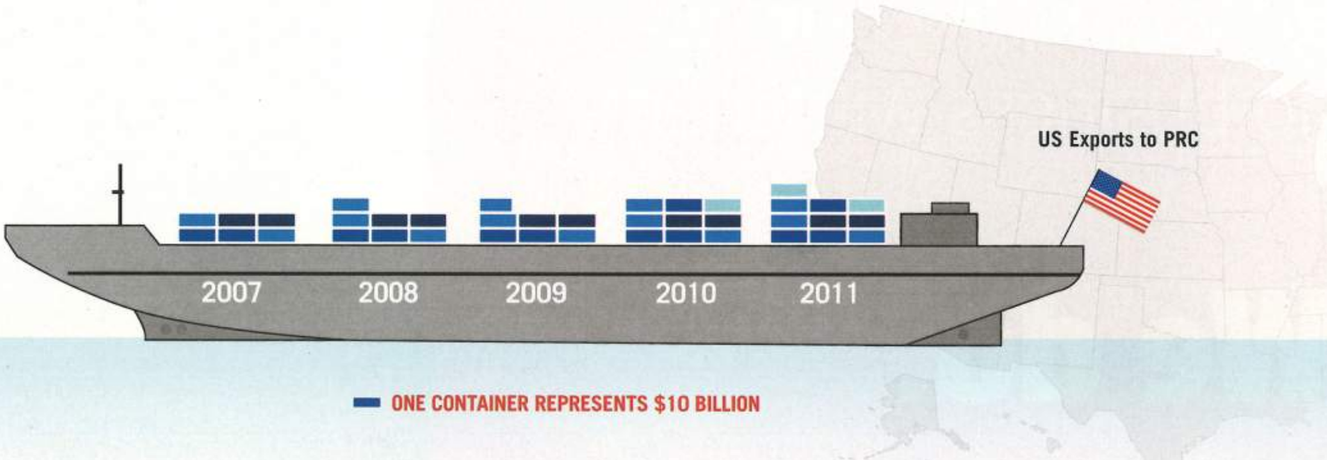


CHINA'S US-BOUND FDI, 2006–11

China's US-bound FDI skyrocketed from 2006 to 2010, but weakened in 2011. Chinese investment in the United States has picked up in 2012 with Dalian Wanda Group Corp.'s purchase of AMC Entertainment Holdings and ENN Group's plan to build a $5 billion solar complex in Nevada.

Sources: US International Trade Commission, PRC Ministry of Commerce, Rhodium Group, UN Conference on Trade and Development

IN THE LAST FIVE YEARS, THE US TRADE DEFICIT WITH CHINA WIDENED EVEN AS US EXPORTS TO CHINA GREW BY MORE THAN 50 PERCENT.



RANKING OF GLOBAL FDI OUTFLOWS, 2009-10

In 2010, China was the fifth largest investor globally.

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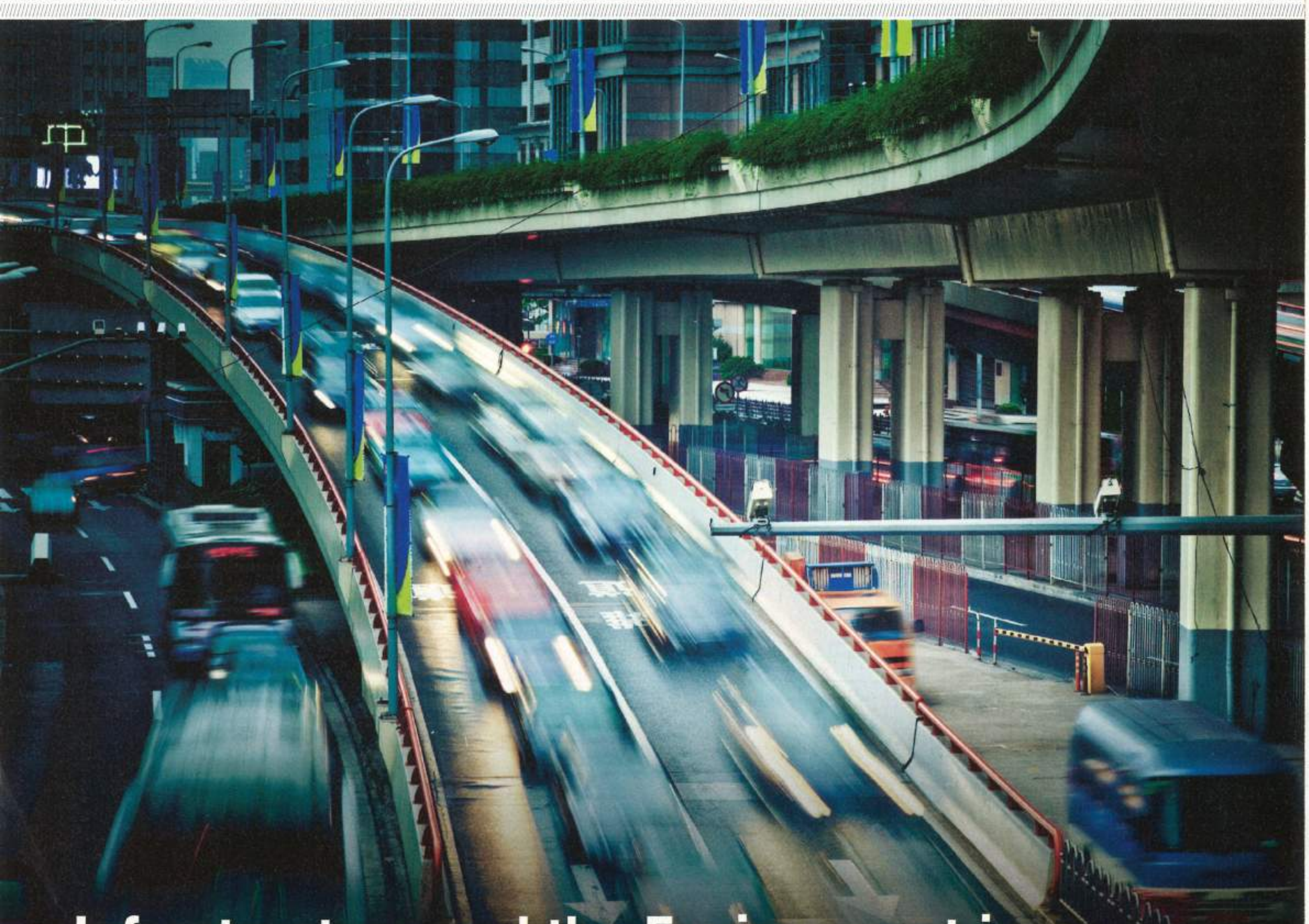


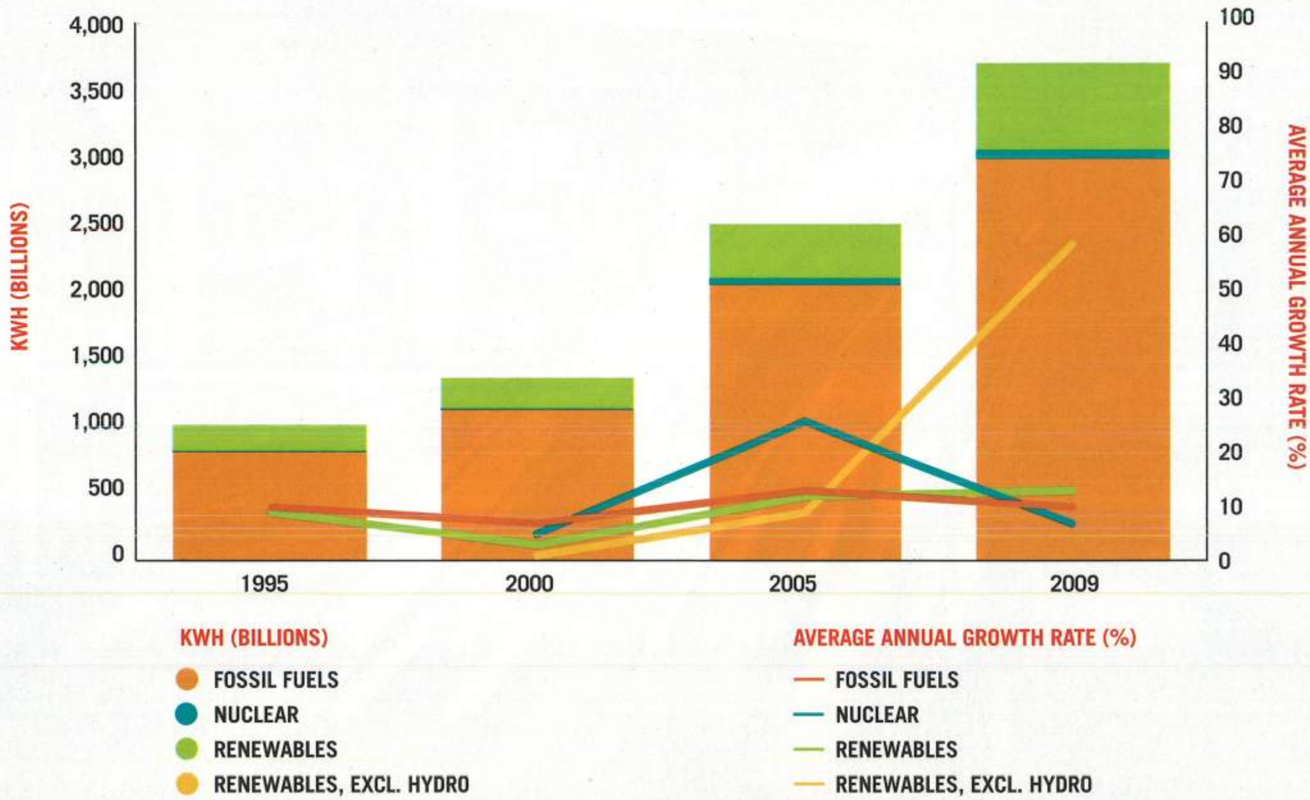
Infrastructure and the Environment in Chinese Cities: Prospects for Improvement

BY **JOHN BACHMANN AND JOE BURNETT**

Infrastructure has opened the door to socio-economic development in China. Economic growth—facilitated in part by roads, water, and power investments—has helped pull roughly 700 million people above the poverty line in the last 20 years. China's extraordinary economic achievements have been made possible by a range of factors including export-friendly trade and investment policy, sound macro-economic management and political stability. The timely delivery of urban infrastructure has also been an essential driver of economic growth, underpinning the rapid development of industry and breakneck growth of cities in eastern China.

While the socioeconomic results are indisputable, China's performance in the area of environmentally sustainable development leaves room for improvement. According to the PRC Ministry of Environmental Protection, two-thirds of China's lakes have chemical deficiencies caused by pollution. As a result of pollution and increasing consumption, two-thirds of China's cities are short of potable water. Air is heavily polluted across the northern heavy industry belt from Shanxi to Liaoning provinces and along the heavily industrialized east coast. Many polluted industrial sites will require extensive soil remediation before they will again be fit for human use.

Development on a scale such as China's will entail some environmental cost. The objective of environmentally sustainable development is not to eliminate all damage to the environment, but rather to keep the damage at a level that is consistent with environmental *fig. 1* **CHINA'S ELECTRICITY PRODUCTION BY SOURCE**



Source: World Bank Databank

carrying capacity—the ability of an eco-system to support and sustain life. The main tools here are demand management and environmental management, including infrastructure delivery. But in three key sectors—energy, water, and transport—the track record in China is decidedly mixed. There is a lot more that city leaders, infrastructure professionals, and local residents can do to bring environmental conservation into a more reasonable balance with urban and economic growth.

ENERGY

The government's 12th Five-Year Plan (FYP, 2011–15) set aggressive sustainability targets in the energy sector: reducing the energy intensity of economic output by 16 percent over five years and increasing non-fossil fuel use to roughly 11 percent of primary energy consumption. Now more than a year into the 12th FYP, China seems to be on track to meet these targets.

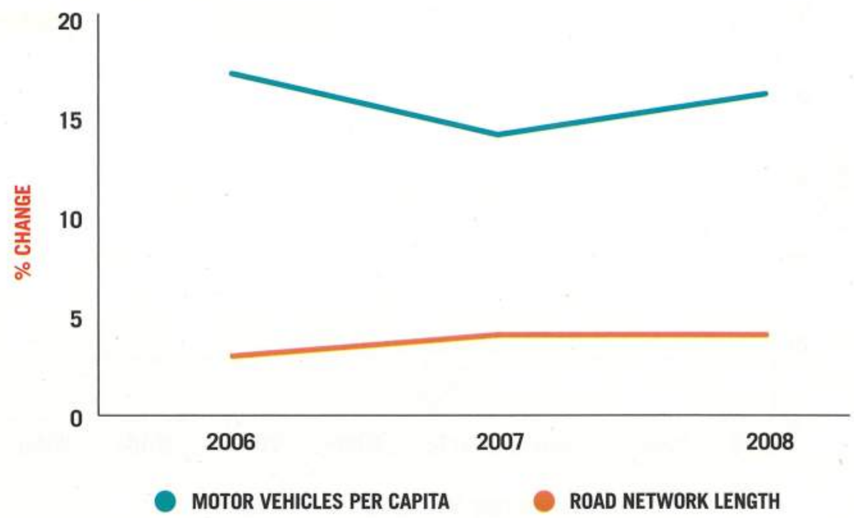
Energy intensity per unit of gross domestic product (GDP) in 2011 dropped by 2 percent compared to 2010, according to a February 2012 announcement by the PRC National Bureau of Statistics. At the same time, however, electrical power intensity is on the rise. China's National Energy Board reported that electricity consumption in China grew by 11.7 percent in 2011, significantly faster than GDP growth. This suggests that industry, which accounts for most non-electrical energy consumption, has made efficiency gains while domestic, commercial, and other users of electrical power are becoming less efficient. This trend will have major implications, as electricity production in China now doubles nearly every 10 years. China now generates 18 percent of all electricity globally, only slightly less power than the United States.

China's non-fossil fuel electrical power sources are still overwhelmingly nuclear and hydro (96 percent combined), according to the World Bank. Ongoing investments in these sources will ensure that China will hit its 11 percent non-fossil fuel power target during the period.

The more difficult target to achieve will be 20 percent renewable power production by 2020. Despite rapid growth, wind and solar energy sources still make up less than one percentage point of total electricity production in China. Since solar power is still more expensive to produce than electricity from coal-fired turbines, the government offers subsidies either for capital investment or operations, but neither subsidy is sufficient to break-even under current conditions. To achieve financial viability and promote investment, Zhejiang and Jiangsu provinces, among others, have introduced additional subsidized "feed-in tariffs" to supplement the national incentives. (A feed-in tariff is a special, higher price at which an electricity distributor will buy power from a renewable energy generator to reflect the additional cost of generating certain types of renewable energy. Feed-in tariffs can be phased out as the cost of electricity production drops.) There is also a challenge related to bringing renewables on-line. According to statistics from the China Electricity Council and China Wind Energy Association, only 68 percent of installed wind capacity was connected to the grid at the end of 2009. The growth and ultimate impact of wind and solar power will depend on decreases in the cost of the technology as well as the interim subsidy measures the government introduces. Increasing the cost of coal-fired electricity to account for the environmental costs would speed up the development of renewable sources such as wind and solar.

In addition to renewable power generation, there is a growing market for energy service company (ESCO) projects, which can help to reduce energy consumption and greenhouse gas emissions. ESCO projects typically finance the purchase of new energy-efficient equipment through projected savings on future fuel bills in comparison with old or energy-hungry machinery. While the World Bank and many smaller "green funds" have already entered this market, many local investors are hesitant, since they find the five-to-10 year payback period too long. This is one factor contributing to opportunities for foreign energy savings companies with local partners.

fig. 2 **CHINA'S VEHICLE FLEET IS GROWING FASTER THAN ITS ROADS.**



Source: World Bank Databank

Note: Numbers reflect year-on-year growth rates

WATER AND WASTEWATER

The 12th FYP set a target of reducing water use per unit of industrial output by 30 percent. The same target was achieved during the 11th FYP (2006–10), and it is expected that China will repeat that success during the current planning period. But as in the energy sector, domestic users are not keeping pace with industrial ones. Water consumption per capita and per unit of GDP is rising in many cities across China, despite dwindling supplies in the northern third of the country. Water use is expected to rise from 599 billion cubic meters in 2010 to 670 billion cubic meters by 2020. Meeting this demand is driving water providers farther afield, pumping more water over longer distances to users, and towards more sophisticated and energy-intensive water treatment technology.

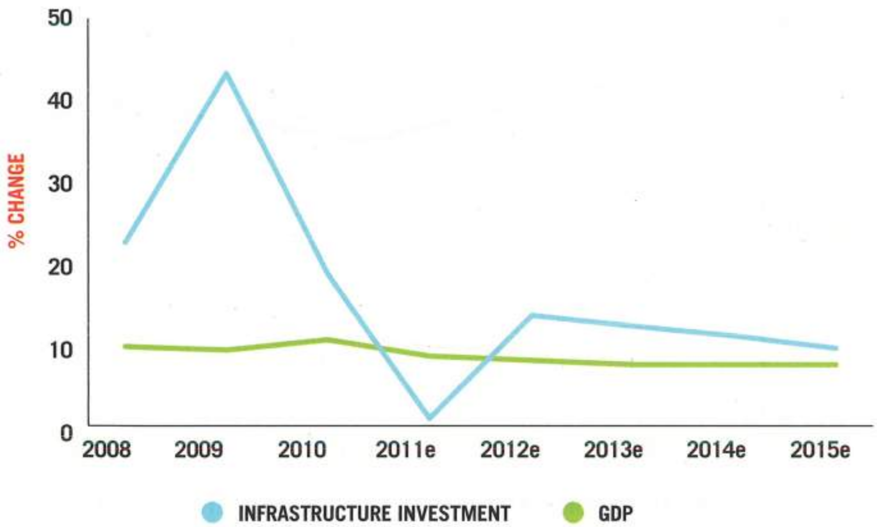
Wastewater treatment is one of China's modern urban infrastructure success stories. From 2000 to 2010, the number of wastewater treatment plants in China quadrupled (to about 1,700), while total treatment capacity increased five-fold (to 10,670 cubic meters per day), according to the PRC Ministry of Housing and Urban-Rural Development. This reflects the central government's strong commitment to preserve surface water quality. This major effort has not yet been enough: China's rivers and lakes—unable to absorb the pollution load discharged into them daily—are increasingly polluted. The environmental disruption caused by water transfer schemes, increasing energy intensity of water treatment, and steadily declining water reserves will continue to undermine the sustainability of China's water systems.

Future efforts to increase water sector performance should adopt a more integrated approach. The different components of urban water systems—water, wastewater, and stormwater—are often handled by different government organizations with different, sometimes competing agendas. Integrated water resource management can be used to match water quality to water uses, improve treatment cost-effectiveness, and raise the quality of discharged water to environmentally safe levels.

China's water industry will open up for reverse osmosis, membranes, and other advanced treatment technologies that minimize energy inputs and simplify operations. As local governments are expected to finance larger portions of their water infrastructure, foreign firms that are willing to invest debt and equity in treatment plants will become more welcome.

TRANSPORTATION

Perhaps the most complex sustainability challenge for infrastructure development in China is in the transportation sector. The PRC government is moving *fig. 3* **INFRASTRUCTURE GROWTH WILL CONTINUE TO EXCEED OVERALL GDP GROWTH IN THE NEAR TERM.**



Source: AECOM analysis

Note: Numbers reflect year-on-year growth rates.
e = estimate

to expand public transport, tighten fuel efficiency standards, and improve fuel quality. However, ever-expanding road networks and rising living standards are pulling people to live farther from work, ride bicycles less, and drive their cars more. China's road network has more than tripled in length in the last two decades; it is now half as long as that of the United States. In 2011, GDP growth was far outstripped by vehicle ownership rates, which rose 16.4 percent for all vehicles and 25.5 percent for compact private cars versus 2010, according to the PRC government.

Current urban planning and design practices are also contributing to the increase in private vehicle use in China. Residential areas are being built far from employment centers. The large city blocks and wide streets popular with city planners and real estate developers make it more difficult to walk rather than drive. While it is difficult to determine the extent to which road construction has fueled private vehicle use, the layout of urban road networks clearly does not support China's efforts to stem climate change. Compact, mixed-use developments that provide safe and convenient access to jobs and services by non-motorized or public transport would go a long way to reducing air pollution and carbon emissions per capita in China.

Transit-oriented development (TOD) is a bright spot in the development of Chinese cities. While the consideration of land use and density implications during rapid transit design is not systematic, many cities retrofit their zoning codes after subway construction to allow development to cluster around transit stops. With the right land use mix, this offers the possibility of higher use of non-motorized transport. At least 13 Chinese cities currently have one or more subway lines under operation, 54 lines covering 1,700 km. Another 76 lines, or an additional 1,600 km, are under construction. The target is 40 subways systems by 2020 covering about 7,000 km. At this pace and scale, TOD is poised to make a big difference in the long-term sustainability of urban living.

THE WAY FORWARD

China now has the opportunity to raise the bar of urban infrastructure delivery to safeguard the natural environment and open the door to the next phase of socioeconomic development. As China climbs the industrial value ladder and expands its service sector to cater to growing domestic demand, environmental quality will become central to achieving sustainable economic growth. Urban residents in the more sophisticated markets are already putting a substantial price premium on high-quality urban environment. To attract the right labor pool, Chinese cities will need to raise their game further.

The backbone of the next phase of infrastructure development should be the "one-system" approach. Infrastructure planners need to consider the development of the entire city-wide infrastructure system, including its energy, transport, land, and water subsystems. Realizing the potential synergies between subsystems will require technology for real-time information, conservation pricing, and demand management. Foreign infrastructure providers and experts with strong track records in these areas should be poised to make a major contribution to achieving higher infrastructure performance standards in the coming years.

Government stimulus and financing will also be critical. The central government can redouble its commitment to environmental sustainability by continuing to pursue aggressive resource conservation and economic productivity targets, and by backing those efforts up with funding for investment in infrastructure. Given the high price tag for the sophisticated projects that cities will have to build and local governments' over-leveraged financial condition, foreign companies that can bring technology, high-level expertise, and financing will be increasingly attractive in coming years.

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7 Steps to Weibo Success

Companies can use China's Twitter platform to market their products and services in China, but effective Weibo marketing campaigns require careful planning.

BY **ZAHEER NOORUDDIN** AND **LEON ZHANG**

Weibo, China's version of Twitter, is a powerful digital communications and marketing channel. Use of this real-time microblogging social technology in China has been unprecedented, and companies have a unique opportunity to use Weibo to reach and engage new audiences in China. Weibo has an estimated 300 million registered users in China. Users cover a broad swath of China's internet population, including youth, domestic and international celebrities, CEOs, professionals, and media personalities. First developed as China's answer to Twitter, Weibo has developed its own features that some would argue make it a unique marketing and communications proposition in China, and in many ways a more diverse and dynamic platform than Twitter. Because of these differences, international brands and companies cannot necessarily assume that their Twitter strategy will work for Weibo. Weibo requires its own strategy. For example, 140 Chinese written characters on Weibo can tell a full story, but the same number of characters in English on Twitter gets a sender only as far as a teaser message or a one-liner with a link.

How can a company successfully create a sustainable and results-driven Weibo program for reputation management and marketing in China? Traditional marketing and communications strategies should be the core of a company's Weibo program, but it should also consider Weibo's unique features to reach more people and increase audience engagement.

These seven steps will help you develop a successful Weibo strategy for your business in China.

IMAGINE CHINA

STEP 1: CHOOSE YOUR DIRECTION

Before moving into a strategic planning exercise for your organization's Weibo account, clarify your business and communication objectives, as well as your target audience. For example, a business may want to increase a product's sales by 20 percent in China's Tier 1 cities in one year. This specific business objective can help guide a company's Weibo strategy.

A company should not only map specific business objectives, but also communications, digital, and social media objectives. These objectives can include the company's target audience. For example, if a company wants to generate talent leads, it would need a dramatically different Weibo strategy than if it wants to engage with loyal customers. Generating consumer leads on Weibo requires a completely different strategy from a customer relationship strategy. Because these concepts are so basic and fundamental, they are often overlooked. It is essential to confirm the company's overall business direction at the very beginning before developing a tailored and strategic plan for Weibo.

STEP 2: EXPLORE YOUR POTENTIAL

A good Weibo strategy requires that a company review audiences and environments inside and outside of the company. A company should analyze four groups: the target audience, the organization's direct or potential competitors, the company's employees, and everyone else. The organization should also understand Weibo's latest social technologies and features, including:

- **Weibo Voting** This built-in polling system allows brands to develop surveys as a way to engage and gather useful information from their followers and audiences.
- **Weibo Live Interviews** This feature allows users to broadcast live events, allowing users to interact with interviewees in real-time.
- **Weibo on the Wall** This is a stream of tweets that can be projected onto a real wall at live offline events.

Understanding audience preferences and meeting these needs will help meet targeted marketing and communications goals. For example, an analysis of audience tweets, comments, and shares over a seven-day or 24-hour period will help a company identify the best times to engage. What days and what time of the day is your audience most likely to engage with content? For different organizations and different audiences, behavior will be different. This calls for companies to use analytical tools to better understand their core audiences, to deliver targeted content, and to develop marketing strategies and plans.

Companies need to understand their competitors, including basic facts about a competitor's Weibo presence. For example, a company should understand some basic metrics about their competitors' Weibo accounts, such as number of followers, number following, total number of tweets, when they posted their first tweet, and the topics the competitor posts about. If your company already has a Weibo account, include your metrics as a comparison. This analysis will help the company identify opportunities and challenges as it develops a powerful strategy.

If your organization already has a Weibo presence, then it is essential to analyze your state of play. Think of it as a "digital check-up." First, assess your current condition and compare it against benchmarks to identify any problems. Only then can you determine the prescription. In addition to the competitor comparison, you can also conduct other analyses from different perspectives to determine the direction of the strategy. This includes an analysis of the organization's existing Weibo account, an analysis of target users, and a comparison of industry best practices. For example, you should review the effectiveness of your existing activities by comparing the 24-hour distribution of company-generated tweets with shares and comments from your target audiences during the same time period.

STEP 3: DEFINE YOUR GOALS

Weibo communication and marketing objectives should be consistent with business and integrated communication objectives. Follow SMART goals: specific, measureable, attainable, relevant, and time-bound.

Companies should set achievable performance metrics. The number of followers is easy to understand, but the number of active followers can be defined differently and can be more important. There are different levels of follower activity. For example, there are followers who share or comment once a month or those who share or comment three times a week or more. Once performance metrics are confirmed, the criteria should not change very often. Otherwise, it will be impossible to compare different time periods.

When setting performance indicators, avoid ranking quantity over quality. If a Weibo

QUICK GLANCE

- Because of Weibo's unique features, companies should not assume that their Twitter strategy will work for Weibo.
- A company's Weibo stream should feature a mix of content, including useful articles, funny stories, and promotional material.
- A successful Weibo stream requires ongoing maintenance.

stream has 2 million followers, but a tweet attracts only one comment and two retweets on average, then the relationship between this Weibo stream and its followers is weak. The accumulation of high quality followers is similar to the accumulation of brand advocates: It requires sustained effort, building trust and relationships. Companies should not expect success overnight.

STEP 4: DESIGN YOUR 'PRESENCE' BY PLANNING YOUR STRATEGY

After deciding your communication objectives and performance indicators, the next step is to plan a strategy and tactics. Companies may have multiple Weibo accounts, and their relationships determine how a company should operate and manage them. There are five Weibo management strategies that companies operating in China can consider: distributed, centralized, coordinated, multiple hub and spoke, and holistic (see p.45).

As with Twitter and other social media channels, designing and building the right brand presence on Weibo is critical to a brand's corporate reputation management and marketing efforts. A distributed Weibo structure is uncoordinated and works better for start-ups and small businesses. A centralized Weibo structure works well for companies with a single well-known brand and several product lines. A coordinated or hub and spoke approach to Weibo maintains an organized structure, and it is useful for larger organizations with multiple divisions and markets. A holistic approach to Weibo can work for companies that empower their employees to speak consistently, yet independently of each other, as the voice of the company. No matter which structure a company chooses, the following steps will help companies develop and execute a Weibo strategy.

- » **Follow** A company should develop a follow strategy that includes both who the Weibo stream should follow and how it can attract followers. Following other influential Weibo streams is a smart way to increase followers. An organization's Weibo stream can reward active brand advocates—such as those who continuously engage with the company's Weibo content—simply by following them back.
- » **Let the world know** To attract followers, a company can promote its Weibo presence using all types of media available to the organization, including owned, paid, and earned media. Promote social media streams on company websites, emails, and blogs, through traditional paid advertising, and by attracting new followers through current followers.
- » **Content** A strong content strategy is vital to the success of your Weibo program. Ensure the quality of your content, and post valuable content at the right times. While developing a content strategy, take advantage of the most frequently shared topics on Weibo—social news and events, helpful information and tips for users or their friends, and humor and interesting news. Tell stories, be generous, and be funny. Organizations can and should take advantage of these topics and integrate them with corporate positioning, business objectives, and communication goals.
- » **The 1/3 principle** A corporate or brand Weibo account must also align with corporate or brand communications objectives—not simply be based on what's trendy and popular. A general rule of thumb is the "1/3 principle" for content. Divide your content among three main areas of focus: value-added, engagement, and branded or promotional content. Value-added content, such as how-to and other informational articles, provides useful information for users and their networks and can increase shares and exposure for your posts. Engaged content, such as asking your followers questions, encourages users to interact with your stream. Promoted content is related to the company's branding, products, or events. Reviewing audience feedback will help to fine-tune the content proportions specifically to the company's strategy and program.
- » **Posting** A company should also decide when it is best to post content on Weibo. A company can develop annual, quarterly, monthly, and weekly posting calendars depending on business needs. Prepare and maintain a posting timeline—much like an editorial calendar—and develop and keep content ready in advance to guide daily posts and updates.
- » **Define a process to respond and engage** The goal of an engagement strategy is to guide your Weibo activities with your audience, such as when to share (retweet) and respond to users. Guidelines and management processes can help Weibo operational teams engage with users in different situations while ensuring compliance with legal and company marketing rules.
- » **Reporting** Companies should collect data through continuous monitoring, analyze data for insights and recommendations, and take action based on these insights and recommendations. It is necessary to develop a measurement and reporting system that is in line with your performance indicators as the foundation for continuous monitoring. This system will provide guidance for future improvement through regular review and analyses with an organization's management team.

STEP 5: MANAGE YOUR STREAMS

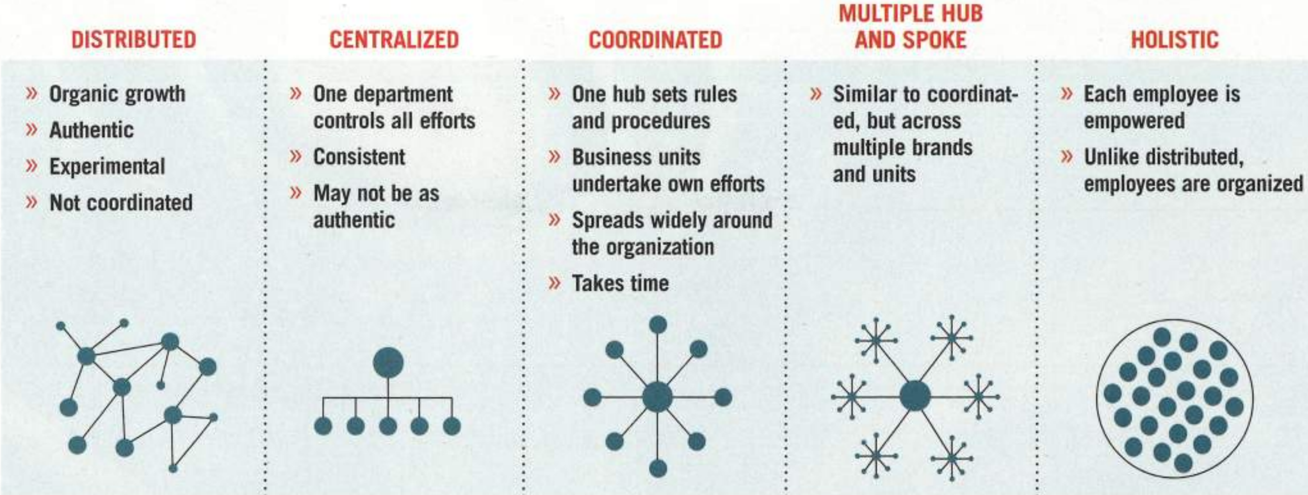
A company's official Weibo presence is just as much a part of its corporate identity as a website. Just like a website, a company's Weibo stream is not a one-time investment—it requires ongoing operation and maintenance. These steps will help companies direct long-term maintenance, relevant activities, and integration with other communications marketing channels.

Form a community

Weibo users behave differently. Approach your audience segments differently to manage them more effectively and build stronger relationships and advocacy. For example, Burson-Marsteller segments Weibo audiences into creators, sharers, critics, and spectators. Weibo management principles can be developed based on a group's unique interests and characteristics.

Nurture influencers

Managing a company's social media influencers, or "key opinion leaders," is not simple, short-term, or static. It is a long-term and dynamic process that requires support and resources. Opinion leaders should be analyzed for their relevance, influence, and cooperation opportunities. An influencer's relevance should be evaluated against the company's communications



objectives. Influence is the opinion leader's power among peers and followers. Cooperation opportunity is the probability of working with the influencer.

Plan a Weibo campaign

The basic principles for planning a Weibo campaign are to be consistent with overall business objectives and communication objectives; tailor particular communication approaches for target audiences; and select the most suitable Weibo features for a given marketing campaign.

Integrate Weibo

Weibo is one of many social media marketing and communications tools available—just one approach to achieve an organization's overall communications and marketing objectives. To be truly effective, a company must integrate Weibo with other marketing, communications, sales, and customer service programs. Doing so will serve overall company objectives and show stronger value and results.

Ready your resources

Organizations often jump onto Weibo without planning resources and investment, and they end up failing, giving up, or achieving a very low return on investment. Companies must not overlook proper resource planning, including allocating talent, financial, and material resources for a Weibo marketing program. All are fundamental to ensuring successful and smooth operations.

Track performance

Most companies acknowledge that Weibo's potential for marketing and communications is great. But when customers complain or say negative things, organizations tend to be unprepared to respond or deal effectively with a crisis. To manage crises, real-time monitoring on Weibo is critical.

There are many digital monitoring tools available for organizations to choose from, but only a handful can effectively monitor Chinese social media conversations and sentiment in real-time and analyze results. Select a program that works specifically for the Chinese social media environment.

STEP 6: PLAN YOUR ACTION

After a holistic strategy and specific planning process, take action. Develop an action plan—lay out the exact information of who will do what and when—and then take action.

Empower your team

It is important to assign roles and responsibilities within the organization or agency and set up the right team structure. Weibo management requires team members with different specialties and skills. For instance, general Weibo content development and editorial calendar planning requires content and copywriting skills. Video content requires video production skills.

Get set, go!

Depending on the organization's requirements, a company may want to outsource certain tasks to a professional agency in addition to its own internal staff. A typical approach that many organizations use is to assign an in-house person—a social media manager or online marketing manager—to take charge of Weibo. Other companies hire agencies—a PR firm, or an interactive agency—to help with planning, execution, monitoring, and optimization.

STEP 7: OPTIMIZE

It is essential to maintain your presence on Weibo to optimize its performance. For optimization, an online monitoring tool, such as Weibo's platform statistics and analysis, can help assess a Weibo account's performance. The tools not only allow companies to monitor data from their own Weibo account, but they can also provide information about conversations on all social media platforms. Analyzing data provides companies with valuable insights that can serve as further direction for future optimization.

CONTENT IS KING

With your Weibo strategy now off the ground and in motion, remember that content is king. The shelf life of digital assets, channels, and programs is related to the maintenance of a company's Weibo presence. A good digital housekeeper will ensure that the content is fresh and frequent, and will quickly address any bugs and quirks. There is no better way to conduct quality assurance for a digital campaign than the utilization of real-time monitoring tools.

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IMAGINE CHINA

China's Mixed Transparency Record

BY **SHELLY ZHAO**

The PRC government's scorecard dipped in the last year, but regulators can take measures to improve rule-making transparency.

The PRC government has taken positive steps in recent years to increase regulatory transparency, but China's lawmakers still have a mixed record when it comes to implementing transparency commitments. According to an analysis by the US-China Business Council (USCBC), the National People's Congress (NPC) released one-third of laws passed during a recent 12-month period, while the State Council and its ministries posted for public comment 62 percent of rules and regulations during the same period.

For US companies, transparency in government remains an important issue. In USCBC's 2011 member company survey, transparency ranked number eight in members' top 10 issues that affect their operations in China, and transparency has consistently ranked as one of the top concerns for US businesses in China. Because foreign and domestic businesses often modify their strategies based on regulatory changes, rule-making transparency helps businesses make informed and efficient decisions. Maintaining regulatory transparency means soliciting public feedback during the creation of new laws and regulations, promoting open government decision-making, and granting access to regulatory information.

In April, USCBC released its fourth annual report on transparency, which covered the PRC government's transparency efforts from the period of mid-March 2011 to mid-March 2012. The report focused on areas in which the central government has pledged to improve transparency. Overall, USCBC found that PRC government agencies showed mixed results in meeting their transparency goals.

MEASURING TRANSPARENCY

To measure the government's commitment to transparency, USCBC identified new laws and regulations the PRC government said would be posted for comment on the State Council Legislative Affairs Office (SCLAO) comment pages or ministry website pages. Specifically, USCBC monitored government efforts to:

- **Comply with the NPC Standing Committee's announcement in 2008 that it would solicit public comments on most draft laws and amendments.**
- **Adhere to the May 2011 Strategic and Economic Dialogue (S&ED) commitment to "publish for public comment all trade and economic-related administrative regulations and departmental rules" for at least 30 days on the SCLAO website.**

If a document was issued but not posted for comment it was classified as not meeting China's transparency commitments. In addition, documents posted for comment were evaluated as to whether they had been posted on either the main SCLAO comment page or the ministry page, and were evaluated on whether the comment period met the 30-day commitment.

Defining transparency can be difficult. China's May 2011 S&ED transparency commitments did not define which regulatory documents would fall under "trade and economic-related administrative regulations and departmental rules."

USCBC uses a narrow and broad definition to evaluate transparency. The narrow definition includes documents explicitly labeled as State Council or departmental administrative regulations, such as "provisions" (*gui ding*), "regulations" (*tiao li*), and "measures" (*ban fa*). The broad definition includes regulations in the "narrow" interpretation as well as other administrative regulations that appear to function as State Council or departmental administrative regulations, such as "opinions" (*yi jian*), "notices" (*tong zhi*), and "guides" (*zhi yin*). USCBC tracks the activity of PRC agencies that are most relevant to US industry issues and concerns, but recognizes that such lists may not be all-inclusive due to the nature of China's transparency challenges.

IMPLEMENTATION OF TRANSPARENCY COMMITMENTS

USCBC found that the PRC government had a mixed record of meeting its transparency commitments from March 2011 to March 2012.

NPC transparency commitments

The NPC's compliance with its transparency commitments has been inconsistent. Compliance between March 2011 and March 2012 deteriorated significantly compared to previous periods. Out of a total of nine laws and amendments passed within the 12-month period, only three (33 percent) were posted to the NPC website for comment during the drafting or revision process. Notably, the other six laws that were not released for public comment were amendments to existing laws. During the previous three tracking periods—from 2008 to 2011—the NPC released most draft laws for a 30-day comment period at least once during their standard three rounds of NPC Standing Committee review. The previous tracking period—from 2010 to 2011—showed that the NPC released 11 out of 14 laws and amendments (78 percent) for a comment period of 30 days.

S&ED transparency commitments

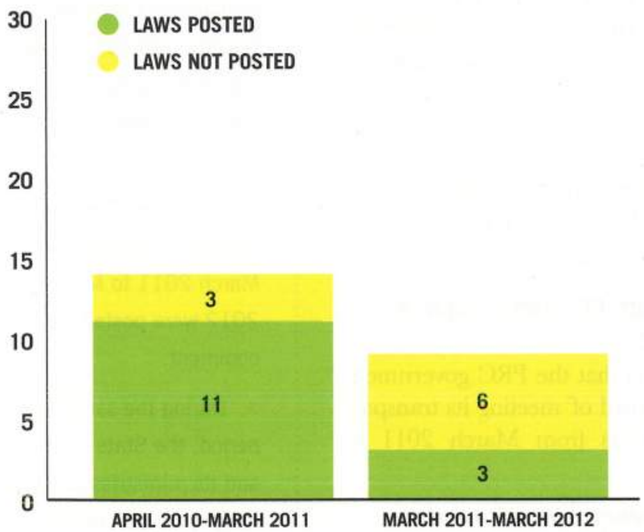
Though PRC agencies have been inconsistent in the publication of trade and economic-related rules and regulations for comment on SCLAO's information website, there has been some improvement since 2009.

Using the broad interpretation of administrative rules and regulations, 130 of 259 relevant documents (50 percent) issued between mid-March 2011 to mid-March 2012 were posted for public comment to SCLAO's dedicated webpage. An additional 31 documents (12 percent) were posted on

QUICK GLANCE

- Though some PRC agencies improved their transparency records, the government's overall transparency record remains mixed.
- One-third of laws passed by the National People's Congress from March 2011 to March 2012 were posted for comment.
- During the same period, the State Council and its ministries posted roughly 62 percent of rules and regulations for comment.

fig. 1 **NATIONAL PEOPLE'S CONGRESS' TRANSPARENCY RECORD**



Source: USCBC

ministry sites, but not on a designated SCLAO site. Of the documents posted on either site, 87 out of 161 (54 percent) were posted for the full 30 days. This is an improvement from the figures profiled last year when 142 of 503 documents (28 percent) were posted to a designated SCLAO website.

Using the narrow interpretation of administrative rules and regulations, 120 of 164 relevant documents (73 percent) issued from mid-March 2011 to mid-March 2012 were posted for public comment on a designated SCLAO website, and an additional 16 of 164 documents (10 percent) were posted to ministry websites. Of these total documents posted, 77 of 164 (47 percent) were posted for the full 30-day period. These figures still fall short of the goal of posting all documents but show an improvement from previous periods. The figures from the 2010 to 2011 reporting period showed that 72 of 165 relevant documents (44 percent) were posted, with only 11 of those posted for a full 30 days. From 2008 to 2009, 44 of 135 documents (33 percent) were posted for comment.

The adjusted average comment period for all documents posted to either website during the 2011–12 period was roughly 25 days. This was an increase from USCBC's previous report, which showed an average of 17 days.

The frequency of comment solicitation on draft rules and regulations varies greatly among ministries under the State Council. Three agencies with fairly consistent records of soliciting comments are the Ministry of Transport (MOT), Ministry of Agriculture (MOA), and State Administration of Work Safety (SAWS). These agencies posted most of their circulated or issued documents for comment on the SCLAO comment pages. MOT posted all of the documents it issued, MOA posted eight out of nine documents, and SAWS posted 16 out of 17 documents.

TRANSPARENCY TRACKING CHALLENGES

Ambiguity over key terms allows different interpretations of the commitments and multiple ways of measuring compliance, which makes tracking transparency commitments challenging. Furthermore, the 2011 S&ED commitment states that posting rules and regulations is "subject to limited exceptions," but it does not provide clarification on what these exceptions are. While the PRC government may consider certain documents to be exceptions to this commitment, such exceptions do not justify such low rates of compliance.

PRC government website issues also pose challenges for tracking transparency. The website URLs to which some administrative items are initially posted expire after a short time, especially for those posted on agency websites, making it difficult to locate regulations later. This is particularly common with administrative items released by the Ministry of Finance. Such issues hinder the effectiveness of government efforts to improve transparency.

Because the government does not appear to maintain a central database of items that have been released for comment, one of the few ways to verify whether laws and regulations were published for comment is to check the SCLAO and departmental websites regularly. This makes it difficult for anyone—public and private sector alike—to track transparency in a comprehensive fashion.

RECENT DEVELOPMENTS IN PRC TRANSPARENCY

The PRC government continues to emphasize its commitment to increase transparency through various statements and regulations aside from the NPC and S&ED commitments.

State Council aims to improve government websites

The State Council in April 2011 issued a notice calling on all government agencies to improve website administration—meaning sharing non-confidential documents with the public, posting policies related to public interests on government websites, and improving website operation and technical support maintenance.

State Council statement to strengthen budget transparency efforts

The State Council in May 2011 stated that PRC government and Chinese Communist Party departments should provide more details in public financial information and budget expenditures, particularly spending on government receptions and entertainment, overseas trips, and vehicles. According to the comments, government and party departments should publicize their budgets prior to NPC approval.

State Council releases public comment requirement on laws and regulations

In April 2012, SCLAO released the Provisional Measures on Draft Laws and Regulations for Public Comment prior to the May 2012 S&ED. Article 6 of the measures stated that "administrative regulations should generally be posted for no less than 30 days on the SCLAO website, with the exception of emergency or special circumstances." While these measures addressed the 2011 S&ED commitment, it did not mention trade- and economic-related regulations specifically. A separate article in the provisional measures exempted certain national security, exchange rate, and monetary policy-related regulations from the public comment requirement.

Other transparency reports

The Peking University Center for Public Participation Studies and Supports in September 2011 published a report that measured the transparency of 43 State Council departments. The report assigned failing grades to 35 out of the 43 departments, and said that the State Council needed to improve information disclosure and access.

The Chinese Academy of Social Sciences (CASS) ranked government ministries by their progress on transparency commitments in February 2012. The Ministry of Commerce, National Population and Family Planning Commission, Ministry of Environmental Protection, SAWS, and MOT were ranked among the most transparent agencies. The CASS report ranked Beijing, Tianjin, Jiangsu, Fujian, and Shanghai as having the most transparent provincial or municipal governments.

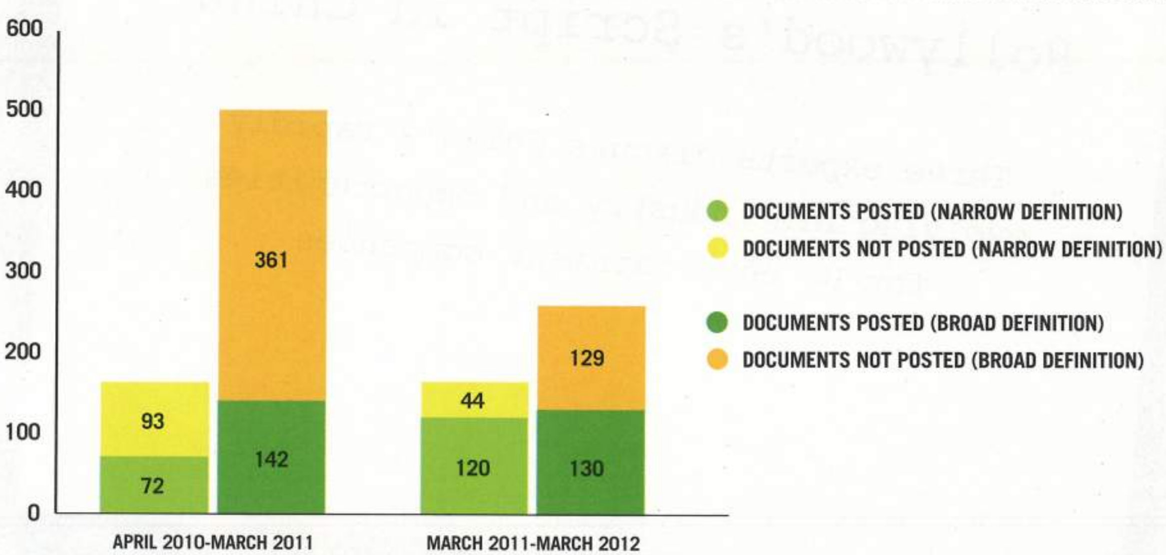
RECOMMENDATIONS

While the PRC government has improved its record of complying with some transparency commitments, the government could do more to raise transparency and clarify exactly which documents warrant public notice. To increase public participation and promote China's transparent regulatory processes, USCBC recommends that the State Council take further action to:

- **Ensure that all administrative regulations and departmental rules are posted on the designated SCLAO information website comment page for the full 30-day comment period. An even longer comment period of 60 or 90 days would be preferable and result in better comments for the consideration of government regulators.**
- **Publish a clear definition of the documents covered under the State Council's transparency commitments. Regulatory documents such as catalogues, notices, and opinions can significantly affect how a business is run.**
- **Explain in detail, and within the bounds of confidentiality, the economic methodology and rationale that underpin administrative reviews and decision-making by central government bodies, including antimonopoly merger reviews, countervailing duty and antidumping investigations and case rulings, and decisions based on national economic security considerations.**

This article is adapted from USCBC's fourth annual report on government regulatory transparency. **SHELLY ZHAO** (szhao@uschina.org) is a manager of business advisory services at USCBC in Washington, DC.

fig. 2 **TRANSPARENCY RECORD OF THE STATE COUNCIL AND PRC MINISTRIES**



Source: USCBC

ACTOR LI XUEJIAN on the set of the Chinese historical film *The Emperor and the Assassin* in 1998. China has become Hollywood's largest foreign box office market, and US film studios have been looking for ways to cooperate with and profit from China's film industry.

Hollywood's Script in China

Three experts discuss China's rapidly evolving film industry and opportunities for US entertainment companies

CHRISTOPHE D'YVOIRE/SYGMA/CORBIS

It's been a busy year for the US film industry in China. During Xi Jinping's visit to the United States in February, the PRC government announced it would loosen China's quota on imported films. In April, the Walt Disney Co. announced it would co-produce *Iron Man 3* with Chinese company DMG Entertainment. Shortly after, the US Securities and Exchange Commission (SEC) announced an investigation into whether Hollywood movie studios had been paying bribes while working in China, but that hasn't stopped business deals between the two countries' film industries. In May, Dalian Wanda Group Co. said it would buy AMC Entertainment Holdings, which operates more than 300 movie theaters in the United States. And this spring, American films have been opening at the top of China's box office rankings.

To make sense of these developments and the potential of the Chinese film market for US companies, three film industry experts recently spoke to *CBR* Editor Christina Nelson about trends in producing and distributing films in China. These interviews have been edited for length. To read the full interviews, visit www.chinabusinessreview.com.

Mathew Alderson, a Beijing-based partner at Harris & Moure Attorneys, represents individuals and companies in media, entertainment, and intellectual-property intensive industries. He recently discussed legal troubles companies run into while producing and distributing films, as well as whether China will increase the quota on the number of foreign films it allows into the country.

Why are studios co-producing films in China?

Alderson: China now has the largest foreign box office market in the world, but in China there are effectively no sources of ancillary income, such as income from Internet downloads and home rental. So, Hollywood studios want a piece of the box office action. There is a quota for foreign films that can share in box office revenue. The reason for the interest in co-productions is that they are regarded by the Chinese as domestic films and are therefore not subject to the quota. The share of box office payable on co-productions is higher: a co-production can command around 38 percent of box office as opposed to 13 to 25 percent available for imported films. The Chinese authorities also require that around 55 percent of total box office is taken by domestic films so a certain return on domestic films is guaranteed.

What is the most common legal mistake you see companies make when it comes to producing and distributing films in China?

Alderson: There are several common mistakes. First, companies often fail to undertake proper due diligence on their Chinese co-producers and other Chinese counter-parties. As a result, fundamental matters such as the existence, identity, and domicile of a Chinese person or a Chinese company are not established, and the permits or licenses these parties require under Chinese law are not verified. Second, there is a tendency to assume that US law and jurisdiction should apply to all contracts in all circumstances. US law and jurisdiction are of little value unless the Chinese party has assets in the United States. These days good results can often be obtained by foreigners seeking to enforce contracts in the Chinese courts, particularly in the top-tier cities. Finally, there is a tendency to sign brief memoranda of understanding (MOU) or other short-form documents without taking independent advice. Normally prepared by the Chinese party, such documents tend to lock the foreigners into a particular type of entity or a particular deal structure when these may be inappropriate or even unlawful. Foreigners are often reluctant to subject these types of documents to close scrutiny for fear of insulting their partner and losing some advantage or opportunity, which is usually illusory anyway.

What can you tell us about the SEC investigation into whether Hollywood studios were bribing PRC government officials to film and distribute movies in China?

Alderson: The investigation was announced during the 2nd Beijing International Film Festival. The timing was instructive. Clearly, the SEC is sending Hollywood a message here. The message is that the entertainment business in China is no longer the "Wild West."

What are a few best practices the movie studios—and companies in general—can implement to avoid violating the Foreign Corrupt Practices Act (FCPA)?

Alderson: At least put FCPA compliance provisions in all contracts made in or in connection with China. The US Association of Corporate Counsel recommends that contracts should specifically mention the importance of FCPA compliance and require partners to represent that they know the elements of the law and will comply with it. You should have a clearly worded audit clause that requires the partner to provide documents and assistance in an investigation. You should also ensure that you are able to terminate a contract if your partner is in violation of the FCPA. Other than that, you should be aware that the SEC tends to regard representatives of state-owned enterprises (SOEs) to be representatives of the Chinese government, and financial dealings with those representatives are in the cross hairs. Any US corporation that has formed a joint venture with an SOE needs to be very careful about the payments made to representatives of that SOE.

What are the implications of the announcement in February during Xi Jinping's visit to the United States that China would increase the quota of films it allows in the country?

Alderson: Have the Chinese really made such a decision? I am not yet convinced. During Xi Jingping's recent visit to Hollywood, the US announced the signing of a new film-related agreement with China. The agreement was said to improve the terms on which the US may import films into

China for theatrical release. This all took place in the context of the World Trade Organization (WTO) dispute between the two countries over the importation and exhibition of "audiovisual entertainment products" in China.

If the film agreement exists at all, it has not been published at the time of this interview. So far, all we have seen is a draft joint communication from the US and China delegations to the WTO's dispute settlement body. The communication reports that "progress" has been made in resolving the dispute and that an MOU sets out some "preliminary arrangements" made by the two countries. The MOU has not been published, but the joint communication says that it includes certain "key elements." Three of these elements in particular are worth mentioning. First, enhanced format films (for example, IMAX) are not subject to the 20-film quota. Second, the distributor of a film imported on a revenue-share basis is entitled to 25 percent of gross box office takings. Third, Chinese entities other than China Film Group [China's largest state-owned film company] will be entitled to import and distribute films. Clearly, it is impossible to form a view on the situation without reading the MOU. The deal has apparently been put forward in an effort to resolve part of an ongoing WTO dispute. The key elements of the deal are preliminary.

Robert Cain, a partner at film co-production company Pacific Bridge Pictures, has been doing business in China since 1987. He has worked on co-productions in China, including the film *Mongol*, which was nominated for the 2008 Academy Award for best foreign language film. Cain says co-productions between US and Chinese film companies offer immense opportunities, but Hollywood studios may have to change their business model to adapt to the China market.

There has been a lot in the news about Hollywood studios doing co-productions in China. Is there actually an uptick in this trend, and why would a film studio decide to pursue a co-production?

Cain: There's certainly been an uptick in talk and announcements. The reality is there have been very few real US-China co-productions. You can really count on one hand the number that have been done in the last three or four years. What people tend not to know or talk about is that there's a huge co-production business in China with companies from other places like Hong Kong, Taiwan, and [South] Korea.

The reasons for doing a co-production are pretty clear. There's still a—and I think there will be one for a while—quota on the import of films into China. Even with the increased number of slots that are expected to open up this year, [the Chinese government is] still restricting the number of films that can get in. So doing a film as a co-production is a way of getting around the quota. If films qualify as approved co-productions then they are treated just like any domestic production with open access to distribution. And the other important reason is the economics are better. You get a better share of the box office.

Are American companies trying to model themselves after companies from Hong Kong and Taiwan that have done co-productions before?

Cain: No, in fact I'm not sure how aware they are of the existing, pretty successful approaches. Particularly in Hong Kong and Taiwan, there's such a cultural affinity and understanding. They speak the same language, and it's easier for them to work with each other. They also, in my experience, come with more of an attitude of meeting the Chinese producers at least halfway and making an effort to understand what their needs and the needs of the marketplace are. They really tailor their films and their approach to be successful in China. The Hollywood studios are still trying to figure that out.

Are we going to see more Chinese characters or plotlines that fit with Chinese traditions of storytelling in Hollywood films?

Cain: I think there's an awareness in Hollywood that they need to figure out how to cater better to the Chinese audience. I wasn't at the Beijing International Film Festival this year, but what I've been reading, what I've been hearing is there's been more activity around US-China co-productions. I don't know what the result is from those conversations. But generally speaking, I think the studios are at least at the point where they now understand how quickly China is growing, and how important it's becoming. You can't ignore the numbers because they're growing so quickly. How that's translating into effective action, I'm not sure. I haven't seen very much of it yet.

Is piracy still a big industry concern? If so, what can you do about it as a foreign company?

Cain: There's been a huge amount of pressure applied for many years. It is still a concern. It's interesting that where online piracy is also a big problem at least there is a lot of spending and legitimate acquisition of film titles by online distributors. So where there was no money coming back to the studios from that, at least there's some revenue stream [from online sources] and it's one that's growing from China. So much of the viewing in China has shifted from physical media to online—that change is happening really quickly.

What is it like to work with a Chinese company to make a movie? What are some of the challenges and benefits of doing this?

Cain: I really enjoyed the experiences I've had working with the Chinese producers and crews. I can't really say I've had any more problems or challenges than I've had elsewhere. The difficulty in working there is the infrastructure for making films is still at an early stage of development, and the talent pool is not very experienced yet. There are great film-makers and great writers, but there just aren't many of them. It's hard to find people at the level of skill and professionalism that you're accustomed to finding here in Los Angeles. And that goes all the way down the line, sourcing cameras and equipment and sound stages. But that's changing; there's been a lot of investment in China so it's getting better. It's an issue that's going to go away as they make more films there and get more experience. The opportunity, of course, is just to show a part of the world that people are eager to learn about and understand. They are also phenomenal locations. I made a couple of productions in Beijing and Shanghai, and they are really spectacular locations. Just having access to such a big and growing market is a real plus.

Brent Reynolds has been traveling and doing business in China for almost 30 years. Through a company he founded in 2006, Q Global, Reynolds licenses and distributes films in China to television stations and web portals, including China Central Television (CCTV), Sohu.com, and Tudou. Reynolds recently answered questions about distributing films in China and the fast growing market for on-demand video.

What are the steps a company would take to distribute a film in China?

Reynolds: It's a little bit more convoluted than purchasing the film rights, taking it to another country, and distributing it. We have to authenticate it first. So we take our contracts to a government bureau and they check with wherever we bought the film. The Chinese group actually goes back and verifies within that country from the supplier you bought it from that you actually own the rights you say you do. Once that's done, and that takes a month or so, then you get your chops and your stamps and you go to the censors with it. The censor will decide whether this film will pass, if it needs to be edited, or if it's outright rejected. There's a different censor for TV, theatrical, and new-media or web-based distribution models. It's fairly convoluted and time consuming. Once you get it through those first couple of steps, should you succeed, then you can take it out and try to show trailers to your different customers or go to one of the film festivals—in Shanghai, Beijing or Hong Kong—and try and show it and market it. Then you can sit down and write contracts, and after you sign the contracts, you get to chase your valued Chinese customers to get them to pay you.

What are some of the challenges associated with chasing down payments?

Reynolds: The only challenges are delays. We get paid by everybody. For instance, I have sold to DVD makers, and they pay me pretty quickly. And some of the other folks pay on time, and others take three to six months depending on the contract. It's not really bad, you just have to chase a little bit harder.

Is the legitimate market for on-demand, streaming video growing now?

Reynolds: That's increasing and that's a fairly robust distribution model in China. The big studios in the United States seemed to fight the idea of web distribution, but now we have Netflix. China didn't have those legacy businesses that stifled music or film distribution on the web. Initially, China had a lot of pirated films and a lot of pirated music being distributed on the web, but in the last couple of years the government has started to crack down seriously on that and we're dealing with a lot of extremely large, profitable, legitimate Chinese web portals that buy and verify legitimately licensed entertainment from Western sources. They almost can't get enough of it. They want so much of that stuff. It's incredible to see the change in China as far as licensed distribution of legitimate products.

When did this side of the business start to take off?

Reynolds: I would say in the last two years. It's been very recent. Before that they were buying the films, but there was a lot of pirated product out there and the legitimate companies weren't paying very much for the films.

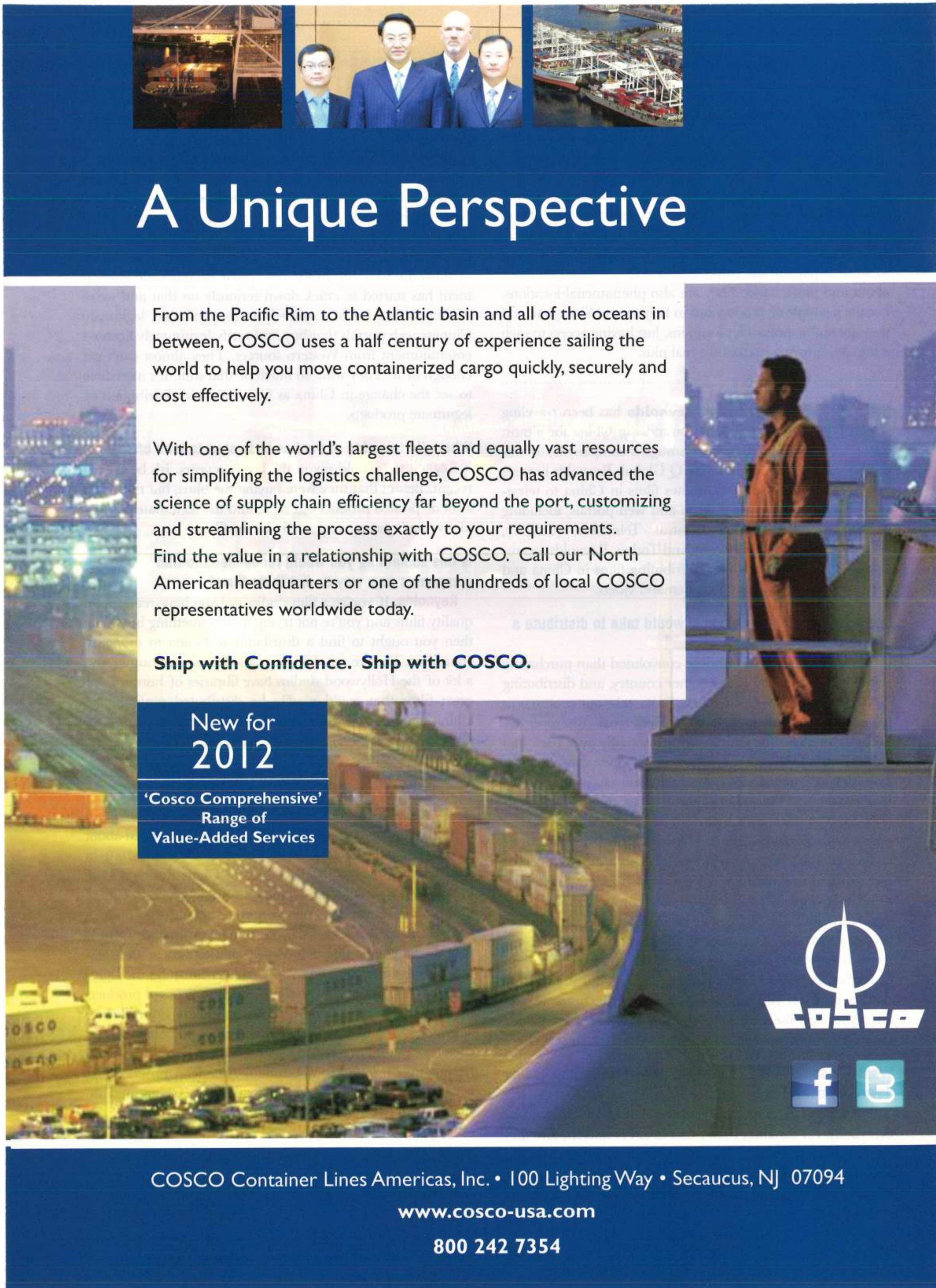
Is this something you would recommend to film companies as a way to distribute films?

Reynolds: If you're a film studio and you have really good quality films and you're not trying to do something in China, then you ought to find a distributor in China to monetize your films. They're not doing any good staying at home. And a lot of the Hollywood studios have libraries of hundreds of great films that could readily be distributed profitably in China. I'm not sure which ones are doing very much, but we don't see a lot of them succeeding at a high level.

What about piracy? How can film studios protect against piracy?

Reynolds: A few years ago the top Hollywood studios got behind in China because their executives were worried about piracy. Well, the fact is that when a movie comes out in America theatrically or even before, the Chinese already have it. So when I get a film to China or a studio gets it to China, if the Chinese want it, they've pirated it, but they have a second-quality copy and the distribution is limited. CCTV, new media companies, universities, airlines, hotels, and military installations will still buy [the real versions]. So the legitimate distributors of film that can only use licensed products that are checked by the government will still buy our films.

Piracy is a fight that we should continue to battle, but we shouldn't put all our resources into it. Our resources should be put into bringing our beautiful American product that we're the best in the world in producing to China, and we should push the name brand in China.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THE BIG SWITCH

The maturation of trade relationships between the U.S. and China is accompanied by significant role reversals

IN PARTNERSHIP WITH USCBC THE US-CHINA BUSINESS COUNCIL 美中贸易全国委员会

Ahead of the U.S.-China Strategic and Economic Dialogue earlier this month came reports of ebbing criticism over China's current-account surplus and persistent weak-yuan policy. From a high of 10.1 percent of GDP in 2007, China's trade surplus fell to below 3 percent in 2011. That surprise trend was seen blunting Western calls for a rise in Chinese currency valuations.

As those controversies lost steam, another familiar one arose. The demands of human rights activist Chen Guangcheng dominated news reports as Dialogue conferees gathered in a jittery Beijing.

To a growing cadre of American business interests, these matters remain prominent, even as they signify a timeworn paradigm. Replacing the status quo is a newer narrative—all about nascent opportunities and challenges abroad for companies from China and other emerging nations.

For a segment of Chinese corporations and investors, profiting as part of a low-cost global manufacturing center, or as a cog in the state-directed machinery for infrastructure building, has bred a confidence to seek far-flung alliances and new ventures. Thus, Chinese capital now streams Westward for reasons beyond purchasing low-yield U.S. debt. Along with the investable cash come

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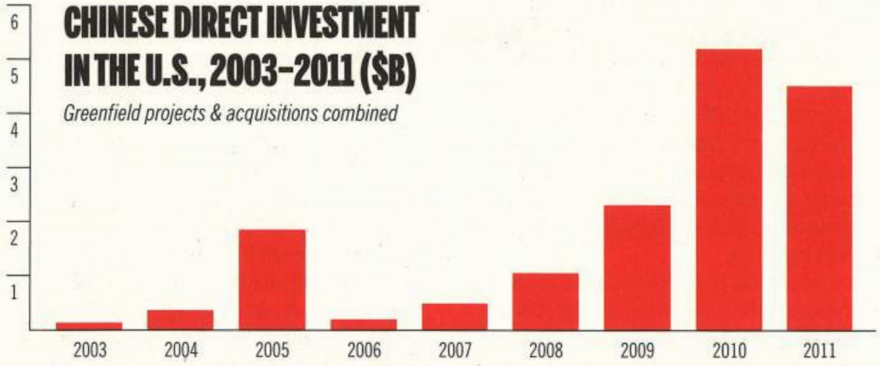

competencies and ambitions that promise a value-creating presence in the U.S.

"In 2006, foreign direct investment in the U.S. by Chinese interests was just over $200 million," says X. Rick Niu, Senior Managing Director and Head of Starr Strategic Partners, a division of the global insurance and financial services organization Starr Companies. "By the end of 2010, that figure had risen to over $5 billion," Niu says. "Direct investment of $5 billion is still relatively small, but you note the rate of change in just four years—these two countries have evolved and their potential is significant." Starr Strategic Partners was formed to bring this potential to life, advising global Asian investors and other emerging-market companies on entering and expanding in the U.S.

A familiar figure in China-U.S. commerce, Starr's Chairman Maurice "Hank" Greenberg, can be credited for the openings Niu surveys on behalf of Starr Strategic Partners. It is historical shorthand, but accurate all the same, to say that Nixon went to China in 1972 and Greenberg arrived shortly thereafter. "From a commercial standpoint, he conducted the trailblazing business missions to and with China," Niu says of Greenberg. "From 1975 on, he has made a half-dozen trips there each year, and there is no sign of him slowing down." It was Greenberg's understanding of how, patiently and persistently, trust can be built—and how unshakable it could come to be—that finally won him unprecedented approvals in China to set up the first and only wholly owned foreign insurance company in 1992, and to directly manage a Chinese state-owned insurance enterprise in 2011.

Earlier this year, Greenberg boldly proposed that the U.S. and China should begin negotiating a free trade agreement. Premier Wen Jiabao and other senior Chinese officials responded positively. The idea is also gaining traction in the U.S.

The U.S.-China Business Council (USCBC) is in step with this movement, and works to facilitate it. In a February memorandum, the USCBC's board of directors energetically cited progress in the two nations' commercial relationship and called for additional efforts toward important goals. That memo's first bullet point was a "pledge to openness" based on a joint affirmation that "foreign direct investment is good for economic development, employment, innovation, competition, consumers and public welfare." On that basis, USCBC believes, investments should be permitted to flow in both directions "free from political interference," other than what is needed for "legitimate national security interests."

Getting more granular, USCBC has also set out a long series of measures that would help FDI go forth in each direction briskly. These measures include the elimination of duplicative and inconsistent payroll taxes, such that "companies and employees are not required to pay payroll taxes [social insurance taxes in China] in both countries." Likewise, USCBC is seeking to adopt a stronger deterrent against counterfeiting, in accord with World Trade Organization standards, and "broaden the use of higher penalties and stronger deterrents against all types of intellectual property rights infringement, including patent, copyright, trademark and trade secrets violations."

For opportunity-seeking Chinese firms, Niu explains, success in the U.S. with their own brands takes time. His alternate model would be the current robust presence of a Chinese auto components group in the Rust Belt. Having negotiated with a cluster of U.S. auto parts manufacturers that were bankrupted post-2008, this company now finds itself managing no fewer than 28 parts plants in 14 states, saving 3,500 American jobs. The new owner's operating decisions have included retention of local management and open dialogue with front-line employees. Further, some of the restored profit flow is being used to invest in clean technology and electric cars in the U.S.

FOREIGN DIRECT INVESTMENT (FDI) IN AMERICA, FROM ONCE-UNLIKELY SOURCES LIKE CHINA, IS NEW ECONOMIC TERRITORY AND WORTH PLANTING YOUR FLAG IN.

"Part of pursuing these new paths," says Niu, "is uniting the technology and production capacities available in the U.S. and in China." Along with sharing America's sustainability ideal, Asian investors are also showing sensitivity to the domestic imperative for economic recovery through creation of American jobs. "They understand that it's in their interest to help restore the U.S. labor market, and it has to be a win-win," Niu says.

This new pattern takes place against a political backdrop, depending in part on avoidance of rhetorical backlash. Keeping China as a strong market for U.S. goods and services helps that cause. A recent USCBC report showed the Chinese continuing in their No. 3 spot, behind Canada and Mexico, among markets for U.S. goods. "Between 2000 and 2011, total U.S. exports to China rose 542 percent, from $16.2 billion to $103.9 billion," USCBC Vice President Erin Ennis says. "In addition, U.S. exports to China recovered faster after the recession than exports to anywhere else in the world."

THE ASIAN PRECEDENT

Risk management, a core business of Starr Companies, is one of three chief functions provided through Niu's business unit for global emerging-market investors. The other two are investment advisory and co-investments in selected industry sectors, as well as a first-to-market in-language and in-culture strategic partners network that connects clients with an end-to-end array of professional services in the States.

It's natural to recall the 1980s precedent of a giant Asian economy producing capital flows into the U.S., and the ensuing trophy hunt through prominent U.S. assets that led to Japanese ownership of Rockefeller Center in New York, Columbia Pictures and Pebble Beach Golf Resorts on the Monterey Peninsula, in California. "People are aware of that precedent," says Niu, "but this is a different

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DATA: RHODIUM GROUP

sort of foreign direct investor, a different network of professional services partners, and a very different strategic and bilateral relationship between countries. I highly doubt that a full replay of history would result from the work currently being done with global Chinese investors."

Whatever a future free trade agreement, or the USCBC, may do to foster trade and investment, there is an overarching need for Chinese companies and investors to become more sophisticated. Standards and practices observed by the leading global corporations can't be learned on the fly without making expensive mistakes. That's where Starr Strategic Partners comes in. "When U.S. companies went to China 30 years ago, many learned the hard way that they should have had a trusted, experienced and influential local strategic partner from the start," says Niu. "The same is true now, as emerging-market investors come to the U.S."

With this potential comes concern over intellectual property. Navigating these and other multinational business challenges is the *raison d'être* of CREAIe.org. Launched with support from Microsoft as a nonprofit industry group in 2011, the group's full title is the Center for Responsible Enterprise and Trade. CREATe.org works with multinational corporations (MNCs) to foster innovation and economic prosperity by protecting intellectual property (IP) rights, fighting corruption and driving responsible business practices in global supply chains and business networks.

According to CREATe.org's CEO and President, Pamela Passman, MNC's are looking more holistically at both the challenges and opportunities in each market. Meanwhile, calls for action worldwide against unlawful and unfair practices are multiplying. "Governments do have a role to play, but in some countries there are low levels of compliance with the law and little adherence to internationally accepted responsible business practices," says Passman. "As a result, the onus of protecting intellectual property often falls on individual companies.

"Our work is focused on creating tools and resources that MNCs can implement and manage themselves within their own supply chains. Responsible business practices need to be implemented faster. If they aren't, MNCs will continue to face vast losses that are far beyond what most people realize."

Here's the relevant rationale: MNCs focus keenly on how their intellectual property is used and managed by a supplier, but generally don't take time to assess the supplier's overall IP practices. "There is an opportunity for MNCs to play a more deliberate and proactive role in protecting IP and trade secrets by engaging in responsible business practices across their global supplier networks." Increasingly, MNCs are speaking openly about these challenges, and that is a big step in the right direction.

Discussions of the global economy since the birth of that concept have speculated about the effects of large developing countries becoming industrialized. The globe is finite, and when all sleeping giants awake, the movement of capital sheds its old patterns. To be on the receiving end, as the U.S. now is with China, is an idea worth getting used to, and even profiting from. — *David Gould*

Get ahead, take a seat

Join us at the table to reduce IP theft and corruption

Counterfeit and pirated products costs multinational companies as much as $250 Billion USD annually. On their own, companies face an uphill battle against intellectual property infringement, corruption and unfair business practices.

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USCBC BULLETIN

EVENT WRAP-UP

BEIJING

APRIL

Update on Social Insurance for Foreign Employees and Labor-Related Laws and Regulations
Rui Lixin, deputy director general of the Department of Law and Regulation for the PRC Ministry of Human Resources and Social Security, updated US-China Business Council (USCBC) members on how to enroll foreign employees into China's social security system, bilateral treaties on social insurance between China and other nations, and on the newest labor law and regulation developments.

MINNEAPOLIS, MINNESOTA

JUNE

Lunch Program on Current Issues in US-China Trade
USCBC and Faegre Baker Daniels LLP co-hosted a lunch panel addressing on-the-ground developments in the Chinese business environment, challenges for US companies in China, and managing PRC employees and Chinese labor laws. USCBC Vice President Erin Ennis, USCBC Shanghai Chief Representative Julie Walton, and Faegre Baker Daniels Shanghai Head of China Labor and Employment Practice Kevin Jones led the panel discussion.

ONLINE

APRIL

4th Annual Webinar on Mergers and Acquisitions (M&A) in China
Barry Chen, director of M&A advisory for InterChina Consulting, and Bing Ho, a partner with Baker & McKenzie LLP in Shanghai, discussed consolidation trends in China and what this might mean for foreign companies.

SEATTLE, WASHINGTON

MAY

Panel Discussion on Current Issues in US-China Trade
USCBC, Davis Wright Tremaine LLP, and the Washington State China Relations Council (WSCRC) co-hosted a discussion on the latest developments in US-China trade politics and innovation in China. WSCRC President Joseph J. Borich moderated the panel, which included USCBC Vice President Erin Ennis and Davis Wright Tremaine Partner Fraser Mendel.

SHANGHAI

APRIL

PRC Environmental and Energy Policies Program
Morrison & Foerster LLP Managing Partner Paul McKenzie and AECOM Technology Corp. Managing Director Stephane Asselin addressed China's most recent environmental and energy policies, such as carbon trading, energy efficiency targets, and how companies can best position themselves in the face of new regulations.

Tax Update 2012
USCBC members joined KPMG Advisory (China) Ltd. Tax Partner Chris Ho for a discussion on PRC government tax policy priorities, including value-added tax reforms and audits.

MAY

Program on Collective Bargaining and Labor Policy Developments
Gordon Feng, head of the employment law practice at Paul, Hasting, Janofsky & Walker LLP's Shanghai office, shared insights on new regulations in the PRC Labor Contract Law. The discussion covered standardization of the process for collective bargaining and how it will impact foreign companies.

WASHINGTON

APRIL

Strategic and Economic Dialogue (S&ED) and US-China Investment Forum Briefing
USCBC, the Coalition of Service Industries, and the US Chamber of Commerce co-hosted a briefing on the US-China Investment Forum and a preview of the S&ED. The briefing included senior officials from the departments of State, Treasury, and Commerce, and the Office of the US Trade Representative.

Issues Briefing with Former World Trade Organization (WTO) Appellate Judge Jennifer Hillman
Hillman analyzed China's decade-long WTO membership—where the country is one of the most frequent targets of dispute settlement cases—and what its participation means for the WTO, US trade enforcement, and US companies.

Intellectual Property (IP) Issues Roundtable with PRC Government Officials
Six delegates from the PRC Ministry of Industry and Information Technology and the China Academy of Telecommunications Research discussed IP law evolution, new IP standards, and corporate IP strategy and management with USCBC and US Chamber of Commerce members.

Briefing with Treasury Department Officials
US Treasury Department officials—Under Secretary for International Affairs Lael Brainard, Deputy Assistant Secretary for Trade and International Affairs Sharon Yuan, and Deputy Assistant Secretary for Asia Robert Dohner—discussed the most recent US-China Investment Forum and preparations for the next S&ED.

UPCOMING EVENTS

BEIJING

JULY 12

China Operations Conference 2012

WASHINGTON, DC

DECEMBER 6

Gala 2012

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

USCBC BOARD ELECTS PROCTER & GAMBLE CEO AS CHAIR, WELCOMES INCOMING DIRECTORS

US-China Business Council (USCBC) members in June welcomed Robert A. McDonald, chairman, president, and CEO of the Procter & Gamble Co., as USCBC chair at a reception in Washington, DC.

In addition to McDonald, USCBC President John Frisbie on June 6 announced the following elected officers: vice chair, the Honorable William S. Cohen, chairman and CEO of the Cohen Group; vice chair, Gregory Q. Brown, chairman and CEO of Motorola Solutions; secretary-treasurer, Thomas J. Lynch, CEO of TE Connectivity; and counsel, Andrew W. Shoyer, partner at Sidley Austin LLP.

USCBC also welcomed three new board members: Hamid Biglari, vice chairman and head of emerging markets at Citicorp, Citigroup Inc.; Marc N. Casper, president and CEO of Thermo Fisher Scientific; and Marurice R. Greenberg, chairman and CEO of C.V. Starr and Co., Inc.

USCBC President **John Frisbie**, PRC Ambassador to the United States **Zhang Yesui**, and USCBC Chair and the Procter & Gamble Co. Chairman, President, and CEO **Robert A. McDonald** at a reception welcoming McDonald to USCBC's board chair position.

Under Secretary of State **Robert D. Hormats, McDonald, Zhang,** and **Frisbie** at a reception welcoming McDonald as USCBC's incoming board chair.

WASHINGTON, CONTINUED

MAY

Briefing on Economic and Political Reform in China
USCBC President John Frisbie and director of the Kissinger Institute on China and the United States J. Stapleton Roy discussed how recent events, such as the actions taken against former Chongqing Party Secretary Bo Xilai and his family, could impact foreign businesses in China.

Treasury Department Debriefing on the S&ED
The US Chamber of Commerce, Coalition of Service Industries, and USCBC co-hosted a debriefing on the May S&ED, which featured Treasury Department officials Yuan and Dohner.

Reception for PRC Embassy Minister He Ning
USCBC hosted a reception for Minister He Ning, who recently stepped into a senior position managing commercial affairs at the PRC Embassy in Washington. USCBC members met the minister and embassy's Commercial Affairs staff at the event.

JUNE

USCBC's 39th Annual Membership Meeting
See p.61.

Employment Law Roundtable
Jonathan Isaacs from the Employment Law Group at Baker & McKenzie discussed unions, strikes, collective bargaining, and expat social insurance at the USCBC-hosted roundtable on employment law.

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EXPERTS OFFER VIEWS ON SLOWING ECONOMIC GROWTH, LEADERSHIP TRANSITION, AND CAMPAIGN POLITICS

At the US-China Business Council's (USCBC) 39th Annual Membership Meeting in Washington, DC, a strong cast of speakers addressed key topics for member companies, including China's economic slowdown, top operating challenges, the PRC leadership transition, and the US presidential election campaign.

This year, the Rhodium Group's founding partner and Columbia University adjunct associate professor Daniel Rosen opened the meeting with an economic update for the more than 100 attendees at the Madison Hotel on June 5.

Rosen noted the strength and potential in China's rising household consumption and the important role both central and local governments play in balancing its import/export ratio, keeping government expenditures efficient, and facilitating day-to-day business. As the Chinese economy matures, the country's initial phase of rapid growth and profit is paving the way for a second wave of opportunities. "We are going through an ostensibly controlled slow down, a soft landing strategy in the People's Republic of China," Rosen said. Still, he expects the Chinese economy to grow at a rate of around 9 percent in 2012.

USCBC's Shanghai Chief Representative Julie Walton presented an on-the-ground view of business operations in China. Although USCBC member companies have felt the rising costs of doing business in China, she also noted there are tremendous opportunities for companies moving westward in China. If global companies are looking to stay long-term in China and develop in these areas, government cooperation will be crucial. "Companies are telling us that managing these local governments closely is increasingly necessary," Walton said.

Grant Aldonas, former undersecretary of commerce under the Bush administration, who is now advising Republican presidential candidate Mitt Romney, discussed how a Romney administration may approach the US-China commercial relationship. Both he and the Brookings Institution's Jeffrey Bader, who was formerly the National Security Council's principal advisor on Asia to President Barack Obama, discussed how this year's presidential elections might impact US-China relations for the next four years.

Cheng Li of the Brookings Institution, an expert on Chinese leadership politics, updated USCBC members on China's leadership transition and offered an analysis of the downfall of Chongqing Party Secretary Bo Xilai this past March.

—Jennifer Sun

Dan Rosen of the Rhodium Group provided an overview of China's economy at USCBC's 39th Annual Membership Meeting on June 5.

Grant Aldonas, adviser to Republican presidential candidate Mitt Romney, discussed how a Romney administration might approach the US-China relationship.

Cheng Li, a scholar at the Brookings Institution, offered insight into the politics of China's upcoming leadership transition.

Jeffrey Bader, former senior director for East Asian Affairs on the Obama administration's National Security Council, discussed election politics and US-China relations.

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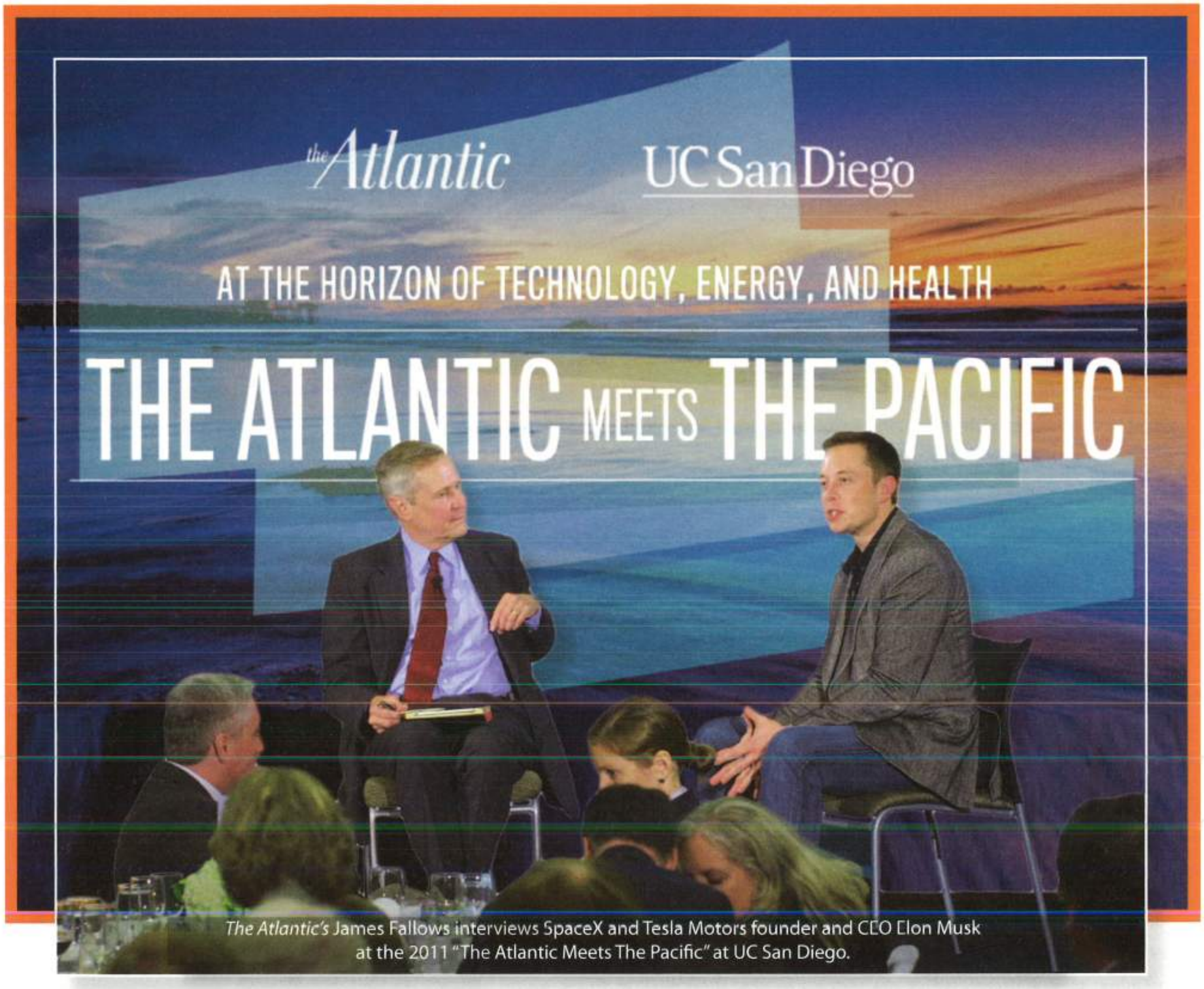

The Atlantic's James Fallows interviews SpaceX and Tesla Motors founder and CEO Elon Musk at the 2011 "The Atlantic Meets The Pacific" at UC San Diego.

Come Where Newsmakers Gather

[The Atlantic Meets the Pacific]

The Atlantic magazine and the University of California San Diego's yearly world-class event, "The Atlantic Meets the Pacific," will gather thought leaders on October 7–9, 2012 in beautiful La Jolla, California. Don't miss this rare opportunity to be up close and personal for conversations with award-winning editors and writers of *The Atlantic* along with these newsmakers:

Chris Cox—Mark Zuckerberg's right hand man at Facebook
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"Rama" Ramachandran—brain scientist and one of *Time* magazine's 100 most influential people in the world
Sir Robert Swan—Arctic explorer and environmental advocate
Gretchen Rubin— *New York Times* bestselling author and happiness expert
Jessica Jackley—microlender of $300 million to women around the world and KIVA founder
Jane McGonigal—"World Without Oil" alternate reality game creator

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BY **IAN BREMMER**

The United States and China in a G-Zero World

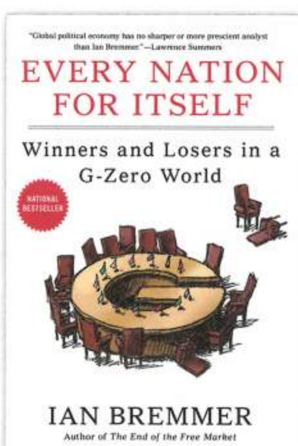
Editor's note: In his book, Every Nation for Itself: Winners and Losers in a G-Zero World, *Ian Bremmer argues that the world has entered a period of transition. The United States, Japan, and Europe no longer have the desire or ability to lead the world through transnational problems, such as stabilizing the global economy, reversing the effects of climate change, and tackling cybersecurity issues. Emerging economies like China still face too many domestic issues to deal with global problems. Bremmer, president of the Eurasia Group, a political risk research and consulting firm, says with the G20 and other multilateral organizations unable to lead because of the diverse interests of their members, the world has entered the G-Zero. In an excerpt from his book, Bremmer discusses what this leadership vacuum may mean for US-China relations.*

Governments don't accept costs and risks until they believe they have to—and until they become convinced that other governments won't do it for them. But to protect their domestic political positions, leaders of established powers will act to try to ensure that transnational challenges don't threaten their countries' security, wealth, and privileges. Political elites in emerging states will try to make certain that crises don't prevent their countries from emerging. As the G-Zero generates turmoil, decision makers in both sets of countries will have to build new systems, alliances, and global institutions. They will work together or act separately. They will adapt existing international institutions or build new ones. Either way, the G-Zero is not the new world order. It's a period of transition that will give way to something else.

To predict what the new international order will look like, we must answer two questions in particular. First, will the United States and China act as partners or enemies? No political and commercial relationship is more important for 21st century peace and prosperity. Second, will other countries have the strength to play an important, independent role in the international order?

Some of the problems and opportunities that will shape the future of US-Chinese relations depend on developments inside each country. Confrontation becomes more likely if one or both of them suffer serious economic setbacks that send leaders scrambling for foreign scapegoats. In China, policymakers face the profoundly complicated task of implementing the reforms needed to keep the country's economy humming while managing the threats that all these changes pose to the country's domestic tranquility. In Washington, if partisan rivalries continue to poison American politics and prevent lawmakers from restoring the country to fiscal health, US frustration with the US-Chinese trade imbalance could reach a boiling point. In 2012, the transition to the next generation of Chinese leaders begins with a new president and a new Politburo in Beijing. In November, US voters go to the polls for both presidential and congressional elections. For better or for worse, all these new legislators and decision makers will change the relationship.

Then there are the factors determined by direct interaction between the two countries. If US companies continue to earn large profits inside China, they will have a stake in China's success and in stable US-Chinese relations. That would give them good reasons to lobby the White House and US lawmakers to avoid unnecessary confrontations. If, on the other hand, Chinese companies use their growing leverage within China's bureaucracy to craft new rules and regulations that tip the competitive playing field in their direction, US companies are likely to drive the two governments toward a more aggressive commercial competition. If China continues to allow its currency to appreciate against the dollar, we could see a healthy rebalancing of US-Chinese trade relations—and less demand in Washington for punitive legislative action. But a major cyberattack launched by someone on one side against someone on the other—or even the appearance of one—might spark a politically reckless response. A shock that sends oil prices sharply higher will give US and Chinese officials a powerful common interest in easing the resulting pain, but a coup in North Korea, depending on how it develops, or a fight over Iran, would likely put US and Chinese officials on opposite sides of a security crisis.



Excerpted from *Every Nation for Itself: Winners and Losers in a G-Zero World.* Published by Portfolio | Penguin. Copyright © Ian Bremmer, 2012.

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