AmCham China QUARTERLY

Issue 2 2019

Executive insights, interviews, and intelligence for business in China

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P18 China Innovation at Merck
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Extraordinary Accession

Former USTR Charlene Barshefsky on China

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The *AmCham China Quarterly* magazine is published by the American Chamber of Commerce in the People's Republic of China (AmCham China).

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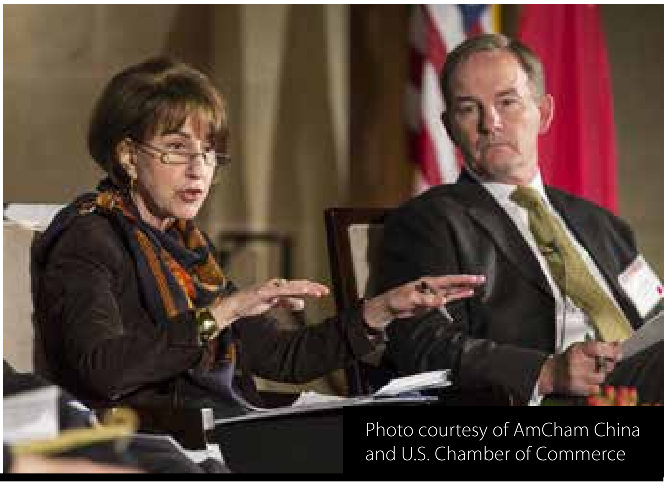
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AmCham China

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The American Chamber of Commerce in the People's Republic of China

AmCham China Leadership

AmCham China's success is rooted in the vision, hard work, and dedication of its members. Through their efforts, these volunteer leaders make it possible to provide the information and intelligence, business services, networking opportunities, and events that benefit all members and the advocacy initiatives that help shape the business environment in China. At AmCham China's national level, the chairman, two vice chairs, and 10 governors comprise the organization's Board of Governors. Additionally, AmCham China's three Chapters each have their own local executive committee to ensure they are responsive to the needs of local AmCham China members.

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Continuing to Serve

China's recently released White Paper on the state of the US-China economic negotiations begins by stating that the commercial relationship between the two countries has historically been the propeller and the ballast of the overall relationship. We very much agree with that sentiment and, as American companies doing business in China, we're proud of the contribution we've made to economic development in China. Many of us have been working in, and with, China for decades, building personal friendships as well as strengthening business ties.

But that critical nature of the relationship has also become vulnerable: the levels of risk and uncertainty for our member companies are rising, forcing companies to take mitigating action.

A recent survey we conducted in partnership with AmCham Shanghai among our member companies – about which you can read more on pages 22-23 – found that 40% of those who responded have either moved or are considering moving manufacturing outside of China. If the level of uncertainty increases, then this activity is going to continue and it's not going to be reversed very easily.

A healthy trading relationship is beneficial to both countries – as well as to the wider world – but if each side gives ultimatums to the other in a public setting, then there's no space for either side to back down without facing a huge political cost domestically, thereby putting resolution further out of reach.

It also doesn't help the future progress of any negotiations to place blame entirely on the other side, as each side has done here. From our own family experiences, we know that whenever there is a dispute, there tend to be good reasons on both sides. The fact remains that the US and China have very different political systems, not to mention cultural and linguistic backgrounds, and understanding these differences will help lessen the tendency to play the blame game.

That said, many of the same issues long faced by our members remain. We will continue to represent the collective voice of the American business community in China, helping to shield individual companies from getting caught in the crossfire of a wider conflict.

Last month, a large delegation of senior AmCham China members traveled to Washington DC, where we met with nearly 40 senators and members of Congress representing both parties to advocate on behalf of our members. Back home here in China, we recently launched an initiative to help our member companies apply for an exclusion from Chinese tariffs, and we will continue to advocate to both governments on your behalf.

Importantly, we are making the case that AmCham China member companies – who stand at the heart of the US-China commercial relationship – shouldn't be deterred from doing business here, or fear running afoul of very narrow legal restrictions either in the US or in China.

We continue to urge both sides to keep negotiating, while allowing each other enough political space to sort out the problems that remain to be resolved.

We remain laser focused on the path ahead – but we need your help. Join our meetings, and share your views with our community. I look forward to seeing all of you at our events in the coming months.

Tim Stratford
AmCham China Chairman

So Mooch More: Inside the Trump White House

Photo courtesy of AmCham China and U.S. Chamber of Commerce

Anthony Scaramucci, nicknamed "The Mooch", is an American financier, entrepreneur, and political consultant who briefly served as the White House Director of Communications from July 21 to July 31, 2017. Scaramucci spoke recently at the 10th China Business Conference, hosted by AmCham China and the U.S. Chamber of Commerce, where he spoke about his short tenure in the White House, his insights into the mind of President Trump, and his interpretations of Trump's policies on China.

Above
Anthony Scaramucci (left) on stage at the 10th China Business Conference on May 1, 2019, alongside Axios's Mike Allen.

In recent trade talks, the president has dropped the terms calling for a ban of commercial cyber theft to get a swift deal, trying to reach a summer signing target. A lot of people are worried that the president would want to rush to get a deal. Any thoughts?

Anthony Scaramucci: Well, let's talk about that narrative for a second. The narrative is that the president wants a quick deal so that they can notch a victory on the tape, and then there'll be some snarky CNN analysts that say the deal is not exactly what he promised the American people, and point to the things that are disadvantageous to the United States.

But I think that, and I'm going to use a George W. Bushism – everybody is "misunderestimating" the president. The reason why he gets underestimated is he's an unbelievable communicator from the podium, but he doesn't speak in the complete sentences of a Yale University English professor. However, he gets these things and he understands the intuition behind them, and he's been talking about these things for 30 years.

I have an enormous amount of respect for China, Chinese culture, and the Chinese government. Don't take my word for it. Listen to Graham Allison, the Dean of the Kennedy School. When he wrote his book, *Destined for War*, he said one thing that differentiates the US and China is that we are R&D, and they at times have been RD&T, which is research, development, and theft. And so, this is a very big issue.

The president is a common sense-oriented person, so he recognizes how much theft we would actually be able to stop by simply signing an agreement to stop theft. People are sore with the president for the climate accord deal, but he pulled out of that deal for many different reasons. One of the reasons was that it wasn't having that big of an effect.

How much of an actual reset do you think that there will be if a signing ceremony between Presidents Trump and Xi takes place at Mar-a-Lago? How much will that signing ceremony revive the relationship?

Anthony Scaramucci: You've met the president, right? He likes some rhetorical flourishes once in a while. He's going to get to the podium, and he's going to say this is the greatest thing that's ever happened in

“I got fired from the White House like an Austin Powers film – just shot up into the sky and dropped in the fire.”

the history of mankind. He’s going to set the expectations very high.

Now, let me say this to the Americans that are in the room: the stupendous, legendary, and miraculous growth and transformation of China has been phenomenal for the world. The fact that the Chinese have been able to lift their people out of poverty and into a Western-style, consumption-based capitalist experience is an unbelievable thing for the world.

And so, what we have to do now is be cautious. We can’t allow their rise to threaten us. That’s the Thucydides's Trap that Graham Allison discusses. For me, what I would say to people is that: we can do this. We’re smart enough to do this, we’re smart enough to avoid the pitfalls of history, and we’re smart enough to not allow our cultural differences to spark too much pride or too much nationalism.

Every time in my life that I have put my pride and my ego into my decision making, it has led to a downfall for me. I got fired from the White House like an Austin Powers film – just shot up into the sky and dropped in the fire. I made a mistake. I made a fireable mistake, and it was born from ego and pride. And it was born from high emotions. It is so important for the United States and China to reduce pride, to reduce ego, to reduce emotion, and think about the context of the global civilization, and think about how we can all live and cohabitate with a very strong bilateral relationship.

You talk about 5G as mission critical for the United States.

Anthony Scaramucci: The most mission critical thing. So, if you’re a leader in the US, I beg you to please put some influence on your elected officials. Put some influence on the public policy people. This is the gateway and the portal to the future.

When you say “4G” and then “5G” to the average American citizen, they think they are getting a 20% or a 25% move. It’s not. This is a quantum move in the velocity and the flow of communication and the density of deliverables over those channels. And if you’re Chinese in the room, you’re going to be sore at me for saying this. I’m sorry, but some argue that there are things in Huawei where there are backdoors in the system that will allow too much information to flow in a direction where you wouldn’t want it to flow if you spent hundreds of billions of dollars on your drug research, or your military research, or other aspects of research.

The big advantage that the Chinese have over the US is that they have married their public enterprise, China Inc., to their private enterprises, and they’ve created a platform for their businesses to grow off of that platform. “Abide by these rules and we are in harmony with each other.” We don’t do that in the United States.

The United States and China will directly benefit from a much stronger United States. Trust me on this – I have a pretty good understanding of both of our cultures, and we both respect strength. And the stronger we both are, the better our relationship is going to be. And if we don’t get ahead of ourselves and 5G, immediately, that’s going to be a problem for us, and a problem for the world.

You said we need to remember that China is not a hostile power, but that it is an aggressive power.

Anthony Scaramucci: Yes, and they should be. And by the way, the president would say the same. The president has an enormous amount of respect for China. The president looks at the economic miracle in China and says, “Hey, they are doing exactly what they should be doing for their people and for their country.”

And so, I don’t see China as our adversary. But I do see China as an aggressive economic competitor on the world stage. Everybody in this room is smart enough to know that there are pockets of people in the Chinese government that may see us as an enemy or an adversary. And there are pockets of people in the US that see it that way too. But reasonable people, people that want to see peace, and want to see prosperity, don’t see it that way. They know that there are mechanisms that we can put in place, diplomatically and economically, that can make this work.

What did the president think of your freedom of press op-ed?

Anthony Scaramucci: He didn’t love it. Actually, to be honest with you, I don’t think the president read it. He read the headline, because in the op-ed I write that he’s doing a very good job, that he’ll likely be reelected. But, he is the leader of the longest standing republican democracy and we do have one big advantage over the Chinese. And, if you’re a Chinese national in this room, you should pay attention to what I’m saying.

The free press, and when you read the federalist papers, and when you understand the original design of the country – the design of the country from the founders was to protect the most important minority in the world. Who is the most important minority in the world? That would be the individual. And what the founders decided was that they would create in the new world an ability for the individual to be protected from its government. The result of which required a free press to hold those in power in check, because we know from Lord Actin that absolute power corrupts absolutely.

The free press is not the enemy of the people. It is a beacon that protects our liberties. What the free press does for society is it creates innovation, because when you teach your second grader to think freely and to speak freely, they will innovate. When you’re telling your second grader that they can’t rail on their government, and they can’t look at certain internet sites, and they are censored into a sort of group think, you are reducing their level and their capability of innovating. Facebook, Apple, all of these things are invented here for a reason, and that’s the ancillary benefit of the free press.

Red Flags on the Horizon

Photo courtesy of George Magnus

George Magnus is an independent economist and commentator, as well as a Research Associate at the China Centre, Oxford University, and at the School of Oriental and African Studies, London.

Magnus was the Chief Economist, and then Senior Economic Adviser at UBS Investment Bank from 1995-2012. He famously anticipated the global financial crisis in 2006-2007 with a series of research papers in which he warned of an impending Minsky Moment.

He previously worked as the Chief Economist at SG Warburg (1987-1995), and before that in a senior capacity before the 'Big Bang' at Laurie Milbank/Chase Securities. He also previously worked at the Bank of America in London and San Francisco.

Magnus comments on the global economy, China, and demographics, and is a regular contributor to the Financial Times, Prospect Magazine, BBC TV and radio, Bloomberg TV, and other outlets. His written works and a blog can be found on his website, www.georgemagnus.com

In his latest writings, George Magnus examines China's contemporary economic and commercial challenges, and aspirations to modernity in light of a governance system that is a throwback to much earlier times in the People's Republic. In this extensive interview, he shares his thoughts on the Made in China 2025 policy, GDP targets, ideology, and more.

Many western economists criticize the inefficiency of China's SOEs and the government's intent of turning these into national and international champions. France has arguably done the same in the nuclear, rail, and aircraft industries, yet few people complain about its dirigiste nature. Is China's approach really any different?

George Magnus: Certainly, amongst western nations, France is exemplary in the sense of its dirigisme and its state enterprises and state sponsored efforts in things like space, high-speed rail, and nuclear.

I think it's different in China's case. I don't think the issue is that China nurtures national champions or that companies get special privileges from the government and are favored and earmarked to achieve great things in the future. That phenomenon is not unique to China at all.

What makes the difference is three things. The first is the Party's role in China, that is the politicization of state policy towards state enterprises. This is something that westerners find different and a little bit threatening, particularly because China is not just a big country, but is now deemed to be, in many respects, an adversary rather than just a customer and competitor.

The second way people feel that China is different is because of the whole panoply of industrial policy that goes along with that. There is concern about the way in which industrial policy discriminates in China, allegedly, in favor of domestic enterprises as opposed to foreign, and, within the domestic enterprises, in favor of state-owned enterprises rather than private enterprises.

On February 19, the People's Daily ran an editorial in which Xi Jinping is quoted saying, "The status of public ownership is the backbone of our economy and must not be jeopardized and the leading role of the state-owned economy must not be questioned." When people look at that from outside of China, they feel that the scales are tipped in a way that is unique. That is not the hallmark of the French policy or any other western country.

The third is about the rights of redress to correct what companies may feel are unfair policies or injustices. It is the absence of what we would call the rule of law, and the subordination of law in China to the whims of the Party and the state. People feel that if there is discrimination, whether it is about procurement, special favors, or industrial policies, it is difficult for these to be corrected in the way that you might have recourse in a western country. That is why it is felt that China's practices are unique and not akin to those of France.

Some economists argue that the "Made in China 2025" (MIC 2025) policy is ill-fated because it emulates unsuccessful policies plied by Japan's MITI in the 1980s. Do you subscribe to this argument? Or could China pull off MIC 2025 if it continues to throw cash at industries like chip manufacturing?

George Magnus: I don't have any doubt that China will continue to throw cash at the 10 sectors – 11 now if you include AI as a generic sector. Everyone wants to be top dog in technology. That applies equally to the US and Europe, as well. It has more than just enormous commercial application in the future, but also implications for defense and military purposes, too. I don't imagine that the intent of China is matched in places like DARPA and other establishments and intelligence services in the West.

We shouldn't criticize China for wanting to prioritize its technology and to articulate a view which many of us are coming around to, which is that the world is bifurcating between two technological universes. We will be very wary about using Chinese technology in our economies and the Chinese don't want western tech companies given free license in China. Then there is the emerging developing countries, where it is full on competition to see who can gain a foothold.

MIC 2025 and other advanced technology policies have security and foreign policy implications. They morph very easily from commercial and military capacity into soft power and security, control, and influence. It is in this sense that I think we should expect the Chinese government to continue to further back and promote its technological

80%

Target for domestic market share of Chinese products in EVs, high-tech ship components, and renewable energy equipment

6.0 – 6.5%

China's GDP growth target for 2019

60%

of China's GDP contributed by the private sector

80%

of China's urban jobs contributed by the private sector

ambitions, whatever the cost. Obviously, if in the next 10 years China went through a period of economic stagnation or very slow growth, then there may be financial constraints, but the intent will still be there.

For the Japanese, competition was purely a commercial issue, and in the end the comparative advantages they enjoyed were chipped away at and then mastered by American and western tech companies. China is already a leader in mobile payments and e-commerce, 5G, and also electric vehicles. Some think that in AI, China's catch-up trajectory is a big threat. Soon after he came to power, Xi made quite clear how he saw China's historic role and function and I think that MIC 2025 is an integral part of what he sees as China's ambition.

You write that China's GDP targeting is a "license to deliver bad GDP." Do you see any signs that China will wean itself off the practice?

George Magnus: At the 19th Congress, there was suggestion that once the Party's commitment to double income per head between 2010 and 2020 had been achieved, that growth targets thereafter may be abandoned. There has not been any suggestion since then that that will be the case.

What I meant by "bad GDP" is the creation of uncommercial construction projects and economic activity. At some point in the future this will have to be written down or written off because it is uncommercial. In a state-run economy, this can take much longer than in a western economy. In a western economy, we more or less have to write down bad investments in real time, but this discipline doesn't exist in the same way in China. That does not mean that they get a kind of pink slip that allows them to do this in perpetuity. The longer that this goes on and the greater the accumulation of uncommercial debt or bad credit-created economic activity, the bigger the adjustment will have to be when it comes.

In your latest book, Red Flags, you suggest that the US should use carrots and sticks to nudge China toward a more level playing field in trade and investment. By jettisoning TPP, has the US thrown away one of its best sticks?

George Magnus: Yes. I think the US Administration's early stance on trade and on America First type policies made allies in Asia, and across the Pacific, question America's commitment to their economic security and possibly even national security.

A year later, the Trump administration came out against the Chinese in terms of tariffs and the trade war. Now, of course, we are not sure where the Trump administration stands, whether they want a trade deal at any cost or whether US Trade Representative's underlying concerns about China's industrial and technology policies are likely to prevail. I take on board the idea that not everything with the TPP echoed or resonated well with the concerns some people had about the US economy or the previous US administration, but it was an extreme and damaging thing – almost self-harm, really – to play loose with the institutional structure of US foreign and trade policy in Asia, and indeed elsewhere.

Things are different now. In the past, China was encouraged to "follow our practices" and align its interests with the western world, and this flowed in large measure from the coherence with which the United States acted as a benign global hegemon and was looked up to by allies. It wasn't always agreed with, but it was respected by other allies in its broad geographic alliances.

Now, though, in the wake of not only China's greater self-confidence, but also the Trump Administration's policies, China seems much more inclined to paddle its own canoe, and define its own interests both within established global governance systems and outside them. The United States in withdrawal mode – as the TPP withdrawal demonstrated – is, in effect, a license for China to press on. It exacerbates the adversarial chasm between the two major powers and gives China every justification for thinking that it doesn't have to bend to pressures which otherwise might have been more forceful.

In recent years, China has placed ideology over pragmatism. If China is unwilling to change its ideology, what can it do within its current ideological strictures to ensure economic growth continues?

George Magnus: Every economy, including China's, has a sustainable rate of growth – what we call trend growth or potential growth, and it is given by a number of supply side factors. From one year to the next, you can change tax rates, you can change infrastructure spending, you can change all sorts of things that affect demand. The supply side of the economy is given to you by the quantity and quality of the labor force, and the efficiency with which you put capital to use.

In the medium- to long-run, you can bolster trend growth by boosting total factor productivity. This is not easily measurable but it is an efficiency term. It comes from how you deploy labor and capital to produce something bigger than the sum of the parts. This is about institutions, it is about law, it is about competition policy, it is about regulatory policy, it is about technology.

"China could do a lot of things to sustain reasonable rates of economic growth, because it is in a strong position to control and influence all the main levers of economic growth."

Looked at this way, China could of course do a lot of things to sustain reasonable rates of economic growth, because it is in a strong position to control and influence all the main levers of economic growth. It has an economic and financial system in which it is predominantly an owner and a participant, so it could create higher rates of growth for a long period of time. But this is where ideology gets in the way.

This commitment means that China is unlikely to pursue what we in the West would regard as the appropriate policies to sustain good growth over the long term. It doesn't mean China can't do it for a while, but I think that it will run into road blocks and constraints. Arguably, we may be now seeing some of those constraints. For example, what we call here in Brexit Britain, "cake-ism" – the idea of having your cake and eating it – is taking root in China. Cake-ism, as we know, means pursuing incompatible goals. Can you deleverage the economy while at the same time sustain elevated rates of growth which are not compatible with that deleveraging? The question is rhetorical, and already in 2019 we have seen that the authorities are backing away from deleveraging in order to boost growth, and stimulate the economy again.

This could go on for a little while, but if you do this, then you are not going to succeed in reducing financial instability risk and cutting the leverage out of the financial system and the economy. I don't think it is possible to do both, and another moment will come in the near future when China will again be obliged to make difficult choices.

More broadly, Professor Stein Ringen at Oxford has written a book in which he talks about China as being a control-ocracy. The thesis of more and more control, stifling of initiative, and the rising influence of the Party in all walks of economic and social life, does not sit comfortably with the economic goals that China has set for itself in the next 20 or 30 years. Certainly not from a western economists' standpoint.

You suggest that if the economy slows, China might have to row back on ideology. How would you envisage such a process unfolding and where do you imagine the government loosening the reins? Is the recent effort to placate entrepreneurs with cheaper loans already a sign of this?

George Magnus: I can't see that the question is answerable under the governance system that Xi Jinping has introduced and to which the senior echelons of the Party seem committed. If I can just back track for a second, in a theoretical or other world context, I would echo some of the sentiments that have been made by Chinese intellectuals over the last year, that the government is reciting the wrong narrative. The essence is that China owes its success to the influence of the Party, the role of state enterprises, and industrial policy, and these have brought China out of poverty and brought the country to where it is today.

The critique from some prominent intellectuals is that this train of thought is not true, and that the reason China has been successful is because it adapted markets to its own circumstances, encouraged entrepreneurship and the dynamic creative forces of private enterprises, and learned from the outside world things that it couldn't do itself and maintained open engagement. These are two very different narratives.

The government may well have been taken aback by a flagging private sector over the last year or two, but it is not negated by the soft rhetoric that we have seen or the meetings that have been arranged to assure private companies that they are still important, or the encouragement of cheap loans to private entrepreneurs or to get banks to lend more.

In a way, the banks are conflicted. They are being told to raise their capital ratios and de-risk their balance sheets, but are simultaneously being told to increase their exposure to the riskiest enterprises and the riskiest forms of lending in the economy, which is small- and medium-sized enterprises and smaller private companies. There is an incoherence in that kind of strategy. I don't expect cheaper loans to solve the problem. I think it is an attitudinal problem. When I recited the quotation from People's Daily earlier, it vindicates or corroborates the idea that China's priorities, regardless of what leaders say in public, are to the state sector and the primacy of the state sector in the economy in critical areas in the future.

This may not be of great relevance to small family businesses and micro-enterprises, but I think it certainly makes a big difference to what people generally regard as the most dynamic part of China's economy. Q

This interview first appeared in AmCham Shanghai's Insight magazine.

Leading the Charge

Scott Kennedy is Senior Adviser in the Freeman Chair in China Studies and Director of the Project on Chinese Business and Political Economy at the Center for Strategic & International Studies (CSIS). A leading authority on Chinese economic policy, specific areas of focus include industrial policy, technology innovation, business lobbying, US-China commercial relations, and global governance.

He is the author of *China's Risky Drive into New-Energy Vehicles* (CSIS, November 2018), *The Fat Tech Dragon: Benchmarking China's Innovation Drive* (CSIS, August 2017), and *The Business of Lobbying in China* (Harvard University Press, 2005). He has edited three books, and his articles have appeared in a wide array of policy, popular, and academic venues.

From 2000 to 2014, Kennedy was a professor at Indiana University; while there he created the Research Center for Chinese Politics & Business and was the founding academic director of IU's China Office. Kennedy received his Ph.D. in political science from George Washington University and his M.A. in China Studies from Johns Hopkins-SAIS.

You've been on record as being pretty pessimistic over the past few months with regard to the future of the US-China relationship. How are you feeling these days?

Scott Kennedy: Since the trade talks broke down and the US used the nuclear option on Huawei, the Chinese are retreating into a nationalist corner. And so I'm not very optimistic about the prospects for the relationship through the rest of the Trump administration. It's going to take significant political leadership on both sides for them to be willing to soften their respective positions to find any common ground or for the relationship to achieve some sort of stability, let alone progress.

So you don't see a real possibility of making progress unless the administration changes in the US, or could others there get things back on track?

Scott Kennedy: I think it would require both China and the US to modify their basic negotiating positions. China has offered a significant amount of concessions in trade negotiations, but withdrew a significant portion of them without notice and without sufficient explanation, which is why the United States responded with retaliatory tariffs. And now the Chinese are going further, with their "unreliable entity list," some harassment of American companies and organizations in China, and warnings to Chinese tourists and students to reconsider their plans in the United States.

In the US, the stalemate in the commercial talks created an opportunity for those concerned about American national security to push their pet issues, one of which is Huawei. We now have nationalist hawks dominating policymaking on both sides, and both the Americans and Chinese believe they have the upper hand. So, until you have policy that's not made by hawks and each side feels more vulnerable, I don't see the relationship turning around.

In any kind of negotiations, there will be ups and downs. Is this to be expected or do you think we've seen a fundamental change?

Scott Kennedy: These aren't standard negotiations. Yes, talks wax and wane and there are moments of slamming one's fists on the table, threatening to walk away, or walking away and then coming back. But the way these talks broke down suggest that there was not a political consensus in China for the concessions that they had originally made, or that Xi Jinping wasn't going to push to maintain those concessions that they had offered.

At the same time, the United States hasn't been ready to lower its demands to what China would find politically acceptable, and so the gap that existed at the beginning of the talks is still there. China is willing to make token modifications in a gradual way, in a process in which China is the only arbiter of whether China has made the appropriate concessions. The United States wants China to make much further adjustments with its economic policies, at a more rapid pace, in which the US gets to be judge and jury of China's changes. So once all politically important voices on each side have had a say, this is not a negotiation that has made fundamental progress. That's why the US showed its frustration in terms of going to the next round of tariffs, which the Chinese probably didn't expect.

Let's put this in some sort of historical context. Where are we on the timeline of US-China relations in terms of high and low points?

Scott Kennedy: High points would have been when China entered the WTO and the first five years of its membership – the "honeymoon" era – when China reduced tariff and non-tariff barriers and American and other multinationals moved a great deal of investment into China. They began to modify global supply chains, which benefitted everybody. The implementation of WTO commitments wasn't perfect by any means and there was certainly a lot of frustration with regard to specific commitments, but the overall tenor of the relationship was positive, and that was helped by the fact that the US was focused on responding to 9/11 and making the War on Terrorism its chief foreign policy focus.

We've fallen quite a bit away from that point. We've had the global financial crisis, the Snowden revelations, other types of tensions in the US-China relationship, the election of an iconoclastic political leader in the US, the rise of Xi Jinping, the end of the Era of Reform and Opening, and the start of the New Era in China. The grand bargain that originally undergirded the US-China relationship has totally collapsed. Although there is still a very large commercial relationship encompassing trade, investment, people-to-people ties, and innovation, it is really hanging on by a thread.

We've got very little political support in the capitals of either country for a deep integrated relationship. China doesn't want to open up because of the vulnerabilities to their economy and some of the important components of their political system, such as those related to information and state-owned enterprises. The US is deeply concerned about China's strategic ambitions, the theft of intellectual property, the negative consequences of state capitalism, including overcapacity, and what that means for the US and global economies.

Since the US pushed the button on Huawei, that really takes us into a whole other level. The actions against Huawei are not an incremental adjustment that should be included in a long list of things that the US is doing. It's a fundamental statement about the relationship and about the rules of the game. Things can get worse. The actual overall levels of trade can shrink considerably, the amount of investment flows can fall even more than they did last year, people flows could also slow dramatically, which they haven't yet.

Certainly, the US could decide to radically restrict the visas to Chinese students and Chinese workers in the US. China could also do the same with visas on its side. The Chinese also could begin to harass more American companies or take actions against several high-profile companies. The US could do the same, and so this could be a messy divorce, with an immense amount of collateral damage strewn across the globe that could affect everybody.

Below
Scott Kennedy speaks at the 2016 APCAC Business Conference in Beijing.

Photo courtesy of AmCham China

AmCham China has been preaching to both sides the importance of keeping issues in their respective lanes, but it seems like this has been muddied. What's your view on the crossover of issues here, and the importance of keeping issues clearly defined?

Scott Kennedy: I agree with the general principle that keeping economic and national security issues in their respective lanes makes it easier to compartmentalize problems, and not let them affect the rest of the relationship when cooperation is feasible and both sides really want it. That applies to issues like regional hot spots, like North Korea, the Taiwan Strait, and the South China Sea, but when there is great concern about the overall direction of the relationship, or when economic issues inherently have some national security component to them, it's almost impossible to fully keep everything separate.

The Trump administration has said that economic issues are so important that the US can't move forward with a normal relationship with China without addressing these deep underlying economic concerns that are facing the US. In addition, some of the specific economic concerns that the US have are directly relevant for national security, most importantly in the telecom sector, where the internet has global reach. Chinese companies and business inherently reaches into the US and potentially threatens its national security. It's very difficult to disentangle those two things and so in the telecoms sector, both national security and economic concerns are deeply intertwined and hard to entirely disentangle.

It would be the same with banking. Doesn't China have more access and operations to the American banking system and securities markets? These are America's national security concerns. Why can't Facebook and Google operate in China? Well, China has domestic security concerns. Both sides have certain concerns which put restrictions on the relationship. The US concerns are newer, the Chinese concerns have been there for a long time, so some feel like they're baked in and should just be accepted, but they're all there and difficult to disentangle.

A big reason why the US and China are at loggerheads is because the US has not collaborated effectively with everyone else who faces the same challenges. There is extensive coordination with the Japanese and the EU on some specific issues, but the US has not been willing to collaborate in international organizations or via the TPP. That has put the US at a huge disadvantage and really given China a lifeline, which has made them much more willing to be resistant to the calls for reform that the US has made, and I think that's as big a reason as any why we're in the place that we are.

What specifically can AmCham China do? What can we as a business community try to do to pave a better way forward?

Scott Kennedy: I think you can make sure that the Chinese government knows exactly what American business concerns are, and that these are concerns shared by other businesses in China, whether they're Europeans, Japanese, or Koreans. Make sure that the Chinese understand that the problems you're raising are problems that everyone faces. More coordinated actions by different Chambers of commerce in China or different parts of the business community would be very helpful.

I also think it's really important to let the US government understand what your top priorities are, things that they really need to get accomplished in any negotiation and things that are less important that can be addressed perhaps in other ways or left off the negotiating table. I think you also need to let the US understand what types of solutions they're thinking of or sanction actions, what those would do for American businesses – positive or negative – being very explicit about the health or harm of any step the US takes.

I think you could also continue to explain to the American people the value of the commercial relationship, not just for the companies and their board members and stockholders, but for their employees around the world, including in the United States, and for American consumers. I think that those messages have been lost and need to be clarified. If business doesn't step up and shout very loudly, no one else is going to be able to do that.

"A big reason why the US and China are at loggerheads is because the US has not collaborated effectively with everyone else who faces the same challenges."

The last thing is that AmCham China needs to continue to look far into the future, beyond any individual trade dispute, about what the shape of technology and business is going to be 10 years out, and help American companies and everybody else prepare – whether that's about business models, supply chains, areas of investment, or infrastructure – helping build a consensus around the ethics and values that should undergird the adoption of new technologies, whether it's in autonomous vehicles, or pharmaceuticals, or parts of AI.

What are the biggest risks for companies going forward? What do you foresee in a worst-case scenario and what contingency plans should they be making?

Scott Kennedy: It's possible that the US and China will place tariffs across the board on each other's goods, and that some high-profile American companies will be targeted and have their businesses in China fundamentally limited. Individual Americans that are on the ground in China need to be aware of the risks of operating in China should the overall strategic relationship fundamentally change and the Chinese decide that there is no opportunity for progress. Xi Jinping made a statement recently that the US and China need to both struggle and hug – and not just struggle – which means that we need to compete and cooperate. But if the Chinese decide that cooperation is not possible, and they fundamentally lose interest in the commercial relationship and the overall relationship, I think that puts American companies in a very vulnerable position across the board.

I have to say there is a great deal of uncertainty across every sector, even those that seem totally innocuous and non-strategic, like consumer goods. I think everyone has to have their antennas up, make Plan Bs – and those Plan Bs may end up becoming Plan As. To some extent, it's going to be about following signals and to some degree it's going to be about trying to provide signals to everybody else and provide leadership, because left to their own devices, Washington and Beijing are both headed in a dark direction.

Cross-sector Synergy: China Innovation at Merck

By Jordan Papolos

Photo courtesy of Merck

Sophie Sun is the Managing Director for Merck China's Innovation Hub and Vice President of Strategy and Transformation. She returned to China two years ago after working as Director, Global Commercial Oncology in Merck's Boston offices when she was offered the opportunity to develop the Strategy and Transformation function in China. Under her guidance, this function is the first of its kind with a nation wide focus. Before returning to China, Sun also worked with Merck's US organization on the fertility market and neurology business operations; before that, she was a member of the Senior Leadership team for biopharma in China, contributing to the global expansion of the biopharma business.

Merck China's Sophie Sun discusses best practices in corporate innovation in China through comprehensive internal innovation efforts, leveraging of local startup ecosystems, and collaboration with government bodies to advance core businesses and to further develop key industries in China.

With a corporate history spanning 350 years, Merck is one of the world's largest science and technology companies, thriving across the globe with a focus on three core businesses – life sciences, healthcare, and performance materials. For Merck, the key to such long-term success has been a holistic and comprehensive approach to innovation and global strategy, addressing the crucial needs and concerns of businesses and consumers around the world.

In recent decades, the industry giant has found the greatest intersection of its innovation efforts and global strategy in China – a business landscape where Merck has deep penetration in not only sales and consumption, but in the ability to tap into the local technological, entrepreneurial, and academic ecosystems, allowing for the successful advancement of their technologies and corporate innovation strategy. For the past two years, Sophie Sun, Managing Director at Merck China's Innovation Hub and Vice President for Strategy and Transformation, has been spearheading Merck's efforts in China. Under Sophie's leadership, Merck has revolutionized their China strategy, aligning their business units and resources in search of the synergies between their cross-sector business lines and their mission of advancing human progress.

"At Merck, we position ourselves as a vibrant science and technology company, and for that, innovation is the driving force. We are a company built on curiosity – made up of curious minds that are dedicated to human progress. In many ways, what has allowed us to thrive over these 350 years has been our emphasis on the importance of entrepreneurship, responsibility, technology, and innovation," says Sun. "Whether it's driving the current business or developing some new technology or solutions for future growth, innovation guides us in our efforts."

The Merck Model

The source of Merck's long-time success is intrinsically intertwined with its penchant for innovation and deep roots in science, technology, and research and development, which the company expertly applies in each of the three key areas. In healthcare, Merck designs and develops medicines and devices that strive to provide ongoing care for patients, focusing on allergies, cardiovascular, oncology, fertility, diabetes, and thyroid diseases. In life sciences, Merck's products are empowering the science community and solving their problems with solutions from drug discovery and development, to manufacturing and diagnostics. And in performance materials, Merck's expertise includes groundbreaking liquid crystals and OLED materials for displays, materials for the production of integrated circuits or effect pigments for coatings and color cosmetics, and functional materials for energy solutions.

Sun describes that, "As a science and technology company, we believe that for different areas and different businesses, we want to leverage our technology and our R&D to benefit our customers. For example, if you look at the healthcare industry, we put a lot of emphasis on neurology, oncology, and immuno-oncology." She goes on to explain, "Those three areas are our primary focus and account for 80% of our pipeline. For our life sciences business, one of our focuses is on driving new technology in novel therapies, such as gene-editing. In performance materials, we are the leader in solutions – putting a great deal of emphasis on developing next-generation materials for semiconductors and displays. We see a great deal of synergy in these sectors."

Innovation in China

At the heart of Merck's industry leadership is a simultaneous commitment to both a top-down and bottom-up innovation mindset. In China, this approach to innovation manifests itself in a variety of ways and permeates out to China's academic, startup, and technological ecosystems.

According to Sun, "Internally, we believe that the company needs to go beyond our R&D departments and our dedicated innovators, and instead we need to leverage the entire Merck workforce – we need to tap into the employee's innovative mind. As such, we engage employees in several ideation programs to achieve a holistic and bottom-up approach towards innovation." In China, a great deal of Merck's innovation strategy involves creating platforms in which they can look to employees from all departments who have good ideas and who have the drive to transform their ideas into viable businesses.

To accomplish this goal, Merck has institutionalized a variety of initiatives to tap into their workforce and elevate the innovative minds of the whole organization. "Through programs like Innospire," says Sun, "we encourage employees to submit and further develop their ideas for new products or business opportunities. And, through our Innovation Think Tank, we create dedicated teams to analyze future trends and technologies through a three-month stay at the Innovation Center."

Simultaneously, Merck realizes that leadership with an acute understanding of the importance of innovation sets the tone for the rest of the company and informs the direction an organization takes into the future. "A bottom-up approach is very important, but at the same time a top-down approach is just as important," says Sun. "We know that innovation is something that doesn't immediately show results over the short term, and as such does not directly impact P&L. Unfortunately, in many businesses, this reality means that not enough effort, or the necessary effort, is put forth to see the benefit of innovation efforts materialize."

As Sun describes, ensuring innovation remains a long-term corporate strategy and not simply a menagerie of one-off efforts is often a difficult task. The solution at Merck is to look to leadership as an anchor that can see beyond the short-term bottom line and understand the compounding benefits in the future. Sophie explains that, "The driving force behind the Innovation Center and also the S&T function comes from the very top – from the CEO and the other executives – to push innovation and to establish these efforts at an organizational and company-wide level, rather than sequester innovation off into any single sector or any single commercial organization."

Sun advises that in order to make innovation happen, top leadership needs to believe that there must be a focus on more than just existing business goals, and instead attention be given to future technologies that can help the company succeed down the line. "It is imperative that those at the top, as well as the employees, have an innovation mindset and are truly engaged in the ideation process and the incubation of ideas," says Sun. "You need people at every level of the organization who really want to transfer their and others' ideas into meaningful business opportunities."

Integrating into Local Ecosystems

As corporate internal innovation strategies mature, subsequently refocusing efforts on external innovation becomes paramount – looking to local entrepreneurs, startups, and academia for partnership opportunities that enhance the success of both parties. To this end, Merck places a great emphasis on external innovation and, today, has a litany of partnerships working to develop the technologies of tomorrow to advance human progress. "When we tap into the greater innovation and technological ecosystem, we recognize there are many key stakeholders that all play important roles, such as startups, venture capitalists, incubators, and accelerators, as well as academia and the government – we actively engage with all of them," says Sun.

In China especially, there is a vibrant startup ecosystem in which thousands of startups are created each year, all looking to develop solutions for consumer and corporate needs. Oftentimes, for these startups to thrive amidst the ocean of competition, a helping hand from multinationals such as Merck is the perfect solution.

"For startups, we have an Accelerator program in which we target seed stage to series-A stage startups who are active in the field of healthcare, life sciences, performance materials and also some areas like AI-enabled healthcare solutions, liquid biopsy, biosensing, and interfaces. At these intersections, we can build between one of our sectors," says Sun, going on to state, "This is a three-month program in which we provide funding, and more importantly, we provide the startups with access to Merck internal resources. Whether the resources are commercial or research expertise, these startups get the opportunity to work with us, with our business units, with our experts, and also with other networks, such as venture capital groups. We can sometimes even connect the startups with our suppliers or our distributors. Through this program, the startups get to benefit from the entirety of Merck's operations in China."

Further leveraging China's vibrant startup ecosystem, Merck enlists help from local accelerators and incubators in addition to partnerships with other leading MNCs. "When it comes to incubators or accelerators," says Sun, "we have worked with Zhangjiang Vi Pai to aid us in finding some recommended startups. As well, we have partners such as Microsoft Accelerator in which we jointly promote corporate innovation amongst the community."

One of the richest wellsprings of innovation Merck looks to tap into in China is the copious amounts of research institutes and prolific academic arenas found across the nation. "When it comes to universities, we tend work with the technology transfer office of universities to help us to look for those interested in working with Merck," says Sun. "The advantage of the technology transfer office is that they can engage with an assortment of different schools. As Merck has quite a wide business, we not only look at the medical schools or biochemistry-focused departments, we look at a variety of different areas of academia. The technology office can help facilitate that. As well, we often work directly with specific professors or their labs."

The Chinese government is yet

Left
A Merck engineer examines latest performance materials developments.

Photo courtesy of Merck

> "We want to work with all the major players in China to...help the Chinese economy transform into an innovation-driven economy."

another key player in Merck's strategy for innovation. "We take a lot of different approaches in our innovation efforts – we want to work with all the major players in China to help startups develop technologies that can help the industry upgrade, to help the Chinese economy transform into an innovation-driven economy, and to help the government in their agenda of entrepreneurship and innovation," says Sun.

Merck supports the Chinese government in an assortment of ways, including organizing community events and identifying and selecting promising local innovations and technologies. "For Merck's government collaboration, we support them through different ways," says Sun. "We were the co-organizer of the Anti-Cancer Competition of the Shenzhen International Entrepreneurship Innovation Competition, which recruited startups with good ideas from nine international markets. During the competition, we supported in the evaluation and selection of the startups that would be chosen to enter the China market. In such competitions, Merck provides expertise in oncology to benefit the Chinese healthcare sector."

Innovating in China Vs. Innovating Globally

With their first non-headquarters innovation hub established in Silicon Valley just two years ago, Merck's global innovation strategy and global footprint is expanding rapidly. Now, only a year later, the China Innovation Hub is gearing up to soon be in full swing, spearheading strategy for the entire country with Sun at the helm. This rapid expansion is a testament to Merck's acknowledgement that a diversity of thoughts, cultures, and locations holds a massive benefit to their own corporate innovation strategy and the advancement of their technologies.

"The reason that Merck wanted to have not only the one innovation center at headquarters is that we see the opportunities with different ecosystems," says Sun, "Whether it's Silicon Valley or Israel or China, all locations have different advantages regarding the opportunities and resources they have to offer." By establishing innovation hubs across the world, Merck is approaching innovation with a global mindset that enables the company to work with a greater diversity of efforts, initiatives, and activities.

"The difference between our China Innovation Hub and that of Silicon Valley," Sun explains, "is that we not only look at new technologies with a global priority but also with an eye to support China's business growth." Sun describes how, today, Merck has integrated into the Chinese business environment, with the innovation hub development as an integral part of their overall China strategy. "If you look at how we wanted to leverage our China operations, we have to engage the Chinese employees and actively understand and pinpoint what the company offers with different businesses," she says. "That's something we do differently from the Silicon Valley hub."

Eyes on Tomorrow

For Merck's China business, the scope of opportunity for innovation addressing China-specific issues is vast, dynamic, and technologically intricate. For example, in diagnoses of ailments such as hyperthyroidism and diabetes, the diagnoses rates in China are extremely low relative to other developed countries. "If we can leverage technologies like AI to help to increase the diagnosis rate," says Sun, "this could greatly help our healthcare business. If we can help those patients in their ability to be properly diagnosed using cutting-edge technology, then they really have solutions to then be able to access the right treatment. And, of course, that helps those businesses."

In China, while healthcare research and quality healthcare are at an international level in many cases, it is not always the reality in every hospital. "Currently, the healthcare resources are not very balanced. You can see that resources are mainly concentrated in the big hospitals. But, if you look at the population of China, 90% of the hospitals are not at the same level as the big hospitals. The community hospitals and the small hospitals which see most patients are just not at the same level. So, if we can develop advanced tools or assisting tools with AI by working in the big hospitals, and then leverage those tools for use in the smaller hospitals, that could really help patients who don't have the same access to quality healthcare," says Sun.

As such, there are several innovation fields that Merck is looking at, such as liquid biopsy, bio-sensing, and AI-enabled healthcare solutions that exemplify the type of cross-sector innovation they intend to achieve in order to raise the overall level of China's healthcare system. Sun describes that, "For AI-enabled healthcare solutions we have identified how artificial intelligence can massively affect several areas, such as with diagnosis rates and how to improve diagnosis overall. Another area is in drug discovery, and how artificial intelligence can help in clinical development to make treatments more cost effective, more accurate, and more widely available."

Thanks to their in-depth understanding of local and global markets, and their ability to meet the needs of patients, Merck China is exploring and expanding in an array of different areas which are developing rapidly. In building out their global footprint and leveraging the creative and innovative minds of their employees around the world, Sun and Merck China are helping the global brand build off of a historic 350-year portfolio with solutions and digital technologies that will be able to provide people in China, and people around the world, with a better experience, better outcomes, and better lives.

2nd Joint Survey on the Effect of the Tariffs

From May 16-20, 2019, AmCham China and AmCham Shanghai conducted a joint survey of our member companies to assess the impact of the increase in US and Chinese tariffs on companies operating in China. The survey received nearly 250 responses, with companies represented as follows: 61.6% manufacturing-related, 25.5% services, 3.8% retail and distribution, and 9.6% from other industries. A similar survey was conducted in September 2018. The key findings from the survey are:

The negative impact of tariffs is clear and hurting the competitiveness of American companies in China.

The vast majority (74.9%) of respondents said the increases in US and Chinese tariffs are having a negative impact on their businesses. The impact was higher for manufacturers at 81.5% for US tariffs and 85.2% for Chinese tariffs. The impact of the tariffs is felt through lower demand for products (52.1%), higher manufacturing costs (42.4%), and higher sales prices for products (38.2%).

To cope with the impact of the tariffs, companies are increasingly adopting an "In China, for China" strategy (35.3%), or delaying and canceling investment decisions (33.2%).

"In China, for China" is a strategy to localize manufacturing and sourcing within China to mainly serve the China market. Such strategy constitutes a rational choice for many companies to insulate themselves from the effects of tariffs while maintaining their ability to pursue domestic market opportunities.

While over half of respondents (53.1%) have not seen any increase in non-tariff retaliatory measures by the Chinese government, roughly one in five have experienced increased inspections (20.1%) and slower customs clearance (19.7%).

Members also experienced slower approval for licenses or other applications (14.2%) and other complications from increased bureaucratic oversight or regulatory scrutiny (14.2%).

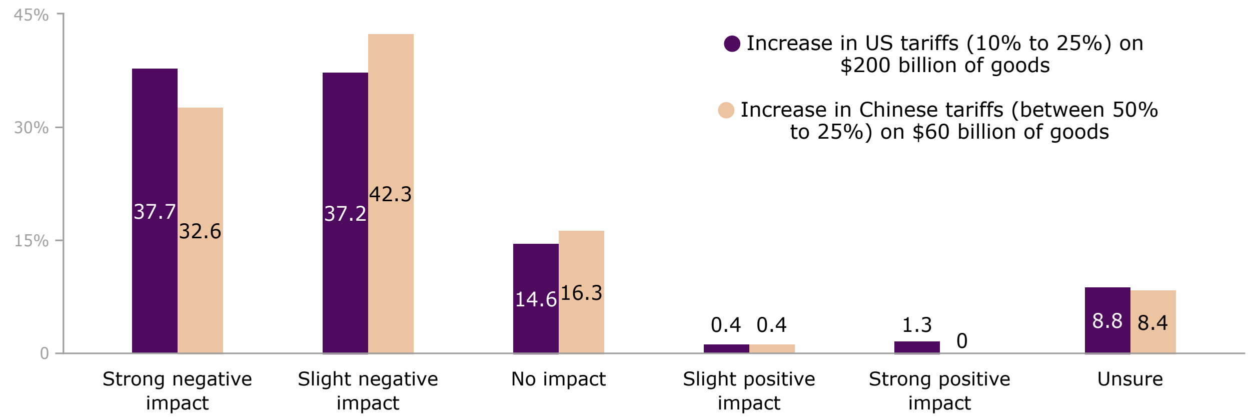
Approximately 39.7% of respondents are considering or have relocated manufacturing facilities outside China.

For those that are moving manufacturing out of China, Southeast Asia (24.7%) and Mexico (10.5%) are the top destinations. Fewer than 6% of members said they have or are considering relocation of manufacturing to the US.

If no agreement to resolve the trade frictions is reached within the next two months, members are most concerned about a deterioration of the bilateral relationship (52.7%).

As a reflection of this sentiment, 42.7% of members supported a return to the status quo, showing that members want a deal and a return to the pre-tariff predictability and stability of the US-China trade relationship. At the same time, this would suggest that 53.3% of members favor negotiations continuing towards a deal that addresses structural issues allowing them to operate on a more level playing field. Additionally, members are also concerned about an increase in operating costs (45.6%) and being forced to find alternative sources for items currently produced in either the US (22.2%) or China (22.2%).

How will the latest round of tariffs impact your business?



If you have relocated or are considering relocating China-based manufacturing facilities to other countries because of the tariffs and/or concerns over the future of US-China trade relations, where have you/are you relocating to?

No plans to relocate manufacturing facilities	60.3%
Southeast Asia	24.7%
Mexico	10.5%
Indian Subcontinent (India, Bangladesh, Pakistan, Sri Lanka)	8.4%
Elsewhere	6.3%
United States	5.9%
East Asia	4.2%
Europe	3.8%

How are tariffs and US-China trade tensions impacting your business strategy?

	Percentage of Respondents
Restructuring China operations to be more heavily "In China, for China"	35.3
Delaying or canceling investment decisions	33.2
Adjusting supply chain by seeking to source components and/or assembly outside the US	25.2
Adjusting supply chain by seeking to source components and/or assembly outside China	22.7
Considering relocation of some or all manufacturing out of China	19.7
No impact	14.3
Other	9.7
Considering relocation of some or all manufacturing out of the US	9.7
Increasing investments	2.9
Considering exiting the China market	2.5

Bringing Global Food Safety Standards to China

By Mark Dreyer

Photo courtesy of Mars

Abigail Stevenson is the Director of the Mars Global Food Safety Center in Beijing, China. In this role, she leads a global team focused on addressing the most significant food safety challenges facing global food supply chains through scientific research and new technologies, partnerships, collaborations, and expert engagement.

Previously, Stevenson served as Director of Stakeholder Relations and Science Communications for the Mars Petcare segment, where she led development of the Mars Petcare Academy Associate advocacy program and segment communications, supporting several acquisitions. Prior to this role, she was a member of the WALTHAM Centre for Pet Nutrition leadership team as Head of WALTHAM Science Communications.

She began her career at Mars in 1993 at the WALTHAM Centre for Pet Nutrition as a Research Scientist and went on to obtain her PhD in nutrition and urinary tract health from University College London in 2002.

In 2015, Mars set up its Global Food Safety Center – the first of its kind globally – an hour north of Beijing. Now led by Abi Stevenson, the Center employs the latest technologies to tackle some of the planet's most pressing food safety concerns. The Center's focus for the next decade has three main goals: mycotoxin risk management, microbial risk management, and food integrity, but much of the work is undertaken in partnership with a variety of public, private, and governmental stakeholders. With the world set to feed nine billion people by 2050, while also drastically reducing agriculture's impact on the environment, the need for the scientific community to focus on these topics has never been greater.

In 2008, a scandal caused by the addition of the industrial plastic melamine into milk powder somewhere along the supply chain harmed hundreds of thousands of children, with six infants dying. The incident continues to cast a shadow over the food industry in China. "I think it still drives mistrust in local manufacturing, and particularly in the milk sector – I still see a huge predominance of imported milk here," says Abi Stevenson, Director at the Mars Global Food Safety Center (GFSC) in China. "It is a challenge for the industry as a whole to drive up China's reputation for food manufacturing. Everybody, whether domestic or international companies operating here in China, has a joint responsibility to help with that."

Global Standards, Local Implementation

The shared responsibility between companies and suppliers to increase China's reputation in food manufacturing is particularly challenging in China due to the fragmented nature of the supply chain. In China there are many more small players in the industry, as opposed to the fewer, bigger suppliers typically found in the US due to years of consolidation. "In China, there is a massive tail of smaller, lower-scale facilities that are essentially being left behind. So, how do you lift the average so that everyone can move towards more efficient and safer production, from an agricultural and manufacturing perspective?"

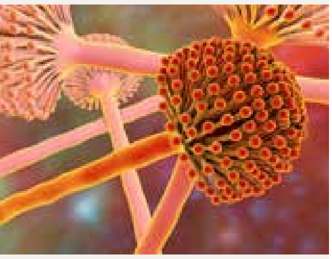
For Mars, at least, the answer lies with their Global Food Safety Center, which enables the firm to help ensure a safer supply chain for everyone in China. "We believe in manufacturing locally, but manufacturing to global standards and then really sharing those standards with the intention of driving global standards implementation in China over time" says Stevenson.

This was one of the main reasons behind the decision Mars made to set up the Global Food Safety Center in 2015 in Huairou, on the outskirts of Beijing. "There were a number of reasons why we chose China," says Stevenson. "Mars has been in China for 30 years, and our commitment here is long-term. Before we built the Center, we talked a lot with stakeholders here, with the government, with our own business, and with other organizations, and we felt the pull was very strong."

From West to East

Stevenson's own journey to the GFSC was quite different, however. "I graduated from the University of Stirling in Scotland, with an Ecology degree, and then went to work in Alaska for four months as a

> "Things move fast, so that's a huge benefit that I see in China. Once a decision is made to do something, and everyone gets behind it, it moves very fast."


Above: A selection of photos from the Global Food Safety Center.

Photo courtesy of Mars

research assistant. When I came back, I looked in The New Scientist – as a science graduate, it was the place to look for jobs at the time – and I saw a job advertised there for a research assistant role, working with cats and dogs at the company's global pet nutrition research center, WALTHAM, based in England. It sounded amazing – I love animals – and, to cut a long story short, I started in January of the following year."

Two and a half decades later – and still at Mars – Stevenson says she was looking to help inspire the next generation of scientists and associates coming through the company, as well as looking for a geographical challenge. When Mars colleague Bob Baker, who led the creation of the GFSC, moved on to another role, China presented itself as her new opportunity.

"Moving to China, my goodness, what a whirlwind of experience, of personal growth and learning! I work with an amazing, talented team of scientists, around half of whom have had their training from outside of China. Most of them are looking to apply the science they do to make a difference and serve a greater good, and that's really what we try to do at the food safety center, working on the biggest challenges for both Mars and the food industry as a whole."

Tackling Toxins, Informing the Public

One challenge that the GFSC team is focused on is aflatoxin, a highly toxic substance produced by a fungus that can contaminate foods such as peanuts and corn, and, if consumed, has been linked to liver cancer and stunted growth in children. The toxin isn't unique to China – other warm climates such as Africa and India have similar problems – but Mars is working with the government and growers here to help develop the peanut industry. "We use peanuts in Snickers and in M&Ms, which we manufacture here in China. We really want to use Chinese-grown peanuts, but we can't yet meet our entire demand, so we currently import a percentage. It also doesn't make sense, from a sustainability perspective, to ship heavy goods between countries, so we always try to [use locally-grown ingredients] where possible."

Having also worked in communications at Mars, Stevenson takes a particular interest in consumer-facing issues. She cites the negative perception in the US and elsewhere over genetically-modified crops, or GMOs. Despite an absence of science-based evidence to support these claims, Stevenson points out this perceptions could really limit scientific progress in the future. With 50% more food needed globally by 2050 – much of which would be demanded in Asia – many of the future solutions, she says, are going to come through scientific discovery. "If we're going to feed the planet, we're going to have to address the impact of climate change and be able to grow crops in this increasingly challenging world. GMOs and gene-editing – or CRISPR, as it's called – are really going to help drive solutions," says Stevenson.

More specifically for China, there is a lingering – and, Stevenson argues, increasingly outdated – perception that "Made in China" is bad, but unique challenges emerge when access to credible information is limited. "The best thing we can do here is work together with the academic community, who are often working on behalf of the government on these challenges and work in a way that drives us toward solutions, without talking very proactively about the problem, because the government wants solutions."

But if public advocacy remains a challenge in China, the central role of the government can also be an advantage. "Things move fast, so that's a huge benefit that I see in China. Once a decision is made to do something, and everyone gets behind it, it moves very fast. I see that on many different levels – both in my personal life and in work life."

Pet Projects

Stevenson says Mars sometimes works with other multinationals in the industry, such as Danone and Romer, saying, "It's to everyone's advantage to drive

Top: Stevenson (back row, center) poses with fellow scientists at the GFSC.

Photo courtesy of Mars

Bottom: Stevenson speaks to attendees at an AmCham China event on food safety.

Photo courtesy of AmCham China

good food safety practices here in China. It's an area we view as non-competitive, and we're very open to those kinds of collaborations." Other partnerships involve a variety of stakeholders: the GFSC works with Cornell, Maryland, and Kansas State universities to help foster US-China collaboration, while, more locally, the Center partners with non-government organizations such as the China Children & Teenagers Fund, Chinese trade associations, and Chinese universities such as the Chinese Academy of Agricultural Sciences and the Chinese Agricultural University, to drive change, not just on the confectionery side of the business, but also on Mars' other main focus, petcare.

"I initially joined Mars because I love pets," says Stevenson. "One thing we've done here in China is we've advocated for a long time that pet food should have regulations to ensure you are feeding your pet for a long, healthy life. So, last year, we, together with the government, were successful in introducing pet food regulations, which included both nutrition and food safety. That was a big win for us, helping drive a better world for pets in China."

"We are a small team of 30," Stevenson continues. "That really isn't very many, but we have big ambition. We bring global networks, high-capability laboratories, and skilled scientists to the table, and we want to collaborate even more with academic communities here in China. We believe that we shouldn't just be conducting science on our own, we believe in working together with the world's experts in academia, NGOs, growing the talent pool for scientists here in China, driving a collaborative, credible, unbiased approach, and publishing our findings together in journals that are independently peer-reviewed."

Issues Without Borders

Stevenson highlights the fact that it's not realistic for one country on its own to solve some of the world's biggest challenges, adding that a global approach is required. "Food safety doesn't stop at the border," she says. "We know, more than ever, that the food supply chain is global, and food moves around the world across many borders. So that's why we believe that the greatest solutions will come from collaboration."

"I think what differentiates the GFSC from other innovation centers here in China is that we're doing fundamental science," Stevenson continues. "We also have innovation centers where we're doing new product development, and optimizing the way we manufacture, but the Food Safety Center is different. This is about taking a very fundamental look at the biggest challenges and how we can address them through science and technology that we share for the greater good. We really do believe that food safety is not something that should be a competitive advantage and that no one entity can solve the challenges alone."

Stevenson may be half a world away from her original home, but the GFSC perfectly combines her personal mission with that of her firm. "I have a real passion for meaningful science that really makes a difference to the world at large. Here at the Center, we believe we can be the bridge between the China science community and the global science community to drive the sharing of knowledge, expertise, and capability, addressing some of the biggest problems that China faces. That's what we're doing through employing local scientists and bringing our global network to China. After all, if it's not safe, it's not food."

Extraordinary Accession: China's WTO Agreement From Every Angle

By Jordan Papolos

Former USTR Charlene Barshefsky discusses her historic involvement in China's accession to the WTO and analyzes the divergent course China has taken in the past decade from market-based economic reform, the role of the WTO both past and present, and how these factors have led to the US-China trade dispute.

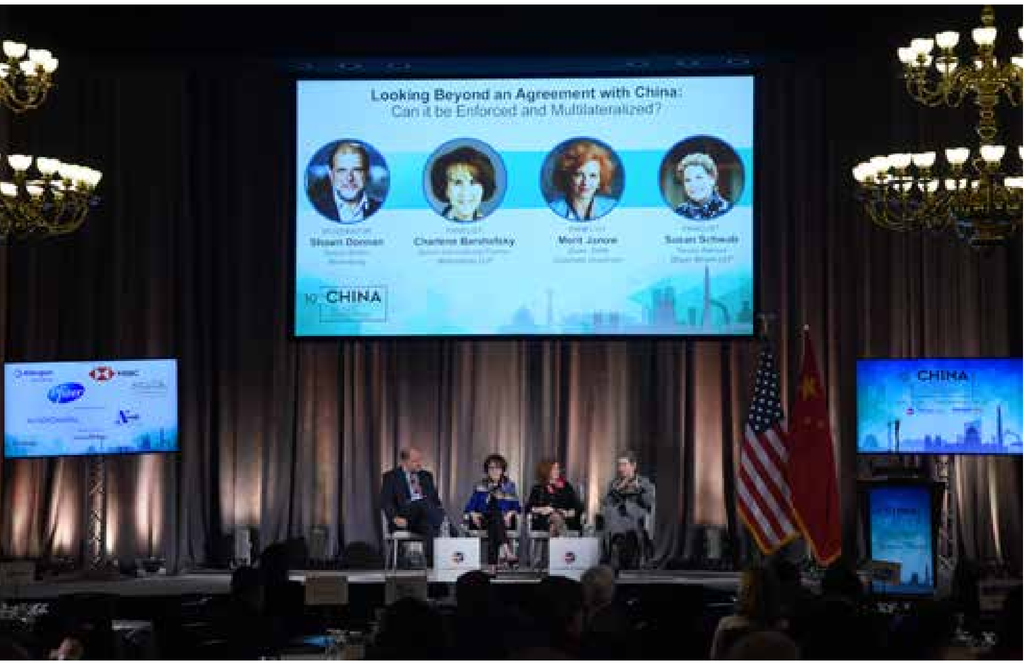
Charlene Barshefsky served as United States Trade Representative, the country's top trade negotiator, from 1997 to 2001, after four years as Deputy US Trade Representative from 1993 to 1997. She is a partner at the law firm of Wilmer Cutler Pickering Hale and Dorr. She is also an advisor at Moelis & Company.

On December 11, 2001, the global economy changed forever with China's accession into the World Trade Organization (WTO). This was a historic event, bringing China into the fold of international trade, furthering China's reform and opening up, and building an economic foundation between China and the US – a foundation which promised to one day dovetail into greater, constructive political engagement. This accomplishment was 15 years in the making, requiring back and forths between the US and China from representatives of both governments, endless hours of closed-door discussion, and was an initiative that garnered both the ire and praise of US citizens, politicians, and businesses. Leading the US side of these negotiations as far back as 1993 – an expert in identifying the import of this monumental multilateral development – was former United States Trade Representative (USTR) Charlene Barshefsky.

From 1993-1997, Barshefsky served as deputy USTR where she negotiated heavily with China, focusing her attention on issues such as intellectual property rights, textiles, and a variety of market access issues. Barshefsky's success in these areas saw her quickly promoted to the position of USTR, where she determinedly worked across two continents, championing the significance of China's WTO accession to both governments, going head to head with then Premier Zhu Rongji, and, ultimately, finalizing the trade negotiations that led to China's admission into the WTO. Today, there are few people who better understand the importance of China's accession to the WTO, how it has led to today's US-China trade dispute, or who can see through such an acute historical lens how things have gone off course, and more importantly, how that course can be corrected.

The Upside of an Exceptional Accession

Both the road preceding the accession and the one that followed saw great challenges, however, the rewards for the US, China, and the rest of the world have been staggering. Since China's accession, the value of US agricultural exports to China has risen by 1,000%. American companies and consumers have seen the benefit of these trade normalizations, as well. Between 2013-2018, for example, Boeing delivered more aircraft to China than in the US. And, in 2015 alone, US exports to China directly and indirectly supported 1.8 million new jobs.



Ambassador Barshefsky speaks on an expert panel discussing the US-China trade dispute at the 10th China Business Conference. **Photo Courtesy of AmCham China and U.S. Chamber of Commerce**

"The US and Chinese economies are infinitely more interconnected today than 20 years ago. That's obvious on the basis of almost any measure, including the very structure of business and the advent of supply chains," says Barshefsky. "The reform and opening leading to and following China's accession, of course, was a great boon not only to the Chinese and US economies, but also to the global economy. China's market became a world market, leading China – over time – to become the world's second largest importer, right after the United States."

Preceding China's accession to the WTO was nearly two decades of tireless negotiations in which historic conditions were placed upon China, including a series of widespread liberalization commitments, dropping of tariffs on goods, opening of agricultural trade, and the removal of barriers to foreign service providers. Barshefsky notes that, "The basis on which China entered the WTO was one of the strictest agreements in history. Apart from the historic liberalization of trade in goods, services, and agriculture, the agreement contained special rules that pertained only to China, and have since pertained to no one else."

"Through that process," Barshefsky explains, "China's economy opened at an extraordinary pace, allowing China to become, as previously mentioned, the world's second largest importer. This would never have happened without the WTO. In the process, China also lifted hundreds of millions of people out of poverty in an effort that has no historic parallel."

The former USTR is also quick to highlight the ways in which China's accession has benefitted the international community, and global economy. "We know," says Barshefsky, "that China was a stabilizing force in the 1997 Asian financial crisis, as well as in the 2008 global financial crisis. That crisis, in '08-'09 is, in part, what gave China room to become, on a very rapid basis, more muscular and more aggressive internationally."

The Problem with Hindsight

Current USTR Robert Lighthizer has argued that the US had "erred in supporting China's entry into the WTO on terms that have proven to be ineffective in securing China's embrace of an open, market-oriented trade regime." However, the question then becomes, what would have been a better alternative, and what would the global economy look like had China not joined the WTO? In the case of China's accession, identifying a superior alternative, even in hindsight, is surprisingly problematic – a point on which Barshefsky is clear.

"If we also consider that China is a fifth of the world's population, a nuclear power, a permanent member of the UN Security Council and so on, including China in the WTO on very strict terms was absolutely the right thing to do," says Barshefsky. "The disappointment is in the backsliding by China which began in 2006–07, years after WTO entry. Frankly, because of political hesitation on the part of the US or a failure to understand that early backsliding had to be rectified, I think that a more serious response by the US was necessary far earlier than occurred."

Nothing is ever certain – especially on the political stage. And, as Barshefsky posits, you must make the best decision at the time, knowing full well that there will always be uncertainty. "The backsliding is obviously of concern," Barshefsky says. "Having said that, there are no guarantees whenever you do a trade deal. We're not witnessing the end of history here. Policies can change. Donald Trump will be gone at some point. With new leadership, policies may toughen or change in different ways – one never knows. I am reluctant to say that what we see today is what will always be."

Acknowledging the realities of China's backsliding, the former USTR points to the origins of the nation's divergence from market-based norms. "From Deng's time to 2006, or so, China had been on a more convergent course with market-based economies," says Barshefsky. "But, beginning around 2006 or 2007, the reform and opening which had characterized the previous 20 years began to sputter. Policies such as 'indigenous innovation' were inaugurated. By the time Xi Jinping came into office, reform and opening had virtually halted. Indeed, even while Hu Jintao was president, the words 'reform' and 'opening' were rarely coupled together, and the word 'opening' began to drop out entirely."

While China's push for greater reform since 2006 has certainly slowed, the pace at which it opened leading to and immediately following WTO accession was, and continues to be, unprecedented, according to Barshefsky. "The WTO agreement took a Chinese economy that was in the process of internal economic reform on a very small scale, and vastly broadened, deepened, and extended that reform in a manner unprecedented among WTO members," explains Barshefsky. "There is no historic parallel between the changes that China had to make to its economy under WTO and that of any other country in the world."

As the market-based economies of the world attempt to reconcile China's divergences, Barshefsky is quick to note that much of what is seen today was simply unforeseeable in 2001. "Today, one can point to a large number of features of the Chinese economy that do not comport with the spirit, if not the letter, of its WTO obligations. At the same time, a number of divergent actions encompass areas that the WTO does not cover, such as investment policy, or areas which it covers in an incomplete way, like new technologies that didn't exist in 2001."

"A number of [China's] divergent actions encompass areas that the WTO does not cover, such as investment policy, or areas which it covers in an incomplete way, like new technologies that didn't exist in 2001."

Failures to Enforce

Looking back on how China's divergent course has unfolded into today's US-China trade dispute, Barshefsky underscores the US's historically limited enforcement of China's WTO agreement. "The WTO contained a number of provisions that were very China-specific, designed to prevent backsliding by China and to prevent import surges from China. For example, China's WTO accession agreement contains provisions prohibiting forced technology transfer," Barshefsky explains. However, the utilization of these provisions, according to Barshefsky, has been woefully lacking.

"Remarkably, neither the Bush, Obama, nor Trump administrations sued China on the basis of these technology transfer provisions. China's WTO agreement also disciplines the commercial conduct of state enterprises, and the influence government can have on state enterprise decisions," Barshefsky says.

These lapses in enforcement extend even further. "Perhaps most remarkably, China's WTO protocol contained an anti-surge mechanism, preventing market disruption in the United States from Chinese imports," she says. "Under that provision, the president had authority to do whatever was deemed necessary, including tariffs of the kind you see today, as well as import bans or other prohibitions."

Much to her surprise, this anti-surge mechanism was "used only once by President Obama, and that was on tires. It was never used during the Bush administration, which denied relief four times. The provision expired at the end of 2013. Had it been used," says Barshefsky, "the potential loss of US manufacturing jobs, which have been attributed to Chinese import surges during that period, would not have occurred."

In the period from 2001 to 2011, it has been estimated that about 1-1.5 million jobs were lost in manufacturing to Chinese import surges. Yet, the mystery remains as to why every administration failed to use the full force of the anti-surge mechanism to combat these losses.

Barshefsky remarks, "With respect to the anti-surge mechanism, if you were losing a million jobs as has been alleged, and you were president, you think you'd do something about it." On the other hand, she does point to some likely explanations why past administrations did not proceed under these various provisions. "With wars going on in Iraq and Afghanistan, and the US financial crisis, I don't think [George W. Bush] wanted any more problems. I think he wanted a stable China relationship. My guess is that he denied relief largely on political grounds. Obama did use the provision once. But industry itself probably complained too little."

"There was substantial lost opportunity: the prophylactic effect of enforcement would have been substantial," says Barshefsky. "It would have created a great deal of legal leverage, a cause of action which China had agreed to in its accession." Barshefsky goes on to state, "With respect to forced technology transfer and SOEs, it is partly a question of evidence, and that's a problem that persists to this day. Additionally, companies tend to be reluctant to come forward." The former USTR however counters that, "It still doesn't explain why more trade associations, which tend to shield individual companies, didn't come forward, and it doesn't explain why the US wasn't more proactive with respect to some of these issues."

Barshefsky remarks that, "If you want to resolve issues with China, as we all know, it doesn't take very many people in the room. The more people you have, the less likely you are to resolve anything. Dialogues such as the JCCT and S&ED became a way for China to manage the United States, not the other way around. The result is that the US lost a lot of time."

The Future of the WTO

As the Ambassador plainly points out the copious administrative failures to leverage China's WTO agreement, many today question the strength and utility of the WTO – especially in the case of China. However, Barshefsky firmly believes in the WTO's imperative position as arbiter of fair trade across the globe, despite its need for reform. "I think the WTO, or an institution like it, is vital for the fair conduct of global trade," Barshefsky says. "It's vital as a source of agreed upon rules of the road. Period. I think reform of the WTO is needed, however – reform geared toward the negotiation of meaningful agreements in a timely manner."

Barshefsky highlights that what is most important for China, the US, and, indeed, all WTO members, is a framework built on agility, reflective of the pace of change under which today's markets now operate. "The WTO agreement that most countries

Ambassador Charlene Barshefsky speaks at the 10th China Business Conference.
Photo Courtesy of AmCham China and U.S. Chamber of Commerce

operate under was the agreement that came into effect in 1994. That agreement was based on an agenda first created in 1982 and subsequently revived in 1986. That's really old." Having said this, Barshefsky notes, "China's agreement incorporates areas covered in 1995-96 such as the ITA, the global telecom agreement and the global financial series agreement – plurilateral deals under WTO auspices. But even these agreements are dated, except for ITA II. You need to have a WTO that reaches agreements quickly, which are commercially important, and that ensure the global trading system operates as intended – on a fair basis."

"There's a future for the WTO," Barshefsky continues, "but only if the members recognize that if it becomes irrelevant, the US, China, and one or two other players will dominate. If you're India, or Brazil, or South Africa, or any one of a number of other countries, I can't imagine that's the outcome that you'd want."

Moving forward, with the dawn of advanced technologies, the question of a 25-year-old framework's relevancy becomes more salient every day. "I think this is in part why you see the advent of bilateral and regional FTAs," says Barshefsky. "When you've got a coalition of the willing, and a coalition of relatively like-minded economies, things are much easier to do. Unless the WTO begins again to operate on that basis, as we did in 1995-96, its downward slide will continue unabated."

Taking Care of Business

At such a turning point in US-China relations, Barshefsky discusses the US's opportunities for recourse, looking at the nation's historical sources of strength and its own divergences as a global power. "The American business community has always been the leavening force with respect to US policies on China and with respect to Chinese anti-western rhetoric," says Barshefsky. "But that community has been burned, either because of the theft of intellectual property, or because of the exercising of administrative discretion against foreign companies, or any one of the many reasons businesses well know, including abuse of the anti-monopoly laws by the Chinese authorities."

"The business community today has relatively little interest in advocating for China," she says. "I think China has been slow to recognize that current China policy is broadly supported in the US – maybe not the means, but the range of concerns is broadly agreed upon in the US by Republicans, Democrats, by the business community, and by many academics and scholars of China."

"I think China has been slow to recognize the change in US mood, and how deep that change runs," says Barshefsky. "That, I think, is very unfortunate. It has led to the repeated misreading of Trump by the Chinese, and it has exacerbated the current confrontation."

While both sides wrestle with each other on the global stage, Barshefsky regards what she believes to be an even greater threat to the US – the US itself. "Above all else, the United States better get its own act together," she says, "because if we don't, what China does to us is far less than what we'll do to ourselves." With a litany of areas circled for improvement, Barshefsky highlights that the US's greatest way of maintaining a competitive advantage with China will not come from China's reform, but from domestic reform's reflecting the nation's trajectory from years past.

Barshefsky highlights infrastructure, education, a return to basic R&D spending (with a reinstitution of the positive triangle between government, universities, and businesses), healthcare, and the full range of domestic economic issues, including greater economic equality which should be taking center stage in Washington. "Every one of these issues has been discussed ad nauseum," says Barshefsky. "I can't even count the number of presidential commissions, agency commissions, think tank reports, and all of the rest, which surely number in the hundreds, all saying essentially the same thing – the US must embark on structural change and the full finding of key priorities to maintain economic preeminence."

Despite the deluge of overwhelming evidence from myriad respected sources, today, there is little alignment between what the US *should* be doing, and what it *is* doing in terms of its economic preeminence and positioning on the world stage. Barshefsky simply says, "The US does relatively little, as you know every time you ride down the street and navigate the potholes or the crumbling bridges, or every time you look at K-12 education. It's no answer to say that we still have great universities – the best in the world – when A) you starve them of great foreign talent, and B) other countries have marvelous universities, some of which are catching up to the US. The US must move forward in a productive way. That means both the administration and Congress. There is no excuse. These are all things that we control ourselves. China is not culpable for our domestic inaction."

Navigating the Seas of Uncertainty

McLarty Associates is a global strategy firm, that helps clients deal with political and policy challenges all around the world. Headquartered in Washington DC, the firm has people based in 22 countries around the world, and employees collectively have held ambassador positions in more than 50 countries. AmCham China spoke with Co-founder and President Nelson Cunningham about his firm's work in China, the 2020 presidential election, Washington's current stance on China, and his fears for the future of the US-China relationship.

By Mark Dreyer

February 2 no doubt occupies a particular place in Nelson Cunningham's heart.

Not because it's his birthday, or has any special personal relevance, but because his work for McLarty Associates often resembles Groundhog Day, marked informally in the US at the start of February each year. "You see the same problems coming up again and again and again", says Cunningham, "So many businesses are affected by data processing rules, they're affected by data localization rules, cross-border data flows, trade issues, border, visa, and movement-of-people issues. The local players are very adept at using their government to keep out the foreigners – this is something that you see in every country – and so very often we are hired by the foreigners in that country to try to help them push back against the local competitors who are using the government's instruments against them."

When it comes to China in particular, Cunningham notes some of his clients definitely feel that they are being affected by the overall tensions between the two countries. Whether it is regulatory approvals being held up or slowed down, or inspections being stepped up, his clients' "foreignness" in China appears to have become a salient factor in the success of their business operations here. But, he adds that the same phenomenon is also being seen in the US, where foreign companies feel that they are now being disadvantaged. "It doesn't matter if they are Mexican, or Chinese, or Korean, or German," he says. "These tensions are rising on both sides and not in helpful ways."

Trump Card for the Democrats?

Like many other Democrats, Cunningham places the blame for this deterioration squarely on the ruling party in Washington. "This US government has destabilized the US-China dynamic more powerfully than any one of its recent predecessors, and it has done so in ways that please some American interests and that discomfort many other American interests." With attentions now starting to turn towards the US presidential elections in 2020, Cunningham says the whole world will be looking at whether Donald Trump will still be in the White House 18 months from now, or, if not, whether any of his policies endure under the next administration. Although Trump is currently the favorite to stay in power, there are plenty of others lining up to replace him.

After a long career in Washington, Cunningham is well placed to opine on the state of US politics today. Not surprisingly, given his connections, he sees the Democrats as parading a stronger line-up of candidates. "The Democratic field is as broad and as diverse

Nelson W. Cunningham is President and Co-founder of McLarty Associates, a firm with global reach and over 80 employees and advisors, stationed in Washington and around the world. Cunningham is responsible for guiding the firm's service to clients and is a skilled strategist on national and international policy issues. Prior to co-founding McLarty Associates in 1998, Cunningham served in the White House as Special Advisor to President Clinton on Western Hemisphere affairs and as General Counsel at the White House Office of Administration. He previously served as General Counsel of the Senate Judiciary Committee, under then-Chairman Joseph R. Biden. Before moving to Washington, Cunningham served as an Assistant United States Attorney in the Southern District of New York from 1988 until 1994, having been hired by Rudy Giuliani, and in 1984 he was a staffer on the successful Senate campaign of John Kerry.

Cunningham is a member of the Department of State's Advisory Committee on International Economic Policy, a past member of the Secretary of State's Foreign Affairs Policy Board, and past Chairman of the Export-Import Bank Advisory Committee. He also served as a member of the Obama-Biden Transition Team and as an advisor during the campaign, and was a foreign policy and trade advisor to John Kerry's 2004 presidential campaign, as well as to several presidential and Senate campaigns. Additionally, Cunningham serves as President of the Board of the American Security Project, a think tank founded by then-Senator John Kerry in 2005, and as Vice Chair of the board of the Business Council for International Understanding (BCIU). A lawyer by trade, Cunningham is a member of the DC, New York, and Massachusetts bar associations.

as any we've ever seen," he says. "As a Democrat, and as somebody who worked for John Kerry, Joe Biden, and Bill Clinton, I'm very proud of the diversity in the field."

Speaking to AmCham China six weeks before Biden announced his candidacy, Cunningham correctly predicted his old boss would indeed join the race, adding, "[Biden] is the only one of the candidates who brings that foreign policy experience, and who can say, 'For 30 years, I've been closely watching power dynamics around the world, and I'm the only one who can understand China, or India, or Europe, or Latin America in a profound way.' Other than Biden, it is a strong domestic field, but the others would have to learn foreign policy, either during the campaign or on the job."

US Views on China

It is no secret that the stance on China in Washington has hardened over the past few years, and with the issue gaining broad bipartisan support, Cunningham points out that it's become a topic to score points with. "It has been easy for some time in the US to get political attention by shouting about China. Democrats have done this and Republicans have done this, because China is big and powerful, and, to many Americans, they feel that it has taken their jobs and weakened the American economy."

But Cunningham warns that the administration's unique approach to tackling China could have serious repercussions further down the line. "What Donald Trump has done is he has taken two separate issues and he has linked them together," says Cunningham. "One is the trade deficit between the United States and China, which he views as the United States losing $500 billion a year. Mainstream economists will tell you that's simply not the case, but that's how he sees it and he actually finds more support from those on the left when it comes to talking about trade deficit issues."

"The other issue that he has taken up is a structural one of intellectual property, joint ventures, cyber espionage, and technology transfers, where the American business community has become increasingly concerned and disenchanted with Chinese policies. So you have these two issues – the trade deficit and these structural changes – which have very different constituencies in the United States, yet the president has linked them together through the use of tariffs. Now he's got to come up with a conclusion that deals with those tariffs and that satisfies those two constituencies. That's a very complicated game to win."

Cunningham cautions that while, for example, China might agree to buy vast quantities of soybeans, chips, autos, and other American goods to reduce the trade deficit, that still would not address the much broader concerns in the American business community. "If that is the case, it would be hard for [Trump] to claim victory in a way that is durable, because the American business community will say, 'No, no, you didn't solve our issue. You solved another issue, which we never thought was a problem, but you did not solve our fundamental issue.' And it makes it very hard for the president to declare victory."

Cunningham further worries that, two or three years down the line, the two countries would likely clash once again, even if issues are resolved in the short term. "These are two powerful countries that have fundamentally different operating systems – the Chinese OS and the American OS. It's hard to imagine that we're not going to see tensions in the years ahead. The trick is to make those healthy tensions and resolve them in a healthy fashion."

Above
Cunningham (second from left) speaks to attendees at an AmCham China Policy Plus event.

Photo courtesy of AmCham China

Decoupling Fears

According to Cunningham, there are some people in the president's circle who speak of decoupling the US and the Chinese economies, but he warns that would be "a horrendous tragedy". Cunningham worked in the White House when President Clinton pushed for the changes to American law that allowed China to enter the WTO, and, while he concedes that, with hindsight, a different deal might have been more fair to American companies, he still maintains it was a "seminal elemental deal" when it came to integrating China into the global economy. "I am somebody who believes that there is nothing that promotes peace like collaboration, interaction, and trade," he says. "If we decouple the two economies, then the forces of stability and the forces for collaboration and cooperation will become smaller and we put ourselves on a very treacherous trajectory."

Cunningham talks about the huge strength of feeling that President Trump has about the China issues that he raises, noting that many others in his government feel even more strongly than he does, especially about the military challenge that China poses. But he cautions against too strong a line, expressing concern about the lack of balance from elsewhere in government. "Congress can play a moderating influence, but this administration listens less to Congress than many of its predecessors have," Cunningham says.

Geopolitical Chits

The talks between the US and Chinese presidents at the G20 Summit in Argentina last year took a surprising turn when news broke about the arrest in Canada of Huawei CFO Meng Wanzhou, prompting an escalation in rhetoric as well as the arrests of two Canadians, a situation that worries Cunningham deeply. "[The arrest of Meng] is the most unfortunate intersection of law enforcement and policy issues I've seen in a long time," he says. "It came out of a very narrow, but well-defined case, of Huawei and her personal intervention in lying to regulators and to banks about the unlawful sales of telecom equipment to Iran. Nothing is worse in Washington today than to trade illegally with Iran, so the Meng case is viewed very much as an Iran matter."

He continues, "What is different is that it came in the middle of a broader dispute between the US and China over Huawei's role as a global supplier of high-tech telecommunications equipment. That has now been mixed in with this issue of one woman's arrest over Iran sanctions, and I think it's most unfortunate that President Trump linked the two by suggesting that the resolution of her case could be part of a bigger deal."

But Cunningham cautions that China's response to Meng's arrest could have a chilling effect on the global business community. "When I talk to my friends who are Canadian diplomats, they are very cautious about warning their citizens to travel to China now, and it's only because Meng was arrested in Vancouver," he says. "It is a huge vulnerability to China to be viewed as retaliating personally against businesspeople for reasons that have nothing to do with their conduct, but simply to create geopolitical chits. I can't think of anything that will set China back more in the eyes of the international community than for that to continue."

Cunningham was talking to AmCham China following an exclusive Policy Plus event. For more details on Policy Plus, please see page 17 or email policyplus@amchamchina.org

Keeping it Real(ty)

You've been in China for quite some time now. What led you to living and working here?

Eric Hirsch: Looking back on things, I guess it's really quite interesting. I've now been in China for 15 years, with 11 years of experience in real estate before coming here. I spent 11 years working in New York, my hometown, before coming out to China in 2004 full-time. I've been here in Beijing ever since. But the interesting thing is, contrary to some of the other people that I've known and who have also been in Beijing and in China for a very long time, China was not necessarily on my radar before I came.

If 25 years ago someone said to me that I was going to not only just move to China, but also make a career here, I would've said they were crazy. It was not a language that was taught at my university - when I went to school, it just wasn't something that I thought about. But, in the end, I found out that life has its ways of choosing your path for you, as opposed to you playing that active role in the decisions. So, lo and behold, I came in 2004 to Beijing and I haven't looked back since.

How did you first get involved with AmCham China?

Eric Hirsch: My involvement with AmCham China has been almost as long as I've been in China. My experience with AmCham China has always been one of positivity and engagement, which was one of the things that really drew me to it. For the past four years, I've been on the board of governors, and so I really appreciate the recognition from the business community, especially the American business community, in electing me to the board of governors.

I was also vice chairman of the board last year, which helped me further enhance my skill set and grow as a professional. But most importantly, it's also recognition by those in the business community of what I bring to the table. That, to me, is the most important aspect of it, because being a board member is a privilege. It's an honor to be so heavily involved with the Chamber, but it's also one that comes with great responsibility, a responsibility to the membership. We are here not just to be members, but to lead the membership, grow the membership, and help drive the membership forward.

Can you explain how your founding of the Real Estate Forum came about? What are your future goals for the forum?

Eric Hirsch: In 2004 or so, when Charlie Martin was still President of AmCham China, the American business community

Photo courtesy of AmCham China

Eric Hirsch is Executive Director for Jones Lang LaSalle, a Fortune 500 professional commercial property services company with more than 14,000 employees in 14 offices across China. Based in Beijing, Eric leads business strategy and development for the Beijing office market, driving international best practices for the firm which he also serves as a member of the Regional Tenant Representation Board. After more than a decade in the capital, Eric is widely regarded as a leading expert in the field and is frequently sought by industry leaders and the media to comment on the latest market movements and trends. As an industry leader, he continues to be instrumental in building up the firm's growth in Beijing and throughout China. Hirsch is also a long-time board member of the American Chamber of Commerce.

Left
Eric Hirsch and JLL team enjoy the 2019 American Ball.

Photo courtesy of AmCham China

Right
Eric Hirsch (left) receives AmCham China's 2018 Chairman's Award from Bill Zarit.

Photo courtesy of AmCham China

seemed – at least to me – much smaller, and I was the only American in Beijing for JLL at that time. Even though we're an American company, in Asia-Pacific the majority of expats were either British or Australian. Then, as it happened, I was invited to breakfast with Charlie, some of the board members, and some other new members of the Chamber. As part of that conversation, it came up that we should look into creating a real estate working group at the Chamber.

I started to think about what a real estate working group could accomplish, and really what all working groups can accomplish. One, is the feeling of inclusiveness and providing engagement opportunities to membership and providing members with the ability to be more involved in things that match their interests and professional needs. And two, it creates the sense that the Chamber is open to other people that are here for the American business community and welcomes them with open arms.

The next day I had a call with Charlie, and we decided to start the Real Estate Forum. Shortly after its inception, we had a lot of involvement from various organizations, far beyond those in the real estate service industry. That was the best part – we had some great engagement through different members of government, as well, which we were able to source through members of the forum.

With the long-term establishment of the Real Estate Forum as it is today, I think it would be great to expand the forum's scope and inclusiveness to involve members from the legal community, the investment banking community or from the investment side of things, and even from the accounting community, or consulting firms. I have a vision of further developing the forum in a way where it can work hand in hand with organizations like ULI (Urban Land Institute) and BOMA (Building Owners and Managers' Associations).

What skills or experiences have led to your success that then parlayed into your position on the board of governors?

Eric Hirsch: I think life is full of experiences, and coming from New York, I believe that that also helped me on a certain level. New York City, in and of itself, is really a multicultural melting pot, and so growing up there, I've worked with so many people from so many different backgrounds and perspectives. It's a very dynamic city. And, it's also a city where people are expected to stand up for themselves and to make their own way.

From that perspective, it was helpful for someone who had never lived overseas before, even though I'd been to China several times previously. It gave me the necessary "stick-to-itiveness" to tackle a transition that was not necessarily the easiest, because I was client-facing moving into a role in which expats had not historically found success, especially in Beijing. From that, I learned to never give up and have a lot of patience – you have to be patient.

You truly have to rely on building relationships and proving yourself – demonstrating and differentiating yourself from others. You need to be able to build trust. When you're able to build trust and prove yourself over an extended period of time, then everything else is able to come into focus and come into play. Only then are you able to truly develop long-lasting client relationships, as well as friendships. Because, you can demonstrate the proven ability to make a difference.

What accomplishments have you made that you are particularly proud of as a member of the American business community?

Eric Hirsch: One example that I'm very proud of was the white paper that we wrote a few years ago about air quality in office buildings. It's not a secret that Beijing, and China overall, don't have the best reputation when it comes to air quality and air pollution. So, I, Steven McCord, who was our Head of Research for North China at the time, and his team, we decided to write a paper on air quality in office buildings, focusing on what can be done to make a healthier atmosphere and working environment.

This came after the new US embassy was built with their AQI monitor, which changed the whole landscape of people's awareness of the extent of the air quality issue. We recognized that there are things that can be done inside of an office building which can be a benefit for the staff and lead to

"You should be true to yourself and not be afraid to speak out and give your opinion. Every board member is there for a reason."

better productivity, better employee engagement, as well as decreased turnover, etc. We wrote this paper and it was extremely well-received by not just the business community in China, but also internationally. And so that's something that I'm very proud of.

How do you engage as a board member?

Eric Hirsch: I'm a firm believer that you get out of it what you put into it. And the beauty of the board is that you have so many people with many different skill sets, personal and professional backgrounds, as well as cultural backgrounds. This is my fourth year on the board, my fourth year of seeing things change and evolve over three different chairmen. It's interesting seeing the different dynamics, as well as the different individuals at play. But when I first came here and I mentioned how welcoming the chamber was, my personal take is that the chamber should continue to take on that role and be welcoming to any and all American businesses here, as well as those who are doing business in the United States.

Some of the things that I've been involved in that I'm very proud of include things such as being a speaker at the HR Conference last year, as well as a speaker at the AGM, helping create the Pioneer Award and some of the other awards that we now give out. And last year, being able to give the Pioneer Award to Stephon Marbury as well as receiving the AmCham China Champion's Award, to me, was a very nice acknowledgement. Furthermore, being a co-chair of the American Ball, for example, have all been very nice experiences.

I'm very proud of what I've been able to help with good causes and in an effort to help others build their careers. Things such as speaking at the Young Professionals lunches and always trying to make myself available for those who are less experienced or younger, or even those who are more experienced or have different perspectives on things.

We always have to be sponges, and I, for one, learn from everybody. One of the great things about being on the board is being exposed to so many different things, events, and perspectives, learning from those around me, and then seeing how I can apply a lot of their knowledge to my daily life or how I can help others as they continue to grow – and vice versa. I like to think that I've had a positive impact on others and that's just for the sake of having a positive impact on others. There's no greater personal gratification other than that, which to me, is great.

What would your advice be for incoming board members next year – those who have never been a member of the board of governors?

Eric Hirsch: You should be true to yourself and not be afraid to speak out and give your opinion. Every board member is there for a reason. The business community at large definitely recognizes what each person brings to the table. I especially appreciate how everyone has tremendous respect for each other and that we all communicate well, even if we might have some different opinions at times.

One should not be afraid to speak their mind, because it's all there to enhance the future of the board in order to move things forward. It never ceases to amaze me – people that I thought wouldn't have opinions on certain areas have some very astute observations on things I wouldn't have expected. So that's an eye-opener for me, as well, because it's a reminder that we should never just look at someone or something on the surface. I would also suggest that for those who are on the board or those who have been around is not to dismiss people on the board because they might have a different mindset or background.

Why Self-Disruptive Leaders are Critical to Future Success

Michael Distefano, President of Asia Pacific for Korn Ferry, an executive search firm founded in 1969 that now advises companies on their talent and leadership needs, addresses some of the most pressing issues facing the HR community and explains why being agile and adaptive are the keys to future success in the workplace.

How did you arrive at Korn Ferry and can you describe your career to date?

Michael Distefano: I joined Korn Ferry 18 years ago in March 2001. I was in Silicon Valley, where I was part of a team that had just sold a dot-com business to a bank. As fate would have it, I was introduced to a very persuasive headhunter named Richard Ferry, who had an online company called Futurestep, which matched candidates to jobs. He offered me an opportunity to use some of my newly formed dot-com skills in a job search environment in Los Angeles instead of in the financial arena in San Francisco. I joined as Head of Marketing for Futurestep and a couple of years later moved over to international marketing for Korn Ferry, later becoming the Chief Marketing Officer. I then had the opportunity to start the Korn Ferry Institute, which is our think tank and a repository for all of our IP, where we have 50 scientists, statisticians, econometricians, and analysts. Two years ago, I was asked by our CEO and the Board if I would come over to Asia Pacific and help look after our businesses over here, and it's been an incredible adventure thus far.

What is the "talent crunch" and how can companies prepare for it?

Michael Distefano: The Korn Ferry Institute has come to the conclusion that we will be massively underemployed in terms of the number of skilled workers to fill job openings. It's not necessarily that there are not enough people in the world, it's that there aren't enough of the right people. Korn Ferry is predicting that by 2030, there will be 47 million unfilled and open jobs around the world that will cost us trillions in unrealized GDP growth. You see the greatest gap in terms of demand for talent and available supply in the more developed countries, but this is a global phenomenon that is pretty pronounced in China, as well.

What do you recommend companies should be doing to guard against this?

Michael Distefano: First, companies should have a plan. It's the old boy scout adage – "Those that fail to plan, plan to fail". Are you looking around the corner, in terms of where the business is going? What's your vision and strategy for the business, and who are the people that you'll need to get you there? Second, not all talent is created equal, but that doesn't mean that everybody in the organization has to be the top 1%. Obviously that can't be possible, but you need to understand how much A-level talent you need, and how many B-level and C-level employees. Third, am I building the right pipeline and network so that I've got ready talent, whether it's full time or part time?

The smartest companies don't merely compare themselves to their direct competitors. They ask who is the most disruptive and transformative? How do they set strategy and execute it? How can we emulate those best practices? Self-disruptive companies consider the new unicorn startups as much as they do those they've been competing against for the last 100 years.

What is a self-disruptive leader?

Michael Distefano: Our research has told us that there's a massive talent crunch looming

Above
Distefano delivering a speech at Korn Ferry's 40th anniversary event in Hong Kong.

Photo courtesy of Korn Ferry

on the horizon, but what got us here won't get us there. We have assessed and surveyed the people who are leading massive transformation agendas, in terms of how they think and lead, their experiences, competencies, personalities, and how agile they are. Through big data analysis, our algorithms can tell us what the most successful people on the planet look like, in terms of their experiences, leadership style, personal drivers and motivators and how competent they are. And, the picture changes quite extensively by geography, industry and role function.

Out of millions of executives in the database, the analysis found that only 15% of us have the most disruptive, open-to-change leadership profiles that will be required for successful leadership in the future. We have entered into an era of continual learning, being comfortable with ambiguity and at ease with constant change. These are some of the requirements that self-disruptive leaders, and organizations embody.

Are these self-disruptive qualities learned or natural?

Michael Distefano: The easiest stuff is often the hardest to learn. For example, we can teach you how to program in Python. What's far harder to teach, however, is agility, or how to cope when you need to make a 180-degree strategy shift quickly and mobilize it on a global basis. Although difficult to teach, there's definitely a best practice that companies can follow so that their current and future leaders can start to get comfortable with what we called the five dimensions of self-disruptive leadership. Clearly, the more you practice, the more you have a plan, the more you put people in these positions – not only to succeed, but to fail and to learn from failure – the better off they will be inside your organization, as you develop them and build their commitment back to you in return.

Is this going to revolutionize education and the way that we're teaching our children, even before they start to think about the workplace?

Michael Distefano: I would hope so. We've seen a number of universities who are assessing students at the MBA level for their leadership profiles, and giving them some work throughout the course of their schooling and then reassessing them at graduation and seeing demonstrable change. You don't really change your personality throughout your life, but you definitely change and adapt your leadership style, so I do think that there is a huge opportunity for education to implement some of this. All too often, kids come out of school with a solid education, but it doesn't necessarily teach you how to be successful in the work world. We always say, you get hired for what you know and you get fired for who you are, so I think being self-disruptive, adaptive, and being able to fit into a variety of cultures is what's going to drive success for people going forward.

Outside of leadership, what other dimensions will be most pivotal for employee success in the future?

Michael Distefano: We're seeing this multi-generational workforce today. You have Generation X's who have a lot of institutional knowledge, but, on the other hand, you have millennials who are much more technologically inclined and adaptive. It's not about replacing one with the other, it's about finding a blend and a balance. We always have a client-centric focus – what do they need and what are they struggling with? To use the Wayne Gretzky hockey analogy, think about where the puck is going, not where it is at the moment. If you have people who are passionately in pursuit of that destination, those are companies that are going to be successful.

If there is one piece of advice with respect to the workforce, it's hire the agile, because they are hard to find, but they will outperform. Large corporations have a challenge because it's a lot harder to rotate the aircraft carrier than it is the rowboat, so its harder to be nimble, but you have to have an eye towards the future. You have to have one foot in today and one foot in tomorrow. You're not betting the ranch on an innovative strategy, but you're looking for small projects that could turn into pilots that could turn into scalable solutions for the future. That's going to be what dictates the winners and the losers. It's not whether you're big and small, it's whether you have a certain risk appetite, and whether you have a pragmatic strategy for developing initiatives, as well as not overcommitting – if it doesn't work, get rid of it and try something else.

Where do you see the future of HR? Are there any exciting technologies you see now or anticipate that will disrupt HR?

Michael Distefano: There are some really interesting things happening in predictive analytics in terms of knowing when somebody is burnt out, or forecasting your attrition levels based on social media activity. They will help us to have a better sense of where employees are in terms of how they're feeling, their engagement, productivity, and satisfaction throughout the workday, but beyond that, I really like the ability to use big data to help people on their leadership journeys.

People are trying to achieve different things in their own careers, so we can have a very personalized conversation and use the science and the data to set them off on their leadership and learning journeys, and do it in a customized fashion. People don't leave companies because they can make ten dollars more across the street at the competition. They generally leave because they don't feel fulfilled or satisfied, or not enough boxes are being checked in terms of their career aspirations. Using data to create a roadmap both to guide us and to warn us where to watch out is a wonderful thing both for the organization and the individual. That's what I'm really inspired by.

From an executive perspective, what are the biggest HR pain points for today's companies?

Michael Distefano: Executives don't know where to get the best talent. They don't know where to onboard or assimilate their employees, or how to keep them. It's very hard, because you have to look at ways to do HR at scale. If you have 10,000 people that work inside the organization, you can't possibly sit down with each of them every day to assess them. You have to leverage technology to make those inferences in an automated fashion. If you can do that and show that you are recruiting better people faster, that you are creating incentive and reward systems that encourage the right behavior and also excite people, that you are putting them into jobs that inspire them, and that they are growing with the organization – that's the winning combination.

Time and research has proven over and over again that companies that do take a pragmatic view on talent and do align their talent strategy to their business strategy outperform in the public arena by about 25% compared with their peers. You then become a magnet for talent, people come sooner in their careers, they stay for longer, contribute more, and it becomes a self-fulfilling prophecy that you outperform your competitors. Just like on the football field, the team with the best talent generally wins.

China's VAT Reforms: Enhancing Economic Activity

An in-depth look into China's new VAT policies, explaining where you and your company can save money and how the new reforms aim to enhance economic activity and boost China's economy.

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Dezan Shira & Associates is a pan-Asia, multi-disciplinary professional services firm, providing legal, tax and operational advisory to international corporate investors. For further information, please email kyle.freeman@dezshira.com or visit www.dezshira.com.

Following the announcements made in the annual Work Report delivered at the Two Sessions, the Ministry of Finance, State Taxation Administration, and General Administration of Customs have jointly issued new policies on value-added tax (VAT).

The new polices, which took effect on April 1, 2019, continue China's overall VAT reform process and build upon already significant, positive VAT policy changes in 2018.

The 2018 changes notably consolidated and reduced the number of VAT brackets from four to three levels, unified the annual sales threshold for small-scale VAT taxpayers, and reduced the VAT rate on the highest two brackets by 1% each – China's first reduction in VAT rates since 1994.

The 2019 changes aim to enhance economic activity in certain sectors by further lowering VAT rates and increasing VAT credits, and come as part of a larger RMB 2 trillion ($298.3 billion) cost-cutting package intended to boost China's economy.

Here, we highlight three major changes to the new VAT policies, all effective for general VAT taxpayers from April 1, 2019.

1. Reducing VAT Rates

VAT rates on the top two VAT brackets were reduced for the second straight year. Lowering the VAT rate on a large number of traded goods, the highest bracket, originally 16%, was reduced significantly to 13%. The VAT rate for the middle bracket, originally 10%, was reduced to 9%, following a similar 1% reduction of this bracket in 2018.

During the transitional period, businesses should pay careful attention to management of VAT rates. Generally, if the VAT invoice was generated or issued prior to April 1, 2019, the old tax rate will apply.

This reduction in VAT rates will further ease the tax burden of both businesses and consumers, stimulating consumption and enhancing the competitiveness of Chinese businesses globally. However, VAT and Goods and Services Taxes (GST) in other neighboring countries still generally remain lower than in China, with rates at 12% or lower in these countries.

The government has indicated the current three VAT brackets will be consolidated into two brackets, which suggests VAT rates may be further reduced at that time, helping Chinese businesses to remain competitive globally. Additionally, this potential further consolidation of VAT brackets, will ease compliance requirement risks for businesses and ease tax decisions for authorities, especially in complex business transactions where it may be difficult to categorize taxable activities and determine the appropriate tax rate.

2. Allowing VAT Refund for Excess Input VAT Credits

Under the new policy, when a company's input VAT exceeds its output VAT, the business is now eligible to enjoy a refund on its excess input VAT if it meets the following criteria:

- If the incremental overpaid VAT for each of the six consecutive months (two consecutive quarters if taxed quarterly) is a positive number, and the incremental overpaid VAT in the sixth month is not less than RMB 500,000 ($75,000)
- The taxation credit is rated as A or B
- There has been no VAT fraud in the last 36 months prior to claim
- There have been no penalties by tax authorities 36 months before its claim for VAT refund; and they have not received refunds on their levy
- Taxpayer doesn't enjoy the policy of refund-upon-levy or refund-after-levy from April 1, 2019

This new policy improves upon the previous system where excess input VAT credits could only be carried forward to offset the output VAT incurred in the next tax period, but not refunded. The refund now being accessible across all industries builds upon the 2018 pilot program in which a one-time refund of unutilized input VAT was permitted to businesses operating in certain industries.

The ability for businesses to now apply for input VAT refunds will help to ease cash flow problems and increased capital costs under the previous system, particularly for businesses with sales revenues realized over long periods of time after initial purchase or when the sales price is lower than the costs, investment, or related purchases.

Affected goods and services are as follows

Taxable Activity	VAT Rate	
	Before	Current
Sales and imports of general goods; processing, repair, and replacement services; and leasing services of tangible and movable assets.	16%	13%
Sales and imports of specified goods; transportation, postal, basic telecom, and construction services; leasing services of immovable property; and sale of land use rights or immovable property.	10%	9%
Provision of value-added telecom services; financial services; modern services and lifestyle services; and sales of intangible assets other than land use rights.	6%	6%

3. Increasing Input VAT Credits

New policies now permit additional input VAT credits in the following areas:

Service Industry "Super Credits"

During the period between April 1, 2019 to December 31, 2021, taxpayers in the following service industries will be eligible for a "super credit" in the form of a 10% additional VAT deduction permitted to be added to their already creditable input VAT in the current period:

- Postal services
- Telecommunication services
- Modern services
- Livelihood services

To enjoy the "super credit", applicable businesses in these industries will be required to meet a 50% sales test; demonstrating that the abovementioned services account for more than 50% of total sales.

Businesses with multiple subsidiaries with relatively small portions services in the applicable industries, may consider centralizing applicable services in a structure that would allow them to meet the 50% sales test. To ensure the credits are fully utilized, applicable businesses should set up separate accounts to track the movement of the additional deduction and its balance.

Overall, the additional "super credit" will help to incentivize businesses in these industries by ensuring their VAT burden is reduced, which is especially important for the service sector given that VAT rates for most services were unchanged by the April 1 reduction, and remain at 6%.

Immovable Property

Businesses can now claim the full input VAT credit all at once for acquisition of fixed or immovable assets under construction in process, abolishing the previous two-instalment method and allowing any input credit not yet applicable under the previous system to be creditable as of the change.

This will ease cash flow problems and increased capital cost as the previous system only permitted input VAT credits for such assets acquired after May 1, 2016 to be claimed over a two-year period, with deduction instalments equaling 60% in the first year and 40% in the second year.

Passenger Transportation Services

Businesses can now claim input VAT credits for domestic passenger transport services and credit its input tax against its output tax, where previously such transportation services were not creditable.

However, the new input VAT for transportation services will be calculated differently according to the documentation provided and mode of transportation taken.

For taxpayers who fail to obtain a special VAT invoice, but can obtain an electronic general VAT invoice, the input VAT credit is the amount indicated on the electronic general invoice. Credits will be calculated differently for taxpayers who can claim input VAT credits for domestic flights, rail, road, and waterway transportation services using supporting invoice or ticketing documentation and passenger ID information.

Preparing for Changes

In addition to the above changes, this round of reforms also saw export VAT refund rates, discounted input credit rates for purchase of agricultural products, and departure tax refunds for goods purchased by overseas visitors adjusted in accordance with the abovementioned VAT rate reductions.

To be able to fully take advantage of and comply with these new policies, businesses should reflect on how the new changes affect both their external business operations and internal management systems.

In doing so, businesses should carefully review sales contracts with customers and suppliers as well as ERP and invoicing systems, to ensure they are in line with the new VAT policies and that they are positioning the business to take advantage of any newly permitted benefits, such as whether they are eligible for additional input VAT deductions and/or refund for excess input VAT credits.

Businesses should also share the new policy of input VAT credits for passenger services with staff to make sure proper documentation and reimbursement procedures are being conducted to take advantage of this policy for staff travel.

Aligning staff, systems, and internal procedures with changes in this most recent round of VAT reforms will not only ensure that compliance requirements are met and new tax benefits taken advantage of, but also position businesses for additional changes in future rounds of VAT reforms.

Seeking the Truth: the Use of Cross-Examination in China-Seated Arbitration

By Arthur Dong and Darren Mayberry

Your day in court. Months of preparation. Millions on the line. Today, your lawyers will finally press the other side's evasive CEO / CFO / Low-level lackey with the tough questions. And this time, there is no escape. Or is there? If the arbitration is in China, there can be no guarantee that your opponents have to answer the tough questions. Proper preparation permits no substitute here.

Cross-examination remains a dominant presence in international commercial arbitration proceedings in leading jurisdictions. China commonly recognizes this in foreign-related proceedings, but the parties must have opted for arbitration.

Chinese domestic arbitration often dispenses with testimony, both written and oral, altogether. Safeguard your privilege to cross-examination, select the right arbitrators, put it in writing in the agreement, and demand it at the very start of the dispute. In most international arbitration cases, China-seated tribunals will permit the parties to present witnesses and cross-examine the other side. But it is important to prepare in order to be certain.

Cross-Examination

Cross-examination allows one side the opportunity to confront the other side's witnesses. This is simple and straightforward at heart. The lawyer asks a witness a series of questions. The witness must answer truthfully and to the best of his or her ability. The witness's answers form the basis of his or her testimony.

International lawyer and academic Gary Born indicates that often cross-examination may address "any matter relevant to the dispute," although Tribunals may "sometimes limit [it] to matters addressed in the witness statement." Notably, Born stops short from including cross-examination or the examination of witnesses as a procedural given, even for seats where parties are guaranteed a "full opportunity" to present their cases.

The Value of Cross-Examination Arises out of the Limitations of Written Testimony

The Tribunal often places more weight on answers given under cross-examination than the dead words which sit on the pages of the witness's statement. Few scholars have devoted so much of their life to gleaning the esoteric meanings of ancient dialectical written works as has philosopher Leo Strauss. Yet, even he admits to the limitations of reading. The most careful reader cannot "know anything of the expression of [the speaker's] face, of his gestures, and of the inflections of his voice." Thus, a reader cannot divine which words "rang true and which rang false."

Furthermore, meticulous review alone may summon the more pressing questions from a witness statement, but rarely can it support definitive or reliable conclusions. Cross-examination in international arbitration provides the Tribunal with the witness's elaboration on both the witness's own written account as well as the commercial documents.

Chinese Domestic Arbitration and its "Examination of Documents"

Normally, Chinese arbitration features no cross-examination whatsoever. Chinese domestic procedure gives prominence to documents; it dwells on their contents, provenance, and authenticity. Occasionally at conferences, Chinese practitioners may be heard praising the harmony or inquisitorial nature of Chinese arbitration and tradition, in implicit contrast to the combative or 'confrontational' style prevalent in international commercial arbitration. Chinese hearings can last an entire day, but only if they have gone long. More often, Chinese hearings conclude within the span of half a day.

Chinese courts offer no genuine opportunities to confront the other side's witnesses. If your agreement opted for Chinese litigation (or there was no dispute resolution agreement), you will almost certainly find yourself out of luck in this regard.

Approach #1: Choose Your Arbitrators Wisely

The companies embroiled in the dispute at arbitration have some say over the procedure. But much of that influence comes through the selection of the arbitrators. The old adage applies here; the proceedings are ultimately only as good as the arbitrators chosen. And it will be the presiding arbitrator, the chairperson, who exerts the greatest influence over the proceedings. Thus, in most disputes, a non-Chinese party can secure cross-examination in China through thoughtful arbitrator selection. Indeed, many multilingual Chinese arbitrators, including nearly every one of the leading Chinese international commercial arbitration practitioners, understand and value cross-examination's purpose in revealing the truth.

The presiding arbitrator will make the ultimate decision as to whether cross-examination of witnesses will occur. Generally, the participation of a party hailing from a jurisdiction with a common law background should be sufficient reason for the presiding arbitrator to consider the adoption of cross-examination. The designation of English as the language of choice alone may likewise suffice.

Nonetheless, the prospect of no cross-examination scenario may present a low-risk, high-impact proposition. It is therefore worthwhile for parties to undertake certain precautions to preserve a cross-examination procedure for which Chinese law accords no particular guarantee or special favor.

Approach #2: Draft Cross-Examination Specifically into the Agreement

In the arbitration clause, the parties should affirm the "opportunity to confront the other party's witness with questions." The agreement to arbitrate may otherwise allow the arbitrators to define the limits of such a right to cross-examine. Alternatively, the agreement may require that the presiding arbitrator have had at least one experience in cross-examination in a prior proceeding, either as counsel or arbitrator. This offers a softer mandate for cross-examination. It nonetheless lightly trespasses on the custom and guideline which limits qualifications imposed of arbitrators to a strict minimum.

Approach #3: Incorporate Guidelines on Evidence into the Agreement

The parties can select either the International Bar Association's Guidelines on the Taking of Evidence or the CIETAC Guidelines on Evidence. The IBA Guidelines presume cross-examination. Likewise, Rule 17.1 of the CIETAC Guidelines on Evidence set forth that parties will be able to cross-examine witnesses. The CIETAC Guidelines on Evidence represent the leading comprehensive set of Chinese procedural rules applicable to international commercial arbitration.

Such rules layer over, but would not displace, the arbitration rules outlined by the institution. For example, the parties could select a CIETAC arbitration accompanied by the IBA Guidelines. The CIETAC Arbitration Rules would apply as supplemented by the IBA Guidelines. Or, a contract may designate a Hong Kong International Arbitration Center arbitration, supplemented through the CIETAC Guidelines on Evidence.

Approach #4: Request Cross-Examination at the Outset of the Dispute

Once the dispute arises, a party may demand cross-examination as early as the Notice of Arbitration or the Response to that Notice. It should also request the procedure again specifically at the initial procedural hearing. We sometimes recommend the appointment of a Chinese national as co-arbitrator, assuming all other considerations are equal; this will only increase the chance that the institution, or the co-arbitrators themselves, may select a non-Chinese presiding arbitrator. A non-Chinese presiding arbitrator is extremely unlikely to discard the procedure of witness cross-examination.

Singapore, Hong Kong, and related East Asian seats of arbitration have streamlined the structure and logistical planning of the procedure. However, parties should bear in mind that Chinese institutions have different approaches and assumptions when it comes to cross-examination support. Therefore, it is incumbent that the parties arrange proper transcription services, and do so well ahead of the hearing.

Conclusion

It is a fair general rule for life: make a reasonable request, make it early, and repeat the request whenever possible. Arbitration in China is no different. If your agreement says you can have an opportunity to confront the other party's witnesses, you can be sure that you will. Failing that, you are likely to get it, as long as you make it a priority.

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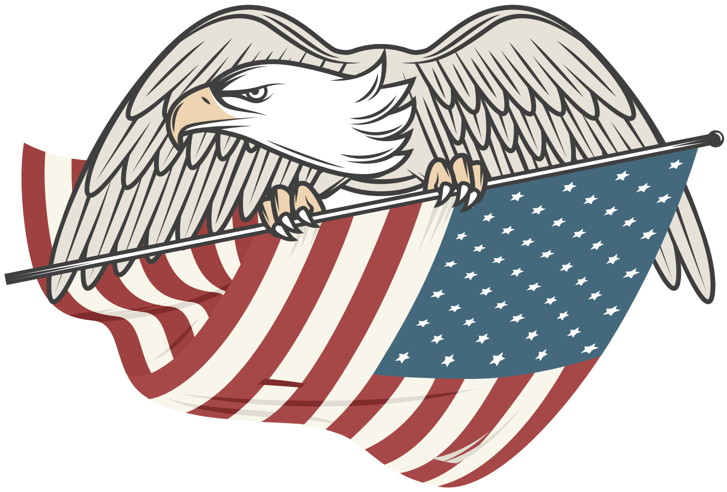

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