CKGSB KNOWLEDGE

CHEUNG KONG GRADUATE SCHOOL OF BUSINESS

Volume No. 38
SUMMER 2020 $12.00

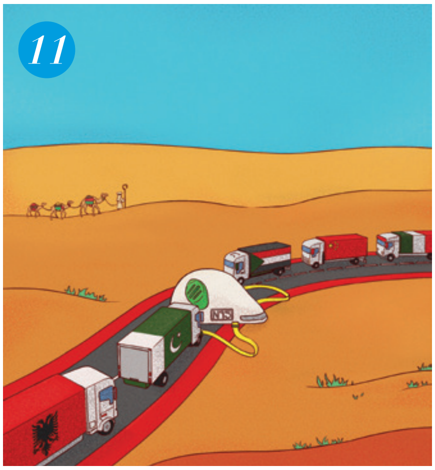
FACING DOWN THE VIRUS

How did East Asian nations effectively flatten the curve?

- The prospects for China's specialty town approach to manufacturing
- COVID-19 and the Belt and Road Initiative
- Yuen Yuen Ang on how corruption in China has evolved

Table of Contents

Economy and Policy



Issue: Summer 2020
Vol. No. 38

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ISSN 2312-9905

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Business Trends

Company

Business Barometer

Downtime

Pandemic Fallout

With the effects of COVID-19 still not yet fully seen and relations between the world's two largest economies—the United States and China—worsening, many things are hanging in the balance right now. This issue of *CKGSB Knowledge* addresses several economic and business trends that have been exacerbated by the virus crisis as we look toward the future and what it may bring.

With economies around the world still very much challenged by the pandemic and many not able to meet their debt payment responsibilities, where does that leave China's massive infrastructure project, the Belt and Road Initiative? "**Ambitions Disrupted**" (page **11**) explores the future of the expansive plan.

The countries of East Asia, however, appear to have found a way to flatten the curve of pandemic cases and deaths. Our cover story "**Facing Down the Virus**" (page **31**), looks at what the winning formula has been for countries like China, Japan and South Korea.

Borders are slowly beginning to reopen around the world, with stringent virus prevention measures set firmly in place. But it is unlikely that tourism rates will rebound to 2019 levels any time soon. "**Trip Delayed**" (page **43**) looks at what the prospect of fewer Chinese tourists around the world means for the global travel industry.

With working from home becoming the new norm, the purpose and value of office buildings around the world have called into question. "**Out of Office**" (page **27**) looks at how that trend is impacting on China's office property market, while "**Smartphone Dominance**" (page **19**) takes a closer look at the market for the devices that have been keeping us all connected throughout the lockdown. Chances are that your smartphone was made in China, but things may be changing.

Which leads us one of the factors that has made China the "Factory of the World" in the past few decades—the specialty town approach of localities specializing in manufacturing single products to gain a market advantage, is addressed in "**Picking a Product**" (page **39**).

But many countries are now beginning to feel increasingly uncomfortable about the reliance on China that stems from its "Factory of the World" role. "**Uprooting Factories**" (page **15**) delves into how many companies are considering diversifying their supply chains and moving at least some production out of China. Tesla, however, has done the complete opposite by just opening a new factory in Shanghai. "**The Tesla Model**" (page **51**) looks at how that is playing out.

We have some great interviews in this issue, including a conversation with Jörg Wuttke, President of the European Chamber of Commerce in China, who discusses how European companies are faring in the country (page **8**). Yuen Yuen Ang, author *China's Gilded Age*, looks at how corruption in China has evolved over time (page **23**), while Hans Vries, (page **35**), founder and Managing Partner of Vriens & Partners, looks at the growing relationship between China and South-East Asia (page **24**). Jeremy Heimans, co-founder & CEO of public benefit corporation Purpose, looks at the influence that individuals have on society (page **48**).

While the world may be in chaos, your skin doesn't have to be. To combat stress, many people—men and women alike—turn to beauty products. "**Chinese Beauty**" (page **62**) analyzes China's fast-expanding cosmetics market.

Recent flooding in central China has placed food security under the spotlight. Our Snapshot provides a statistical breakdown of China's food sources.

We at CKGSB are committed to providing the best sense of the economic consequences of the pandemic and keeping both our readers and alumni aware of views and analyses on this epoch defining event. As always, if you have any comments or opinions to contribute, we would love to hear from you (lzhou@ckgsb.edu.cn or ckgsb.knowledge@ckgsb.edu.cn).

Yours Sincerely,

Zhou Li
Assistant Dean, CKGSB
Editor-in-Chief, *CKGSB Knowledge*

For more insights on the Chinese economy and business, please visit the CKGSB Knowledge *site: http://knowledge.ckgsb.edu.cn/*

Managing the Differences

The two largest economies in the world need to find a way to work together

By Zhou Li

The relationship between China and the US has been deteriorating further in the past months with escalated confrontational rhetoric and actions—some of them military—by both sides. While hopes for the world's two largest economies to work together amicably are fading for the foreseeable future, the two need to find a way to live together for the good of everyone on the planet.

Many, especially the China Hawks in the current US administration, use the analogy of a "Cold War" to describe the anticipated next phase in relations between the US and China. Before it goes too far, we must acknowledge the major differences that exist between today's China and the former USSR and also recognize how the two sides of the last Cold War were able to manage their differences and prevent a direct military confrontation despite their irreconcilable ideological differences.

In his recent comments, US Secretary of State, Mike Pompeo, has gone further on the issue of China than any US leader had for many decades. "On China, we see the Chinese Communist Party also for what it is: the central threat of our times," he told the Senate Foreign Relations Committee. In a trip to Central Europe, he repeatedly warned the leaders in the former East Bloc countries that China represented a threat which could be worse than 'Cold War 2.0'."

Pompeo constantly emphasized the word "communist" in his comments, and linked the China of today to the Soviet Union of yesteryear. But this broad-brush characterization ignores the reality of China's society and economy today, encompassing a diversity that far exceeds that of the old Soviet Union.

> **Despite the structural differences in the world's two largest economies, those differences need to be compartmentalized and contained**

One of the key distinctions is the significant role and huge importance within China's economy today of private enterprise, which was never allowed in the former USSR, nor in China before the start of the market reforms 40 years ago. Over time, the private sector has developed from being a minor component of the Chinese economy to playing a central role. A single figure—56789—is often used to describe how the private sector supports the economy. Entrepreneurs contribute 50% of tax revenue, 60% of output, 70% of industrial modernization and innovation, 80% of jobs, and 90% of enterprises. Even though those numbers are not entirely accurate, they symbolically encapsulate the core truth of modern China, that it would not be where it is today without privately-owned small and medium enterprises. Alibaba, Tencent, DJI, Xiaomi, and other leading companies in China's "new economy" were all established and developed by entrepreneurs in the private sector. ByteDance, the holding company of TikTok, is a great innovation story of how a Chinese entrepreneur took his dream global in the digital world, and the many of the actions by the US government have both worked to weaken the private sector in China and also give an unintended message to ordinary Chinese people that the US government intervenes in the private sector just as the Chinese government does, but in a less rational way.

Unlike the former USSR, over these past decades, China has become an important part of the international framework and an important player in all of the key institutions created after World War II, institutions which have fundamentally always been dominated by the United States and the West. China has been an active participant in all of these institutions, including the WTO and the WHO, even as the US under Trump has wavered and has to some extent reduced its support for them. China is, and will remain, very supportive of this international framework.

To show China's commitment to opening its market, including its once closely-guarded financial sector, two of the world's largest investment banks, Morgan Stanley and Goldman Sachs, have in recent months been granted the right to full ownership of their operations in China. This is a sign of the times, and as long as the West remains open to China, China will continue on the path of reform and opening.

Ultimately, it is one world, and the trend of globalization which has done so much to bring the world together ... must be allowed to stay

The current political leaders in the United States, by denying the positive changes that occurred as a result of Richard Nixon's visit to China in 1972 and his bold "engagement" policy, are ignoring an obvious truth—that China has changed for the better in the past 40 years, to the benefit of both its own people and the rest of the world. Within the new domestic and international context, China needs to decide how it is going to further change just as the US does. But regardless of the specific direction that China is going to take, it will never be the same as in the United States, as the history and culture of the two countries are so different.

Despite the structural differences in the world's two largest economies, those differences need to be compartmentalized and contained. And more importantly, the stress should be on the common areas that affect both of countries and indeed all of humanity: pandemics current and future, the possibility of a global recession or even depression, climate change and the proliferation of nuclear weapons, to name but a few.

In the future, the overall relationship can be one of competitive co-existence, both dynamic and stable, as long as there is mutual respect. But for today, as the governmental dialogue heats up and heads towards deadlock, it is more important than ever that business communities, civil society and other non-governmental, non-political institutions take more ownership and join forces in the fight for the common challenges of humanity.

Ultimately, it is one world, and the trend of globalization which has done so much to bring the world together over the past four decades must be allowed to stay on track with more, not less, interaction and integration between all the countries of the world, and most especially the two most powerful economies.

The heads of state of the G20 at a meeting held in Buenos Aires, Argentina

Misaligned Expectations

Jörg Wuttke, President of the European Union Chamber of Commerce in China, discusses how European companies are faring

The EU Chamber of Commerce in China, currently led by President Jörg Wuttke, was founded in 2000 by 51 member companies with a shared goal of establishing a common voice for European businesses operating in the country. It has now expanded to over 1,700 members with chapters active in nine cities across the country. The Advisory Council of the Chamber includes the CEOs and presidents of some of the largest EU companies with investments in China.

Wuttke has also been the Chief Representative of German multinational chemical company BASF in Beijing since 1997. In May 2019, he was elected for a third term as the President of the European Union Chamber of Commerce in China. Since 2019, he has been Vice Chairman of the CPCIF International Cooperation Committee, a group representing multinational companies in China's Chemical Association. From 2011 to 2019, he served as Chairman of the Business and Industry Advisory Committee to the OECD's China Task Force.

In this interview, Wuttke looks at the state of China-EU relations and how COVID-19 has impacted on European businesses operating in the country.

Q. How would you rate the state of China-EU relations?

A. On the economic side of the relationship, China sells products worth about €1.1 billion ($1.3 billion) to the EU every day. We are their largest market and the biggest customers of Chinese products. The EU sells about €500 million of products a day back to China, with China being the EU's second largest market after the United States. On the streets of Beijing and Shanghai, one can see many European cars and luxury European brands. When it comes to trade, it seems like we quite like each other's products.

Of course, Europe would like to partake in more trade with China, but companies are experiencing many market access problems. We are addressing these issues in the European Chamber, so the potential for things to get better is still there. Economically, the openness of China can be improved, but the real problem lies on the political side of things.

Q. What prospects are there for resolutions on issues that exist?

A. The real issue lies in a lack of understanding of the other side's position. China still believes that it only has to worry about economic relations with Europe and doesn't realize how the mood is shifting in the political realm.

On the other hand, Europe is struggling to understand that China has some economic red lines involving state-owned enterprises (SOE). China's stance on SOEs is something that Europe and the US want them to change, but they're not willing to, as SOEs are one of the power tools of the Communist Party. Reaching a middle ground in that regard is going to be difficult. Communication channels between China and Europe are few and limited, and there is also media on both sides distorting the picture. Chinese media often depicts the image of Europe sinking and China rising, while on the EU side, the media depicts China as intimidating and controlling.

We at the European Chamber are trying to bring facts to the table because we want to make people aware of what the real EU-China situation is—even if it may be uncomfortable. I am not full of optimism. The Russians have a proverb that describes this sort of situation: "An optimist is just a badly informed pessimist."

Q. How have EU businesses in China been faring pre- and post-virus?

A. EU businesses were doing quite well before COVID-19, but now we are facing significant problems, particularly in the service and tourism sectors, which have essentially fallen to their knees. In manufacturing, however, we're doing surprisingly well, especially in the chemicals sector, which is up even in comparison to 2019.

European businesses have proven to be fast at responding to the needs of China, such as for masks and personal protective equipment in January and February. Then after Europe started running out of equipment at a later stage, we all went into overdrive to buy those products here in China to send back home. My company alone bought 150 million masks to be shipped to Germany earlier this year.

I believe we are doing much better than our peers elsewhere in the world, as China's economy was the first to recover from the coronavirus. European companies here are therefore now relying to a large extent on the profitability of their operations in China.

Q. In light of the announced adjustments to foreign business regulations in China, do you see any of those changes impacting EU companies?

A. Small steps in a huge market might mean that in some areas you actually gain some business traction but, in many ways, it is more of a cosmetic change. Beijing always relaxes rules when business is basically already fully in the hands of Chinese companies, so there is no way that we can compete.

We always only get permission to step onto the platform once the train has left the station, and at the entrance of the train station there is always a celebration, as if the occurrence is a massive benefit for European companies. I always say: I would really like to step onto the platform and see a train waiting for me.

Q. Made in China 2025 [a government policy to develop the country's manufacturing sector] is no longer referred to by Chinese media, but it appears to still be very much in place. What is the EU view on Made in China 2025 and what do you see as the impact of its implementations?

A. The chamber launched a study in March 2017 on the potential impact of Made in China 2025, which was actually viewed among Chinese decision makers as a warning on overcapacity. Made in China 2025 was perceived to be a threat on technology globally. It was because some people realized that it could cause negative perceptions for China itself that it disappeared.

Beijing has learned that if they protect China's massive market, provide subsidies and indicate that there is no foreign competition—excluding us—that it will lead to overcapacity. Presently we believe it means that China, in pursuit of technology gains, will adopt a different tactic to achieve the goal, particular because of the tech war with the US. It is likely that they will put even more money behind it, but technology gain issues are still present, now more than ever.

Q. To what extent are the interests of the EU and US aligned in terms of addressing the question of economic relations with China?

A. The communication interests of the American Chamber of Commerce in China and the European Chamber are aligned. We engage with each other on a deep level. But when it comes to the US and the EU government members, there is virtually no alignment, which makes things difficult. The US has unleashed a trade war of sorts with Europe, so there's no love lost. But I can see some green shoots of hope where the US has realized that to

> **If you refuse to sit at the table with China, then you will be on the menu**

take on China, they need allies. So far, the US has managed to disengage itself around the world, such as from the Trans-Pacific Partnership. However, there are some people now realizing that if you want to get things done, you must stick together.

It's going to take Biden to reconnect the dots, but up until this moment, there is practically zero alignment between the US and Europe.

Q. Do you view decoupling as a real possibility? And what kind of scenarios do you see in this reconfiguration of the world?

A. Decoupling is always seen as deglobalization, which I believe is wrong. Decoupling is something that will happen in some areas, but the world is too intertwined to create two islands of happiness. There are still many areas in between where we can see decoupling on trade, such as in the form of tariffs. We could also see decoupling occurring on the technology front, which has different standards, export controls and screenings. That will get more and more pronounced in the US, but I can see this also happening in the EU. Then, of course, the ultimate decoupling question mark is in finance. That is where we must see to what extent the US is willing to leverage on the fact that the dollar is the global currency and how much they essentially want to punish China. We have seen how this can be done with Russia. Decoupling on the financial front would really be the nuclear option.

Everything is possible at this stage. The European Chamber will be releasing a study in December on what a decoupling between China and the US would mean for European businesses.

Q. Supply chain dependence on China has been highlighted by the virus and even more so by the political strains that exist now. To what extent should supply chains move [out of China], and to what extent can they move?

A. Supply chain dependency has now primarily been labelled a security issue, meaning it deals with items such as health care equipment and pharmaceuticals. European leaders are rightfully saying that we should be producing these kinds of items closer to home. It's not wise to be 60% dependent on antibiotics coming

> Decoupling is always seen as deglobalization, which I believe is wrong ... the world is too intertwined to create two islands of happiness

out of China. But then the question European leaders must ask themselves is whether insurance companies and consumers are willing to pay more. That leads me to the fact that moving supply chains out of China is virtually impossible.

Moving out is tricky when there is a global recession and you're short on cash. The problem that companies face now is that they actually have too many factories on their hands. To diversify would mean adding another factory into the mix, which includes the elements of cost complexity and challenges to resources. Nobody is going to do this. Moving will mainly be in security-related areas, where governments are driving and eventually paying for the move. Companies in other sectors are not diversifying, they would rather close factories.

Every survey we've done recently has shown that around 10% of companies are considering moving out of China. What's interesting about that is how in 2011, 22% said that they're considering moving out. It's now less than it used to be.

Q. During the early decades of globalization, manufacturing in the EU and the US fundamentally closed and was moved to China. What would be your view on this? Did it go too far? Are we looking at a revival of manufacturing in Europe?

A. Moving manufacturing home would be difficult because China is still seen as a growth story for decades to come. China's gross domestic product per capita is around $10,000, which is only 60% that of the US and 21% of Germany's. China still has a lot of growing and catching up to do.

According to my company's assessment, China will represent 30% of global growth over the next 10 years. That is as much as the growth of all OECD countries combined. You simply cannot avoid China. As the saying goes: "If you refuse to sit at the table with China then you will be on the menu." People must realize that China's growth story—given the size and backwardness of this economy—is not over yet.

There needs to be a wake-up call. For us to move to China was an obvious choice, but we need manufacturing in Europe as well. We cannot leave all production up to others as manufacturing drives services and innovation. A country cannot rely solely on services. The hope that I have is that China's success story will eventually put some pressure on Europe to introduce reform, to increase science in schools and access to high-tech equipment and software. Europe really must get its act together to compete. Too much complacency is not good.

Q. Overall, what do you see as the future of European businesses in China? Where are we likely to be in five to 10 years' time?

A. In five to 10 years from now, businesses will become more China focused, China bound and China dependent. If China stands for 30% of global growth, in chemicals it's even as high as 60%, it's ultimately going to be a China story. If we disregard this, then we're going to be in real trouble.

All sectors will see European businesses shrink in percentage of market share but grow in actual business. With China getting bigger, even if we have a smaller portion of the pie, we will still see the volume of our business increase. Again, we must be in China to compete with Chinese companies. If we wait for them to come to global markets, it will be too late.

Q. How many members does the chamber have now compared to three years ago? And what would be your expectation on the future trend?

A. Our membership has plateaued. We have almost the same number of members now as we did three years ago. But even though we haven't grown in numbers, our members' business has grown.

One constraint is market access problems, as some companies that want to come over here are sometimes not permitted to do so. Another is that very often the localization of top management in European companies leads to the fact that Chinese nationals are not really convinced that a chamber is a good thing to join. They see it as a waste of money and don't believe in the lobbying power that we have. Therefore, there has been a tangible culture shift and a challenge.

Over the next few years, we will likely grow slightly but not much more. We will definitely face challenges now because of the incredible restrictions we're facing due to COVID-19. Our residents can't come back to China, which is in stark contrast to Chinese residents in the EU who can travel freely. Anglo-Saxon schools in China still have 50-60% of their staff members stuck abroad, companies' employees are still outside of China and it has also affected companies' recruitment. I don't see this issue being resolved this year.

AMBITIONS DISRUPTED

What does the COVID-19 pandemic mean for China's Belt and Road Initiative?

By Samantha HuiQi Yow

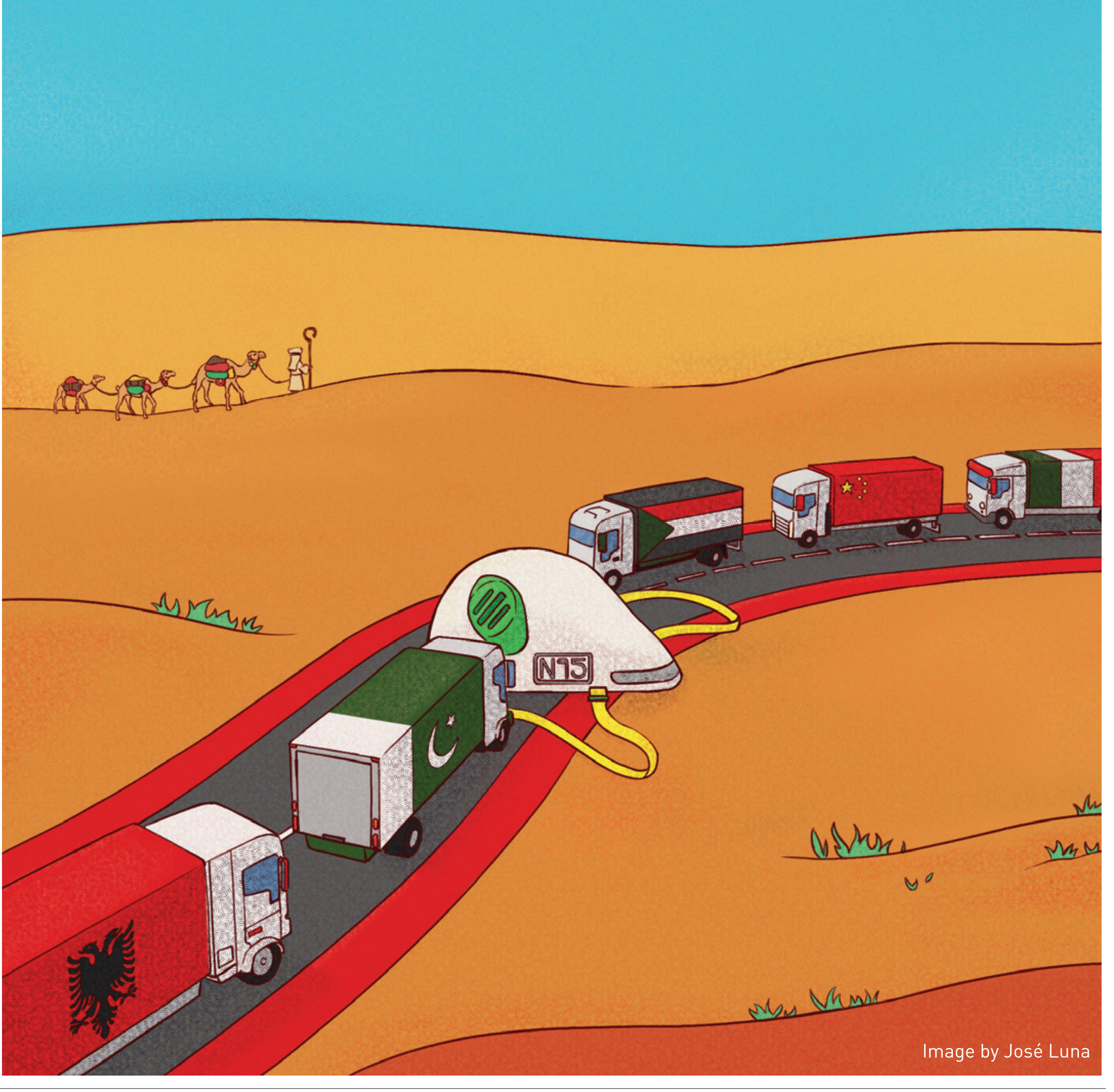


Image by José Luna

The Belt and Road Initiative is one of the biggest development projects in history, but the pandemic has had a huge impact on the economies of the countries involved in it

Pakistan has long been the jewel in the Belt and Road Initiative's crown with China infrastructure projects under construction spanning some 3,000 kilometers and expected to cost more than $62 billion. Then came the pandemic.

Prime Minister Imran Khan vowed to complete the flagship project, known as the China Pakistan Economic Corridor (CPEC), "at all costs" but in April Islamabad appealed to Beijing for debt relief and to relax the terms on loans worth $30 billion.

Similar pleas have since echoed across the world, particularly from developing countries. To different extents, these countries have grown dependent on Chinese aid and loans and are just realizing the implications that the COVID-19 virus has added to their economies.

The foundations

The Belt and Road Initiative (BRI) was officially set in motion in 2013, with the vision of a seamless, transcontinental transport network—railways and roads, ports and pipelines—to connect Africa, Asia and Europe and bind the world in "mutual progress." As the name suggests, there are two primary components: the Silk Road Economic Belt overland and the Maritime Silk Road at sea.

The former consists of six economic corridors linking Central Asia, Eastern and Western Europe with China through a snaking network of rail and road links. The latter involves a series of seaports marking the way from China to Africa, Europe and South-East Asia.

The BRI is made up of nearly 3,000 projects worldwide, racking up infrastructure costs so far worth a staggering $3.87 trillion, according to Refinitiv, a global provider of financial market data. The World Economic Forum estimates that $1.14 trillion worth of BRI projects will be completed by 2025.

Plugging a gap that other countries such as the United States missed, China was ready to finance the needs for big infrastructure upgrades, and in effect a revival of the ancient Silk Road linking China with the rest of the world. The loans used to fund most of the projects have come primarily from two sources: The Export-Import Bank of China and the China Development Bank. At the Belt and Road Forum in 2017, it was announced that both banks would designate an estimated $54 billion for BRI-related projects. Two years later, it seemed that both banks had already exhausted their credit lines.

Potential returns on projects are uncertain, but the debt implications for recipient countries are clear. According to the American think tank Council on Foreign Relations, as of 2017, Pakistan borrowed at least 7% of its GDP from China. Debts for Djibouti, Kyrgyzstan and Ethiopia totalled approximately 80%, 40% and 20% of their respective GDPs. All four countries have been identified as being highly vulnerable to debt distress. The Council's BRI tracker found many other countries in a similar plight. COVID-19 has obviously complicated their situation.

The walls

Many nations buy into the promise of BRI as a catalyst for economic growth. In a survey conducted by Central Banking Publications, albeit pre-pandemic, 53% of the 30 participating central banks believe that BRI projects will boost their GDP by up to 1%. The remaining respondents think the yield will be even greater.

"Developing nations with either no means to finance their own projects or who are politically unwilling to accept the quid pro quo terms of Western or multilateral funding have found the initiative attractive," says Kelsey Broderick, an Asia analyst at political risk consultancy Eurasia Group. "There was only one string [attached]: the use of Chinese components and firms to make the projects 'bankable' for China."

"It has been beneficial for some less developing countries to host these projects," says Yasiru Ranaraja, director at the Belt & Road Initiative Sri Lanka. "It helps them rebuild. In Sri Lanka, for example, there have been a lot of developments in the past 10 years thanks to BRI."

The Southern Expressway, one notable example, was built with Chinese loans. This 222-kilometre-long (138 mi) highway linking the capital of Colombo with major towns in the south of the island and has allowed tourism and other industries to flourish.

Gwadar Port, situated in a small coastal city in southwest Pakistan, is another standout. The port's potential has always been its strategic location at the intersection of oil and shipping lanes. Sure enough, it took center stage when CPEC was announced in 2015. Contracts worth $1.02 billion for port expansion were reportedly awarded, and the port was officially leased to China for 43 years, until 2059. China Overseas Port Holding Company, the port's sole operator, envisaged it would help create 47,000 local jobs.

Yet as of 2018, only 99 ships have anchored at Gwadar Port. Critics say such underperformance calls into question the practicality of many BRI projects. But analysts such as Yue Su, China economist at The Economist Intelligence Unit, warn against rush judgements. "For such large-scale infrastructure projects, it can sometimes take 20 or 30 years to see a positive outcome. To measure their success and real impact, we need maybe another five years."

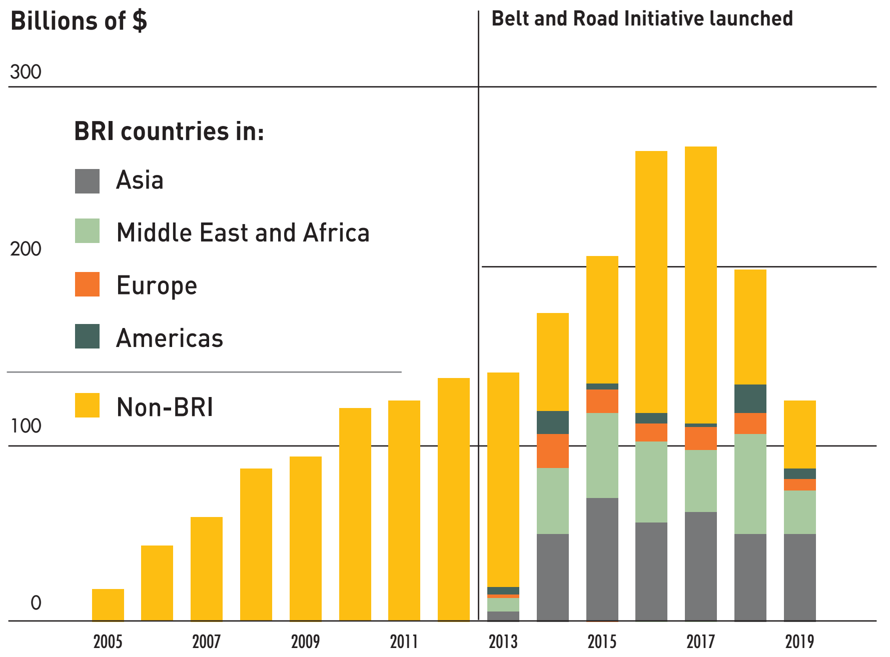
The cracks

The trillion-dollar initiative is not without controversies. Criticism abounds about whether the BRI deals are in the best interests of recipient countries as the terms often lack transparency. Experts repeatedly cautioned against signing onto what some have called "debt-trap diplomacy." But for many countries, there was no alternative sources of funding if they wanted to invest in specific infrastructure.

"Many are mired in a chicken-and-egg situation," says Yihao Li, a PhD candidate in urban planning and development at Harvard University. "They don't have money to develop their infrastructure, but the lack of it means they then cannot attract foreign investments. Securing loans too might be difficult as credit ratings for many of these countries are poor."

Keshmeer Makun, an economics lecturer at Fiji's University of the South Pacific, echoes this sentiment. "This lack

BIG BUILDER | Chinese investments and contracts abroad



Sources: AEI, the Economist

in infrastructure investment, together with new risks like climate change, has been a huge barrier to economic progress. The introduction of BRI provided an alternative form of aid for many Pacific Island countries."

Makun adds that funding under the initiative has also been more accessible relative to financing from other international agencies and players. "Long repayment plans and quick project completion timeframes were further draws."

Another attraction: Many projects were not subject to the number or breadth of feasibility studies required by other lenders, says Broderick.

Also, what constitutes a BRI project is not so clear; many ongoing infrastructure investments by China have simply been rebranded under the initiative. "Take Hambantota Port in Sri Lanka, it was not designed for BRI," says Ranaraja. "The port predates the initiative."

Pandemic exposé

While hiccups were to be expected, a pandemic was low on the list of possibilities. The coronavirus outbreak has spared almost no one and the virus has wreaked havoc on many BRI projects. Virtually all projects were impacted as borders closed, while lockdowns brought economies to a standstill and disrupted global supply chains. China's Ministry of Foreign Affairs estimated that almost all projects have been impacted with about one-fifth "seriously affected."

Pakistan downsized its annual budget for CPEC by one-third—to $159 million from $241 million a year ago. Bangladesh shelved plans for a huge coal plant in Gazaria. Contract-signing for the Bangkok-Nakhon-Ratchasima high-speed rail link was postponed again, even though the coronavirus outbreak was not explicitly cited as the reason.

It comes as no surprise that low- and middle-income nations are struggling to deal with the economic fallout of the crisis. The truth is they were barely above the water before the coronavirus outbreak. In 2018, the Center for Global Development found that additional BRI-related loans could bring a "quite high" risk of debt distress for 23 of the 68 participating countries.

A Chinese construction company helps build infrastructure in Namibia, a Belt and Road Initiative country

"The debt issue has been thrown into the spotlight again this year with COVID-19," says Broderick, as countries have had to redirect limited funding and resources towards healthcare services instead. Many BRI loans were on the verge of default and debtors found themselves in an even more difficult repayment position than before.

The Asian Development Bank has predicted growth in most regional economies—where BRI projects are abundant—will slow, and many participating countries have asked for debt relief. One concern is that China may agree but with caveats that are hard to swallow. In 2017, Sri Lanka, unable to service an $8 billion loan, conceded control of 70% of its Hambantota Port to China on a 99-year lease.

Ready for redemption

In April, China announced it would suspend loan repayments for low-income countries until the end of the year. Several other announcements followed: during a virtual summit, President Xi said that interest-free loans to African nations due to be serviced this year would also be written off.

This also serves China's interests by expanding its trade with huge developing markets just as its relationship with the developed world—particularly the US—is being thrown into question. "China needs to find other trading partners. Providing debt relief may help secure them," says Yue. "BRI is also strategically significant, because China can use it as an economic tool to strengthen political ties with developing countries."

China has the economic capabilities to support the strengthening of ties. The country's second-quarter GDP growth was positive, and exports have started to climb again. "This means there is probably room to use its foreign reserves to lend to BRI countries," adds Yue.

But precisely how much money would be re-allocated to BRI relief is not yet known. "The outward capital flow to the rest of the world has been very opaque," says Li. "What we can expect, however, is more renegotiations and refinancing deals between BRI host countries and Chinese lenders."

Another opportunity for China to capitalize on is the digital side of BRI. "It was already flourishing but it's now supercharged due to the focus on healthcare," says Ben Simpfendorder, founder and CEO of advisory firm Silk Road Associates. "Because the BRI region has a huge population, you can't just go out and build hospitals across all cities. You need to find other solutions, and those solutions will be digital."

He points to China's Pearl River Delta, where exports have been growing faster than the rest of the country. "This is largely because the region is selling goods that are high in demand due to COVID-19—simple medical devices like hand-held temperature reading devices."

The demand for other products, like thermal scanning systems and infrared temperature sensors, has similarly boomed. "There are huge opportunities for Chinese digital companies to provide such equipment and supporting technology to help strengthen the region's health system."

Making BRI the "project of the century" is a legacy President Xi keenly wants to leave behind. While the initiative is described as "an economic cooperation initiative … an open and inclusive process," it is clear China needs to lead by example.

Buckle up

BRI looks likely to press ahead regardless of problems, including the body-blow from COVID-19. Beijing maintains that whatever impact the virus has on the initiative will only be "temporary."

Whatever happens, the huge amount of money pumped into ambitious infrastructure projects so far will not have been for naught. And while the scale, nature and terms of agreements may be recalibrated, the game plan will remain the same. BRI will continue to pave new roads and new futures for economies.

"Such a mega initiative would be nothing without the leadership of China," says Li. "And since the extent to which China is able to exercise that leadership depends highly on the domestic economy, BRI is likely here to stay."

At the end of June, Beijing announced it had suspended debt repayments for 77 developing countries that have been sent reeling by the pandemic. While it is not yet clarified precisely to what extent Pakistan's pleas for relief have been answered, overall, the Belt and Road Initiative will continue.

"The long-term impact is not yet clear," says Broderick, "but it is likely that China will continue to promote and expand the initiative, including finding new areas of growth."

UPROOTING FACTORIES

Companies are considering moving production out of China, but how many can successfully do so?

By Shi Wei Jun

Image by José Luna

The diversification of production away from the "Factory of the World" is happening, at least to some extent. But some industries are finding it hard to break free of the China hold

With facemasks flying off the shelves at the beginning of the year, it dawned on the world that China was their only source of the pandemic must-haves. While Japan, Taiwan and the United States produce PPE, they did not have enough to even satisfy domestic demand, giving China an arm lock on production when it came to scale. Production is now being ramped up, but industry insiders say that in terms of the raw materials alone, China is probably irreplaceable as the primary source of masks for at least three years.

Over the past 30 years, the world has shifted sizable amounts of manufacturing to China because of its low labor costs and high efficiency. But the production and logistics freeze-ups that accompanied the early weeks of the pandemic caused many companies to realize the danger in concentrating all production in one place.

Different sectors and types of businesses have various reasons why they might want to move, but the virus has underlined the necessity to diversify supply chains away from the Middle Kingdom. This swing away from China was underscored by comments in August from Liu Young-way, the chairman of the Taiwan-based contract manufacturing giant Foxconn that supplies Apple and other tech titans.

China's "days as the world's factory are done," said Liu. "No matter if it's India, Southeast Asia or the Americas, there will be a manufacturing ecosystem in each," Liu added. Foxconn started manufacturing Apple's top-end iPhone models in India for the first time this summer. It is reportedly investing $1 billion to expand one of two factories in the country.

A mask monopoly

Masks and PPE illustrate how China has captured and optimized supply chains over the past four decades, and the extent to which it remains dominant. Once the market demand became clear, Chinese manufacturers responded instantly. Mask production on a daily basis surged eightfold between the start and end of February, up to 76.2 million units, with most of them shipped overseas.

Through the building of ports, railways and telecom networks, low labor costs and a relatively skilled workforce, China has created a manufacturing ecosystem of production that has dominated in a way unmatched in human history. But many countries and businesses have now realized how an over-dependence on Chinese goods involves considerable risk.

"I don't think people quite appreciated the extent to which they are reliant on China until the beginning of this year," says Deborah Elms, founder and executive director of the Asian Trade Centre, a consultancy and advocacy group in Singapore. "What caught many off-guard was the extent to which they rely on China for non-obvious things."

British carmaker Jaguar Land Rover is a case in point. The shutdown of Chinese manufacturing for most of January and February left the company with barely enough inventory to last two weeks. And after Wuhan went into lockdown in late January, prices for the LCD panels used in laptops, smartphones and TVs more than doubled as five factories in the city account for a sizable share of total global production capacity.

As the world's largest exporter, China has been continuously upgrading its manufacturing industry in capacity and quality. The Chinese share of global manufacturing value added soared from 1% in 1990 to 28% in 2018, according to a McKinsey study from July 2019. China accounted for 12% of global manufacturing output from 2003 to 2007, but 33% during 2013-2017.

Nowhere is China's dominance more visible than in electronics. Two-thirds of the world's smartphones were made in China last year, along with half of all printed circuit boards—the guts of any device—in 2018. And of all the production facilities operated by Apple's top suppliers in 2019, 381 were in China. Just 58 were in the US.

Swing away

The world's dependence on China for key parts of its supply chains for everything from face masks to smartphones has shot up on the political agenda—particularly in the United States. This has sparked calls for diversification of China-centric global supply chains.

"There is some hard thinking going on," says Gerry Mattios, vice president at Bain & Company's Singapore office. "Companies are thinking about how to de-risk their supply chains so they don't put all their eggs in one basket. They are appreciating the fact… that shorter supply chains producing closer to where they sell are actually less risky."

Australia, the European Union, India, Japan and South Korea have all joined in the effort to convince companies to re-route supply chains to some extent, and it appears that Beijing could face a tough fight to hang on to many foreign manufacturers. Japan, for instance, earmarked ¥243.5 billion ($2.27 billion) in April to tempt Japanese firms back home or to other parts of Southeast Asia. In mid-August, US President Donald Trump pledged to punish American companies that move jobs abroad and reward firms with tax breaks for shifting work from China to the US.

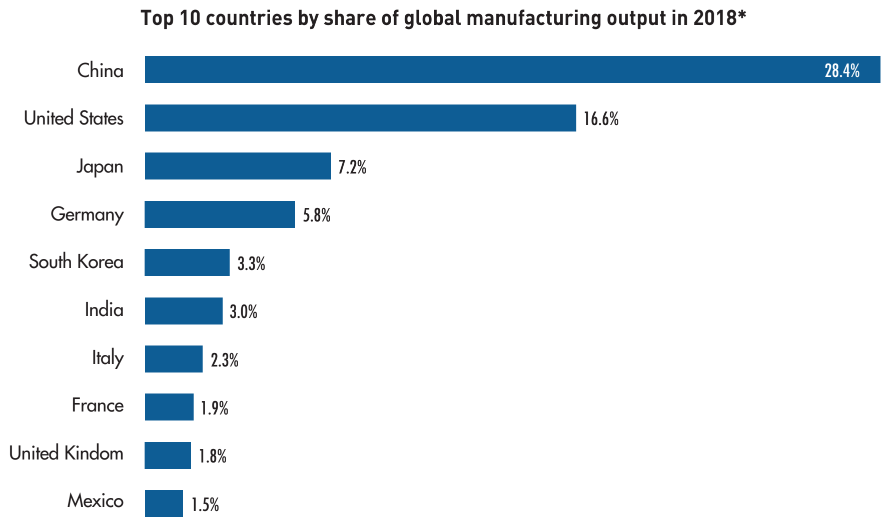
Trump's carrot-and-stick approach underlines how much the threat of politics intervening in business has heightened this year as decoupling between the US and China accelerated. The seismic shocks from the ongoing split are still ongoing.

Global chip and phone supply chains were jolted by US sanctions in August that barred Huawei from buying semiconductors developed with US software or equipment. But how much production will return to the US and other major consumption markets is an open question.

"There are lots of discussions about supply chain diversification, but only a smaller sector is talking about reshoring," says How Jit Lim, a managing director in Shanghai with consultancy Alvarez & Marsal (A&M).

It would be wrong, however, to characterize the situation as a wholesale and sudden shift out of China. The trend started several years ago, and not everything is going to move. A member survey by the American Chamber of Commerce in Shanghai in April showed that 70% of respondents were not thinking of moving supply chains due to the virus. Likewise, only 11% of companies responding to a business confidence survey by the European Union Chamber of Commerce in China said they were "considering shifting investment to other countries," down from 15% the previous year.

FACTORY OF THE WORLD | China is the world's manufacturing superpower



* output measured on a value-added basis in US dollars
Source: United Nations Statistics Division, Statista

The strategic goals of each company determine the extent to which they can, and even want to, move manufacturing out of China, according to Elms from the Asian Trade Centre. Firms in China for the domestic market will approach the debate differently from those using China as a production and supply base for global sales.

"If you're an American company making products in China and selling into your local market or Europe, it is getting more challenging to do that for political reasons," says Elms. "For those firms, I would say restructuring or at least thinking about restructuring is important."

Still chained to China

Moving supply chains out of the world's biggest manufacturing nation is easier said than done. Many companies find China a hard habit to break thanks to the country's advanced infrastructure, low-cost labor market and business-friendly regulations. In addition, China has a huge domestic market with rising disposable incomes. Furthermore, its workers already have the technical skills that companies need.

"You can argue that China ought not continue to dominate manufacturing and supply chains. The reality is that alternative locations still cannot match speed, flexibility and often price. Even if an individual item can be created elsewhere, the support ecosystem is lacking—labels, logistics, packaging, warehousing, etc.," says Elms.

Supply chains were already leaving China in certain industries, including apparel, footwear and textiles, which have shifted to lower-cost destinations such as Bangladesh, Indonesia and Vietnam. Southeast Asia in general is one of several regions positioning themselves as alternatives, but Mattios from Bain says that moves only make sense for specific sectors.

"The answer is not the same for every industry," he says. "Take an expensive one, like automotive—global automakers do not have a lot of choice about where they can move without having to commit billions in investment to bring the ecosystem with them."

With thousands of suppliers involved

China boosted its facemask production capacity by 450% to keep up with demand

in a vehicle's value chain, diversifying suppliers to increase resilience involves considerable ongoing costs, says Mattios. Suppliers, wherever they are, need to be able to produce to detailed specifications, and meet strict quality and safety standards.

Other manufacturers, such as of consumer goods, are more flexible, and China's share of global exports of consumer goods, including handsets and household electrical goods, fell to 42% in 2019 from 46% in 2018. Meanwhile, Latin America and South-East Asia each gained a percentage point to reach 14% and 7% respectively.

Production of home appliances such as refrigerators and air conditioners could move from China to Malaysia and Thailand. But South-East Asia is a mixed bag: worker protests are weighing on Cambodia's productivity, for instance, while restrictive foreign investment policies and high taxes work against Indonesia. Vietnam is benefiting from the swing away from China in the manufacturing of products such as computer hardware and audio visual technology, according to a recent report from law firm Baker McKenzie and consultancy Silk Road Associates.

Another option is Eastern Europe, which Elms says has a manageable cost structure. "Countries like Poland are well connected and tend to have people with skills, so Eastern Europe is another location that that we're noticing firms shifting to."

Closer to home for American companies is Mexico, which emerged as a sought-after alternative at the peak of the China-US tariff war, particularly after the passage of the US-Mexico-Canada agreement (USMCA). Proximity makes Mexico a tantalizing possibility for American firms because companies do not need to wait weeks for goods to be shipped from China.

Fragmenting supply chains

The consensus among most experts appears to be that for many businesses, adjusting supply chains means expanding from China, but not necessarily leaving. What seems likely to emerge is a bifurcation of supply chains: one part would serve China; the other, the rest of the world.

Many companies are pursuing a "China plus one" strategy in Asia, setting up factories in lower-cost countries to serve other markets or hedge against disruption in China, but the approach come with extra costs. "China plus one still has to pass the business case, it's not free," says Lim from A&M. "There is risk involved, there's a lot of friction, a lot of investment needed."

More investment is an understatement. The total bill for shifting all export-related manufacturing not intended for Chinese consumption out of China could reach $1 trillion over the next five years, according to Bank of America.

There will be a human cost to redrawing supply chains too, which will inevitably raise prices of goods. "The US consumer is going to be worse off," says Mattios.

The fear expressed by some economists is that higher costs from supply chain changes will lead to a vicious cycle—as consumers' wallets are hit by rising costs, they will rein in spending and consumption, which reduces demand and leads to economic contraction.

While China is unlikely to emerge unscathed, the trend provides an opportunity to upskill its manufacturing workforce and climb up the value chain—which dovetails with the government-led "Made in 2025" manufacturing initiative. There will inevitably be job losses, but they could be balanced by job creation in other areas.

"There may be fewer textile jobs, but more manufacturing jobs, potentially," says Elms. "They could be better jobs, so one shouldn't assume that disruption automatically means no jobs or worse jobs. It just means different jobs."

China's vast and still-expanding market ensures it remains a growth opportunity for companies. But many analysts do think the age of China as the undisputed factory of the world is closing—manufacturing will become more fragmented globally, with smaller regional factories working alongside China.

Foreign investment in Chinese manufacturing will likely be largely for the domestic market, as underlined by BASF's $10 billion plastics project underway in southern China, which will primarily serve local customers.

"We went from a world that was relatively isolated to an interconnected one with global supply chains in China," says Mattios. "Now we're heading more toward a multi-polar manufacturing strategy with higher levels of fragmentation. We will have more of 'China for China', but also more 'Poland for Europe' and 'Mexico for North America'."

SMARTPHONE DOMINANCE

China leads the global smartphone market both in terms of manufacturing and smartphone brands

By Matthew Fulco

Image by José Luna

China has built up a remarkable lead in the global smartphone market over the last decade, both in manufacturing and brands. But things may be changing

Throughout the recent China-US trade war, one consumer electronics product has been conspicuously exempt from Washington's tariffs: the smartphone. In many a tweet, US President Donald Trump threatened to slap 15% levies on Chinese-made handsets, but it never came to pass and was put to rest—at least for a while—with the signing of the phase-one trade deal in January.

Trump never pulled the trigger on smartphone tariffs because it would have had a significant impact on the price of most mobile phones sold in the United States. It would have particularly hit Apple, which has almost half of the US smartphone market and relies on Chinese factories for the bulk of iPhone assembly.

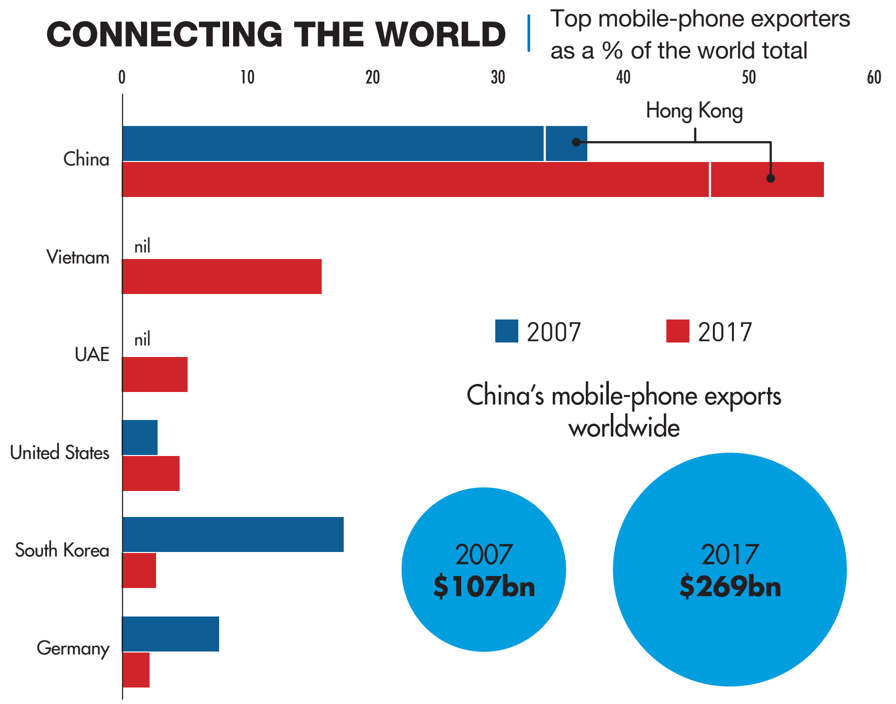
Such is China's current dominance of the global smartphone supply chain. Among the world's top five smartphone makers by shipments, only South Korea's Samsung produces the majority of its handsets outside of China. Apple and all the Chinese brands, led by Huawei, vivo and Xiaomi, make most of their phones in the Middle Kingdom. The components are sourced from suppliers around the world, but the phones are considered "Made in China" because that's where the finished product is assembled.

Dialing in

China currently dominates not only the manufacturing of smartphones, but also smartphone brands globally. Of the world's top seven smartphone brands by shipments, five are Chinese: Huawei, Lenovo, Oppo, vivo and Xiaomi, according to Beijing-based Counterpoint Research.

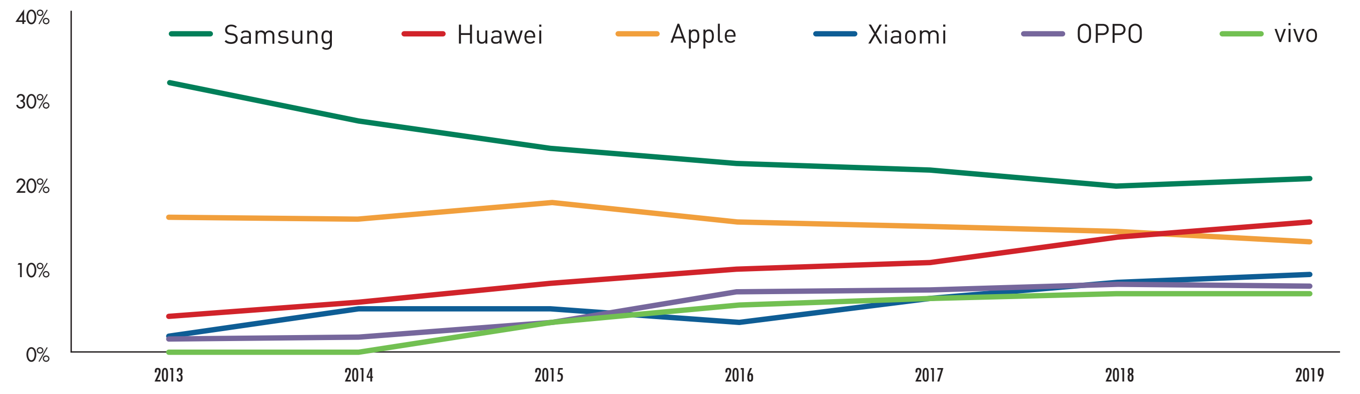
Worldwide smartphone vendors shipped a total of 275.1 million units during the first quarter of 2020, with over two-thirds of them being manufactured in China. Samsung phones made up the biggest portion, with 59 million units, Huawei came in second with 49 million and Apple third with 40 million.

For the most part, Chinese brands dominate their home market, South-East Asia and Africa. In China, Apple is the only major non-Chinese brand. In South-East Asia and Africa, the major non-Chinese player is Samsung. In Europe, Chinese brands are gaining ground on Apple and Samsung. Xiaomi was the third leading smartphone maker by shipments in the second quarter of 2020, while Huawei



Sources: International Trade Center, the Economist

GROWING SHARE | **Top six smartphone brands by worldwide volume market share, 2013-2019**



Source: TrendForce

was fourth, according to Canalys, a global technology market analyst firm based in Singapore. In North America, Lenovo was the fourth handset brand in the second quarter, according to Counterpoint.

"Due to the high cost-performance ratio of their products, Chinese brands have been more popular in price-sensitive markets, including South-East Asia, India and Africa," says Eddie Han, a smartphone analyst at the Taipei-based Market Intelligence & Consulting (MIC) Institute. "In the European market, before the US ban, Huawei also had a good market share owing to its cooperation with Leica and its innovative design."

But things are changing. Smartphone brands want to mitigate risk and "not have production centered in just one country," says CK Lu, a senior director analyst at research firm Gartner. He sees the pandemic playing a paramount role in their calculations. When Chinese factories were forced to shut down earlier this year, smartphone makers strained to meet shipment targets. That highlighted a need to diversify production facilities.

But the pandemic has simply accelerated a trend that began in 2016 in response to China's rising labor costs and continued amid the trade war. China's share of global smartphone production fell from 75% in 2016 to 68% in 2019, according to Counterpoint.

Brands both international and Chinese are moving smartphone assembly to other emerging markets in Asia, chiefly India and Vietnam, where costs are considerably lower. "The shift to India is fueled by the anticipated massive local market opportunities and India's increased tariffs on imports," says Han from the MIC Institute. With a population of 1.3 billion, the Indian market is especially important, and Chinese smartphone brands are among the top sellers there.

The pivot to India and Vietnam

India is currently the world's fifth largest economy with a population second only to China's. India will surpass China as the world's most populous nation in 2027, according to the United Nations' *2019 World Population Prospects* report.

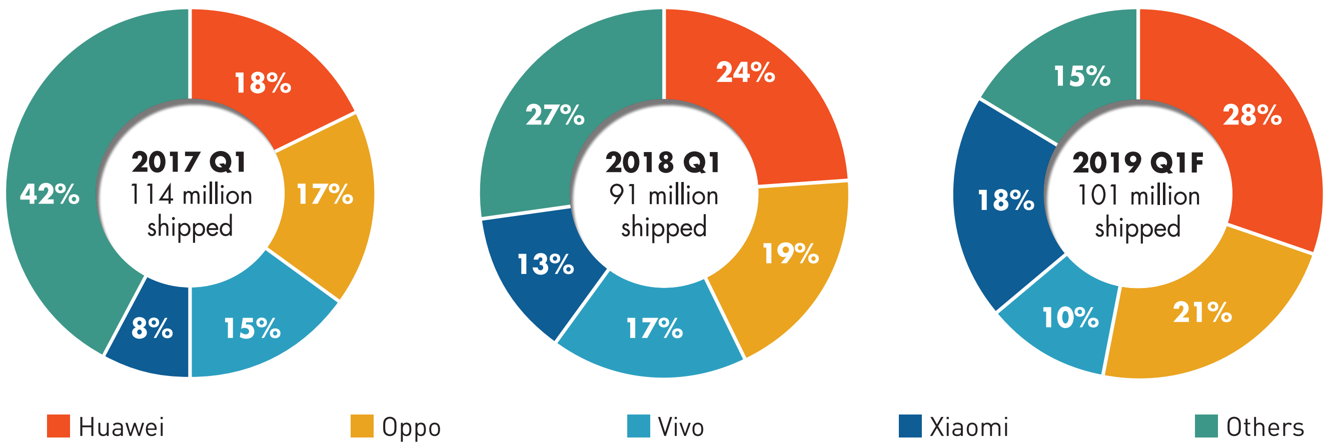
To attract smartphone manufacturers, New Delhi is dangling a range of incentives. In June, IT Minister Ravi Shankar Prasad announced the launch of a $6 billion plan to strengthen India's electronics manufacturing, focusing first on boosting the local production capacity of five global handset makers: Apple, Samsung, Oppo, vivo and Xiaomi.

"The trade tension between the US and China has coincidentally occurred at the same time that India has a business-friendly government in power, which facilitates making India a potential manufacturing replacement," says Ross Darrell Feingold, a Taipei-based political risk analyst.

According to India's *Economic Times*, Apple plans to move as much as 20% of its

> Due to the high cost-performance ratio of their products, Chinese brands have been more popular in price-sensitive markets
>
> Eddie Han
> Market Intelligence & Consulting Institute

HOMEGROWN | **China's smartphone market is increasingly becoming a four-way contest**



Sources: Canalys estimates, Smartphone Analysis

iPhone assembly from China to India over the next five years. The value of the iPhones produced in India during that period could reach $40 billion, a huge increase over the current $1.5 billion. Apple would rely on its Taiwan-based contract manufacturers Foxconn and Wistron, which already have India production facilities, to assemble the phones.

India is already a key consumer market, especially for Oppo, vivo and Xiaomi, which has been India's top smartphone brand by shipments since 2018. Counterpoint Research estimates the Beijing-based firm will produce 60 million smartphones in India this year, up from 40 million in 2019. Vivo and Oppo are even more ambitious, planning to double their respective India annual smartphone production to 50 million and 100 million units, respectively.

Vietnam is another winner of the shift of smartphone production out of China. In the summer of 2019, Google began moving production of its Pixel smartphone from China to Vietnam to take advantage of its lower costs and to avoid possible US tariffs on Chinese-made smartphones. The US accounts for about 70% of Google's smartphone sales.

Vietnam has also become a smartphone production hub for Samsung, which closed its last China handset factory in October 2019. That move made sense as Samsung holds less than a 2% market share in China while it leads the Vietnam smartphone market with an almost 40% share, according to research firm GfK. The South Korean electronics giant is also Vietnam's top foreign investor, having invested $17 billion in the country, according to a March statement.

When the coronavirus struck South Korea earlier this year, Samsung even temporarily shifted production of its flagship Galaxy S20 and Z Flip handsets for the domestic market from its home country to Vietnam.

"The establishment of smartphone factories in Vietnam is a matter of corporate strategy," says Mia Huang, an analyst at Taipei-based market intelligence firm TrendForce. "Samsung chose Vietnam as a major manufacturing site for smartphones because the country has an acceptable level of infrastructure and human resources."

Battle of the brands

Even as its share of global smartphone production declines, China's own handset brands remain formidable players. One reason for that is they sell lots of phones in China, the world's largest smartphone market. Huawei, whose phones are known for being good value for money, has ridden a wave of patriotism at home amid mounting US sanctions. Huawei's market share in China rose to a record 36% in the first quarter, according to Counterpoint.

"US sanctions, including on Huawei's use of Google's Android OS, will strongly impact its overseas sales. It will have to pivot and concentrate on the domestic market," says Daniel Tu, managing director of Hong Kong-based Active Creation Capital and former chief innovation officer of Ping An Insurance. "However, if it prevails as the dominant player in China, other local brands will suffer."

Rising geopolitical tensions are a risk for Chinese brands, especially Huawei. The Shenzhen-based telecoms giant is facing the prospect that restrictions on its use of American technology could eventually crimp its ability to ship new devices.

"The international market's preference for Chinese brands may be reduced," says Eddie Han. "Their loss is likely to be Apple and Samsung's gain, and to a lesser extent, Google, LG and Nokia."

Huawei's key international market is Europe, where it has made significant inroads in recent years. Europe accounts for about 30% of Huawei's overall smartphone sales, according to MIC. Lacking Google Mobile Services (GMS) could eventually end its European foray. Telecoms carriers in Europe worry that they will have trouble selling Huawei phones without Google's system, MIC noted in an April research report about Huawei's supply chain.

For the time being, Huawei has found a Band-Aid solution: It is shipping older phones overseas not subject to the U.S. export ban, which can still be sold with

Android. "Huawei is buying time," says Gartner's Lu. "At some point though, it will be hard for them to compete with other brands shipping phones with more advanced hardware."

Huawei has also launched its own mobile operating system, HarmonyOS, but it remains at a fledgling stage. "Word is the operating system is unproven at scale and stability is an issue," says Tu. "The Achilles' heel [for its global smartphone business] is that Huawei lacks a large and credible app developers' community."

In Europe, Huawei has lost market share to Apple, Samsung and Xiaomi. A Canalys report of first quarter smartphone sales in Europe shows Huawei's sales fell 40% year-on-year, the most of any major brand. Huawei has an 18% share of the European market, compared to Samsung's 37% and Apple's 24%. Xiaomi has a 10% market share and is growing fast, with shipments surging 79% in the January-March period. It could soon surpass Huawei.

Both vivo and Xiaomi have slowly increased their global market share over the past year, as Huawei's troubles have grown. Research by International Data Corporation (IDC) shows that Huawei's share of the global smartphone market has remained flat at around 17.7% since the second quarter of 2019. Buoyed by India sales, vivo has increased its market share to 9% from 8.6% while Xiaomi accounts for 10.7% of global smartphone shipments, up from 9.7% in the second quarter of 2019.

Multipolar world

Chinese smartphone brands could eventually face serious competitors based in other emerging markets, especially Vsmart, a Vietnam-based handset brand. Like Chinese brands, Vsmart uses its home team advantage, drawing on niche sales channels and tweaking the phones' Android operating systems to suit local consumer tastes. By April, just 15 months after the brand's launch, Vsmart had a 16.7% share of Vietnam's smartphone market, according to GfK.

In July, Vinsmart, the parent company of Vsmart, announced the launch of Vietnam's first 5G smartphone, the Aris 5G. The phone will play a foundational role in a homegrown Vietnam 5G ecosystem, the company said in a statement.

The Xiaomi Store on Champs-Élysées Avenue in Paris

But in the short term, neither India or Vietnam is likely to challenge China in the global smartphone business. "In order to quickly develop a competent team specializing in smartphone R&D, emerging smartphone brands require a large amount of investment capital and a diverse range of software and hardware development competencies," says TrendForce's Huang. "All of these requirements must be met in order to succeed in the hypercompetitive smartphone industry. Judging by the current state of the market, Vietnam or India are unlikely to compete at the moment."

Looking ahead, China may accelerate efforts to transform its tech manufacturing sector from labor-intensive to capital- and technology-intensive. To this end, China has invested hugely in a domestic semiconductor supply chain with the goal of being self-sufficient by 2025. In October 2019, it set up a new state-backed semiconductor fund of RMB 204.2 billion ($28.9 billion) in a bid to cultivate domestic chip-making champions. This fund is $9 billion larger than a similar one established in 2014.

"The success of the transition will depend on whether the US will continue to impose new restrictions on semiconductor technology and components to be shipped to Chinese brands such as Huawei and how much space is still left for the cooperation between China and integrated circuit makers in Asia," says MIC's Han.

Meanwhile, in the long term, China's dominance of smartphone manufacturing will likely ebb. "The Apple supply chain can be seen as a bellwether for China's hold on smartphone production," says Tu of Active Creation Capital. "Look at the movements of companies like Foxconn, who are long-time suppliers to Apple. Many are opening plants in South-East Asia or India for a host of reasons including costs, the trade war, COVID-effect and growing geopolitical tensions."

A Balancing Act

Hans Vriens, founder and Managing Partner of Vriens & Partners, looks at the growing relationship between China and South-East Asia

Hans Vriens has lived and worked in Asia since 1990 and is the founder and Managing Partner of Vriens & Partners, a leading government affairs, public policy and political risk analysis firm in South-East Asia. Headquartered in Singapore, the firm also has offices in Cambodia, Indonesia, Malaysia, Myanmar, Thailand, Vietnam and the Philippines.

Before establishing Vriens & Partners, Vriens was Vice Chairman, Asia, at management consulting company APCO Worldwide. He set up and served as Managing Director of the Indonesia practice for six years. Before that, he worked as a political economist at the Political and Economic Risk Consultancy in Hong Kong. He is a founding member of the Europe ASEAN Business Alliance as well as the founding chairman of the Dutch Chamber of Commerce in Singapore.

In this interview Vriens explores the direction in which relations between China and the ASEAN countries are moving and what factors are shaping the relationship.

Q. How do you view the economic relationship between ASEAN countries and China, and where do you see it going in the years ahead?

A. It's important to note that South-East Asia may be one region, but it's also incredibly diverse. I foresee the relationship between ASEAN and China only becoming closer over the next decade. China is already exporting much of its excess capacity to South-East Asia in terms of products but is also involved in the building of infrastructure. Many Chinese state-owned enterprises are working on large infrastructure projects in South-East Asian countries, which is something that they need quite badly.

Chinese tech companies are also quickly expanding into South-East Asia and treating it as their backyard, so the economic bridge between the two is only going to get stronger. On the political side, however, things are much more sensitive, with some countries not exactly seeing eye to eye with China on various issues.

Q. People talk about the shift of supply chains out of China and into South-East Asia. To what extent is South-East Asia capable of benefiting from this shift and what are the key obstacles that they are facing?

A. If there is one country benefiting from this, then it would be Vietnam. Not only have some multinational companies been moving part of their supply chains to the country, but Chinese companies are part of this trend as well. Many are shifting production to Vietnam to circumvent the economic sanctions that the United States has placed on China as part of the US-China trade war. But geographically, Vietnam is only the size of a single Chinese province, so they could never absorb all that demand alone. Another country that has benefited from this shift is Malaysia. Malaysia's tech sector has had a strong presence in South-East Asia for many years. Originally some of these companies moved from South-East Asian countries to China because they found it cheaper to manufacture there, but now they are returning to countries like Malaysia because costs in China have risen.

Other countries like the Philippines and Indonesia are quite shocked to discover that they are barely benefiting from this trend or not benefiting at all. The regulatory framework and infrastructure are so poorly developed that the investments are usually focusing on the domestic market and not at the country's own exporting. If you can't get your goods out of the port because systems are so corrupt, it's difficult to really set a part of your supply chain there.

Q. One of the biggest obstacles so far appears to be in logistics. What do you see as the prospects for South-East Asia upgrading its logistical capabilities?

A. There are massive opportunities for this. What many countries in Southeast Asia must do, and are doing, is upgrade its ports, particularly Indonesia and the Philippines. It's important not to forget, however, that these are two big archipelagos which are difficult to develop. Overall, infrastructure is poor and there is a lot of room for development.

Infrastructure in mainland South-East Asia, however, is making great progress. Thailand has made significant progress, Malaysia's situation is good, and Vietnam is building rapidly. On the other side of the spectrum, Myanmar is still 20 years behind.

Q. To what extent is South-East Asia likely to fall within the Chinese "sphere"?

A. South-East Asia can and will eventually fall in line with the idea of co-prosperity but there is an underlying nervousness in many countries. This nervousness is stemming from how aggressive Chinese behavior has been in the South China Sea and many countries in South-East Asia don't want to become tribute or client states of China, as they are familiar with this treatment from the past.

Q. What would be your advice to South-East Asia in terms of balancing its relationships between China, India and the West? What is the right relationship that they should have with these three parties?

A. My advice for balancing the relationship with China varies from country to country. Vietnam has been dealing with its northern neighbor for the past 2,000-3,000 years, and they have no illusions whatsoever. China has been humiliating Vietnam in the South China Sea by not allowing it to develop its own resources in its own economic zone, which has obviously been terrible for Vietnam. They realize that for there to be a balance and that maintaining the strength to stand up against China is an important part of the equation.

Other countries are also trying to strike a balance, though a major worry for them is the fact that the US is now completely missing in action with a president who is focused only on the US. There is a lot of concern. India is nearby, but they are maintaining focus on their domestic political and economic issues and aren't able to project power, let alone military power in South-East Asia.

Q. How would you rate the various countries of South-East Asia and Indochina in terms of their economic prospects in the next decade?

A. There is a distinction between potential and the ability to fulfill potential, so it is difficult to rate countries on their economic prospects. Indonesia, for example, has huge potential, but has always been unable to fulfill it. Vietnam is focused on a long-term vision of growth and prosperity. Singapore and Malaysia have clear economic prospects. The Philippines is another country where full potential isn't being reached. So overall, Vietnam, Malaysia, Singapore, and hopefully Myanmar are the countries with the best economic prospects. It mostly depends on how the COVID-19 crisis plays out.

Q. The relationship with the Chinese diaspora has at times over the past century been difficult. How do you see the relationship between Chinese people and locals in South-East Asia?

A. Today's relationship between the diaspora and locals compared to the past differs from country to country. In some countries, more of an underlying tension is noticeable. We can only hope that another scenario like the one witnessed in Indonesia in 1998, which resulted in massive social unrest, doesn't repeat itself. In other counties like Thailand, the Chinese diaspora are well integrated into society. In Singapore, they're in charge. The Chinese diaspora are clearly important for the economy, but, for the most part, we see them going about their own business rather than working closely with mainland Chinese companies around South-East Asia.

Q. What should be the role of Western businesses, specifically European and American, be in South-East Asia in the future, given the rise of China?

A. It's better to think of it as China having had two bad centuries, but that it's now back. Given that South-East Asia is in China's backyard, it is of no surprise that they are economically active here. South-East Asian countries are relatively open to foreign investment and business. Besides Chinese involvement, Japan, South Korea, and America are already active participants in these countries as well. This is not going to change, so the nature of future competition is going to be interesting to witness. It is clearly the region where the US and Chinese tech companies will really go head to head. South-East Asia can only benefit from more competition.

Q. To what extent is the China business and political model attractive to South-East Asian countries as opposed to the Western model?

A. How attractive the models are depends on the specific country being discussed. There may be admiration for the success of China's rise over the last 30-40 years, but to some extent, the economic and political model right now is more a hindrance in the continuation of development. Countries in South-East Asia, despite them being young, post-colonial nation states, are open and realistic, which doesn't seem to be what the Communist Party in China wants to adhere to.

Q. How effective do you see the ASEAN alliance being and to what extent is it achieving the purposes it was essentially set up to handle?

A. ASEAN was set up to stop the domino-effect spread of communism in South-East Asia. Despite the alliance originally going against Vietnam's interests, Vietnam is now its biggest, most enthusiastic member as it sees it as a way to slow down the power of China. However, economically speaking, the challenge is that most countries are focused on domestic issues and have no real interest or willingness to integrate their economies much deeper, particularly when it comes to going beyond lowering tariffs.

OUT OF OFFICE

How are COVID-19, a slowing economy and changes in work culture impacting on China's office property market?

By Claire Hacker

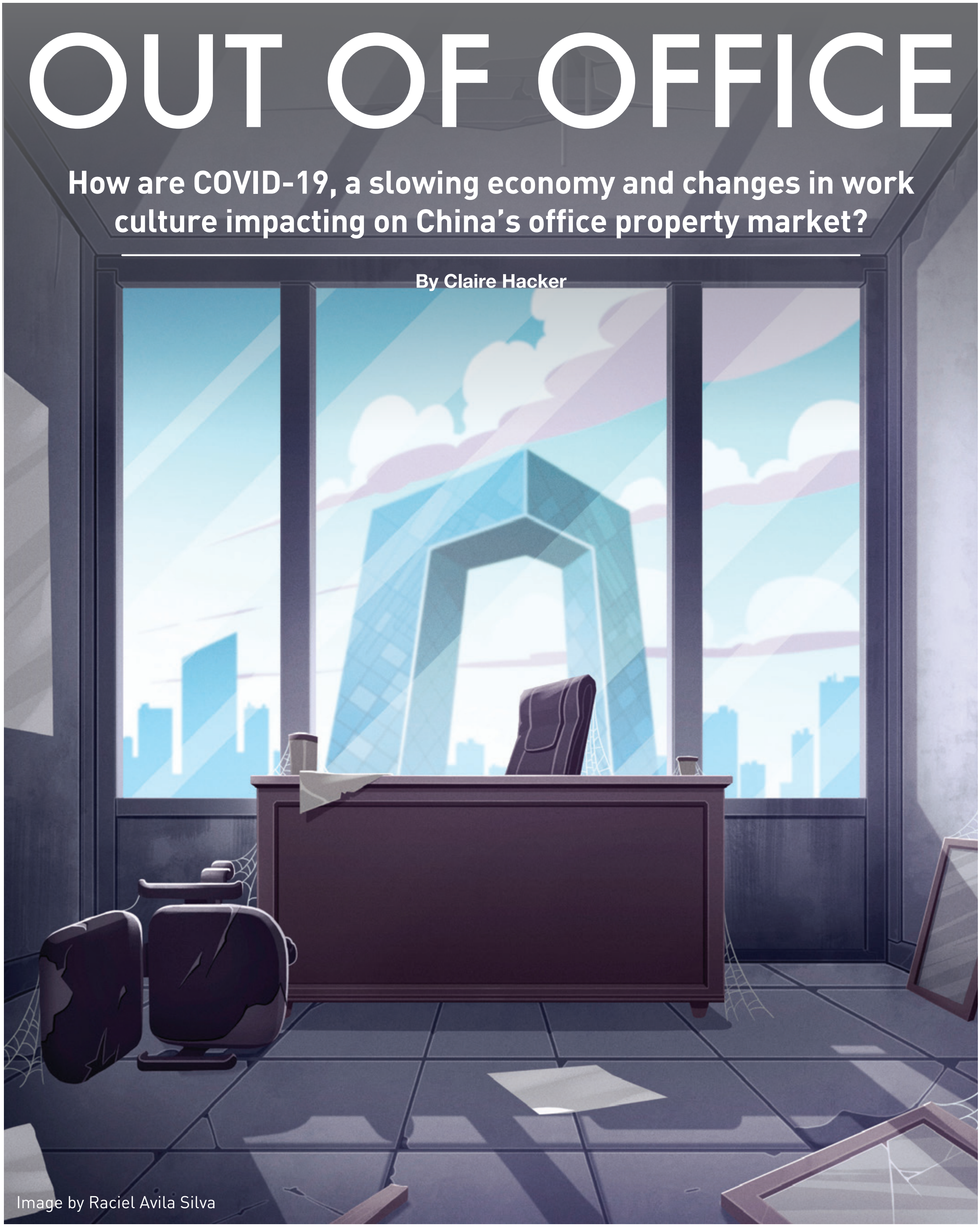


Image by Raciel Avila Silva

China's commercial property market has been a huge winner over the past three decades, but have the virus, a slowing economy and changes in work culture created a turning point?

In early February, as the Lunar New Year holiday drew to a close and COVID-19 infections in China surged, Winnie Li found herself an unwitting participant in the world's biggest work-from-home experiment. Li, a web developer at an e-commerce company in Shanghai, used to commute each day for up to an hour to her downtown office. Instead, she began clocking in at home.

The experiment was not an immediate success. "For the first week or two it was truly challenging," says Li. "There were many distractions… my sons, my parents and my husband, who also began working from home. But then I started getting used to it, and even learned to enjoy it."

Li and 200 million other office workers quickly learned an entirely new work schedule, far away from their usual workplaces in once-bustling office towers and business hubs. With desks deserted and phones silent, the abrupt change sounded alarms over the prospects of China's commercial office space.

"I don't think anybody really had a sense about how big an impact it was going to have on the economy, how long the lockdowns would be enforced or the potential international impact," says James Macdonald, senior director of China research at Savills, a real estate services provider.

The uncertainties were compounded by extensive disease control measures for the few professionals returning to workplaces. In Beijing—home to some of the world's priciest office spaces—workplaces were permitted to operate at only half capacity. Other precautions included compulsory mask-wearing, temperature checks and rigorous physical distancing between staff.

The picture that emerged from the empty office blocks and the overnight boom in remote work arrangements was that China's office space sector headed into a period of serious uncertainty, with significant negative implications for the economy. The commercial real estate sector—including office buildings—has played a major role in China's economic development over the past four decades. Valued by Goldman Sachs at $52 trillion in 2019, the sector remains an important foundation of the world's second-largest economy and a key driver of growth.

Much of China's premium office space—known in the industry as Grade A—has been built over the last 20 years, as the country's booming economy created demand from a new generation of homegrown private companies and multinationals setting up local operations. At the same time, many of China's older state-owned companies traded up as they became more internationally corporate in style.

Even before COVID-19 disrupted work patterns and temporarily hollowed out office towers, China's office market faced uncertainty due to slowing economic growth and fraying ties with the US. These headwinds prompted multinationals to temper investment in local properties.

The current slump has its roots in the China-US trade war rather than COVID-19, according to Tammy Tang, China managing director at the commercial real estate organization Colliers International. In particular, US companies postponed investment as the trade war escalated. "It was a wait-and-see mentality. They were not cutting down… but because of the political situation, they were more prudent in expansion."

Cracks appear

Commercial real estate is a slow-moving and conservative sector, but while the China-US trade tensions might have been having a negative effect the coronavirus took little time to accelerate the underlying trends. Investors turned cautious as lockdowns began to bite on economic growth. National sales of office buildings in the first two months of 2020 slumped by 40.6% year-on-year. The decline eased to 28% for the first half of the year, but still remain near historic lows.

A record number of offices were left empty in China's first-tier city real estate markets of Beijing, Guangzhou, Shanghai and Shenzhen during the first quarter of 2020, according to China Real Estate Information Corporation. Around 7 million square meters of Grade A office space—

> **In many second-tier cities, where supply is mostly abundant, a city-wide vacancy rate of 20-30% is common**

equivalent to 12 times the total space in the Shanghai Tower, China's highest building—lay empty in the four cities by the end of March.

Macdonald from Savills says market changes did not start appearing until after China's historic GDP (gross domestic product) contraction in the first quarter of 2020. "Landlords only started increasing rental discounts significantly in April and May. They had a sense that it wasn't going to return to normal and they'd have to offer greater incentives to attract tenants."

But there is also data to suggest the office market has been resilient. Vacancy rates in the four commercial hubs averaged 15.7% at the end of June, on par with the end of March and up only slightly from 15.3% at the end of last year, according to data from Colliers.

A vacancy rate under 10% is considered healthy for China's first-tier cities but is significantly higher than other prime real estate markets. In Beijing, the percentage of unoccupied office space rose from 15.9% at the end of last year to 16.7% at the end of March, but inched down to 16.5% three months later.

Meanwhile, the average office rent in the four Chinese cities declined by an average of 3.5% from the end of March to the end of June, which was a steeper drop than the 2.2% decline from the end of 2019 to the end of March.

The modest declines in vacancy rates and rents in the first six months of 2020 suggest the market has weathered the pandemic fairly well. What has happened is an acceleration of trends that were apparent before COVID-19 struck. China's property market started cooling years ago, spurred by the general economic slowdown and plentiful supply coming onto the market.

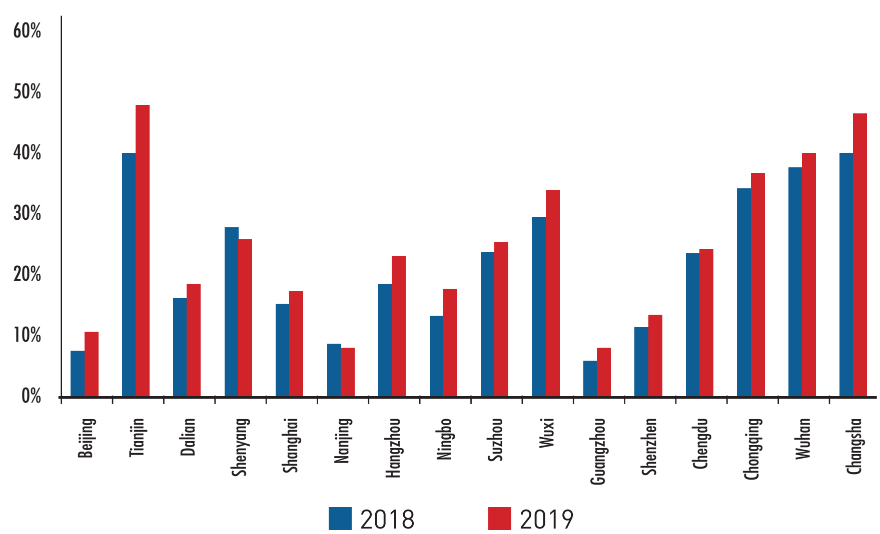
The latter factor in particularly has helped push up vacancy rates while depressing rents. Beijing, Guangzhou, Shanghai and Shenzhen had approximately 38.4 million square meters of Grade A office space by the end of June, but Macdonald forecasts another 11 million to be completed by the end of 2022. And over the same period, 18 million square meters of new office stock will be added to the existing 13.2 million square meters across the second-tier cities of Chengdu, Chongqing, Hangzhou, Tianjin, Wuhan and Xi'an, as tracked by Savills.

Demand is unlikely to absorb all the new supply in the short term, according to Macdonald. Even before COVID-19, vacancy rates had been tipped to edge higher on a combination of the extra supply and a slowing economy.

"COVID-19 hasn't helped, though developers have postponed the handover of some projects, helping to reduce some supply pressure," says Macdonald. He adds that the looming flood of new supply is likely to put downward pressure on rents and occupancy rates, which will lower capital values—effectively the price of whole buildings.

First-tier cities tend to fare better than lower-tier ones in digesting new office space, says Tang from Colliers. "In tier one cities where office demand is strong, the imbalance of supply and demand will recover over one-to-two years. In many second-tier cities, where supply is mostly abundant, a city-wide vacancy rate of 20-30% is common."

EMPTY OFFICES | Office vacancies in 17 major Chinese cities are set to rise



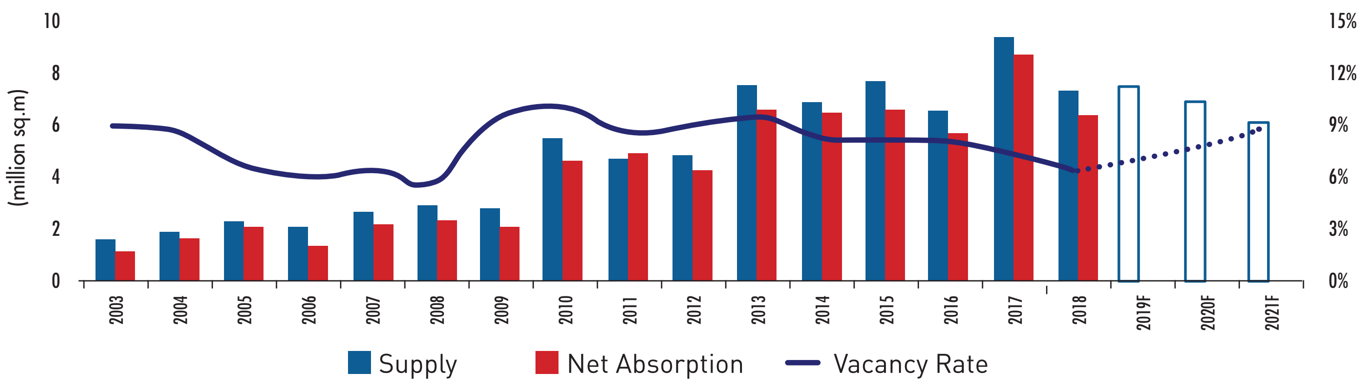
Sources: CBRE Research

There's no place like work

The scale of remote working seen in the first half of 2020 is unprecedented, and the sense is that flexible work arrangements will leave a lasting impression on the way people work for years to come. Twitter in the US, for instance, told staff in May that they could remain out of office permanently if they desired.

But in China, the discussion never truly got off the ground. "The lockdown was relatively short-lived," says Macdonald from Savills. "Most parts were back to normal quickly … people were in the office. It won't revert completely back to

AN OVERSUPPLY | Forecasts of the China retail property market show that supply far exceeds demand



Source: CBRE Research

the way it was before but won't be too far off either."

Tang of Colliers believes reports of the office's demise are wide of the mark. "It is ludicrous to think that companies will not return to offices," she says. "Anyone who says they're not going to be in offices is naive about how company culture is built."

Claire Stephens, consulting director at global architecture firm Gensler, says two 'camps' have emerged on office space. The first are multinationals challenged by the global economic downturn.

"That will impact all of their decision-making, and will mean cutting back on the size of office space and looking at alternative strategies at getting more bang for their buck. This probably means cost-conscious decisions when it comes to new real estate."

The second group comprises companies still expanding, such as e-commerce players and those in the wider IT sector. "They're just looking at doing it in a smarter way."

Chinese white-collar employees have not embraced remote working with as much aplomb as their American peers either. Zhang Xiaomeng, Associate Professor of Organizational Behavior at CKGSB, found that many employees reported reduced efficiency when working from home. In a survey conducted by her team, which had 5,835 respondents, more than half reported reduced efficiency when working from home. Nearly 37% reported no difference, while less than 10% said they worked more efficiently from home.

"You can be as open-minded as you want, but Chinese still want to be face to face," says Tang from Colliers. She adds there was less chance of a pushback from staff after their bosses asked them to return to their desks. "The Chinese management style is easier in this regard. We can't push people, but you can say 'please come back' and they will."

Traditional management thinking will also help the office retain its importance as a physical space for corporations. This is especially true of state-owned enterprises, which rely on highly structured management systems to get work done and managers who measure contribution by overtime at the desk. "You do have managers who like to see staff working," says Savills' Macdonald. "They don't necessarily prioritize output but think about input in terms of number of hours worked."

Rather than abandoning offices, the likelihood is that they will adapt. The corner office may remain the ultimate sign of success, but otherwise modern corporate workplaces could be redesigned for health and wellness in mind. Changes could range from installing touchless fixtures to implementing one-way routes around the office so staff avoid crossing in opposite directions, according to Gensler.

No disruption

The stay-at-home orders that emptied offices made real estate developers and state planners wonder about the economic impact of reduced demand for office space, given the importance of construction to the economy. The building industry is important for employing vast armies of laborers and consuming materials. It is also critical for the construction machinery and auto sectors as it drives demand for bulldozers, excavators, mobile cranes and heavy-duty trucks, while exerting an influence on energy demand.

However, a significant falloff in new office construction is unlikely. After a brief pause during the lockdowns, China's real estate market bounced back sharply. "China is so policy-driven—when a local government says we are building a new business district, then it is going to proceed," says Tang from Colliers. "If anything, I think we've seen some big projects speeded up because of COVID-19."

Li, the Shanghai web developer, received the all-clear to return to the office in late March after eight weeks of working at home. "I felt stuck at home toward the end and was ready to go back as I missed socializing with my colleagues. But I would also like the option of working from home occasionally," Li says.

She may get her wish. "Having that communal focal point where you can meet with colleagues and have meetings face to face is still incredibly important," says Macdonald. "But it may not mean that you have to go into the office from nine to six, five days a week."

FACING DOWN THE VIRUS

How did countries in East Asia effectively flatten the COVID-19 curve?

By Mable-Ann Chang

Image by Raciel Avila Silva

East Asia has seen some of the lowest infection and death rates from COVID-19 in the world. What has been the winning formula?

COVID-19 is thought to have moved out of China at the beginning of the year, and while the virus quickly spread around the world, it has surprisingly not been China—with a population of 1.4 billion—which has recorded the highest number of cases and deaths. Even Russia, with a population a 10th the size of China's, has had a reported death count of 20,385 in September compared to China's 4,634.

Meanwhile Japan, with a population of around the same as Russia, has had 1,548 deaths, South Korea recorded 407, Malaysia 134, Thailand 59, Vietnam 35, Singapore 27 and Taiwan just seven.

What has enabled societies in East Asia to be relatively successful in managing to contain COVID-19? The answer seems to be a combination of three factors—fast government action, effective use of technology and cultural acceptance that the interests of the group outweigh that of individuals.

Flattening the curve

Many countries have instituted a variety of measures to contain the virus, including closing borders, lockdowns and shutting schools and businesses, with vastly differing results. The United States, Brazil and India have all been at the other extreme of the virus impact precisely because the three factors don't apply there—government action was slow, technology use was incomplete and cultural issues stressing individual freedom over group safety gave the virus an open road.

"East Asian countries adopted more stringent prevention and control measures, such as closing borders, reducing flights, closing public places and reducing population mobility," says Pinghua Gong, a pediatrician in Changshu No.1 People's Hospital in eastern Jiangsu Province. "In addition, South Korea and China have carried out large-scale virus nucleic acid testing, trying to find the positive cases and preventing the spread of the virus from the source."

"Even though China and other Asian countries had little to no time to prepare and were the first to face the virus, their response was remarkably fast," says Bipul Neupane, a doctor at Ruijin Hospital in Shanghai. "Many Western countries did not use those initial weeks to prepare and when the virus eventually reached them, their response time was often slow, leading to the virus spreading like wildfire."

Even though there is some skepticism surrounding the accuracy of China's official death toll figures, especially after Wuhan revised its total deaths up by 50% to 3,869 in April, no East Asian country features on the list of top 15 countries with the most confirmed cases, while Western countries dominate, according to a report by Johns Hopkins University.

Some Western countries have also been successful in controlling the virus, including Finland, Germany, Iceland and New Zealand. And even though they have relatively lower population densities compared to countries in Asia, fast government action and health care preparedness appear to have been key factors in providing COVID-19 control.

Top down

Health experts tend to agree that the best approach in containing the spread is by widespread mask wearing, instituting rigorous social distancing, testing on a large scale and ensuring that those infected by the virus are effectively isolated. The COVID-19 experience has shown government direction and involvement to be crucial in these measures.

"The specific role of the government in epidemic prevention includes controlling the source of the virus, popularizing nucleic acid detection, accelerating the research and development of vaccines," says Gong. "Asian governments have adopted more stringent control measures, such as quickly reducing international flights and population mobility."

Zhang Lier, a sales manager in the eastern province of Zhejiang, which saw 1,270 cases, says that preventative action by the government was updated so quickly that she had to be glued to her phone to ensure that she was up-to-date.

"During the height of COVID-19, rules were changing daily," says Zhang. "First, masks became mandatory and public places were closed, then schools and business shut and we were placed under lockdown. When the virus continued to spread, each household was only permitted to send one person out to buy groceries twice a week. It was all monitored strictly and we weren't even allowed to cross into other districts in the same city."

"China blocked off a whole city [Wuhan] very quickly," says Neupane. "When China took steps, they took big steps. But even when the cities were locked down, the government made sure that the populations there were taken care of with supplies and food. There were no shortages."

Frank Tsai, a Shanghai-based global political risk consultant, agrees that fast government action is key, but also says that it can only work when there is a high level of trust between society and its leaders. "The deciding factor in how quickly COVID-19 is brought under control would be both the government's ability [to manage the problem] and the ability of the people to follow the government's direction," says Tsai.

"There's a degree of trust that people must have in their government for leaders to be effective. South Korea provides us with an example on how that trust is essential, with the government setting up testing centers and people listening and going to get tested. Their success can be seen in how they didn't even need to execute a lockdown to reach the same objective."

Health QR codes are displayed on smartphones

21st century technology

The use of digital technology to contain the virus was also widespread in East Asian countries. Mobile apps for contact tracing and body temperature checks at checkpoints, including apartment complexes, supermarkets and subway entrances, became commonplace. At the height of the pandemic, local authorities in China were even making use of drones to follow members of the public to tell them to wear masks or to return home. While mobile technology was adopted by some Western countries, its implementation was different from East Asia where it was more mandatory than voluntary.

Relying on smartphone technology and big data, China instituted a mobile QR health code system that effectively monitored and controlled population movements on the app, Alipay. Almost everyone with a smartphone in China has the app Alipay, Alibaba's online payment platform, installed on their phones. In order to travel or even take the subway during the peak of the pandemic, people had to fill out a brief health survey on the app, which issues users with a colored QR health code depending on their answers—green, yellow or red.

The color code dictated whether people could leave their homes and where they could go. Even three months after the virus is under control, it remained common for residents to be asked to show their health code before being entering public places, including hotels, gyms and restaurants.

"I remember getting my temperature checked up to five times a day, depending on where I went," says Zhang. "And even after things had returned to relative normalcy, restaurants were asking to see my green health QR code before seating me." Gong adds, "At every hospital entrance, health codes need to be registered and temperatures are taken, so that everything can be monitored through big data."

Believed to be the first to have used mobile phone tracking to enforce quarantine was Taiwan. The government reportedly calls those in quarantine twice daily to make sure they are abiding by the rules and not leaving their phones at home.

Singapore launched a contact-tracing app called TraceTogether in March, which exchanges Bluetooth signals between smartphones in close proximity of each other, letting users know if they have been in contact with an individual who tested positive. A government poll reported in the

Nikkei Asian Review found that over 70% of respondents supported this development.

Hong Kong, made use of the app StayHomeSafe, which requires users to don a wristband that uses geofencing technology to help catch those that violate mandatory quarantine measures.

Reported by the Harvard Business Review as being the more striking case of curve-flattening is in South Korea, where private app developers took it upon themselves to develop apps that assisted in official government contact tracing. The app Corona 100m, according to *MarketWatch*, was downloaded over 1 million times by South Koreans in just a few weeks.

The app, which has “overwhelmingly positive reviews,” collects data from public government sources that alert users of any diagnosed COVID-19 patient within a 100-meter radius along with the patient’s diagnosis date, nationality, age, gender and prior locations.

“The monitoring of big data helps to ensure timely detection and helps to quickly search for the close contacts of patients that tested positive patients,” says Gong. “Technology also plays an important role in diagnosis and drug development.”

China’s use of digital technology in addressing COVID-19 has not only been limited to contact tracing. High-tech firms SenseTime and Megvii, both well-known for their facial recognition technology, developed AI-based temperature detection software.

A “Smart AI Epidemic Prevention Solution” developed by Sensetime integrates AI algorithms with infrared thermal technology, detecting a fever within 0.3 degrees Celsius accuracy and identifies individuals not wearing a face mask with over a 99% success rate.

The use of technology to monitor the movement of people naturally brings forth questions about privacy surveillance. Concerns in Western democracies about privacy and civil liberty created substantial impediments to rolling out such technologies. But even amongst democracies, there are clear cross-national differences to the degree of voluntary adoption of contact-tracing technologies.

“While, yes, I agree that such close surveillance can be an infringement on privacy, in times of crisis it becomes a really fine line,” says Neupane. “It’s important to protect individuals’ privacy, but when contact tracing could save millions of lives then I’m willing to temporarily give up my privacy. Surveillance and big data have proven to be a gamechanger.”

Tsai, however, sees mobile applications more as a means of governments ensuring that society follows the rules that have been laid out.

“In a low trust situation, the government often has to implement compliance measures,” says Tsai. “Chinese people rightfully see the government as effective in virus control, but in Chinese society you need a more top-down authority to get people to do things. In countries like Germany or South Korea, where there is a strong bond between the people and the government, there tends to be more voluntary and less top-down compliance with government measures. Technology in China creates the compliance that otherwise takes place in these countries that performed nearly as well.”

Bottom up

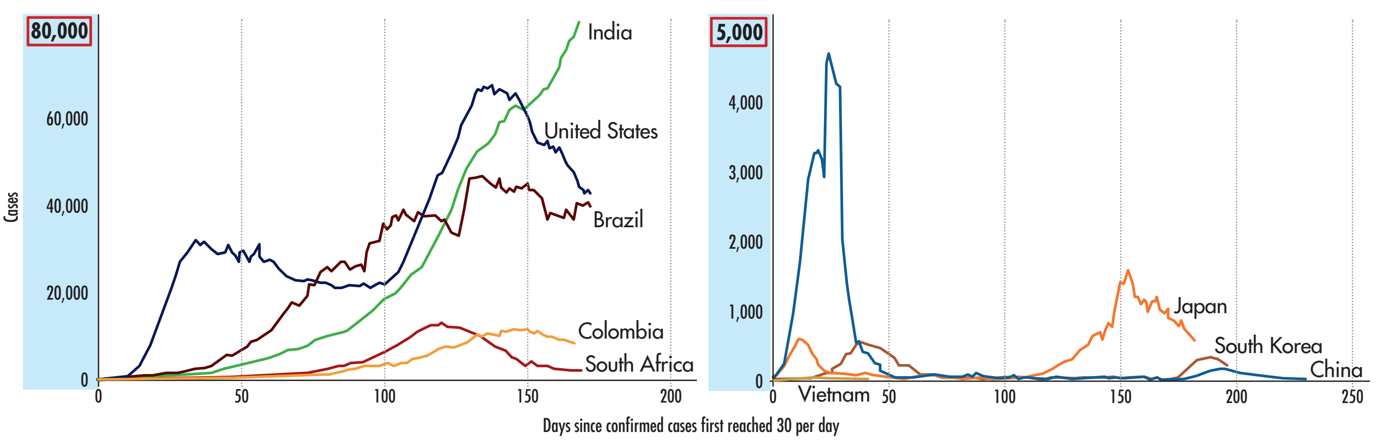
A common argument when reviewing the strengths of Asian societies in dealing with COVID-19 is in how they tend to have collectivist-leaning cultures, where individuals are willing to make sacrifices for the good of the group. “Asian cultures emphasize obeying social rules for the benefit of everyone,” says Gong.

Many Asian countries that have done well have cultures linked to Confucian ideals. “Confucianism provides a sense of morality that governs role relationships,” says Tsai. “A Confucian society does not necessarily equate to a collectivist society where everyone is willing to sacrifice for the greater good of the group, but it does bind people to each other. Hong Kong, Singapore, South Korea, Taiwan and Vietnam are all Confucian societies. These neighboring Confucian countries all did relatively well regardless of government type.”

Another factor that worked in favor of

A STARK CONTRAST

Confirmed COVID-19 cases in East Asia have been significantly lower than the global average



Sources: Our World in Data

East Asian countries, is that they already had a culture that translated into a ready willingness to wear masks, something that has been strengthened by the rise of pollution levels in recent years.

"In China, when the government first started announcing the danger, everyone immediately put masks on, even before information campaigns on the benefits of wearing masks began," says Neupane. "Many people already had a few masks at home and didn't need to buy them. In places like Japan and South Korea, they wear masks out of courtesy even if they just have a cold. It's a sign of respect."

Tsai believes that one of the reasons why East Asian countries did so well in curbing coronavirus was its experience with the SARS epidemic in 2003, which provided a level of epidemic preparedness.

"Western democracies have had nothing even close to this in a very long time," he says. "People already had an insecurity of things possibly spiraling out of control."

Having a recent history of the Ebola epidemic also certainly helped countries in West Africa with their level of preparedness when it came to COVID-19. Nations including Cote d'Ivoire, Liberia, Nigeria and Sierra Leone ranked as better prepared for coronavirus than wealthier countries with more sophisticated health systems, according to the World Health Organization. Countries that dealt with the Ebola outbreak still have the isolation facilities and expertise in controlling infectious diseases.

"Our preparedness is based on the system we built after Ebola," said Mosoka Fallah, Acting Lead of Liberia's National Public Health Institute to business news publication *Quartz Africa*. "The national institute now leading preparedness for coronavirus did not exist before Ebola," he says. "The skill did not exist before, the knowledge did not exist before, the manpower did not exist before and the infrastructure did not exist before."

Mask-wearing quickly became a requirement across East Asia

Moving forward

Ultimately, the pandemic has given surveillance a level of legitimacy that it did not have before, as it has solved a problem in a less physically intrusive way. A high level of government involvement has also proven advantageous in crisis situations such a pandemic, but some are concerned that complacency is inevitable as the threat ebbs.

"This has opened governments' eyes on how diseases can spread and mutate uncontrollably quickly," says Neupane. "It's a wake-up call. In the future, governments will likely prioritize funding for disease control, but the sense of complacency toward infectious diseases is likely to return within the next generation."

Tsai highlights how going forward, the pandemic has impacted on views of what the ideal system of governance is. "Countries like Vietnam and even China do not have the same level of health care capacity as countries in the West, and they performed better than Germany, which has a good government and much better capacity and infrastructure," says Tsai.

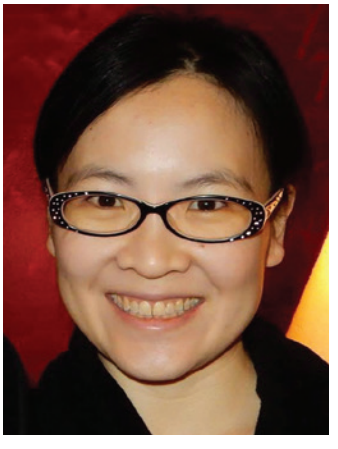
"During the COVID-19 pandemic, it has become popular to debate whether democracies or autocracies are better at fighting the outbreak," says Yuen Yuen Ang, political scientist and author of *How China Escaped the Poverty Trap*. "I say that this is misguided because the debate is framed to present a false choice, namely that if democracy is imperfect, then people should choose autocracy. The right question to ask is: What are the strengths and weaknesses of the two political systems in dealing with a pandemic?"

In the meantime, life has returned to a "new normal" for some. But full recovery from COVID-19 is going to be a slow process, even for countries that have handled the crisis well. "Looking at how other places are still struggling, I'm actually grateful that we were on lockdown for so long," says Zhang. "Businesses have been severely affected and people are still cautious, but I've gone back to work and can now move around freely."

An Age of Paradoxes

Yuen Yuen Ang, author of *China's Gilded Age: The Paradox of Economic Boom and Vast Corruption*, looks at the global impact of China's rise and how corruption has evolved over time

How has China managed to grow so fast for so long despite corruption on a large scale? That is the question Yuen Yuen Ang has addressed in her latest book, and her answer is that while all corruption is harmful, not all types of corruption impede growth.



Ang, a political scientist and expert on China and emerging economies, is also the author of the award-winning book, *How China Escaped the Poverty Trap*, which challenged conventional linear models on the development of China's political economy after the implementation of market reforms in 1978. She has been an adviser to the United Nations Development Programme (UNDP) and several governments on innovation and inclusive development, as well as China's Belt and Road Initiative (see pages 11-14). She has recently been examining the impact of China's rise on the global order and international development.

In this interview, Ang reflects on what "the China model" really is, how China's gilded age compares to America's gilded age, and whether China is "winning" in the post-COVID era.

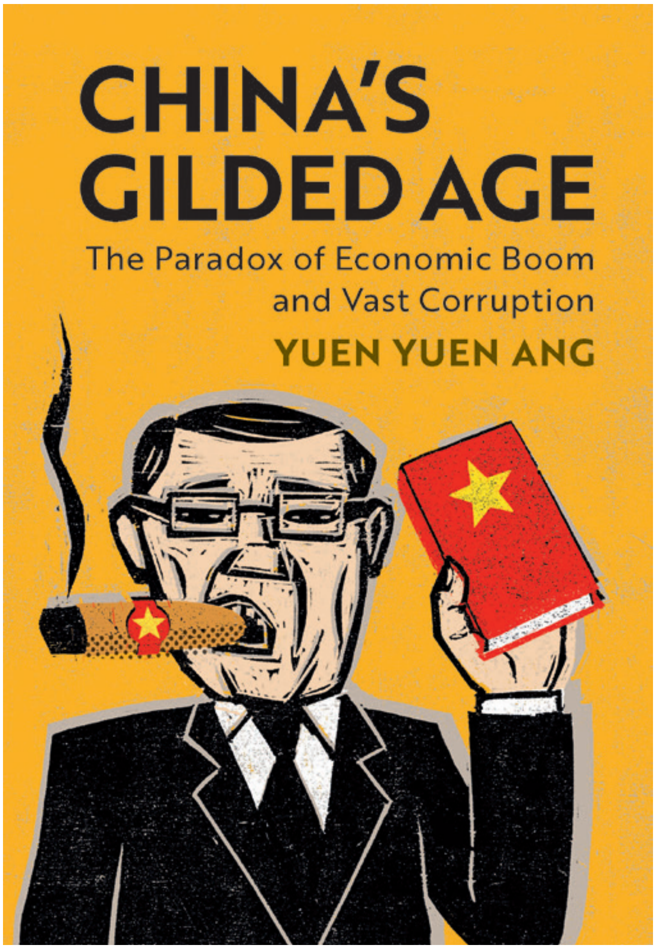
Q. Your last book was about how China escaped the poverty trap. Could you summarize how China did it, and whether it is sustainable?

A. *How China Escaped the Poverty Trap* is often misunderstood to be a book on poverty alleviation policies—but it isn't. China achieved its accomplishment of lifting 700 million people out of poverty since market opening in 1978 through rapid capitalist growth, accompanied by inequality and corruption. President Xi's poverty alleviation policies only came after 2012, when China was already a middle-income economy.

My book tells a historical story from 1978-2012. Those were the critical 35 years that took China from a closed, impoverished and communist society to the world's second largest economy—one that is now integrated into the global capitalist economy. While there are many factors behind this tectonic process, my book focuses on its political foundations. Simply put, I examine what changed inside the government that enabled China's economic rise. And this change can be captured in two words: directed improvisation.

First, the word 'directed' captures the fact that the central government changed its role from dictating to directing. It provided guidance and a conducive environment for local actors to experiment and find local solutions to local problems, instead of telling them exactly what to do. That was a big movement away from central planning.

The second word, 'improvise,' implies adapting by 'using what you have.' If you look at the cases in this book, you'll find that solutions are locally specific. Local officials made best use of particular advantages in their jurisdiction. Localization is familiar



to Chinese culture and thinking. It is more foreign to Western culture, which values standardization and universal best practices. It is the reinvention of governance along this line of directed improvisation that provided the political foundation for the extraordinary dynamism that we saw in China from 1978 onward.

"Directed improvisation" is enduring, even timeless. Its lessons will always be relevant for China, because at any point in time, and particularly in a context of tremendous uncertainty, societies need an adaptive and flexible governing system. But over the past few years, China has regressed toward a more controlling and top-down approach. This in part has to do with misunderstanding within China of how China rose. There is a predominant opinion that it was autocracy that made China great again. That it was centralized rule and conformity around a single ideology that made China great again. Many have failed to see that it was actually an adaptive, flexible and pragmatic governing system that enabled China's rise.

Q. What lessons from the "China model" of economic growth are transferable to other societies?

A. The country that most needs to learn from China's reform history is China itself. In recent years, China has been eager to share lessons with other countries but first, China must learn what it did right and wrong in the past before it can teach other developing countries.

To date, there has not been an official consensus on what the "China model" is. One common narrative is that the China model is centralized authoritarian rule plus large infrastructure investment. This is misleading. Under Chairman Mao, China was a highly centralized authoritarian regime, and yet it failed miserably. We also learn from the Maoist period that although centralized authoritarian power has certain advantages in mass mobilization, which we have seen during the COVID-19 pandemic, it also has some fatal flaws. When power is highly centralized, the nation's fate is completely dependent upon the personality of the top leader. As for the infrastructure boom, this came late, in the 2000s. Before this, China's economy did not take off by splurging on grand infrastructure projects—it began with rural industrialization and liberalizing small private businesses.

In short, telling the story of China's development is by itself a contested and politicized process. If people buy into the narrative that centralized control and mammoth state enterprises had led to China's rise, then it justifies these policies domestically. It also gives foreign critics reasons to claim that the so-called "China model" is threatening.

Q. People talk about the system that has allowed China to escape poverty as being state capitalism. What do you think of that characterization?

A. The term "state capitalism" is thrown about frequently but rarely defined. Most people associate state capitalism with two things. The first is a dominant public sector and big state-enterprises and the second is industrial policies. Thus, for many, the term "state capitalism" basically means a centrally planned economy. I have met Western business executives who are under the impression that China's rise is the result of central planning.

The label of "state capitalism" is misleading because it ignores the fact that China's economic boom was and is driven by the private sector. The private sector accounts for 60% of gross domestic product (GDP), 70% of innovation, 80% of urban employment, and 90% of new jobs. The most successful Chinese companies such as Alibaba and Hengli are private companies.

Another pattern to highlight is that from 2012, under President Xi, China has moved away from the private sector toward the state sector. Private entrepreneurs have become increasingly concerned that the political system is less welcoming of them than before, to the point where Xi held a symposium in 2018 to reassure them of the government's support. That by itself indicates real concern on the part of the private sector. This shift reinforces the popular perception in the West that China is a centrally planned economy.

Q. In your most recent book you talk about China's "gilded age" and the paradox of economic boom and corruption. Has this age ended? What is its future trajectory?

A. First, it's not clear when China's gilded age began—this is a matter of interpretation. The American gilded age happened more than 100 years ago, so historians have already established its start and end dates. In China, however, the gilded age is recent, and perhaps still ongoing. Thus, there is no consensus yet on when it began and whether it has ended.

My interpretation is that the reform period, starting from 1978, is the gilded age because it fits the defining characteristics of what we understand to be gilded ages, namely rapid growth and transformation accompanied by crony capitalism, massive poverty reduction along with rising inequality and the creation of a new super-rich class. It's an age of paradoxes. Has it ended? One interpretation is that it ended in 2012, with Xi's administration. He has launched the Party's most vigorous anti-corruption campaign, and to that extent we might say that it seems to be aligned with the American progressive era.

The future is hard to tell because of the pandemic and the China-US Cold War, but if we look at long-term trends, it is clear that China's experience has been mirroring the American evolutionary path of moving away from petty bribery and embezzlement into a type of corruption that I call access money—elite exchanges of power and wealth. This form of corruption is also becoming more sophisticated in the way it is carried out.

Q. How does China's gilded age compare to the gilded ages that occurred in the US in the 20th century, particularly from a systemic perspective?

A. There are both similarities and differences. Both were periods of rebuilding after destruction. In the US, the gilded age followed the Civil War. In China, it was after the Cultural Revolution. Therefore, both were periods of reset, and in this period of reset, you see a new class of super rich being formed.

For thousands of years, China had a land-holding wealthy class, which was destroyed when the Communist Party took over. Under Mao, there was no growth for anyone. But after markets opened in 1978, a whole new class of rich arose. I've interviewed many successful entrepreneurs in China, and for those who are middle-aged, their stories are those of rags to riches. They were born into poverty or witnessed the confiscation of their family's wealth. All of them experienced hunger under Mao. Then because of a combination of luck, hard work and connections, they managed to climb to the top. Their stories bear resemblance to the tycoons of America's gilded age, many of whom also came from humble backgrounds. Both groups knew how to take advantage of an emerging economy that was chaotic but also full of opportunity.

When it comes to differences, there are a few that are worth noting. The key difference is that one is a democracy and the other is not. That means that these two societies had different reactions to corruption. In the American gilded age, democracy was mobilized to fight corruption whereas in China it has been the opposite. President Xi dealt with the corruption by employing the disciplinary arm of the party in a strictly top-down manner. It was an expansive campaign that has disciplined more than 1.5 million officials to date.

Access-money-corruption stimulated growth but also produced perverse outcomes, resulting in a distorted economy

Q. Most countries with high levels of corruption are poor. How was corruption in China different?

A. China's corruption is different in that the most dominant type of corruption in China is access money—the exchange of power and wealth—rather than petty bribery, bureaucratic extortion or embezzlement. In my book, I created my own index of corruption that allows us to compare corruption structures between China and other developing countries. This index reveals stark differences. India and China are both perceived as corrupt. But in India, the most dominant type of corruption is petty bribery, whereas in China it is access money.

Different types of corruption have different economic consequences. I compare access money to steroids. In China, access money spurred economic growth and investment because it encouraged businesses to invest and rewarded politicians for promoting development. But this corruption also produces perverse outcomes: inequality, over-investment in real estate, and a movement away from manufacturing into speculation, to name just some. By understanding the type of corruption that prevails in China, we can better understand why China has a high growth but also distorted and unequal economy.

Q. How would you rate the corruption level in China now compared to the pre-Xi Jinping era? Has it decreased or has it just become more discreet?

A. We don't know for sure because measuring corruption is difficult, but Chinese officials are definitely more cautious than they were before. Xi's corruption campaign has been so vigorous that it has produced a backlash, which is that officials are terrified

> **The truth is that nobody will win in the 21st century**

of doing anything. That has led to a common Chinese term called 'lazy governance.' It remains to be seen how corruption will evolve in the coming years, especially given the global disruptions we're facing.

Corruption will not be eradicated completely because as long as government officials have tremendous power over the economy and resources to distribute, there will be a demand to buy their favors. The question is whether it will evolve into different forms and migrate into different sectors, such as technology. Corruption used to be highly concentrated in land and real estate because those are the sectors where power is most easily monetized.

Q. In your most recent article in* Nature*, you talk about how the political debate about whether autocracies or democracies are better at fighting epidemics is misguided. What do you mean by that statement?

A. During the COVID-19 pandemic, it has become popular to debate whether democracies or autocracies are better at fighting the outbreak. I say that this is misguided because the debate is framed to present a false choice, namely that if democracy is imperfect, then people should choose autocracy. The right question to ask is: What are the strengths and weaknesses of the two political systems in dealing with a pandemic?

Different types of corruption have different economic consequences

Authoritarian regimes have certain advantages, particularly in mass mobilization, which we have seen in a dramatic fashion in China. When the president declared that the outbreak was a crisis, the government spared no expenses to curb infections and it was truly effective. But, on the other hand, there are weaknesses. In the absence of a vibrant civil society and a climate where ground level actors feel free to speak the truth, it is difficult to prevent epidemics from arising in the first place. The government, no matter how strong and powerful, cannot always detect every virus and every problem. When you have a highly centralized regime, where civil society is weak, what you often find is effective action at curbing a problem only after it has already been blown out of proportion.

By contrast, the key advantage of democracies is the strength of civil society, the bottom-up responses. Despite the failure of the federal government in the US, local governments and civil society have been stepping up every day. In New York City, when there was a call that went out for volunteers, tens of thousands of retired doctors and nurses stepped forward to essentially enter a battlefield. If we look at the discourses coming out of China, they tend to only talk about the ways in which democracies have failed, without talking about the ways in which voluntary civic actions can be empowering. It also does not mention examples of democracies that have combined freedom with state efficacy, such as New Zealand.

Q. Thomas Piketty and others have pointed to the kind of global issues that are coming to the fore more and more often as examples for the need of greater international coordination. How do you envision the global balance of power in the decades to come?

A. Understandably, geopolitics has been getting a lot of attention lately. The hot debate is which nation will dominate in the 21st century, and whether China is "winning" in the post-pandemic world. This conversation is appealing but misleading.

It's true that Western hegemony is diminishing relative to the past and we are moving toward a multipolar order. But it doesn't mean that the 21st century will belong to China or to Asia in the same way that the 20th century belonged to the United States and the 19th century to the United Kingdom.

The truth is that nobody will win in the 21st century. People have been so fixated on "winning" that they're not willing to see this obvious truth. The reality today is that we face existential crises shared by all of humanity, which were not salient in the 19th or 20th centuries. We're facing climate change, rising seas, the pandemic and other transnational problems. Given these kinds of crises and disruptions, it just doesn't make sense to fixate on who is going to win in this environment.

PICKING A PRODUCT

Many Chinese towns are dedicated to producing a single type of product. What are the prospects for the specialty town approach?

By Lucy Black

Image by Raciel Avila Silva

One of the secrets behind China as the "Factory of the World" is the mass specialization of towns on the production of single items

It is July, it's a hot and humid 35°C outside the Yiwu International Trade Market in east China, but inside it is Christmas. Red, white and green stretch for as far as the eye can see in what has been called the "largest small commodity wholesale market in the world." If you want to buy bulk Christmas decorations—gaudy tinsel, glowing fiber optic trees or a sax-playing Santa—then this is far and away your top choice.

Yiwu, a city of 1.2 million people in China's eastern province of Zhejiang, is reported to produce nearly 60% of the world's Christmas decorations, exporting goods worth RMB 1.92 billion ($275 million) between January to October last year. That is up more than 10% from the same period in 2018. While Yiwu also produces other cheap plastic commodities, its domination of Christmas goods makes it a leading "specialty town," that is, a place that focuses on the production of just one or a few core types of products.

The rise of specialty towns

The specialty town approach stems from the 1980s, soon after Deng Xiaoping implemented the market reforms that launched China on its trajectory to becoming the "factory of the world." While now facing headwinds, this remains a fundamental part of the manufacturing mass-production setup. The goal was to maximize production efficiency, cut costs and monopolize the market for individual products. Some examples include shoes made in the port city of Wenzhou, socks in Zhejiang province's Zhuji, bamboo goods in the eastern city of Anji, and car parts in the southern city of Guangzhou.

The poster children of the "Made in China" phenomenon for decades, specialty towns largely emerged from local collective enterprises that were later privatized, or small privately-owned companies that blossomed during the 1980s and 1990s.

"Many towns started organically," says Heather Kaye, co-founder of Loop Swim, which produces its specialized swimwear in cities in Fujian province. "Often, it started off with someone having the idea, getting the equipment and then people coming out of agriculture and switching into manufacturing."

"The leaders were setting up one giant state-owned factory to supply the whole country," explains Christian Faubert, managing director of Silk Ventures, which has been trading from specialty towns for almost 20 years. "Inside those companies there would be a few renegades who would take the technology and start making the exact same thing two doors down."

The modern incarnation of specialty towns is more top-down. Recognized as a way to achieve the central government's ambition to limit the size of China's biggest cities, a program was rolled out where local officials of smaller cities were charged with identifying and specializing in something that makes them unique.

There were set to be 1,000 such towns by 2020, but officials forged ahead, far exceeding the official targets. Some 6,000 were estimated to have been in development by 2017 alone. That same year, the average investment into each specialty town was estimated by brokerage firm Shenwan Hongyuan at RMB 5 billion ($755 million), which would equate to 7% of China's gross domestic product at the time if that amount of money was pumped into just the 1,000 towns initially approved by Beijing. There are no official figures, but government investment into such areas to date is clearly astronomical.

A swimming success

Huludao, a remote northern coastal city in Liaoning province, is one of the most successful specialty towns. It is estimated to produce a quarter of the world's swimwear. The 1,200 companies employ 100,000 people, one in five of the city's residents.

A testament to organic growth, Huludao's story begins in the 1980s, when poor residents sewed swimsuits to sell on the beaches. In time, factories were established and merchants began shipping the stretchy garments across the country. Orders fell as labor costs rose, so the city partnered with the e-commerce platform Taobao in 2014 to launch China's first cross-border online retail platform.

Taobao opened the factories up to a bigger customer base, both across China and around the world. This brought new and more customers to the factories. Rather than just dealing with manufacturers, Huludao merchants could sell their own wares directly to international customers for whom labor costs are not an important factor.

Today, Huludao is home to more than 35,000 swimsuit enterprises that use e-commerce to export to 140 countries and regions. In 2018, Huludao delivered more than 200 million pieces to global customers, generating revenue of RMB 15 billion ($2.24 billion). "Swimwear is still a very human and complicated process," says Kaye. "It makes sense to concentrate it into one area."

Another specialty city is Danyang, set alongside the southern bank of the Yangtze River in eastern Jiangsu province, which has become known as "Spectacles City." Built in 1986, it is one of the largest eyewear merchandise centers in China. The industry first took root when factory technicians moved from Shanghai and Suzhou to set up their own businesses. The Danyang factories have seen ups and downs over the decades, but the ones that survived are those that have learned from foreign brands and work hard on innovation.

For example, Situ Lens joined forces with French ophthalmic optics company Essilor Group in 2012. In 2018, Danyang Tianlu Eyewear E-commerce Company rolled out Bluetooth glasses with bone conduction technology. Today, Danyang produces around 70% of China's optical lenses, a market that generated $68 billion in 2018.

Bright Vision Optical is a relatively small Danyang factory of 150 workers, churning out just 200,000 frames a year. Having started in 1995, the factory was working on a 100% export model until orders ground to a halt as COVID-19 took hold. They also lost American clients who saw the price of lenses increase due to tariffs. The company is now preparing to pivot to the domestic market, leveraging the power of China's e-commerce ecosystem for the first time.

"We're setting up a Tmall shop but it's more expensive these days, as you need to hire a photographer, models and do lots of marketing," says sales manager Monica Wu.

Another example of domestic-led growth is Taizhou—a city of 5.9 million also in Zhejiang province—which has survived and thrived through innovation in bathroom products. Starting out as a cluster of factories making traditional sanitary ware such as porcelain toilet bowls and basins, Taizhou is now home to more than 300 companies that specialize in the production of smart toilets, supplying more than 50% of the domestic market demand.

The city produced $1.1 billion-worth of intelligent toilets in 2018, tripling the output recorded in 2015 and reaching an annual capacity of 2.5 million units. According to state media, such impressive results can be attributed to huge investment in R&D, which accounted for 4.7% of the total revenue of Taizhou's business sector in 2018.

One success story is Zhejiang Wanjie Intelligent Bathroom, which teamed up with Korea's VOGO in 2011 to develop a line of smart toilets, patented as the first in China to work without a water tank. With advanced production and testing equipment and automated production lines, the 28,000 square-meter factory has an annual production capacity of 10 million units. While 80% of the company's market is domestic, they have been aggressively employing agents to market and sell their products through foreign e-commerce platforms.

"In future, the foreign market will be more important," says sales executive Andy Zhou. "In China there are so many factories doing smart toilets, but in foreign countries the competition is much less."

Products and comparisons

There are many cities across the world known for manufacturing, but few have quite the same laser-focus, scale and market dominance as those in China. In Osaka, Japan, iron and steel engineering naturally progressed into high-tech; in Randstad, Netherlands, a holistic ecosystem of head-quarters, logistics and R&D centers supports myriad manufacturing sectors; in Houston, Texas, losses felt after the oil price collapse of 1982 saw the city branch into professional services, health care and

A man selling Christmas decorations in China's Yiwu city

The southern city of Guangzhou, known for its mass production of electrical items

medical research.

In contrast, China's specialty towns traditionally drill down into one small segment. Sialkot in Pakistan offers a comparative example, with the city of 655,000 producing 99% of the domestic surgical instruments and supplying 80-90% of those used by Britain's National Health Service.

Just as Sialkot dominates surgical equipment, many of China's specialty towns supply nearly all of the local market and fulfill a massive portion of global demand, too. For a number of years until last year, for example, China was the world's largest supplier of car parts, exporting $34.8 billion-worth in 2018. It has since fallen to third behind Germany and the US, largely due to tariffs imposed on imports to America. What is clear is that despite historic successes, towns that specialize too narrowly can quickly lose out to market changes.

E-commerce game changer

The explosive growth of e-commerce after 2010 has changed specialty towns. Small, medium and even micro enterprises can now compete on the same level as established brands, reaching far-flung buyers with the click of a mouse.

China has more than 904 million internet users and is the largest e-commerce market in the world, with consumer spending online estimated at $1.94 trillion in 2019, more than three times that of the US. Last year, e-commerce within China represented 36% of total retail sales, a figure expected to jump to 64% by 2023.

Hayes says that she has seen huge changes in specialty towns since domestic and foreign e-commerce platforms came into play. "They now have a lot more direct access to customers, so they're getting a pulse on what people want and marketing and diversifying accordingly. They're not just factories anymore. They're brands."

This is great news for agile and tech-savvy companies, but potentially disastrous for those who fail to innovate. Amanda International Group has been exporting goods from specialty towns for more than 10 years, but these days they are losing out to e-commerce. "Many of the factories have started their own online businesses and are selling directly to customers around the world. Our business has got less and less," admits a representative of the group.

The way forward

Many specialty towns are seeing leaner sales, not only due to a slump in orders caused by corona, but also because of growing pressure from competitors in other Asian countries. Cambodia and Vietnam, for example, both have rock-bottom labor costs compared to China's rising wages.

Foreign manufactures are increasingly moving their production out of China (see *Uprooting Factories* on page 15), and while the Chinese tend to patriotically buy big ticket purchase from local manufacturers, even some established domestic companies are following suit in order to quell China's thirst for cheap consumer goods. Add a faltering domestic economy, the trade war with the US, the growing impact of automated production and the global diversification of supply chains, and one big question begs to be asked: Will specialty towns survive?

The advantages and disadvantages of specialty towns are easy to deduce. The advantage: clusters of similar manufacturers form near-vertical supply chains and economies of scale, helping centralize expertise, cut costs, increase productivity and ultimately win a bigger market share. The disadvantage: total reliance on one product leaves towns extremely vulnerable to drops in demand, increasing labor costs and tech advancements, such as automation.

The consequences are varied. Some factories will close, switch industries or relocate to other countries, while others will innovate, consolidate and automate. But as globalization slows, specialty towns may find themselves focusing more on the domestic market and Asian neighbors.

"Production that is more labor intensive will move away," predicts Kaye. "There will be less manufacturing for the global brands but more focus on building brands locally."

While Yiwu and its sparkly market may suffer, those that forge their own paths and cement themselves as world industry leaders—such as the southern tech city of Shenzhen—are better placed to weather the storm.

"The more innovative places linked to developed countries will find their way, whereas places like Yiwu that are still just copying cheap products may not," says Faubert. "They'll need to reposition themselves higher up the food chain if they want to survive."

TRIP DELAYED

Chinese people have become a major force in global tourism, but will the pandemic and friction with the US end the holiday?

By Crystal Reid

Image by Gabriel Heredia

The world's tourism industry has become addicted to big-spending Chinese travellers, but events seem to be conspiring to disrupt the trend, at least temporarily

Mandarin is the dominant language as the crowd murmurs and shuffles past the fair maiden, smartphones held aloft for a snapshot. But this is not a red-carpet event for China's latest starlet, it is Paris' Louvre Museum, specifically the Mona Lisa exhibit. At least that was a typical scene in the summer of 2019, and at top tourist attractions around the world. But when the museum reopened in July 2020 after France's COVID-19 outbreak had peaked, there were three notable differences: mandatory face masks, designated visiting time slots to reduce crowding and a distinct lack of Chinese tourists.

As the pandemic took hold in the first half of 2020, people around the world were confined to their homes and the global travel industry ground to a halt. But while domestic tourism is recovering strongly as China emerges earlier than others from the virus, the lack of Chinese tourists visiting the rest of the world has had a huge impact on the countries and sectors that have come to rely upon them. Chinese people, like people all over the world, are spending less, waiting for an end of the virus or the arrival of a vaccine. But they are also wary of what they see as undisciplined health policies in many countries and discouraged by the fear of possible discrimination.

The rise of Chinese tourism

Chinese people are relatively new to the wonders of foreign travel. As the country's middle class has grown in terms of affluence and size in the past two decades, so too has their taste for exotic experiences. From Bangkok to Belgium, Sydney to Stockholm, flocks of Chinese tourists have become an ever-present aspect. Chinese residents took 116 million overseas trips in 2019, marking an annual increase of 11%, and they stand miles clear at the top of the leader board for worldwide spending—$277 billion compared to second-place US at $144 billion.

Up until the start of 2020, China's thirst for outbound travel seemed impossible to quench. Records were broken at Chinese New Year in 2019 as outbound tourism numbers reached 6.3 million, up by more than 12% on the year before. According to the National Migration Administration, international trips were expected to reach 178.4 million a year by 2022, amounting to a total expenditure of RMB 1.2 trillion ($171 million).

Such a huge movement of people with money in their pockets—Chinese travelers typically spend twice as much abroad as they do when they vacation at home—has an obviously positive effect on the economies of the countries they favor. Chinese tourists have become the main revenue source for hotels, restaurants, and attractions all over the world, which bend to their wants and whims.

Cihan Cobanoglu, Professor of Hospitality Technology at the University of South Florida, says tourism-related industries have been drastically reconfigured over the past decade to accommodate Chinese visitors. Hotels have added dumplings and noodles to their breakfast buffets, attractions are allowing for payment via Chinese digital money QR codes and Chinese-speaking personnel are in high demand.

"The tour operators who serve the market always employ Chinese speaking

> Chinese tourism is vital to our industry
>
> Ariela Kiradjian
> Co-founder
> Boutique Lifestyle Leaders Association

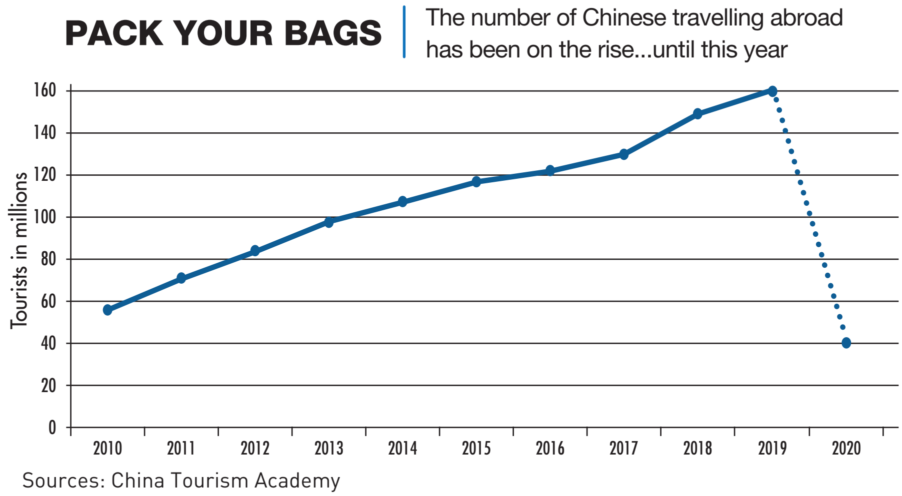
tour guides," says Cobanoglu. "In addition, shops and other businesses, especially high-end product stores, employ Chinese speaking staff."

But according to a March report by the University of Thessaly in Greece, the pandemic could lead to 25 million fewer outbound trips by Chinese travelers in 2020, wiping out $73 billion in global tourist spending.

Feeling the loss

Thailand is the foreign country most favored by the Chinese, with the Southeast Asian nation welcoming 11 million last year, an increase of 4.4% on 2018 and amounting to more than 27% of all overseas tourism arrivals. The Tourism Authority of Thailand has predicted that the number of Chinese tourists will drop by 2 million this year, however, resulting in a 50 billion-baht ($1.6 billion) loss, around 0.3% of gross domestic product (GDP).

"Thailand has developed a considerable reliance on inbound tourism from China," says Stuart McDonald, co-founder of Thailand-founded website Travelfish. "When Thailand turned off traffic from China [in March] it effectively wrote off almost a third of their inbound numbers," he added. "This was catastrophic."



Australia's Gold Coast is another hard hit destination, with visitor numbers down by 90%, largely due to a reliance on tourists from China. Hotels have slashed rates by as much as half in a bid to attract domestic tourists, but those in more remote areas have been less able to pivot to the home crowd. Cairns on the far north-eastern Australian coast, for example, lost $200 million in bookings by February as the Chinese government urged citizens not to travel.

Ariela Kiradjian, co-founder, partner and COO the Boutique Lifestyle Leaders Association, an official organization for the world's leading boutique hotel and travel brands, says Chinese tourists are now "undoubtably a force" in her sector.

"Chinese tourism is vital to our industry and a drop would affect properties over the next few years," she says, adding that her partners are striving to lure back Chinese travelers for future bookings. "We're seeing boutique hotels adapt their strategies to accommodate and grow with this sector. For example, how accessible is your website? How active is your social media?"

A Chinese tour group taking pictures at the Manneken Pis statue in Brussels, Belgium

> **Thailand, over the last 10 years, has developed a considerable reliance on inbound tourism from China**
>
> Stuart McDonald
> Co-founder
> Travelfish

Global travel company Booking.com confirmed to *CKGSB Knowledge* that many of their partners have been impacted. "China continues to be one of our most important markets and the lack of Chinese international travel did have an impact," said a representative.

Better safe than sorry

People around the world are wary about travel. Indeed, according to a study by South Florida University, 63% of people across 28 countries say they will reduce their travel plans over the next 12 months, resulting in a predicted 50% contraction for the global travel industry. But with their country currently locked down against almost all foreign tourists, a mandatory 14-day quarantine on their return if they do vacation abroad and the possibility of encountering COVID-19 related xenophobia overseas, the Chinese have more reason to stay put than most.

Yang Huaping, a mother-of-two from Sichuan province, says she now only feels safe traveling to destinations within driving distance of her home. "I don't want to go to airports or train stations as I have children," says the 29-year-old. "China has more or less got the virus under control, but things can change quickly and I don't want to risk it."

Wendy Min, Director of International Affairs at Trip.com Group, the largest online travel agency in China, says that while many customers are eager to travel abroad again, few are willing to deal with the hassle. "They prefer to remain within China," says Min. "Some have thought about making trips within Asia but only if they can cross with ease and don't have to go through quarantine."

Lydia Zhang, a 35-year-old freelance teacher from Hubei, traveled abroad regularly before the pandemic and is keen to get back out into the world. While she says some of her friends living abroad have reported discrimination, as China experiences its most severe economic downturn since the 1970s, money issues are what's stopping her. "At the moment I am busy working," she says. "My work really dried up at the start of the outbreak, so I am making the most of being busy now. Busy is good. I'm lucky."

Bouncing back

If you think the Chinese travel a lot abroad, international travel figures are dwarfed by travel numbers at home. The national holidays usually bring about the biggest annual human migrations in the world, with train and plane tickets selling out months in advance. In 2019 alone, Chinese citizens took more than 6 trillion domestic trips, an increase of 9.5% from 2018. The domestic tourism industry accounts for 11% of the country's GDP and employs more than 100 million people. In February, however, the China Tourism Academy predicted that domestic visits would decline by 15.5% and revenue by 20.6% in 2020.

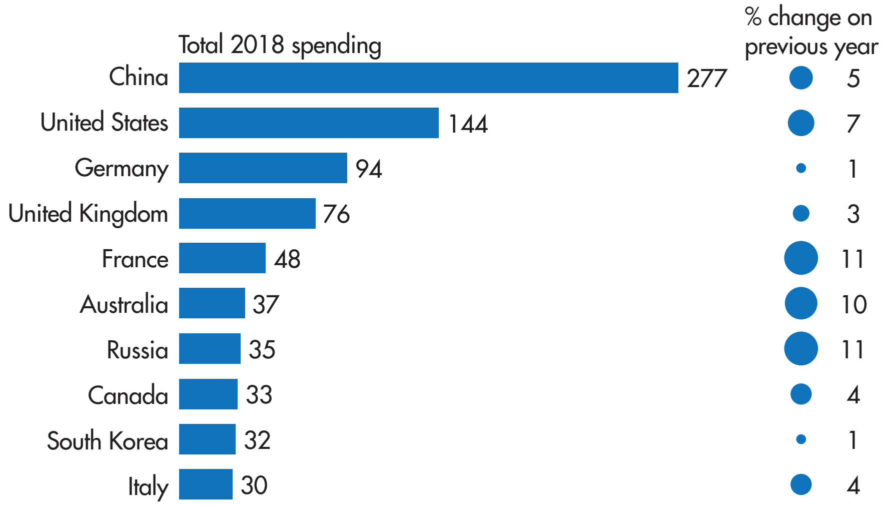
Focusing on domestic air travel, the industry all but ground to a halt by mid-February as people across the country were told to stay home. Ticket sales slowly picked up in March and April as seat capacity was increased and the economy began to reopen, but it wasn't until the Labor Day holiday in May that a significant bump was seen with rates hitting 50% of the same time last year. Encouragingly, the domestic travel industry has recovered even more rapidly away from air travel. Car rental, for example, rebounded to the same level as last year in May and some hotels were already seeing occupancy rates above 70%.

"Toward the end of April we saw early indications that domestic travel was starting

Taking photos in front of the Hermitage museum in St. Petersburg, Russia, a top destination for Chinese tourists

SPENDING POWER | Chinese tourists spend the most abroad

Top countries by international tourism expenditure in 2018 (billion $)



Sources: World Tourism Organization

to return in certain markets where shelter-in-place rules were relaxed, including Greater China," says the Booking.com representative.

As to inbound tourism into mainland China, it has also been growing in recent years, with the first three quarters of last year seeing 108 million visitors, up 4.7% on the same period in 2018. But foreign arrivals halted almost completely when the government closed its borders towards the end of March. Foreign tourists represent only 2.5% of the country's total tourism-generated revenue, so it was a hit the government was seemingly willing to take.

Green shoots at home

Companies across the spectrum of the Chinese travel industry have been dealing with the virus fallout in different ways. Niccolo Hotel in Chengdu was expecting 100% occupancy at Chinese New Year, only to see business become "basically non-existent." The hotel, however, managed to keep all staff employed and busy with training, deep cleaning and preventative maintenance, and even resisted engaging in a price war with other five-star hotels, offering guests value-added extras instead. The group has employed several new safety protocols, such as the regular changing of air con filters and extra cleaning of rooms, all of which are advertised front-and-center on its website. Thanks to a guest profile that was already 90% domestic, occupancy increased to 60% by April and hit 100% in July as locals enjoyed "staycations" and visitors from neighboring cities and provinces resumed short-haul trips.

"I feel local travelers are confident to start China-wide travel again," says General Manager Michael Ganster. "At the moment, in Chengdu it feels like nothing happened."

By the summer, top resorts and hotels were reporting nearly capacity business, largely because Chinese people decided to stay at home this year.

Things have not been so plain sailing for the Bespoke Travel Company, which typically targets inbound foreign tourists. Founder Sarah Keenlyside scrambled to cut costs immediately, downsizing the company's shared office space, laying off some staff and putting those remaining on minimum wage. The team has, however, since repositioned itself toward a new segment of business—expats currently stuck in China and unable to travel abroad. They are offering city-based scavenger hunts, an online speaker series and off-the-beaten-track domestic itineraries.

"We just don't want the company to close so we're using our creativeness to our advantage," says Keenlyside. "But it takes an awful lot of effort for very little return."

Meanwhile, Trip.com Group is betting big that its more than 400 million worldwide users will return to international travel soon. After providing refunds to 10 million customers at the peak of the outbreak, they are now offering flexible reservations with discounts of up to 60% in more than 180 countries. Focusing first on the Asia-Pacific region where domestic travel is showing signs of recovery, they have also launched in-destination livestreams with further exclusive discounts, achieving $70 million in sales by July.

Looking to the future

According to research by Cobanoglu and his team, travelers' priorities have changed. Where online reviews, security and price were previously the most important factors in travel decisions, a destination's COVID-19 situation, cleanliness and health service now come out top. This could be good news for the domestic rebound, as while the research found the country's image had deteriorated severely in the eyes of international travelers at the start of the outbreak, it's likely to bounce back quickly thanks to its strict virus prevention measures.

In terms of Chinese people traveling abroad, Booking.com predicts that global tourism may take years, and not quarters, to rebound to previous levels, but that ultimately Chinese people will want to return to international travel.

"Even though COVID-19 has restricted our ability to travel around the globe, as we move beyond this pandemic we know that people will again want to experience the world, perhaps in a more meaningful and sustainable way than ever before," says the company representative.

"For the next several years, I believe that domestic tourism will be the main driver for tourism activities until travelers gain back their travel confidence," says Cobanoglu. "Chinese tourists are no exception, but I do believe that as soon as the current situation relaxes and traveling goes back to somewhat normal, they will start going abroad again."

THE TESLA MODEL

Tesla is known for going against the grain, but will this tactic prove successful in China?

By Mark Andrews

Elon Musk's Tesla is bucking many trends in its new venture in the massive China market

At an event held at Tesla's brand-new Shanghai factory on January 7, CEO Elon Musk was recorded busting out some awkward dance moves onstage to celebrate the deliveries of the first China-made Model 3 cars. The video instantly went viral, and if the sales reception of Tesla cars in 2020 is anything to go by, he may well have the entire country dancing to the same tune for quite a while.

Musk, synonymous with Tesla, is a household name all over the world. If one thing is common throughout his ventures as a serial-entrepreneur and investor, it is that he has dared to dream what others describe as "impossible." Tesla's factory is exactly that. Not only is Tesla the first foreign corporation to build cars in a wholly-owned factory in China, but also the setup—from permits to a finished plant—took just 168 days to complete.

Tesla committed to a minimum investment of RMB 14 billion ($2 billion), and the company's plant, called the Gigafactory 3, opened its doors in Shanghai in October 2019. At a time when the overall business trend between China and the United States has been one of decoupling and many foreign companies are looking at pulling out or diversifying, Tesla has gone against the grain and dived even deeper into China.

Amping up

Founded in 2003, Tesla didn't sell its first car, the Roadster, until 2008. But since then, the company has grown at an exponential rate and produced its millionth vehicle in early 2020. It now offers a wider range of vehicles, namely the Tesla Models S, 3 and Y, as well as X, which is a mid-size crossover sport utility vehicle (SUV). Tesla has three manufacturing plants around the world, the first two in the United States and the third in Shanghai, with a fourth set to be built in Berlin in 2021.

Recently, Tesla has faced competition as the world's best-selling electric vehicle (EV) brand from Chinese companies, namely Warren Buffet-backed BYD and state-owned BAIC, but managed to best them handily in both 2018 and 2019. Globally, Tesla won top spot with sales of 367,820 cars in 2019, followed by BYD's 229,506, and BAIC coming in third, selling 160,251 EVs.

Tesla's top competitors in terms of volume of sales in the local market are BYD, BAIC, Geely, Guangzhou Automobile Group, commonly known as GAC, and state-owned SAIC Motor (which partners with Volkswagen and General Motors Corp). There is also NIO which went public in September 2018 and produces an SUV similar to Tesla's Model X. The first half of 2020 saw Tesla win 23% of the EV market share, selling 47,565 Model 3s. The second and third most popular EV cars were BYD's Qin Pro EV selling 20,990 and GAC's Aio S at 18,211.

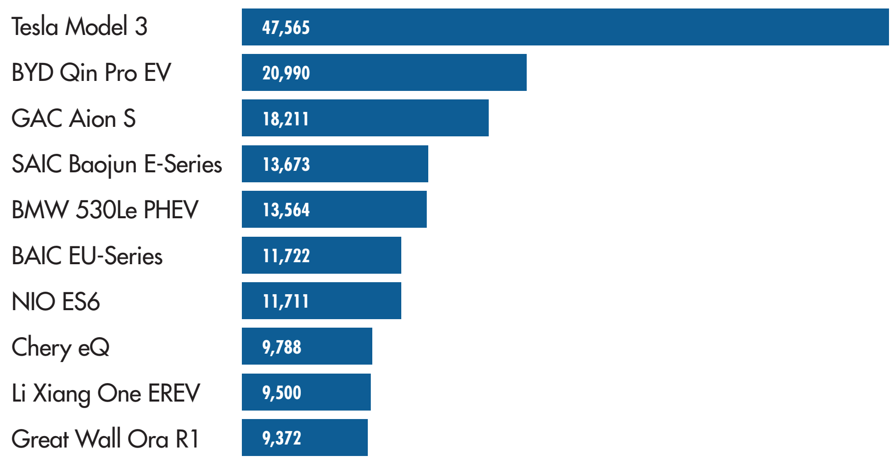
"Tesla became the number one player during its first year of localization," says auto analyst, David Zhang.

Largely thanks to a push by Beijing in support of EVs, China is now the world's largest market by volume for green cars—known locally as New Energy Vehicles (NEV)—making it an obvious choice for Tesla when it came to establishing a manufacturing presence in Asia. This massive NEV market grew 85% year-on-year, significantly above the industry average, according to a 2019 report by American consulting firm McKinsey & Company. In the second quarter of 2020, Tesla delivered around 30,000 vehicles in China, meaning that the country represented

> **Tesla became the number one player during its first year of localization**

CHINA'S TOP 10

Tesla's Model 3 led in EV sales by a wide market in January-June 2020



Source: EV Volumes Created with Datawrapper

around one-third of Tesla's entire export deliveries.

"China is the largest EV market in the world, accounting for 1.1 million EV sales, out of 2.2 million sold globally in 2019," says Aman Madhok, senior analyst Smart Automotive at Counterpoint Research, a global industry analysis firm based in Asia.

Although Tesla had wanted a factory in China since 2015, it didn't happen immediately, due to Musk's unwillingness to operate under a joint venture arrangement. Foreign automakers since the 1980s have typically been required to form a 50:50 joint venture with a local partner. The year 2018 saw the relaxation of joint venture rules, starting with companies producing NEVs.

Having its own factory gives Tesla a major advantage over other automotive multinational corporations in the country.

"Not having a local partner makes the business simpler and less bureaucratic," says China-based Bill Russo, CEO of strategy and investment advisory firm Automobility. "Strategic misalignment is the overhead and risk of a partnership model, especially if it means partnering with a government agency. They also don't have to split profits."

Tesla effect

Tesla has generally prioritized marketing the technological innovations that are present in their cars as opposed to design. This has led to a near cult-like following that is more comparable to the supporters of Silicon Valley tech companies—something that has carried over into the Chinese market.

"Tesla's speed in innovation in the market for high-end vehicles is more like a Google or an Amazon than an automaker," says Cherrie Rao who bought an imported Model 3 earlier this year. Tesla is in many ways a tech company rather than an automaker. The Model S, which was Tesla's first volume model, is now eight years old and still in production. On the outside it looks largely the same but the technology on the inside has improved considerably.

Madhok cites technology in the key areas of Autopilot (Tesla's self-driving system), over the air updates (OTA), batteries, and infotainment and connected services as part of the appeal to buyers in China.

"Tesla cars are perceived to be of better quality, better designed, offer a high range, durability and relatively long-lasting when compared to other EV brands," he says. Consumers seem to agree. Bai Zhaoyang, Deputy Editor-in-chief of Autoreport, Bitauto, purchased a Chinese made Model 3 in February. He mentions design and technology as key purchasing influencers "It's really beautiful and easy to use."

The majority of cars in China are sold in dealerships known as 4S stores. But Tesla is taking a different and more direct approach, opening a few small boutique-like stores which it directly owns and sells cars for fixed prices.

"Normally, buying a car can be a grueling process and most dealerships do not make it easy for consumers," says Rao. "It's kind of like the retail equivalent of spending the day at the ER (emergency room). But it doesn't have to be so painful. Tesla has changed the game."

There are a number of Chinese NEV startups looking to challenge Tesla, including Leading Ideal, NIO, Weltmeister and Xpeng, but they are struggling to gain traction in sales—NIO currently leads the pack with 3,740 deliveries in June 2020.

Many analysts are not hopeful about their prospects. "The challenges are greater than opportunities for startups," says Zhang. "These startups are already struggling to make sales and profits, and Tesla is expected to give them competition with its global experience and expertise in EVs, batteries and technology," adds Madhok.

Going green

Despite Tesla vying with BAIC and BYD for the best-selling EV brand accolade, these along with the new NEV offerings from GAC, Geely and SAIC are not necessarily Tesla's main competitors. Madhok says Tesla is more likely to be competing with both premium conventional cars and imported upmarket EVs. "Most local brands have more of a 'fleet' image as most EV sales have been into the ride hailing taxi segment," says Russo.

Consumer sentiment is at the core of the Tesla sales surge. "I didn't consider any petrol-fueled cars, I believe EV is the future," says Bai. "I compared the NIO ES6 and Tesla Model 3 a lot."

And there is still huge potential for growth as Madhok points out government targets call for NEVs to make up 25% of sales by 2025, which is likely to amount to 5 million plus vehicles. Currently NEVs make up 4.7% of sales.

"The market structure of the NEV market is going to change—the regulation mandates all manufactures to produce a certain ratio of NEVs," says Sa Boni, Director China Automotive at information provider IHS Markit. "General Motors, Toyota, Volkswagen—all these current market leaders in China will need to produce NEVs. So not only will Tesla challenge the market share of domestic brands in the NEV market but all the global automotive brands."

Supercharged

In most of the world, Tesla's success has come from a growing consumer interest in sustainability backed up by government subsidies. In China, however, the whole NEV market is very much driven by government policy.

From 2010 there have been both local and national subsidies for purchasers of NEVs, and from 2016 green license plates were introduced. In Shanghai, where a license plate typically costs around RMB 90,000 these are given away for free and in Beijing the lottery system for drivers favors green-plate holders.

"With the government's support and financial incentives, China has become the biggest market for battery electric vehicle globally," says Sa. "The growth potential is much bigger than any other country including in Europe and the US. It's critical for the future of Tesla."

This demand made it logical for Tesla to open its first overseas factory in China. But it ironically comes at a time that other US companies are struggling in the market. Fiat Chrysler Automobiles now has a negligible presence and Ford in 2019 sold 232,555 cars down from a peak of 951,396 in 2016. Going against the grain of the general decoupling of American businesses, Musk's key weapons are technology and data.

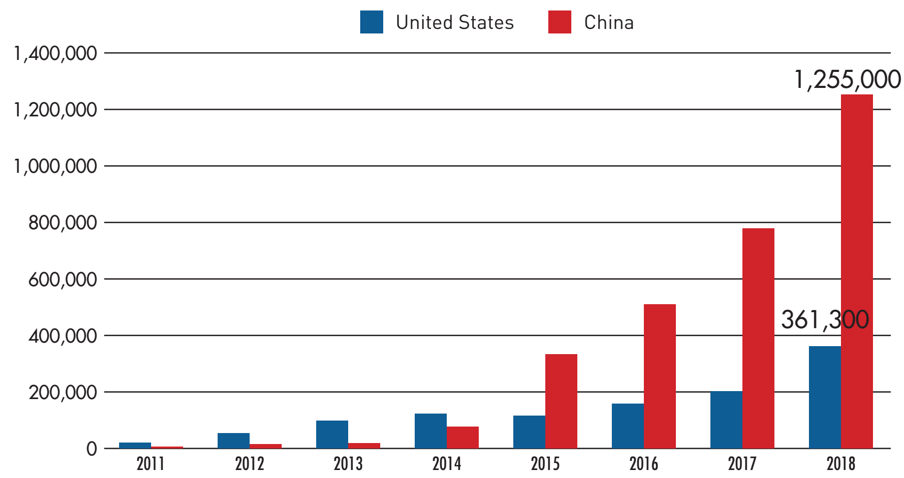
"The company has the advantage of collecting feedback and data from these cars and this improves its software like Autopilot and Smart Summon," says Madhok. This year will likely see around 120,000 new Model 3s in China, adding to this pool.

However, Tesla runs the risk of encountering cases of IP infringements. Already it has alleged that two former employees, who now work for Xpeng, stole Autopilot source code which they supplied for Xpeng's Xpilot system. Ultimately though, it is about innovation. "The best way is to keep developing new technologies to remain competitive," says Zhang. "Old IP can't be kept secret for a long time."

In China, Tesla is cooperating with the local battery supplier CATL to provide some of the company's battery needs. "Low-cost zero cobalt batteries will be manufactured by CATL based on prismatic lithium iron phosphate (LFP) and will be installed in Model 3s sold in China," says Madhok. "The battery is expected to last for a million miles and to positively impact the sales and profitability of Tesla." Similarly, increasing local content and suppliers should help Tesla to be competitive against other NEV producers.

Part of Tesla competitiveness, though, will depend on government policies. Already Tesla has had to reduce the starting price of the Model 3 twice due to changes in the subsidy policy—the most recent of which stopped subsidies for NEVs priced above RMB 300,000.

RACING AHEAD | Plug-in electric vehicle sales in China are becoming increasingly popular



Source: InsideEVs, CAAM

Stable current

With the COVID-19 crisis biting into sales in most of Tesla's markets in the first half of 2020, China is likely to be its saving grace. Tesla's California plant had to shut production in March, at a time when its Shanghai factory was churning out 3,000 electric cars per week. It was also the first company to benefit from relaxation of the joint venture rules for the automotive industry.

BMW has since upped its stake to 75% in the BMW Brilliance JV and will start production of the electric iX3 model in China for export to world markets. In May 2020, Volkswagen announced that not only was it taking 75% control of its JV with JAC but also buying half of parent group Anhui Jianghuai Automobile Group Holdings.

Madhok, however, believes that local companies will still dominate the NEV market in the long run as they are generally cheaper—an important factor in a country where consumers are known to be frugal. "The vast majority of cars sold in the country cost less than $45,000, a price segment in which Tesla does not compete."

Despite that, Tesla and China are currently enjoying a dynamic waltz. "Having the world's leading EV company present accelerates the country's path to electrification," says Russo. "It accelerates a shift it has planned for several five-year planning cycles." It seems that Musk has found himself in a sweet win-win situation.

The Power of Individuals

Jeremy Heimans, Co-founder & Chief Executive Officer of public benefit corporation of Purpose, looks at the influence that individuals have on society

Jeremy Heimans is the co-founder and CEO of Purpose, a public benefit corporation headquartered in New York with offices around the world. He is also the co-founder of GetUp!, an Australian political organization with more members than all of Australia's political parties combined, and Avaaz, the world's largest online citizens' movement, now with more than 50 million members worldwide.

With Henry Timms, Heimans is also co-author of the bestselling book *New Power*, which has just been released in the Chinese mainland. It is a guide to spreading ideas, building movements and leaping ahead in our chaotic, connected age. The book was short-listed for the 2018 FT & McKinsey Business Book of the Year and named a best book of the year by Bloomberg, Fortune and CNBC.

Heimans has served as chair of the World Economic Forum's Global Agenda Council on Civic Participation and has been a keynote speaker at venues such as the World Economic Forum at Davos, the Aspen Institute Ideas Festival, Chatham House and the United Nations.

In this interview, Heimans explores the power that individuals have in making a difference on major issues and the influence technology and COVID-19 have had on governance.

Q. Could you explain what a public benefit corporation is and how such an organization would have any benefit and relation to China?

A. A public benefit corporation (PBC) in the US context is a legal construct for a company that must serve a constituency beyond its shareholders and that has the mission to serve the interests of society and push for social progress. A PBC is obliged not just to return value to shareholders, but also to return value to society. It is a relatively new legal construct but it's really a way of capturing the idea of a mission-driven business. In theory, it was designed to protect companies from being sued by shareholders for making decisions that might not maximize shareholder value, but that might be in the interests of carrying out the company's social mission.

In the Chinese context, there are some companies that have become B corporations—corporations that meet the highest global standards of social and environmental impact, and can lead other companies in the industry to use business as a force for good. B corps, however, are more of a voluntary certification, while PBCs are a legal construct. These companies are relevant all over the world to the extent where their mission can be executed with a degree of freedom and discretion.

Q. How much influence do individuals have in making a difference on the major issues that face humankind, and what is the best way for individuals to promote and advance their perspective?

A. People have a huge influence in making a difference in social issues. We see that through things like the Black Lives Matter movement. For years there have been movements around racial justice in the United States and around the world, but the capacity now for people to turn those moments into incredibly powerful expressions of collective action and to create change has increased. It isn't a dynamic where people are dependent on the mainstream media gatekeepers to amplify their voices anymore. Messages are now coming from ordinary people, which is a new dynamic to this complex question.

We're also seeing a rise of authoritarianism, particularly populist authoritarianism, which is an interesting blend being added to the older power dynamics. There's no doubt that there's more participation happening, and that participation means everyday people are shaping society in dramatically new ways.

Q. How would you compare the reaction to COVID-19 and its impact on the economies of the West and China?

A. We still haven't seen the end of the crisis, so we could say that China has proven to be relatively resilient right now and was able to get on top of the virus early, but in three months there might be a second wave. The virus knows no borders and it's not interested in geopolitics. It's hard to assess the economic impact of the crisis while it's still ongoing. In the US, we went from thinking that we were getting the virus under control over the summer and anticipating a possible second wave in the fall, and instead we have a virus that is running rapidly out of control in many parts of the country.

What we've learned is that the countries and jurisdictions that take their public health responses seriously are also the ones that tend to do best economically. It serves no one to not get cases under control and it ends up creating uncertainty and fear. Some countries have opened and then have had to lock down again. Those I believe are the countries that are going to lose out. We saw China act very aggressively early in the crisis by addressing public health dimensions, but how it would respond in the context of a second wave remains an open question.

Q. Government involvement in the Chinese economy is greater than that in the West, with the COVID-19 pandemic appearing to have indicated the need for more government coordination. What do you feel is the right balance globally in terms of government involvement?

A. This crisis has certainly caused a renewed view on the role of governments all over the world, not just at the economic level but also in the role of public health experts and authority. People have returned to the idea of old power gatekeepers and sources of expertise. There's also been a recognition that there's no way to respond to a crisis this big and this global, without a robust government response. I do believe that this has shifted attitudes toward government involvement in the economy all over the world. In the US, for example, we're already seeing a public recognition of how we really need a good government in place and when a government fails, we all fail.

The European response, however, has in many ways been quite adept, particularly in the way that relief packages have been handled. The European response of essentially keeping people employed and paying most of their salary so that they didn't have the dislocation in the labor market was much more effective in maintaining stability and continuity than the US response of writing individuals and companies checks.

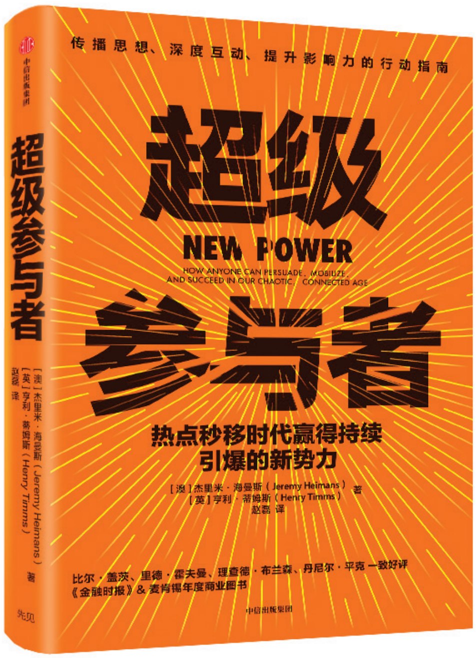
If I were to make a prediction, I would say that there will be a greater understanding of the failures of the neoliberal economic paradigm coming out of this crisis. I think there will potentially be a renewed interest in localism because ultimately this crisis has brought people's immediate communities into context. There will likely be a renewed appreciation for the role of working-class people in the economy, given that the front-line workers suddenly became the people who were keeping us alive. This understanding of the role of working people is an interesting moment for the debate about the future of the economy. More people have also come to appreciate the role of small, privately-owned businesses and just how vulnerable they are. All these things connect to the role of governments, but they also go beyond the role of governments. We're not going to return to a 1950s style kind of welfare state-ism, but the European social democratic model that has emerged out of this crisis looks surprisingly good compared to the current American model.

Q. Did the virus and its impact change your views on the impact of government involvement and personal freedoms in terms of how society operates? Are there any benefits to de-emphasizing civil society in favour of overall greater government involvement?

A. I'm not sure that civil society and government involvement trade off against each other necessarily. In fact, I would say that in crises like these, you need both sectors to be working closely together. We can all achieve more by getting the voluntary sector and the government sector to provide key social services together. We should, however, regard with some suspicion efforts to use a crisis like this to entrench policies of surveillance or limiting of individual freedoms in the name of the public health response. It may be that people are happy to submit voluntarily to greater surveillance such as contact tracing apps because of this crisis, and that makes a lot of sense. What we should be careful about is extending those policies of surveillance or limitations on freedom beyond the response to the crisis because governments find that they have the opportunity to do so. We need to be careful about the distinction. You could easily justify limitations on liberties because of a public health response. Mandating people to wear masks and mandating contact tracing is easy to justify, but not if it's being used as a kind of ruse to create a surveillance state.

Q. Some Chinese brands including Xiaomi have done very well by offering cheap, good quality tech, which now plays a huge role in the rest of the world. What does this say about the significance of China's role as "Factory to the World"?

A. It's clear from the current crisis that there's a real dependence on China for PPE and of key equipment, which is a significant development. What does that mean? I think you're going to see some countries try to develop their own national manufacturing capabilities, particularly around pandemic preparation in order to insulate themselves from the political pressure that might result from being dependent on any one country's supply chain and



Heimans' book, *New Power*, recently published in Mainland China

manufacturing. What it shows is that manufacturing capacity is essentially power. It's a power that can be wielded by those who have it. For countries that are trying to be responsible, they're probably going to want to think about distinguishing between goods and services that are non-essential.

Xiaomi producing masses of high quality, low cost tech is okay because there're many other ways to get that tech that don't involve a dependence on one country's manufacturing. It's different when it comes to essential products. Governments are now wanting to make sure that there's a truly global supply chain and that comparative advantages are being respected.

Q. How is tech changing the fundamental principles of governance around the world?

A. It's clear that some tech platforms have become so powerful that they're now beginning to impact on the way that governments and democracies work. Facebook is arguably now as powerful as many countries are in terms of its capacity to influence discourse, and that's certainly true as well for some of the big tech platforms in China. Technology can be an arm of the state and can be used to manipulate the public. It can be used to stoke hatred of minority groups and to increase a government's capacity for surveillance. The way Facebook was used to enable hatred toward the Rohingya in Myanmar is an example of this, and it's something that Facebook very much let happen in many ways. However, technology can also be used to create very positive social movements like Black Lives Matter.

There are extremely close links between governments and these allegedly private platforms in the West, just as in China. You could argue that there's a similar dynamic in the US—it just looks a little bit different. Ultimately it's a dangerous dynamic, whether it's in China or in the US.

Q. While you stress the role of individuals, leadership clearly plays a role in the way societies operate. China promotes its system as being meritocratic and avoiding the messy appearance of Western systems. What would be your view?

A. Meritocracy is a word that's used by a lot of people to justify a lot of things, and meritocracy is very much in the eye of the beholder. It's certainly not clear to me that the Chinese system is inherently more meritocratic than other systems around the world. When it comes to messiness, certainly there is messiness in the law, and there is no doubt that democratic governance in Europe and the US is messy, and you could argue it's getting even messier. That messiness also produces better social outcomes in some ways than a system that's slightly neater, but that also has huge negative implications for individuals' well-being in certain contexts.

Q. Globalization has been the overarching trend over the last four decades but now appears to be under question, with talk of a decoupling. What would be your view on what both China and the US should do and what the goal should be?

A. Philosophically, I would start with the position that we need a fair and open international trading order. One that creates justice and fairness for workers, one that respects the environment and takes the environment seriously as a criterion, but that also creates economic opportunity and helps reduce poverty, which is much harder to do without a fair and open trade order. That's kind of where I would come from philosophically. I expect that if we get a change of administration, we'll get a less erratic approach to those negotiations, which will lead to some progress.

I don't see protectionism or the putting up of trade barriers as the best way to solve some of the problems created by the current global trading waters. We need to fix those problems without destroying the benefits that come from freer trade. And I think that applies to the China-US relationship as well.

Q. There are those who say that regardless of culture, society and political system, there is a convergence of mentality and outlook across the world. Do you see anything like that happening and what would be your view on it?

A. The idea that there has been a globalization of culture is both true and not true. It's certainly the sort of trend toward global integration of everything that we kind of expected in the early days of globalization. We didn't expect to see this rise in nationalism, this rise in tribalism that we see all over the world, from Brazil to India to parts of Europe and arguably to China. At the same time, among young people particulalry, there is a common cultural language in many parts of the world. There is an ability now to transmit ideas, Black Lives Matter being a great example. It's a truly global and transnational movement. I think there's going to be competing trends in both directions.

CKGSB MBA RESEARCH

The Road to Poverty Alleviation

An MBA field study by Min Yan, a case researcher at CKGSB, under the guidance of Professor Xinyu Fan, digs into the details of bringing prosperity to every corner of China

One of the great successes of China in recent decades has been the sharp rise in prosperity across previously poor regions of the country, using a variety policies and initiatives to bring people into the mainstream of economic life, to provide income where there was none and to create economic opportunities that would provide self-sustaining support.

The poverty problem has been addressed in fundamentally three ways - support from and actions by government, social organizations and private enterprises. A prime example of the creative coordination that has allowed China to announce this year "the end of poverty" is Xinxian, a rural county in central China, about 440 kilometers southeast of Zhengzhou City, the capital of Henan Province.

In 1983, 82% of Xinxian's residents lived below the poverty threshold, but on August 8, 2018, the Henan provincial government announced that Xinxian had officially been dropped from its list of impoverished counties. They did it with a mix of initiatives and cooperation and using tourism, farming, education and manufacturing as the drivers.

In this study, we looked at three key aspects that helped to reduce poverty, the bodies involved and how the measures were implemented:

- Targeted and improved labor training and sending labor overseas
- Development of rural tourism
- Synergy between local for-profit enterprises and poverty alleviation policies

Labor training and export

Xinxian is a remote location, but the number of passport holders has reached 124,000 (33.7% of the county's total population), far higher than the national average. The reason is some 8,000 Xinxian residents now work overseas, which amounts to 10% of the county's working-age population. Xinxian now ranks first among counties and county-level cities across the nation ion passport ownership, and the foreign exchange income earned by overseas workers in 2017 amounted to more than RMB 1 billion ($150 million). In the same period, the fiscal revenue of the local Xinxian government was only RMB 501 million.

The export of labor and cultivation of talent have been crucial supports for poverty alleviation in Xinxian. Since 1984, Xinxian has shipped contract workers to many Chinese construction companies around China, and since 1991, around the world. In 2011, the Xinyang International Vocational Institute was founded, and the poverty alleviation model of "foreign vocational education + foreign high-paying employment + returning to China for entrepreneurship" was born. By the end of 2017, Xinxian had sent 38,000 laborers to more than 20 countries and regions, including Japan, Singapore and South Korea. The accumulated foreign exchange resulting has reached RMB 10 billion.

Vocational education

Vocational education in Xinxian is based on the concept of "demand-driven talent cultivation." People are trained as needed, thus greatly improving the quality of overseas workers and achieving growing numbers of new workers each year. The training program is divided into three stages:

The first is vocational skills training for domestic laborers in construction, mechanical and electrical engineering, sewing, auto repair and similar areas. The second, implemented after 2002, involves systematic international labor training that focuses on improving the overall quality of the trainee and cultivating talents that meet the requirements of foreign employers. The training focuses on aspects such as professional technical training, foreign language training, legal and regulatory knowledge.

The third stage was the establishment of Xinyang International Vocational Institute in 2011, which has gradually developed five streams of courses, including entrepreneurship education, quality-oriented education, skill-oriented education and practical education. Each aims to improve the practical ability of students to adapt to society and enterprises more quickly. As of August 2019, Xinyang International Institute had 3,240 full-time students, and more than 3,000 students in short-term training courses.

Returning entrepreneurs

On their return to China, graduates from Xinyang International Institute often end up using the entrepreneurial knowledge learned in the college, the advanced service concepts acquired overseas and accumulated capital to create businesses. Others work for Japanese- or South Korea-funded enterprises in China's coastal cities, or take government office jobs. In addition to entrepreneurial education, Xinyang International Institute helps graduates by coordinating loans from financial institutions and winning policy support from various government departments.

Building tourism

With the development of China's tourism industry and years of effort by the government of Xinxian, tourism has grown into a "foundation industry" for the local economy. In the past three years, the revenue generated by tourism and the number of tourists arriving in Xinxian have both maintained an annual growth of more than 20%. In 2018, Xinxian received 6.363 million tourists and its tourism revenue reached RMB 3.31 billion, a year-on-year growth of 35.7% and 42.5% respectively. The tourism industry contributed 23.5% to the county's gross domestic product.

Xinxian has a permanent population of 280,000, of whom 50,000 work in tourism and related industries, which has helped raise the annual per capita income of poor households to nearly RMB 8,000. Thirty-two key villages in the county have lifted themselves out of poverty, and more than 11,000 individuals below the poverty line have steadily increased their income through the development of tourism.

China categorizes tourist attractions ranging from 1A being the lowest to 5A being the highest. Actively led by the government, four 4A scenic spots and six 3A scenic spots have been created in Xinxian stressing three concepts:

- Red tourism: Xinxian was a local headquarters for the Communist Party in the early 1930s, and is famous as an old revolutionary base area. There are 365 Red tourism destinations in the county, and more than two million tourists visit "red" sites annually.
- Green tourism: With densely forested mountains, Xinxian's has a forest coverage of 76.7%. It is one of the two national ecological counties in Henan Province.
- Rural tourism: There are 26 villages and 23 scenic spots in the county, and each has a team of experts responsible for planning and forming a differentiated landscape to attract tourists.

Pharmaceuticals for the common good

In 1988, with a loan of RMB 258,000, the Xinxian government established the Xinyang Lingyangshan Pharmaceutical Factory to help alleviate poverty, and after restructuring, Lingrui Pharmaceutical was listed on the Shanghai Stock Exchange in October 2000. By 2018, annual revenues of Lingrui Pharmaceutical reached RMB 2.05 billion, making it the leading enterprise of medical plaster in China.

Over the past 30 years, apart from charity work such as donations to education and flood relief, Lingrui Pharmaceutical has created its own initiatives on poverty alleviation through employment and industry. This case focuses on Xinyang Lingrui Ecological Agriculture Co., Ltd., a wholly owned subsidiary of Lingrui Pharmaceutical that established a demonstration base of Chinese medicinal materials in Xinxian. It has guided local farmers to grow traditional Chinese medicinal materials, helping to stabilize supplies of medicinal materials for the company and to assist farmers escape from poverty, while aiding the government to complete poverty alleviation.

Lingrui Pharmaceutical's contribution to local poverty alleviation is multi-dimensional. In areas of conventional poverty relief, financial aid and flood relief, its donations total nearly RMB 50 million. In terms of employment and poverty alleviation, by 2018, there were nearly 2,100 employees in Xinxian with an average monthly salary of about RMB 3,000. In terms of industrial poverty alleviation, Lingrui Pharmaceutical mainly aids farmers through camellia oil production and traditional Chinese medicine products, which also creates value for company development.

Camellia oil industry

Lingrui Pharmaceutical set up Henan Lvdashan Camellia Co., Ltd. and Xinyang Lvdashan Camellia Resources Development Co., Ltd., and developed the camellia industry for poverty alleviation following the model of "company + professional cooperative + base + farmers". It has built a refined camellia oil production process with an annual output of 5,000 tons.

Due to the large-scale production of camellia oil, the purchase price of camellia seed per kilogram has increased from RMB 4 in 2010 to RMB 13.5 in 2017. Farmers in mountainous areas can earn more than RMB 16,000 per year. After deducting RMB 5,000 in input and labor costs, the net annual income can reach more than RMB 10,000.

By the end of 2018, Lingrui Pharmaceutical had transformed large areas of low-yield forest and attracted tens of thousands of farmers to work in the industrial chain. Its "camellia model" of targeted industrial poverty alleviation has achieved a great social response.

Traditional Chinese medicine industry

In 2014, Lingrui Pharmaceutical established Xinyang Lingrui Ecological Agriculture, which has helped farmers escape poverty and accumulate wealth in a variety of ways. Xinyang Lingrui Ecological Agriculture.

- invested RMB 15 million at the beginning of 2014 to establish

PROSPERITY AHEAD | Benefits comparison of Belladonna and other Crops

Item / Crop	Cost per (RMB)									Income per mu (RMB)			Benefits per mu (RMB)
	Fertilizer	Seeding	Soil preparation	Planting	Weeding	Pesticide	Harvesting and processing	Others	Total	Yield per mu (kg)	Unit price (RMB/kg)	Total	
Belladonna	200	300	200	120	120	50	300	80	1370	250-400	12	3000-4800	1630-3430
Rise	80	80	150	180	—	20	100	100	710	450	2.8	1280	570
Peanut	50	170	150	80	150	20	285	—	905	200	6.4	1280	375
Rape flower	120	10	150	—	180	20	240	—	720	150	5.4	810	90

Source: Lingrui Eco-Agriculture Co., Ltd.

a traditional Chinese medicine demonstration base. Through land reform, farmers are able to earn rent, and each family receives an annual income of more than RMB 1,200. By working in the base, more than 30 farmers have increased their annual income by RMB 5,000 or more per capita.

- provides free seeds and seedlings as well as technical services for poor farmers who grow traditional Chinese medicine. It also signs a guaranteed buyback contract with farmers to guide poor farmers to grow traditional Chinese medicine materials, increasing the annual income of each poor family by more than RMB 3,000.
- has signed household income increase contracts with 458 poor families in 12 administrative villages, including Yangfan of Shawo Town in Xinxian. Each poor family gets more than RMB 450 annually from dividend income. Through income earned from Chinese medicine cultivation, policy support, and dividends of land, labor and project, every poor family can increase its income through Chinese medicine cultivation by about RMB 3,000 per year.

Belladonna plantation

Belladonna, also known as wild solanum, is an herbaceous plant and one of the main raw materials for bulk medicinal materials in Lingrui Pharmaceutical. Stability in supply and price is important for enterprise operation, but fluctuations in supply is inevitable because of the planting process, uncertain planting cycle of the medicinal farmers and other factors. If a buyer takes advantage of the low price to purchase the ointment and stores it for sale, they could increase the price sharply.

In recent years, Lingrui Pharmaceutical's annual demand for belladonna unguent has been about 600 tons. According to the industry, 1 kg of unguent is extracted from 10 kg of belladonna. Due to the influence of climate, diseases and pests, the yield of belladonna per mu varies between 250 kg and 500 kg.

Given that the average yield is 300 kg per mu, Lingrui Pharmaceutical needs about 20,000 mu of planting area for belladonna. Belladonna also has strict crop rotation restrictions. To obtain better planting effects, a piece of land must not plant belladonna or other nightshade plants in the second and third year after planting belladonna in the first year. Planting can only take place again in the fourth year.

As a result, at least 60,000 mu of land is needed for crop rotation to meet Lingrui Pharmaceutical's raw material demands. At present, the planting area of belladonna in Xinxian is only 3,000 mu, and a large amount of belladonna planting and promotion is needed to meet its own demands.

Sustainability

Due to the large initial investment, Lingrui Ecological Agriculture is yet to make a profit and relies on the parent company's investment and subsidies. At present, the cost of obtaining belladonna unguent is RMB 200,000 per ton. That is, one ton of unguent requires 10 tons of dry belladonna, at RMB 12 per kilogram, which amounts to RMB 120,000; the extraction cost is about RMB 80,000 per ton. The market price for the unguent is usually RMB 100,000-200,000 per ton.

The novel practice of Lingrui suggests an implementable way to shoulder corporate social responsibility. In particular, the poverty-alleviation-oriented belladonna planting benefits both villagers under and above the poverty line, while stabilizing the supply of the plant to the company. However, several questions remain: How significant is the impact of the strategy used in increasing the income of participating villagers? Is it sustainable? Are there any risks from production, and from competition? The answers will shed new light on how corporations may achieve common good in business, and in society.

Looking ahead

Alleviating poverty is a goal of great social significance for China, and all parts of society should play a role. Xinxian provides an example of how the advantages and resources of different players can be used to achieve that goal, with profit not necessarily being the primary motive. However, the best methods are still those which are commercially viable and sustainable over the longer-term. There is a good chance that each of the three methods detailed here—including the training of workers for employment either overseas or in China—can be sustainable to the benefit of Xinxian and to China as a whole.

CKGSB WEBINAR

Companies of Tomorrow

CKGSB partnered with Mars Incorporated to address sustainability and the future of business

Many people study how to do business, but very few discuss the reasons behind why business is done and how to ensure the long-term sustainability of companies. The concept and purpose of corporations has changed over time and as the world responds to the often devastating impact of COVID-19, enterprises are discovering the importance of addressing needs that exist in society, even if those needs fall beyond what is thought to be the traditional scope of a company. Should maximizing profit for shareholders still be the ultimate goal of a corporation? What should the right level of profitability be? How can corporations transform themselves and their business approach to ensure that all stakeholders benefit appropriately?

To address these questions, the Cheung Kong Graduate School of Business (CKGSB), held an E-Dialogue Series on June 22 on the topic, "The Future of Sustainable Business," in collaboration with Catalyst, Mars Incorporated's internal think tank, and Mars China. The key speakers were Zhu Rui, CKGSB's Professor of Marketing and Director of the Social Innovation and Business for Good Center, and Bruno Roche, the Chief Economist of Mars, Incorporated, and Founder of Economics of Mutuality (EoM).

Bruno Roche speaks about how companies should enhance sustainability efforts post COVID-19

Originally, the only party a corporation needed to answer to were its shareholders, said Professor Zhu—the sole purpose of a company has generally always been viewed as to make as much profit as possible to maximize shareholder value. But over time, that idea has changed. It is not just shareholders that companies now need to be responsible to, but also other stakeholders too—other parties that are related to the business such as employees, partners and suppliers and the community at large upon which the company depends. Considering the interests of all a corporation's stakeholders has become essential to ensuring the health of the ecosystem of business.

Corporations have created a tremendous amount of wealth, Zhu continued, but they also often created problems, such as environmental pollution and income inequality, in their single-minded race for profitability. There is now a growing demand from society at large for companies to take on a sense of responsibility for the communities in which they operate. Society as a whole is becoming less and less tolerant of companies shirking their responsibilities and they are expecting more transparency and better governance.

The public is increasingly focusing environmental issues, social issues and governance issues, collectively known as ESG. But this raises an unavoidable question: How can companies still make a profit while also paying sufficient attention to ESG?

To provide insight to business owners on how they can make their company more responsive to society's needs, Zhu advocates a three-step approach to sustainable business.

The first is to place a high value on mutual benefit. Corporations cannot solely focus on their own goals, there is also a need to understand and appreciate all of the elements that make up the chain of their business. The second step is for corporations to match their strengths with societies' weaknesses. What does society need that is your specialty? Focus on that for the well-being of both your corporation and the community. The final step is ensuring a comprehensive governance structure. Doing business in a way that is aligned with your corporation's values is vital. Focusing on this last step also incentivizes employees and the company to unite and strive for a common goal.

Bruno Riche backed up Zhu's views, saying that EoM was established to study the question: "What should the right level of profit be for a company?" To answer this question, said Roche, we have to understand five basic principles underlying corporate activity. The first is that the purpose of business is no longer to maximize profit, but to develop profitable and scalable solutions to the problems that society is facing. When businesses take this first step in realigning their purpose, it becomes a source of strength and innovation, helping them to outperform companies that do not respond in the same way.

Emphasis must be placed on taking care of your community, as well as your shareholders

The second principle is that of ecosystem mapping and orchestration. The role of business is not to dominate the ecosystem, but to orchestrate it and treat it in such a way that companies mobilize capital to develop overall business performance. The third principle is to establish non-financial performance metrics, while the fourth is ensuring mutual profit by equipping businesses with a new accounting system that no longer focuses solely on corporate gain. Roche proposed the mutual calculation of profit levels to prevent predatory behaviour in a business ecosystem. The fifth principle is that of expanding leadership and developing reciprocal relationships. All of these principles, he said, help improve overall performance in businesses.

The argument he puts forward is that business needs to be re-established on the bedrock of practical positive applications rather than on the shifting sands of unfulfilled promises. "Whilst capitalism has been very useful to some extent to entrepreneurship, it needs to be fundamentally reformed in order to be useful and relevant for years to come."

Professor Zhu Rui's new book *Companies of the Future: A Three-Step Approach for Sustainable Business*

Moderated by CKGSB Assistant Dean Zhou Li, Zhu and Roche then discussed the notions of sustainable business and social innovation, stressing the key importance of mutuality.

Zhu said the key concept in her model is sustainability, while Roche pointed to the emphasis placed by the Economics of Mutuality movement and companies like Mars on balancing profit and social responsibility.

There is both an opportunity, said Roche, but also a duty for business leaders, investors, management schools and policy makers to reposition the corporation positively in ways that reflect the changing needs of society and the environment. "We are at a point where we can reshape business on the right bedrock and create a foundation with practical applications rather than a shifting sense of unfulfilled promises," he said.

Business and entrepreneurship existed before the market economy—doing business and exchanging goods and services is what we do as human beings, regardless of culture, religion or country, said Roche. Capitalism in the form it has developed over recent decades has to some extent been useful to entrepreneurship, but it now has to be reformed fundamentally in order to remain useful and relevant in the years to come.

"We should take advantage of the COVID-19 crisis and not waste this opportunity to change," said Roche. "One of the most acute definitions of leadership in my view are people who know how to make sense of the time and season."

CKGSB BUSINESS CONDITIONS INDEX

A Positive End

CKGSB's Business Conditions Index shows a high possibility that China's 2020 economic performance will end positively

The BCI is directed by Li Wei, Professor of Economics at the Cheung Kong Graduate School of Business

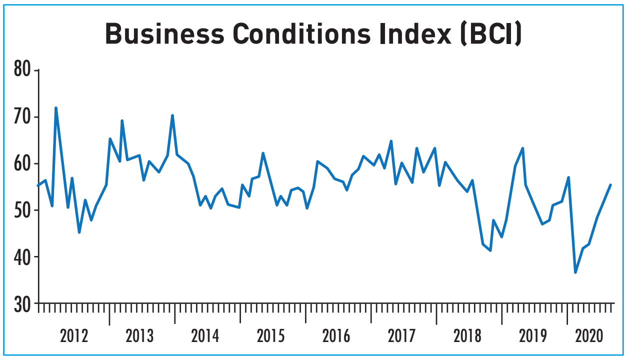
Recovering economic growth over the first half of the year pushed the CKGSB Business Conditions Index (BCI) in August above the confidence threshold of 50.0, indicating that most respondents have a positive outlook on business prospects.

The government's economic rescue policies are having an impact and there is a high possibility that China's economic performance this year will end positively. August's Business Conditions Index (BCI) data looks considerably healthier, increasing to 54.9 from July's figure of 51.4.

Introduction

Since June 2011, CKGSB has conducted the Business Conditions Index (BCI), a monthly survey of executives about the macro-economic environment in China. The BCI is skewed toward small- and medium-sized enterprises (SMEs) competitive in their industries, and so provides a reliable snapshot of business sentiment among successful private companies.

The BCI is a set of forward-looking diffusion indicators. The index takes 50 as its threshold, so a value above means that the variable the index measures is expected to increase, while a value below 50 means that the variable is expected to fall. The BCI uses the same methodology as the PMI index.



Key Findings

- In August, the CKGSB BCI saw a small rebound, increasing from 51.4 to 54.9.
- The producer price index rose more than the consumer price index—a rare occurrence, revealing confidence in manufacturing.
- August's corporate financing prospects deteriorated, with the index falling from 52.0 to 50.0.

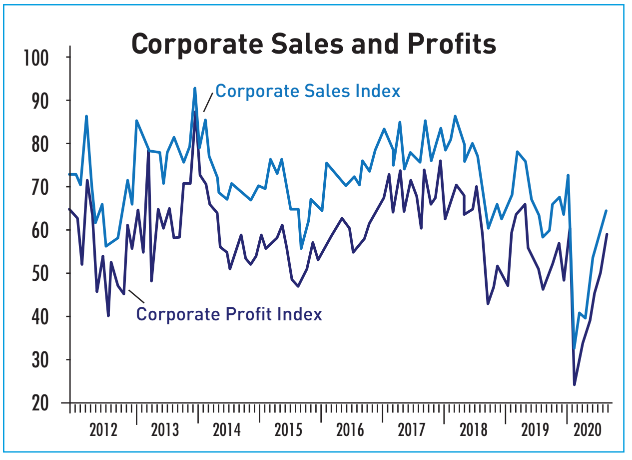
Analysis

The CKGSB BCI comprises of four sub-indices: corporate sales, corporate profits, corporate financing environment and inventory levels. Three measure prospects and one, the corporate financing index, measures the current climate.

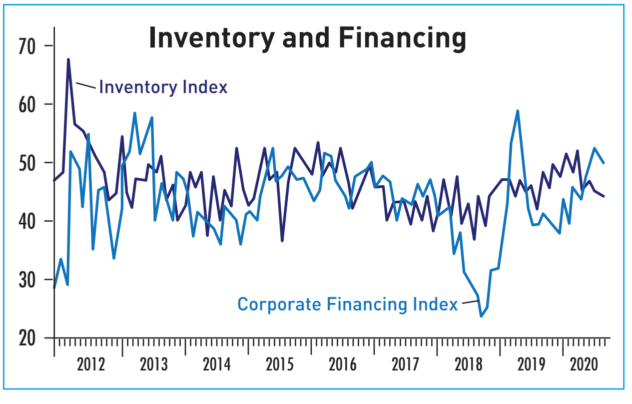
In August, two rose and two fell. The corporate sales index moved further into the realm of confidence, from 58.7 to 64.3, and the corporate profit index rose from 49.4 to 58.4.

August's corporate financing prospects deteriorated, with the index falling from 52.0 to 50.0. The inventory index fell minimally from 44.9 to 44.6.

Turning to prices, the consumer price forecast improved



slightly (46.4 to 47.8), while the producer price index rose from 45.5 to 50.7. It is important to note that this is a rare example of the producer price index rising more than the consumer. It is also rare to see producer price prospects rise above 50.0. It reflects a degree of confidence in manufacturing.



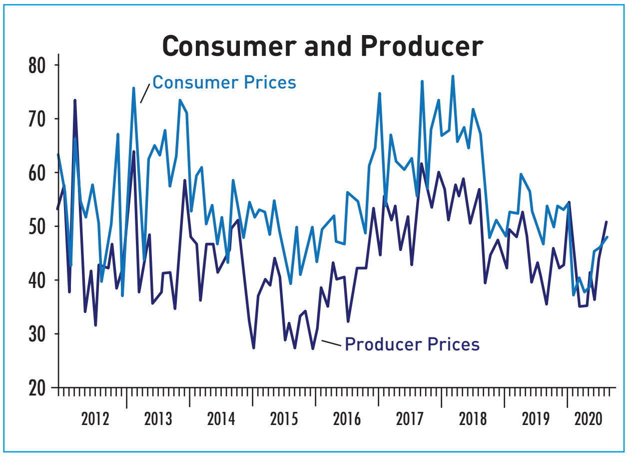
We now turn to investment and recruitment. These two indices have been consistently at the confident end of the scale since the BCI began. In recent months, however, both weakened, before rebounding this month to 63.3 from 60.1 for investment and from 58.5 to 65.4 for recruitment.

Conclusion

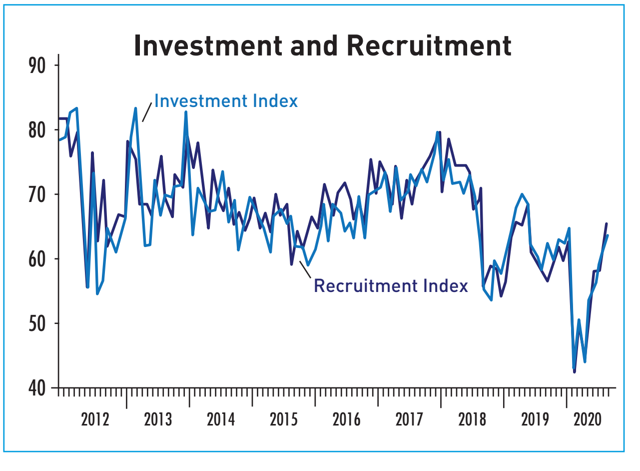
There are several bright spots. First, labor and total costs have rebounded, which means companies have a brighter outlook for the second half of the year. It also indicates that the economy may be in a better operating state. When costs rise, the economy should boom.

Second, consumer and producer goods are performing relatively well. Product prices look optimistic, although the consumer prices gauge remains below 50. This means surveyed companies still have reservations about future trends. Somewhat unexpectedly, the index for producer goods not only passed the confidence watershed, but also exceeded consumer prices.

The consumer price index has been above 50 for a long time, while producer prices languished below 50 for an equally long period. Now the two are inverted. We believe this is due to economic stimulus. Amid the COVID-19 pandemic, China's economy has been hard hit, and the government resorted to heavy "new infrastructure" spending. This is the likely origin of the producer price index hike.



Finally, we turn to the investment and recruitment indices. Both are above 60, at the same level of confidence before COVID-19. The recovery represents confidence of our sample in development but concerns of risk in increased investment and recruitment, and overheating of the economy resulting in inflation.



From this point of view, we support the Chinese central bank's position of "staying its ground." As private firms remain the main driver of the economy, from the second half of this year to next year, there is a high chance that China's economy will return to growth levels seen in recent years.

CHINESE BEAUTY

China's beauty market is undoubtedly growing at a rapid pace, but its growth differs from what is seen in other countries

By Mable-Ann Chang

China's beauty market is growing at a breakneck pace, but in some interesting directions that are unique

China has a rich history in cosmetics spanning centuries. However, the second largest market for cosmetic products in the world is rapidly changing not just in terms of size, as it looks to overtake the United States, but also in terms of consumers and how it works.

"The beauty industry is thriving," says Cecilia Zhou, APAC Client Director of ecommerce marketing firm Edge by Ascential. "The market has been growing at a rapid pace over the past few years and, with all of the exciting developments that we're seeing in the market, that growth is only set to continue."

As China's economy has prospered in recent decades, its middle class has grown and so has its spending power. Cosmetics and other beauty products feature prominently on the shopping list. But the cosmetics market here is diverging from the rest of the world in interesting ways. Skincare is ubiquitous, the male segment of the market is seeing unprecedented growth, and live streaming and the rise of domestic brands are also becoming new norms in the industry.

Diverging standards

Beauty standards in China have historically aligned more closely with those of its neighbors, Japan and South Korea. Slim figures, double-lidded eyes and fair skin are desired, with many beauty products promising a "whitening" effect. The aim is to achieve a beauty that looks natural and effortless, as opposed to the obvious use of makeup products to create it.

"Chinese beauty standards fall more in line with northeast Asian beauty standards and less with European and North American," says Zhou. "Even now in 2020, beauty standards are still more conservative than those in the West."

Even though China has over the past century followed the lead of Japan and South Korea when it comes to beauty, it is starting to branch out on its own, with subtle changes in what is considered attractive.

"In Asia, all the traditional criteria of beauty are still pretty much there," says Dao Nguyen, founder of Essenzia by Dao, a boutique marketing creative strategy agency that helps fragrance and cosmetics brands reach young consumers.

"But there is a difference between China and Japan and South Korea. Five years ago, beauty standards were influenced by Japanese and Korean standards, but increasingly we can observe other unique factors, such as how eyebrows are being shaped differently. There are definitely unique elements of beauty in China that aren't seen elsewhere."

Cashing in

China is gaining on the United States in cosmetics sales. It is now home to the world's second-largest beauty market, with retail sales reaching RMB 261.9 billion ($38.7 billion) in 2018 compared to $56 billion in the US, according to American media company Cision PR Newswire. The year-on-year growth rate in 2018 was 12.9%, three times the US. According to a report by investment bank JPMorgan, China is set to become the world's largest market—worth RMB 400 billion—by 2023, even if growth slows.

The burgeoning market has allowed longstanding luxury cosmetics companies, such as France's L'Oréal, America's Estée Lauder and Japan's Shiseido, to see massive increases in sales. Numbers are hard to come by but the L'Oréal group said that overall global sales revenue came in at $33.27 billion in 2019, and that sales growth in China boosted its overall sales during the fourth quarter of 2019. The Asia-Pacific region became its largest regional market for the entire year for its core hair color, haircare, skincare, sun protection, perfume, makeup and sun protection products. Its Kiehl's skincare brand, reached sales of over $432 million in China alone.

In terms of product segments, unsurprisingly, skincare products dominate the cosmetics market. The rapid growth of China's economy in recent decades has led to higher pollution and concerns over air quality. Skincare products are not only seen as a way to whiten the skin, but also to clean and protect it.

According to industry market research company IBISWorld, while makeup traditionally accounts for the largest

> **In the future, we will increasingly be looking at the Chinese market to learn best practices, innovation and creativity**
>
> Dao Nguyen
> Founder
> Essenzia by Dao

segment of cosmetics sales globally, skincare sales accounted for 55.2% of cosmetics revenue in 2018. Makeup is still a relatively new beauty segment, but it is quickly gaining traction among younger consumers. The top players in the local luxury skincare scene in 2018 were L'Oréal with a 17% share, followed by Estée Lauder with 13% and Shiseido with 6%, according to market research company CosmeticsDesign Asia.

The pandemic has certainly impacted sales for 2020, but Daxue Consulting, a China-based online market research company, said that COVID-19 has impacted various sectors in the beauty market differently. The virus fallout had a more negative impact on cosmetics than skincare products, while personal care products saw a rise in popularity.

According to China's National Bureau of Statistics, the cosmetics retail sector fell 14% from January to February in 2020. But by April, the sector had rallied and saw a growth of 3.5%. Data for May showed a strong recovery back to double-digit growth of 12.9%.

All online

Even before the coronavirus crisis, online shopping was booming with the country's e-commerce market worth a whopping $2 trillion in 2019. That is over three times more than the $600 billion in the United States, according to US-based market research company eMarketer.

Online sales went through the roof when the virus hit for all categories of products including cosmetics, but even in 2019 more than 70% of cosmetics sales revenue in 2019 came from e-commerce channels. Alibaba's Tmall and JD.com accounted for the majority of cosmetic products sold online.

"One of the unique things about modern day China is its e-commerce economy," Vivian Ge, owner of a beauty store in the eastern city of Rui'an. "The convenience has really propelled the beauty market forward."

Both Chinese and international brands have taken full advantage of the expanding digital landscape, prioritizing a strong online presence on social media and e-commerce platforms. One that is ever-popular is Xiahongshu ("Little Red Book"), which is a social media platform blending e-commerce, shopping and user-generated content and reviews. Live streaming has also become increasingly popular as consumers attach more and more importance to immersive experiences and personalized recommendations.

"E-commerce has become the only channel of choice for many consumers," says Maggie Men, Trend Director of trend forecasting company WGSN China. "In the retail industry of the future, e-commerce will continue to rise. Different e-commerce transformations and strategies, including changes in the luxury goods market, new social e-commerce platforms, and AR and VR tools used by brands to connect with home consumers will increasingly be used."

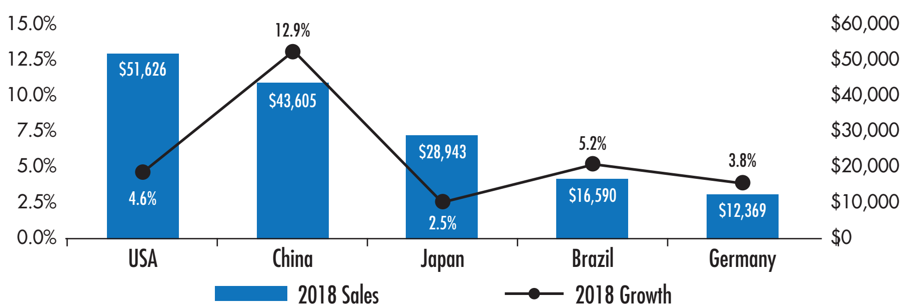
China has taken the phenomenon of online influencers to a whole new level with what is known as KOLs—key opinion leaders. In some cases, these attract hundreds of millions of followers who buy the products they promote on streaming and social media platforms.

"KOLs are the new makeup sales clerks," jokes Zhou. "They play a tremendous role in beauty ecommerce. But sales clerks only sell products one-to-one with the customer, KOLs are one-to-millions."

"In Western societies, people who buy products their idols promote are usually teenagers or are young," says Nguyen. "Following idols in the West is almost a sign of immaturity but in China it's a more complex picture. Chinese consumers are more receptive to idols because they tend to trust collective intelligence. KOLs are powerful, something that brands can't ignore. This trend will definitely not disappear."

MASSIVE GROWTH | China's beauty market is gaining ground at an incredible pace

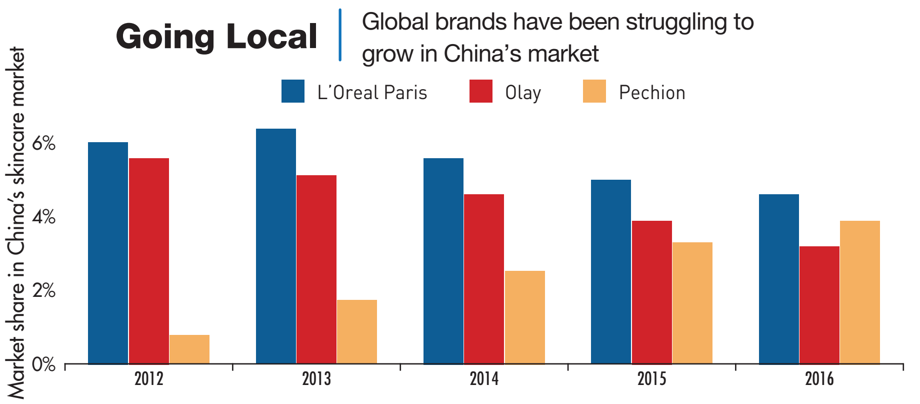
Top five global beauty countries by 2018 sales



Source: Euromonitor and J.P. Morgan estimates

Online platforms have made the beauty market accessible to a significantly wider audience and have provided smart brands with a way to access consumers directly in a way never previously possible.

"Before the development of e-commerce, consumers got most of their information about beauty products from department stores and sales staff in beauty stores," says Zhou. "But now, e-commerce has made beauty accessible to everyone, even those living in more rural areas."



Source: Euromonitor International

Masculine beauty

Men have not been left behind in these new beauty trends and in some ways they're taking the lead. Alibaba's news group Alizila even says that sales of men's personal-care products grew faster than women's in 2018, at 31% year-on-year compared to 29%.

The male interest in beauty products is different. In the West, men typically strive for a more rugged appearance, and probably the top seller in this category are colognes. But in China, an androgynous appearance is not only acceptable, but even apparently desirable.

"There is a big difference between the rise of male beauty in the West and in China," says Nguyen. "The first brands that launched dedicated lines of makeup or skincare for men [in the West] were targeting the gay community. But many youngsters in China now find it normal to take care of their appearance."

There seems to be in some ways a different definition for masculinity compared to the West. "Many people look at Asian men and may have the feeling that they're not as masculine," says Nguyen. However, men within China don't question their own masculinity, nor that of their fellow men.

"Men are valued when they're responsible and can take care of their families," she adds. "So even if a man doesn't look as 'strong' physically, they could be perceived as being very manly."

So, what are the main male cosmetic products being purchased? According to Daxue Consulting, facial masks rank first, followed by tinted skin (BB) creams, lip and eyebrow pencils and lipsticks all being primary choices. "Two-thirds of men born after 1995 are now using BB creams," says Nguyen.

At the moment, male cosmetics are sold mostly in major cities, but these trends can quickly spread to the huge populations in second and third-tier cities.

"In the bigger cities, there are more and more men using skincare products, but in smaller cities inland, it is still not popular," says Ge. "This will take time, but eventually it will seep into smaller cities and men there will likely start using skincare as well, particularly among young people."

Going local

Foreign brands have long dominated the cosmetics market, but local brands have recently been making inroads, particularly in the middle segment of the market. Popular domestic brands include Chando, Pechoin and Perfect Diary.

"Over the past two and a half years, Chinese brands have become absolutely gigantic, such as Perfect Diary, who in some months performs better than even established brands like Lancôme," says Nguyen. "It's truly incredible when you think that many of them were only created in 2016."

But Ge feels local brands still have a long way to go to dominate the market. "I believe Chinese brands will become big one day but they are not significant now… these brands still need time to grow and develop."

Nguyen attributes the birth and growth of local brands to the development of the mobile internet. "Those brands are especially agile and invent new online business models all the time. This is a real threat to Western brands who simply don't get it."

The leading cosmetics consumer groups are people born from the 1990s onwards. Consumers aged 30-35 years of age have the strongest purchasing power, while consumers in the 25-29 years old range are the second most important group. They are more tech-savvy and more exposed to social media with its proliferation of beauty-related content.

"Because Chinese society moves so quickly, every five years or so, youngsters have a different set of brands that they love," says Nguyen.

A bright future

While China's beauty market is multifaceted and transforming at a breakneck pace, experts agree on one thing: The market is only going to get bigger and domestic brands are likely to play an ever-bigger role.

"China is currently the world's second largest beauty market, but the per capita consumer value is $44, which is far behind the United States, Japan and other countries," says Men. "With the continuous improvement of the economy and the awakening of their beauty awareness, there is huge room for growth."

Nguyen says that "Even though the beauty market is already so big, it still has a lot of growth potential. In the future, we will increasingly be looking at the Chinese market to learn best practices, innovation and creativity."

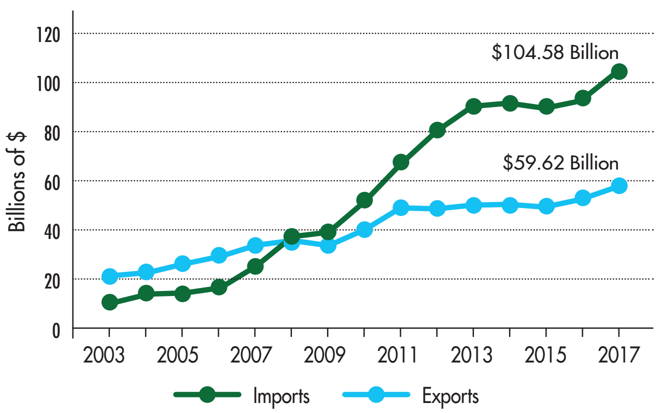
Food Security

China's demand and supply of food has significant implications for both its own national food security and that of the world. How does China feed its population?

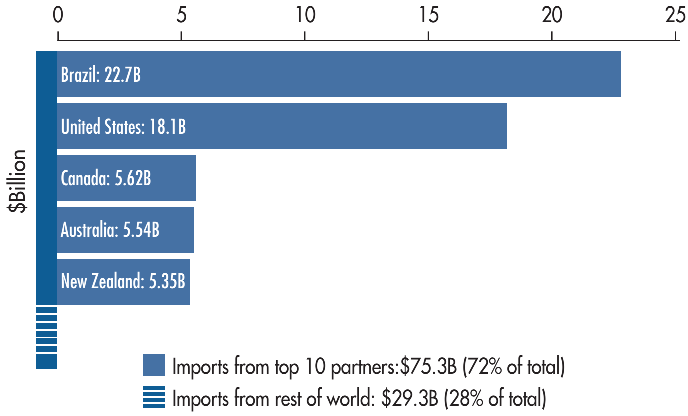
The Breakdown

Massive changes in food production and demand have affected China's position in the global food trade. Amid continuously increasing food consumption, over the past decade China has shifted from being a net exporter to a net importer, importing $104.58 billion of food in 2017. China's major import sources are Brazil, USA, Canada, Australia and New Zealand.

China's imports and exports of food



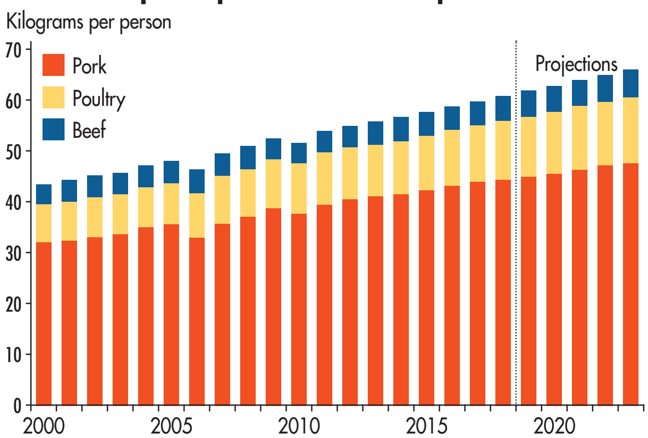
Top sources of food imports



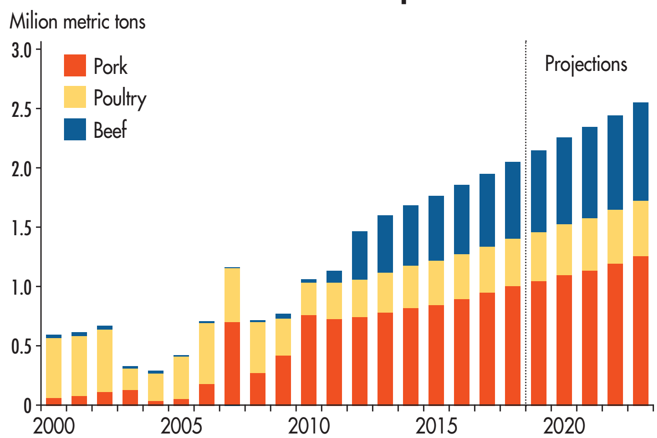
Meat

Urbanization and rising incomes are changing what is being served, with pork consumption continuing to rise. China's meat production is set to increase, but meat imports are also expected to rise. Pork imports are projected to show most growth, rising to 1.2 million tons by 2023.

Continued growth projected in China's per capita meat consumption



China's global meat imports projected to continue to trend upwards

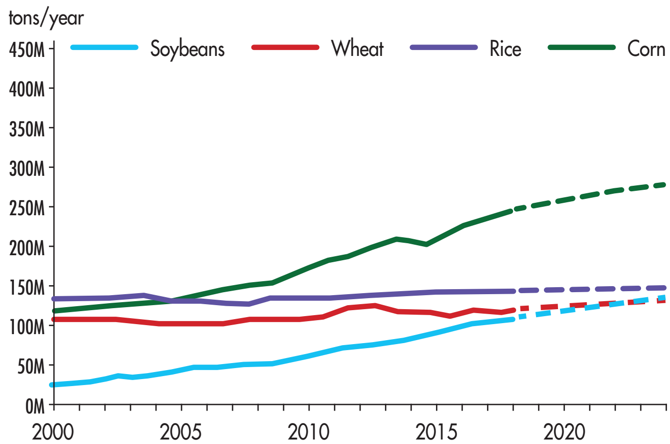


Sources: CSIS ChinaPower, Observatory of Economic Complexity, US Department of Agriculture

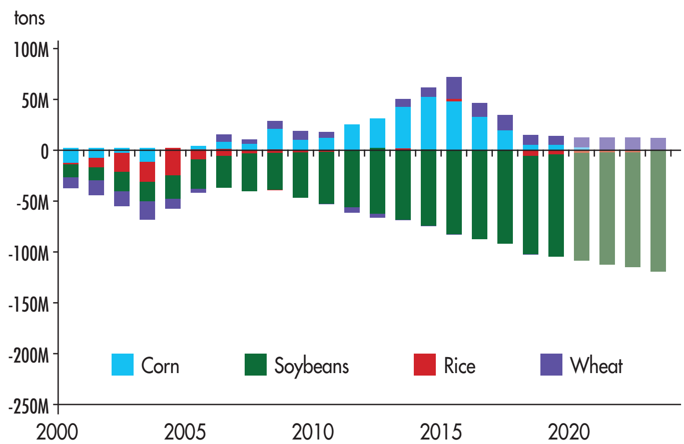
Grain

Over the past decades, there has been increasing demand and production of major crops, including corn, rice, soybeans, and wheat. But thwarting its goal of self-sufficiency is China's hunger for soybeans. It import around 100 million tons of soybeans a year, mainly as feedstock for farm animals, making China the world's biggest importer of the oilseeds.

China demand projections



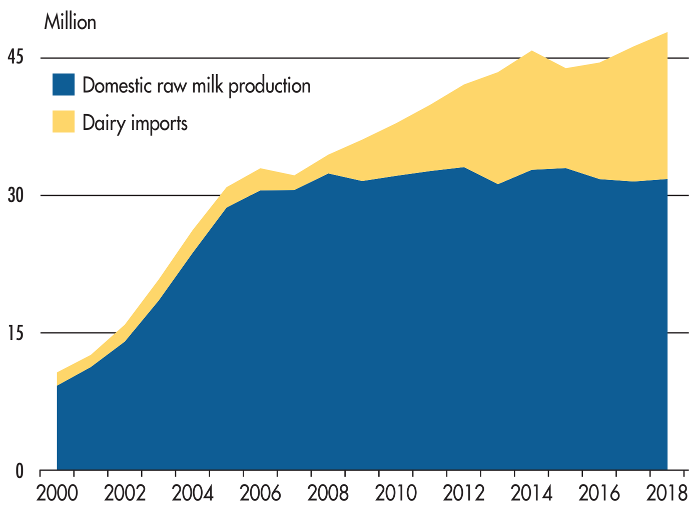
China crop surplus/deficit in tons



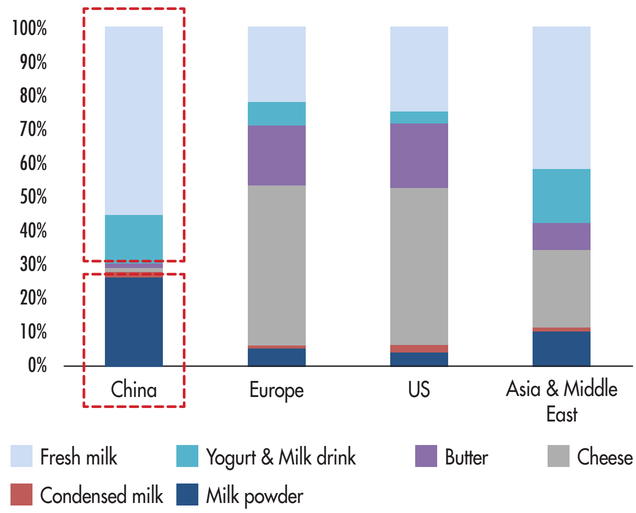
Dairy

China's dairy deficit experienced a structural lift post-2008 with diary imports rising. Compared to other major dairy markets, China consumes significantly more fresh milk and milk powder but less butter and cheese.

China dairy production and net imports (tons of raw milk equivalent)



China consumes significantly more fresh milk and milk powder



Sources: PwC, Gro Intelligence, OECD, FAO Population Forecasts, USDA PS&D, CASDE

The stats you need to know

Macro

Back to growth

China's gross domestic product fell **6.8%** in the first quarter as the country struggled to deal with the COVID-19 crisis, but it returned to growth in the second quarter, reaching **3.2%**.

Source: Bloomberg

Chinese education

China's government has offered **12,000** scholarships to African students in the coming academic year, more than the number offered by leading Western governments combined.

Source: Financial Times

No more waste

China will end all imports of solid waste from 2021. The "National Sword" policy already fueled a more than **99%** year-on-year decline in scrap plastic imports between 2017 and 2018.

Source: Caixin

Business

Topping Fortune Global

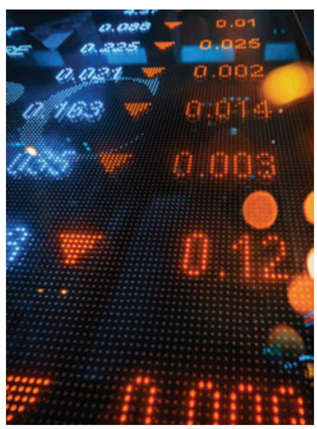
For the first time, more Chinese mainland enterprises have made it onto Fortune magazine's list of the world's top 500 companies than those from the US. A total of **124** enterprises were included on the list—with an average annual revenue of **$66.9 billion**—eclipsing the US's **121**.

Source: Caixin

Plunging M&As

In the first half of 2020, outbound Chinese merger and acquisition activity declined **17%** year-on-year to **248** announced deals, its lowest in **10** years. Total transaction value dropped **40%** to **$14.6 billion**, with China's overall outward direct investment decreasing to **$54.9 billion**, down **4.4%**.

Source: Reuters



Bond bailout

China launched a bailout fund with a fundraising goal of **RMB 100 billion ($14.3 billion)** to deal with potential bond defaults by state-owned enterprises. The new fund has quickly raised **RMB 10 billion** from **32** state firms.

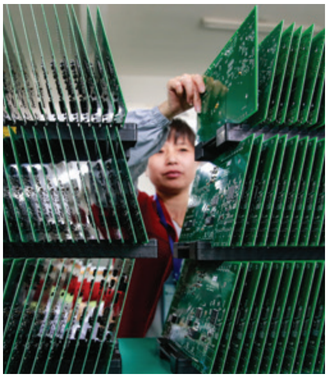
Source: China Daily

Winning control

Regulators have approved JPMorgan Chase & Co.'s application to take full control of China's first **100%** foreign-owned futures business. Before the change, Shenzhen Wallace Rand Equity Investment Fund Management held a **50%** stake in the venture, and a local investment company in Jiangsu held **1%**.

Source: CGTN

Technology



Biggest IPO

SMIC, the giant Chinese chipmaker that returned home to list on Shanghai's Star board, became one of China's top 50 most valuable public companies after the listing and the biggest IPO on the Chinese mainland in a decade. SMIC has sold roughly half its placement to institutions, raising **RMB 53.2 billion ($7.6 billion)**.

Source: Financial Times

Driverless future

WeRide, a Chinese autonomous vehicle startup, has become the first company to start fully driverless vehicle testing in China, as the world's biggest auto market accelerates development of autonomous technologies.

Source: Reuters

Navigating with Beidou

China has begun the mass production of a complete industrial chain of chips, modules, boards, terminals and operation services for the Chinese navigation system Beidou, starting with **28**-nanometre chips that enable mobile devices to receive signals from Beidou.

Source: Reuters

Frozen updates

Apple has frozen updates for tens of thousands of mobile games on its App Store in China as it faces increasing government pressure to comply with local regulations on official licensing. Apple currently hosts roughly **60,000** games on its App Store in China, but regulators have issued just over **43,000** licenses since 2010. Only **1,570** were granted in 2019.

Source: Financial Times

Consumer

Satisfied citizens

Chinese citizens' satisfaction with the government improved overall from 2003 to 2016, says a Harvard University study published in July. According to the study of **31,000** respondents, those satisfied with the central government rose from **86.1%** in 2003 to **93.1%** in 2016.

Source: South China Morning Post

Plummeting consumption

Retail sales of consumer goods in China declined **11.4%** year-on-year to **RMB 17.23 trillion ($2.47 trillion)** in the first half of 2020 due to sluggish consumption demand amid the COVID-19 pandemic.

Source: Global Times

Linking markets

China is set to launch a pilot program to allow cross-border investment in wealth management products (WMPs). Chinese residents in the Greater Bay Area of Guangdong province in southern China, will be allowed to open special investment accounts with banks in Hong Kong and Macao to buy qualified WMPs, and Hong Kong and Macao residents can buy WMPs sold by mainland banks operating in the Greater Bay Area.

Source: Caixin

BOOKSHELF

Chinese Thinking

Frank Tsai, founder and CEO of the Shanghai-based business consultancy and events organizer China Crossroads, recommends books that help readers better understand the way China understands itself

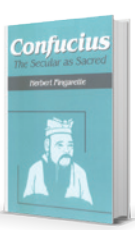
Frank Tsai, founder of the Shanghai-based China Crossroads, hub of the largest series of public lectures in Shanghai, recommends books that help readers better understand the way China understands itself

Previously the Associate Director for Greater China at the Economist and manager at the global political risk consultancy, Control Risks, Tsai has been living in Shanghai for the past 11 years. Since 2010, he has created one of Shanghai's most vibrant intellectual communities, running a universe of lectures on "China and the world" now comprising over 70 talks per year at China Crossroads, M Talks China, and Hopkins China Forum. Topics range from China business to international relations to book launches and Chinese society, and speakers are typically China-focused scholars or senior business figures at well-known companies.

What would be your number one book recommendation for someone looking to learn more about China?

My top recommendation for novices to learn about China would be ***Wealth and Power: China's Long March to the 21st Century*** by Orville Schell and John Delury. It covers Chinese history of the last century with a chapter (or two) on each important figure who contributed to modern China. It does so in a way that allows foreigners to understand how China understands itself, that is that the current Chinese regime is authoritarian because China's foremost goal was to attain "wealth and power," and in particular to solve the collective action problems that made China weak in the face of foreign powers.

What book on China have you re-read the most?

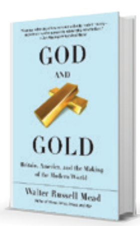


I have reread ***Confucius: The Secular as Sacred*** by Herbert Fingarette the most. This slim volume is written by a philosopher in the 1960s and it contains the most convincing and inspiring interpretation of Confucianism I know. It acts as a positive vision that would prove useful for Western societies today.

What are you reading currently?

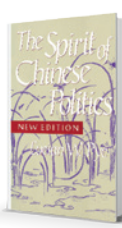
I just finished reading ***Escape from Freedom*** by Eric Fromm for my book club. Written in the 1940s, it discusses whether people have a natural tendency toward submission, and whether this accounts for the rise of fascism and the social conformity in democratic capitalism. Though not on China per se, everything we read in China is actually about China. In this case, the book leads us to ask whether the Chinese also willingly "escape from freedom" for either the market today, or for the state in the recent past.

What book totally changed your perspective on a certain topic?



God and Gold by Walter Russell Mead is the non-China book I've read in China that has most changed my perspective on the competition between China and the US hegemony it chafes against and opposes. The book explains why either the British or the Americans have been on the winning side of every major world conflict in the last 300 years, constituting an Anglo-American hegemony. The relevance for China is that the Anglo-Americans seemed to have had a "secret recipe" largely unknown to themselves, but well-understood by its enemies, including China and Russia.

Which China book do you think is the most underappreciated?



The Spirit of Chinese Politics by Lucian Pye was written in the 1960s, the author being a political scientist of a now derided and outmoded school of scholarship which attempted to probe national character on the basis of psychology. For this reason, it is not popular today, but for those who know China well, it reads as a handbook for how to understand Chinese political culture, or more generally how Chinese deal with power, whether in the workplace or the state, in ways specific to Chinese culture and its recent socialist experience.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Duration: 5 weeks
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Mid-Sep 2020
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