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A DOUBLE LOOP

What does China's Dual Circulation policy mean?

- How does China fit into the global financial system?
- China has made strides in boosting food security
- Daniel Bell on meritocracy in China

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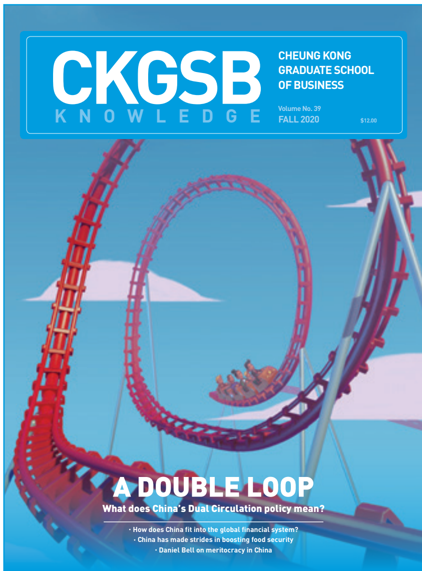
China's Evolving Role

The world has been fighting the COVID-19 virus for a year now and China is the only major economy to see GDP growth in 2020. This issue of *CKGSB Knowledge* looks toward the future and considers China's ever-expanding role in it.



China is now a crucial player in the global community, but there are clearly unique elements to the way Beijing views the world and runs its economy. In considering the relationship between China and the world, our cover story, "**The Infinity Loop**" (page **11**), examines what China's new "Dual Circulation" policy means, what its goals are as well as the possible outcomes. "**An Awkward Fit**" (page **31**) also looks at the prospects of China's evolving role in the global financial system.

As usual, we look at key developments in the Chinese economy. "**The Framework for Success**" (page **6**), discusses the role and responsibilities of private companies in the Chinese economy, while "**Investment Intermission**" (page **15**) explores how Chinese investment around the world has fallen.

Swimming against the trend of business losses in 2020 was hotpot chain Haidilao, which has bounced back from the impact of COVID-19 relatively quickly and continues to open new restaurants around the world. "**Hotpot Hospitality**" (page **40**) looks at what makes Haidilao unique and how it has managed to dominate China's hotpot scene. Also on the food front, Beijing's recent campaign against wastage has highlighted the issue of food security. "**Full Stomachs**" (page **27**) looks at the extent to which food security is an issue for the future.

In the field of science, we look at China's entry to an elite group of countries with the launch its own global navigation system, BeiDou. "**Navigating the World**" (page **40**) looks at how BeiDou compares to the existing systems—GPS, Galileo and GLONASS.

While the world is mostly preoccupied with the pandemic, signs of global climate change have been surging. But there are two sides even to that coin. As the ice in the Arctic continues to melt, new logistics routes are opening and undersea resources are becoming available. "**Arctic Activity**" (page **19**) considers what the role for China will be at the top of the world.

With many people being stuck at home under varying degrees of lockdown, we look at the arts as a way of coping during these difficult times. "**The Art of China**" (page **45**) looks at China's vibrant and still-young art market.

We have some great interviews in this issue, including a conversation with Daniel Bell, Dean of the School of Political Science and Public Administration at Shandong University, who talks about the value of hierarchies and meritocracy in China (page **8**). Andy Xie, former Morgan Stanley Chief Asia-Pacific economist, predicts what China-US relations will look like over the next few years (page **23**), while Thomas Orlik, author of *China: The Bubble that Never Pops*, discusses how China's economy has managed to repeatedly succeed against the odds (page **36**). And Christophe Olivro, regional manager of Aman China resorts, looks at the impact that COVID-19 has had on the hospitality and tourism sector (page **53**).

To wind down, meditate on "**Wealth in Wellness**" (page **62**), which looks at how wellness is the new luxury in China. The Chinese people have unique notions of what health and wellness mean.

Our Snapshot surveys the property market and explores the reasons behind skyrocketing home prices, how much urbanization contributes to rising prices as well as the existence of at least 50 million vacant apartments across the country—nearly double the number in the United States.

We at CKGSB are committed to providing the best sense of the economic consequences of the pandemic and keeping our readers and alumni aware of the latest views and analyses on this epoch-defining event. As always, if you have any comments or opinions to share, please feel free to contact us at (lzhou@ckgsb.edu.cn or ckgsb.knowledge@ckgsb.edu.cn).

Yours Sincerely,

Zhou Li
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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/*

The Framework for Success

Both the private sector and the state have a responsibility to society

By Zhou Li

Over the past decades, the wired world of tech and business have come to dominate economies around the world, and nowhere more than in China and the United States. Interestingly, the power of these massive, almost monopolistic, tech giants, as well as their role and impact on society, are now finally being reconsidered in both places.

The star of private enterprise high-tech in the China world is Jack Ma, who launched China's most valuable private Chinese company, Alibaba, in 1999. The company and its offshoots dominate e-commerce and digital money in China and have a growing influence in other places around the world, particularly Southeast Asia and Africa. But his latest venture, Ant Financial, hit a problem last November. The company's initial public offering (IPO) planned for both Hong Kong and Shanghai would have been the largest in history but, at the last minute, the Chinese government canceled the listing.

Speculation afterward as to why the Ant Financial IPO was stopped focused on a speech Ma made in Shanghai in early November in which he was critical of China's financial industry regulators. But it is more likely the cancellation was related to the growing concerns of the Chinese government about the huge impact that financial technology companies have, and a determination that they should operate in the interests of the public good and not solely in the interests of shareholders.

In late November, regulators unveiled draft antitrust regulations that resulted in a fall in the share prices of many Chinese tech stocks, and the government later fined Alibaba and two other fintech companies for not reporting past acquisition deals, closing a regulatory gray area that China's foreign-listed tech companies had enjoyed. Big Chinese tech companies such as Alibaba and Tencent had not previously had to seek explicit antitrust approval for such deals.

Meanwhile in the United States, large tech firms are also under pressure to be more transparent and responsive to the public good. In mid-December, the FEC and 47 states filed a joint suit against Facebook, stating that it was in effect a monopoly and demanding that it be broken up. It was an action which focused on the power that these massive tech companies have, and questioned the motives of Facebook and, implicitly, the motives of other major tech companies too.

Key sectors of China's economy are dominated by state-owned enterprises (SOEs) and they operate fully within the system, with the policy goals of the system transcending profit as the main guiding principle. But China's largest and most influential private companies, which tend to be in either the property or tech sectors, have been operating in a gray area. The articles of association of such companies stress shareholder value, but they are all, to one extent or another, linked to China's highly centralized economic system.

None of the laws and regulations in any country around the world is capable currently of dealing fully and effectively with companies with the size and power of Ant Financial, Facebook, Google and Tencent. There has been much talk of anti-trust laws being used to address the role of the tech giants in the US, and in China the authorities are stressing the same need to impose limits on the activities of these giant companies. It is a synchronicity of trends addressing what is seen by the authorities in both countries as a lack of self-discipline on the part of private entrepreneurs, and a failure to consider the full social implications of their business activities.

Where self-discipline and self-regulation are absent, government regulation will emerge. Given the breakneck pace at which the tech world and fintech in particular have developed, the regulations are always behind. Capitalism—in fact, any system—at its extremes is a problem. As the current Secretary-General of the United Nations António Guterres has pointed out, 26 people in the world hold half of the world's wealth, and while capitalism in all its various forms is global, the jobs and social issues created are local.

Ant Financial, a financial technology company that operates much like a bank, takes in funds and dispenses loans through its online platform. It started out as a provider of loans at reasonable rates to small and medium private enterprises, but it has latterly been widely criticized for charging high interest rates on many of its loans.

As China emerges from the pandemic, the role of private businesses in the economy is once again coming to the fore. The performance of the Chinese economy through the difficult months of 2020 showed how important the private sector is in maintaining employment and general economic development, and its role will continue to be bolstered in the difficult times ahead.

But companies need to know where to draw the line, to not take advantage of areas relatively unregulated and to operate to the clear benefit of society. The Chinese government in recent months has stressed two things: the importance of private enterprise to the maintenance and growth of the economy, and the need for all companies, from SOEs to private and foreign firms, to operate strictly in line with government regulations.

> **Where self-discipline and self-regulation are absent, government regulation will emerge**

The biggest players in China's corporate world are the SOEs, a group of companies with significant control and influence over major sectors of the economy—finance, energy, transport and construction—and the message from the center in recent times has been the flipside of the message being sent to private companies. While the first duty of the SOEs is to support policy directives, they are being told that they must also operate more on commercial terms and meet the requirements of the markets.

A recent rash of defaults and financial problems involving SOEs has highlighted inefficiency and high debt levels, but it is a tricky problem to resolve because SOEs are so fundamental to China's economy. A spate of regulations and announcements indicate that authorities have less and less patience for SOEs operating inefficiently.

Wang Min, President of XCMG Group, the country's biggest construction machinery business, recently told the *Financial Times* that struggling SOEs in China were not worth rescuing because they could not survive without government backing. "The fall of state firms isn't just a result of bad management, unclear strategy and inadequate entrepreneurship," he said. "It also has to do with government mismanagement that puts [unreasonable] performance targets on these companies."

"Let them die and don't save them," he added. "Government protection won't create a good company [but] competition will."

While the markets have to some degree interpreted Beijing's decision to cancel the Ant Financial IPO as a negative in terms of corporate diversity, there is another way of looking at it: China's economy, like all economies around the world, is facing significant challenges, and the authorities are concerned about the potential for economic or systemic disruption. Most experts agree that one sector that could cause a crisis in China's economy is the finance industry in general and fintech in particular.

China's small- and medum-sized enterprises were arder hit by the COVID-19 crisis than any other part of the corporate economy, but the majority were saved thanks to a very proactive response by the authorities, providing bridge loans and other assistance.

The new Dual Circulation economic policy is also encouraging everyone to focus on China's domestic economy and make use of the massive potential of a market of 1.4 billion people. Many companies are investing in response to the opportunities that are being created by this policy.

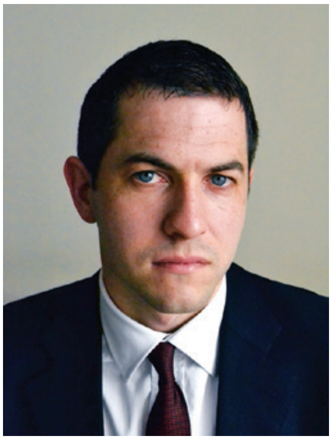
Both China and the US have their own ways of regulating and controlling the activities of companies in the midst of the process. There has always been and always will be a framework of control within which companies must operate in any country, and the tech sector right now is the one which the world seems to have decided must be brought to heel.

China's Iron Bubble Economy

Thomas Orlik, author of *China: The Bubble that Never Pops*, looks at how China's economy has managed to repeatedly succeed despite the odds stacked against it

A veteran of more than a decade as a journalist and economist in Beijing, Tom Orlik's new book shines a light on China's banks and borrowers, explaining why the system many see as a bubble ready to pop has so far managed to defy the doubters.

Q. To what extent is the China system that you describe in your book unique and unprecedented, and what are the characteristics that make it so?



A. China's development model borrows heavily from South Korea, Japan, and other Asian neighbours, which accelerated up the GDP rankings thanks to the combination of engagement with the global economy and determined industrial planning.

Despite those similarities, it's also important to recognise what's unique about China.

An important contrast with Japan and South Korea is China's enormous size. A home market of 1.3 billion people means when China develops or learns a new technology, they can put it to work at a very large scale and achieve world-beating levels of efficiency.

Put those factors together—the developmental state, the engagement with the world economy, and the advantages of enormous scale—and you have the essential ingredients of the Chinese growth story.

Q. One of the biggest risks you talk about is the massive pile of debt that the China system has built up, but you seem to be suggesting that there are no consequences for this. Is that the case? Or if there are consequences, what consequences are there?

A. China has taken on a huge amount of debt in a short period of time. In 2008, borrowing was about 150% of GDP. Now it's about 300%. Other countries that have taken on so much debt so quickly have almost always had a financial crisis.

Why should China be different? Three factors stand out.

First, China's high savings rate and controls on taking funds offshore mean the banks have very stable funding. Banks with stable funding don't tend to collapse.

Second, with GDP per capita at about a third of the level in the US, China still has some room to grow through its problems.

Third, from President Xi Jinping down, China's policy makers have made managing down financial risks a high priority. That doesn't guarantee success, but it gives them more than a fighting chance.

Q. There are analysts who say that China is likely to plateau and even stagnate over the next decade as a result of the inflexibility of its system. What would be your view on that?

A. If we think about when Japan plateaued, it was when GDP per

China's high savings rate and controls on taking funds offshore mean the banks have very stable funding, says Orlik

capita was around 80% of the level in the United States. Japan was basically already an advanced economy.

China's GDP per capita is around a third of the level in the United States. That number tells us that this probably isn't the moment when China is going to grind to a halt. There's not as much space for development as there was 20 years ago, but there's not zero space either.

Q. How does the Chinese economy, in the state that you describe it, interface with the rest of the world? What are the implications for the rest of the world given the state of China's economy and the prospects you lay out?

A. A China financial crisis would be bad news for China. It would also be bad news for the rest of the world. Asian neighbors like Korea and Japan, and commodity exporters like Australia and Brazil, would suffer the most damage.

The argument I make in the book, though, is that those waiting for a China financial crisis will continue waiting for a long time. That gives the rest of the world a different challenge to wrestle with – how to deal with China's continued rise.

We saw in the Trump administration some of the tensions that can cause. The Biden administration offers an opportunity for a reset. I expect we'll see the diplomatic guardrails come back on. But the underlying stresses aren't going to go away, and may well continue to get worse.

Q. The view of Beijing is that "We have our system and other places have their systems, there should be a flexibility that allows countries to decide their own systems." To what extent would you agree with that view?

A. I'm sure some of your readers have seen the recent Pew survey that revealed a sharp increase in negative perceptions of China, not just in the US, but also in Europe and in some of China's Asian neighbors.

Some of the reasons for those negative perceptions aren't going to change. But if we focus on the economic and financial aspects of the relationship, there's still opportunities to find win-win solutions.

> **No one is immune from crises, and China's recent economic history contains some near misses**

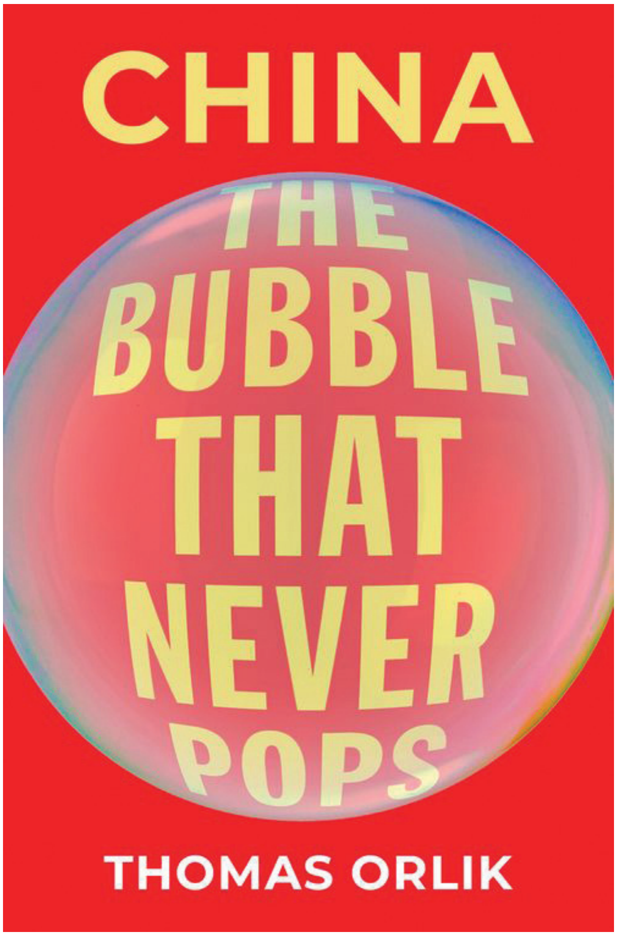
A Chinese economy which is more open and market-oriented, with a more level-playing field for state- and private-firms, domestic- and foreign firms, would be more dynamic and productive. Those shifts would also go some way to allaying foreign concerns that China doesn't play by the rules.

Q. Does China's economic success have lessons for other countries?

A. People talk a lot about vested interests in China and how they make it difficult to get things done. Actually, I think one of the remarkable things about China's economic policy makers is that they do manage to push past vested interests and make far-sighted decisions.

On liberalization of the exchange rate, for example, there was tooth and nail opposition from the entire export industry. On interest rate liberalization, there was opposition from the banks. But the People's Bank of China was able to keep their eyes on the prize of an increase in efficiency across the economy, and push through the opposition.

That long-term orientation and willingness to fade out special pleading from vested interests is I think something other countries could learn from. Of course, there's a lot that China can learn from overseas as well.



Q. What are the prospects for private enterprises in the context of the China system as you characterize it?

A. There is a narrative about the advance of the state and the retreat of the private sector in China, which has an important element of truth in it. If we think about the supply side reform agenda for example—when the government moved to lose excess capacity in steel and cement, that was a state-dominated agenda.

At the same time, if we think about the companies which I'm sure CKGSB students are excited to work for in the years ahead, or if we think about the technologies shaping life in modern China, we immediately think about a group of dynamic private sector firms—Alibaba, Tencent, DiDi.

The narrative about the advance of the state and the retreat of the private sector does capture an important aspect of what's going on in China. The commanding heights of banking, energy, heavy industry remain in state hands. But if we look at the industries of the future, it's often private sector firms that are leading the way.

Q. If you are wrong, what are likely to be the top three potential scenarios for how the bubble could pop?

A. No one is immune from crises, and China's recent economic history contains some near misses. The equity market collapse and capital outflows we saw at the end of 2015 is one example. The exodus of investors, firms, and workers from rustbelt provinces in the Northeast is another.

Those examples also provide clues about what could go wrong. There could be a period of uncontrolled capital flight, eroding the banks' funding base There could be continued massive misallocation of capital in loans to zombie companies, resulting in a Japan-style inertial drag on the economy.

There's certainly a lot of things that could go wrong. My view, though, is that managed slowdown is more likely than sudden stop.

Q. Exports appear to be challenged in the medium term and China's response to that has been the Dual Circulation Policy. What is your view on that policy and what are its chances for success?

A. One of the mistakes that people in Washington DC make is to think it is America that's deciding what kind of relationship to have with China, and China's passive about it and will just accept whatever role it is given. In reality, China is making a decision as well.

Trade wars, technology sanctions, sanctions against officials, are obviously shaping the way China thinks about the US I don't have a window into Zhongnanhai. But I am fairly certain that China's top leadership now see the world as more hostile place than it was five or 10 years ago.

Dual Circulation is an extension of past policies, such as Indigenous Innovation and Made in China 2025, not an entirely new idea. The aim is to reduce China's dependence on foreign markets and technology. Chinese leaders' perception that the world is becoming a more hostile place will add urgency.

THE INFINITY LOOP

President Xi Jinping is reinventing state capitalism and has a new economic agenda: "Dual Circulation"

By Crystal Wilde

Image by José Luna

What does China's new Dual Circulation policy mean for international trade and will it be successful?

The words "giant panda" have taken on a new meaning in the central city of Datong. A patchwork of dark and light solar panels glittering in the sun resembles nothing more than a standard solar farm from the ground. But from above the panel arrangement forms the image of a panda, the perfect representation of China's bid for energy self-sufficiency.

Despite being the world's biggest coal producer, China has long relied on other countries for its massive energy needs. It imported more than $238 billion-worth of oil in 2019 alone, around 60% of its total oil consumption. With international tensions rising and attitudes about globalization changing, this is one of many dependencies Beijing wants to reduce.

In May 2020, President Xi Jinping announced a new economic policy, "Dual Circulation." While there has been much discussion over what it means, in its essence it is an attempt to rebalance the country's economy away from relying on external forces and toward a more inward-facing system of production and consumption. Xi urged the nation to, "fully bring out the advantage of China's super-large market scale and the potential of domestic demand to establish a new development pattern featuring domestic and international dual circulations that complement each other."

Experts have extrapolated that to mean trying to reduce imports of strategically important items, particularly in the fields of energy and technology, and encourage citizens, companies and organizations to buy locally produced goods as much as possible. Manufacturers who have worked for decades to build export markets around the world are being told to now focus instead on the domestic market.

"The government has been talking about import substitution and domestic demand for 20 years, so I'm not surprised by the destination," says Anne Stevenson-Yang, co-founder of research firm J Capital Research. "The question is, what are the policy measures to take it there?"

How did we get here?

Dual Circulation as a name is an echo of a policy proposed by the leadership in 1987—"international circulation economic development strategy"—when Beijing was desperate to expand its economic ties with the outside world by whatever means possible. The original policy, pushed by reformist leader Deng Xiaoping, correctly presumed that China could fund national development by using its low-cost workforce to develop export-intensive industries. In the following years, the country became the "world's factory," manufacturing a mind-boggling range of goods and shipping them across the globe.

But the limitations of an export-dependent system first appeared during the global financial crisis of 2008, when factory orders for a time dried up. Hu Jintao, Xi's predecessor, proposed countering the crisis by expanding domestic consumer demand. The government rolled out a swathe of new policies to this end, including tax breaks for businesses supplying the domestic market and subsidies for farmers buying locally-made home appliances.

The trend was turbocharged in 2015 when Premier Li Keqiang launched the Made in China 2025 policy, a national strategy to move the country's manufacturing sector higher up the food chain through a process of import substitution. By encouraging the local production of previously imported products and services, the goal is more independence from foreign suppliers in areas like biotech, energy and, crucially, the semiconductor chips vital for high-end electronics.

In recent years, the Chinese economy has been slowing. That, plus the trade war with the United States and the desire of many countries and companies to become less dependent on China supply chains, heightened by the COVID-19 pandemic, has made Beijing hyper-aware of its economic vulnerabilities. Having once seen global trade ties as a source of geopolitical and economic growth, China is being forced to consider the consequence of its own reliance on other nations. The US government's punishment of Chinese tech champions like Huawei and ZTE for breaking sanction rules by denying them access to key US components and technologies has had a clear impact on thinking.

"The trade war initiated by the US has made China realize that it couldn't rely on imports of key equipment and core technologies anymore," Cong Yi, a professor at Tianjin University of Finance and Economics, told the state-run *Global Times* in July. "Hence, the country will surely ramp up its efforts to make key breakthroughs in bottleneck technologies such as semiconductors and high-end manufacturing."

Other countries in the region, most notably Japan and South Korea, which created the blueprint for economic development, have already shifted their economies from export-focused to domestically led. China now has a rapidly growing middle-class, calculated to be at least 400 million-strong, increasingly willing to buy local products. The difference is however, that Japan and South Korea had ready reached a general level of prosperity when exports began to fade in importance, while China is still well behind them in per capita gross domestic product (GDP) terms.

Despite that, the switch is underway. Domestic consumption has been the fastest-growing part of the economy for the last eight years and accounted for 60% of GDP growth in 2019. Retail sales have also increased more than 200% in the last decade, putting them almost on par with the US in dollar terms and growing twice as fast.

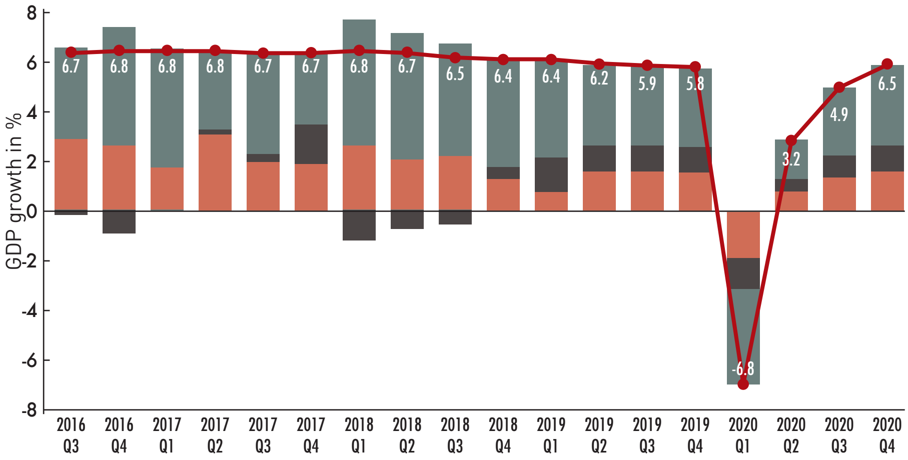
"China is the world's best consumption story and Dual Circulation seems designed to support this trend," says Andy Rothman, investment strategist for investment firm Matthews Asia.

However, Michael Pettis, Professor of Finance at Peking University, says "China can only rely on domestic consumption to drive a much greater share of growth if workers begin to receive a much higher share of what they produce, so the very process of rebalancing must undermine China's export competitiveness."

"This means that for 'internal circulation' to succeed, "international circulation" must be undermined," he wrote in the *Financial Times*. "One cannot boost the other, as Beijing proposes: the shift itself will require a difficult adjustment period."

COMPOSITION OF GDP GROWTH

Net exports still make up a significant portion of China's economy



Source: National Bureau of Statistics, Medium

What does it mean?

In various mentions of Dual Circulation since May, President Xi has stressed "dual," saying that "internal circulation" will be supported by "external circulation." Details remain scant, but China watchers expect to learn more during the annual parliament session in early 2021 when Dual Circulation is expected to be put forward as a key priority of China's 14th five-year plan.

"The 'dual' part is using domestic and international circulation to reinforce each other," explains Gilliam Collinsworth Hamilton, China Editor at research company Gavekal Dragonomics. "What that means specifically is weaning the country off its vulnerabilities in global economic trade and using the domestic economy, particularly consumption, as a buffer, just in case global headwinds arise, whether in the form of another trade war or pandemic."

Investing in tech innovation and pushing manufacturing further up the value chain will affect both internal and external circulation, Rothman says. The smaller export portion of the economy is also likely to shift from developed markets, such as Australia, the European Union and the US, toward developing countries.

Again, this is nothing new. China's total export value to the EU, United Kingdom and US has been falling. Meanwhile Beijing has been the biggest trading partner for ASEAN countries for the past decade, with bilateral trade reaching $292 billion in the first half of 2019. President Xi's signature Belt and Road Initiative—a $1 trillion transcontinental trade and infrastructure network—is also diversifying the export portfolio away from more developed countries.

"The government likes slogans," says Rothman. "Sometimes they have political meanings, sometimes they are just designed to reiterate what's happening. Dual Circulation is an easy way to describe what's been going on for a long time."

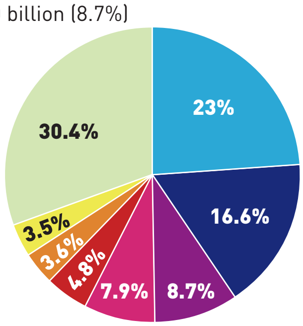
How will it be achieved?

Efforts to implement Dual Circulation are being made across all areas of the economy. In July, the Ministry of Infrastructure and Information Technology announced the "same standard, same quality" initiative, aimed at boost domestic consumption of locally-made goods by ensuring the quality matches those exported. More duty-free shopping areas are also opening in a bid to encourage some of the luxury spending the Chinese are famous for overseas to take place at home.

Meanwhile, government financing and private support is pouring into industries seen as too reliant on imports. Banking and insurance regulators put out a notice in March encouraging banks to lend to

WHAT'S NEEDED? | The composition of China's imports in 2019

- **Electrical machinery, equipment:** $496.8 billion (23% of total imports)
- **Mineral fuels and mineral oil:** $343.6 billion (16.6%)
- **Nuclear reactors, boilers and mechanical appliances:** $180 billion (8.7%)
- **Ores, slag, coal ash:** $163.6 billion (7.9%)
- **Optical, technical, medical apparatus:** $98.7 billion (4.8%)
- **Vehicles:** $75.1 billion (3.6%)
- **Plastics, plastic articles:** $71.6 billion (3.5%)
- **Other:** 30.4%



Source: IMF, International Trade Center, Trendeconomy

China's "core enterprises," an effort to accelerate research and development into substitutes for imported components. Energy, pharmaceutical supplies and technology are likely to be the focus of investment, according to the Economist Intelligence Unit (EIU). In the tech field alone, the government has released a multi-billion-dollar fund and 10-year tax exemptions for companies developing domestic alternatives to integrated circuits.

"We believe that under Dual Circulation, reducing these vulnerabilities and fortifying self-reliance in production and distribution will be the priority even if it results in some economic inefficiencies," says EIU principal China economist Yue Su.

But the building of domestic consumption and supply chains does not appear to be a simple policy of autarky and isolation. Beijing is still encouraging foreign investment, having released guidelines in August on how to streamline regulations for international businesses. Shutting off exports would also be counterproductive given how well Chinese manufacturing performed in the pandemic. Exports rose almost 10% to an all-time high of $239.8 billion in September, buoyed by global demand for medical supplies and personal protective equipment (PPE).

"A great deal of the economy is still dependent on global trade," says Collinsworth Hamilton from Gavekal. "China's really trying to have its cake and eat it to gain more control over its long-term growth without losing its position as a central manufacturing hub."

Whether Dual Circulation is a relabeling of older policies or not, most analysts think it will make life harder for some foreign companies doing business in China. Domestic firms are not only being prioritized and receiving investment, but are also likely to be more adept at executing according to the needs and preferences of domestic consumers. Foreign companies may need to localize operations, invest more in the business ecosystem and align carefully with government policies to compete effectively.

Those that find themselves in the right sector at the right time, however, will still reap rewards. General Motors, which teamed up with SIAC Motor in 1997, has sold more cars in China than in the US for each of the past eight years, while Nike posted 22 consecutive quarters of double-digit revenue growth in China before COVID-19 took hold.

"The rebalancing of the economy toward domestic demand has already turned China into the world's best consumer store," says Rothman. "As a result, many foreign companies are making a lot of money selling a lot of stuff to consumers and that's going to continue."

Will it work?

Both risk and opportunity will come together with changes in China's economic policy. Despite the best efforts to boost domestic consumption over the past decade, private consumption as a share of GDP has only increased slightly. As measures have focused on subsidies for consumer-facing industries and incentives for shoppers to make planned purchases earlier, it is unlikely most Chinese, known to be steadfast savers, are going to empty their coffers with gusto, especially after the hit the economy took over the last year.

The EIU is also doubtful about the country's ability to compete with other global players when it comes to semiconductor design. And while China may reduce imports in the low and mid-range chip sector, a whole new ecosystem will need to develop before manufacturers have workable replacements for the most sophisticated foreign chips. Finally, placing resilience above productivity will come at a cost.

"The new growth model will reduce productivity, thus having an impact on income levels, which will also risk household debt sustainability if wages cannot compete with borrowing cost," says Yue Su.

"Past growth has depended heavily on the current distortions in income distribution. The transformation to a new model will almost certainly require a difficult adjustment period," writes Pettis. "For Dual Circulation to work, internal circulation can only come at the expense of international circulation and as this happens, wealth—and with it, power—must be shifted from today's elites to ordinary households."

However, according to an October report by Japanese financial holding company Nomura, directing funds to high-end manufacturing could boost productivity and increase growth potential, with China achieving economies of scale in many sectors thanks to its huge population of consumers. This will also enhance commercial opportunities and jobs in key sectors, again helping to boost consumer spending.

"This has been going on for years," says Stevenson-Yang. "It tends to kill innovation, but if your goal is to spend less on foreign exchange and make more stuff yourself, it tends to be pretty effective."

INVESTMENT INTERMISSION

Chinese outbound investment has seen a sharp fall globally. Will the trend last?

By Samantha HuiQi Yow

Image by Gabriel Heredia

Chinese investment around the world is plummeting due to recipient reluctance and difficulty in getting money out of the country

Everything seemed to be moving smoothly for China's leading dairy producer Mengniu, one of the world's biggest industry players, in its takeover of Australia's second-largest milk processor, Lion Dairy and Drinks. Then suddenly, in August 2020, Australian Treasurer Josh Frydenberg told the bidder that the investment would be "contrary to the national interest." Mengniu had to walk away from the deal worth an estimated $423 million.

The Australian government's decision raised eyebrows as Lion was already foreign owned by Kirin, a Japanese brewery company. The conclusion was that the decision to ban the sale was related to Australia's growing diplomatic and trade dispute with China.

For two decades, China has been one of the world's biggest M&A players with state firms, private enterprises and individuals buying up assets around the world at an unprecedented rate. But 2020 saw M&A activity hit a 10-year-low, after peaking in 2016. There are two reasons—ever stricter controls by the government on capital outflows, and ever tighter restrictions on firms making asset purchases in other countries.

Purchase history

The sharp fall in Chinese purchases is a huge shift in global investment flows. Beijing's "Going Out" policy encouraging companies to make strategic purchases abroad, which began more than a decade ago, resulted in an enormous number of deals. "Europe in particular became a frequent destination," says Kathrin Neunteufel-Steyer, co-founder of CultureBeyond Think and Do Tank. "Acquiring a local brand in the region helped companies have an easier start with European customers."

In 2005, outbound M&A activity was valued at an estimated $13.3 billion, which accounted for 0.7% of the total global M&A market that year. Five years on, the number had more than quadrupled—in 2010 it was worth $59.5 billion or around 2% of the world total. The number of deals jumped during the period from 55 to 124. The Belt and Road Initiative, under which China has been funding infrastructure projects across the developing world, has also added to the outbound flow of funds.

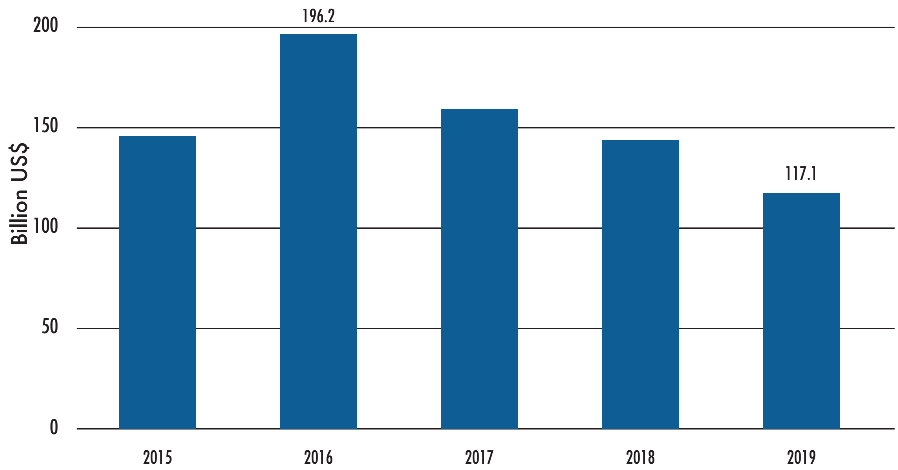
"Economic growth and years of foreign exchange reserves provided China with the capital ability to pursue outbound investment," says Carl Li, senior partner at AllBright Law Offices in Shanghai. "The Go Global strategy and Belt and Road Initiative drove it further."

A significant proportion of the M&A deals have always been in the dairy, energy, mining and utilities sectors due to China's huge demand for natural resources and agricultural and food products. One of the largest moves early on was the purchase in 2010 by state-owned Chinese National Offshore Oil Corporation (CNOOC) of a 50% stake in Argentinian oil and gas company Bridas Corporation.

> "...expectations and attitudes toward Chinese M&A in the US took a downturn
>
> Felicia Pullam
> Regional Manager of East Asia
> Maryland Department of Commerce

SHRINKING INVESTMENT | Outbound investment has become increasingly challenging

Chinese companies' outbound direct investment



Source: National Bureau of Statistics, State Administration of Foreign Exchange, Caixin

The $3.1 billion transaction also granted the Group partial ownership of Pan American Energy LLC, in which Bridas held a significant stake. But the peak of the spending spree overseas came in 2016 when total outbound M&A deals value reached over $220 billion—an astounding 246% increase compared with 2015. Of the 932 transactions, 51 were worth over $1 billion each.

The following year saw what was probably the single biggest purchase—a state Chinese company paid $43 billion for the Swiss agrochemical business Syngenta—and it may have been that deal which marked the turning point. China's ambassador to Switzerland Gen Wenbin arrived after the deal was done, but in 2019, he told the *Tages-Anzeiger* newspaper that, "If I had been the ambassador a year earlier, the takeover wouldn't have taken place. It wasn't a good deal for the Chinese side. It was for Switzerland—it got $40 billion."

Capital controls

But the money has not flowed at the same rate since. In the first half of 2020, global advisory firm EY said that outbound M&A activity declined 17% with transaction values down 40%, and while the COVID-19 pandemic played a role in the sharp reduction in deal making, other trends also strongly contributed.

Restrictions on capital outflows is one factor. Worries that capital flight—often disguised as investment—would shrink the country's foreign reserves and weaken the currency, the renminbi, promoted Beijing to institute tough controls in 2016, citing "irrational" foreign purchases.

But the suggestion that the spending spree was curtailed because China had already cornered the market and captured the assets it needed is "not a fair statement," says Li. "There are many contributing factors as to why the heat of outbound M&A reduced after 2017 but having purchased everything is not one of them."

All Chinese companies, both state and private, wishing to make purchases outside of China must go through a complex approval process involving the State Administration of Foreign Exchange and the National Development and Reform Commission, which oversees the economy. The government has long promised to make the renminbi fully convertible on the capital account, but it remains highly constrained.

The huge capital outflows in a variety of guises in 2015 and 2016 prompted the Chinese authorities to act. Increased restrictions on Chinese firms making overseas investments in industries such as real estate and hospitality followed. Potential acquirers were warned against purchasing "non-core" foreign assets. Even state-owned companies were not spared scrutiny as regulators demanded that they lay out the financial arrangements before a deal could be inked.

China's state banks were further instructed to review their exposure to China's most active players in the outbound M&A market. This dealt another blow to those eyeing global expansion through acquisitions, while also encouraging them to invest in China instead.

"The new regulations were intended as an incentive for domestic businesses to grow while minimizing uncontrolled capital outflows," says Neunteufel-Steyer.

Growing negativity

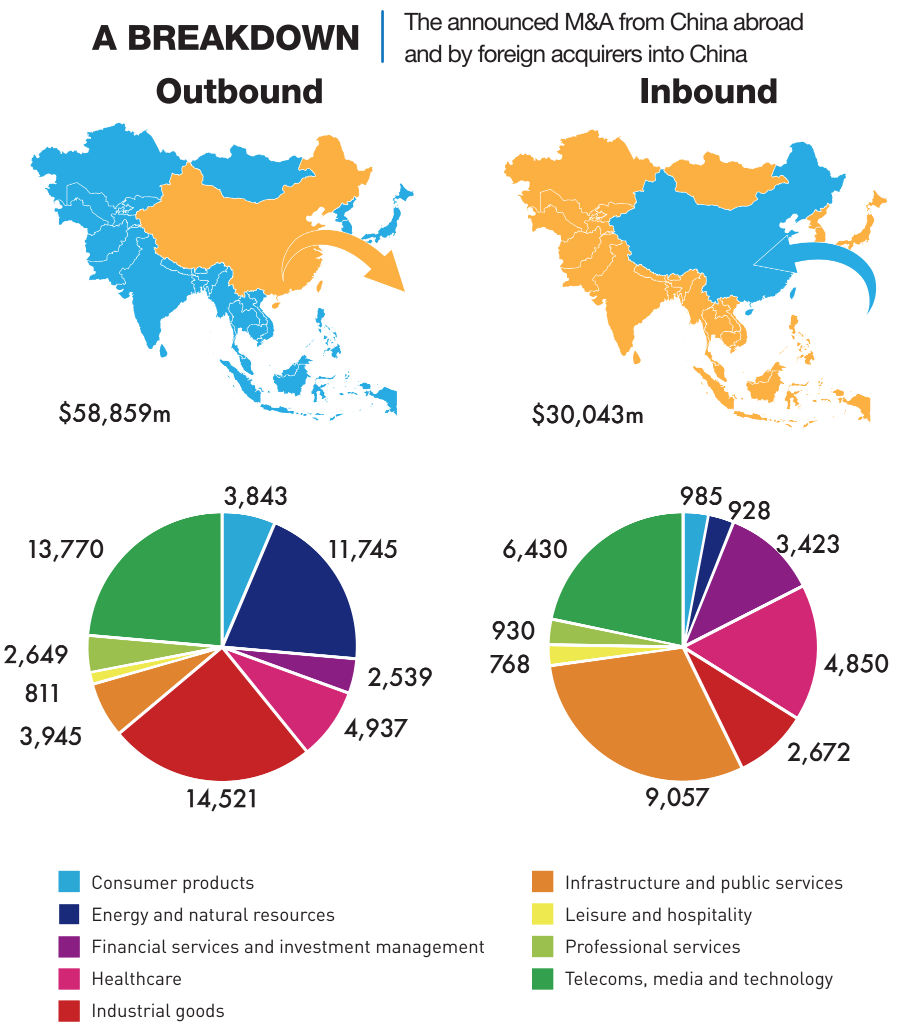
In addition to stricter capital controls, the last few years have witnessed a growing sense of discomfort in many places around the world about the big-spending of Chinese companies buying up nationally strategically assets.

"M&A can be politically controversial," says Felicia Pullam, regional manager of East Asia at the Maryland Department of Commerce. "If you're attracting foreign M&A, you could potentially be recruiting foreign competitors to take over local companies."

The former Trump administration in the United States was particularly cautious and critical of Chinese investments, with the Committee on Foreign Investment in the US (CFIUS) slamming the brakes on several nearly done deals. "The way the US market is structured, a president or a senator or a governor does not necessarily have that much say in what private companies decide to do," says Pullam. "So CFIUS is how the federal government can exert actual influence on M&A deals."

One deal nixed by CFIUS was the sale of global payment service MoneyGram to Alibaba's Ant Financial in 2018, as confirmed by a statement by the former's CEO that the Committee on Foreign Investment in the United States "[did not] approve this merger."

Public sentiment in the US appears to support a harder line. "Of course, there's a variety of public opinion, but I think to



Source: IMAA analysis, Dealogic, Daxue Consulting

some degree, expectations and attitudes toward Chinese M&A in the US took a downturn," says Pullam. "And I think it will be difficult to change that perception among the general public."

Europe has also grown less welcoming. "Investments are expected to further slow in the short-term as Europe continues to tighten their foreign investment screening mechanism," says Neunteufel-Steyer. For example, strengthened regulatory reviews over political concerns delayed approval for the acquisition of Energias de Portugal, Portugal's largest utilities company, by state-owned China Three Gorges Corporation, leading to the cancellation of a $10.3 billion offer in May 2019.

But at the end of December 2020, China and the EU unveiled a long-awaited investment treaty that aims to open lucrative new corporate opportunities. The basic terms of the accord were confirmed by President Xi Jinping and EU leaders, closing seven years of often difficult negotiations.

Valdis Dombrovskis, the EU's trade commissioner, told the *Financial Times* that the deal contained the "most ambitious outcomes that China has ever agreed with a third country," in terms of fair competition, market access and sustainable development. "We expect European businesses will have more certainty and predictability for their operations," he said, adding that "for a long period, trade and investment relations with China have been unbalanced."

In some parts of the developing world, there is little opposition to doing deals with China. However, fund shortages and a slowdown in Belt and Road Initiative projects from 2019, has meant a fall in the number of deals being done in places such as Africa and South America.

A focus of M&A from the 1990s has been commodities and energy, and this remains key. Chinese state-controlled firms have made significant investments into power utilities companies including the purchase in 2019 by the State Grid Corporation of China (SGCC) of the Chilean arm of Sempra Energy and Oman Electricity Transmission at $3.84 billion and $2 billion, respectively. The latter also marked SGCC's first major foray into the Middle East.

But starting in the 2010s, technology firms also became an area of interest, creating a growing dilemma for Western countries—is China a strategic competitor? If so, to what degree, and what technology should be withheld?

Decoupling

The buying spree in recent decades paralleled the rising trend of globalization, which has seen a huge shift in manufacturing capacity to China, plus a rise in prosperity in much of the world. But concerns about the impact of globalization also led to the rise of protectionism and nationalism, as represented by Britain's departure from the European Union and the election in 2016 of Donald Trump as US president. And protectionism makes it harder to get approval for foreign takeovers, particularly by Chinese firms.

The result is that for the first time in a decade, between January and May 2020, inbound M&A surpassed Chinese outbound M&A activity in both volume and value terms. It seems unlikely that the world will see large capital outflows from China again any time soon.

But stemming Chinese investment is not necessarily a good thing, either for the world economy or for individual local economies, says AllBright's Li. "The real harm to the world economy," says Li, "is the protectionism and unilateralism driving China's reduced M&A activity."

THE ART OF CHINA

China's still-young art market is vibrant, but is the money going to be spent on local or Western art?

By Crystal Wilde

China's still-young art market has huge potential, but how does it compete in today's winner-takes-all global art economy?

In a buzzing auction house in the affluent coastal city of Shanghai, the throng of buyers shuffle to their seats. Up at the podium, the auctioneer begins calling out works by celebrated contemporary Chinese artists Shang Yang and Zhou Chunya, but it is the names of Western artists—Marc Chagall, Salvador Dali and Pablo Picasso—that captivate the audience. When the final bids are tallied, the lots from Western greats pull in double those of the Chinese.

That 2015 Christie's international art auction personified a notable change in the tastes of Chinese buyers that the industry is still grappling to understand. In earlier years, the Chinese preferred traditional artworks and antiques, long considered particularly sound investments. But over the previous two decades, both the number and sophistication of buyers has been gradually increasing. Rather than gravitating towards local contemporary art, many Chinese investors are beginning to see Western art, which hangs in museums and galleries around the world, as a safer bet.

International interest in Chinese contemporary art has also declined since a decade ago, with African art the current flavor of the month. So, what is the future for the art market? Will the next generation of Chinese buyers reinforce existing market dynamics by looking towards Western and Africa art, or will they support local contemporary art, allowing it to carve out a strong space in the ecosystem?

Developing the market

After lying largely dormant from when the Communist Party assumed power in 1949 through to the end of the Cultural Revolution in the late 1970s, the domestic art scene underwent an astounding four-decade boom. Under the planned economy, only state-owned antiquities stores could buy and sell artworks, but this began to change in the 1980s with Deng Xiaoping's market reforms. By the early 1990s, private galleries and domestic auction houses were emerging, marking the transition to a market art economy.

China's first art auction house, state-owned Duo Yun Xuan, launched in Shanghai in 1992, followed by China Guardian Auctions in Beijing a year later. The arrival of auctions, coupled with rapid economic growth and rising individual wealth, created substantial domestic demand for domestic art. While in the West, galleries serve as the primary market for artists to sell to collectors, in China it is local auctioneers who whip up interest and shape tastes.

"Artists didn't have gallery representation because there were no commercial galleries. Auction houses played the primary market role," says Anita Archer, director of Pegasos5, an Asia-focused art consultancy. "The auction houses were crucial for the development of the contemporary art market."

According to a 2019 survey of Chinese collectors by The European Fine Art Fair, TEFAF, auctions are considered more trustworthy and transparent than dealers and galleries and are still overwhelmingly the preferred choice for buying and selling art. "The Chinese like auction houses," says Olivier Hervet, partner of HdM Gallery, which has outposts in Beijing and Hangzhou. "You feel safer in your investment when people are fighting to buy the same works as you."

During the 1990s, art shows, galleries and private museums began to emerge. The Yan Huang Art Museum, the first to feature an individual's collection, opened in Beijing in 1991. The Red Gate Gallery, China's first private contemporary gallery, pioneered by Australian collector Brian Wallace, followed shortly after. In 1992, Art Bazaar, the first art fair, launched in Guangzhou. By 2017, there were 525 auction houses, including the 2005-founded Poly Auctions. Today, Poly Auctions and China Guardian Auctions are the third and fourth largest auction houses in the world, trailing only the international duopoly of Sotheby's and Christie's.

Altogether, there are now 20 major art fairs, nearly 1,500 private museums and more than 4,000 galleries. China is the third-largest art market after the US and UK, with 18% of global sales in 2019, equating to $11.7 billion of a total market of $64.1 billion. Despite this, the 2019 figures mark a decline from second place in

2018 and first in 2011. While art was once seen as a safe investment by the nouveau riche, many dropped out of the market after realizing that gains are neither quick nor guaranteed.

Heritage revival

Every year, around the October anniversary of the looting of the Summer Palace by Anglo-French forces in 1860, the government announces plans to catalogue and retrieve stolen artifacts from overseas. Buoyed by a surging economy and a sense of patriotism, dealers and collectors have joined the quest, bidding huge sums for lost treasures, including ancient books, jade jewelry, porcelain and traditional ink paintings.

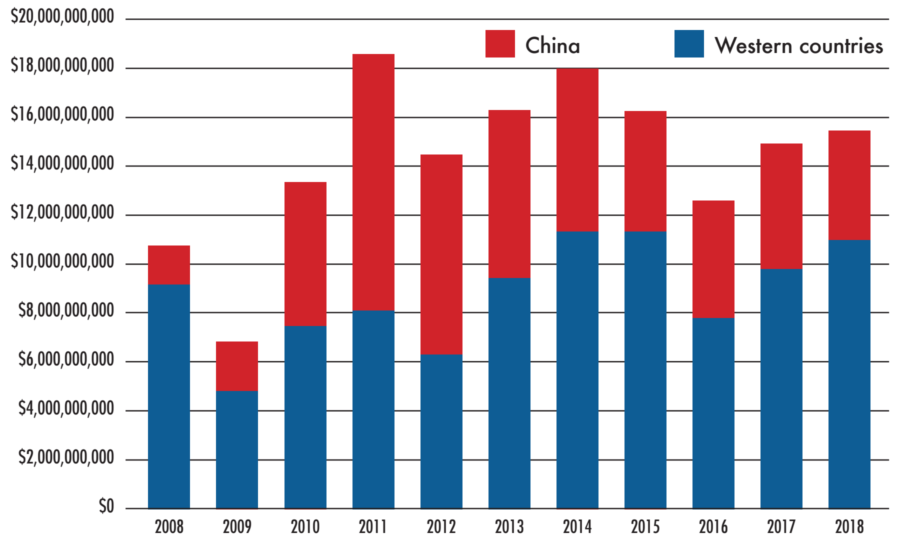
In 2010, a Qing Dynasty vase was purchased from an English auction house by a Beijing-based bidder for $85.9 million, 50 times its pre-sale estimate. In 2018, Shanghai real estate developer Xu Rongmao acquired a Ming Dynasty painting of the Silk Road for $20 million from a private collector. He then donated it to the Forbidden City Palace Museum. Over the last 15 years, thousands of other items have been recovered by members of the Chinese American Collectors Association, who pool resources to buy back artifacts and donate them to institutions.

"Many say they collect for patriotic reasons," says Samantha Culp, curator and consultant at international art agency Paloma Powers. "They say it's their duty to support, collect and conserve treasures of Chinese art history."

"Some repatriation of artwork is to do with patriotism and can be ostentatious," adds Christopher Moore, publisher of Shanghai's Randian Art Magazine. "They want to show they're supporting Chinese institutions and the restoration of China."

According to Archer from Pegasos5, however, the incentives behind such purchases are not always so noble. "Earlier this decade, artworks were given as gifts to bureaucrats who did not necessarily know their value. The Chinese were buying [Chinese antiquities] to win influence domestically, but also as a means of moving capital internationally," she says.

SPENDING POWER | China contributes a growing portion of global auction revenue



Sources: Artprice

Looking West

As the art market has matured, buyers have developed an interest in Western art, driven by the popularity of international art fairs like Art021 and the West Bund Art and Design fair in Shanghai, as well as an increasing presence of foreign galleries. With a better support network of museums, galleries and experts behind it, Western art, whether it be works of masters like Monet or those of more modern blue-chip artists like Andy Warhol, is now seen by many as a safer investment bet.

"A local artist only supported by local buyers is much more vulnerable," says Hervet. "The slightest market dip will see them disappear completely."

Movie mogul Wang Zhongjun bought a Van Gogh in 2014 for $61.8 million. He followed up with a Picasso for $29.93 million the next year. Liu Yiqian, founder of Shanghai's Long Museum and one of the biggest clients of Sotheby's and Christie's, set a record in 2015 with the purchase of "Nu Couche," a painting by Italian artist Amedeo Modigliani, for $170.4 million.

"Chinese buyers are not willing to pay over a million dollars for a Chinese artist and even get nervous above $100,000, whereas they feel spending that amount or more on a Western artist is a more reliable investment," says Moore. "It's not about quality but how the market perceives the art."

Although TEFAF's Chinese Art Market Report 2019 predicts Chinese artwork will continue to be popular with the current generation of collectors, it also predicts that Western contemporary art will be the focus of the up-and-coming generation of well-traveled, overseas-educated buyers. This could propel art fairs and foreign galleries into a more prominent market position as Chinese auction houses have limited supply and expertise in Western art.

Let's get contemporary

Two distinct periods inspired international interest in Chinese contemporary art. The first was in the mid-1990s, when a series of international exhibitions, including the 22nd Sao Paolo Biennial in 1994 and the 46th Venice Biennial in 1995, thrust Chinese contemporary artists onto the global stage. The second started in 2004, when Sotheby's Hong Kong gave the segment its own category for the first time. Two years later, in the lead up the 2008 Beijing Olympics, a painting by Zhang Xiaogang sold at Sotheby's New York for $979,200, marking the first time a piece of Chinese contemporary art came close to the million mark.

Antique Chinese porcelain pieces fetch high prices at auctions

The sale triggered immense growth within China's cynical realism movement—typified by Yue Minjun's laughing self-portraits, Zeng Fanzhi's "Mask" series and Zhang Xiaogang's "Bloodline" paintings—becoming the aesthetic of the moment. Popular works were often characterized by pop art-style easy signifiers: Mao statues, Red Guards and propaganda iconography.

"Knowledge of Chinese contemporary art was mediated through foreign tastes, which tend to follow a neoliberalism narrative," says Nixi Cura, a senior teaching fellow at SOAS University of London and a specialist in Chinese art. "Any exiles or dissidents seen to have been repressed by the government were viewed through this romantic lens and would gain traction in the international market."

Then the bubble in Chinese contemporary burst after the global financial crisis of 2008, and many opportunist China-based buyers dropped out of the market. In the absence of a well-developed domestic art infrastructure, artists who had not yet achieved fame overseas—the vast majority—all but disappeared, both at home and abroad.

The contemporary art scene is much more diverse these days, "influenced by a similarly kaleidoscopic range of things as artists all over the world," says Culp from Paloma Powers. While Chinese collectors surveyed by TEFAF still consider Chinese contemporary art their top collecting category, it has fallen out of favor with Western buyers partly due to worsening diplomatic relationships and a global pivot towards African art.

Business is still good for artists who made a name during the boom years, however. In 2019, the most expensive piece of Chinese contemporary art was Sanyu's "Five Nudes," which sold at Christie's Hong Kong for $38.85 million, placing it among the top 12 global auction performances for the year. Another sold in Hong Kong in July 2020 for $33.3 million, confirming Sanyu's status as one of the most sought-after names.

Art world made anew

Chinese antiques will remain a popular market subsection having found a new appreciation among collectors from America and Europe. While the nationalities of buyers are difficult to ascertain, Sotheby's featured more than 2,400 Chinese antiques in auctions across Asia, Europe and the Americas in 2020, pulling in a total of $179 million.

But Chinese art, Chinese art buyers and the domestic market will change dramatically in coming years. Artists are more connected to the world via the internet, education and personal travels, so are less influenced by traditional masters. They are moving towards universal themes and new mediums, to the point where Chinese contemporary art is no longer easily distinguished from that of the West.

More collaboration and crossover between industries, such as design, fashion and technology, can be expected and the number of experience-based installations with broad public appeal (and that generate money primarily through ticket sales) are also likely to increase, according to the TEFAF report. Successful recent examples include digital installations like MoMA Rain Room, which attracted 200,000 visitors to Shanghai's Yuz Museum in 2015, and Team Lab, which lured 400,000 selfie-snappers to Pace Beijing in 2017.

With more international galleries entering China, domestic galleries are likely to struggle, leading to consolidation. Auction houses, less favored by the new generation of Chinese buyers, may also be forced to diversify their offerings. China Guardian Auctions, for example, has already moved into art investment, education and publishing.

Despite slower economic growth, uncertainty around the China-US trade relationship and capital control regulations, China will remain a key player globally. As young Chinese start buying through galleries and attending international shows and art fairs, their interest in Western art will increase. A healthier domestic market will also develop thanks to these changes, so up-and-coming Chinese contemporary artists will in turn enjoy more exposure.

Moore of Randian Art Magazine is optimistic that the coming breed of Chinese contemporary artists will gain attention from both domestic and international buyers. "[The Chinese art market is] going to get bigger, stronger and more vibrant internationally, regardless of what governments say or do to each other," he says. "Despite their efforts, the world is becoming more connected, not less."

Economic Headwinds

Andy Xie, former Morgan Stanley Director and Chief Asia-Pacific Economist, predicts what the future of US-China relations hold

Andy Xie is a renowned independent economist based in Shanghai, specializing in China and Asia. He is the former Morgan Stanley Managing director and Chief Asia-Pacific Economist, and currently Director of Rosetta Stone Advisors. In 2013, Bloomberg named him as "one of the 50 most influential persons in global finance."

Xie is renowned for provocative views on the Chinese economy and a formidable accuracy rate in his predictions. Prior to joining Morgan Stanley, he had spent five years as an economist with the World Bank. In this interview, Xie discusses issues including China's role in the global financial system and the future trajectory of US-China relations.

Q. What is your view on the state of China's economy and how do you see it progressing in the short- to medium-term?

A. China's economy is stable as COVID-19 has been brought under control domestically. The pandemic's impact on the service sector is not now as dramatic as it was. Other countries, however, are in trouble and cannot get production going, so China being the "Factory of the World" is working out for them at this time. China is benefiting from the pandemic in a way.

On the other hand, we see headwinds. The first is the affect that the pandemic had on incomes. The government did not hand out helicopter money like other countries. Many businesses suffered, and personal income levels suffered. That negative effect is not reflected in statistics. White collar workers make a significant amount of their income from bonuses and benefits, but those have since disappeared. We are seeing the effect of this on consumption, especially white-collar consumption, such as in expenditure on clothing, coffee and restaurants. Blue-collar income seems to be holding up because we have a labor shortage in that sector. But overall, consumption is not doing well. It is stable, but not driving the economy.

Another point: 20% of China's gross domestic product (GDP) is infrastructure. It is questionable how sustainable that is, but it is holding up. In the property market, sales are not holding up despite the propaganda. In terms of investment, its mainly government driven. Those three parts of the economy—exports, infrastructure and property—make up half of GDP. The other half is not doing well but is where we are at present.

> China is hunkering down for stagnation. The old story of focusing on growth is gone

Q. The topic of the moment is the Dual-Circulation policy to place less emphasis on external economic activity and more on domestic activity. What is your opinion on the policy and what do you think its prospects are?

A. Dual Circulation is another way of promoting consumption and that idea has been around for about 20 years. Hu Jintao, the former leader of China, was promoting it in 2007 when he talked about capital income. The government then stoked a stock market bubble as it was seen as the way to make people rich so that they could spend money. Afterward there was this property bubble, which was essentially the same idea, but it worked in the opposite direction.

So, the Dual Circulation policy is just another idea to promote consumption, but it doesn't work because the Chinese consumption problem is driven by income distribution. Personal disposable income is 43% of GDP. On the other side you could look at property sales in the last few years, which is 17% of GDP. Property sales are driven by the fear factor of, 'If you don't buy now, you won't be able to afford it in the future and will not have a place to live.' That's how the whole thing works. So, if you look at the 43% and compare it to the 17%, you realize that is why the housing sector's been accumulating significant debt.

Q. Exports are doing well, but headwinds internationally may mean that will be difficult to maintain. What would be your assessment?

A. China is hunkering down for stagnation. The old story of focusing on growth is gone. The political agenda is now stability, and that is based on two things: One, that the people do not starve and, two, that everybody is under control. Resources are being put in to increase social control. That is the priority now, not growth.

The most critical thing for the government is ensuring food security, that's why they are cracking down on waste. Pork has also become less available because of surging prices. So again it comes down to the Chinese way of efficiency—food efficiency. The Chinese government is immensely powerful, they can change the prices to make you eat something that fits the agenda for food security, such as more chicken and less pork.

Q. What do you see as the trajectory of China-US relations in the next two to three years?

A. The rivalry is a long-term change, with many elements at play—ideological, political and power. It is impossible for us to go back to the way things were, the rivalry is here to stay and it will define this century.

In my view Biden is not a decisive person and lacks historical vision. He does not fully understand what's going on between China and the US. Obama and the last few US presidents didn't fully understand the history and ideology behind the relationship either. Trump was more focused on the power struggle between the two nations but didn't understand how to diffuse the situation. He rocked the boat to vent his frustration. Biden is clearly not interested in adopting an aggressive tactic. He says he wants to work with allies to find a solution, but that really means procrastination and further delay in dealing with the root of the problem.

The relationship will eventually cool down on the surface. Many people have been against trade war tariffs, so it's likely those will be rolled back. In the technology sector, however, they will stay, because that is not just up to the president. Defense and intelligence teams will watch the situation closely. There will be selective sanctions against Chinese companies that use global technology supply chains to make products that endanger information security. That means Chinese companies will be cut off from advanced chips. But Western companies manufacturing products in China, like Apple, will continue to have access to those chips. This will push China back to being the Factory of the World of ten years ago, before the rise of companies like Huawei and Xiaomi. A significant piece of China's economy will be disconnected from the global system as a result.

Q. What do you see as the prospects for China-listed companies in the US and other markets around the world?

A. It will very much be gone. There will also be a tightening of scrutiny in terms of accounting standards. It will end up being too troublesome for Chinese companies to get listed in the US. Additionally, the US is a deficit country and China is a surplus country. Why are companies going there for capital? In the future, the relationship will be defined by reciprocity. If Chinese companies can list in the US, then US companies should be able to list in China.

Xie believes that the new Biden administration lacks the historical vision to find a long-term solution to US-China friction

The equity market has never been important in China because most companies are private companies but are still kept on a short leash by the government. An equity market does not function well in this kind of environment. China has a government-controlled banking system, and the government counts money in terms of the overall economy, they don't consider the health of individual companies. These companies serve a political purpose too. Companies have to listen to the Party, they cannot solely follow the call of profit.

Q. What is your view on the US dollar and its dominance? China's is clearly trying to create a digital currency alternative to the US dollar. What would you view as the likely prospects?

A. If China really wants to do that, then that is what they will do. But that goal falls, of course, under their political agenda as well because China does not allow free capital flows. The entire system is very centralized, so you cannot have a currency that flows freely globally. That is why the US dollar, despite the US government abusing the dollar in unimaginable ways, is still holding up.

China is set to emerge as the largest economy in the world, but it has a huge deformity in that it cannot have its own free financial system. It can only latch on to another existing financial system. To have a proper financial system you must allow real ownership, which is something that the government does not allow. When money flows around the world, you must be able to buy real assets. China does not have any real assets. Even property is sold under usage rights, which is very odd. I do not see a way of breaking out of this trap, so the status quo will continue.

Q. What will the fundamental structure of the Chinese economy look like in the future, particularly the balance between the state and private sectors?

A. Things are leaning toward the government with even private companies now under tight control. I'm not sure if they're even really private companies anymore. We are in a situation where there are Chinese people living like tycoons and talking to international media, when in reality they're not real tycoons. Whatever they do, they need to get government approval first.

Q. What are the implications of that for the private sector?

A. The private sector plays a supportive role in terms of employment. Coffee shops, flower shops, hair salons—these are the kinds of businesses that the government likes, because they contribute to the agenda of the state. They are small, unimportant and never amount to anything. They are just a solution and they never challenge the government, which is something that they like.

If it is a big technology company, that totally different. China has this model where big companies can make piles of money with government support, and they can have a good time with it unless someone at the top tells them to stop. These people know that they really work for the government and so are always trying to understand what the government wants from them. It is a weird creature that has risen in China over the last ten years. It is something that would never work in the West because nobody there would want to work for something that isn't really theirs.

But in China, so many people want to enjoy the ride while it is good. It's comparable to being a leaseholder. You can be a billionaire for a month or a year, based on your performance.

Q. People say the property market is fundamental to the economy. Prices seem to be so high compared to international prices. What is your prediction for the property market?

A. The Chinese government has been holding up the market again, using banking systems, and encouraging speculation in tier-two cities, especially because local governments are facing financial trouble.

You get the banks to lend to people who buy properties, then their money goes to local governments to become physical revenue that pays their civil servants. It's an entirely political process and the Chinese government can play the people so well. If you can get the propaganda machine and the banks going, you can get people worked up about property again, then when the government feels like the fiscal crisis for local governments has eased, you cool it off again. Therefore, the property bubble for the government is a kind of asset. Like a tap, you can turn it on and off. It's a useful tool. It's also sustainable because if a lot of people want to sell at the same time, there are policies in place that prevent them from doing so.

> **Now, China will have to go backward to ten years ago in terms of economic relations. The ambition of Chinese companies will need to be scaled back.**

Q. With the Made in China 2025 policy in mind, what opportunities are there for foreign companies in the China economy in the next few years?

A. China is going back to being the Factory of the World, offering cheaper capital, cheaper land and cheaper labor. There's no other country like China. There's a combination between how well the government and people work together here and it cannot be replicated elsewhere on such a large scale. India is trying to do the same, but I've been speaking to the Indian government for 20 years and they still don't understand how to make it all work. It's not possible.

The Chinese government will return to accepting foreign companies, as that's the only path forward. If we use Apple as an example, local governments are still competing for Apple production. And even if Chinese companies stop making phones, the government would still like other companies to make phones in China. But China will never allow foreign companies like Facebook or Google to operate in China.

Now, China will have to go backward to ten years ago in terms of economic relations. The ambition of Chinese companies will need to be scaled back. China can be the Factory of the World because they are available to multinational companies, but in terms of internal policies, everything is still the same.

Q. How important is China to the global financial system? Is it still a small player still?

A. It is important. If you look at the corporate profit margin over the last 20 years, it has much to do with China. If you look at the auto industry, for example, many car parts are made in China and exported elsewhere. China exports $2.5 trillion of products each year. If those products were made elsewhere, it would cost three times as much! So, if you look at global profit margins over the years, those margins are largely due to China.

Q. How will China's role in the global financial system change over the next decade?

A. China's financial system will only change when its political system changes. What we are going to see is that China will become slightly bigger over the next ten years but its currency will remain closed. It might also have more offshore financial assets. But other than that, I see no fundamental change.

Another issue is that China's labor force is contracting. If we look forward, it is going to become even worse. Births last year were only around 15 million. In the 1970s, it was close to 30 million. China's demographic issues are becoming remarkably similar to those that Japan is facing.

FULL STOMACHS

China has made considerable strides in increasing food access and security across the country

By Shi Wei Jun

Decades of economic growth have enabled China's leaders to make considerable strides in increasing food supply

On a typical day this past summer, the bin for organic waste behind Huang Simei's popular canteen restaurant in Shanghai would be overflowing with leftovers by the end of the lunch rush. But since mid-August, the bin has been barely half-full when the garbage truck comes to empty it later in the evening.

As in restaurants across the country, many of Huang's customers used to order more than they could eat, creating huge amounts of waste, but a new government campaign reflected in posters plastered on the walls of her restaurant has changed that—the new mantra is "no waste, finish your food."

"Operation Clean Plates" is the brainchild of President Xi Jinping who declared in August that China has to "maintain a sense of crisis about food security" and stop being wasteful. The national campaign also sparked a bout of speculation over the government's ability to safely feed its 1.4 billion citizens amid crises on multiple fronts—locusts, once-in-a-lifetime floods, pandemic and rising tensions with major trading partners.

A message easier to swallow

Over the past 10 years, food self-sufficiency has been steadily declining, according to the Ministry of Agricultural and Rural Affairs. China had previously aimed for domestic supplies to cover 95% of demand. Over the last few years, however, self-sufficiency in grain alone fell to around 80%, due to a significant increase in imports of soybeans, largely used as feed grain for pigs.

But despite the posters and the agonizing as people digested the directive, most analysts view concerns over food supplies as misdirected. "Food security isn't currently something citizens have to worry about," says Matteo Marchisio, country director of China and representative for China at the International Fund for Agriculture Development (IFAD), a United Nations agency.

"However, the notion of food security has a powerful meaning for the population," he adds. "Talking about food waste from the standpoint of food security has a stronger effect than in terms of preserving the environment or the economic benefits." Linking the two also becomes easier to swallow when one considers that more than one-third of the food produced on farms—enough to feed 500 million people—is never eaten.

The campaign revealed how food security never strays far from the minds of policymakers—an anxiety summed up by the predicament that China must feed 20% of the world's population with 7% of its arable land. "The mentality about food security is very necessary for the country," says Si Zhenzhong, a researcher on food security in China at Wilfrid Laurier University in Ontario, Canada.

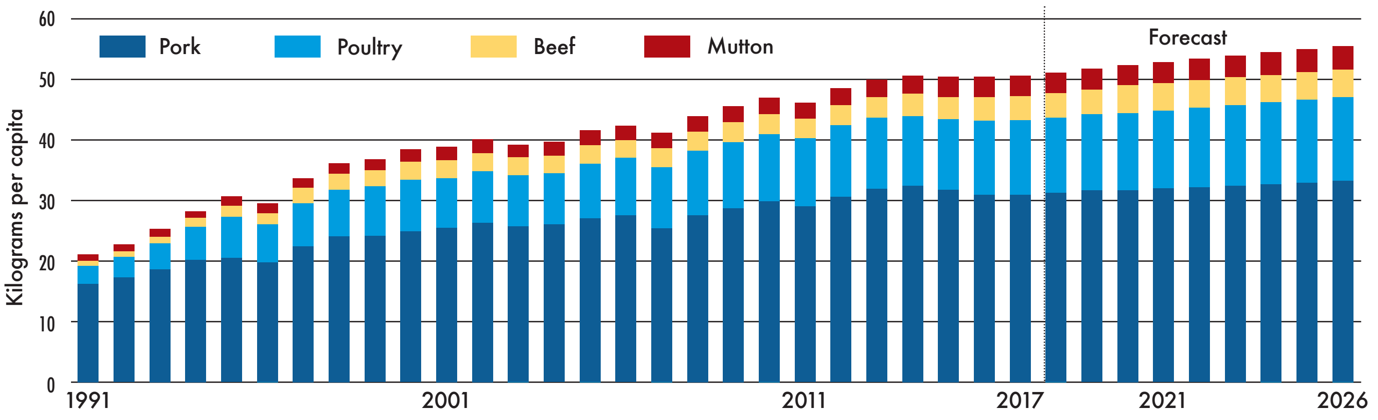
It is a staggering accomplishment that even with the most mouths to feed, China has been able to basically ensure food security and that the country is self-sufficient in its three major cereal grains—wheat, corn and rice. It is the result of massive amounts of research, major investment into crop technology and improved agricultural farming methods that taken together have turned the country into an agricultural powerhouse.

Nice to meat you

Diets have altered since the market-opening. In the late 1970s, the changes initiated sparked a prosperity boom that has allowed hundreds of millions of people to afford a new range of foods. As incomes have grown, so too have waistlines: Consumers have to a significant extent switched from traditional foodstuffs, characterized by grains and vegetables, to high-sugar and high-fat Western foods. Appetite for meat and animal products, including dairy has especially grown, says Chang Tianle, director of the Beijing Farmers' Market, a pioneer in China's organic farming movement, and a former program officer for the US-based Institute for Agriculture and Trade Policy.

Meat was a rare luxury during the era of Chairman Mao Zedong (1949 to 1976). But the average person last year ate 82% more chicken than 20 years ago and nearly 50% more beef and veal, according to data from the Organization for Economic Co-operation and Development (OECD) and

A MEATIER DIET | China is consuming increasing amounts of poultry, beef and mutton



Source: Caixin

the United Nation's Food and Agriculture Organization (UN FAO).

But while the Chinese have become more carnivorous over the past few decades, appetites for different animals have varied. Rising demand for beef and poultry—seen as healthier alternatives to pork—has been accompanied by a slump in the consumption of pig flesh, which has declined by 22% since peaking in 2015. This, however, was also partly due to soaring prices for pork after African swine fever decimated the nation's pig farms. Prices started falling toward the end of 2020 with the outbreak now resolved.

"The single biggest change to local diets is demand for fresh vegetables and salads, and meats that were not previously part of the Chinese diet such as beef and lamb," says Kitty Smyth, founder of China strategic advisory firm Jingpinou. "These products are difficult to find and expensive to purchase."

China produces most of the meat it consumes but remains a big importer. USDA data shows Chinese pork imports made up 44% of the global total and nearly 10% of domestic supply last year. Beef and veal imports accounted for 20% of world trade and 30% of domestic supply, although, again, the import and consumption figures for pork are skewed due to African swine fever.

A growing preference for beef has been followed by booming demand for dairy. China is now the world's top market for dairy imports, valued at $11.1 billion in 2019. Consumption of dairy products has grown rapidly from a historically low base, rising from 2010 to 2017 by 18% in urban households and by 94% in rural households. But per capita consumption per year remains low at around 36 kg compared with 300 kg in Western Europe.

The huge appetite for meat means that while the country is self-sufficient in grains, for humans, its livestock are another matter. Domestic feed supplies have been unable to keep up with soaring demand, forcing imports of soybeans and other feed ingredients to expand rapidly. China, the largest global buyer of soybeans, increased imports by 15.5% year-on-year to 74.3 mt in the first nine months of 2020—putting shipments on track to comfortably beat last year's 88.5 mt. Imports accounted for about 85% of domestic soybean consumption in 2019.

"Soybean is perhaps the biggest challenge for the stability of food supply," says Si. "As a major source of animal feed, soybean import is critical for China's livestock industry. If the global food trade market is significantly disrupted, the country's livestock sector will be greatly affected."

Huge appetite for grains

But grain is still the cornerstone of diets, supplying the bulk of calories for most people. Demand for the three staple cereals has been stable over the past years. Wheat consumption is predicted to reach a record 130 mt for the crop year from September 2020 to August 2021, a modest increase from 126 mt over the previous year and up from 117.5 mt in 2015-2016. Corn demand has tapered off at 270-280 mt since 2018-2019, while rice has been stable at 140-145 mt for the past five years.

Wheat, rice and corn cultivation are economically and culturally important—China is the biggest producer globally of all three. The self-sufficiency rate of wheat and rice exceeded 100% last year and was more than 90% for corn, according to a world food database maintained by Kyushu University in Japan.

Chinese people ate an estimated 145 mt of rice in the 2019-2020 crop year, maintaining its status as by far the world's biggest consumer of rice since the USDA started keeping records six decades ago. Consumption per capita, however, peaked in 1991 and has been stable at around 100kg for the past decade.

Ensuring food security

China has been able to draw upon thousands of years of experience as an agrarian society in its pursuit of food security. "It's a country especially recognized for her long tradition of sustainable farming knowledge," says Si. This prowess has long been acknowledged by the West, he says—as evidenced by the

1911 publication of the influential book *Farmers of Forty Centuries*, which detailed the highly productive and fertilizer-free farming practices employed in East Asia for centuries. "It's a demonstration of the rich knowledge of the country, accumulated throughout the long history of its cultural development."

More recently, China has parlayed its economic clout into science and technology allowing it to become an agricultural powerhouse. UN FAO data shows that China's spending on agricultural research in 2013 hit $9.34 billion—more than double the US, nearly triple India and nearly one-third more than Western Europe. Total government expenditure on agriculture, fishing and forestry has also surged since 2001, from $228 billion to $3 trillion in 2017.

The flood of money into farming technology has supercharged the sector. Many of the recent changes in farming practices aimed to reduce the demand for farm labor and at making that work physically easier as well, says Even Rogers Pay, an agriculture analyst at research firm Trivium China.

In the past few years, there have also been major efforts to reduce the environmental impact of farming. "Overuse of chemical pesticide and fertilizer was a particular problem in the early 2000s, and regulators saw it was risking public health and overtaxing the rural environment and soils," says Pay.

One-way policymakers frame this shift in approach to food security as being from yield-based to capacity-based. "It's a recognition that real food security means farms and the rural environment need to be healthy and productive in the long-term, rather than just maximizing yield through heavy chemical use in a specific year," says Pay.

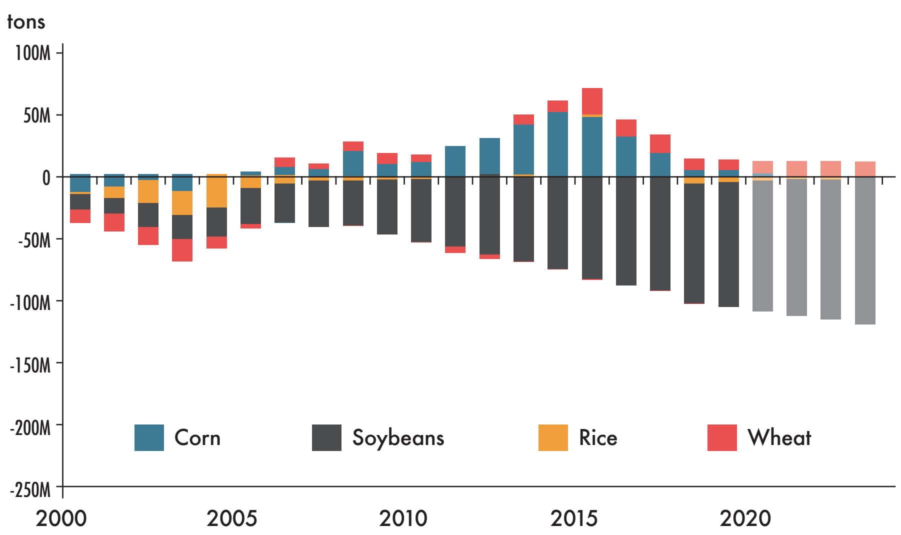
Mover and shaker

Even as the country works to boost agricultural productivity, imports will remain an important contributor to national food supply. "China was pretty much self-sufficient in food when people were mostly eating rice and noodles, but as diets shifted toward meat, it means that grain and oilseed imports are needed to feed huge populations of pigs and chickens," says Pay.

"Meat and dairy imports have also risen to meet demand. Some food imports are 'nice to have'—chocolate and wine—but other categories are important to keeping food prices affordable and supply of key products, like infant formula, stable."

Imports have become more important in the aftermath of the African swine fever epidemic that wiped out half of the national pig herd in 2018-2019. "It was a monumental crisis," says Smyth. "As a result, substantially more pork imports were needed, but it also had a ripple effect on the price of all protein sources, including beans, chicken and eggs." This has had a knock-on effect on domestic food prices, consumer prices in general and pushed up inflation over the past two years.

A BALANCE | China's crop surplus/deficit in grain



Sources: CBRE Research

The sheer size of the agricultural and food sector means China is a major player in the global markets for the soft commodities that it buys. "Whenever China changes its procurement plans, it can use that as potential leverage to affect political relationships—whether that is with Brazil, the US or any other country," says Si.

Soybeans are the most prominent example of outsize influence. China purchased 61% of world soybean exports in the last crop year, dwarfing the second-placed Europe Union's 9.0%. China also ranks as the largest importer of beef and veal, pork, fluid milk, milk powder, cherries and sorghum, encouraging exporters of these products to play nice with Beijing.

The half-empty trash bins behind Huang's restaurant in Shanghai are a vivid sign of how Operation Clean Plates has resonated with the public. However, Beijing's goals could be better served by reining in its fixation with self-sufficiency.

"If China needs to feed its own people it can do so, without question," says Pay. "But from the perspective of whether China would want to grow and raise all its own food under normal circumstances, the answer is no. It's much better off relying on international markets for some portion of its food supply."

That view is seconded by IFAD's Marchisio, who says shocking quantities of food are lost as they travel through the supply chain. He argues "China could optimize its system and make it more effective by implementing measures such as promoting the adoption of mechanized agriculture and more efficient farm machinery, increasing the number, capacity and functionality of storage facilities, and improving road connections and logistics. It's really a matter of making the food chain more efficient than dealing with any perceived notion of food insecurity."

AN AWKWARD FIT

What are the prospects of China's evolving role in the global financial system?

By Mable-Ann Chang

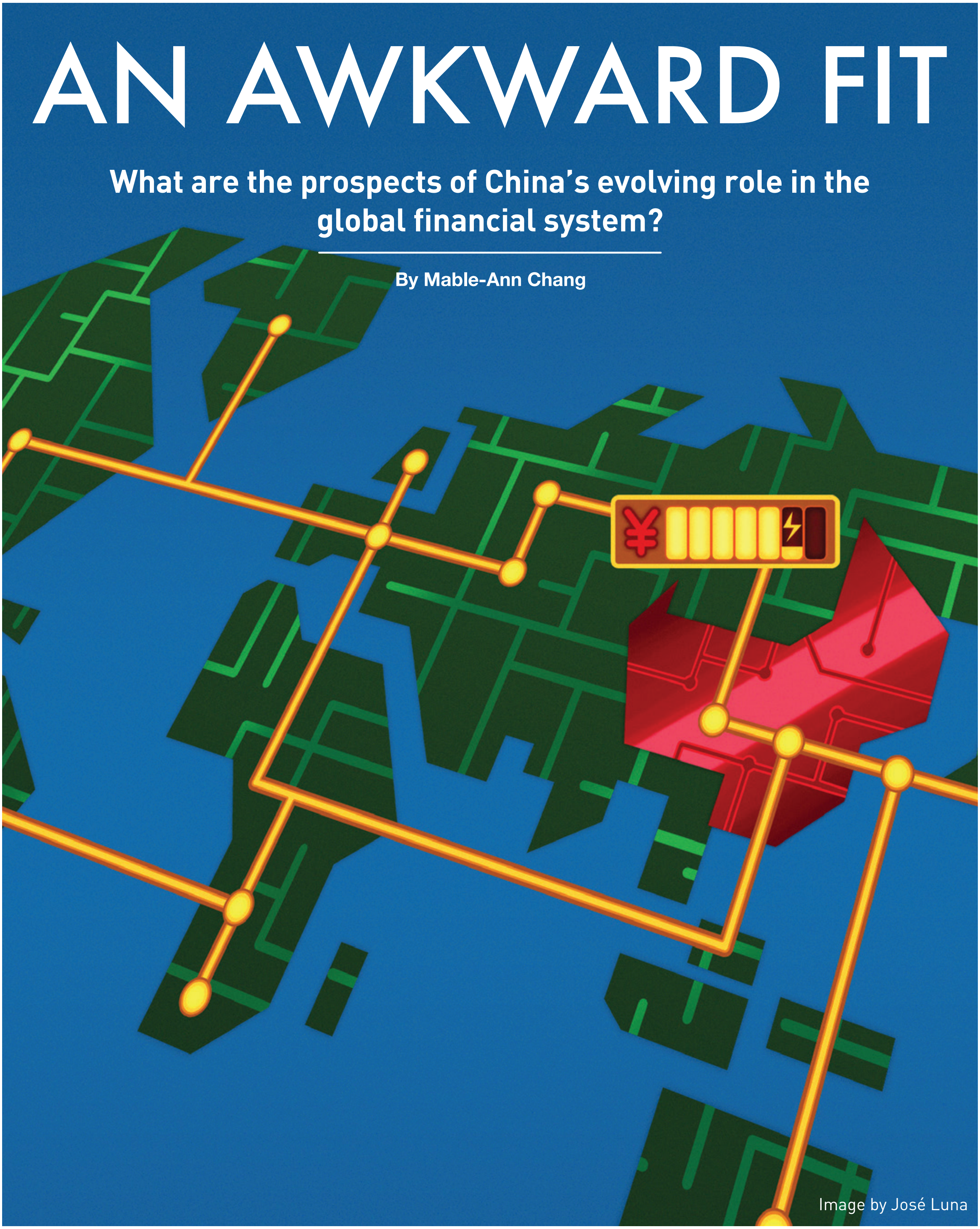


Image by José Luna

As the relationship between China and other major economies enters a new phase, how does China fit into the global financial system and what will its role be in the future?

In 2020, an exodus of Chinese companies started from stock exchanges around the world—primarily New York—returning back home to list in Hong Kong and Shanghai. At the same time, China continued to reduce its holdings of the world's most liquid assets—United States Treasury bonds—and Beijing pushed to reduce the preeminence of the US dollar in the global financial system.

The global financial system is changing. China is one of the great drivers of the change, but 20 years after China joined the World Trade Organization, the question is still open as to how China fits into a structure that the US has dominated since World War II.

China is now the world's second-biggest economy, largely through its hugely successful export drive in recent decades. But while some changes are in the offing, China's financial system remains remarkably separate from the global system. Its currency is not freely convertible, there are strict controls on both the import and export of cash, and there is a notable distinction between the highly centralized financial system of China and the much more diverse and freewheeling systems in the world's other major economies.

The dilemma was neatly highlighted in early 2021 with the New York Stock Exchange flip-flopping on whether it would require China's three top state-owned telecommunications companies to delist. The issue arose after the US Treasury Department requested that companies closely related to China's military capabilities be removed from US trading.

On December 31, the New York Stock Exchange (NYSE) announced that the companies would be delisted by early January, but on January 5 it reversed the decision, allowing the companies to stay. Then again on January 6, it did another U-turn, announcing yet again that the companies would have to leave. The bottom line is that while the Chinese companies to a considerable extent need New York's markets, New York markets also need Chinese companies despite the systemic differences that exist between China and the US.

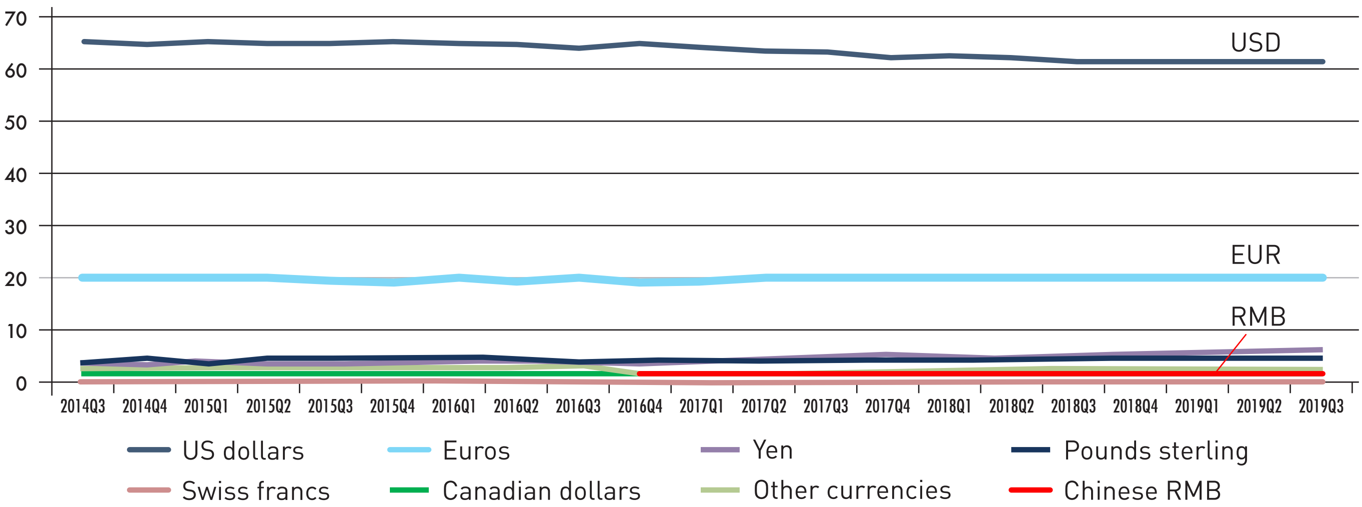
A growing role

The expansion of China's role in the world's financial system over the past 40 years, from almost zero impact in the early 1980s through to its towering role today, has occurred without any basic changes being made to China's own system of highly centralized economic management. The state continues to own and directly run large parts of the economy including in the construction, energy, finance and transport sectors.

But while the US is still the biggest

> **Chinese capital can't leave in any meaningful way, but now access (to China) is no longer the problem for foreigners ... the underlying issue of integration is China itself**
>
> Fraser Howie
> Co-author
> *Red Capitalism*

A HEGEMONY | **The status of the US Dollar as a global reserve currency**



Source: IMF

player in the world's economy, it is no longer in effect the sole arbiter as it was when China was invited to join the global system via entry to the World Trade Organization in 2001. That entrance enabled the Middle Kingdom to become both the "World's Factory" and a major global investor. China now represents more than 18% of global gross domestic product (GDP), but US dollars still represent over 80% of global trade.

"Twenty years ago, when China joined the WTO, everyone felt sympathetic for poor, developing China," says Ken Jarrett, Senior Adviser of global business strategy firm Albright Stonebridge Group, based in Washington D.C. "But now that China is the world's second-largest economy and a huge economic power, the country still wants to be treated as a player that's lagging behind."

"Though China has deepened its integration into the global financial system, it is still far from globalized compared to developed countries," says Dr. Tim Klatte, a partner in the Forensic Advisory Services practice of Grant Thornton China. "Integration continues to experience the challenges of geopolitical and global trade tensions."

China is a huge player in commodities, global property and stock markets but is still very dependent on foreign exchange systems, global banking and the US dollar.

"In terms of trade, China has a lot of influence over the global financial system," says Jarrett. "But when you get into bonds and investment flows, their influence is not that great. The bond markets are opening more to foreign investment, but in other aspects, they're not as significant a player."

Neither China on one side or the major economies on the other seem happy with the way things are at present. China often complains that the West is bullying and constraining it. The West complains that China is using the global system based on ideas of free trade and open borders to its own advantage without providing reciprocity.

Integration issues

How China's system fits into the global financial system is one of the top questions of the new decade, but given the size and importance of its economy, China now has more cards to play with than during the WTO negotiations 20 years ago. Today, China is ironically becoming both more integrated into the world and also more disconnected.

"China's financial system is far less dependent on the rest of the world than is its trade system," says Sara Hsu, Associate Professor of Economics at the State University of New York. "We can see that the financial system is opening gradually, allowing foreign lenders and insurance companies to set up wholly-owned entities. Still, it is not easy for foreign firms to compete in China, and the system is not fully market-based."

In the last few years, the flow of investment funds has changed dramatically. Until 2010, inbound investment funds dwarfed China outbound investments. Then suddenly China became a major investor around the world, with outbound investment peaking in 2016, prompting a clampdown by Chinese authorities due to fears of capital flight. Now Chinese companies report it is almost impossible to get money out of the country. About $74 billion left China through regulated channels in the first half of 2019, the smallest amount in a decade, according to a report by the Institute of International Finance.

"Chinese capital can't leave in any meaningful way, but now access (to China) is no longer the problem for foreigners, in a word, the underlying issue of integration is China itself," says Fraser Howie, co-author of *Red Capitalism: The Fragile Financial Foundations of China's Extraordinary Rise*. "It has traditionally closed off its financial system to non-Chinese through capital and administrative controls. It is important, though, to acknowledge the steps

China has taken over the past few years to open selected doors in the capital controls which have made financial markets open to foreign capital."

The exchanges

Foreign stock markets have been an extremely important source for kick-starting Chinese state owned enterprises (SOEs) and private companies for the past three decades, but to what extent does China still need the financial resources available in New York? The Shanghai Stock Exchange is now the third largest market in the world, and Hong Kong is number four. As of 2020, there were 3,829 companies listed on the Shanghai and Shenzhen exchanges, with a total market capitalization of $8.2 trillion, according to investing and finance education firm Investopedia.

"There is huge IPO activity in Hong Kong and Shanghai, and it's set to become even greater than what we see in New York," says Jarrett from Albright Stonebridge. "The attractiveness of listing in New York or elsewhere for Chinese companies is fading."

Looser standards of accounting and a general lack of transparency with Chinese companies, plus a general sense of negativity currently attached to Chinese companies, has led to low valuations on American exchanges. Nasdaq also unveiled new restrictions on IPOs in May after Luckin Coffee, a Chinese would-be Starbucks competitor, announced that an investigation had shown its chief operating officer and other employees had fabricated sales figures. The scandal had an immediate impact on the viability of other Chinese companies listing on US exchanges, encouraging them to list back home, despite the limitations of the homeland markets.

"China's stock markets allow companies to raise capital, but its corporate bond and other asset markets are underdeveloped," says Hsu. "Assets are often mispriced and overrated."

Investors tend to view movements on the Shanghai and Shenzhen markets as reactions to government policy rather than a reflection of economic and corporate trends. "The Chinese stock markets are not really a true metric of the economy," says Jarrett. "The New York stock market is better at giving people a sense of the market. In China there is so much speculation that it seems to go up and down according to a range of factors. The issue of moral hazard is not as strong, there's always the feeling that the government will come in and save things from collapsing."

Money talks

Despite China's fast development and dominance in so many markets, the US dollar remains king globally. The majority of all trade deals around the world are denominated in US dollars, and the renminbi is, despite concerted efforts over the past two decades, is an insignificant player. This is largely due to two factors—the scale and transparency of the US economy and the controls on the Chinese currency.

"The US dollar and the financial system—currently the most advanced in the world—strengthen the longevity of US domination of global financial," says Klatte Grant Thornton China. "While the US financial system is easily the largest, it also has the most extraordinary diversity of institutions, the widest variety of instruments and the most advanced derivative markets. The transparency also adds to investor confidence and further consolidates its stability and efficiency."

The renminbi currently accounts for two percent of global foreign exchange reserve assets, reported Morgan Stanley. The research group predicted that the currency would account for five to ten percent of global foreign exchange reserve assets by 2030, which would place it still way behind the US dollar and the Euro.

"Although China's banking, securities and bond markets exceed in size, they have limited presence as international players," explains Klatte. "All of the major financial systems, including the banking, bond and stock sectors, face the challenges of being more liberalized under the current strict regulations than the US or most developed countries. The low percentage of renminbi in global foreign reserve poses severe challenges for the Chinese government to catch up with the integration of its other sectors."

The value of the renminbi against the US dollar has remained relatively constant, swinging between six and seven RMB to the US dollar over the past decade. In early 2020, the exchange was RMB 6.5.

"In the short run, there could be room for appreciation [of the RMB] based on an optimistic expectation of the Chinese economy resulting from its fast recovery from the pandemic," says Klatte. "However, due to uncertainties including China's high debt levels, fast debt growth, industrial overcapacity, imbalanced real estate market and possible aggravated geopolitical tensions, the appreciation is expected to experience significant volatility."

> China's stock markets allow companies to raise capital, but its corporate bond and other asset markets are underdeveloped
>
> Sara Hsu
> Associate Professor of Economics
> State University of New York

Power banks

The Chinese-US trade war and the decoupling that started after 2016 raised questions of China's role in international banking. At one point toward the end of the Trump era, there was consideration by the administration of shutting China out of the SWIFT currency transfer network in retaliation for its lack of reciprocity and other issues.

"The SWIFT system is a point of vulnerability for China," says Jarrett. "It is a financial weapon that the US government has used against many countries. It's a unique weapon that the US enjoys—but that [excluding China from SWIFT] is not going to happen."

Banking is increasingly a sensitive and political area, because of the heightened tensions between China and the West, and particularly with the US. Caught in the crossfire are HSBC and Standard Chartered, major Western banks with big exposure to the China market. When China implemented the National Security Law in Hong Kong in 2020, both banks immediately issued a statement in support of the law, prompting some criticism from officials in both London and Washington.

"The superpower squeeze is not a new phenomenon and less of a direct threat than it seems," writes Tom Braithwaite for the *Financial Times*. "The real worry is indirect and financial: that the trade and capital flows between east and west that are HSBC's lifeblood are choked off as the US and China break apart."

Disconnect

"Overall, I would say China is not highly financially dependent on the rest of the world and vice versa," summarizes Hsu from the State University of New York. However, the differences between the financial systems in China and the West are a fundamental cause of the problems that exist between the two.

"The cause of this disconnect is control," says Howie. "The Chinese Communist Party has wanted to retain control over the financial system and the blunt force way of doing that has been to keep things walled off and out of bounds to foreigner players and investors."

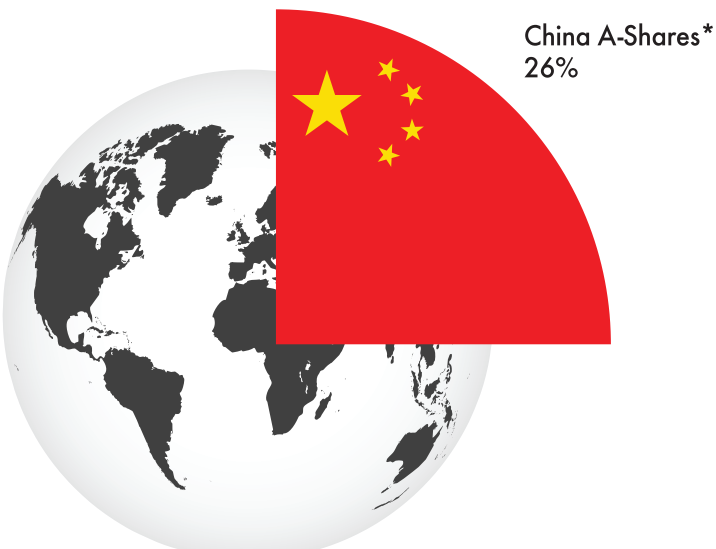
However, Jarret sees developments slightly differently. "There is a systemic difference in political cultures which is leading to intrusions in the financial system," he says. "You have the Communist Party now wanting to be in control of everything, more than we've seen in a while. There is a feeling China is backtracking from its commitment to a market economy. If you look at the attention given to SOEs or the Party's involvement in the economy, you can actually say the country is moving in the wrong direction."

One way or another, the two sides are going to have to find a way to figure their differences out because real decoupling in the financial markets area is not feasible. "In the future I see China opening and attracting more inbound funds because these are huge liquid markets providing opportunities for investors," says Howie. "But that runs counter to the other thread of a tougher world for China."

> **The SWIFT System is a point of vulnerability for China**
>
> Ken Jarrett
> Senior Adviser
> Albright Stonebridge Group

UNDERREPRESENTED | Global Equity Trading Volume

$303.2 Billion YTD 2019 (daily average)



* Based on the volume of A-shares traded in the Shanghai and Shenzhen stock exchanges divided by the volume of global equities traded in 2019 through 30 September

Global equity trading volume as per 30 September 2019, MSCI ACW index composition as per October 2019, foreign ownership of China A-shares as per March 2019

Sources: Goldman Sachs, Bloomberg, MSCI and AB

Power in Hierarchy

Daniel A. Bell, co-author of *Just Hierarchy: Why Social Hierarchies Matter in China and the Rest of the World*, discusses the benefits of meritocracy in China

Daniel A. Bell is Dean of the School of Political Science and Public Administration at Shandong University. He was born in Montreal, educated at McGill and Oxford, has taught in Singapore, Hong Kong and Shanghai, and has held research fellowships at Princeton's University Center for Human Values, Stanford's Center for Advanced Study in the Behavioral Sciences and Hebrew University's Department of Political Science.

His latest book, co-authored with Wang Pei, *Just Hierarchy: Why Social Hierarchies Matter in China and the Rest of the World* (Princeton, 2020), examines how hierarchical social relationships can have a useful purpose, not only in personal domains but also in larger political realms. He is the author of numerous other books including *The China Model: Political Meritocracy and the Limits of Democracy*, *China's New Confucianism: Politics and Everyday Life in a Changing Society*, and *Beyond Liberal Democracy: Political Thinking for an East Asian Context*, all published by Princeton University Press. He writes widely on Chinese politics and philosophy for the media including *The New York Times*, *Financial Times* and the *South China Morning Post*. His articles and books have been translated into Chinese and twenty-two other languages. In 2018, he was awarded the Huilin Prize and was honored as a "Cultural Leader" by the World Economic Forum. In 2019 he was awarded the Special Book Award of China.

In this interview, Bell explores the benefits of meritocracy in a political system and the various forms of hierarchies that exist in China today.

Q. Meritocracy is a key part of the argument in your new book,* Just Hierarchy: Why Social Hierarchies Matter in China and the Rest of the World. *To what extent is there inevitably going to be internal politics, personal vendettas, factions, groupings and corruption in such a system? How does a system such as China's effectively offset these kinds of issues?

A. Our book mainly focuses on China, but we argue that there are different forms of social hierarchies present in the modern world. One of them is the hierarchy between rulers and citizens. We argue that the most desirable form of hierarchy is one where the rulers serve the citizens and where there is trust between the citizens and the rulers. More concretely, in the Chinese case, there is a system we call political meritocracy, where the public officials are selected and promoted based on superior ability and virtue. Also, there are a lot of democratic ideals and practices, such as consultative democracy.

We think that is the ideal. But there's a huge gap between the ideal and reality, and we propose ways of reducing or minimizing that gap. Corruption is of course a huge issue in China, and rulers should focus on minimizing that gap. Corruption really undermines the whole legitimacy of a system which is supposed to be founded on the ideal of political meritocracy. That's one reason why corruption has been taken as a huge issue in China especially since President Xi Jinping assumed power. Because if the corruption had not been dealt with, it really would have posed an existential threat to the whole system.

In a system that has an electoral democracy, in one sense corruption is less serious because when you have competitive elections, people can just use the voting system to remove political leaders who are supposed to be corrupt. Whether that actually works in reducing corruption is in itself a question. Arguably, many democratic countries such as India and Indonesia are actually more corrupt than China, but at least there are safety valves in place to prevent the whole system from imploding. In

China, if the corruption had not been dealt with in a serious way, it really would have posed an existential threat to the whole political system.

We have to understand that the Chinese system is legitimized at the end of the day by this ideal of political meritocracy. This has been informing the longest and most systematic anti-corruption drive in China's post-1949 history. And it has been relatively successful in changing the situation on the ground. Before 2012, it was quite common to pay bribes to get into schools or hospitals, and for public officials to get bribes when they are engaged in their work. All that has really come to an end, and in that sense it's successful. That's one reason why the current government is quite popular among ordinary people, because they feel that there's less corruption than there used to be. But on the other hand, to reach that goal they used fear, punishment and harsh laws, which has led to problems such as public officials becoming overly conservative and less experimental than they used to be, which really was key to China's success. So arguably, there is a need to move away from strong Legalist (法家) measures to deal with corruption and to use measures that are softer, such as moral education—which speaks a lot more to the Confucian tradition—as well as measures such as increasing salaries for public officials and reducing the linkage between economic and political power.

Q. In what ways has a hierarchical system benefited China during the time of COVID-19?

A. There are two key hierarchies that are important here in the case of the fight against COVID-19. The first is the respect for conscientious public officials, who were really able to make a whole country listen and mobilize appropriately. In a way, if you compare that with other countries like the United States, where the political culture is different, there's this anti-elitist tradition and much less respect for conscientious professionals which makes the fight against COVID-19 problematic.

The second is the idea of a very strong state, one that has the capacity to take harsh measures in the short-term to serve the people. This happened when most of Hubei was put under lockdown. Keep in mind that this is first time in world history where there was such a massive lockdown of a population, and it worked because of the state's capacity to enforce such strong measures. It also worked because people had faith, to an extent, that the state was acting in their best interests and that the lockdown was not meant as a permanent totalitarian measure to stop people from leaving their homes, but rather as a short-term measure meant to deal with an urgent situation. The moral foundation is Confucian, in that the whole point is to serve the people's interests and the people's well-being, and not to serve the people in power. Countries that lack these two traditions, I believe, find it harder to deal with COVID-19.

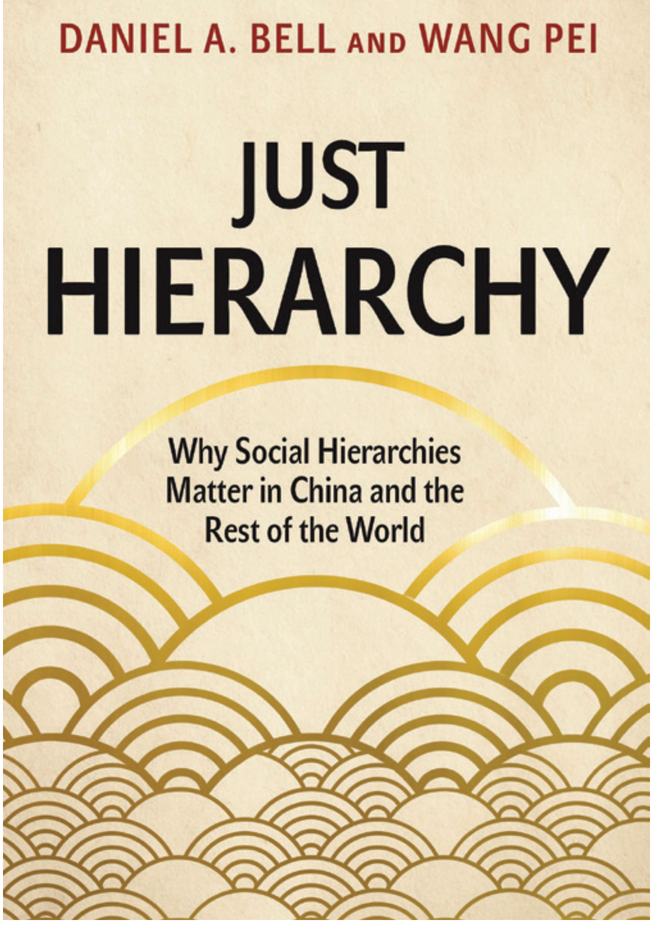
Q. Has COVID-19 changed in any way the way that the West would view the hierarchical system of China?

A. To be frank, not much. Of course the original epicenter of COVID-19 was Wuhan, so in some sense China will be blamed for the pandemic. It could turn out at some point that the origin may not be in China but as things stand now, it looks like the origin is from China. But also, the Western media doesn't really report in any great detail on China's success in dealing with COVID-19. They report on New Zealand and Taiwan, but China hardly ever features. It's amazing that China, as this huge and diverse country, can deal with this in an effective way. The US should actually be looking at China more than anywhere else, for lessons, given the challenges of dealing with a pandemic in a huge country.

Q. The elements in Western systems that seem to resonate most with people are not democracy but rule of law, transparency and accountability. Would you agree with that and to what extent would you say that China has rule of law, transparency and accountability?

A. That's true when it comes to the way that many Chinese think about what's good about Western political systems. There's much more of a consensus that there's a need for rule of law for example, than there is the need for democracy, especially electoral democracy, to select leaders.

What works about China is that all political leaders have substantial political experience before they assume the top-level



place of power. But if you had an electoral democracy, somebody with no political experience like Donald Trump could get through the political system even though he's not equipped for the role. Leaders in China can then take a long-term view, without worrying about the next election and that matters when it comes to issues like climate change. Therefore there's a good reason to favor rule of law in China, as opposed to electoral democracy, especially at higher levels of government. Electoral democracy and other forms of democracy work well at lower levels of government, but less at higher levels of government where the issues are complex and policies affect many stakeholders. Regarding transparency and accountability, yes, I'd agree modern countries need those values, and obviously there's much room for improvement in China. The challenge is how to promote more rule of law, democracy at lower levels of government, transparency and accountability without undermining the advantages of political meritocracy at higher levels of government.

Q. How does the existence of a middle class change the equation of China's hierarchical form of systemic rule?

A. There are now hundreds of millions of Chinese citizens who are viewed as middle-class, meaning that they're no longer poor, they're more educated, they travel abroad often and obviously they have different aspirations. There's a strong need to have a much more open society in the future—for things like opportunities to find jobs, travel abroad, the right to marry, the right to divorce and so on. The Chinese middle class will want a more open society and they will also have the need to have some sort of say in politics. There will need to be more mechanisms that allow for more political participation in the future, especially at the local level. The trends arguably are not very positive at the moment, but I'm quite confident that in the next few decades there'll be a much more open environment.

Q. There are those who say that a common world view is required for the world to achieve true stability. To what extent would you agree, and what kind of world view would you see as being acceptable to both the West and to China?

A. There are some common global challenges, with COVID-19 being one. Others are the need to control climate change, regulate nuclear weapons and regulate dangerous forms of AI. On all of those issues, we need to have some kind of global consensus on which countries working together can deal with those common challenges, and sometimes countries will compete to do good things, like promoting clean energy. Whatever works best at dealing with those global challenges is fine. But in other areas there needs to be different spheres of influence.

The US can and arguably should be the dominant power in North America as long as the relationships between weaker countries like Canada and Mexico benefit from those relations. But China as the larger and most prevalent country in East Asia needs to have more space. It's almost inconceivable that in a few decades from now, the US is going to be the dominant naval power in the Asia Pacific region. In our book, we also argue that India will develop into a major power, and the kind of defensible and realistic power arrangement in a few decades would be China and India both working together as great powers in the interest of Asia, with weaker countries benefiting as well. Those should be the long-term aims, but the problem is that the US seems very reluctant to give up the view that it needs to be the most dominant power in the world, including in East Asia.

Q. What do you anticipate in terms of China's future role in the international community?

A. China will have a greater role because of its growing economic and military power. The way to make it beneficial for everyone, as mentioned, is to ensure that the way that it projects its power also benefits weaker countries. On things like the Belt and Road Initiative, the investment put into the initiative are beneficial to both China and weaker countries as well.

I'm a political theorist, so I focus more on how things ought to be and then try to think of how those ideals can be made practicable. How things ought to be is that relationships should be win-win. And on global issues, that's something that China can do. It's easy to say things, but they have to be seen as doing things that can be beneficial for not just for weaker countries, but for the whole world. China can take the lead on climate change. At the moment, they're not doing enough, but China should really forcefully takes the lead as a positive actor, and legitimately so on the global scene, in order to have a great role internationally. Of course China also needs to set a good model at home. If it doesn't treat its own citizens in a humane way, it cannot be seen to do so abroad.

Q. How would you see China's system developing in the future? What changes overall to the system would you envision in the decades ahead?

A. There's going to be a need in China for a much more open and participatory society. One that's more respectful of pluralism. There's going to be very strong pressure to have a more open society, but also at the same time there's going to be a need to maintain and improve what works about the political system. It will mainly be some form of political meritocracy to select public officials at middle and higher levels of government.

Economically, I'm not an expert by any means, but what we cannot expect is that China will move towards a complete free market system or at least one that is closer to an American-style free market system. There's always going to be a state which has an important stake in key industries and there are good reasons for that, for example the need to ensure that Artificial Intelligence serves the people. There's always going to be a need for a state which regulates industries to try and ensure that that happens. But beyond that, there's going to be—and there already is—a strong move towards individual enterprise and innovation in other industries that are not so crucial to the overall wellbeing of the country.

ARCTIC ACTIVITY

As Arctic ice melts, commercial opportunities have become viable

By Mable-Ann Chang

Image by José Luna

With new logistics routes opening up and undersea resources becoming available, what will China's role be at the top of the world?

While the world has been distracted by the pandemic, long-term climate change issues have raged on with massive forest fires in Australia and California, devastating flooding in Central Asia and the continued melting of the two poles. A warmer planet presents problems for us all, but also commercial opportunities, particularly in the Arctic, where China looks like becoming a major player.

New logistics routes, vast areas of undersea resources and tourism are three ways the defreezing of the Arctic is going to change the world. And China is determined to have a significant role in the region despite it not being officially classified as an Arctic state.

"The melting ice … provides economic opportunities for the development of the Arctic, including for the Asian countries," said Gao Feng, China's special representative for Arctic Affairs, at the October 2019 Arctic Circle conference in Reykjavík, Iceland.

Disastrous melting

The Arctic Circle consists of the Arctic Ocean, adjacent seas and parts of Canada, Finland, Greenland, Iceland, Norway, Russia, Sweden and the United States (Alaska)—which are collectively known as the eight Arctic states. The Arctic states are officially recognized as stewards of the region. Both national jurisdictions and international law govern the lands surrounding the Arctic Ocean and its waters. The Northern provinces of the Arctic states are also home to more than 4 million Indigenous people.

The region is warming significantly faster than climate scientists had previously expected, with a persistent heatwave in the summer of 2020 providing average temperatures around ten degrees Celsius above historic norm, according to the Copernicus Climate Change service.

Canada's 4,000-year-old Milne Ice Shelf broke off into the Arctic Ocean in August 2020, because of both warmer water and hotter air. As Canada's last fully intact ice shelf, it shrunk the remaining mass by 43%—more than 30 square miles, which is bigger than the size of Manhattan, according to the Yale School of the Environment. Many of the Earth's other ice shelves have also collapsed due to rising temperatures.

While the extent of the Arctic ice shelf waxes and wanes depending on the season, research from the National Snow and Ice Data Center revealed that on 15 September 2020, the Arctic ice reached its minimum extent in recent history, at 3.74 million square kilometers. Apart from rising sea levels around the world it is leading to a fast growth in human activity in the region.

"One thing we know for sure is that the ice will continue to melt," says Malte Humpert, Senior Fellow and Founder of The Arctic Institute, a research and policy institute based in Washington DC. "The long-term trend is set to be less ice overall and that the annual period that the Arctic is navigable for traffic will become longer and longer. It's just a matter of time before we see an ice-free Arctic."

"Based on developments, including the fact that we saw very low levels of ice in

> **China has been using the Northern Sea Route for cargo shipments already**
>
> Olena Borodyna
> Research Officer
> Overseas Development Institute

the summer of 2020, it's been suggested that we might be seeing a situation whereby the entire Arctic Ocean is more or less ice free by 2035," says Marc Lanteigne, Senior Research Fellow at the Norwegian Institute of International Affairs. "That would be a very significant environmental shift."

Smooth sailing

Since the late 2000s, the shrinkage of the Arctic ice shelf has presented growing opportunities for shipping lines to reroute their cargo ships away from the longer, traditional routes closer to the equator linking the Americas with Europe and Asia. The last few years have seen growing numbers of commercial ships taking the much shorter, cheaper and faster routes across the roof of the world.

Currently the most important routes across the Arctic Ocean are the Northern Sea Route (NSR) running west from the Bering Strait along the Siberian coast, or east through the Canadian Arctic Archipelago, the Northwest Passage (NWP). A third route called the Arctic Bridge (AB) provides a shorter path through to Canada and Northern Europe.

These routes are generally only open in summer unless a ship is escorted by an ice breaker. However, in 2018, the first ships made it through in winter without an ice breaker, so shipping companies are increasingly investing in vessels that can break through thin ice.

For China, the Artic offers shorter and cheaper alternatives to current shipping routes, which reach major markets in Europe via either the Indian ocean and the Suez Canal or the Pacific and the Panama Canal. For instance, a voyage from Shanghai to Hamburg via the NSR shaves 30% of the distance off a similar trip via the Suez Canal and avoids the pirates operating in the Strait of Malacca and in waters off the Horn of Africa. The operators can either arrive at their destinations early or use the extra time for super-slow sailing, reducing fuel costs and emissions.

A round-trip from Shanghai to Rotterdam via the NSR takes about 50 days and costs around $1.13 million. Going via the Suez Canal requires 60 days and

Sources: JKS, FEA

about $1.5 million, according to research published by the *Sustainability* academic journal. The number of cargo vessels that transited the NSR rose from five in 2013 to 71 in 2019.

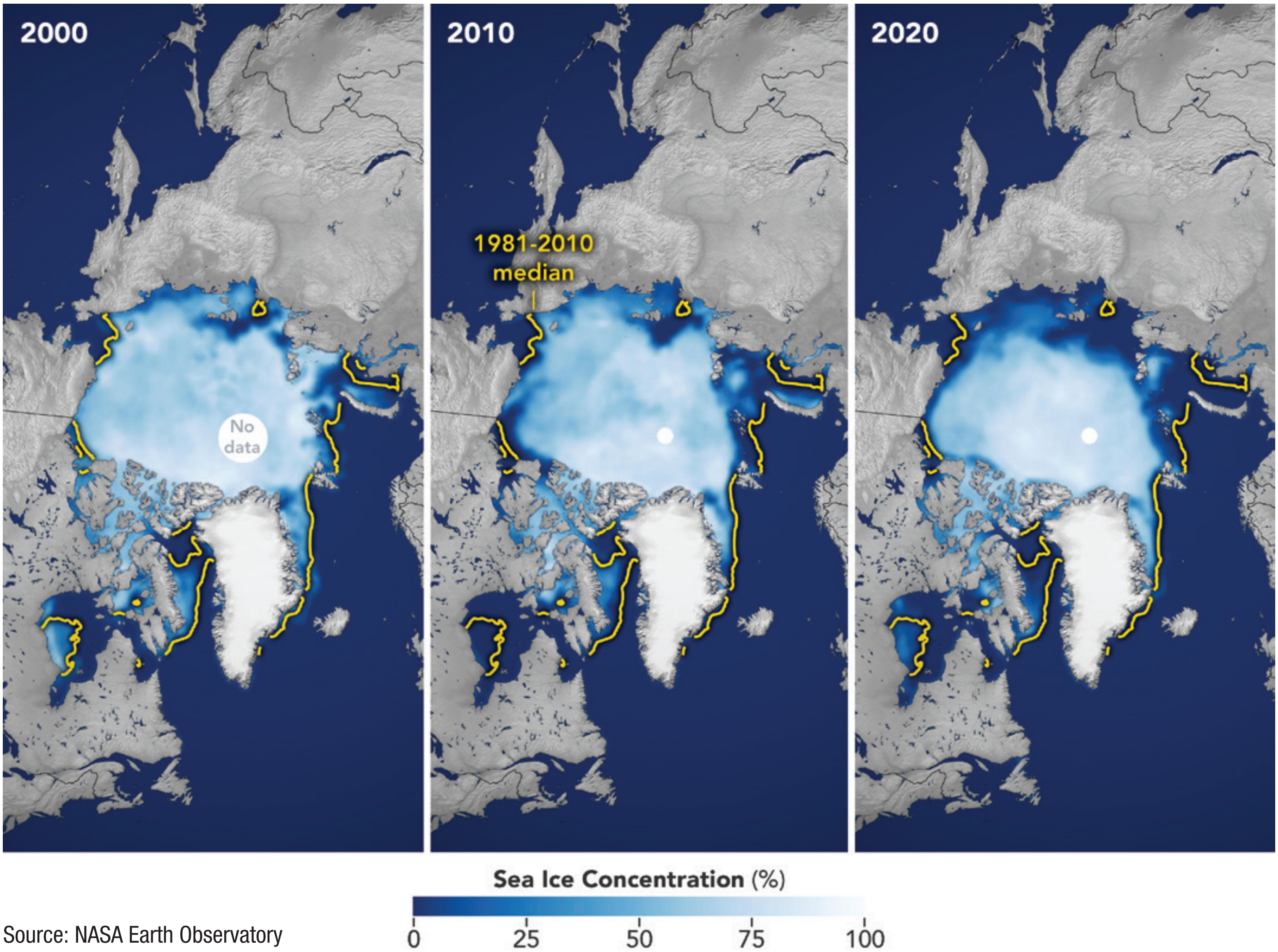
The Suez Canal, meanwhile, has an annual throughput of 17,000 ships. The volume of shipping sent through the Arctic is expected to grow sharply. Russia is investing tens of billions of dollars in the constructions of new Arctic ports in the hope that the region will emerge as a serious challenger to the Suez Canal.

"There are a lot of opportunities for companies making icebreakers and specialist vessels for shipment in the Arctic. Shipping companies like MAERSK will also be well placed to benefit from the opening of the NSR and the other sea routes," says Olena Borodyna, Research Officer in the Global Risks and Resilience team at the Overseas Development Institute, a research and policy thinktank based in London.

"In terms of shipping routes, China has been using the Northern Sea Route for cargo shipments already, so that's definitely going to intensify," Borodyna notes. "Consumers will benefit, too, as the new shipping routes shorten the transit time between northern Europe and East Asia which will be reflected in consumer prices."

China is investing heavily in the increasingly ice-free Northern Sea Route, which promises to cut shipping times between the Far East and Europe by ten to 15 days. "As China produces more cars needing to be exported to Europe or requires more European luxury cars to be shipped back, the Arctic route might come into greater use," says Humpert. "Figures indicate you could save about $500 per vehicle on a mid-sized compact car in terms of shipping costs."

But there are challenges to shipping along these new routes. Even during the summer, unpredictable weather and ice floes make navigation difficult. Ships often require an icebreaker escort, which can cost $400,000 plus additional insurance that offset potential savings. Finally, while the NSR may provide a viable alternative for



Source: NASA Earth Observatory

shipping bulk cargo such as oil, coal and ore, it may be of less value for container shipping, which operates on a tighter delivery schedule. Many analysts believe it will take at least ten years of further warming before large volume shipping through the Arctic is practical.

Hidden resources

Underneath the Arctic Circle lie massive oil and natural gas formations. The United States Geological Survey estimates that the region contains approximately 13% of the world's undiscovered oil resources and 30% of undiscovered natural gas resources. Melting ice provides greater access to these mineral deposits laying under the sea and the frozen lands bordering the Arctic. So far, most exploration has occurred on land, which accounts for a third of the Arctic's area.

"From the US side, it's quite unpredictable," says Borodyna. "Under the Biden administration, the Arctic Wildlife Refuge in Alaska will not be explored for gas and oil for the next four years, but what will happen afterwards is unclear. China, Russia and other countries involved in natural gas extraction will continue building their projects and exploring for gas and oil."

Russia has been keen to invest because its economy relies heavily on hydrocarbons. Of the nearly 60 large oil and natural-gas fields so far discovered in the Arctic, 43 are in Russia, 11 in Canada, six in Alaska and one in Norway, according to a 2009 US Department of Energy report.

"When it comes to economic opportunity in the Arctic, I think China's emphasis has been placed for now on cooperation with Russia," says Lanteigne. "This is where we see most of the tangible examples of the polar Silk Road, like the liquified natural gas (LNG) projects, and also greater interest in using the northern sea route for shipping."

But there are other opportunities emerging as the ice melts.

"There has primarily been a focus on mega projects like oil and gas, but there is growing interest in developing tourism and the infrastructure required to receive them," says Elana Wilson Rowe, Research Professor at the Norwegian Institute of International Affairs. "There has also been interest in seeing how economic development can benefit communities of Indigenous people who live in the Arctic."

China's position

From the moment that it became clear that the Arctic was opening, China has been actively stating its case for significant involvement. "China hopes to work with all parties to build a 'Polar Silk Road' through developing the Arctic shipping routes," said China's 2018 official policy paper on the polar region. It also stated that every country's "rights to use the Arctic shipping routes should be ensured."

According to the policy paper, China acknowledges interests in oil and gas, minerals, fishing and other resources in the region, but expresses an interest in developing those resources with other nations based on principles of "respect, cooperation, win-win result and sustainability."

"China is a passive receiver of natural gas and oil resources, not an active participant besides providing funding and some industrial know-how in construction," says Humpert. "But the country has long-term economic interest in the Arctic, particularly in access to shipping lanes and building LNG carriers."

Consider it as early moves in a chess game, says Humpert. "You're getting all of your pieces in the right position so that in the next ten to 30 years, you are in a position to benefit from whatever happens in the Arctic."

"China's Arctic position is based on three pillars, the first being scientific diplomacy," says Lanteigne from the Norwegian Institute of International Affairs. "What is happening in the Arctic is having a significant impact on Chinese weather, such as heavy rainstorms and colder temperatures. What China is seeking to do is to better understand the connection between changes in the Arctic and the direct effects on China."

The second pillar, he says, is economic activity. China has been active in partnering with Russia to develop LNG projects. The third pillar, which is less defined, is governance. China has said it would like a stronger voice in emerging issues in the Arctic.

> In terms of challenging sovereignty and international law, there is no sign of China doing that
>
> Marc Lanteigne
> Senior Research Fellow
> Norwegian Institute of International Affairs

For example, China has been a formal observer on the Arctic Council in Tromsø since 2013, which means they can participate in activities but cannot vote. Voting is reserved for members of the eight Arctic states. "China has said that even though it doesn't have any Arctic geography, it still wants a role in discussions about Arctic governance," explains Lanteigne. "It argues there are certain areas of the Arctic which are international in scope and that there should be a role for non-Arctic states to play."

China's position is controversial. The Trump administration was extremely critical, saying that the Arctic is primarily of interest to Arctic states only.

China's statements on sustainable economic development and environmental issues resonated well globally during the Trump administration. When the US withdrew from the Paris accords, China remained the largest economy still part of the agreement. And the fate of the Arctic is one of the top environmental issues the world faces.

"There are positive aspects and aspects where work needs to be done," says Humpert. "The positive is that China is a big investor in renewable energy. If you look at the solar and wind energy projects being constructed in China, it surpasses every country ... but China is obviously the largest polluter in the world, more than the EU and US combined."

The great game

Many analysts thought that the melting of Arctic ice would create significant international competition for control of the sea lanes and resources. So far it does not appear to be playing out that way.

"In terms of challenging sovereignty and international law, there is no sign of China doing that," says Lanteigne. "Where the situation gets complicated is when the Arctic opens up to new economic activity and discussions about international security. Then we are going to see more ships enter the region. It is there where China has said that there should be greater participation for non-Arctic states in dealing with issues, because what's happening in the Arctic does have a global dimension."

While the melting of the Arctic is an environmental tragedy, it is also a huge opportunity for China in terms of logistics and stepping up on the global platform to fight climate change. Global warming has provided the country with an opportunity to become a significant player in yet another part of the world.

"There's always a risk in predicting that tomorrow's weather will be somewhat like today's," says Rowe from the Norwegian Institute of International Affairs. "But the fact that Arctic states all have significant economic interests in the region points in the direction that they will continue over the next decade to work on managing conflict and finding opportunities to cooperate. Arctic states would like to show that they can manage this region within the framework provided by the Arctic Council and the United Nations Convention for the Law of the Sea.."

NAVIGATING THE WORLD

How China's global navigation system, BeiDou, is challenging the major satellite systems of Galileo, GLONASS and GPS

By Mark Andrews

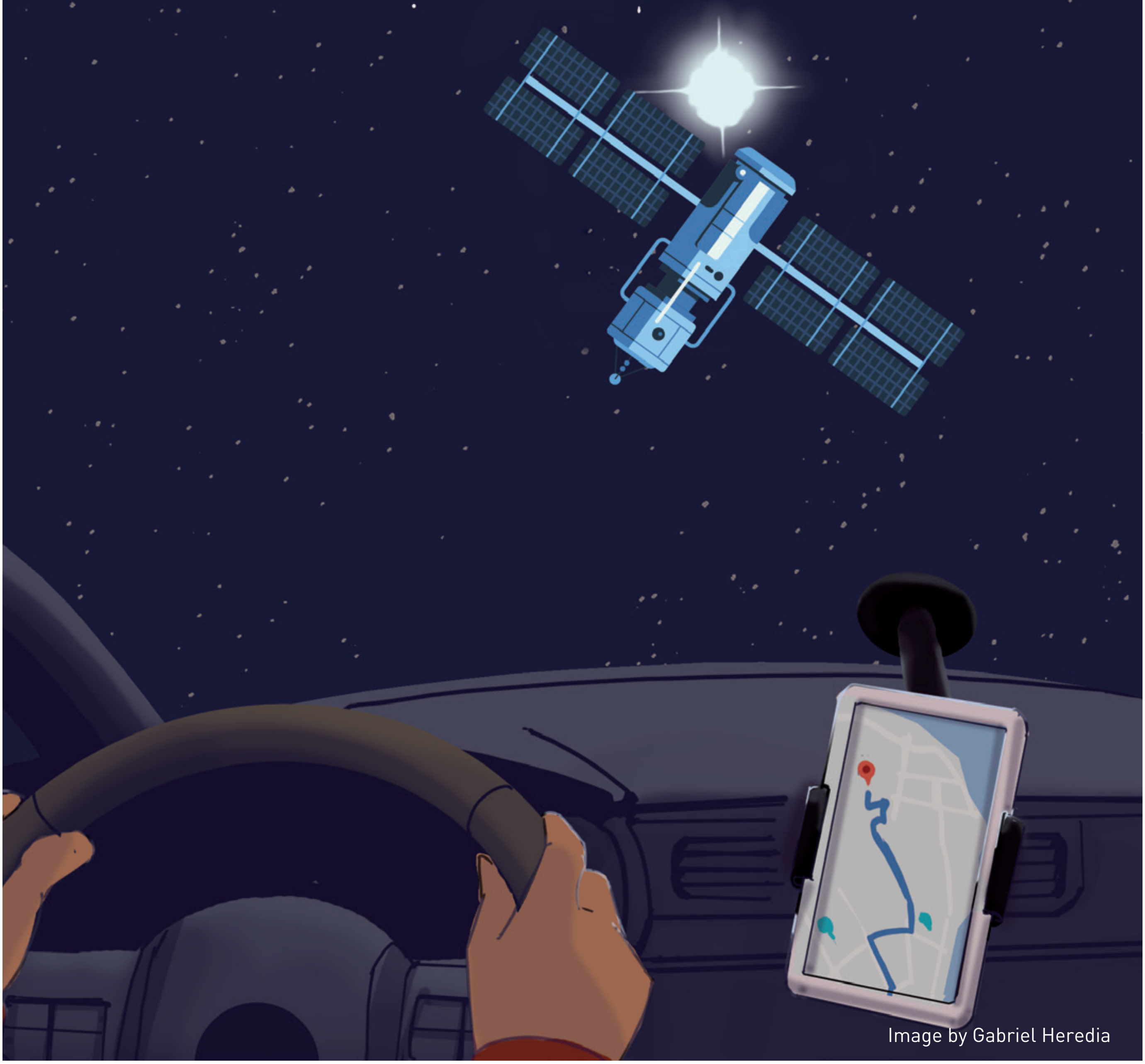


Image by Gabriel Heredia

China recently joined an elite group by launching its own global navigation system, BeiDou. But how does it stack up against the other major systems of Galileo, GLONASS and GPS?

On 23 June 2020, China completed a decades-long project to build a global navigation satellite system by launching yet another satellite into outer space. It was the final piece in the jigsaw of satellites needed to provide global coverage for a navigation system to rival the more famous, US-owned Global Position System (GPS). China's network of satellites is BeiDou, which means "Big Dipper," a natural constellation stars long used for navigation.

After the launch of the final satellite, BeiDou went fully live. Less than six months later, state-owned media *China Daily* reported that the system was used in more than 120 countries and regions globally. Some 70% of mobile phones in the country now use the system, along with 6.2 million taxis, buses and trucks throughout the country, according to statistics from the China Satellite Navigation Office.

However, the system's key strategic importance is national security—China has for years been uncomfortable about being locked into the use of the GPS developed by and still controlled by the US military.

The big question is how does the BeiDou system compare with GPS and other navigation systems? The answer appears to be that it is a strong contender and might end up making more money than any of the others.

Empty space

BeiDou is the latest of several Global Navigation Satellite Systems (GNSS) used to supply positioning, navigation and timing (PNT) information. The first system, the Global Positioning System (GPS) from the United States, was initiated in 1978, and achieved global coverage by 1995. Russia's Global Navigation Satellite System (GLONASS) followed in 1982 and achieved global coverage in 1996. Galileo from the European Space Agency started in 2005 and achieved full operational capabilities in 2019, although not all the projected 30 satellites have yet been launched. India and Japan also have systems although they both only have regional coverage.

The systems all work by beaming radio signals to devices on the ground. Signals from at least four satellites are used to calculate the receiver's location, direction and velocity.

"There are several key differences between BeiDou and Galileo, GLONASS and GPS, including the number of satellites, functionality, accuracy and orbital period," says Heath Sloane, Yenching Scholar at Peking University.

Lift off

Plans for a Chinese GNSS system were conceived in the 1980s. Impetus came from an alleged incident in 1996 when China fired three missiles in the ocean near Taiwan but lost contact with two of them. China believes the US cut the GPS signal that the missiles were dependent upon.

"Keep in mind that signals can be jammed, cutting off access to PNT, or spoofed, sending a false location or direction," says Larry Wortzel, commissioner on the US-China Economic and Security Review Commission. "Having the capability to receive a variety of PNT signals and process them provides alternatives in the event one country's system is jammed, spoofed or taken offline

> **BeiDou comprises the largest constellation, totaling 35 operational satellites**
>
> Heath Sloane
> Peking University

for any reason."

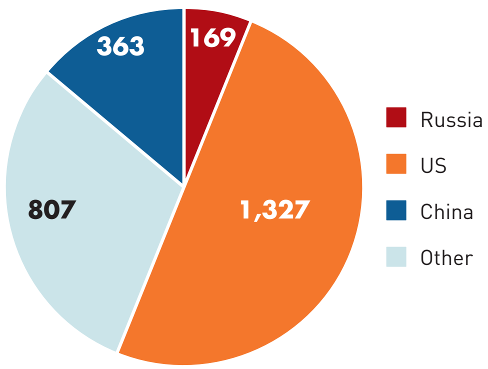
As with GPS, the original goal behind BeiDou was military support and to close a loophole exposed by the lost missiles. "In 1996, China decided to build its own navigation system, to be completed within 25 years, to establish truly independent military command and control, and precision missile guidance and tracking," says Namrata Goswami, an independent analyst and author specializing in space policy.

BeiDou is now in its third phase. BeiDou 1 consisted of four satellites launched between 2000 and 2003 and only covered China and parts of Asia. BeiDou 2, consisting of 14 satellites launched from 2004 to 2012, completely superseded the original system with coverage extending over the whole Asia-Pacific region. BeiDou 3 (BDS3) created a constellation of satellites providing global coverage. Goswami says Beijing invested about $9 billion in setting up the system and that BeiDou is now the largest of the four global navigation systems.

"BeiDou comprises the largest constellation, totaling 35 operational satellites," says Sloane. "This outnumbers other systems by at least four satellites. Notwithstanding the truism that positional accuracy depends on the number of satellites, it isn't the only metric that counts."

WHO HAS MORE SATELLITES?

China has passed Russia but is still far behind the US



Sources: Bloomberg, Union of Concerned Scientists

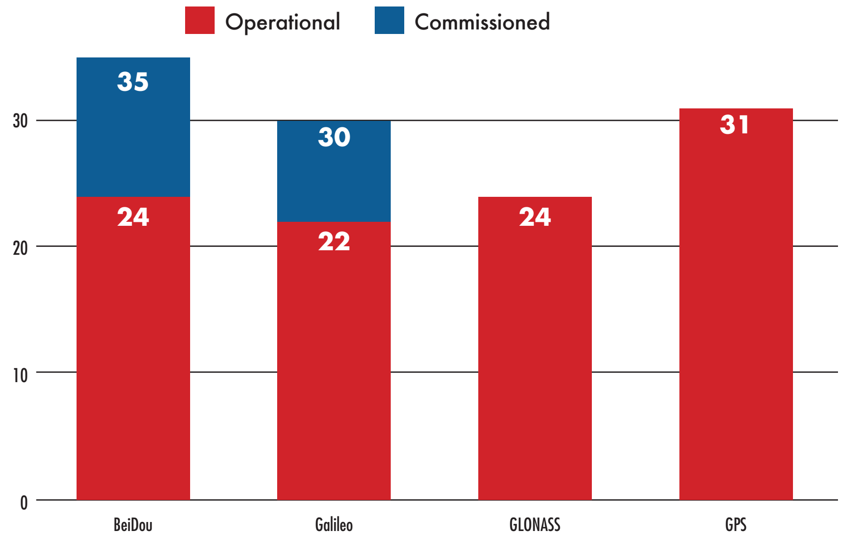
According to Goswami, open-source data shows BeiDou's signal accuracy to be better than GPS—0.41-meter versus a 0.5-meter average for GPS. The accuracy of the network in China is enhanced by 155 framework reference stations and over 2,200 regional stations across the country, which take accuracy to the centimeter level. A 2014 article in the *China Daily* stated that Beijing planned to build a network of similar ground stations in other parts of Asia, including 1,000 in Southeast Asia alone.

"Both [systems] provide positioning services globally using broadly similar technology and for broadly similar purposes, both military and commercial," says Blaine Curcio, a space and satcom industry consultant. "But BeiDou has certain features that GPS does not, such as a short messaging system."

BeiDou is unique amongst satellite navigation systems in having a two-way function where a receiving device can

A BeiDou satellite being launched into space on 23 June 2020

COUNTING STARS | Operational satellites by global system



Sources: Information and Analysis Centre, Europeam GNSS Agency

send a 1,200-character message. The French SPOT system, another smaller player, stresses imaging rather than PNT functionality, but does offer a similar messaging service.

"In the event of an emergency, I can generate an emergency locator signal that will allow the Coast Guard or marine rescue to come to my aid," says Wortzel about the system on his boat, which uses SPOT. "The SMS text system will allow me to send pre-programmed, very short, text messages to a specific number."

A mission

For China, having its own GNSS system is an essential part of power projection and security in the Asia-Pacific region. "Global navigation systems have become the essential condition of modern armed forces," says Sloane. "In addition to its explicit role in enabling accurate navigation, GPS technology allows accurate communications, mapping and targeting, among other applications."

Without a domestic GPS alternative, any modern armed force has little choice but to rely on foreign systems. Outsourcing these capabilities leaves the People's Liberation Army (PLA) vulnerable to jamming or spoofing in the event of war, effectively rendering GPS-dependent weaponry and communications systems inoperable.

But as the US discovered with GPS, the commercial advantages might be even greater than the military imperative. PNT services, usually offered for free, are an enabler for an increasing array of technologies in an ever-more connected world—autonomous driving cars being one example. "To that extent, China now has a lot more control over the foundation of these services," says Curcio.

Developing home-grown cutting-edge technology is one key aim. BeiDou was one of 16 science and technology megaprojects under China's 2006-2020 medium-long term plan. It directly challenges the dominance of the US in satellite navigation and gives China a more prominent place at the table.

"An independent BeiDou offers a strong hold on global infrastructure and rulemaking," says Goswami. "This enables China to challenge the centrality of the United States to form partnerships and alliances and to control the standards for 5G, information technology, mobile devices, self-driving cars and drones, and the broader Internet of Things (IoT)."

Pay back

GPS was only opened to civilian use after Soviet fighter planes shot down a Korean Airlines plane—flight 007—in 1983 when the plane strayed into Soviet airspace due to a navigation error. All 269 people on board were killed. In comparison, BeiDou 3 was developed very much with an eye on commercialization.

Like GPS, the basic positioning services of BeiDou are free, but it is estimated that the return on investment will amount to $59 billion in 2019 alone. "This would include selling its satellite services in an ecosphere were satellite-based communications is critical for an entire economy of a country to work," says Goswami, who adds that the global navigation market is forecast to grow to $146 billion by 2025.

While Curcio does not believe BeiDou has enough differentiating advantages over Galileo of GPS for users in other parts of the world to switch on technical grounds, he says he believes there may be ways to successfully market the system internationally.

"I could imagine two ways: One by subsidizing BeiDou-related equipment, which could allow customers to justify switching from GPS to BeiDou to save money. Two, which is more likely, to market BeiDou as part of a suite of services," Curcio says. "For example, if we think about a world 10-15 years down the road, we could imagine China having fleets of autonomous vehicles using the BeiDou satnav standard for location tracking."

Pakistan and Thailand are already important customers. Pakistan was the first country outside China to use BeiDou for their military. Thailand has said it aims to integrate the system with its public sector. All countries involved in the Belt and Road Initiative are key target markets.

"BeiDou is intrinsically linked to 5G and IoT, as they collectively comprise a major component of China's 'Digital Silk Road'," explains Sloan. "In addition to the Belt and Road Initiative, the Digital Silk Road is a blueprint to become a global leader in advanced technologies, including artificial intelligence, satellites, smart cities and telecommunications, among others."

Domestically, thanks to government guidance, uptake has been fast. Along with smartphones now having BeiDou compatibility, most fishing boats used the system by as early as 2012. By the end of 2019, there were also over 6.5 million commercial vehicles in China deploying the system.

"BeiDou has brought down costs for farming, logistics, robotics and support to domestic aviation in PNT critical for the local industrial and economic production base," says Goswami. But the critical factor for BeiDou versus GPS internationally is whether it can deliver 100 times more accuracy at a lower cost, as claimed. "We will have to wait and see if that will be the reality," she adds. "But like in other sectors, including 5G, ground solar and rare earth minerals, China could take the lead."

Space alone

BeiDou is also viewed by observers as an example of what President Xi Jinping means by his "Dual Circulation" growth strategy (see article pp 12-14), which puts an emphasis on developing homegrown technology.

"While discourse around 'decoupling' tends to focus on US efforts to reduce its reliance on China, the case of BeiDou shows China's technological disengagement with the USA," says Sloane. It harks back to one of the long-term guiding principles of China since 1949—self-sufficiency.

Curcio says, the development of BeiDou is not something that can be solely attributed to the deterioration of China-US relations in recent years, but it makes decoupling easier.

"China's aim to establish an independent navigation system is about decoupling from dependence on foreign navigation systems," says Goswami. "The need for it arises even further with protectionist measures and the penchant to cut communication signals in times of conflict." She adds that Chinese companies targeted by US sanctions can now easily switch to BeiDou without fearing losing business.

Shooting for the stars

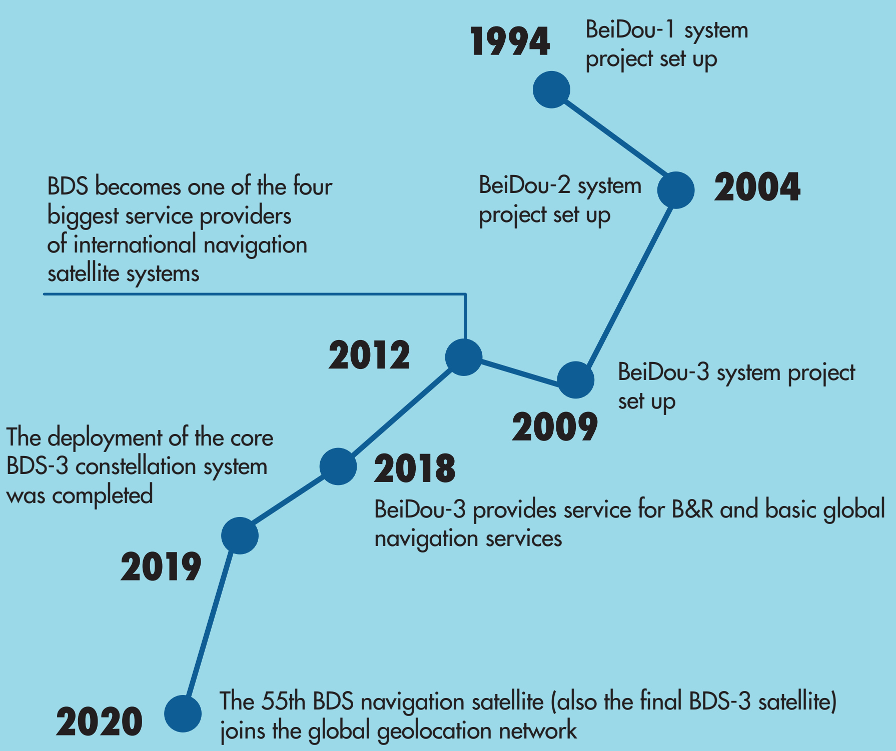
There is little doubt that souring relations with the US has enhanced China's desire to be more self-sufficient in the tech sphere. Beijing considers BeiDou to be one of "The Two Pillars of a Great Power," the other being 5G telecommunications capability.

In 2018, China accounted for 23% of global research and development (R&D) spending versus 25% for the US. "Learning a lesson by getting key technologies cut off due to US national security concerns, China will make self-reliance in core technologies a priority, and as in other sectors including 5G, space navigation and telecoms, will work toward self-reliance," says Goswami. "This will become the top policy focus given China is the world's largest consumer of computer chips. Such efforts are visible with increased funding in semiconductor research, increasing job opportunities and high salaries drawing outside talent, all with an aim to develop 70% of chips within the country by 2025."

But despite the apparent success with BeiDou, China still lags Western nations in satellite technology. "The Chinese space industry can produce most of the same types of satellites that the West can produce, but at a somewhat lower level of technological sophistication," says Curcio. "The most advanced Western-made communications satellites offer hundreds of Gbps [in signal speed]. The most advanced Chinese communications satellites are around 30-50 Gbps. This puts them probably 7-10 years behind where the West is right now in communications satellites, for example."

Ultimately, China's GNSS candidate has provided a huge advantage domestically and a potential win in many other parts of the world. "If BeiDou can provide a highly accurate and cost-competitive alternative to other GNSS systems, it may present an enticing option," irrespective of any shortcomings says Sloane.

Key Moments in BeiDou's Development



A more ubiquitous, mixable, intelligent national navigation system based on BDS is planned to be finished by 2035.

Source: Global Times

HOTPOT HOSPITALITY

Haidilao has been hailed as a business that offers up unexpected innovation insights and has been expanding at a rapid pace

By Colin Shek

Business for Haidilao has surged ahead, despite the pandemic. What makes the hotpot chain unique?

The pre-pandemic sight of diners lining up for spicy hotpot at Haidilao restaurants returned quickly to China once the chain reopened most of its outlets in March. But it didn't stop there—even as the world reeled from the impact of COVID-19, Haidilao kept adding new hotpot stores, not only in china but in locations around the world.

Over the past quarter-century, Haidilao has become one of China's few homegrown restaurant chain success stories, and it now has a presence in ten countries outside Greater China, including Australia, Canada, Singapore, Japan and the United States.

While the company has set its sights on global expansion and has made inroads in many countries, the jury is still out as to its chances of becoming a major international brand on par with the likes of McDonalds and Starbucks. Much will depend on whether diners in the West embrace the idea of Chinese hotpot as well as Haidilao's "above-and-beyond" customer service approach.

Meals and manicures

Haidilao is China's largest dining chain serving hotpot—basins of simmering spicy broth in which diners cook their à la carte-ordered meat and vegetables tableside. The experience is communal—like roasting marshmallows around a campfire—and ubiquitous in China. But what has made Haidilao a hit—with revenue approaching $4 billion in 2019—has more to do with its ambience and attentive customer service than its selections of abalone, condiments and, Sichuan-style crispy fried pork.

The appeal of Haidilao starts from the moment one enters a restaurant—patrons queuing for a table are waited on hand and foot, pampered with a barrage of complimentary services including free snacks, board games, shoeshines, hand massages and manicures intended to make even the waiting time part of the experience.

Diners continue to be indulged once seated. Warm towels, hair bands, splashguards for smartphones and aprons are all handed out before the first dish is delivered. Diners are treated to spectacles such as noodle-pulling breakdances and Sichuan "face changing" Opera.

Haidilao effectively leaves nothing to be desired, according to Joel Silverstein, founder of East West Hospitality Group and who has more than 35 years of experience operating restaurants in the Asia-Pacific. "All of it basically means value for money," he says. "They've gone well beyond other Chinese restaurant chains."

Sitting in a Haidilao restaurant in central Tianjin in late October, with the temperatures outside in the low single-digits, Belinda Liu says she dine at her local branch at least twice every month, the 26-year-old beautician attributed her repeat visits to both the taste and service. "The broth, meat, vegetables and dishes are all good, but I come for the service above all else," she says.

Haidilao's success has helped husband-and-wife founders Zhang Yong and Shu Ping claim the title of the world's richest restauranters, thanks to their 68.16% holding in the Hong Kong-listed company. The Sichuan natives—now Singaporean citizens as well as graduates of CKGSB's MBA program—were worth $30 billion at the time of writing in early January, nearly quadruple the $7.9 billion when Haidilao went public in Hong Kong in September 2018. And with a market cap of $44 billion, the food service giant now is more valuable than Western names such as Restaurant Brands International, Chipotle Mexican Grill and Yum! Brands.

The COVID-19 pandemic, still raging in some parts of the world but largely subdued within China, did initially knock Haidilao's growth, but business has fared better than most rival chains. Revenue slumped 19% year-on-year in the first half of 2020, compared with declines of 23% for Jiumaojiu Group, 29% for fellow hotpot chain Xiabu Xiabu and 43.5% for Ajisen Ramen.

Humble beginnings

Zhang's story, from factory worker to billionaire restaurant mogul, is a classic rags-to-riches tale that speaks to the entrepreneurial zeal of modern-day Chinese society. After a six-year stint at a tractor factory and a couple of failed attempts at

Haidilao Corporate Timeline

Year	Description
1994	First hotpot restaurant in Jianyang, Sichuan Province opening
1999	Haidilao expanded network outside of Sichuan to Xi'an, Shaanxi Province
2002	Expand restaurant network to Zhengzhou, Henan
2004	Expand restaurant network to Beijing
2006	Expand restaurant network to Shanghai
2007	Received HACCP quality management system certification
2008	Awarded title of Chinese Famous Hot Pot by China Cuisine Association
2010	Introduced self-operated hot pot delivery
2011	Haidilao is recognised as a well known trademark in China by the State Adminstration for Industry & Commerce
2012	Expand restaurant network to Singapore
2013	Expand restaurant network to US
2014	Expand restaurant network to South Korea Opered 100th hot pot restaurant
2015	Opened first restaurant in Japan & Taiwan
2017	Opened first restaurant in Hong Kong
2018	Opened 300th hotpot restaurant Successfully launched IPO on HKEX

Source: Haidilao, Research Wise

entrepreneurship, Zhang—then a 19-year-old high school dropout—got into the restaurant business with his then-girlfriend-now-wife Shu and another couple, Shi Yonghong and his wife Li Haiyan. The chain began as a four-table cafe that opened in 1994 in rural Jianyang—a city near Sichuan's provincial capital of Chengdu renowned for its mutton soup.

"I was penniless, so the others were the real investors, although the entire investment was less than RMB 10,000 yuan ($1,514)," Zhang said in an interview with China's *Economic Observer* in 2011.

Since that first humble mom-and-pop shop, Haidilao has grown at a dizzying rate, reflecting co-founder Zhang's philosophy that "it's better to scale fast and be everywhere instead of having a single towering presence." Haidilao expanded beyond Sichuan for the first time in 1999 to Xi'an, capital of Shaanxi province. The venture failed after just six months at a cost of RMB 700,000.

The company then opened stores in Henan province in 2002, Beijing in 2004 and Shanghai in 2006. The first overseas branch opened in Singapore's touristy Clarke Quay at the end of 2012, and then the US in 2013. Haidilao opened its 100th outlet in 2014 and operated 300 eateries by the time it listed in 2018. It has more than tripled its store count since then.

Serving up a winner

Hotpot restaurants are as abundant in China as burger joints are in the US—one estimate placed the number at more than 700,000 at the end of 2019—and Sichuan-style hotpot is easily the nation's most popular eat-out cuisine. But Haidilao is not just adored by spicy hotpot aficionados; in fact, its business model is held up as an example in China. A Tsinghua University case study about Haidilao in 2011 likened the cook-it-yourself food preparation to Ikea's assemble-your-own-furniture model, while teams of government officials even visit the restaurant chain to learn tips on how to truly "serve the people."

What has helped Haidilao cut through the noise of all the other hotpot operators is extraordinary customer service in a country where "good service" is a relative term. "Their overall rankings are not much better than other hotpot chains, their food quality not necessarily better, but service is their main point of difference," says East West Hospitality Group's Silverstein.

Another aspect of Haidilao's winning formula is its corporate culture. "People in the hospitality sector say that Haidilao was one of the first private companies to create a 'family' culture within the company, well before Alibaba, Zappos and others started," says Kitty Smyth, founder of China strategic advisory firm Jingpinou.

Haidilao is renowned for its generous compensation system for employees from top to bottom, and the company has a higher-than-industry retention rate. For example, while restaurant managers are rewarded with up to 3.1% of their location's profits, they also receive a cut of the profits at stores managed by their first- and second-generation apprentices. This profit-sharing scheme incentivizes managers to mentor talented staff to prepare them for management, helping to accelerate the pace of new store openings. New hires can work their way up to manager regardless of background within four years.

"Haidilao grew their managers from the bottom ranks up, and that gave the company stability and loyalty from employees, creating a solid foundation for expansion," says Smyth, who has supplied Haidilao with pork from Ireland and the UK.

Two major consumer trends buoyed Haidilao too. The first is that Haidilao's boom in the early 2010s coincided with the exponential rise of social media—particularly Tencent's WeChat, which was launched in 2011. "Haidilao skews to a much younger audience with all of their WeChat postings," says Silverstein. "Early on, they had strong viral marketing on the internet. People went to Haidilao, posted it on their WeChat Moments and their friends became interested."

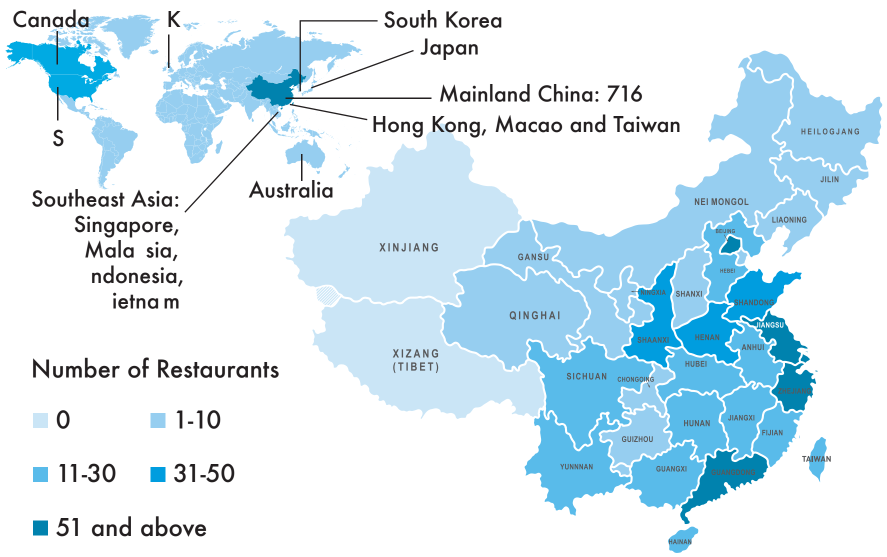
The second is China's passion for hotpot, which held a 13.7% share of the domestic cuisine market in 2017, according to independent research cited by Haidilao in its listing prospectus. The second-largest share was Sichuan food with 12.4%, followed by Cantonese with 8.2% and Jiangsu-Zhejiang cuisine with 6.3%. "Sichuan spicy food has been a preference of younger consumers for years now. That trend is not going away," says Silverstein.

That may have something to do with the simplicity of hotpot, which is easier to standardize and replicate compared with other Chinese cuisine types. Hotpot restaurants like Haidilao can make do with smaller kitchens to prepare ingredients ahead of time. "Hotpot is the easiest type of Chinese food to execute. It's very scalable," says Silverstein. "The labor costs are low because the customer does the cooking most of the time."

Stumbles along the way by the company have been turned into opportunities to learn and improve. After three restaurants in Beijing and Singapore closed temporarily in 2017 over questionable hygiene, Zhang pledged to use technological advances to avoid future food scandals. The hotpot chain made good on the promise a year later by opening a "smart restaurant" in Beijing that included an automated kitchen, replacing chefs with robotic devices to prepare and serve food, and an automated warehouse that operates in temperatures too cold for pests to survive.

But the high cost and difficulties of retrofitting existing stores with smart technologies has prohibited wider roll out. By the end of June, Haidilao had fitted three restaurants in Beijing with intelligent robotic arms that prepare ingredients and equipped 23 restaurants with automated mixing machines for readying soup bases. Some 958 robot waiters that take orders and deliver ingredients to dining tables were

RESTAURANT NETWORK | Expansion and Penetration



Source: Haidilao, Macquarie

also working in stores worldwide.

"The application of new technology is aimed at improving the customer experience," says Haidilao spokeswoman Cui Xiawan. "It has optimized kitchen management and improved food safety." Other tech flourishes that have won over diners include touchscreen ordering on iPads and the ability to customize soup bases based on customers' requests.

Global ambitions

As recently as 2018, Haidilao's Zhang predicted the company's overseas footprint would eventually exceed its China presence. "Much of [China's] history and customs can be learned through food," he told *Forbes* in 2018 to explain the overseas potential of hotpot. COVID-19 has slow down plans to conquer foreign markets but doubts about Haidilao's global expansion actually date back to 2011.

Nine years on, just how much of an international success Haidilao can be remains to be seen. In Europe, the US and other Western markets, Chinese hotpot barely registers as a dine-out option. "Brand awareness of Haidilao outside of China and outside of overseas Chinese, is low," says Smyth from Jingpinou. "Understanding of hotpot as a cuisine and of the fun, social experience of hotpot, is also missing."

"There will need to be an advertising strategy that introduces people who haven't eaten hotpot before to the joys of hotpot. They will have to start at the beginning, in much the same way KFC did when they first went into China."

Elements that drove Haidilao's success in China will work against its quest to become a global behemoth. A meal at Haidilao is a more formal setting, with a higher price point and a more varied menu, so any global expansion would be slower than that of the Western fast-food chains. Brands such as Burger King, KFC, McDonald's and Starbucks crept into markets via off-the-shelf franchises, whereas Haidilao establishes and manages its own restaurants.

"I don't believe it's going to be a big international brand," says Silverstein. While the chain has promise in markets where spicy hotpot is already popular, such as Singapore, Thailand and Vietnam, prospects in the West are likely to be limited to where there are considerable Chinese or Asian communities.

"There's not much of a global opportunity, but that doesn't mean they can't do 50 stores in the US, for example. There are enough ethnic Chinese enclaves to be able to have a business but it's not going to be a major chain."

Hospitality and the Pandemic

Christophe Olivro, regional manager of Aman China, looks at the impact COVID-19 has had on the hospitality, tourism and luxury sectors

With the world facing an unprecedented global health, social and economic emergency as a result of the COVID-19 pandemic, the tourism and hospitality industry has been hit particularly hard. The World Tourism Organization estimates that international travel declined by 75% in 2020, returning global tourism to levels last seen 30 years ago.

But while demand for international travel remains subdued, domestic tourism has grown in China, and domestic air travel has already returned to pre-COVID levels. In this interview, Christophe Olivro, regional manager of Aman China and general manager of one of its properties, the Amanyangyun near Shanghai, reflects on what trends in the hospitality sector will be post-pandemic and what is unique about China's growing hotel and resort market.

Aman Resorts International is a luxury hotel group with 32 destinations in 20 countries. Each resort has a small number of rooms—typically fewer than 55—and the brand mandates a concern for architectural and ecological conservation. Olivro describes the Amanyangyun as being one of the "boldest conservation projects in China's history."

Q. COVID-19 hit the hospitality and tourism industry around the world. How did the virus affect business in China?

A. COVID-19 has had an undeniable impact. Earlier in 2020, there was a three-month period toward the end of the first quarter and the beginning of the second where that impact was felt the most. We have recovered in what we call the post-pandemic period. We ended up finishing strong in summer and autumn. The only properties recovering at a slower pace are the ones in Beijing, and that is due to the second wave that they've experienced. But they, too, are starting to bounce back.

There were a lot of unknown factors and uncertainty when the pandamic hit, especially since it's a public health issue. Priorities had to be set and actions taken to protect people. At the time that it hit, the first thing that we needed to do was to work closely with local government authorities as they are kept in the loop when it comes to regulatory changes. Then when the situation started to stabilize—in the second month going on to the third—we still wanted to show care and provide motivation to our team. We wanted to send the message that no one is alone and that we are all in it together. We had to focus on moving as one team or as one business component. We had to stay connected with our colleagues and with our business partners. It's very important to stay connected, because it allows for the information to filter through to everyone, which is important. Our business partners gave us precedents of what's happening and what they planned to do in terms of moving business forward. The key is to really be informed in a timely manner by taking advantage of the digital world. It's important to be on the forefront. Every crisis is different, so we are all learning as we go along.

Q. What positive outcomes have there been for the business from the pandemic?

A. Any crisis brings lessons for the future perspective on business.

Amid the pandemic, we had to rethink our business model. When you do that, you have to really reconcider all aspects of the business, whether it's communications, marketing, operations or from a sales point of view. You have safety and sanitation, which definitely come to the forefront. You have special obligations either to the group or to the owners and you have to take those into consideration. And because it's a public situation, the most important part to consider is the human factor: Be there for your team, for your friends, for the staff and whoever is in need of help. We have made changes during these dark times, we didn't sit and wait. We've made changes in the business and I think the business became stronger as we moved out of the crisis. Except for Beijing, we were ahead of the game and that's why our overall performance in the second part of the year has been strong. On a side note, when you go through this pandemic crisis, the health issue initiates a different set of behaviours, the right kind of behaviours. And I think it will continue to do so as we are moving through it. Basically, it's the start of a new outlook in the hospitality and tourism industry, particularly in how you would conduct business within those sectors. This is now the new normal so everyone has to look at things differently.

Q. China managed to control the number of COVID-19 cases much better than most countries. What are the prospects for the business over the next three years?

A. We are now living in a world of impermanance. A year ago, nobody had any idea that this is what would happen. In 2021, if we continue focusing on the domestic market in China, we'll have to make some adjustments. Winter is coming and it could be a testing period for us.

What we can expect in the next couple of years, hopefully, is that the situation stabilizes at some point in China and that stability extends outwards to other markets. It depends on how countries will control the pandemic and what kind of economic and political ties they have. We hope to see bubbles of trade and travel between countries that have managed to control the virus. There is likely to be more multilateral engagements, for example, bilateral or three-party engagements for at least the next year to three years.

There is still a lot of interest in business opportunities within the hospitality sector and it can be reinforced, especially now, because you have strong domestic demand. So if you look at it for the next few years, there are definitely good prospects ahead of us in China.

Q. What trends are there in terms of the profile of guests staying at Aman properties in China, including the proportion of Chinese guests versus foreign guests. Has it changed?

A. It's changed a lot. We have a whole spectrum in terms of age, couples, families, singles and different generations. Our guests join us for both leisure and business. This year, of course, is an abnormal year because 99.9% of our guests have been Chinese. The proportion of Chinese versus foreign guests has changed from location to location. If you take Beijing, for example, Beijing would have more international guests, reaching a ratio of around 50:50. But then in Shanghai, you would have less Chinese guests, the ratio would be about 75:25. And then if you go to Hangzhou you're back to 85 or 90% Chinese. It has changed because of COVID-19.

Overall, it would rebalance over the next years. There is a strong focus on the domestic market to reinforce the brand image and what the people who are coming want to experience. In the future, there is likely to be a balance between what we had in 2020, which is an extreme, to what we've experienced in the past.

What you have with Chinese consumers is that they are now well-informed travellers. They are very curious about the destination they are going to. And they want to experience its unique offerings, which is no different from what you would have anywhere else.

Q. Seeing as Aman is a luxury brand, what sense do you have of the willingness of China's wealthy consumers to spend?

A. Our Chinese guests reveal different consumer behaviours to Western counterparts. An example would be the lengths of stay. The typical length of stay for Chinese guests is one to two nights, versus Western guests who usually stay three to four nights. While doing four nights in the Shanghai area, Chinese guests might choose to spend two days in one place and the rest at another place, whereas a foreign visitor would stay three to four nights at the same place.

Q. Looking at the hospitality market as a whole, what do you see as the prospects for China over the next 10-20 years?

A. I see it as being positive. Domestically, what you will see is higher quality services. More consumers will be interested in sustaining a luxury lifestyle associated with a particular brand, which is important for Chinese consumers. You will have different hospitality trends and behaviors as well. It's a fast-moving market, and coming out of this pandemic it is going to change and grow even faster. The key to success in the years to come is being very agile in this highly competitive market.

Q. Is there any specific area in the hospitality industry that will see a significant surge in development?

A. There has been a great deal of discussion around wellness and anything related to overall health. With urbanization increasing around the world and people becoming digitally crazy, people are going to be searching for missing human connections. Ensuring that a healthy lifestyle is connected to nature will be at the forefront of future developments and integrating wellness with the medical field is also becoming important. That integration is going to change the world and the way we look at our lives. Nowadays, the pace of people's lives has become faster than ever before, but the true value of wellness lies in helping to maintain that necessary healthy balance.

CKGSB CASE STUDY

The Future of Eco-Fashion

By Li Mengjun, a researcher at the CKGSB Research Center for Social Innovation and Business for Good, and conducted under the guidance of Professor Zhu Rui of CKGSB

Liang Zi, an eco-minded designer, first stumbled across Gambiered Silk in 1994 and instantly felt a deep connection to the texture and technique used to produce this ancient Chinese material. Gambiered Silk is hand-dyed with the juice of *dioscorea cirrhosa*, a wild plant unique to Guangdong Province in southern China and known for its medicinal properties. It is produced in the open without the use of chemicals or machines, which Liang Zi felt reflected the harmony that should exist between humans and nature.

The material and process surrounding it motivated Liang Zi to establish her company, TANGY • Gambiered Silk, with the hope of both protecting the legacy of, and injecting new vitality into, a piece of 500-year-old cultural heritage. Twenty years later, the company is established as one of the many boutique Chinese companies that meet the demands of the growing middle-class. Like other entrepreneurs, Liang Zi has faced ever-changing consumer requirements, growing costs, sales channel issues, as well as marketing and management challenges.

TANGY's sustainable brand image initially helped it achieve a reputation and broad consumer support. The business grew quickly and by 2009, TANGY had opened over 400 stores in more than 160 cities across China. As time passed, however, sales declined year-on-year. By 2019 the number of stores was down to 93, including 53 franchised stores and 40 direct-sale stores. TANGY's management has tried different ways of improving sales while sticking to the core concept of environment protection, but none of the changes have yet worked.

Product mix and pricing

The company currently has two product lines, TANGY for the mid-market and TANGY Collection for the high-end. The average order value of TANGY ranges from RMB 2,000 to 3,000 ($305-$458), while for the high-end it is over RMB 5,000.

TANGY is aimed at consumers aged 45-65 with core buyers in the 50-59 age bracket. This demographic mostly resides in major cities such as Beijing, Guangzhou, Shanghai and Shenzhen and usually wear the clothes on a daily basis. TANGY Collection is aimed at high-income earners with strong cultural awareness. Typically they are aged 35-55, with most buyers being in the 40-49 age group. Customers of TANGY Collection tend to have an annual income of RMB 500,000-2,000,000 and wear the products when attending events.

Producing the TANGY Collection requires a large amount of Gambiered Silk. The production process for this material is extremely complicated: producing a quality batch takes six months and involves more than 30 steps. Climatic conditions, such as humidity, sunlight, temperature and wind direction can influence the process, so production only occurs during a few months each year. The strict production requirements create challenges to the timely supply of raw materials, and the manual process incurs high labor costs.

Sales channels and marketing

TANGY now has both online and offline sales channels. TANGY Collection is only available offline. But even the sale of TANGY products is 89% offline.

Liang Zi had earlier created an online

sales channel. Branded Liangzi Fashion, it was originally intended to help the company clear stock and materials at a low price. But the concept attracted a new group of price-sensitive consumers. However their lack of brand awareness damaged the TANGY name, and online sales grew only slowly through to 2019.

Offline, Liangzi Fashion mainly sells in department stores and shopping malls that match its higher-end brand positioning. It also promotes its concepts, culture and brand values through activities such as culture & art exhibitions, cultural fairs and fashion weeks.

In terms of online marketing, Liangzi Fashion attracts target customers by developing Gambiered Silk "experience products." On social media, it provides special coupons for consumers who follow TANGY or who purchase its products. It also organizes EMBA exchanges for working students to study at a top international institution, livestreams Gambiered Silk production, and organizes online flower festivals and other interactive activities to attract both online and offline customers.

Customer management

To promote sales, TANGY• Liang Zi explores the needs and pressure points of consumers through data analysis and surveys. It uses the findings to enhance the offline service experience of members and to converse with online members using targeted marketing.

For member management, the company has established a member label database and a membership system. For highly "sticky" customers, the company offers specific promotions and benefits. The TANGY system has accumulated tens of thousands of registered members, but the number of new members in both product lines has been declining, as has repurchase rates.

According to the analysis by the company's management, the main reason for the decline is that the benefits of shopping mall membership programs exceed those of the TANGY membership program. The decline in both the repurchase rate and the number of new members has created challenges for the company.

A model wearing Gambiered silk products of the TANGY Collection
Source: Première Classe

Challenges facing TANGY• Liang Zi

As one of the first designer clothing brands established in China, TANGY• Liang Zi has gone through more than 20 years of development. During the first two decades, TANGY adhered to the original intention of eco-environment protection and realized rapid development while protecting Gambiered Silk. However, with market competition intensifying, few customers and production and sales costs increasing, the company faces continuous decline in sales. The challenges are:

Challenge 1: Brand operation and marketing capabilities need to improve.

TANGY products are mostly made of Gambiered Silk, cotton, flax, wool and other natural fabrics. Different from other durable fabrics, Gambiered Silk is too delicate to be machine washed or treated with chemical agents. It can only be hand-washed and air-dried. These washing demands may adversely affect the attractiveness of products among customers. Compared with other designer brands engaged in multi-brand operation, such as JNBY Design, the company finds itself stranded in servicing an aging demographic. A failure to develop the brand name amongst the 1980s and 1990s generations could be one reason why sales are declining as these cohorts increasingly assume spending power.

Challenge 2: Online sales channels are weak and sales positioning affects brand power

TANGY's online sales channels were originally established for stock clearance. Hence, the styles of products online are slightly outdated and carry a low price. While it adds little to the bottom line, it may be negatively impacting the perception of consumers concerning the TANGY brand.

Challenge 3: Employees are aging, while production and time costs of Gambiered Silk are not easy to control

TANGY is also facing production challenges. The production of Gambiered Silk is complicated and a small mistake or a slight change in weather may boost the reject ratio. Also, employees are aging, especially first-line craftsmen. As the production of Gambiered Silk entails long-term experience, it is impossible for TANGY to solve this problem in a short period by employing a large group of young employees.

Liang Zi has managed to bring back a clothing fabric with a rich history, synonymous with nobleness, healthiness and environmental friendliness. But the question is: How will Liang Zi Fashion develop in the future?

Lessons from peers

Like TANGY • Liang Zi, other designer brands also face market pressure from the success of their own online sales channels, as well as falling margins caused by the influx of foreign high-end brands with flexible supply chains of fast-fashion brands. The question for Liang Zi fashion is how to strike a balance between staying true to the original concept and satisfying changing market demands.

Other players in the same space as TANGY • Liang Zi are also having mixed fortunes.

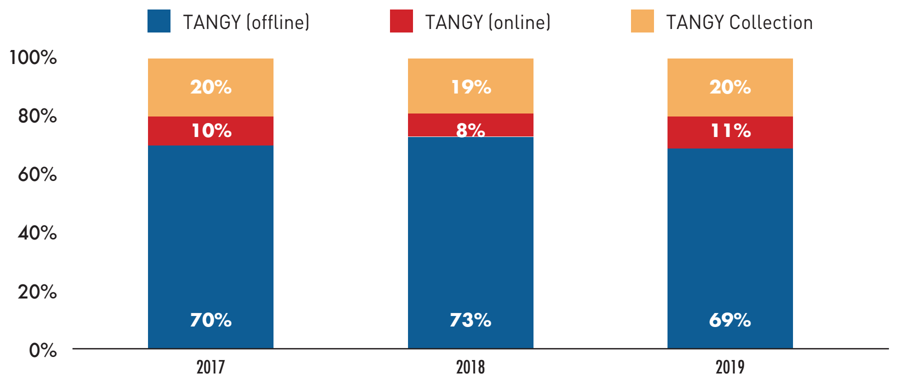
Exception, another designer clothing brand, was established at the same time as TANGY • Liang Zi. It took a different path in the designer clothing market with elegant design based on an inheritance of Oriental culture and a brand concept of "origin, freedom and purity." But high prices and the failure of its designs to attract younger generations means its expansion has been impacted. The company has developed special stores such as "double-service" and eco-stores to try and improve sales, but has invested little in online channels.

JNBY Design has successfully solved the contradiction between designer brands and the mass-market with a multi-brand incubation approach. So far, JNBY Design has incubated seven sub-brands, including Croquis, JNBY, JNBYHOME, jnby by JNBY, less, SAMO, and Pomme de terre that cater to consumers of different genders and ages. JNBY Design is also exploring overseas markets. At present, it has 39 distribution outlets and five direct-sale stores outside of mainland China, in 17 countries and regions in the world.

ICICLE Group is an environment-friendly Chinese designer brand with a management concept of globalization. It was founded in Shanghai in 1997 and has incubated numerous brands, including ICICLE and SILEX. In 2018, ICICLE Group acquired CARVEN, a famous French brand. ICICLE adheres to the concept of "comfortable and environment-friendly commuting clothes," uses natural fabrics and shows its unique charm through a low profile. It is committed to providing high-quality, easy-to-care-for pure natural commuting clothes for young, middle-class people.

Stella McCartney, a well-known British eco-fashion designer, has a development concept of protecting wildlife and developing sustainable fashion. She refuses to use leathers and furs in designs and insists on the research and application of environment-friendly clothing fabrics. In 2001, she co-founded Stella McCartney with Gucci. However, profitability was a problem. In 2004, Robert Polet, the then CEO of Gucci Group, gave McCartney an ultimatum: the company must be profitable within three years, otherwise financial support may be withdrawn. McCartney began to turn a profit two years later.

SHOPPING IN-STORE | Proportion of Sales of Liangzi Fashion by Channels (2017-2019)



Source: Liangzi Fashion

Stella McCartney's design idea of using sustainable materials coincided with that of Adidas. Adidas had hoped to launch a high-performance women's sport suit made of new fabrics that balanced the sense of design and performance in 2005. A joint product series, Adidas by Stella McCartney, was then born—the first functional sports product series run by a first-class brand designer in the global sports market. Through its collaboration with Adidas, Stella McCartney earned profit for the first time. This cooperation continues today. In addition, Stella McCartney also launched environment-friendly clothes worldwide with H&M, which resulted in an immediate increase of 11% in sales that month and achieved great success.

Relying on its research and application of environment-friendly fabrics and crossover cooperation, Stella McCartney has increased brand awareness, improved business performance and become an international brand covering 72 countries. Stella McCartney has since developed men's, women's and children's clothing, as well as luggage and undertaken many joint product series.

Facing fierce market competition, these designer brands have each innovated in different ways.

Where to TANGY?

When looking back over the history of the company she founded, Liang Zi says, "The production of Gambiered Silk may not make or may even lose money in the short run. The process of getting consumers to accept and like Gambiered Silk is a long one. Therefore, the production of Gambiered Silk cannot continue without perseverance. It can be said my deep love for Gambiered Silk is the reason for TANGY's success. I have always believed that good things will be accepted sooner or later."

The COVID-19 virus has also added a new level of unprecedented challenges to TANGY, a brand that has primarily relied on offline sales. Will TANGY be able to meet its existing challenges and survive through a pandemic? Only time will tell. Stay tuned.

CKGSB WEBINAR

Converging Trends

Professor Sun Baohong, Dean's Distinguished Chair Professor of Marketing at CKGSB, speaks about the drivers of change in China's digital economy

Sun Baohong, Professor of Marketing at the Cheung Kong Graduate School of Business, researches rational and strategic consumer choices, dynamic and interactive marketing mix and customer information management. Most recently, she has focused on modeling inter-dependent consumer decisions on e-commerce and social media platforms. She recently shared her insights on how converging trends will result in the tech sector expanding "at full speed."

China's tech sector is expanding rapidly, with the number of its unicorns—tech startups valued at more than $1 billion—surpassing that of the United States in 2019. And with the government increasingly emphasizing the role that tech can play in China's future prosperity, it is a sector to watch.

"China's digital economy is about one-third of total GDP," says Professor Sun. "In terms of e-commerce, China already has the biggest share of global sales."

For Sun, China's digital economy

Professor Sun Baohong believes the tech sector will expand "at full speed."

shows no sign of slowing down. "It will only move forward—and at full speed." But what's driving this rapid growth? According to Sun, there are several factors at work.

COVID-19

Much has been written about how COVID-19 has accelerated trends that existed before the pandemic. In China, rapid adoption of new tech is most certainly one of those trends, with an unprecedented number of services being pushed online in 2020.

"Businesses that were previously totally offline are now online," Sun said. "We've seen the rise in virtual showrooms and there are even real estate companies doing virtual tours of homes.

"Chinese companies have been very innovative in consumer engagement and how they sell to customers during the crisis."

The social impact of the pandemic has also played a role in China's tech expansion, Sun said. "During the lockdowns, we saw many tech-savvy young people living in first and second-tier cities move home to be with their parents." This has enabled tech platforms to enjoy greater penetration in third and fourth tier cities.

COVID-19 has also driven an expansion of the already-popular social commerce market in China, while digital innovations such as contactless payments

Professor Sun Baohong further elaborated on her research during a webinar hosted by CKGSB and Asia House

have also been boosted by the changes in habits brought by the pandemic.

Entrepreneurs in a thriving ecosystem

A crucial factor in China's rapid tech expansion is that the optimal conditions for such growth have been created in recent years through a combination of dynamic entrepreneurship and changing consumer habits.

"Unlike the UK or the US, China's tech companies are operating in a large and complete ecosystem," Sun says. The sheer number of people using digital services in China means companies have access to large data resources and can expand quicker than they may elsewhere.

Tech firms have also been highly creative in how they approach consumers, integrating e-commerce with social elements that have resulted in multi-billion-dollar successes such as the hugely successful e-commerce platform Pinduoduo.

"The ecosystem is already in place, which puts companies at an advantage." It also enables tech firms to access lower tier cities sooner than they would in other markets, and thus expand at a faster pace, Sun adds.

Government-backed infrastructure

In large part, that ecosystem is the result of strong support from the government, which is investing heavily in China's future tech sectors.

"The government is investing $1.4 trillion in digital infrastructure," Sun said, referring to the ambitious plans unveiled at the National People's Congress session last May. This investment, planned over the next six years, will see efforts to make China's tech sector less reliant on external markets by boosting domestic capabilities in a range of areas, from artificial intelligence to 5G and Internet of Things innovation.

This, of course, is good for China's digital companies, which will benefit from improved infrastructure and the possibility of greater investment.

"This has made digital retailers happy," Sun said.

Challenges ahead

However, concerns have been raised over this domestic tech push, with commentators fearing it could lead to a more insular Chinese digital economy. For Sun, the current discourse around tech decoupling between China and the US is worrying.

"China has been very strong on the application side, but it is lagging behind when it comes to fundamental research," she said. "The skills and craftsmanship to make the high-end kit, such as microchips, are also no longer there."

A more insular digital system would therefore be detrimental to China's long-term tech ambitions, Prof Sun suggested. "I'm a researcher, so I understand the importance of engaging with other researchers for our collective benefit," she said.

"The fundamental research that enables innovation relies on the free exchange of ideas."

This article was originally published by Asia House.

> **Unlike the UK or the US, China's tech companies are operating in a large and complete ecosystem**

CKGSB BUSINESS CONDITIONS INDEX

Risk and Return

CKGSB's Business Conditions Index reveals the effect of stubborn problems of the financial market

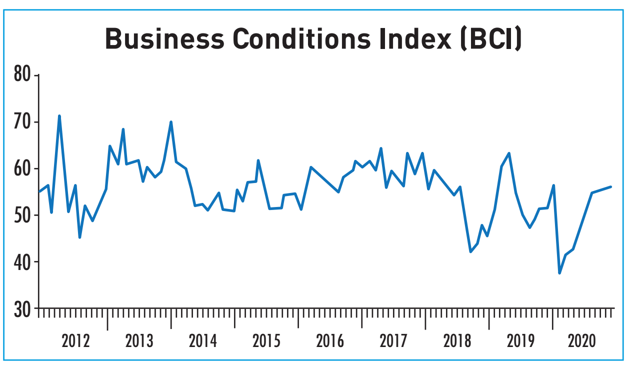
The BCI is directed by Li Wei, Professor of Economics at the Cheung Kong Graduate School of Business

The CKGSB Business Conditions Index (BCI) reported a slight rise from 55.4 to 55.8 in November 2020. With confidence above 50.0, it appears economic relief policies implemented by the government are having a decided impact on private business.

The data has not altered significantly in overall terms, but there are highlights, the most obvious of which is that the majority of sub-indices are on the rise to some extent. For example, the investment prospects index rose from 65.0 to 67.4, and the recruitment index from 67.6 to 69.3, indicating that most surveyed companies are expanding and that the Chinese economy is operating at full capacity.

Introduction

Since June 2011, the CKGSB Case Center and the Center for Economic Research have conducted a monthly survey to gauge the business sentiment of executives regarding the macro-economic environment in China—called the Business Conditions Index (BCI). Under the direction of Professor Li Wei, 107 surveys have now been completed and 103 monthly reports published.



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

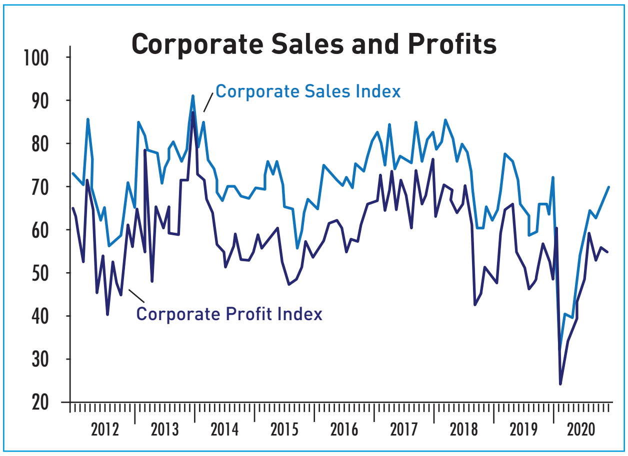
- In November, the CKGSB BCI registered at 55.8, a minimal rise on October's figure of 55.4.
- Corporate financing prospects were revised downwards, with the index falling from 52.5 to 50.6.
- The investment and recruitment indices have both weakened. These two indices have been consistently at the more confident end of the scale since the BCI began

Analysis

The CKGSB BCI is comprised 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.

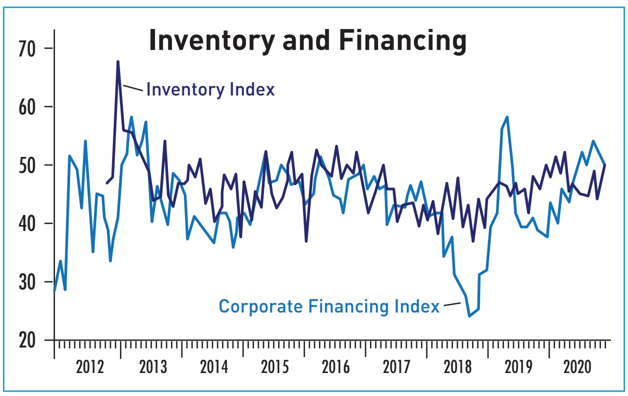
In November 2020, two rose and two fell. The corporate sales index rose from 66.7 to 69.9, and the corporate profit index fell from 55.5 to 54.5, but kept on the positive side of the threshold.

November's corporate financing prospects were revised downwards, with the index falling from 52.5 to 50.6. The inventory index rose somewhat from 44.4 to 49.3.



The labor cost forecast rose from 76.6 to 81.4. The overall cost forecast also climbed, from 77.7 to 80.3.

We now turn to investment and recruitment. These two indices have been consistently at the more confident end of the scale since the BCI began. In recent months, however, both have weakened, especially recruitment, but this month both have risen, with investment conditions rising from 65.0 to 67.4, and the recruitment situation on the up, rising from 67.6 to 69.3.



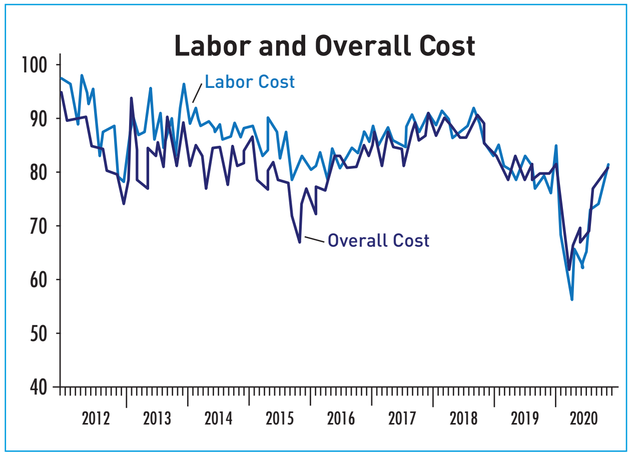
Conclusion

On November 25, Liu He, Vice Premier of the State Council, wrote in the *People's Daily* that his main focus was on serving the real economy, making structural adjustments to the financial system and actively increasing the proportion of direct financing in the economy. This is a very important signal, as it heralds the general direction of future financial reforms. Increasing the proportion of direct financing will likely drive the banks towards the small-and middle-sized enterprises (SMEs) market.

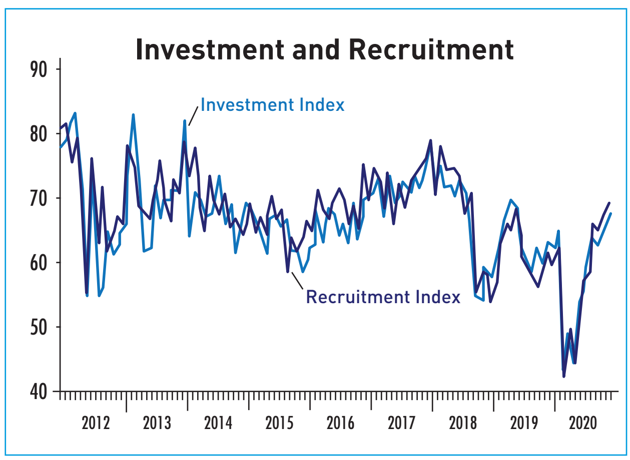
So how are the banks serving business at present? Unfortunately, things are not looking great.

Financing is an old problem for China's economy as a whole. Poor performance indicates that interviewed companies suffer long-standing financing difficulties and high costs. In other words, our financial institutions mainly serve large enterprises, while SMEs struggle to obtain their support. This also means the market mechanism is somewhat unsound.

Apart from finding a way to increase direct financing, there is another important problem that needs resolving—the rigid payment terms given to large enterprises, especially state-owned enterprises.



The underlying problem remains to be resolved. This is the problem of rigid payments, a concept derived from the trust sector, which means that trust companies must allocate principal and earnings to investors after a trust product matures. When the trust plan cannot be paid on schedule or there is difficulty in redeeming it, the trust company has to deal with the entire situation.



To sum up, whether by increasing the proportion of direct financing or breaking down the system of rigid payments from state-owned enterprises, it is necessary to straighten out market mechanisms, let risk correspond to return and let people do what they are best suited to do. Only in this way can we overcome the two most stubborn problems of the financial market—moral hazard and adverse selection.

WEALTH IN WELLNESS

Wellness is the new luxury in China that everyone wants a piece of

By Faye Bradley

China's wellness market is seeing huge growth in China, but Chinese people have different notions of what wellness means

Four decades of unprecedented economic growth has led not only to a massive rise in urbanization, but also increases in pollution and heightened stress levels for China's hardworking population. Looking for ways to regain a sense of personal balance in their lives, many are turning to a wide variety of solutions, from hot stone massages and meditation sessions to kale-infused smoothies.

The average Chinese employee spends around 46.3 hours per week at work, 12 more than American counterparts, according to the Organization for Economic Co-operation and Development. The Chinese work and business environment is also notorious for its high levels of stress.

"The high demand and pressure on long working hours mean solutions are needed for physical and mental health," says Jamie Waring, Managing Director at the immersive wellness hotel SANGHA Retreat by Octave Institute, in Suzhou west of Shanghai.

The seismic shift from focusing only on work through to prioritizing self-care has opened many opportunities for growth in the burgeoning health and wellness industry, drumming up interest from foreign businesses looking to invest and enter the already competitive market.

Wellness enters

The Global Wellness Institute (GWI), the world's leading authority on wellness research, defines wellness as the active pursuit of choices and lifestyles that lead to a state of holistic health. These include gyms, healthy-eating restaurants, holistic medicine, mental health clinics, spas and a wide variety of consumer products that fit into these categories.

"Wellness is the new status symbol among the 400-million-strong Chinese millennials," says Jenny Lo, a Shanghai-based general manager at global marketing and communications firm CatchOn Finn Partners. "International brands still lead the industry. Brand-savvy consumers still value the stringent safety standards, improved quality and innovation that foreign brands promise, and are willing to pay premium prices for them."

But despite the dominance of international brands in some sectors of the wellness industry, including hardware, the market is fragmented between a variety of health and well-being concepts, influenced by a variety of social and technological factors. Traditional Chinese medicine plays a big role and consumers tend to be more open to high-tech solutions than people in other markets.

According to the GWI, the global health and wellness industry is valued at $4.5 trillion. China is second only to the United States in size in several categories including Physical Activity Economy, Wellness Communities and the Spa Industry, while it ranked first in Thermal/Mineral Springs ($17.5 billion). The GWI projects that the physical activity economy will surpass $1.1 trillion by 2023, with China and India driving one-third of all growth.

Meanwhile, China's health care product market was worth RMB 222.7 billion ($34 billion) in 2019, according to high-tech industry portal OfWeek.. And the speed of growth in recent years has outpaced almost all other markets. In the first quarter of 2020, health food purchases via Alibaba platforms increased by 16.01%.

The fitness industry is benefiting. The pandemic lockdown in 2020 brought focus on home workouts and saw a 200%-plus surge in the sales of weight-training machines. Research by e-commerce giant JD.com showed an increase in sales of yoga mats on JD.com's first-party stores by nearly 142% year-on-year.

Home fitness also saw a huge surge through phone apps, including Chinese fitness app KEEP, which in May 2020 gained unicorn status—corporate valuation in excess of US$1 billion, according to iResearch Consulting Group. It is estimated that 70% of Chinese internet users are now regular consumers of such health products.

Parceling and strengthening those social trends, the Chinese government has announced a "Healthy China 2030" drive, promoting healthy living and eating to help keep medical costs down. But so far, the impact has mostly been in mega cities. "There's a lot of advertising encouraging people to engage in physical

> There are more wellness products and services targeted at children, as parents are very willing to spend on their only child
>
> Jenny Lo
> General Manager
> CatchOn Finn Partners

activities and citywide sports activities such as marathons," comments Lo on the government's role in wellness.

There are also trends which come and go. "In Shanghai, wellness goes through peaks and troughs," says Kimberly Ashton, a wellness coach who lived in Shanghai for 18 years. "At the peaks, everyone is in it, like the juice bar craze—that lasted one summer."

"China picks up some wellness practices from the West, but not as quickly," acknowledges CatchOn's Lo. "You will see higher levels of adoption in first-tiered cities, especially in Shanghai and among the younger generation."

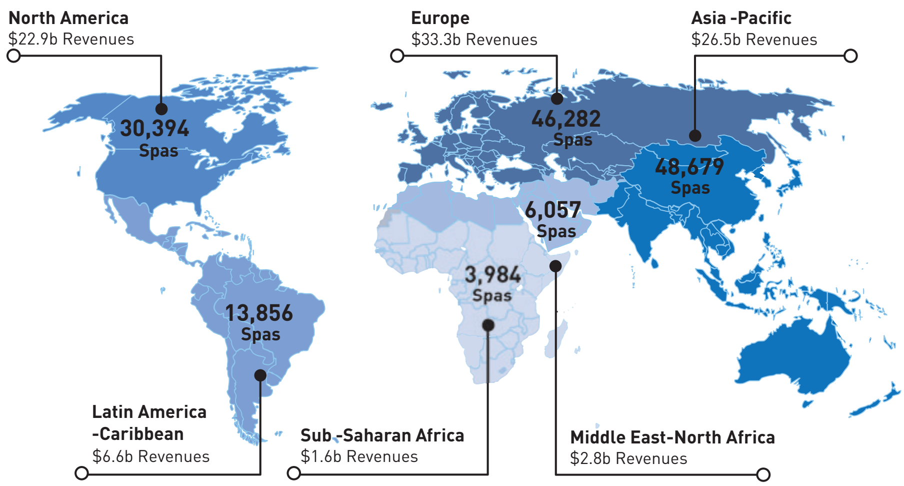
Chinese people look at wellness from a different perspective from the West and they are heavily influenced by the tradition. Traditional Chinese Medicine (TCM) stresses holistic wellness and preventative measures—the latter achieved through fitness and diet—rather than the focused sledgehammer approach of Western medicine and wellness. Its roots go back over 2,000 years old and is deeply embedded in the country's culture, consciously or unconsciously.

"We are seeing more modernized TCM versions coming up to ensure convenience and effectiveness," notes Lo. "Electric-current acupuncture, herbal medicine pills, home cupping devices, for example, are gaining traction."

Another trend is the stress on children' health, partly because most children have no siblings and generally face significant stress at school and life compared to other societies. "There are more wellness products and services targeted at children, as parents are very willing to spend on their only child," says Lo.

SUCCESS IN SPAS

The number of spa and spa facilities in the Asia-Pacific lead the world



Source: Global Wellness Institute, Global Wellness Economy Monitor, October 2018

Health is wealth

It was not too long ago when designer handbags and haute couture were all the rave for increasingly prosperous people in cities. Although such consumer status symbols are still common, many young urbanites have shifted their focus to health and wellness as the new form of luxury and even conspicuous consumption.

"There has been an increase in the middle-class population," says Olivier Verot, CEO of Digital Marketing Agency Gentlemen Marketing. "They are willing to spend more money on luxury health and wellness products and services."

"There is much more emphasis on fitness and health now, not just beauty and spa," says Janice Chen, a 27-year-old consumer in Shanghai. "The realization that we live happier, healthier lives when we take time for restorative activities has become firmly established."

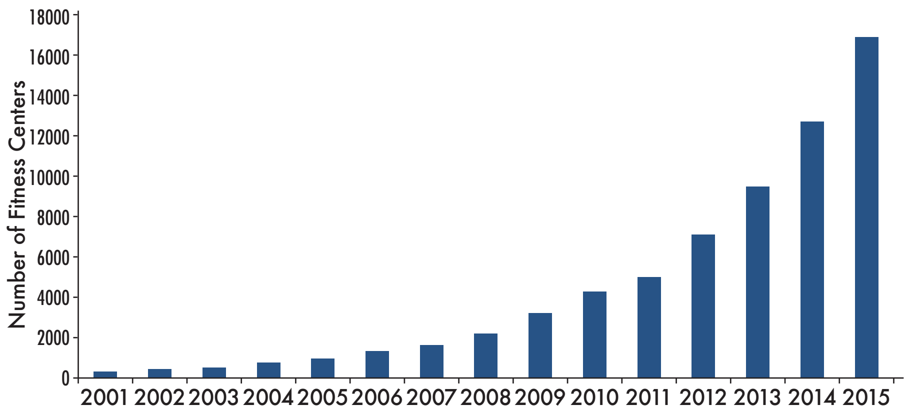
Chinese consumers are thus willing to pay premium prices for fitness and spa memberships, for healthy foods, and a wide range of equipment and services which promise better health and longer active living.

"People are seeing their health deteriorate with age," explains Ashton, "so they seek wellness to see what they can offer—better sleep, physique and overall health."

Foreign brands entering the market

There are many ways that both foreign and domestic investors can benefit from trending wellness opportunities by meeting the needs of this new generation of young, middle-class consumers. There is still a widespread preference for foreign products for anything related to health. "In the wellness space, foreign brands are still seen as offering good quality and advanced technology, while Chinese brands focus on

STRESS RELEASE | The number of fitness centers nationwide has soared in China



Source: Daxue Consulting

TCM," says Lo. "The division is clear, and the association remains strong."

"There are huge opportunities for growth in all wellness sectors in the Chinese market," says Verot, "Foreign businesses can franchise concepts, venture into yoga and cosmetics. Vitamins and health supplements are also playing a huge part in the wellness boom."

Foreign brands that are benefitting include fitness equipment providers such as Technogym and Venus Concept, an non-invasive cosmetic procedure firm, and Nike. The demand for what is known as "athleisure" and yoga-related accessories has impacted everyday attire, and many younger Chinese people like to display their focus on wellness by sporting head-to-toe athleisure garb.

"Yoga pants are a trend pushed by Lululemon, a brand that is surfing the wellness market in China," notes Verot. "Popular foreign brands include Fancl, Shiseido and Swisse," notes Ashley Galina Dudarenok, founder of Chinese digital marketing agencies ChoZan and Alarice.

"Wellness is experiencing a spending boom on 'being' rather than 'having,'" says Catharine Nichol, former editor at the spa and wellness magazine AsiaSpa, commenting on the consumer shift from luxury goods to wellness experiences. "With the ever-growing population of middle-class young consumers interested in holistic healing, the wellness boom will continue to surge."

Wellness-centric resorts and hotels are also doing strong business, including properties like SANGHA by Octave and Aman resorts. The SANGHA Retreat by Octave Institute, for example, blends Eastern wisdom with Western science so guests can "seek self-clarity, find harmony and achieve a new level of conscious awakening," according to the advertising brochures. Lo predicts there will be more foreign retreat openings, as well as more boutique concepts, like Ahn Lu and Tsingpu Retreat.

"Temple getaways have attracted an increasing following," she notes. "A number of pilgrims seek a short stay to self-cleanse by eating vegetarian food, practicing meditation and engaging in physical exchange with spiritual gurus, be it Buddhism, Confucianism or Taoism."

When it comes to spa experiences, Johnny Chang, founder of Spa Solutions Training and Management Consultancy based in Shanghai, says younger consumers now have the money to invest in the best. "But what they really want is express treatments with instantly visible results," he adds.

The food & beverage industry also offers a wealth of opportunities to serve the market with healthier options. Imported water and yoghurt, and high-end health foods are all selling well both online and offline. "International companies are seen as more trustworthy as they are willing to spend more money on luxury health and wellness products and services," says Klaus Petersen, co-founder of Green Planet Foods, a plant-based food and beverage company. "The critical enabler for the market to take off is when companies can offer more quality products at an affordable price."

But the market is not limited to Western imports. "Ready-to-eat traditional Chinese health products, such as bird's nest soup and a gelatin tonic called Ejiao, have been a hit recently," says Dudarenok. "Brands such as Dong'e Ejiao and Xiaoxianduan have managed to package these ancient premium health products into everyday convenience and have been very well-received among Chinese consumers."

Home-grown

The nation's complex consumer market is heavily influenced by technology and social expectations, which require close monitoring. "Made in China brands are gaining traction fast," says Nichol. "The current boom is spearheaded by younger consumers who may buy local to feed their social identity and national pride. Brands such as Chando, Hedone and Marie Dalgar are thriving as a result."

As the Chinese economy continues to surge, so does the demand for wellness. Businesses are looking to invest in wellness the same way people were looking to invest in tech ten years ago. Much investment is focused on opening new fitness centers, TCM clinics and yoga studios

CatchOn's Lo said the wellness trend was already shifting to second and third-tier cities such as Changsha, Wuxi and Xian. "There will continue to be an increase in the number of gyms and fitness studios, and the growth rate will be highest in second-tier cities," says Lo. "We also expect to see an increase in online fitness communities and large-scale outdoor group activities too."

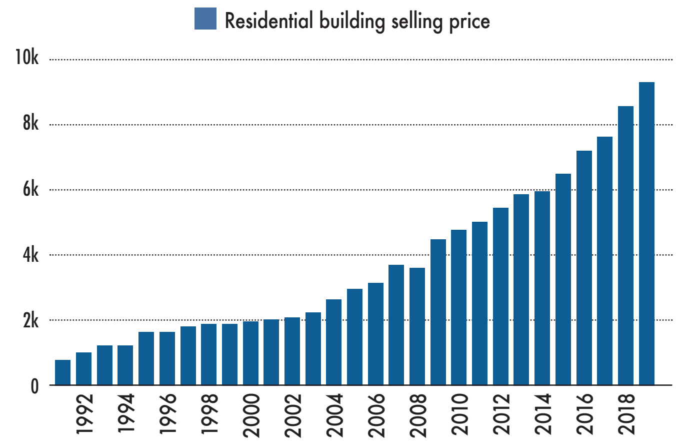
"With continued adoption of wellness trends that provide a results-based approach, there will be growth in all areas of wellness to create a holistic and balanced life," says Waring from SANGHA by Octave. "China has massive potential for growth and will soon be the largest wellness market in the world based on its population size and progressive mindset."

The Price of Property

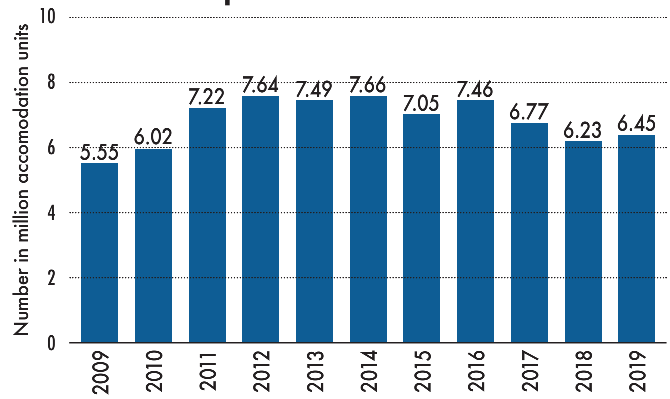
China's property market has long been under the microscope, especially for investors and emerging populations looking for a home

The Breakdown

Property prices have skyrocketed in China's biggest cities over the past 30 years and continues to do so. The average price of new homes in the country's 70 cities rose by 10.78% year-on-year in June 2019, according to the National Bureau of Statistics. Millions of new homes are being constructed each year. In 2019 there were around 6.45 million newly built apartments.



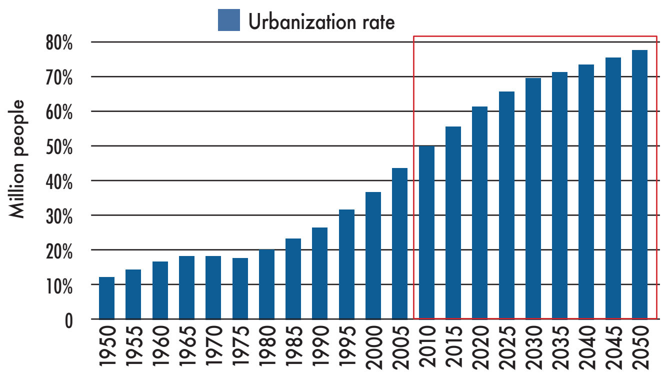
Number of apartments finished by property developers between 2009 and 2019



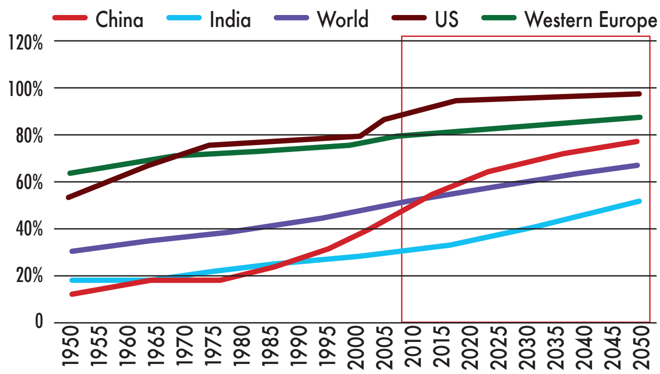
Urbanization

Between 1997 and 2017, urbanization in China increased from 29.92% to 58.52% and it is expected to rise to nearly 80% by 2050. At present, China is behind only the US and Western Europe in the rate of urbanization, and it is expected that it will still be in third place in 2050.

China's urbanization levels, 1950-2050



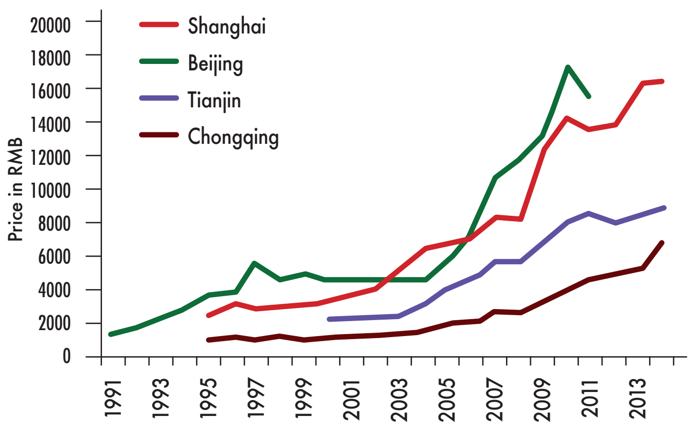
Selected country urbanization levels, 1950-2050

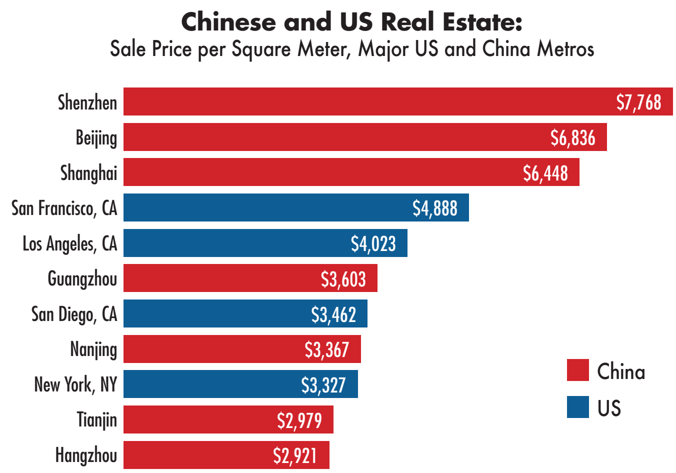


Sources: Daxue Consulting, National Bureau of Statistics, University of Nottingham Asia Research Institute, Statista

Price Comparison

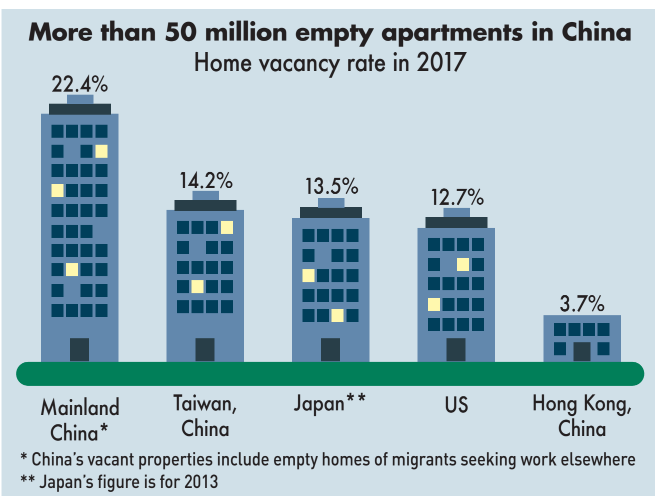
It is more expensive to buy comparable property in China's major cities than in other world metropolises such as San Francisco, New York and London. In 2016, it cost more than double the price to purchase property in Shenzhen than in New York, but within China, the prices between cities can vary.

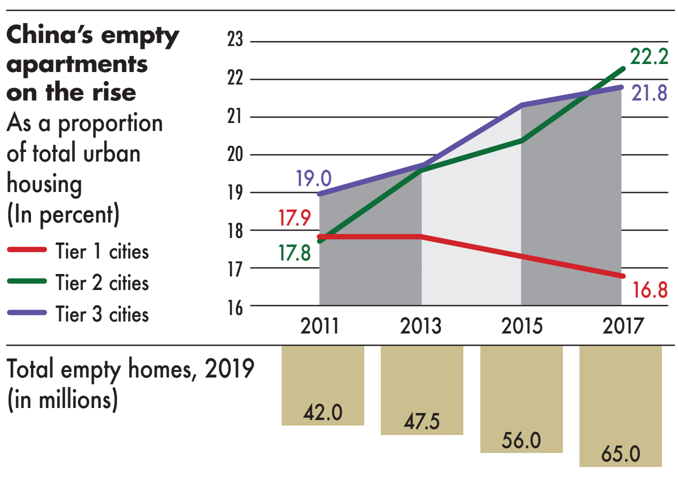




High Vacancies

Approximately 22% of housing units in China are unoccupied, adding up to more than 50 million empty apartments and houses across the country, according to the China Household Finance Survey in 2017. This is significantly higher than in societies such as Japan and the US.





Sources: Survey and Research Center for China Household Finance, Suzhou News Bloomberg, Lianjia, Zillow

The stats you need to know

Macro

Trading without borders

Leaders from **15** Asia-Pacific nations signed one of the biggest trade deals in history in November, the Regional Comprehensive Economic Partnership (RCEP), which could add almost **$200 billion** annually to the global economy by 2030.

Source: *Financial Times*

Speedy recovery

China's economy expanded **4.9%** year-on-year in the third quarter as the country continued its rapid recovery from the COVID-19 pandemic. The expansion in gross domestic product (GDP) was well ahead of the **3.2%** increase in the second quarter and represents a sharp turnround.

Sources: Reuters

Carbon-neutral goals

China, which emits about **28%** of global carbon dioxide, announced at the virtual UN General Assembly in New York in September that it has set the target of cutting its carbon dioxide emissions to nearly **zero** by **2060**.

Source: *Financial Times*

Business

The first

S&P Ratings (China), New York-listed S&P Global's wholly-owned subsidiary in China, has become the first wholly foreign-owned credit ratings agency to win approval to carry out credit ratings business in China's exchange-traded bond market.

Source: Caixin

Selling China

WeWork sold its China division to private equity firm Trustbridge Partners in September, as it steps back from a competitive market where it has suffered low-occupancy rates and fundraising issues. Concurrent with the deal, the division has received **$200 million** in funding from existing investors.

Source: Reuters

Awaiting payment

China's business owners have sped up collecting debts from clients as growth plans are trimmed for fear of late payments. Official data shows it took an average of **54 days** for Chinese private manufacturers to get paid in the first three quarters of this year. That is up from **45 days** in 2019 and is **twice** as long as in 2015.

Source: Reuters

Going electric

Volkswagen and its Chinese partners will pour **$17.5 billion** into electric vehicles in the country over the next four years as competition in the market intensifies. The investment will be used to design and manufacture **15** electrified models for the Beijing market by 2025.

Source: *Financial Times*

Technology

Lost Honor

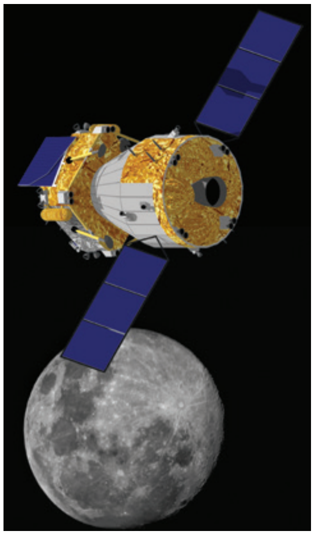
Huawei is selling off its budget smartphone unit, Honor, as the firm reels from US sanctions that have throttled its chip supplies. Earlier in 2020, Huawei's smartphone sales plunged **15%** to **156.6 million**, out of which Honor's smartphones decreased a similar **15%** to **42.2 million**.

Source: Caixin

Moon rocks

China successfully brought back minerals from the moon after launching its Chang'e 5 probe on December 1. The successful return of a lunar landing craft to Earth was the world's first since a Soviet mission in 1976.

Source: *Wall Street Journal*



Virtual yuan

The southern city of Shenzhen used the central bank's new digital currency in October to provide **RMB 10 million ($1.5 million)** in coupons to **50,000** residents as part of the ongoing pilot program to test China's virtual yuan, a sign that the digital currency is approaching widespread use.

Source: Caixin

Self-sufficiency

China's 14th five-year plan, which starts in 2021, places special emphasis on becoming self-sufficient in technology and developing a robust domestic market. The government plans to increase its support for the development of semiconductor chips, artificial intelligence, 5G networking and autonomous vehicles to achieve its goal.

Source: *South China Morning Post*

Consumer

Single's day boom

Alibaba's e-commerce platforms saw orders worth a record **RMB 498.2 billion ($75.1 billion)** during the Singles' Day shopping extravaganza on November 11, compared to the **$38.4 billion** they made in 2019.

Source: Caixin

Rising energy

Sales of electric, plug-in hybrid and hydrogen-powered vehicles in China are forecast to rise to **20%** of overall new car sales by 2025 from just **5%** in 2020. The State Council advocated for significant improvements in the technologies of China's electric vehicle components to make them more convenient to use.

Source: Reuters

P2P crackdown

China's three-year clampdown on the peer-to-peer (P2P) lending industry chopped the number of platforms down from about **6,000** at its peak to just **three**. As of August, investors still held more than **RMB 800 billion ($115 billion)** of unpaid debt from failed P2P platforms.

Source: Caixin

BOOKSHELF

Exploring Rivalry through Literature

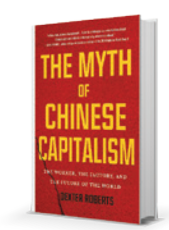
James Kynge, global China editor of the *Financial Times* and author of best-selling book *China Shakes The World*, recommends books that help readers make sense of the China-US rivalry

With over 25 years of experience reporting from Asia, James Kynge writes about China's growing footprint in the world in areas such as technology, commerce and geopolitics. He also edits "Tech Scroll Asia," a new weekly newsletter on technology issues in Asia, and is the principal of China Confidential and Renminbi Compass, proprietary research services from the *Financial Times*.

In 2016, Kynge was named the Financial Journalist of the Year by the Wincott Foundation. His award-winning book, *China Shakes the World*, has been translated into 19 languages worldwide and describes the development of China as a superpower.

Kynge also speaks fluent Mandarin and is a regular commentator on Chinese and Asian issues for media outlets including NPR, CNN and the BBC.

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

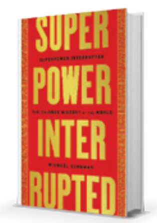


My top recommendation would be *The Myth of Chinese Capitalism* by Dexter Roberts. China is not becoming more capitalist. Its free-market reforms have stalled and, in several areas, gone in reverse. Any study of China in the here and now has to start with the economy, and this skillfully written book is just the ticket.

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

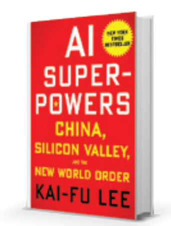
Factory Girls by Leslie T. Chang is one of my favorites. Chang spent two years with women workers in Guangdong to produce this book. It provides revealing insights into Chinese society while also making clear that much of China's economic rise was built on the backs of a vast army of female migrant workers. This book exposes the impact on young people of being displaced from their families without a lifeline and the conflict they have to face between honoring a duty to the family and making choices about their own future.

What are you reading currently?



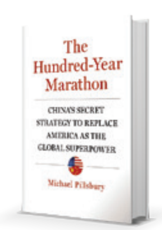
It may seem strange to include a history book in a list intended to illuminate the current US-China rivalry. But read *Superpower Interrupted* by Michael Schuman and see why China's emergence as a great power is to an almost eerie extent a rehearsal of dynasties gone by. He provides a dynamic and compelling account of four thousand years of Chinese development, describing strategies of domination and wealth creation. This is a truly exceptional read and Schuman demonstrates an unrivalled understanding of China's transition.

What book totally changed your perspective on a certain topic?



The book *AI Superpowers: China, Silicon Valley, and the New World Order* by Kai-Fu Lee provides a great introduction to China's startup/technology ecosystem and development. The "tech war" between the US and China—which is at the heart of their rivalry—was triggered in part by China's extraordinary advances. Lee shows how two strands (China and AI) are being irreversibly woven together into an unbreakable high-power cable that will transform, control and possibly strangle humanity's economic future.

Which China book do you think is the most underappreciated?



The title of this book says it all. You may not agree with everything in *The Hundred-Year Marathon* by Michael Pillsbury, but it has helped to set the tone for the sharp upsurge in US suspicion toward China in recent years. This book is an earth-shattering account of how a whole generation of US government officials and China experts have gotten China completely wrong, and how US China policy is grounded in naivety and wishful thinking. It will make you rethink the reasons behind some of the global incidents that have happened.

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