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China between lockdowns and the 20th Party Congress: What can we expect for the EU and globally?

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Whether it is aggressive industrial subsidies, the militarization of the South China Sea, human rights violations in Xinjiang or political suppression in Hong Kong, there is a whole litany of foreign policy concerns which are attributed by media and China watchers to the People's Republic of China. This policy brief will try to make some sense out of these worries by focusing on how current events might shape the outcome of the 20th Party Congress. It will start by assessing China's track record and examining some of its main policy drivers. Consequently, it will explore what it means for the EU and its companies doing business with China, focusing on supply chains and strategic autonomy. Finally, the policy brief will come to the question whether we do not focus too much on the great power competition between the US and China.

In July 2021, President Xi choreographed a smooth celebration of the 100th birthday of the Communist Party of China (CPC). A few months later at the 6th Plenum of the 19th Central Party Committee his standing was elevated with the adoption of a resolution on party history. Then came the Olympic Winter Games where Xi Jinping met Vladimir Putin and signed with him a “no-limits” partnership on 4 February 2022. That same month Russia invaded Ukraine. A month later the omicron variant of COVID-19 arrived in China and quickly spread around the country resulting in punishing lockdowns leading up to a paralysis of Shanghai's economic and financial center. These lockdowns heralded slower economic growth forecasts. Rising youth unemployment (16-24 year old) is particularly worrying at 19.9%. The omicron surge came

on top of a preexisting real estate crisis and a government clampdown in certain sectors of the private economy. It has further undermined economic confidence. The latest disturbances came from home buyers refusing to pay mortgages. As I will explain in the next paragraphs, China's leadership sits in a comfortable position to respond to the challenges arising from these events.

PRESIDENT XI

First of all, President Xi is a more dynamic leader than his predecessor Hu Jintao, who is generally believed to have suffered from Jiang Zemin's long-cast shadow. Xi was hired nonetheless in difficult circumstances. The Bo Xilai case in 2012 was undoubtedly the epitome of the difficulties facing the CPC in those days. The President's most pressing issue was thus to bring the disciplinary and coercive apparatus of the State back under CPC control. In so doing he has applied the Leninist rulebook that recommends political purges to maintain Party discipline. The return to this leadership recipe tremendously benefited his standing at the core of the Party and one sees no immediate opposition to contest his leadership. He may have created new enemies in the process, but there are undoubtedly comrades who are supportive of this clean-up without which the CPC may not have survived.

Another tool to accomplish Xi's mission of reinstating order within Party ranks, has been the use of ideology. The gradual espousal of “Xi Jinping Thought” by the CPC boosted his standing as a leader, because it allowed him to gain control over the propaganda department. As a result he controls by now not only the sword, but also the

pen, via state media and all other monopolized channels of communication.

The third policy domain which has been brought increasingly under the President's control is the design of economic policy. Whereas in the past it was especially the Chinese Premier who was in charge of setting economic policies, Xi Jinping has managed to transfer the locus of economic decision-making to new bodies directly under his guidance. During his tenure the Party's Central Commission for Comprehensively Deepening Reform has taken center stage to this end. It makes Premier Li Keqiang and his State Council more of an executive manager of economic policy instead of the originator of economic policies.

The downside of this power centralization is that the President will have to solely shoulder all the responsibilities and liabilities in case of a policy failure. Notwithstanding the heightened political risks that he may incur by consequence, Xi has been able to augment his leadership position so far. At the 20th Party Congress he may even aim further to secure a third term in office as President or at least to remain China's top leader. To facilitate his policy-making he wants to see as many of his lieutenants as possible to be elevated to the Politburo and the Central Committee. To bolster his political heritage he undoubtedly hopes to get a spot in the CPC's cannon next to Mao Zedong. For that to happen it will be interesting to see what official title the Congress may have in stall for him.

POLICY MISTAKES

Apart from his transformative successes, there are some observers who have suggested that Xi has made some policy mistakes which will cost him dearly. However, it is still too early to tell, and these mistakes will likely not immediately endanger the President's position at the 20th Party Congress.¹

One so-called policy mistake often cited is the Government's zero-covid policy. This policy may not be to the liking of many, but the Chinese leadership has succeeded in convincing the Party constituency and large swathes of the population that by adhering to the

principle of "people first and life first" they really managed to do a much better job than Western governments. The Politburo has explained that it wants to prevent a meltdown of the underdeveloped health system and despite the economic costs Xi Jinping may get away with it, contrasting Chinese good governance with Western failure. Having said this, urban populations having suffered terrible lockdowns undoubtedly have second opinions, but they do not represent a direct threat to the current policy or to social stability because of the digital tools to keep their opposition in check. It is true of course that the longer these restrictive sanitary policies last, the hollower the advantages will ring. However, by the time of the 20th Party Congress the economy is unlikely to sink to a level (as a result of the dynamic zero-covid policy) that poses a direct political threat. Besides, the Government has already saved its face by lifting or easing some of the measures.

Xi Jinping has equally been criticized lately for his "no-limits" partnership with Russia. Some observers claim that this declaration is a reputational albatross around his neck. The document has definitely alarmed many capitals in the world, but it certainly is not irrational behavior on the part of the CPC if one assumes that the US is unlikely to change its China policy in the near future. This policy is considered also by many Western observers as a bipartisan course of action with an aim to slow down China's rise. If this assumption is likely, then Russia can only be a natural partner for China to possibly counter this development. A secondary effect of Xi signing this Sino-Russian declaration has been a remarkable improvement of Europe's Trans-Atlantic ties with Washington. This is definitely to the detriment of the Sino-European relationship, but it is still early days in the war between Russia and Ukraine, and we have no clear indication yet of who will become the next tenant in the White House. Europe also has become politically much more volatile and can still become a critical swing factor. As worried as Europeans may be by these signs of a Sino-Russian entente, it is unclear how voters will interpret the economic costs they might have to pay over a longer term. In any case, this criticism of the President's current foreign policy will not threaten him during the upcoming Congress.

The third policy over which the Chinese government has been criticized lately, is its crackdown on some sectors of the private economy. Xi Jinping has defended his approach by arguing that technology companies pose a risk in areas of data security and the finance sector. As a result some important IPOs were halted and more restrictive sector regulations were implemented. The Government equally intervened in the real estate sector where a number of developers defaulted. The compelling explanation to justify this interference is the looming threat for economic and social stability. Surely comrades at the 20th Party Congress will understand this reasoning. Where Jiang Zemin at the time tried to co-opt entrepreneurs in the party, Xi believes it has backfired and that this practice corrupted party officials.

So despite certain criticism on these policies, there are reasonable grounds to imagine that the President will continue his political course of action after the Congress. With some audacity he will remain China's strongman for years to come. Immediate threats to his standing will certainly not come from Western detractors over policies such as human rights in Xinjiang or political suppression in Hong Kong. With Xi's adage "the East is rising, the West is declining" (东升西掉), he is betting that moribund Western governments and societies are largely dysfunctional and in no position to keep pace with the challenges that China present. It is up to the West to prove him wrong (as will be discussed further on). However, being able to stay in power for the foreseeable future does not mean that one is equally able to implement all the policies of one's choice. It will therefore remain important to see who of Xi's lieutenants will get elevated during the Party Congress.

EU-CHINA RELATIONS

What will Xi's prolonged stay mean for our relationship with China? What are China's main policy drivers likely going to be? And what will be their possible impact on doing business in China over the coming years? These questions are frequent subjects of discussion among policy planners.²

The first driver for the relationship in the coming years is the belief that China will continue trying to defy the rules-based international world order as it was shaped after the second World War. China has become a selective revisionist power. It will use the existing order to its advantage wherever it can, and in cases where it cannot China will try to supplant the existing order with alternative solutions more suited for its own governance model. In order to successfully do so, it will summon the support of the Global South to this cause. The Global Development Initiative (GDI) and the Global Security Initiative (GSI) are the latest examples to back this argument.

China is promoting the GDI and the GSI as a way to boost its ties with African nations. It extends the level of cooperation into areas such as military training, intelligence sharing and counterterrorism. The realization of lasting peace and universal security on the African continent has become a common aspiration for China. Against unilateral sanctions and long-arm jurisdiction, China wants to prove itself as a leader in global governance and security. Beijing has already sent thousands of troops in Peace Keeping Operations. It has recently become involved in peace negotiations in the Horn of Africa. There is also a growing number of African countries buying military arms and equipment from China. China's Minister of Defense, Wei Fenghe, wishes to strengthen technological cooperation and wishes to hold joint training exercises. Chinese security firms are also gaining a foothold on the continent. Both GDI and GSI are pushed as non-Western alternatives and mechanisms by the global South and for the global South. To advance its cause, Beijing works with the elites, promises them political stability and development without Western strings attached.

This policy driver is completely commensurate with the overarching goal of Chinese Rejuvenation (中华民族伟大复兴), the objective to bring back China center stage after the tremendous humiliations it has suffered in the last 150 years. It is also often referred to as the China Dream (中国梦).



If we take China's significant expansion of regional and global influence seriously, then we are likely to witness further military modernization and enhanced investments in economic statecraft. This is the second policy driver we observe. China has been building since quite some time a strong, capable navy for its Indo-Pacific ambitions. It is building this capacity mainly in case of a major escalation around the Taiwan Straits in view of seeking reunification. The timeframe of this reunification is flexible, but it is highly probable that Xi wants this to happen during his political lifetime. The military option may not be the preferred one, because losing a military battle against the US would almost certainly run the risk of bringing the CPC down. Since China can never be sure to prevail in case of a military conflict, it may prefer economic statecraft instead. China is working very hard on a coercive toolbox with all kind of grey zone tactics. It is also leveraging its economic attractiveness and its centrality to global supply chains. The more it can control and manage the global economy, the less likely it will face opposition to its plans for reunification. This reunification is an existential life or death policy for the CPC. It should therefore be taken very seriously by the international community. The most recent white paper on Taiwan³ released in August 2022 reaffirms the wish for peaceful reunification, but does not rule out the use of force if deemed necessary. Probably, China will continue wading through the stream by stepping from stone to stone. Coercion works best in that manner.

At the forefront of this struggle we also find the technology race as the third driver that will shape our relationship with China in the next coming years. Let us not forget that, for instance, quantum technologies and artificial intelligence are dual use goods which can be used for malicious ends and will be capable to determine the outcome of any future conflict. China tries to leapfrog the existing technology gap and has succeeded in many sectors already. Once it has acquired the technology it usually doubles down on self-reliance and tries to create dependencies in its relations with others. Therefore we need to invest in resilience and future technologies.

EU RESPONSE

As a result of the above-mentioned policy drivers doing business in China will become more entangled with politics. Companies, especially SMEs, no longer understand the political context in which their business operates. Governments therefore need to engage with economic stakeholders to find better convergence in handling the challenges presented by China. This leads to the question what administrations have been doing and what else they can do to formulate policy answers?

In 2019 the EU adopted its strategic outlook⁴ to deal with China's unique complexities in a multifaceted way. Whereas the outlook established that China is also an economic competitor and a negotiating partner, it has stood out recently especially as a systemic rival. It is important to say, though, that the EU does not exclude competition and cooperation from the relationship. But it is fair to say that Chinese actions and domestic policies, where they affect European values and interests, necessitate pushback and limit the scope for cooperation. China engages with our institutions and governments without the required transparency and has increasingly been called out as a source of disinformation. It interferes with our academic freedoms, it intimidates researchers and experts. So the EU needs to be more vigilant where Chinese policies affect its own.

China's diplomatic support to Russia's war in Ukraine, its coercive practices as well as its anti-Western narrative highlight the depth and the degree of the systemic rivalry. Some observers will go as far as to say that the rivalry has spilled over onto all aspects of EU-China relations. This is something we must avoid. However, it is important to raise awareness and to have a whole-of-society approach, especially in those domains where disinformation and interference have become a challenge. The EU and its entire society must show coherence and unity.

Coherence is also something the EU has looked for in its growing Trans-Atlantic concertation and coordination on China. In substance and style the EU's efforts still differ from the US. The EU is usually more country-neutral



and will try to avoid politicization, though things have changed somewhat since the start of the Ukraine war. The European export control system was always designed for very narrow purposes, such as non-proliferation and counterterrorism. The EU might now consider more geopolitical objectives. The alarm over the strengthening Russia-China axis, where China is seen as supporting Russia's attempts to redraw European borders and the aggrandizement of Russia's sphere of influence, has made the EU a more willing partner of the Americans. The EU may have no other choice, though, because it is geopolitically seen riding on the back of US defense. And as far as its economic sanctions regime is concerned, it also needs the backing of the US financial market. Moreover, slapped by the Trump administration in the recent past, the EU also wants to stay clear of any US-China trade war. All these factors have led to a broader support for a more hardline China policy in the EU.

On top of that many Member States are genuinely disappointed by poor Chinese investments and limited access to the Chinese market despite the many promises. Despite opposition from German automakers, chemical companies and French luxury brands which still have influential lobbying forces, the EU is building new defensive rules. The first aim is to block state-directed acquisition of European technology, the second is to mitigate market distortion by foreign subsidies and the third one is to counter economic coercion. The focus is mainly on sectors targeted by China's Made in China 2025 initiative by which the country hopes to achieve global dominance in strategic industries.

DECOUPLING VS STRATEGIC AUTONOMY

Germany has tremendously benefited from China's economic rise. Whereas in the US and elsewhere many jobs were lost as a result of competition with China, German exporters were able to add jobs to their factories. Its dependence on export to China now has become a problem. China is Germany's most important trading partner, whereas Germany is only China's 6th trading partner. In 2021 Volkswagen sold 3.3 million cars and earned about 12 billion euro in sales with a market

share of 16%, 33 plants and over 100,000 jobs in China. Needless to say that China too benefited enormously from this relationship.

A complete decoupling is not realistic. Of course we must manage our interdependence and reduce some critical dependencies. It is wishful thinking, however, that we can get climate neutral by 2050 without silicon and other Chinese raw materials for wind and solar energy. In Germany 65% of electric engines, 54% of wind turbines and 53% of photovoltaic cells are sourced from China. The dependencies of China are much more complex than those we have with Russia. Diversification and supply chain resilience are easier said than done. They cannot be successful unless there is a push as well for more reciprocity addressing the uneven level playing field.

The semiconductor industry is another example where the EU has a supply chain problem. The US, Japan, South Korea and Taiwan intend to facilitate stabilizing the semiconductor supply chain and fostering talent within its ecosystem. Taiwan, US and Japan are not exactly amicable to China. South Korea is the only one that can balance its weight, because China has the biggest influence on North Korea. It is a double-edged sword though, because this influence could also see South Korea come to depend more on the US for security. It is difficult to see how the EU might fit in this geopolitical puzzle to solve its dependencies.

Strategic autonomy should mean that we not only look at our dependencies on China, but also at those we have with Russia and the US. This is a herculean task. The best way to avoid falling hostage is to find allies which can reciprocate the dependency. Even then there is no guarantee of success, because we mistakenly thought that Russia would remain dependent on German money in return for energy. The problem is perhaps not so much the dependency itself but the lack of a ready alternative when the relation fails. The best way is to keep thinking in scenario's including the worst-case ones.

An interesting question is whether Industrial policy can be an efficient tool to address the supply chain problems



and dependencies we currently face. China has been a champion of industrial policies, but has it worked? At first sight massive debt has been built up in ineffective industries. There are also productivity challenges surrounding China's industrial policy efforts. Economists will remind us that it is extremely difficult to pick winners. Another burning question is about the accountability of these policies for which most of the money is spent by local governments. It makes it difficult to keep the general oversight. Industrial policies may also condone practices, such as access money, and be rife with possible corruption as well as creating a collusive environment. It can therefore easily be argued that China's industrial policies are more of a problem than a solution. They have in the past also led to overcapacity. So the EU should be very cautious in adopting industrial policies because their mistakes can make the problems worse.

GREAT POWER POLITICS

By contemplating the policy variables which are expected to underpin the forecast about our relations with China, it is of course also legitimate to ask whether the EU is not focusing too much on the great power competition between the US and China. Should we not compete more selectively as some China watchers believe?⁵ Should we not bet more on domestic economic renewal and show more openness to establish some kind of competitive coexistence? It would be much safer for the world to establish some form of collaboration or cohabitation between China and the US, instead of a confrontation of which nobody can predict the outcome, and which will come at a huge cost. Some have called already for a "G3" in which the EU should play a role to manage a strained cohabitation between China and the US.⁶ For the EU it is important to know what it can and what it cannot control. In any case the EU is in no position to dictate to China nor to the US; it can only hope to influence both parties.

Sanctions, export controls, trade defense instruments and so on can slow down China's economic growth, but they cannot stymie China forever. They also are purely reactive in nature, whereas we should perhaps devote more time in building proactive policies for which we

should focus on our own capacities. The EU and its Member States need their own investments in education, infrastructure and energy to build confidence. There is so much psychological discomfort into our attitude to today's global challenges, of which China is an important factor, but not the only one. Anxiety should not be our guide. We need to stand up in order to adapt and to adjust to China's resurgence. Therefore we should not forget that China also can make policy mistakes. We will have to prove that we are not the moribund society China has mistaken us for. We should not turn the Chinese adage that the West is in decline into a self-fulfilling prophecy. We need to galvanize our purpose and objectives. We have to respond to the challenges, to focus on our comparative advantage and to play to our strengths. This should be our main strategy instead of being paralyzed by China as a fear factor. For this we also need to renew trust in our own economic and political system in which we seemingly have lost confidence. Our democratic institutions are feeding our anxiety for illiberalism spreading in our own society. When democracies become afraid of their own electorate, it is a clear sign that something must be wrong. It does not automatically mean that we should blame China or Russia.

Of course the EU needs to enlist partners and should do so beyond the family of like-minded countries with which it already sustains useful coalitions. The EU can play a role as a balancing actor, because it also has its own interests to defend. The world order has to change. India, Germany and Japan cannot forever stay in the waiting room of the UN Security Council. China and the US also have to accept that this cannot be just a bipolar discussion and that the world order has to become more inclusive. They cannot regard themselves as the only drivers of the new world order.

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Endnotes

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