



STABLE AND IN CONTROL?

CHINA'S PARTY REGIME AND ITS CHALLENGES

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Despite domestic and international difficulties, the survival and stability of the Chinese Communist regime does not seem to be severely threatened. China's successful domestic handling of the pandemic and its quick economic recovery has served to reaffirm the confidence of the Chinese leadership in the superiority of their political-economic system and will have boosted the domestic standing of the regime. Yet as it seems that the Chinese leadership will have to accept an economic slowdown sharper than expected under normal circumstances, they will likely be relying on the appeal of nationalism even more than usual. Despite the fact that China's continued economic development risks being hampered by its heavy-handed international conduct and by its domestic oppression, the regime remains in a stable state of control.

Series on Security in Northeast Asia

During 2020 ISDP arranged its first virtual annual conference on Northeast Asian Security in the wake of the Covid-19 pandemic. The conference aimed to provide an overview of the security challenges and tensions that have occurred over the last year and to explore various policy paths that could improve the current situation. This paper makes up one of the many talking points that came out of the 2020 conference.

Regime Maintenance and Slower Economic Growth

WIn the third quarter of 2020, China's GDP grew 4.9 percent compared to a year ago, which brings growth for the first three quarters of the year to 0.7 percent compared with the corresponding period in the previous year. Retail sales contracted 7.2 percent in the first nine months of 2020, which could be considered concerning as Chinese leaders have

increasingly been counting on domestic consumption as the major source of economic growth in lieu of the previous heavy dependence on infrastructure development and exports. Experts expect that unemployment, diminished household income and changing consumer behaviour may adversely affect domestic consumption in the near future.¹

The official surveyed urban unemployment rate declined slightly in September 2020 to 5.4 percent,

which had hit a record high of 6.2 percent in February 2019.² Without specifying the actual unemployment rates, Chinese officials acknowledged that the unemployment rate for 20-24 year-olds holding at least a college degree was 4 percent higher in September 2020 than a year ago, and 3.8 million fewer migrant workers from rural areas had returned to their urban jobs in the same period. These statistics may well be the envy of developed countries, but there are many doubts regarding their accuracy.⁴

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The Chinese authorities appreciate the potential impact of unemployment, especially that of young fresh graduates, on social stability, and they have usually been working hard to contain unemployment. Fixed asset investment rose only 0.8 percent in the first nine months of 2020; and this demonstrates the self-restraint on the part of the Chinese leadership to avoid pumping money into the economy to stimulate economic growth.⁵ There were lessons learnt from the substantial stimulus package introduced in the wake of the global financial crisis in 2008-2009, and Xi Jinping appeared to have realized the danger of a bubble economy. Even though the official statistics may present a little too bright a picture, the Chinese leadership nonetheless seems to have executed a generally sensible economic policy.

Greater Dependence on Domestic Consumption and Technology

However, Chinese leaders anticipate a deteriorating external environment and are adjusting economic policies and strategies accordingly. The international boycott of Huawei Technologies is seen as a harbinger of an economic Cold War with the West. In response, President Xi Jinping, in May 2020,

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announced a new “dual circulation growth strategy” which is described as “a new development pattern in which domestic and foreign markets boost each other, with the domestic market as the mainstay.”⁶

This is in line with the greater emphasis on domestic consumption and less on exports. Increase in labour supply has been on the decline; China now faces stagnant labour supply while the rate of urbanization is expected to slow down. Thus, the two factors that have supported China's spectacular economic growth since the 1980s will be weakening in the future. Increase in labour productivity is consequently becoming urgent, while the Chinese economic development will become more dependent on innovations.

Investment accounted for 43 percent of China's GDP in 2019, a high rate that discourages consumption. Returns on investment as reflected by the incremental capital-output ratio have been disappointing: it increased from 3.3 percent in 2005 to over 6 percent in 2017, meaning a halving in returns on investment during this period. At present, private companies' rate of return on assets is around 9 percent whereas that of state-owned enterprises is approximately only 4 percent.⁷

Private-sector investment has been a weak point in China's economy in recent years, but the authorities have not been able to provide a level playing field for the private sector. The issue of private entrepreneurs'

lack of credit supply has been discussed in national media for some two decades, but their situation has still not been improved. The development of the underground banking sector offers ample evidence of the plight of small entrepreneurs who do not have the political connections to access credit from the state banking sector.⁸

The underground banking sector not only means considerable higher interest rates for the borrowers, but it poses serious business risks as well. In times of financial crisis, some of these underground financial institutions may suffer from credit crunches and go bankrupt, leading to financial crises in the cities concerned. This is perceived as a potential source of economic stability in difficult economic times. Besides, corruption is involved as the underground banks enjoy the protection of local officials.⁹

During recent years, it has become clear that the party expects the private sector to shoulder greater responsibilities for economic development and for securing social stability. In November 2020, in a visit of the hometown of the famous entrepreneur Zhang Jian from Nantong, President Xi Jinping appealed to the country's successful entrepreneurs to assume social responsibility and help late comers, especially when China is suffering from domestic and external difficulties. This was generally interpreted as demanding rich entrepreneurs to support the party regime; the demand was clearly a form of political pressure.

Jack Ma, head of the Alibaba Group, one of the most successful businessmen in China, has suffered the consequences of his inability or unwillingness to live up to the expectations of the party regime: having failed to please the party, he announced his early retirement in the wake of the troubled stock market debut of his Ant financial technology group. Another example is Sun Dawu, who was detained by the Chinese authorities in November 2020, together with his son and at least ten other high-level executives of his Dawu Group.¹⁰ Sun was a well-known philanthropist and a critic of the Chinese authorities.

Businessmen in China are fully aware of the political risks they face; they understand that they need to cultivate and maintain good connections with senior officials and exhibit strong support for the party regime. The political risks they incur are one important reason why they have chosen to place a considerable part of their wealth overseas, as an insurance policy.¹¹ As a result, private-sector investment has not been expanding as it should have, and much capital is being wasted from the point of view China's economic development. In light of worsening economic prospects, it can be expected that the Chinese authorities will seek to tighten the control over private-sector entrepreneurs and check capital outflows.

China's overriding objective remains the survival of the party regime.

Deteriorations in External Environment

China's continued economic development also risks being hampered by its international conduct; Beijing's heavy-handed approach in bilateral relations is increasingly triggering a backlash and has notably severely impaired its relations with Australia, with Canberra taking a firm stand against Beijing.¹² China's lack of respect for intellectual property rights, the oppression in Xinjiang and Tibet and its stance toward Hong Kong have dashed hopes that were earlier entertained in the West that China's economic development would eventually result in a corresponding political development and liberalization and damaged China's international standing. The Chinese leadership wants to avoid an all-out trade war with the United States, but it has nonetheless no intention to alter its foreign and domestic policies in the name of reconciliation with Western countries. Its overriding objective remains the survival of the party regime. As the Xi administration appeals to patriotism and nationalism to shore up its legitimacy and to silence its domestic and foreign critics, President Xi Jinping can ill afford

to be seen to be weak in dealing with the U.S.

The recent trade disputes with the U.S. and the anticipated, continued deterioration in Sino-American relations have made the Chinese leadership even more determined to achieve self-sufficiency in advanced technology. Chinese hi-tech firms have reported that there is a growing enthusiasm to replace imported components with domestic parts in response to the concept of “independence and controllability” in the fields of science and technology and in accordance with the objective to create a domestic system in the next six to seven years for research and development, manufacturing and the internal market.¹³ Meanwhile, local governments and state enterprises have been boosting support for Chinese tech companies. The more strongly a company embraces self-sufficiency or presents itself as the victim of Western sanctions, the greater its prospects of securing orders and subsidies from the central and local governments.¹⁴

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Nonetheless, there is a concern among Chinese citizens that China and the West will end up having two different and incompatible systems for hardware and algorithm development. Chinese economists argue that the pursuit of independence may come at the expense of exploiting the country's comparative advantages.¹⁵ But the major economic test for China is the competence of its research and development system. Chinese authorities typically rely on a team of trusted experts to identify the areas of priority and design projects, which are then distributed to

the nation's top research institutions with ample funding support. There is, therefore, little room for the kind of Bill Gates type of breakthroughs. Yet the Chinese leaders fully appreciate that science and technology will be decisive in the great power rivalry and intend to make sure that China prevails.

Tighter Political Control

While funding for research and development is no longer an issue, the Chinese authorities have been tightening the restrictions on free thought and on the free exchange of ideas. In early November 2020, the Cyberspace Administration of China announced a series of measures to further limit the activities of community information type of internet platforms, criticizing some of them by name for spreading ideas of “historical nihilism”, a label that is used to denote deviations from the official ideological positions.¹⁶ The freedom of discussion in cyberspace has been tightly restricted and a number of prominent internet critics have been arrested and silenced. In recent years, Chinese leaders have also been open in their demand that party media toe closely to the party line, and have warned against “idle discussions” on party policies.¹⁷

Since the era of the Hu Jintao administration, the Communist Party has been attempting to strengthen its organization at the grassroots level. Basic party units now exist in foreign corporations and even in the central business district in Shanghai. Ideological indoctrination has also been enhanced in tertiary institutions.¹⁸ These efforts on the whole have not been very fruitful as the Chinese society is now much less totalitarian. However, the introduction of the social credit system through the grading of people's daily behaviour patterns in the past two years has proven extremely effective in monitoring the nation.¹⁹ Through the exploitation of the most advanced data-processing and surveillance technology, the Chinese authorities have established an effective system for rewarding and sanctioning the population's quotidian behaviour, and people in general have displayed an eagerness to improve their social credits in order to obtain rewards, such as securing spots in the best schools for their children. Despite political rumours in foreign media to the contrary, there are no effective

challenges to Xi's strong grasp of power. In the fifth plenum of the Communist Party's Nineteenth Central Committee in October 2020, Xi Jinping's role as the party chairman was reaffirmed; and as expected, the plenum approved the Fourteenth Five-year National Economic and Social Development Programme (2021-2025) and the Long-term Objectives for 2035. A week before the plenum, the party leadership commemorated the 70th anniversary of the Korean War in a conspicuously high style.

Official sources suggested that Xi Jinping served as the head of the drafting team of the Fourteenth Five-Year Development Programme,²⁰ which means that Xi as the paramount leader not only controls the party machinery and commands the military but that he is in charge of the economy as well. While no political factions or interest groups are presently in a position to challenge Xi's leadership, the paramount leader has to assume responsibility for the deterioration of China's international standing. His administration, therefore, has to rely less on the delivery of the goods in view of the slower economic growth and the raising of China's status for legitimacy, and more on the facts that there is no obvious replacement, as well as the high costs of opposing the regime from within.

Challenges Ahead

Challenges to Xi Jinping's paramount authority can be expected in the run-up to the Twentieth Party Congress in late 2021 or early 2022.²¹ By then, the leadership succession will have to be addressed. Much will depend on China's domestic economic conditions which in turn will be affected by the consequences of the pandemic and by international developments. In the event of a serious economic downturn, Chinese leaders will likely rely on the appeal of nationalism as they often do.

In the wake of the pandemic, the Chinese elite's exposure to the Western world will become more limited: In 2020, the flow of Chinese students to the United States was reduced to only 1 percent of the normal level, while flows to other popular Western countries have also been reduced to a considerable extent.²² Even though the flows can be expected to resume after the pandemic, they will likely not regain

their previous levels, especially in the hi-tech fields.

China will, in the foreseeable future, be more inward-looking and isolationist as deteriorations in relations with the West would reduce exchanges. Resources for expanding its foreign influences will be limited; it is expected that the Belt and Road Initiative would receive less generous financial support than before. It will be eager to restore full economic and scientific exchanges with the Western world, and may even be willing to make certain economic concessions such as reducing its trade surpluses and showing more respect for intellectual property rights. But it will be reluctant to be seen to be weak, and it will not reconsider its core nationalist position.

The Western world may have been re-assessing the nature of the Chinese authoritarian capitalist regime in recent years, losing its earlier optimism regarding the prospects of liberalization in China, but China's successful domestic handling of the pandemic and its economic recovery has served to reaffirm the confidence of the Chinese leadership in the superiority of their political-economic system and will have boosted the domestic standing of the regime. ■

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