



How to Face up to an Uncompromising China? (II): China's Economy Towards a Stronger Governance Coexisting with Negotiations/Coordination with US

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Key points

- Toward an “unknown normality” after the US-China conflict and COVID-19
- Stronger governance and a more sophisticated, expanding Chinese economy
- Japan to continue to exert influence on thoughtful action

The concept of the new normal entered the picture after the advent of the Xi Jinping administration. The end of the rapid economic growth and China becoming a middle-income country transformed national issues. The new normal indicated that the administration recognized this fact. But now, after the US-China conflict and COVID-19, China's political economy finds itself in an unknown normality in a dual sense. This article will confirm the economic situation during the COVID-19 crisis and examine trends in China from the perspective of structural change.

There are both strong and weak aspects to the economy in China after COVID-19. At the start of the COVID-19 outbreak in Wuhan, it was widely thought that the vulnerability of the political and economic systems had been exposed. Appeals from frontline doctors were not passed on and the activation of the emergency alert mechanism was delayed. On the other hand, the infection was contained by mobilizing digital technology and the grassroots organizations that date back to the time of the planned economy.

The economic growth rate has recovered from a year-on-year negative of 6.8% in the first quarter to a positive 3.2% in the second quarter. The economy is currently expected to grow by about 2% for the whole year. According to a questionnaire survey by the Japan External Trade Organization (JETRO) Wuhan office (conducted in July), 86% of the 71 Japanese companies operating in Hubei province have recovered and normalized their businesses, and 23% are considering scale expansion.

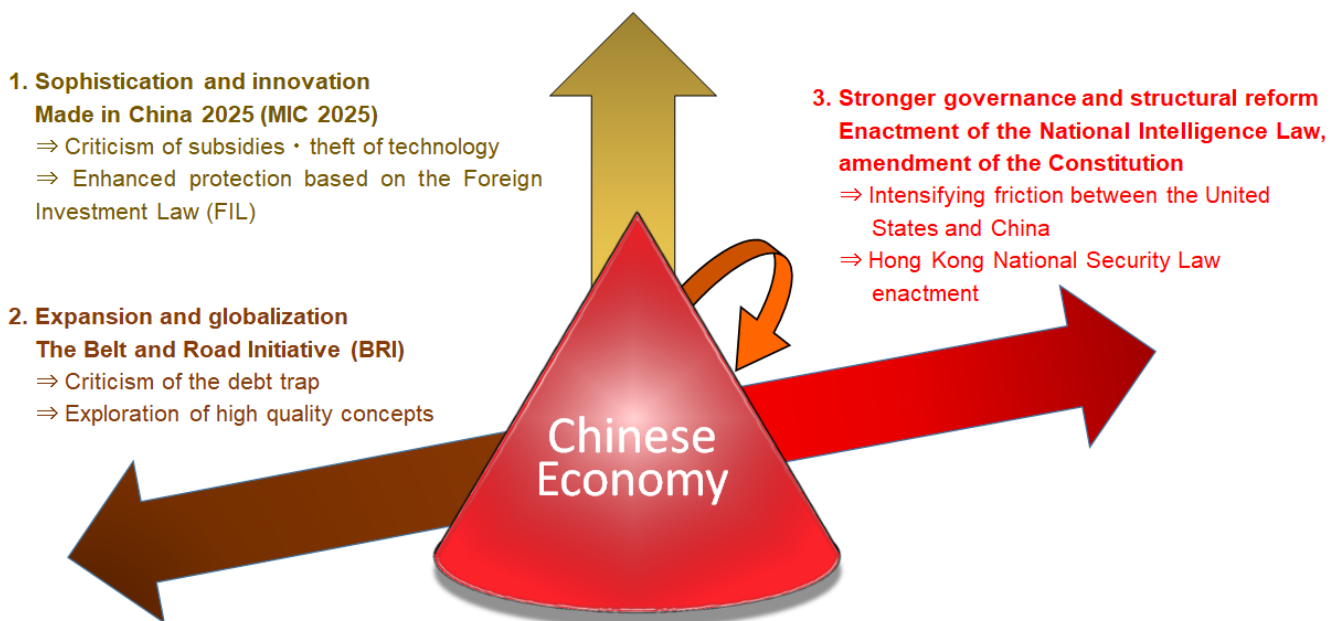
The stimulus package presented at the National People's Congress (NPC), which was postponed until the end of May, was modest. Although investment in new infrastructure including data centers and 5G equipment for the next-generation communication standard has started, memories of the escalating debt problems caused by the large-scale fiscal stimulus after the global financial crisis, the so-called four trillion yuan phobia, are fresh.



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The trade structure has also changed. In the first half of the year, ASEAN was the largest trading partner by region. There are also the flickering shadows of economic regionalization where the priority is on strengthening economic relations with neighboring countries. It is also noteworthy that since May, the leadership has hammered out a policy based on internal circulation. It is highly likely that this policy will be included in the next five-year plan (2021–25) and in the long-term plan leading up to 2035. In addition to sluggish external demand due to the COVID-19 crisis, China recognizes that the US-China conflict will be a war of attrition.

Three Turning Points for the Chinese Economy in the 2010s



In the 2010s, the Chinese economy underwent three transformations at the same time. The first was increasingly sophisticated industry including hi-tech fields. The second was external expansion that focused on neighboring countries and emerging nations in terms of foreign trade, investment, and assistance. The third was the strengthening of guidance by the Chinese Communist Party on internal governance and structural reform including the state-owned sector.

Supported by more investment in research and development, the increasing sophistication of industry is expressed in the rising numbers of international patent applications and published scientific papers. In an environment where trial and error is permitted, new business models are expanding centered on the digital economy. Supported by the enlargement of foreign currency reserves, the Belt and Road Initiative (BRI), China’s supra-regional economic plan, has shifted the focus on overseas expansion as far as Africa since 2013. In terms of stronger governance, the Xi administration power base has been consolidated, and in March 2018, the Constitution was amended to incorporate the leadership of the Chinese Communist Party into the provisions of Article 1 of the Constitution.

As a result, a more sophisticated and globalized China with stronger governance has emerged.

The context of the US-China conflict is not only that China is catching up with the United States economically, but also the intensification of the features mentioned above. The Made in China 2025 industrial policy, the road map that sets out its goals, and the subsidies for its implementation, as well as technology theft and inadequate protection for intellectual property are viewed as problematic by the Trump administration. The BRI is also increasingly criticized for inviting debt traps through excessive lending to developing countries.

What about the adjustments to the internal system? The British current affairs magazine *The Economist* questions the characteristics of the Xi Administration economic policy in three respects: (1) monitoring of corporate growth, (2) administration efficiency, and (3) blurring the line between state-owned and private companies.

In terms of strengthening governance, Article 7 of the National Intelligence Law (enacted in June 2017) requires any organization and citizen to “cooperate with state intelligence work.” This has become an obstacle to the sound global business of Chinese companies. Article 38 of the Hong Kong National Security Law, which came into effect at the end of June, stipulates that it also applies outside the Hong Kong Special Administrative Region. The situation is so serious that some universities in the United States are considering anonymizing discussions on related topics in classrooms.

In an article entitled “The Endangered Asian Century” published in June, the Singapore Prime Minister Lee Hsien Loong pointed out that the fundamental issue is the choices that the United States and China make. If confrontation is chosen, Asia's economic prosperity will be shaken to its foundation. Questions are being asked about how and to what purpose China is applying its growing technology sector, expanding influence, and empowerment.

There are also moves to avoid aggravating the situation. With the United States, the Economic and Trade Agreement (Phase One) signed in January 2020 agreed to strengthen the protection of intellectual property and to prohibit market access that is conditional on technology transfer. China also agreed to purchase US agricultural products and to further open the Chinese market including securities and insurance. The agreement also includes market liberalization that runs counter to decoupling.

Regarding BRI, the Chinese government recognizes debt sustainability and aims to shift to a rigorous scheme based on the concept of high-quality BRI. There are no hints of policy changes where stronger governance is concerned, but in terms of systems, governance is becoming more refined as indicated by the enactment of a Civil Code that includes responses to digitization, and the consolidation of patent litigation to the Supreme People's Court. There is also progress with market reforms as seen in the reduction of the negative list for foreign investment and the improvement in China's position on the World Bank Business Environment Index.

Uncompromising responses are operating side by side with negotiation and adjustments. However, even if the business environment improves, foreign companies and imported goods are at risk of disciplinary action if the thinking comes under pressure from hardliners.

How should Japan respond? Firstly, supply chains must be adjusted for redundancy and tenacity. However, for reasons of agglomeration economics and the scale of the domestic market, this does not mean withdrawal from China.

Secondly, as long as the US-China strategic competition continues, separating the economy from security and whittling down required areas, especially where sensitive technology is concerned, is unavoidable. However, it would be unproductive to cut off personal exchanges and finance, and to put restrictions on general commercial transactions.

Thirdly, there must be sustained engagement on China. In the United States, there is talk of a complete withdrawal from policy involvement with China, but the author thinks that Japan should maintain its efforts because we are at the start of an unknown normality.

Engagement is necessary to promote increased transparency and thoughtful structural reform, to increase domains where China acts within the framework of multilateral institutions, to disclose information about foreign aid, and to ensure that internal circulation does not mean a closed economy. There should be renewed emphasis on the significance of division of labor between the party and the government, and on distinction between business and the party as was the case in the early days of reforms and liberalization. Cooperation on infectious diseases, climate change, and other shared issues should be strengthened.

Even so, hardline thinking may still win the day in a China that is now more sophisticated and globalized with stronger governance. Hinging on the deepening of the Japan-US relationship under the Abe administration, the Japanese government has strengthened international coordination and collaboration among willing nations by means of TPP11, the Japan-EU Economic Partnership Agreement, and Free and Open Indo-Pacific, while stepping up cooperation with China. However, this has not resulted in any document that would form the basis for Japan-China relations during the era of US-China conflict. Japan must secure a pragmatic standpoint and envision a long-term order while maintaining the position that the long-term administration has built.

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