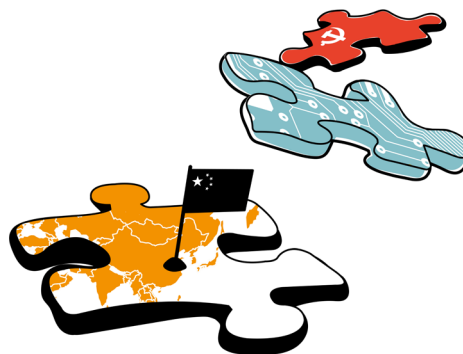


DECEMBER 15, 2022

# MERICS

## China Essentials



### CONTENTS

TOP STORY .....	2
Beijing wants to quickly regain control after disorganized lockdown reopening.....	2
METRIX.....	2
22 million .....	2
TOPICS.....	3
Foreign policy: China will focus on coalition building in competition with the US .....	3
Xi’s focus on economic revival is challenged by structural vulnerabilities.....	4
Science and technology: US containment versus China’s self-reliance quest .....	4
VIS-À-VIS .....	5
“European actors have gone from a very positive view of science and technology cooperation with China towards a much more cautious stance” .....	5
REVIEW.....	7
Demystifying China’s Innovation Machine by Marina Zhang, Mark Dodgson and David Gann (Oxford University Press, 2022).....	7
MERICS CHINA DIGEST .....	8

## TOP STORY

### Beijing wants to quickly regain control after disorganized lockdown reopening

In 2023, Beijing will have to overcome the social and economic disruptions of a momentous and politically charged past year. In the run-up to the National People's Congress (NPC) in March, the leadership will attempt to regain control over a currently uncertain domestic situation. A key move will be to ease the lockdown-induced stresses its recently abandoned zero-Covid policy created in China's economy and society.

Xi Jinping and colleagues will have their work cut out: an already frustrated public is contending with Covid ripping unhindered through the population for the first time, the economy will have to deal with the resulting effects on production and consumption, local authorities are constrained by public coffers drained by Covid-testing and lockdowns.

Xi will have to re-establish economic stability, local-level fiscal stability, popular trust in healthcare – and finally present a blueprint to generate wealth for the many. The sudden shift away from zero-covid shows he is willing to end damaging policies quickly. But now more firmly in charge than ever before, Xi has a chance to also push less popular but necessary policy: property and income tax reforms, a higher pension age, a further loosening of “Hukou” rules that divide the population into rural and urban and restrict the provision of public services accordingly. Such redistributive measures are necessary if Xi wants to reach his goal of making China an equal, middle-income country by 2035.

**MERICS analysis:** “Politically, 2022 was the year of the 20<sup>th</sup> Party congress and Xi cementing his power. Economically and socially, however, it was the year that pitted zero Covid against Omicron”, says MERICS Lead Analyst **Nis Grünberg**. “By beginning of the NPC at the latest, Beijing needs to present a plan on how to rebuild trust, stabilize growth and employment, and counter inequality. ‘Common prosperity’ needs actions, not only words.”

#### Media coverage and sources:

- Financial Times: [China faces an uncertain future in the zero-Covid endgame](#)
- SCMP: [China GDP: avoiding ‘middle-income trap’ is key in 2023, and 5 per cent economic growth possible, Beijing adviser says](#)
- BBC: [China Covid: Hospitals under strain in wave of infections](#)
- HKFP: [China protester detained for 9 days after rallying against Covid restrictions, mother says](#)

## METRIX

# 22 million

This is the number of people in China that have been freed from lockdown since popular protests flared a few weeks ago. Based on official information about Covid risk areas,

MERICS estimates that the number of citizens still locked down has fallen to around 8 million from 30 million mid-November. Authorities announced major changes to the zero-Covid strategy on December 7, ending mass-testing and abolishing major contact-tracing apps. Despite mounting pressure on hospitals, the end of zero Covid is nigh.

## TOPICS

### Foreign policy: China will focus on coalition building in competition with the US

After almost three years of Covid-induced absence, China will re-enter the international stage in full force in 2023. After Russia's invasion of Ukraine and China's decision to stand by Moscow, Beijing's increasingly confrontational approach towards the US and its allies has been solidified. Like Moscow, it sees the US as its main adversary and opposes the current global order -- a stance that will become that much more noticeable.

Despite the friendlier tone struck by Xi at the G20 summit in Bali and during bilateral meetings with world leaders, the direction set at the recent party congress paints a different picture of what to expect from China in 2023 and beyond. Beijing has a much glummer view of the international environment than it did five years ago. Triumphant language about China "standing tall and firm in the East" and enjoying a period of strategic opportunity has given way to Beijing's emphasis on the risks and challenges it faces. This includes the intentions of other international actors toward China.

That means geopolitical competition with the US will again shape China's foreign policy – although developing nations will be the main targets of its diplomatic outreach, in an attempt to build a competing coalition of countries. Pressure on Taiwan will be maintained in the run up to the January 2024 presidential election, as Beijing prepares for the post-Tsai Ing-wen era. Another flareup in the Taiwan Strait is not unthinkable. The likely next US House Speaker, Kevin McCarthy, is reportedly planning a visit to Taiwan early next year – and Beijing is likely to respond with a show of military force.

**MERICS analysis:** "China's leadership is in for a tough year – global challenges will be compounded by domestic crises, including a slowing economy and a growing number of Covid cases," said **Helena Legarda**, Lead Analyst at MERICS. "Beijing could shift its focus to domestic issues, reducing the space for international compromise even more. But this is not assured, and global actors face a year of uncertainty and unpredictability."

#### Media coverage and source:

- China's MFA: [President Xi Jinping Meets with U.S. President Joe Biden in Bali](#)
- Xinhua (CN): [20<sup>th</sup> Party Congress Work Report](#)
- Bloomberg: [Hard-Line China Push Is Vowed by Republicans Taking Control of the US House](#)

## **Xi's focus on economic revival is challenged by structural vulnerabilities**

Beijing is finally loosening its zero-Covid policy. While essential for economic revival, strong headwinds remain. Moving from zero-Covid to rising infections and a likely overburdened health care system may stoke temporary volatility and economic interruptions in 2023. The government will likely have to reintroduce restrictions in hotspots to manage spiraling infections. Faced with this prospect, and against the backdrop of weak consumption, a housing crisis and record-high youth unemployment, the outset of 2023 looks bleak.

China's economy was already under severe stress in 2022. The country failed to hit the government's initial 5.5 percent GDP growth target, and 2022 growth of 3.3 percent is near historic lows, down from 8.1 percent in 2021. On the domestic front, consumption is unlikely to revive quickly in 2023, given the overall strains on households after months of lockdown. On the global front, recessions looming in the US and Europe could weaken demand for Chinese manufacturing. Things are likely to get worse before they get better, leading to overall continued slow growth.

**MERICS analysis:** "The Chinese economy will likely only stabilize in the second half of the year. Beijing will put all focus on getting its economy back on track, now that Xi Jinping has secured his third term as president," says MERICS analyst **Aya Adachi**. "However, China's current challenges – low consumption, a housing crisis and a potential decline in exports – are exposing the structural weaknesses of its economic model. To deliver on its common prosperity promise, Beijing needs to make substantial progress in rebalancing its economy."

### **More on the topic:**

- MERICS Short Analysis: [The structural economic reform challenges for Xi's 3rd term](#)
- Economy Indicators Q3: [Economy improves in QR but faces mounting risks](#)  
(MERICS Members publication)

### **Media coverage and sources:**

- SCMP: [How China's zero-Covid policy has pushed people, economy to the brink](#)
- New York Times: [How will China turn its economy back on – The world is about to find out](#)

## **Science and technology: US containment versus China's self-reliance quest**

Further export restrictions to China are expected in 2023 after the US curbed semiconductor exports in 2022. Future restrictions are likely to cover other strategic emerging technologies like biotech and quantum computing. Beijing filed suit against the US with the World Trade Organization (WTO), although Washington claims national security concerns trump WTO rules.

The expanded definition of national security in the so-called Sullivan doctrine is evidence that nationalization and securitization of science and technology, in particular semiconductors, has risen to the top of the agenda. The EU and Japan have struggled with how to

position themselves with regards to US export controls, but they are now expected to implement their own restrictions along similar lines in 2023.

In 2023, the politicization of science and tech in China is likely to stymie international cooperation, with spill-over effects into critical global issues like climate change. China will further strengthen its drive for tech sovereignty, steering both basic and applied research to serve national interests. For Europe, this means that the current policy toolbox needs to be fundamentally reconsidered. It is no longer tenable to exempt basic research from national security scrutiny.

**MERICS analysis:** “The US is clearly pursuing a containment strategy by expanding its definition of national security to effectively include China’s rise in technology as a threat,” says MERICS analyst **Antonia Hmaid**. “China, which has already been reorienting its science and technology system toward strategic priorities, will up the pace in 2023. There is a very real risk of decoupling in more and more sectors of science and technology. Europe will need to contend with this increasingly geo-politicized world.”

#### **More on the topic:**

- Input Paper by Rebecca Arcesati, Irène Hors and Sylvia Schwaag Serger: [Sharpening Europe’s approach to engagement with China on science, technology and innovation](#)

#### **Media coverage and sources:**

- Bloomberg: [Japan to join US effort to tighten chip exports to China](#)
- Washington Post: [Expect more China-related tech crackdowns, U.S. official says](#)
- Xinhua (CN): [Xi Jinping Speech at Science Conference: “Science has no borders, but scientists have motherlands”](#)

## **VIS-À-VIS**

**“European actors have gone from a very positive view of science and technology cooperation with China towards a much more cautious stance”**

*Sylvia Schwaag Serger is Professor in the Department of Economic History at Lund University. She focuses on China, international science and technology cooperation, and science, technology and innovation policy. In a recent feasibility study that was funded by the Swedish Government Agency for Innovation (Vinnova), Schwaag Serger and co-author Jerker Hellström make suggestions for how governments can support firms in managing risks in international research and innovation cooperation. MERICS China Brief spoke with her about the future of research cooperation between Europe and China.*

**Europe is having reservations about science and technology collaboration with China in terms of knowledge exchange and people – be it researchers or students. Is this justified?**

A combination of factors is causing European universities, researchers, firms and governments to rethink their approach to science and technology collaboration with China. First, states that only 30 years ago played a marginal role in the global research and innovation (R&I) landscape have now grown into important hubs, both in terms of supply and

demand. Second, while democratically governed countries have long dominated research and innovation resources, autocratic states have now become major investors in R&I. Third, knowledge, technology and innovation — key drivers of competitiveness and growth — are increasingly linked to states' national security, influence and power. Fourth, R&I has become increasingly globalized through cross-border and international collaborations in academia and industry.

This is reflected in the growing number of international academic co-publications, but also in the increasing share of business R&D activities outside of companies' home markets. China is the most important manifestation of these trends, due to its sheer size, its explicit aims to become a world leader in certain critical technologies and industries, the close coupling of civilian and military uses of technology, and the increasing politicization, government control, even instrumentalization of economic and academic environments, including international science and technology cooperation.

### **How are European actors responding?**

Within a short time, European actors have gone from a very positive view of science and technology cooperation with China towards a much more cautious stance to engagement with China, in general, and particularly regarding science and technology. Governments, higher education institutions and research funders have published guidelines, checklists or launched other initiatives, some of which are China-specific and some country-agnostic, on how to approach international cooperation that is deemed to incur risks for national security, competitiveness and other strategic interests.

At the same time, the research we and others are doing does not yet show a significant decline in European co-publications with China. This pattern differs from the US where co-publications with China as a whole, and particularly within specific fields such as material sciences, energy and computer science, are declining (both in absolute terms and as a share of total publications). Moreover, this trend shift precedes the outbreak of Covid-19, indicating a decline or decoupling in research collaboration is explained by other factors than the pandemic.

Similarly, we do not yet see a significant reduction in European firms' research and development activities in China, although it appears that the pattern may be shifting in terms of which firms maintain or even increase their R&D activities in China and the nature or focus of those activities.

### **How can we manage international collaboration with complex countries like China – how can we be better at balancing risks with the value of open knowledge exchange?**

Our work on international science and technology cooperation shows essentially the following. First, there are cases of collaboration with China that, for various reasons, undermine national security and other strategic national and European interests. At the same time, a large number of research collaborations are unproblematic and contribute significantly to enhancing our knowledge of Chinese society, economy and science and technology. These collaborations are particularly important given that Covid, but also Chinese

policies, have made it increasingly difficult to engage with actors and follow developments in China.

Second, many responses on how to manage risks in research and innovation cooperation with China have focused on academic research. They do not address the needs and risks regarding companies and industries when it comes to advice, support and guidance. Third, in line with its explicit ambitions, China is becoming, and in some fields already has become, a global research leader in terms of both the quantity and quality of its research. We see a tendency and potential risk in reducing or ending engagement with China in areas where it might be particularly relevant and beneficial to continue to interact and cooperate in a strategic and responsible fashion.

## REVIEW

### **Demystifying China's Innovation Machine by Marina Zhang, Mark Dodgson and David Gann (Oxford University Press, 2022)**

This extensive overview outlines the many different actors and mechanisms involved in China's innovation and industry. Entrepreneurs and other bottom-up actors are driving China's remarkable progress, argues the book, rather than a grand government vision. Innovation peaks when government retreats – and innovation thrives away from the capital, in places like Shenzhen. The book presents case studies on telecoms equipment, smart manufacturing, mobile payments, biopharma and new energy vehicles. It looks at the stock market as a crucial part that shows how the system works as a whole – entrepreneurs, policy makers and investors (private equity and state “guidance funds”) create what the authors call an “antifragile” ecosystem that thrives on chaos and change.

The book depicts a tension between decentralized, bottom-up creativity and centralized, top-down planning. The former is represented by diction borrowed from evolutionary biology, such as “antifragile”, “ecosystem” and “variety-selection-propagation”. These terms contrast with those of the well-oiled innovation machine, designed top-down by a nation-state that perceives itself to be in competition with other nations (and their innovation machines). The deliberate contrast of organic and inorganic metaphors beautifully illustrates China's unique blend of anarchy and authoritarianism.

But it also clouds the lessons that can be drawn, especially for foreigners. The book is a tribute to China's innovation machine, it roots for it to overcome key challenges like technological bottlenecks, outsourcing to low-wage countries and geopolitical competition with the US. To address existential threats such as climate change and unknown viruses, Zhang, Dodgson and Gann argue, China needs the world – and the world needs China. Alongside this plea for global collaboration, the book argues for China to become a responsible superpower, complete with free markets, true rule of law and a free press. But the book leaves the reader mystified about how this can be realized.

Reviewed by MERICCS Analyst **Jeroen Groenewegen-Lau**

## MERICS CHINA DIGEST

### [India and China troops clash on Arunachal Pradesh mountain border \(BBC\)](#)

Indian and Chinese forces have clashed for the first time in over a year in the Tawang sector of Arunachal Pradesh state last Friday, at the eastern tip of India. The situation had remained mainly calm ever since a major battle took place in June 2020 in the Ladakh region where several Indian and Chinese soldiers died. (22/12/14)

### [Xi holds talks with crown prince and prime minister Mohammed bin Salman of Saudi Arabia \(Xinhua\)](#)

At the end of his multiple-day state visit by to Riyadh, Xi Jinping described Saudi Arabia as a key and independent force in the multipolar world and China's important strategic partner in the Middle East. He also signed a number of agreements, one of which being a memorandum with China's Huawei Technologies on cloud computing and building high-tech complexes in Saudi cities. (22/12/09)

### [China readying USD 143 billion package for its chip firms in face of US curbs \(Reuters\)](#)

The Chinese government is preparing a fiscal incentive package to support its semiconductor industry to the amount of more than one trillion yuan. The plan could come into fruition as soon as spring next year according to unnamed sources. This financial injection is a direct response to US policies to curb the sale of chips and related machinery to China. (22/12/13)



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