



# THE CCP'S NEXT CENTURY

Expanding economic control,  
digital governance and national security

No 10 | June 2021



MERICS

Mercator Institute for China Studies



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Expanding economic control,  
digital governance and national security

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## Introduction

# Unlocking anti-fragile China: How Xi reinforces the party state for global leadership

Nis Grünberg

### KEY FINDINGS

- China's leaders are convinced that the governance model of the party state is proving itself as the superior political system. "The West is in chaos, China is in order" is the CCP's diagnosis of current global affairs, and the leadership has announced the beginning of a "New Development Stage."
- The evolving party state is aware of the systemic fault lines that weaken its power. Institutional reforms initiated under Xi Jinping are meant to address governance shortcomings by employing the CCP's 'power tools' of political centralization, mobilization and control.
- Digitalization has become a crucial element in the CCP's governance approach. It serves both better governance and public service, but also enhances the party state's surveillance and monitoring capabilities.
- The party leadership considers this to be the most challenging period of its rule. Potential threats to regime security lie round every corner. In response, everything is viewed through a "comprehensive national security" paradigm.
- Under Xi, China has left behind its defensive stance. The party state is translating its more muscular posture at home into its status abroad.
- The sustainability of Beijing's type of authoritarianism is unclear. Despite the narrative of China's superior model of governance, it invests growing amounts of resources into a ballooning security apparatus - desperately trying to extinguish any threat to stability.

The belief in party-state governance is deepened by Beijing's sobering view of global trends

As the CCP celebrates its 100<sup>th</sup> anniversary, it presents itself as a political goliath brimming with pride and ambition. The CCP's Marxist historiography always saw the party progressing towards a better future, but the increasingly confident messaging out of Zhongnanhai is more than the former rags-to-riches narrative. Looking at the past years, China's leaders are convinced that the governance model of the party state is proving itself as the superior political system.

After four decades of rapid economic growth and impressive social development, confidence in the party's ability to lead China's 'national rejuvenation' is not without merit. The belief in party-state governance is deepened by Beijing's sobering view of global trends, including the state of the economic and political capabilities of China's peers. The tumultuous impact of President Trump's four years in power, the inability by most Western peers to curb the Covid-19 pandemic, and the unraveling of the US-led global system are seen as

a new order. At the US-China meetings in Anchorage, State Councilor Yang Jiechi made it clear that China's tolerance for what it perceives as being spoken to "... in a condescending way from a position of strength" has come to an end. China wants to be seen and treated as an equal.

A number of analyses have viewed China's domestic and international challenges as potential last straw moments. China is a fragile superpower, so the thinking goes, awaiting one precipitous, terminal event. Yet others see China as increasingly anti-fragile. For Xi and his fellow CCP leaders, building an anti-fragile China entails not only being able to 'get through' systemic shocks such as financial crises, pandemics or disruptions in tech supply chains. It requires an ability to benefit from such uncertainty and stress, emerging from crises even stronger by exploiting others' weaknesses and eliminating vulnerabilities in the institutional setup.

To the leadership in Beijing, a strong party state is the key for unlocking institutional advantages in a systemic competition

"The West is in chaos, China is in order" is the CCP's diagnosis of current global affairs, and the leadership has announced the beginning of a "New Development Stage." During this new stage, China aims to become a middle-income per-capita economy by 2035 and a global economic center by mid-century. As a key part of the process, the country requires full strategic autonomy in resources, supply chains, and technology. Xi Jinping wants to be the figure that marked the departure from Dengist reform and opening-up into a distinct Chinese modernity. With term limits abolished, and 10 years of preparing and streamlining the party apparatus around him, Xi is set to become the torch bearer for a China with a global status of wealth and power.

"No one can defeat us or crush us! Accelerating the construction of a new development pattern will enhance our survivability, competitiveness, development and sustainability in the midst of various foreseeable and unforeseeable storms and turbulent waves and ensure that the process of the great rejuvenation of the Chinese nation will not be delayed or even interrupted." – Xi Jinping

Much of the core politics of Xi Jinping remain centered around domestic development. The aim is to show the CCP has not forgotten its socialist roots - putting "the people as the center" of the modernization project. China's chief economic planner Liu He identified inequality and 'out of touch' national governments as two key causes of the 2008 global financial crisis. The poverty alleviation program and now the rural revitalization drive are therefore crucial for the new stage of development, which must establish a broader distribution of wealth.

The evolving party state is aware of the systemic fault lines that weaken its power. Many of the institutional reforms initiated under Xi are meant to address governance shortcomings (短板) by employing the CCP's well-known 'power tools' of political centralization, mobilization, and control.

Not only has political authority been centralized around Xi as 'core leader', but the party center's decisions are meant to serve as 'top-level design' – governance blueprints for the entire system. Fragmented bureaucracy and selective local implementation of central-level policy are targeted. More centralized decision-making and strong messaging reminds officials to strive towards centrally defined objectives. The strong degree of centralization, however, is by many seen as detrimental to local policy innovation.



Political mobilization has always been part of the CCP's toolbox, but under Xi Jinping it is being normalized as a governance tool throughout society and economy. The handling of the Covid-19 crisis has shown how effective mass mobilization can be. Deep integration and institutionalization of CCP within social services, public administration and security was taken to new levels. Technological advances in governance and policing are aiding public service and government efficiency. But the sprawling surveillance networks are increasingly putting citizens private lives under the microscope.

Since control is better than trust, sustained rounds of audits, and frequent discipline and anti-corruption inspection teams paying visits to local governments and administrative branches add an incentive to toe the central party line. Xi wants to make sure the vast party state is stable and disciplined enough to pull into one centrally concerted direction, attempting to end centuries of central-local disparities in policy making. Non-compliance with Xi's political priorities has often been the focus of anti-corruption investigations, and it remains to be seen how effective a sustained discipline pressure on officials is for pushing governance to become more uniform across China.

The unprecedented institutionalization of party rule under Xi is not simply about personal power. It represents a carefully concerted long-term effort to cement the party state as a governance system. The CCP is attempting to build a resilient and adaptive state – an anti-fragile China – that is capable of taking the global lead over the next decades. It aims to do this by building on the development experience of past decades, banking on the economic power of China's large economy, and mobilizing a network of party organizations, a disciplined administration, and a vast security apparatus. To the leadership in Beijing, a strong party state is the key for unlocking institutional advantages in a systemic competition.

## 1. PARTY-STATE CAPITALISM: INTEGRATING THE ECONOMY UNDER POLITICS

To steer the forces of economic liberalization, globalization, and marketization, the CCP is turning China's decentralized state capitalism into an organic "party-state capitalist" model. Here, the CCP's authority remains the key driver and veto power in strategic economic decision making - at both government and corporate levels.

The goal is to forge an economy in which main flows of capital can be steered and activity is disciplined by politically defined development objectives

The goal is to forge an economy generally operating like a market economy, but in which main flows of capital can be steered and economic activity is disciplined by a common set of politically defined development objectives. For this task the public sector, i.e., state-owned enterprises (SOEs), maintains a vital function. The deeper integration of state-controlled capital into the economy has two functions. Firstly, it will allow for increased macro steering of economic development. Secondly, it is supposed to inject more market discipline into SOEs, making them leaner and less wasteful.

Systemic shocks such as the global financial crisis have also convinced the leadership that more political oversight is necessary. This is especially the case in finance (including the platform economy), which, if left unfettered, is seen as a source of imbalances and systemic risks. Finally, the CCP-led national project of modernization is increasingly expected to be part of the corporate mission among industry leaders, and the CCP is calling for patriotic sentiments and support in the private sector.



## 2. DIGITALIZATION: LEVERAGING SMART GOVERNANCE AND CCP CONTROL

To remain at the vanguard of (and not just responding to) social and political development, CCP leaders are advancing digitalization forcefully throughout the system. Digitalization has become a crucial element in the CCP's governance approach. It serves both better governance and public service, but also enhances the party state's surveillance and monitoring capabilities.

The deployment of digital technology to handle the Covid-19 pandemic is seen as a successful test of the capabilities of digital tools. On one hand, digitalization generates citizen support through better services. On the other, it is creating an unprecedented surveillance state that enforces its norms via the digital space. Digitalization also fuels China's drive for more self-reliance, as it remains dependent on foreign technology. The prospects of technological breakthroughs are driving vast state-driven development programs intended to break the dependence on imports from non-Chinese industry leaders.

## 3. SECURITY FIRST: VIEWING THE WORLD THROUGH A LENS OF NATIONAL SECURITY CHALLENGES

The party leadership considers this to be the most challenging period of its rule. Potential threats to regime security lie round every corner. In response, everything is viewed through a "comprehensive national security" paradigm. This now covers a disparate range of issues, from education, media, the environment, to supply-chains, resource politics and foreign actors. This tendency to view virtually everything through a lens of national security makes China more confrontational in its presence and interactions with the world. Under Xi Jinping, China has left behind its defensive posture.

In dealing with what are viewed as domestic issues, the party is increasingly assertive. This can be seen in the more aggressive policies towards Hong Kong, Taiwan, and Xinjiang. Within Mainland China, securitization continues to grow, preemptively policing citizens' physical and digital lives even more than before.

In dealing with what are viewed as domestic issues, the party is increasingly assertive

China's foreign relations are also becoming more proactive. Government policy aims to shape global standards according to its preferences. It also responds more confrontationally when acting on behalf of overseas Chinese interests. Where there are perceived threats to Chinese interests, reaction comes with less restraint. This happens whether those interests be economic, political, or in global narratives. The party state is translating its more muscular posture at home into its status abroad. This more direct imposition of Chinese interests internationally is part of the securitization of international behavior, carried out in order to foster a safer environment for China's rise.

## CONCLUSION: THE WORLD NEEDS TO BE PREPARED FOR AN EVER MORE ASSERTIVE CCP - AND A CHINA ENGAGING IN SYSTEMIC COMPETITION

The leadership in Beijing believes China is engaged in systemic competition, and that it is winning. They see the relative performance and stability of the party state as confirmation of its viability and legitimacy as a system. In foreign relations, they exude increasing confidence. At home, China is doubling down - strengthening its party-state capitalist model by enforcing discipline and central control.

Beijing wants to bolster its defenses against what it views as Western containment of its rise. More effective legal and regulatory tools are being developed in response. Extraterritorial application of Chinese law and pre-emptive action will become more frequent. The rapid retaliation to European sanctions against Chinese officials exemplifies China's new strategy.

The CCP's organic integration with the political system ties the party's political program and China's national interest ever closer. Nowhere is this more starkly exemplified than in its "comprehensive national security" concept. This will increasingly spill over to international arenas - creating more friction when Chinese, or the CCP's, interests are perceived under threat. For public actors this means less compromise and a more offensive stance on a broad array of Chinese interests in international relations. For foreign firms this means that boycotts and souring business ties over political sensitivities will become more frequent.

China's digitalization drive has turned the country into a laboratory for new solutions and approaches to business and governance unseen elsewhere. These include new markets and industries, but also a politically controlled surveillance apparatus more capable than ever. China's wish to be a shaping actor in the global digital economy will be increasingly challenging to navigate for external stakeholders.

Despite calls for more self-reliance and a more proactive defense of national interests, China will need to remain an open economy, albeit more on its own terms than before. Home advantages and state support for priority sectors will remain in place, and a "level playing" field is further out of reach as both US and EU governments consider how to create protective regimes of their own.

Reliance on foreign technology and vital resources make decoupling impossible at this point

Reliance on foreign technology and vital resources make decoupling impossible at this point. But the inward-looking economic development model will cause greater issues. China's partners in trade and businesses, hoping to grow their markets in China, will increasingly find this being linked to political concessions and strategic commitments to the Chinese market. Normative and legal considerations will make collaboration on technological development and trade in high-tech more difficult. Already, overseas firms are struggling to keep supply chains clear of potential issues concerning human rights, labor, and environmental standards. This challenge will only grow.

The party state under Xi Jinping is geared towards stability and security more than ever. In its attempt to streamline and control China's heterogeneous population under a CCP-defined vision of society, it is disenfranchising political, ethnic, and other minorities, and risks to deepen existing rifts in society. In pursuit of this control, it is deploying its favored power tools, centralization, mobilization, and control. The sustainability of this type of authoritarianism is unclear. Despite Beijing's narrative of China's superior model of governance, it invests vast and growing amounts of resources into a ballooning security apparatus – desperately trying to extinguish any threat to stability.

The increasingly politicized business environment is making Sino-foreign joint ventures more difficult. The low threshold for sudden political issues with foreign partners, when, e.g., hit by boycotts over statements made outside China, will lead Chinese actors to stay away from cooperation.

Europe should expect Xi Jinping to stay in power unchallenged for at least one more 5-year term. He has rallied key allies around him and eliminated leadership contenders. In doing so, he is driving the systemic remake of the party state. Recent years have seen both central administration and provincial leadership posts staffed by Xi loyalists. There are no indications a successor to Xi will emerge before the next CCP Congress in 2022. Only a truly unpredicted, existential crisis – precisely the kind of ‘black swan’ event the party state is getting better at handling – threatens this trajectory. His increasingly marginalized adversaries will watch on; mostly in hope, likely in vain.

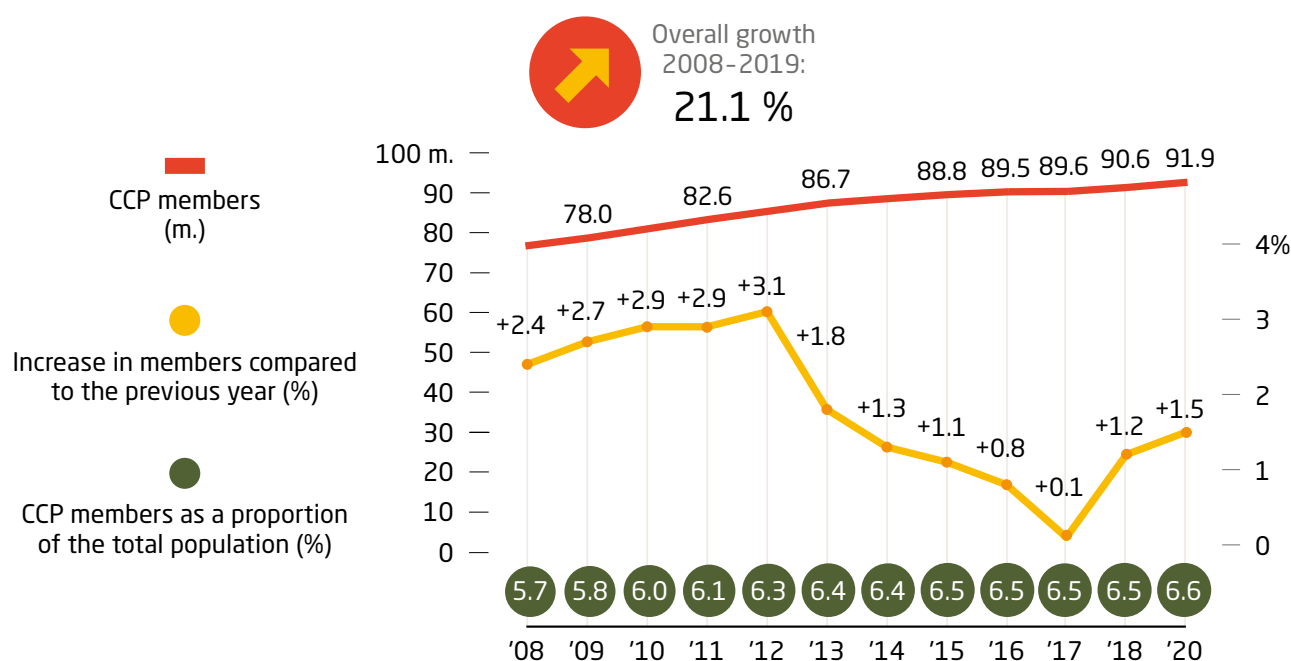


Who is the CCP?

Facts about the Chinese Communist Party in infographics

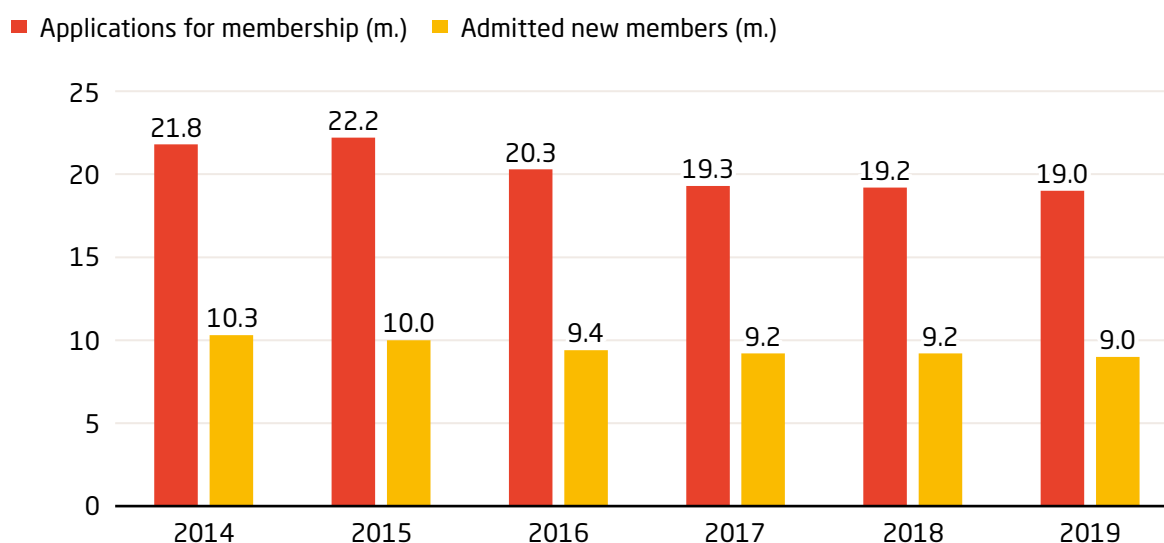
# Who is the CCP? Facts about the Chinese Communist Party in infographics

## The CCP continues to grow steadily Membership development since 2008



Source: Central Organization Department of the CCP and National Bureau of Statistics of China

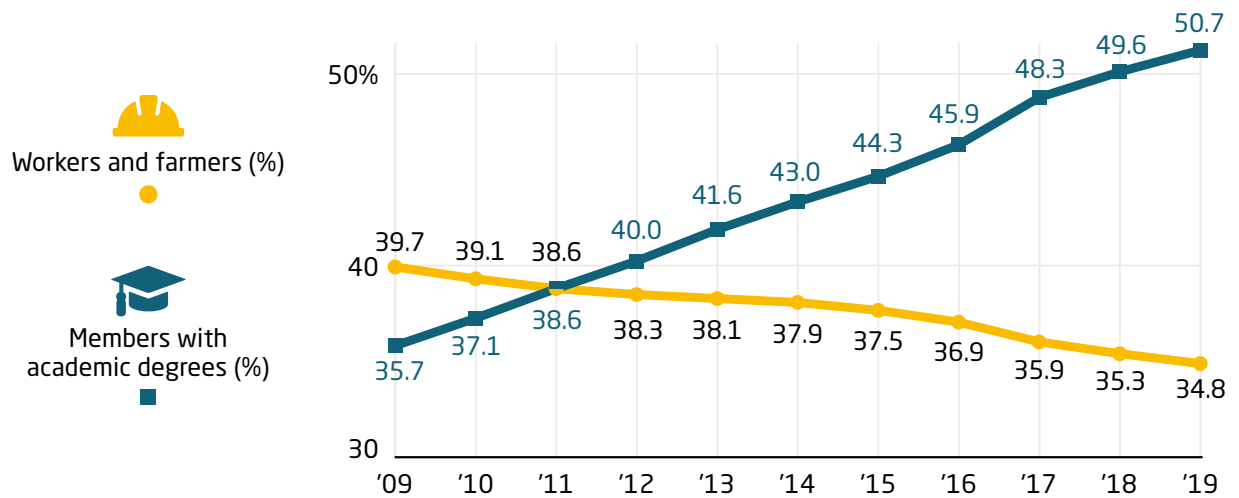
## Recruitment of new members CCP members is slowing down after 2015 Applications for membership and admittance of new members (2014-2019)



Source: Central Organization Department of the CCP

**The CCP is becoming more elitist**

Share of different professional groups

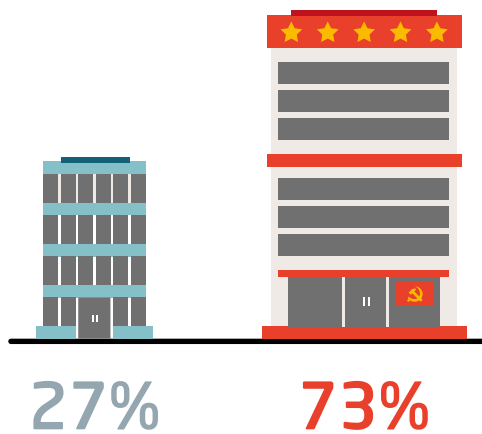


Source: Central Organization Department of the CCP

**The party enters into businesses**

Share of private companies with party cells

Out of the  
**15.61 million**  
private companies in China,  
**73 percent**  
have a party cell  
installed.

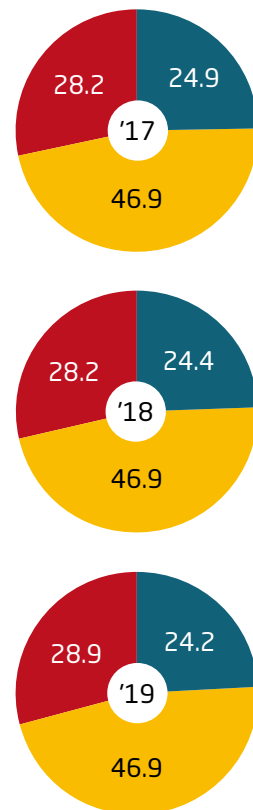


Source: Organization department of the CCP (2018)

**The party is aging**

Share of different age groups in the CCP

■ Younger than 35 years (%) ■ Between 35 to 60 years (%)  
■ Older than 60 years (%)



Source: Central Organization Department of the CCP

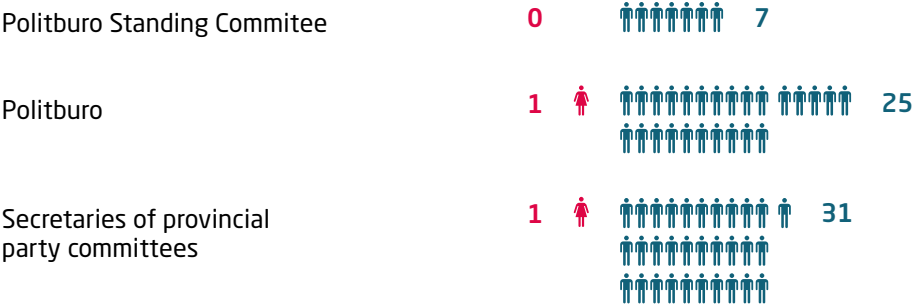


Chances for promotion are slim for women  
Gender distribution in top positions in party and state bodies

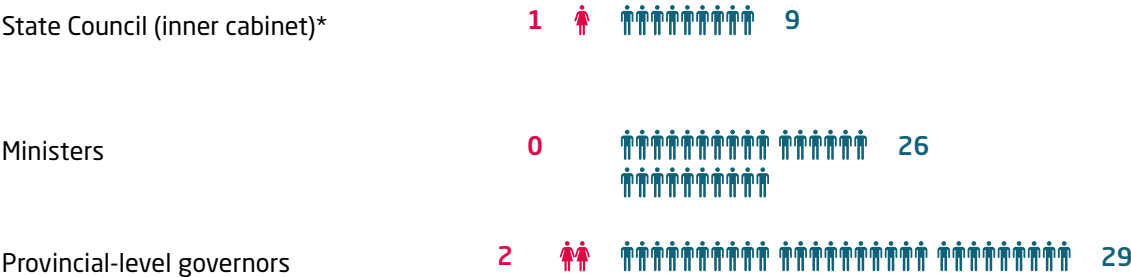
Male/female ratio in the CCP



Leading CCP bodies



Government authorities



\* The inner cabinet is made up of the Premier, four Vice-Premiers and five State Councilors.  
Information on membership ratio: 2019 data, leading bodies: February 2021.

Source: MERICS

## The path to CCP membership

Five main application steps have to be taken

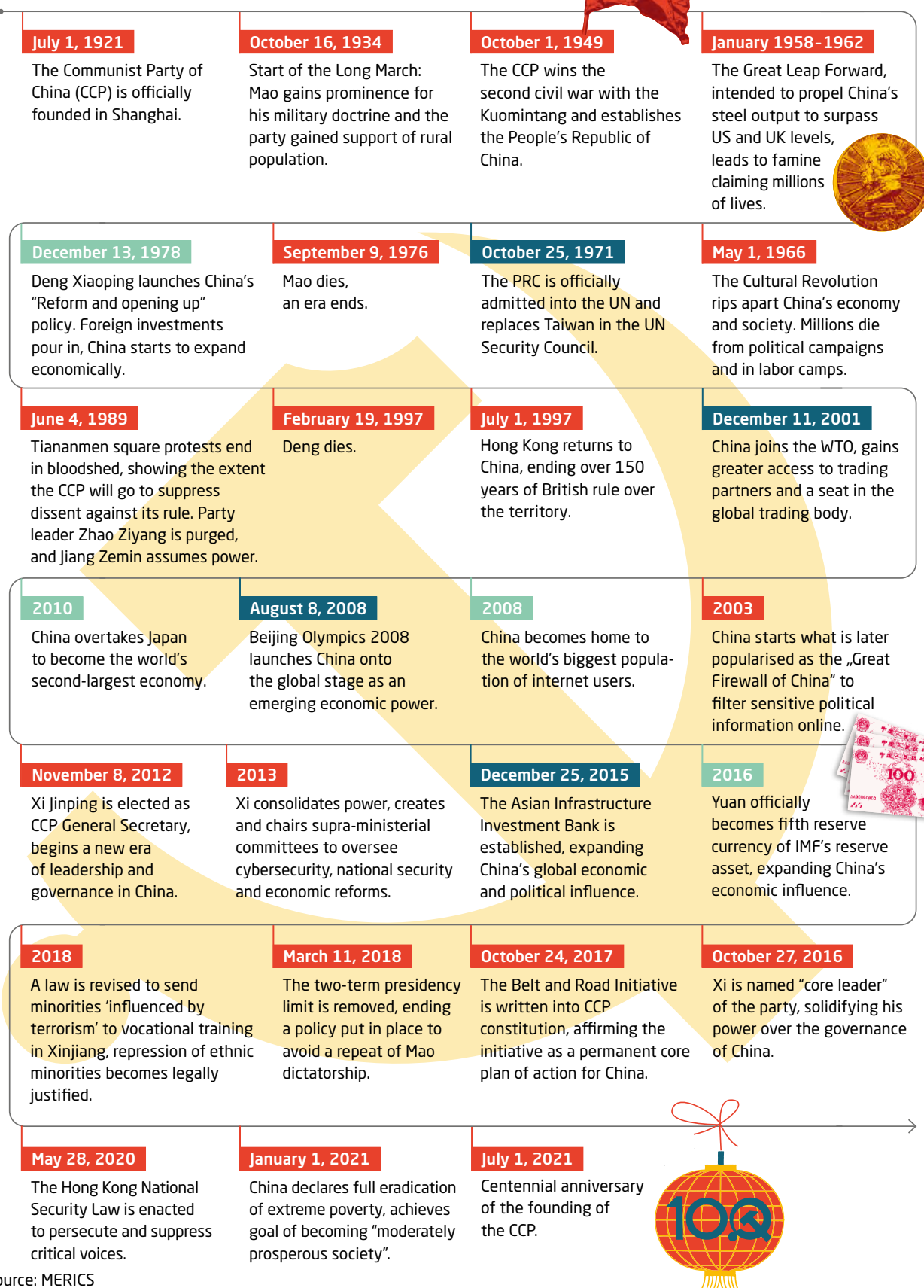


Source: MERICS

## From rags to riches

How the CCP shaped China over the past 100 years

■ Party politics ■ Foreign relations ■ Economic development



Source: MERICS

# Party-state capitalism under Xi: aligning the economy with political objectives

Nis Grünberg



# Party-state capitalism under Xi: aligning the economy with political objectives

Nis Grünberg

## KEY FINDINGS

- For China's leaders, the CCP's centenary serves not only to highlight the party's own rags-to-riches story but also, more broadly, China's economic and geopolitical rise.
- Under Xi, the idea of China converging towards liberal economic systems is thoroughly dismantled. China wants to present the world with a better governance model able to control and resolve the dangerous imbalances caused by laissez faire capitalism and poorly regulated finance.
- The public economy, led by state-owned enterprises, remains crucial to China's socio-economic fabric. The private economy is much larger, but SOEs dominate strategic sectors and are considered vital for the national interest.
- China will unlikely nationalize private players like Alibaba, Tencent, or Huawei. But Beijing has signaled that tolerance of their dominant market positions is dependent on their active alignment with party politics.
- China's current direction of travel is clearly towards a business environment in which CCP leadership and objectives point the way.
- In its systemic competition with liberal capitalism, Beijing is convinced that its political control, flexible economic governance and technological breakthroughs will eventually lead it to superpower status.

## 1. TURNING 100, THE CCP CAN CELEBRATE ITS ECONOMIC POWER

As it celebrates its 100<sup>th</sup> anniversary, the Chinese Communist Party (CCP) is stronger than ever before. It is firmly in charge of the world's second largest economy – one set to overtake the United States in only a few years' time. For China's leaders, the CCP's centenary serves not only to highlight the party's own rags-to-riches story, but more broadly China's economic and geopolitical rise. In this official narrative, economic growth and development come hand in hand with party leadership. "Without the CCP, there is no new China" (没有共产党, 没有新中国), as the saying goes.

The CCP's guiding principles of party hegemony and the primacy of politics over economics are long familiar, indeed today's "Xi Jinping thought on socialism with Chinese characteristics for a new era" has many things in common with the party discourse of the last decades.<sup>1</sup> But the enormous authority of the General Secretary of the CCP (and President of the People's Republic of China) and the means available to him through a modernized party-state apparatus mean that Xi has more power than any Chinese leader before him to put many of the party's ideas into practice.

Xi's unprecedentedly powerful, ideology-infused political steering of the economy is establishing a new economic order

The vision is one of China governed as one social unit in an organic relationship between the party state and the economy

In a speech delivered in early 2021, Xi pointed out that China has entered a “new development stage.”<sup>2</sup> The way Xi’s administration now governs the economy has become so distinctive that scholars have shifted from talking about the familiar state capitalism to a more recent “party-state capitalism,”<sup>3</sup> or from thinking in terms of “China Inc.” to “CCP Inc.”<sup>4</sup> Xi’s unprecedentedly powerful, ideology-infused political steering of the economy is establishing a new economic order.<sup>5</sup> This party-state capitalism is characterized by centralized leadership, a hybrid economy that blends market capitalism with macro-economic development plans based on objectives outlined by the center, and private and public economic actors working with or alongside each other in various constellations.

Xi and the leadership he has gathered around him consider the system they have forged to have withstood major economic and social shocks – the result of financial crises or the Covid-19 pandemic – better than many so-called developed economies. Beijing sees the party state as the better governance system and party-state capitalism as the better economic model. Modernization and economic growth seen as the success story of party-state capitalism have lent Xi’s regime significant financial means and legitimacy. The material development success, growing technological capabilities, and faith in China’s ability to withstand major shocks comparatively well (such as the global financial crisis and Covid-19), are fueling the conviction of the party state’s systemic advantage.

Under Xi, the idea of China converging towards the liberal economic systems is thoroughly dismantled, and Beijing is entrenching its party-led and state-driven economy. In his succinct analysis of the global financial crisis, Liu He (currently China’s most senior economic policy planner) diagnosed that “the world is expecting the arrival of a new theory” for economic governance. He also channeled Henry Kissinger, predicting a new world power every century.<sup>6</sup> This is what China wants to present the world with, at the CCP’s 100<sup>th</sup> anniversary: a better governance model able to control and resolve the dangerous imbalances caused by laissez faire capitalism and poorly regulated finance, and economic governance disconnected from political and social priorities.

In its purest, ideal type form the vision is one of China governed as one social unit in an organic relationship (under hierarchy) between the party state and the economy. This new governance model is seen as more resilient and adaptive than the fragile liberal economies of the West.

Party-state capitalism is geared towards stability and control over the domestic arena, rather than solely market efficiency. China’s leaders are willing to grapple with this continual trade off because they see this systemic feature as an advantage in a time in which the international order is beginning to shift. A more organic integration of economic governance under political leadership is not only for more control, but it gives China more adaptiveness in the face of “black swan events:” sudden critical and unforeseen shocks to the system. It enables the leadership to mobilize economic resources towards political ends much more directed than most other systems. Looking at major Western economies struggling to deal with Covid-19, Beijing is ever more confident it will come out top in what it deems deep systemic competition with liberal democracies.



Finally, the “new era” also comes with a “new pattern” of global integration. The Dual Circulation concept again takes national economic priorities – “the great internal cycle” – as the foundation for policy making. China is and remains highly integrated in the global economy, but in the new era its ascent as world power will mean the economic center of gravity will shift to China. This entails more bargaining and norm-setting power in supply chains, technology, finance and economic governance in ways that aid, or at least don’t harm Chinese domestic interests.

### Dual circulation

The dual circulation concept was put forth in 2020 describing a reorientation of China’s economic system. Of the two cycles, internal and external, emphasis is now on strengthening the domestic economy, including consumption, innovation, and reduced dependence on foreign imports of vital resources and technology. This does not mean a hard decoupling from global markets, but a push to climb up from the lower-end positions in global value chains.



Of course, there are limits to the CCP’s control and its all-of-society governance capabilities, especially in the economy. But the direction of travel of the past years show it is unwise to disregard Beijing’s willingness and ability to implement political plans more forcefully than before. In the economy we see these shifts unfolding in important ways, as will be discussed in this chapter.

## 2. BUILDING AN ECONOMIC ORDER AROUND PARTY LEADERSHIP

The party leads, the market allocates resources, is the often-recited logic of China’s so-called “socialist market economy.” It insists on the “public economy as the backbone of the economy,” and dominant state-owned enterprises (SOEs), but allows for market capitalism to exist at the same time. For most parts, China’s economy is a highly competitive market economy, but the party state reserves its rights to control strategic sectors, support priority industries, and use its ownership and control rights in the public economy, as well as regulatory and financial incentives to steer development towards key political objectives.<sup>7</sup>

### 2.1 The CCP cements state-owned enterprises as the economic foundation

Direct control and natural monopolies in strategic sectors have long been a feature of China’s economy. Controlling energy, information networks and other types of infrastructure ensures Beijing’s ability to govern China as a whole. The country’s leaders value the role of SOEs as macro-economic levers, and developments over recent years show that SOEs remain the backbone of Xi’s party-state economy. When the job market slumped in early 2020 due to the Covid crisis, the “national team” of central SOEs were told to jump in to boost employment and aid pandemic fighting efforts.<sup>7</sup>

**Xi Jinping:** “[...] we must improve at making SOEs bigger and better... and increase the public economy’s competitiveness, innovation, control, influence, and resilience against crises.”<sup>8</sup>

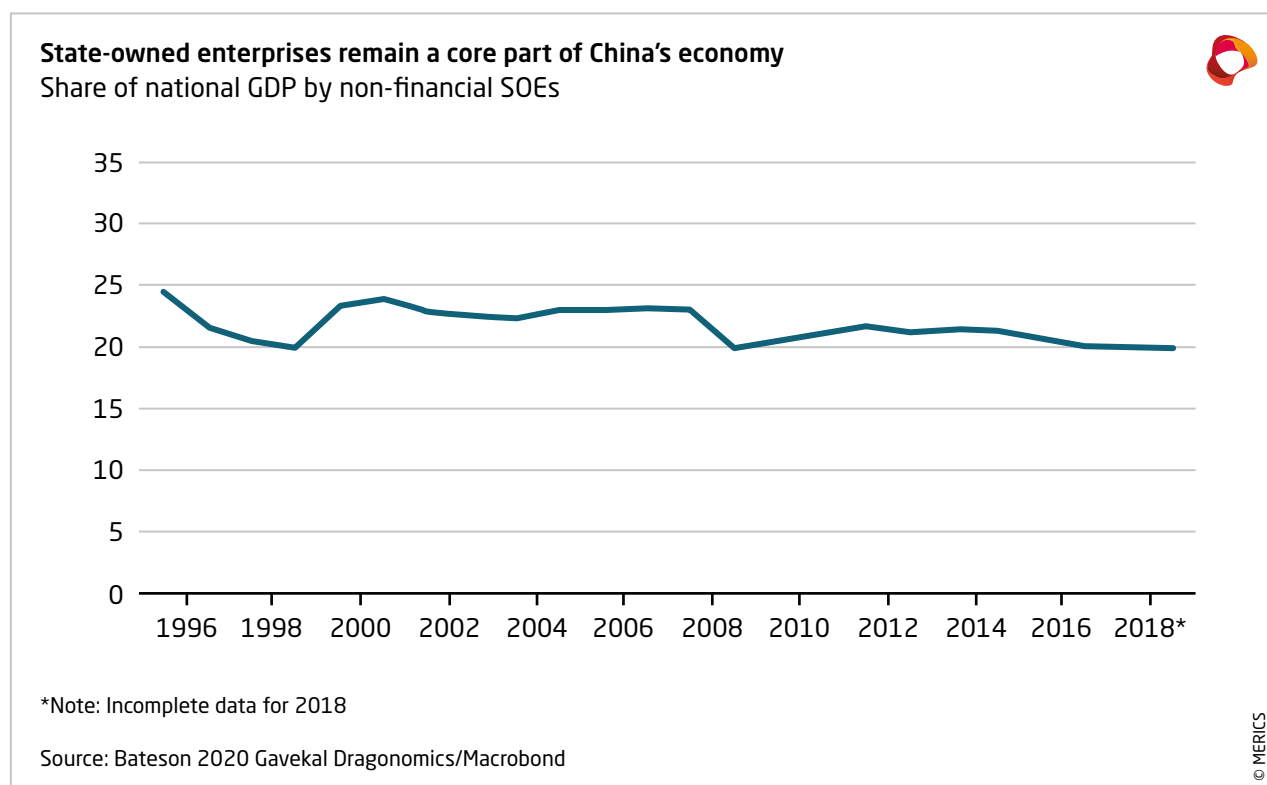
**Xi Jinping:** “We must [...] build bigger, better and stronger SOEs, unwaveringly strengthen their control, influence, risk-prevention ability, and realize the protection and expansion of state-owned capital.”<sup>9</sup>

**Hao Peng (Director of China’s SOE watchdog):** “Whether it is a state-owned company or a private company, they all are Chinese companies [...]”<sup>10</sup>



The SOE-led public economy is crucial to China’s socio-economic fabric. Employing at least 60 million people, SOEs are a corner stone of the job market. They contribute 20 - 25 per cent to the country’s gross domestic product (GDP), a figure that has remained constant for many years as the Chinese economy and SOEs grew in co-step to become significant global players today.<sup>11</sup> The private economy is much larger, but SOEs dominate energy, transportation, public utilities and other strategic sectors where they hold “natural monopolies”<sup>12</sup>

Exhibit 1



considered vital for the national interest. In these sectors 96 “national champions” are overseen by the central state, while leaders are vetted by the central party apparatus.

SOEs are still less efficient and less profitable than private companies. SOE reforms have long been on the agenda, but efforts to establish modern corporate governance and increase efficiency are moderated by more important political considerations. The Third Plenum of the CCP's 18<sup>th</sup> Congress in 2013 declared a "decisive role of the market in resource allocation." Two years later, new guidelines outlined a modern corporate governance with Chinese characteristics and stated that party leadership should be "the core of the corporate governance system."<sup>13</sup> This latter move gave each SOE's party group, in effect its highest leadership body, formal power of decision over strategy, major investments, leadership personnel, and issues relating to national security.

In 2020, a new regulation again stressed the requirement that SOEs must establish party groups.<sup>14</sup> China's SOE reform does not entail privatization, equal treatment, or independent corporate governance. SOEs are seen as important state asset meant to protect and increase state-owned capital. While commercialization and profit-driven strategies are part of the reforms, differential treatment, political involvement and beneficial policies will remain in place.

Exhibit 2

### Large state-owned enterprises dominate strategic sectors

Ten biggest non-financial SOEs and five biggest private firms in China

■ State-owned enterprises (SOE) ■ Private companies

COMPANY	TYPE	SECTOR	REVENUE (USD BILLION)
Sinopec	SOE	Energy	407
State Grid	SOE	Energy	384
China National Petroleum	SOE	Energy	379
China State Construction Engineering	SOE	Construction	206
Huawei	Private	Telecommunications	124
China Railway Engineering	SOE	Construction	123
SAIC Motor	SOE	Automotive	122
China Railway Construction	SOE	Construction	120
China National Offshore Oil	SOE	Energy	109
China Mobile	SOE	Telecommunications	109
Pacific Construction	Private	Construction	98
Amer International Group	Private	Metals	89
JD.com	Private	Internet services	84
China Southern Power Grid	SOE	Energy	82
Hengli	Private	Chemicals	81

Source: Fortune Global 500 (2020)

Party leaders are meant to serve as directors on company boards, further integrating party leadership and corporate governance in SOEs. For them, the political utility of SOEs as owners, operators and investors in infrastructure and strategic sectors is often more important than mere profit.

Party-state control over SOE's capital allows targeted investments in an increasing number of ways. While China continues to support state-owned enterprises and their strategic industries, large state-owned investment funds are playing an ever-bigger role in advancing industrial policy and development targets beyond the scope of SOEs. Capital earmarked to support industrial-policy targets (including those of the Five-Year Plans) is channeled through specialized 'state guidance funds' (政府引导基金), set up to raise funds for investment into priority industries. There are over 1700 of such funds controlling around 700 billion USD (see exhibit 3).<sup>15</sup>

The perhaps most prominent example is the National Integrated Circuit Industry Investment Fund that was created in 2014 and charged with developing a domestic semiconductor industry.<sup>16</sup> In two fundraising calls it has raised over 50 billion USD, investing in both private and publicly owned companies. The second round was also followed by an incorporation of the fund.<sup>17</sup> Fund managers are evaluated by return on investment, but the fund is a hedging mechanism as much as generator of returns.

The party state wants to back multiple players in the sector and work towards a clear political objective

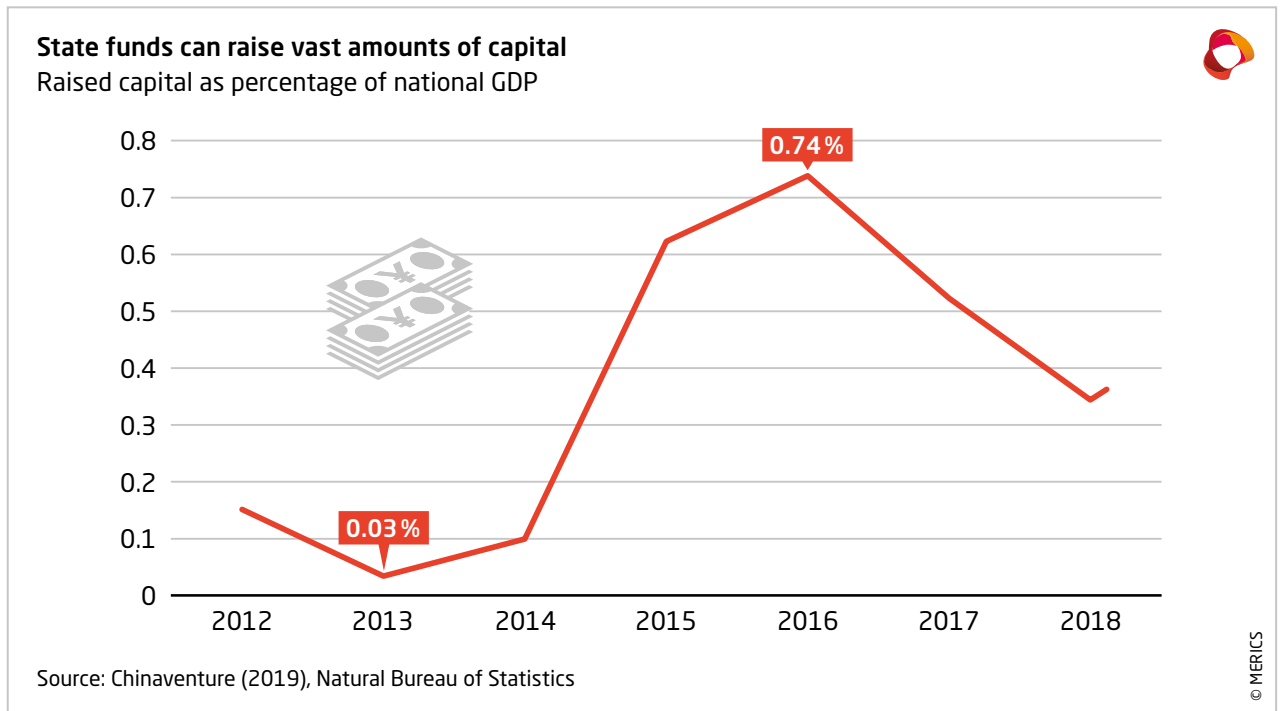
As an investor, the party state wants to back multiple players in the sector and work towards a clear political objective – developing a homegrown semiconductor industry. Compared to direct subsidies and cash-gifts to SOEs of the earlier days, the evolving state guidance funds also show how Beijing is learning and trying to tweak its development steering mechanisms.

The rise of state-owned investment funds is meant to bring more market discipline to allocating resources to high-impact projects, but they have not been a silver bullet against poor investment returns. Their ultimate goal is not profit maximization, but technological development and breakthroughs in priority industries – as defined by the party-state leadership, e.g., via Five-Year Plans.

There are many reports about bankruptcies, illicit uses of funds, and failed investments due to poor due diligence.<sup>18</sup> Tens of thousands of companies in the semiconductor industry have been established in the last few years alone, encouraged by the vast amounts of capital that sprung out of government support for the sector.<sup>19</sup> Beijing bets on the potential of a few players achieving technological breakthroughs in strategic emerging industries, a feat that will outweigh the economic cost of poor investments with no or little returns.<sup>20</sup>

Party-state capital is also being used strategically to absorb the risks of downward swings in markets. Economic shocks such as the global financial crisis and the collapse of large conglomerates like Anbang and HNA Group have shaken China's financial system and rattled the leadership, which has made financial risks a top priority for regulators.

When an equity crisis sent stock prices tumbling in 2015-16, Beijing realized it could not control China's increasingly complex financial markets. SOEs and state investment funds were ordered to step in to stabilize collapsing stock prices that were endangering dozens of listed companies and millions of private investors. Initially seen as providing a quick fix for market turmoil, state entities have since not retreated from the stock market and continue to invest in public and private companies.<sup>21</sup>



## 2.2 The CCP has an eye on strategic emerging industries

Alibaba, Huawei, Tencent, Bytedance and other private companies in China have emerged as industry leaders in sectors like information communication technology (ICT), artificial intelligence (AI), media and fintech. They are driving innovation in technology that also powers official information service platforms and have developed into system-relevant players through their economic size alone. They are also central to China's digital infrastructure – infrastructure that provides the party state with the means to build up its own surveillance and governance capacities (see chapter by Drinhausen and Lee) – and allows political elites to benefit from the huge profits of these new industry leaders.<sup>22</sup>

China will unlikely nationalize useful private players like Alibaba, Tencent, or Huawei. But Beijing has signaled that its tolerance of their dominant market positions in strategically crucial sectors like fintech, media, and ICT is dependent on their active alignment with political priorities, including preventing financial risks. For example, the consumer loans market is worth over CNY 14 trillion, and popular microlender Ant Group alone has around CNY 1.7 trillion worth of consumer loans, enough to make regulators nervous about financial risks and potential black swan events in the fintech sector.<sup>23</sup> Their answer has been a mix of more political oversight, stronger regulation, and intense anti-corruption efforts in the state-dominated banking and finance sector.

The implicit deal – letting China's private national champions do what they do best as long as they comply with party state rules and norms – seems to be approaching its limits. Companies such as Alibaba have become so large that they are considered by regulators to be “too big to fail” and so have potential to become systemic risks.<sup>24</sup>

At the same time, industry leaders and innovators in the private sector are enlisted to achieve the technological breakthroughs and research in frontier technologies and strategic emerg-

ing industries, outlined in the 14<sup>th</sup> Five-Year Plan for 2021-25.<sup>25</sup> Companies such as Huawei and Baidu are vital parts of the technology development clusters evolving around state plans.

As a result, the party state finds new strategies to better monitor and control them. As discussed above, state-owned funds have increased their investments in and cooperation with private companies, especially the larger ones. It is also using equity stakes to deepen its ties with – and information disclosure from – corporations in the private sector. This gives the party state deeper insights into new markets and the private sector, while the entrepreneurs it has co-opted gain access and secure special deals like tax breaks.<sup>26</sup>

### 2.3 The CCP wants a seat in corporate board rooms

The party state is pursuing the integration of party organizations also with private enterprises. Party leadership is being written into corporate charters and governance systems, and regulation has become tougher and more ideologically informed.

China's Company Law requires any company with three or more party members to establish a party group. Smaller private companies long viewed this as a meaningless formality, but under Xi the institutionalization and use of party groups for political mobilization is rising. More than 70 percent of all private companies have established party groups, according to the CCP.<sup>27</sup>

Party groups are meant to play a consultative role in the “modern enterprise system with Chinese characteristics”

Although they do not have formal decision-making powers in private companies, party groups are meant to play a consultative role in the “modern enterprise system with Chinese characteristics.”<sup>28</sup> Regulations encourage the groups to recruit their leaders from company management or people representing the “business backbone” (业务骨干) to integrate corporate officers and the company's CCP leadership.<sup>29</sup>

New forms of party-state interaction with private firms are also being developed. The city of Hangzhou in 2019 started a pilot program that dispatched 100 CCP cadres as “government affairs representatives” to 100 private firms, industry leaders such as Alibaba and Geely among them.<sup>30</sup> The program's stated aim was to smoothen these companies' relations with local authorities. But it also institutionalized and deepened the formal links and information channels between the party state and the private sector. Other localities have since established similar programs.<sup>31</sup>

Party groups in the private sector recently have been urged to take a proactive role in shaping a sense of mission and political awareness within their companies. In September, the CCP issued a new policy calling upon its United Front Department, which is charged with integrating and aligning non-party organizations and groups with the “party line,” to increase its ideological engagement with the private sector.<sup>32</sup>

In a speech published two days after the document was released, the vice chairman of the All-China Federation of Industry and Commerce, Ye Qing, laid out the intentions behind:

“Private enterprises can establish a monitoring and auditing department under the leadership of the party organization. This department will be responsible for supervising the implementation of the enterprise's compliance with laws and regulations as well as company management structure, alerting and educating management and employees [about problems with the former], supervising unusual behavior on the part of employees, investigating and handling disciplinary violations and rule-breaking, and to conducting risk assessments in key business fields and other related work.”<sup>33</sup>

But the motivations for more oversight are also about stability. Chen Yixin, chairman of the Central Political and Legal Commission, the party organization overseeing legal issues, underlined the need to better regulate and control online platforms and financial services companies, in particular also in order to “prevent financial risks from spilling over into areas of social stability or even political security.”<sup>34</sup> Fine-tuning the regulatory framework to reflect changing economic risks and social imbalances is an important move in poorly regulated and fast-growing industries.

The evolving approach to the burgeoning private sector follows a control-performance logic, in which the former is being reinforced after years of relatively loose regulation, especially of China’s ballooning financial industry. As private fintech companies have forged a valuable business sector of significant economic scope and growing strategic importance for the economy, Beijing is pushing for better regulation, more effective monitoring and stronger risk control – both political and economic.

## 2.4 The CCP calls for corporate allegiance

The integration of the party state and private companies through equity links and closer supervision through regulatory changes have been flanked by an ideological push from Beijing that invokes the patriotic role of entrepreneurship. Xi Jinping in July 2020 reminded business leaders of their need for “patriotic sentiments” and pointed out that “great entrepreneurs have a high sense of mission and a strong sense of responsibility for the country [...] linking business development with national prosperity.”<sup>35</sup>

Research shows that the use of ideological mobilization to engender support for the party state in social issues can be as effective as coercive methods.<sup>36</sup> Stirring nationalism and patriotism to stimulate political support is a common strategy in China. Foreign companies, for one, now need to be increasingly careful about Beijing’s patriotic sensitivities and dozens of them – from Audi to the NBA – have been forced to apologize for “hurting the feelings of the Chinese people” in some way or another.<sup>37</sup>

The Chinese leadership’s attitude towards private companies is based on the idea of an organic relationship between party, state, and society. Companies should see themselves as “corporate citizens” and with this “citizenship” come benefits – and duties: Don’t only ask how to get rich, ask how to contribute to the national project of development. For most companies this means little more than ideological window dressing, but for strategically important ones, and for those popping up on government radars because of political reasons, it is an increasingly big issue.

Companies should see themselves as “corporate citizens” with benefits – and duties

Industry-leading companies and private firms seen as important have felt how recent efforts to improve China’s regulatory regimes – in areas like anti-monopoly rules and fintech – also had a political dimension. The party state’s treatment of Ant Group was driven by important and arguably much-needed improvements in industry regulation but came coupled with the demand for a pledge of allegiance. This highlights how industry regulation and political control are two sides of one coin: trimming Ant to prevent it from becoming a black swan by increasing political oversight, and by introducing better fintech industry and anti-monopoly regulation that serve social and economic purposes (see exhibit 4).



Exhibit 4

## The regulatory take-down of the Ant Group shows the party state's stricter approach to fintech and big private firms



**On November 2, 2020** founder Jack Ma and executives of *Ant Group* were summoned by regulatory agencies and the People's Bank of China, days before its "biggest IPO in human history." Ant Group is an affiliate of the Alibaba Group. Ant owns China's largest digital payment platform, Alipay, which has over 1 billion users. After the "regulatory interview," a company spokesperson said Ant would "... implement the meeting opinions in depth ... embrace supervision .. and assist the development of the economy and the people's livelihoods." The IPO was postponed indefinitely.

Prior to the summoning **Ma had given a speech at the Bund Finance Summit on October 24, 2020 criticizing state banks as "pawnshops."**



In the following weeks, Ma largely disappeared from public view. On April 12, 2021 regulators forced Ant to initiate a restructuring into a holding company, and news platform Huxiu, also part of the Alibaba group, was shut for a month after it defended Ma's criticism. Meanwhile, state regulators announced new anti-monopoly rules, and a regulatory overhaul of the entire fintech industry which had become "too big to fail."

Chief financial regulator Guo Shuqing stated: "[fintechs are] helpful to the real economy ... but we need to prevent their risks." Beijing had become too wary of "financial risks" posed by a ballooning private finance industry.

**The new anti-monopoly rules restrict Ant's lending operations and give state banks a bigger share of the business,** and cap any platform's lending-to-capital ratio at 25 percent. On April 10, 2021 Alibaba was further fined USD 2.8 billion, around 4 percent of the groups 2019 revenue, for monopolistic behavior. An "administrative guidance" given on April 6, 2021 warned Ant to adhere to anti-monopoly rules and to create a more consumer-friendly platform.



**Regulators also collected "pledges" from 34 leading platform companies to rectify practices of using their market power to lock-in users on their products,** while blocking other companies from offering services on their platforms. China's second biggest platform Tencent e.g., issued a statement on April 14, 2021 pledging to create a CNY 50 billion charity program for promoting "sustainable social values."



Source: MERICS

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The CCP is deepening its organizational integration with businesses through party cells, is co-opting business elites and strengthening its regulatory capacity. The biggest efforts to influence corporate control yet remain limited to firms of certain size or impact. But the balance between control and performance has clearly shifted, and under Xi Jinping mobilizing the CCP apparatus is used increasingly as “organizational weapon” for asserting more control over social organization at large.<sup>38</sup> Technological innovation and entrepreneurs willing to take risks are hampered by an outdated and cumbersome bureaucracy – as a disgruntled Jack Ma pointed out in his 2020 speech that angered regulators.<sup>39</sup>

China’s current direction of travel is clearly towards a business environment in which CCP leadership and norms point the way, powerful state agencies apply tougher regulation and leading private enterprises are expected to pledge their support for political objectives – or at the very least don’t openly resist the party line.

### 3. BEIJING SEES THE PARTY STATE ASCENDANT OVER THE LIBERAL STATE

China’s leadership sees the ability of party-state capitalism to steer economic development and technological modernization as a distinct systemic advantage over free market capitalism. Decades of economic growth, broad provision of public goods and stability have cemented China’s belief in its governance model. Recent months and years have proven its ability to withstand systemic shocks.

Decades of economic growth cemented China’s belief in its governance model

Beijing believes in its mix of risk-preventing regulation, state-guided development planning, and an all-of society mobilization towards the CCP-led national project of China’s revival as global power. The 20<sup>th</sup> CCP Congress in 2022 will most likely see the ascent of Xi to even more power, and with that deepen the organic integration of the economy under politics.

Politically determined targets for development, state-led investment, state-owned equity ties into the private sector, industrial policy and guidance funds will not go away. On the contrary, leaders are calling for an all-of economy effort to “break the US tech blockade”.<sup>40</sup> State support will remain an important part of this effort, as highlighted again in the 14<sup>th</sup> Five-Year Plan. With improved investment screenings and policy learning from the numerous experiences with finds, this way of economic mobilization will generate competitive Chinese players in emerging industries in the coming decade.

Institutionalizing party organizations in corporate governance structures is intended to establish a guiding mechanism to make sure private companies stay in line with national interests. Private companies are currently under no legal obligation to comply with party rules, but recent CCP regulation shows the party is keen to increase its political leverage over all economic actors. On top of formal rules, ideologically-driven messaging is creating a deeply politicized business environment.

Exhibit 5

<b>The business environment is becoming more politicized</b> Recent examples of consequences for crossing red lines and pledges of CCP support		
DATE	ACTOR/COMPANY	CONSEQUENCE
October 2019	Daryl Morey, General Manager of the Houston Rockets	Fans and Chinese business partners called for boycotting the Houston Rockets, games were not shown in China. Both Morey and players apologized publicly to avoid more damage to the <i>NBA's</i> large Chinese market.
July 2020	<i>HSBC, Jardines Group</i> and other large companies in Hong Kong	Having large footprints in Hong Kong and China, corporations offered public statements stressing their formal support for the Law. This led to concerns raised by foreign stakeholders, but appeased Beijing.
March 2021	<i>H&amp;M, Adidas</i> and others	The companies voiced concern over forced Uighur labor in Xinjiang's cotton industry. Western fashion brands were faced with boycotts and erasure of names on billboards and ads, and had dozens of sponsorship contracts cancelled.

Source: MERICS

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The complex relationships between China's private companies and state enterprises means foreign governments and non-Chinese companies will increasingly be confronted with tensions over security, technology and market access when interacting with Chinese partners. With more party state involvement in the economy, potential interfaces with public actors and political sensitivities will increase also in commercial dealings. Foreign enterprises operating in China will also have to make sure they are not seen as harming party-state interests – and make sure they are seen as contributing to China's economic and social development (see exhibit 5).

These developments strongly suggest that the “level playing-field” that foreign companies want for doing business in China is not in sight. On the contrary, systemic differences will become an ever-greater challenge. Beijing's vision for China's political economic order is blurring the lines between public and private ownership and drawing new priorities for global integration. The dual circulation concept is not about decoupling China or severing cooperation and trade, but about upgrading China's place in the value chain, being more self-reliant in essential resources and core technologies.

There are, of course, also limitations to the degree the leadership can push ideology into the daily management concerns of companies. The CCP is still no monolithic all-encompassing power, and Beijing's political strategies have always been met with local tactics to shirk policy viewed as unreasonable or overreaching. Most companies operate freely by following the law without proactively engaging in political activities.

However, the trends discussed in this paper should be seen as coordinated effort to improve alignment with and compliance to central policy. Codifying party rules as state laws and pushing party organizations in firms is advancing the party-state model of combining regulation with supervision, to enable both better regulatory and political-disciplinary line-of sight into the economy. Often this is not about daily management, but about the potential to steer strategic decisions.

How deep political entrenchment in the economy will go is unclear, but few things look likely to alter the current trajectory. Party-state capitalism strives for political stability and control over macro-economic developments – and has so far done so with a sufficient level of economic performance. It accepts inefficiency as the price for control. Unanswered questions about its sustainability are many. But the reality is that China’s leaders believe in the resilience and advantages of their model, and the new development concept is meant to double down on its strengths and increase China’s political-economic resilience and adaptiveness.

Xi and his colleagues have been humble – and realistic – enough to publicly acknowledge “challenges unseen in a century” ahead – like inequality, to mention but one. But they look back at China’s last four decades and see an economic model that is constantly adapting and getting better at overcoming shocks and crises.

However, the challenges China faces today are new and complex in nature, and Beijing’s recipe to tackle them puts preventing economic risks, safeguarding political stability, and national security first. In its systemic competition with liberal capitalism, Beijing sees China’s party-led state capitalist system winning. It is convinced that its political control, flexible economic governance, readiness to incur economic losses for the sake of social and political stability, and technological breakthroughs will eventually lead it to superpower status.

How deep political entrenchment in the economy will go is unclear, but few things look likely to alter the current trajectory

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# The CCP in 2021: smart governance, cyber sovereignty and tech supremacy

Katja Drinhausen, John Lee





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## KEY FINDINGS

- Achieving greater technological self-reliance is integral to the CCP's vision for the digitalization of China, and Chinese authorities continue to extend and calibrate their control over the internet.
- China's government has embraced digitalization of government services, leapfrogging developments in many Western states.
- China's government has built a solid foundation of digital infrastructure. Citizens and private sector have seen tangible gains; a flourishing digital economy, better access to goods and improved public services.
- The CCP's hope is that digital technologies can proffer new access channels to public goods and ultimately bolster its legitimacy.
- Its all-encompassing understanding of national security extends to cyber and cultural security, where the focus is on cleansing China's internet of ideas and information that might be harmful to the party's hold on power.
- The CCP's challenge is to keep open international channels for technological imports and exchanges in the face of growing tensions with advanced economies.

## 1. DEVISING AN INSTITUTIONAL SYSTEM FOR MANAGING DIGITALIZATION

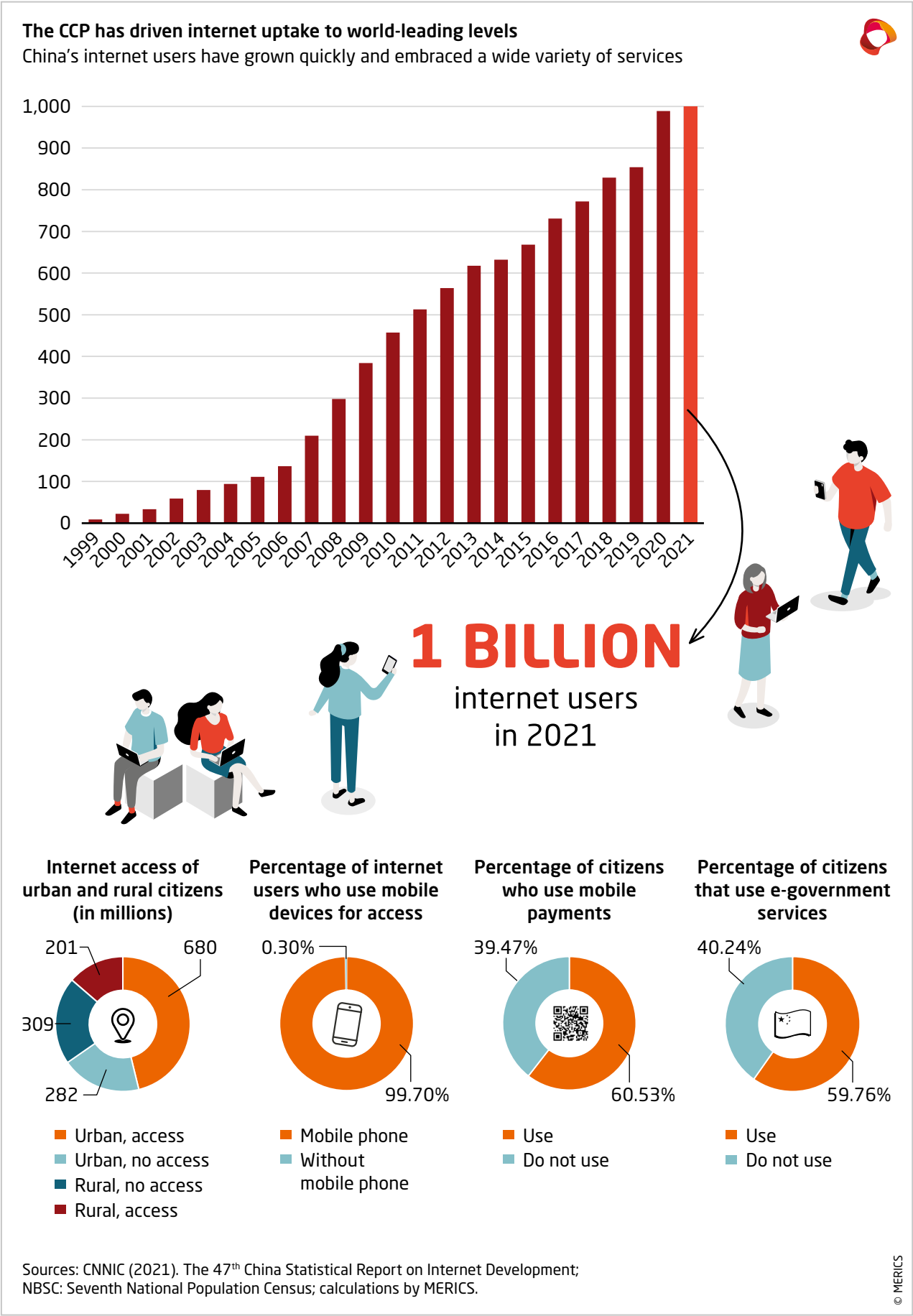
For two decades, the CCP's top leaders have recognized that “informatization” – the application of digital technology throughout Chinese society – is key to achieving domestic development goals and improving China's position vis-à-vis the world's leading nations. Despite former US President Bill Clinton's prediction that trying to control the internet would be like “nailing jello to a wall,” the CCP has managed to maintain control in cyberspace, while leveraging it as a multiplier for economic growth and technological progress. The expansion of China's internet-based economy has fueled national growth, while giving China's authorities new tools for surveillance and censorship.

Yet the CCP's leaders still perceive significant threats from the digital environment, eyeing the ongoing presence of foreign firms in China's digital infrastructure, and the dominant US position in some critical capabilities. Achieving greater technological self-reliance is integral to the CCP's vision for the digitalization of China, and Chinese authorities continue to extend and calibrate their control over a technological system, the internet, that was originally designed for a largely uncontrolled global flow of information.

Under President Xi Jinping's rule, China has devised an institutional system for managing cyberspace and the effects of digitally networked technologies across society.<sup>1</sup> This system coordinates and oversees a rapidly expanding network of legislation, regulation and pol-

The CCP has successfully coopted and disciplined powerful new actors that have arisen from the digital economy

Exhibit 1



icy reaching into every area of China's cyberspace. The CCP has successfully coopted and disciplined powerful new actors that have arisen from the digital economy, notably China's internet platform businesses, while policing and mobilizing the masses online. The activities of foreign entities are not exempt from this oversight and control.

Leadership in key digital technologies and applications coupled with control over information transmitted through cyberspace, is seen as central to economic and systemic competitiveness. The Chinese government has rapidly driven forward the country's network expansion. The number of Chinese internet users is set to cross the one billion mark in 2021, or a penetration rate of more than 70 percent. Chinese citizens now account for one fifth of global internet users.<sup>2</sup> The leadership strives to stay at the forefront of new technological developments. China's telecoms operators had installed around 819,000 5G telecoms base stations by May 2021 (see exhibit 1).

Life in China has gone digital during the last decade, as services, sales and payments have moved online. Chinese tech companies have flourished in this environment: China's internet companies are among the biggest global players. Xiaomi alone claimed to have 325 million smart home appliances connected to its proprietary Internet of Things (IoT) platform by the end of 2020. Using "top-level design," an approach of guiding policy from the pinnacle of party-state authority, the CCP aims to control and harness economic digitalization and the internet for its goal of "socialist modernization and national rejuvenation."

## 2. GENERATING SUPPORT FOR CCP-RULE THROUGH SMART GOVERNANCE

Digitalization and informatization remain key items on China's political agenda, with the explicit goal of using big data to modernize national governance. The 14<sup>th</sup> Five Year Plan (2021-2025), adopted by the National People's Congress (NPC) in March 2021, is supposed to usher in a new chapter of smart and modern Chinese Communist Party (CCP) rule.<sup>3</sup> Building on the "Internet+"-strategy established in the previous five-year plan it focuses on leveraging information and communication technologies (ICT) to improve governance efficiency across sectors.

The CCP's hope is that digital technologies can proffer new access channels to public goods and ultimately bolster the Chinese people's trust in the party and its leadership. Whether in poverty reduction, basic services or public security, digital technologies are expected to contribute to sustainable economic and social development. For instance, smart cities are designed to help manage urban areas sustainably – an urgent topic given the sheer number of large cities in China, all of which use vast amounts of scarce resources such as water and energy, and struggle with transport and social infrastructure bottlenecks due to high population density.<sup>4</sup>

Rural digital infrastructure and literacy still notably lags behind urban areas. The government plans to expand access to internet services and e-commerce platforms as well as training in rural areas to promote economic growth and consolidate its poverty reduction achievements.<sup>5</sup> Even if rural residents won't turn into online entrepreneurs overnight, this has already provided faster and cheaper access to goods.<sup>6</sup>

Digitalization is also intended to accompany institutional reforms in the areas of social security and health. For example, a new digital social security card has been developed and has already been issued to over 460 million citizens, allowing easier access to benefits across regions – addressing a key challenge for China's large domestic migrant population of more than 200 million.<sup>7</sup>

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Under the “Healthy China” strategy of 2015, a national information system has been rolled out. E-services and online consultations are intended to better connect doctors and patients, counteract the uneven regional distribution of medical care, and make healthcare more cost-efficient.<sup>8</sup> This task can only become more urgent, as China’s population is aging rapidly due to the one-child policy.

China’s government has embraced digitalization of government services, leapfrogging developments in many Western states. A national e-government system has been in the works since 2016. The new Five-Year Plan sets further goals for expansion. The aim is to offer a wide variety of services online and ensure that citizens “do not have to appear in person more than once.” Identity verification is increasingly offered online via digital ID or face recognition, implying significant time savings for users given the great distances often involved.<sup>9</sup>

A number of cities, such as Fuzhou, have developed comprehensive local service apps to facilitate everything from buying tickets for local public transport, managing social security accounts and starting a business, to paying for doctor’s visits, electricity or other services.<sup>10</sup>

Data-driven solutions are seen as essential for streamlining bureaucracy. China’s leadership believes far reaching-digitalization will improve government agencies’ ability to identify needs and risks, and to determine who is deserving of licenses and resources. Data-sharing and integration across government agencies is emphasized, in order to generate better use of big data analysis and AI to predict and prevent risks – from economic and environmental to public health and political risks.

Since late 2019, the construction of an ecosystem of public databases has been in the works under the label of “internet + monitoring,” in which diverse data points on the behavior of companies, non-governmental organizations, individuals and public institutions will be collected. The most notable example of the governments endeavors is China’s Social Credit System, which tracks the compliance of individuals, companies and institutions with laws and regulations under unified identification numbers.<sup>11</sup>

Despite the massive amounts of data collected, privacy and data security issues have been insufficiently addressed

The party-state sees data, including personal data, primarily as a resource for governance and the promotion of economic development. Despite the massive amounts of data collected, privacy and data security issues have been insufficiently addressed. Excessive data collection and leaks by companies and public administrations have caused public discontent. In a 2019 survey, more than 77 percent of internet users reported being affected.<sup>12</sup>

The government is taking steps towards greater regulation. China’s first Personal Information Protection Law as well as new privacy and data security regulations and restrictions on the use of facial recognition and AI are in the making. However, they can be expected to continue to mainly target the private sector. Government departments will have to adhere to higher standards, but still face less stringent restrictions on what they can collect and share.<sup>13</sup> Most importantly, laws and regulations allow for broad national and public security exemptions.

### 3. HARNESSING DIGITAL TECHNOLOGIES FOR POLITICAL CONTROL

Safeguarding national and regime security remain top of the CCP's political agenda. China's all-encompassing understanding of national security extends to cyber and cultural security, where the focus is on cleansing China's internet of ideas and information that might be harmful to the party's hold on power. To implement its political project, the CCP deploys technologies that were long conceived in Western countries as fostering pluralistic debate and potential drivers of political liberalization.

Social stability and regime security is seen as resting on the state's competency and capacity to monitor and censor. From the mid-2000s, China has gradually shut out the major international communication and media platforms from its market. Chinese companies have flourished, developing their own innovative products while offering the state a high degree of control over content.

To be economically successful and retain market share, Chinese companies must comply with regulatory demands and institutional supervision; for instance, in-house CCP committees, licensing procedures and content review. These factors ensure that platforms self-govern in the desired direction and build products and services that only allow for controlled civic engagement.<sup>14</sup>

The CCP is particularly concerned about the viral dissemination of information critical of the government and spill-over effects that might result in protests or political movements offline.<sup>15</sup> A core component of media policy under Xi has therefore been building a “healthy internet” in which negative information is contained and “positive energy” is spread by state actors. In recent years, a lengthy series of laws and regulations for content control in the digital space have been passed.

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New regulations in January 2021 specifically targeted social media.<sup>16</sup> Responsibility for their implementation has been put upon online media and communication platforms. A comprehensive system to detect and contain collective online actions harmful to the party is now in place. This was visible in the early information management and containment of criticism surrounding the government's handling of the outbreak of the pandemic.<sup>17</sup> No such limitations are placed on outbursts of nationalistic fervor, as visible in the boycott calls against international companies.<sup>18</sup>

The party state not only wants to monitor, shape and contain online behavior, it aims to monitor and control citizens' offline behavior, too. Over the past decades, it has built a layered system of monitoring and surveillance platforms.<sup>19</sup> A key indicator is the growing number of safe cities and residential communities. These reflect an intent to improve social governance, with a heavy emphasis on ensuring “social stability” (see exhibit 2).

Most public spaces are covered by cameras - not just streets and train stations, but also buses and taxis, schools and universities, places of religious worship, bars and restaurants. Train and long-distance bus journeys are only possible with real name registration and identity checks.

China now boasts the world's most comprehensive surveillance coverage. Facial recognition is being widely applied in practice and development of smart, AI-driven policing encouraged. China's success in containing Covid-19 pandemic has highlighted this comprehensive coverage and has domestically legitimized widespread surveillance.

Exhibit 2

## Political control trumps data protection in the party's vision of a 'healthy' internet

### Key policy tasks of internet regulation





Source: MERICS, based on analysis of PRC policy documents.

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The intensity of control is highest in minority regions such as Xinjiang and Tibet, where the distinct identities of ethnic and religious minority groups are seen as a latent threats to state security. Measures in Xinjiang include, for example, the forced installation of spyware and continuous monitoring of mobile devices. It also entails the use of various apps through which cadres and other public personnel feed information into multiple databases, most notably the Integrated Joint Operations Platform.

The platform has been built over the past five years to integrate and assess information about individuals from ethnic and religious minority groups. The collected data is used to identify behavior that deviates from state-defined norms. Rooted in highly discriminatory state perceptions, the use of technology has contributed to wide-scale extra-legal detention of more than a million people since 2016 and significant restrictions on freedom of movement and expression in Xinjiang and beyond.<sup>20</sup>

A key characteristic of China's growing surveillance state is how it connects with and supports long established offline capacities in monitoring and policy enforcement. Public security personnel, party officials and residential community workers are tasked with maintaining social stability. In pursuit of their goal, they make use of digital solutions to enter information and help enforce policy, identify risks, resolve issues and prevent protests. In addition, numerous apps and platforms seek to mobilize citizens to, for instance, alert authorities to suspicious behavior or report ideological failings, such as an "incorrect" understanding of the party and its historical contributions.

Automation levels within the various surveillance initiatives, especially those that are partly locally-built, often remain relatively low. However, China's government is pushing for joint standards and better integration of data sources.

#### 4. CLOSING GAPS TO ACHIEVE A SECURE AND CONTROLLABLE DIGITAL ECOSYSTEM

The CCP's top leaders recognize that to secure this vision of a digitalized China, they must achieve greater independence in the technologies that constitute cyberspace. As foreign governments place more restraints on China's freedom to import 'core technologies', ensuring that Chinese firms are capable of producing these for themselves has become a first-order priority.

However, the CCP also seems to have grasped that the complexity of new technologies and the globally connected nature of the digitalized economy make complete autarky neither realistic, nor desirable. The goal is to reshape global economic and technological systems and supply chains increasingly on China's terms (see exhibit 4).

The PRC's techno-nationalist tradition of seeking independence in key technologies dates from the Mao era, when it was focused on strategic weapons.<sup>21</sup> As China opened up from the 1980s onwards, the CCP began instituting policies to catch up with advanced economies. Policies sought to foster indigenous development of technologies that were seen as vital for economic competitiveness and military competition, and to address the global shift in technological innovation from defense to civilian industry.<sup>22</sup>

Since coming to power, Xi has stressed that China's "greatest hidden danger lies in core technologies being under the control of others."<sup>23</sup> China's last five-year science and technology innovation plan (issued in 2016) emphasized growing the nation's capacity for independent innovation, and national policy initiatives like 'Made in China 2025' were aimed expressly at import substitution and industrial upgrading.<sup>24</sup>

The urgency of boosting domestic technical capacities has increased with expanding US export controls and other measures that target leading Chinese digital technology firms, such as Huawei, and technology exchanges with China in general. These imperatives combined with the Covid-19 global economic slump have led the party-state to redouble efforts to accelerate development of Chinese capabilities along all segments of technological supply chains and applications.

The focus is on technologies that support the national roll-out of digital "new infrastructure," such as 5G telecoms networks, and frontier technologies such as artificial intelligence.<sup>25</sup> The CCP's 'Fifth Plenum Proposal' of October 2020, in anticipation of the 14<sup>th</sup> Five Year Plan (2021-2025), declared that self-reliance in science and technology was a "strategic

The CCP aims at reshaping global economic and technological systems and supply chains increasingly on China's terms



Exhibit 3

**China strives for domestic growth and global leadership in key technologies**Digital development and innovation are key items of the 14<sup>th</sup> Five-Year Plan

CATEGORY	FOCUS AREAS	MAIN GOALS IN THE 14 <sup>TH</sup> FIVE-YEAR PLAN
<b>Key technologies</b>	Quantum information sciences	Development of free-space quantum communication, quantum computing prototypes and quantum precision measurement technologies.
	Integrated circuits	Improvement of R&D in circuitry design, key equipment and semiconductors.
	Cloud computing	Large-scale development of cloud services, including storage, computing, and virtualization.
	Big data	Innovation in big data collection, storage and analysis; development of relevant standards, applications, and procedures in this field.
	Internet of Things	Development of technologies such as sensors and software necessary for autonomous vehicles, smart homes, and other areas.
	Industrial internet	Promotion of an ecosystem of "internet+ smart manufacturing," especially development of standards, safety management and research in the use of internet in industry and home appliances.
	Blockchain	Development of smart contracts, asymmetric encryption, use of blockchain in financial technology, supply chain management and government services.
	AI	Development of dedicated chips for AI, deep learning, algorithmic decision-making, as well as speech, image, and video recognition.
	Virtual reality and augmented reality	Development of VR/AR and VR/AR-based software and hardware solutions.
<b>Product application</b>	Smart transportation	Autonomous driving, smart management of infrastructure (e.g. traffic signals), and the use of smart tools in airports, ports, etc.
	Smart resources	Use of smart tools for efficient resource management and extraction, such as in mines, oil and gas fields.
	Smart manufacturing	Development of technologies such as networked equipment, digital production links, intelligent supply chain management, etc.
	Smart agriculture and water resources	Promotion of technologies for precision-use of agricultural resources (e.g. seeds, fertilizer, pesticides); construction of a "smart water conservation systems."
	Smart education	Integration of online courses and other digital teaching tools, also to improve quality of rural education.
	Smart medicine and health care	Development of smart medical devices and technologies to help diagnosis and supervision. Establishment of electronic health and medical records, digital prescriptions, etc. and promotion of data sharing across institutions.
	Smart neighborhoods	Integration of government service platforms, emergency systems and smart monitoring systems for residential communities.
	Smart household appliances	Development of technologies such as voice control, remote control of home appliances, e.g. smart lighting, security monitoring, wearables and service robots.
	Smart government services	Development of "one-stop" online government services as well as electronic certificates, signatures and files; improvement of review systems.

Sources: 14<sup>th</sup> Five-Year Plan (2021–2025) for National Economic and Social Development and the Long-Term Objectives for 2035 of the People's Republic of China.

support” for national development and gave innovation a “core position” in the national modernization project.

The CCP’s challenge is to keep open international channels for technological imports and exchanges in the face of growing tensions with advanced economies while boosting domestic capabilities to develop and build core technologies. Internally, greater self-reliance is being pursued by stimulating self-contained domestic economic activity (“dual circulation”) while making foreign technology providers conform increasingly to Chinese rules (“secure and controllable”).

This aims to address the threat of foreign state intervention in China’s digital networks which has exercised China’s leaders ever since Edward Snowden revealed the extent of US government cyberspace capabilities and their potential exploitation of private US technology providers.

Chinese firms are increasingly turning to domestic suppliers to mitigate the risk of losing access to foreign inputs. This will raise the level of self-sufficiency in China’s domestic technological ecosystems. For instance, Huawei has reacted to targeted US pressure by cultivating domestic industry partnerships and investing in smaller firms that show potential to substitute for foreign vendors.

Efforts to develop domestic capabilities despite US export controls also benefit from the willingness of firms from other advanced economies to replace US vendors. However, in some areas US supply chain dominance is so pronounced that it is hard to circumvent over the short term.

Even as the party state tightens its surveillance and control over China’s cyberspace, it still accommodates the developmental imperative for cross-border flows of information. For example, trial projects to facilitate international data transfers are being developed in pilot zones around China at the central authorities’ direction.<sup>26</sup>

Xi Jinping recently reiterated the need to ‘proactively integrate’ China into global science and technology networks. The CCP’s long-standing, pragmatic approach of “crossing the river by feeling the stones” can be expected to inform future efforts to reconcile its seemingly contradictory goals of control and interconnectedness in a digitalized society.

These contradictions are unlikely to be resolved by 2035. However, from the party’s viewpoint the risks to control can be mitigated by leveraging the two-sided nature of interdependence; as Xi has put it, by building structural dependence on China into global production chains.<sup>27</sup> The willingness of foreign interests to continue investing and, increasingly, to locate research and development operations in China has likely reinforced the viability of this approach to the CCP leadership.

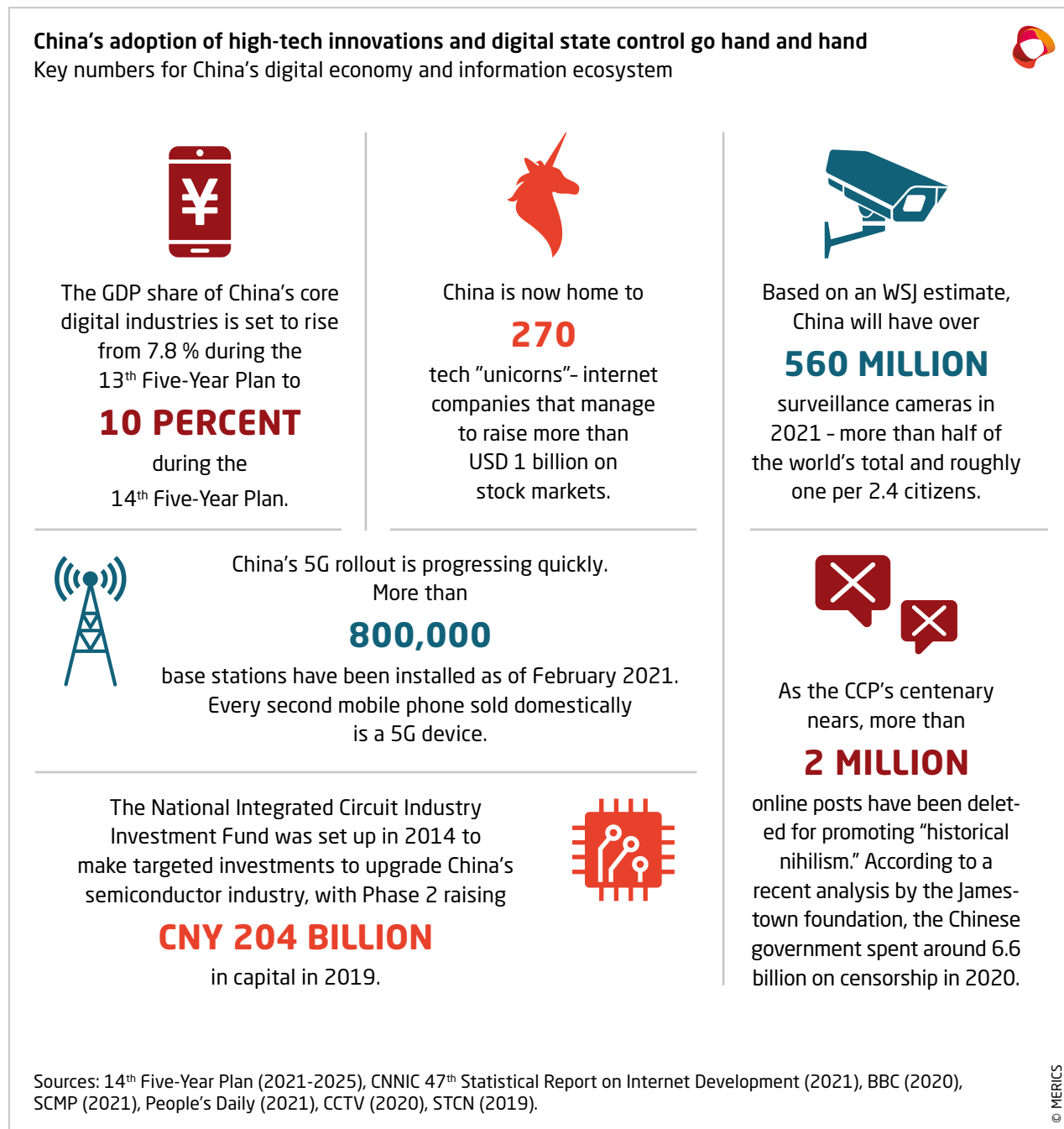
Even as the party state tightens its control over China’s cyberspace, it accommodates the developmental imperative for cross-border flows of information

## 5. ICT IS NOT A FAIL-SAFE FOR SECURING CHINA’S AND THE CCP’S FUTURE

China’s leadership takes a two-pronged approach to using ICT in domestic governance. To strengthen its legitimacy, the party state invests in efficiency and better services, while building up capacities to safeguard its hold on power. China’s government has built a solid foundation of digital infrastructure. Despite domestic criticism surrounding data privacy risks and digital barriers for the elderly, disabled, or poor, China’s citizens and private

sector have seen tangible gains; a flourishing digital economy, better access to goods and improved public services. Digital solutions will continue to be used to improve governance efficiency in the coming years – including their application for repressive policies such as censorship and surveillance.<sup>28</sup>

Exhibit 4



In Beijing's eyes, it is pioneering the future of modern governance, based on centrally guided and constant monitoring, surveillance and assessment. This assessment has become part of the growing discourse within China of systemic competition, which sees "chaos in the West and order in China" (西方之乱，中国之治).<sup>29</sup>

China's data- and technology-driven governance model is contrasted with the outdated Western approach to governance; centered on the rule of law and independent supervision

of state power through the separation of powers, press freedom and civil society. The government has adeptly framed its pandemic containment successes as a direct result of its systemic advantage.<sup>30</sup>

Despite Beijing's narrative of China's superior model of governance, the sheer amount of resources that are being invested to detect and contain perceived threats to stability and regime security tells another story. China's growing surveillance infrastructure is an indicator of what the party state fears will happen if it cannot control its people and the various societal stakeholders. It is a costly undertaking. According to a recent analysis by the Jamestown foundation, the Chinese government spent around USD 6.6 billion on censorship in 2020.<sup>31</sup> Building this tight security network swallows public funds that could be spent on addressing root causes of discontent – for instance social inequality, rising living costs and gaps in the education and welfare system.

The leadership's security-focused domestic approach also has international implications. The party state has identified data that it sees as politically necessary and taken steps to guarantee access to it. This includes legally mandating access rights for state organs and setting strict data localization requirements. China's integration into the international digital economy is therefore impeded by difficulties for Chinese and foreign actors wanting to transfer data across borders. Pilot programs for special international data transfer rules in free-trade zones around China can only partly alleviate this issue.<sup>32</sup>

Broad “national security exemptions” permitting the state to demand information have also harmed the perception and opportunities of Chinese companies abroad. Increasingly, Huawei, ZTE, Bytedance and others are met with suspicion and regulation.<sup>33</sup> The trend is being exacerbated by the tarnished reputations of companies which have taken part in the suppression of dissent and discrimination or violated the human rights of ethnic and religious minorities.<sup>34</sup>

China faces significant obstacles to closing the gap with global industry leaders in core digital technologies. In many supply chains for sophisticated digital technologies, more complex inputs and intellectual property rights are often still dominated by US firms or those of US allies. Yet despite mounting pressure on China's access to cutting-edge research and overseas products and processes, there is still little sign of a coordinated technological blockade against it, even among technologically advanced liberal democracies.

China's internal economy and innovation system is now probably capable of self-sufficiency in most fields, albeit at performance levels that trail behind trailing global industry leaders. If Chinese firms were faced with coordinated “decoupling” in digital technology by the US and its allies, they would still probably not be confined to domestic markets, given their extensive international presence and influence in emerging technological ecosystems. Much growth in the global digital economy is occurring in regions where China's economic influence is relatively strong. For example, Southeast Asia's digital economy is projected to triple in value to 300 billion USD by 2025.<sup>35</sup>

The CCP's leadership has made clear that, even as it extends its control over China's cyberspace, it still seeks to both shape and adapt to the global digital economy. For example, the government recently issued directions to promote greater harmonization of Chinese technical standards with international ones. Chinese actors remain engaged in international cyberspace governance and technical standards-setting processes for digital systems.

The CCP's leadership has made clear that it still seeks to both shape and adapt to the global digital economy

At home, China is building a resource-intensive but effective system of digitally enabled social control and governance. Abroad, it is building a national profile in the integrated global digital economy, in which it currently remains internationally competitive. For the CCP to realize its 2035 goals, its ability to reconcile this model with growing external pressures for digital “decoupling” will be critical. It is proceeding through playing technological catch-up with foreign industry leaders and by keeping open key foreign markets and partnerships in the face of political pressure from the US government and other quarters.

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# China's new international paradigm: security first

Helena Legarda





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## KEY FINDINGS

- The CCP has established a centralized and unified national security system built around the concept of “comprehensive national security.” Reaching into all areas of policy, the party aims to increase its control over both its internal and external environments.
- Since Xi Jinping came to power, protecting China's national security has risen to the top of the party's agenda. Cooperation and compromise with the West have been set aside in favor of a more proactive mode of action meant to make the world safer for the CCP in the long run.
- From trade ties with other countries to China's global image and reputation – everything has become a matter of national security.
- This new approach involves the party taking forceful preemptive action against perceived threats to its rule, pursuing the extraterritorial application of Chinese laws and trying to enforce formerly domestic red lines overseas.
- Other countries must be prepared to deal with a Chinese leadership that will respond forcefully to any perceived criticism or attack against its interests, and that is ready to escalate any conflicts if matters of national security are concerned.
- As the party refocuses its efforts towards achieving its 2035 and 2049 goals, this securitization of China's international behavior is only likely to be intensified.

## 1. THE PARTY GOES ON THE OFFENSIVE: THE ERA OF LOW-PROFILE FOREIGN POLICY HAS BEEN LEFT BEHIND

Over the last few years, but especially since Xi Jinping came to power in 2012, China has adopted a substantially more assertive foreign policy and altered its international behavior. Underlying this new approach is the party's new and expanded concept of national security, which encompasses almost every policy field. Even China's all-important development goals have been subsumed within the protection of China's national security, with the ultimate goal of preserving the long-term survival and stability of the system.

The change in approach, visible in traditional diplomacy and many other policy fields, reflects both the party's confidence and ambitions – and its fears and insecurities. China's global push demonstrates confidence and forms part of the struggle for “the great rejuvenation of the Chinese nation” (中华民族伟大复兴), a concept introduced by Xi in 2012.<sup>1</sup> Its goal is to restore China to its former status as a global power by 2049. In Beijing's eyes, China is not a rising power, but a returning one. The Western-dominated global order is viewed as a historical anomaly that therefore can – and must – be reversed.

At the same time, China's new international posture must also be understood as a reflection of the CCP's threat perceptions . It is an extension of the party's fundamental mission, which is to preserve regime stability and survival. The CCP's worldview is marked by a feeling of being under siege, surrounded by Western countries and their allies who are intent on containing China and subverting the CCP's hold on power, with the ultimate goal of provoking regime change.

**The party has established a new national security system**



Under Xi, the party's long-standing strategy of erecting barriers to keep threatening Western ideas and influence out of China so as to guarantee the party's survival has become more rigid. However, an outward-looking parallel strategy has also been rolled out. A new ideological and policy framework, built around Xi's concept of "comprehensive national security" (总体国家安全), has been established to tackle threats to China and the party that flow from China's growing integration in, and exposure to, the outside world.

The CCP has established a centralized and unified national security system with the National Security Commission, chaired by Xi, at the top. And it has passed legislation in order to institutionalize this new outlook, including the National Security Law, the National Intelligence Law and the Cybersecurity Law, among others. Reaching into all areas of policy, the party aims to increase its control over both its internal and external environments, with a view to turning China into a global power by 2049 (see exhibit 1).

With this new model, the party has turned from the passive or reactive defense of China's national security to a more proactive, and at times even preemptive, approach meant to tackle any threats to the current system and shape the international environment to make it safer for the CCP in the long run. China's national security state, formerly mostly kept within China's borders, is now expanding internationally.

## 2. A NEW MODEL: NATIONAL SECURITY IS REDEFINED AND GOVERNS THE PARTY'S AGENDA

Preserving the system's stability and survival has long been the party's top priority; national security has always been seen as the bedrock of these efforts. At the foundation of the People's Republic of China (PRC), the leadership was initially laser-focused on traditional security issues. The emphasis was on preserving China's independence and territorial integrity against US or Soviet aggression, and on protecting the system from "counterrevolutionary elements."

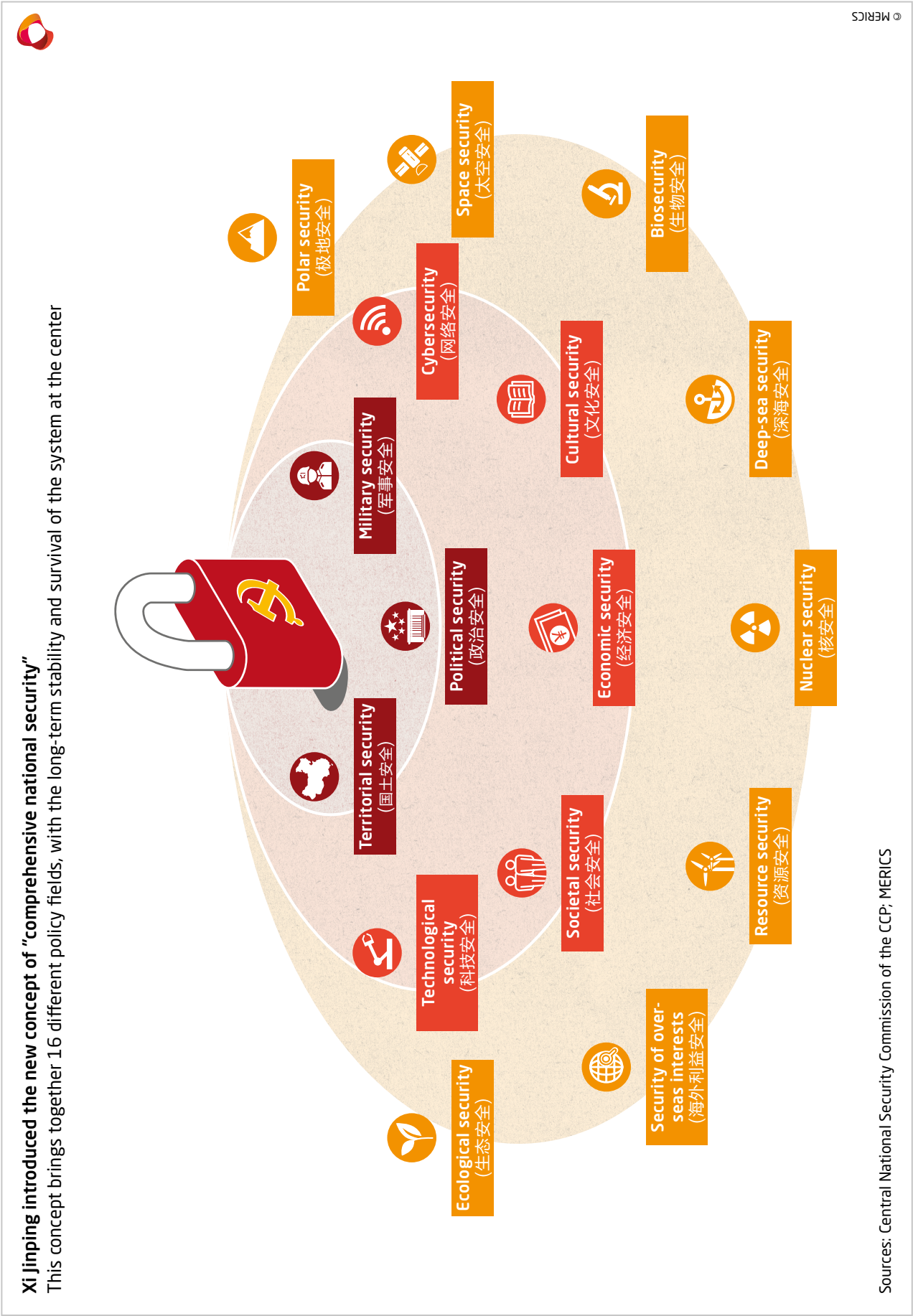
It was only in the late 1970s, as the risk of war seemed to have receded, that the CCP incorporated non-traditional security elements into its concept of national security. As China opened up to the world during a time of global economic growth and industrial modernization, issues such as economic security, transnational crime and ideological security rose up the party's security agenda. New tools were needed as the military and other security forces were no longer considered sufficient protection.

At the same time, however, this was a period when China's development goals were at the forefront of party policies. Without abandoning the focus on traditional security concerns, the "reform and opening up" period also brought with it an understanding that guaranteeing China's economic growth must take precedence. Economic development was seen as the key to the country and the system's long-term stability. This, in turn, would require cooperation and compromise with the West.

Preserving the system's stability and survival has long been the party's top priority

For a while, China therefore pursued a path of integration into the international community – joining the WTO and other international organizations and engaging in diplomacy and exchanges with the rest of the world even on sensitive issues like human rights.

Exhibit 2



Only with the arrival of Xi did the party put security front and center again: development goals were subsumed within the protection of China's national security. In response to global trends towards greater instability – and thus heightened threats to the party – after the 2008 global financial crisis and the United States' pivot to Asia, Xi expanded on the traditional concept of national security. In 2014, shortly after coming to power, he articulated his new concept of comprehensive national security during the first meeting of the newly established National Security Commission.<sup>2</sup> This was a new vision of national security, intended to bring together different policy fields and strands under an overarching framework.

The concept currently encompasses 16 types of security - though the number is constantly growing - including traditional security areas such as political security, territorial security, and military security, alongside new areas such as cultural security, scientific security and the security of China's overseas interests (see exhibit 2).<sup>3</sup>

The underlying logic behind this new outlook is the integration of development and security (统筹发展和安全): development is seen as “the basis for security, and security as the condition for development” (发展是安全的基础，安全是发展的条件).<sup>4</sup> National security has thus become the central element in the party's strategy to maintain China's economic growth and continued development which is, in turn, one of the CCP's main sources of legitimacy. This view clearly connects national security to the party's own struggle for long-term stability and survival. Since protecting China's national security rose to the top of the party's agenda, cooperation and compromise with the West have been set aside in favor of a more proactive mode of action.

National security has become the central element in the party's strategy to maintain China's economic growth

### 3. INTERNATIONAL ENVIRONMENT: THE CCP IS ON THE ALERT FOR EXTERNAL THREATS TO DOMESTIC STABILITY

Links between internal and external security are seen as key issues for the new national security system to focus on.<sup>5</sup> National security has broadened from protecting China against military attack by the US or others. The new, expanded template covers all policy areas and actors – domestic or international – that could impact China's development and therefore the CCP's legitimacy, or harm political and social stability. From trade ties with other countries to China's global image and reputation – everything has become a matter of national security.

Developments over the last few years have only underscored the importance of the international side of this equation. The party, in a nutshell, sees clear external challenges to its power and stability that must be tackled to reach its 2035 and 2049 goals. US trade sanctions and the blacklisting of multiple Chinese firms has demonstrated the vulnerability of China's economy and industrial bases, given their dependence on foreign markets and suppliers for key components, such as chips.<sup>6</sup>

The emergence of a new transatlantic cooperation agenda that includes China policy and extends to the NATO space, along with increased cooperation among the Quad member countries, has highlighted the risk that a coalition to contain China's rise may be in the making.<sup>7</sup> Ongoing debates in the West about China's violations of human rights in Xinjiang and Hong Kong have made clear to the party that its image as a responsible global power that will rise peacefully is in jeopardy. And the Covid-19 pandemic has further clarified that China's security in the face of global challenges is dependent on the policies and decisions of other countries.



Under the new model, the passive defense of China's national security is no longer felt to be enough, as there are many developments that might turn into existential threats for the party, if left unmanaged. The party has therefore decided to move towards proactively shaping the international environment in order to make the world safer for the CCP in the long run. Xi's dictums that the party wants to build a "new type of international relations" (新型国际关系)<sup>8</sup> and a "human community with shared destiny" (人类命运共同体),<sup>9</sup> one element of which is a "security community" (安全共同体), and play a central role in reforming the global order are all logical next steps in this process. The CCP hopes that by increasing control over its external environment and reshaping the global order in its image, it can preempt any threats to its rule emanating from Western liberal democracies.

In essence, the party sees this as a fraught moment for China. Although the party has rapidly and efficiently expanded its domestic mechanisms of control, the international environment remains a challenge. The 14<sup>th</sup> Five-Year Plan (FYP), released in March 2021, notes that China's "development environment is facing profound and complex changes," which include a new scientific and technological revolution, industrial transformation, and deep shifts in the international balance of power. "Instability and uncertainty have increased significantly," according to the plan, as the world enters a period of turbulent change, accelerated by the Covid-19 pandemic and its economic impact.

Control over the international environment has turned into a matter of self-defense for the party

The plan cites current trends towards deglobalization – a veiled reference to US-China tensions and efforts towards economic decoupling – and a volatile global political landscape.<sup>10</sup> These changes, which are indirectly blamed on the United States ("unilateralism, protectionism and hegemony") are seen as posing clear threats to the world's and China's peace and development. Control over the international environment has turned into a matter of self-defense for the party.

#### 4. A NEW PREEMPTIVE POSTURE: THE CCP WILL PROACTIVELY CONFRONT POTENTIAL CHALLENGES TO ITS RULE

Leaving behind the old defensive posture, the party has turned towards an increasingly proactive approach to national security. This new approach involves the party taking forceful preemptive (or even preventive) action against perceived threats to its rule, pursuing the extraterritorial application of Chinese laws and trying to enforce formerly domestic red lines overseas by attempting to control China-related narratives internationally. In this new paradigm, where all matters are seen through a security prism, the party may take any perceived slight or attack against China's citizens, companies, overseas interests, or its image in the world as an attack on its bottom line, warranting an aggressive response.

For the rest of the world, the implications of this shift have been quick to materialize. Aggressive behavior and reactions formerly reserved for sensitive domestic issues, such as opposition to CCP rule in Xinjiang or Tibet, calls for independence in Taiwan, or human rights activism on Chinese soil, are now increasingly common on the international stage as well.

Nowhere has this shift been clearer than over Hong Kong, a city that unites the interplay between internal and external security with the CCP's stronger extraterritorial focus and preference for taking forceful preemptive action against potential threats. The National Security Law for Hong Kong (HKNSL), passed on June 30, 2020, as part of Beijing's broader effort to crack down on protests in defense of Hong Kong's autonomy, nominally targets subversion, secession, terrorism and foreign interference as well as the vague offense of

“collusion” with foreign entities. In practice, however, its intention is to root out threats to national security posed by the “ideological virus” that are the city’s liberal (i.e., Western-influenced) political and civic values.<sup>11</sup>

Tackling internal threats to the party’s rule is no longer enough, however. The protests that rocked Hong Kong throughout 2019, and the pro-democracy camp’s victory in the Fall 2019 elections, were deemed events that could only be due to coercion or interference by foreign actors intent on undermining the party’s rule. The HKNSL, therefore, included extraterritorial provisions that extend its jurisdiction to govern the actions of foreign individuals or organizations, irrespective of their nationality, residence, or whether they have any connections to Hong Kong. A similar provision – although less expansive in nature as it only targets the financing of activities that endanger national security – had previously been included in China’s Criminal Law through its 2011 amendment.<sup>12</sup>

Acting against China’s national security or supporting anyone who is deemed to be a threat is now a crime worldwide, regardless of the nationality of the accused. The most recent instance of these extraterritorial provisions being used was against Lee Henley Hu Xiang, a Belizean national, who was arrested in November 2019 in Guangzhou city and charged in April 2020 with “financing criminal activities against national security” according to article 107 of the Criminal Law. His crime was reportedly to have funded US-based “hostile elements” and to have “colluded with overseas anti-China forces to intervene in Hong Kong affairs.”<sup>13</sup>

The trend for applying Chinese laws to activities beyond China’s borders is only going to accelerate. In early 2020, Minister of Justice Fu Zhenghua announced China would “improve the standards and procedures for the extraterritorial application of existing laws, strengthen the judicial practice of law enforcement in foreign countries, and enhance the international influence of China’s judicial practice.”<sup>14</sup>

Another example of the focus on applying Chinese laws extraterritorially in national security matters was the March 2021 sanctions that China imposed on an array of individuals and institutions in Europe, the UK, the US and Canada. The measure came as push-back against coordinated sanctions censuring four Chinese officials and one entity for human-rights abuses in Xinjiang imposed by Brussels, London, Washington and Ottawa. The official reason behind the asymmetric escalation was that the sanctioned parties “spread lies and disinformation” about China from overseas. China’s Foreign Ministry also framed it as a move to “safeguard [China’s] national sovereignty, national security and development interests”<sup>15</sup> (see exhibit 3).

Further examples of Beijing’s new preemptive approach and its efforts to enforce its own red lines overseas are seen vis a vis international debates over the risks of Huawei’s inclusion in overseas 5G networks, and steps taken following the Australian government’s calls for an independent investigation on the origins of the Covid-19 pandemic. Both were seen as threats against elements of China’s national security, such as its economic security and global reputation. Party and state officials immediately intervened on behalf of Huawei, ostensibly a private company, and issued veiled threats against Germany – or any other country – should Huawei be banned from their 5G network rollouts.<sup>16</sup>

The trend for applying Chinese laws to activities beyond China’s borders is only going to accelerate



Exhibit 3

**China attempts to control the narrative internationally**

Comparison of sanctions exchanged between the EU, the UK, Canada, the US and China

**EU, UK, CANADA AND US SANCTIONS OVER HUMAN RIGHTS VIOLATIONS IN XINJIANG****State structure****Zhu Hailun 朱海仑\***Former Deputy Head of the 13<sup>th</sup> People's Congress of the Xinjiang Uyghur Autonomous Region (XUAR)**Chen Mingguo 陈明国**

Director of the Xinjiang Public Security Bureau and Vice-Chairman of the XUAR People's Government

**Party structure****Wang Junzheng 王君正**

Party Secretary of the Xinjiang Production and Construction Corps and Deputy Secretary of the Party Committee of XUAR

**Wang Mingshan 王明山\***

Member of the Standing Committee of the Party Committee of XUAR and Secretary of the Political and Legal Affairs Committee of the XUAR

**Entity****Xinjiang Production and Construction Corps Public Security Bureau****新疆生产建设兵团 公安局\***  
Responsible for management of detention centers**EU, UK, US, CANADA**

- Asset freeze
- Travel ban
- Persons and entities prohibited from making funds available to those targeted

**CHINA'S RETALIATORY SANCTIONS****EU****10 individuals****4 entities****UK****9 individuals****4 entities****Canada****1 individual****1 entity****US****2 individuals\*\*****0 entities**

- Travel ban to Mainland China, Hong Kong and Macao (extended to families)
- Restriction against doing business with China for those sanctioned and entities associated with them

\*The US had already sanctioned Zhu Hailun, Wang Mingshan and the Xinjiang Production and Construction Corps in July 2020.

\*\*Previous Chinese sanctions against former US officials and other individuals remain in effect.

Sources: Council of the EU; Foreign, Commonwealth &amp; Development Office of the UK; Global Affairs Canada; US Department of the Treasury; Ministry of Foreign Affairs of the PRC

Beijing was similarly outraged when the Australian government sponsored an April 2020 resolution at the World Health Assembly, seeking an investigation into the origins of the Covid-19 pandemic. China ultimately accepted an investigation recast as a more collaborative effort. Meanwhile, though, it suspended Australian beef and barley imports and launched an anti-dumping probe into Australian wine sales. Chinese diplomats called Australia's original motion a "betrayal" for "provoking trouble on issues involving China's core interests."<sup>17</sup>

China's reaction to the joint communique issued after the G7 foreign ministers' meeting in May 2021 was another interesting example of this trend. China's Ministry of Foreign Affairs (MFA) accused the G7 countries of "interfering in China's internal affairs and interests" and of committing a "flagrant trampling on norms of international relations," given the communique's condemnation of human rights violations in Xinjiang and Tibet, and of China's erosion of Hong Kong's autonomy, among other issues.

While these accusations are very much in line with the current forceful language being used by Beijing when defending China's comprehensive national security, the irony is that MFA spokesperson Wang Wenbin demanded that the G7 "stop the wrong practice of stretching the national security concept."<sup>18</sup> This is not the first time this line has been used by Beijing, however. It has come up a few times before, often in the context of further US measures to restrict tech transfers to Chinese firms.<sup>19</sup>

## 5. FULL STEAM AHEAD: THE CCP FEELS CONFIDENT OF ITS CHANCES OF SUCCESS

Since Xi came to power, China has adopted a new, multi-faceted approach to national security. The new system is intimately linked to the party's and the system's stability and survival and subsumes all other elements of policymaking, including China's development goals. A solid institutional and legal framework has been built to implement the new approach. Although China's official foreign policy principles remain unchanged,<sup>20</sup> the party has re-framed ever-wider areas of policy - diplomatic, economic, military or cultural - in national security terms. The new paradigm has produced a clear change in China's behavior in the international arena.

China's expanded definition of national security has led to a correspondingly greater list of issues that the leadership considers to be core interests, attacks on which trigger a much stronger response from Beijing. This has had immediate consequences for China's international counterparts. Other countries must be prepared to deal with a Chinese leadership that will respond forcefully and aggressively to any perceived criticism or attack against its interests, and that is ready to escalate any conflicts if matters of national security are concerned. This is often the case regardless of the impact on bilateral ties.

A clear example of this was Beijing's decision to impose sanctions on a wide range of European actors, which triggered strong backlash across Europe and reduced the prospects for the long-awaited EU-China Comprehensive Agreement on Investment (CAI) to be ratified.

The party's stronger focus on extraterritoriality and on improving its ability to police narratives and behavior overseas will also impact other actors' relations with China, both in the public and private sectors. Foreign companies with a presence in China, in particular, are likely to find themselves caught between the party's demands that they respect China's red lines and abide by Chinese laws around the world, and their own (and their home coun-

China has adopted a new, multi-faceted approach to national security

tries') values and interests. Additionally, the expansion of China's extraterritorial application of its laws is also likely to change the risk calculations of companies and individuals considering traveling to China.

**The securitization of China's international behavior is likely to be intensified**

As the party refocuses its efforts towards achieving its 2035 and 2049 goals, this securitization of China's international behavior is only likely to be intensified. The CCP wants to preempt any challenges to the system, whether internal or external, to ensure the long-term survival of its governance model. Underlining the interconnectedness between domestic and international security, the CCP Central Committee has said that the goal of China's diplomacy is to "actively create a favorable external environment" that can allow China to reach its development goals.<sup>21</sup>

The way to achieve this is clear in the party's mind: create a global national security state that is under the CCP's absolute control and has access to all the resources it needs to establish China as a global power in the face of Western opposition and other external threats. This is likely to remain the party's approach to international relations for the foreseeable future, or at least until the party feels safe enough in the international arena.

The road ahead is unlikely to be smooth. China's increasingly assertive – and at times even aggressive – behavior in the international arena has triggered a growing pushback from Western countries and other states. By alienating allies and potential partners in the name of China's comprehensive national security, Beijing may find itself increasingly isolated against efforts to contain its attempts to reform the rules-based international order.

Recent efforts to reduce tensions in China's relationships with Europe and the United States are also unlikely to last. Sources of friction in China's relations with the rest of the world will continue to emerge and will keep escalating as long as the party continues to frame all issues – no matter how minor they may seem – as a matter of national security and, thus, attacks against its bottom line.

Despite this, the CCP seems confident in its ability to confront these challenges and come out on top. As the party leadership puts it, "time and momentum" are in China's favor, as the "East rises and the West is in decline" (东升西降).<sup>22</sup>

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## Outlook

Systemic competition on new terms -  
what a crisis-driven, globally ascending party  
state means for European stakeholders

Mikko Huotari



## Outlook

# Systemic competition on new terms – what a crisis-driven, globally ascending party state means for European stakeholders

Mikko Huotari

For China's current leadership, expanding the robustness of the Chinese state comes above everything else. As previous chapters have laid out, Xi Jinping and his team are implementing a hard charge to transform China's governance system. They are reinforcing the center's grip on an organic party-state economy and leading with integrated digital governance while increasing the global reach of China as a comprehensive national security state.

European stakeholders should expect a China that is doubling down on non-convergence. They will meet a more offensive and less compromising China; presenting itself as a distinct alternative model, seeking to pre-empt perceived attacks and prevent criticism, more conditional in collaboration and "retaliating" against perceived misconduct by others.

European stakeholders should expect a China that is doubling down on non-convergence

When five years ago, MERICS authors proposed scenarios for China in 2025, they assessed that there was no chance that the Chinese party-state is "developing into a liberal competitive democracy under the current leadership." In contrast, they predicted as China's likely development path until 2025 a "centralized and disciplined party and security state (the Xi-system)." However, the prediction was, that this system would have to "moderate" itself by granting significant concessions, specifically in terms of economic policy, considering slowing growth rates and rampant economic inefficiencies.<sup>1</sup>

Today, we have seen few signs of moderation and concessions, and must go one step further in our assessment: China is not only not converging – its leadership is assembling an *anti-fragile*, less efficient, but largely effective system of party-state governance capable of coherent autonomous action that aims at robustness under uncertainty and in previously unknown environments.

## 1. CHINA'S AMBITION HAS MOVED BEYOND ACHIEVING RESILIENCE AND ADAPTATION

Just in time to celebrate the CCP's 100<sup>th</sup> anniversary, China can present itself as a global force that not only has withstood critical tests at home but is a dominant factor shaping global developments. Leading the world once more in its economic recovery, the CCP is leveraging China's gravitational force abroad, consolidating its grip at home and in "periphery" regions, including Hong Kong and Xinjiang. The previous chapters have indicated that China is not just temporarily operating from a position of strength; Xi's team is pursuing an ambitious re-structuring of the Chinese party state, seeking to benefit from global turbulences and preparing for tougher times ahead.

Often ignored by international observers, China under Xi is on high alert. When he called upon his fellow CCP leaders 2019 to take "strategic initiative to prevent and defuse major risks" he was, with hindsight, making the right call. The party state began preparing the country internally for an escalating trade and technology conflict with the only peer-com-



petitor, the United States, and potentially other shocks, which soon enough materialized in the form of a global pandemic emanating from China's homeland.

Xi's increasingly entrenched governing philosophy is built around crisis prevention and risk management

Xi's increasingly entrenched governing philosophy is built around crisis prevention and risk management. It pervades all aspects of the new architecture of CCP power that has been established since the 19th party congress in 2017. China's government now has a full integration of state and party organizations to enforce the CCP's monopoly on political power and ideology as deeply as possible. Doing so, the party state is proving not just responsive and adaptive to the changing societal, technological, and global environment, but proactive. Its leaders are leveraging digitalization and technological development while adjusting China's global economic interdependence to bounce back stronger from new domestic and international challenges.

## 2. CHINA'S WEAKNESSES AND CRISIS ANTICIPATION MAKE FOR A NEW TYPE OF SYSTEMIC COMPETITION

Much more clear-eyed about its own weaknesses and vulnerabilities than most international observers, the CCP is preparing for "challenges unseen in a century" – disruptions at home and profound global structural change.

- Politically, the coming year is probably the most precarious period in a decade. On the road to the 20<sup>th</sup> Party Congress in Fall 2022, Xi's men are trying to clear the ground for extended Xi Jinping rule. Yet many of the costs for his break with the party's protocol for leadership succession are still hidden within the system that has been forced in line, but not necessarily convinced.
- Societally, growing nationalism and political performance requirements are only masking the challenges of mobilizing a fragmented, polarized and often exhausted society.
- Economically, Beijing will be overseeing a confluence of multiple challenges coming to a head in coming years: productivity gains will be harder to achieve, social and regional inequality are becoming more pronounced, high leverage leaves the financial system vulnerable, social insecurity and what the government describes as "disorderly expansion of capital" will keep leaders in Beijing occupied.
- Technologically, CCP leaders are struggling to deal with deep dependence on critical inputs and components, and the threat of further decoupling from global markets as well as sources of innovation looms large.
- In the international environment, leaders in Beijing are searching for support to respond to growing alignment and nascent coalitions of 'like-minded countries' against China's influence (seen as 'hostile forces') – as well as preparing for a Taiwan crisis.

This is, therefore, a new kind of 'systemic competition' between China and Europe as well as other liberal democracies. Under conditions of deep interdependence and global connectivity. Beijing sees itself mostly competing for sources of political robustness and economic stability, building up effective state capacity and dealing with what it perceives as existential global risks.

For leaders in the West, this competition should less be about simple dichotomies such as capitalism/democracy vs communism/dictatorship but about dealing with a one-party-state successfully integrating with and restructuring global capitalism, shaping international rules, and reinventing dictatorship under digital conditions.

Does all of this make conflict inevitable? Many international observers – including at MERICS – continue to hope that with such challenges ahead, China’s current leaders could conclude that it is in China’s best interest to turn back to more open, liberal, cooperative, and decentralized approaches. But the track record of Xi’s decision-making patterns from the past seven years makes it clear that a more likely trajectory – considering predictable crises – sees China in permanent struggle mode, more radical internally, and restricting international connections that are perceived as risky.

### 3. CHINA’S STRUGGLE MODE AND THE PROSPECTS OF AN “ANTI-FRAGILE” XI-SYSTEM CARRY MAJOR RISKS FOR INTERNATIONAL COUNTERPARTS

China’s leaders appear convinced they do not need “the West” anymore, or only very selectively. And where they depend on such global connections, they seem confident that they can co-opt and disunite foreign counterparts to maximize China’s state interests. Under such conditions, Beijing makes cooperation with China more conditional, expecting compliance in return.

While the CCP-led government is driving this development, growing domestic (cyber) nationalism and an increasingly difficult environment for foreign residents and business are likely to have an amplifying effect. Fueled by years of intense patriotic education, but also the real successes of China’s government, its hardline global posturing and the propaganda surrounding it, emotions and societal perceptions will shape relations with China much more than in the past.

This more nationalist, non-compromising and self-centered China will seek to further limit and excessively control access to information and political actors in China as part of its risk management strategy. It is a key characteristic of the Xi Jinping era that externals know too little about the internal deliberations and divergences within the Chinese leadership. While tight control of narratives, and the space for debate, might make sense seen from Zhongnanhai, Chinese leaders will know less and be faced with growing myopia abroad. This is likely to result in a greater possibility for tensions to escalate and for accidents to occur.

More specifically, international counterparts will need to prepare for:

#### **Integrating and competing with a party-state economy that is expanding globally**

As the CCP expands control over the economy, foreign business needs to prepare for further politicization and greater need to toe the party-line. Companies will have to further localize while acting as ‘good corporate citizens’ on CCP terms. In Beijing’s eyes, this means shifting profits and value-added production to domestic actors and proving their investment utility by contributing to Chinese domestic development.

Hopes that international agreements or internal pressure will lead to a level playing field for foreign companies in China remain pipe dreams. They will need to compete with Chinese firms in an extremely challenging environment. In effect, foreign firms are not only competing with their peers but often with integrated industrial systems. In China, realizing the ideal of ‘competitive neutrality’ remains an illusion. A networked party-state capitalism drives innovation and leverages domestic advantages in strategic industries while selectively deploying international competition at home.

Companies will have to further localize while acting as ‘good corporate citizens’ on CCP terms

China's leaders aim at dominance in an expanding set of strategic industries by achieving full control of relevant value chains. This can involve diverse actors and different modalities of party-state influence, but the underpinning goals are clear: control, reducing dependence, import substitution and, eventually, global market dominance.

### **Engaging with a digital power player and norm-setter aiming for self-reliance**

Western actors – private companies, non-governmental organizations, and individuals – situated in China are affected by the expansion of digital control mechanisms. Data is collected and often insufficiently protected. New regulations and initiatives strive to further allow the government access to data and make monitoring more comprehensive.

The long-term solution is to ensure foreign interactions increasingly take place on China's terms

Digital interconnectedness with the outside world remains critical to achieving the party's 2035 goals for “socialist modernization,” core tech autonomy, full informatization and digital economy. The party has to juggle access to ‘open’ cyberspace with its own model of cyber sovereignty. The long-term solution is to ensure foreign interactions increasingly take place on China's terms.

European businesses in China will need to further localize operations to comply with different rules and political pressures. Where this proves impossible, they will face hard choices about prioritizing or even choosing between key international markets.

China has made setting technical standards and norms in cyberspace a key goal. European stakeholders will meet and compete with forceful Chinese initiatives in relevant UN forums, governance and technical standards bodies. China's digital infrastructure footprint in parts of the developing world will grow rapidly, creating challenges on the ground for European governments and businesses.

### **Facing-up to a comprehensive Chinese national security state with global reach**

National security will become the dominant paradigm in China's foreign relations. With Xi's ‘security first’ perspective permeating institutions in and interactions with China, international counterparts are likely to be surprised by increasing intransigence in exchanges and cooperation.

When security gains are a predominant goal, costs in the form of worsened bilateral relations become more tolerable. Xi's China will not just be more assertive and proactive in its foreign relations but potentially aggressive – where it perceives key interests under threat. More diplomatic partnerships and cooperative arrangements are likely to be disrupted by China's ‘security first’ approach.

The biggest impact for Europeans will result from China's steady shift towards ‘extra-territoriality’, the intent to proactively control behavior and narratives beyond China. China will claim and police formerly domestic red lines more forcefully abroad – leaving public and private sector counterparts torn between competing value imperatives.

#### 4. EMBRACING CHINA RISKS AND RECALIBRATING EUROPE'S BALANCING AND HEDGING STRATEGIES

While it was already apparent in 2016 that China is charting a different course, back then one could still assume this would have a moderate impact for Europeans. This is different now: in the 100th year of the CCP, China's party state presents itself as a force to be reckoned with – despite the persisting domestic vulnerabilities caused by, i.e., demographic challenges or inherent instabilities in the financial system. It remains in Europe's best interest to deepen relations with China, but China's organic party-state economy, digital leadership, and globalizing national security state require responses.

**European public and private sector stakeholders, therefore, need to:**

- Invest in pooled foresight and anticipatory capacity on China-related risks based on a realist assessment of China's anti-fragile trajectory. Play out “what if” scenarios. Prepare for crises.
- Further invest in China competence and policy coordination at all levels of governance, from local to regional, national and EU levels.
- Craft consistent China policy: actions on China should be guided by clearly defined national security challenges, an identification of vital interests, specified assumptions and desired end-states.
- Work towards a European consensus on an overarching China paradigm, combining open strategic competition with principled precaution.
- In the meantime, continue to cooperate where necessary; maintain openness for dialogue and exchanges.
- Prevent an over-securitization of relations. Invest in strategic confidence building, Track-2/1.5 dialogues and capacities to understand mutual signaling better.
- Avoid symbolic posturing but coordinate proportionate responses to Chinese violations of international law and agreements as well as threats to national security and vital interests.
- Support economic diversification more offensively. A robust European anchor to transatlantic engagement and cooperation with like-minded liberal market economies around the globe matters more than ever.
- Europe must “win at home,” by playing offense and running faster. Focus on increasing innovation and being better than, not undermining, competitors.

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STOCKMAR+WALTER Kommunikationsdesign  
Titlegraphic: Anton Ohlow

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Mercator Institute for China Studies (MERICS)

Printed in Berlin, Germany

ISSN (Print): 2509-4319

ISSN (Online): 2509-5862





