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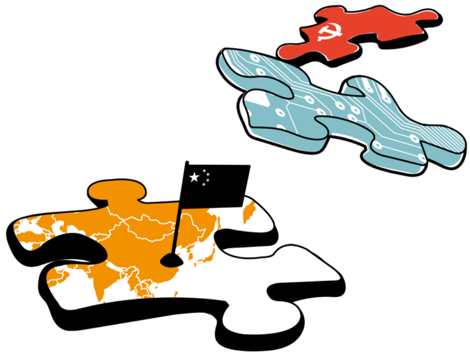
MERICS China Essentials



CONTENTS

MERICS
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TOP STORY

Beijing will try for cautious approach after Evergrande liquidation order

The Hong Kong court order to begin liquidating embattled Chinese property giant Evergrande correlates with a broader effort by Beijing to crack down on the industry and comes at a pivotal moment in its deleveraging campaign. The Hong Kong ruling could theoretically be recognized in Shenzhen, Shanghai, or Xiamen under a 2021 pilot program on liquidation rulings, although this has only been applied in one previous case. The party state only feels beholden to the rule of law when this suits its interests – and its desire to send a strong message to other property developers means it could recognize the liquidation order. But it will proceed as cautiously as it has until now.

Evergrande has been in slow-motion collapse since it first defaulted on loan payments in 2021. State-affiliated companies and banks have purchased Evergrande assets to inject liquidity and wind down the company, while shifting some unfinished projects to other developers to ensure their completion for households that made advance payments. That has helped, but with over 300 billion USD in liabilities, Evergrande is beyond saving.

At the same time, authorities have in recent years inflicted a combination of regulations and rhetoric on developers. The "three red lines", for example, capped key financial ratios – specifically, liabilities/assets, net debt/equity, and cash reserves/short-term debt – and seriously undermined their highly risky business models. Meanwhile, President Xi Jinping's repeated insistence that "homes are for living in, not for speculation" added an ideological element to the sector for the officials and cadres that oversee it.

It's still unclear what exactly Beijing now will do. Not recognizing the Hong Kong ruling would broadcast that deleveraging has reached its limits and undermine foreign investor sentiment at a time when Beijing is actively courting foreign direct investment. But from a stability perspective, sentiment and property values could deteriorate considerably if Beijing recognizes the ruling, eroding what is functionally the sole asset class for middle class Chinese. That could also further burden broader financial market confidence.

All taken, Beijing will be wary of sending a weak message to property developers. Leaders will likely choose to follow the ruling and liquidate, but proceed cautiously, extending the current gradual strategy towards Evergrande to the real estate sector as a whole.

MERICS analysis: "My money is on Beijing recognizing the ruling, then doing it 'with Chinese characteristics' to slowly unravel the risks while clearly signaling its deleveraging campaign endures," said **Jacob Gunter**, Lead Analyst at MERICS. "Xi has made it clear real estate doesn't serve his strategic agenda and that capital needs to flow to industrial upgrading, supply chain resilience and technology. Formalizing the death of Evergrande would make that clear – and slow-walking its dismantling mitigate an acute crisis."

Media coverage and sources:

- Caixin: Evergrande heads to liquidation in milestone for property crisis
- Nikkei: Evergrande case could test China-Hong Kong insolvency arrangement

METRIX

42,500%

Japanese investment firm Softbank said on January 25 it expects to have made around USD 8.5 billion after divesting from e-commerce company Alibaba, a 42,500% return on its initial USD 20 million investment in 2000. Softbank has reduced its ownership from one third to about 13% of outstanding shares, selling around JPY 1.26 trillion in shares (EUR 7.9 billion) between October 2021 and January 2024. The divestment came as China's regulators pressured Alibaba to restructure its business, resulting in a loss of market share. It marks the end of an era of fast growth, lax regulation, and large foreign stakes in Chinese internet firms.

TOPICS

UN human-rights review highlights Beijing's unwillingness to accept supervision

The facts: Criticism and praise alternated in quick succession at China's Universal Periodic Review by the UN Human Rights Council, as 161 countries gave short inputs about the country's recent human rights record. The non-governmental organization International Service for Human Rights counted "at least" 50 countries that raised specific concerns about Tibet, Xinjiang and Hong Kong and more general ones about religious freedom, civil rights and surveillance. Meanwhile, China's state news agency Xinhua reported that "more than 120 countries positively assessed" China's human rights efforts. Every UN member has to undergo a UPR every four-and-a-half years.

What to watch: China brushed off major issues – the USA, for example, called for "unhindered" UN access "particularly in Xinjiang and Tibet" – and presented all state actions as serving development, security and ethnic harmony. The hearing left little hope for China changing its stance and highlighted a growing divergence in the understanding of human rights between liberal democracies on the one hand and China and a growing number of supportive governments, many from the Global South. This rift widens as the European Union is introducing new corporate due diligence and forced labor regulations rooted in UN standards. European companies, in particular, face the problem that the required audits could be hampered by a lack of reliable information from China.

MERICS analysis: "Both at the UN and in exchanges with Western governments and companies, China's leadership is putting forth its own version of human rights," says **Katja Drinhausen**, Head of MERICS' Politics & Society Program. "It claims the right to certify its own compliance with international norms and requires others to take its pronouncements for granted. This puts China on a collision course with a growing number of ethical supply-chain requirements that rely on credible reporting."

Media coverage and sources:

- SCMP: China's United Nations human rights review puts global divide on display
- ChinaFile: Beijing is pouring resources into its UN Human Rights Review – All to prevent any real review from taking place
- European Commission: Forced labor: Council adopts position to ban products made with forced labour on the EU market
- ISHR: At the UN review of China's rights record, States lay bare laundry list of atrocity crimes, generalized crackdown

German dual-use tech exports to China show difficulty of EU controls

The facts: Just as the European Commission tries to better control exports of technology with dual military and civilian use, some companies are finding loopholes. In Germany, for example, the government has reportedly licensed exports to China of a foam, produced by tech company Evonik, that can make military aircraft invisible to radar. China is also using German precision equipment to produce chips for quantum computers, which could have significant military applications in the future. Unlike the machines made by Dutch company ASML, that equipment is currently not a focus of US export restrictions on China.

What to watch: The EU has until now relied on the Wassenaar Arrangement, a voluntary international regime, to control arms and dual-use exports. But this cannot keep pace with rapid technological developments, and export controls at the multilateral level are deadlocked. Wassenaar counts Russia among its members, making political agreement difficult. To solve the impasse, in a white paper issued on January 24 as part of the EU's economic security package, the Commission has proposed member states coordinate with each other to add items to the EU dual-use export control list when consensus cannot be reached in Wassenaar.

MERICS analysis: "Export controls are no silver bullet in preventing undesirable technology transfers to China, especially when it comes to emerging dual-use technologies. Some exports will still be diverted to the military, not to mention via smuggling," says MERICS Lead Analyst **Rebecca Arcesati**. "But strategic design could be improved, and for that, EU countries should coordinate better among themselves and with partners. Europeans have so far been divided and reactive, often following US pressure instead of driving the conversation."

Media coverage and sources:

- Wirtschaftswoche: Deutschland und China: Der Kontrollverlust
- Asia Times: China uses foreign machines to make quantum computers
- European Commission: White Paper on export controls

China is unmoved by US appeals to urge Iran stop Houthi attacks in Red Sea

The facts: China remains reluctant to use its diplomatic power to stop Houthi rebels in Yemen attacking ships in the Red Sea. US National Security Advisor Jake Sullivan late January urged China's foreign-policy supremo Wang Yi to pressure Iran into getting the Tehran-backed grouping to change course. After their meeting in Bangkok, there were media reports about Chinese officials pressing Iranian counterparts. However, aside from warning of potential damage to business ties with Beijing, China did not name specific consequences should Tehran fail to comply. At the start of January, Beijing had abstained from voting on a majority-backed United Nations Security Council resolution calling for the Houthi rebels to immediately cease attacks on commercial vessels in the Red Sea.

What to watch: Beijing appears to be placing its geopolitical interests in the Middle East and its standing in the Global South above its economic interests – some 60 percent of its exports to Europe usually pass through the Red Sea and Suez Canal. Like their counterparts in the Global South, Chinese decision-makers view the Red Sea crisis as a spill-over from the conflict between Israel and the militant Palestinian group Hamas. They all support the eventual creation of a Palestinian state next to Israel and an immediate ceasefire in Gaza. As the latter would likely ease the Red Sea crisis, China appears to see no point in falling in with Washington and hurting its reputation in the Global South. Also given US reluctance to pressure Israel into a ceasefire with Hamas in Gaza, Beijing appears to have little incentive to urge Iran to restrain the Houthis.

MERICS analysis: "Amid intensified US-China competition, China has little geopolitical interest in cooperating with Washington to support US dominance of the Middle East by pressing Iran, even under the guise of maintaining public goods, such as freedom of navigation," says MERICS Analyst **Claus Soong**. "As long as Chinese ships are safe, Beijing will see the Houthis and Hamas more as resistance groups than terrorist organizations."

Media coverage and sources:

- Financial Times: US urges China to help deter Iran-backed Houthis in back-channel meeting
- Reuters: Exclusive: China presses Iran to rein in Houthi attacks in Red Sea, sources say
- Chinese MFA (CN): 王毅就红海紧张局势表明立场 (Wang Yi's statement on the tense situation in the Red Sea)
- Caixin (CN): : 红海危机持续冲击贸易供应链 美英空袭为何难遏止胡塞武装？(The Red Sea crisis continues to impact trade supply chains. Why are US and UK airstrikes struggling to contain the Houthi rebels?)

REVIEW

The Political Economy of Science, Technology, and Innovation in China by Yutao Sun and Cong Cao (Cambridge University Press, 2023)

This book provides a comprehensive overview of Beijing's efforts to build a world-leading science and technology (S&T) eco-system – what government ministries are involved, how policy is made and funding organized, how China is trying to attract foreign talent and generate breakthroughs through mega research and development projects.

The authors, Yutao Sun, an economic-management professor at Dalian University of Technology, and Cong Cao, a professor of innovation studies at the University of Nottingham Ningbo, then use data-driven analysis and international comparison to assess these efforts. This leads them to call for better coordination between more stakeholders, more clarity in research missions and more support for curiosity-driven research.

These recommendations will be uncontroversial for anyone sympathetic to integrating China into global innovation networks so that challenges can be jointly tackled. Sadly, progress in any of the areas named by the authors is scant. Beijing is instead increasing government control, obfuscating key policies (illustrated by Cao and Sun's occasional lack of access to the latest data) and redefining all S&T as primarily serving national security.

The authors downplay the US-China tech rivalry: "It is very unlikely that China will ever close its door to the outside world" as this would undermine "the ultimate purpose of innovation" – new technologies and products "with international competitiveness". But Western stakeholders will ask when China will stop using the arrangements to amplify its own benefits and reciprocate more by sharing more funding and research results.

It would be too much to expect the book's China-based authors to head on criticize the Chinese Communist Party. But in a time when the country's innovation eco-system is often over-simplified and government plans depicted as a gold standard, Sun and Cao do end their investigation of the diversity, contradictions and challenges of China's S&T ecosystem with something remarkable – a passionate call for independent thinking.

Reviewed by **Jeroen Groenewegen-Lau**

MERICS CHINA DIGEST

China's clean energy boom "an example to the entire world" (South China Morning Post)

China in 2023 added more renewable energy capacity – especially solar PV – than all other countries combined. But challenges like supply chain vulnerabilities and the need for integration call for more regulatory attention. (24/01/27)

WuXi company shares tumble on US bill aimed at Chinese biotech (The Wall Street Journal)

Shares in the WuXi group of companies plummeted owing to the concerns over a proposed US legislation that could prohibit US firms from doing business with Chinese biotech companies over fears of potential ties to China's military. (24/01/26)

Tesla cars face more entry bans in China as 'security concerns' accelerate (Nikkei Asian Review)

Tesla cars can no longer enter some Chinese government-affiliated sites amid data-security concerns and ongoing tensions between the US and China. (24/01/24)

China stakes global dominance in race to build intelligent ports (South China Morning Post)

China has unveiled its first self-reliant intelligent port management and control system at Qingdao Port. It enhances efficiency at container terminals and positions China at the forefront of efforts to automate the global shipping. (24/01/30)

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MERICS | Mercator Institute for China Studies
Alte Jakobstrasse 85-8610179 Berlin
Tel.: +49 30 3440 999 0
Mail: info@merics.de
www.merics.org